GOVERNMENT ATTORNEY'S OFFICE-
DIRECTORATE FOR STATE LEGAL SERVICES

SUBDIRECTORATE-GENERAL OF LITIGATION SERVICES

IN THE CASE OF AN ARBITRATION UNDER THE CONVENTION OF 1965 ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES (ICSID CONVENTION)

AND

UNDER THE ENERGY CHARTER TREATY
(ICSID ARBITRATION CASE No. ARB15/44)

BETWEEN:

WATKINS HOLDINGS S.À.R.L. AND OTHERS
Claimants

and

THE KINGDOM OF SPAIN

Respondent

COUNTER-MEMORIAL ON THE MERITS AND MEMORIAL ON JURISDICTION

ARBITRATORS:

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10 February 2017

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I. LIST OF PRINCIPAL ABBREVIATIONS

"Spanish Cabinet Meeting Decision of 2009": Spanish Cabinet Meeting Decision of 19 November 2009, proceeding to the management planning of the projects or facilities submitted to the administrative register for pre-assignment of remuneration for electric energy production plants, specified in Royal Decree Law 6/2009, of 30 April, which adopts certain measures in the energy sector and which approves the Social Tariff.

"**SWA":** Spanish Wind Association.

"**AREP":** Association of Renewable Energy Producers.

"**BIT**": Bilateral Investment Treaty.

"**NEC**": National Energy Commission. It is the Spanish energy systems' Regulating Body. Since 7 October 2013, its functions are taken over by the National Markets and Competition Commission.

"**CNMC**": National Markets and Competition Commission.

"**Intra-EU dispute**": dispute between an investor of the EU and an EU member state.

"**Vienna Convention":** Vienna Convention on the Law of Treaties, of 23 May 1969.

"**DCF**": *discounted cash flow*, or the current value of future cash flows.

"**Claimant"** or "the **claimant party**": Watkins Holdings S.à.r.l. (the first Claimant), Watkins (Ned) BV (the second Claimant), Watkins Spain S.L. (the third Claimant), Redpier S.L. (the fourth Claimant), Northsea Spain S.L. (the fifth Claimant), Parque Eólico Marmellar S.L. (the sixth Claimant) and Parque Eólico La Boga S.L. (the seventh Claimant).

"**Respondent**": the Kingdom of Spain.

"**Directive 2001/77/EC**": Directive 2001/77/EC of the European Parliament and of the Council, of 27 September 2001, on the promotion of electricity produced from renewable energy sources in the internal electricity market.

"**Directive 2009/28/EC**": Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC.

"**This arbitration**" or "**the present arbitration**": ICSID ARBITRATION No. ARB/14/44, formally instituted by the Claimants.

"**This Memorial**", "**this statement",** or "**the present statement":** Counter-Memorial on the Merits and Memorial on Jurisdiction of the Kingdom of Spain, of 10 February 2016.

"RREE" or **"RE":** Renewable Energies.

"**Expert Report of Accuracy**": An Expert Report of Accuracy on the claim of the Claimants, dated 10 February 2017, which is attached with this Memorial.

"**Brattle regulatory expert report**": A Brattle Expert Report on changes in the regulation of the wind power plants in Spain as from December 2012, dated 14 November 2016, attached with the Claimant's Memorial on the Merits.

"**Brattle quantum expert report**": A Brattle Expert report on the financial damages sustained by the investors, dated 14 November 2016, attached with the Claimant's Memorial on the Merits.

"**Intra-EU investment**": investment in the EU by an EU investor.

"**CPI**": Consumer Price Index.

"**CPI-CT":** Consumer Price Index at constant tax rates, excluding unprocessed food and energy products.

"SI": Standard installation

"**TVPEE**": Tax on the value of the production of electrical energy. It was created with effect from 1 January 2013 by Act 15/2012 and is regulated in articles 1 to 11 of such Act 15/2012.

"Juan Ramón Ayuso": Witness statement by Juan Ramón Ayuso, 9 February 2017.

"Order HAP/703/2013": Order HAP/703/2013, of 29 April 2013, approving form 583 "Tax on the value of the production of electrical energy. Self-assessment and Part Payments", and establishes the form and procedure for its submission.

"**Act 15/2012**": Act 15/2012, of 27 December 2012, on fiscal measures for energy sustainability.

"Act 54/1997" or **"LSE 54/1997**" Act 54/1997, of 27 November 1997, on the Electricity Sector. It was repealed by Act 24/2013, of 26 December 2013, on the Electricity Sector, in the terms stipulated in its sole Repealing Provision.

"**Act 24/2013**": Act 24/2013, of 26 December, on the Electricity Sector.

"REIO" Regional Economic Integration Organisations.

"**PER**": Spain's National Renewable Energy Action Plan.

"**RAIPRE**": Administrative record of electricity production facilities.

"**RD 2818/1998**": Royal Decree 2818/1998, of 23 December 1998, on production of electric energy by installations supplied with renewable energy, waste or cogeneration resources or sources.

"**RD 1432/2002**": Royal Decree 1432/2002, of 27 December, on the methodology of the average reference tariff.

"**RD 413/2014**": Royal Decree 413/2014, of June 6 2014, which regulates the electric energy production activity from renewable energy sources, cogeneration and waste.

"**RD 436/2004**": Royal Decree 436/2004, dated 12 March 2004, establishing the methodology for the updating and systematisation of the legal and economic regime for electric power production under the special regime.

"**RD 661/2007**": Royal Decree 661/2007, of 25 May 2007, regulating the activity of electricity production under the special regime.

"**RD 1578/2008**": RD 1578/2008, of 26 September, on remuneration for production of electricity using solar photovoltaic technology for facilities after the deadline for the maintenance of the remuneration fixed under Royal Decree 661/2007, of 25 May, for such technology.

"**RD 1565/2010**": Royal Decree 1565/2010, of 19 November 2010, which regulates and modifies certain aspects of the electricity production activities under the Special Regime, published in the Official State Gazette on November 23, 2010.

"**RD 1614/2010**": Royal Decree 1614/2010, of 7 December, regulating and modifying certain aspects related to of electric energy production using thermoelectric solar and wind power technologies.

"**RD-Law 7/2006**": Royal Decree-Act 7/2006, of 23 June, establishing urgent measures in the energy sector.

"**RD-Law 6/2009**": Royal Decree Act 6/2009, of 30 April 2009, which adopts certain measures in the energy sector and which approves the Social Tariff.

"**RD-Law 1/2012**": Royal Decree-Act 1/2012, 27 January 2012, which proceeds to the suspension of the remuneration pre-assignment procedures and the elimination of the economic incentives for new electric energy production plants based on cogeneration, renewable energy sources, and waste.

"**RD-Law 2/2013**": Royal Decree-Act 2/2013, of 1 February 2013, on urgent measures in the electricity sector and in the financial sector.

"**RD-Law 9/2013**": Royal Decree-Act 9/2013 of 12 July 2013, establishing urgent measures to ensure the financial stability of the electricity system.

"**RD-Law 14/2010**": Royal Decree Act 14/2010, of 23 December, establishing urgent measures for the correction of the tariff deficit in the electricity sector published in the Official State Gazette of 24 December 2010.

"**RD-Law 20/2012**": Royal Decree Law 2/2013, the Kingdom of Spain approved Royal Decree Law 20/2012, of 13 July, on measures to guarantee budgetary stability and promotion of competitiveness.

"**OR**": Ordinary Regime.

"**SR**": Special Regime.

"**REE**": Red Eléctrica Española.

"**ECT**": Energy Charter Treaty, executed in Lisbon on 17 December 1994.

"**TFEU**": Treaty on the Functioning of the European Union. Consolidated version published in the Official Journal of the European Union on 26 October 2012.

"**CJEU**": Court of Justice of the European Union.

"FET": Fair and Equitable treatment

"ARET": Average Reference Tariff.

"**SES**": Spanish Electricity System.

"**EU**": European Union.

II. INTRODUCTION

1. Pursuant to the provisions of Procedural Resolution No. 1, of 26 May 2016, and to the schedule set out in Annex A of the aforementioned Procedural Resolution, the Kingdom of Spain (hereinafter the "**Respondent**" or the **"Respondent party**") hereby submits its Counter-Memorial on the Merits and Memorial on Jurisdiction.

2. In their Memorial on the Merits, dated 14 November 2016, Watkins Holdings S.à.r.l., Watkins (Ned) BV, Watkins Spain S.L., Redpier S.L., Northsea Spain S.L., Parque Eólico Marmellar S.L. and Parque Eólico La Boga S.L. (hereinafter, the "**Claimants**" or "**Claimant parties**") maintain that the Kingdom of Spain has failed to fulfil the obligations assumed under the Energy Charter Treaty (hereinafter "**ECT**") by adopting various legislative measures and regulations adopted by the Spanish Parliament and the Government that affect the producers of electricity from photovoltaic and hydraulic sources of energy.

3. In particular, the Claimants allege that the Respondent has violated the obligations contained in section (1) of article 10 of the ECT referring to: i) promoting stable, equitable, favourable and transparent conditions, ii) Fair and equitable treatment, iii) not impairing, in any way, through exorbitant or discriminatory measures, the management, maintenance, use, enjoyment or liquidation of the investments, and iv) fulfilment of obligations contracted with investors or investments (umbrella clause).

4. Without prejudice to the defence submitted by the Respondent regarding the merits of the matter, proving that the Kingdom of Spain has not in any way violated international obligations assumed under the ECT, this statement contains two Jurisdictional Objections of essential relevance that arise in this case.

5. Firstly, the **Jurisdictional Objection contained in section III.A** of the present Memorial makes reference to the lack of jurisdiction of the Arbitral Tribunal due to the non-existence of investors protected according to the ECT, given that the investors in question do not come from the territory of another Contracting Party, as required by article 26 of the ECT, to be able to go to arbitration. Both Luxembourg and the Netherlands, the countries of the Claimants for the purposes of this arbitration, and the Kingdom of Spain are member States of the European Union (hereinafter "**EU**"), also an ECT Contracting Party. The arbitration mechanism for resolving disputes, envisaged in article 26 of the ECT, does not apply to an intra-EU dispute such as this one, which determines that the Arbitration Tribunal lacks jurisdiction for hearing the dispute.

6. Secondly, the **Jurisdictional Objection contained in section III.B** of the present Memorial refers to the lack of jurisdiction of the Arbitral Tribunal to hear the dispute on an alleged breach of section (1) of Article 10 of the ECT, through the introduction of the Tax on the Value of the Production of Electrical Energy (hereinafter "**TVPEE**") by Act 15/2012, of 27 December 2012, on fiscal measures for energy sustainability (hereinafter "**Act 15/2012**"). That lack of jurisdiction is due to the fact that the Kingdom of Spain has not given its consent to submit such issue to arbitration given that, pursuant to Article 21 of the ECT, section (1) of Article 10 of the ECT does not create obligations regarding taxation measures of Contracting Parties.

7. The first of the stated Jurisdictional Objections is an Objection of a total nature, that is, it affects the entirety of the dispute brought by the Claimants. Thus, should this Objection be upheld, it would entail the exclusion of the dispute in its entirety from the jurisdiction of the Arbitration Tribunal. The second of the stated Jurisdictional Objections is an Objection of a partial nature, that is, that only affects a certain part of the dispute brought by the Claimants.

8. Regarding the merits of the case, the Respondent, from this very moment, asserts that the measures alleged by the Claimant do not in any way represent a breach of the obligations assumed by the Kingdom of Spain at international level under the ECT. The Kingdom of Spain has always fulfilled its obligations arising under the ECT.

9. Therefore, and regardless of the stated Jurisdictional Objections, the Kingdom of Spain will request the Tribunal to fully dismiss the pretensions of the Claimants in the merits, and a ruling for them to pay the costs of this Arbitration.

10. The position of the Claimant is based on a partial, biased and out-of-context conception of the Spanish Electricity System (hereinafter "**SES**"), which can only be reached by omitting basic and fundamental aspects such as the following:

    a) That the Spanish regulatory system is based on the principle of hierarchy and all the rules that it comprises are the result of regulatory development procedures legally stipulated.

    b) That the fundamental principle that subsidies to the SR are a cost for the SES, subordinated to the principle of its economic and technical sustainability.

    c) That the remuneration under the Special Regime has always been structured through the collection of a market price plus a subsidy, with the aim of providing SR plants with a reasonable return in accordance with the capital market on investment costs, calculated on the basis of certain Installation Types.

    d) That the determination of the subsidies has always been fixed on the basis of demand evolution and other base economic data, embodied in Renewable Energies Plans.

    e) That the principle of reasonable return establishes a dynamic and balanced character to the remuneration regime of the RE. As the case law of the Supreme Court has been justifying long before the Claimant made its investment. This case law of the Supreme Court has been confirmed, in relation to the measures challenged in this arbitration, by the Constitutional Court of the Kingdom of Spain, in its condition of ultimate guarantor of fundamental rights. The value of this case law, as a determining factual element for setting the legitimate expectations of any investor, has been highlighted by the first Arbitration Award which has ruled on the interpretation of the Spanish support system for renewable energy.

    f) That the different regulatory changes in the remuneration regime of the RE, including those that took place before the Claimant's investment, have been motivated (i) either to correct situations of over-remuneration, (ii) or by the strong

alteration of the economic data that served as the basis for the initial configuration of the premiums.

11. The Claimant, by omitting these basic features of the SES seeks to give the Tribunal the impression that the CSP installations could be an "island" outside the system in which they are integrated. In this way, the Claimant overlooks the fact that electricity generation from renewable sources is part of the SES. Therefore, this activity participates in the objectives of the SES and is also subject to the principles that govern it.

12. However, the Claimant, before making its investment, knew that electricity supply was a service of general economic interest. The Claimants also knew that the different amendments being made to the remuneration regimen were aimed at (1) guaranteeing the technical and economic sustainability of the SES and (2) correcting situations of over remuneration. Proof of this is the fact that the RE Sector itself was fully aware of these circumstances, as will be amply accredited throughout this Memorial.

13. The Claimant also knew of the Supreme Court case law on amendments to the remunerative regime of REs. However, in its statement it omits any reference to this case law. The aforementioned case law has determined, since 2005, the expectations that an investor might have in light of the various regulatory changes. This case law states that the Spanish regulatory framework lays down the following principles:

    - There is no right to an economic system not being changed;

    - It is not fitting to challenge an amendment either on the basis of the principle of legal certainty or that of legitimate expectations;

    - While Article 30(4) of Law 54/1997 is not amended, the only limit that must be respected by the Government in regulatory changes is to grant the facilities of SR a *reasonable return* with reference to the cost of money in the capital market.

    - The integration of the installations of the SR within the SES results in companies having to assume some regulatory risk.

14. It is surprising that the Claimant has not referred to this case law over the 166 pages of its Memorial, having been aware of it. This deliberate omission shows that the Claimant has built a fictional regulatory framework that is out of touch with reality. The Award in the Charanne case stressed the importance, as a fact, of this Case Law when determining the legitimate expectations of any diligent investor.

15. Within this artificial building, the Claimant intends to turn the Principle of *"reasonable return"* into a simple programmatic principle devoid of any value. This thesis clashes head-on with reality. This is the core principle on which the legal system of remuneration is built. A minimum diligent knowledge of the Spanish regulatory framework lays bare that all the regulations issued during the decade of its investment have been based on this principle. Moreover, of the more than 100 Judgements of the

Supreme Court that have been issued on this matter, 100% have been resolved on the basis of this *Principle of reasonable return.*

16. Therefore, the Spanish support system for renewable energy has always been founded on the principle of *"reasonable return based on the cost of money in the capital market*" as an objective. This principle was first established in Article 30.4 of Act 54/1997 and has remained in Article 14.7 of Act 24/2013. This Principle guaranteed and guarantees investors, until they reach a *"level playing field",* the recovery (1) of the investment in the construction of the Plant, (2) of the operating costs and (3) obtaining a return, which must be reasonable in the capital market.

17. This principle of reasonable return, as observed in the Supreme Court case law, must apply to the entire life of the facility, in the sense of ensuring that investments made in the facilities earn a reasonable return throughout the existence of the same as a whole. This does not mean the permanence of a mechanism of public support during the entire life of the facility, given that it could so happen that said investments had already been amortised and had generated said reasonable return long before the end of the operational period.

18. For this purpose, the same methodology has always been maintained. This methodology consisted and consists of defining, within each technology and according to lex artis existing in each period of time, different *Installation Types*. Once these Installation Types had been determined, different *standards* were established in each one of them (investment cost, operation cost, useful life of the plant, hours of rewarded production, market price) that allowed such an *installation type* to reach a *reasonable return* according to the cost of money in the capital market.

19. The Claimant knew that the *leitmotiv* of such regulatory adaptations and the proposals for reform of the SR Sector have always been the same: the guarantee of a reasonable return in the framework of a sustainable SES. This *leitmotiv* was made explicit in each and every regulatory measure adopted between 2006 and 2013.

20. The Respondent will accredit that the legislation in force during the decade that the claimant has been investing in Spain never made a commitment to freeze the regimen, as the claimant erroneously affirms. There have been successive amendments based on the purpose of guaranteeing the sustainability of the SES and correcting situations of over-remuneration. Consequently, these reforms led to the improvement or worsening of the situation of the Claimants. The motive behind reforms was never to maintain or increase investor return to attract them to the SES. As we will accredit later, the harsh criticism of several of these reforms made by associations do not differ much from the criticisms that they have subsequently made about the measures contested in this arbitration.

21. The Claimant shall demonstrate that RD 2818/1998 developed for the first time a remuneration framework based on a *subsidy* (Premium) that complemented the market price of the energy produced, plus a supplement for reactive energy. All of this was to meet the legal principle of reasonable return.

22. It will also demonstrate that RD 436/2004 modified the remuneration model. This RD 436/2004, linked to the RE Development Plan 2000-2010, continued to respond to the methodology consisting of defining various *Installation Types*. Once these *Installations Types* had been determined, different *standards* were established in each one of them (investment cost, operation cost, useful life of the plant, hours of rewarded production, market price) that allowed such *Installation Types* to reach a *reasonable return* according to the cost of money in the capital market.

23. This methodology was in turn linked and conditioned to the base economic parameters (such as electricity demand) which were reflected in the aforementioned Plan. No diligent investor could be oblivious to this reality.

24. The Respondent will accredit that Royal Decree 436/2004 linked the evolution of the subsidies set out therein to the evolution of the Mean Reference Tariff (hereinafter TMR). Linking the subsidies to the TMR posed a potential hazard to the economic sustainability of the SES, and it also created situations of over-remuneration. Therefore, Royal Decree-Act 7/2006 was passed in 2006, and given that this amendment was not envisaged in Royal Decree 436/2004, it froze RE subsidies until regulations for a new remuneration model could be developed. This freezing was considered by the sector as harmful to its investments.

25. The Claimant will accredit that RD 661/2007 was a consequence of RD-Act 7/2006. This royal decree did not improve the remuneration conditions of the Claimant party. Proof of this is that it was appealed by several electrical energy producers under the special regime. These producers, just like the Claimant does, claimed the freezing of the subsidies of RD 436/2004 based on the same arguments sustained by the Claimant before the Arbitral Tribunal. As we will accredit, these claims were rejected by the Supreme Court.

26. RD 661/2007, in determining subsidies, maintained their link with the methodology set out previously on installation types, which was embodied in the RE Plan 2005-2010. It also maintained their link to the base economic parameters embodied in the aforementioned Plan.

27. In 2009, the impact of the international crisis caused an economic imbalance of the SES, derived mainly from a sudden and unprecedented drop in electricity demand. Consequently, RD-Law 6/2009 was passed, introducing amendments to RD 661/2007 that were not envisaged in its articles. Furthermore, it represented a warning about the need for all system income and expenditure items to be adapted to the new base economic circumstances, always respecting the principle of reasonable return.

28. The Respondent will also accredit that, when faced with this situation, the Sector (1) harshly criticised this RD-Act and (2) proposed in May 2009 a draft for the integral reform of the RE remuneration model, defined by the Sector itself as the best (a) for achieving *reasonable rates of return* with reference to the cost of money in the capital market, (b) providing "*secure and stable investments"* and (c) allowing "*the full potential of RE to be developed in a sustainable and long-lasting manner"*.

29. This model was based on two essential points: (a) Linking the reasonable return to the 10-year government Bonds of the Spanish State + 300 basis points and (b) that such return would be fixed in relation to the various *"kinds of installations, differentiated by technology and size, in a manner that reflects the common values reached by such investments in reality.*" The similarity with the remuneration model implemented from 2013 on is more than evident.

30. The measures taken during 2010 (Action Plan for Renewable Energy, Royal Decree 1565/2010, Royal Decree 1614/2010 and the subsequent Royal Decree Law 14/2010) responded, as did the former measures, to the need to ensure the technical and economic sustainability of the SES as well as to correct the situations of over-remuneration which were detected.

31. Due to the fact that it has been omitted by the Claimant, Spain will accredit that an exceptional reduction in the demand for electricity was suffered during 2009-2010. Said circumstance caused, among other things, the RE Sector to demand a reform of the Electricity Sector.

32. Of this regime and the successive modifications thereof, interpreted by the Supreme Court in its case law, no diligent investor could reasonably deduce the existence of a commitment to freeze a specific remuneration model in their favour. To wit, Spain never committed to maintaining or continuously improving the situation of investors. And less so, to indefinitely freeze subsidies.

33. The only guarantee that investors had was to achieve a reasonable return in the context of a technically and economically sustainable SES. Spain will demonstrate that the Claimant had that understanding of the System and knew the *"relatively wide margin of the "ius variandi" of the Administration in a regulated industry where general interests are involved."*

34. In the same vein, in the years 2012 to 2014, the Kingdom of Spain adopted measures to reform the Electricity Sector which had been announced publicly and which obeyed the same guiding thread. These measures are reasonable and proportionate and affected all subjects of the SES. In particular, the measures affected consumers, whose electricity bill increased disproportionately between 2003 and 2012. Measures affecting Transporters, Distributors and ordinary Producers were also adopted. In addition, for the first time ever the promotion of renewable energies was charged to the State Budget.

35. This reform has maintained the essential elements of the support system for renewable energies:

    (a) Access priority.

    (b) Dispatch priority.

    (c) Methodology for setting the subsidies based on the establishment of installation types and common standards.

(e) The perception of the *market price* for energy sold, plus a *subsidy* in order to achieve reasonable rates of return, with reference to the cost of money in the capital market, which allows them to compete on equal terms on the market.

(f) The premiums are a cost of the SES, which should ensure their sustainable operation.

36. All the rules included in the new regulatory economic framework have complied with the procedure laid down by Spanish law. All the necessary reports, even non mandatory ones, have been recollected to ensure the full compliance of the new regulatory text with the Spanish legal system. There have been several hearing procedures, in which all the parties in the Sector were able to participate. All of this processing lasted for almost a year, so that all stakeholders would have the opportunity to participate.

37. The Kingdom of Spain has made predictable, reasonable and proportionate use of its regulatory power with an accredited purpose of public interest. This regulatory power was not limited by any type of *specific* commitment. In this regard, the Kingdom of Spain has not made a commitment of immutability of RD 661/2007 with the Claimant, nor with any of the investments set out in the Memorial on the Merits, in its favour.

38. Therefore, the Kingdom of Spain has not broken any specific commitment that it had previously undertaken with the Claimant. The Kingdom of Spain has limited itself to exercising its regulatory power fairly, in accordance with the legally established procedures to ensure, at all times, (1) the sustainability and balance of the SES and (2) the reasonable return of renewable energy Plants. The Kingdom of Spain has thus not violated the standard of Fair and Equitable Treatment of Article 10(1) of the ECT.

39. This Counter-Memorial brings to light the relevance and applicability of various Tests proposed by Arbitral Tribunals. These Tests credit that the measures adopted by the Kingdom of Spain were neither discriminatory, exorbitant nor disproportionate. On the contrary, the treatment provided by the Kingdom of Spain to the Claimant has been fair and equitable taking into account (1) what the Claimant knew when it executed its alleged investment, (2) the lack of commitments by the Spanish State towards the claimant, (3) the correct functioning of the regulatory framework, (4) the concurrent economic circumstances and (5) the purpose of the public policy underlying all the measures.

40. Therefore, and as developed in this Counter-Memorial, the Kingdom of Spain has not breached the obligations under Article 10.1 of the ECT.

41. Finally, secondarily, this Counter-Memorial shows that the alleged damages are totally and absolutely speculative. The Claimant has not met the burden of proof required for its claim to be addressed.

42. In the present case, the *discounted cash flows* method (hereinafter **"DCF"**) is inappropriate due to the concurrent circumstances, in accordance with doctrine.

43. Attached with this Memorial is an economic-financial expert accuracy report dated 10 February 2017 (hereinafter "**Accuracy Report**").

44. The rates of return indicated in the Accuracy Report and obtained by the Claimant, which are the same or far above the reference rates of return, show both that the claims is speculative and that no damages are applicable.

45. In this regard, it should be highlighted that the rates of return are effective and not estimated. They are based on the amount obtained by the Claimant in the disposal of the investment in 2016. The claimant has earned a capital gain of over 42 million euros, which means an annual return after-tax of 11.2%. Claiming damages under these circumstances is reckless.

46. Furthermore, the Accuracy experts conducted a DCF exercise based on the Brattle method: correcting the parameters used a result is obtained according to which the value of the Claimant's investment has increased by 0.7 million euros due to the disputed measures.

47. Based on the above arguments, extensively developed in this Statement, the Kingdom of Spain will request the Tribunal to fully dismiss the pretensions of the Claimant, and a ruling for them to pay the costs of this Arbitration.

48. Similarly, a witness statement is attached to this Counter-Memorial on the Merits. The statement of the following witness is provided:

- Mr Juan Ramón Ayuso, 9 February 2017

- Accuracy expert report dated 10 February 2017, which is attached with this Memorial.

III. JURISDICTIONAL OBJECTIONS

A. Lack of jurisdiction of the Arbitral Tribunal *ratione personae* to rule on the dispute raised by the Claimants due to the absence of investors protected under the ECT. The Claimants are not from the territory of another Contracting Party, given that both Luxembourg and the Netherlands as well as the Kingdom of Spain are Member States of the European Union. The ECT does not apply to disputes relating to intra-EU disputes.

(1) Introduction: need for the existence of an investor "of another Contracting Party"

49. The Claimants have resorted to this arbitration by attempting to benefit from the protection of Article 26 of the ECT[1], regarding the settlement of disputes between an investor and a Contracting Party.

50. Article 26(1) ECT sets out the compulsory requirement that the dispute occur between **"a Contracting Party"** and an **"investor of another Contracting Party**", which inevitably implies the exclusion of this article from any case where an investor of an EU State has a dispute with an EU State, in relation to an investment in said State (hereinafter respectively referred to as "**intra-EU dispute**" and "**intra-EU investment**").

51. Watkins Holdings S.à.r.l. (the first Claimant) is a legal person founded under the laws of Luxembourg. Watkins (Ned) BV (the second Claimant) is a legal person founded under the laws of the Netherlands. The remaining Claimants -Watkins Spain S.L. (the third Claimant), Redpier S.L. (the fourth Claimant), Northsea Spain S.L. (the fifth Claimant), Parque Eólico Marmellar S.L. (the sixth Claimant) and Parque Eólico La Boga S.L. (the seventh Claimant)- are legal persons founded under the laws of the Kingdom of Spain, but according to the Claimants themselves, they are controlled by Watkins (Ned) BV, which in turn is owned in its totality by Watkins Holdings S.à.r.l. Therefore, according to the Claimants, these Spanish companies must be considered nationals of another Contracting Party for the purposes of this arbitration, in accordance with the provisions set forth in Article 25(2)(b) of the ICSID Treaty and Article 26(7) of the ECT.

52. Based on the preceding premises, it should be kept in mind that both Luxembourg and the Netherlands, as well as the Respondent, the Kingdom of Spain, are members of the EU, also an ECT contracting party.

53. Furthermore, both Luxembourg and the Netherlands, as well as the Respondent, the Kingdom of Spain, were already members of the EU at the time of their ratification of the ECT, wherefore they were unable to contract obligations between themselves within the framework of the Internal Energy Market harmonised by the EU.

54. The investment of the Claimants is an investment made within the framework of the Internal Market in Electricity of the EU. Within this framework, the EU system confers

[1] ECT. RL-0006

particular protection upon the EU-national investor, which is preferential to the protection conferred by the ECT and any BIT.

55. In a dispute between the ECT and EU Law, which is also applicable international Law, the latter must prevail. EU Law forbids the existence of any dispute settlement mechanism other than that established by its Treaties, which may interfere with the bases of the Internal Market.

56. To resolve this arbitration, the Honourable Tribunal must deliver an opinion on the rights of alleged intra-EU investors as regards the Spanish State in the Internal Market in Electricity, by interfering with the competence of the judicial system of the EU.

57. That is why the Arbitral Tribunal, with all due respect, does not have jurisdiction to rule on the claim submitted by the Claimants.

(2) The EU system confers particular protection upon the EU-national investor, which is preferential to the protection conferred by the ECT and any BIT

58. The EU is an economic integration area which includes as part of its regulations on the Internal Market an integral system to promote and protect intra-EU investments, which prevails over the provisions of the ECT.

59. The aforementioned Internal Market comprises, as indicated in Article 26 of the current Treaty on the Functioning of the EU (hereinafter referred to as "TFEU")[2], an "*area without internal frontiers in which the free movement of goods, persons, services and capital is ensured*".

60. The Internal Market measures include the Directives that have established the objectives that the Member States must achieve to become part of the Internal Market in Electricity[3]. On the other hand, the energy policy has been part of the EU policies since the TEU was signed[4].

[2] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, published in the Official Journal of the European Union of 26 October 2012 (the former and latter and hereinafter respectively referred to as "TEU", and "TFEU"). RL-0001 and RL-0004.

[3] Council Directive 90/547/EEC of 29 October 1990 on the transit of electricity through transmission grids, published in the Official Journal of the European Union on 13 November 1990 (English version) (RL-0012); Council Directive 90/377/EEC of 29 June 1990 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users, published in the Official Journal of the European Union on 17 July 1990. (English versions) (RL-0013); Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, published in the Official Journal of the European Union on 30 January 1997. (English version) (RL-0014); Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal market in electricity published in the Official Journal of the European Union on 27 October 2001.(RL-0015); Directive 2003/54/CE of the Parliament and of the Council, of 26 June 2003, on common rules for the internal market in electricity, published in the Official Journal of the European Union on 15 July 2003. (Spanish version) (RL-0016), Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and

61. In fact, the promotion of the investment in renewable energies by the Kingdom of Spain is enshrined in the obligations that Spain, in its capacity as a Member State, undertook in order to achieve the aims established by the Directives handed down by the EU, as acknowledged in the Memorial of Claim itself. One of the main aims imposed by the aforementioned Directives is to protect the investor. Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (hereinafter, "**Directive 2009/28/CE**") states in its Recital (14):

> *"The main purpose of mandatory national targets is to provide certainty for investors (...)."*[5]

62. These same Directives are precisely those which enabled the Kingdom of Spain to incentivise the investment by means of the concession of State aid, as permitted by the EU with certain limitations.

63. This unique area by which the Internal Market is concerned is supplemented by an integral protection of Fundamental Rights and a principle of financial responsibility of Member States for breaches of the Legal System, all of which is guaranteed by the jurisdictional system of the EU, to which the monopoly is attributed in the latest interpretation of EU Law.

64. Indeed, the institutional and judicial framework of the EU provides the appropriate judicial appeals and action when the rights of investors are violated. The investor can always claim damages against the State before the corresponding national courts on the basis that it has been unduly discriminated against in relation to the nationals of that same Member State. It can also report any violation of EU Law, which can be directly invoked, including legislation in matters of energy. In the event that, in resolving the dispute, a doubt arises as to the interpretation of community Law, national courts have the option and obligation, if this is the final instance, to give a preliminary ruling before the Court of Justice of the EU pursuant to Article 267 TFEU. When a national court fails to fulfil its obligations pursuant to EU Law, the injured party has grounds to claim damages from the Member State.

65. This integral system to promote and protect investments determines that no distinction is made within the EU between investors from one State or another but rather simply

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amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC published in the Official Journal of the European Union of 05 June 2009 (RL-0017).

[4] Currently Title XXI of the TFEU. The origins of the current EU data back to the signing of the Treaty of Paris of 18 April 1951, creating the European Coal and Steel Community (main sources of energy in the region at that time) or "ECSC". It was followed by the creation of the European Economic Community ("CEE") and the European Atomic Energy Community ("EURATOM") in the Treaty of Rome of 25 March 1957. RL-0005.

[5] Recital (14) of Directive 2001/77/EC also establishes*: "one important means to achieve the aim of this Directive is to guarantee the proper functioning of these mechanisms in order to maintain investor confidence"* (in reference to the support mechanisms for renewable energy sources). RL-0015.

between EU investors and investors from third countries. The category of foreign investor in the EU therefore corresponds exclusively to the investor of third countries.

66. The EU protection standard implies an additional obligation, without comparison, not only in Investment Treaties, but also in any other International Treaty, which prohibits any kind of standard which dissuades the investor of the EU from establishing itself if the Member State. As the Court of Justice of the European Union (hereinafter **"TJUE")** has established regarding the predecessor of Article 54 TFEU:

> *"According to settled case-law, Article 43 EC precludes any national measure which, even if applicable without discrimination on grounds of nationality, is liable to hinder or render less attractive the exercise by Union nationals of the freedom of establishment that is guaranteed by the Treaty (see, to that effect, inter alia, Case C-19/92 Kraus [1993] ECR I-1663, paragraph 32; Gebhard, paragraph 37; Case C-442/02 CaixaBank France [2004] ECR I-8961, paragraph 11; and Case C-169/07 Hartlauer [2009] ECR I-0000, paragraph 33 and the case-law cited)."*[6] *(emphasis added)*

(3) The preferential application between Member States of the EU of their own protection system is reflected in the literal interpretation, context and purpose of the ECT.

67. The intra-EU investor protection system prevails over any in any other international treaty. This conclusion, merely arising from the peculiar nature of the EU, also has its literal recognition in the ECT itself.

(3.1) The literal interpretation of the ECT provides that between EU Member States, the EU system prevails

68. Indeed, the definition of the Contracting Parties of Article 1(2) ECT, includes Regional Economic Integration organizations ("REIO") such as the EU, the only REIO that is part of the ECT.

69. Similarly, Article 1(3) of the ECT defines REIO as:

> *"an organization constituted by states to which they have transferred competence over certain matters a number of which are governed by this Treaty, including the authority to take decisions binding on them in respect of those matters" (emphasis added)*

70. This article acknowledges the special nature of the EU as an international organization constituted by States to which they have transferred competence over certain matter in an irrevocable and binding way. It is obvious the if the ECT had not wanted to consider the reality of the fact that part of the matters by which the purpose of the ECT is concerned was exclusively decided by the EC it would have omitted the final item, bearing in mind that the EC is the only REIO that has subscribed to the ECT.

[6] Judgement of the Court of Justice of the European Union, of 11 March 2010, Case C-384/08, Attanasio Group [2010] ECR I-2055, paragraph 43. RL-0020.

71. Similarly, Article 1(10) of the ECT defines the "Territory" of the REIO, referring again to the provisions of said organization, i.e. the EU.

72. Article 16 of the ECT establishes the rules of compatibility between earlier and later treaties with ECT. These Treaties include those governing the EU, which prevail over the ECT in intra-EU relations.

73. Article 25 ECT, as a result of signing the ECT and through the most favoured nation clause, states that the integral system to promote and protect intra-EU investments cannot extend to any signatory States of the ECT that are not Member States.

74. Furthermore, this reality is considered in Article 36(7) of the ECT when it is admitted that the EC and Member States vote on matters are fall within their competence, stating: *"when a Regional Economic Integration Organisation votes, it will have a number of votes equal to that of the member states of the latter that are Contracting Parties to this Treaty."*

75. Finally, section (1) of Article 26 of the ECT requires that the dispute occur between the Investor of a Contracting Party and another Contracting Party. While section (6) requires disputes to be resolved "*in accordance with this Treaty and applicable rules and principles of international law*", which means treating EU law and applicable International Law on equal terms when it comes to resolving the dispute.

(3.2) Article 26 of the ECT prevents arbitration between an intra-EU investor and an EU Member State

76. It is precisely Article 26(6) ECT that prevents an intra-EU investor from bringing arbitration proceedings against an EU Member State for reasons related to its investment. Admitting this possibility would be contrary to EU Law, which is applicable International Law. In *Electrabel S.A vs. The Republic of Hungary,* the Arbitral Tribunal determines that:

> *"[…]the Tribunal concludes that Article 307 EC precludes inconsistent preexisting treaty rights of EU Member States and their own nationals against other EU. Member States; and it follows, if the ECT and EU law remained incompatible notwithstanding all efforts at harmonisation, that EU law would prevail over the ECT's substantive protections and that the ECT could not apply inconsistently with EU law to such a national's claim against an EU Member State."*[7]

77. Article 344 of the TFEU establishes that: "Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein." The application of this precept means that Spain cannot submit any matters relating to the Internal Market in electricity to arbitration.

[7] *Electrabel S.A vs. Hungary,* ICSID Case no. ARB/07/19, Decision on jurisdiction, applicable Law and liability, of 30 November 2012 (original version in English) Paragraph 4.189 RL-0002.

78. Admitting the arbitration would mean that the Arbitral Tribunal would have to rule on the rights of the European investor in the Internal Market.

79. The CJEU has already categorically issued an opinion on the impossibility of this interference. In the Legal Opinion 1/91, Economic Area Agreement[8], of the CJEU, the Court issued an opinion on the *"Draft agreement between the Community, on the one hand, and the countries of the European Free Trade Association, on the other, relating to the creation of the European Economic Area*." The CJEU declared the impossibility of the legal system created by the draft because it determines the future interpretation of the EU rules on free circulation and competence.

80. To reach this conclusion, the first thing stipulated by the European Court of Justice (hereinafter "**ECJ**") is that:

> *"when a dispute relating to the interpretation or application of one or more provisions of the agreement is brought before it, the EEA Court may be called upon to interpret the expression 'Contracting Party', within the meaning of Article 2(c) of the agreement, in order to determine whether, for the purposes of the provision at issue, the expression 'Contracting Party' means the Community, the Community and the Member States, or simply the Member States. Consequently, the EEA Court will have to rule on the respective competences of the Community and the Member States as regards the matters governed by the provisions of the agreement.*
>
> *[...] It follows that the jurisdiction conferred on the EEA Court under Article 2(c), Article 96(1) (a) and Article 117(1) of the agreement is likely adversely to affect the allocation of responsibilities defined in the Treaties and, hence, the autonomy of the Community legal order, respect for which must be assured by the Court of Justice pursuant to Article 164 of the EEC Treaty. This exclusive jurisdiction of the Court of Justice is confirmed by Article 219 of the EEC Treaty, under which Member States undertake not to submit a dispute concerning the interpretation or application of that treaty to any method of settlement other than those provided for in the Treaty. Article 87 of the ECSC Treaty embodies a provision to the same effect."*[9]

81. The ECJ also states that:

> *"It follows that in so far as it conditions the future interpretation of the Community rules on the free movement of goods, persons, services and capital and on competition the machinery of courts provided for in the agreement conflicts with Article 164 of the EEC Treaty and, more generally, with the very foundations of the Community. As a result, it is incompatible with Community law."*[10]

82. Finally, the same Opinion of the ECJ recalls that:

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[8] Opinion 1/91 on 14 December 1991 issued by the Court of Justice of the European Union regarding the "Agreement to Create a European Economic Area" (EEA) (original Spanish version). R-0022
[9] Ibid, paragraph 34.
[10] Ibid.

> *"It must be pointed out that the agreement is an act of one of the institutions of the Community within the meaning of indent (b) of the first paragraph of Article 177 of the ECC Treaty and that therefore the Court has jurisdiction to give preliminary rulings on its interpretation. It also has jurisdiction to rule on the agreement in the event that Member States of the Community fail to fulfill their obligations under the agreement."*[11] *(emphasis added)*

83. On the other hand, it should be pointed out that when the ECT was signed, the Member States of the then European Community were unable to contract obligations between them as regards the Internal Market as it is an area in which they had transferred their sovereignty to the then European Community. It is for this very reason that the EU is a Contracting Party. Hence, Article 26 of the ECT does not generate any obligations between the Member States.

84. The only possible arbitration in the context application of the ECT, in an interpretation which is in harmony with the EU system (Articles 16 and 26(6) of the ECT) is, as is asserted in *Electrabel S.A v. Hungary*, that of "*a non-EU investor and an EU Member State or between an EU investor and a non-EU Member State."*[12]

85. In this way, the intra-EU investor, with a protection level provided by EU Law, is protected by the judicial system of the EU. The investor from a third party country which is a signatory to the ECT (for example, a Japanese investor) which does not receive through the ECT in the EU Member States the "national" treatment which EU Citizen investors do receive because they are from the EU, may resort to arbitration to defend the rights granted to it by Article 10 (1) of the ECT. Any Arbitral Tribunal hearing this latter arbitration may not interfere with the competencies of the ECJ because the EU system does not apply to the investor from a third party country.

(3.3) The purpose of the ECT confirms the interpretation of the Kingdom of Spain

86. Assuming that intra-EU disputes are included within the scope of the protection of the ECT would also mean giving up the objective and purpose of the ECT. To be precise, it would mean assuming that the EU and its Member States promoted, as key players, the creation and conclusion of the ECT to cover an area, that of intra-EU investments, which had been totally covered - and in a far superior manner - for years by EU Law. What's more, it would mean taking competences away from the ECJ and mistrusting the very protection system given by the EU to its Citizens.

87. The objective of the ECT is to establish "a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter."[13] For its part, the Charter was intended to "promote East-West industrial cooperation through the establishment of legal safeguards in areas such as investment, transit and trade." The

[11] Ibid, paragraph 38.
[12] *Electrabel S.A v. Hungary*, ICSID No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012 (original version in English), paragraph 4.158 RL-0002.
[13] Article 1 of the ECT. RL-006

ECT "is based on an energy community between the regions of the world that were divided by the iron curtain."[14]

88. In actual fact, the origin of the ECT lies in the wish of the Council of the then EC to speed up the economic recovery of Eastern Europe after the fall of the Berlin Wall through cooperation in the energy sector.[15]

89. Hence, the literal interpretation of Article 26 of the ECT, not only section (1) thereof but also section (6), in accordance with its context and purpose, leads to the fact that there are no grounds for submitting to arbitration disputes between an intra-EU investor and an EU Member State.

(4) The position of the Kingdom of Spain and the European Commission is confirmed by doctrine

90. The position expressed by the Respondent is also endorsed by doctrine. In this regard, Bruno Poulain has indicated that:

> *"The [ECT] was initially concluded with the former Soviet republics to improve the safety of the energy supply from Eastern Europe. Bearing in mind the initial raison d'être of this instrument, we cannot do any more than have reservations about its application to purely intra-community situations. Certain elements of its text also seem to endorse the inapplicability of [ECT] Article 26 to intra-Community situations."*[16] *(free translation) (footnote omitted).*

91. Moreover, as aptly stated by Professor Jan Kleinheisterkamp:

> *"Why should investors from certain member states enjoy a greater degree of protection than that afforded by the European Treaties? Why should arbitral tribunals, in a purely intra-EU context, not be bound to the same restrictions on judicial review as courts of the Union and the member states? Moreover, in the light of the fact that the European Treaties have put into place the well-tested procedural mechanisms that ensure that the EU laws, establishing supra-national standards of protection of investments within the internal market, are they applied and interpreted autonomously, untainted by national parochial conceptions, and uniformly? And going beyond the substantive standards of protection: why should European investors in the Internal Market be allowed to crosscut the existing supranational judicial system of the ECJ by using an alternative system of international arbitration?*

[14] Preface to the ECT. RL-006
[15] Ibid.
[16] Développements récents du droit communautaire des investissements internationaux, Bruno Poulain, Revue Générale de Droit International Public, C XIII/2009, 4; page 881. The omitted footnote says: "Our opinion is based on Article 25 of the [ECT], which proposes a disconnection clause to the benefit of the parties of a regional economic integration organization and in Article 16, which appears to link material right and the controversy solution mechanism." (free translation). RL-0060.

> *[…]In summary, there seem to be good reasons for the Commission to push for ensuring that EU law is the only regime governing investment flows within the European market and that the ECJ is the only ultimate instance for interpreting and applying these rules. And, indeed, it does not seem too far-fetched to expect the ECJ to follow the Commission on this point.[…]*
>
> *Given the Commission's strong determination to eliminate the parallelism of standards and recourses for investments inside the Internal Market, it can be expected that also the intra-EU dimension of the ECT will be eventually targeted by the Commission and may disappear if member states cooperate or are forced to cooperate by the ECJ."*[17] *(footnotes omitted)*

92. This author adds that:

> *"The essence of this conflict is, indeed, about whether tribunals can be allowed to review, on the basis of the latter, the legality of government measures that are, at least in theory, fully under the ECJ's control of the European market rules and fundamental rights, and the above sketched 'policy space' they reserve to the Union and the Member States."*[18] *(footnotes omitted)*

93. In actual fact, as is stated by Professor Jan Kleinheisterkamp, the problem raised is not a problem of the selection and application of the "most favourable regulation". The issue is that between EU Member States and their Citizens, EU Law puts aside the application of any other regulation by dint of the principle of supremacy.

94. It is thus a question of determining whether in the light of EU Law, it is valid to apply within the European Union in conflicts between an EU investor and an EU State the provisions of an International Treaty or whether, by contrast, in these intra-EU relations solely EU Law applies. Assuming that is not disputed that EU Directives on Renewable Energies are the framework for Spanish legislation which the Claimants supposedly believed when making its investment, the issue must be settled in the light of the interpretation of Community Law and with regard to these matters Spain cannot submit its decision to forums other than the EU judicial system by dint of Article 344 of the TFEU.

95. As has been stated above, any dispute settlement system introduced by a Treaty affecting the fundaments of the EU is incompatible with the EU Law. Article 26(6) of the ECT requires the settlement of those issues under litigation in accordance with *"this Treaty [the ECT] and applicable rules and principles of international law"*. The rules and principles of the EU are rules and principles of International Law and must be applied with the same hierarchy as the ECT itself. Accepting arbitration to settle litigation which affects the freedom of establishment and the free circulation of capital

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[17] *Investment protection and EU Law: the intra- and extra- EU dimension of the Energy Charter Treaty*, Jan Kleinheisterkamp, Journal of International Economic Law 15 (1), Oxford University Press, 2012, pages 101, 103 y 108. RL-0064.
[18] Ibid.

of a Community investor in EU territory in the context of Renewable Energies is contrary to EU Law and incompatible with the actual content of Article 26(6) ECT.

96. For the sake of transparency and good faith, this Objection cannot be concluded without mentioning the impact on the result of this arbitration that may have the existence of a procedure before the European Commission as regards the evaluation of the measures supporting Renewable Energies and cogeneration in Spain (procedure SA.40348 2014/N).

97. This case must be understood in the light of the Order of 22 October 2014 of the Court of Justice of the European Union laid down regarding preliminary ruling C- 275/13, (ELCOGAS case) referring to Spain, paragraph 33, which concludes as follows:

> *"Article 107 of the TFEU, section 1, must be interpreted in the sense that the amounts attributed to a private electricity producing company which are financed by all the electricity end users established in national territory and which are distributed to Electric Sector companies by a public organization in accordance with predetermined legal criteria, constitute a State intervention or by means of State funds."*[19]

98. Said legal classification made by the ECJ assume that the Member States are required to bear in mind the Guidelines on State aid for environmental protection and energy 2014-2020, approved by means of a Communication from the European Commission 2014/C 200/01 as well as those revoked and approved by the latter by means of a Communication from the European Commission 2008/C 82/01.

99. The existence of this procedure is particularly relevant in the light of the decision of the Commission of 26 May 2014, ordering Romania to suspend payment of an award handed down in an ICSID arbitration, *Micula vs. Romania*. The Commission adopted a first decision, in accordance with Council Regulation (EC) No. 659/1999, which allows the Commission to suspend the payment of any aid which it considers illegal. Subsequently, through a decision on 30 March 2015 the Commission decided that "*the payment of compensation by Romania to two Swedish investors by dint of the revoked aid regime breaches the EU State Aid rules*" and that "*by paying the compensation granted to the Claimants, Romania is actually granting an advantage equivalent to the revoked aid regime*". The Commission thus concluded that said compensation is equivalent to State Aid incompatible with EU Law and must be returned by the beneficiary companies.[20]

100. We must likewise make mention of Decision C(2016) 7827 final, of 28 November 2016, of the European Commission, issued in the case of aids SA.40171 (2015/NN)– Czech Republic, regarding the "Promotion of electricity production from renewable

[19] Order of the Court of Justice of the European Union laid down regarding the preliminary ruling C-275/13, ELCOGAS, on 22 October 2014. (English version). RL-0019.
[20] Decision (EU) 2015/1470 by the Commission on 30 March 2015 pertaining to State aid SA.38517 (2014/C) (ex 2014/NN) carried out by Romania, Arbitration Award Micula/Romania on 11 December 2013. R-0025

energy sources". The interpretation made in said Decision by the European Commission about the application of the ECT with respect to intra-EU conflicts is particularly relevant:

> *"(147) In case of the Energy Charter Treaty, it is also clear from the wording, the objective and the context of the treaty that it does not apply in an intra-EU situation in any event. In general, when negotiating – as in the case of the Energy Charter Treaty – multilateral agreements as a "block", the Union and its Member States only intend to create international obligations vis-à-vis third countries, but not inter se. That has been particularly clear in case of the Energy Charter Treaty, which had been initiated by the Union in order to promote investment flows from the then European Communities to the East, and energy flows in the opposite direction, as part of the external action of the European Communities. It is also borne out by the wording of Articles 1(3) and 1(10) of the Energy Charter Treaty, which defines the area of a regional economic integration organisation as the area of that organisation. The lack of competence of Member States to conclude inter se investment agreements and the multiple violations of Union law set out above in recitals (143) to (145) also constitute relevant context for the interpretation of the Energy Charter Treaty in harmony with Union law, so as to avoid treaty conflict.*
>
> *(148) For those reasons, the ten investors cannot rely on the Energy Charter Treaty or the German-Czech BIT.*
>
> *(149) In any event, there is also on substance no violation of the fair and equitable treatment provisions. First, as explained above, the Czech Republic has not violated the principles of legitimate expectation and equal treatment, neither under its domestic law nor under Union law. As both under the Energy Charter Treaty and the German-Czech BIT Union law is part of the applicable law, the principle of legitimate expectation under the fair and equitable treatment provision has to be interpreted in line with the content of that principle under Union law. Second, in case of the Energy Charter Treaty, it has been expressly recognized by Arbitral Tribunals that the provisions of the Energy Charter Treaty have to be interpreted in line with Union law, and that in case of conflict, Union law prevails. It is settled case-law that a measure that does not violate domestic provisions on legitimate expectation generally does not violate the fair and equitable treatment provision.*
>
> *(150) Finally, the Commission recalls that any compensation which the Arbitral Tribunals were to grant would constitute in and of itself State aid. However, the Arbitral Tribunals are not competent to authorise the granting of State aid. That is an exclusive competence of the Commission. If they were to award compensation, they would violate Article 108(3) TFEU, and any such award would not be enforceable, as that provision is part of the public order"*[21] *(emphasis added).*

(5) Conclusion

[21] Decision C(2016) 7827 final, of 28 November 2016, of the European Commission handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. RL-0021

101. In view of the above, it is considered that the Arbitral Tribunal, with all due respect, lacks the jurisdiction to hear the present intra-EU dispute brought by alleged investors of Luxembourg and the Netherlands against the Kingdom of Spain. Both Luxembourg and the Netherlands, as well as Spain, were EU member States when the ECT came into force. Hence, the Claimants fail to comply with the requirement foreseen in Article 26(1) of the ECT which states that to access arbitration the dispute must be between a Contracting Party and an investor from a different Contracting Party.

B. Lack of Jurisdiction of the Arbitral Tribunal to hear the dispute on an alleged breach by the Kingdom of Spain of obligations derived from section (1) of Article 10 of the ECT through the introduction of the TVPEE by Act 15/2012: absence of consent from the Kingdom of Spain to submit this matter to arbitration given that, pursuant to Article 21 of the ECT, section (1) of Article 10 of the ECT does not generate obligations regarding taxation measures of the Contracting Parties

(1) Introduction

102. Without prejudice to the jurisdictional objection that has just been expounded, the Arbitral Tribunal, with all due respect, lacks jurisdiction to hear the dispute on an alleged breach by the Kingdom of Spain of obligations derived from section (1) of Article 10 of the ECT through the introduction of the Tax on the Value of Production of Electrical Energy (TVPEE) by Act 15/2012, of 27 December 2012, on fiscal measures for energy sustainability (Act 15/2012).[22]

103. This lack of jurisdiction of the Arbitral Tribunal is due to the fact that the Kingdom of Spain has not given its consent to submit such dispute to arbitration.

104. In this sense, the Contracting Parties of the ECT, among which is the Kingdom of Spain, have only consented to submit to investment arbitration alleged breaches of obligations derived from Part III of the ECT, according to Article 26 of the ECT.

105. As we shall see, pursuant to Article 21 of the ECT, section (1) of Article 10 of the ECT invoked by the Claimants, although located in Part III of the ECT, does not generate obligations regarding taxation measures of the Contracting Parties.

(2) Taxation measure disputed by the Claimants: the TVPEE

106. In their Request for Arbitration[23] and in their Memorial on the Merits,[24] the Claimants include the following taxation measure among the disputed measures: the TVPEE introduced by Act 15/2012.[25]

107. Act 15/2012, adopted by the Kingdom of Spain and which introduced, among other taxes, the TVPEE, entered into force on 1 January 2013.[26]

[22] Act 15/2012, of 27 December, on fiscal measures for energy sustainability. R-0030
[23] Request for Arbitration, of 26 October 2015, paragraphs 69 to 71.
[24] Memorial on the Merits, of 14 November 2016, paragraphs 36(a) and 226 to 231.
[25] The TVPEE is regulated in Articles 1 to 11 of Act 15/2012.

108. The TVPEE is levied on the performance of the activities of production and incorporation into the electrical system of electricity within the Spanish electrical system.[27] The TVPEE is a tax of general application, that is, it applies to the production of all generation facilities, both renewable and conventional.

109. In this regard, Article 4 of Act 15/2012 regulates the TVPEE taxable event in the following terms:

> *"Article 4 Taxable event*
>
> *1. The taxable event is comprised of the production and incorporation into the electricity system of electrical energy measured in busbars, including the mainland, the non-mainland and the island territories electricity systems, in any of the installations referred to in Title IV of Law 54/1997, of 27 November, of the Electricity Sector."*[28]

110. Furthermore, Article 5 of Act 15/2012 defines the taxpayers of the TVPEE as follows:

> *"Article 5. Taxpayers.*
>
> *The taxpayers of the tax are the natural or legal persons and the entities referred to in Article 35.4 of Law 58/2003, of 17 December, on General Taxation, who carry out the activities referred to in Article 4."*[29]

111. The tax base of the TVPEE consists of the total amount that the taxpayer is to receive for the production of electrical energy and its incorporation into the electricity system, at each installation, in the taxable period.[30]

112. The applicable tax rate is 7%.[31]

113. The taxable period will generally coincide with the natural year and the TVPEE will be accrued on the last day of the taxable period.[32]

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[26] Act 15/2012, Fifth Final Provision:
"Fifth final provision. Entry into force.
This Law shall enter into force on 1 January 2013." R-0030

[27] Article 1 of Act 15/2012 refers to the nature of the TVPEE:
"The tax on the value of the production of electrical energy is a tax of a direct and real nature which is levied on the performing of activities of production and incorporation into the electricity system of electric energy, measured in busbars, through each one of the facilities indicated in article 4 of this Law." R-0030

[28] Act 15/2012, Article 4. R-0030

[29] Act 15/2012, Article 5. R-0030

[30] Article 6 of Act 15/2012 regulates the tax base of the TVPEE:
"Article 6 Tax base
1. The tax base consists of the total amount that the taxpayer is to receive for the production of electrical energy and its incorporation into the electricity system, measured in power plant busbars, at each installation, in the taxable period […]" R-0030.

[31] Article 8 of Act 15/2012 regulates the tax rate of the TVPEE:
"Article 8 Tax rate
The tax shall be payable at a rate of 7 percent." R-0030

114. According to the Claimants, the introduction of this new tax through Act 15/2012 allegedly implies a breach by the Kingdom of Spain of its obligations under section (1) of Article 10 of the ECT. In particular, according to the Claimants[33], the creation of the TVPEE would have supposedly breached the following standards of protection included in section (1) of Article 10 of the ECT:

- To promote stable, equitable, favourable and transparent conditions.

- Fair and equitable treatment.

- Not to impair, in any way, by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of the investments.

- To observe any obligations entered into with an investor or an investment (umbrella clause).

115. As analysed below, the Claimants are mistaken in their approach since section (1) of Article 10 of the ECT does not generate any type of obligation for the Contracting Parties, nor correlative rights for the investors, with respect to taxation measures of the Contracting Parties. Therefore, there is no possible alleged breach of obligations derived from section (1) of Article 10 of the ECT through the introduction of the TVPEE that enables the Claimants to submit such issue to the Arbitral Tribunal.

(3) The Kingdom of Spain has only consented to submit to investment arbitration disputes related to alleged breaches of obligations derived from Part III of the ECT, in accordance with Article 26 of the ECT

116. It is usual for the signing States of international Treaties on reciprocal protection of investments, whether bilateral or multinational, to envisage the possibility of resorting to arbitration to resolve controversies that derive from these treaties. It is also usual for those signing States to delimit in these Treaties, as is the case with the ECT, the scope of their consent for resorting to arbitration.

117. The Arbitral Tribunal of the case of *ST-AD GmbH v. Republic of Bulgaria*, clearly stated this idea:

> *"At the outset, the Tribunal wants to restate that it is of the utmost importance not to forget that no participant in the international community, be it a State, an international organisation or a physical or a legal person, has an inherent right of access to a jurisdictional recourse. For such right to come into existence, specific consent has to be given. As far as investment arbitration is concerned, such consent can be given in a contract, a domestic law or an international bilateral or multilateral treaty. In all these different hypotheses, the State can shape its consent*

[32] Article 7 of Act 15/2012 regulates the taxable period and the accrual of the TVPEE:
"Article 7 Taxable period and accrual
1. The taxable period coincides with the natural year, unless the activity of the installation ceases, in which case the taxable period ends on the day when this cessation is understood to have taken place.
2. The tax shall be accrued on the last day of the tax period." R-0030

[33] Memorial on the Merits, of 14 November 2016, paragraphs 51 and 540(a).

> *as it sees fit by providing the conditions under which it is given – in other words, the conditions subject to which an "offer to arbitrate" is made to the foreign investors."*[34] *(emphasis added)*

118. In the particular case of the ECT, Article 26 of the ECT grants the investor the possibility of resorting to arbitration in the case of an alleged breach by a Contracting Party of an obligation derived from Part III of the ECT:

> *"Article 26. Settlement of disputes between an investor and a contracting party*
>
> *1. Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an* ***obligation of the former under Part III*** *shall, if possible, be settled amicably.*
>
> *2. If such disputes cannot be settled in accordance with the provisions of section 1 within three months from the date on which either party to the dispute requested an amicable settlement, the investor concerned may choose to submit a dispute for settlement: […]*
>
> *c) In accordance with the following sections of this Article.* [referred to international conciliation or arbitration] [...]*."*[35] *(emphasis added)*

119. That is to say, in the field of the ECT the Contracting Parties, among them the Kingdom of Spain, have only given their consent to submit to arbitration disputes with an investor relating to alleged breaches of obligations derived from Part III of the ECT.

120. In view of the cited Article 26 of the ECT, there is no doubt that if no obligation derived from Part III of the ECT exists, there cannot be an alleged breach of it and thus, there is no consent of the Contracting Party to resort to arbitration, with the Arbitral Tribunals therefore lacking the jurisdiction to hear the issue.

121. This is precisely what occurs in this case regarding the TVPEE. There cannot be an alleged breach of obligations that legitimises resorting to arbitration simply because there is no obligation with respect to taxation measures, in this case the TVPEE.

122. As analysed below, section (1) of Article 10 of the ECT, on which the Claimants try to base their claims, despite being located in Part III of the ECT, does not generate any obligation with respect to taxation measures of the Contracting Parties. For this reason, there can be no alleged breach of obligations derived from such section through the adoption by the Kingdom of Spain of taxation measures, in particular, through the introduction of the TVPEE. As a consequence, we are facing a dispute on which the Kingdom of Spain has not given its consent to submit to arbitration.

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[34] *ST-AD GmbH v. Republic of Bulgaria*, UNCITRAL, PCA Case No. 2011-06. Award on Jurisdiction of 18 July 2013, paragraph 337. RL-0044

[35] ECT, Article 26(1). RL-0006

(4) Section (1) of Article 10 of the ECT does not generate obligations for the Contracting Parties with regard to taxation measures, according to Article 21 of the ECT

(4.1) The ECT does not generate obligations or rights with regard to taxation measures of the Contracting Parties, with certain stipulated exceptions

123. The ECT does not impose obligations or create rights with regard to taxation measures of the Contracting Parties, with certain stipulated exceptions stated in Article 21 of the ECT. This is established by Article 21 of the ECT itself, on taxation, which clearly establishes the following in its section 1:

> *"Article 21. Taxation.*
>
> *1. Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency."*[36] *(emphasis added)*

124. That is to say, Article 21 of the ECT is clear and express when it states that:

- The ECT does not include any provision that creates rights or imposes obligations with respect to taxation measures of the Contracting Parties, with certain exceptions stated in the same Article 21 of the ECT. That is, Article 21 of the ECT contains a general exclusion of taxation measures from the scope of application of the ECT (*taxation carve-out*) which only presents certain exceptions (*claw backs*) expressly stipulated in such Article 21.
- In the case of conflict between Article 21 of the ECT and any other Article of the ECT, the Contracting Parties give priority to the cited Article 21.

125. Regarding what those exceptions are, the same Article 21 establishes in its sections (2) to (5) the Articles or sections of Articles of the ECT that do apply to taxation measures of the Contracting Parties. Those Articles or sections of Articles mentioned in Article 21 are, therefore, the only ones that do generate obligations for Contracting Parties with respect to taxation measures.

126. In this sense, sections (2) to (5) of Article 21 ECT provide the following:

> *"2. Article 7(3) shall apply to Taxation Measures other than those on income or on capital, except that such provision shall not apply to: […]*
>
> *3. Article 10(2) and (7) shall apply to Taxation Measures of the Contracting Parties other than those on income or on capital, except that such provisions shall not apply to:[…]*
>
> *4. Article 29(2) to (6) shall apply to Taxation Measures other than those on income or on capital.*

[36] ECT, Article 21(1). RL-0006

5. a) Article 13 shall apply to taxes." [37]

127. The terms of the cited Article 21 of the ECT are absolutely clear: the ECT excludes the taxation measures of Contracting Parties from its scope of application, with the sole exceptions expressly stipulated in Sections (2) to (5) of the cited Article 21.

128. This is recognised by the Secretariat of the ECT itself in its document "*The Energy Charter Treaty. A Reader´s guide":*

> *"The issue of taxation has great significance both for the private economic agents in the energy sector and the involved states. While foreign companies have a keen interest that they are not fiscally discriminated, host countries may wish to retain some discretion concerning their tax treatment. In an international context, the issue is primarily and most commonly dealt with in bilateral agreements on the avoidance of double taxation.*
>
> *The ECT confirms the priority of the latter agreements and seeks to avoid a potential conflict with them. Accordingly, Article 21 excludes taxation matters, in principle, from the scope of application of the agreement. However, this carve-out of taxation issues does not affect the application of the principle of non-discrimination as included in agreements on the avoidance of double taxation existing among ECT CPs.*
>
> *Article 21 does not entirely exclude taxation matters:*
>
> *According to Article 21 (2),(3), the principle of non-discrimination in transit and investment matters shall apply to taxation measures other than those on income and capital. […]*
>
> *Pursuant to Article 21 (4), the ECT covers taxation matters in trade with the exception of income or capital taxes.*
>
> *According to Article 21 (5), the provision on expropriation (Article 13) applies to taxes. A foreign investor may therefore claim that a tax measure has expropriatory effects."*[38] *(emphasis added)*

129. This meaning of Article 21 of the ECT is totally peaceful, and it may be mentioned in this same sense that the Tribunal in *Plama Consortium Limited v. Republic of Bulgaria* also indicated the following:

> *"The Arbitral Tribunal cannot see how this claim gives rise to a violation of Bulgaria's obligations under the ECT. In the first place, Article 21 of the ECT specifically excludes from the scope of the ECT's protections taxation measures of a Contracting State, with certain exceptions, […]."*[39] *(emphasis added)*

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[37] ECT, Article 21, Sections (2) to (5). RL-0006
[38] *The Energy Charter Treaty: A Reader's Guide*, Energy Charter Secretariat, pages 38 and 39. RL-0053
[39] *Plama Consortium Limited v. the Republic of Bulgaria*, ICSID case No. ARB/03/24. Award of 27 August 2008, paragraph 266. RL-0034.

130. Thus, there is no doubt that taxation measures of the Contracting Parties are excluded from the scope of protection of the ECT, with the only exceptions stipulated in Article 21 of the ECT.

(4.2) Section (1) of Article 10 of the ECT is not found among those stipulated exceptions. Therefore, section (1) of Article 10 of the ECT does not generate obligations with respect to taxation measures for the Contracting Parties

131. None of the exceptions stipulated in Article 21 of the ECT by which taxation measures are included in the scope of protection of the ECT comprises section (1) of Article 10 of the ECT. That is to say, according to Article 21 of the ECT, it is clear that section (1) of Article 10 of the ECT, on which the Claimants try to base their claims, does not impose any obligations for the Contracting Parties regarding taxation measures.

132. The only sections of Article 10 of the ECT that do apply to taxation measures of the Contracting Parties, if the case, are sections (2) and (7). This is clearly established in Article 21 of the ECT:

> *"1. Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. […]*
>
> *3. Article 10 (2) and (7) shall apply to Taxation Measures of the Contracting Parties other than those on income or on capital, except that such provisions shall not apply to: […]."*[40] *(emphasis added)*

133. Apart from such mention to the application of sections (2) and (7) of Article 10 of the ECT to certain taxation measures and with certain limitations, Article 21 of the ECT does not contain any additional mention that any other section of Article 10 of the ECT applies to taxation measures.

134. As a consequence, section (1) of Article 10 of the ECT, invoked by the Claimants, is not applicable to taxation measures of the Contracting Parties. Thus, with respect to taxation measures of the Contracting Parties, section (1) of Article 10 of the ECT does not impose any obligation on the Contracting Parties nor does it generate any correlative right for the investors.

(5) The provisions on the TVPEE of Act 15/2012 are a taxation measure for the purposes of the ECT

135. As analysed below, the provisions of Act 15/2012 on the TVPEE are considered as a taxation measure for the purposes of the ECT.

(5.1) According to Article 21(7) of the ECT, the term "taxation measure" includes any provision relating to taxes of the domestic law of the Contracting Party

[40] ECT, Article 21. RL-0006.

136. Article 21 of the ECT itself, on taxation, makes reference to what should be understood as a "taxation measure" for the purposes of said Article 21. In this regard, section (7)(a)(i) of Article 21 of the ECT provides that the term "taxation measure" includes any provisions relating to taxes of the domestic law of the Contracting Party:

> *"7. For the purposes of this Article:*
>
> *a) The term "taxation measure" includes:*
>
> *i) **Any provision relating to taxes of the domestic law of the Contracting Party** or of a political subdivision thereof or a local authority therein; and;*
>
> *ii) any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound."* [41] *(emphasis added)*

137. In view of the aforementioned Article 21(7)(a)(i) of the ECT, the following question must be made: what is the applicable law to determine whether we are dealing with provisions relating to taxes? Given this question, there are two possible interpretations: to understand that the applicable law to determine whether we are dealing with provisions relating to taxes should be the domestic law of the Contracting Party or to understand that it should be international law.

138. Regarding the first interpretation, there are several reasons to believe that the law governing the determination of whether certain provisions are provisions relating to taxes should be the domestic law of the Contracting Party.

139. The first reason is the wording of Article 21(7)(a)(i) of the ECT itself. From the ordinary meaning of its terms it is clear that the Article contains a reference to the domestic law of the Contracting Party for the purpose of determining when we are dealing with provisions relating to taxes:

> *"i) Any provision relating to taxes **of** the domestic law of the Contracting Party […]"*[42] *(emphasis added)*

140. The arbitration case law has acknowledged the possibility that in international investment treaties a particular term be defined by reference to the domestic law of a Contracting Party. In this sense, we can cite the Arbitral Tribunal of the case *Saipem v. Bangladesh,* which recognizes such a possibility, although it did not occur in that case:

> *"in the absence of any indication that the contracting states intended to refer to 'property' as a notion of Bangladeshi law, the Tribunal cannot depart from the general rule that treaties are to be interpreted by reference to international law."*[43] *(emphasis added)*

[41] ECT, Article 21(7)(a). RL-0006.
[42] ECT, Article 21(7)(a). RL-0006.
[43] *Saipem S.p.A. v. The People's Republic of Bangladesh,* ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures, of 21 March 2007, para. 82. RL-0029

141. *The Oxford Handbook of International Investment Law* also recognises the possibility that international treaties can contain an explicit reference to domestic law:

> *"While treaty claims are obviously to be decided on the basis of international law, national law still has a role to play. […] Some of the facts on the basis of which to resolve international claims have been produced by, and may only be assessed by applying, national law […]. Examples of such 'preliminary' or 'incidental' questions governed by national law are whether an investment is valid, or a contract has been concluded […]. Further examples may, depending on the exact claim, comprise such issues as […] taxation, […]. Also, a treaty may make express reference to national law."*[44] *(emphasis added) (footnotes omitted)*

142. Another reason for interpreting that Article 21(7)(a)(i) of the ECT refers to domestic law to determine whether we are dealing with provisions realting to taxes is the reference to domestic law contained in the Convention to avoid double taxation between Spain and Luxembourg, the country where one of the Claimants is incorporated. Thus, Article 3 of this Convention to avoid double taxation provides that:

> *"For application of the Convention by a Contracting State, any expression not defined therein shall have, unless its context infers a different interpretation, the meaning attributed to it by the legislation of that State concerning the taxes that are the object of the Convention."*[45] *(emphasis added)*

143. The same thing is contained in the Convention to avoid double taxation between Spain and the Netherlands, the country where another one of the Claimants is incorporated.[46]

144. Note that the Conventions to avoid double taxation signed by Spain with Luxembourg and with the Netherlands are international treaties in force between the Respondent and the States of the Claimants for the purposes of this arbitration. Therefore, those Conventions must be taken into consideration pursuant to Article 31(3)(c) of the Vienna Convention, which states, regarding the interpretation of international treaties, that:

> *"3. Together with the context, the following shall be taken into account:* [...] *c) any relevant rules of international law applicable in relations between the parties."*[47]

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[44] The Oxford Handbook of International Investment Law, Muchlinski, Ortino and Schreuer, Oxford University Press, pages 111 and 112 RL-0066.

[45] Convention between the Kingdom of Spain and the Grand Duchy of Luxembourg for the avoidance of double taxation with respect to taxes on income and capital and for the prevention of fraud and tax evasion, of 3 June 1986, Article 3(2). R-0001

[46] Convention between the Government of the Spanish State and the Government of the Kingdom of the Netherlands for the avoidance of double taxation regarding taxes on income and on capital, made in Madrid on 16 June 1971, Article 3(2): "For the application of this Convention by a State, any expression not otherwise defined shall, unless its context infers a different interpretation, have the meaning attributed to it by the legislation of that State concerning the taxes that are the object of this Convention." (emphasis added). R-0001-bis

[47] Vienna Convention. RL-0010.

145. Finally, it should be borne in mind that in the context of international treaties on investment other than the ECT it may be necessary to resort to international law to define the concept of taxation measure because the Treaties themselves do not include a provision such as that contained in Article 21(7)(a)(i) of the ECT. For example, Article 2103 of the NAFTA[48] also includes a general *taxation carve-out* (with certain exceptions) for taxation measures, but such Treaty does not refer to what is meant by taxation measure, as the ECT does.

146. Moreover, a second interpretation of Article 21(7)(a)(i) of the ECT implies understanding that in order to consider that we are dealing with provisions relating to taxes, it is necessary to resort to international law. This can be argued based on what is stated in Article 26(6) ECT, which provides that:

> *"A tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law."*[49]

147. The Kingdom of Spain particularly shares the first of the stated interpretations of Article 21(7)(a)(i) of the ECT. However, to the extent relevant for this arbitration, either of the two stated interpretations of Article 21(7)(a)(i) of the ECT leads us to conclude that the TVPEE is a tax.

148. In short, as explained, Article 21(7)(a)(i) of the ECT provides that the term "taxation measure" includes any provision relating to taxes of the domestic law of the Contracting Party. As we will analyse below, Act 15/2012 is part of the domestic law of the Kingdom of Spain, and the provisions on the TVPEE are in any case provisions relating to taxes, whether we use the concept of tax of the domestic law of the Kingdom of Spain or we use the concept of tax of international law.

149. Therefore, there is no doubt that the provisions relating to the TVPEE of Act 15/2012 are a taxation measure for the purposes of the ECT.

(5.2) Act 15/2012 is part of the domestic law **of the Kingdom of Spain**

150. In the first place, Law 15/2012 is part of the domestic law of the Kingdom of Spain. In particular, Law 15/2012 is a domestic law passed by the Parliament of the Kingdom of Spain (comprised of the Congress of Deputies and the Senate) in accordance with the corresponding ordinary legislative procedure provided for in the Spanish Constitution and the rest of the Spanish legal system.[50]

151. In this respect, the Spanish Constitution provides in its Article 66 that:

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[48] NAFTA, Article 2103. https://www.nafta-sec-alena.org/Home/Legal-Texts/North-American-Free-Trade-Agreement. RL-0011

[49] Article 26(6) of the ECT: RL-0006.

[50] The procedure of processing and approval of Law 15/2012 by the Spanish Congress of Deputies and the Senate is public and can be consulted in detail on the website of the Congress of Deputies and of the Senate. R-0034

> *"1. The Parliament represents the Spanish people and shall consist of the Congress of Deputies and the Senate.*
>
> *2. The Parliament exercises the legislative power of the State, [...]."*[51]

152. Moreover, Act 15/2012 that introduces the TVPEE was passed in accordance with Article 133 of the Spanish Constitution, which grants the State the original authority to establish taxes, by law. In this sense, article 133(1) of the Spanish constitution provides that:

> *"1. The original power to establish taxes corresponds exclusively to the State, by means of law."*[52]

(5.3) The provisions on the TVPEE of Law 15/2012 are provisions relating to a tax

153. Moreover, as will be discussed below, the TVPEE is a tax both under the domestic law of the Kingdom of Spain and under international law.

154. Therefore, the provisions on the TVPEE of Law 15/2012 are provisions relating to a tax, both under the domestic law of the Respondent and under international law.

(a) The TVPEE is a tax under the domestic law of the Kingdom of Spain

155. From the perspective of the domestic law of the Kingdom of Spain, there is no doubt that the TVPEE is a tax. The Spanish Constitutional Court itself has ratified the taxation nature of the TVPEE and its conformity with the Spanish Constitution.

156. In this regard, Act 15/2012 is clear about the taxation nature of the TVPEE. According to Act 15/2012, the TVPEE is a direct tax levied on the performance of the activities of production and incorporation into the electrical system of electrical energy within the Spanish electrical system. In this regard, Article 1 of Act 15/2012 provides the following:

> *"Article 1 Nature*
>
> *The tax on the value of the production of electric energy is a tax of direct character and real nature that taxes the performance of activities of production and incorporation into the electric system of electric energy, measured in power plant busbars, through each of the installations indicated in Article 4 of this Law."*[53] *(emphasis added)*

157. The concept of taxes and its different types (imposts, fees and special contributions) under Spanish Law is set out in Article 2 of Act 58/2003, of 17 December, on General Taxation:

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[51] Spanish Constitution of 1978 (Consolidated Version), Article 66. R-0035

[52] Spanish Constitution of 1978 (Consolidated Version), Article 133(1). (R-0035). Act 58/2003, of 17 December, on General Taxation, provides the same when stating in its Article 4 that "1. *The original power to establish taxations corresponds exclusively to the State, by means of law. [...]".* R-0036

[53] Act 15/2012, Article 1. R-0030

"Article 2 Concept, purposes and types of taxes

1. Taxes are public incomes that consist of monetary contributions required by a public Administration as a consequence of the performance of an act to which the law connects the duty to contribute, with the primary purpose of obtaining the necessary income to support public spending.

As well as being a means to obtain the resources needed to support public spending, taxes may also serve as instruments of general economic policy and attend to the compliance with the principles and purposes contained in the Constitution.

2. Taxes, whatever their denomination, are classified in fees, special contributions and imposts: [...]

c) Imposts are taxes required without compensation, whose taxable event is made up of deals, acts or events that show the economic capacity of the taxpayer."[54]

158. As we have indicated previously, the TVPEE applies to all installations for electricity production, both from renewable and conventional sources. The tax base of the TVPEE consists of the total amount that the taxpayer is to receive for the production of electrical energy and its incorporation into the electricity system, measured in power plant busbars, at each installation, in the taxable period. The applicable tax rate is 7%. The taxable period will generally coincide with the natural year and the TVPEE is accrued on the last day of the taxable period.

159. The self-assessment and payment to the Public Treasury of the TVPEE is made through Form 583 "*Tax on the value of production of electrical energy*. Self-assessment and instalment payments".[55] Said Form 583 was approved by Order HAP/703/2013, of 29 April 2013, which also establishes the manner and procedure for its presentation.[56]

160. Note also that the Spanish National Court has stated that Ministerial Order HAP/703/2013 is in full conformity with the Law.[57]

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[54] Act 58/2003, of 17 December, on General Taxation, Article 2. R-0036

[55] Website of the State Tax Administration Agency where information is provided about Model 583 and where it can be submitted electronically. R-0037
https://www.agenciatributaria.gob.es/AEAT.sede/procedimientoini/DR01.shtml

[56] Order HAP/703/2013, of 29 April, which approves Form 583 "Tax on the Value of the Production of Electrical Energy. Self-assessment and insltalment payments", and establishing the form and procedure for its submission. R-0038

[57] The Spanish National Court has dismissed various contentious-administrative appeals brought against Ministerial Order HAP/703/2013, of 29 April 2013, and has declared that this Order is in conformity with to the Law. In this regard, the following Judgements of the National Court may be cited: i) Judgement of the National Court, of 2 June 2014, dismissing contentious-administrative appeal 297/2013 (R-0039), ii) Judgement of the National Court, of 2 June 2014, dismissing contentious-administrative appeal 298/2013 (R-0040), and iii) Judgement of the National Court, of 30 June 2014, dismissing contentious-administrative appeal 296/2013 (R-0041).

161. The taxation nature of the TVPEE has also been recognised by organisms such as the Institute of Accounting and Auditing (ICAC)[58], which when analysing the accounting treatment of the TVPEE established in an enquiry in June 2013 that:

> *"The tax on the value of the production of electrical energy is a tax of direct character and real nature [...] having to be recorded as an expense in the profit and loss account; account 631 Other Taxes may be used for such purpose."*[59]

162. In addition, it must be borne in mind that, according to Spanish law, the TVPEE is a deductible expense on the Corporations Tax of the TVPEE taxpayers.

163. In this regard, as the aforementioned ICAC states, taxpayers must register the TVPEE as an expense in their accounts. The accounting expense corresponding to the TVPEE is tax deductible on the Corporations Tax of the taxpayers. In this regard, Article 15 of Act 27/2014, of 27 November, on the Corporations Tax sets out the expenses that are not considered tax deductible expenses. The expense corresponding to the TVPEE does not fit into any of the cases of non-deductible expenses and, therefore, it is deemed a tax deductible expense in the Corporations Tax.[60]

164. This tax deductibility of the accounting expense of the TVPEE according to Spanish law has been confirmed by the General Directorate of Taxation[61] of the Kingdom of Spain. Thus, in an answer of 23 December 2014 to a written tax consultation received, the General Directorate of Taxation stated:

> *"The taxpayer making the inquiry asks whether the amount self-assessed as "Tax on the Value of Electrical Energy production" through the filing of Form 583 is regarded as a fiscally deductible expense, in electrical energy production activity (heading 151.4), both for the Corporations Tax taxpayer as well as when calculating the income from activity in direct estimation for taxpayers of the Personal Income Tax. [...] insofar as the Corporations Tax regulations do not include any specific provisions with regard to the Tax on the Value of the Production of Electrical Energy, we will consider its accounting treatment, [...] In conclusion, the taxpayer of the Tax on the Value of the Production of Electrical Energy must record an expense for it, in the month of November of each year, an expense that will be* ***fiscally deductible*** *in the taxable period when it was recorded.[...]"*[62] *(emphasis added)*

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[58] The Institute of Accounting and Auditing (ICAC) is an Autonomous Body of the Spanish State Administration, affiliated with the Ministry of Economy and Competitiveness. Among its functions is the answer to the queries put to it regarding the application of the rules contained in the applicable regulatory framework on financial reporting and the regulations of the audit activity. R-0005

[59] Consultation 1, no. BOICAC 94/June 2013. R-0006

[60] Act 27/2014, of 27 November, on the Corporations Tax, Consolidated text, article 15. R-0007

[61] The General Directorate of Taxation is a body of the Ministry of Finance and Public Administration of the Kingdom of Spain which has among its functions the interpretation of tax laws and regulations, among other ways, by answering written tax queries received. Webpage of the Ministry of Finance and Public Administrations on structure and functions of the General Directorate of Taxation. R-0008

[62] General Directorate of Taxation's reply, of 23 December 2014, to the binding Tax Consultation V3371-14. R-0009

(i) The Spanish Constitutional Court has ratified the taxation nature of the TVPEE and its conformity with the Spanish Constitution

165. In addition, the Spanish Constitutional Court has ratified the taxation nature and the legality of the TVPEE.

166. In this respect, the Spanish Constitutional Court, the supreme interpreter of the Spanish Constitution[63], through its Judgment of 6 November 2014, has dismissed unconstitutionality appeal number 1780-2013 submitted to it against the TVPEE, particularly against Articles 4, 5 and 8 of Act 15/2012, relating respectively to the taxable event, the taxpayers and the tax rate of the TVPEE.

167. In the said Judgement of 6 November 2014, the Spanish Constitutional Court declared that the aforementioned TVPEE regulation contained in Act 15/2012 is perfectly valid and in accordance with the Spanish Constitution.[64]

168. The Claimants make absolutely no mention to the Judgement of 6 November 2014 in their Memorial on the Merits.

169. Therefore, there is no doubt that the TVPEE is a tax under Spanish law.

(b) The TVPEE is a tax under International Law

170. In addition, there is no doubt that the TVPEE is a tax from the perspective of International Law.

171. In this respect, as well shall see below, the TVPEE is a tax according to the concept of tax under International Law used by arbitration case-law. Moreover, the European Commission has ratified the taxation nature of the TVPEE and its conformity with EU law.

(i) The TVPEE is a tax according to the concept of tax under International Law used by arbitration case-law

172. If we resort to a concept of "tax" of international law, especially the concept that the Arbitral Tribunals have repeatedly used, it can be seen that the TVPEE is a tax.

173. *Black* 's *Law Dictionary* includes the following definition of tax:

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[63] Organic Act 2/1979, of 3 October, regarding the Constitutional Court:
"First Article
1. The Constitutional Court, as supreme interpreter of the Constitution, is independent of the other constitutional bodies and is subject only to the Constitution and the present Organic Law
2. Its order is unique and its jurisdiction reaches all national territory. R-0042

[64] Judgement 183/2014, from 6 November 2014 issued by the Constitutional Court Plenary in unconstitutionality appeal number 1780-2013 promoted by the Cabinet of the Andalusian Regional Government with regard to articles 4, 5 and 8 of Act 15/2012 (and other regulations), published in the BOE (Official State Gazette) on 4 December 2014. R-0043

> *"**tax**, n. (14c) A charge, usu. monetary, imposed by the government on persons, entities, transactions, or property to yield public revenue. […]"*[65]

174. It should be noted that this ordinary concept of tax is substantially equal to that included in Spanish law in Article 2 of Law 58/2003, of 17 December, on General Taxation -in essence, a mandatory contribution to the Public Treasury-.[66]

175. The Arbitral Tribunals have repeatedly ruled along the same lines as *Black* 's *Law Dictionary*.

176. The Arbitral Tribunal of *EnCana v. Ecuador* referred to the meaning of the term "taxation measures", which was not defined in the Canada-Ecuador BIT applicable in that case, by providing the following:

> *"It is in the nature of a tax that it is imposed by law.[…]The question whether something is a tax measure is primarily a question of its legal operation, not its economic effect. A taxation law is one which imposes a liability on classes of persons to pay money to the State for public purposes. The economic impacts or effects of tax measures may be unclear and debatable; nonetheless a measure is a taxation measure if it is part of the regime for the imposition of a tax.[…]"*[67] *(Emphasis added)*

177. The opinion of that Arbitral Tribunal was upheld by Arbitral Tribunal of *Duke Energy v. Ecuador,* which when referring to the concept of "matters of taxation" mentioned in Article X of the US-Ecuador BIT and not defined by it, stated:

> *"The Treaty does not define the term "matters of taxation". In seeking to elucidate its meaning, the ruling in EnCana v. Ecuador appears to be of particular relevance."*[68]

178. Following this line, the Arbitral Tribunal of *Burlington Resources v. Ecuador,* when also referring to the concept of "matters of taxation", provided the following:

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[65] *Black´s Law Dictionary,* Ninth Edition, Bryan A. Garner Editor in Chief, page 1594. RL-0025.

[66] Article 2 of Act 58/2003, of 17 December, on General Taxation:
" Article 2 Concept, purposes and types of taxes
1. Taxes are public incomes that consist of monetary contributions required by a public Administration as a consequence of the performance of an act to which the law connects the duty to contribute, with the primary purpose of obtaining the necessary income to support public spending.
As well as being a means to obtain the resources needed to support public spending, taxes may also serve as instruments of general economic policy and attend to the compliance with the principles and purposes contained in the Constitution.
2. Taxes, whatever their denomination, are classified in fees, special contributions and imposts: […]
c) Imposts are taxes required without compensation, whose taxable event is made up of deals, acts or events that show the economic capacity of the taxpayer.." R-0036

[67] *EnCana Corporation v. Republic of Ecuador,* LCIA Case No. UN 3481, Award of 3 February 2006, para 142. RL-0027.

[68] Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador, ICSID Case No. ARB/04/19, Award 18 August 2008, para 174. RL-0033.

> *"To answer the question whether Law 42 is a tax for purposes of Article X of the Treaty under international law, the Tribunal finds that the EnCana and Duke Energy decisions are indeed apposite. In EnCana, the tribunal held that a "tax" is "imposed by law" and that this "taxation law is one which imposes a liability on classes of persons to pay money to the State for public purposes." In Duke Energy, the tribunal, dealing with the Treaty applicable to this dispute, held that "the ruling in EnCana v. Ecuador appears to be of particular relevance" to elucidate the meaning of "matters of taxation" under Article X of the Treaty.*
>
> *Building on EnCana's ruling, Duke Energy stands for the proposition that there is "tax" under Article X of the Treaty if the following four requirements are met: (i) there is a law (ii) that imposes a liability on classes of persons (iii) to pay money to the State (iv) for public purposes. Under this definition, the Tribunal is of the view that Law 42 is a tax."*[69] *(emphasis added)*

179. In view of all the above decisions, the concept of tax in international law that the Arbitral Tribunals have repeatedly used has a number of defining characteristics that can be summarized as follows:

- That the tax is established by Law,
- That such Law imposes an obligation on a class of people, and
- That such obligation implies paying money to the State for public purposes.

180. As we shall see below, in this case all these defining characteristics are met in relation to the TVPEE, so there is no doubt that this is a tax from the perspective of international law.

The TVPEE is established by Law

181. Firstly, as already discussed, the TVPEE was established by Law: Act 15/2012. Act 15/2012 was passed by the Parliament of the Kingdom of Spain (Congress of Deputies and Senate) in accordance with Article 133 of the Spanish Constitution, which states that the original power to establish taxes corresponds exclusively to the State by means of law.

That such Law imposes an obligation on a class of people

182. Secondly, Act 15/2012 which regulates the TVPEE imposes the obligation to pay this tax on a class of people. Specifically, as already discussed, according to Act 15/2012, the TVPEE is applied to anyone that performs the activities of production and incorporation of electrical energy into the Spanish electricity system, whether the electricity production facilities use renewable energy or conventional energy.

[69] Burlington Resources Inv. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Jurisdiction, of 2 June 2010, paras 164 and 165. RL-0036

That such obligation involves paying money to the State for public purposes

183. Thirdly, Act 15/2012 imposes on taxpayers of the TVPEE the obligation to pay money to the State for public purposes.

184. In this regard, TVPEE taxpayers are required to make the payments relating to this tax to the State in accordance with Article 10 of Act 15/2012 on assessment and payment of the tax,[70] and Order HAP/703/2013, of 29 April, approving Form 583 "Tax on the value of the production of electrical energy. Self-assessment and Instalment Payments", and establishing the way and procedure for its submission.[71]

185. The TVPEE is an income of the Spanish State. The revenue corresponding to the TVPEE is public revenue that is included in the Spanish General Budgets of the State. This can be clearly seen in the Spanish General Budgets of the State for 2013 -the first year the TVPEE was in force-, 2014, 2015 and 2016.

186. Thus, in the Spanish General State Budget for 2016, the latest Budgets approved, it can be seen that the revenue from the TVPEE is included in these General Budgets in Section *"State Income"* (Section 98), Chapter *"Direct taxes and social contributions*" (Chapter 1) and, within the latter, under "*Taxes on production and storage of electricity and fuel*" (item 13), sub-heading "*On the value of the production of electric power*" (sub-heading 130)[72]:

[70] Act 15/2012, Article 10. R-0030

[71] Order HAP/703/2013, of 29 April, which approves Form 583 "Tax on the Value of the Production of Electrical Energy. Self-assessment and Instalments Payments", and establishing the way and procedure for its submission. R-0038

[72] Extract of the General Budgets of the Spanish State for 2016. R-0010.
Spanish version published at the State Secretariat for Budget and Expenditure of the Ministry of Finance and Public Authorities.
http://www.sepg.pap.minhap.gob.es/Presup/PGE2016Ley/MaestroDocumentos/PGE-ROM/doc/1/2/1/2/1/N_16_E_R_2_101_1_2_198_1_101_1.PDF

NATIONAL BUDGET
STATE

BUDGET YEAR
2016

Section: 98 STATE INCOME
Service: 01 STATE INCOME

(Thousands of euros)

Economic	Explanation		Total
1	DIRECT TAXES AND SOCIAL CONTRIBUTIONS		
10	Income tax		66,466,000.00
100	On Natural Persons		39,610,000.00
10000	Personal Income Tax	39,854,000.00	
10099	Tax assignment to the Catholic Church	-244,000.00	
101	On Corporations		24,868,000.00
10100	Corporations Tax	24,868,000.00	
102	On non-residents		1,988,000.00
10200	Non-residents Income Tax	1,988,000.00	
11	On capital		151,000.00
119	Other capital taxation		151,000.00
11900	General Inheritance and Gift Tax	113,000.00	
11901	Wealth tax	38,000.00	
12	Social contributions		923,000.00
120	Contributions from the special regimes for civil servants		923,000.00
12000	Pension contributions	923,000.00	
13	Tax on the production and storage of electrical energy and fuel		1,868,000.00
130	Tax on the value of the production of electrical energy.		1,627,000.00
131	On the production of spent nuclear fuel and radioactive waste resulting from the generation of nuclear energy		230,000.00
132	On the storage of spent nuclear fuel and radioactive waste in centralised facilities		7,000.00
	TOTAL DIRECT TAXES AND SOCIAL CONTRIBUTIONS		69,404,000.00
2	INDIRECT TAXES		
21	On Added Value		31,334,000.00
210	Value Added Tax		31,334,000.00
21000	VAT on imports	5,956,000.00	
21001	VAT on interior operations	25,369,000.00	
22	Excise duty		7,923,000.00
220	Special taxes		7,923,000.00
22000	On alcohol and derived beverages	361,000.00	
22001	On beer	126,000.00	
22003	On tobacco products	3,236,000.00	
22004	On hydrocarbons	3,605,000.00	

187. Similarly, in the Spanish General State Budget for 2013, 2014 and 2015, the revenue from the TVPEE is also included as State revenue in the same sections as those indicated above for the 2016 Budget.[73]

[73] Extract of the General Budgets of the Spanish State for 2013. R-0079.
Spanish version published at the State Secretariat for Budget and Expenditure of the Ministry of Finance and Public Authorities.
http://www.sepg.pap.minhap.gob.es/Presup/PGE2013Ley/MaestroDocumentos/PGE-ROM/doc/1/2/1/2/1/N_13_E_R_2_101_1_2_198_1_101_1.PDF
Extract of the General Budgets of the Spanish State for 2014. R-0080.
Spanish version published at the State Secretariat for Budget and Expenditure of the Ministry of Finance and Public Authorities.
http://www.sepg.pap.minhap.gob.es/Presup/PGE2014Ley/MaestroDocumentos/PGE-ROM/doc/1/2/1/2/1/N_14_E_R_2_101_1_2_198_1_101_1.PDF
Extract of the General Budgets of the Spanish State for 2015. R-0081.

188. Thus, the TVPEE is a public income which, together with the other State revenue, contributes to form the State's resources with which public expenditures are financed.

189. In relation to the above, note that Law 47/2003, of 26 November, on General Budgets, provides:

> *"Article 27 Principles and rules of budgetary management*
>
> *1. The public sector is managed by an annual budget system which is approved by the Parliament and framed within the limits of a multi-year scenario [...]*
>
> *3. The resources of the State, those of each of its autonomous bodies and those of entities of the state public sector with budget limitations will be destined to pay all of their respective obligations, unless their allocation for specific purposes is established by law."*[74]

190. It is worth adding that the second additional provision of Law 15/2012 provides that an amount equivalent to the estimated annual collection of the State arising from the taxes included in Law 15/2012, including the TVPEE, will be allocated each year in the Laws on the Spanish General State Budgets to finance the costs of the electricity sector:

> *"Additional provision two. Costs of the electricity system.*
>
> *In the Laws of General State Budgets of each year an amount equivalent to the sum of the following will be used to finance the costs of the electricity system provided for in Article 13 of the Electricity Sector Law:*
>
> *a) The estimate of the annual collection derived from taxations and fees included in this Act.*
>
> *b) The estimated revenue from the auctioning of emission rights for greenhouse gases, with a maximum of € 500 million."*[75] *(emphasis added)*

191. This second additional provision was complemented and made concrete by the fifth additional provision of Law 17/2012, of 27 December, on the General State Budget for 2013. Said Fifth Additional Provision of Law 17/2012 establishes that an amount equivalent to the estimated annual collection arising from the taxes included in Law 15/2012, including the TVPEE, will be allocated to finance, among the costs of the electricity system provided by the Electricity Sector Law, specifically those relating to the promotion of renewable energy:

Spanish version published at the State Secretariat for Budget and Expenditure of the Ministry of Finance and Public Authorities.
http://www.sepg.pap.minhap.gob.es/Presup/PGE2015Ley/MaestroDocumentos/PGE-ROM/doc/1/2/1/2/1/N_15_E_R_2_101_1_2_198_1_101_1.PDF

[74] Act 47/2003, of 26 December, on General Budgets, Article 27. R-0011

[75] Act 15/2012, second additional provision. R-0030

> *"Five Contributions to the Financing of the Electricity Sector*
>
> *1. In the Laws of General State Budgets of each year an amount equivalent to the sum of the following will be used to finance the costs of the Electricity Sector,* ***relating to the promotion of renewable energy****, provided for in the Electricity Sector Law:*
>
> *a) The estimate of the annual collection derived from taxations included in the Act of fiscal measures for energy sustainability* [Act 15/2012].
>
> *b) 90% of the estimated income from auctioning greenhouse gas emission rights, with a maximum of EUR 450 million.*
>
> *2. 10% of the estimated income from auctioning greenhouse gas emission rights, with a maximum of EUR 50 million, is earmarked to the policy of combating climate change."*[76] *(emphasis added)*

192. It should not be forgotten that among the taxes included in Act 15/2012 to which the cited additional provision five refers there is not only the TVPEE. Act 15/2012 not only creates the TVPEE, but also creates three more new taxes: i) the tax on production of spent nuclear fuel and radioactive waste from the generation of nuclear electric energy, ii) the tax on storage of spent nuclear fuel and radioactive waste at centralised facilities, and iii) the levy on the use of continental waters for the production of electrical energy.

193. In short, as has been stated, the TVPEE was established by Act 15/2012 which imposed on a particular class of people the obligation to pay money to the State for public purposes.

194. Therefore, the TVPEE is a tax according to the concept of tax under international law that Arbitral Tribunals have repeatedly applied.

(ii) The European Commission has ratified the taxation nature of the TVPEE and its conformity with EU Law

195. In addition, further proof that the TVPEE is a tax under international law is the fact that the European Commission has ratified the taxation nature of the TVPEE and the compliance of this tax with EU Law by closing the *EU Pilot* procedure 5526/13/TAXU on considering that the TVPEE is in accordance with EU Law.

196. It should be taken into account that an *EU Pilot* procedure is an information exchange process between the European Commission and an EU member state to analyse whether a certain measure taken by that Member State complies with EU Law. The *EU Pilot* procedure constitutes a prior phase, if the case, to the EU Law infringement procedure, regulated by article 258 of the TFEU.

[76] Law 17/2012 of 27 December, on the General Budgets of the State for 2013, Fifth Additional Provision: R-0075.

197. Thus, specifically, when a complaint is filed by citizens or companies claiming that a measure of a Member State allegedly violates EU Law (or when the European Commission ex officio detects a possible infringement of EU Law), the European Commission initiates an *EU Pilot* procedure. Through this *EU Pilot* procedure, the European Commission requests information from the corresponding Member State regarding the measure in question of said state.

198. In view of the information and observations provided by the Member State in the corresponding *EU Pilot* procedure, if the European Commission considers that there is grounds to understand that there has been an infringement of EU Law, it formally initiates an EU Law infringement procedure, regulated by Article 258 of the TFEU.On the contrary, as has occurred in relation to the TVPEE, if the European Commission considers that there is no reason to believe that an infringement of EU law has occurred, the *EU Pilot* procedure is closed and thus no EU Law infringement procedure is commenced.

199. This is explained on the website of the European Commission itself:

> *"Further to an enquiry or a complaint (by citizens, businesses and organisations), or on their own initiative, the Commission's services might need to gather additional factual or legal information for a full understanding of an issue concerning the correct application of EU law or the conformity of the national law with EU law. In such cases, the Commission's services submit a query to the Member State concerned via EU Pilot. Member States normally have 10 weeks to respond and the Commission's services, in turn, also have 10 weeks to assess the response (if the response is not satisfactory, the Commission will normally launch infringement proceedings by sending a letter of formal notice to the Member State concerned)."*[77]

200. With regard to the TVPEE, in 2013 the European Commission initiated a procedure to request information from the Kingdom of Spain for the purpose of verifying that the TVPEE is compliant with EU Law (*EU Pilot* procedure 5526/13/TAXU).

201. Said *EU Pilot* procedure for requesting information from the Kingdom of Spain was not initiated on the initiative of the European Commission, but was initiated as a result of a complaint filed with the European Commission by private individuals who alleged that the TVPEE violated EU Law.

202. After receiving the complaint, the European Commission requested information from the Kingdom of Spain in relation to this issue. The Kingdom of Spain provided the European Commission with the information requested.

203. After receiving the information provided by the Kingdom of Spain, the European Commission concluded that there were no reasons to consider that the TVPEE

[77] European Commission's website regarding "EU Pilot" Procedures. http://ec.europa.eu/internal_market/scoreboard/performance_by_governance_tool/eu_pilot/index_en.htm. R-0012

breached EU Law and, therefore, that there were no reasons to initiate the EU Law infringement procedure regulated in article 258 of the TFEU. Consequently, the European Commission proceeded to close the aforementioned *EU Pilot* procedure on 8 September 2014, thereby considering that the TVPEE is in accordance with EU Law.[78]

204. In summary, in view of the foregoing considerations, there is no doubt that the TVPEE is a tax both from the perspective of Spanish domestic Law as well as from the perspective of International Law and that it has been established by a domestic law of the Kingdom of Spain: Act 15/2012.

205. In other words, both from the point of view of domestic Law as well as that of International Law, the provisions relating to the TVPEE of Act 15/2012 are provisions relating to taxes of the domestic law of the Kingdom of Spain.

206. Consequently, pursuant to the aforementioned Article 21(7)(a)(i) of the ECT[79], we stand before a taxation measure for the purposes of Article 21 of the ECT.

(6) Conclusion

207. Taking into account all of the above, in summary, the following is concluded:

i) The Kingdom of Spain introduced the TVPEE through Act 15/2012, passed by its Parliament (Congress of Deputies and Senate). The provisions of Act 15/2012 on the TVPEE are considered as a "taxation measure" for the purposes of the ECT, according to article 21(7)(a)(i) of the ECT.

ii) The Kingdom of Spain has only provided its consent to submit to investment arbitration disputes related to alleged breaches of obligations derived from Part III of the ECT (Article 26 of the ECT).

iii) The Claimants allege a supposed breach by the Kingdom of Spain of obligations derived from section (1) of Article 10 of the ECT -an article included in Part III of the ECT- through the introduction of the TVPEE by Act 15/2012.

iv) However, section (1) of Article 10 of the ECT does not generate obligations with respect to taxation measures of the Contracting Parties (Article 21 of the ECT).

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[78] Case file sheet of *EU Pilot* Procedure 5526/13/TAXU on the TVPEE, which records the closure thereof by the European Commission as there is no evidence that there is an infringement of EU law by the TVPEE. R-0085. We warn that the aforementioned document is confidential and that the European Commission has only given its consent for its use in this arbitration. The identity of officials has been "deleted" for reasons of data protection.
European Commission's email to the Spanish Ministry of Foreign Affairs informing on the closing of the *EU Pilot* Procedure 5526/13/TAXU. R-0044

[79] ECT, Article 21(7)(a)(i):
"7. For the purposes of this Article:
a) The term "taxation measure" includes:
i) Any provision relating to taxes of the domestic law of the Contracting Party or of a political subdivision thereof or a local authority therein; and;
ii) any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound." (emphasis added) RL-0006.

v) Thus, there is no obligation arising from section (1) of Article 10 of the ECT that could have been allegedly breached by the Kingdom of Spain through the adoption of taxation measures, in particular, through the introduction of the TVPEE by Act 15/2012.

vi) Therefore, the Kingdom of Spain has not given its consent to submit to arbitration the dispute stated in section iii) above and, thus, with all due respect, the Arbitral Tribunal lacks jurisdiction to hear the same.

208. Consequently, it is requested that the Arbitral Tribunal declares its lack of jurisdiction to hear the dispute on the alleged breach by the Kingdom of Spain of obligations derived from section (1) of Article 10 of the ECT through the introduction of the TVPEE by Law 15/2012.

IV. MERITS OF THE MATTER: THE KINGDOM OF SPAIN HAS RESPECTED THE ENERGY CHARTER TREATY (ECT)

209. To comprehend and resolve this case, it is necessary to analyse the following matters: (A) The Spanish Electricity System as a legal regulatory framework and its functioning; (B) The principle of reasonable return for investors and its economic balance with the costs of the system; (C) The legal regime applicable at the time the Claimant made the alleged investment, in contrast to the perspective of the Claimant; (D) The culmination of the reform on Renewable Energy in Spain (E) The measures challenged by the Claimants and (F) Respect for the FET standard of the ECT by the Kingdom of Spain.

A. <u>The Spanish Electricity System (SES)</u>

210. The Spanish Electricity System (hereinafter **"SES"**) is a set of activities aimed at ensuring the supply of electricity in the Spanish territory. It is an economic, technical and legal system. The individual rights, obligations and legal relations arising from participation in the SES are enshrined in a number of regulations.

211. For a correct understanding of the evolution of the SES, it is necessary to analyse, in advance, a number of vital issues: (i) types of standards used for the regulation of the SES and the relationship between them, in the context of the Spanish legal system, (ii) the activities and subjects of the SES and (iii) The principles of the SES.

(1) The rules governing the SES and the relationship between them

212. The regulation of the SES in general, and that of renewable energy (hereinafter **"RE"**) in particular (as part of the SES), is undertaken through regulations of various natures. These regulations are in accordance with the general scheme of sources of law in the Spanish legal system.

213. To explain, therefore, the regulation of the SES it is desirable to plainly describe the sources of the Spanish legal system:

- The Spanish Constitution of 1978: This is the supreme legislation of the Spanish legal system, which establishes the organization of the public authorities, their institutional and territorial structure, and regulates the essential aspects of the rights and duties of citizens[80].

- A Law: is a written regulation emanating from the legislature. Two kinds of laws can be distinguished:

    - Organic Laws: those reserved for the regulation of certain matters provided for in the Constitution (Fundamental Rights and Public Liberties, general electoral system, among others). An absolute majority of the Congress of Deputies is required for their approval.

    - Ordinary laws: these regulate matters not reserved by the Constitution to an Organic Law. A simple majority of the Congress of Deputies is sufficient for their approval.

- Royal Decree-Law: this is a regulation with force of law which the Constitution authorizes the government to approve in situations of extraordinary need or urgency. The approval of a Royal Decree is subject to strict conditions, controls and limits and its subsequent parliamentary validation.[81]

- Royal Decree: a Royal Decree is a regulatory standard that emanates from the Government. Complements or implements the Laws and is hierarchically inferior to them[82]. It can regulate within the authorisations granted by the Law and cannot infringe them[83].

- The Ministerial Order: this is the regulatory standard emanating from one or several ministerial Departments. In the field of energy, the most frequent of these is the Ministerial Order emanating from the Minister for Industry, Energy and Tourism.

214. Resolutions, meanwhile, are not regulations but acts which rank below Ministerial Orders, emanating from the competent bodies of the Administration, and having a technical content.

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[80] Within the system of constitutional guarantees, the Constitutional Court is the supreme interpreter of the Constitution and, in accordance with Article 1 of Organic Law 2/1979, of 3 October 1979. R-0042.

[81] The Memorial of Claim mentions various Royal Decree-Laws without explaining their basis in the legal system and omitting any reference to subsequent ratification laws passed by Parliament.

[82] The principle of regulatory hierarchy is recognized by the applicant itself in footnote 44 of its Memorial of Claim.

[83] In the electricity sector, the establishment of subsidies in a regulatory standard (i.e. RD 661/2007) meant that the Law empowered the Government to amend this regulation by a subsequent regulation. The Business Associations concerned, aware of the obvious risk, tried to change this situation, requesting the determination of the *"reasonable return"* of Article 30.4 of Law 54/1997 in a regulation with the force of an Law. This was affirmed in 2010 by the most authoritative scholars:
"The Spanish FIT scheme has the legal Rank of a Royal Decree. Even though it is "stronger" than for instance a Ministerial Order, the Spanish renewable associations have long called for a FIT law. Before the last general elections, the current Socialist government had promised to initiate the respective legislative process, but up to now nothing has changed." (Powering the Green Economy. The feed in tariff handbook. Miguel Mendonça, David Jacobs and Benjamin Socacool. Editorial. Earthscan, 2010. RL-0062.

215. It should be noted that the relevant procedures for developing these regulations include, in any case, hearing and information proceedings[84] for holders of rights and legitimate interests that may be affected by them.

216. The above regulations are articulated among one another according to the principle of hierarchy. This principle means that the regulations of a lower rank cannot contravene the regulations of a higher rank. This, in turn, brings significant practical implications[85]: (1) no regulatory provision may be contrary to the law that it implements; otherwise, it is null and void and the courts must revoke it, (2) any regulatory provision must be interpreted and implemented in line with the Law it implements (3) no regulatory provision may prevent the adoption of regulatory measures aimed at complying with the requirements of the Law.

217. Moreover, in the Spanish legal system, we should emphasize the importance of European Union law. Since Spain joined the European Union in 1986, EU Law forms part of the Spanish legal system.

218. Within European Union law, together with the Treaties (Maastricht Treaty and the Treaty on the Functioning of the European Union), it should be remembered for their impact on the electricity sector, the different legal acts of the European Institutions (Article 288 of the Treaty on the Functioning of the European Union, hereinafter **"TFEU"**):

- *Regulations* which have a general scope and are binding in their entirety and are directly applicable in all Member States.
- *Directives* which create an obligation for the Member State of destination as to the result to be achieved, leaving the choice of form and methods to the national authorities.
- *Decisions* which are binding on the Member State in their entirety.
- *Recommendations* and *opinions* are not binding.

219. Finally, in the Spanish legal system, the relevance of the case law of the Supreme Court should be taken into consideration. Under Article 1.6 of the Spanish Civil Code:

[84] Indeed, these procedures are mainly reflected in the following regulations: respect for the Laws in Articles 109 and 124 of the Regulation of the Congress of Deputies of 10 February 1982 and Article 104 of the Regulation of the Senate of 3 May 1994 (R-0111) (R-0112), regarding the Royal Decrees in Article 24 of Law 50/1997, of 27 November (R-0071), and finally, with regard to the administrative decisions, Article 84 of Law 30/1992, of 26 November, on the Legal Regime of Public Administrations and the Common Administrative Procedure. R-0068.

[85] Articles 9.3 and 103 of the Spanish Constitution (R-0035), Article 6 of the LOPJ (R-0067) and Article 62.2 of Law 30/1992, of 26 November, on the Legal Regime of the Public Administrations and the Common Administrative Procedure. R-0068

> *"Case law shall complement the legal system by means of the doctrine repeatedly upheld by the Supreme Court in its interpretation and application of statutes, customs and general legal principles."*[86]

220. Therefore, the jurisprudence of the Supreme Court when *applying* and *interpreting* the legal regulations (including the Laws) is binding on other courts. That case law, due to its uniformity, strength and clarity, is essential to understanding and resolving this case, especially when the Supreme Court is the constitutional body responsible for ensuring the legality of the actions of public authorities in Spain[87].

(2) Activities and subjects of the SES

(2.1) Classification and description of the activities

221. Until 1997, the SES was structured as a regulated system in which the Government established the price of electricity, which compensated the costs (primarily the generation, transmission and distribution of electricity) of all electricity companies.

222. From the entry into force of Law 54/1997, the deregulation of the sector began due to EU requirements. Such deregulation is based on the vertical division of activities and their subsequent specific regulation, with the aim of introducing competition and increasing the overall efficiency of the electricity sector. The resulting division resulted in the identification of various activities of the SES: generation, transmission, distribution, marketing.

223. The activities having been identified, Law 54/1997 associated each of these activities to one of the following categories:

- *Deregulated Activities:* Generation (with the exception of generation under the Special Regime) and bringing the energy to market.

- *Regulated activities:* Transportation, distribution and system operation[88].

224. Below, we proceed to a brief summary of each of these activities:

- *Generation* of electricity is the responsibility of the Producers of electricity or entities with capacity to supply electricity to the grid. Since 1994[89], Spanish legislation distinguishes between (i) generation subject to an Ordinary Regime of Remuneration (hereinafter, **"OR"**) and (ii) that subject to a Special Regime of Remuneration (hereinafter, **"SR"**). Act 54/1997, of 27 November 1997, on the Electricity Sector (hereinafter **"Act 54/1997"**) maintained this distinction and submits certain Special Regime generation activities (technologies that use renewable sources, waste biomass and cogeneration in the cases provided for in the regulations). The main distinction

[86] Article 1.6 of the Spanish Civil Code. R-0096. Vienna Convention on the Law of Treaties, 23 May 1969, published in the Spanish Official State Gazette of 17 June 1980. RL-0010.
[87] Article 106 of the Spanish Constitution. R-0035
[88] Act 54/1997, of 27 November, on the Electricity Sector, article 11. R-0003.
[89] Act 40/1994, of 30 December, on the regulation of the Electricity Sector. R-0070.

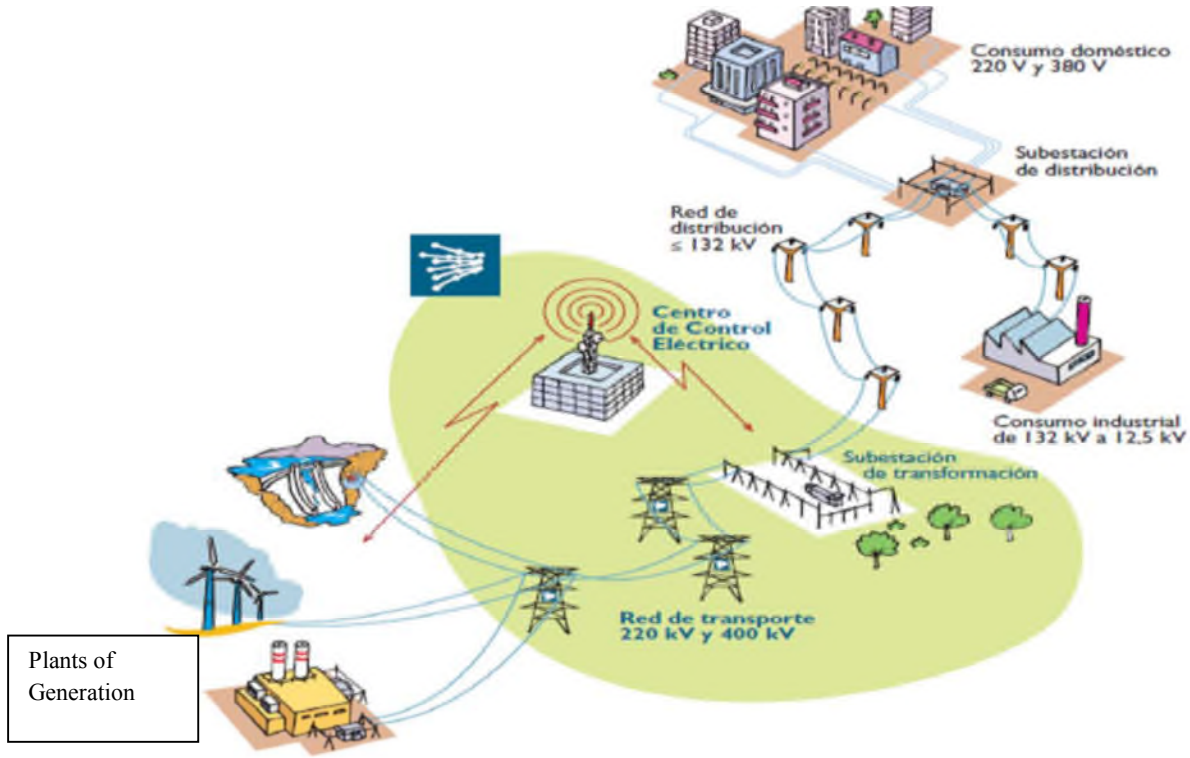
between the two Regimes is the regulation of the compensation for certain renewable energies.

- *Transport* corresponds to Red Eléctrica de España (hereinafter **"REE"**) under a monopoly regime and has the nature of a regulated activity[90].

- *Distribution*, which consists of the supply of electricity from the transmission network to the point of consumption. It has the character of a regulated activity and is performed by the distribution companies.

- *Marketing*, which corresponds to the companies that buy the electricity produced and sell it to consumers.

225. The following table shows in a simple way the different *activities* of the SES that we have just described of Generation, Transmission, Distribution and Marketing:



226.

227.

228. Subjects that develop these activities do not act in the SES disconnected from each other, as separate compartments. Far from it, the SES is characterized by a strong interdependence between its agents and their activities:

[90] In addition, REE acts as *System Agent,* responsible for managing and coordinating the technical aspects of the system, which includes the management of the network. Along with REE, there is another *Agent,* OMEL (Spanish Electricity Market Operator Company), responsible for coordinating the economic operations of buying and selling of electricity.

- The inability to store electricity requires that supply equal demand at all times. This implies coordination with demand in the production of electricity, as well as coordination between investment in generation and the infrastructure to transport the electricity.

- Technically there is an actual network structure, a system in which the generation, transport and distribution must have harmonic dynamics in their operation and in which the agents are in fact physically interconnected. Technical integration, which is essential if we consider the low-level of interconnection of the network of the Iberian Peninsula with the rest of Europe which makes Spain an energy island.

- All operators are subject, separately and jointly, to the intervention of a Regulatory System.

- The SES participants share the source of their income: Spanish consumers.

(2.2) The Regulators

229. In the SES there are two regulators that exercise public powers over the *activity* of the economic agents and the subjects of the system: the Ministry of Industry, Energy and Tourism (hereinafter, **"MINETUR"**) and the National Markets and Competition Commission[91] (hereinafter, **"CNMC"**), as successor entity of the National Energy Commission[92] (hereinafter, **"CNE"**).

230. The Minetur is the Department of the General State Administration responsible for proposing and implementing government policy on energy. It approves Ministerial Orders to implement energy policy, and proposes to the Council of Ministers (the Government) the Royal Decrees on energy, for its approval. It is the main Regulator in the energy field.

231. The CNMC in this area has, among others, the following functions:

a) Act as an advisory body of the Administration in energy matters by issuing non-binding reports.

b) Participate, through proposals or non-binding reports, in the process of drafting general provisions on energy matters

[91] Act 3/2013, of 4 June, on the creation of the National Commission of Markets and Competition (CNMC), includes the CNE under the CNMC. This law is publicly accessible at the web address: http://www.boe.es/boe/dias/2013/06/05/pdfs/BOE-A-2013-5940.pdf. R-0076.

[92] The CNE, currently integrated within the CNMC, was created by Act 34/1998, of 7 October, on the Hydrocarbons Sector, in its eleventh additional provision. R-0073.
It was established as a public body regulating the operation of the Energy Sector. Its purpose was "to promote the competitive functioning of the energy sector to ensure the effective availability and delivery of services and quality, as regards the supply of electricity and natural gas, for the benefit of the whole market and consumers and users".

c) Issue Circulars on the development and implementation of the Decrees and Orders of the Ministry of Industry and Energy to be issued on energy matters, provided that these provisions authorise it to do so. These Circulars on implementation are mandatory for the subjects affected by the scope thereof, once published in the Official State Gazette.

d) Management of settlements of the Electrical System. Perform 14 settlements for each financial year for those entitled to receive amounts from the SES.

e) Monitoring and control in the electricity sector including, among others:

- Monitor the adequacy of the legal system regarding prices and conditions of supply to final consumers and issue recommendations to adapt supply prices to the obligations of Public Service and consumer protection.
- Manage the system of guarantee of the origin of the electricity from renewable energy sources and high efficiency cogeneration.
- Publish the final prices of the electricity market, based on the information from the market operator and the system operator.

232. Therefore, the CNE was (and the CNMC is) a consultational body that collaborates with the Government, by issuing proposals and reports. The Government is the holder of regulatory power and legislative initiative in the process of drafting general provisions on energy matters[93]. The CNE issued proposals or reports in the strict sphere of its competence.

233. This nuance is very relevant for the purposes of this case, as in issuing its non-binding reports, the CNE never takes into account nor assess matters outside its competence such as: macroeconomic circumstances, budgetary obligations and international commitments made by Spain.

(3) SES principles

234. The SES has been based since Act 54/1997, of 27 November, on the Electricity Sector (hereinafter, **"Act 54/1997"**)[94], and until the current Electricity Sector Law, Act 24/2013, of 26 December, on the Electricity Sector (hereinafter, **"Act 24/2013"**)[95] on the following principles:

1. Energy supply is a service of strategic importance.

2. Security of the supply requires the economic sustainability of the system.

(3.1) Energy supply as a service of strategic importance.

[93] Article 97 of the Spanish Constitution attributes to the Government the exercise of regulatory power and article 81, legislative initiative. R-0035
[94] Act 54/1997, of 27 November, on the Electricity Sector. R-0003.
[95] Act 24/2013, of 26 November, on the Electricity Sector. R-0077.

235. The strategic importance of electricity supply is an indisputable fact. Its security is a necessity for the functioning of the economic and social activity of any developed country. The price of electricity and energy intensity are factors that have a direct impact on economic growth and macroeconomic fundamentals, such as inflation and competitiveness.

236. Such factual circumstance is reflected at the regulatory level. Act 54/1997, by requirement of Community law[96], described the activity of energy supply as an *"essential service"*[97]. Subsequently, in Act 24/2013 it was described as a *"service of general economic interest"*[98].

237. The configuration of the electricity supply activity as a strategically important service results in the laws of this Sector regulating it in detail, and also establishing certain burdens and obligations on persons involved in its various activities.

(3.2) Security of supply: technical and economic sustainability of the system

238. The main objective of the SES established by Act 54/1997[99] is to ensure that all consumers have access to electricity in conditions of equality and quality, ensuring that it is produced at the lowest possible cost, taking into account environmental protection.

239. Security of supply means that the actions of the public authorities will flow primarily to ensure that a power supply will be maintained at affordable prices for consumers and that this supply will be sustainable in the long term. "Sustainability" therefore involves the technical, environmental and economic-financial viability of the SES. This guarantee has been maintained in Act 24/2013, of 26 December, on the Electricity Sector[100].

240. In this regard, it should be noted that the economic viability of the SES rests on its financial self-sufficiency. This implies that the costs of the SES must be paid with SES revenue. Thus, if an imbalance is generated in the system and the costs are higher than the revenues, the measures that can be taken are: either increase revenue or decrease costs.

241. Financial self-sufficiency[101], as reflected in Act 40/1994, of 30 December, regulating the National Electricity System[102] (hereinafter, **"Act 40/1994"**) was expressly reaffirmed in 2011 by a law that the Claimant has omitted to mention to the Arbitral Tribunal. Act 1/2011, on the Sustainable Economy of 2011, explicitly established the need for any planning to be done on the basis of a ***sustainable system.***

[96] Treaty Establishing the European Community (92/C 224/01), published in the Official Journal of the European Communities on 31 August 1992, Article 86. RL-0005.
[97] Act 54/1997, of 27 November, on the Electricity Sector. R-0003.
[98] Act 24/2013, of 26 December, on the Electricity Sector. R-0077.
[99] Act 54/1997, of 27 November, on the Electricity Sector. Preamble and Article 10. R-0003.
[100] Act 24/2013, of 26 December, on the Electricity Sector. Preamble and Article 7. R-0077.
[101] Act 54/1997, of 27 November, on the Electricity Sector. Articles 15 and 16. R-0003.
[102] Act 40/1994, of 30 May Articles 15 to 20. R-0070.

242. The need for self-financing of the SES has also been maintained in Act 24/2013, of 26 December, on the Electricity Sector. Exceptionally, since 2013 significant contributions have been made by the General State Budgets, but with the sole purpose of paying compensation to certain power generation facilities using renewable energy sources.

243. As the SES is a closed economic structure, its sustainability depends on the balance between its income and its costs:

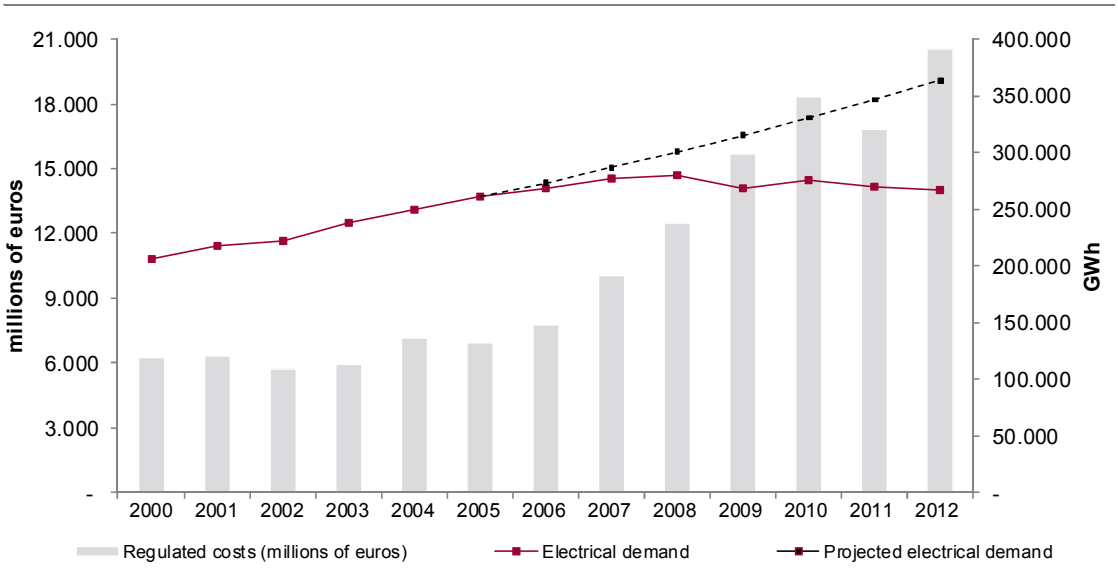
(a) SES revenues and its evolution

244. SES revenues come exclusively from the Spanish consumer. Indeed, a consumer in Spain when paying the bill for the electricity consumed pays the price of energy consumed and also the amount corresponding to *tolls* and *charges*.

245. Access *tolls* are intended to support the transmission and distribution networks. *Charges,* meanwhile, pay for those System costs that are not directly linked to the electricity supply received by the consumer. These *charges* are the amounts paid to the facilities generating electricity from renewable energy sources entitled to additional compensation.

246. Therefore, the evolution of the revenues is linked to electricity demand. Thus, the economic sustainability of the SES requires that the cost forecast matches the forecast of the evolution of demand.

247. Electricity demand in Spain, contrary to the provisions of the Regulator in its cost planning ("baseline scenario"), has suffered a significant drop as a result of the international economic crisis in recent years and its consequent impact on Spain. This trend can be seen in the chart below[103]:



[103] Accuracy Report, par. 38

248. Despite the significant reduction in demand, attempts have been made to guarantee the economic sustainability of the SES through a significant increase in the electricity bill.

249. For these purposes, we should bear in mind the evolution of an annual bill of a domestic consumer in Spain, which highlights an average consumption[104]. The details by amount of the annual bill and by increments are as follows[105]:

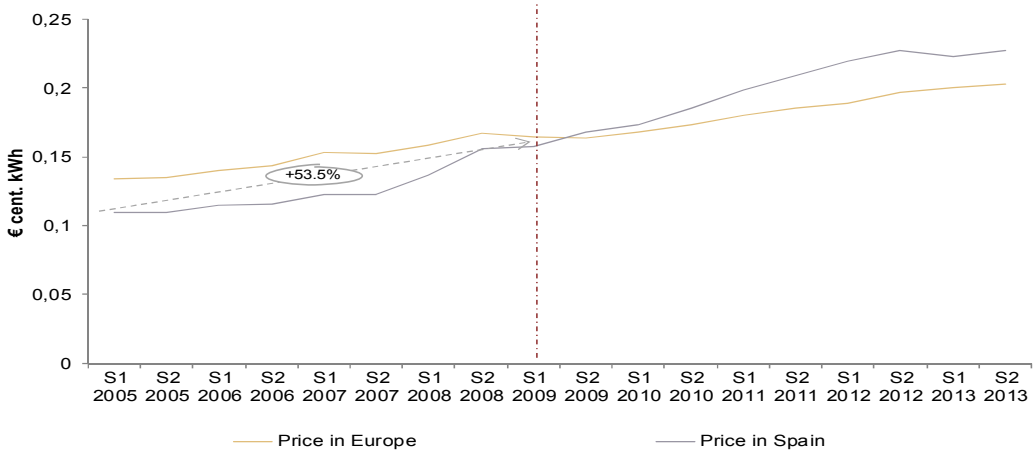
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Bill with taxes	370.0	375.3	381.7	400.0	412.6	453.7	503.2	532.6	627.0	669.7	648.7	616.2
Increase Annual bill with taxes		1.4%	1.7%	4.8%	3.1%	10.0%	10.9%	5.9%	17.7%	6.8%	-3.1%	-5.0%
		2004-2003	2005-2003	2006-2003	2007-2003	2008-2003	2009-2003	2010-2003	2011-2003	2012-2003	2013-2003	2014-2003
Increase cumulative annual. Bill with taxes		1.4%	3.2%	8.1%	11.5%	22.6%	36.0%	44.0%	69.5%	81.0%	75.4%	66.6%

250.

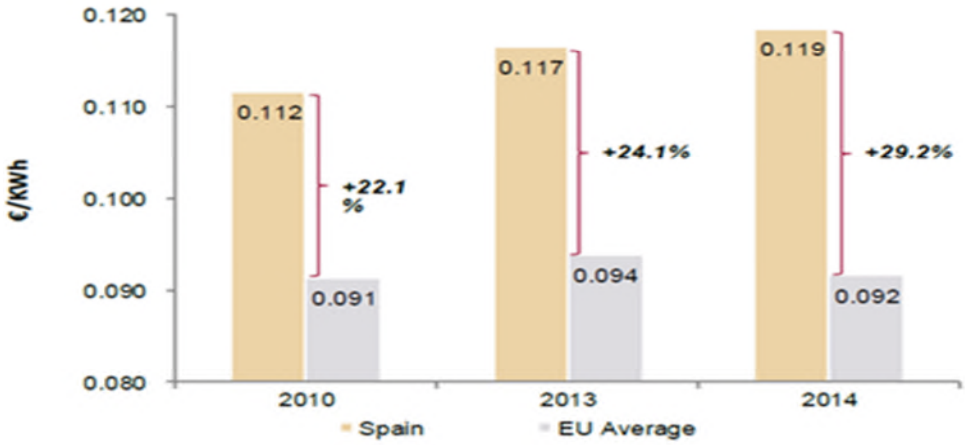
251. Therefore, a consumer paid on their electric bill 370 euros per year in 2003 and went on to pay in 2012 a total of 669 euros. Indeed, in those years the cumulative increase is disproportionate, since the same service was being received, with the largest increases occurring in 2008 (10%), 2009 (10.1%) and 2011 (17.7%).

252. In the following graph the evolution of the price of electricity between 2007 and 2014 for households in Spain and the average of the European Union is shown[106]:

[104] Contracted power 3.3 kW and consumption 3,000 kW/year. Typology applicable to a family in a flat of four people.
[105] Source: internally prepared based on data from settlement reports of the CNE/CNMC years 2005-2013 (http://www.cnmc.es/es-es/energía/energíaeléctrica/régimenespecialyliquidaciones.aspx?p=p3&ti=Liquidaciones sector eléctrico) and OMEL (Compañía Operadora del Mercado Español de Electricidad) (http://www.omie.es/files/flash/ResultadosMercado.swf)
[106] Accuracy Report, par. 42



253. The electricity bill for Spanish industry has had the same upward trend. The aforementioned evolution can be seen in the following table[107]



254. The evolution of the bill has been upwards except in the last two years in which the price of energy has resulted in a reduction of the final price. Therefore, consumers have endured an extraordinary increase in their bill without the service provided having been increased or varied in a relevant manner. All this in the context of a strong global economic crisis.

255. The Spanish consumer, therefore, has made a significant effort to meet the costs of the electricity system, taking into account that any increase has a major impact on the economy and growth of the country. In this sense, we cannot forget that among the consumers are also companies that lose competitiveness if their costs rise (including the electricity they consume in order to manufacture).

[107] Ibid, par. 220

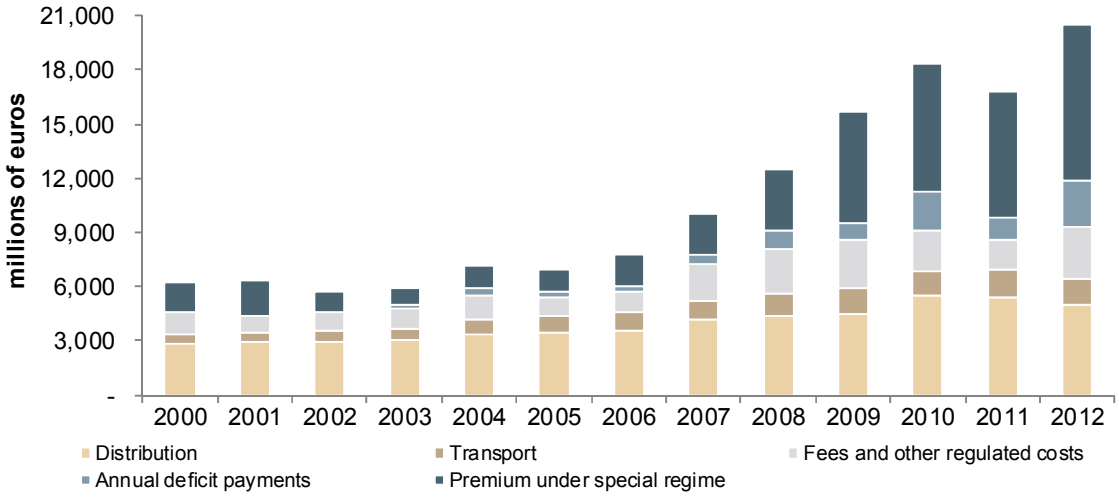
(b) SES costs and their evolution

256. The costs of the electrical system have evolved exponentially according to the evolution of investments in the various activities, particularly in *transportation, distribution* and *generation*. In the *generation* business, the costs have evolved according to the granting of compensation systems to certain facilities included in the Special Regime.

257. Additionally, since the facilities that use renewable energy as a source are usually not *"manageable"*, in the sense that they do not generate electricity according to the will of man but that of nature, it is necessary to establish mechanisms to guarantee security of supply. Thus, it is necessary to have facilities that remain practically inactive, but serve as a "back-up" or support in the event of a decrease in production due to sudden climatic changes. Therefore, ordinary production facilities, such as combined cycle, receive from the SES *capacity payments,* to meet these possible energy production needs.

258. Consequently, the priority of selling the energy generated by renewable energy installations and high efficiency cogeneration results in it being necessary to pay the *capacity payments* to ordinary producers, which must be available to produce energy. This has also led to an excess capacity existing in the system thereby causing higher costs.

259. The following chart shows the evolution of system costs[108]:



260. The trend shows that all the costs of the SES were multiplied by 3.2 between 2006 and 2013; and that the income, despite the fall in demand, was multiplied by 2, by increasing the electricity bills paid by consumers. This difference between revenues and costs led to the so-called *tariff deficit.*

[108] Accuracy Report, par. 218.

(c) The SES imbalance: the tariff deficit and its evolution.

261. When the income and expenses of the SES are not equivalent, an imbalance occurs. If this imbalance arises because the income are insufficient to cover the costs, the so-called "tariff deficit" arises.

262. This imbalance in the SES has been very important in recent years, since the electrical system, despite raising tolls and charges permanently over the years, has been unable to cover the costs because these have increased at a higher rate than the bill paid by consumers.

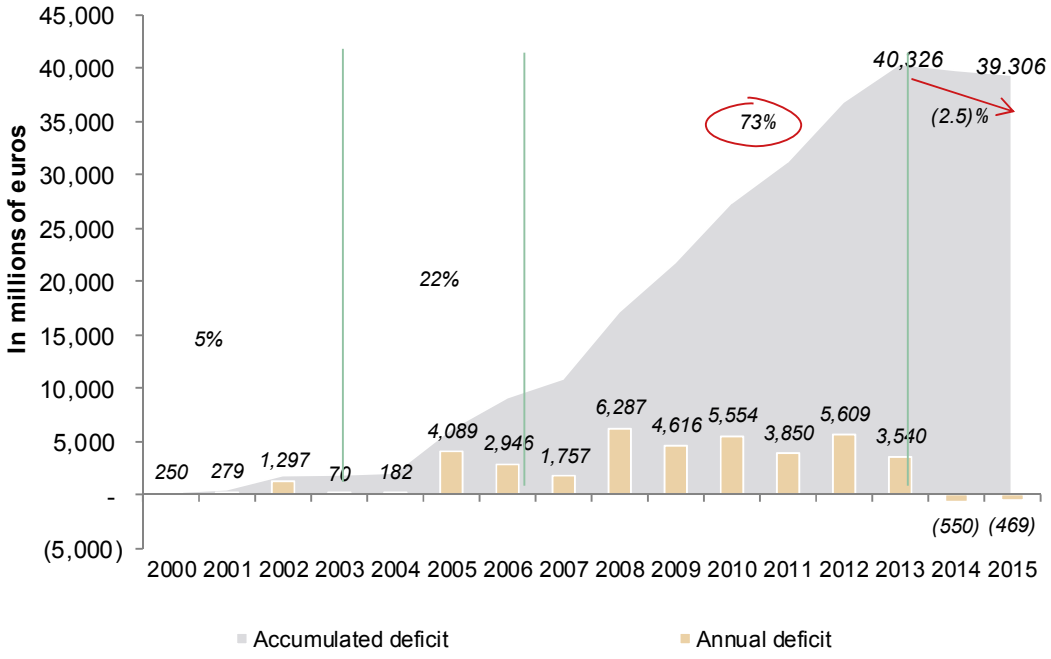
263. This deficit has generated an accumulated debt in recent years which reached 40,326 million euros. Although this debt has been amortized gradually, in 2015 the amount remaining was still over 26,000 million euros. Recall that this debt is being paid by Spanish consumers on electricity bills at a rate of about 2,800 million euros annually.

264. In addition, a number of companies were required to finance the system by providing the amounts that were required for the costs to be paid and generating, in return, a receivable against the electrical system. This receivable could be securitized directly by the companies or through the Electric Deficit Amortisation Fund (hereinafter, **"FADE"**)[109].

265. The following chart shows the evolution of the electricity deficit and the unamortized accumulated debt. [110].

[109] FADE issuances were suspended between March and November 2012, as they were unable to obtain financing abroad at a reasonable interest. Certificate of the Agreement adopted by the Interministerial Commission of art. 16 of Royal Decree 437/2010, of the session of 26 November 2012, R-0254.

[110] Accuracy Report, par. 225.
http://www.cnmc.es/es-es/energía/energíaeléctrica/régimenespecialyliquidaciones.aspx?p=p3&ti=Liquidaciones sector eléctrico



266. These amounts must be added to the average annual costs of the electricity system, which are located at around 20,000 million euros, which determines the annual charge for amortization and interest of around 2,900 million euros.

267. Following the entry into force of the contested measures, for the first time in the year 2014 it was found that the income was sufficient to cover all the regulated costs, recording a positive gap of 550.3 million euros[111]. That is, the end result of the settlement of the regulated activities in the year 2014 has resulted in a surplus of 550.3 million euros.

268. However, the SES has never failed to meet its obligation to provide a reasonable return to the Special Regime facilities.

B. SES regulation on renewable energies

(1) The policy of the EU

269. The Spanish energy policy forms part of the policies of the European Union, both in the field of energy and the environment. The Claimant recognizes this importance in its Claim, as it makes numerous references to Community legislation.

270. The policy of the European Union has been characterized by setting targets which Member States, by obligation, are required to meet and which are aligned with the overall objectives agreed in the Kyoto Protocol.

[111] This is evident from the "Report on the final settlement of the Electricity Sector in 2014. Analysis of the results regarding the annual projection of revenues and costs of the electricity system" carried out by the CNMC on 24 November 2015, which may be viewed at the address http://www.cnmc.es/Portals/0/Ficheros/Energia/Informes/Liquidaciones_Electricidad/151124_LIQ_DE_346_15_Liq_definitiva%202014_energiaelectrica.pdf- R-0134

271. To achieve such objectives, Directive 2001/77/EC of the European Parliament and of the Council, of 27 September 2001, on the promotion of electricity produced from renewable energy sources in the internal electricity market, was approved (hereinafter, "**Directive 2001/77/CE**").[112] This Directive recognized the need to provide public aid to renewable energies, in line with the Community guidelines on State aid for environmental protection.

272. The Claimant mentions this Directive while omitting to mention a relevant circumstance to the Arbitral Tribunal. Such Directive established that public aid to renewable energy sources would be set by States within the obligations imposed in Articles 87 and 88 of the Treaty on State Aid[113]. In this regard, the ECJ has declared that amounts that end users pay to a private company producing electricity are considered State aid.[114]

273. In January 2007, the European Union set new targets in the so-called "20-20-20 package". To achieve these Community targets, Directive 2009/28/EC[115] was adopted, on the promotion of the use of energy from renewable sources. This standard establishes a common framework for the promotion of such sources, setting mandatory national targets.

274. Directive 2009/28/EC also considers necessary the public aid for the promotion of electricity produced from renewable energy, "for as long as electricity prices in the internal market do not reflect the full environmental and social costs and benefits of energy sources used"[116]. However, this directive recognizes the difficulty of Member States to achieve the targets and the need for the EU to take measures to achieve them[117].

275. Therefore, the Member States are required to bear in mind the Guidelines on State aid for environmental protection and energy, approved by means of a Communication from the European Commission 2008/C82/01[118], and substituted for the period 2014-

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[112] Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal market in electricity, published in the Official Journal of the European Union on 27 October 2001. RL-0015.
[113] Recital (12) of Directive 2001/77/EC. RL-0015.
[114] Court Order of 22 October 2014, issued in a Preliminary Ruling C-275/13 (Elcogás Case).
Para. 21: "For advantages to be categorized as aid within the meaning of Article 107, par. 1, TFUE, it is necessary, firstly, for them to be granted directly or indirectly through State resources and, secondly, to be attributable to the State".
Par. 33: "The amounts attributed to a private electricity producing company which are financed by all the electricity end users established in national territory and which are distributed to Electric Sector companies by a public organization in accordance with predetermined legal criteria, constitute a State intervention or by means of State funds." RL-0019.
[115] Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC. RL-0017.
[116] Recital (27) of Directive 2009/28/EC. RL-0017.
[117] Directive 2009/28/EC. RL-0017.
[118] Notices from European Union Institutions and Bodies. R-0065.

2020, by means of a Communication from the European Commission 2014/C 200/01.[119] These guidelines state that from 2020 the subsidies and exemptions from liability in balance matters should be phased out.[120]

276. For these purposes, the Decision C (2016) 7827 final, of 28 November 2016, of the European Commission, issued in the case of aids, SA.40171 (2015/NN)–Czech Republic, regarding the "*Promotion of electricity production from renewable energy sources*", is very significant.

277. This decision analyses each and every one of the guidelines indicated by the Commission, first of all recognising their nature as State Aid:

> *"(76) With regard to financing as of 1 January 2011, the Commission observes that both feed-in tariffs and green bonuses are funded through a combination of transfers from the State budget, and a levy which is imposed on the users of the transmission and distribution systems, which are used to compensate the entity that is obligated to purchase the renewable electricity or pay the green premium.*
>
> *(77) Aid granted directly by transfers from the State budget is an advantage granted directly by the State[121]".* (footnotes omitted).

278. Subsequently insisting on the fact that this State Aid cannot, in any event, give rise to remuneration and therefore imposing upon the Czech Republic the obligation to constantly revise the remuneration levels of renewable energy generators:

> *"(56) In light of the lack of provisions ensuring adjustment of support levels in case of aid cumulation, the Czech authorities have committed to introducing a review mechanism. The purpose of the review mechanism is to eliminate any risk of overcompensation that may result from cumulation of aid or overestimation of any of the cost elements, factored in in the support level calculations. The review of support will be carried out 10 years after the commissioning of installations benefitting from support under the scheme.*
>
> *(57) The Czech authorities will monitor the overall level of support which installations receive under the notified scheme. In any case where, by virtue of either decreased production costs and/or a combination of investment and other operating aid with the aid granted under the notified scheme, a beneficiary is in receipt of overall revenues which would result in a return above the acceptable range of returns deemed reasonable by the Czech authorities and the Commission*

[119] Guidelines on State aid for environmental protection and energy 2014-2020, 2014/C 200/01, Communication of the European Commission, published in the Official Journal of the European Union of 28 June 2014. R-0066.
[120] Guidelines on State aid for environmental protection and energy 2014-2020, 2014/C 200/01, Communication of the European Commission, published in the Official Journal of the European Union of 28 June 2014. Paragraph 108) R-0066.
[121] Commission Decision C(2016) 7827 final, of 28 November 2016, handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. RL-0021

(see Table 3 above), the Czech authorities will adopt the below measures, to ensure any overcompensation is avoided and, where necessary, recouped.

(58) In any case of overcompensation, the Czech authorities will alternatively reduce the level of future support, limit the period during which support is paid out or, where necessary, recover the amounts of aid that have led to overcompensation[122]*"(footnotes omitted) (emphasis added).*

279. Likewise, the Commission reiterates that the purpose of these development measures is to cover the difference between the market price and the cost of renewable energy production, which could include the earning of a "fair return" on the investment, which must be limited time-wise to amortisation of the investment:

"(96) According to point 59 of the 2001 EAG, operating aid for the production of renewable energy can be granted to cover the difference between the cost of producing energy from renewable sources and the market price of the form of energy concerned. The aid can only be granted until plant depreciation and can include a fair return on capital (...)[123]*" (emphasis added).*

280. Finally, the Commission's interpretation of the ECT's applicability to intra-EU disputes should also be mentioned:

"(147) In case of the Energy Charter Treaty, it is also clear from the wording, the objective and the context of the treaty that it does not apply in an intra-EU situation in any event. In general, when negotiating – as in the case of the Energy Charter Treaty – multilateral agreements as a "block", the Union and its Member States only intend to create international obligations vis-à-vis third countries, but not inter se. That has been particularly clear in case of the Energy Charter Treaty, which had been initiated by the Union in order to promote investment flows from the then European Communities to the East, and energy flows in the opposite direction, as part of the external action of the European Communities. It is also borne out by the wording of Articles 1(3) and 1(10) of the Energy Charter Treaty, which defines the area of a regional economic integration organisation as the area of that organisation. The lack of competence of Member States to conclude inter se investment agreements and the multiple violations of Union law set out above in recitals (143) to (145) also constitute relevant context for the interpretation of the Energy Charter Treaty in harmony with Union law, so as to avoid treaty conflict.

(148) For those reasons, the ten investors cannot rely on the Energy Charter Treaty or the German-Czech BIT.

(149) In any event, there is also on substance no violation of the fair and equitable treatment provisions. First, as explained above, the Czech Republic has not violated the principles of legitimate expectation and equal treatment, neither under

[122] Commission Decision C(2016) 7827 final, of 28 November 2016, handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. RL-0021

[123] Commission Decision C(2016) 7827 final, of 28 November 2016, handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. RL-0021

its domestic law nor under Union law. As both under the Energy Charter Treaty and the German-Czech BIT Union law is part of the applicable law, the principle of legitimate expectation under the fair and equitable treatment provision has to be interpreted in line with the content of that principle under Union law. Second, in case of the Energy Charter Treaty, it has been expressly recognized by Arbitral Tribunals that the provisions of the Energy Charter Treaty have to be interpreted in line with Union law, and that in case of conflict, Union law prevails. It is settled case-law that a measure that does not violate domestic provisions on legitimate expectation generally does not violate the fair and equitable treatment provision.

(150) Finally, the Commission recalls that any compensation which the Arbitral Tribunals were to grant would constitute in and of itself State aid. However, the Arbitral Tribunals are not competent to authorise the granting of State aid. That is an exclusive competence of the Commission. If they were to award compensation, they would violate Article 108(3) TFEU, and any such award would not be enforceable, as that provision is part of the public order"[124](emphasis added).

(2) The regulation of production subsidies based on RE sources in the SES

(2.1) Introduction: basic conditions

281. The regulation of the activity of generation of electricity from renewable energy sources under the Special Regime in Spain has been based since Law 54/1997 on the following conditions:

- The activity of production from renewable sources is an activity integrated, not isolated, within the SES and therefore its compensation constitutes a cost of the SES, subordinated to the principle of economic sustainability.

- Since the sustainability of the SES depends on the balance between its revenue and costs, the cost of implementing the renewables is determined based on the likely trend in demand and other economic base data.

- To the extent that the producer of renewable energy cannot recover through the market price the costs it has incurred, it is necessary that the SES complement that market price through a subsidy that guarantees *a level playing field.*

- This subsidy was fixed based on the operation and investment costs of a standard facility, in order to enable investors to recover the CAPEX, OPEX and obtain reasonable profitability according to the capital market.

- The principle of reasonable profitability, as the cornerstone of the remuneration system for the production of electric power from renewable sources, is characterised by its balance and dynamism.

[124] Commission Decision C(2016) 7827 final, of 28 November 2016, handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. RL-0021

(2.2) Act 54/1997, of 27 November, on the Electricity Sector.

(a) Introduction

282. Law 54/1997, on the Electricity Sector, in line with the guidelines established by the regulations of the European Union, deals with the regulation of renewable energy in the SES, in the generation of electricity.

283. In this regard, Directive 2001/77/EC established the need for national indicative targets[125]. For its part, Directive 2009/28/EC empower Member States to support the deployment of energy from renewable sources. However, this power was subject to the achievement of the implementation targets established in this Regulation, which is legally binding[126]

284. For this purpose, Act 54/1997, following the scheme of Act 40/1994[127], distinguished between an Ordinary Regime (hereinafter **"OR"**) and a Special Regime (hereinafter **"SR"**). This dual regime was established due to the need to encourage production using energy sources which can only obtain a price in the competitive market that is insufficient to cover its costs of construction and operation, with a *reasonable return* on the investment. Therefore, they require subsidies to be profitable.

(b) Identification of subsidized facilities

285. Act 54/1997 established in Article 27.1 thereof the requirements the facilities needed to meet in order to voluntarily be accepted to the SR. Among others, they should be *"facilities whose installed capacity does not exceed 50 MW"* and *"use as a primary energy source any of the non-consumables renewable energies"*[128]. In any case, the possibility of being accepted into the SR was (and still is) voluntary for producers.

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[125] Directive 2001/77/EC, Article 3: "Member States shall take appropriate steps to encourage greater consumption of electricity produced from renewable energy sources in conformity with the national indicative targets referred to in paragraph 2. These steps must be in proportion to the objective to be attained." RL-0015.

[126] Directive 2009/28/EC of the Parliament and of the Council of 23 April 2009 on the promotion of the use of energies from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC. Article 3 (3). RL-0017.

[127] Law 40/1994, of 30 December, on the National Electricity System (hereinafter, "Law 40/1994"), distinguished between activities *"which constitute a natural monopoly and those which are exercisable under competitive conditions."* It set a target to *"establish the most appropriate compensation to each of them."*
Article 16 of 40/1994, in regulating the setting of the tariffs that must be paid by the users of the integrated system, refers to the necessary *"recognition of the costs attributable to each of them on objective and non-discriminatory criteria which motivate improvement in management efficacy, the efficiency of said activities and quality of electricity supply*." This article sets a system of recovery of investment costs which takes into account the investment and operating costs over the useful life of the facility, according to a rate of compensation established by the Ministry of Industry and Energy according to developments in the financial markets. This system, set in 1994, coincides with the current one, which will be discussed below. R-0070.

[128] Act 54/1997, on the Electricity Sector, article 27(1). R-0003.

(c) Legal and economic integration of the RE in the SES

286. Despite being described as "special", this regime was integrated by Act 54/1997 on the SES, both from a legal perspective and from a technical and economic perspective.

287. From a legal perspective, the SR was subject to the other principles of the SES:

> *"The surplus energy as defined in Article 30.2.a) shall be submitted to the legislative principles of Title II and to those of Titles III and IV of this Law that apply to them."*[129]

288. Therefore, the SR activities were subject, as with any activity of the SES, to the principles of *security of supply* and *economic and technical sustainability* discussed above.

289. From an economic perspective, the main part of the compensation for SR activities (the subsidies), were integrated as a cost of the SES. In this regard, Article 16 of Law 54/1997 classified the SR subsidies as a *"cost of diversification and security of supply"*.

290. Act 54/1997 maintains, therefore, the remunerative regime for electricity generation from renewable sources under the SR in a regulated environment, as was done prior to this Law. This means that the remunerative regime of generation under the SR is similar to that of the regulated activities: transport and distribution[130].

291. To the extent that the subsidies were a cost of the SES, the implementation of the RE required a planning effort by the regulator, who must accommodate the costs of the deployment of REs to the forecast revenues of the SES, that is, to the forecast of changes in demand. Therefore, Act 54/1997 took special care to note:

> *"For renewable energy sources to cover at least 12% of the total energy demand in Spain by 2010, a Renewable Energy Promotion Plan shall be established, the objectives of which shall be taken into account in setting bonuses"*[131]

292. This planning has been reflected through successive Renewable Energy Plans. In these, the cost deriving from achieving the implementation targets of renewable energies has been linked to the forecast of electricity demand and other base economic variables, contained in its *"baseline scenario"*.

293. These renewable energy plans relate to the concept of indicative planning. Through these plans, we establish the "indicative planning of the parameters under which we

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[129] Act 54/1997, on the Electricity Sector, article 29.R-0003

[130] Ibid, Article 16 (2) (3). R-0003.

[131] Act 54/1997, on the Electricity Sector, sixteenth transitory provision. Law 17/2007, of 4 July, amended the content of this provision and moved it to the Twenty-Fifth Additional Provision, noting that: *"The Government shall modify the Renewable Energy Promotion Plan to adapt it to the targets set in this regard by the European Union of 20% by 2020, maintaining the commitment that this plan established of 12% for 2010. These targets will be taken into account when setting bonuses for these kinds of facilities"* R-0003

expect the electricity sector to develop in the near future, which can facilitate the investment decisions of different economic agents".[132]

(d) Duties and rights of producers under the SR

294. To the extent that, for its holders, the SR entails the receipt of subsidies, the latter were subject to the fulfilment of certain specific obligations[133]. Obligations that reveal the subjection of the special regime to the so-called technical and economic sustainability of the SES. These obligations include:

- Furnish the Administration with information on generation, consumption and the sale of power and on any other matters which may be laid down.
- Apply safety standards and technical and standardisation certification regulations for installations and instruments as stipulated by the responsible Administration.
- Comply with technical generation standards as well as those for transmission and for the technical management of the system.
- Contract and pay the toll corresponding to the distribution company or transporter to which it is connected for feeding energy into their networks134.

295. Since the subsidies are a cost of the SES paid by consumers, the Regulator is obliged to respect the principle of *"reasonable return",* as discussed below, by adjusting the amount of the subsidies to the actual costs of investment and operation. To do so, Act 54/1997 obliges RE energy producers to submit to the Regulator information on the investments, costs, revenues and other parameters of the various real installations[135]. This obligation does not apply to producers under the OR.

296. Also, given the important technical implications for the SES involved in the deployment of renewable energies, Act 54/1997 is careful to warn SR producers that they shall be subject to the technical standards that may be established to ensure the technical sustainability of the SES.

297. Alongside these duties, renewable energy producers enjoy a series of rights[136], which include: (i) priority of dispatch, (ii) priority of access and (iii) entitlement to a specific remunerative regime, different to that of the ordinary regime. It should be noted that in any case, Act 54/1997 guarantees that all of the net energy produced and sold must be subsidized.

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[132] Act 54/1997, on the Electricity Sector, Preamble. R-0003.
[133] Act 54/1997, on the Electricity Sector. Article 30 (1). R-0003.
[134] Royal Decree-Law 14/2010 of 23 December, establishing urgent measures to correct the tariff deficit in the electricity industry. Article 1 (five). R-0090.
[135] Ibid, Article 30 (1) (d). This reporting obligation is specified in Circular 3/2005, of 13 October, of the Spanish Energy Commission, on requesting investment information, expenditures, revenues and other parameters for electricity production installations of electricity under special regime. R-0117
[136] Act 54/1997, on the Electricity Sector. Article 30 (2). R-0003.

(e) Specific remunerative regime of renewable energies

298. The power generation plants from renewable sources included in the SR of Act 54/1997 enjoy a specific remuneration regime. Its purpose is "*to achieve reasonable rates of return with reference to the cost of money on the capital market*".[137] That is, the RE Plants are guaranteed by law to receive a *"reasonable return"*.

299. This principle of *"reasonable return"* translates into a compensation that combines two components: the *market price* for the sale of electricity[138] and a *subsidy* to ensure the economic viability of such activity. This subsidy is granted through the payment of a premium that complements the market price[139]. This *subsidy* is set by the Government by regulation[140] and the amount is considered a *cost* of the SES[141].

300. The Government, when determining the subsidy, must take into account the criteria set out in Article 30.4[142] of Act 54/1997. In this sense, the last paragraph of that article, in its original wording, provided that:

> *"To decide the premiums the following will be taken into account: the level of delivery voltage of power to the network, the effective contribution to improving the environment, saving primary energy and energy efficiency, the production of economically justifiable useful heat and the investment costs incurred for the purpose of achieving reasonable rates of profit with reference to the cost of money on capital markets"*[143] *(emphasis added)*

301. Thus, the pairing market price plus subsidy in Act 54/1997 has a clear and precise objective: to give a reasonable return on investment, according to the cost of money in the capital market.

302. The principle of **reasonable return** is thus enshrined in the Spanish legal system, a concept which, on the other hand, does not apply to the installations not covered by the so-called Special Regime. This principle of reasonable return has remained unchanged since 1997 until today, despite regulatory changes.

303. Indeed, both RD-Law 9/2013[144] and Law 24/2013[145], challenged in these proceedings, maintain the principle of *reasonable return* for the facilities, as a keystone of the remuneration system for renewable energy.

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[137] Ibid, Article 30 (4). R-0003.
[138] Ibid, Articles 16 and 30 (3). R-0003.
[139] Ibid, Article 30(4) (b). R-0003.
[140] Ibid, Article 30 (4). R-0003.
[141] Ibid, Article 16 (6): known as the "cost of diversification and security of supply". R-0003.
[142] Ibid, Article 30. R-0003.
[143] Ibid, Article 30.4. R-0003
[144] Royal Decree-Law 9/2013, of 12 July, establishing urgent measures to ensure the financial stability of the electricity system. R-0095.
[145] Act 24/2013, of 26 December, on the Electricity Sector. R-0077.

C. The Principle of Reasonable Return

304. As just noted, the remunerative regime of the production of energy from renewable sources under the RE is based on the principle of reasonable return, which has been and remains stable since 1997.

305. At this point, we must emphasize that the creation of the RE took place through Royal Decree 2366/1994, of 9 December. Since its inception, the economic system of renewable energy was aimed at ensuring a necessary balance between *"the adequate profitability of the project and the cost to the electricity system"*[146].

306. Reasonable return involves receiving revenues sufficient to recover investment costs (CAPEX), operating costs (OPEX) and make a profit in line with market criteria. This adaptation to market criteria meets at the same time the triple objective of (i) compensating the investor proportionately, so that it can compete on equal terms (*"level playing field")* with conventional energy, (ii) ensuring the power supply at an efficient cost for consumers and (iii) making the SES sustainable, as we have previously discussed.

307. Thus, the methodology followed by the Regulator to set the remuneration for the activity of generation under the RE, based on renewable sources, is the one that has historically been held to set the compensation of any non-liberalized plot of the SES. This method comprises two phases:

1. Recognizing and reconstructing an economic operating structure (standard facility), identifying the investment costs (CAPEX) and operating and maintenance costs (OPEX), according to market criteria and in accordance with the actions of a "diligent investor";

2. Setting a target for the economic return, for a given period of time, which is dynamic, balanced and proportionate, in accordance with the capital market. This target should be achieved through the sum of two components: a) market price b) subsidies.

308. This methodology has been followed by the Kingdom of Spain continuously. This is demonstrated, among others, in the following documents:

- Renewable Energy promotion Plan in Spain 2000-2010.[147.]
- Spanish Renewable Energy Plan 2005-2010[148.]
- Renewable Energy Plan 2011-2020[149]

[146] Royal Decree 2366/1994, of 9 December, on the production of electricity by hydraulic, cogeneration and other facilities supplied by renewable energy resources or sources. Preamble. R-0222.
[147] Renewable Energy promotion Plan in Spain 2000-2010. Chapter 6, pages 204 to 231. R-0118
[148] Spain Renewable Energy Plan 2005-2010. Chapter 3.4, pages 142 to 145 and Chapter 4 pages 270 to 313. R-0119.

309. Based on the concept of reasonable return and the methodology followed for setting it, the characteristics thereof are discussed below:

(a) It requires a balance between the cost of the premiums for consumers and the profitability for the investor.

(b) It has a dynamic character.

(c) It represents a guarantee for the investor.

(d) It imposes on the regulator an obligation of a result.

310. Similarly, as we will demonstrate later, this principle was known and was invoked by the associations of producers of renewable energies, both Spain's most important association — the Association of Renewable Energy Producers (hereinafter, the **"APPA"**)[150]; and other minority associations —the Spanish Wind Energy Association (hereinafter, the **"AEE"**), the Photovoltaic Industry Association (hereinafter, the **"ASIF"**)[151]— and by all the producers of RE and the most important consultants in Spain. Therefore, the Claimants could not reasonably have been unaware of this principle nor the established case law of the Supreme Court which interprets and enshrines it.

(a) Balance between the cost of subsidies and the return they generate for the investor.

311. The return must be "reasonable" for the investor and "reasonable" for the system. A reasonable return means a balance between the revenues of the SR producer and the costs that such revenues entail for the consumer. An imbalance between the two elements will lead either to the unsustainability of the System or to excessive burdens for consumers. The need for this balance was established when the SR was established in 1994[152] and it has been maintained in the various policy instruments that have been developed by Law 54/1997.

312. Thus, Royal Decree 436/2004, dated 12 March, establishing the methodology for the updating and systematisation of the legal and economic regime for electric power production in the special regime (hereinafter, "**RD 436/2004**"), states in its Preamble:

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[149] Renewable Energy Plan 2011-2020 This refers in several paragraphs to the target of balanced economic return, in terms of reasonable profitability:
- Pag. 14. "The premiums (...) are intended to ensure a reasonable return on the investments."
- Pag. 536. "Reviews of remuneration levels: The remuneration levels can be modified depending on the technological evolution of the sector, market behaviour, [...], while always ensuring reasonable rates of profitability. In any case, these reviews are based on the evolution of the specific costs associated with each technology, with the ultimate triple aim that (...) the remuneration scheme evolve towards the minimum socio-economic and environmental cost." (emphasis added) R-0120.

[150] Proposal of the Draft Law for the Promotion of Renewable Energies of 20 May 2009 by APPA-Greenpeace to the Ministry of Industry, Tourism and Trade, on 21 May 2009 and a Letter sent to the Institute for Energy Diversification and Saving (IDEA) of the Association of Renewable Energy Producers (APPA) and Greenpeace regarding the Draft Law on the Promotion of Renewable Energy, dated 21 May 2009.R-0187 and R-0186.

[151] Pleadings submitted by ASIF to the Draft of RD 1565/2010. R-0190

[152] Royal Decree 2366/1994, of 9 December, on the production of electricity by hydraulic, cogeneration and other facilities supplied by renewable energy resources or sources. Preamble R-0222.

> *"the Royal Decree guarantees the operators of special regime facilities* ***reasonable*** *remuneration for its investments and electricity consumers a* ***likewise reasonable*** *allocation of the costs attributable to the electricity system". (emphasis added).*[153]

313. The 2005-2010 Renewable Energy Plan furthermore highlighted:

> *"The analysis conducted aims to balance the application of resources so that levels of return on investment are obtained that make it attractive relative to other alternatives in an equivalent sector in terms of profitability, risk and liquidity, always aiming to optimise available public resources."* [154]

314. For its part, Royal Decree 661/2007, of 25 May, regulating the activity of electricity production under the special regime (hereinafter, "**RD 661/2007**") reiterates in its Preamble:

> *"The economic framework laid-down by this Royal Decree develops the principles contained in Act 54/1997, of 27 November, on the Electricity Sector, ensuring the operators of special regime facilities* ***reasonable profitability on their investments and electricity consumers a likewise reasonable allocation of the costs attributable to the electricity system****"*[155]*. (Emphasis added)*

(b) It has a dynamic character.

315. Article 30 (4) of the Act of 1997 defines the return to be granted to SR producers as "reasonable". According to the Dictionary of the Spanish Royal Academy, *"reasonable"* means *"adequate, according to reason, proportionate or not excessive"*[156]. The provision, therefore, does not require that the return granted to the RE producers be "unchangeable", "fixed", or the like. Act 54/1997 uses the term "reasonable".

316. Additionally, the Law defines the reasonable return with reference to the cost of money on the capital market. The Dictionary of the Spanish Royal Academy defines "reference to" as the *"action or effect of referring"*[157] and "refer to" is defined as *"to direct something to a specific and determined end or object or put something in connection with something else or with a person."*[158]

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[153] Royal Decree 436/2004, dated 12 March, establishing the methodology for the updating and systematisation of the legal and economic regime for electric power production in the special regime. R-0100.

[154] Spain Renewable Energy Plan. 2005-2010. Institute for Diversification and Energy Saving of the Ministry of Industry, Tourism and Trade. Pag. 27. R-0119.

[155] Royal Decree 661/2007, of 25 May, regulating the activity of electricity production under the special regime. R-0101

[156] Definition of the word "reasonable" according to the RAE. R-0213.

[157] Meaning of the word "reference to". RAE - Meaning of the word reference. (RAE) Dictionary of the Spanish language electronic version (twenty-third edition October 2014). R- 0214.

[158] Meaning of the word "refer to". (RAE). Dictionary of the Spanish language electronic version (twenty-third edition October 2014). R-0215.

317. Consequently, the cost of money on the capital market is not simply a "programme criterion". Far from it, it is comparison criterion imposed by Law that makes it possible to determine whether profitability at a given time is reasonable or not.

318. Therefore, the criterion used by the legislator to judge such reasonableness is not a *static* element, but rather is a fundamentally *dynamic* element. As dynamic as is the *cost of money on the capital market.* As indicated by the Supreme Court of the Kingdom of Spain:

> *"The thesis that the "reasonable return" must remain unchanged [...] cannot be shared. Depending on the changing economic circumstances and other changes, a percentage of profitability can be "reasonable" in that first moment and require a further adjustment precisely to maintain the "reasonableness" after the modification of other economic or technical factors."*[159]. (Emphasis added)

(c) It represents a "guarantee" for the investor.

319. The reasonable return is a guarantee for the investor. By legally imposing that the subsidies must provide a reasonable return, the Law seeks to give security to investors. Thus, the SES is committed to the former recovering their investment and operation costs and obtaining, in any case, a return which can be understood as "reasonable" in the system as a whole.

320. With this guarantee the investment risk is reduced. It is recalled that the investment risk is a basic financial assumption to be made before undertaking an investment. Therefore, the risk reduction implicitly entails a softening of the expectations of the returns to be obtained by the investors. It is evident that in economic theory the pairing "profitability"—"risk" means the lower the risk, the lower the return.

(d) It imposes on the Regulator an obligation of a result.

321. Article 30.4 of Act 54/1997 does not establish the precise mechanism through which reasonable profitability must be granted. Said article only empowers the Government to establish it in the relevant Regulation. In this regard, the Supreme Court of the Kingdom of Spain, since its Judgement of 25 October 2006, has indicated that:

> *"The remuneration regime which we examine does not guarantee, on the contrary, holders of facilities under special regime the inviolability of a certain level of profits or income in relation to those obtained in past years, nor the indefinite permanence of formulas used for fixing premiums."* [160] (Emphasis added)

322. Faced with a possible change in the subsidy mechanism for renewables, the only limit that is established in the Law is that, in any case, the new model that is

[159] Judgement of the Third Chamber of the Supreme Court of 25 September 2012, rca 71/2011, Third Point of Law (R-0148) Law, reiterating the pronouncement of Judgement of the Third Chamber of the Supreme Court of 19 June 2012, rca 62/2011. R-0146.

[160] Judgement from the Third Chamber of the Supreme Court dated 25 October 2006, appeal 12/2005, reference El Derecho EDJ 2006/282164 (Spanish). Third Legal Basis. R-0138.

implemented continue to guarantee a *"reasonable return"* for the investments. Reasonable for investors and also reasonable for the consumers who have to pay the cost.

D. Case law of the Supreme Court: determination of the basic conditions of the SR

323. By application of Act 54/1997, the Kingdom of Spain has adopted different regulations that have led to changes in the subsidy mechanism of the SR. These changes have led to a strong litigation which, in turn, has given rise to a settled case law of the Supreme Court of the Kingdom of Spain.

324. The Supreme Court is the ultimate interpreter of the Spanish Legal System.[161] It is also the competent court to hear appeals against regulations (royal decrees) issued by the Government of Spain[162]. Its case law complements the Spanish Legal System[163]. Therefore, no diligent investor could ignore the case law of the Supreme Court regarding the Special Regime.

325. The Claimant, who is aware of the importance of the case law of the Supreme Court, limits itself to invoking it when it is convenient to do so[164]. It is not, therefore, plausible that the Supreme Court's case law on the rights of producers of REs did not include the expectations of the Claimant to make its investment in Spain. As we shall see later, not only the Claimant but also the most representative industry associations of the RE Sector were well aware of the limits to the *ius variandi* of the Regulator established by the Supreme Court of the Kingdom of Spain.

326. The Arbitral Tribunal cannot therefore ignore this case law when ruling on the expectations that the Claimant knew or should have known during the time period of its investment. This case law sets the nature, scope and limits of the remuneration regime of the RE.

327. The Supreme Court, ruling on the direct challenge of Royal Decree 436/2004, expressly refused the possible grandfathering of the remuneration regime in its Judgement of 15 December 2005[165].

328. Following that ruling, the Supreme Court has ruled on the regulatory changes made to RD 436/2004. In all cases, it confirmed their legality. In the important Judgement of 25 October 2006, the Supreme Court expressly refused to investors the *vested right* to receive an *unchangeable* rate. They are only granted the right to obtain a *reasonable return* under Article 30.4 of Act 54/1997. Pursuant to this Judgement:

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[161] Article 122 of the Spanish Constitution. R-0035.
[162] Act 29/1998, of 13 July, regulating the Jurisdiction for Judicial Review, art. 12. R-0072.
[163] Article 1.6 of the Spanish Civil Code. R-0096.
[164] Memorial of Claim, paragraphs 321 and 481. Notable is para. 321, in which it holds alleged breaches of the State that are not true. It even provides as relevant two Judgements of the Supreme Court, Documents C-0116 and C-0117.
[165] Judgement of the Supreme Court, of 15 December 2005: "No legal obstacle exists for the Government, in the exercise of the regulatory power and the large authorisations which it has in a heavily regulated field such as electricity, to modify a particular compensation system, [...]." R-0137.

> *"the owners of electrical energy production facilities under the special regime do not have an "unmodifiable right" to maintain unchanged the way in which the collection of premiums is governed. This regime actually attempts to promote the use of renewable energies by means of an incentivising mechanism which, like any of this kind, is not guaranteed to be retained without modifications in the future."*[166] *(emphasis added)*

329. In addition, the case law established that the regime of subsidies for renewable energy in the SES is linked and contributes to the sustainability of the system. In this sense, the Judgement of 25 October 2006 stated that the system of incentives and bonuses of RD 436/2004 is part of the whole system, which is influenced by economic circumstances at all times. Therefore, the system can be modified to adapt it to changing economic circumstances[167].

330. In the same Judgement on 25 October 2006, the Supreme Court ruled that the remunerative modifications do not contradict the principles of legal certainty and legitimate expectations. Regulatory changes are permissible provided that the principle established by Act 54/1997 is respected: a reasonable return[168].

331. This case law was confirmed and repeated in 2007. Accordingly, it is appropriate to highlight the Judgements of the Supreme Court of 20 March 2007[169] and of 9 October 2007, in which the High Court once again confirms that there is no *vested right* to receive a specific subsidy in the future[170].

332. Royal Decree 436/2004 was replaced by Royal Decree 661/2007[171]. The replacement of the regime established in Royal Decree 436/2004, led to the filing of

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[166] Judgement from the Supreme Court dated 25 October 2006 Rec. 12/2005, subsequently adds: "*the remuneration system that we examined does not guarantee (...) the owners of installations under the special regime that a particular level of profits or revenue in relation to those obtained in previous fiscal years shall remain untouched, nor the indefinite continuance of the formulas used to set the premiums".* (emphasis added) R-0138.

[167] Judgement of the Supreme Court dated 25 October 2006 Rec. 12/2005: "Just as depending on factors of economic policy [...] the premiums and incentives for the production of electricity under the special regime may increase from one year to the next, they may also decrease when those same considerations so warrant it. Whenever, we insist, the variations remain within the legal limits that regulate this type of promotion, the mere fact that the update or the economic significance of the premium rises or falls is not in itself grounds for invalidity nor does it affect the legitimate expectations of the recipients." (emphasis added) R-0138.

[168] Judgement of the Supreme Court dated 25 October 2006 Rec. 12/2005: "legal certainty is not incompatible with the regulatory changes from the perspective of the validity of the latter, [...] The same consideration applies to the principle of legitimate expectations [...] The appellants argue that their investments in the activity of production of electrical energy under the special regime were made at a given time "trusting that the Administration will not change the legal conditions that were decisive for (...) them to decide to build the facility," a premise from which they infer that the reduction of premiums subsequent to Royal Decree 2351/2004 regarding those established in Royal Decree 435/2004 would be contrary to that principle. Such reasoning, based on an incentive mechanism as that of the premiums in question, cannot be shared." R-0138.

[169] Judgement of the Supreme Court, of 20 March 2007. R-0139.

[170] Judgement of the Supreme Court, of 09 October 2007. R-0140.

[171] Royal Decree 661/2007, of 25 May. R-0101.

several appeals to the Supreme Court. Similar to what the applicant claims in this arbitration regarding RD 661/2007, several producers of electricity in the special regime argued that Article 40.3 of RD 436/2004[172] contemplated the *"grandfathering"* of the previous incentive scheme.

333. The Spanish Supreme Court reiterated, once again in 2009, its case law on the scope of the regulation of the electricity sector and the rights and guarantees that the economic agents have. It reiterated that among those rights, in no case is the *right to the immutability* of the economic system included.

334. Indeed, according to the Supreme Court, the only limitations to the regulatory power of the state are two: 1) that the change does not reach the already received yields and 2) that the principle of reasonable profitability does not conflict. This is established in three important Judgements, one dated 3 December 2009 and two dated 9 December 2009. In the first one, the Supreme Court states:

> *"the prescriptive content of Act 54/1997, [...], does not give rise to the grandfathering or freezing of the remunerative regime of the holders of electric power facilities in the special regime nor the recognition of the right of special regime producers to the inalterability of that regime, as the Government has, according to the intention of the legislature, discretion to determine the energy efficiency offered, [...] taking into account in exercising its regulatory powers the obvious and essential general interests involved in a properly functioning system of production and distribution of electricity, and in particular the rights of users."*[173] *(emphasis added)*

335. The clarity of the case law applicable to this sector is obvious: the regulatory development of the remuneration of the RE is made to depend on the legal regulation (Article 30.4 of Act 54/1997), which is subordinated by case law under the principle of hierarchy. It is clear therefore that the Kingdom of Spain did not offer any investor the grandfathering of its premium system, to the detriment of the consumers or the SES.

336. The 2009 appellants argued before the Supreme Court a breach of the principle of legal certainty. However, this Court stated that:

> *"The argument [...] should be rejected because it does not follow that this regulation [RD 661/2007] does not meet the requirements of the principle of legal certainty, which does not include any right to freeze the existing legal system."*[174] (emphasis added)

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[172] Royal Decree 436/2004. Article 40:
"Article 40. Revision of tariffs, premiums, incentives and supplements for new facilities. [...]
3. "The tariffs, premiums, incentives and supplements resulting from any of the revisions referred to in this section shall apply only to the installations that become operational after the date of entry into force referred to in the preceding paragraph, without retroactivity to previous tariffs and premiums". (Emphasis added). R-0100.

[173] Judgement of the Supreme Court, of 3 December 2009, Third Point of Law. R-0141.

[174] Judgement of the Supreme Court, of 3 December 2009, Fourth Point of Law. R-0141.

337. The appellants also claimed in 2009 the violation of the principle of legitimate expectations. However, the Spanish Supreme Judicial Body reiterated in all these statements that:

> *"The principle of legitimate expectations does not guarantee the perpetuation of the existing situation; which can be modified at the discretion of the institutions and public authorities to impose new regulations taking into account the needs of the general interest."* (emphasis added)

338. The case law described is sufficiently clarifying. However, two other Judgements of 9 December 2009 must be noted, issued in two appeals against RD 661/2007. In those Judgements, the Supreme Court clearly established the rights of investors in the SR, even criticizing the appellant for not taking into account the settled case law:

> *"[...] [The Claimant] does not pay sufficient attention to the case law of this Chamber issued specifically in relation to the principles of legitimate expectations and non-retroactivity applied to successive incentives regimes for electricity generation. These are the considerations expressed in our Judgement of 25 October 2006 and reiterated in that of 20 March 2007, inter alia, on the legal status of the owners of facilities producing electricity under the special regime, for whom it is not possible to recognize pro futuro an "inalterable right" to the maintenance of the remuneration framework approved by the holder of regulatory power, provided that the requirements of the LSE are respected as regards the reasonable return on investment."* [175] (emphasis added)

339. In these judgments, the Supreme Court reiterates what was already established in 2006 and 2007 in respect of the regulatory amendments to the RD 436/2004, now applying in relation to RD 661/2007[176]. That is, its cases remains constant: there is no inalterable right to a specific compensation framework being maintained. We can only require that such compensation framework respect the principle of reasonable return.

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[175] "As stated by this Court in its Judgement of 25 October 2006 (R-00138), reiterated in that of 20 March 2007 (R-0139): "the owners of electrical energy production facilities under the special regime do not have an "unmodifiable right" to maintain unchanged the way in which the collection of premiums is governed. This regime actually attempts to promote the use of renewable energies by means of an incentivising mechanism which, like any of this kind, is not guaranteed to be retained without modifications in the future. [...]. Any companies that freely choose to enter a market such as the special regime electricity production market, knowing in advance that it is largely dependent upon economic incentives established by public authorities, are or must be aware that these may be modified, within legal guidelines, by these authorities. One of the "regulatory risks" to which they are subject, which they must necessarily take into account, is precisely the variation of the parameters of the premiums or incentives, which the Electricity Sector Law —in the sense above— tempers but does not exclude."[175] (emphasis added) Judgement of the Spanish Supreme Court of 09 December 2009, Rec. 152/2007, reference The Act 2009/307357, Sixth Point of Law. R-0002.

[176] Judgement from the Third Chamber of the Supreme Court, 9 December 2009, rec. 152/2007, reference The Act 2009/307357, Fifth Point of Law. R-0002.

340. RD 661/2007 was subsequently amended by RD 1565/2010[177] and Royal Decree-Law 14/2010[178]. Again, many producers contested this reform before the national courts alleging that these changes were retroactive and unforeseeable by a diligent investor when making its investment according to RD 661/2007. With respect to all of these challenges, the Supreme Court issued from 12 April 2012 (date on which the first one was rendered) and until November of the same year, a long series of Judgements that once again reiterated and confirmed for the investors its case law on the limits and scope of the concept of reasonable return[179]. .

341. In this case law, the Supreme Court reiterated once again that the holders of special regime facilities have no *inalterable right* to the economic regime governing the receipt of their compensation *remaining unchanged*. In this regard, it is noteworthy that the Supreme Court introduces in its ruling an assessment of the circumstances of the economic crisis that the Kingdom of Spain was suffering at that time, and the existence and amount of the tariff deficit:

> *"If the latter involve adjustments in many other productive sectors [...], it is not unreasonable that it is also extended to the renewable energy sector, which wants to continue receiving the regulated tariffs instead of using market mechanisms [...]. And all the more so when faced with situations of widespread economic crisis and, in the case of electricity, with the increased tariff deficit which, in some part, arises from the impact on the calculation of the access fees made by the remuneration of*

[177] Royal Decree 1565/2010, of 19 November, which regulates and modifies certain aspects of the electricity production activities in the Special Regime, published in the Official State Gazette on November 23, 2010. R-0104.

[178] Royal Decree-Law 14/2010 of 23 December, establishing urgent measures to correct the tariff deficit in the electricity industry. R-0090.

[179] Judgements of the Spanish Supreme Court of 20 December 2011, rec. 16/2011 (R-0143); of 12 April 2012, rec. 50/11 (R-0032) and 112/11 (R-0033); of 19 April 2012, rec. 39/11 (R-0046) and 97/11 (R-0047); of 23 April 2012, rec. 47/2011 (R-0048); of 03 May 2012, rec. 51/11 (R-0049) and 55/2011 (R-0050); of 10 May 2012, rec. 61/11 (R-0051) and 114/2011 (R-0052); of 14 May 2012, rec. 58/2011 (R-0053); of 16 May 2012, rec. 46/11(R-0054); of 18 May, rec. 70/11 (R-0055) and 74/11 (R-0056); of 22 May 2012, rec. 45/11 (R-0057) and 49/11 (R-0058); of 30 May 2012, rec. 59/2011 (R-0059); of 18 June 2012, rec. 54/11(R-0060), 56/11(R-0061), 57/11(R-0061 Bis) and 63/11 (R-0097); of 25 June 2012, rec. 109/11(R-0100 bis) and 121/11(R-0106); of 26 June 2012, rec. 566/10 (R-0107); of 09 July 2012, rec. 67/11(R-0129), 94/11 (R-0130) and 101/11 (R-0135); of 12 July 2012, rec. 52/11 (R-0136); of 16 July 2012, rec. 53/11(R-0145), 75/11 (R-0149) and 119/11 (R-0158); of 17 July 2012, rec. 19/11(R-0165) and 37/11(R-0171); 18 July 2012, Rec. 19/11(R-0142); of 19 July 2012, rec. 44/2011 (R-0173); of 25 July 2012, rec. 38/2011 (R-0188); of 26 July 2012, rec. 36/11 (R-0191); of 13 September 2012, rec. 48/11 (R-0198); of 17 September 2012, rec. 43/11(R-0199), 87/11(R-0210), 88/11(R-0212), 106/11(R-0216) and 120/11(R-0217); of 18 September 2012, rec. 41/11 (R-0218); of 25 September 2012, rec. 71/11 (R-0219); of 27 September 2012, rec. 72/2011 (R-0220); of 28 September 2012, rec. 68/2011 (R-0221); of 08 October 2012, rec. 78/11(R-0225), 79/11(R-0226), 100/11(R-0227) and 104/11(R-0228); of 10 October 2012, rec. 76/2011 (R-0229); of 11 October 2012, rec. 95/11(R-0230) and 117/11(R-0231); of 15 October 2012, rec.64/11(R-0236), 73/11(R-0239), 91/11(R-0240), 105/11(R-0241) and 124/11(R-0244); of 17 October 2012, rec. 102/2011 (R-0245); of 23 October 2012, rec. 92/2011 (R-0246); of 30 October 2012, rec. 96/2011 (R-0247); of 31 October 2012, rec. 77/11(R-0248) and 126/11 (R-0031); 26 November 2012, rec. 125/2011 (R-0217); of 05 November 2012, rec. 103/2011; of 09 November 2012, rec. 89/2011; of 12 November 2012, rec. 98 and 110/11, of 16 November 2012, rec. 116/11; of 21 November 2012, rec. 34/2011. R-0142.

such by way of the regulated tariff, in terms of cost attributable to the electricity system"[180] (Emphasis added)

342. Moreover, the Supreme Court stated in this and subsequent judgments, three very specific considerations on which it reiterates, once again, the possibility of modifying the remunerative regime of renewable technologies.

a) First, the Judgement of 12 April 2012 provides that Article 30.4 of Act 54/1997 does not guarantee the receipt of a regulated rate for a certain period of time:

"The reasonable compensation [...] does not have to entail, again, that the compensation be obtained precisely through the regulated rate (it could be done, in the future, at market prices) and, above all, that the former be guaranteed past thirty years." [181]

b) Second, another Judgement of the same date, 12 April 2012 (Appeal 59/2011), established that a "reasonable return" does not entail the right to receive a fee for each year of the useful life of the facility. It states that it is possible that these investments have already been amortized and have produced a reasonable return well before the end of their period of operation. [182]

c) Finally, the Supreme Court denies that a particular rate of return can be maintained or even unchanged:

"According to the claim, [...] the "significant loss of profitability" [...] should be compared by contrasting the rates of return arising from the former [RD] with those resulting from the legislation preceding said RD. [...] The thesis that the "reasonable return" which was estimated at a given time should simply remain unchanged in successive periods cannot be shared. Depending on the changing economic circumstances and other changes, a percentage of profitability can be "reasonable" in that first moment and require a further adjustment precisely to maintain the "reasonableness" after the modification of other economic or technical factors." [183] (Emphasis added)

343. These pronouncements are reproduced in very similar terms in the Judgement of 25 June 2013[184] and has been more recently confirmed by Judgement 63/2016, of 21

[180] Judgement of the Spanish Supreme Court of 12 April 2012, rec. 40/2011, Fourth Point of Law. R-0144.
[181] Judgement of the Spanish Supreme Court of 12 April 2012, Rec. 40/2011, Seventh Point of Law. R-0144.
[182] Judgement of the Supreme Court, of 12 April 2012: "The principle of reasonable return is to be applied [...] to the entire life of the installation, but not [...] in the sense that throughout such period this principle guarantees the generation of profits, but rather in the sense that it ensures that the investments made at the installation obtain a reasonable return on the entire existence thereof. This [...] does not mean the continuation of a certain premium throughout the entire lifetime of the installation, as it may perfectly be that these investments have already been amortized and have produced such a reasonable return well before the end of its period of operation." (emphasis added) R-0144. Also mentioned, among others, in the Judgement of the Supreme Court of 19 June 2012 (appeal 62\2011). R-0146.
[183] Judgement of the Supreme Court dated 19 June 2012 (appeal 62/2011). R-0146.
[184] Judgement of the Supreme Court dated 25 June 2013 (RJ/2013/6733), rec. 252/2012. R-0150.

January 2016, by the Supreme Court,[185] when it rejected new appeals against RD 1565/2010, of 19 November, and Royal Decree-Law 14/2010 of 23 December. In this Judgement, the Supreme Court again insists that RD 661/2007 never froze the current economic system:

> *"We do not understand that the aforementioned Royal Decree [661/2007] envisages a tariff regime forever, nor that the Government, in the exercise of regulatory authority that it holds, or that the legislator, in use of its legislative power, cannot adapt or modify that regime to meet the new circumstances (economic, productive, technological or of any other nature) that might occur in such a very lengthy period of time."*[186]

344. The forcefulness, clarity and continuity of the applicable Jurisprudence leaves no doubt about the scope, content and legal limits of the remuneration regime based on the reasonable profitability to which the investors were entitled. And therefore, there is no doubt on the real legitimate expectations that the Kingdom of Spain offered to all national or foreign investors.

345. That is, every investor knew or should have known the following *essential* conditions of the SR remuneration system:

a) The activity of production from renewable sources is an activity integrated, not isolated, within the SES and therefore its compensation constitutes a cost of the SES, subordinated to the principle of economic sustainability.

b) Since the sustainability of the SES depends on the balance between its revenue and costs, the cost of implementing the renewables is determined based on the likely trend in demand and other economic base data.

c) Given that the producer of renewable energy cannot recover through the market price the costs it has incurred, it is necessary that the SES complement that market price through a subsidy that guarantees *a level playing field.*

d) This subsidy was fixed based on the operation and investment costs of a standard facility, in order to enable investors to recover the CAPEX, OPEX and obtain reasonable profitability according to the capital market.

e) The principle of reasonable profitability, as the cornerstone of the remuneration system for the production of electric power from renewable sources, is characterised by its balance and dynamism.

346. The importance of the case law of the Supreme Court of the Kingdom of Spain has been recognized by the first Arbitration Award that has been issued on RD 661/2007 and the Spanish regulatory framework. This is the Award issued in the case *Charanne*

[185] Judgement 63/2016, of 21 January 2016, of the Supreme Court handed down in cassation appeal 627/2012. R-0155.
[186] Judgement 63/2016, of 21 January 2016, of the Supreme Court handed down in cassation appeal 627/2012. Sixth legal basis. R-0155.

BV vs. Spain on 21 January 2016[187]. The Award rules on the value of the case law of the Supreme Court of the Kingdom of Spain:

> *"506. For instance, the Spanish Supreme Court had considered in December 2005 that: "There is no legal obstacle for the Government, in the exercise of the regulatory powers entrusted thereto as well as its broad powers in a heavily regulated area such as electricity, to modify a specific remuneration scheme, provided that it remains in compliance with the framework provided by the LSE." Likewise, in October 2006, the Supreme Court decided that: "the owners of electricity production facilities under the special regime do not have an 'unmodifiable right' to have the feed-in remuneration scheme remain unchanged. Said regime, indeed, aims to promote the use of renewable energies by means of incentives which, as is always the case with incentives, are not guaranteed remain unchanged in the future."*
>
> *508. Although these decisions by the Spanish courts are not binding on this Arbitration Tribunal, they are factually relevant to verify that the investor was unable, at the time of the disputed investment, to have the reasonable expectation that in the absence of a specific commitment the regulation was not going to be modified during the lifespan of the plants."*[188] (Emphasis added and footnotes omitted)

347. The Tribunal of the *Charanne* Case not only rules on the value of the Case Law of the Kingdom of Spain, but rather also on the principle of "reasonable return" as a guide to the remuneration given to the REs:

> *"518. The Arbitration Tribunal understands that RD 661/2007 and RD 1578/2008 establish specific rules whose essential characteristics are offering a guaranteed tariff (or a premium, where appropriate) as well as privileged access to the electricity transmission and distribution grid, to each energy producer that fulfils the established requirements. Within the framework of the LSE, said principles make it possible to guarantee to renewable energy producers the reasonable returns to which Article 30.4 LSE refers."*[189] (Emphasis added)

E. <u>The legal regime applicable at the time the Claimant made its investment.</u>

(1) Introduction

348. The Claimants made their investment in May 2012. Their investment consisted in the acquisition of shares in Spanish companies, as well as debt of said companies. The assets of the companies acquired by the Claimant included different wind farms whose economic activity consisted in producing electrical energy.

349. In May 2012, the facilities related to this arbitration had been subject to successive regulations issued in implementation of Article 30 (4) of Act 54/1997. Thus, before the

[187] *Charanne BV vs. Spain,* SCC Arbitration No. 062/2012. RL-0049.
[188] Ibid, par.507 and 508.
[189] Ibid, paragraph 519

Claimant made their investment, the plants related to this arbitration had been subject (1) to Royal Decree 436/2004, (2) to Royal Decree-Act 7/2006, (3) to Royal Decree 661/2007, (4) to Royal Decree-Act 6/2009, (7) to Royal Decree 1565/2010, (8) to Royal Decree 1614/2010, (9)to Royal Decree-Act 14/2010 and (10) to Act 2/2011.

350. Moreover, prior to construction of the plants object of this arbitration, the economic regime applicable to wind farms in Spain had been subject to two amendments: (1) Royal Decree 2366/1994 and (2) Royal Decree 2818/1998.

351. Consequently, at the time when the Claimants made their investment, they knew that the economic regime applicable to wind farms had been successively altered. However, regardless of the regulatory changes that have occurred, there are essential principles that have remained unchanged since Act 54/1997:

a. The principle that subsidies for renewables are a cost of the SES has never been changed, and therefore their establishment and maintenance are linked to the SES's economic sustainability.

b. Article 30 (4) of Act 54/1997 sets forth the essence of the renewable energies remuneration system in Spain, and it has not changed since being introduced in 1997.

c. Within the framework of a sustainable SES, subsidies have always been established with the objective of providing a standard facility with "*reasonable return in accordance with the cost of money in the capital market*". This return was linked exclusively to the cost of construction and operation of the so-called standard facilities.

d. The methodology used to determine reasonable return has always consisted in the following operations:

- Recognising and reconstructing a financial operating structure (standard facility), therefore identifying the investment costs (CAPEX) and the operating and maintenance costs (OPEX), according to market criteria and in accordance with the actions of a "diligent investor";

- Based on said standard facility, establishing, within a certain period, a dynamic, balanced and proportionate target of financial return in accordance with the capital market. This target should be achieved by adding together two components: a) market price and b) subsidies

e. Reasonable return is foreseeable with respect to a standard facility, but not with respect to a specific and certain plant. Consequently, to the extent that a specific plant equals or improves the standards that serve as the basis for building a standard facility, said plant will reach a reasonable return.

f. Regardless of the specific model of remuneration established in the successive regulations, said models have been subject to the principle of financial sustainability of the SES and the principle of reasonable return.

352. Similarly, if we consider that the party made their investment May 2012, the opportunity would have existed for some time for its qualified advisers to explain the settled case law of the Supreme Court of the Kingdom of Spain which, since 2005, establishes the rights of investors in the event of changes in the remuneration models of the SR. Case law which, as with Article 30 (4) of Law 54/1997, has remained intact to date. This case law is based on the following points:

- there is no right to an economic system not being changed;
- an amendment cannot be challenged neither on the basis of the principle of legal certainty nor on that of legitimate expectations;
- until such time as Article 30(4) of Law 54/1997 is amended, the only limit that must be respected by the Government in policy changes is to grant the facilities of RE a reasonable return with reference to the cost of money in the capital market.
- the integration of the facilities of the RE within the SES results in companies having to assume some regulatory risk.

353. In May 2012, when the Claimant made its investment, it was aware that all changes to the economic regime of wind farms had been made for two reasons: (i) To guarantee the economic sustainability of the SES and (ii) to eliminate situations of over-retribution. Similarly, it was aware that all of these changes were made without any change taking place in the wording article 30 (4) of Law 54/1997.

(2) Royal Decree 2818/1998

354. This RD 2818/1998 was the first regulatory development of Article 30.4 of Law 54/1997. Its aim was to establish: *"a system of temporary incentives for those facilities that require them in order to place them in a competitive position in a free market*[190]". (Emphasis added)

355. This Regulation promoted the development of Special Regime facilities and established a remuneration framework based on a *subsidy* (Premium) that complemented the market price of the energy produced, plus a supplement for reactive energy.[191]

[190] Royal Decree 2818/1998. R-0098.

[191] Articles 26 and 28 of RD 2818/1998.R-0098. Regarding the reactive energy supplement we must remember that it did not always mean an income in favour of the producer. Its payment was conditional upon the output factor with which the energy was transferred to the distribution company. This way if the output factor was higher than 0.9 the producer would be entitled to receive the supplement. However, if the power factor was less than 0.9 the producer would suffer the corresponding discount.

356. However, wind technologies could choose not to apply the system of a market price plus a premium and obtain instead a total price to be earned as a certain amount of pesetas per KWh[192].

357. Royal Decree 2818/1998, provided that all the production facilities under the special regime be registered in an Administrative registry. This Registry allowed the government to keep track of the rates and premiums, by type of energy, on the installed capacity and, where applicable, the date of commissioning. It also allowed it to know the evolution of the electricity produced, the energy transferred to the network and the primary energy used.[193] The creation of this registry - subsequently called the Administrative Registry of Electrical Energy Production Facilities (hereinafter, the "**RAIPRE**")[194] - proves the desire of the legislator to verify, in any event, compliance with the targets for renewable energies.

358. The Arbitral Tribunal's attention is called to the fact that in the Administrative Registry, all the facilities, both Ordinary and Special Regime, were registered[195]. The RAIPRE is a mere section of the Administrative Registry, Section Two[196]. Registration in this Registry was not, therefore, a State commitment to maintain indefinitely the future profitability of the facilities registered therein, but a way to control and know those involved in the SES.

359. The aforementioned registration is not a novelty introduced by RD 2818/1998. Said Registry existed under RD 2366/1994[197]. It was then established, as in 1998, also to control the proper monitoring of energy planning.

360. RD 2818/1998 does not recognize at any time the grandfathering of the subsidies. On the contrary, Article 32, under the heading *"changes in premiums and prices"* provides reviews every four years of the premiums, according to the following criteria: (a) changes in the price of electricity on the market, (b) participation of these facilities in the coverage of demand and (c) their impact on the technical management of the system.

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[192] Royal Decree 2818/1998, article 28 (3). R-0098.
[193] Royal Decree 2818/1998, article 9.1. R-0098.
[194] RD 661/2007 introduces this name. R-0101.
[195] Law 54/1997, of 27 November, on the Electricity Sector. Article 21: "[...] 4. At the Ministry of Industry and Energy, an Administrative Registry of Electricity Production is created [...] 5. Registration in the Administrative Registry of Electricity Production Facilities will be required to participate in the market for electricity production in any of the types of contracts with physical delivery.
6. [...] Failure to comply with the conditions and requirements established in the authorizations or any substantial variation in the budgets that determined their award may lead to its revocation, under the terms provided for in the applicable penalty system. [...]". R-0003.
[196] RD 661/2007, Article 9.1 R-0101.
[197] Royal Decree 2366/1994, of 9 December. Article 6: "1. For the proper monitoring of energy planning, both in terms of installed capacity and the evolution of the energy produced and the primary energy used, a General Registry of Special Regime Production Facilities is created at the Directorate General of Energy of the Ministry of Industry and Energy, without prejudice to those in the Autonomous Communities. 2. Registration of an installation in the relevant Registry, according to the competent authority for granting the authorisation, will be a prerequisite in order to apply the special regime to that installation, as covered by this Royal Decree." As can be seen, the content of Article 6 of the Royal Decree of 1994 is very similar to Article 9 of Royal Decree 2818/1998. R-0222

361. That is, a mandatory review was expected based on the above criteria, without prejudice to the fact that other circumstances or criteria such as those relating to the economic sustainability of the electricity system or the reasonableness of the profitability received by the facilities, would make it possible to undertake, at any time, reforms other than those provided for in this article.

362. In any case, it is clear that no investor could undertake an investment trusting in the grandfathering of the remunerative regime established by RD 2818/1998. In fact, this remuneration regime was characterized by its volatility, since as it was indexed to the pool, the expectation of income of the investor in REs floated over the pool.

363. However, under this framework it began a sustained development of wind energy. Therefore, this framework was stable enough to allow the funding of projects that required a high investment in fixed assets in a long-term time horizon.

(3) Renewable Energy Promotion Plan 2000-2010

364. In application of LSE 54/1997[198], in December 1999 the Development Plan of Renewable Energies 2000-2010 was approved[199] (hereinafter, **"PFER"**). The close link between bonuses (cost of the SES) and the economic sustainability of the SES require the rollout of renewable technologies and their impact on the sustainability of the SES to be planned with due detail.

365. The planning described is developed in *"Renewable energy plans"*. In these Plans, the costs to the SES that the deployment of renewable energy involves are assessed in terms of the profitability that it is foreseen will be granted as *reasonable*[200]. Therefore, the Plan looks at whether those costs are *sustainable* for the SES in the foreseeable energy scenario. Consequently, the Renewable Energy Plans constitute an essential regulatory instrument.

366. Thus, the PFER 2000-2010 set the targets for implementation of REs for a baseline scenario of an annual increase in electricity demand at 2%[201].

367. Under that scenario, the PER 2000-2010 conducted a thorough analysis, among others, of wind[202] technology. In this Plan: (i) the status of these technologies in the EU is analysed; (ii) the degree of implementation in Spain is described, addressing: its current situation and its potential, the technological aspects, regulatory aspects, environmental aspects, economic aspects and existing barriers; (iii) the measures necessary to remove barriers are specified and (iv) finally, the implementation targets for 2010 are set.

[198] Law 54/1997 on the Electricity Sector, Sixteenth Transitory Provision. R-0003.
[199] Renewable Energy Promotion Plan 2000-2010. R-0118.
[200] Ibid pages 276-279. R-0118.
[201] Ibid, paragraph 31. R-0118.
[202] Ibid, pages 66 to 80.. R-0118.

368. In any case, for wind and hydroelectric technologies, the PFER in addressing the necessary measures to achieve the targets, indicated that it was not necessary to increase the remuneration to such technologies:

> *"It is a sufficiently developed and implemented technology whose economic viability is assured with merely maintaining the current policy on premiums for electricity production"*[203]

369. To do so, the PFER established the economic conditions and basic techniques and methodology to be followed for determining the remunerative regime of the RE, which should be implemented by regulation.

370. Specifically, this methodology consisted (and has always consisted) of defining, within each technology and according to the state of the art existing from time to time, different *standard facilities*. Once these *standard facilities* had been determined, different *standards* were established in each one of them (investment cost, operation cost, useful life of the plant, hours of rewarded production, market price) that allowed such plant to reach, in a given period of time (useful life), a reasonable return according to the cost of money in the capital market[204]. The profitability of the *standard projects* is estimated at *"7% with own resources, before financing and after tax"*[205].

371. In this sense, the PER 2000-2010 noted:

> *"Taking as a baseline the proposed energy objectives, the financing requirements have been determined for each technology according to its profitability, defining a range of* ***standard projects*** *for the calculation model. These standard projects have been characterised by technical parameters relating to their size, equivalent hours of operation, unit costs, periods of implementation, lifespan, operational and maintenance costs and sale prices per final unit of energy. Similarly, some financing assumptions have been applied, as well as a series of measures or financial aid."*[206]

372. RD 436/2004 was issued in order to achieve by 2011 the targets of installed capacity planned in the PFER.

(4) Royal Decree 436/2004

(4.1) It introduces a new remunerative regime

373. Under the force of Royal Decree 436/2004 (hereinafter, **"RD 436/2004"**) six wind facilities of the Claimant were set into motion: Marmellar, Lodosa, el Perul, Lastra, Lora I and Lora II.

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[203] Ibid, pages 201 and 203. R-0118.
[204] Ibid, pages 200-218. R-0118.
[205] Ibid, paragraph 182. R-0118.
[206] Ibid, paragraph 180. R-0118.

374. RD 436/2004, of 12 March,[207] repealed RD 2818/1998, in order to achieve the objectives of the PFER and eradicate the volatility of the previous system of calculating the remuneration of the REs. All of this was always subject to the principles of economic sustainability of the SES and permitting a reasonable return, according to the cost of money in the capital market enshrined in Law 54/1997. The characteristics of the remuneration system of RD 436/2004 were:

a. The remuneration to investors in REs is integrated within the SES. It is not, therefore, isolated from it.

b. It fixes the subsidies using the calculation methodology contained in the PER 2000-2010. This methodology involves identifying the economic exploitation structure of each technology *(standard facility)*, and within each standard facility, in accordance with certain standards (useful life, equivalent operating hours, unit costs, execution periods, operation and maintenance costs and selling prices of the final energy unit) setting a remuneration that is sufficient to achieve a given profitability target. This methodology, which also applies in RD 661/2007, also applies to the calculation of the remuneration of REs today.

375. At this point it is relevant to note the consideration contained in the Economic Report of RD 436/2004. In this report it states:

> *"The A parameter (cost of investment, operation and maintenance of each technology) has great weight in setting the amount of the regulated fee for sale to the distributor. Thus, we ensure that any plant in the special regime installed in Spain, provided that it is equal to or better than (the* ***standard plant****) of its group, will obtain a reasonable return"*[208].

376. From the above it follows that the subsidies established in RD 436/2004 are not intended to grant an indeterminate profitability. These subsidies respond to a specific methodology aimed at granting a *standard facility* a reasonable return over a given period of time. Furthermore, with Royal Decree 436/2004 having been approved based on the forecasts of the 2000-2010 PFER, the useful life used as the reference for calculating the subsidies was the useful life provided for in the plan itself, which is 20 years for wind facilities.

377. On this basis, the Royal Decree defined a system based on the free will of the owner of the facility, which could choose between (i) selling its production or surplus electricity to the distribution system, receiving remuneration in the form of a regulated tariff or (ii) selling such products directly on the daily market, receiving in this case the price traded in the market, plus an incentive for participating in it and a premium, if the particular facility was entitled to it.

378. In any case, as indicated by its preamble:

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[207] Royal Decree 436/2004, dated 12 March, establishing the methodology for the updating and systematisation of the legal and economic regime for electric power production in the special regime. R-0100.

[208] Financial Report of RD 436/2004 R-0014.

> *"Whatever the remuneration mechanism chosen, the Royal Decree guarantees the operators of special regime facilities reasonable remuneration for their investments and electricity consumers a likewise reasonable allocation of the costs attributable to the electricity system (...)"*[209].

379. As noted, RD 436/2004 essentially changed the previous remunerative regime. This is what was understood by the Asociación Empresarial Eólica (hereinafter, "AEE"), which stated that:

> *"Electricity production under the special regime has experienced in 2004 a change which, for wind generation, clearly goes beyond what has also been a redefinition of the economic model on which this electrical activity is based."*[210]

380. Under the new model, the Tariff, or as the case may be a Premium and the incentive, consisted of a multiple of the Average Reference Tariff (hereinafter **"TMR"**). In the case of wind power, in the tariff option, the incentive decreased as the years of use of the facility increased. Specifically, the facilities would receive a tariff equal to 90 percent of the TMR during the first five years of its commissioning, 85 percent over the next 10 years and 80 percent thereafter[211].

381. The TMR was set by the Regulator in response to the procedure set by RD 1432/2002[212] and determined the selling price of electricity to consumers. It was

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[209] Preamble of RD 436/2004. R-0100.

[210] Spanish Wind Energy, overview 2004, page 13. R-0223.

[211] The possibility that the remuneration to be received by the existing facilities declined over time was endorsed by the CNE in its report of 22 January 2004 on the Royal Decree proposal which established the methodology for the updating and systematization of the legal and economic regime of the special regime activity:
"The application to existing installations of the new regulated tariff regime, which includes a decrease as the years pass, does not mean retroactivity, since it is only a compensation formula based on costs. Furthermore, it should be noted that during the five years of RD 2818/1998 the existing facilities have received remuneration that equals or exceeds the remuneration now being proposed for the first years of life. For example, wind has received during the last five years remuneration above 90% of the average price of electricity, which is what is set in the proposal for the first phase of its economic life (...) Therefore, we can say that the application at this time of declining remuneration as the economic life moves forward does not harm existing facilities, as these facilities have already received or are receiving a remuneration equal to or exceeding that set in the proposal for the first part of their economic life."
Speaking of the transitional regime, it adds: "Production facilities included in the special regime are entitled to receive a certain remuneration for the energy sold, but obviously they only have the vested right to receive such compensation relative to the energy already sold, but not with respect to the energy they foresee selling in the future, which is only an expectation.
The Second Transitional Provision of the draft Royal Decree does not therefore violate the principle of non-retroactivity of rules restricting rights, and it cannot be regarded that since it is a transitional provision it cannot modify "pro futuro" the regime established in Royal Decree 2818/98, without affecting any vested right.
Nor can it be considered that it is violating the principle of non-retroactivity of restrictive rules due to the fact that for the purposes of calculating the compensation for each installation it takes into account the age of the same (Articles 34.1,34.2, 35.1, 36.2, 37.1 and 37.2, all of the draft Royal Decree), since it is simply a calculation rule, which besides being reasonable, is only taken into account in setting future remuneration, that is, for the energy sold in the future, not for that already sold under other legislation." R-0126.

[212] RD 1432/2002. R-0099.

subject to variables such as electricity demand, generation costs, inflation, capital costs, which are volatile variables.

382. The difference between the tariff and premium did not break the remuneration duality imposed by Article 30.4 of the LSE 54/1997 with the aim of permitting REs facilities to reach a reasonable return in accordance with the cost of money in the capital market: *market price + subsidy*. They were two different ways to articulate the subsidy. One by contemplating an activity without risk, regulated tariff; and the other with a certain risk, market price plus premium. In either case the aim of the remuneration was to provide a reasonable return to the facility[213]

383. It should be clarified that the market price plus premium option does not respond only to the aim of giving the plants a reasonable return. This incentive was established in order to encourage the participation of REs in the market. To that end, if the facilities chose the market option, they were paid an incentive to cover the extra cost involved in participating in the market.

384. As with the previous RD 2366/1994 and 2818/1998, RD 436/2004 maintained the requirement that all production facilities in the special regime register with an administrative registry.

385. As with the preceding Royal Decrees, this Registry was established in 2004 in order to allow the government to keep track of the rates and premiums, by type of energy, on the installed capacity and, where applicable, the date of commissioning. It also allowed it to know the evolution of the electricity produced, the energy transferred to the network and the primary energy used.[214] The creation of this Registry (known as the RAIPRE from 2007 onwards)[215] demonstrates the intention of the legislature to verify, in any case, compliance with the targets set in the Plan for the Promotion of Renewable Energy in Spain 2000-2010.

386. Registration in this Registry was not, therefore, a State commitment to maintain indefinitely and unalterably the future profitability of the facilities registered therein, but a way to control and know those involved in the SES.

387. As we already stated, under the validity of Royal Decree 2366/1994 and Royal Decree 2898/1998, multiple wind farms began their operation. All of these facilities were registered in the corresponding Administrative Registry. However, said registration did not prevent the new remuneration model established by RD 436/2004, based on the TMR, from being applied to all these facilities. Therefore, through registration, they did not acquire a right to maintain the previous remuneration model.

[213] Report of the CNE 4/2004, dated 22 January 2004, on the Royal Decree proposal establishing the methodology for the updating and systematisation of the legal and economic regime for the activity in the special regime. Pages 16 to 22. R-0126.
[214] RD 436/2004, Article 9.1. R-0100.
[215] RD 661/2007 introduces this name. R-0101.

(4.2) It did not guarantee the grandfathering of the premiums and tariffs.

388. RD 436/2004 does not contain any grandfathering of the remunerative regime contained therein. It is sufficient to observe the wording of Article 40.3 of Royal Decree 436/2004 to determine that it is not a stabilization clause.

389. Thus, Article 40.3 of Royal Decree 436/2004 provides that:

> *"Article 40. Revision of tariffs, premiums, incentives and supplements for new facilities.*
>
> *1. During 2006, in view of the results of the monitoring reports on the degree of achievement of the Plan for the promotion of renewable energy, the revision of the tariffs, premiums, incentives and supplements defined in this royal decree will be conducted, based on the costs associated with each of these technologies, the degree of participation of the special regime in covering demand and its impact on the technical and economic management of the system. Every four years starting from 2006, a new revision will be performed (...).*
>
> *3. "The tariffs, premiums, incentives and supplements resulting from any of the revisions referred to in this section shall apply only to the installations that become operational after the date of entry into force referred to in the preceding paragraph, without retroactivity to previous tariffs and premiums"*[216] *(Emphasis added)*

390. The article does not refer to *"any"* revisions of the premium, the regulated tariff and complements[217]. This is very relevant for the purposes of this arbitration because that article confines its scope exclusively to the revisions provided in *"this section"*. That is, it only refers to the revisions that are intended to control the degree of achievement of the implementation targets of REs established in the PFER and which necessarily must be performed "in 2006", and subsequently, every 4 years.

391. A reading of the transcribed article leads to a simple interpretation *"a sensu contrario"* that, apart from the revisions provided in Article 40(3), other different revisions could exist. That is, RD 436/2004 did not anticipate, nor did it have any reason to foresee, all the possible regulatory changes that may have been necessary to ensure the sustainability of the SES and the principle of reasonable return contained in Law 54/1997. Such revisions were already guaranteed and permitted by the principle of hierarchy.

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[216] Royal Decree 436/2004, article 40. R-0100.

[217] This is a conscious error by the Claimant, which is based on this section 40.3, in order to hold before the Arbitral Tribunal that: "*RD 436/2004 increased the level of incentives and expressly included a stability clause whereby **any** change in the tariffs would not apply to installations that had already commenced operation. Spain's express promises that **any** future downward adjustments in the tariffs would not apply to existing investments*" Para 267 of the Memorial on the Merits. A simple reading of Article 40.3 excludes the biased and ulterior interpretation of the Claimants.

392. Furthermore, if we stick to the literal wording of Article 40(3) it only refers to the revisions *"of the tariffs, premiums, incentives and complements."* It does not refer to anything else. Therefore, no investor could consider frozen in their favour aspects other than those under the regime of RD 436/2004. These are: (1) years of life of the plant during which subsidies were received, (2) hours of subsidized production, and (3) updates to the subsidies under the TMR.

393. In fact, as we shall see below, Article 40(3) of Royal Decree 436/2004 did not prevent, in circumstances beyond those provided for therein, the Regulator from choosing:

- Freezing in 2006 the variable subsidies of RD 436/2004.
- Repealing in 2007 and replacing the remunerative scheme for a new one.

394. And all this for a simple reason. The change of the remuneration scheme was not due to the periodic review under Article 40(3), but rather the need to ensure the sustainability of the SES and to respect the principle of reasonable return, in accordance with the cost of money in the capital market.

395. Moreover, in the event a diligent investor had any doubts, the evolution from the model included in RD 2818/1998 to that of RD 436/2004 resulted in the first rulings of the Supreme Court of the Kingdom of Spain. In 2005 it formed its case law on the remuneration of the Special Regime[218] and this has remained constant until today. Since 2005, any diligent investor knew or should have known that the RE facilities are not entitled to a *specific* remunerative regime nor to the remuneration set at a given time *being received throughout the operational life* of the facilities.

(4.3) RD 436/2004 led to perverse effects for the sustainability of the SES

396. Linking the RE subsidies to the TMR involved a potential risk to the economic sustainability of the SES. This was because the TMR was calculated on the basis of the costs of the SES themselves, including subsidies to the RE. Therefore, a constant feedback arose in the mechanism for setting premiums: the premium was a percentage of the TMR which, in turn, was calculated taking into account the increase in the amount of the premiums. This constant feedback meant a disproportionate increase in the costs of the SES.

397. By 2006, the weight of REs (especially wind) in the SES already represented 17% of the total production[219]. The problem of cost overrun was compounded in light of the planning targets established in the PER 2005-2010, which will be discussed below and would have meant a greater participation of the RE in electricity generation.

398. Additionally, since the adoption of RD 436/2004 there was an extraordinary increase in the market price of energy, due to the rise in oil prices and the inclusion of

[218] Section IV.D of this writing.
[219] PFER 2000-2020, P. 18. R-0118.

the emission rights of greenhouse gases in the price of energy. Thus, the price of energy reached as high as 50-60 Euros/MW.

399. This meant that, in a situation where all the facilities were applying the regulated tariff option, another situation arose where the majority of the installations opted for compensation according to the market price plus premium, obtaining a much higher return than provided by the Regulator. In particular, 96% of wind farms were applying the market option, and the profitability of the wind farms had increased from 8% to 15% (even reaching 26% with funding).

400. As a result, the Regulator urgently approved RD Law 7/2006, of 23 June. This regulation, in its Preamble, highlighted the inefficiency of the current remuneration system. Therefore, its Second Transitory Provision froze the RE subsidies until a new remuneration system was implemented based on the modifications that RD-Law 7/2006 introduced into Law 54/1997[220]. These changes included the untying of premiums from the TMR. Therefore, updating the TMR operated by RD 809/2006, of 30 June, according to which the electricity tariff is revised from 1 July 2006, was not applicable to the premiums and tariffs of the RE.

401. RD-Law 7/2006 led to a cut in the remuneration in force under RD 436/2004. The aforementioned RD-Law was widely criticized by renewable energy producers and industry associations. The latter considered the measure retroactive and demanded greater regulatory stability through the adoption of a Renewable Energy Law.[221]

402. In particular, the APPA Association, in its report from May to July 2006, used the following adjectives to describe Royal Decree-Act 6/2007:

> *"On the other hand, RD-L 7/2006 was released as in days of old: at night and with treachery: without prior consultations with stakeholders and, against the word repeatedly given, the rules of the game were changed in the middle of the game. Vested rights have been changed retroactively"*[222]

403. Furthermore, the leading associations of the renewables sector, AEE, ASIF and APPA sent a joint letter to the Minister of Industry on 26 July 2006 where, in relation to RD-L 7/2006 and the reform of the remuneration model of renewables which said

[220] Royal Decree-Law 7/2006, of 23 June, establishing urgent measures in the energy sector. Second Transitory provision. "Until the regulatory implementation of the provisions contained in paragraphs one to twelve of Article 1 in accordance with the provisions of the second final provision of this Royal Decree-Law: 2. The revision of the average rate performed by the Government shall not apply to prices, premiums, incentives and tariffs that form part of the remuneration of the activity of production of electricity in the special regime" R-0088.

[221] "Review Economic Regime of Renewable Energy; Report on APPA proposals", November 2006. R-0224.

[222] "The Controversial Energy Decree-Law", APPA Info magazine no. 22, May –July 2006. Editorial. R-0015.

RD-Law announced, they requested the *"immediate cessation of the ongoing regulatory process."* These associations then said[223]:

- *"the appearing business associations can only express their rejection, their deepest discomfort and most serious concern, both in substance and in the ways in which the process is being carried out."*
- *"RD-L 7/2006 substantially breaks the regulation of renewable energy established in the Electricity Sector Law (Law 54/1997)"*
- *"RD-L 7/2006 abolishes the objective parameters that set the minimum remuneration for the various renewable energies included in the Law. These minimums were the guarantee of stability, predictability and durability that have attracted investment to the sector* (...)"
- *"This situation, already compromised and disconcerting, is further compounded when it is learned that the planned revision of RD 436/2004 is becoming the delivery system for a new regulatory framework- in which none of the signatory associations was able to take part before it will be made public through the CN- whose remuneration criteria are clearly and objectively discouraging for addressing the development of the projects planned under the 2005-2010 Renewable Energies Plan (PER), approved by the Cabinet on 26 August 2005."*
- *This approach would cause a widespread adverse reaction by investors and financial institutions in a very difficult economic situation that could lead to the deactivation of the renewable energy sector"*

404. In the month of December 2006, the APPA association continued to criticise this RD-Act 7/2006:

- *"Royal Decree 436/2004 [...] is conditioned both by the elements of* ***retroactivity and legal uncertainty*** *introduced in the sector by the aforementioned RD-L 7/2006."*
- *"Last June, Royal Decree-Law 7/2006 was approved, which contains a* ***frontal attack*** *against the national policy of promoting renewables: it eliminates the 80-90% band and the retributive stability mechanisms [of RD 436/2004], without also contemplating the guarantees and timeframes established. The regulation, which breaks the rules of the game in the middle of the match, introduces* ***retroactivity*** *and* ***grievously breaks*** *the legitimate expectations of the investors."*[224] (Emphasis added)

405. The new remuneration regime which announced RD-Law 6/2007 was implemented by RD 661/2007 which we discuss below.

[223] "The Controversial Energy Decree-Law", APPA Info magazine no. 22, May –July 2006. Editorial. R-0015.
[224] "RD-L 7/06 and review of RD 436/04. Storm in the renewable energy sector", APPA Info Magazine No. 23, August-December 2006. Editorial and page 9. R-0016

(5) The Renewable Energy Plan 2005-2010

406. Parallel to the approval of RD-Law 7/2009, the Renewable Energy Plan in Spain (hereinafter, the **"PER")** 2005-2010 revised the PFER 2000-2010, with a dual objective: (a) to maintain the commitment to cover with renewable energy sources at least 12% of total energy consumption in 2010 as part of the policies to promote renewable energy in the European Union and (b) to incorporate two other objectives not contained in the PFER 2000-2010 (29.4% of electricity generation from renewables and 5.75% from biofuels in transport).

407. For these purpose, the PER 2005-2010 followed the traditional methodology and established its profitability targets for the plants in a given period of time (lifetime) based on the calculation of the costs of the standard facilities for the various technologies and revenue forecasts, according to the prevailing macroeconomic circumstances.

408. Therefore, the PER 2005-2010 is essential to understanding the key aspects of the system of remuneration included in RD 661/2007.

(5.1) The PER 2005-2010 determined the implementation targets of wind and hydro technology

409. Within the reference energy framework, the PER 2005-2010 determined, for all the technologies, the deployment targets which could be aspired to for 2010.

410. To that end, in the PER 2005-2010, as did the PFER 2000-2010, it conducted a thorough analysis, among others, of wind[225] and hydro technology[226]. Specifically: (i) the status of these technologies in the EU was analysed; (ii) the degree of implementation in Spain was described, addressing: its current situation and its potential, the technological aspects, regulatory aspects, environmental aspects, economic aspects and existing barriers; (iii) the measures necessary to remove barriers were specified and (iv) finally, the implementation targets for 2010 were set.

411. Regarding wind technology, the PER highlighted its extraordinary development,[227] considering the wind targets set by PFER 2000-2010 prior to 2010 to be easily attainable, without the need to change the remunerative regime.

412. As regards hydro technology, the PER 2005-2010[228] stressed that this was a mature and well established technology. According to barriers detected in this Sector, the PER proposes a series of economic measures. The measure of increasing the subsidies of that technology is not among them.

[225] Renewable Energy Plan 2005-2010 pages 35 to 67. R-0119.
[226] Ibid, pages 69 to 95. R-0119.
[227] In this sense, the PER 2005-2010 highlighted that: "In 2004, 1920 MW were put into operation in Spain, a figure that well exceeds the average annual value set in the Development Plan for the period 2000-2006, estimated at 597 MW." R-0119.
[228] Ibid, pages 69 to 95. R.0119.

(5.2) Energy scenario in which the deployment of the RE of PER 2005-2010 is expected

413. The Renewable Energy Plan 2005-2010, as with the PFER 2000-2010, was based on forecasts of electricity demand. Thus, the PER 2005-2010 considered:

> *"(...) two general energy scenarios (called Baseline Scenario and Efficiency Scenario) and three other scenarios of development of renewable energies (Current, Likely and Optimistic), having chosen the baseline energy scenario as a reference for setting the targets of the Plan, and as the renewable energy scenario, the "Likely" scenario.*[229]

414. Consequently, the materialisation of the returns by type of technology that were included in the PER 2005-2010 was conditional on a certain scenario of primary energy consumption. This is, to an estimated evolution of electricity demand.

(5.3) Methodology used in the PER to quantify the cost of its targets

415. One of the main purposes of the PER was to determine the cost of achieving the implementation targets laid down therein. For this purpose, the PER 2005-2010, as the PFER 2000-2010 had done previously, described a methodology that had to be consistent with the economic sustainability of the SES:

> *"To make a success of its stated goals, a detailed assessment has been conducted of the investment that it is expected shall be made during the period, the nature of that investment and government support necessary to achieve the targets. The methodology and criteria of economic and financial analysis that were applied in the Development Plan in 1999 have been maintained. The analysis, based on the specificities of each technology —degree of maturity, costs, contribution to the global target—, is founded on the balancing of all the factors, such that it manages to achieve private and public profitability, mobilising the necessary resources to carry out the planned investments.*[230] *".*

416. The methodology used to determine this cost, as did the PFER 2000-2010 and the Economic Report of RD 436/2004, was explained as follows:

> *"Taking as a baseline the proposed energy objectives, the financing requirements have been determined for each technology according to its profitability, defining a range of* ***standard projects*** *for the calculation model.*
>
> *These standard projects have been characterised by technical parameters relating to their size, equivalent hours of operation, unit costs, periods of implementation, lifespan, operational and maintenance costs and sale prices per final unit of energy. Similarly, some financing assumptions have been applied, as well as a*

[229] Ibid, paragraph 323. R-0119.
[230] Ibid, paragraph 272. R-0119.

series of measures or financial aid designed according to the requirements of each technology." (Emphasis added)[231]

417. Specifically, according to the state of the technology at that time, 3 standard facilities were established for the wind energy sector and a further 3 for the hydro sector[232]. In all cases it set the different parameters required for each standard facility to reach a return on the project and with equity close to 7%[233] throughout its lifetime.

418. In this regard, the PER 2005-2010, in line with the PFER 2000-2010, established the following conception of profitability of *standard projects:*

419. *"**Profitability of standardised projects**: calculated on the basis of maintaining an Internal Rate of Return (IRR), measured in local currency and for each standardised project, close to 7%, with own capital (before financing) and after tax.*" (Emphasis added) [234]

(6) Royal Decree 661/2007

(6.1) Introduction

420. Under this Regulation, only two of the Claimant's plants began their operation: the Sargentes Wind Farm and the Arroyal Wind Farm.

421. The Claimant conveys a misinterpretation on the reason that justified the approval of RD 661/2007. It inaccurately claims that the only reason for the enactment was to improve incentives to achieve the objectives set by the EU. This statement is not supported by any evidence provided by the Claimants.

422. As previously stated, the motivation behind RD 661/2007 was a need to guarantee the economic sustainability of the SES, which could have been affected by a system of subsidies tied to the Average Reference Tariff (TMR). Furthermore, this risk was heightened through the new targets of implementation of renewables as established in the 2005- 2010 REP. In this regard, Mr Juan Ramón Ayuso points out:

> *"The Royal Decree 661/2007 entailed a review of the regulatory framework on remuneration in force in 2007, which was established by Royal Decree 436/2004. This review amended the regulated tariffs for special regime technologies for all existing facilities. It also amended the way in which these tariffs are updated, which went from being a direct percentage of the Average Reference Tariff (TMR) to be updated using the Consumer Price Index (CPI). In both cases, the tariffs were fixed from calculations based on standard cases.*
>
> *The TMR was defined in the Royal Decree 1432/2002 of 27 December as a relationship between the projected costs for remunerating the electrical energy*

[231] Ibid, paragraph 281 to 283 and 280. R-0119.
[232] Ibid, pages 285 to 288. R-0119.
[233] Ibid, paragraph 274. R-0119.
[234] Ibid, paragraph 274. R-0119.

supply activities and the forecast, for the same period, of the final consumption demand.

$$\boldsymbol{ARET} = \frac{\sum CSupply\ costs}{Demand} = \frac{Costs\ of\ production + transport + distribution...}{Consumer\ demand - Generation\ self-consumptions}$$

As it can be seen, the TMR average or reference tariff is calculated using an expression in which one of the factors (Production Costs) includes a term (Special Regime Costs), calculated based on the TMR itself, creating a feedback loop.

Therefore, if the installed power increased, the costs associated with the production of renewable energies also increased (special regime generation costs). When the formula described above was applied, this lead to an increase in the TMR.

This TMR increase immediately led to an increase in special regime production costs, as the regulated tariffs and premiums were a direct percentage of the TMR.

Thus, without changing any other parameter, the TMR would be increased again according to the formula of RD 1432/2002, which would lead to a further increase in production costs in special regime, and so on indefinitely, generating an escalation of artificial increase of in electricity system costs and over-remuneration of these technologies, which was broken with the publication of RD Law 7/2006, which applied to all existing facilities.

Not only did the link between the TMR and the regulated tariffs and premiums cause excess remuneration across all technologies, it also had an unfavourable effect on the economic sustainability of the SES. This effect on the sustainability became more acute if the renewables implementation targets established in the 2005-2010 REP, and the real installed power of some technologies, are taken into account.

RD 661/2007 implemented a new remuneration regime for all existing facilities that a priori avoided this perverse effect, which caused an unjustified increase in remuneration for all special regime technologies just through new plants coming on stream. This is without prejudice to the deficiencies that, a posteriori, resulted from application of the remuneration formula contained in Royal Decree 661/2007."[235]

423. The Claimant seems to forget that RD-Law 7/2006 called for a new development of Article 30(4) LSE 54/1997, consistent with the SES' principle of economic sustainability. Indeed, the Preamble of RD 661/2007 made clear the subjection to the principles of economic and technical sustainability of the SES and reasonable profitability:

"The economic framework laid-down by this Royal Decree develops the principles contained in Law 54/1997, of 27 November, on the Electricity Sector, ensuring the operators of special regime facilities ***reasonable remuneration on their***

[235] Juan Ramón Ayuso paragraphs 31 to 40.

> ***investments and electricity consumers a likewise reasonable allocation of the costs attributable to the electricity system"***[236]. *(Emphasis added)*

424. This entails that the various sections of RD 661/2007 cannot be analysed in isolation. These sections should be analysed harmonically and without contradicting the principles established in Law 54/1997. Indeed, the correct understanding of RD 661/2007 requires keeping in mind that the rates contained therein are the result of an important work of previous analysis carried out by the Regulator, on the basis of PER 2005-2010 and the methodology previously stated.

425. Regarding Royal Decree 661/2007, the following questions must be analysed: (i) the measures introduced by RD 661/2007 to ensure the SES' economic and technical sustainability (ii) the rates of RD 661/2007 as a means to achieve reasonable profitability according to the methodology known by any investor; (iii) the premiums and fees' subjection to the economic sustainability of the SES (ii) the impossibility that Article 44.3 of RD 661/2007 should preclude the adoption of measures to ensure the economic sustainability of the SES or maintaining the principle of reasonable profitability

(6.2) Measures introduced by the RD 661/2007 for the SES' economic and technical sustainability

(a) Measures introduced by the RD 661/2007 for economic sustainability

426. RD 661/2007, of 25 May, was enacted to eliminate the perverse effect that the previous system, based on the TMR, produced for the SES' economic sustainability. The Preamble of RD 661/2007 stipulates:

> *"The economic circumstances established by Royal Decree 436/2004, of 12 March, due to the behaviour of market prices, in which lately some variables not contemplated in the aforementioned remuneration regime of the special regime have been more relevant, make it necessary to modify the remuneration regime and de-link it from the Average Electricity Tariff, or Reference Tariff, which has been used to date."* [237]

427. Therefore, the RD 661/2007, within the limits of Article 30.4 of Law 54/1997, was a change of the remuneration regime to the existing RE used to date. Thus, it decouples subsidies from the TMR and updated them on the basis of an adjusted Consumer Price Index (hereinafter **"CPI")**. In this regard, the rates were indexed to the CPI, although not directly, but limiting their update by subtracting the CPI 25 basis points until 31 December 2012 and 50 basis points thereafter[238].

[236] RD 661/2007. R-0101.
[237] RD 661/2007. R-0101.
[238] RD 661/2007, Article 4 and First Additional Provision. R-0101.

428. In addition, the choice between regulated tariff and pool plus premium was kept but not for all technologies[239]. However, with regard to the pool plus premium option, maximum and minimum limits were established ("cap and floor") in order to avoid what happened under the previous remuneration regime, that an unforeseen increase in pool prices could lead to over-remuneration situations (or under-remuneration if any), which could jeopardize the economic sustainability of the SES. As the Preamble to the RD 661/2007 states:

> *"This new system protects the promoter when the revenues deriving from the market price falls excessively low, and eliminates the premium when the market price is sufficiently high to guarantee that their costs will be covered, thus eliminating irrationalities in the payment for the technologies the costs of which are not directly related to the prices of petroleum in the international markets."*[240] *(Emphasis added).*

429. This new remuneration regime would apply to all facilities, even those which were already in operation since 31 December 2012. Indeed, the First Transitory Provision of RD 661/2007 eliminated the possibility that the facilities, which according to RD 436/2004, opted for selling electricity at market price plus premium, would keep on benefiting from this form of subsidies from 2012. The facilities benefiting from this option would continue to receive premiums (complementary to market price) provided for in RD 436/2004 until 31 December 2012. From that moment, they would then be governed, according to their economic regime, as provided in RD 661/2007[241].

430. However, said transition period did not contemplate the entire application of Royal Decree 436/2004. The transition period, while it was in force, prevented the premiums from being the object of update. These subsidies during the transition period were frozen. They would not be updated either according to the TMR, the model provided for in Royal Decree 436/2004, or according to the CPI, the model provided for in Royal Decree 661/2007.

431. All the Claimant's facilities subject to Royal Decree 436/2004 decided to avail themselves of the transition period. If, as the Claimant states, Royal Decree 661/2007 improved the remuneration conditions of the plants in comparison with Royal Decree 436/2004, it is not understandable that all the Claimant's plants would decide to remain temporarily in a less advantageous remuneration model.

432. Therefore, it is clear that the First Transitory Provision of RD 661/2007 had an economic impact on the subsidies that Wind power plants opting to keep RD 436/2004 premiums would receive until 31/12/2012, since those premiums were not updated since 2006 and would not be updated until 2012.

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[239] For example, the photovoltaic technology during the term of Royal Decree 436/2004 the two options could be used, after the entry into force of Royal Decree 661/2007 only the regulated tariff option could be used.
[240] RD 661/2007, Preamble: R-0101.
[241] RD 661/2007. First transitory provision. R-0101.

433. Neither the draft of Royal Decree 661/2007 nor its final approval was well received by the Wind Energy sector, as they involved a cut in their remuneration regime[242]. Proof of this is that virtually all facilities, including the Claimant's wind farms, benefited from the transitory pool plus premium option of RD 436/2004, considering it most advantageous.

434. Further proof that this regime change resulted in a decrease of the remuneration received by producers in RE comes from the appeals against the RD 661/2007 and more specifically against its First Transitory Provision lodged by Renewable Energy Producers. The Supreme Court Ruling of 3 December 2009, when determining one of these challenges, confirmed its previous case law:

> *"the accusation formulated against the First Transitory Provision, section 4 of the challenged Royal Decree, is unfounded in breach of the principle of legitimate expectations, since the recurring commercial entities, as companies operating in the generation of electricity (...) do not have a right to keep the remuneration regime of the electric power sector unchanged. [...] As we held in the ruling of this Court of Administrative Litigation of the Supreme Court on 15 December 2005, "«there is no legal obstacle for the Government, in exercise of its regulatory power and the broad authorisation which it has in such a heavily regulated field such as the electrical field, to modify a particular remuneration regime, provided it remains within the framework established by the LSE»"*[243].

(b) Measures introduced by RD 661/2007 on the SES' technical sustainability

435. Regarding the SES' technical sustainability, the Preamble to the RD 661/2007 reasoned that:

> *"(...) the growth seen in the special regime over recent years tied to the experience accumulated during the application of Royal Decree 2818/1998, of 23 December and Royal Decree 436/2004, of 12 March, has shown the need to regulate certain technical aspects in order to contribute to the growth of those technologies, while maintaining the security of the electrical system and ensuring the quality of supply."*[244]

436. RD 661/2007 required that, (I) all facilities under the special regime with a power greater than 10 MW must be attached to a generating control centre, which shall act as contact with the operator of the system[245] and (ii) certain response requirements must be met in response to voltage voids for wind facilities[246]. Compliance with these

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[242] The press became aware of the over-remuneration situation that the wind farm had experienced under the previous regime, as well as the discontent of the sector before the announcement of the reform of such regime. In this regard, the annexed R-0159, R-0160, R-0161 and R-0162 news are provided.
After the reform, the Spanish Wind Energy Association (hereinafter "AEE") itself showed the decline in the remuneration resulting from the implementation of RD 661/2007. R-0163, R-0164 and R-0184.
[243] Judgement of the Spanish Supreme Court of 03 December 2009, rec. 151/2007. R-0141.
[244] RD 661/2007, Preamble: R-0101.
[245] RD 661/2007, Article 18.d). R-0101.
[246] RD 661/2007, seventh additional provision. R-0101.

requirements was considered essential to enable proper operation of the system in safety conditions and, as a result, to enable maximum integration in the SES of the RE technologies.

437. For Wind Power facilities previous to 1 January 2008, RD 661/2007 established 1 January 2010 as the deadline to meet the response requirements to voltage voids. Failure to comply with this obligation meant the lost of the right to receive the premium or, where appropriate, equivalent premium for the energy produced. It is therefore evident that RD 661/2007 required new obligations from wind farms aimed at ensuring the SES' technical sustainability, with an economic impact.

438. That obligation was not any agreement between the companies in the sector and the Government to maintain the remuneration regime, as the Claimant seems to understand. It was an obligation imposed in order to ensure the SES' technical sustainability, which could be compromised by the penetration of RE in the SES.

439. In addition, RD 661/2007 regulated the reactive power supplement for maintaining certain power factor values. The supplement should be reviewed annually.[247]

(6.3) RD 661/2007 Premiums and fees as a means to achieve reasonable profitability

440. The subsidies set in RD 661/2007 were the means to achieve reasonable profitability in accordance with the methodology known to every investor.

441. The Claimant argues that RD 661/2007 agreed to pay subsidies in any option, for all production and throughout the useful life of the facilities. This statement seems to ignore that rates respond to the reasonable profitability target required by Law 54/1997. This also means accepting the ridiculous assumption that rates appear spontaneously, regardless of any previous analysis activity. Quite the contrary, any investor that had been being given the slightest advice would have known that the subsidies established in Royal Decree 661/2007 were tied to the macro-economic, technical and methodological bases set forth in the 2005-2010 REP.

442. Specifically, subsidies collected in RD 661/2007, both in the regulated tariff and the pool plus premium option were fixed with the aim of providing standard facilities a return **"next to 7%"** during their useful life, with own capital (before financing) and after taxes." This was anticipated in PER 2005 - 2010 as previously proven.

443. At this point, it is revealing to note that the Report on Regulatory impact of Royal Decree 661/2007, responding to the methodology used in the PFER 2000-2010, Economic Memory of Royal Decree 436/2004 and PER 2005-2010 pointed out:

> *"The regulated tariff has been calculated in order to ensure a return between 7% and 8% depending on the technology. Premiums have been calculated following*

[247] RD 661/2007, Article 29. This permits, however, that the facilities opting to sell their energy on the market and comply with certain technical requirements, could waive this supplement and voluntarily participate in the procedure of controlling voltage, applying their own remuneration mechanisms. R-0101.

the same criteria as in Royal Decree 436/2004, that is, the premium is calculated as the difference between the regulated tariff and the expected average market price by these technologies " [248]

444. The Report on Regulatory impact stated regarding wind power technology:

"The two selling options are kept. In the case of market option, the value of the premium to be received by energy generated will vary, depending on the set limits. (...)

Therefore, the current tariff staggering has been kept, although amounts have been calculated so that wind projects provide a reasonable profitability, for the standard cases considered.

With the expected remuneration, the profitability would be 7% in the regulated tariff option, and limited between 5 and 9%, in the case of the market sale option"[249]

445. In this sense the Manual *"Powering the Green Economy. The feed in tariff handbook* "after analysing the Spanish regulatory framework noted that the tariffs contained in Royal Decree 661/2007 are intended to provide a specific objective of reasonable profitability on investment.

"*Different names have been used to describe the tariff calculation approach based on actual cost and profitability for producers. The German FIT scheme is based on the notion of "cost-covering remuneration", the Spanish support mechanism speaks of a "reasonable rate of return" and the French "profitability index method" guarantees "fair and sufficient" profitability. Despite the variety in names and notions, in all cases the legislator sets the tariff level in order to allow for a certain internal rate of return, usually between a 5 and 10 per cent return on investment per year*". [250]
(Emphasis added)

446. In the Spanish case, said manual is aware of the legislator's intention to grant a 7% return on investment,

"To give an example, the Spanish legislator calculated the tariffs based on 7 per cent returns on investment under the fixed tariff option, and 5-9 per cent under premium FIT option."[251]

447. The Manual goes on to state that:

"After a good frame of reference is established for tariffs, cost factors related to renewable electricity generation have to be evaluated. We recommend basing the calculation on the following criteria:

. Investment cost for each plant (including material and capital cost);

[248] The Report on Regulatory impact of Royal Decree 661/2007. R-0082.
[249] The Report on Regulatory impact of Royal Decree 661/2007. R-0082.
[250] Powering the Green Economy. The feed in tariff handbook., pag 19. RL-0062.
[251] Powering the Green Economy. The feed in tariff handbook., page 42. RL -0062.

. Grid-related and administrative cost (including grid connection cost, costs for the licensing procedure, etc);

. Operation and maintenance costs;

. Fuel Costs (in case of biomass and biogas); and

. Decommissioning costs (where applicable)"[252]

448. We must also remember that in the Spanish model the CAPEX and the OPEX have never been drawn up in reference to a particular installation of a particular investor. These costs have always referred to a *standardised* installation. Always imagining an efficient investor in terms of cost. Moreover, said Manual states:

> *"For the estimate of the average generation cost, regulators can use standard investment calculation methods (such as the annuity method). The Spanish legislator even obliges renewable electricity producers to disclose all costs related to electricity generation in order to have optimal information when setting the tariff"*[253]

449. The link between subsidies established by Royal Decree 661/2007 and the methodology contained in PER 2005-2010 has been so evident that the major consultancies Spain have emphasised that relationship.

450. The Deloitte expert report of 23 May 2011 estimates that the expected return is close to 7%. This expert report calculates the profitability of PV plants after RD 661/2007 at 6.41%, and after RD 1565/2010 it quantifies it at 5.43% or 5.77%. The Deloitte Expert Report of 23 May 2011 reflects the profitability that it considers "reasonable" within the regulatory framework of REs in Spain in 2011:

> *"The Spanish Renewable Energy Plan 2005-2010 (August 2005) of the Ministry of Industry, Tourism and Trade-Institute for Diversification and Saving of Energy, assumes that the profitability of a standardised project of renewable energy is 7%.*
>
> *Spanish Renewable Energy Plan 2005-2010 (August 2005).*
>
> *"Profitability of standardised projects: calculated on the basis of maintaining an Internal Rate of Return (IRR), measured in local currency and for each standardised project, close to 7%, with own capital (before financing) and after tax"*[254] *(emphasis added)*

451. In addition, the Deloitte experts make a comparison with a parameter that they consider comparable, the Spanish 10-year bond, to examine the profitability derived from RD 1565/2010 for the photovoltaic plants[255].

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[252] Powering the Green Economy. The feed in tariff handbook., page 20 RL-0062.
[253] Powering the Green Economy. The feed in tariff handbook., page 20. RL-0062.
[254] Expert Report DELOITTE. of 23 May 2011, page 57/177. R-0017.
[255] Expert report DELOITTE of 23 May 2011, page /177. R-0017.

452. In line with the above KPMG in its May 2012 report noted that:

> *"Concept of reasonable return:*
>
> *• The regulations governing the implementation of the Special Regime is based on the concept of reasonable profitability, mentioned in Law 54/1997 on the Electricity Sector but does not define a value for it.*
>
> *▪ In this report, a reasonable return shall be deemed to be a profitability of 7% (before financing) and after taxes, which is the reference value used in the PER 2005-2010 and used by the CNE in its reports."* [256]

(6.4) RD 661/2007 tariffs are subject to the SES' economic sustainability

453. The Claimant argues that RD 661/2007 included in Article 44 (3) a commitment to *"no"* future revision of the tariff established for plants that have enrolled the RAIPRE at the appropriate time. According to this precept:

> *The reviews referred to in this section of the regulated tariff and the upper and lower limits will not affect facilities whose commissioning certificate was awarded before 1 January of the second year following the year in which the review was carried out".* [257] *(Emphasis added)*

454. The contention of the Claimant is means disregarding that the special regime's subsidies are SES' costs and, therefore, are linked to its sustainability. As already noted, the periodic reviews under Article 40.3 of RD 436/2004 did not prevent freezing regime (and even its repeal) due to the need to ensure the sustainability of the SES or the principle of reasonable profitability. The wording of Article 40.3 of RD 436/2004 is virtually identical and even clearer than article 44.3 of RD 661/2007.

Article 40.3 of RD 436/2004	**Article 44.3 of RD 661/2007**
1. In 2006, in view of the results of monitoring reports on the degree of compliance with the Development plan for renewable energy, the revision of tariffs, premiums, incentives and supplements defined in this royal decree will be conducted, attending the costs associated with each of these technologies, the degree of participation of the special regime in covering demand and its impact on the system's technical and economic management. A new revision will be carried out every four years starting from 2006. 2. The tariffs, premiums, incentives and supplements resulting from any of the revisions	3. During the year 2010, on sight of the results of the monitoring reports on the degree of fulfilment of the Renewable Energies Plan (PER) 2005-2010, and of the Energy Efficiency and Savings Strategy in Spain (E4), together with such new targets as may be included in the subsequent Renewable Energies Plan 2011-2020, there shall be a review of the tariffs, premiums, supplements and lower and upper limits defined in this Royal Decree with regard to the costs associated with each of these technologies, the degree of participation of the special regime in covering the demand and its impact upon the technical and economic management of the

[256] KPMG report, May 2012. R-0251.
[257] Royal Decree 661/2007. R-0101.

referred to in this section will come into force on 1 January of the second year after the year the revision is carried out. 3. "The tariffs, premiums, incentives and supplements resulting from any of the revisions referred to in this section shall apply only to the installations that become operational after the date of entry into force referred to in the preceding paragraph, without retroactivity to previous tariffs and premiums"	system, and a reasonable rate of profitability shall always be guaranteed with reference to the cost of money in the capital markets. Every four years, thereafter, there will be a further review, maintaining the above criteria. The reviews referred to in this section of the regulated tariff and the upper and lower limits will not affect facilities whose commissioning certificate was awarded before 1 January of the second year following the year in which the review was carried out".

455. The reform made by RD 661/2007, was reviewed by the Supreme Court of the Kingdom of Spain, which ruled on the effect Article 40.3 of RD 436/2004 had regarding the modification of subsidies, as seen before[258].

456. For the purposes of this case, it is relevant to note that Article 44.3 of RD 661/2007 did not refer to *"any"* review of the regulated tariff and the upper and lower limits. That article limited its scope exclusively to the revisions provided in *"this section"*. That is, it only refers to the revisions that must by obligation be made "in 2010" and to the revisions that must be made every "four years". A "sensu contrario" apart from the reviews provided for in Article 44(3), there could be other different revisions. Revisions which, if they occur, would be exempted from said Article 44(3).

457. Additionally, if we stick to the literal wording of Article 44(3) it only refers to the revisions *"of the regulated tariff and the upper and lower limits."* It does not refer to anything else. Consequently, no investor could consider frozen in their favor other different aspects of the RD 661/2007 regime, such as: (1) the useful life years of the plants during which subsidies would be received, (2) hours of subsidised production, and (3) subsidy updates under the CPI.

(6.5) Conclusion: RD 661/2007 is subject to the SES' regulatory principles

458. The foregoing shows that no minimally informed investor could ignore that fixing subsidies in the RD 661/2007 was linked to specific base economic data, on which the objectives of deployment objectives of renewable energies were planned. The cost of achieving these goals for the SES should accommodate the SES' revenue forecasting. This is required by the SES' principle of economic sustainability.

459. Similarly, no investor, as stated above, could ignore that RD 661/2007 tariffs were established with the aim of providing reasonable profitability, within the framework of a sustainable SES. Consequently, if tariffs generated over-remuneration situations every investor should know that the Regulator would act to correct the situation.

460. Therefore, no investor could hope to maintain the subsidies set out in RD 661/2007 unchanged in the case of a substantial change in the base economic data taken into

[258] Section IV.D of this Memorial.

account to set them, or where such subsidies would generate over-remuneration situations and even less if these situations were to endanger the SES' economic sustainability.

461. The Claimant's thesis, which defends freezing of remunerative conditions established in RD 661/2007, is contrary to the doctrine of the Supreme Court of the Kingdom of Spain existing at the time on the effects of regulatory changes in the context of Article 30(4) of Law 54/1997[259].

462. This Case law, as it should, refers to CNE report 3/2007 of 25 January 2007[260] to support its view of the regulatory changes introduced by RD 661/2007. A diligent investor could not ignore this fact.

(7) Royal Decree 6/2009.

463. As noted above, one of the pillars on which the SES rests is that of financial sustainability. In order to ensure sustainability, RD-Law 6/2009 of 30 April is approved, as acknowledged by the Claimant itself[261].

464. It should be noted that Royal Decree-Laws are rules with the force of law that the Government may issue in cases of extraordinary and urgent need. At that time it was extremely urgent and necessary to try to rebalance the sustainability of the SES. Moreover, RD-Law 6/2009 created the so-called "social bond" in order to protect the most vulnerable consumers, who could not cope with the increasingly high cost of electricity bills.

465. The Preamble to RD 6/2009 stated in this regard that:

> *The increasing tariff deficit [...] is causing serious problems which in the current context of international financial crisis, is profoundly affecting the system and endangering, not only the financial situation of the companies in the electricity sector, but the system's sustainability itself. This imbalance is unsustainable and has serious consequences by deteriorating the security and investment financing capacity necessary to supply electricity in the quality and safety levels demanded by Spanish society. " [...]*
>
> *Fourthly, by its increasing incidence on the tariff deficit, mechanisms are established with regard to the remuneration system of the facilities under the special regime" The trends followed by these technologies could put at risk in the short term, the sustainability of the system, both from the economic point of view due to their impact on the electricity tariff, and from a technical point of view, further compromising the economic viability of the already completed facilities, whose operation depends on the proper balance between manageable and non-manageable generation."* [262] *(Emphasis added)*

[259] Section IV.D of this Memorial.
[260] CNE report of 14 February 2007 pages 16 and 17. R-0128.
[261] Memorial on the Merits, paragraph 283
[262] Royal Decree Law 6/2009, of 30 April, on certain measures in the energy sector and approving the Social Tariff. Preamble. R-0088.

466. The main measure of this RD-Law was to set a goal to eliminate the tariff deficit. In particular, it was established that, from 1 January 2013, access tariffs should be sufficient to meet the entire cost of regulated activities without ex ante deficit could appear[263].

467. As from this moment, any agent connected with the SES would be aware that the Regulator would adopt, within the Spanish legal framework, the regulatory measures that were necessary to achieve the above-mentioned objective. That is, while this objective was not achieved, all SES' cost items and revenue would be subject to their achievement.

468. Moreover, the RD-Law noted that the REs would not be outside the regulatory measures necessary to adopt. The RD-Law 6/2009 expressly warned that because of "*The trends followed by these technologies could put at risk in the short term, the sustainability of the system both from the economic point of view due to their impact on the electricity tariff, and from a technical point of view (...)".* Therefore, the RD-Law noted that without prejudice to other immediate measures that could be taken, it was necessary to set *"the basis for the establishment of new economic regimes that foster compliance with the intended objectives."*[264]

469. Thus, in order to achieve the established objective, RD-Law 6/2009 introduced significant changes to RD 661/2007: a) the Registry of pre-allocation was created, and b) assigned to the Government the power to stagger the entry into operation of the pre-registered Facilities when so required by the SES' economic and technical sustainability. This power was made effective by The Spanish Cabinet Meeting Decision of 13 November 2009, staggering the entry into operation of the pre-registered facilities[265]

470. Royal Decree-Act 6/2009 is depicted by the Claimant to the Arbitral Tribunal in a biased manner as a regulatory instrument aimed at stimulating investment in RE sources and at guaranteeing the correct operation of Royal Decree 661/2007[266]. However, this positive vision contrasts with the strong criticism of Royal Decree-Act 6/2009 by the Sector.

471. In May 2009, the most important Association of the RE sector, APPA, ran a strong editorial against the then Minister of Industry making him responsible for the publication of RD-Law 6/2009. When analysing the RD-law said editorial states[267]:

- "[The Minister] *has never received* [the RE Sector] *nor has he taken the sector into account for regulatory changes"*

[263] Ibid, Article 1.
[264] Ibid Preamble R-0088.
[265] "Spanish Cabinet Meeting Decision of 13 November 2009. R- 0116
[266] Memorial on the Merits, paragraphs 192 and 196.
[267] "Europe, new policy. Spain, new imposed decree". APPA info May 2009. Editorial.R-0018

- *" Various measures are adopted to reduce tariff deficit which increase the administrative burden of clean energies".*

- *"The measures of the RDL, [...] will further hinder the development of the sector, which suffers, like the rest, financing problems arising from the crisis"*

- *"The government has a unique opportunity with the Renewable Energy Law, for which it has a proposal from Greenpeace and APPA to demonstrate its commitment towards a "green economy" and allow Spain* to *lead, for the first time in history, in technology and development worldwide" (Emphasis* added)

472. The previous editorial was accompanied by a joint Letter signed by various associations from the renewable sector against R-DL 6/2009. The title of the Memorandum read *"The RDL 6/2009, new imposed decree against renewables"*[268].

473. This letter was presented by APPA in its Partner gazette:

> *"APPA, ADAP, APREAN, EolicCat, GiWatt and The Extremadura Cluster of Energy harshly criticised the decree and asked the Government for its contents to be developed in the future Law on Renewable Energy." (Emphasis added)*

474. Through this joint letter, the various signatories Associations strongly criticised this rule, referring to its similarity to the previous RD 1578/2008, of 26 September[269], Issued in the PV Sector months before:

> *"There is a clear and ominous experience in RD 1578, which regulates the activity of photovoltaic solar technology and which has actually caused the stoppage of this sector, with factory closures and relocation of investments. The new RDL can cause the same effect on the rest of renewable technologies and affect even the most developed technology, wind power technology"*[270]*. (Emphasis added)*

475. Clearly, the RE Sector did not appreciate RD-Law 6/2009 as a policy instrument aimed at further stimulating investment on RE sources and ensuring the proper functioning of Royal Decree 661/2007. It is clear that the Claimant seeks to present the Arbitral Tribunal with a distorted account of the RE development before the challenged measures.

476. The measures necessary for the corresponding RE sectors to ensure the economic sustainability of the system were adopted at any given time (2006, 2007, 2008, 2009). Simply reading the Preamble of RD-Law 6/2009 is enough to appreciate that Spain had not committed or guaranteed freezing any legal regime. On the contrary, the Government was convinced of the need to take measures to rebalance the tariff deficit.

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[268] "Europe, new policy. Spain, new imposed decree". APPA info 29 May 2009. Pages 12 to 13. R-0167.
[269] RD 1578/2008, of 26 September, remuneration for electricity production through solar technology, R-0102
[270] "Europe, new policy. Spain, new imposed decree". APPA info May 2009. Pages 12 to 13. R-0018

477. The imbalance of the SES emanated largely by the sharp reduction in electricity demand as a result of the crisis. This made SES reform necessary, at least in the remuneration regime of the REs. As we have already stated, that was the understanding of the Regulator and the industry. To that end, the RE Sector created a reform proposal for the RE Remuneration Framework RE which we will state below.

(8) Proposal for the RE Sector Remuneration Framework of 20 May 2009.

478. The RE Producer Associations were fully aware of the dynamic nature of the reasonable profitability and the need to take steps to ensure the SES' economic sustainability in line with the objectives established by RD-Law 6/2009.

479. Since January 2009 the Association of Renewable Energy Producers (APPA), the largest Spanish association of renewable energy producers, worked on the Drafting of a Law that would meet the RE Sector's cause of action. To do this, they commissioned a law firm, Cuatrecasas Gonçalves Pereira, with the drafting of a proposed "Draft Law on the Promotion of Renewable Energy".

480. Said draft law was presented jointly by the APPA Association and Greenpeace on 20 May 2009 by Press Release[271]. This Press Release from APPA refers to the need to change the energy model, developing a Draft Law based on the *"legislation best practice for RE"* and on a *"sustainable energy model"*:

> *"APPA and Greenpeace with legal support from Cuatrecasas, Gonçalves Pereira, have worked in a separate RE promotion draft law whose first objective is the transposition of the new Directive into Spanish law. This draft is based on the best practices for RE legislation in different countries and in a sustainable energy model, and sees the new RE directive [...] as a starting point for a change in the current energy model. In addition, it aims to assist the Government in formulating an ambitious and farsighted RE law. But above all, this draft wants to be a legislative instrument that provides security and stability to the necessary investments for the REs to develop their full potential in a sustainable and lasting way." (Emphasis added)*

481. The two largest newspapers in Spain published this news, both the El Mundo and[272] El País[273] newspapers. Clearly, the main RE Sector association was keen to publicise their Draft Law. Moreover, said presentation was publicised by other RE Associations RE, such as the wind power association, APECYL in May 2009[274] and by Foundations

[271] APPA-Greenpeace Press Release on the Draft Law for the Promotion of Renewable Energy, of 20 May 2009. R-0167.
[272] News release, "Spain could be 100% renewable by 2050", El Mundo, 25 May 2009. R-0168.
[273] News release, "Too many renewables or too expensive?" El País of 26 May. El País of 26 May 2009, on this presentation: "The Association of Renewable Energy Producers (APPA) and Greenpeace. Both organisations presented this week a draft law to promote renewable energy which proposes to reach 30% renewable on gross final consumption by 2020". R-0182.
[274] Apecyl Press Release, "Greenpeace and renewable energy producers propose a law to make Spain a leader in clean energy", 20 May 2009 R-00181

dedicated to the REs[275]. This proposal was also subsequently reiterated by the APPA Association[276].

482. APPA and Greenpeace suggested the Government that the reasonable profitability guaranteed to the REs, as the axis of its remuneration regime should be determined by reference to the Treasury obligations yield to 10 years, plus a spread of 300 basis points:

> *"The Government shall fix the amount of regulated tariffs, premiums and supplements, assessing, in any case the costs of operation and maintenance and investment costs incurred by the facility owners in order to achieve reasonable profitability rates with reference to the cost of money in the capital market. As for the capital remuneration tariff, an annual percentage equal to the average of the previous year's remuneration average of Treasury obligations to 10 years will be taken, plus a spread of 300 basis points."* [277] *(Emphasis added)*

483. The index proposed by the concerned associations to set reasonable profitability is precisely equivalent to that established by the Kingdom of Spain in the challenged measures in this Arbitration. As stated by the most important Association in the RE Sector when proposing it, this is a method that provides *"security and stability for the necessary investments so that REs can develop their full potential in a sustainable and lasting manner"*[278].

484. Since this is the regime proposed by the RE Sector, it is clear, then, the reasonableness of the remuneration regime established in the challenged measures in this Arbitration.

485. Moreover, the APPA Association also proposed in 2009 that the estimated investment costs be carried out through *standard facilities,* according to the *usual market prices*, in order to avoid speculative costs:

> *"To this effect, the Government will estimate investment costs associated with the different kinds of facilities, differentiated by technology and size, in order to reflect the common values that such investments reach in reality."* [279] *(Emphasis added)*

486. The similarity between the proposal from the RE Sector of May 2009 and the measures taken by the Kingdom of Spain in 2013 is evident. In 2009 the RE sector was

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[275] Presentation of the "Fundación Ciudadanía y Valores" (Foundation on Citizenship and Values) on the APPA and Greenpeace proposal, November 2009. R-0019

[276] APPA Magazine, "Info" No. 30, 2010, p. 14: "The APPA-Greenpeace agreement is a consensus model to consolidate Spain as a world leader in renewable energy." [...] The Draft Law on Renewables presented last May by APPA and Greenpeace is to date the only document provided in the sector[...] As such, it is an open proposal for discussion with the different administrations and social agents involved." R-0189 and a Power Point Presentation of 27 April 2010 on the APPA and Greenpeace proposal, exhibited at the XII Forum of Sustainable Energy. R-0189.

[277] Article 23.4 of the Draft Law presented by APPA-Greenpeace in May 2009. R-0187.

[278] APPA-Greenpeace Press Release on the Draft Law for the Promotion of Renewable Energy, of 20 May 2009. R-0167.

[279] Article 23.5 of the Draft Law presented by APPA-Greenpeace in May 2009. R-0187.

already fully aware of the economic and technical sustainability difficulties the SES was going through. Therefore, a Law was proposed to amend the remuneration scheme of the REs, within the limits of respecting the principle of "reasonable profitability according to the capital markets" as enshrined in Law 54/1997.

487. Moreover, since the RE sector was fully aware that the management principles of the SES' remuneration regime are contained in the Law (and not in the development regulations), they sought to establish the realisation of reasonable profitability in law. The most authoritative doctrine reported this claim:

> *"The Spanish FIT scheme has the legal Rank of a Royal Decree. Even though it is "stronger" than for instance a Ministerial Order, the Spanish renewable associations have long called for a FIT law. Before the last general elections, the current Socialist government had promised to initiate the respective legislative process, but up to now nothing has changed."*[280]

488. The Preamble of the Draft Law of 2009 proposed by APPA to the Government refers to the need to strengthen legal certainty:

> *"the rank itself of the standard [proposal] should serve to reflect the will of stability and continuity that aims to provide measures contained therein, in order to generate adequate confidence and credibility for the legal and economic model chosen and thereby ensuring security and certainty required by investments covered thereby. " (Emphasis added)*

489. The Draft Law proposal from the primary APPA Association certifies that any investor in Spain knew or should have known the *dynamic* nature of the reasonable profitability guaranteed by Article 30.4 of Law 54/1997 and the need for *sustainability in the* SES. Therefore, the Claimants knew or should have known that no regulation issued in implementation of Law 54/1997 could have ensured the investors' the freezing *sine die* of remunerations. And even less in the scenario of international crisis, of decline in electricity demand and increase the tariff deficit since 2008.

490. In fact, it is undisputed that since January 2009 the main Spanish RE Association, which the Claimant belongs to, knew and gave public importance to the influence of the tariff deficit and the international crisis on the sustainability of the SES, as causes that justified the need to amend the regulation and remuneration applicable to the REs.

(9) National Action Plan for Renewable Energy in Spain 2011- 2020.

491. Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources establishes the need for each Member State to prepare and notify the European Commission (EC), no later than 30 June 2010, a National Action Plan for Renewable Energy (hereinafter

[280] Powering the Green Economy. The feed in tariff handbook. Miguel Mendonça, David Jacobs and Benjamin Socacool. Editorial. Earthscan, 2010. RL-0062.

"PANER") for 2011-2020, in order to meet the binding targets established by the Directive.

492. Pursuant to this mandate of the Directive the Kingdom of Spain adopted its PANER on 30 June 2010[281]. It must be highlighted that prior to said PANER's final approval a participatory process involving companies, associations and citizens was opened until 22 June 2010. In this phase many contributions and suggestions were made and were very useful for the preparation of the final document of PANER 2011-2020.

493. In the PANER, after making an analysis of the expected final energy consumption in the 2010-2020 period and defining the objectives and paths of renewable energy, support measures are determined to achieve those objectives. Specifically in determining the measures in the field of renewable energy with power generation the PANER provides

> *"Establishing a stable, predictable, flexible, controllable and safe framework for developers and the electrical system".* [282]

494. The warning that the PANER made regarding support measures involving the commitment of financial resources must be highlighted

> *"The application of measures involving the commitment of financial resources must be conducted in* a *manner compatible with the adjustment and balance needs the Spanish economy must meet."*[283]

495. Later, in describing the legal framework on which the financial assistance is based on for electricity generation with renewable energy sources, it states that the tariff and premium regime for special regime facilities *"includes levels of remuneration for electricity generation pursuing obtaining reasonable rates of return on investment. For its determination the specific technical and economic aspects of each technology, the facility power and date of commissioning are taken into account, all of this using criteria on sustainability and economic efficiency in the system"*[284].

496. The necessary control and adaptability mechanisms the Spanish systems uses on subsidies for renewables are described as follows. In particular, and with regard to flexibility mechanisms, the PANER states the possibility of changing the remuneration levels for renewable technologies:

> *"The levels of remuneration may be changed depending on the sector technological evolution, market behaviour, the degree of compliance with renewable energy targets, the degree of participation of the special regime in demand coverage and its impact on the system's technical and economic management, while always ensuring reasonable rates of return - the current RD 661/2007 establishes four-year reviews. In any case, these reviews address the evolution of specific costs associated*

[281] National Action Plan for Renewable Energy in Spain (PANER) 2011-2020. R-0120
[282] Ibid. Page 50. R-0120
[283] Ibid, paragraph 61. R-0120
[284] Ibid. Page 116. R-0120

with each technology, with the triple ultimate goal for renewable technologies to achieve the highest level of competitiveness possible with the Ordinary Regime, favouring a balanced technological development and for the remuneration scheme to evolve towards the minimum socio-economic and environmental cost." [285] *(Emphasis added)*

497. Moreover, when addressing the future evolution of the remuneration system for renewable energy, according to the methodology followed to date, the PANER relies on a premise:

> *"For the determination of the remuneration, technical parameters and investment costs incurred will be taken into account, with the purpose of achieving reasonable rates of return with reference to the cost of money in the capital market, taking into account the provisions of the Electricity Sector Law."*[286] *(Emphasis added)*

498. Then the PANER emphasizes the Government's duty to control the subsidies' remuneration system, and where appropriate, to take any necessary measures to avoid unwanted retributive adjustment:

> *"In addition, the effective protection of the Administration must ensure the transfer to society of the gain from the proper development of these technologies in terms of relative cost competitiveness, minimising speculative risks, caused in the past by excessive profitability that damages not only to consumers, but also the industry in the perception we have of it. It will therefore be necessary to arbitrate sufficiently flexible and transparent systems to provide and obtain economic and market signals that minimise the risks associated with both the investment and its remuneration and those caused by fluctuations in the energy market*[287] *". (Emphasis added)*

499. Accordingly, the Kingdom of Spain, through the maintenance PANER notes that remuneration mechanism for renewable based on the principle of reasonable profitability on investment has to pivot about its necessary "flexibility" to avoid unwanted situations.

(10) RD 1565/2010

500. The need to ensure the technical sustainability of the SES, as a result of the increasing degree of penetration of the REs, forced the regulator to dictate Royal Decree 1565/2010, of 19 November, which regulates and modifies certain aspects concerning the activity of electricity production under the special regime (hereinafter "RD 1565/2010"). In this regard, the Preamble showed that the RE sector:

> *"Is a very dynamic sector with a very fast pace of technological evolution. Currently, about 25 percent of the electricity produced comes from renewable energies. These facts, combined with the structural characteristics of our electrical*

[285] Ibid. Page 119. R-0120
[286] Ibid. Page 123. R-0120
[287] Ibid. Page 123. R-0120

system, require the establishment of additional technical requirements to ensure the functioning of the system and enabling the growth of these technologies."[288]

501. On the one hand, for technological development reasons, it was agreed to extend the deadline for wind farm facilities to meeting response requirements due to voltage voids[289].

502. On the other hand, it included additional requirements for reactive power supplement[290]. In this sense, all facilities under the special regime, with the exceptions established by regulation, would receive a supplement or penalty, as appropriate, for keeping certain power factor values. That is, the facilities were obliged to be maintained on an hourly basis, within the required power factor range, expressly sanctioning noncompliance with the payment of penalties for the incurred noncompliance hours.

503. Additionally, the definition of the concept about substantial modification[291] of a facility for the renewal of the economic regime was specified, to the extent that it was anticipated that this concept would be massively used in the coming years, since the power generation facility had reached certain age in which equipment renewal became necessary.

504. Article 45 of RD 661/2007 regulated the right to receive a subsidy for facilities with power over 50 MW that used one of the renewable energies as primary energy. However, hydroelectric technology is excluded from this possibility. RD 1565/2010 extended the exclusion to thermoelectric and wind technology[292]. As a result, wind power facilities with power over 50 MW lost the right to receive the subsidy provided for in article 45 of RD 661/2007. This elimination of the subsidy took place despite these plants, like the renewable technology plants with less than 50 MW, having to register on the Administrative Register of electricity production facilities.

505. It is noteworthy that the Claimant omits any mention of RD 1565/2010. The aforementioned Royal Decree introduced important technical and economic measures on the Wind Energy Sector and, consequently, on their own wind farms. This omission is especially striking in view of the allegations made by the AEE before the CNE while processing this RD 1565/2010[293].

506. In those claims the AEE, after recalling the case law of the Supreme Court, states that:

[288] RD 1565/2010, Preamble: R-0104.
[289] RD 1565/2010, Article 15, which amends the Fifth Transitory Provision of RD 661/2007. R-0104
[290] RD 1565/2010, Article 8 amending Article 29 of RD 661/2007. R-0104.
[291] RD 1565/2010, Article 1 amending Article 4.3 of RD 661/2007. R-0104.
[292] RD 1565/2010, article 1, which amends article 45 of RD 661/2007. R-0104.
[293] AEE allegations before the CNE during the Spanish National Energy Commission public information process on the draft Royal Decree which regulates and modifies certain aspects of the special regime. R-0166.

> *"Any review of the Remuneration Regime established in Royal Decree 661/2007 must necessarily ensure reasonable profitability on investment and also meet the criteria themselves established in that Royal Decree (which have not been modified) and the higher principles of legal certainty and proportionality"*[294].

507. These claims are very relevant, because they prove that the RE Sector was fully aware of the possibility that the remuneration regime of RD 661/2007 is modified, with the only limit to ensure the perception of a reasonable profitability.

508. Moreover, the measures introduced by RD 1565/2010 seem to have been left out of the alleged negotiation process between the REs and the Government that, according to the Claimant led to the adoption of Royal Decree 1614/2010, despite its obvious technical and economic impact.

(11) RD 1614/2010

(11.1) Announcement and processing of RD 1614/2010

509. Continuing with the same *leitmotif* of the preceding measures, namely the need to ensure the economic sustainability of the SES, RD 1614/2010 was adopted by the Government of Spain regarding the imminent need to reform the RE remuneration regime.

510. As discussed above, the main association of RE producers, APPA, also recognised the need to undertake a RE regime reform and for this purpose it presented its proposal for a Renewable Energy Law, discussed above.

511. In the same vein, the AEE, which comprises 95% of the Wind Energy Sector including the Claimant, was aware of the need to take measures because of the *"exceptional drop in electricity demand"*[295]. Therefore, the whole RE sector knew that the approval of RD 1614/2010 responded to a basic purpose and so in its preamble the following was explained:

> *"So the support regime, as stated in its formulation, should be adapted, with legal certainty of investment and the principle of reasonable return, to the dynamic reality of the learning curves of various technologies and technical conditions that arise with their increasing penetration in the generation 'mix', in order to maintain a necessary support and sufficiently coherent with market conditions and strategic objectives on energy and contributing to the transfer to society of the gain from the proper development of these technologies.*

[294] Ibid, paragraph 7. R-0166.
[295] AEE allegations before the CNE during the Spanish National Energy Commission public information process on the draft Royal Decree which regulates and modifies certain aspects of the special regime, page 2. R-0166.

Therefore, the present royal decree intends to resolve certain inefficiencies in the implementation of Royal Decree-Law 6/2009, of 30 April, for wind and solar thermal technologies (...)[296]*".*

512. In short, the aim was to rebalance the contribution of different technologies to the SES' sustainability, according to their varying degrees of penetration. It was obvious, and investors were fully aware of, that there was a clear will on the Government to achieve the objective and, therefore, any necessary measures would be taken to achieve it[297].

513. The fact that in the process of elaboration of RD 1614/2010 the support by operators in the Sector was achieved does not alter (i) neither the legal nature of the *erga omnes* norm, (ii) nor its contents (iii) nor the possibility of adopting new measures aimed at achieving the same purpose, if Macroeconomic circumstances so require.

514. In this regard, it is important to recall that consultations with the associations representing the affected sectors when preparing regulations not only comes under the authority of the government, but it is also a duty expressly provided for in Article 24 of the Government Act.[298]

515. The Claimant's arguments aimed at turning Royal Decree 1614/2010 into some kind of contract resulting from negotiations are, simply, nonsense. There are multiple examples that can be given about dialogues with associations carried out by the Government of Spain for the purpose of implementing a regulation[299].

516. The fact that consultations may eventually lead to an agreement or not regarding the text of laws will depend on their success. The important thing so that a regulation doesn't suffer from a defect of invalidity is that the associations representing the sector be heard at some point, either before coming up with the draft or during the subsequent processing thereof. It could happen that negotiations even result in a law not being approved, such as what happened with the 2011 reform of renewable energies announced by Act 2/2011, on a Sustainable Economy, which was approved, by the way, before the Claimant's investment in solar thermal plants was made. In 2012, the Wind Energy Business Association published in its yearbook that during its

[296] Royal Decree 1614/2010, Preamble: R-0105.
[297] In this sense, please analyse the Power Point presentation by Protermosolar before the Popular Party in July 2010. C-0197. And also the news "The Government decides to put an end to the energy bubble", La Vanguardia, 21 March 2010. R-0180.
[298] Act 50/1997, on the Government. R-0004.
[299] This is the case for the Framework of action for coal mining (R-0013); for negotiations by the government with employers of the television industry (R-0023); for the Great Government-Unions Social Pact, Actualidad ,EL PAÍS (R-0026); Bank sector negotiates financial reform with the Government, ABC (R-0027); Ministry of Justice - Union Associations Agreement on the employment conditions of civil servants (R-0029); The Ministry pacts with students on a provisional reform of university entrance exams (R-0045); The dairy sector signs an agreement that Tejerina sees as "ambitious" but is rejected by farmers (R-0083); Truck drivers agree with the Ministry of Public works to voluntarily not drive on some sections of highways, article in ABC (R-0255); Industry agrees with the electrical utilities and increases electricity price an average of 4% on Thursday, El Diario de León (R-0256); Education agrees on the basis of the new law with unions and business owners, El Diario de Extremadura (R-0257); Health reaches an agreement with the fashion world on clothing sizes to fight anorexia (R-0258).

negotiations with the Government, they applied pressure so that a new Regulation wouldn't be adopted.[300]

517. It is also cautioned that when the Government of Spain actually enters into protocols or conventions with the affected sectors in order to implement a regulation, it signs them, it introduces monitoring commissions to ensure compliance and it expressly states this in the rules that it approves in the development of such pacts.[301] None of these circumstances is present in the famous "agreement of 2 July 2010" between the AEE, Protermosolar and the Government.

518. Moreover, Act 54/1997 itself is the result of an agreement between the Regulator and the affected sectors, as it is noted in its Statement of Reasons[302]. That agreement was recorded in a Protocol signed by representatives of the Government and of the sectors[303]. The existence of said agreement neither altered the legal nature of Act 54/1997 nor prevented it from subsequently being modified or even repealed.

519. The Wind Energy Sector also knew that the reform would be adopted regardless of whether this was accepted by them. The necessary sustainability of the SES demanded it. In this regard it should be remembered that more stringent measures regarding the photovoltaic sector were also adopted, despite its opposition.[304]

520. RE producers were aware that the alleged agreement of 2 July 2010 contained no commitment on freezing the remuneration regime. In this regard, it is clear that the AEE Association does not advocate the existence of any freezing commitment as stated in its allegations of 29 August 2010:

> *"In any case, safeguarding legal certainty and ensuring reasonable return on investments constitute inviolable limits of* ***any regulatory changes affecting existing facilities."***[305] *(Emphasis added)*

521. That is, the AEE not only recognises the lack of commitments but admits that there may be further changes in the profitability and the regime of existing facilities. It's only required that two principles are respected: legal certainty and ensuring reasonable return.

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[300] In this regard, Act 54/1997, on the Electricity Sector, announces in its Statement of Reasons that it is the result of negotiations with the sectors involved. R-0003

[301] For example: Agreement with the Transport Sector; R-0258; Protocol of cooperation between the General State Administration and the Pharmaceutical Industry; R-0260; MAGRAMA-Dairy Sector Protocol-Agreement.R-0261

[302] Statement of Reasons of Act 54/1997. R-0003

[303] Protocol of the Electricity Sector Act. R-0260. Documents R-0263 and R-0264 show the evolution of the drafting of what was later Article 30.4 of Act 54/1997 based on the initial bill.

[304] In this regard, measures regarding the photovoltaic sector were adopted by the RD 1565/2010 (R-0104) and RD-Law 14/2010 (R-0090), although the latter also affected the wind and thermosolar sectors, as will be discussed later.

[305] AEE allegations before the CNE during the Spanish National Energy Commission public information process on the Proposed Royal Decree which regulates and modifies certain aspects of the special regime, page 2. R-0166.

522. In addition, the AEE Association expressly recognises before the CNE the existence and linking of the consolidated stated Case law:

> *"It is true that the Supreme Court has stated, in relation to this type of retroactive reforms, that there is no "unalterable right" for the economic regime to remain unchanged and that "from the prescriptive content of Law 54/1997 of 27 November of the Electricity Sector no freezing of the electricity power facility holders' remuneration regime in special regime can be drawn nor the impossibility to reform such regime",* ***recognising thus a relatively wide margin of the Administration's "ius variandi" in a regulated sector where general interests are involved.*** *However, without prejudice to the above, Case Law established limits to the Administration's "ius variandi" regarding the retroactive modification of that remuneration framework, especially "that the requirements of the Electricity Sector Law are respected regarding the investments' reasonable return." Moreover, a breach of the principle of legal certainty by a retroactive rule "can only be settled case by case "(...)". [306] (Emphasis added and footnotes omitted).*

523. In short, the AEE revealed in its allegations that they had complete knowledge of the Spanish legal system, quoting Supreme Court Judgements of 25 October 2006, 3 December 2009 and 9 December 2009. This reflects clearly the expectations that RE producers had regarding "any" regulatory change. The AEE does not claim neither the freezing of the remuneration regime as contained in RD 661/2007, nor the assumptions or commitments established in RD-Law 6/2009, nor in the alleged agreement with the Ministry of Industry one month before submitting these claims. All they claim is respect for the legal principle of reasonable return and legal security of the rule.

524. In addition, AEE states that the retroactive effects of the changes must be assessed case by case by Case Law, which they clearly accept. As will be discussed later, Spanish Case Law has already held that the challenged measures are not retroactive.

525. It is therefore clear that the Claimant knew the "relatively **wide** range of *ius variandi* of the Administration in a regulated sector where general interests are involved." That is, it knew the possibility of future regulatory changes and limits that could adjust these regulatory changes: the SES' economic sustainability and ensuring reasonable return.

526. And relevant point, for the purposes of the skewed statement of the facts made by the Claimant, is that it is clear that the Claimant knew about and used the Case Law of the Supreme Court invoked before the CNE by the AEE. Therefore, it is surprising that, in its Memorial on the Merits, it should omit these judgements of the Supreme Court and contribute others that are irrelevant to the case.

527. In any case and, moreover, neither the AEE nor PROTERMOSOLAR, associations that are party to the agreement, have invoked their existence on the appeals that have been filed with the Supreme Court, which were ruled on through different Judgements

[306] Ibid. Page 6. R-0166.

of the Supreme Court[307]. On this point, with regard to the appeal lodged by the AEE, the alleged counterpart of the agreement reached with the Government, the Supreme Court states:

> *"In this case, there is of course no type of commitment or external sign, or at least none is invoked in the claim, made by the Administration to the appellants in relation to the immutability of the regulatory framework in force at the time of the start of their activity of generating energy from renewable sources."*[308] *(Emphasis added)*

528. Therefore, it is clear that the Claimant cannot be linked through an alleged agreement whose existence has not even been acknowledged by those that would have executed it.

(11.2) Royal Decree 1614/2010 follows a single *leitmotif:* SES sustainability

529. The Claimant tries to convey the message that RD 1614/2010 constitutes an alleged agreement with the Wind Energy Sector. However, reading the Project's Analysis Memory of Regulatory Impact of RD 1614/2010 (hereinafter "MAIN") is enough to realise that this only intended to ensure SES sustainability, through cost containment linked to the RE subsidy:

> *"The aims of installed power under the Renewable Energy Plan 2005-2010 have been reached or exceeded for thermosolar and wind power technologies. While this development can be considered a major achievement of all stakeholders (...) it has also caused problems that need to be addressed before they pose an irreversible threat to the economic and technical sustainability of the system*[309]*."* *(Emphasis added)*

530. This Memory adds:

> *"This Royal Decree provides a series of austerity measures to contribute to transferring to society the gain from the proper evolution of these technologies in terms of competitiveness in relative costs, reducing the deficit of the electrical system, while safeguarding the legal security of investments and the principle of reasonable return*[310]*" (emphasis added).*

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[307] Judgement 1730/2016 of the Supreme Court, of 12 July 2016, which rejects the appeal filed by the Wind Power Business Association (AEE) against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 456/2014). (R-0265) and Judgement 1964/2016 of the Supreme Court, of 22 July 2016, which rejects the appeal filed by PROTERMOSOLAR against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 500/2014). R-0266

[308] Judgement 1730/2016 of the Supreme Court, of 12 July 2016, which rejects the appeal filed by the Wind Power Business Association (AEE) against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 456/2014). R-0265

[309] The Project's Analysis Memory of Regulatory Impact of the Royal Decree draft regulating and modifying certain aspects related to electric energy production using thermoelectric solar and wind power technologies. R-0082.

[310] Ibid. R-0082

531. Therefore, it is clear that the purpose of RD 1614/2010 was consistent with the rest of the measures taken so far: ensuring a reasonable return for investors, in the context of a sustainable SES. In fact, this object is what motivates each and every one of the measures contained in RD 1614/2010, as discussed below.

(11.3) RD 1614/2010 did not incorporate freezing guarantees

532. In order to achieve the aforementioned purposes, RD 1614/2010 adopted a series of measures for the wind energy sector which are the following

(a) The limitation of operating hours with rights to an equivalent premium (Article 2).

533. This measure was also adopted in relation to Photovoltaic Technology through the RD 1565/2010[311] and RD-Law 14/2010[312].

534. This measure helped to ensure the economic and technical sustainability of the SES. Indeed, by limiting operating hours during which each renewable technology could sell electricity generated for a subsidised Tariff, the cost linked to subsidies could be controlled.

535. However, the limitations of equivalent operating hours introduced by Royal Decree 1614/2010 cannot be considered arbitrary, since they have their origin in PER 2005-2010. Here, the descriptions of the standard facilities of each RE technology contained in PER 2005-2010[313] include a delimitation of operating hours. These hours were used to determine the tariff, with the aim of providing a reasonable return, later collected in RD 661/2007.

536. Reality showed that the facilities were producing for more hours than initially planned in the PER 2005-2010. Consequently, the collection of tariffs for a few hours over the time taken into account for setting the tariff, determined obtaining a higher return than considered reasonable.

537. Note that this did not prevent RE producers from producing above the corresponding operating hour limit. In this case, additional hours could not benefit from the subsidy, but could be sold at market price. The electricity produced during these additional hours also had access and dispatch priority guaranteed by Act 54/1997.

538. That measure highlights the undeniable link between the methodology used by the regulator and subsidies established in RD 661/2007. These subsidies are not spontaneously established but are the result of a major review aimed to set reasonable profitability on standard facilities based on standards established for each of them. Analysis contained in the various Renewable Energy Plans. Subsidies are the means to achieve the reasonable profitability established for different standard facilities

539. In this regard, the MAIN points out in RD 1614/2010 that:

[311] RD 1565/2010. R-0104.
[312] RD-Law 14/2010: R-0090.
[313] PER 2005-2010, Chapter 4 Financing. R-0119.

"The RD 661/2007 remuneration values were calculated in order to obtain reasonable profitability rates and taking as starting hypothesis the facilities' operating hours of these three technologies.

These operating hours are found in the Renewable Energy Plan 2005-2010, for all technologies.

Later, in the actual operation of the system, it was shown that the hours of operation of the facilities, in some cases, exceed the initially planned (...). In any case, this means that, for them, the remuneration obtained is more than reasonable[314]*".*

(b) The future remuneration regime is not frozen

540. As explained, the simple reading of RD 1614/2010 contains no evidence of any commitment or agreement between the Government of Spain and the Wind Energy Sector. Far from it, this Regulation constitutes a unilateral action of the regulator in the exercise of its powers[315] that does not include a guarantee of future freezing of a specific remuneration regime[316], as the Claimant is arguing, in Article 5 (3) of the Royal Decree.

541. However this Claimant's statement goes against the reason that justified the introduction of that article and its wording.

(i) The reason for the introduction of Article 5(3) of Royal Decree 1614/2010

542. The Agreement of the Council of Ministers of 19 November 2009[317] imposed, under the provisions of the fifth transitory provision of RD-Act 6/2009,[318] a staggering of the entry into operation of the wind plants registered in the Remuneration Pre-assignment Registry. Such staggering was configured in four phases:

- Phase 1 (850 MW): In progress.
- Phase 2 (1,350 MW): Between 1 January 2011 and 1 January 2013.
- Phase 3 (1,850 MW): Between 1 January 2012 and 1 January 2013.
- Phase 4 (Remaining power pursuant to fifth transitory provision of RD-Act 6/2009): between 1 January 2011 and 1 January 2013.

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[314] The Project's Analysis Memory of Regulatory Impact of the Royal Decree draft regulating and modifying certain aspects related to electric energy production using thermoelectric solar and wind power technologies. R-0082.
[315] Section IV.A. 1) of this Memorial.
[316] RD 1614/2010. Article 5.3: "Without prejudice to the provisions of this Royal Decree, for wind power facilities covered by Royal Decree 661/2007, of 25 May, the revisions of tariffs, premiums and lower and upper limits, referred to by Article 44.3 of said royal decree, will not affect the facilities definitively registered in the administrative Register of production facilities in the special regime under the Directorate General for Energy Policy and Mines dated 7 May 2009, nor those which would be registered in the pre-allocation Registry under the fourth transitional provision of Royal Decree-law 6/2009, of 30 April and fulfilling the obligation under Article 4.8 thereof." R-0105.
[317] Spanish Council of Ministers Agreement of 13 November 2009: R-0116
[318] Royal Decree Act 6/2009, of 30 April, on certain measures in the energy sector and approving the Social Tariff. Fifth Transitional Provision. R-0089

543. Such staggering led to the possibility that plants in Phase 2, Phase 3 and Phase 4 could be affected by the periodic revision that was to take place in 2010 and every four years thereafter. The literal wording of 44 (3) Royal Decree 661/2007 led to this result.

544. Given this circumstance, Article 5 (3) of Royal Decree 1614/2010 was introduced. It did not involve giving greater protection to those plants, but rather simply to correct a result that was not intended by the regulator, by deferring beyond 2010 their entry into operation. Therefore, the Preamble of Royal Decree 1614/2010, after noting that the purpose of this Regulation is to safeguard the principle of reasonable return, states that:

> *"Therefore, the present royal decree intends to resolve certain inefficiencies in the implementation of Royal Decree-Law 6/2009 of 30 April, for wind and solar thermal technologies. The latter aimed to ensure the economic regime in force in Royal Decree 661/2007, of 25 May, regulating the activity of electricity production under the special regime, for projects that were in an advanced degree of maturation."*[319]

545. Accordingly, Article 4 merely extends the provisions of Article 44(3) 2nd paragraph of RD 661/2007 to plants which, by application of Royal Decree Law 6/2009, could fall outside of it. That is, it merely prevents the periodic review under Article 44 (3) RD 661/2007 for 2010 and every four years thereafter from being applied to plants that were classified in Phases 2, 3 and 4. Nonetheless, it did not make any alteration to the principles and purposes of the SES.

546. This extension was criticised by the CNE. Thus, in its report of 17 September 2010 it said:

> "*However, and without it being justified either technically or economically, extensions were granted for the application of the tariffs and premiums applicable to the new thermoelectric wind and solar installations implemented from 1 January 2012, which will have a significant impact on the cost borne by the consumer, besides contradicting the provisions of Article 44.3 of Royal Decree 661/2007 of 25 May, and being discriminatory to other technologies. In addition, the wording in the text of the proposed RD amends that article by introducing legal uncertainty and a lack of definition in other technologies. Therefore, the Commission understands, on the one hand, that it is not appropriate to grant unjustified extensions to wind or solar thermal technologies for the non-application of the new tariffs and premiums from 2012, and on the other, it believes that Article 44.3 should not be amended*[320]*" (Original emphasis)*

[319] Royal Decree 1614/2010, of 7 December, regulating and modifying certain aspects related to electric energy production using thermoelectric solar and wind power technologies. Preamble. R-0105

[320] Report 24/2010 of the CNE on the Proposed Royal Decree which will regulate and amend certain aspects of the special regime. R-0020

(ii) The literal wording of Article 5 (3) does not constitute a stabilisation clause.

547. A simple reading of Article 4 of RD 1614/2010 allows us to see that all that article does is to extend the provisions of the second paragraph of Article 44 (3) paragraph 2 of RD 661/2007 to plants not covered by it. We recall that the revisions provided for in Article 44 (3), namely the one that was to occur in 2010, would affect those plants whose commissioning certificate had been granted after 1 January 2012.

548. The *"protection"* afforded by Article 4 of RD 1614/2010 is the same as that granted by RD 661/2007. Although it does extend to plants whose commissioning certificate was received subsequent to 1 January 2012. Therefore, these plants could remain unaffected by the mandatory review that was to take place in 2010.

549. However, at no time is it stated that Article 4 of RD 1614/2010 should apply to revisions or modifications other than those set out in Article 44 (3) of RD 661/2007. Moreover, at no time is it stated that the wind plants shall be left outside the scope of Act 54/1997 and that, therefore, the regulatory measures necessary to ensure the economic sustainability of the SES will not be applicable thereto, nor the regulatory measures aimed at avoiding situations of over-remuneration in the event they are detected.

(c) Review of RD 661/2007 premiums

550. Royal Decree 1614/2010 also reformed the wind technology facilities' premiums of Royal Decree 661/2007 of 25 May. Article 5 regulated the RD 661/2007 reference premiums, considering several possibilities [321]:

a) Premiums applicable from 7/12/2010 to 31/12/2012:

The set reference premium values are those corresponding to the date of entry into force of Royal Decree 661/2007, reduced by 0.35% and without updates.

These premiums would apply to facilities covered by the RD 661/2007 remuneration regime, excluding the ones covered by the First Transitional Provision.

b) Premiums applicable from 1/1/2013:

The values of the premiums fixed for 2010 (by ITC Order/3519/2009) are applied, updated in accordance with the coefficients of Article 44.1 of RD 661/2007. Therefore, rather than receiving the premium of RD 661/2007, for 2013, the corresponding premium to 2010 would apply. That is, the premium is frozen, depending on the one corresponding in 2010.

This rule applied to all facilities, including those from the First Transitional Provision of RD 661/2007. Regarding the latter facilities, it must be noted that since 2006, by approval of RD Act 7/2006, premiums and tariffs of RD 436/2004 under the TMR are not to be updated. These premiums and rates had not been updated therefore since 2006

[321] RD 1614/2010. Article 5 R-0105.

to 1/1/2013. Moreover, following approval of RD 1614/2010, from 2013 RD 661/2007 premiums would not be applied, updated at that time, but premiums in 2010. Therefore, firstly, premium updates are frozen for 6 years and afterward, those premiums frozen to 2 years before are applied.

It is indisputable that this implied a loss of the premium to be received by wind power farms, given the gap between the freezing of premiums and the increase in the CPI that occurred during those years.

(11.4) Conclusion: proportionality of the measures

551. All changes to the remuneration regime were appropriate and proportionate to the degree of implementation of wind technology in the SES and its impact on the tariff deficit.

552. Thus, it is evident that, contrary to what the Claimant argues, RD 1614/2010, as RD-Act 7/2006, RD-Act 6/2009 and RD 661/2007 had, confirmed again that wind technology could not be configured as an island within the SES.

553. RD 1614/2010 confirmed that the subsidies planned for this technology remained a cost for the System and, therefore, were subordinate to the legal principle of SES' sustainability. Said Royal Decree stated that wind technology, like the rest of the technologies included in the SR, were subject to possible regulatory measures that needed to be taken in the future, to ensure the necessary sustainability of the SES and the principle of reasonable return.

(12) Royal Decree-Law 14/2010, of 23 December.

554. The deficit ceilings established by Royal Decree-Act 6/2009 for the years 2010, 2011 and 2012 were raised by Royal Decree-Act 14/2010[322] since the previous limits could not be met. In fact, this is explained in its Preamble:

> *"Since the adoption of said Royal Decree-Act [RD-Act 6/2009] a series of circumstances have taken place which have had a direct impact on the tariff deficit forecast for the electricity system and have meant that the maximum deficit limits [...] have been widely exceeded. The impact of the global crisis in the Spanish economy has led to a significant drop in power demand while some circumstances on the supply side have had an impact such as [...] favourable weather conditions that have led to increased electricity production from renewable sources.[323]" (Emphasis added)*

555.

556. Regarding all SR technologies, RD-Act 14/2010 established in Article 1.2 that:

[322] Royal Decree-Law 14/2010 of 23 December, establishing urgent measures to correct the tariff deficit in the electricity industry. R-0090.
[323] Royal Decree-Law 14/2010 of 23 December, establishing urgent measures to correct the tariff deficit in the electricity industry. R-0090.

"The remuneration of regulated activities will be financed through the revenue from access fee to transmission and distribution networks satisfied by consumers and producers." [324]

557. This RD-Act requires therefore that all power producers, both OR and SR, pay an access fee for the use of transmission and distribution networks[325]. This affected the profits of the RE producers, demonstrating the inconsistency of the Claimant's argument on the *freezing* or impossibility to reform the RD 661/2007 regime after RD 1614/2010. In fact, the access fee introduced by RD-Act 14/2010 was challenged by some Photovoltaic producers in the Supreme Court, which dismissed the appeal, reiterating (once again) its consolidated Case law[326].

558. Again, this Case law emphasised that investors knew that their remuneration could be affected by future measures, both positive and negative, without any inalterability of the remuneration over time or of the mechanism to obtain it. However, they also knew, as established by the consolidated Case law, that measures should always respect the principle of *reasonable return.*

559. Indeed, access fees and limitation of the equivalent operating hours introduced by this RD-Act 14/2010, along with other adjustment measures adopted for the photovoltaic sector by RD 1578/2008, were the subject of the first international arbitration against the Kingdom of Spain. This arbitration has been resolved by the Award of 21 January 2016, dismissing all the Claimants' claims. [327]

560. It must be highlighted that the Claimant does not even mention this RD-Act 14/2010. For them, this regulation has not existed. It is obvious that by omitting it, they

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[324] Ibid. R-0090

[325] Ibid. First transitory provision. R-0090.

[326] In this regard, the Supreme Court has also spoken in the case of various appeals against the ministerial orders setting tolls for 2011 (starting with Order 1TC/3353/2010), in which the RD-Act was being indirectly challenged. The Supreme Court ruling of 25 June 2013 is worth noting, in which, among other considerations, states:

"The rationale of the appellants' complaint is limited, in short, to the fact that the payment of the toll impacts negatively on their income statements, and therefore, the profitability of their investments. And as they are based on the premise - even though they do not express it in the same way - that the legal situation laid down in Royal Decree 661/2007 is virtually inalterable or unchangeable over the next thirty years (and even later), any unfavourable measure that alters it would violate the principles repeatedly invoked (principles of legal certainty and legitimate expectations). This inalterability, in their understanding, would extend even to subsequent provisions of a tax nature —which is the nature they attribute to the tolls— which would also not be allowed to affect adversely the profits stemming from the remunerative regime they enjoyed under RD 661/2007.

This Chamber of the Court has rejected this premise in the preceding judgments and will do the same in this one. If the former, referring to the challenge of RD 1565/2010, we held that the principles invoked by the appellants did not obstruct the regulatory power holder from - within the respect for the limits of "reasonable return" set by the LSE - introducing certain modifications in the remuneration regime established by Royal Decree 661/2007, the more we must confirm that these principles do not obstruct the holder of legislative power (...) to take general, tax or non-tax measures, that affect them. It may therefore legitimately decide that all electricity generators, without exception, should contribute by paying tolls on the costs attributable to the investments required precisely so that the energy they produce may be transported and distributed." (emphasis added) R-0150.

[327] Award in the case Charanne B.V vs. Kingdom of Spain. RL-0049.

intend to hide that the implementation of the tolls had an economic impact on the profitability of their plants. In addition, the passing of this Act on 23 December 2010 (that is, sixteen days after RD 1614/2010) demonstrates that this last Royal Decree in no way meant the freezing of the economic regime defined in RD 661/2007.

(13) Act 2/2011 of 4 March on Sustainable Economy

561. At this point we must remember that the Act on Sustainable Economy was published April 2011. In this legal text the criteria to be met in energy regulation in general and the incentives for the primary regime in particular are revealed[328], pointing out:

- The link between planning and legislation concerning the management of public incentives to meet the objectives in such planning.
- The need for the planning to collect various scenarios for guidance on the future evolution of energy demand, on the resources required to meet it, on the power requirements and, in general, forecasts useful for making investment decisions for private initiative and for energy policy decisions, promoting an appropriate balance between system efficiency, security of supply and environmental protection.
- The legislation will organise public incentives ensuring an adequate return on investment in special regime technologies that encourages an installation volume compatible with the objectives set out in the Energy Plans.
- In any case the legislation will organise public incentives adjusting to the need for planning objectives to be met taking into account the principles of economic efficiency between different alternatives and the economic sustainability of the measures taken.

(14) Announcement of future regulatory changes by the Prime Minister

562. The candidate for Prime Minister announced at the Congress of Deputies on 19 December 2011, possible measures to be taken in the energy sector:

> *"We must be very aware that Spain has an important energy problem, especially in the electricity sector, with an annual deficit of over 3,000 million euros and an accumulated tariff debt of more than 22,000 million.*
>
> *Electricity tariffs for domestic consumers are the third most expensive in Europe and the fifth highest for industrial consumers.*
>
> *[...] If reforms are not undertaken, the imbalance will be unsustainable and increases in prices and tariffs would place Spain in the most disadvantaged situation in terms of energy costs throughout the developed world. We will therefore have to apply a policy based on curbing and reducing the average costs of the system in which decisions are taken without demagoguery, using all*

[328] Act 2/2011, of 4 March, on Sustainable Economy, Articles 77, 78, 79. R-0074.

available technologies, without exception, and regulate it with the primary objective of the competitiveness of our economy." [329] *(Emphasis added)*

(15) CNE Press Release of 28 December 2011

563. The Regulatory Authority of the Spanish electricity system, the CNE, issued a press release on 28 December 2011 in which, on the occasion of its report on the order proposed that would establish access fees from 1 January 2012 and rates and premiums for special regime facilities, states:

> *"The lack of convergence between the revenues and costs of regulated activities in the last ten years has generated a growing debt in the electrical system, which has been translated into a progressive increase in financing payments through present and future access fees for electricity consumers, as well as a temporary impact on the debt of companies that are required to finance the system's deficit. Consequently, the CNE reiterates the need to implement immediately, inter alia, proposals on the regulation of activities aimed at eliminating the structural deficit of the system and mitigating debt financing costs."* [330] *(Emphasis added)*

564. In the context of this announcement of a structural reform, on 27 January 2012, the first measures on the reform of the electricity sector as primary legislation were adopted: the approval of a regulation that would avoid an increase of the deficit, and the request to the regulating body for a report about the Spanish electricity system on proposals for measures to be taken.

(16) Royal Decree-Act 1/2012, of 27 January.

565. First, Royal Decree-Act 1/2012 of 27 January is approved, proceeding to the suspension of remuneration pre-allocation procedures and the elimination of the economic incentives for new electric energy production plants using cogeneration, renewable energy sources and waste (hereinafter, "**RD-Act 1/2012**")[331].

566. When justifying the measures, the Statement of Reasons of Royal Decree-Act 1/2012 clearly states the insufficiency of the measures adopted to date to guarantee the economic sustainability of the SES. It likewise points out that "*the complex economic and financial situation recommends the temporary elimination of the incentives to build these installations, temporarily, at least until solving the main problem threatening the economic sustainability of the electricity system: The tariff deficit in the electricity system*".[332]

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[329] Transcription of the Speech of Mariano Rajoy in his inaugural address as President of the Government, to the Spanish Congress, Monday 19 December 2011, www.lamoncloa.gob.es. R-0192.
[330] "The CNE analyzes the review of the grid access fees and certain tariffs and premiums of facilities under the special regime", press release of the National Energy Commission, 28 December 2011 R-0170.
[331] Royal Decree-Act 1/2012, 27 January, proceeding to the suspension of the remuneration pre-assignment procedures and the elimination of the economic incentives for new electric energy production plants using cogeneration, renewable energy sources. R-0091.
[332] Ibid. Statement of Reasons

567. Furthermore, Royal Decree-Act 1/2010 cautions about the need to design a new remuneration model for renewable technologies:

> *"It has become necessary to design a new remuneration model for this type of technologies that takes into account the new economic scenario, promoting a cost-effective assignment of resources through market mechanisms. It is thus endeavoured to coordinate in the future a system that promotes market competitiveness by means of mechanisms similar to those used in other EU countries and which ensure the future feasibility of the system.*
>
> *Likewise, the new frameworks should encourage cost reduction making use of the learning curve and promoting the capture of maturity of technology so that they are reverted to consumers."*[333]

568. In the Press Release of the Ministry of Industry, Energy and Tourism, after the Spanish Cabinet Meeting approved this RD-Act 1/2012, it was confirmed that they were working on a reform for the Electricity Sector:

> *"The complex economic and financial situation and the situation of the electricity system, advise the removal of incentives for the construction of these facilities on a temporary basis, while launching a reform of the electricity system to avoid the generation of tariff deficit that is, the difference between income from access fees to electricity transmission and distribution networks and the costs of the system's regulated activities."*[334] *(Emphasis added)*

(17) The report of the National Energy Commission on the Spanish Energy Sector 7 March 2012.

569. The second measure adopted by the new Government on 27 January 2012 was to ask the CNE[335], in its capacity as the advisory body in energy matters, to compile a report on regulatory adjustment measures that could be adopted in the energy sector. In particular, the study of measures aimed at addressing the evolution of the tariff deficit in the electricity sector was requested[336].

570. The CNE issued Report 2/2012 *"On the Spanish Energy Sector"* [337]on 7 March 2012, the first part of which is dedicated to the *"Measures to Ensure the Economic and Financial Sustainability of the Electricity System"*. For the preparation of this report,

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[333] Ibid. Statement of Reasons

[334] *"The Government will temporarily suspend premiums for these new special regime facilities"*. Press release from the Ministry of Industry, Energy and Tourism, 27 January 2012. R-0172.

[335] Copy of the letter from the Secretary of State for Energy to the President of the National Energy Commission of 27 January 2012. R-0193.

[336] Information on the public consultation on regulatory adjustment measures in the energy sector of 2 February and 9 March 2012, published at the National Energy Commission website: www.cne.es. R-0194.

[337] Report on the Spanish Energy Sector Part I. Measures to guarantee the financial-economic sustainability of the electricity sector, National Energy Commission, 7 March 2012. R-0131.

the CNE had begun a period of public consultation in early February 2012 in which 477 claims were received from companies and sectors affected[338].

571. The report on the SES has an Introduction and Executive Summary[339] attached in which the CNE explains the situation of the sector[340], demonstrating its unsustainability and stressing that the economic crisis, the rising price of fossil fuels and the introduction of measures against climate change, had exerted upward pressure on prices paid by final consumers.[341]

572. In this context, the CNE proposes a series of measures in the short and medium term for all activities in the power sector, including renewable energies, reflecting the urgent need to make changes in their regime.

573. Specifically, as for the promotion of renewable energy schemes is concerned, the CNE, in order to ensure the economic sustainability of the SES, proposes a series of measures to be taken in the short term: (i) *"establish the time-frames of the premiums to be received by the solar thermal power plants registered in the pre-assignment registry, but without a final commissioning certificate because it is the technology with the greatest degree of penetration in the medium term and the most committed"*[342]; (ii) the limitation on the use of fossil fuels with premium support to 5 percent of primary energy[343]; (iii) avoid the automatic increase in the X factor of the efficiency in the tariffs and premiums update index (CPI-X); (iv) make uniform the premium on the tariff applicable to solar thermal plants to avoid situations of over-remuneration[344] (v) the partial financing of the Kingdom of Spain premiums charged to income charged to CO2 auctions, performed under Directive 2009/29/EC[345]; (vi) the possible partial financing of premiums of the SR partially charged to sectors responsible for the consumption of fossil fuels or alternatively through the General State Budget; (vii) the

[338] Information on the public consultation on regulatory adjustment measures in the energy sector of 2 February and 9 March 2012, published at the National Energy Commission website: www.cne.es. R-0194.
[339] Report on the Spanish Energy Sector. Introduction and Executive Summary. National Energy Commission, 7 March 2012 R-0131.
[340] These same issues will be highlighted by the European Commission in its document European Commission guidance for the design of renewable support schemes, Commission Staff Working Document SWD (2013) 439 final, 5 November 2013. R-0200.
[341] Report on the Spanish Energy Sector. Introduction and Executive Summary, National Energy Commission, 7 March 2012, page 2. "In recent years new challenges and problems in regulatory models that were established at the beginning of the liberalisation of European energy markets are emerging. The triggers are many and specific for each country in general. Among the common, the fall in demand for energy products, the difficulty of financing new infrastructures associated with the economic crisis, the rising price of fossil fuels and the introduction of measures against climate change should be noted. They all can exert upward pressures on prices that final consumers pay in respect of use of energy facilities and/or acquisition of energy, depending on the regulatory and financing mechanisms chosen in each country." (emphasis added) R-0131.
[342] "Report on the Spanish Energy Sector Part I. Measures to guarantee the financial-economic sustainability of the electricity sector, National Energy Commission, 7 March 2012, pages 52. R-0131.
[343] Ibid, pages 23 and 24.
[344] Ibid, page 23.
[345] Ibid, page 40.

modulation of the rate of penetration initially expected in the PER in line with the provisions of Royal Decree-Act 1/2012[346];

574. It also proposed measures to be taken in the medium term: (i) a revision of the existing regulation proposing two mechanisms: the establishment of competitive mechanisms (auctions) and premiums based on cost regulatory information[347]; (ii) the removal of subsidies from the end of economic life (estimated useful life) of the plant[348]; (iii) Consideration of the premium's ceiling and floor, so that when the market price exceeds the ceiling, the premium is returned as the system net tax income[349]; (iv) allocation of actual operating costs (additional power reserves, management of deviations in real time or of cross-border balance service mechanisms[350]

(18) National Reform Programme and Memorandum of Understanding with the EU, 2012

575. On April 27 the Government approved[351] the "National Reform Programme 2012"[352]. In the section: *"Actions aimed at solving the existing imbalance between the revenues and costs of the electricity system"* (pages 208 and 209), reaffirms the commitment of the Kingdom of Spain to eliminate the tariff deficit.[353]

576. This need was appreciated and expressly stated by the International Monetary Fund in June 2012[354]. Likewise, this was also appreciated and stated at the European Union Council's Recommendations of 10 July 2012 on the National Reform Programme 2012 and the Council Opinion on the Stability Programme for Spain 2012-2015:

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[346] Ibid, pages 40 and 41.
[347] Ibid, pages 73-80.
[348] Ibid, pages 81-82.
[349] Ibid, pages 82 and 83.
[350] Ibid, pages 84 and 85.
[351] Reference from the Council of Ministers, 27 April 2012. www.lamoncloa.gob.es R-0195.
[352] National Reform Programme 2012, Spanish Government. R-0121.
[353] National Reform Programme 2012, Spanish Government: "The Government has a firm commitment to eliminating the tariff deficit and the repayment of accumulated debt in a reasonable time. The effort in achieving this objective shall be divided equally among consumers, the public sector and the private sector in the context of a profound reform of the electricity sector, which will involve measures to reduce the costs of regulated activities, an increase of toll revenues, the review of energy planning and establishment of a stable regulatory framework. Reduction of the costs of regulated activities: The path of the costs of the regulated activities has been strongly expansionary since 2006. Since that year the average revenue per access fee has increased by 70% in cumulative terms, while the access cost has increased by 140%. The three most significant access cost items today are the special regime premiums (40.3% of total costs), the items with a greater contribution to the growth of regulated activities' costs have been special regime premiums [...] items which have increased fivefold since 2006. [...] In the immediate future, these measures will deepen, so that all sectors will contribute evenly to the adjustment of regulated costs." (emphasis added) R-0121.
[354] The International Monetary Fund in "Article IV Consultation with Spain Final Statement of IMF Mission, Madrid, 14 June 2012", states in Section 19, *"The implementation of the other planned structural reforms will be important to complement the labour reform. [...] and the Government's reform agenda of is properly focused on [...] the elimination of the tariff deficit. It is important that these reforms were implemented quickly and effectively - a detailed and ambitious timetable would help to structure and communicate efforts"*. (emphasis added) R-0196.

"Complete electrical and gas interconnections with neighbouring countries and address the tariff deficit in the electricity sector globally, particularly improving the profitability of the power supply chain"[355] *(emphasis added).*

577. That is, the reform that was being announced was part of a set of structural macro-economic control measures taken following the recommendations of the European Union and the International Monetary Fund. These measures have affected all citizens and Spanish companies, which have had to make sacrifices or bear charges in a very negative economic environment. Included as such are the macro-economic control measures taken in: (i) the labour market, (ii) social protection by reducing spending on it, (iii) Public Administration, by taking measures to reduce its size and (iv) reduction of wages in the public sector, and so on.

578. The Kingdom of Spain faced macro-economic control measures in the framework of reforms in the electricity sector to meet international commitments. The Council Recommendations of March 2012 have already been stated[356]. However, because of its binding nature, the Memorandum of Understanding signed with the European Union on 20 July 2012 is also worth noting, as a result of the need certain Spanish banks had for a bailout. Said Memorandum links the financial situation with other macroeconomic imbalances and commits the Kingdom of Spain to adopt structural reform measures to correct these imbalances[357]. In the mid of such structural reforms, the Memorandum expressly refers to the need to "*address the electricity tariff deficit in a comprehensive way*".

579. In this economic and legal context, the adoption of macro-economic control measures also in the framework of the electricity regulation was reasonable and justified. This, in the light (1) of the unsustainable imbalance in the SES, after the reduction of demand due to the economic crisis and (2) the accumulated tariff deficit. This need for reform was specifically observed and required, as has been accredited by the IMF and the EU.

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[355] Council Recommendation of 6 July 2012 on the National Reform Programme 2012 of Spain and delivering a Council opinion on the Stability Programme for Spain, 2012-2015. R-0062.

[356] Council Recommendation of 10 July 2012 on the National Reform Programme 2012 of Spain and delivering a Council opinion on the Stability Programme for Spain, 2012-2015. R-0063.

[357] Memorandum of Understanding signed with the European Union on 20 July 2012: "*VI. Public Finances, Macroeconomic Imbalances And Financial Sector Reform:*

29. "There is a close relationship between macroeconomic imbalances, public finances and financial sector soundness. Hence, [...], with a view to correcting any macroeconomic imbalances as identified within the framework of the European semester, will be regularly and closely monitored in parallel with the formal review process as envisioned in this MoU. [...]

31. Regarding **structural reforms**, the Spanish authorities **are committed** to implement the country-specific recommendations in the context of the European Semester. These reforms aim at **correcting macroeconomic imbalances,** as identified in the in-depth review under the Macroeconomic Imbalance Procedure (MIP). In particular, these recommendations invite Spain to: [...] 6) [...] address **the electricity tariff deficit in a comprehensive way**." (emphasis added) RL-0067.

F. The Claimants' investment

580. The Claimants have invested in eight wind energy projects in Spain that are the object of this arbitration: Marmellar, Lodoso, El Perul, La Lastra, Lora I, Lora II, Sargentes and Arroyal.

581. Below we will analyse the most significant aspects of said investment for the purposes of this arbitral procedure. Among other matters, we will analyse how the Claimants knew about the possibility of regulatory changes when making their investment.

(1) Date of the investment

582. The Claimants made their investment in the wind sector in Spain on 8 May 2012.

583. On that date, the purchase by Watkins Spain S.L. (the third Claimant), Redpier S.L. (the fourth Claimant) and Northsea Spain S.L. (the fifth Claimant) of the equity shares in Parque Eólico Marmellar S.L. (the sixth Claimant) and Parque Eólico La Boga S.L. (the seventh Claimant) was closed[358]. Parque Eólico Marmellar S.L. and Parque Eólico La Boga S.L. own the wind farms that are the object of this arbitration[359].

584. On that same date and through the same agreement[360], the acquisition by Watkins Holdings S.à.r.l. (the first Claimant) and by two other group companies that are not claimants[361] of intra-group loans granted to Parque Eólico Marmellar S.L. and Parque Eólico La Boga S.L. was likewise closed.

585. This is explained by the Claimants in their Statement of Claim:

> *"On 8 May 2012, upon fulfilment of the conditions precedent applicable to the Wind Farms, the entire share capital of the Project Companies were transferred to Watkins Spain, Redpier and Northsea. On that same date, the intragroup loans in place between the Project Companies and the sellers were transferred to Watkins Holdings, Redpier Holdings S.à r.l. and Northsea Holdings S.à r.l."*[362] *(footnotes omitted)*

(2) Speculative nature of the investment

586. The nature of the investment by the Claimants in the wind farms, object of this arbitration is speculative.

587. The Claimants' strategy regarding their investment in the Spanish wind sector consisted in acquiring the wind farms and reselling them after five years, obtaining a

[358] Closing Agreement for the purchase of shares and intra-group loans dated 8 May 2012. C-121
[359] Parque Eólico Marmellar S.L. owns the Marmellar wind farm, and Parque Eólico La Boga S.L. owns the Lodoso, El Perul, La Lastra, Lora I, Lora II, Sargentes and Arroyal wind farms.
[360] Closing Agreement for the purchase of shares and intra-group loans dated 8 May 2012. C-121
[361] Redpier Holdings S.à.r.l. and Northsea Holdings S.à.r.l.
[362] Statement of Claim of 14 November 2016, paragraph 213.

capital gain with the sale. This is explained by the Claimants themselves in their Statement of Claim:

> *"On 8 February 2016, the Claimants sold the Wind Farms, nearly five years after the initial investment. The sale of the Wind Farms was part of the exit strategy that the Claimants had envisioned from the outset. This strategy entailed acquiring a solid platform of wind farms, adding value to the holding company by both improving the operational performance of the Wind Farms and selling the investment after five years."*[363] *(footnotes omitted)*

588. It should be noted that the acquisition and subsequent sale of the investment by the Claimants followed the strategy that had been designed. According to the Claimants themselves, they acquired their investment on 8 May 2012 for the amount of 91 million euros, and they sold it on 8 February 2016 for the amount of 133 million euros, thus obtaining a significant capital gain with such sale.[364]

(3) The Claimants have not provided any legal due diligence on the Spanish regulatory framework requested by them before making their investment

589. In their Statement of Claim, the Claimants affirm that before making their investment in the renewables sector of Spain they carried out a detailed due diligence process during which they conducted a comprehensive analysis of the Spanish regulatory regime.[365]

590. However, the Claimants have not provided with their Statement of Claim any legal due diligence on the Spanish regulatory framework requested by them during said due diligence process.

591. The only document provided by the Claimants that contains a legal opinion about the Spanish regulatory framework is a memorandum from Allen&Overy dated 24 February 2010[366]. According to the Claimants, such memorandum informed their understanding that the tariffs established by Royal Decree 661/2007 were guaranteed[367]. However, this memorandum cannot be accepted as proof of the arguments of the Claimants for the following reasons:

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[363] Statement of Claim of 14 November 2016, paragraph 49.
[364] Brattle Expert Report on Quantum of 14 November 2016, paragraph 32. The mentioned purchase and sale prices each include both the equity consideration and the intra-group loans.
[365] Statement of Claim of 14 November 2016, paragraph 191: "*the Claimants conducted a thorough analysis of the stability of the regulatory regime, […]. In addition, the Claimants also carried out a focused due diligence process covering a number of areas (technical, financial, tax, accounting and legal), in combination with the analysis of the regulatory regime.*"
[366] Allen & Overy Memorandum on the tariff risk of Royal Decree 661/2007 in relation to the retroactive effect of future regulations. C-102
[367] Statement of Claim of 14 November 2016, paragraph 192. "*The Claimants' understanding that the RD 661/2007 FIT was guaranteed was informed by legal advice when analysing investment opportunities in the Spanish RE sector. […] the Claimants specifically instructed their lawyers, Allen & Overy, to prepare a legal note which addressed the RD 661/2007 regulatory regime (the A&O Memorandum)*"

a) Firstly, the memorandum is not addressed to the Claimants, it is addressed to T-Solar.[368]

b) Secondly, the date of the memorandum is not contemporaneous with the date of the Claimants´ investment.

The date of the memorandum is February 2010. After February 2010 and before the Claimants' investment, retroactive regulatory changes already took place in the Spanish renewable sector.

Specifically, at the end of 2010, retroactive regulatory changes were approved, according to the Claimants' concept of retroactivity, which affected wind energy producers and, particularly, photovoltaic producers. Said changes were carried out by Royal Decree 1565/2010, Royal Decree 1614/2010 and Royal Decree-Act 14/2010.[369]

These regulatory changes, prior to the Claimants' investment, clearly showed that Article 44(3) of Royal Decree 661/2007 did not represent a petrification of the remuneration conditions of renewable energy producers established in such Royal Decree.

We must recall that these retroactive regulatory changes approved at the end of 2010 were validated by the Spanish Supreme Court itself in numerous judgements, the first of which was dated 12 April 2012[370], in line with its previous case law.

It should also be noted that the retroactive regulatory changes approved at the end of 2010 were the object of an investment arbitration filed against the Kingdom of Spain under the ECT, which the Arbitral Tribunal of that arbitration resolved in favour of the Kingdom of Spain, wholly rejecting the claims of the claimants regarding the merits of the case.[371]

c) Thirdly, the opinion of Allen & Overy regarding the Spanish regulatory framework contained in the memorandum of February 2010 is not even shared by the recipient of said memorandum, T-Solar.

The opinion of Allen & Overy about the supposed petrification of the specific remuneration conditions set forth in Royal Decree 661/2007 did not seem to even

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[368] Allen & Overy Memorandum on the tariff risk of Royal Decree 661/2007 in relation to the retroactive effect of future regulations:
"*Allen & Overy*
MEMORANDUM
To T-SOLAR
From Antonio Vázquez-Guillén / Noemí Alonso Allen & Overy" (emphasis added) C-102

[369] On 19 November 2010, Royal Decree 1565/2010 of 19 November was approved, which regulates and modifies certain aspects pertaining to the activity of electrical energy generation under the special scheme. On 7 December 2010, Royal Decree 1614/2010 of 7 December was approved, which regulates and modifies certain aspects related to of electrical energy generation using solar thermal electric and wind power technologies. On 23 December 2010, Royal Decree-Act 14/2010 of 23 December was approved, which establishes urgent measures for correction of the tariff deficit in the electricity sector.

[370] See Section IV.D of the present Memorial.

[371] Charanne B.V. and Construction Investments S.A.R.L. c. Kingdom of Spain (SCC V 062/2012), Final Award of 21 January 2016 and dissenting opinion. RL-0049

convince T-Solar for an obvious fact: T-Solar filed a claim in July 2011 before the Spanish Supreme Court against Royal Decree 1565/2010, one of the regulations of the end of 2010 that introduced regulatory changes. In said claim, T-Solar expressly acknowledges that: i) the activity of electrical energy generation from renewable sources, under the special regime, is subject to a regulatory risk; ii) that possible regulatory changes are limited by the reasonable return that has to be assured for producers in any case; and iii) that said reasonable return is close to 7%.[372] Furthermore, such claim expressly refers to the case law that the Supreme Court had been maintaining since 2005 and that configured the legitimate expectations of any investor in the Spanish renewable energy sector.[373]

Like T-Solar, other investors filed similar claims against the retroactive regulatory changes of late 2010. However, we must insist that all these claims were dismissed. Those regulatory changes were declared valid by the Spanish Supreme Court through numerous judgements, the first one being dated 12 April 2012[374]. Those judgements were in line with the case law that the Supreme Court had been maintaining since 2005, which does not coincide with the interpretation of the regulatory framework made by the Claimants.

592. Finally, there is knowledge that a legal due diligence requested by the Claimants before making their investment in Spain, commissioned to the Spanish law firm Uría Menéndez exists[375]. We are unaware if the purpose of said legal due diligence is to analyse the Spanish regulatory framework or different legal matters. In any event, said legal due diligence has not been provided by the Claimants and therefore the Kingdom of Spain will request it during the document production phase.

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[372] Claim from T-Solar Global S.A. Group and others, of 4 July 2011, filed before the Spanish Supreme Court against Royal Decree 1565/2010, contentious administrative appeal number 1/64/2011.

Page 130: "*the activity of electricity production under the special regime, which is subject to undeniable risks (which include technological risk, financial risk, operation and maintenance risk, environmental risk and regulatory and political risk, the existence of which is clearly proved by this claim)*" (emphasis added)
Page 127: "*it is undeniable that article 30.4 of the Electricity Sector Act subjects the legality of regulation of premiums to compliance with a specific objective, which is that of maintaining reasonable rates of return in relation to the cost of money in the capital market. Any determination (and, likewise, any modification) of these premiums has to comply with this canon of legality, such that when the premium no longer offers a reasonable return in relation to the cost of money in the capital market the regulation that governs it will be contrary to Law by infringement of Law 54/1997*." (emphasis added)
Page 128: "*Neither the Electricity Sector Act nor its implementing regulations say anything about what can be defined as reasonable profitability with reference to the cost of money in the capital market. However, there are some estimates in this respect that should be considered as an authentic interpretation of the concept; in this respect, the 2005-2010 Renewable Energies Plan […] defined the reasonable nature of profitability in the rate […] as being approximately 7%*" (emphasis added) R-0267

[373] Claim from T-Solar Global S.A. group and others, of 4 July 2011, brought before the Spanish Supreme Court against Royal Decree 1565/2010, contentious administrative appeal number 1/64/2011, pages 78 to 80. R-0267

[374] See section IV.D of the present Memorial.

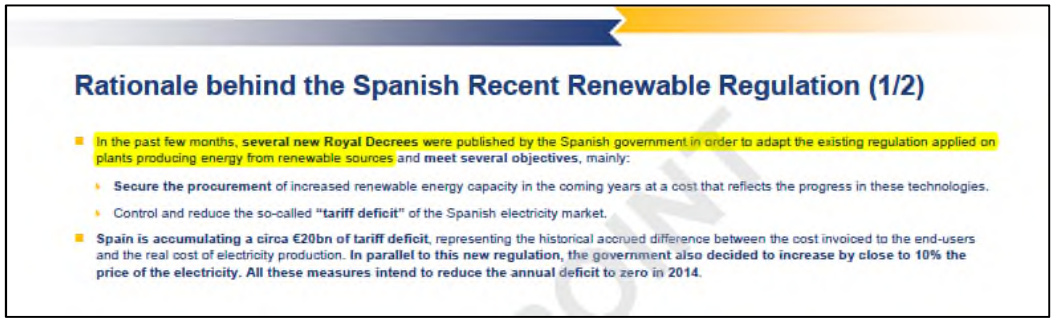
[375] Such legal due diligence is mentioned in document C-113, pdf page 39.

(4) All other reports obtained by the Claimants before making their investment do not recognise the alleged immutability of the remuneration regime

593. The remaining reports obtained by the Claimants before making their investment in the wind farms object of this arbitration which have been provided with the Statement of Claim, do not recognise the alleged immutability of the remuneration regime of renewable energy producers, which the Claimants try to sustain before this Arbitral Tribunal.

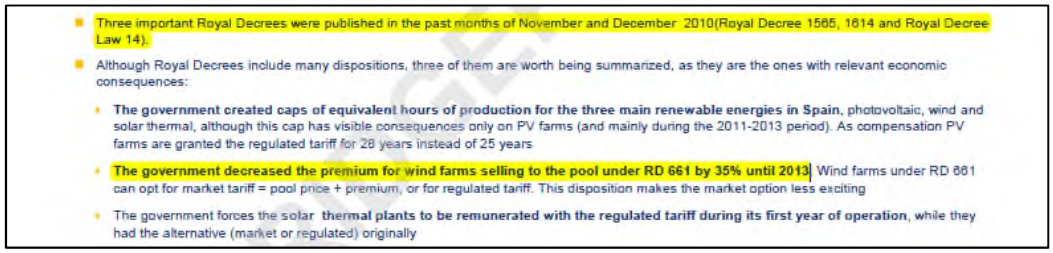
594. First of all, we can refer to the "Information Memorandum" of May 2011, which Société Générale and Mediobanca submitted to the Claimants regarding the opportunity to invest in the wind farms object of this arbitration[376]. Said "Information Memorandum" contained general information regarding the investment and details of the wind farms.

595. Without prejudice to the fact that the "Information Memorandum" itself warns that the content thereof must not be considered legal advice[377], in any event said "Information Memorandum" makes reference to the retroactive regulatory changes in the renewable energies sector that had already occurred at the end of 2010, changes that were not prevented by the existence of Article 44(3) of Royal Decree 661/2007. In this sense, the "Information Memorandum" indicates the following:



Rationale behind the Spanish Recent Renewable Regulation (1/2)

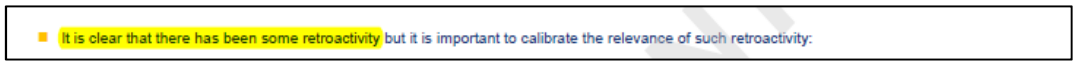
- In the past few months, **several new Royal Decrees** were published by the Spanish government in order to adapt the existing regulation applied on plants producing energy from renewable sources and **meet several objectives**, mainly:
  - **Secure the procurement** of increased renewable energy capacity in the coming years at a cost that reflects the progress in these technologies.
  - Control and reduce the so-called **"tariff deficit"** of the Spanish electricity market.
- **Spain is accumulating a circa €20bn of tariff deficit**, representing the historical accrued difference between the cost invoiced to the end-users and the real cost of electricity production. **In parallel to this new regulation, the government also decided to increase by close to 10% the price of the electricity. All these measures intend to reduce the annual deficit to zero in 2014.**



- Three important Royal Decrees were published in the past months of November and December 2010(Royal Decree 1565, 1614 and Royal Decree Law 14).
- Although Royal Decrees include many dispositions, three of them are worth being summarized, as they are the ones with relevant economic consequences:
  - **The government created caps of equivalent hours of production for the three main renewable energies in Spain**, photovoltaic, wind and solar thermal, although this cap has visible consequences only on PV farms (and mainly during the 2011-2013 period). As compensation PV farms are granted the regulated tariff for 28 years instead of 25 years
  - **The government decreased the premium for wind farms selling to the pool under RD 661 by 35% until 2013**. Wind farms under RD 661 can opt for market tariff = pool price + premium, or for regulated tariff. This disposition makes the market option less exciting
  - The government forces the solar **thermal plants to be remunerated with the regulated tariff during its first year of operation**, while they had the alternative (market or regulated) originally

[376] "Information Memorandum" of Société Générale and Mediobanca on the Greco Project, dated May 2011. C-103

[377] "Information Memorandum" of Société Générale and Mediobanca on the Greco Project, dated May 2011, pdf page 2: "*The Investor should not construe the contents of this presentation as legal, tax, accounting or investment advice or a recommendation. The Investor should consult its own counsel, tax and financial advisers as to legal and related matters concerning any transaction described herein. […] No investment, other financial decisions or actions should be based solely on the information in this presentation*." C-103



596. We must insist that the legality of these retroactive changes that occurred at the end of 2010 has been endorsed by the Spanish Supreme Court, following the doctrine that said Supreme Court already maintained since 2005.

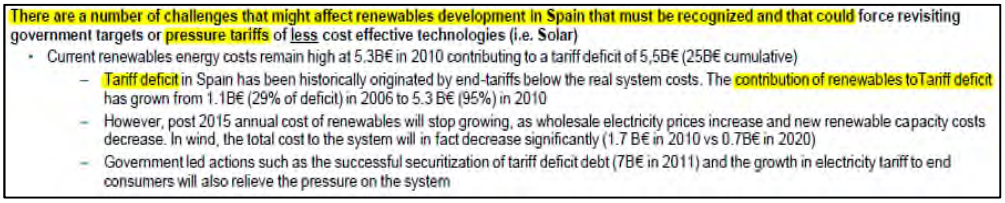
597. We can also refer to the "Commercial Due Diligence" of the Boston Consulting Group obtained on 6 July 2011 during the due diligence process prior to acquisition of the investment object of this arbitration by the Claimants.[378]

598. Without prejudice to the fact that such document is not a legal due diligence on the regulatory framework of the Spanish renewable sector either, said "Commercial Due Diligence" also refers to the fact that there had already been retroactive regulatory changes in 2010.[379]

599. Moreover, that "Commercial Due Diligence" does not refer at any time to a supposed immutability or petrification of the tariffs to be received by renewable energy producers. It does not state that new retroactive regulatory changes are impossible. It says that they are "unlikely". Therefore, even though in its opinion they are unlikely, it recognises that such changes are possible.[380]

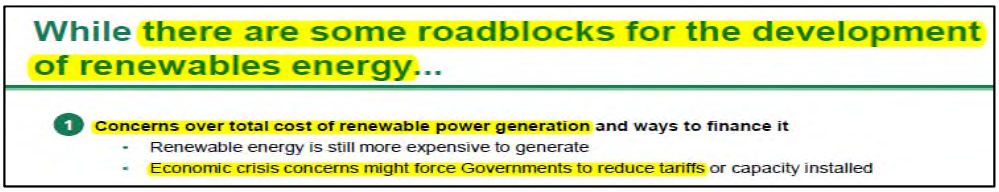
600. In fact, the "Commercial Due Diligence" itself recognises the existence at the time it is issued, July 2011, of one of the circumstances that had already triggered the regulatory changes that took place in the Spanish renewables sector before the measures disputed in this arbitration: the risk to the economic sustainability of the Spanish electricity sector.

601. In this regard, the "Commercial Due Diligence" warns that there are a series of challenges that could affect the renewable sector in Spain and the tariffs that renewable energy producers receive, among which is the tariff deficit particularly[381]:



602. Likewise, the "Commercial Due Diligence" indicates that[382]:

[378] "Commercial Due Diligence" of the Boston Consulting Group, of 6 July 2011. C-115
[379] "Commercial Due Diligence" of the Boston Consulting Group, of 6 July 2011, pages 16, 28 and 29 of the pdf. C-115
[380] "Commercial Due Diligence" of the Boston Consulting Group, of 6 July 2011, page 16 of the pdf:"*The regulatory framework for wind onshore in Spain has remained very stable and any material retroactive changes on wind regulation are very unlikely*". Página 28 del pdf: "*It is unlikely to have retroactive regulatory changes affecting wind profitability*". C-115
[381] "Commercial Due Diligence" of the Boston Consulting Group, of 6 July 2011, page 17 of the pdf. C-115



603. In addition, this "Commercial Due Diligence" also acknowledges that both the previous regulation on remuneration of renewable energy producers and the new regulation aim to grant a return of approximately 7%-8%. [383]

604. Other reports, contemporaneous with the aforementioned reports commissioned by the Claimants, already warned about the risk of future regulatory measures to ensure the economic sustainability of the Spanish electric system and eliminate situations of over-remuneration, the two objectives that had already justified past regulatory measures. Moreover they warned that future reforms would affect all technologies. In this regard, we can mention a report issued in March 2011 by the consulting firm Pöyry, who warned that:

> *"If the zero tariff deficit target by end of 2012 is postponed, it will open up the opportunity to more deficit generation, Considering the Government behavior, it is likely that future changes might be implemented if considered needed. RDL 14/2010 is aimed at tackling the lack of funds in the electricity system, reducing the revenue of renewable generators as well as introducing additional revenue sources (i.e., grid tolls). We feel that the Government is in a position to continue with the same energy policy, if considered a requirement, including implementation of further reductions in remuneration to renewables and non-renewable technologies"*[384]

605. In brief, the two aforementioned reports commissioned by the Claimants before making their investment prove that the Claimants knew that there was no guarantee or commitment to the immutability of the remuneration regime of renewable energy producers provided for in Royal Decree 661/2007. The Claimants knew that there had already been retroactive regulatory changes in the renewable sector at the end of 2010 and that new changes could occur again in the future.

(5) The contracts of the Claimants: the possibility of regulatory changes is expressly foreseen in the contract of acquisition of the investment

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[382] "Commercial Due Diligence" of the Boston Consulting Group, of 6 July 2011, page 12 of the pdf. C-115

[383] "Commercial Due Diligence" of the Boston Consulting Group, of 6 July 2011, page 16 of the pdf: "*For wind assets entering the market after 2012, a new Royal Decree will be issued later in 2011 providing new remuneration scheme. The regulation is expected to guarantee a reasonable project rate of return of 7-8%. Actual project returns are slightly higher, despite previous regulations had the same target returns of 7-8%*". C-115

[384] Pöyry Management Consulting, "Current State and Future Trends of Solar Power in Spain: An ILEX Energy Report to RREEF Infraestructure", page 139 of the pdf. R-0268

606. The Claimants have provided with the Statement of Claim the Sale and Purchase Agreement whereby they acquired their investment in the wind farms object of this arbitration, as well as the Closing Agreement of said purchase.[385]

607. The most evident proof that the Claimants knew before making their investment about the possibility of regulatory changes is precisely the Sale and Purchase Agreement whereby the Claimants acquired their investment.

608. Said Sale and Purchase Agreement expressly foresees the possibility of regulatory changes and it is agreed that the sellers will not be liable for those regulatory changes, whether retroactive or not.

609. In this regard, section 11 of the Agreement refers to "THE SELLERS´ LIABILITY". In that section, clause 11.5 sets forth the following:

> 11.5 **Changes in legislation or in interpretation of existing rules**
>
> The Sellers shall not be liable for any Damage where that Damage is the result (i) of the approval or amendment of any rules, or of the current interpretation of any rules, whether or not having retroactive effect, arising subsequently to the date of this Agreement, or (ii) any change in the accounting or tax management procedures made by the Buyers or the Companies after the Closing Date.

610. On the other hand, the Claimants have not provided with the Statement of Claim other contracts related to their investment, such as the bank financing agreements. It would be convenient to know the bank financing contracts signed by the Claimants regarding the wind farms object of this arbitration, and thus the Kingdom of Spain will request them in the document production phase.

G. The measures challenged by the Claimant in this proceeding.

(1) Justification of the regulatory measures challenged

611. The justification of the measures taken by the Kingdom of Spain can only be approached from a rational understanding of the SES as a whole. In this sense, we should not forget that the activity of subsidized production from renewable sources is an integral part of the SES and, therefore, is subject to its principles and purposes.

612. Indeed, the achievement and maintenance of these principles and purposes prompted the adoption of various regulatory measures that are the subject of this arbitration. It must be emphasised from the outset that, contrary to what appears from the Claimant's Memorial, these measures affected all the activities of the SES and not only the SR production.

[385] Sale and Purchase Agreement, of 12 August 2011 (C-35) and Closing Agreement, of 8 May 2012 (C-121).

613. It is not disputed that, at the time the measures were adopted, Spain was suffering the impact of a profound international economic and financial crisis. The effects of the crisis can be assessed taking into account the following macroeconomic parameters[386]:

Table 1 – Macroeconomic indicators of Spain

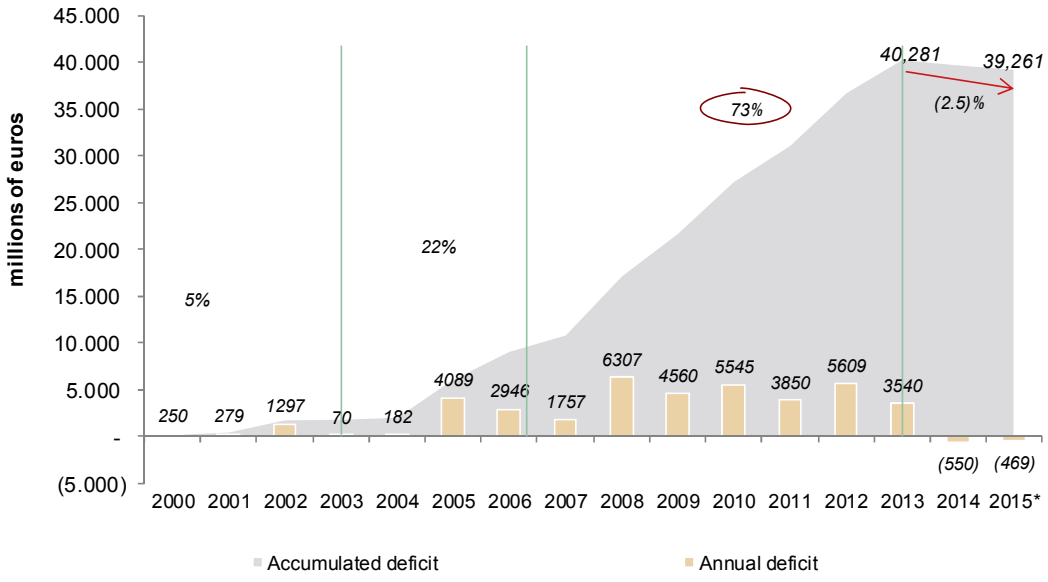
Indicator	2007	2008	2009	2010	2011	2012	2013
State Revenue	442	410	376	392	387	391	394
Public deficit (in % GDP)	2.0 %	(4.4)%	(10.9)%	(9.4)%	(9.5)%	(10.5)%	(7.0)%
Unemployment Rate	8.2 %	11.3 %	17.9 %	19.9 %	21.4 %	24.8 %	26.1 %
Variation of GDP	3.8 %	1.1 %	(3.6)%	0.0 %	(1.0)%	(2.6)%	(1.7)%

Source: IMF Database, Bloomberg and Accuracy analysis. Attached Document ACQ-0011.

614. This crisis resulted in a sharp drop in electricity demand for the SES. Such reduction in demand resulted, hence, in a substantial reduction in income available to the SES to address its costs, which included the subsidies to renewables.

615. At this point it is appropriate to compare the primary energy consumption projected at the time of preparation of the PER 2005-2010 and the actual primary energy consumption:[387]

Figure 5 – Tariff Deficit of the Spanish Electrical System



Source: CNMC Report for 2000-2014 and 2015 information obtained from a MINETUR press release. Attached Documents ACQ-0009 and ACQ-0010.

[386] Accuracy report. Paragraph 39.
[387] Accuracy report. Paragraph 38.

616. Meanwhile, the costs of the SES, designed in the context of a radically different economic situation, not only remained but increased. This compromised the economic sustainability of the SES.

617. In this context, the different preliminary analyses, regulatory developments, technical knowledge and technological developments, revealed the existence of remunerations which, either by up or down, did not maintain the criterion of reasonable return established for the remuneration of the so-called special regime.

618. These regulatory adjustments not only have affected facilities as those of the Claimant, but also have spread to all the facilities receiving remuneration under the electrical system. A comprehensive and proportionate response has been given to the unsustainable imbalance issue in the SES. In addition, measures have been undertaken, *inter alia*, subject to a thorough analysis of the remuneration, which affects almost all activities of the electrical system.

619. Thus, before addressing the challenged measures in this arbitration, a short paragraph will be dedicated to measures concerning other sectors of the SES activity, which have been affected by these regulatory adjustments.

(1.1) Transmission and distribution activities

620. The reform revises remuneration methodologies for Transmission and Distribution activities in accordance with the costs required to perform the activity for an efficient and well-managed company and by applying uniform criteria throughout the Spanish territory[388].

621. However, reasonable return was not guaranteed but rather, *adequate remuneration.* This concept has been translated in fixing return as average performance of State Obligations to ten years in the secondary market increased at a spread of 200 basis points[389]. Therefore, 6.398%; i.e. lower remuneration received for these activities than by renewable energy production facilities.

622. 6-year regulatory periods and revisions are also established based on remuneration parameters that influence the perception of the remuneration of each of these activities to their investments. This new regulation affects all facilities regardless of their date of implementation and is developed through regulations that were approved on 27 December 2013[390].

[388] Royal Decree-Act 9/2013. Article 1 (1). R-0095.
[389] Ibid. Article 6 (1). R-0095.
[390] Royal Decree 1047/2013, of 27 December, which establishes the methodology for calculating the remuneration for electricity transmission (R-0108) and Royal Decree 1048/2013, of 27 December, which establishes the methodology for calculating the remuneration for electricity distribution and other regulations. R-0109.

(1.2) Production remuneration regime in non-mainland systems.

623. Very significant changes have affected the remuneration of the electricity production economic system in non-mainland electricity systems (Balearic Islands, Canary Islands, Ceuta and Melilla).

624. The measures taken have led to a reduction in the remuneration received by companies that generate electricity in those territories over 600 million euros. The net asset value, the non-remuneration of facilities, the accrual period of amounts, updating the price of fuel used, the criteria for the system's technical management system and facility processing have been affected.

625. The regulation has been introduced in Royal Decree Acts 13/2012[391], 20/2012[392], 9/2013[393], in Act 24/2013[394] and Act 17/2013[395] of 29 October, on guaranteeing supply and increasing competition in the electricity systems of the mainland and non-mainland territories.

(1.3) Capacity Payments

626. Capacity payments are subsidies that are paid to holders of certain power generation facilities, mainly combined cycles, to give security to the power supply even when its power is not added to the system. They were granted as a result of increased renewable generation and given the feature of renewable energies of not being manageable by people.

627. I.e. daily wind power generation or in certain areas wind power generation at a higher intensity cannot be managed. As explained when stating the SES[396], "backup power" that will guarantee the supply to decreases in production is necessary.

628. The amount corresponding to the incentive for investment in long term capacity for production facilities dropped from 26,000 to 10,000 €/MW/year and the term left to cover the period of 10 years was doubled.[397]

(1.4) Non-interruption system

629. The non-interruption system has also undergone a very significant regulatory change that has resulted in a decline, in 2014, of 300 million euros on a lower remuneration than 700 million [398]euros.

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[391] Royal Decree-Act 13/2012, of 30 March. R-0092.
[392] Royal Decree-Act 20/2012, of 13 July. R-0093.
[393] Royal Decree-Act 9/2013, of 12 July. R-0095.
[394] Act 24/2013, of 26 December 2013. R-0077.
[395] Act No. 17/2013, of October 29, on guaranteeing supply and increasing competition in the electricity systems of the mainland and non-mainland territories R-0078.
[396] IV.A.3 section of this Counter-Memorial.
[397] Royal Decree-Act 9/2013. Article 7. R-0095.
[398] Order IET/2013/2013, of 31 October, regulating the competitiveness mechanism of allocating the management service of non-interruption demand R-0114.

630. To this end an auction system was established. Under this system all companies that want to provide the service offer the price they are willing to interrupt their electricity consumption. Thus, the energy to be consumed is used to cover lack of generation situations.

(1.5) Supply guarantee restriction procedure.

631. The supply guarantee restriction procedure subsidising the operation of coal plants used in the region has been removed. The annual amount was over 480 million euros[399].

(1.6) Contributions from the State Budget to the electrical system for the promotion of renewable energy

632. Finally, it should be stressed that the State Budget included, in the financial years 2013[400], 2014[401] and 2015[402] budget items involving direct contributions to the electrical system to alleviate the existing deficit.

633. In 2015[403] a contribution of 887 million euros was made to finance power generation in non-mainland systems. There is a second batch of 330 million euros to finance the remuneration regime of renewable energy, and a third batch of 2.989 billion euros for the same purpose.

634. This implies that the Spanish taxpayers contribute to the electrical system a total of 4.206 billion euros to promote remuneration regime facilities and which generate power with renewable energy. These amounts are subtracted from other public policies because the State has decided to keep these subsidies under the principle of reasonable return.

(1.7) Social Tariff

635. The social tariff consists of a significant reduction in electricity bills for certain groups of society, such as unemployed people, pensioners, large families and others.[404]

636. This help goes from being a cost charged to the electrical system, to be assumed by the parent group of companies that simultaneously carry out the activities of production, distribution and sale of electricity, particularly affecting traditional power companies and not companies such as the Claimant's.

637. That is, there are a number of companies that must assume a cost, even if this affects their profitability and even if they are holders of renewable energy facilities, since they are within the SES.[405]

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[399] Sole Article of Royal Decree 134/2010, of 12 February, establishing the supply guarantee restriction procedure and modifying Royal Decree 2019/1997, of 26 December, organising and regulating electric energy production market R-0103.
[400] General Budgets' Extract of the Spanish State for 2013. R-0079
[401] General Budgets' Extract of the Spanish State for 2014. R-0080.
[402] General Budgets' Extract of the Spanish State for 2015. R-0081.
[403] General Budgets' Extract of the Spanish State for 2015. R-0081.
[404] Article 45.2 and tenth transitional provision of Act 24/2013: R-0077.

(2) New announcements of energy reforms after the investment was made by the Claimant

638. In this context and more specifically with regard to the renewable energies sector, at the end of 2011 and as we previously stated, it was decided in Spain that it was necessary to reform the electricity sector, targeted at improving the regulatory framework and taking into consideration the changes that have taken place in the SES since the approval of Act 54/1997.

639. Following the worsening of the economic and financial crisis stemming from the financial bailout of banks and some Spanish Autonomous Communities, the Government undertook different actions to show the markets the proximity of the structural reforms announced in the Prime Minister's inaugural speech and which have been backed by both the International Monetary Fund and the European Union.

640. In September, the Government published another document: "*The reforms of the Government of Spain: Determination to face of the crisis*"[406]. In the Chapter called "*Projected reforms*", there is reference to the "Reform of the energy sector":

> *"Very shortly, the reform of this sector shall be approved through a Bill of Energy Reform, to ensure that the cost of energy does not condition the competitiveness of our economy to such an extent. The aim is to provide a definitive solution to the problem of the huge tariff deficit of our energy system."*

641. On 27 September, at the Council of Ministers, the Government approves the "Bill of General State Budgets for 2013"[407]. This Council of Ministers also approves the "Spanish Strategy for Economic Policy: Balance and structural reforms for the next six months"[408]. This Strategy mentions the "Energy reform" and announces the take-up of structural measures to correct the tariff deficit once and for all, as well as presents a new Electricity Sector Act to resolve the inefficiencies that had been detected.

642. In 2012, in addition to RD-Act 1/2012, the Government approved two other royal decrees-acts (Royal Decree-Act 13/2012[409] and Royal Decree-Act 20/2012[410]), which contained important measures to cut the cost of the system. None of these measures affected renewable generation facilities, although they did affect ordinary generation facilities and the owners of distribution and transmission facilities, which had their remuneration significantly reduced.

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[405] Royal Decree-Act 9/2013, Article 8. R-0095.
[406] *The reforms of the Government of Spain: Determination to face the crisis*, State Secretariat of Communication of the Ministry of the Presidency, September 2012. Chapter III, Page 18. R-0174.
[407] Reference from the Council of Ministers of 27 September 2012, www.lamoncloa.gob.es. R-0197.
[408] Spanish Strategy of Economic Policy: Balance and structural reforms for the next six months, Government of Spain, 27 September 2012. Section C.8, page 70. R-0122.
[409] Royal Decree-Act 13/2012, of 30 March, which transposes directives in matters of the domestic electricity and gas markets and in issues of electronic communications, and through which measures are introduced to correct the deviations through imbalances between the costs and revenue of the electricity and gas sectors. R-0092.
[410] Royal Decree-Act 20/2012, of 13 July, on measures to guarantee budgetary stability and promotion of competitiveness. R-0093.

643. Furthermore, there was an important increase of the access tolls payable by consumers[411].

644. However, these measures failed to prevent the continuing growth of the tariff deficit and the consequent aggravation of the risk of financial unsustainability of the SES.

645. The reform in the feed-in system was not only duly announced as we have already stated. The foregoing reform was considered by the sector to be an urgent need. In this regard, in March 2010 the APPA Association stated:

> *"The long promised and long-awaited Renewable Energies Act will be delayed for many further months."*[412] *(Emphasis added)*

646. In line with the foregoing, APPA emphasises, in March 2010, the need for a comprehensive reform of the remuneration regime of renewable energies, by stating that:

> *"The renewable energies sector continues to wait for the promised Renewable Energies Act and fears that the publication thereof will be postponed beyond this legislature due to being subordinate to development of the Sustainable Economy Act"*[413] *(Emphasis added).*

647. With the focus on that necessary Renewable Energies Act, APPA alludes to the draft Bill to which we have made reference. A proposal, let us remember, that was submitted together with Greenpeace. In this regard, APPA summarises the fundamental parts of that proposed regulation in the following sentence:

> *"It is based on the best legislative practices of various countries and on an economically and environmentally sustainable energy model"*[414].

648. In line with the foregoing, in July 2012 it once again pushes the need for a comprehensive and sweeping review of the energy system due to the profound economic crisis suffered by Spain. More specifically:

> *"The Association of Renewable Energy Producers considers that a comprehensive and sweeping review of the energy system is needed, particularly in the current context of economic crisis and in the scenario of rising prices of hydrocarbons"*[415].

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[411] Order IET/843/2012, of 25 April, which establishes the access tolls from 1 April 2012 and certain tariffs and premiums of the special regime installations. R-0113.
[412] "The investment in renewables is very profitable for Spain", APPA Info No. 30 of March 2010. Publishing house. R-0189
[413] "The investment in renewables is very profitable for Spain", APPA Info No. 30 of March 2010. Pages 14 and 15. R-0189
[414] "The investment in renewables is very profitable for Spain", APPA Info No. 30 of March 2010. Pages 14 and 15. R-0189
[415] "Renewables: Moving forward in the world, on the back foot in Spain". APPA info 33, July 2012, pages 14 to 18. R-0021

649. In this context, on 11 March 2013, the Claimant, after adopting some of the measures that were the subject of this arbitration, claimed the need for structural reform of the remuneration model. Thus, the document, "Reviews Committee Paper - 6 Months Review", of 11 March 2013,[416] analyses the causes of the reforms that were implemented by the Kingdom of Spain in the energy sector and that affect renewable energy producers. Said document points out in this regard that "*[t]he reason behind Government's legislative actions is to address the historical deficit between regulated prices and market costs in the electricity industry*"[417] and that "*[t]he local difficult economic conditions are affecting the historical stability and visibility of the energy industry. The Government has approved a number of economic reforms with the objectives of controlling final electricity prices*".[418] It likewise, indicates that *"[t]he Government has announced that a new structural law regulating the electricity sector will be passed*",[419] and it foresees regarding what would be the new Electricity Sector Act (Act 24/2013), that *"[t]he new structural law will provide us with a stable framework to implement our strategy*."[420]

(3) Measures challenged by Claimants

650. The claimants challenge specific measures, which although they will be analysed more specifically to answer their claims on the alleged infringement of ECT as a result of these measures, they are briefly described below:

i. Tax on the value of the production of electrical energy (TVPEE).

ii. The update of remuneration, tariffs and premiums from activities of the electricity sector pegged to the Consumer Price Index at constant taxes excluding unprocessed foods or energy products.

iii. Reduction to 0 euros of the premium in the pool plus premium remuneration option.

iv. RD-Act 9/2013, Act 24/2013 and its implementing rules.

651. According to the results presented above and using the terminology of the CNE, the first four correspond to measures taken in the short term and the fifth with medium-term measures. For clarity, the first four will be analysed first and the fifth will be analysed afterward which, because of its importance, deserves a separate chapter, constituting the current remuneration regime for renewable energy. In any case the following exceptions must be considered:

- The possible economic repercussions that the measures referred to in points (i), (ii) and (iii) could have on the installations have been absorbed by the measures referred to in point (iv).

[416] Reviews Committee Paper – 6 Months Review, 11 March 2013. C-173
[417] Reviews Committee Paper – 6 Months Review, 11 March 2013, page 13 of the pdf. C-173
[418] Reviews Committee Paper – 6 Months Review, 11 March 2013, page 33 of the pdf. C-173
[419] Reviews Committee Paper – 6 Months Review, 11 March 2013, page 13 of the pdf. C-173
[420] Reviews Committee Paper – 6 Months Review, 11 March 2013, page 13 of the pdf. C-173

- Those measures ensure the reasonable return of the plants in a sustainable SES.

(3.1) Tax on the value of the production of electrical energy (TVPEE)

652. This taxation measure was introduced by Act 15/2012[421], an Act to which we will refer briefly before referring specifically to TVPEE.

653. Act 15/2012 is a tax provision that came into force on 1 January 2013.[422]

654. Act 15/2012 creates four new taxes: i) the tax on the value of production of electrical energy (TVPEE), ii) the tax on production of spent nuclear fuel and radioactive waste from the generation of nuclear electric energy, iii) the tax on storage of spent nuclear fuel and radioactive waste at centralised facilities, and iv) the Levy on the use of continental waters for the production of electrical energy. Likewise, Act 15/2012 amends Act 38/1992 of 28 December, on Excise Duties[423]in order to, among other things, introduce changes in the Tax on Hydrocarbons and the Special Tax on Coal. In particular, tax rates established for natural gas and coal are amended, and the exemptions provided for energy products used in electric power production and cogeneration of electricity and useful heat are eliminated.

655. In addition, Act 15/2012 determines that the costs of the electricity system will be financed both from revenue coming from access fees and other regulated prices, such as the corresponding items from the State Budget.

656. In addition to the aforementioned taxes collected for an annual amount of approximately 2.7 Billion euros, an amount equivalent has been included in the State Budget to finance the electrical system for the costs of promoting renewable energy.

657. In this regard, according to Act 15/2012[424], supplemented by Act 17/2012 of 27 December on the State Budget for 2013,[425]the State, in the Acts of the State Budget for

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[421] Act 15/2012, of 27 December, on fiscal measures for energy sustainability. R-0030.
[422] Act 15/2012, Fifth Final Provision: "This Law shall enter into force on 1 January 2013." R-0030.
[423] Act 38/1992, of December 28, on Excise Duties, consolidated version on 28 November 2014. R-0069.
[424] Act 15/2012. Additional provision two:
"Second Additional provision. Costs of the electrical system.
In the General State Budget Laws for each year, in order to finance the costs of the electricity system stipulated in article 16 of Act 54/1997, of 27 November, for the Electricity Sector, an amount equal to the sum of the following shall be allocated:
a) The estimation of the annual collection for the State derived from the taxes and levies included in this Act.
b) The estimated revenue from the auctioning of emission rights for greenhouse gases, with a maximum of € 500 million". R-0030.
[425] Act 17/2012 of 27 December, on the State Budget for 2013, Fifth additional provision:
"Five Contributions to the Financing of the Electricity Sector
1. In the General State Budget Acts for each year, in order to finance the costs of the electricity system stipulated in the Electricity Sector Act referring to promoting renewable energy, an amount equal to the sum of the following shall be allocated:
a) The estimation of annual collection deriving from taxes included in the law on fiscal measures for energy sustainability [Act 15/2012].
b) 90 per cent of the estimated revenue from the auctioning of emission rights for greenhouse gases, with a maximum of € 450 million.

2013, 2014, 2015 and 2016, has allocated an amount equivalent to the collection of taxes included in Act 15/2012 to cover the costs of the electrical system referred to the promotion of renewable energy.

658. Additionally, Act 15/2012 provides that the proceeds from the auctioning of CO2 emission allowances are allocated, with a ceiling, also to the promotion of renewable energy by allocating this amount to the electrical system. In 2013 and 2014 these amounts exceeded 300 million euros.

659. Focusing specifically on the TVPEE created by Act 15/2012, as already discussed in this Counter-Memorial in the section on Jurisdictional Objections,[426] this tax is levied on the activities of production and incorporation into the electrical system of electrical energy within the Spanish electricity system.

660. The TVPEE is applied to the production of all generation facilities. That is, this new tax is a measure of general application which applies both to conventional production facilities, as well as to facilities for renewable energy production with and without a recognised economic regime.

661. The taxable base of the TVPEE consists of the total amount that the taxpayer is to receive for the production of electrical energy and its incorporation into the electricity system, at each installation, in the taxable period. The applicable tax rate is 7%.

662. The impact of the TVPEE on renewable producers such as those subject to this arbitration has been neutralised, given that the TVPEE is one of the costs remunerated to those producers through the specific remuneration they receive, as analysed in this Counter-Memorial when examining the current remuneration regime of renewable energy producers. In other words, the specific remuneration received by renewable producers enables them to recover certain costs that, unlike conventional technologies, cannot be recovered in the market, and, also, to obtain a reasonable return. Among those costs is precisely the TVPEE.[427]

(3.2) Update of remunerations, tariffs and premiums for activities in the power sector linked to the Consumer Price Index at constant tax rates, excluding unprocessed foods and energy products.

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2. 10 per cent of the estimated revenue from the auction of emission rights for greenhouse gases, with a maximum of € 50 million, is set aside for the policy of combating climate change". R-0075.

[426] Section III.B (2) and (5.3) of this Counter-Memorial.

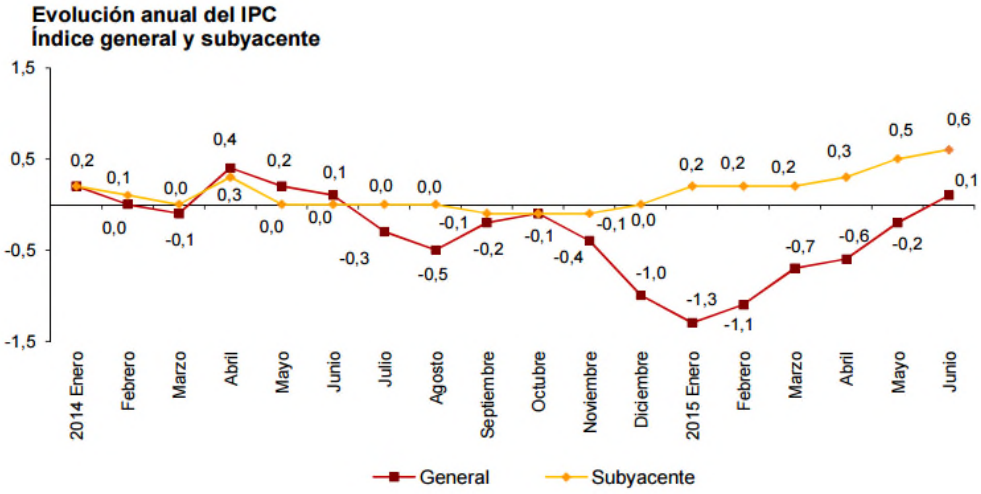
[427] Order IET/1045/2014, of 16 June, approving the remuneration parameters of standard facilities for certain electricity production facilities using renewable energy sources, cogeneration and waste, Preamble III:

"Furthermore the variable operating costs based on production of the standard installation include, for merely illustrative purposes, the following: insurance costs, administrative expenses and other overheads, cost of representation in the market, cost of the toll to access the transport and distribution grids that need to be paid by producers of electricity, operation and maintenance (both preventive and corrective), tax on the value of the production of electrical energy as per Act 15/2012, of 27 December, on fiscal measures for energy sustainability, as well as the remaining taxes regulated in said Act.[…]". R-0115

663. This measure was implemented by Royal Decree-Act 2/2013, of 1 February, on urgent measures in the electricity sector and the electricity sector (hereinafter, "**RD-Act 2/2013)**[428]. In the Ruling 28/2015, of 19 February 2015, of the Constitutional Court, the constitutionality of this Royal Decree is declared. [429] The Supreme Court has also endorsed the legality of the measure, because these indices, as the Spanish Supreme Court noted, do not *"have to be the same for different activities or have to remain unchanged over time."* [430]

664. Royal Decree-Act 2/2013 agrees to replace with effect from 1 January 2013, the Consumer Price Index governing the adjustment of remunerations, fees and premiums for power sector activities, including the production of renewable energy, by the Consumer Price Index at constant taxes excluding unprocessed food and energy products (hereinafter **"CPI-IP").**

665. This measure, justified both scientifically and legally, has produced effects that do not harm the Claimant, as it has been beneficial to those facilities. CPI at constant taxes has evolved over the CPI in certain periods of 2013, 2014 and 2015. This evolution is confirmed with the following table[431]:



[428] Royal Decree-Act 2/2013, of 1 February, on urgent measures in the electricity sector and the R-0094.
[429] Judgement of the Constitutional Court 28/2015, of 19 February 2015, in Constitutional Question number 6412-2013. Legal basis 3: *"The situation that the measures here contested should address was the diversion of electricity system costs caused by various factors (the excess costs of special regime premiums, the allocation of costs for non-mainland electricity systems and the deficit increase due to the declining in electricity demand) displayed explicitly in the preamble or in the parliamentary debate on recognition. Factors whose conjunction had led to a higher than initially planned deficit by the Government. Thus, it can be estimated that, [...], the Government has met the need to explain and reason the existence of a situation of extraordinary and urgent need, [...] it is clear that the proposed measures as pursuing an adjustment in the electricity sector costs, keep the necessary connection between the situation of extraordinary and urgent need and the measures taken to address it.*" R-0151.
[430] Judgement of the Supreme Court, of 26 March 2015. Fifth Point of Law. R-0153.
[431] Information from the National Institute of Statistics, available at: http://www.ine.es/daco/daco42/daco421/ipc0615.pdf.
This information does not include tax, with quantitatively negligible effects in the period considered.

666. The methodological change in this measure is only to change the overall CPI by a form of underlying CPI at a constant tax. In this sense, the use of underlying price indices at a constant consumption tax is largely based on the global economic doctrine[432] and avoids general index distortions attributable to the volatility of certain elements or modifications of indirect taxes.[433]

667. That is, the update methodological change made by Royal Decree-Act 2/2013 responds, in general, to the usual standards for calculating the consumer price indices in the international economy and aims to avoid distortions in the consumer price index, unrelated to the fundamentals of the economy. This will be discussed in detail in the analysis of ECT protection standards. It also involves a change endorsed by the rules and criteria of the European Union[434].

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[432] For example, this type of indexes are included in the analysis methodology of price indices in *The Consumer price index manual. Theory and practice*, jointly elaborated by International Labour Organization, International Monetary Fund, Organization for Economic Cooperation and Development, Statistics Office of the European Union, United Nations and World Bank. 2006. R-0183.
Similarly, the main report on the world economic situation, the *World Economic Outlook* of the International Monetary Fund uses underlying price indices in its analysis Methodology. *World Economic Outlook,* International Monetary Fund, April 2014. R-0201.
The same core inflation method of analysis is used by the Federal Reserve of the United States. *What is inflation and how does the Federal Reserve evaluate changes in the rate of inflation?* Board of Governors of the Federal Reserve System, available at www.federalreserve.gov, 10 April 2015 (date of last access).

[433] In terms of the report on the subject of the Organisation for Economic Cooperation and Development (hereinafter "OECD") *Measuring and assessing underlying inflation,* OECD Economic Outlook, Preliminary Edition, 2005, page 187): "*Headline inflation rates can be volatile, often because of substantial movements in commodity or food prices. Such volatility in a key price index can make it difficult for policymakers to accurately judge the underlying state of, and prospects for, inflation. Therefore, core inflation rates -- excluding or downplaying the more volatile price changes so as to reveal the underlying, more persistent component -- can be helpful."* (emphasis added) R-0127.
Indeed, one of the most common methods for calculating the underlying price index is used by Royal Decree-Act 2/2013, that is, the overall CPI excluding unprocessed food and energy products, as well as indirect taxes or variations thereof. As stated in the report cited above: "*A standard core measure excludes food and energy from the overall CPI. This is often the one that receives the most public attention. There are, however, other variants that are readily available or in use: for example, there are versions for the euro area and the United Kingdom that exclude energy and unprocessed food; in Japan, fresh food is removed; and in Canada, the eight most volatile components, as well as indirect taxes, are taken out of the index. […] The economic argument for excluding these components from the calculation of headline inflation rates is that they are the ones most likely to be subject to disruptions in supply, as opposed to reflecting aggregate demand. In this case, and provided that the stance of monetary policy has not changed, the influence of such large, one-off price changes (either positive or negative) will fade over time. Hence, excluding them provides a better picture of existing underlying inflation pressures*."(emphasis added). *Measuring and assessing underlying inflation*, OECD Economic Outlook, Preliminary Edition, 2005, pages 188 and 189. R-0127.
434 Under this reform, the proposal from the Commission was from 2009 and this is the reason why the National Institute of Statistics, the Spanish authority responsible for statistics, began to publish the IPCA-IC as early as September of that year.
Once the reform was formally approved on 26 September 2012, the INE proceeded to incorporate this magnitude into the CPI scope and published it on 11 October 2012 in a press release on its website, stating, inter alia the following: *"This indicator aims to deduct from the price variation the section that may be due to changes in taxes on consumption. To do this, the CPI evolution is assessed under the assumption that these taxes have not changed since the reference time. […] The CPI-IC will usually only vary differently from the CPI when there* are *changes in taxes considered in its calculation: Value Added Tax (VAT), taxes on fuel, taxes on tobacco, vehicle registration tax, and taxes on insurance premiums.*"

668. It is also a change announced by the proposals contained in several Reports of the National Energy Commission[435] and the National Markets and Competition Commission[436].

669. The predictability of this reform by a prudent and diligent operator, being a measure in an economic context which required urgent decisions, has also been recognised by the Supreme Court repeatedly, saying:

> *"A "prudent and diligent economic operator", therefore, could not be surprised by the adoption, in 2013, of a measure of this kind, much less since that was neither unpredictable, but on the contrary it had been suggested by the energy regulator, nor - in the words of the aforementioned judgment of the Court of Justice- "the economic operators may have a legitimate expectation that an existing situation which may be modified in the exercise of the discretion of national authorities is maintained." In a generalised crisis scenario, as was that of Spain in late 2012 and early 2013, similar changes in economic value index updates were carried out in this and other sectors of economic life."*[437]

670. Indeed, the Spanish Supreme Court has ruled on the matter stating that the reform made by Royal Decree-Act 2/2013 is limited in scope, since the differences between the two update methodologies are not especially significant.

671. In fact, it was such a predictable measure and yet so insignificant, that the partner of the Claimant, Aprovechamientos Energéticos S.L. considered it as a *"mere progressive adaptation(s) and adjustment(s) from the same remuneration regime to the reality of the sector.*"

(3.3) Reduction to 0 euros of the premium in the pool plus premium remuneration option

672. The second measure introduced by Royal Decree-Act 2/2013, of 1 February, was to reduce the amount of the premium to a value of 0 euros in the pool plus premium

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Regulation (EC) No 2494/95 of 23 October 1995, concerning the indices of consumer prices (RL-0018, page 1), developed as the sub-indices by Regulation (EC) No 2214/96 of 20 November 1996 concerning the indices of consumer prices: transmission and dissemination of indices of consumer prices sub-indices (RL-0022, page 8). The latter was modified by the proposal approved on 26 September 2012, producing Regulation (EU) No 119/2013 of the Commission on 11 February 2013, by which Regulation (EC) No 2214/96 is modified, regarding the creation of IPCA-IC. (RL-0023 page 1).

[435] Report on the Spanish Energy Sector Part I. Measures to guarantee the financial-economic sustainability of the electricity sector, National Energy Commission, 7 March 2012, page 16: "In line with what was observed by the Council of European Energy Regulators (CEER)" and noted that *"it is necessary* to *review the current update mechanisms with efficiency factors X and Y fixed, and link them to target efficiency improvements. Provisionaly, as long as the study of these parameters is not made according to efficiency analysis, a downward revision of updates is proposed, taking into account the current economic situation*". R-0131.

[436] National Competition Commission Report 103/13 on the Electricity Sector draft Bill, page 11. R-0132.

[437] Judgement of the Third Chamber of the Supreme Court of 26 March 2015, RCA 133/2013, reference CENDOJ: 28079130032015100087. Ninth Point of Law (R-0153) and Judgement from the Supreme Court of the Third Chamber, dated 16 March 2015, RCA 118/2013, reference CENDOJ, 28077913003201510072 (R-0152).

option provided for in Royal Decree 661/2007,[438] in order to ensure reasonable return[439].

673. Elsewhere we should remember that the pool plus premium option was established in Royal Decree 436/2004 as a mechanism to encourage the participation of RE in the market. This measure aimed to motivate its participation in the market by covering the higher additional costs that said participation involved. So, in the event that it did not enter the market, there are no additional costs and the incentive therefore lacks justification.

674. On this point we should remember that RD 661/2007 removed the pool plus premium option for photovoltaic installations. Likewise, RD 661/2007, by regulating the transition period that several of the Claimant's plants availed themselves of, eliminated the possibility of opting between the regulated tariff and the pool plus a premium during that period. Consequently, we cannot consider that we are faced with an arbitrary, unreasonable or unforeseeable measure. In the same way that this was not the case for photovoltaic or wind technology in 2007. Moreover, RD 1614/2010 temporarily suspended the pool plus premium option for solar thermal technology.

H. The current model of remuneration for certain installations that produce energy with renewable sources.

(1) Objectives of the current system.

675. The analysis of the electricity system revealed that the remuneration paid, through the electronic invoice, ought to be reviewed for the purpose of complying both with EU regulations as well as the domestic legal system, to ensure the guarantee of a reasonable return.

676. The complex economic situation affecting the Kingdom of Spain through the existence of a profound crisis demanded that the basic principles already mentioned be fulfilled in the Electric System

677. Within this context, and as we have already set out, the different preliminary analyses, the regulatory evolution itself, technical knowledge and technological evolution revealed the existence of remuneration which, either by default or by excess, failed to maintain the criterion of *reasonable return* established for the remunerations of the so called special regime and of the *adequate remuneration* for the remaining regulated activities, particularly the activities of transport and distribution.

[438] Royal Decree-Act 2/2013, of 1 February, on urgent measures in the electricity sector and the electricity sector. Art. 2 section one. R-0094.

[439] "On the other hand, considering the volatility of the market price of production, the remuneration option for energy generated in special regime that complements that price, makes it difficult to fulfil the dual objective of ensuring a reasonable profitability for these facilities, while avoiding their over-remuneration, which would affect other electrical subjects. It is therefore necessary that the premium economic regime is sustained only in the regulated tariff option, without prejudice to the operators of facilities selling their energy freely in the market without receiving premiums." RD-Act 2/2013. R-0094.

Consequently, a remuneration system was established to guarantee the reasonable return of RE producers within the framework of a sustainable SES.

678. The resulting model from this review is shown in Act 24/2013, which has been implemented through Royal Decree 413/2014[440] and by Order IET/1045/2014[441]. Through this model, the support system for renewable technologies is strengthened. The measures adopted between 2012 and 2014, measures that have affected all sectors of the SES, have guaranteed the economic sustainability of the SES. Achieving this objective represents the main protection for investments made in the Spanish renewables sector. In this regard:

> *"It is not possible to compare support through aid for renewables generation and safeguarding the financial sustainability of the system, when the latter is a necessary condition for the very subsistence of the former, since it makes no sense to design a support system for these technologies that is financially unsustainable and is therefore not economically viable in the medium and long term."*[442]

679. Moreover, the new remuneration model continues to guarantee the support of the Kingdom of Spain for the investments that have been made in renewable assets. Thus, the SES is going to channel, in favour of facilities that were previously referred to as under the special regime, since 2014 and until the end of their regulatory life, the amount of 150.565 billion euros. This amount will be charged to subsidies paid for by Spanish citizens.[443]

TECHNOLOGY	Estimated premiums received 1998-2013 (millions of €)	Estimated premiums yet to be received from 2014 to the end of the useful life (millions of €)	Estimated total premiums received throughout the useful life (millions of €)
CO-GENERATION	12,917	19,504	32,421
PHOTOVOLTAIC	14,617	64,234	78,851
THERMAL SOLAR	2,640	32,464	35,104
HYDRAULIC	4,263	1,250	5,513
WIND	15,400	20,500	35,900
BIOMASS AND BIOGAS	2,003	6,685	8,688
TREATMENT OF WASTE	2,626	4,220	6,846
COMBUSTION OF WASTE AND BLACK LIQUOR	1,827	1,708	3,535
TOTAL RENEWABLES, CO-GENERATION AND	56,294	150,565	206.859

[440] Royal Decree 413/2014. R-0110.
[441] Order IET/1045/2014. R-0115.
[442] Judgement 1730/2016 of the Supreme Court, of 12 July 2016, which rejects the appeal filed by the Wind Power Business Association (AEE) against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 456/2014). R-0265
[443] Administrative enquiry relating to Draft Order IET/1045/2014); Report on the Analysis of the Regulatory Impact, page 100. R-0084. (Procedure, document 15.03).

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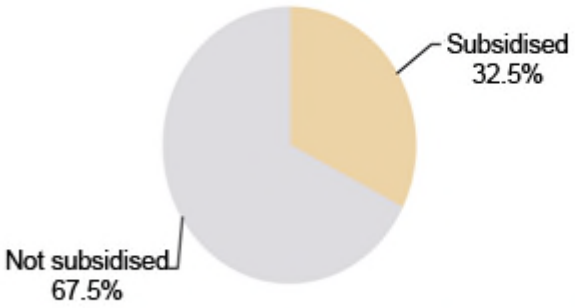
680. The plants that the Claimant transferred in 2016 to a third party are no exception. These plants, with the new remuneration model, continue to enjoy a high level of subsidies that complement the income derived from their ordinary economic activity: producing and selling energy. An activity that they continue to develop with any limitation. An activity that, unlike all other energy producers, is protected and emphasised by priority rights of access and dispatch. In the following graph, we can observe the weight of the public subsidies received by the plants in the total amount of their income:

Figure 1 - Percentage of income from subsidies



Source: First Brattle Economic Report - Model of assessment at 20 June 2014, table A15

681. In any event, as it was indicated by the European Commission when assessing the public aid schemes to the deployment of renewable energies within the framework of the European Union, the idea that "*there is no "right to State aid*" must be underscored[444]. A non-existent right that is being claimed herein. On this point, we must recall that what the Claimant is claiming in this arbitration is that a certain level of public subsidies should be kept frozen and non-modifiable over time.

682. This new regulatory framework is configured, as it will be shown below, as an evolution of regulation of the system. In any event, it maintains the public support for the deployment of renewable energies while respecting the principle of reasonable return within the framework of a sustainable SES. Likewise, it keeps all the other essential elements of the preceding remuneration framework unchanged. In any event this reform has been inspired, in many of its key aspects, by the different rulings handed down by the Supreme Court during preceding years.

(2) The new model maintains and strengthens access priority to the network and energy dispatch.

[444] Decision C(2016) 7827 final, of 28 November 2016, of the European Commission handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. Paragraph 142. RL-0021

683. The regulation maintains the principles of priority of access and dispatch of electricity generated by installations that use sources of renewable energy and highly efficient cogeneration.

684. This regulation even goes beyond the provisions set out in community regulations[445] and represents a novelty as an explicit recognition of this privilege, given that this was not contained in the previous regulation.

685. With regard to priority dispatch, article 26 of Act 24/2013 states that[446]:

> *"Electricity from plants that use renewable energy sources and, after these, high-efficiency cogeneration plants, will have priority dispatch on an equal economic playing field in the market, without prejudice to the requirements relating to the maintenance of the reliability and the safety of the system, under such terms and conditions as may be defined in regulations issued by the Government.*
>
> *Without prejudice to the security of supply and the cost-effective development of the system, producers of electricity from renewable sources of energy and high efficiency cogeneration plants shall have priority of access and connection to the grid, under such terms and conditions as may be defined by regulations, on the basis of objective, transparent and non-discriminatory criteria.*" [447]

From a simple reading of this regulation, it is clear that priority dispatch and access and connection to the grid are rights that are held by producers of energy from renewable sources. This right may only be limited because of reasons relating to the maintenance of the reliability and the safety of the Spanish Electricity System (hereinafter SES). Furthermore, in contrast to that which was set forth in the previous regime, this priority dispatch even prevails over high-efficiency cogeneration plants.

(3) The model of remunerating renewable energies continues to revolve around the principle of a reasonable return.

686. The new model of remuneration is configured for the purpose of providing investors with a reasonable return on their investments. With regard to this point, the

[445] Directive 0021/EC of the European Parliament and of the Council of 2009/28 April 23 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2009/EC and 2001/77/EC. Article 16(2) (c): "*Member States shall ensure that when despatching electricity generating installations, transmission system operators shall give priority to generating installations using renewable energy sources in so far as the secure operation of the national electricity system permits and based on transparent and non-discriminatory criteria*." RL-0017..

[446] Act 24/2013, of 26 December, on the Electricity Sector, Article 26 (2). R-0077.

[447] The above wording of the Act has been reiterated in article 6(2) of Royal Decree 413/2014, when it states that: "electricity from plants that use renewable energy sources and, after these, high-efficiency cogeneration plants, will have priority dispatch on an equal economic playing field in the market, without prejudice to the requirements relating to the maintenance of the reliability and the safety of the system, under such terms and conditions as may be defined in regulations issued by the Government." Royal Decree 413/2014. Article 6 (2) R-0110.

main new item has been that of setting the reasonable return in a specific way through legal regulations.[448]This has given the System with greater stability and security.

687. In line with the provisions set out in Act 54/1997, with the methodology pursued in the Renewable Energy Plans and relevant case law, the system of remuneration is based on a reasonable return for a standard project.

688. As a consequence, the new model, the same as the previous one, is constructed for the purpose of enabling any investor in renewable energies to recover their investment cost within specific period of time, as well as their operation costs and also to obtain a reasonable return.

689. The same as in Act 54/1997, the reasonableness of the return must be determined in accordance with the cost of money in the money markets. However, the new regulations specify the specific money market to be used in order to judge the reasonableness of the return: the secondary market of state bonds at 10 years.

690. This reasonable return, before tax, shall be based on average return of State ten year bonds on the secondary market, applying the appropriate spread. This spread, according to RDL 9/2013, is 300 base points[449]. The specific figure for facilities already operating is around 7.398 percent return for the whole of project for a standard facility.

691. Consequently, the new regulatory framework makes it possible to forecast the System and ties the return to the evolution of State Bonds over 10 years.

692. Here we should remember that in its expert report of May 2011, Deloitte considered the Spanish Bond at 10 years as the asset to replace renewable assets. For these purposes, said report compares the return of renewable assets with the return on 10-year bonds to determine whether the return arising from RD 1565/2010 for photovoltaic plants is reasonable.

693. On this point, we should also remember the proposal made by the APPA Association in 2009, which expressly quantified the return required from renewable energies as that of the Spanish Bond at 10 years plus 300 base points:

> *"The Government shall set the amount of the regulated tariffs, premiums and supplements, assessing in all cases the* ***operation and maintenance costs*** *and the* ***investment costs*** *incurred by the owners of installations, to ensure reasonable rates of return with reference to the cost of money in the capitals market. The fee*

[448] As set out in the Preamble of Act 24/2013, of 26 December, the investments in certain installations that use these technologies: *"shall continue to be protected and developed in Spain through this new regulatory framework, which enshrines the principle of a fair return and establishes the criterion of review of the remunerative parameters every six years in order to comply with this principle. This attempts to consolidate the ongoing adaptation that the regulation has experienced to maintain this fair return through a predictable system and subject to a specific timeline."* R-0077.

[449] Royal Decree-Act 9/2013 of 12 July 2013, establishing urgent measures to ensure the financial stability of the electricity system. Additional provision one. R-0095.

> *for the remuneration of capital shall be taken as an annual percentage equivalent to the* ***average of the previous year of the remuneration of 10-year Treasury bonds, plus a spread of 300 base points***.*"*[450]. (Emphasis added)

694. Aside from the foregoing, in the Spanish SES there are several references to the Spanish Bond of 10 years as the criterion set for the remuneration of regulated activities. Moreover, these references, as we shall see further on, have existed since 2006.

- The remuneration of the activity of production and remuneration of the power guarantee for ordinary production facilities of the mainland and island electricity systems. Article 5 of Order ITC/914/2006, of 30 March[451] set the remuneration of this regulated activity at the Spanish bond at 10 years plus 300 base points. Subsequently, Royal Decree Law 20/2012 lowered the spread to 200 base points[452].

- Transport activity. Royal Decree 325/2008[453] set the remuneration of this regulated activity at the Spanish Bond at 10 years plus 375 base points. RD–Law 9/2013 set the remuneration of said regulated activity at the Spanish bond at 10 years plus 200 base points.

- The distribution activity. RD–Law 9/2013[454] set the remuneration of the Spanish bond at 10 years + 200 base points.

695. In all circumstances we should point out that the aforementioned figure does not represent a cap on the return or a limit on return. It is a forecast return for that installation, whose investment and operating costs match the parameters of the applicable standard facility.

696. Consequently, the model put in place by the regulator in 2004 is maintained, and which expressly set out that:

> *"Parameter A (the investment, operating and maintenance costs of each technology) is heavily weighted in setting the amount of the regulated tariff for sale to the distributor. Thus, any plant of the special scheme installed in Spain, as long as it is equal to or better (than the* ***standard plant*** *of its group), will succeed in earning reasonable return"*[455].

697. In this regard, if the investor is efficient and manages to reduce their investment cost below the parameters established for the applicable standard facility, they will

[450] Article 23.4 of the Bill presented by APPA-Greenpeace in May 2009. R-0187.
[451] Order ITC/914/2006, of 30 March, which sets out the calculation method of remuneration of the power guarantee for ordinary production facilities of the mainland and island electricity systems. R-0269
[452] Royal Decree 325/2008, of 29 February, which establishes the remuneration for the transportation of electricity for facilities put into service after 1 January 2008. R-0270
[453] Ibid
[454] Royal Decree-Act 9/2013 of 12 July 2013, establishing urgent measures to ensure the financial stability of the electricity system. R-0095
[455] Economic Report of Royal Decree 436/2004. R-0014.

obtain a higher return on the investment. Similarly, if the installation manages to reduce its operation and maintenance costs below the parameter established for the standard facility, there will be greater remuneration through operation.

698. Similarly, if the plant continues to produce more energy than forecast for the standard facility it could sell that energy in the market receiving the corresponding market price and consequently obtaining a higher return than forecast for the standard facility.

699. Furthermore, these new measures do not impose any restriction on the production by the installations, as these installations can continue to produce and to sell all of the electricity they produce in the market. Furthermore, all energy produced is protected with priority of access and dispatch.

700. Consequently, if the facility manages to improve the parameters taken into consideration to define a standard facility (investment cost, cost of operation and production, etc.) it would beat the standards and obtain a return in excess of 7.398 %.

(4) Reasonable return continues to revolve around the investment costs of a standard facility.

(4.1) Criteria for calculating cost. An efficient and well run company.

701. The remuneration model, just like the previous model did, is based on the delimitation of various standard facilities, subsequently establishing for each one a series of remuneration standards that allow reaching the reasonable return of 7.398.

702. To calculate the different remuneration standards, those of an "*efficient and well-managed company*" have been used[456]. This refers to a company equipped with the means required to carry out its activity, the costs of which are those of an efficient company in this activity and considering both the corresponding revenue as well as a reasonable profit for the performance of its functions.

703. The aim is to guarantee that the high costs of an inefficient company are not taken as reference given that, firstly, it is the electricity consumer that must pay these costs and, secondly, the Spanish regulation has always been supported on principles of efficient management, minimum cost possible and a reasonable return.

704. This principle has been set out successively in all acts of the electricity sector that have been referred to in this claim, given that the obligation to guarantee that all consumers have access to electricity under conditions of equality and quality, but at the lowest possible cost, has always been taken as the guideline.

705. As a consequence, it is difficult to argue that the previous system protected business owners that were inefficient in the construction or operation of their plants,

[456] Royal Decree-Law 9/2013. Article 1 (Two) (R-0095). 14.7 and final provision three of Act 24/2013, of 26 December, on the Electricity Sector. R-0077.

generating an excessive and unnecessary cost in the SES. More so when a large part of its remuneration comes from public subsudies.

(4.2) Standard facilities pursuant to standard costs and remuneration. Determination of the remunerative parameters. Order IET/1045/2014.

706. In accordance with the methodology historically followed by the Spanish regulatory framework, the standard facilities have been established in each renewable technology. Standard facilities "*represent a set of installations that share the same technological and remuneration characteristics, and they correspond to the same commissioning year*"[457] The procedure for establishing standard facilities and the results thereof has been endorsed by regulatory bodies[458].

707. In accordance with the aforementioned, in the wind energy area 46 standard facilities have been established, thereby distinguishing them according to two criteria: (i) their range of power, installations of power that is equal to or less than 5 MW and installations with a power of over 5 MW; and (ii) the year of definitive operating authorisation fo the plants[459].

708. After having established the standard facilities, Order IET/1045/2014[460] contains a list of all the remuneration standards. Said Order details the costs of investment, operation and exploitation, revenue from the sale of energy, consumption of ancillary services, where appropriate, as well as the equivalent hours of performance of each standard facility.

709. Each standard installation is associated with a set of remuneration parameters that allow establishing remuneration that is in addition (a subsidy) to the market price that each SF earns in order to reach a return of 7.398. These remuneration parameters are:

a) Standard value of the initial investment of the standard installation.

b) Electricity production.

c) Operating costs.

d) Income.

710. The definition of such a high volume of standard installations and the calculation of a series of parameters for each of them represented a technical task of much greater

[457] Juan Ramón Ayuso, paragraph 42. RW-1

[458] Council of State Report, 6 February, 2014. " For these installations, the standard value of the initial investment cannot be determined through a competitive procedure, and will therefore need to be set in the ministerial order of remunerative parameters of standard installations, which shall be classified based on the technology, power, years of service, electricity system, as well as any other segmentation deemed appropriate. In this regard, based on the regulatory impact analysis report, we are carrying out "an in-depth analysis with a level of detail far greater than that hitherto carried out, to properly recalculate all remuneration of approximately 63,000 installations of this group, classified into approximately 900 standard installations." R-0124.

[459] Juan Ramón Ayuso. Paragraphs 42-60. RW-1.

[460] Order IET/1045/2014. R-0115.

magnitude than initially envisaged. Work that took place over documentation of around 150,000 pages and which led to the new regulation of a remunerative framework with a level of detail extraordinarily superior to that of previous regulations. During the processing of the Royal Decree and of the Ministerial Order, a large number of allegations were filed[461]. In this case, it should be pointed out that both the AEE and Protermosolar and APPA, as from 2012, filed numerous allegations against the drafts of the RD[462] and OM[463].

711. The first of said standards is the initial value of the investment. The investment value set by the Government, as it has been done since 1994, is that of the initial Project. It therefore does not include speculative values or profits that the first owners of the plants obtained on transferring these to third parties. In other words, the investment has been set over the value of the initial investment, not over the value of second and subsequent transfers, which already include the capital gains and profits obtained by the transferring parties[464].

712. This is because the remunerative systems cannot cover and include the profits which, through sale or other act in the law that affects the installation, have been obtained by the owners of the installations and the subsequent acquiring parties. As declared in the 2010 PER:

> "*Likewise, the effective guardianship by the Administration must guarantee that any gains made in the appropriate evolution of these technologies is passed onto society with regard to the competitiveness in relative costs, minimising speculative risks, caused in the past through excessive returns that not only damage consumers but also the industry itself with regard to the way it is perceived.*"[465]

713. This determination of the value of the investment is fully in accordance with the proposal given by the APPA Association in 2009, which requested that the investment costs be estimated in accordance with the different *types* of installations, differentiated by *technology* and *size*, such that they reflect the standard values that these investments actually achieve[466].

714. Moreover, other subsidies that finance or remunerate these transfers would alter the free market rules within the EU, implying the possibility of incurring State Aid that is contrary to community regulations.

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[461] We attach the table of contents of the RD 413/2014 file of 6 June (R-0086) and of Order IET/1045/2014, which show the number of statements submitted. R-0087

[462] The Spanish Wind Energy Association presented Statements in response to the proposed draft of RD 413/2014 on 1 August 2013 (R-0232) and 11 December 2013 (R-0233). Protermosolar, for its part, submitted statements against the same draft of RD on 30 July 2013 (R-0234) and 11 December 2013 (R-0235 and R-0252). UNEF 30 of R-0271R-0272. Likewise, the three producer associations presented statements during the processing of MO ITE/1045/2014, included as R-0204 R-0205, R-0237, R-0238, R-0242 and R-0243.

[463] The association UNEF also presented statements on two occasions in relation to the draft of the Ministerial Order on 25 February 2014 (R-0203) and 26 May 2014 R-0206

[464] Declaration of Don Juan Ramón Ayuso. Paragraphs .

[465] Spain's National Renewable Energy Action Plan (PER) 2011 - 2020 R-0120.

[466] Article 23.5 of the Bill proposed by APPA-Greenpeace in May 2009R-0187

715. Therefore, to determine the standard value of the initial investment of each standard facility,"*specific references have been consulted and numerous documents have been analysed, including specific national reports, reports issued by official bodies, reports issued by national and international associations/organisations in the wind power sector, reports published by international public bodies and private institutions, public information on wind power companies obtained from the Companies Registry and information available at IDEA"*[467].

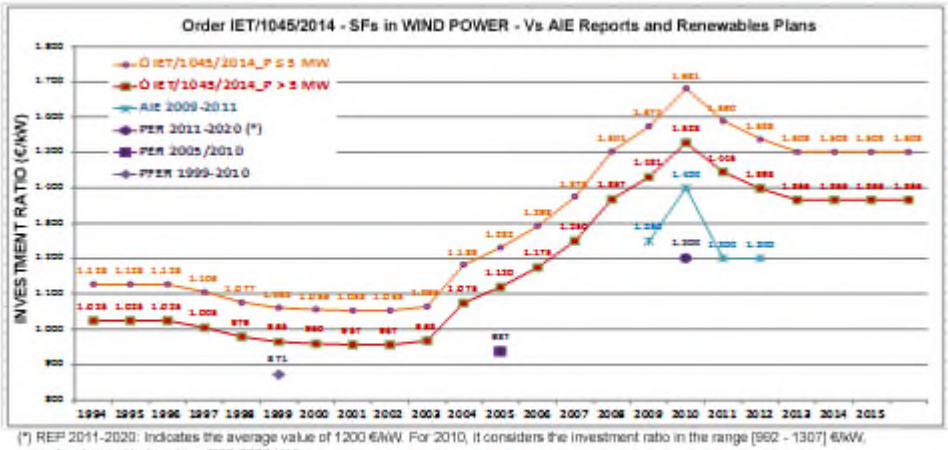
716. As Juan Ramón Ayuso points out:

> *"In determining the investment costs of wind power facilities, the following main cost items have been taken into account:*
>
> *Wind turbines, including their haulage, installation and commissioning.*
>
> *Building work: access roads, assembly platforms, cable ditches and other building work.*
>
> *Electrical infrastructure: Internal power grid, substation, transformation centre, apparatus, evacuation line, including electrical equipment to adapt the wind farm to the system operator's requirements.*
>
> *Development, engineering and implementation expenses prior to the start-up of operation, wind power gauges and others."*[468]

717. The biggest cost of investments of wind farms on land, historically, is the cost of the wind turbines. "*The analysis of figures for investment costs for this item has been made based on, among other things, market prices applied by wind turbine manufacturers and supply agreements for wind farm projects in Spain, as well as gross figures taken from the Companies Registry"*[469]

718. The investment costs finally established in Order IET/1045/2014 for the different standard facilities are higher than the investment costs included in the 2005-2010 PER (basic instrument for setting the tariffs of RD 661/2007) and from previous renewable energy plans. It can thus be appreciated in the following table:[470]

[467] Juan Ramón Ayuso. Paragraph 63. RW-1.
[468] Ibid. paragraph 65
[469] Ibid. paragraph 64
[470] Ibid. paragraph 67



(*) REP 2011-2020: Indicates the average value of 1200 €/kW. For 2010, it considers the investment ratio in the range [962 - 1307] €/kW, according to wind turbine type [850-2000 kW].

719. The second standard of each standard facility is the operating costs. "*Operating costs for SFs for wind power have been calculated based on reference ratios from the REP 2011-2020 Technical Study 'Technological evolution and outlook for renewable energy costs' for a specific year, updated in the past with the CPI and in the future at a rate of 1%, except for deviation costs, the generation toll and generation tax*"[471]

720. The_variable operating costs taken into account include but are not limited to the following: land leasing, management expenses, security, operation and maintenance of the plant, insurance costs, Special Property Taxes, representation expenses and deviations in the market, cost of the toll to access the transport and distribution grids that must be paid by producers of electricity (the TVPEE)[472]

721. Also the costs derived from payment of the tax on the value of the generation of electrical energy that is established in Act 15/2012, of 27 December, are also taken into account as operating costs. Consequently, the return of 7.398 guaranteed for standard facilities is established while taking said tax into account. Consequently, the effects of said tax are absorbed by the new regulation.

722. The Claimant criticises the new remuneration model but also doesn't provide any data that allows analysing the investment costs incurred during construction of the plant. The Claimant also hasn't provided a breakdown of the operating costs of the plants. In the document discovery phase, all the necessary information will be requested to justify that the investment costs incurred during construction of the plants related to this arbitration and the operating costs thereof have been included in the Parameters Order.

723. Awarding subsidies that fund or remunerate these transfers would alter the free-market rules within the EU, implying the possibility of incurring State Aid contrary to community regulations.

(4.3) Non-changeability of the investment costs.

[471] Ibid. paragraph 79.
[472] Ibid. paragraphs 83-107.

724. As referred to previously, the recovery of the investment costs in general represents one of the essential components of the new model. However, we must not forget that the mandate whereby the remunerative regime needed to allow the recovery of the investment costs is provided for under Spanish law, for this specific remuneration regime, from the original wording of article 30 of Act 54/1997[473].

725. The new regulation maintains the principle whereby the remunerative regime, as well as providing a reasonable return, must guarantee the recovery of the investment costs and simply provides it with greater development and specification[474] [475].

726. However, on this point Act 24/2013 introduces a major safeguard when it states that the investment value allocated to a facility, once set, cannot be reviewed. This has a dual objective: (i) to maintain the stability and non-changeability of such value[476] and; (2) to avoid, in turn, the distortions generated by RD 661/2007.

727. The Claimant conceals the fact that the mechanism used to update the subsidy pursuant to the CPI as established in RD 661/2007 produced similar effects to those of the Average Regulated Tariff. In its report of 7 March 2012, the CNE diagnosed the problem on stating:

> *"The indexing to the inflation indicator is justified because, in the absence of fossil fuel, the variable cost of these technologies depends fundamentally on the performance of different services (operation, maintenance, insurance ...). So then, also for these technologies a large part of their annual revenue is dedicated to covering their investment costs (approximately 85% in the case of wind and photovoltaic energy), so updating the total of the premium is disproportionate (only 15% should be updated).*

728. The explanation of what was stated by the CNE is based on the fact that the system of remuneration to renewable energies is for the purpose of enabling investors to recover their investment costs, their operation costs and also to obtain a reasonable return. As a consequence, when it comes to establishing the subsidy we need to bear in mind that this, together with the market price, needs to cover the three concepts: recovering the investment costs, recovering the operation costs and providing a reasonable return.

729. However, unlike operation costs, which are variable, investment costs are sunk costs. Once they have been made, they are not subject to any factor that changes their

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[473] Section 30.4 last paragraph of Act 54/1997 original wording: "In order to determine the premiums, the voltage level of energy fed in to the grid shall be taken into consideration, along with the effective contribution to environmental improvement, the saving of primary energy and energy efficiency, as well as the investment costs incurred, for the purpose of achieving fair rates of return with reference to the cost of money in the money market". R-0003.

[474] Articles 14, 21, 26, 27, 33, 53 and 61 et seq of Act 24/2013. R-0077.

[475] The new regulation is also consistent with the declarations of the regulating authority, the National Energy Commission (CNE), in its report of 7 March 2012. R-0131.

[476] Article 14.4 2 of Act 24/2013: "In no case, once the regulatory useful life or the standard value of the initial investment of an installation has been recognised may said values be reviewed". R-0077.

value. In light of this circumstance, the CNE declares that the updates of the subsidies must exclusively affect the part of the subsidies that cover variable costs. In other words, the operating costs: The part of the tariff targeted at covering investment costs must not be updated as these are sunk costs. The updating of the part of the subsidy targeted at recovery of investment costs produces additional returns that are not justified.

730. Here, the CNE proposes only updating 15% of the subsidies. The part of the subsidies targeted at covering operation costs. Moreover, let us not forget another major reflection carried out by the CNE:

> *"Given that the values of the tariffs and premiums are calculated each year (or quarter) with reference to the values of the previous period, this measure has a cumulative economic impact: it would mean reducing every year the overall amount of the equivalent premium of the special regime by around 200 million euros from 2013"*[477]

731. Consequently, the updating of all of the subsidies to the CPI was generating unjustified returns. Furthermore, given the cumulative effect of that measure, the updating was carried out each year on the amount of the subsidies that had been updated the previous year, and so on successively, the aforementioned updates jeopardise the economic sustainability of the SES.

732. The current model of remuneration provides a response to the foregoing situation and is in line with the essence of the remuneration model as specified by the CNE.

733. Firstly it draws a distinction between the part of the subsidy that is targeted at recovering the investment and the part of the subsidy that is targeted at recovering the operation costs. The operation costs can be reviewed, as we shall see further on. Second, once the investment costs have been determined for each standard facility, said value cannot then be reviewed. This avoids the distortions that the previous system generated

(5) The reasonable return is reached by completing the market price with a subsidy.

(5.1) Introduction.

734. As we have already explained, in the previous model the objective of recovering investment costs and providing a reasonable return should have been the result of the sum of two elements: the market price and a subsidy[478]. Currently, the foregoing objective must be achieved through the sum of the same components as in the previous model: the market price and a subsidy.

[477] Report on the Spanish Energy Sector Part I. Measures to guarantee the economic-financial sustainability of the electricity system, National Energy Commission, 7 March 2012. Page 23. R-0131.
[478] Act 54/1997 of 27 November, on the Electricity Sector. Articles 16 and 30 (4). R-0003.

735. However, in the new model of remuneration, the subsidy, the Specific Remuneration, is broken down into two elements: the Return on investment (Ri) and the Return on operation (Ro). Concepts that we will analyse in due course.

736. The difference lies in the fact that the previous model incorporated into a single concept (regulated tariff or pool plus premium) the three elements that had to be remunerated: (i) recovery of the investment cost; (ii) recovery of the operation cost, and; (iii) obtaining a reasonable return. Once these three elements had been considered, the subsidy paid per unit of energy produced was obtained. In this way, the market price plus the subsidy enabled the reasonable return required under law to be achieved.

737. The current model, as with the previous one, sets out the aim of remunerating the three aforementioned elements. However, payment of the subsidies is carried out in disaggregated way. One part regarding the installed power, the Ri, and another regarding the energy generated in relation to the operating costs, the Ro.

738. First of all, when the revenue derived from sale in the market does not cover the operating costs, the plant has a right to receive a subsidy (the Ro) to cover the operating costs. In the event that the revenue derived from the sale of energy covers the operating costs, the plant will not receive this subsidy (the Ro). Secondly, any surplus revenue from the market, once the operating costs have been covered, together with the return on investment (Ri) must cover the investment costs and also allow the plant to access the reasonable return of 7.398.

739. Consequently, the subsidy regime, previously called the special regime, has not been eliminated. The plants that were previously included in the special regime continue to receive the necessary subsidies for reaching a "*level playing field*". With the current remuneration model, the plants of the Claimants continue to enjoy a high level of subsidies:

740. On this point we should remember that Act 54/1997 never set in stone a specific formula or mechanisms through which the reasonable return could be obtained. Moreover, Act 54/1997 did not tie the payment of subsidies to the energy produced. Since 2006, the Supreme Court has interpreted article 30.4 of Act 54/1997 in this way, stating that:

> *"The remuneration scheme that we analyse does not guarantee [...] the intangibility of a particular level of profit or income for owners of facilities under the special scheme in relation to that which was obtained in previous years, or the indefinite permanence of the formulas used to set the premiums."*[479] (emphasis added).

741. Along the same line, this case law from 2006 was subsequently reiterated in a Judgement of 3 December 2009[480] and in two Judgements of 9 December 2009.[481]. In

[479] Judgement of Chamber Three of the Supreme Court of 25 October 2006, RCA 12/2005, reference case-law database EDJ 2006/282164. Legal Ground Three. R-0138.
480 Judgement of the Supreme Court of 3 December 2009, Legal Ground Three. R-0141.

this regard we must highlight what was specified by the Supreme Court in the latter of the Judgements referred to

> *" This must be taken to mean that the establishment of the economic regime for installations covered by the special regime of electricity energy production, advocated by Royal Decree 661/2007, of 25 March, cannot be qualified in abstract as arbitrary, because it is conditioned to the objective of guaranteeing a fair return throughout the service life of these installations, in such a way that the Government, in accordance with the provisions set out under article 15.2 of Act 54/1997, of 27 November, on the Electricity Sector, is empowered to approve the calculation methodology and the updating of the remuneration of the foregoing activity with objective, transparent and non-discriminatory criteria (...)" (Emphasis added)*[482]

742. In any case, both remunerative systems have the same purpose: to provide plants with a reasonable return over the investment costs. Furthermore, both models take into consideration the same components to achieve this purpose: the market price and the subsidy that supplements the former. The essence of the remuneration model set out in Act 54/1997 currently remains in force.

743. At no time does the remuneration model limit the production of electricity that plants could have. There is no obstacle that prevents plants from producing more energy than what is signalled as standard for a standard facility. In this case, if the plants improve the production standard, they will receive the pool price corresponding to that production. It must also be kept in mind that that production is covered by access and dispatch priority. This represents an incentive for plants to increase their production.

(5.2) Price obtained through the sale of energy in the market.

744. As with the previous regime, the remunerative regime of renewable energies, cogeneration and waste is based on the necessary participation of these installations in the electricity market. Consequently, the determination of the reasonable return is based on revenue resulting from participation in the market, coupled with additional remuneration, where necessary, to cover those investment costs that an efficient and well-run company is unable to recover in the market.

745. The system takes into consideration the remuneration that the installations obtain by participating in the market. *The market price of each technology (Technological Pool Price) has been based on general market price evolution, applying a specific wind power technology coefficient, owing to its real production profile (kurtosis), which takes the value of 0.8889 according to information provided by the payment body, the*

481 Judgement of the Third Chamber of the Supreme Court of 9 December 2009. R-0002.
[482] Judgement of the Supreme Court of 3 December 2009, Legal Ground Four. R-0141.

National Commission for Markets and Competition (CNMC), formerly the National Energy Commission (CNE)[483].

746. To determine the revenue obtained by the installations until the entry into force of Royal Decree-Act 9/2013, of 12 July, the actual average income published by the CNMC was taken for each standard facility[484].

747. Thus, given that they are technologies that do not recover the investment costs solely with the remuneration obtained from the market, a specific regulated remuneration is set that enables these technologies to compete under equal conditions with the other technologies in the market and to obtain the aforementioned reasonable return on their investment.

(5.3) Return on investment (Ri) and Return on operation (Ro).

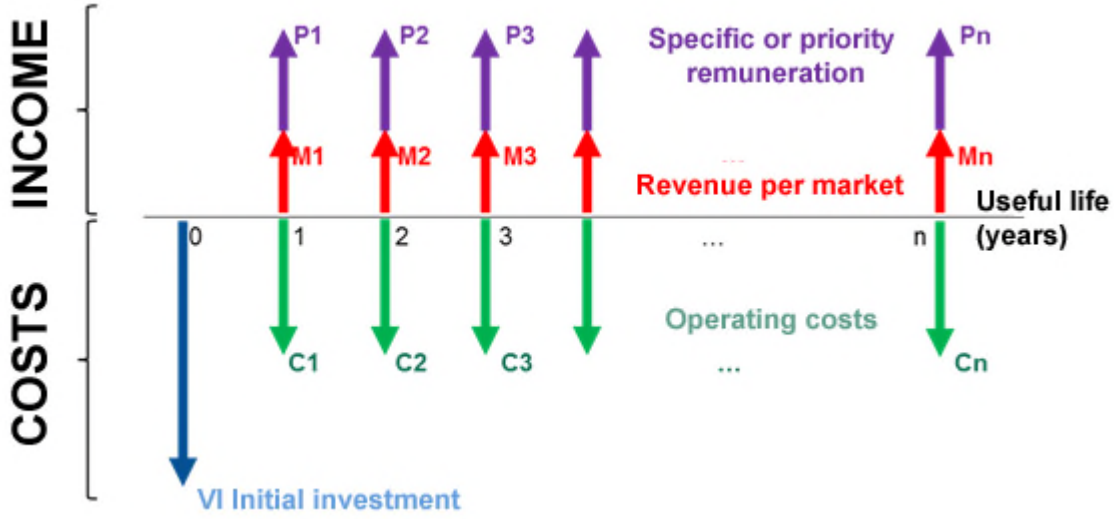
748. This specific supplementary remuneration is sufficient for reaching the minimum level required to cover the costs which, unlike conventional technologies, cannot be recovered in the market. This enables them to obtain an appropriate return with reference to the standard installation applicable in each case.

749. This additional remuneration comprises the Return on investment (Ri) and Return on operation (Ro) items. Ro is the specific remuneration that covers, where appropriate, the difference between the operating costs and the revenue through participation by said standard installation in the production market. Ri is the specific remuneration comprising a term per unit of installed power and which covers, where appropriate, the investment costs for each standard installation that cannot be recovered through the sale of energy in the market.

750. To calculate the return on investment and the return on operation, as we pointed out earlier, we have considered, for a standard installation, the standard revenue through the sale of energy measured at the market price, the standard operating costs required to carry out the activity and the standard value of the initial investment, all of this with regard to an efficient and well run company.

751. The following table explains the flows for the different items[485]:

[483] Juan Ramón Ayuso, paragraphs 123 to 130.
[484] Juan Ramón Ayuso, paragraph 119.
[485] Page 12 of the Environmental Impact Analysis Report included in the Administrative file relating to the draft order that approves the remunerative parameters for standard plants that are applicable to specific electricity production plants that use renewable energy, cogeneration and waste sources. R-0084.



752. Thus, as we have seen thus far, the owner of a facility has certain investment costs and other operating costs and receives revenue from the electricity system, composed of: (i) the amount that they receive for the sale of energy in the electricity market, and (ii) the additional remuneration granted by the electricity system to cover the difference between the costs and the revenue obtained through the market and which includes the Ri and the Ro[486].

(6) The period for receiving additional remuneration. Regulatory useful life.

753. The remunerative regime is supplemented with another parameter, the regulatory useful life. It is the period of time established so that plants can recover their investment costs and earn a reasonable return. The number of years set for each technology is the representative number for each standard installation, based on the design life of the main equipment and assuming that the appropriate preventive and corrective maintenance actions are undertaken.

754. This useful life shall remain unchanged for each standard installation pursuant to the provisions set out under article 14 of Act 24/2013, of 26 December. Consequently, it is expected that once the installations exceed the regulatory useful life they shall no longer receive the return on investment and the return on operation.

755. The end of the regulatory life determines the moment when the investor has recovered all their investment costs and has reached the guaranteed reasonable return[487]. In other words, the shorter the regulatory life the greater the additional

[486] Juan Ramón Ayuso, paragraphs 121 to 137. RW-1

[487] We should also highlight the opinion of the Council of State with regard to the regulation and more specifically with regard to its remunerative regime, the Report from the Council of State of 6 February 2014: "*In summary, to calculate this specific remuneration, we base ourselves on the figures from the entire regulatory useful life of the installations, therefore including those prior to the entry into force of the current reform. The environmental impact analysis report makes a commendable effort to point out in economic terms that the concept of a "fair return", to be guaranteed to owners of installations, "irrespective, from the financial point of view, of whether the flows of revenue (or costs) take place at the*

remuneration to be received by the investor, given that the investment value of the installation is paid in fewer years.

756. However, this setting of the useful life does not imply that those installations which, on the entry into force of the reform, have already recovered their investment costs and earned the reasonable return, are entitled to continue receiving the subsidies. This would be contrary to EU recommendations[488] that clearly establish that, once the *level playing field* has been achieved, the payment of any additional subsidies is not applicable. It would also go against the essence and purpose of any *feed-in tariff system*.

757. Furthermore, the Supreme Court of the Kingdom of Spain, before the Claimant made their investment, clearly established the extent of the concept of a reasonable return with respect to the duration of subsidies:

> *"the principle of a reasonable return should be applied [...] to the entire life of the facility, but not [...] in the sense that during that entire life said principle might guarantee the generation of profits, but rather in the sense that it is ensured that the investments used in the facility earn a reasonable return throughout the existence of the same as a whole. This [...] does not mean the permanence of a certain premium during the entire life of the facility, given that it could so happen that said investments have already been amortised and have generated said reasonable return long before the end of the operational period."*[489].

758. In line with the aforementioned, the European Commission has pointed out that the purpose of these development measures is to cover the difference between the market price and the cost of renewable energy production, wherefore it could include the earning of a "reasonable return" on the investment, which must be limited time-wise to amortisation of the investment:

> *"(96) According to point 59 of the 2001 EAG, operating aid for the production of renewable energy can be granted to cover the difference between the cost of producing energy from renewable sources and the market price of the form of energy concerned. The aid can only be granted until plant depreciation and can include a fair return on capital (...)*[490]*" (emphasis added).*

759. The time limitation for receiving the subsidies does not prevent these installations from remaining owned by the investor and being kept in operation. If they continue to operate, they can sell all of the production and obtain the corresponding market price.

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beginning or at the end... it is the legislation of coverage which designs a remunerative model for existing installations based on the consideration of the entire useful life of the project. (Emphasis added). Administrative enquiry relating to draft Royal Decree 413/2014 (document 20.02) R-0124.

[488] Guidelines on State Aid in the issue of protection of the environment and energy approved through EC Communication 2008/C82/01 (R-0065), and substituted for the 2014-2020 period through EC Communication 2014/C 200/01 (R-0066).

[489] Judgement of the Supreme Court of 12 April 2012, app. 40/2011 (R-0144). Also cited, among others, in the judgement of the Supreme Court of 19 June 2012 (appeal 62/2011). R-0146

[490] Decision C(2016) 7827 final, of 28 November 2016, of the European Commission handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic RL-0021

760. Consequently, setting the regulatory life is fully consistent with the purpose of the support mechanisms to guarantee the operability of the installation during its useful life and allow a fair return to be obtained. This is without, contrariwise, said mechanisms needing to continue to pay a premium to the installation, once it has received the amounts that enable it to amortise the same. For wind energy facilities, a regulatory useful life of 20 years is established.[491].

(7) Regulatory periods.

761. A further important element of the legal and economic regime that applies to the Claimant's installations are the different regulatory periods provided for. These represent flexible regulatory tools for the purpose of adapting remunerations to cover costs and to provide a reasonable return. The setting of these regulatory periods, as analysed hereunder, provides the system with greater stability and predictability.

762. The need for both stability and predictability is provided for in the economic standards and criteria, with the requirement for remunerative regimes[492] that adapt in order to comply with both their objectives and the legal system. This responds to a regulated technique that is accepted in a great many countries and provides for predictability of modifications and adaptations in order to comply with the purpose of the economic regimes. Consequently, it permits the full recovery of costs and a reasonable return on investments.

763. Indeed, the regulatory periods constitute an appropriate mechanism for preventing inadequate remuneration from being maintained, whether positive or negative, due to price variations, due to circumstances that influence the costs and due to other, basic economic data that condition the level of support for renewables, such as the evolution of the demand for electricity or a cyclical situation of the economy. However, as we have stated previously, in accordance with this purpose, neither the value of the investment nor the regulatory useful life can be amended in any of the regulatory periods.

764. In other words, under no circumstances -once the regulatory useful life or the standard value of the initial investment of a facility has been recognised- can these values be reviewed. This means that the investor will have the amounts of the investment fixed in their standard, and will be unable to change this in the future[493].

765. This mechanism represents a relevant guarantee for the protection of investments already made or which may be made in the future, by protecting new economic regimes and which is not considered for the remaining activities of the electricity sector.

[491] Article 5 Order IET/1045/2014. R-0115
[492] Act 24/2013. Article 14(4). R-0077.
[493] Ibid. Article 14 (4).

766. Stability is related to the permanence of the regulatory periods. Based on the new regime, each regulatory period is enforceable for six years[494]. Any changes will take into consideration the cyclical situation of the economy, the demand for electricity and the reasonable return for the activity[495].

767. In the review that takes place with each regulatory period, all of the remunerative parameters may be amended, including the value on which the fair return shall be based for the rest of the regulatory life of standard installations.[496]

768. Each regulatory half-period has an enforceability of three years[497]. The income estimates through the sale of energy produced shall be reviewed in the half-periods, measured at market price of production, based on the evolution of market prices and the forecasts of hours of performance with regard to the estimates made for the previous three-year period.

769. Every year, the return on operation values will also be reviewed for those technologies whose operating costs depend essentially on the price of fuel[498], in order to adapt to the price of this. The purpose of this is to adapt it in accordance with market variations so that undue amounts are not received, whether too much or too little. Likewise, the remunerative parameters may be reviewed at the end of each half-period or regulatory period in accordance with the terms set out therein. The accompanying witness statement of Juan Ramón Ayuso explains how the different reviews are carried out[499]

770. As we have explained, the part of the subsidies targeted at providing a fair return may also be updated. This update may be undertaken at the end of each regulatory period: this is set at every 6 years. Given this possibility, the Claimant believes this measure to be one of the main new items of the new regulatory framework that has generated a radical change with regard to the previous model.

771. The Claimant has not paid attention to the previous model. As we have set out previously, the subsidies, with the market price, covered the investment cost, operations cost and provided a fair return over the investment of around 7%. However, the part of the subsidy targeted at providing a fair return was also subject to updates in accordance with the CPI. This update took place every year.

772. The CPI is a variable index whose fluctuation generated alterations in the profitability of plants. Thus, if the CPI went up, the part of the subsidy targeted at

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[494] As regards the six-year regulatory periods, it sets out that the first regulatory period is from the date of coming into force of Royal Decree-Law 9/2013, 12 July, and 31 December 2019. Royal Decree 413/2014, Additional provision one. R-0110

[495] Article 14.4 of Act 24/2013, of 26 December. R-0077.

[496] Royal Decree 413/2014. Article 20(1). R-0110.

[497] Each regulatory period is divided into two regulatory half-periods of three years each, with the first regulatory half-period corresponding to the one that exists between the date of entry into force of Royal Decree-Law 9/2013, of 12 July, and 31 December 2016. Royal Decree 413/2014. R-0110.

[498] Act 24/ 2013, of 26 December, on the Electricity Sector. Article 14(4). R-0077.

[499] Juan Ramón Ayuso, paragraphs 138 to 143.

providing said return also went up and a higher return was obtained. Contrariwise, if the CPI went down, the part of the subsidy targeted at providing the return also went down, and thus lower returns were achieved. This latter scenario was aggravated if we take into consideration that in addition to the fall of the CPI it would have been necessary to add a negative correction factor of -0.5.

773. As with the previous model, in the current model the part of the subsidy targeted at providing a fair return (the Return on Investment – Ri-), is also variable. What happens is that instead of the return being pegged to the CPI it is pegged to an equally robust index such as the Spanish bond at 10 years. Furthermore, the updating does not take place every year, only every six years. At the end of the regulatory period.

774. For the first regulatory period (6 years) the fair return was established at 7.398, which is the result of increasing the average performance of ten-year state bonds in the secondary market, increased by 300 basis points, for the ten years prior to the entry into force of this Royal Decree-Law[500].

775. In future regulatory periods, the fair return of the standard installations will be calculated as the average return of State Bonds at 10 years in the secondary market for the 24 months prior to May of the year before the year in which the regulatory period begins, plus a spread[501].

776. In all circumstances, as with the previous model the foregoing return must be set duly respecting two essential elements: the economic sustainability of the SES and the guarantee of a fair return for investors. More specifically, the Preamble of Act 24/2013 sets out:

> *"The parameters for setting the remunerations shall remain in force for six years and in order to be reviewed, which will take place at the beginning of the regulatory period, the cyclical situation of the economy will be taken into account along with electricity demand and a fair return for these activities." (Emphasis added)*[502]

777. As we already explained, the pegging of the return to the Spanish 10-year bond is nothing new in our regulatory framework. Moreover, said pegging was proposed in 2009 by the sector itself

778. Lastly, we cannot overlook the fact that this dynamism protects the value of the investment over time. This is because at all times the value of the asset depends on the return offered by alternative investments, and if the return was set in the past and was based on evolution of the market and macroeconomic variables it is now very low with

[500] Royal Decree-Act 9/2013 of 12 July, establishing urgent measures to ensure the financial stability of the electricity system. Additional provision one. R-0095.
[501] Royal Decree 413/2014, of 6 June, which regulates the electric energy production activity from renewable energy sources, cogeneration and waste. Article 19. R-0110.
[502] Act 24/2013 of 26 December, on the Electricity Sector. Preamble and Article 14 (4). R- 0077.

regard to other investments, meaning the asset will depreciate and may even lose all of its value[503].

779. Having set out the following, the system of reviews in the current remuneration model combines the needs of stability and predictability in the regulation and economic criteria with the requirement of adapting remunerative regimes for the purpose of complying with their needs and with the legal system. They respond to a regulatory technique that is accepted in a great many countries and which enables predictability of modifications and adaptations in order to comply with the purpose of economic regimes. Consequently, they enable the full recovery of costs and a reasonable return on investments.

780. Accordingly, it is not odd that the Claimant states, when it comes to assessing the regulatory changes:

> *"Furthermore, the modifications within the current legislative framework concerning the tariff review methodology, including the remuneration of electricity generated, represent the main mechanism of support to the development of the sources."*[504]

781. Exactly the same is set out in the Notes to the Financial Statements of 2015 of Parque Eólico La Boga S.L. (The Seventh Claimant).[505]

(8) Participation of parties interested in regulatory procedures.

782. All the regulations that are included in the new legal framework have been adapted to the procedure envisaged in Spanish law. All the necessary reports have been gathered together, in order to ensure that the new regulatory text conforms fully with Spanish Legal Order. Reports have been requested, even reports that were not obligatory[506], and several hearing procedures have been arranged in which all interested parties have been able to take part. Furthermore, an important part of the pleadings of the interested parties, who presented myriad observations, have been accepted.

783. Examining the pleadings of the interested parties, the State Council, the Government's Supreme Consultive Body[507], has issued three Advisory Opinios. The State Council has endorsed the new remunerative regime, expressly admitting the legitimacy of the regulatory change, given that the previous regulation did not

[503] Expert Report by Accuracy paragraphs 235 to 259.
[504] 2015 Annual Financial Statements for Parque Eólico Marmellar S.L., page 42 of the pdf. BQR-38.1A_ESP
[505] 2015 Annual Financial Statements for Parque Eólico La Boga S.L., page 42 of the pdf. BQR-38.2A_ESP
[506] For example, by the issuance of Ruing 539/2014 by the State Council to Order IET/1045/2014, which was not obligatory, as this consultative body expressly stated. Administrative enquiry relating to Draft Order IET/1045/2014. R-0125.
[507] The State Council is a Body that is consecrated in the Constitution as the supreme consultative body of the Government. Article 107, Spanish Constitution of 1978. R-0035.

contemplate the right to regulatory petrification. The State Council also insists on the notoriety of the need for the reform[508].

784. The State Council also confirmed that the approved regulation should not be retroactive. In this way and far removed from that which is repeatedly sustained in the Statement of Claim, it declares that it lacks any "*retroactive vocation*" given that it does not affect the amounts that were effectively received prior to Royal Decree Act 9/2013 coming into effect[509]. Unlike the Claimant, in its reports the Council of State praises and explains the complex processing and effective public participation in this.[510]

785. This process was prolonged for almost a year, to ensure that the interested parties might have the opportunity to participate as and when the regulatory process progressed and at different times during that progress, against different bodies and without imposing whatsoever limitation insofar as their pleadings were concerned[511].

786. The National Markets and Competition Commission also issued no less than four reports on the procedure of the reports referred to above.

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[508] Advisory Opinion 937/2013 of the Permanent Committee of the State Council, of 12 September 2013. General Observation VI: "On the other hand, with respect to the principle of legitimate expectation, the reform of the electricity sector should not be thought of as something unexpected; given the gradual deterioration of the sustainability of the electricity system, those who are involved in the different activities in the supply of electricity, aware of such deterioration, could not legitimately expect that the parameters that had degenerated into the situation that has been described could be preserved.**"**(Emphasis added). R-0123.

[509] Advisory Opinion 937/2013 of the Permanent Committee of the State Council, of 12 September 2013. General Observation VI: "the draft bill lacks retroactive vocation, given that it is not called upon to determine the past remuneration of the existing plants, rather that which the plants may receive, no matter whether they already exist or they are new ones, subsequent to the effective date of the reform that began with Royal Decree-Act 9/2013, of 12 July." (Emphasis added). R-0123.

[510] Administrative enquiry relating to the Draft Royal Decree 413/2014; Report of the State Council, 6 February 2014: Report 18/2013 of the National State Council contained myriad observations on the contents of the draft bill, many of which were accepted into the draft). As stated in the report on the analysis of the regulatory impact, following the analysis of said report and of the pleadings presented as to the text through the Electricity Advisory Board, important modifications were made to the text, which justified beginning its processing again, based on the draft of 26 November 2013.

This led to the report by the National Markets and Competition Commission (CNMC) of 17 December 2013, in which the Electricity Advisory Board participated for the second time. This report took into consideration the pleadings that were made during the hearing that took place in the headquarters of the Electricity Advisory Board and which were attached as an annex to the actual report.

During the enquiry, this Board received several requests for a hearing, which were duly granted. Thirteen written pleadings were presented during this procedure. In the written pleasings that were presented during this procedure, the participant parties invoked or reiterated the arguments that had been put forward in the headquarters of the Electricity Advisory Board, adding the pleadings that they considered to be in their best interests." (Emphasis added). R-0124.

[511] *Administrative* enquiry relating to the Draft Royal Decree that regulates the production of electricity from renewable energy, cogeneration and waste sources (Royal Decree 413/2014); State Council Report of 6 February 2014:

"The renewal of the procedure allowed the Electricity Advisory Board and the National Markets and Competition Commission (CNMC) to participate once again; the hearing procedure for those interested should be considered to have been completed, insofar as all the sectors that are affected by the draft have had the opportunity to participate in the drafting of the regulation - in this particular case, in fact, on two occasions, through the Electricity Advisory Board." (Emphasis added). R-0124.

787. All the reports issued by the CNMC were favourable and acknowledged that the remuneration set was reasonable, and even higher than the remuneration set out in some of its reports[512]. The CNMC insists that the procedure and values used are correct, focusing on the predictability and knowledge of the values by operators[513].

788. Furthermore, the National Markets and Competition Commission was surprised by the increased remuneration that certain installations received, which also see their remuneration adjusted to the reasonable return set[514]. In turn, this regulatory authority submitted the texts sent to the Electricity Advisory Council.

789. During certain of these procedures, more than 600 pleadings were sent by all the interested parties belonging to all the sectors that participate in the electricity system and the other State Public Administrative Bodies. These pleadings were explained and answered in the procedural enquiries of the regulatory legislation.[515].

(9) Conclusion.

790. The Spanish State, by dint of its legislative and executive powers, has conferred a legal regime on plants that generate renewable energy and which received of may receive in the future remunerations payable by the electricity system.

791. This legal regime is framed within a complete reform of the different activities within the electricity system that have taken place, primarily, from January 2012 to the present day.

792. The aim of the reform has been to revise each and every one of the costs that are assumed by the electricity system in order to comply with the current legal order, both

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[512] The report by the CNMC stated that:
"Generally speaking, it is noted that the investment ratio data, in euros per MW installed, employed at that time by the CNE when estimating the tariffs and premiums, even though in certain cases they were of no statistical importance, were positioned, with some exceptions, close to or beneath those that are now being proposed. Therefore, the reduction of the remuneration cannot be attributed generically to the application of low investment ratios. The remunerative adjustment is fundamentally due therefore, to the establishment of a rate of profitability applicable to the entire useful reglementary life of each plant that is less than the rate implied in the premiums and tariffs in force in the remunerative regime prior to Royal Decree-Act 9/2013, premiums that it is worth mentioning were in many cases significantly higher than those envisaged at that time by the Commission in their mandatory reports on the proposed regulatory changes that have taken place throughout the past decade." (Emphasis added). Administrative enquiry relating to Draft Order IET/1045/2014. CNMC report. R-0133. (Procedure, document 01.05).

[513] Administrative enquiry relating to the Draft Order IET/1045/2014); CNMC Report: "the classification employed is, notwithstanding its complexity, possibly the most objective, and probably also the most robust" ((Procedure, document 01.05). R-0133.

[514] The regulatory body states that: "One of the aspects of the Proposal that appears to be that paradoxical, in a context of important realignment and the possible closure of plants, is the fact that it contemplates an increase in the remuneration of specific plants, especially in their first years of exploitation." Administrative enquiry relating to Draft Order IET/1045/2014; CNMC report. (Procedure, document 01.05). R-0133.

[515] Administrative enquiry relating to Draft Order IET/1045/2014); Report on the analysis of the *regulatory* impact of the draft order that approves the remunerative parameters for typical plants that are applicable to specific electricity production plants that use renewable energy, cogeneration and waste sources. Point 3 (2). (Procedure, document 15.03). R-0084.

domestic and that of the European Union, so that the consumer of electricity should not have to assume cost overruns in the different activities.

793. The result of the reform has been that certain activities and their plants have seen how their remunerations have been increased and other plants have seen theirs decrease. The intention being to respect the basic principles of the return of the investment, maintaining the operation and obtaining a reasonable profitability.

794. This legal regime has respected the principles that have been legally established, developed and validated by jurisprudence and are known by each and every diligent operator.

795. The new regulations are characterised by their comprehensiveness given that they carry out a detailed examination of the costs of some 2,000 typical plants, the publicity given to the procedure that led to the IT being established and the parameters and given the thoroughness that went into their establishment.

796. The different remunerative parameters have been calculated pursuant to prudent criteria of appraisal, in accordance with verifiable and perfectly replicable data in the renewable sector activity.

797. The parameters are revisable as the case may be, for regulatory periods that are fully foreseeable and determined in time[516], even though the investment value and the useful regulatory life remain invariable and are not subject to review during the regulatory periods. In this way, at the end of the useful regulatory life of the plants, these continue to be the property of the investors and may remain operational, selling the energy with priority dispatch in the electricity market, without such income being in any way taken into account in the remunerative regime.

798. Consequently, above and beyond the regulatory life, it is not possible to continue to receive further public aid, as this would incur in a situation of excess remuneration or of unjustified remuneration, contrary to the legal order. It is even possible that certain plants no longer receive subsidies to the account of the new remunerative model as they have already received, prior to its coming into force, the reasonable profitability guaranteed by Law.

799. The appraisal of the impact on a specific plant that the different measures that have been adopted during the past year have had, must be made in the light of the new remunerative regime and its future projection on income, costs and profitability.

[516] It should also be pointed out that the modifications to the remunerative regime are not exclusively envisaged for the generation of electricity from renewable sources. Act 24/2013, of 26 December, on the Electricity Sector. Article 14(4) states, specifically: "*The remuneration parameters of activities involving transmission, despatch, production from renewable energy sources, high-efficiency and waste cogeneration with a specific remuneration regime and production in non-peninsular electrical systems with an additional remuneration regime will be set bearing in mind the cyclical situation of the economy, electrical demand and the appropriate return for these activities for regulatory periods lasting six years.*" R-0077.

800. The new remunerative regime has taken into account both the positive and the negative measures, so that the profitability of the plant may be maintained in terms of reasonability.

801. For that reason, the following elements have been accepted as costs included in the R.O.: the tax on the value of the production of electrical energy, the BICES, and all those costs that are not contemplated nor taken into account under previous regulations.

802. Furthermore, the new remunerative regime responds to the new model established by the European Commission for State aid in the renewable sector that is eligible for such subsidies.[517]

803. In summary, this regulatory framework not only provides a global response to the protection of investments and the fostering of these in Spain, but furthermore the Kingdom of Spain maintains the commitment to continue subsidising installations such as those of the Claimant.

(10) Existence of a European Commission State subsidy procedure in relation to Order IET/1045/2014 and the regulations that this replaces.

804. As has already been stated, in the European Union, the remuneration policy in favour of renewable energies is subject to a number of directives that have been approved by the European Commission.

805. Until recently, there were different interpretations as to whether amounts received by producers through invoices paid by consumers ought to be considered State aid. Such doubts of interpretation have been clarified by the Order of 22 October 2014 of the Court of Justice of the European Union laid down regarding preliminary ruling C-275/13, (ELCOGAS case) referring to Spain, paragraph 33, which concludes as follows[518]:

> *"Article 107 of the TFEU, section 1, must be interpreted in the sense that the amounts attributed to a private electricity producing company which are financed by all the electricity end users established in national territory and which are distributed to Electric Sector companies by a public organisation in accordance with predetermined legal criteria, constitute a State intervention or by means of State funds."*

806. As a result of said legal resolution, Spain communicated to the European Commission the support measures for renewable energies and cogeneration that it had adopted by dint of Ministerial Order IET/1045/2014. The Commission has opened to that effect, procedure SA.40348 2014/N.

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[517] Guidelines on State aid in issues of environmental protection and energy 2014 -2020, 2014/C-2020, point 129. "The aid is only granted until the plant has been fully depreciated according to normal accounting rules and any investment aid previously received must be deducted from the operating aid". R-0066.

[518] Order of the Court of Justice of the European Union laid down regarding preliminary ruling C-275/13, ELCOGAS, of 22 October 2014. R-0024

807. Article 4.3 of the Treaty of the European Union (TUE) establishes the obligations that the State assume by virtue of the principle of sincere cooperation. In this way, in accordance with paragraphs two and three of this precept:

> *"The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union.*
>
> *The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives".*

808. This precept does not establish a mere principle of an illustrative nature, rather it imposes obligations that may be demanded of the States whose non-compliance may give rise, by the application of articles 258 and 260 of the Treaty on the Functioning of the European Union (TFUE), to a Sentence by the Court of Justice of the European Union that may impose an economic penalty and/or a coercive fine on that State.

809. Within the obligations that TFUE imposes on Member States is the prohibition to grant State aid, save in cases permitted by the Treaties. In accordance with article 107.1 TFUE,*"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market".*

810. In the light of the definition in the Elcogas Sentence as to the concept of State aid, the Respondent was obliged, under the provisions of articles 107 and 108 TFUE, to notify the European Commission as to the existence of measures to support renewable energy and cogeneration in Spain, related to the arbitration procedure that this Court is hearing.

811. The notification of aid enables the State not only to comply with the obligations stemming from the Treaties, but also to request the Commission to declare the compatibility of this aid on the basis of the Guidelines that govern state aid in issues of environmental protection and energy 2014-2020. The declaration of compatibility, through a Commission Decision, is the only legal channel to enable the aid in question to be irrecoverable, pursuant to the provisions set out in articles 107.3.c) and 108 TFEU.

812. Pursuant to article 108 TFEU, the Commission holds exclusive power to declare the compatibility of aid with Union Law, and the only competent body to review the legality of this Decision is the EU Court of Justice, in accordance with highly consolidated case law.

813. Both the exclusive competence of the Commission to declare the compatibility of the aid and that of the Court of Justice of the Union to review the legality of said

declaration are imperative regulations that cannot be derogated under any circumstances and that form part of the public order of the European Union.

814. Therefore, and for reasons of transparency and goodwill in the development of the arbitration procedure, the Kingdom of Spain makes the Arbitration Court aware of the existence of said procedure.

815. This communication is of particular relevance in the light of the decision of the Commission dated 26 May, 2014[519], in which it ordered the suspension of the payment by Rumania of an arbitration award laid down in an ICSID arbitration, *Micula c.. Rumania*.

816. Thereafter, by a decision dated 30 March, 2015[520], the Commission has resolved that "the payment of compensation by Rumania to two Swedish investors by virtue of the abolished aid regime violates the rules governing EU State Aid" and that "by means of the compensation granted to the Claimants, Rumania is in actual fact awarding an equivalent advantage to the abolished aid regime". The Commission thus concluded that said compensation is equivalent to an incompatible State Aid and must be returned by the beneficiary companies.

I. The Measures that are in conflict have been acknowledged as necessary macro-economic control measures that stabilise the economy and are reasonable.

817. The Claimant questions the rationality and proportionality of the measures from a regulatory viewpoint, based on the subjective opinion of its experts. However, this opinion contrasts with the opinions of various institutions and agents that have appraised the new regulatory framework.

(1.1) Appraisal of the measures by the Domestic Courts of the Kingdom of Spain

818. The new remuneration model has been subjected to examination by the Kingdom of Spain's highest judicial institutions. All of them have affirmed the rationality and proportionality of the new system,

(a) Position of the Constitutional Court of the Kingdom of Spain

819. The Constitutional Court of the Kingdom of Spain has already issued a number of pronouncements about whether the new system violates the Spanish Constitution. In particular it has already decided on the appeals of unconstitutionality submitted by the

[519] Document of the Commission C (2014) 6848 final, of 1 October 2014, which orders the suspension of the payment by Rumania of an arbitration award laid down in an ICSID arbitration, Micula against Rumania. R-0208.
[520] Decision of the European Commission of 30 March 2015 declaring as state aid incompatible with the Treaty on the Functioning of the European Union the compensation awarded in *Micula against Rumania* (Commission press release, English version). R-0025.

Autonomous Community of Murcia[521], the Foral Community of Navarre[522] and the Socialist Parliamentary Group against Royal Decree Law 9/2013.[523]

820. The Constitutional Court,[524] the highest interpreter of the Spanish Legal System in matters for protection of fundamental rights, in its Judgement of 17 December 2015, [525]affirmed and consolidated the jurisprudential line marked by the Supreme Court, regarding the conformity of the reforms introduced in the SES for the principles of legal certainty and its corollary of legitimate expectations, to that of normative hierarchy and non-retroactivity of sanctioning or restrictive regulations of individual rights.

821. In fact, on deciding on the appeal of unconstitutionality filed by the Governing Council of the Autonomous Community of the Region of Murcia, against Article 1, paragraphs 2 and 3 and first additional provision, third transitional provision and second final provision of Royal Decree Law 9/2013, of 12 July, adopting urgent measures to ensure the financial stability of the electrical system, it examines successively, the alleged breaches of the principles of the normative hierarchy, legal certainty, legitimate expectation and non-retroactivity of the unfavourable or restrictive penalty provisions of individual rights, which the petitioners invoked with regards to said provisions.

822. Thus, as has already been advanced, the Constitutional Court reproduces the same criteria sustained by the Supreme Court in its well-established jurisprudence.

823. With regard to the alleged infringement of the principles of legal certainty and protection of legitimate expectations, the Constitutional Court establishes that:

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[521] Constitutional Court ruling of 17 December 2015, delivered in an appeal of unconstitutionality 5347/2013. R-0154.

[522] Constitutional Court ruling of 18 February 2016, delivered in an appeal of unconstitutionality 5582/2013. R-0156.

[523] Constitutional Court ruling of 18 February 2016, delivered in an appeal of unconstitutionality 6031/2013. R-0157.

[524] The functions of the Constitutional Court are included, expressly, in Article 161 of the Spanish Constitution, which provides that: "*1. The Constitutional Court has jurisdiction throughout the Spanish territory and is competent to try:*
a) The appeal of unconstitutionality against laws and regulatory provisions with the force of law. The declaration of unconstitutionality of a legal regulation with the rank of law as interpreted by jurisprudence, shall affect this, although the judgement or judgements handed down shall not lose the value of res judicata.
b) The appeal for protection due to violation of the rights and freedoms referred to in Article 53, 2, of this Constitution, in the cases and ways established by law.
c) The conflicts of jurisdiction between the State and the Autonomous Communities or of these among themselves.
d) Other matters assigned to it in the Constitution or the organic laws.
2. The Government may appeal to the Constitutional Court against provisions and resolutions adopted by the bodies of the Autonomous Communities. The Government may contest before the Constitutional Court the provisions and resolutions adopted by the agencies of the Autonomous Communities, which shall bring about the suspension of the contested provisions within a period not exceeding five months". R-0035.

[525] Constitutional Court ruling of 17 December 2015, delivered in an appeal of unconstitutionality 5347/2013. R-0154.

> *"The respect of this principle [legal security], and its corollary, the principle of legitimate expectations, is compatible with the modifications in the remuneration system of renewable energies made by Royal Decree-Law 9/2013, furthermore - as in this case-, in an area subject to a high administrative intervention due to its incidence in general interests, and a complex regulatory system that makes it impossible to claim that the more favourable elements are invested of permanence or immutability [...] which obliges the public authorities to adapt this regulation to a changing economic reality"*[526] *(emphasis added).*

824. Furthermore, it added regarding both principles that:

> *"The unexpected modification produced should not be rated, because the evolution of the circumstances affecting that sector of the economy, made it necessary to undertake adjustments of this regulatory framework, as a result of the difficult circumstances of the sector as a whole and the need to ensure the necessary economic balance and the proper management of the system. It must not therefore be argued that the amendment of the remuneration system examined was unpredictable for a "diligent and prudent economic operator", in response to economic circumstances and to the inadequacy of the measures taken to reduce a persistent deficit continuously on the increase in the electrical system which had not been properly tackled with previous provisions.*
>
> *The preamble to the Royal Decree-law determines that its purpose is to avoid the "over-payment" of certain installations under the special regime*[527]*" (emphasis added).*

825. Finally, regarding the claimed violation of the principle of non-retroactivity, it concludes by stating that:

> *"The owners of electrical energy production installations in the premium payment system will be subject to this new remuneration regime from the date that Royal Decree-Law 9/2013 comes into effect [...] without this subjection entailing any unfavourable restriction on the rights acquired, from a constitutional perspective, that is to say, it does not affect any property rights previously consolidated and definitively incorporated to the recipient's estate, or legal proceedings that are exhausted or completed*[528]*"*

826. This clarity and forcefulness have been reinforced by the concurring individual opinion made by the Judge Mr Juan Antonio Xiol Ríos regarding the Judgement itself, joined by Judge Ms Adela Asua Batarrita and Judge Mr Fernando Valdés Dal-Ré.[529]

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[526] Constitutional Court ruling of 17 December 2015, delivered in an appeal of unconstitutionality 5347/2013, seventh legal basis (a) R-0154.
[527] Constitutional Court ruling of 17 December 2015, delivered in an appeal of unconstitutionality 5347/2013, seventh legal basis (a) R-0154.
[528] Constitutional Court ruling of 17 December 2015, delivered in an appeal of unconstitutionality 5347/2013, seventh legal basis (c). R-0154.
[529] Constitutional Court ruling of 17 December 2015, delivered in an appeal of unconstitutionality 5347/2013. Concurring individual opinion made by Judge Mr Juan Antonio Xiol Ríos regarding the

This individual opinion far from rectifying or disagreeing with the ruling of the Judgement, reaffirms it, providing it with greater legal precision and argumentative foundation.

827. Although the clarity and accuracy of this individual opinion may well justify its complete reproduction, those pronouncements that most faithfully reflect the reality of the SES and its regulations shall be extracted, which, moreover, all prudent investor should know well. In this regard, the aforementioned individual opinion contextualises the reason for its issuance, to say that *there are three important elements to examine in more detail the legal arguments set out in the Judgement. These reasons are:*

> *(i) the regulatory development of the regulation and dispute that has come about among the legal operators;*
>
> *(ii) that up to this moment, the Constitutional Court has not decided on the expectations of the legal and economic operators on this issue; and*
>
> *(iii) the existence of a large number of disputes brought before international Courts of Arbitration, regarding a "a more founded decision by the Constitutional Court seems particularly necessary*[530]*".*

828. Starting from this contextualization, this individual opinion focuses on specifying the concept of legitimate expectation. It is defined as the principle that protects the legitimate expectations of citizens that adjust their economic behaviour to the legislation in force against regulatory changes that are not reasonably foreseeable, by reference to the criteria used by the Court of Justice of the European Union for their weighting. In this regard, it states that:

> *"(b) the amendment made by Royal Decree-Law 9/2013 meant a new incentive system characterised by (i) the existence of an additional remuneration to that of participation in the market that covers the costs of investment that an efficient and well managed company shall not recover in the market; (ii) that this remuneration system shall not exceed the minimum level necessary to cover the costs that allow them to compete with facilities equally with the rest of technologies on the market and which allow them to obtain a reasonable profitability by reference to the installation type in each applicable case; and (iii) that the reasonable profitability shall rotate, before tax, on the average yield in the secondary market of the Government Bonds to ten years by applying the appropriate differential.*
>
> *In addition, and as was also justified extensively in the explanatory statement of Royal Decree-Law 9/2013 itself, this change of law brings about the need to meet urgent and higher public interests that were reflected in the need to reduce a tariff*

Judgement issued for the appeal of unconstitutionality No. 5347-2013, joined by Judge Ms Adela Asua Batarrita and Judge Mr Fernando Valdés Dal-Ré. R-0154.

[530] Judgement of the Constitutional Court of 17 December 2015, issued in the appeal of unconstitutionality 5347/2013. Concurring individual opinion made by Judge Mr Juan Antonio Xiol Ríos regarding the Judgement issued for the appeal of unconstitutionality No. 5347-2013, joined by Judge Ms Adela Asua Batarrita and Judge Mr Fernando Valdés Dal-Ré. Legal basis II (6). R-0154.

deficit that, with the passage of time, had become structural, due to the actual associated costs, among others, so that the regulated activities were higher than the collection from tolls fixed by the Administration and that consumers pay".[531] *(emphasis added)*

829. On this basis, the individual opinion concludes categorically:

"the legitimate expectations generated by the reformed legal regulations have been maintained in essence, both in the sense of giving continuity to an incentives system and in subordinating it to obtain a reasonable profitability with reference to the cost of money in the capital market. On the contrary, it cannot be qualified as a legitimate expectation [...] the maintenance of a situation involving some extremely high levels of profitability outside the market and that may be contrary to higher public interest.

(c) This regulatory change, moreover, ***should also not be considered as unpredictable for a prudent economic operator*** *regarding the different concurring circumstances, including the evolution of the general economic situation and the electricity sector.(...)*

The controversial amendment was ***not unpredictable*** *some of those that were already widely set out in the aforementioned STS of 12 April 2012 can be stated, in connection with other previous amendments, as would be (i) the uniqueness of an economic sector that is strategic in nature, which implies a wide regulation density, the presence of underlying public interests and, consistent with this, the need for regulatory amendments that adapt the regulatory framework to the eventualities of the sector and to variations that may occur in the economic data; (ii) the nature of the incentives in the form of a regulated tariff, which mean an exceptional and atypical situation in a free market regime the business risk is eliminated from investments resulting from the system of free competition; and (iii) the implicit conditionality to any incentive measure* ***that cannot be ensured its unchanged permanence*** *and the explicit one that it this linked to the achievement of a series of objectives. To these should be added, in the specific case referred to in this appeal of unconstitutionality,* ***that successive reforms operated in the administrative regulations of development, already anticipated*** *a change in the remuneration system that might affect at least the quantification of the levels of profitability"*[532]*.(emphasis added).*

830. The forcefulness, clarity and continuity of the applicable Jurisprudence leaves no doubt about the scope, content and legal limits of the reasonable profitability to which

[531] Judgement of the Constitutional Court of 17 December 2015, issued in the appeal of unconstitutionality 5347/2013. Concurring individual opinion made by Judge Mr Juan Antonio Xiol Ríos regarding the Judgement issued for the appeal of unconstitutionality No. 5347-2013, joined by Judge Ms Adela Asua Batarrita and Judge Mr Fernando Valdés Dal-Ré. Legal basis II. (7.ii). R-0154.

[532] Judgement of the Constitutional Court of 17 December 2015, issued in the appeal of unconstitutionality 5347/2013. Concurring individual opinion made by Judge Mr Juan Antonio Xiol Ríos regarding the Judgement issued for the appeal of unconstitutionality No. 5347-2013, joined by Judge Ms Adela Asua Batarrita and Judge Mr Fernando Valdés Dal-Ré. Legal basis II. (7.ii). R-0154.

the investors had a right to. And therefore, to appraise the real legitimate expectations that the Kingdom of Spain offered to all national or foreign investors This is therefore essential to specify the legitimate objective expectations that the Claimant was able to form when making his investment.

(b) The Position of the Supreme Court of the Kingdom of Spain.

831. In its Judgement 63/2013 of 21 January 2016[533], the Supreme Court has dismissed the claim for asset liability on the part of the State legislator for damage caused:

> -By Royal Decree 1565/2010, of 19 November, which regulates and modifies certain aspects pertaining to the activity of electrical energy generation under the special scheme.
>
> - By Royal Decree-Act 14/2010, of 23 December, which establishes urgent measures for the correction of the deficit of the electrical sector.

832. In fact, in line with its jurisprudential doctrine that began in the year 2005, the Supreme Court reiterates that same doctrine, pointing out that RD 661/2007 did not result in a petrifaction of the economic regime in force at that time. Thus, it has expressly established that:

> *"And it would also have to emanate from a presupposition that, in the opinion of this Chamber, does not concur (nor did it concur when these same plants began their operation): that the legal regime laid down in Royal Decree 661/2007 would be prolonged indefinitely and that it would be so prolonged, moreover, in identical terms to those expressly provided for at that time. We do not understand, in effect, how the aforementioned Royal Decree might envisage a tariff regime forever, nor how the Government, in the exercise of the regulatory powers that it holds, or how the legislator, in the use of his legislative power, might not adapt or modify that regime in order to address such new circumstances (economic, productive, technological or of any other nature) as may occur during such a lengthy period of time.*
>
> *In short, not only do we not appreciate (as the Third Section of this Chamber already pointed out in the abovementioned Judgement) that the temporary modification that we are analysing violates the principles of legal certainty and legitimate expectation, rather, from the point of view of the institution of patrimonial responsibility, it cannot be argued in any way that the damage that is claimed meets the characteristics of effectiveness and actuality that would allow it to be qualified as compensable[534]".*

[533] Judgement 63/2016 of 21 January 2016 of the Supreme Court handed down in appeal 627/2012. R-0155.
[534] Judgement 63/2016 of 21 January 2016 of the Supreme Court handed down on appeal to the Supreme Court 627/2012. Legal ground six. R-0155.

833. In addition, the Supreme Court has repeatedly ruled on the legality of the measures that are the object of this arbitration in accordance with Spanish Law[535]. Of these rulings, we can highlight the Judgements handed down in the appeals of AEE and Protermosolar[536]

834. The Supreme Court of the Kingdom of Spain has set out that the procedure for preparing the different regulatory measures was adapted to the internal Spanish legality thus guaranteeing all interested parties the right to a hearing[537].

835. In the same way, the Supreme Court has ruled that the measures do not suffer from any prohibited retroactivity[538] and do not infringe the principles of legal certainty or legitimate expectations[539].

836. In coherence with its rulings from 2006 and 2009, the Supreme Court continues to uphold, when addressing the concept of a fair return, that:

> *"On the contrary, it is necessary to state that the holder of regulatory powers has full capability for the implementation of the principles of the remunerative system set out under Law, and that only a development that is clearly arbitrary, incongruent or contrary to logic and the purpose of legal criteria could be annulled. Outside of these extreme cases, which in no way concur, only certain aspects of the remunerative model could be successfully challenged, but it is not possible to base a generic challenge of the model implemented through Royal Decree 413/2014 on the aforementioned legal provision in benefit to the option preferred by the appellant".*[540]

(1.2) Appraisal of the measures by the Institutions of the European Union

837. The new system has been analysed by the European Union. The European Commission has issued various reports on the development of the macroeconomic measures adopted by Spain. In these reports, has recognised the compliance by Spain of the agreements entered into with the EU to adopt macroeconomic control measures since March 2012.[541]

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[535] Judgement of the Supreme Court of 1 June 2016, 1260/2016, app. 56/2011 649/2014). R-0273; Supreme Court Judgement of 1 June 2016, 1266/2016 . R-0274; Supreme Court Judgement of 1 June 2016, 1259/2016. R-0275; Supreme Court Judgement of 1 June 2016, 1261/2016. R-0277; Supreme Court Judgement of 1 June 2016, 1264/2016. R-0276

[536] Judgement 1730/2016 of the Supreme Court, of 12 July 2016, which rejects the appeal filed by the Wind Power Business Association (AEE) against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 456/2014). (R-0265) and Judgement 0265 of the Supreme Court, of 1964/2016 July 22, which rejects the appeal filed by PROTERMOSOLAR against Royal Decree 2016 and Ministerial Order 413/2014 (App. 1045/2014). R-0266

[537] Judgement of the Supreme Court of 22 July 2016, 1964/2016. Legal Grounds Three and Four. R-0278

[538] Ibid. Legal Ground five.

[539] Ibid Legal Ground six

[540] Ibid Legal Ground Seven.

[541] Every year the European Commission draws up a report *"Country report"* undertaking a comprehensive review of the economic situation of each State. These reports are part of the so-called *"Macroeconomic imbalance procedure"* which is a monitoring mechanism to correct the existing

838. The European Union, after having examined the evolution of the economy of the Kingdom of Spain since 2012, has given a favourable judgement of macroeconomic control measures taken. This review refers to the Macroeconomic measures taken in different sectors: financial, public administration, labour market, education, insolvency, Energy and infrastructures. The European Union has confirmed in its Report of 2014, regarding the Energy Sector, that:

> *"The reform of the electricity sector is being completed [...] The reforms in the gas and electricity sectors are helping to contain the tariff deficits [...] On the basis of the analysis in this report, repayment risks for the ESM loan are very low at present. This assumes that the authorities continue to improve the state of public finances and keep reforming the economy to address the challenges. The Spanish state can now borrow cheaper* ***thanks to policy actions at national and European level,*** *restored confidence in the Spanish economy and its public finances."*[542] *(Emphasis added)*

839. These measures are developed in the most comprehensive review of the "*Progress on Policy measures relevant for the correction of Macroeconomic Imbalances.*" In 2014 the European Commission stated:

> *"The 2013 reform of the electricity sector helped to contain the tariff deficit, and the 2014 deficit should be considerably smaller or the system should be in balance. The 'electricity tariff deficit' reached [...] EUR 28.5 bn at the end of 2013, almost 3% of GDP. The increase in access tariffs and the reduction in various costs of the electricity system applied with the 2013 reform help to balance the system in 2014. The authorities consider that the measures taken up to date should be sufficient to close the deficit structurally."543 (Emphasis added)*

840. In the subsequent review of 2015, the European Commission stated that the costs of the tariff deficit of the previous regulatory regime was being excessively passed on to consumers:

> *"The 2013 reform of the electricity sector helped to contain the tariff deficit, and the 2014 deficit should be smaller than in previous years. Energy policy choices in Spain over the last decade have resulted in an increase in regulated costs of the electricity system (Graph 3.4.1) and have been, to a large extent, passed on to electricity consumers."[...] The energy regulator, CNMC, expects that, in 2014, the*

Macroeconomic imbalances. The result of the comprehensive reviews serves as the basis for the Council to issue *Recommendations to the Member States of the EU*, on the measures to be taken to correct these Macroeconomic imbalances.

[542] Spain – Post Programme Surveillance Autumn 2014 Summary Report, page 3. (R-0202) Available at the web address: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp206_summary_en.pdf

[543] Spain — Post Programme Surveillance Autumn 2014 Report. page 27, (R-0250), available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp206_en.pdf

system was closer to equilibrium in structural terms than in previous years."[544] *(Emphasis added)*

841. The Measures taken in the Electricity Sector by the Kingdom of Spain have meant that the Recommendations of the Council in 2015 have considered the macroeconomic problem arising from the tariff deficit as resolved.[545]. Therefore, it does not include any Recommendations for the Kingdom of Spain to take measures in 2015 and in 2016 in this area.

842. In 2014 the National Association of Producers and Investors in Renewable Energies presented a petition to the Commission requesting that the situation be investigated that had been created for the photovoltaic industry by the various regulatory changes that, in turn, are the object of this arbitration. In view of this situation, the Commission in its response dated 29 February 2016 stated:

> *"In previous 'EU semester' recommendations to Spain, the Council emphasised the need for Spain to make the structural and comprehensive reforms to the electricity sector necessary to address this tariff deficit.(...)*
>
> *The Commission has considered the petition carefully and does not believe that under Directive 2009/28/EC there are grounds for the Commission to take legal action against Spain with regard to the changes in their legislation affecting the level of support given to investors in renewable energy projects. In particular, pursuant to Article 3(3) of Directive 2009/28/EC, support schemes are but one instrument that can be chosen by Member States to achieve the binding national targets established by the Directive for the share of renewable energy in gross final energy consumption as well as in transport in 2020. Member States retain full discretion over whether they use support schemes or not and, should they use them, over their design, including both the structure and the level of support. This comprises the right for Member States to enact changes to their support schemes, for example to avoid overcompensation or to address unforeseen developments such as a particularly rapid expansion of a precise renewables technology in a given sector.*
>
> *Therefore, in cases of changes to a support scheme as such, there is no breach of Directive 2009/28/EC" (Emphasis added)*[546]

[544] Macroeconomic imbalances Country Report – Spain 2015, page 62. (R-0209) available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2015/pdf/ocp216_en.pdf

[545] Council Recommendation on the 2015 National Reform Programme of Spain and delivering a Council opinion on the 2015 Stability Programme of Spain: "(9) [...] *The deficit in the electricity system has been effectively eliminated as of 2014*".(R-0064) available at: http://ec.europa.eu/europe2020/pdf/csr2015/csr2015_spain_en.pdf

[546] Response by the European Commission on 29 February 2016. R-0185.

(1.3) Appraisal of the Measures by other International Organisations

843. The measures implemented in the Spanish electricity sector in 2013 were recognised by the International Monetary Fund (IMF) in its report on Spain of July 2014 stating:

> *"While there is encouraging progress, especially the important market unity law (Box 2) there should be no slippage on the planned reforms. For example, it will be important to move ahead with an ambitious liberalization of professional services, improve training for the unemployed, and fully implement an energy reform that eliminates the electricity tariff deficit and contains costs, while promoting a stable business environment and appropriate levels of investment. Given the many regulations at all levels of governments, regions have a critical role to play in improving the business environment—the planned introduction of regional World Bank's "Doing Business" indicators is a positive initiative"*[547].

844. As for the International Energy Agency (IEA), this has emphasised the relevance of the measures taken and has stressed the importance of keeping them to preserve the sustainability of the financing for the electrical system in the future:

> *"The IEA welcomes the government's actions, which have eliminated the annual deficit from 2014 on. The accumulated tariff deficit has thus stopped from growing and will gradually be eliminated. The government must maintain a strong long-term commitment to balancing the costs and revenues in the natural gas system."*[548]

845. In its 2015 report the International Energy Agency makes the following comments regarding the reform submitted to the present arbitration:

> *"The tariff deficit, which had been accumulating since 2001, began to spiral out of control after 2005. From 2005 to 2013, the costs in the electricity system grew by 221% while revenues increased by only 100%. Subsidies for renewable electricity are the single largest cost element. By 2012, the accumulated debt in the system had reached more than EUR 20 billion and was set to expand by billions every year unless action was taken. In 2012, the government temporarily eliminated subsidies for new installations. It also reduced remuneration for transmission and distribution network activities, increased access tariffs, and introduced a 7% tax on electricity generation (22% for hydropower). Nevertheless, the deficit grew to EUR 26 billion by the end of 2012.*
>
> *In July 2013, the government introduced a broader electricity market reform package. The reform reduced the remuneration and compensation for the activities in the electricity system by several billion euros per year. It also introduced the principle of "no new cost without a revenue increase". Importantly, the reform*

[547] IMF Country Report 14/192 Spain, July 2014, pages 6 and 23. R-0207.
[548] Energy Policies of IEA Countries - Spain 2015 Review, Executive summary and key recommendations, published by the International Energy Agency, page 10. R-0211.

introduced a new way of calculating compensation for renewable energy, waste, and co-generation (combined production of heat and power). With some exceptions, by mid-2015 the comprehensive reform had been implemented. The reform has reached its aim: the sector's costs and revenues are back in balance, and the accumulated deficit, which peaked at the end of 2013 at EUR 29 billion or 3% of GDP, should gradually disappear over the next 15 years.

Electricity market reform has been complex but necessary. The electricity system's future financial sustainability depends both on macroeconomic developments and on a sustained commitment to the reform by the country´s politicians. To overcome any perceived risks for investing in electricity infrastructure in Spain, the government should closely follow the principles of transparency, predictability, and certainty when revising the parameters for defining reasonable return. More generally, to avoid any political interference in the future, the principle of "no new cost without a revenue increase" should be strictly enforced."[549]

846. This report also states:

"Spain underwent an electricity market reform from early 2012 to 2015, with the aim of ensuring the sustainability of the system, balancing costs and revenues and protecting electricity consumers. The reform was developed to give predictability and transparency to the Spanish electricity system, to put an end to a burgeoning tariff deficit that had become a financial liability for the government and to bring the electricity system back to financial stability.

Since the last in-depth review in 2009, also the Electricity Directive (Directive 2009/72/EC) was approved. The new Electricity Law approved in December 2013 revised the Spanish legal framework in accordance with the new European regulations and directives (the Third Package), but taking account of the Spanish situation regarding the integration of renewable energy sources and the low level of interconnections with other EU member states."[550]

(1.4) Appraisal of the Measures by the Markets

847. We should also refer to the favourable reception that the Macroeconomic control measures adopted by Spain since 2012 have had. This positive assessment has been given by the main rating agencies, such as Fitch or Moody's[551]. Likewise, the main players of the Spanish electricity system in renewable technology, such as Endesa, Iberdrola, Atlántica Yield or Saeta Yield have positively valued the measures introduced[552].

848. Furthermore, in 2015, with the reform of the electricity system already completed, the regulatory uncertainty has disappeared and investment in renewable energy is recovering. The Court should also have drawn to its attention the many Press reports

[549] IEA_IDR_Spain2015 Report, Page 10 R-0028
[550] Ibid, paragraph 21. R-0028
[551] Accuracy Report, Paragraphs 192 to 194
[552] Accuracy Report, Paragraphs 199 to 205

that have echoed (1) the stability of the system created by the Reform and (2) of the so-called *"renewable boom"* that is taking place in Spain due to the confidence of investors, national and foreign, in the profitability and stability of this system::

- *"Soria envisages a surplus of the electrical system for 2015"*[553]: *"The Minister of Industry has pointed out that "it is good news that there is a surplus", but has insisted that, "whatever that amount is, it shall be destined to reduce the total amount of the deficit accumulated in this system".*

- *"Wind operators in Spain and Portugal attract investor interest."*[554] *"What attracts these investors is the stable profitability that renewable energy companies generally generate. The context of low interest rates globally requires managers to search for yields beyond the equities and fixed income PROFITABILITY: And while the profitability offered by renewable energies are less now than before the reduction of the remuneration, Spain still guarantees an annual yield of 7.5% for the electricity sold by most of the wind farms in the country".*

- *"'Boom' of operations in the renewable sector after the reform"*[555]*: "The purchase of solar and wind power plants so far this year already exceeds 1,000 million. Experts agree that there will be new operations in the coming months in the sector."*

- *"What the disappearance of the premiums has caused is a race to rationalise the industry [Wind], through mergers taking advantage, in addition the abundance of liquidity and the legislative stability which the aforementioned energy reform has provided the sector with."* [556]

- *"The renewable 'Boom' attracts investments of 5,000 million"*[557]*: "The renewable Energy Sector accumulates so far this year almost 5,000 million euros in buying and selling transactions [...]"*

- *"Renewable energies resume their momentum in Spain"* [558]*"Renewable energies come into a maelstrom of millionaire buying and selling transactions. [...] For months, not a week passes without there being a corporate operation in the renewable energy sector. [...] The renewable energy business map is changing at the stroke of a pen"*

849. It is clear that the reform is not as *irrational* and *disproportionate* as the Claimant maintains. If it were so there would be no interest by national and foreign investors in making investments or purchases in the Spanish energy sector. This investor *Boom* discredits the Claimants' arguments. Clearly a profitability of 7.398% is reasonable for

[553] Press article; "Soria predicts a surplus in the electricity system for 2015", El País, 16 June 2015, R-0169.
[554] Article from EFE news agency, 9 June 2015, R-0175.
[555] Article from the newspaper "El Mundo", "Boom" in transactions in the renewables sector following the Reform" of 22 July 2015. R-0179.
[556] Editorial from financial newspaper El Economista, of 24 July 2015 R-0176.
[557] Article from financial newspaper "El Economista", of 17 October 2015. R-0178.
[558] Article from financial newspaper "Expansion" of 17 October 2015 R-0177.

the media and for investors. Especially in the current international economic context, after the global financial crisis suffered between 2010 and 2013.

850. It is also worth noting that in 2015 a tendering process was opened for renewable energy producers of 500 megawatts (MW) of wind power and 200 MW from biomass. In this tender, the offers received from domestic and foreign companies exceeded the power finally awarded in January 2016 by a factor of 5[559]. This corroborates the interest from domestic and foreign markets in the system resulting from the measures challenged.

851. Recently Diario Expansión, one of the economic newspapers with the largest circulation in Spain, published the opinions of various company directors and expert analysts from the sector, according to whom the measures have given the regulatory framework the stability that is demanded:

> *"The electricity reform, that started in July 2013, is already bearing fruit in the market in the form of stability. Marta Méndez Villaamil, legal director of mergers and acquisitions of EDP Renovaveis explained that the market has become more professional, is much more sophisticated and investors are more qualified".*[560]

852. This news, the positive ratings of the Rating Agencies and the favourable reports from the European Commission, is more evidence of the reasonableness and proportionality of the Macroeconomic control measures taken in the Energy Sector by the Kingdom of Spain between 2013 and 2014.

J. <u>The Energy Charter Treaty Objective and purpose</u>

(1) Objective and purpose of the ECT: To provide the foreign investor with national and non-discriminatory treatment.

853. The Claimants consider that the measures taken by the Kingdom of Spain have violated 10.1 of the ECT. The Respondent shares with the Claimants that the protection standards of the ECT need to be analysed in accordance with the current meaning of the terms of the ECT in their *context*, and in light of the *object* and *purpose* of the ECT.[561]

854. In effect, the Claimants acknowledge that the objective of the ECT, according to its article 2, is to establish "*a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, <u>in accordance with the objectives and principles expressed in the Charter</u>*" (emphasis added). This article 2 ECT is therefore the substantive law applicable pursuant to Article 26(6) ECT.

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[559] Decision of 17 March 2016 from the Directorate General for Energy Policy and Mines, which records awarded auction applications in the specific remuneration regime register with the status of advance allocation, in order to allocate the specific remuneration regime to new electricity production facilities based on biomass located in the peninsular electricity system and for wind technology facilities, R-0253.
[560] Story from Diario Expansión of 03 May 2016, "Spain creates a secure legal framework to prevent another energy bubble". R-0249.
[561] Memorial on the Merits, paragraphs 392 et seq.

855. The Claimants cite some alleged objectives of the European Energy Charter Treaty and conclude that "the fundamental objective of the ECT is to facilitate transactions and investments in the energy sector by reducing the threat of political and regulatory risks."[562] The Claimants appear to be saying that the protection afforded to the Investor should be an absolute value, over and above the needs of general interest of the State and, even, above national investors[563]. However, this theory cannot be accepted.

856. The protection of investments must be understood within the *context* of the ECT. The European Community (currently the EU) promoted the signing of the ECT, as Prof Wälde recalls[564]. The ECT aimed to sow the seeds for deregulating the energy market between Western Europe and countries from the so-called "Eastern Bloc" following the fall of the Berlin Wall. The ECT is therefore "*the basis of an energy community between regions of the world that were separated by the Iron Curtain.*"[565]

857. It was ultimately an attempt to export the energy Market model that existed in the EU to other countries beyond its frontiers[566]. The Claimants have left out the real objectives and principles established by the European Energy Charter, and which are applicable to this case through referral of Article 2 ECT. These objectives are:

> *"foster the development of an efficient energy market throughout Europe and a better functioning of the global market, based in both cases in the* ***principle of non-discrimination*** *and on a* ***determination of prices based on the market****, taking into account the concerns expressed in relation to the environment"*[567] *(Emphasis added).*

858. To achieve this goal, the countries that signed the Charter state that they are "*determined to create a favourable climate for companies to work in and for the flow of investments and technologies, by applying market economy principles in the field of energy*".[568] The protection that the ECT offers to investments is geared toward the achievement of that free energy market throughout Europe, based on the principle of non-discrimination and on the formation of prices that are in line with the market.

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[562] Memorial on the Merits, paragraphs 398

[563] Thus, paragraph 436 of the Memorial on the Merits upholds that "the FET standard is an absolute standard that provides a fixed reference point regardless of the treatment others receive" (Emphasis added)

[564]"Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation", T W Wälde, (1996) 12 Transnational Dispute Management 4: "The ECT is largely a product of EU external, political, economic and energy policy. It is meant to integrate the formerly Communist countries, provides an ante-chamber and preparation area for EU accession for many of them".RL-0065

[565] "The Energy Charter Treaty and related documents", consolidated text, page 8. Accessible on the Energy Charter page", Preface (Spanish Version).RL-0006

[566] European Energy Charter, preamble. And this was because it was considered, as stated in the Treaties establishing the European Communities, that "*more extensive cooperation in the field of energy between the signatories is essential for economic progress and, in general terms, for social development and the improvement of the quality of life*." (emphasis added). RL-0006.

[567] European Energy Charter, as established by the clarifying name of TITLE I of the Charter: "OBJECTIVES". RL-0006.

[568] Ibid, Title I. RL-0006.

859. Consequently, the main objective of the ECT as far as the protection of the investor is concerned, is to achieve the introduction of a free market in order to carry out energy-related activities without discrimination on account of the investor's nationality.

860. However, the objective of non-discrimination has not been fully achieved in the ECT. The reluctance of States to limit their regulatory powers even minimally in such a strategic sector as the energy sector, led the signatories of the ECT to differentiate two moments: 1) the so-called "*making-investment process*" (paragraphs (2) and (3) of article 10 of the ECT), in which the conditions to ensure the objective of national treatment or non-discrimination were postponed until the signing of a "*supplementary treaty*", which has not yet been signed and 2) the moment after the investment is made, when the guarantee of national treatment and the most favoured nation clause are applied to the overseas investor, albeit with certain limitations, as we shall shortly see.

861. It should be noted in this regard that with respect to the moment when the investment is made, Article 10 TEC already warns in its first subparagraph, by way of *soft law,* that:

> *"In accordance with the provisions of this Treaty, the Contracting Parties shall promote and create stable, equitable, favourable and transparent conditions so that investors of the other Contracting Parties may make investments in their territory."*

862. As C. Bamberger, a participant in the ECT drafting process said:

> *"As announced in a preambular provision of the ECT, national treatment and MFN treatment is expected to be applied to the making of investments pursuant to a "supplementary treaty". Paragraphs (2) and (3) of Article 10 therefore provide only for a "best efforts" ECT commitment to accord the better of national treatment or MFN treatment to investors of other Contracting Parties with regard to the making of investments".*[569]

863. Once the investment has been made, the best standard of protection afforded by the ECT to the investor and to foreign investments is the "national treatment". The greatest ambition of the ECT is non-discrimination. In this regard, Professor Wälde says:

> *"The main standard imposed by the Treaty on investors is according to all authoritative accounts of the Treaty, "national treatment". (...). The strategy of the*

[569] *"An Overview of the Energy Charter Treaty",* C Bamberger, in T W Wälde (ed), The Energy Charter Treaty: An East-West Gateway for Investment and Trade, (Kluwer Law International, 1996),(RL-0052). In the same regard, Wälde states in"Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation" by Thomas W.Wälde: *"The Treaty distinguishes two phases of investment and treats them differently: the pre-investment phase [...] imposing a duty of "best efforts" at non-discrimination, national and most-favoured treatment. [...]. Once an investment is made ("post-investment phase"), [...], the investments are protected against discrimination, breach of contractual and other commitments, expropriation, destruction and impediments against transfer of capital and earnings (Arts.10-17)* RL-0065.

> *Treaty has been to incorporate the "favourable" element of national treatment, i.e. non-discrimination vis-à-vis national business, while countervailing the negative element, i.e. the application of possibly low-quality standards to foreigners, by the inclusion of international minimum standards. In other words, international law sets the minimum standard, even if national treatment would be much worse, but when it comes to governments favouring their own companies, then national treatment takes precedence".*[570] *(Emphasis added).*

864. In other words, when article 10.1 of the ECT establishes the obligation to give investments already made "no less favourable treatment than that required by international law", it recognises the minimum standard of protection guaranteed by international Law. The maximum aspiration of the ECT is, therefore, national treatment, since this treatment will be applied to overseas investments whenever it is more favourable.

865. In this regard, paragraph 7 of Article 10 of the ECT states that:

> *"Each of the Contracting Parties shall offer in its territory to investments made by investors of other Contracting Parties, as well as to activities related thereto, such as management, maintenance, use, enjoyment or liquidation, a treatment no less favourable than that accorded to the investments and to their management, maintenance, use, enjoyment or liquidation, of their own investors or those of any other Contracting Party or third State; the most favourable situation shall apply."(Emphasis added)*

866. However, in paragraph 8 of Article 10, this guarantee of national treatment to investments that have already been made contains a significant *exception* in the area of public subsidies or aid:

> *"The modalities of application of paragraph 7 in relation to programmes under which a Contracting Party provides grants or* ***other financial assistance****, or enters into contracts, for energy technology research and development,* ***shall be reserved for the supplementary treaty*** *described in paragraph 4". (Emphasis added).*

867. This exception is applicable to this Case, in which the claimant is claiming the payment of subsidies or State aid for the production of electricity. The "supplementary treaty" has not yet been signed, and signatory states to the ECT do not yet have the obligation of according foreign investor the *national treatment* in issues of programmes through which a Contracting Party grants subsidies or "*other kind of financial aid*" to the investor.

868. In the same line, we must remember that Article 9 of the ECT, when regulating the public aid regime to promote overseas trade or investment, expressly provides in its

[570] T W Wälde, *"International Investment under the 1994 Energy Charter Treaty"* in T W Wälde (ed) The Energy Charter Treaty: An East-West Gateway for Investment and Trade (Kluwer Law International, 1996), RL-0051.

fourth paragraph that nothing in this Article 9 "*shall in any way prevent the Contracting Parties from adopting measures*":

> *"(i) For reasons of prudence, including the protection of investors, consumers, depositors, policy holders or persons with respect to whom a financial service entity may have fiduciary obligations, or;*
>
> *(ii) To ensure the maintenance of the integrity and the stability of the financial system and the capital markets."*

869. If the literal nature of the ECT, the European Energy Charter and the opinion of the foregoing Doctrine were not sufficiently clear, the Secretary of the ECT, in his "*Decision of the Energy Charter Conference, Subject: Road Map for the Modernisation of the Energy Process*", of 24 November 2010, establishes non discrimination as an *objective* in Area D, related to "Investment Promotion and Protection":

> *"Area D: Investment Promotion and Protection [...] Objective [...]*
>
> *The Energy Charter Treaty's investment provisions should remain untouched in their fundamentals. The Energy Charter will need to assess the instruments at its disposal in view of their continued ability to promote investments into all parts of the energy chain and to ensure non-discriminatory access to international energy markets. [...]*
>
> *Output 1: Promoting the Investment Climate.*
>
> *The Investment Group should draft policy recommendations for member states [...]to draw on - A comprehensive Review of the exceptions to non-discriminatory treatment in the Blue Book of the Charter [...]."* [571]

870. The Secretariat of the ECT confirmed in 2010 that the maximum aspiration of the ECT in its future evolution is to eliminate barriers to *non-discrimination*. And this objective of the ECT is not breached, as we shall see, on adopting regulatory measures that are (1) proportionate, (2) justified on the grounds of public interest, and (3) applied without discrimination to both national and foreign investors, *erga omnes*.

871. This matter is certainly important in order to decide pursuant to the FET standard that establishes the ECT. In fact, this is been the object of implementation in the Precedents that have applied the fair and equitable treatment standard of the ECT, as we shall now explain.

[571] Energy Charter Secretariat, "Decision of the Energy Charter Conference, Subject: Road Map for the Modernisation of the Energy Process", Energy Charter Secretariat, 24 November 2010. Area D, Pages 6 and 7RL-0063.

(2) The ECT does not prevent justify Macroeconomic Control Measures from being adopted.

872. The Claimants are performing a biased reading of the ECT, pursuant to which this Treaty would guarantee an alleged right to the setting-in-stone of the general regulations in favour of foreign investors, even in prejudice to national investors[572].

873. However, this is not the objective of the ECT. In the absence of a *specific stability* commitment, an investor cannot have an expectation that a regulatory framework such as the one being discussed in this arbitration will not be modified. This has been clearly declared in the precedents that have applied the ECT, such as the *Plama Consortium*[573] Case and the *AES Summit*[574] *Case*.

874. This has once again be reiterated in the Final award of the *Electrabel Case*, which clearly establishes that:

> *"The host State is not required to elevate unconditionally the interests of the foreign investor above all other considerations in every circumstance. […] even assuming that Electrabel had an expectation that it would be awarded the maximum compensation [...], once weighed against Hungary's legitimate right to regulate in the public interest, such an expectation does not appear reasonable or legitimate."*[575] *(Emphasis added)*

875. In the application of the ECT to the Spanish SES, the subsequent Award of *Charanne v. Spain* came to the same conclusion as the cited Awards:

> *"Turning a regulatory provision, due to the limited number of persons that may be subject thereto, into a specific commitment entered into by the State towards each and every one of those persons would be an excessive limitation of the capacity of States to regulate the economy* ***according to the public interest.***
>
> *[...] "in the absence of a specific stability commitment, an investor cannot have the legitimate expectation that a regulatory framework like the one disputed in this arbitration would never be modified in order to* ***adapt it to market needs and the public interest****."*[576] *(Emphasis added)*

876. Consequently, the ECT does not oblige States to maintain a *Regulatory* framework that is predictable during all investments. Let's not forget that Article 10(1) of the ECT

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[572] Memorial on the Merits, paragraph 436.
[573] Plama Consortium Limited v. Republic of Bulgaria, Award of 27 August 2008, paragraph 219.RL-0034
[574] AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary, Award 23 September 2010, para 9.3.25; upheld by the Decision of the Ad hoc Committee for the Annulment, of 29 June 2012, para. 95. RL-0039 and RL-0042.
[575] Electrabel S.A. v. Hungary (ICSID Case No. ARB/07/19), Award 25 November 2015, paras 165 and 166.RL-0048
[576] Charanne B.V. y Construction Investments S.A.R.L. v. Kingdom of Spain (SCC V 062/2012), Final Award, 21 January 2016, dissenting vote, para. 493 and 510. RL-0049.

refers to "*stable conditions*", not to a "*regulatory framework*"[577]. However, under no circumstance does it annul or limit to the extreme the power to modify the regulatory framework.

877. The respondent is in agreement with the claimants in that the ECT should be interpreted within its *context* and in accordance with its *purpose*. Its *purpose* refers to investments in the energy sector, which is a highly strategic and very regulated sector in the signatory countries to the ECT. It is unrealistic that the Signatories to the ECT accord, in such a strategic Sector, a kind of "Insurance policy" to foreign investors that protects them against regulatory reforms adopted in the general interest. The Energy Charter Treaty Guide makes it very clear that the ECT does not prevent States from exercising their macroeconomic control power:

> *"8. Many **Governments' actions**, for example the **macroeconomic control** or the introduction of environmental and security legislation, **may affect investment profit** but cannot be subject to absolute rules. In this case, the best defence for an overseas investor is the **guarantee** that he or she will be **treated at least as well as** national investors, because no government will wish to destroy its own industry."*[578] *(Emphasis added)*

878. This Section 8 of the Energy Charter Treaty Guide has been incorporated into the official Texts, amongst other languages, in Spanish, French[579], Italian[580] and German[581].

879. These consolidated official versions of the ECT Guide graphically explain the *main objective of the ECT*: the guarantee whereby the investor shall be treated at least as well as national investors ("*as no government would want to destroy its own sector*"), without restricting the possibility of States to adopt macroeconomic control measures on the grounds of general interest. The Claimants were aware of or should have been aware of this Reading Guide from the Secretariat General of the ECT.

880. Consequently, the ECT does not oblige Signatory States to maintain a regulatory framework that is predictable during the lifespan of all foreign investments. This would be akin to forcing the setting-in-stone of the regulatory framework in such a strategic Sector. Let's not forget that Article 10(1) refers to "conditions", not to a "regulatory framework"[582]. Professor Wälde shows that the obligations imposed on the States in article 10 must be adjusted to the provisions established in part IV of the TEC:

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[577] The Claimant identifies both concepts in his interpretation of the Legitimate Expectations protected by article 10(1) ECT in paragraphs 250 and 251 of the Statement of Claim.
[578] "The Energy Charter Treaty and related documents", consolidated text, page 8. Accessible in the Energy Charter page:RL-0006.
http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT-es.pdf
[579] "Le Traite sur la Charte de l'Energie et documents connexes", Consolidated Text, page 7. Available at: http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT-fr.pdf. RL-0007
[580]"Trattato Sulla Carta Dell'energia e documenti correlati", page 7, Accessible at: http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT-it.pdf. RL-0008.
[581] "Der Vertrag Über Die Energiecharta und dazugehörige Dokumente", page 9, Accessible at http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT-de.pdf . RL-0009.
[582] The Claimant identifies both concepts in paragraph 371 of the Statement of Claim.

> *"one needs to appreciate that these "primary" obligations are tempered by the miscellaneous provisions of part IV- with reference to sovereignty (Art.18 (1)), presumably an emphasis on respecting the power of economic regulation of states and perhaps equivalent to the reference to "subisidarity" under the EU Treaty, the –partial and some extent only suspensive- tax veto in Art.21, the exceptions in Art.24 and the hotly contested attribution rules in Art.22 and 23."*[583]

881. Elsewhere, Prof. Schreuer states:

> *"At the same time, it is clear that this principle is not absolute and does not amount to a requirement for the host State to freeze its legal system for the investor´s benefit. A general stabilization requirement would go beyond what the investor can legitimately expect. It is clear that a reasonable evolution of the host State´s Law is part of the environment with which investor must contend."*[584] *(Emphasis added)*

882. In conclusion, the Claimant wishes to obtain a legal framework that is non-modifiable (foreseeable) for the entire useful life of its RE Plants. However, the TEC establishes no more limits on the regulatory power of the States than the minimum standards of international law, with the objective of non-discrimination. And we would reiterate that even this treatment does not apply on the subject of public subsidies or aid. In any case, the TEC allows the adoption of macroeconomic control measures by the signatory States, based on reasons of public interest.

883. The respondent has substantiated the fact that regulatory measures have been adopted on reasonable grounds:

> (1) The legal obligation to continuously adjust the economic system to the principle of A fair return for investors, avoiding over-remuneration contrary to EU Law;
>
> (2) The existence of public interest in the sustainability of the SES, in a context of serious international crisis and with a severe reduction in the energy demand, which reduced the income of the SES and financially unbalanced the SES, together with the increased costs of RE; and
>
> (3) The impossibility of allowing consumers to bear the entirety of the economic unbalance. Consumers that have seen how their electricity bill has risen by 61.81% (domestic consumer) and 18.28% (industrial consumers) in recent years. The foregoing increase has positioned the price of electricity in Spain among the most expensive in the European Union[585]. It should also be remembered that the tremendous effort of Spanish consumers has been carried out in a scenario of a major economic crisis.

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[583] T W Wälde, "Arbitration in the Oil, Gas and Energy Field: Emerging Energy Charter Treaty Practice" (2004) 1 Transnational Dispute Management 2. RL-0054.
[584] C. Schreuer, Fair and Equitable Treatment in Arbitral Practice, 2005, Journal of World Investment & Trade ("Schreuer"), p. 365. RL-0056.
[585] Section IV.A.3.2.a (paragraphs 286 and ff.) of this Statement of Claim.

884. Additionally, this occurred in the context of a set of macroeconomic control measures that were adopted in compliance with international commitments, such as the Council Recommendations of March 2012[586] and the Memorandum of Understanding signed with the European Union on 20 July 2012. In both documents, Spain undertook to adopt macroeconomic measures to deal with a specific unbalance: "*address the electricity tariff deficit in a comprehensive way*". This commitment became binding for Spain from July 2012[587].

885. Within the context specified, the contested measures continue to guarantee investors (national and foreign) a fair return within the framework of a sustainable SES. This allows the economic balance of the investment to be maintained, without any discrimination between nationals and foreigners. They are therefore proportionate, reasonable and non-discriminatory measures.

886. Consequently, in light of the purpose and object of the ECT and pursuant to the substantiated facts, the Kingdom of Spain has not infringe the ECT. Below we shall argue and demonstrate that the Claimant has not incurred any of the specific infringements alleged by the Claimants.

K. The Kingdom of Spain has respected the standard of Fair and Equitable Treatment of Article 10.1 of the ECT.

(1) Introduction.

887. The Claimant believes that the Kingdom of Spain has infringed article 10(1) ECT in the following way:

(1) The obligation to provide Fair and Equitable treatment (CJEU). It considers the following to be infringed within this standard[588]:

(a) Their Legitimate Expectations.

(b) The alleged duty to provide a stable and "*foreseeable*" regulatory system for the Claimant's investments.

(c) The duty to provide transparent conditions.

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[586] Council Recommendation of 10 July 2012: "address the tariff deficit of the electrical sector on a global scale, in particular improving the profitability of the electricity supply chain".R-0063.

[587] Memorandum of Understanding signed with the European Union on 20 July, 2012. Sections 29 and 31: "There is a close relationship between macroeconomic imbalances, public finances and financial sector soundness. Hence, [...], with a view to correcting any macroeconomic imbalances as identified within the framework of the European semester, will be regularly and closely monitored in parallel with the formal review process as envisioned in this MoU. [...]
Regarding structural reforms, the Spanish authorities **are committed** to implement the country-specific recommendations in the context of the European Semester. These reforms **aim at correcting macroeconomic imbalances,** as identified in the in-depth review under the Macroeconomic Imbalance Procedure (MIP). In particular, these recommendations invite Spain to: [...] 6) [...] **address the electricity tariff deficit in a comprehensive way**." (Emphasis added). RL-0067.

[588] Memorial on the Merits, paragraph 407

(d) The obligation not to introduce exorbitant measures that are in some way detrimental.

(e) The obligation not to introduce disproportionate measures that are in some way detrimental.

(2) The obligation of meeting any obligation that it has entered into with the Claimant, or with the Claimant's Investment ("umbrella clause") (Article 10.1 in fine).[589]

888. As a premise, we should remember that the burden of proof on infringement of the CJEU standard through the measures challenged falls to the Claimant. The Court recently declared thus in the Electrabel Case:

> *"The Tribunal starts with the premise that it is Electrabel which bears the burden of proving its case under the ECT's FET standard."* [590]

889. Moreover, the parties agree with regard to the need to take into consideration the object and objectives of the ECT, already set out. This means that the protection afforded to the Investor cannot be converted into an absolute value, over and above the needs of general interest of the State and, even, above national interests, as declared expressly in the Final Award of the Electrabel Case.[591].

890. Below it will be demonstrated that the Kingdom of Spain has not violated the FET standard contained in the ECT, as this standard has been interpreted by the Courts of Arbitration that have applied it.

891. We draw the attention of the Court of Arbitration to the fact that the Claimant avoids invoking Precedents that have applied the CJEU standard, such as the AES Summit Award, the Award from the Annulment Committee of the AES Summit case, the Final Award given in the Electrabel Case. Instead it invokes less relevant precedents that were handed down on the basis of breach of *contracts* or *administrative concessions* in countries such as Mexico, Ecuador, Chile or Argentina.

892. It is evident that the Precedents applied by the ECT have taken into consideration the context, the object and the purpose of the ECT. Furthermore, it is strange that the Claimant states that these elements are taken into consideration and, yet, evades applying the Precedents interpreted by the ECT, invoking numerous Awards that apply BITs that have nothing to do with either the object, content and objectives of the ECT, or with the facts being examined in this arbitration.

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[589] Memorial on the Merits, Point 13.5.
[590] *Electrabel S.A. against Hungary* (ICSID Case No. ARB/07/19), Award 25 November 2015, para 154. RL-0048.
[591] Ibid, paragraph 165: "the Tribunal considers that the application of the ECT's FET standard allows for a balancing exercise by the host State in appropriate circumstances. The host State is not required to elevate unconditionally the interests of the foreign investor above all other considerations in every circumstance. As was decided by the tribunals in Saluka v Chech Republic and Arif v Moldova, an FET standard may legitimately involve a balancing or weighing exercise by the host State." RL-0028

(2) The Kingdom of Spain has not violated the Legitimate Expectations of the Claimants.

(2.1) Claimant's Approach

893. The Claimant is attempting to base all of its expectations on RD 661/2007 and RD 1614/2010[592]. It maintains that the expectations of a setting-in-stone of RD 661/2007 on the remuneration regime were reinforced by RD 1614/2010.

894. Accordingly, the Claimant is claiming indemnification pursuant to RD 661/2007, on upholding that it expected that[593]:

i) the plants could choose between selling electricity at a Fixed Tariff or at the Premium;

ii) the Regulated Tariff would apply to *all* of the electricity *produced* without limitations;

iii) the Regulated Tariff would apply to the *entire* operating life of the facilities;

v) the Regulated Tariff would be subject to adjustments pursuant to the CPI.

895. In addition, among these expectations it adds that any future change to the applicable system in detriment to the facilities would only be applied in a prospective manner, in other words, to the new facilities, without existing facilities being affected by these changes[594]. In other words, in practice the Claimant expected (i) that its regime would be *set in stone*, as it could only be modified for future facilities; and (ii) that it has the acquired right to all future tariffs during the *entire* service life of the Plants.

(2.2) Lack of evidence of an analysis of the legal framework by the Claimant.

896. In order to determine if there has been a violation of the CJEU standard, the legitimate expectations that the Claimant had when making the investment in relation to the treatment said investment would receive must be assessed. These expectations must be reasonable and objective with respect to the general regulatory framework in place. As part of this assessment, the Arbitration Court must analyse the investor's knowledge of the general regulatory framework on making its investment, or rather, what this knowledge should have included.

897. International arbitration case law is clear in this respect. When making its investment, an investor should know and understand (i) the *regulatory framework*, (ii) how this is applied (iii) how it affects its investment. An investor makes its investment based on this knowledge and should be aware of the risks it takes on when making such.

[592] Memorial on the Merits, paragraphs 419 and 420
[593] Memorial on the Merits, para. 418
[594] Memorial on the Merits, paragraph 419

898. The Precedent of *Electrabel against Hungary*, which applies the TEC, decreed the following in relation to investor diligence:

> *"Fairness and consistency must be assessed against the background of information that the investor knew and should reasonably have known at the time of the investment and of the conduct of the host State"*[595].

899. On the same subject, the Award of *Charanne against the Kingdom of Spain*, of 21 January 2016, clearly indicates that:

> *"The finding that there has been violation of the investor's expectations should be based on a standard or an objective analysis, the mere subjective belief that the investor may have had at the time of making the investment not being sufficient. [...]In order to be legitimate expectations, the Claimants should have carried out the diligent analysis of the legal framework of their investment"*[596].

900. Any investor investing in Spain therefore has the inexcusable obligation of being familiar with the *general regulatory framework* that governs investments, and which includes the regulations and jurisprudence that will apply to their investment. It does not seem acceptable for the investor, being unaware (or pretending to be unaware) of the applicable legal system, to make the investment and subsequently resort to International Law to try to get the Court to ignore the legal framework in which he invested.

901. It also does not seem acceptable for it to expect the Arbitration Tribunal to only apply part of the regulatory framework or the omission of the part of the regulatory framework that is detrimental thereto.

902. In this arbitration procedure, the Claimant has not proved that it requested a Report on the essential aspects of the Spanish regulatory framework: the relationship between the law and the regulations; case law from the Supreme Court of the Kingdom of Spain on regulatory changes and their value; the concept of a fair return; the methodology used to set the subsidies in RD 661/2007 and the regulatory changes introduced prior to its investment and the reasons behind this; in other words, the Claimant made an investment without knowing the essential aspects of the Spanish regulatory framework.

903. In the scope of the ECT, the Award of the Charanne Case also required proof of a prior, exhaustive analysis of the legal framework applicable to the sector, which the Claimant could and should have done prior to making its investments from 2008 to 2012:

> *"The court deems that the Claimants would have been able, [...] to analyse the legal framework of their investment according to Spanish law and understand that there was the possibility that the regulations adopted in 2007 and 2008 could be*

[595] Award in *Electrabel S.A. against Hungary* (ICSID No. ARB/07/19) 25 November 2015, paragraph 7.78. RL-0048.
[596] Award in the case of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, 21 January 2006, paragraphs 495 and 505 RL-0049.

> *subject to modification. At least that is the level of diligence that is expected of a foreign investor in a highly regulated sector such as the energy sector, where a* ***prior****,* ***comprehensive*** *analysis of the legal framework that is applicable to the sector is* ***essential*** *to be able to make an investment."* [597]

904. The relevance of the Jurisprudence of the Supreme Court in the configuration of an investor's Legitimate Expectations is declared in the Award of the Charanne Case[598]. However, in its Memorial on the Merits the Claimant is biased when it concludes there is breach by the State[599]. It thus overlooks consolidated case law with regard to investors' rights in renewable energy in Spain since 2005[600]. It is inexcusable for the Claimant to have been unaware and ignorant of this Case law in shaping its alleged Expectations with regard to RD 661/2007 or RD 1614/2010, when it has been substantiated that this Case Law was well known by the associations of RE Sector.

905. In this Case, the Claimant does not provide evidence of having had the degree of diligence that could be expected from a foreign investor in a heavily regulated sector like the energy industry, where thorough prior analysis of the legal framework applicable thereto is essential to make an investment.

906. The burden of proof of this diligence lies with the Claimant. The lack of due diligence prevents the expectations alleged by the Claimant from being considered as real and objective. As a result, the alleged frustration of its legitimate expectations by the Kingdom of Spain must be dismissed, given that the Claimant's understanding of the Regulatory framework was incorrect, as the Defendant has shown.

(2.3) Secondarily, even if it had performed an exhaustive Due Diligence, the challenged measures have not violated the Claimant's legitimate expectations.

907. There is already a considerable amount of arbitration Precedent that has applied the standard of legitimate Expectations contained in the ECT. Of the existing Precedent, worth pointing out are the following characteristic notes, from which a basic principle can be deduced: the ECT is not a type of *insurance policy* for investors against the risk of changes in the regulatory framework and, therefore:

a) There must be *specific commitments* made to *an investor* that the regulations in force will remain unchanged. Thus it was declared in the *Plama Case*[601] and this has been

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[597] Ibid.
[598] Award in the case of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, 21 January 2006, paragraphs 506 to 508. RL-0049.
[599] Memorial on the Merits, paragraph 442.
[600] This Case Law is substantiated in section IV.D (paragraphs 356 and ff.) of this Statement of Claim.
[601] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Award of 27 August 2008, paragraph. 219 "the Tribunal believes that the ECT does not protect investors against any and all changes in the host country's laws. Under the fair and equitable treatment standard the investor is only protected if (at least) reasonable and justifiable expectations were created in that regard. It does not appear that Bulgaria made any promises or other representations to freeze its legislation on environmental law to the Claimant or at all." (emphasis added) RL-0034.

ratified by other precedents of the ECT, such as the *AES Summit*, *EDF* and *Charanne* Cases[602].

b) The investor's Expectations must be reasonable and justified in relation to any changes in the laws of the host country[603].

908. Therefore, it is appropriate to develop that, in accordance with the facts already substantiated, neither (a) was there a specific commitment by the Kingdom of Spain in favour of the Claimants nor (b) are the Claimant's expectations reasonable and justified.

(a) No specific commitments exist in the Spanish regulatory framework on the future immutability of the regime of RD 661/2007 in favour of renewable energy facilities.

909. It has been substantiated in the Facts that neither RD 436/2004 nor RDL 661/2007 nor RDL 6/2009 nor RD 1614/2010 contain a guarantee or promise to freeze its regime in favour of the Claimant or their investments[604]. The regulatory framework only guaranteed that renewable energy facilities, during their useful life, could achieve a reasonable profitability.

910. Additionally, this lack of existence of a specific commitment has already been declared by the Arbitral Tribunal in the Charanne Case, which examined the existing Legal Framework in the electricity sector during 2007 and 2008 in Spain:

> *"499. According to the Arbitral Tribunal, in the absence of a specific commitment, an investor cannot have the legitimate expectation that the regulation in place is going to remain unchanged [...]*
>
> *503. In this case, the Claimants could not have the legitimate expectation that the regulatory framework laid down by RD 661/2007 and RD 1578/2008 would remain unchanged during the entire lifespan of their plants. Accepting such an expectation would, in fact, amount to freezing the regulatory framework applicable to eligible plants, even though the circumstances may change. [...] The Arbitral Tribunal cannot accept such a conclusion. [...]*
>
> *504. The conclusion drawn by the Tribunal, i.e. that in the absence of a specific commitment the Claimants could not reasonably expect that the applicable regulatory framework provided in RD 661/2007 and RD 1578/2008 would remain unchanged, is backed by case law from the highest courts in Spain. Prior to the investment, these courts had clearly established the principle that domestic law could modify the regulations in force.*
>
> *505. [...] in this case, the Arbitral Tribunal considers that the Claimants could have easily foreseen the possibility that the regulatory framework was going to be*

[602] Cases *Charanne B.V. v. Spain*, paragraph 499 (RL-0049), *EDF c. Rumania*, paragraph 217 (RL-0035) and *AES Summit v. Hungary*, paragraph 9.3.29. RL-0049.
[603] Plama Consortium Limited v. Bulgaria, paragraph 219. RL-0034.
[604] Sections IV.E (4), (6), (7) and (11) (paras. 408 and ff.) of this Statement of Claim.

amended [...]. Indeed, Spanish law left wide open the possibility of modifying the remuneration scheme applicable to photovoltaic energy. [...]

511. Therefore, the Tribunal concludes that the Claimants could not have the reasonable expectation that RD 661/2007 and RD 1578/2008 were not going to be modified during the lifespan of their facilities."[605]*. (Emphasis added)*

911. This Award has corroborated what the Kingdom of Spain claims and what RE Associations in the sector argued in 2009 and 2010: that RD 661/2007 did not contain any promises or guarantees of freezing of its regime. This noncommittal means that neither (i) the remunerative regime nor (ii) the regime of hours or years of subsidised production nor (iii) the tariff update regime were set in stone.

912. No fully informed investor could expect the *freezing* in its favour of all of these regimes due to the fact of fulfilling a regulatory requirement to obtain subsidies, such as registration in a mandatory administrative resister. Nor could they expect these conditions be maintained indefinitely or be improved in the absence of any commitment in this regard. It is clear that the regulatory risk existed for the Claimant and that they knew or should have known, as they clearly knew (1) the Doctrine that the Spanish regulatory framework examined,[606] and (2) the RE Sector Associations such as APPA and AEE.

913. Furthermore, the agreement through which the Claimant made its investment considers the existence of possible changes in legislation or in the interpretation of this. This fact is diametrically opposed to the Claimant's theory. This fact contradicts the Claimant's theory[607]:

> 11.5 **Changes in legislation or in interpretation of existing rules**
>
> The Sellers shall not be liable for any Damage where that Damage is the result (i) of the approval or amendment of any rules, or of the current interpretation of any rules, whether or not having retroactive effect, arising subsequently to the date of this Agreement, or (ii) any change in the accounting or tax management procedures made by the Buyers or the Companies after the Closing Date.

(b) The Claimant's Expectations are not reasonable and justified in relation to the measures challenged

914. The claimant's alleged expectations are not reasonable with respect to the regulatory framework in place at the time of investment or with respect to other

[605] Award of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, of 21st January 2006, paras. 504 to 508. RL-0049.
[606] "*An integrated assessment of the feed-in-tariff system in Spain*". Pablo del rio, Miguel A. Gual., pages 1009 and 1010, C-0037; and "*Powering the Green Economy. The feed in tariff handbook*." Miguel Mendonça, David Jacobs and Benjamin Socacool. Publishing house. Earthscan, 2010. RL-0062.
[607] Sale and Purchase Agreement, of 12 August 2011 (C-35) and Closing Agreement, of 8 May 2012 (C-121).

supposed sources, like the publicity leaflets and the PowerPoint presentations cited by the claimant.

(i) The Expectations are not reasonable with respect to the existing regulatory framework

915. The Expectations upheld by the Claimant with regard to the setting in stone are not consistent either with the basic principles over which the Spanish Regulatory framework is based or with the evolution of the Spanish regulatory framework in the years prior to the Claimant's investment

916. As has been shown, any investor who had conducted a prior, exhaustive analysis of the legal framework applicable to the Spanish RE sector, knew or should have known that this Regulatory Framework had the following essential principles:

(1) The regulatory system governed by the *principle of regulatory hierarchy* and the result of the legally stipulated procedures for drafting regulations[608].

(2) The regulatory framework is not limited to RD 661/2007 and RD 1614/2010 as claimed by the Claimant. It is configured from Act 54/1997 and the regulations which developed it, as interpreted by case-law[609].

(3) The fundamental principle that subsidies to the SR are a cost for the SES, subordinate to the principle of its *economic sustainability*.[610].

(4) Right to the priority access and dispatch of electricity production.

(5) That the remuneration of the RE consists of a subsidy which, added to the market price, provides renewable energy plants with *reasonable profitability*, in the framework of its useful life, in accordance with the capital market, which is *dynamic and balanced* within the SES[611]. This profitability was linked exclusively to the cost of construction and operation of the plants.

(6) That the determination of the subsidies is fixed on the basis of changing demand and other basic economic data, set out in the Renewable Energies Plans on the costs of investment and operation of standard installations with the objective that these installations achieve reasonable profitability during their useful life[612].

(7) That the regulatory changes to the remuneration regime of REs since 2004 have been *motivated* by (i) correcting situations of over-payment, or (ii) by the strong

[608] VAT Section (1) (paras. 251 and ff.) of this Memorial
[609] Section IV.D, (paras. 356 and ff.) of this Memorial
[610] Section IV.A (3) (paras. 271 and ff.) of this Memorial
[611] Sections IV.C (paras. 337 and ff.), IV.E (paras. 381 and ff.), IV.F (paras. 592 and ff.) of this Statement of Claim
[612] Section IV.E (3), (5) and (9) (paras. 399 and ff.) of this Memorial

alteration of the economic data that served as the basis for the estimate of the subsidies[613].

917. These basic principles constitute the objective legitimate expectations of a diligent investor. Therefore, no diligent investor could expect the Spanish State, faced with a situation of economic deficit or imbalance that affected the sustainability of the SES, not to adopt measures to be able to resolve such. In the same way, no investor would expect that in a situation of "over-remuneration" the State would not correct this situation. As has been established in the facts, the *leit motiv* inherent to all of the measures has been, precisely, to address that situation of unsustainability of the SES and correct situations of over-renumeration, preventing consumers from exclusively bearing the costs.

918. For the foregoing reasons, it has been established that in the Regulatory framework that has existed for more than 11 years during which the Claimant made their investment, regulatory changes to existing facilities were allowed, always maintaining the principle of a fair return within the framework of a sustainable SES.

919. In fact, these changes affected the Plants where the Claimant invested. Thus, this occurred with RD-Act 7/2006, RD-Act 6/2009, RD 1565/2010, RD 1614/2010 and RD-Act 14/2010. These rules did not maintain or improve the conditions and did not compromise to do so, and neither did RD 661/2007 nor RD 1614/2010. The Claimant has also not established that the regulatory Due Diligence requested would confirm the alleged *commitments* arising from these reforms. Therefore, its expectations of freezing the regime of RD 661/2007 are not reasonable. Also unreasonable are its alleged expectations whereby future reforms would maintain or modify its revenue or its regulatory regime.

920. The Arbitral Tribunal's attention is brought to a relevant fact. The Claimant makes an unnecessary argument so that all of its expectations revolve around Article 44.3 of RD 661/2007[614]. However, it bases itself on paragraph 2 of article 44.3 of RD 661/2007, dedicated exclusively to the *periodic* review and tariffs. Consequently, it is clear that this paragraph:

a) It says nothing about "*update*s", "*feed-in hours"*, "*operational life of plants"* or "*priority dispatch*", nor the remaining elements of the legal regime applicable to plants.

b) Neither does it refer to "*any*" review of tariffs. Its wording is limited to the periodic reviews of the previous paragraph, nothing else. And the previous paragraph does not guarantee that "*the tariffs shall remain in force*", unchangeable except in the periodic reviews every four years". Accordingly, "any" modification that is not obligatory is excluded from the sphere of article 44.3. That is, it excludes the modifications that are necessary to (1) ensure the economic sustainability of the SES or (2) to correct situations of over-remuneration. This has been the clear interpretation of the Supreme Court since 2005.

[613] Sections IV.E (paras. 381 and ff.), IV.F (paras. 592 and ff.) of this Statement.
[614] Statement of Claim, paragraphs 421

921. The contrast between the Claimant's statement of facts and the reality of the SES substantiated by the Claimant, is evidence that the Claimant seeks to ignore or distort: (1) The regulatory framework in place at the time of its investment, (2) the highly strategic nature of the economic sector in which it invested; and (3) the regulatory risk that existed at the time when the Claimant decided to invest in Spain;

(ii) The Claimant's Expectations are also unreasonable with respect to other alleged declarations of the Kingdom of Spain.

922. The claimant refers to 4 *Power Point* presentations that allegedly reinforced its expectations, from 2007 to 2009[615]. The claimant is unable to substantiate these presentations which, in any case, are at least two years prior to its investment in Spain. Accordingly, the relevance for its expectations is zero.

923. Furthermore, it does not even substantiate that these presentations were targeted at investors, like the presentations from personnel of the CNE, which possess an evident didactic nature, not to encourage investments in Spain.

924. In addition to the foregoing, even though it provides evidence that it was aware of these four presentations *quod non*, such Documents could not reasonably create a real and objective expectation that the regime of RD 661/2007 was going to be immutable, sine die, in favour of the Claimant. The Award of the *Case ECE Projektmanagement v. Czech Republic* declared that Legitimate Expectations could hardly be generated based on statements made by subjects lacking the capacity or the competence to be able to comply with that stated[616].

925. The Court of the Charanne case has already dismissed the possibility of the information contained in advertising brochures being capable of generating a real, objective expectation for a diligent investor:

> *"The Tribunal does not believe that, by themselves, such documents could have given rise to the legitimate expectations that the tariff provided at the time of the investment was not going to be modified.*
>
> *497. It is true that these documents and the presentation thereof carried out in Spain, show the Respondent's intention to encourage and attract investments in the renewable energy sector. However, these documents are not sufficiently specific to*

[615] Memorial on the Merits, paragraph 162.

[616] ECE Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtundsechzigste Grundstücksgesellschaft mbH & Co v. Czech Republic, CPA Case No. 2010-5, Award of 19 September 2013, p. 4771. "*An important factor in this regard is the limited competence of the City of. And of Mr.as its Mayor, in relation to the overall permitting process. [...] Therefore, although the City of had competence over the local zoning plan, it had no competence over the grant of planning or building permits. In those circumstances, it would have been surprising if Mr had purported to provide any assurance as to the conduct of the planning and building permit proceedings*" (emphasis added) RL-0045.

give rise to any expectations regarding the fact that RD 661/2007 and RD 1578/2008 were not going to be modified."[617]

926. Consequently, the Kingdom of Spain has not infringed the expectations of the Claimant in any of the ways put forward by the Claimant: neither (1) that their conditions in the event of a reform to applicable regime *would be maintained or improved* in any case in the future, nor (2) that the regulatory regime of RD 661/2007 would remain immutable in its favour during the *entire* operating life of the RE plants.

(3) Spain has respected its duty to create Stable Conditions for the Claimant's Investment.

(3.1) Spain has respected the standard established in the ECT

927. The Claimant upholds that the respondent failed to provide a stable and "foreseeable" regulatory regime for Claimant's investments[618]. The Court of Arbitration notes the fact that the Claimant bases the 3 paragraphs of this argument on a succession of Awards, none of which apply the standard of the ECT.

928. An interpretation that requires immutability of the regulatory framework, irrespective of the ensuing economic circumstances, apart from not being realistic, would infringe the concept of fair and equitable treatment, as is internationally conceived. In this regard, Dr Christoph Scheurer, states that the FET standard:

"is not absolute and does not amount to a requirement for the host state to freeze its legal system for the investor's benefit. A general stabilization requirement would go beyond what the investor can legitimately expect. It is clear that a reasonable evolution of the host state's law is part of the environment with which investors must contend"[619] *(emphasis added)*

929. This standard that the Claimant claims also has to be considered within the FET standard[620] of the ECT, as stated by the Court in the Case *Plama v. Bulgaria*:

"stable and equitable conditions are clearly part of the fair and equitable treatment standard under the ECT."[621] *(emphasis added)*

930. According to a consolidated arbitral case-law on the ECT, the "stable conditions" referred to by the ECT clearly allow the adoption of reasonable and proportionate macroeconomic control measures, provided these are as a result of a reasonable cause. This principle has been stated by many previous awards. The Arbitral Tribunal in the Case *Palma v. Bulgaria* (claimed by the Claimant) established that:

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[617] Award of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, of 21st January 2006, paras. 496 and 497.RL-0049.
[618] Memorial on the Merits, 430-432.
[619] *Fair and Equitable Treatment in Arbitral Practice*, 6, Journal of World Investment & Trade, 357, at 374 (2005). RL-0056.
[620] Memorial on the Merits, paragraph 333
[621] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Award dated 27 August 2008, paras. 173 RL-0034.

> *"the Tribunal believes that the ECT does not protect investors against any and all changes in the host country's laws. Under the fair and equitable treatment standard the investor is only protected if (at least) reasonable and justifiable expectations were created in that regard. It does not appear that Bulgaria made any promises or other representations to freeze its legislation on environmental law to the Claimant or at all."* [622]

931. The Arbitral Tribunal came to the same conclusion in the *Case of AES SUMMIT v. Hungary*. Said Award denied that the existence of a *stability clause* could be deduced from a general regulatory framework in the scope of the ECT:

> *"The stable conditions that the ECT mentions relate to the framework within which the investment takes place. Nevertheless, it is not a stability clause. A legal framework is by definition subject to change as it adapts to new circumstances day by day and a state has the sovereign right to exercise its powers which include legislative acts.*
>
> *Therefore, to determine the scope of the stable conditions that a state has to encourage and create is a complex task given that it will always depend on the specific circumstances that surrounds the investor's decision to invest and the measures taken by the state in the public interest."*[623] *(emphasis added)*

932. Said criterion has been reiterated once again in the Case of Mamidoil v. Albania[624] (invoked by the claimant). These precedents are clear and convincing. However, even more relevant is the Precedent that examined and assessed Spanish legislation from 2007 and 2008 in the Case Charanne vs Spain which concluded, pursuant to prior Doctrine, that:

> *"in the absence of a specific commitment an investor cannot have the legitimate expectation that the regulation in place is going to remain unchanged."*[625]

933. It has been shown in the Facts that the measures challenged by the claimant are based on the need to guarantee the sustainability and balance of the SES and were carried out respecting the principle that governed this type of investment according to LSE 1997: the granting of a fair return that the 2005-2010 REP, in harmony with the

[622] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Award of 27 August 2008, paragraph. 219 RL-0034.
[623] AES Summit Generation Limited and AES-Tisza Erömü Kft. vs. Republic of Hungary, AES Summit ICSID Case No. ARB/07/22), Award of 23 September 2010, paras. 9.3.29 and 9.3.30 RL-0039.
[624] Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. c. Republic of Albania, ICSID Case No. ARB/11/24, Award of 30 March 2015, paras 617-618. RL-0046

[625] Charanne BV Final Award Charanne BV and Construction Investment S.A.R.L. vs Kingdom of Spain, Arbitration No.: 062/2012, 21 January 2016, p. 499. RL-0049.

2000-2010 REP[626], calculated to ensure that standard facilities could achieve a return of around 7% during their useful life[627].

934. It has already been established that the model of remuneration derived from the Spanish regulatory framework as a whole was planned with the aim that all investors could recover, taking as a reference a "standard installation", (1) the cost of their investment, (2) the operating costs and (3) obtain reasonable profitability[628].

935. Consequently, the Respondent has granted the Claimant stable conditions according to the ECT's standard, as with the contested measures it has maintained the essential characteristics of the regulatory framework in which the Claimant invested: Following the 2013 reform, the Kingdom of Spain has maintained the subsidies and the dispatch priority, allowing RE investments to recover, In accordance with the "standard facilities": (i) investment costs, (ii) operating costs and additionally, (iii) obtain reasonable profitability in accordance with the cost of money in the capital market. In summary, the Claimant maintains the financial balance of the investment.

936. Furthermore, it is not possible to talk about the violation of stable conditions since the profitability RE producers can hope to achieve was determined by Law following RDA 9/2013[629]. This had been largely proposed and requested by the sector's Associations, as has also been established[630].

937. The Claimants' arguments clash head on with the results obtained with the sale of their assets in 2016. The assets subject of this arbitration were sold to a third party by the Claimant. With such sale the Claimant has obtained a return of 11.2%. Such return is above that expected when making the investment.[631]

938. In conclusion, it is not admissible to assert that there has been a breach of the creation of "stable conditions" referred to in Article 10(1) ECT, when the contested measures (1) have maintained the subsidies to renewable energy sources as a cost for the SES linked to its sustainability, (2) have maintained access and dispatch priority (3) has maintained the principle that RE remuneration consists of a subsidy that, added to the market price, allows standard installations to achieve during their useful life a reasonbale return in accordance with the capital market, which is dynamic and

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[626] See Section IV.E.(5) (paras 445 and ff.) of this Memorial.
[627] Section IV.E 5.3 of this Statement (Paras 454 and ff). In fact the Pöyry Report, provided by the Claimant, calculated the return rates of RD 661/2007 at between 5% and 7%: Page 81, Document C-0103.
[628] The methodology of PER 2005 - 2010 on installation type is developed in Section IV.5.3 (paras 445 and ff.) of this Statement.
[629] The Third Final Provision of Act 24/2013, of 26 December, the specific figure for facilities already operating is around 7.398 per cent profitability for the whole project for a standard facility, as set out in Section IV.G.2.1 of this Statement (paras. 689 and ff.).
[630] "The Spanish FIT scheme has the legal rank of a Royal Decree. Even though it is 'stronger' than for instance a ministerial order, the Spanish renewable energy associations have **long called** for a FIT law." Miguel Mendonça et al., (Powering the Green Economy) in the Feed-in Tariff Handbook. Powering the Green Economy. The feed in tariff handbook." Miguel Mendonça, David Jacobs and Benjamin Socacool. Publishing house. Earthscan, 2010.RL-0062. It refers to the proposal of the Association APPA-Greenpeace for an Act on the Promotion of Renewable Energies, May 2009. R-0187
[631] Accuracy Expert Report, paragraph 73.

balanced within the SES; (4) has maintained the methodology consisting in that the determination of subsidies is set, depending on changing demand and other basic economic data, on the investment and operation costs of standard installations, (4) have resolved a situation of imbalance that endangered the economic sustainability of the SES in a rational and proportionate way.

(3.2) No retroactive measures have been adopted that violate the ECT.

939. This issue is related to the duty of creating stable conditions. The Claimant puts special emphasis on highlighting the alleged *retroactive* nature of the contested measures.

940. As substantiated in the narration of the fact, the investment costs taken into consideration by the measures contested are those actually made for the construction of the *standard installations* at the time when the construction work took place.

941. In addition, it is also proper to declare that, in accordance with the Principles of International Law, no retroactive measures have been adopted over the regime of RD 661/2007. The Claimant insistently reiterates the existence of *retroactive measures*, without justifying or arguing that the measures are retroactive according to the principles of international law.

942. Proof of the forced nature of its claims is the fact that the Claimant is unable to offer any Arbitration Precedent to support its allusions to retroactivity that violates the *stable conditions* standard of the ECT's FET. This is due to the fact that the Precedent is actually contrary to the Claimant's reasoning.

943. The Claimant, by explaining their theory, makes a new, basic and conceptual error: For a regulation to be retroactive, it must affect *acquired rights*. As has already been shown in the facts, the Claimant has never had an "*acquired right*" to any future remuneration, *sine die*, by means of a fixed and unchangeable FIT, not subject to possible measures of macroeconomic control or SES reforms. As has been shown, the reform contained in RDL 9/2013 only affects the future, without affecting *acquired rights*.

(i) International Arbitration Precedents on retroactivity

944. What the Claimant refers to as "*retroactivity*" is not really such according to international Case-Law. The case of *Nations Energy v. Panama* is particularly illustrative. On said occasion, the Tribunal was analysing the concept of *retroactivity* in the protection against cases of illegal expropriation granted by the BIT:

> *"The Arbitration Tribunal does not share said theory and considers that Law 6 is not retroactive as* ***it does not have the effect of revoking acquired rights and only applies to the future****.[...]*
>
> *Said requirements only apply towards the future and cannot have the effect of retroactively cancelling or reducing deductions already made in relation to income tax for previous years. [...]*

> *In fact, the Claimants **are confusing** the principle of non-retroactivity with that of the immediate effect of the new law for the future. Act 6 does not have the effect of retroactively cancelling acquired rights but rather that of modifying the conditions in which the holders of tax credits that have not yet been used may use this in the future."* [632] *(emphasis added)*

945. This Award reflects the principle consolidated in International Law with regard to *Acquired Rights*. If the acquired rights are damaged or eliminated by a regulation subsequent to the acquisition thereof, then the regulation is retroactive. This is different from Regulations that apply to *future facts* in relation to legal situations in progress, but which do not affect *rights already acquired*.

946. RD-Law 9/2013 expressly respects the remuneration received by the facilities, in accordance with its Third Final Provision.4 of the LSE 2013[633]. Therefore, the new regime projects its effects *in the future* and remunerations received prior to that are intangible and not subject to claims.

947. Indeed, the calculation of the remuneration takes into account the standard values determined by art. 30.4 LSE, guaranteeing said remuneration, together with the market income. This will allow the facility to recover the investment and cover its operating costs thoughout its useful life thus obtaining the corresponding reasonable return. But the effects of said regulation shall take place in the future, as the payments made prior to the coming into force thereof must be respected.

948. Another Precedent that has already ruled in relation to the lack of retroactivity of the measures adopted by the Kingdom of Spain is certainly relevant, confirming the reasoning of the Case of Nations Energy v. Panamá. The Award of the Case of Charanne v. Kingdom of Spain establishes the following:

> *"In fact, the retroactivity argument raised by the Claimants is a mere rewording of the argument that the State could not alter in any way the regulatory framework from which the Claimants' plants benefited. [...]This stance would, in fact, freeze the regulatory framework, thus restricting any possible regulatory change to new energy plants installed after said changes.*
>
> *It is undisputed that the 2010 regulations applied immediately, from their entry into force, to the plants already in operation, and that they **did not apply retroactively to previous time periods**. The Arbitration Tribunal considers that unless there are specific commitments in place such as those stemming from a contract, there is no*

[632] Case of Nations Energy Inc. and others v. Republic of Panama (ICSID Case No. ARB/06/19), paras 642, 644, 646 RL-0040

[633] Act 24/2013 of 26 December, on the Electricity Sector. Third Final Provision.4: "Under no circumstances may said new remuneration model result in the reclaiming of the remuneration received for energy produced prior to 14th July 2013, including if it should be found that said profitability might have been exceeded on said date." R-0077.

> *principle of international law* ***that prevents a State from adopting regulatory measures with an immediate effect on ongoing situations***"[634].

949. The reasoning of this Award is fully applicable to this case. As a result, it must be concluded that, according to international Case-Law, the concept of retroactivity in international law does not apply to RD-Act 9/2013.

950. From an international standpoint it is interesting to highlight the opinion of the European Commission with regard to future changes of the regime covering aid to renewable energy and which affect existing facilities. With regard to this issue, the Commission, contrary to what has been argued by the Claimant, and in line with the arbitration precedents provided with this statement, specified that:

> "However, according to the case law, traders are not protected against future changes to an on-going situation, and the immediate application of the new rule is the general rule for the application in time of new rules"[635]

(ii) National Case-Law applicable to the retroactivity of the measures

951. The Supreme Court and the State Council ratified the legality of the legislative modifications which apply to the future, without affecting the acquired rights[636]. This Doctrine is the same as that applied by the international arbitration Precedents.

952. The Spanish Constitutional Court has judged the measures adopted pursuant to RD-Act 9/2013 and has ruled that they are not retroactive given that they are effective towards the future without affecting acquired rights. In this respect, the Judgement of 17 December 2015 clarifyingly declared the following:

> *"Irretroactivity is only applicable to rights that are consolidated, assumed and integrated into the assets of the person and not to pending, future, conditioned rights or expectations [...]*
>
> *Provisions that, lacking ablative or pejorative effects for the past, deploy their immediate effectiveness towards the future even though this may mean having an impact on a legal relation or situation still under way do not come within the scope of prohibited retroactivity. [...] There is no prohibited retroactivity when a regulation regulates the future of legal situations created prior to the coming into force thereof or the effects of which have not taken place"*[637]

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[634] Charanne B.V. and Construction Investments S.A.R.L. v. Kingdom of Spain (SCC V 062/2012), Final Award, 21st January 2016, and dissenting judgement, paras. 546 and 548, RL-0049.
[635] Decision C(2016) 7827 final, of 28 November 2016, of the European Commission handed down in the aid dossier SA.40171 (2015/NN)–Czech Republic. RL-0021
[636] Judgements of the Supreme Court of 9 December 2009 Documento R-0002. Likewise, Ruling 937/2013 of the Permanent Committee of the State Council, of 12 September 2013, is cited and presented. General Observation VI, Document R-0123.
[637] Judgement of the Constitutional Court of 17 December 2015, delivered in constitutional challenge 5347/2013. R-0154.

953. Two later Judgements of the Spanish Constitutional Court, of 18 February 2016,[638] confirmed this Decision.

954. It must be concluded that, according to national and international Case-Law, the concept of *retroactivity* does not apply to RD-Act 9/2013 or to the rest of the measures challenged. Therefore, neither has the Kingdom of Spain violated the duty to create stable conditions, nor the legitimate expectations of the Claimant, because the contested measures are not retroactive.

(4) The conduct of the Kingdom of Spain has been transparent.

955. The Claimant[639] upholds in five paragraphs that the conduct of Spain has not been transparent, having dismantled the previous regime (i) keeping the plants "*completely in the dark*" for 11 months with regard to future revenues; (ii) failing to report the criteria or the underlying calculations for the subsidy; (iii) calculating the subsidies with regard to a standard facility; (iv) without predictability in the method to adapt the subsidy in the following six-year period, and (v) without predictability over the calendar during which the remuneration for installed capacity will apply.

956. The Claimant once again makes the mistake of considering that the ECT guarantees the full *predictability* of the regulatory framework of a State while the investment is in effect even when there is no commitment to maintain it. This would involve freezing the regulatory framework to ensure the alleged "*predictability*". The Claimant cites 3 Awards to support its arguments:

1. It cites the Case of Tecmed. However, this Award has been questioned. In this respect, the Annulment committee of the MTD Case declared the following:

> *"According to the Respondent, the Tecmed programme for good governance" is extreme and does not reflect international law. […]The Committee can appreciate some aspects of these criticisms. For example the TECMED Tribunal's apparent reliance on the foreign investor's expectations as the source of the host State's obligations […] is questionable."*[640]

2. It cites the Electrabel Award. However, the Arbitration Tribunal of Electrabel did not interpret this condition in applying the ECT. Therefore, it is not relevant:

> *"Electrabel makes no allegations regarding lack of transparency"*[641]

3. It cites the Plama vs Bulgaria Award, which limits itself to referring the ECT standard to the FET and to the stability of the regulatory framework.

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[638] Judgement of the Constitutional Court of 18 February 2016, delivered in constitutional challenge 5852/2013 (R-0156) and Judgement of the Constitutional Court of 18 February 2016, delivered in constitutional challenge 6031/2013. R-0157.
[639] Memorial on the Merits, paras. 433 to 437.
[640] MTD Equity Sdn Bhd. & MTD Chile S.A. v. The Republic of Chile (ICSID Case No. ARB/01/7) Decision on Annulment, 21 March 2007 paras. 66 y 67. RL-0030.
[641] Electrabel S.A. V. Hungary (ICSID Case No. ARB/07/19), Award 25 Nov. 2015, para. 115 RL-0048.

957. It has already been pointed out that the ECT does not guarantee the predictability of the Regulatory Framework of the States which are a party thereof if there is no *specific* commitment from the State in this respect[642]. This has been confirmed by the Tribunal in the AES Summit Case that applied the ECT and interpreted this *condition* of transparency established in the ECT.

958. In thiat Case, the company AES Summit alleged a *lack of transparency* in Hungary since, after signing a contract with the Claimant, Hungary reintroduced administrative prices, which was totally unpredictable. The Arbitration Tribunal examined, inter alia, the Tecmed Award[643] invoked by the Claimant. However, the Arbitration Tribunal concluded that, pursuant to the ECT, Hungary did not violate the transparent conditions as it acted within the acceptable range of legislative and regulatory behaviour:

> *"Respondent's process of introducing the Price Decrees, while sub-optional, did not fall outside the acceptable range of legislative and regulatory behaviour. That being the case, it cannot be defined as unfair and inequitable."*[644]

959. In the facts of this Statement, it has been shown that:

(1) The Kingdom of Spain has never committed itself to the Claimant to keep its regulatory framework immutable or the regime established in RD 661/2007;

(2) The Kingdom of Spain has publicised the need to carry out reforms since 2009 as a result of the international crisis and the necessary sustainability of the system.

In fact, RD-Act 6/2009, the Report of RD 1614/2010 and RD-Act 14/2010, in their respective Preambles alluded to the impact of the global crisis on the Spanish economy, falling electricity demand and the need to adapt the SES by means of the necessary reforms.

It should be noted that RE Associations themselves proposed the reform of the sector in 2009, 2010 and 2012, and even proposed the text of a new Act for RE in 2009. Additionally, announcements for a *new* Electricity Sector Act were made by the Government constantly since December 2011, as has been proven.

(3) The Kingdom of Spain has followed the legally established procedures in all the measures taken since 2009, without incurring undue delays and ensuring participation in the legislative process of the holders of legitimate rights.

The arguments submitted by the entire RE Sector to the drafts of RD 413/2014 and the Order IET/1045/2014 that the Claimant stated it was unaware of have been substantiated. This contradicts the unfounded "*kept in the darkness*" which the Claimant states the facilities were in for 11 months. It is completely untrue.

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[642] Section IV.I.2 of this Statement.
[643] AES Summit Generation Limited and AES-Tisza Erömü Kft v. Republic of Hungary, ICSID Case No. ARB/07/22; Award of 23 September 2010. para. 9.1.6, bottom of page 28 RL-0039.
[644] AES Summit Generation Limited and AES-Tisza Erömü Kft v. Republic of Hungary, ICSID Case No. ARB/07/22; Award of 23 September 2010. para. 9.3.73. RL-0039.

(4) The Kingdom of Spain has approved a predictable, dynamic regulatory system that continues to guarantee reasonable returns for RE projects and the financial balance of the investment.

(i) The Claimant argues that the new legal regime sets regulatory periods of three or six years that can be changed by the Government at its discretion and does not determine the methodologies for reviewing certain parameters. However, against that maintained by the Claimant, the regulatory periods are not discretionary. There are predictable deadlines and they constitute an element of security for the investor, by being legally regulated.

(ii) On the other hand, the Claimant states that the methodology for reviewing certain elements has not been indicated. However, both Act 24/2013[645] and RD 413/2014[646] contain regulations to guarantee that investors receive reasonable returns in relation to their facilities at all times. Such guarantees are explained in the witnesses statement of Mr Juan Ramón Ayuso.[647]

As a result, the establishing of regulatory periods gives investors security and guarantees the maintaining of the reasonable return, preserving this return throughout the regulatory useful life, and guaranteeing the value of the investment.[648]

960. Therefore, the Kingdom of Spain has not infringed its obligation to promote transparent conditions in accordance with art. 10(1) ECT.

(5) The measures taken by the Kingdom of Spain were non-discriminatory, reasonable and proportionate.

961. The Claimant argues the exorbitant or abusive and the disproportionate nature of the contested measures[649]. Given the link between both sections, we will show jointly in this Counter Memorial that the measures contested are not discriminatory, were reasonable and were proportionate.

(5.1) Lack of evidence of the infringement by the Claimant

962. First of all, it states that the measures contested are not reasonable because the reasons (excess capacity and the tariff deficit) are attributable to Spain.

963. We should recall that the Claimant has left out facts that are relevant, substantiated and not attributable to the Kingdom of Spain, such as (1) the principal of sustainability of the SES; (2) the worsening of the international crisis between 2007 and 2012; (3) the

[645] Article 14.4 of Act 24/2013, of 26 December. R-0077.
[646] Royal Decree 413/2014. Article 20(1).R-0110
[647] Declaration of Mr Juan Carlos Ayuso of 18 May 2016, RW-001
[648] Expert Report by Accuracy paras. 235 to 259.
[649] Sections 13.3.(d) and (e) of the Memorial on the Merits.

exceptional fall in electricity demand[650]; and (4) the international commitments assumed through the MoU with the EU in July 2012 to bail out Spain's financial sector.

964. The Claimant invokes the *BG v. Argentina* Award. In said Award, the Argentine state committed to *maintaining* tariffs for 5 years and *not amending* licences without the consent of the licensee[651]. The legal and contractual commitments assumed by Argentina are not, in any way, applicable to this case. Precedents where the standard established in the ECT has been applied will be more relevant.

965. It is up to the claimant to show that the measures adopted are "unreasonable and discriminatory". The Final Award of Electrabel recalled that:

> *"The Tribunal starts with the premise that it is Electrabel which bears the burden of proving its case under the ECT's FET standard."* [652]

966. The Claimant has not substantiated that the measures challenged were abusive, by leaving out relevant facts that were substantiated by Spain and by invoking awards not applicable in any way to this Case.

967. Elsewhere, the Claimant declares that the measures are disproportionate (1) by attacking the tariff deficit through removing the regime of RD 661/2007, when the Wind and Hydraulic sector tariffs played a limited role in the Tariff Deficit, and (2) as there are other alternatives such as increasing the bill to consumers or establishing taxes to fund the deficit.

968. Once again, the Claimant omits that the measures applied to the entire System, including consumers, to re-balance the SES. They not only affected the Renewable Energies Sector, because these are not an island within the SES, but rather affected all activities that involve a cost for the SES. In addition, within the renewable sector, the measures affected all technologies. It is as a whole that the proportional nature of the measures should be understood, not in one specific sector as the Claimant is attempting to do.

969. Furthermore, the Claimant has not substantiated the legal, economic and budgetary validity of the alternatives it proposes to re-balance the SES and guarantee its future sustainability. Moreover, these reveal ignorance (1) of the public Deficit obligations assumed by Spain through the MoU signed with the EU and (2) of the Spanish tax and budgetary regulations.

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[650] In the words of the AEE Association in 2010.

[651] *BG Group Plc. v. Republic of Argentina*, CNUDMI, Final Award, 24 December, 2007, paras. 168 to 170 Includes the clauses in paragraphs 47 to 50, establishing specific and concrete commitments. It is worth highlighting the contractual clause contained in par. 48: *"The Grantor will not change these Basic Rules, in full or in part [...] except by written consent of the Licence holder [...]. The provisions that modify the Service Regulation and the Tariff [...] will not be considered modifications to the Licence [...], regardless of the right of the Licence holder to demand the corresponding Tariff adjustment if the net effect of such a modification were to change [...] the economic and financial balance existing prior to such a modification."*RL-0061

[652] *Electrabel S.A. V. Hungary* (ICSID Case No. ARB/07/19), Award of 25 November 2015, para 154.RL-0048

970. To burden electricity consumers with the more than 27.000 billion-euro deficit or happily create a tax to be paid by them is simply pie in the sky. More so when the SES imbalance was set to increase year after year. The Claimant neither calculates not checks the future sustainability of the SES with its cheerful proposals.

971. Accordingly, the Claimant has also not substantiated any infringement of Article 10(1) ECT through disproportionate measures.

(5.2) Relevant facts that reflect the reasonability, proportionality and non-discriminatory nature of the measures challenged.

(i) Economic circumstances of unsustainability of the SES in 2012.

972. The lack of evidence provided by the Claimant (together with the omission of relevant evidence that contradicts its theory) determines the necessary dismissal of the alleged infringements through the abusive and disproportionate nature of the measures. However, to avoid any doubt about compliance with this standard of Article 10(1) ECT by the Kingdom of Spain, it will be argued and substantiated that the contested measures have been reasonable and proportionate.

973. This standard is related to the FET standard of the ECT, which allows, pursuant to the AES Summit Case Award, the adoption of reasonable and proportionate regulatory changes.

974. In the facts of this Counter-Memorial it has been substantiated: (1) the existence of an international economic crisis that led to a reduction in electricity demand; (2) the rise in consumer tariffs, (3) the existence of excess remuneration in the RE Sector, and (4) the existence of expectations of growth of the tariff deficit. All of these circumstances implied the economic sustainability of the SES.

975. The Claimant completely omits the economic situation of the SES, following the fall in demand and the predictable increase of the deficit due to RE costs. The Claimant also omits any reference to the international commitments made by Spain to the EU in 2012 to adopt Macroeconomic control measures in the SES. The Claimant only accepts the existing crisis to allege the encouragement of investments through the need of regional and local organisations to obtain revenue[653].

(ii) These measures were proposed by the RE Sector in 2009.

976. In the Facts it has been accredited that the method of remuneration adopted for RE was expressly proposed by the majority Association in the RE Sector in 2009, the APPA, in 2009. The *reasonableness* of the remuneration measures being challenged is, therefore, obvious, since it corresponds to what the majority Association in the RE Sector wished to achieve in 2009.

[653] Memorial on the Merits, para. 484.

977. Indeed, the RE Association, APPA, with the legal support of Cuatrecasas, Gonçalves Pereira, proposed that the remuneration of renewable energies should be determined in 2009 in a similar way to that established in 2013 by RD-Act 9/2013:

> *"The government will establish the amount of the regulated tariffs, premiums and complements, therefore assessing, in all cases, the **operating and maintenance costs** and the **investment costs** incurred by the owners of a facility in order to obtain **reasonable return rates** with reference to the cost of money in capital markets. As a fee for the remuneration of capital, an annual percentage equal to the average of the preceding year for the remuneration of **10-year Treasury bonds** will be used, increased by **300 base points**.*
>
> *For the preceding purposes, the Government will estimate the investment costs associated with the **various classes of Installations**, differentiated by technology and size, such that they reflect the usual values that said investments actually reach"*[654] *(Emphasis added)*

978. The relevance of this proposal is obvious, because it proves the fact that the remuneration system laid down in 2013 does not violate the FET standard of the ECT. In other words, these 2013 remuneration measures are reasonable and proportionate if the majority APPA Association proposed a similar system as the best one (1) for achieving reasonable return rates with reference to the cost of money in the capital market, (2) provide "*security and stability for investments"* and (3) allow "*the RE to develop their potential in a sustainable and lasting manner"*[655].

979. On the basis of these criteria, the APPA intended in 2009 to build the reform of the renewable energies remuneration regime for the future.

(iii) Acceptance of the measures by the majority of domestic and foreign investors.

980. The current regulatory regime attracted over 5 billion euros in investment in RE in Spain in 2015. This is due to the stability and security of the current system in terms of the receipt of income. However, the Claimant omits these facts before the Arbitral Tribunal, giving a partial and incomplete view of the reform of the disputed regulatory framework. The Claimant omits the so-called "*renewable energy boom*" in the year 2015[656].

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[654] Article 23.3 and .4 of the proposed Bill presented by APPA-Greenpeace in May 2009. Document R-0187

[655] Press Release from APPA-Greenpeace on the Draft Bill of the Renewable Energies Development Act, 20 May 2009 R-0167.

[656]"Operations boom in the renewable energy sector after the reform": "The purchase of solar and wind power plants so far this year is already in excess of 1 billion. Experts agree that there will be new operations in the sector in the coming months." News item in the "El Mundo" newspaper, "Operations boom in the renewable energy sector after the reform", dated 22 July 2015.R-0179
"The boom in renewable energy attracts 5 billion in investments": "So far this year, the renewable energies sector has accumulated almost 5 billion euros in buying and selling operations [...]" News item in the financial newspaper "El Economista", 17 October 2015.R-0178

981. It also omits any reference to the positive assessments these measures have received from the European Commission, the International Monetary Fund (hereinafter, the "IMF") and the International Energy Agency in the years 2015 and 2016.

982. Therefore, the financial reality after the challenged measures and the assessments of international bodies show the *proportionality and reasonability* of the measures adopted and undermine the statements of the Claimant regarding the sector following the adoption of the measures. The mass entry of new investors would only be logical if the new regulation guaranteed reasonable returns. Furthermore, only if the measures are reasonable, proportionate and effective will they merit the positive appraisal of international bodies.

983. In addition, with regard to the Claimant, the introduction of the regulatory measures has not prevented this party from executing its business plan and managing to sell its assets and obtain a return of 11.2%.

(5.3) The Kingdom of Spain has met the requirements of the Tests referring to the Objectives of the ECT.

984. As set out in section IV.I(1), the main objective of the ECT is *non-discrimination* in relation to foreign investors. Furthermore, article 10(1) ECT establishes an FET standard and additionally, in relation to the obligation to give investments already made "*no less favourable treatment than that required by international law*", it recognises the minimum standard of protection guaranteed by International Law.

985. There are different Tests that are applied by the international arbitral Tribunals, which make it possible to assess whether the measures adopted by a State are irrational or discriminatory pursuant to the ECT objectives and standards:

(a) The EDF v. Rumania Test, which makes it possible to examine whether Spain has respected the main objective of the ECT, adopting non-discriminatory measures in respect of the Claimants; and

(b) The AES Summit v. Hungary Test, accepted by the Claimant as relevant, allowing the question of whether or not the Kingdom of Spain respected the FET standard of 10(1) ; and

(c) The *Total v. Argentina* case Test, to assess the respecting of the financial balance of the investment.

986. Compliance with these Tests will determine the Kingdom of Spain's respect for the FET objectives and standards established in the ECT. This will imply *sensu contrario* that no unreasonable or discriminatory measures were adopted:

(a) EDF v. Romania Case Test: non-discriminatory nature of the measures

987. In the *EDF v Romania Case*[657], the Arbitral Tribunal made use of the verification criteria listed by Dr. Christoph Schreuer in order to assess whether or not the measures adopted by a State are discriminatory. In this respect, Dr. Schreuer considers a measure to be *discriminatory* when:

> *"a) A measure that inflicts damage on the investor without serving any apparent legitimate purpose;*
>
> *b) A measure that is not based on legal standards but on discretion, prejudice or personal preference;*
>
> *c) A measure taken for reasons that are different from those put forward by the decision maker;*
>
> *d) A measure taken in wilful disregard of due process and proper procedure."*

988. There are grounds for examining each of these criteria separately:

a) *If it is a measure that inflicts damage on the investor without serving any apparent legitimate purpose.* In this case, it has been substantiated that the purpose of the reform is completely legitimate. The measures attempt to address a situation of unsustainable imbalance, in which the international and national economic circumstances determined a reduction in demand which made it necessary to re-balance the system. This legitimate purpose was implemented taking another legitimate purpose into account: not imposing an excessive burden on consumers in order to achieve this re-balance and avoid unjustified excess remuneration.

b) *If the measure is not based on legal standards but on discretion, prejudice or personal preference.* The reform carried out was implemented in full compliance with the existing legal regulations and the Case Law of the Spanish Supreme Court, guaranteeing the reasonable return that was and is required by the Electricity Sector Act. The measures questioned in this arbitration are for the purpose of underpinning the principle of reasonable return. A principle on which the system of subsidies to production through renewable energies has been traditionally built. In addition, the reform being challenged has a general scope. In other words, it is applicable to all operators and to all sectors intervening in the energy market. Therefore, it is not discriminatory with respect to any investor, neither national nor international.

c) *If it is a measure taken for reasons that are different from those put forward by the decision maker*. In the present case, the Preamble of RD-Act 6/2009 and RD-Act 14/2010, as well as the MAIN of RD 1614/2010, warned about the need to reform the electricity sector in order to guarantee its sustainability. These reasons are the same as those on which the measures being challenged were based.

d) *If it is a measure taken in wilful disregard of due process and proper procedure.* The Spanish government has followed the legally established procedures to enact the

[657] *EDF (Services) Limited v. Rumania,* ICSID Case No. ARB/05/13, Award dated 8 October 2009, para. 303 RL-0035.

regulatory standard of remuneration in the electricity sector. In the present case it is worth mentioning the effort made by the Government to convey the successive drafts of the measures to the interested parties. Also worthy of mention is the opening of processes for supplementary pleadings, as well as the appraisal and consideration of these pleadings. Under no circumstances were they "completely left in the dark", as stated by the Claimant.

989. Therefore, none of the four criteria explained in the *EDF v Rumania Case* for assessing a discriminatory action is met in this case.

(b) AES Summit v. Hungary Case Test: the measures are reasonable and comply with the FET standard laid down by the ECT.

990. The test set out in the *AES SUMMIT* case is used to determine whether or not an unreasonable or disproportionate measure exists that does not comply with the FET standard laid down by the ECT. To do this, the Arbitral Tribunal develops the criterion, which in a more limited way had been established by the Arbitral Tribunal in the *Saluka v. Czech Republic Case* [658]. In the *AES Summit v. Hungary* case, the Arbitral Tribunal stated:

> *"There are two elements that require to be analyzed to determine whether a state's act was unreasonable: the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy.*
>
> *A rational policy is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter.*
>
> *(...) A challenged measure must also be reasonable. That is, there needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented."*[659] *(Emphasis added)*

(i) The Measures are rational and comply with the objective of a public economic policy.

991. As a first requirement, in the present case the existence of a rational policy is confirmed, adopted, by Spain following a logical explanation and for the purpose of addressing a matter of public interest.

992. The system providing support for renewables is based on the legal principle of reasonable returns in the context of a sustainable SES. The Regulator acted, as it had done in previous cases and taking into account the particular gravity of the economic situation in 2013, with the purpose of restoring the balance required by the applicable

[658] *Saluka Investments B.V. v. Czech Republic,* UNCITRAL of 17 March 2006, para. 307. To assess whether the conduct of a State was reasonable it declared: "must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment."RL-0028

[659] *AES Summit Generation Limited and AES-Tisza Erömü Kft. vs. Republic of Hungary*, ICSID Case No. ARB/07/22; Award of 23 September 2010, para. 10.3.7 to 10.3.9.RL-0039

legislation. This imbalance, as well as involving an excessive burden for Spanish consumers, was decisively contributing to the generation of the so-called tariff deficit, the correction of which was required by law.

993. In addition, the imbalance in favour of the producers that the Regulator was trying to stem was taking place in a scenario of acute economic crisis, both in the SES in particular and in the Spanish economy as a whole[660]. These economic circumstances led to the signature by the Kingdom of Spain of a commitment to the EU Member States to adopt macroeconomic control measures[661] that would guarantee the sustainability of the SES.

994. The need to protect both consumers, already affected by increases in their electricity bills, and the very sustainability of the SES compelled the Kingdom of Spain to adopt, together with the measures subject to examination in this arbitration case, several measures that affected all of the SES's income and expense items. Consequently, correcting a Macroeconomic imbalance in a situation of unsustainability constitutes a public policy that fits within the criterion established by *AES Summit*.

995. In the case cited, the Tribunal, after examining the CJE standard laid down by the ECT, declared that the reduction of the excessive profits of investors and the charges to consumers constituted a valid reasonable policy.

> *"the majority has concluded that Hungary's reintroduction of administrative pricing in 2006 was motivated principally by widespread concerns relating to (and it was aimed directly at reducing) excessive profits earned by generators and the burden on consumers.*
>
> *[...] Having concluded that Hungary was principally motivated by the politics surrounding so-called luxury profits, the Tribunal nevertheless is of the view that it is a perfectly valid and rational policy objective for a government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational. One need only recall recent wide-spread concerns about the profitability level of banks to*

[660] It is worth remembering at this point that the FADE issues were suspended between March and November 2012, since no foreign financing could be obtained at a reasonable interest rate. Certificate of the Interministerial Commission Agreement regarding article 16 of Royal Decree 437/2010 from the session on 26 November 2012R-0254.

[661] Memorandum of Understanding signed with the European Union on 20 July 2012: "*VI. Public Finances, Macroeconomic Imbalances And Financial Sector Reform:*
29. "There is a close relationship between macroeconomic imbalances, public finances and financial sector soundness.
31. Regarding structural reforms, the Spanish authorities are committed to implement the country-specific recommendations in the context of the European Semester. These reforms aim at correcting macroeconomic imbalances, as identified in the in-depth review under the Macroeconomic Imbalance Procedure (MIP). In particular, these recommendations invite Spain to: [...] 6) [...] address the electricity tariff deficit in a comprehensive way." (Emphasis added).RL-0067

understand that so-called excessive profits may well give rise to legitimate reasons for governments to regulate or re-regulate."[662] *(emphasis added)*

996. This assessment was expressly confirmed by the Ad Hoc Committee on the application for annulment of the Award[663] (emphasis added).

997. Furthermore, this criterion has been subsequently ratified by the Electrabel[664] and Charanne[665] cases.

998. As a result, an action that has as its aims protection of consumers, avoiding a remuneration higher than what is reasonable for the investor, is compliant with the FET standard established in the ECT. We should remember that this remuneration is directly supported in the bills to consumers who, according to the law, have the electricity supply "at the lowest possible cost".

999. This is, therefore, in line with the first of the parameters considered in the *Aes Summit v. Hungary* case: the policy carried out by the Kingdom of Spain was valid and fulfilled the objective of a public economic policy. This is the correction and prevention, in order to protect consumers, of the payment to investors of a higher remuneration than is reasonable. The relevance and rationality of the measure is, in conclusion, beyond all doubt.

(ii) The Government's action was reasonable, considering the objective of the state public policy and the measure adopted to attain this objective.

1000. The second criterion assessed by the Arbitral Tribunal in the *AES Summit V. Hungary* case required the Government's action to be reasonable, requiring proper correlation between the objective of the state public policy and the measure adopted to attain this objective.

1001. In this case, the reform meets this requirement of *reasonableness*. The reform adopted by the Government affected all subjects involved in the SES. Said reform distributed the measures to increase the income and reduce the costs of the SES between the consumers and all the operators in the system (producers, distributors and transport companies) with the goal of dealing with the tariff deficit.[666]. In addition, for

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[662] *AES Summit Generation Limited and AES-Tisza Erömü Kft. vs. Republic of Hungary*, ICSID Case No. ARB/07/22; Award of 23 September 2010, para. 10.3.31 and 10.3.34.RL-0039

[663] AES Summit Generation Limited and AES-Tisza Erömü Kft. vs. Republic of Hungary, ICSID Case No. ARB/07/22, Decision of the Ad Hoc Committee on the application for annulment, 29 June 2012, para. 78: "a state can exercise its legislative powers with respect to consumer protection against overly burdensome prices even if this has the consequence that private interests such as an investor's contractual rights are affected, as long as that effect is the consequence of a measure based on public policy that was not aimed solely at affecting those contractual rights." RL-0042.

[664] *Electrabel S.A. against Hungary* (ICSID Case No. ARB/07/19), Award of 25 November 2015, para. 179. RL-0048.

[665] Award in the case of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, 21 January 2006, para. 510. RL-0049.

[666] These measures are set out in Sections IV.A.3.2 (paras. 281 and ff.) and IV.F.(1) (paras. 592 and ff.) of this Statement. Among these measures is the fact that a consumer went from paying 370 euros per year for their electricity bill in 2003 to paying a total of 616.20 euros in 2014. The accumulated increase in

the first time since the SES was created in 1994, financial contributions coming from the General State Budget were planned: Spanish taxpayers were also meeting the costs of the SES including remuneration of the Claimant.

1002. In the Facts it has been substantiated that the remuneration measures established correspond to the system proposed by the majority Association in the RE Sector in 2009. Furthermore, these measures have allowed the tariff deficit to be stabilised and reasonable returns to be maintained for the renewable energy producers.

1003. As well as reasonable, the measures adopted are also *proportionate*. The system of subsidies that enabled producers to achieve reasonable returns of around 7.398%, which could be higher in the case of surpassing the standards established on a standard facility, was maintained, at the same time as correcting and avoiding situations of imbalance, which prejudiced Spanish consumers and contributed to endangering the financial sustainability of the SES.

1004. Even the index that was established (Spanish 10-year bond + 300 points) was proposed by the RE Sector in 2009. Consequently, the remuneration established in 2013 could not be disproportionate.

1005. This remuneration is determined in the economic regime developed through RD 413/2014 and confirmed through Order IET/1045/2014. As explained in detail in Section IV.G(2), this regime provides, in those technological areas that so require, remuneration that covers all of the operational costs required to perform the activity efficiently and in a well-run manner. This, providing that these were not already covered by the revenue from the sale of electricity in the market. To calculate the remuneration established following the reform, we have considered both the variable costs as well as the fixed operating costs. The remunerated costs are listed (not exhaustively) in the Preamble of Order IET/1045/2014, of 16 June[667].

1006. Thus, the remuneration system includes and comprises:

a) The revenue from the sale of the electricity generated in the market.

b) Remuneration for operation to supplement the revenues from the sale of energy in the electricity market when they do not cover the fixed and variable operating costs associated with each standard facility, such that in an annual calculation the revenues minus the expenses are at lest equal to zero.

c) It also provides the investment with a remuneration that covers, up to the necessary amount, the reimbursement of the initial investment, reduced by the gross annual exploitation margins associated with each IT during its regulatory life, when they are positive. To this end, it takes into account the equipment, the facilities and the civil

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these years was upwards of 66.54%. The greatest increases nonetheless took place in 2008 (10%), 2009 (10.1%) and 2011 (17.7%).

[667] Order IET/1045/2014, of 16 June, Preamble, section III, paras. 14 to 21. R-0115.

works that are required, together with the costs of promotion, engineering and implementation prior to the plants becoming operational.

1007. In this way, the remunerative parameters for each IT will make it possible to achieve the objective of reasonable annual returns - established at a rate of 7.398%[668]- on the investment made, from the commissioning of the installation until the end of its useful regulatory life, for those IT that had not previously obtained it. May we remind you that such reasonable return is laid down in the Electricity Sector Act and the Case-Law of the Supreme Court recognises it as a basic legitimate expectation of the investor.

1008. Said yield is reasonable and not reviewable until 6 years after the coming into force of RD-Act 9/2013, more specifically, until 1 January 2020. The calculation of the remuneration of the investment and the remuneration of operations is established objectively and reasonably for each standard facility. As is confirmed in the Witness Statement of Mr. Juan Ramon Ayuso, the values applied to all these remunerated concepts are in line with reasonable market value standards[669].

1009. As a result, the claim that the remuneration established through the challenged measures constitutes *disproportionate or unreasonable* measures with respect to the Claimant in the current socioeconomic reality is rejected. To the contrary rather, in the light of the criteria that have been examined, the reform of the electricity sector carried out by the Kingdom of Spain is a valid and rational policy and it has been carried out by means of a reasonable action, which fits within the standard of FET as laid down in the ECT, as stated by the Arbitration Court in the case *Aes Summit vs. Hungary*.

(c) Total v. Argentina Case Test: to assess the respecting of the financial balance of the investment

1010. The Arbitration Tribunal in the *Total v. Argentina Case*[670] assessed the *minimum standard* of protection required in the FET standard under international law, which allows verification of whether or not a State has broken the financial balance of the investment in cases of long-term investment of large amounts of capital, such as investments in the energy sector.

1011. As has been set out in the Section in relation to the Objectives of the ECT[671], this Treaty guarantees protection according to the *minimum standard* of protection guaranteed by International Law. The Arbitration Tribunal in the *Total v. Argentina* Case applies this *minimum standard*. For this reason it is certainly relevant to this Case.

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[668] Its determination is specified in RD-Act 9/2013, as the average yield in the secondary market of ten-year Government Bonds prior to the effective date of RD-Act 9/2013, increased by 300 basis points.R-0095

[669] Statement by Mr. Juan Ramón Ayuso, 18 June 2016. RW-0001

[670]Total S.A. vs *Argentine Republic,* ICSID Case No. ARB/04/01; Decision on Liability, 27 December 2010. RL-0050.

[671] Section IV.I(1) (paras. 844 and ff.) of this Statement.

1012. The Arbitration Tribunal of the Total Case ruled regarding measures taken by the Government of Argentina in the Electricity and Gas sectors. It found that legitimate expectations arising from the general regulatory framework cannot be protected from subsequent modifications. However, in those sectors that involve the long-term investment of large amounts of capital, a State may modify the legal framework provided the investor is still able to recover its operating costs, amortise its investment and make a reasonable return over said period of time.[672]

1013. I.e., the Arbitration Tribunal established as a *minimum FET standard* for these kinds of investments the consideration of whether or not the *principle of economic balance* that would allow long-term investors to recoup the costs and obtain a reasonable return on their investment had been respected[673].

1014. In this case, the energy sector requires long-term investment, and this was made in application of a General regulatory framework. Therefore, the assessments made by the Arbitration Tribunal to verify whether or not the FET standard was violated are applicable to this Case. Said consideration requires the verification of whether or not the reform of the electricity sector carried out by Spain ultimately respects whether or not the investor "*is able to recover its operations costs, amortise its investments and make a reasonable return over time*".

1015. As shown by the witness Statement of Mr Juan Ramón Ayuso[674], the reform carried out following the investment made by the Claimant fulfils said requirements. The remunerative parameters have been calculated to permit the reimbursement of both the operational costs as well as the initial investment. In this case it is relevant that the standard values of the initial investment considered for the Standard Facilities that characterise the actual facilities of the claimants exceed the investment actually made, insofar as the standard facilities into which the Plants are classified have been assigned a cost that is higher than the actual cost of these plants.

1016. The reform pursues the aim and provides the measures required so that each Standard Facility achieves a reasonable return for investment. In this regard, the remunerative system allows an average annual profit to be achieved, from the set-up of the facility through to the end of its regulatory useful life, established at 20 years for wind facilities and 25 years for hydroelectric plants. The current yield of 7.398% is

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[672] Total S.A. v. The Argentine Republic, ICSID Case No. ARB/04/01; Decision on Liability 27 December 2010, ¶122: "when the basis of an investor's invocation of entitlement to stability under a fair and equitable treatment clause relies on legislation or regulation of a unilateral and general character. [...] This type of regulation is not shielded from subsequent changes under the applicable law [...]
In such cases, reference to commonly recognized and applied financial and economic principles to be followed for the regular operation of investments of that type (...) may provide a yardstick. This is the case for capital intensive and long term investments [...]. The concept of "regulatory fairness" or "regulatory certainty" has been used in this respect. In the light of these criteria when a State is empowered to fix the tariffs of a public utility it must do so in such a way that the concessionaire is able to recover its operations costs, amortize its investments and make a reasonable return over time" (emphasis added)RL-0050

[673] Ibid, para. 313.

[674] First witness statement by Juan Ramón Ayuso.RW-1.

reasonable and non-revisable until 6 years following the coming into force of RD-Act 9/2013.

1017. Through the challenged measures, Spain guarantees the remuneration and repayment required by the Arbitration Tribunal in the *Total v. Argentina* Case as a *minimum standard* required to consider the FET *minimum standard* as not violated by modifications occurring in the general regulatory framework for long-term investments of large amounts of capital. Therefore, the respondent is not violating the FET minimum standard established in the scope of international Law, applicable to this case together with the ECT.

1018. It must therefore be concluded that the reform carried out by Spain, in guaranteeing the remuneration and repayment of the investment in a reasonable and proportionate manner, is not violating the FET standard established in the ECT. Much less still could these measures be considered unreasonable or discriminatory.

1019. The introduction of the regulatory measures has not preventedthe Claimant from executing its business plan and managing to sell its assets and obtain a return of 11.2%. In this case, the total Test is fulfilled.

(6) The Kingdom of Spain has not violated any obligation whatsoever undertaken when the Claimant made its investment (Umbrella Clause).

(6.1) Introduction**.**

1020. The Claimant maintains that the Kingdom of Spain has violated the so-called "*umbrella clause*" of Article 10(1), final subsection, ECT. The Claimant claims that the obligations can be found in contracts and in unilateral declarations or regulations. On this basis, the Claimant maintains that the commitments made by the Kingdom of Spain are reflected in RD 661/2007, in the alleged agreement of June 2010 with the wind sector and in RD 1614/2010. The Claimant concludes that the challenged measures imply the violation of this protection clause.

1021. The Claimant's arguments cannot be admitted by the Arbitral Tribunal as:

1. The interpretation the Claimant makes is contrary to the literal sense of Article 10(1) of the ECT and the interpretation thereof by Doctrine and arbitration Precedents.

2. The Kingdom of Spain has not made any direct undertakings in relation to the Claimant or its investment through unilateral acts, as declared by one case of Arbitration Precedent.

(6.2) The interpretation the Claimant makes is contrary to the literal sense of Article 10(1) of the ECT and the interpretation thereof by Doctrine and arbitration Precedents.

(a) Dominant umbrella cause concept in case law and international doctrine.

1022. The Claimant incorrectly interprets the content and purpose of the final subsection of art. 10 (1) of the ECT, taking the application of the "umbrella clause" beyond a reasonable interpretation. By using the expression "*any*", due to its broad nature, the

Claimant would be aiming to include any type of act under the concept of guaranteed obligation. It therefore considers that an applicable erga omnes rule, such as RD 661/2007, are specifically agreed commitments with an investor or their investment.

1023. This approach implies a lack of awareness of the true scope of the umbrella clause, as it obviates that the final subsection of art. 10 (1) of the ECT clearly uses the term "*entered into*", which implies that the State assumes specific obligations with regard to a specific investor or a specific investment. In the *Noble Ventures, Inc. v. Rumanía* Case the Arbitral Tribunal came to this conclusion:

> *"[...] considering the wording of [...] "any obligation [a party] may have entered into with regard to investments", it is difficult not to regard this as a clear reference to investment contracts. In fact, one may ask what other obligations can the parties have had in mind as having been "entered into" by a host State with regard to an investment. The employment of the notion "entered into" indicates that specific commitments are referred to and not general commitments, for example by way of legislative acts. This is also the reason why Art. II (2)(c) would be very much an empty base unless understood as referring to contracts.[...]".*[675]

1024. The obligations of the State have to be, therefore, specific, and have to have been assumed by the State with respect to a particular investor, in a *vis-à-vis* relationship, as stated by the Tribunal in *SGS v Philippines*:

> *"[T]he host State must have assumed a legal obligation, and it must have been assumed vis-àvis the specific investment-not as a matter of the application of some legal obligation of a general character. This is very far from elevating to the international level all the 'municipal legislative or administrative or other unilateral measures of a Contracting Party*[676]*."*

1025. In fact, in almost every case, the litigation that has grown up around the interpretation and scope of umbrella clauses has had to do with contracts concluded between a State and an investor, but not with the legal framework of the receiving State, which reflects, de facto, the conviction that legislative acts are excluded from the sphere of the umbrella clause.

(b) Interpretation of Article 10 (1) final subsection ECT by Doctrine and arbitral Precedents.

1026. The "ECT Reader's Guide", produced by the ECT Secretariat, is relevant as an ECT interpretive element. This Reader's guide defines the provision of the final subsection of article 10(1) of the ECT under the significant label "*Individual*

[675] Noble Ventures, Inc v Rumania, ICSID Case No. ARB/01/11, Award of 12 October 2005, para. 51.RL-0026

[676] Société Général de Surveillance S.A. v. The Philippines, ICSID Case No. ARB/02/6, Decision on objections to the jurisdiction, of 29 January 2004, para. 166.RL-0024

investment contracts", and defines its scope by placing emphasis on its grounding, which is none other than the international principle of *pacta sunt servanda*[677]:

> *"According to Article 10 (1), last sentence, each CP shall observe any obligations it has entered into with an investor or an investment of any other CP. This provision covers any* ***contract*** *that a host country has concluded with a subsidiary of the foreign investor in the host country, or a* ***contract*** *between the host country and the parent company of the subsidiary.*
>
> *Respect of the international principle of "pacta sunt servanda" is of particular relevance in the energy sector where most major investments are made on the basis of an* ***individual contract*** *between the investor and the state. Article 10 (1) has the important effect that* ***a breach of an individual investment contract*** *by the host country becomes a violation of the ECT. As a result, the foreign investor and its home country may invoke the dispute settlement mechanism of the Treaty" (emphasis added).*

1027. With regard to this, the Claimant intends to include a State regulatory standard within this scope, regardless of whether there is a specific *consensual* relationship between the State and the investor or the investment. This represents a lack of awareness of the essence of the umbrella clause, which authors like Wälde call the "*pacta sunt servanda clause*", thus emphasising its "*contractual*" nature. In this regard, Wälde notes that:

> *"The umbrella clause and investment treaties target an abuse of the state when situated in its dual role as both contract party and regulator."*[678]

1028. To these effects, the arbitral Precedent of the *AES Summit Generation Limited vs. Hungary* case is relevant. This precedent, in view of the fact that Hungary features in the list of countries in annex IA of the ECT, denied that an investor could base their claim on Article 10 (1) last subsection ECT and argued their lack of jurisdiction:

> *"This Tribunal cannot rule on the scope of contract obligations and consequently cannot determine if the Claimants' contract rights under the 2001 Settlement Agreement – and the 2001 PPA – were eviscerated because it has no jurisdiction to do so."*[679]

1029. The Claimant has invoked as a sole Precedent that applies the ECT the Award in the Plama Consortium vs Bulgaria case. However, the Tribunal's attention is drawn to the fact that the conclusion reached by the Claimant is completely biased.

1030. In effect, the Claimant states that "the wording of this [Umbrella] clause in Article 10(1) of the ECT is wide in scope since it refers to "any obligation". An analysis of the

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[677] The Energy Charter Treaty: A Reader's Guide, June 2002, pag. 26.RL-0053

[678] The "Umbrella" Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases. Thomas W. Wälde. HEINONLINE 6 J. World Investment & Trade 183 2005, pag. 226RL-0055.

[679] AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary, ICSID Case No. ARB/07/22; Award 23 September 2010.RL-0039.

ordinary meaning of the term suggests that it refers to any obligation regardless of its nature, i.e., whether it be contractual or statutory"[680] However, this Award in no way concludes this statement. Rather, it considers the existing positions in the precedents (of which the Claimant cites the position that interests them) and given that the dispute arising between the parties derived from a contract, it does not consider it necessary to decide whether Article 10(1) last subsection covers commitments arising from the legal rules:

> *"Since the Parties are exclusively concerned with the application of the last sentence of Article 10(1) ECT to [contractual obligations],, the Tribunal need not extend its analysis any further."*[681]

1031. Accordingly, the Claimant has not provided a single Precedent that applies the ECT and accepts its theory, according to which, specific commitments arise from general rules "entered into" with investors.

1032. In short, the scope of the umbrella clause in Article 10 (1) last subsection of the ECT covers the contractual obligations or *specific* commitments that are assumed by the State, we insist, in the framework of a bilateral contract or a similar instrument (administrative contract, concession or license between the State and the investor). It has been interpreted as such by a relevant arbitration Precedent, authors and the ECT's Reader's Guide.

1033. In this case, the Spanish regulatory Framework, including RD 661/2007, is *erga onmes* by nature and its not aimed at any group. Tens of thousands of Spanish and foreign people were the subjects covered by this regulation. The claimed Regulation is not, therefore, the object of this final subsection of Article 10(1) of the ECT.

(c) The case law and doctrine invoked by the Claimant do not abet its interpretation of the umbrella clause of the ECT.

1034. The Claimant cites certain arbitration rulings in support of its thesis. However, below it will be verified that the Claimant's citations do not allow its theory to be upheld.

1035. The Claimant party cites international decisions that apply Treaties other than the ECT, to attempt to show that the final subsection of article 10 (1) of the ECT covers obligations arising from legislation and other unilateral acts. They are not therefore relevant to the application of the ECT standard.

1036. Additionally, the Claimant does not conduct any analysis that might uphold its view that such decisions support its thesis, as it does not justify the similarity of reason between (1) the invoked treaties and (2) the commitments of these States, with this

[680] Footnote 648 of para. 454

[681] *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24. Award of 27 August 2008, para. 187. RL-0034.

Case. This notwithstanding, its thesis in this Case could not even be conceded to by examining the Awards that it invokes.

(a) The Claimant claims the Partial Award of the *Eureko B.V. v. Poland* case of 19 August 2005. This case analysed an alleged breach by Poland of a purchase contract entered into with Eureko B.V. The award analyses the origin and evolution of the umbrella clause. In this sense, it comments on the interpretation given in the award of *SGS v. Pakistan* (also cited by the Claimant). Demeriting the SGS v Pakistan Award, the Tribunal in the *Eureko v. Poland* case accepts the interpretation of the *SGS v. the Philippines* Award (which supports the theory of the Kingdom of Spain).

Therefore, the Eureko v. Poland Award does not interpret "*any obligation*" as obligations other than those arising from a contract. Conversely, it rules out the interpretation of the Pakistan Award with the interpretation of the Philippines Award: the umbrella clause only protects obligations arising from specific State-investor bilateral relations. Furthermore, the Eureko v. Poland Award adds:

> *"The Tribunal adds to the considerations advanced in the Philippines Award its conclusion that to give effect to the plain meaning of an umbrella clause by no means renders the other substantive protections of a BIT superfluous. As Professor Scheuer points out in his cited article, "The BIT's substantive provisions deal with non-discrimination, fair and equitable treatment, national treatment, MFN treatment, free transfer of payments and protection from expropriation. These issues are not normally covered in contracts"*"[682]

(b) The Claimant also claims several Awards pertaining to Argentina, in which there are *specific* commitments between the State and investors through concessions or licenses. It cites among these Precedents the Cases LG&E v. Argentina and *Enron v. Argentina*[683]. These awards refer to the BIT between the United States and Argentina. Therefore, even rejecting the analogy between the BIT and the ECT, the criterion contained in the Decisions claimed by the Claimant has been rectified in other subsequent arbitral Precedents that apply the same United States-Argentina BIT, such as the El Paso v Argentina Case.

(c) The claimant once again reaches a biased conclusion of the El Paso Case. In the award in the *El Paso v. Argentina* case that its cites, the paragraph alluded to in the Memorial on the Merits is remarking upon the SGS v. Pakistan Case. In fact, the decision of the Tribunal in its final Award requires there <u>to be an investment agreement between the parties in order for the umbrella clause to be applicable:</u>

> *"The Tribunal has already decided that El Paso has no contract claim based on contracts or licenses and that there is no investment agreement entered into by El*

[682] Partial Award of Jurisdiction and Background to the case of Eureko B.V. against the Republic of Poland, dated 19 August 2005, para. 258RL-0043.
[683] Memorial on the Merits, paras. 503 to 508.

> *Paso. As a consequence, the question of their elevation to the level of a treaty claim does not arise."* [684]

In this same regard, refuting the LG&E and Enron Awards, we should cite the Ad hoc Committee Decision for the annulment in the *CMS v. Argentina* case[685]:

> *"In speaking of 'any obligations it may have entered into with regard to investment,' it seems clear that Article II(2)(c) is concerned with consensual obligations arising independently of the BIT (...) They do not cover general requirements imposed by law. [...]*
>
> *The effect of the umbrella clause is not to transform the obligation which is relied on into something else; the content of the obligation is unaffected, as is its proper law. If this is so, it would appear that the parties to the obligation (i.e., the persons bound by it and entitled to rely on it) are likewise not changed by reason of the umbrella clause" (Emphasis added).*

1037. In summary, the rationale of the Claimant with regard to the Awards invoked does not apply to this case. The Arbitral Tribunal for the Enron Case analysed the extent to which contractual obligations assumed by the State had been breached, for which purposes it analyses changes in legislation. But this does not mean that the protection clause includes legislative actions and general provisions. The regulatory changes were only analysed with regard to their influence concerning the *agreement* signed between both.

1038. Furthermore, unlike Argentine laws analysed by the Award claimed by the Claimant party, RD 661/2007 does not contain any *specific* obligation in relation to the investor or foreign investment. Any attempt to liken Spanish legislation to Argentine gas legislation is invalid and wrong. This is due to the fact that the Argentine regulatory framework was more interventionist, requiring intervention in the energy Sector through administrative concessions. These concessions determine a specific relationship between Investors and the host State.

(d) The Kingdom of Spain has not become bound "*vis à vis*" the Claimant through unilateral acts.

1039. As explained, RD 661/2007 is a piece of legislation passed by the Spanish Government as part of its regulatory powers. This legislation applies to Plant owner companies and to any electrical energy producers included in its scope of application. Furthermore, the scope of application of this regulation was not limited to a few subjects who met *subjective* requirements, rather it applied to those who met the *objective* requirements established in the legislation.

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[684] El Paso Energy International Company vs Argentine Republic (ICSDI Case No. ARB/03/15, Award, 31 October 2011, para 533. RL-0041.

[685] CMS Gas Transmission Company v. Argentine Republic (ICSID Case No. ARB/01/8), Annulment ad hoc Committee Decision, 25 September 2007, RL-0031.

1040. The *specificity* requirement of the umbrella clause demands that an obligation "*with an Investor or an Investment of an Investor*" must exist. RD 661/2007 was directed at any owner of an electrical plant, regardless of both its nationality and the origin of funds with which it is financed. This has already been declared as such by the Arbitral Tribunal in the Charanne Case:

> *"the Tribunal concludes that Spain has made no specific commitment to the Claimants. (para. 494)*
>
> *The conclusion drawn by the Tribunal, i.e. that in the absence of a specific commitment the Claimants could not reasonably expect that the applicable regulatory framework provided in RD 661/2007 and RD 1578/2008 would remain unchanged, is backed by case law from the highest courts in Spain. Prior to the investment, these courts had clearly established the principle that domestic law could modify the regulations in force.*
>
> *Indeed, Spanish law left wide open the possibility of modifying the remuneration scheme applicable to photovoltaic energy."*[686]

1041. The Claimant is attempting to obtain a specific undertaking from the alleged Agreement of June 2010 between the Ministry and the Wind Sector. However, neither is the last subsection of article 10(1) ECT applicable in its favour, because it requires the specific compromise to be vis-à-vis with the investor. This has been expressly ratified by the Plama Case Award, invoked by the Claimant:

> *"In any case, these obligations must be assumed by the host State with an Investor" (Original emphasis)*

1042. In this Case, the Claimant itself recognises that these were allegedly undertaken by Spain "with the wind industries"[687], not with this party or with its investment

1043. In any case, it is admissible to refute that there ever existed the alleged "specific commitment" assumed with the Wind Sector. It has been substantiated that in August 2010, just one month following the alleged "Agreement", the Wind Sector (95% represented by the AEE Association) neither declared nor upheld that there was any commitment whatsoever in its favour:

> *"any review of the remunerative regime set out in RD 661/2007 must necessarily guarantee the reasonable return on investments"[...]*
>
> *"It is true that, in relation to these types of retroactive modifications, that the Supreme Court has declared that there is no "unmodifiable right" to the economic regime remaining unchanged and that "the prescriptive content of Law 54/1997, of 27 November, on the Electrical Sector,* ***neither leads to the setting in stone, or freezing of the remuneration regime*** *for owners of special regime electrical*

[686] Award of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, of 21 January 2006, paras. 494, 504 and 505.RL-0049.
[687] Memorial on the Merits, para. 179

> *energy facilities, nor the non-changeability of this regimen", **thus recognising a relatively broad margin to the "ius variandi" of the Administration in a regulated sector in which general interests participate.***[688] *(Emphasis added)*

1044. What is true is that there was no specific undertaking to set in stone, neither in favour of the Associations of the RE Sector nor in favour of the claimant nor in favour of its investment. In fact, this alleged commitment has also already been denied in the Charanne Case Award:

> *"as has been stated in previous paragraphs of this award, in the absence of a specific stability commitment, an investor cannot have a legitimate expectation that a regulatory framework such as the one being discussed in this arbitration will never at any time be modified to adapt it to the needs of the market and public interest.*
>
> *The Tribunal therefore concludes that the Claimants could not have the reasonable expectation that RD 661/2007 and RD 1578/2008 were not going to be amended during the useful life of their facilities."*[689]

1045. In any case and, moreover, neither the AEE nor PROTERMOSOLAR, associations that are party to the alleged agreement, have invoked the existence of the appeals that have been filed with the Supreme Court ruled on through different Judgements of the Supreme Court[690]. On this point, with regard to the appeal lodged by the AEE, the alleged counterpart of the agreement reached with the Government, the Supreme Court states:

> *"In this case, there is of course no type of commitment or external sign, or at least none is invoked in the claim, made by the Administration to the appellants in relation to the immutability of the regulatory framework in force at the time of the start of their activity of generating energy from renewable sources."*[691] *(Emphasis added)*

1046. Therefore, it is clear that the Claimant cannot be linked through an alleged agreement whose existence has not even been acknowledged by those that would have executed it

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[688] Arguments by the AEE to the CNE during proceedings with the Electricity Advisory Board concerning the Draft Royal Decree that regulates and modifies certain aspects relating to the special regimen, pag- 2 and 3. R-0166.

[689] Award of Charanne B.V. and Construction Investments S.A.R.L v. the Kingdom of Spain, of 21 January 2006, paras. 510 and 511. RL-0049.

[690] Judgement 1730/2016 of the Supreme Court, of 12 July 2016, which rejects the appeal filed by the Wind Power Business Association (AEE) against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 456/2014). (R-0265) and Judgement of the Supreme Court 1964/2016, of 22 July 2016, which rejects the appeal filed by PROTERMOSOLAR against Royal Decree 413/2104 and Ministerial Order 1045/2014 (App. 500/2014). R-0278

[691] Judgement 1730/2016 of the Supreme Court, of 12 July 2016, which rejects the appeal filed by the Wind Power Business Association (AEE) against Royal Decree 413/2014 and Ministerial Order 1045/2014 (App. 456/2014). R-0265

1047. In short, RD 661/2007 and 1614/2010 do not contain any of the requirements established by the doctrine claimed by the Claimant party, to allow them to unilaterally create obligations or *specific* commitments covered by the umbrella clause of the final subsection of article 10(1) of the ECT.

(e) Conclusion.

1048. The Claimant's claim concerning the breach of the standard laid down in article 10(1) of the ECT should be dismissed, pursuant to its literal interpretation in article 10 (1) final subsection. Neither the Claimant as investor, nor the Claimant's investment are covered by the umbrella clause of the ECT, by not having contracted the Kingdom of Spain with them, *vis-à-vis*, *specific* commitments to freeze the regime of RD 661/2007 in their favour.

1049. Based on the foregoing, the Claimant's petition must be dismissed and declared that Spain has not breached the final subsection of article 10(1) of the ECT.

V. THE CLAIMANT HAS NO RIGHT TO THE REQUESTED REPARATION

1050. In paragraphs 467 et seq. of their Memorial on the Merits, the Claimant briefly states the alleged obligation that Spain would have to restore "*the legal and regulatory regime applicable when the Special Regime was abrogated*". Secondarily, the Claimant sets out a claim for damages caused by "*Spain's breaches of its obligations under the ECT*"[692].

1051. Firstly, it should be mentioned that the foregoing request encloses a contradiction in itself: the legal and regulatory regime, from 1997 to present day, has always granted the same thing, a reasonable retrun. As such, there is no claim to be made if the Claimant has not been deprived of anything nor is there any damage to speak of.

1052. Secondly, as it has been established in the foregoing sections that Spain has not violated the provisions of the ECT in any way, the Respondent is under no obligation whatsoever to indemnify the Claimant.

1053. Therefor, this section V is submitted subsidiarily in the event that, in first place, the Tribunal were to accept jurisdiction over this dispute and, in addition, in second place, if the Tribunal were to find that there was any non-compliance on the part of the Kingdom of Spain with any precept of the ECT.

1054. Additionally, this section is complemented by the content in the economic-financial report by experts from Accuracy of 10 February 2017. This report shows how an "Asset Based Valuation" (section V) reflects that there is no damage.

1055. On the other hand, we must exercise full reserve regarding the formulation of subsequent objections to the calculation of the requested compensation, including: the

[692] Memorial on the Merits para. 467.

incorrect nature of the various parameters considered; the contributory fault of the Claimant; the Flow-Through of the hypothetical damages; the incorrect determination of the valuation dates considered for the FET standard; the inadmissible immunity to business risk; or the necessary discounts for marketability, amongst others.

1056. Regardless of the foregoing, the following arguments shall be made in this section (all of which we stress are subsidiarily and with full reserve regarding any subsequent objections to the *quantum*):

a) The alleged damages are completely and absolutely speculative.

b) The DCF method is not suitable for the concurrent circumstances, in accordance with the doctrine.

c) The return rates obtained highlight the speculative nature of the claim and the non-existence of any damage.

d) Subsidiary DCF calculations.

e) Subsidiarily: incorrect claim for interest.

f) Subsidiarily: unjustified "Tax Gross-Up".

A. <u>The supposed alleged damages are totally and absolutely speculative.</u>

1057. First and foremost, the alleged damages estimated in the Brattle report are not subject to compensation, as they are completely and absolutely speculative.

1058. In the Memorial on the Merits it is stated that compensation must be provided for the loss of historical and future cash flows, differentiating between the cash flows allegedly generated up to 20 June 2014 (a date randomly chosen by the Claimant as the appraisal date), incorrectly classified as "historical"[693], and those that would allegedly be generated from this date forth.

1059. However, said approach of distinguishing between "historical" flows and future flows fails to take into account the essential concept of regulatory useful life and omits the joint consideration of cash flows, past and future, in order to guarantee the reasonable return on the investments that were made. As a result, said approach should be fully rejected.

1060. By Law, wind farms and solar power plants are guaranteed reasonable returns, protected from market uncertainness and fluctuations. Precisely for this reason, it seems paradoxical that, with respect to an investment with a reasonable return guaranteed by Law, a privilege enjoyed by very few investors, the Claimant claims a violation of the FET standard.

1061. Faced with this Guarantee, the Claimant is aiming to uphold a claim based on a simplistic comparison of scenarios (“real” and but-for).

[693] Statement of Claim, para. 485.

1062. Furthermore, in this arbitration, it should be emphasised that despite having recently disposed of the investment, the Claimant ignores the real value of the disposal in its claim. This means that despite having certain information available, it prefers to make long-term hypothetical estimates.

1063. We, as the Supreme Court of the Kingdom of Spain in similar circumstances, understand that the alleged damages have not even been minimally proven. The long time horizon, together with the fact that nothing guarantees that the remuneration shall remain petrified in the current form (always ensuring reasonable return), makes the calculation of damage done speculative.

1064. This reasoning is certainly no novelty to the Claimant, as it was clearly embodied in nearly a hundred judgements in which the Supreme Court has known of modifications to the remuneration regime of renewable energies. Among them, mention can be made of the Judgement of 24 September 2012 that, in its Sixth Legal Basis, declares the following:

> *"In short, with regard to the expert report by the party, provided along with the statement of claim, for the purpose of quantifying the impact the application of Royal Decree 1565/2010, of 19 November, has on the profitability of projects, we will limit ourselves to reiterating that their conclusions cannot be accepted from the moment that they are based on extrapolations into a thirty year future of amounts, the determination of which lacks necessary rigour and certainty. With a "time frame" of limiting to 30 years the right to earn the regulated tariff, the loss of "asset value" of the photovoltaic plants, affirmed in the reports in question, is not demonstrated. As on previous occasions, we refer to that already stated in the judgement of 19 June 2012 (appeal 62/2011) and in ulterior judgements"*[694].

1065. The damages being claimed are, therefore, speculative and hypothetical. In short, the Claimant in no way fulfils the burden of proof required to support this claim.

B. <u>The DCF method is inappropriate due to the concurrent circumstances, in accordance with the doctrine</u>

1066. As the damages are merely speculative, the Claimant had no choice but to use a similarly speculative method for their calculation.

1067. As such, the Claimant has used the DCF method to calculate the market value, considering the future cash flows of the thermosolar power plants and the wind farms.

1068. Without ignoring, obviously, the broad application of the DCF method, this case presents a series of circumstances that strongly advise against its use. In this respect, arbitration case-law is clear and emphatic about vetoing the application of the DCF method when it is excessively speculative.

[694] Judgement from the Third Chamber of the Supreme Court, 24 September 2012, Sixth Legal Basis. R-0147.

1069. In this section, we shall show how arbitration doctrine and case-law fully reject, in certain circumstances, speculative methods such as DCF and, in turn, grant greater credibility to more reliable methods such as those based on assets.

1070. That is, arbitration doctrine and case-law tend towards verifying that investors get their investments back plus reasonable return on the costs of said investments.

1071. In this respect, *Ripinsky* warns that the use of DCF could, in many cases, lead to the overvaluation of financial impacts based on future events:

> *"[…] the future is uncertain and looking into the future requires one to make numerous assumptions and subjective choices regarding future market conditions, sales, costs, additional capital requirements, currency fluctuations, rates of inflation, levels of risk, etc. The end-result is thus inherently somewhat speculative. This explains why litigating parties' experts frequently produce DCF valuations with diverging results. Noting this tendency, Stauffer has warned against a 'Cinderella effect', that is, overvaluation of assets by claimants in their DCF valuations"*[695] *(emphasis added).*

1072. Furthermore, there are various circumstances in the present case that prove both the inadmissibility and the impossibility of using the DCF method:

(a) The fact that it involves a capital-intensive business, with a significant asset base. Practically all its costs arise from investing in tangible infrastructure. There are no relevant intangible assets to analyse.
(b) The high dependency of the cash flows on external, volatile and unpredictable elements, such as the price of the pool, inter alia.
(c) The long-term nature of the forecasts.
(d) The disproportion between the alleged investments (and the alleged assumed risk) and the amount claimed, evidenced by the returns obtained.

1073. Bearing in mind the above elements, we will see different doctrinal pronouncements in this regard. We can thus verify that the DCF has been rejected on numerous occasions in cases such as this one, in which a series of characteristics arise:

> *"The DCF method has been rejected by tribunals on several grounds including:*
>
> *(i) lack of sufficiently long performance record;*
> (ii) *failure to establish future profitability of the investment;*
> (iii) *lack of sufficient finances to complete and operate the investment; and*
> (iv) *large disparity in the amount actually invested and the FMV claimed.*"
> (emphasis added)

[695] *Damages in International Investment Law*, Sergey Ripinsky with Kevin Williams, British Institute of International and Comparative Law (BIICL), 2008, pag. 200 and 201. RL-0057.

1074. For these purposes, it is advisable to remember, concerning the burden of proof, what was stated in the Award in the *Gemplus v. Mexico* case:

> *"Burden of Proof: Under international law and the BITs, the Claimants bear the overall burden of proving the loss founding their claims for compensation. If that loss is found to be too uncertain or speculative or otherwise unproven, the Tribunal must reject these claims, even if liability is established against the Respondent (...)"*[696]

1075. In fact, as the Award in the *Rusoro v. Venezuela* case establishes:

> *"DCF is not a friar's balm which cures all ailments (...)*
>
> *Small adjustments in the estimation can yield significant divergences in the results. For this reason, valuations made through a DCF analysis must in any case be subjected to a "sanity check" against other valuation methodologies"*[697]

1076. Therefore, this "sanity check" of the DCF employing other valuation methodologies, has not been carried out by the Claimant. As the experts from Accuracy state in section VIII.2 of their report, the supposed "reality check" is fictitious and imaginary since it is based on an insignificant number of operations that do not even comply with the most basic requirements in order to be comparable (amongst others, there is no reference to operations in the same sector, or to plants with similar technical features, or to operations taking place near to the valuation time, etc.).

1077. Additionally, in Section VIII.3, the section entitled "Numerous indicators and experts agree on the positive effects of the new regulatory framework", a more genuine reality check is carried out by Accuracy. Therein is extracted, amongst other relevant documentation, the information provided to their investors by two yieldcos, Saeta Yield and Atlántica Yield, the latter being listed on the Nasdaq. This public information, submitted to the scrutiny of the financial markets, confirms that following the measures under dispute, we find that renewable energy plants in Spain are assets that provide a reasonable return, which has not fallen, and that the regulatory risk has been reduced.

1078. It should also be emphasised that *Rusoro v. Venezuela* lists practically the same requirements and characteristics as to whether or not a DCF is appropriate, which we already mentioned when we quoted *Rypinski & Williams* and *Marboe*.

1079. Consequently, given the inadmissibility of the DCF, the Arbitral Tribunals have frequently used, to assess the existence of damages, methods based on the costs of the assets, analysing if the latter are recovered and a reasonable return is obtained on them:

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[696] Gemplus, S.A., SLP, S.A. and Gemplus Industrial, S.A. de C.V. v. United Mexican States, ICSID Case No. ARB(AF)/04/3 & ARB(AF)/04/4, Award, 16 June 2010. Para. 12-56. RL-0032.

[697] Rusoro Mining Limited v. Venezuela, ICSID CaseNo. ARB(AF)/12/5, Award of 22 August 2016. Para. 760 RL-0037.

> *"The method of calculating FMV by reference to actual investments has proved quite popular in arbitral practice. […] they have turned to the historic costs of investment as the relevant approach to valuation when the evidence necessary to apply an income base method has been considered insufficient"*[698]*. (emphasis added).*

1080. For its part, *Marboe* stresses the advantages of methods based on assets, less speculative and more simple to apply:

> *"The advantage of this approach is that, in comparison with the income capitalization approach, it appears to be much easier and less speculative. It looks into the past and not into the future and is seemingly much simpler to apply than the highly complex forecasting and discounting processes"*[699] *(emphasis added).*

1081. Again, *Marboe* it refers to the normal returns and the book value as an obligatory reference, particularly when the investment is very recent. Likewise, it refers to the reasonable rates of return:

> *"Experienced economists point to the fact that the significance of the ABV usually works with companies with normal rates of return. Extraordinarily high or low rated are rather rare and cannot be explained or be appropriately reflected by this method. Stauffer notes that extraordinarily high and 'abnormally poor performance must be explained, since, by definition most firms or ventures realize "average" rates of return'. This is also confirmed by Lou Wells who supports the use of the book value method for recently established businesses*
>
> *When the investment is very recent, or still in process of being made, there is an obvious and often easier alternative to using NPV of future cash flow to determine FMV. If the project was expected to generate 'normal' rates of return for the business, then the amount of investment itself provides a reasonable starting point for determining FMV. In most cases, the FMV of recently acquired assets is unlikely to be substantially different from the cost of those assets. Cost of investment will approximate what a buyer might pay; moreover, the investor who receives his investment back can invest the sum in another project, earn normal returns, and be equally well off. […]"*[700]*(emphasis added).*

1082. Indeed, the foregoing is particularly appropriate when the date of acquisition of the assets is close to the appraisal date. As such, *Ripinsky* stresses:

> *"On the date a particular asset is bought, the price paid for it normally represents the market value of this asset. Accordingly, on that date, the price*

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[698] *Damages in International Investment Law*, Sergey Ripinsky with Kevin Williams, British Institute of International and Comparative Law (BIICL), pag. 227. RL-0057.
[699] *"Calculation of Compensation and Damages in International Investment Law"*, Irmgard Marboe, Oxford, Oxford International Arbitration Series, 2009, pag. 267. RL-0058
[700] *"Calculation of Compensation and Damages in International Investment Law"*, Irmgard Marboe, Oxford, Oxford International Arbitration Series, 2009, pag. 275 and 276. RL-0058.

reflected in the buyer's books represents the asset's book value and market value at the same time."[701]

1083. Going into further detail on the same idea, Sabahi talks about the recovery of the costs plus a return on the same as an appropriate method of compensation:

> *"In Metalclad v Mexico, for example, […] considering that the investment was made recently and lacked a history of profitability, held that the investor could only recover its actual investment […] sunk costs in this case may have approximated the fair market value, because the investment was made recently.*
>
> *Another example is the case of Wena v Egypt […]. The tribunal […] did not consider DCF appropriate because the ventures were new and the claimant has not proved satisfactorily that they would have become profitable. Instead, the tribunal awarded the value of the investment actually made […]."*[702] *(emphasis added).*

1084. In short, agreeing with the factual elements mentioned above, we understand that all of them have to be considered by the Honourable Tribunal, in order to rule out any estimate of value based on a DCF in this case.

C. <u>The rates of return obtained reflect the speculative nature of its claim and the absence of any damage.</u>

1085. In this section we shall check with figures how the DCF of Brattle provides aberrant results, thus verifying that this method of valuation should be discarded. In addition, we will see that the return obtained by the facilities of the Claimant exceeds the reference rates, and therefore no damage to the investments can be argued. To do this, we will primarily refer to what is reflected in section III of the Accuracy report.

1086. The experts from Accuracy thus found that:

a) The Claimant has disposed of its entire investment, obtaining a substantial capital gain.

b) The return obtained by the Claimant in the operation was even greater than expected.

c) The Claimant's claim is based on an unrealistic valuation of the assets that lacks any foundation.

d) The Claimant is attempting to offer the Tribunal a Current scenario that is absurd and irrelevant, considering that the investment was disposed of in 2016 for a specific, determined price.

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[701] *Damages in International Investment Law*, Sergey Ripinsky with Kevin Williams, British Institute of International and Comparative Law (BIICL), 2008, pag. 221. RL-0057.

[702] Compensation and Restitution in Investor-State Arbitration – Principles and Practice, Borzu Sabahi, Oxford, International Economic Law, 201, pag. 132-133. RL-0059.

1087. Indeed, first of all, far from having suffered damage or deterioration to the value of its investment, the Claimant has obtained substantial capital gains on it, as a result of its disposal on 8 February 2016 for 133 million euros. If the purchase price of the Plants in 2012 was 91 million euros, as stated by Accuracy, it can be deduced that the Claimant has obtained an effective capital gain of 42 million euros between the two dates, not forgetting the cash flow obtained during the period.

1088. Secondly, this capital gain, together with the above-mentioned cash flow, involves a return after tax for the Claimant of 11.2%

1089. This return effectively obtained is higher than the one taken into account (cost of equity, Ke) when the investment was analysed, which was 10.5%.

1090. Thirdly, the claim (the But-for) made by the Claimant would involve revaluing the generating assets 127% in two years, which lacks any real economic foundation. There would be no reason for such a revaluation in such a short period of time.

1091. Finally, it happens that despite having a disposal price, the Claimant wishes to inflate its figures by undervaluing the Current price with an estimate of future cash flow when it is already known as information what the Claimant obtained from the investment. Its approach is, at the very least, absurd.

1092. From the return rates effectively obtained by the Claimant, both the lack of existence of any damage and the speculative nature of its claim must of necessity be concluded. Considering that, furthermore, they are not based on future estimates but on the fact that the return and the capital gain obtained from the investment relate to accurate information, since the investment was disposed of in 2016, the claim made by the Claimant can be classified as plainly and simply rash.

D. Subsidiary calculations using DCF

1093. To simplify comparisons, and given that the object of the DCF subsidiary calculations involve proving the volatility of the method in this case, and the mistaken calculation of Brattle, Accuracy has based itself -to the extent possible- on the Brattle method.

1094. The experts from Accuracy have thus calculated the financial impact of the measures, pursuant to a DCF method, which gives the following results[703]:

[703] Accuracy Report, section VI.3.

Table 1 - Economic impact of the Measures using Brattle's DCF method corrected

	€m 20/06/2014		But For	Actual	Impact
			[a]	[b]	[b] - [a]
	Historical FCFE, fully discounted to valuation date		**18.5**	**(2.0)**	**(20.5)**
	Marmellar		*2.8*	*0.7*	
	La Boga		*15.7*	*(2.7)*	
*	*Percentage of stake*	*98.7 %*	*98.7 %*	*98.7 %*	
=	**Historical Bridgepoint FCFE discounted tovaluation date**		**18.2**	**(2.0)**	**(20.2)**
	Marmellar		*2.7*	*0.7*	
	La Boga		*15.5*	*(2.6)*	
	Company value as at valuation date (future flows)		**381.6**	**-**	**n**
	Marmellar		*53.1*	*-*	
	La Boga		*328.6*	*-*	
+	Leverage effect		-	-	
	Marmellar		*-*	*-*	
	La Boga		*-*	*-*	
+	Tax shield debt		30.0	-	
	Marmellar		*1.5*	*-*	
	La Boga		*28.4*	*-*	
+	Net financial position on valuation date		(281.6)	-	
	Marmellar		*(26.5)*	*-*	
	La Boga		*(255.2)*	*-*	
=	**Value of shareholders' equity at 100% before discount**		**130.0**	**-**	**n**
	Marmellar		*26.6*	*-*	*n/a*
	La Boga		*73.4*	*-*	*n/a*
*	Percentage of stake	*98.7 %*	*98.7 %*	*100.0 %*	
-	Illiquidity discount		*18.0 %*	*-*	
=	**Value of Claimant's shareholders' equity as at 20/06/2014**		**105.2**	**126.0**	**20.8**
	Marmellar		*21.5*	*-*	*n/a*
	La Boga		*59.4*	*-*	*n/a*
=	**Value of Claimant's shareholders' equity as at 20/06/2014**		**123.4**	**124.1**	**0.7**
	Marmellar		*24.3*	*n/a*	*n/a*
	La Boga		*74.9*	*n/a*	*n/a*
	Pre-award interest				0.0
=	**Impact of the Measures for the Claimant in Nov. 2018**				**0.7**

Source: Corrected Brattle DCF model on 20 June 2014. Attached Document ACQ-0001.

1095. In other words, even when using a speculative method such as DCF, the result is obtained that the value of the Claimant's investment has been increased by 0.7 million euros thanks to the measures. Which, furthermore, is consistent with the fact that the Claimant has obtained significant capital gains from the disposal of the investment.

1096. Discrepancies between the different DCF (by Brattle and Accuracy) derive from the different parameters that are considered.

1097. It should also be highlighted that Accuracy has considered a useful life of 25 years for the plants compared to the 30 years that were modelled. Furthermore, Accuracy

(contrary to Brattle) has considered that the But-for scenario conditions would obviously entail a greater risk and greater levels of uncertainty than the Current scenario. Income would be subject to a greater risk in the But-for scenario. In fact, the framework that we encounter in the Current scenario under current legislation is stable, more predictable and with a lower risk. This is demonstrated without reservation by the assessments of the market players and the numerous transactions that have occurred since the adoption of the contested measures. It is logical that these considerations will have repercussions on the different discount rates to be considered, and on the different marketability discounts to be applied. Finally, inevitably, the valuation in the Current scenario is identified with the price of the disposal of the investment by the Claimant in 2016, thus avoiding speculative calculations.

1098. In conclusion, we have found that, even when using speculative DCF methods, there are no grounds at all for talking about damage in this arbitration.

E. <u>Subsidiarily: incorrect identification of the interests.</u>

1099. By explanatory logic, let us now address how the Claimant treats interest, for which purpose the Claimant claims interest prior to (pre-award) and after the award (post-award).

1100. Regarding the pre-award, it calculates this according to the "Spanish Government 10-year bond". Meanwhile, the experts from Accuracy would consider a more reasonable reference to be a risk-free asset that is in line with the period of time that such interest is supposed to cover.

1101. Regarding the post-award, the Claimant states that the "*Tribunal should order post-award interest a rate higher*"[704]; this representation must of necessity be opposed to the above-mentioned punitive increase.

1102. In this respect, as the Tribunal pointed out in the *Vestey v. Venezuela* case in its award of 15 April 2016:

> *"First and foremost, the Tribunal does not find it appropriate for it to assume by anticipation that a sovereign state will breach a treaty obligation. Having said this, even if the assumption were made, <u>it would in any event not justify an interest rate incorporating the risk of defaulting on the payment of the award.</u> Indeed, accounting for this risk would mean seeking to repair a (hypothetical) breach of the ICSID Convention when this Tribunal's jurisdiction is limited to breaches of the BIT"*[705]*. (emphasis added)*

1103. Similarly, it is worth pausing a moment at the ILC Articles. Indeed, it is enough to refer to Comment (4) to Article 36:

[704] Memorial on the Merits, para. 538.
[705] Vestey Group Ltd v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/06/4, Award, 15 April 2016. Para. 445. RL-0068

> *"Compensation corresponds to the financially assessable damage suffered by the injured State or its nationals. It is not concerned to punish the responsible State, nor does compensation have an expressive or exemplary character…"*[706] *(emphasis added).*

1104. The inappropriateness of the punitive nature of the post-award interest is also reflected in the *National Grid v. Argentina* and *Micula v. Romania* cases. The *National Grid* award therefore takes a risk-free rate for the post-award interest:

> *"While the subject of post-award interest remains a matter in which arbitral tribunals have adopted a variety of approaches, the Tribunal considers that the function of post-award interest is essentially to protect the value of the Award against inflation. For this reason we have chosen this rate, which has been recognized as a "risk-free" rate"*[707]*. (emphasis added)*

1105. Similarly, the award in *Micula v. Romania* treats the pre- and post-award interest on the same level:

> *"As a preliminary matter, the Tribunal does not see why the cost of the deprivation of money (which interest compensates) should be different before and after the Award, and neither Party has convinced it otherwise. Both are awarded to compensate a party for the deprivation of the use of its funds. The Tribunal will thus award pre- and post-award interest at the same rate"*[708]*. (emphasis added)*

1106. In short, in accordance with the legal grounds and the arbitration doctrine extracted, it is obvious that the post-award punitive interest claimed by the Claimant is inappropriate.

1107. According to the above, it is evident that the interest is unjustified and has been incorrectly determined.

F. Subsidiarily: unjustified Tax Gross-Up.

1108. Finally, we find that the Claimant points out that the hypothetical damages should include "a gross up over the amount awarded for taxes". It further states that "the Claimants reserve their right to provide a figure for gross-up at a later stage"[709]. This request, made in a single paragraph, lacks further detail.

1109. In other words, the Claimant is claiming a "Tax Gross-Up" but does not state the tax (or taxes) in particular that would apply; nor the State in which said tax would be payable (the home country or the host country); nor, of course, does it offer any quantification, not even approximate, of its amount.

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[706] Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001. http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf RL-0069

[707] National Grid P.L.C. v. Argentina Republic, UNCITRAL, Award, 3 November 2008. Footnote 122. RL-0070

[708] Ioan Micula, Viorel Micula and others v. Romania, ICSID Case No. ARB/05/20, Award, 11 December 2013. Para. 1269. RL-0071

[709] Memorial on the Merits, para. 539.

1110. It is obvious that said claim, which is undetermined and indeterminable in view of the abstract terms in which it is made, has to be rejected outright.

1111. The terms of the claim for the Tax Gross-Up would place the Kingdom of Spain in a clear and obvious position of defencelessness, with no comment in this respect being necessary other than to point out its complete and absolute lack of justification.

VI. PETITUM AND RESERVATION OF RIGHTS

1112. In view of the arguments put forward in this writing, the Kingdom of Spain respectfully requests the Arbitral Tribunal that:

a) Declare its lack of jurisdiction over the claims of the Claimants or, if applicable, the inadmissibility of said claims.

b) Subsidiarily, in the event that the Arbitral Tribunal decides that it has jurisdiction to hear this dispute, to dismiss all the claims of the Claimants regarding the Merits, as the Kingdom of Spain has not breached the ECT in any way, pursuant to section III herein, with regard to the Merits.

c) Subsidiarily, to dismiss all the Claimant's claims for damages as the Claimant has no right to compensation, in accordance with section V herein; and

d) Order the Claimant to pay all costs and expenses derived from this arbitration, including ICSID administrative expenses, arbitrators' fees, and the fees of the legal representatives of the Kingdom of Spain, their experts and advisors, as well as any other cost or expense that has been incurred, all of this including a reasonable rate of interest from the date on which these costs are incurred until the date of their actual payment.

1113. The Kingdom of Spain reserves the right to supplement, modify or complement these pleadings and present any and all additional arguments that may be necessary in accordance with the ICSID Convention, the ICSID rules of arbitration, procedural orders and the directives of the Arbitral Tribunal in order to respond to all allegations made by the Claimant in regard to this matter.

Madrid, 10 February 2017

Respectfully submitted,

Diego Santacruz Descartin Fco. Javier Torres Gella