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

Yaroslav Petrov, Counsel
## ABOUT ASTERS

### Key facts

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<th>20+ YEARS OF EXPERIENCE</th>
<th>ONE OF THE LARGEST FIRMS IN UKRAINE</th>
<th>LAW FIRM OF THE DECade</th>
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<td>Since 1995</td>
<td>15 partners 70+ lawyers</td>
<td>Ukraine's Legal Awards 2016</td>
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<tr>
<th>NO.1 LAW FIRM IN UKRAINE</th>
<th>LAW FIRM OF THE YEAR: UKRAINE AND THE CIS</th>
<th>LAW FIRM OF THE YEAR (UKRAINE)</th>
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There is no universally applicable standard as to when investors’ expectations deserve treaty protection under the FET requirement; any evaluation will depend on the facts.

Two approaches to determining when investor expectations are reasonable so as to warrant treaty protection.

The first approach requires the host state to have made clear assurances to the investor regarding the specific business relationship, e.g. stabilization clause in a contract between investor and State (in Ukraine – law on production sharing agreements).

The second approach ‘expectations could be created based on assurances provided in generally applicable laws of a country, and more generally, upon the existing framework at the time of the investment’ (C.F. Dugan, D. Wallace Jr., N.D. Rubins, B. Sabahi, Investor-State Arbitration 502 (2008)).

The Tecmed arbitral tribunal explained, the host state should act ‘consistently, transparently, and in a predictable and rational manner’, so as not to ‘affect the basic expectations that were taken into account by the foreign investor to make the investment’. The tribunal in CMS v. Argentina similarly observed that the stability and predictability of the legal and regulatory environment is an important component of fair and equitable treatment.
LEGITIMATE EXPECTATIONS: APPROACHES (2/2)

- The **third approach** (presented in an UNCTAD paper “FAIR AND EQUITABLE TREATMENT UNCTAD Series on Issues in International Investment Agreements II” (2012) makes the legitimate expectation claim subject to qualifying requirements.

- This approach requires proof of the following elements to find a breach of legitimate expectations:
  - legitimate expectations may arise only from a state's specific representations or commitments to the investor, on which the latter has relied;
  - the investor must be aware of the general regulatory environment in the country and expectations must be reasonable, and founded on the political, socioeconomic, cultural and historical conditions prevailing in the state;
  - investors' expectations must be balanced against the legitimate regulatory activities of the host country.
A change in the host state’s regulatory framework will not necessarily lead to a finding of a breach of the FET guarantee.

In *Charanne v. Spain* the Tribunal concluded that Spain did not breach its FET guarantee under the ECT. As the tribunal noted, ‘in the absence of a specific commitment, an investor cannot have a legitimate expectation that existing rules will not be modified.’ The tribunal then observed that Spanish law pre-dating the investment allowed Spain to modify its solar energy regulations (and so such changes were objectively foreseeable), and that Spain’s commitments to investors were not ‘sufficiently specific’ to create an expectation of a frozen legal environment. The tribunal also rejected the investors’ claim (which relied on *CMS v. Argentina*) that Spain’s regulatory changes operated retroactively and therefore breached their acquired rights to operate under the initial incentive regime.

Is there unified approach as to legitimate expectations for legislative changes based on the recent RES cases?
CHARANNE V. SPAIN

• Having determined that RD 661/2007 and RD 1578/2008 do not constitute specific commitments to foreign investors, the Charanne v. Spain Tribunal opined that the investors’ legitimate expectations can nonetheless be frustrated by modifications of the existing regulatory framework provided that, in enacting such modifications, the State acted unreasonably, disproportionately or contrary to the public interest (Charanne v. Spain Award, paras. 513-516).

• As to the proportionality, the changes would not be proportionate if they are impulsive or unnecessary and amount to sudden and unpredictable elimination of the essential characteristics of the existing regulation.
BLUSUN V. ITALY (1/2)

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

- In particular, the arbitrators stated that:

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

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

• Other Spanish cases recently resolved, namely *Eiser v. Spain* and *Isolux v. Spain* are more in line with the opinion of the Charanne tribunal.

  • *Eiser v. Spain*: “...absent explicit undertakings directly extended to investors and guaranteeing that States will not change their laws or regulations, investment treaties do not eliminate States’ right to modify their regulatory regimes to meet evolving circumstances and public needs...” [emphasis added] (*Eiser v. Spain* Award, para. 362).

  • *Isolux v. Spain*: the award relied on “standard of reasonableness and proportionality” to assess whether the legislator changes infringe the investors legitimate expectations (*Isolux v. Spain* Award, para. 430).
CONCLUSIONS

• There is no universally applicable standard as to when investors’ expectations
deserve treaty protection.

• This is confirmed by recent RES cases.

• Regulatory changes will not frustrate legitimate expectations provided they are
reasonable, proportional and in line with the State’s public interests.
Counsel
Energy (oil & gas, renewable energy) • Dispute Resolution (cross-border litigation & arbitration)

Yaroslav focuses on energy law projects (oil & gas, electricity, renewable energy and energy efficiency) and dispute resolution (international arbitration, commercial litigation).
Yaroslav is a member of the roster of experts of Energy Community and included to the Panel of mediators of the Energy Community, co-chair of the Fuel & Energy Committee of European Business Association; member of Ukrainian Bioenergy Association, Ukrainian Wind Energy Association, Energy Committee of American Chamber of Commerce, Kiev Energy Research Institute.

Recognition:
- Recommended lawyer (Band 3) for Energy and Natural Recourses in Ukraine, Chambers Europe 2017
- Recommended lawyer in Energy, The Legal 500: EMEA 2017
- Recommended lawyer in Arbitration and Mediation, Best Lawyers 2017
- Notable practitioner for International Arbitration and Energy and Natural Resources, Ukrainian Law Firms 2017
- Rising star in Energy and Infrastructure, IFLR1000 2017
- Rising star in arbitration, Expert Guides 2016

Education:
Stockholm University, LL.M in International Arbitration; 2007
Donetsk National University, LL.M in Commercial Law, 2006
University of Nebraska at Omaha (USA), International Business and Management, 2004

Working languages: English, Ukrainian, Russian
CONTACT US

Leonardo Business Center,
14th floor, 19-21 Bohdana Khmelnytskoho St.
Kyiv, 01030, Ukraine

Tel. + 380 44 230 6000
Fax + 380 44 230 6001

E-mail: yaroslav.petrov@asterslaw.com
Website: www.asterslaw.com