Challenges for Foreign Direct Investment in the Solar Energy Sector

Nikos Lavranos*

Introduction

There are basically two main reasons for the importance of the renewable energy sector in general and the solar energy sector in particular. Firstly, the attention paid to climate change, and thus the reduction of CO_2 emissions, has increased dramatically over the past decade. This has resulted in binding obligations (such as the Kyoto Protocol) for states to reduce their CO_2 emissions. At the end of this year a UN conference on climate change will be held in Paris aimed at forging an agreement on further measures at a global level. As will be discussed below, specific binding targets have already been agreed upon within the EU. One obvious way to reduce CO_2 emissions is by increasing the extent of the production of renewable energy sources (RES).

Secondly, European states have recognised that high dependency on Russian gas and oil deliveries exposes the EU and its member states to great political and economic risks. In the past Russia has shown that it is ready to use gas and oil deliveries as a political tool to force its way, occasionally even by stopping deliveries. More recently, the annexation of Crimea and the war in Ukraine are further evidence of the unpredictability of Russia, which can have significant economic and political impact on the EU and its member states.

For these reasons, the promotion and support of RES within the EU has become a top priority and will continue to be of prime importance in the future in order to achieve both a reduction of CO_2 emissions and a reduction of dependency on Russian gas and oil deliveries.

* Head of Legal Affairs, Global Investment Protection AG and Secretary General of the European Federation for Investment Law and Arbitration (EFILA).

The EU law framework

With Directive 2009/28/EC, which is part of the EU's climate and energy package, the EU and its member states agreed to the following targets to be achieved by 2020:

- 20 percent cut in greenhouse gas emissions compared with 1990
- 20 percent of total energy consumption from renewable energy
- 20 percent increase in energy efficiency.

This Directive differentiates between the member states as to their individual targets. Accordingly, the targets range from 10 percent for Malta to 49 percent for Sweden. For Germany the target was set at 18 percent. These aims should be achieved on the basis of national action plans, which each member state must submit to the European Commission for approval.

More recently, the EU and its member states agreed to the following even more ambitious targets to be achieved by 2030:

- At least 40 percent cut in greenhouse gas emissions compared with 1990
- At least 27 percent of total energy consumption from renewable energy
- At least 27 percent increase in energy efficiency.

In order to achieve those targets, the EU member states implemented a number of different tools for the promotion of RES production. Generally, these tools consist of guaranteeing a fixed feed-in tariff (FiT) per kwh of produced energy for a certain period of time, various forms of subsidies and different types of tax breaks. These tools have led to an enormous increase in investments in the RES sector. The following numbers illustrate the investment volumes involved.

Global investment volumes in RES

According to the Renewable 2014 Global Status Report, global new investments in renewable power

and fuels – not including hydropower projects >50 megawatts (MW)-I – was an estimated 214.4 billion US dollars in 2013, down 14 percent versus 2012 and 23 percent lower than the record level reached in 2011. Including unreported investments in hydropower projects larger than 50 MW, total new investment in renewable power and fuels was at least 249.4 billion US dollars in 2013. The second consecutive year of decline in investment – after several years of growth – was partly due to uncertainty over incentive policies in Europe and the United States, and to supporting retroactive reductions in some countries.

Europe's renewable energy investment was down 44 percent from 2012. The year 2013 also saw an end to eight consecutive years of rising renewable energy investment in developing countries. Yet the global decline also resulted from sharp reductions in technology costs. This was particularly true for solar PV, which saw record levels of new installations in 2013, despite a 22 percent decline in dollars invested. Lower costs and efficiency improvements made it possible to build onshore wind and solar PV installations in a number of locations around the world in 2013 without subsidy support, particularly in Latin America. Considering only net investment in new power capacity, renewables outpaced fossil fuels for the fourth year running.

The solar PV market had a record year, adding more than 39 GW in 2013 for a total exceeding 139 GW. China saw spectacular growth, accounting for nearly one-third of global capacity added, followed by Japan and the United States. Solar PV is starting to play a substantial role in electricity generation in some countries, particularly in Europe, while lower prices are opening new markets from Africa and the Middle East to Asia and Latin America. Although it was a challenging year for many companies, predominantly in Europe, the industry began to recover during 2013. Module prices stabilised, while production costs continued to fall and solar cell efficiencies increased steadily. Many manufacturers began to expand production capacity to meet expected further growth in demand.

More specifically, investment volumes have increased significantly in several EU states in recent years. For example, Greece's photovoltaic capacity increased from 620 megawatts (MW) in 2011 to 2,600 MW in September 2013. Italy's solar energy regulations resulted in an increase in subsidies from 750 million euros in 2010 to 6.7 billion euros in 2013. Conversely, investors have invested over 50 billion euros in the Italian renewable energy sector in the past five years. In short, global investment volumes in the RES sector are huge. While investments are now dropping in the EU, they continue to grow in China, the United States and Japan.

The introduction of retroactive measures against RES

However, the overwhelming success of supporting schemes and the ensuing financial and economic crisis meant that many EU member states encountered serious budgetary problems. As a result, Spain, Italy, Greece, Rumania, Bulgaria, the Czech and Slovak Republics all decided to adopt retroactive measures for the reduction and ultimate abolishment of FIT tariffs, subsidies and tax breaks.

Since most investors in the solar energy sector are SMEs, the retroactive removal of the subsidies has created serious financial problems for many of them, pushing some into bankruptcy.

The benefits of international arbitration proceedings

As a result, a huge number of investment arbitration claims have been brought against those countries. As most of the affected investors come from other EU member states, they essentially have three avenues for pursuing their claims for compensation for damages suffered:

- International arbitration on the basis of the Energy Charter Treaty (ECT);
- International arbitration on the basis of Bilateral Investment Treaties (BITs);
- Judicial proceedings before the domestic courts of the host state.

However, judicial proceedings before the domestic courts of the host state entail serious disadvantages for the investor, and notably:

- Potential lack of independence of the courts;
- Potential political influence of the courts;
- Lack of investment law expertise at the courts;
- Long duration of proceedings;
- Lack of clarity as to the level of compensation offered by domestic courts.

Accordingly, it makes sense for affected investors to select international arbitration as their preferred op-

tion. The first option is the ECT, which is a multilateral treaty specifically concerned with the promotion and protection of investments in the energy sector. It was signed in 1994 and entered into force in 1998. 51 States and the EU are parties to the ECT. In addition, a variety of other non-EU member states are parties to the ECT, including Switzerland, Ukraine and several other former republics of the Soviet Union.

The second option is the BITs, which were concluded in the 1990s between the 'old' EU member states and the former Central and Eastern European States. There are currently about 190 so-called intra-EU BITs in force. Both the ECT and the BITs feature comparable substantive investment protection standards such as:

- Fair & Equitable Treatment (FET)
- Most Favoured Nation treatment (MFN)
- National Treatment (NT)
- Umbrella clause
- Compensation for indirect and direct expropriation
- Sunset clause

In terms of procedural rights, the ECT and the intra-EU BITs offer the following advantages:

- The dispute is dealt with outside the jurisdiction of the host state, which excludes the possibility of influencing or pressurizing the tribunal;
- Two of the three arbitrators are selected by the disputing parties, which ensures equality between the parties;
- The investment law expertise is ensured in the arbitral tribunals;
- The level of compensation for damages is clear as it is based on the actual damages suffered;
- The proceedings are concluded on average within 4 years with a final and binding award;
- Arbitral awards are – normally – recognised and enforceable.

Moreover, as mentioned above, the ECT and the BITs offer investors access to international arbitration. In most cases, investors can select from several arbitration rules, including ICSID, UNCITRAL, ICC und SCC Arbitration Rules. Therefore, it is not surprising that investors have been using the ECT and the BITs to try to obtain compensation for damages suffered. Since all cases are still pending, it remains unclear whether and if so, to what extent they will be successful.

Currently, the Czech Republic is facing at least 7 international arbitration cases in the solar energy sector, while Spain is involved in at least 11 disputes. Italy has just been hit by its first cases, while Greece and Rumania are also likely to face claims due to their retroactive measures. Most of those cases were initiated either on the basis of the ECT, or in combination with intra-EU BITs. Both ICSID and UNCITRAL arbitration rules are applied in those cases.

The failure of the European Commission and EU law to protect RES investors

The graphic on the next page illustrates that EU member states are now among the top countries that have been faced with arbitration disputes, instead of developing countries as used to be the case in the past.

The high number of arbitration cases against EU member states proves that the EU internal market has failed to prevent member states from introducing retroactive measures. In fact, the European Commission has never started proceedings against member states for breaches of EU law. In addition, investors do not have direct access to the European Court of Justice in order to challenge the measures of the member states. Moreover, the FET-standard and the umbrella clause are unknown concepts in EU law. Thus, compared to EU law, the ECT and the BITs offer a significantly higher level of investment protection.

Finally, the European Convention of Human Rights is also only of very limited use, since it can only be invoked after the exhaustion of local remedies, which means after 5–10 years of proceedings before national courts. As a result, many investors will be bankrupt by the time they can bring their case before the European Court of Human Rights. In short, the high number of disputes in the solar energy sector illustrates the value and importance of the ECT and BITs for European investors.

Despite the obvious necessity of the BITs and the ECT for European investors to protect their investments, the European Commission has been pushing for several years for the termination of the intra-EU BITs and, more recently, also against the ECT. Indeed, recently the European Commission started infringement procedures against 5 member states before the European Court of Justice. In short, the European Commission is of the opinion that the intra-EU BITs

Figure 1

Geographic distribution of new cases registered in 2014 under the ICSID Convention and additional facility rules, by state party involved

Eastern Europe & Central Asia	Sub-Saharan Africa	Western Europe	South America	Central America & the Caribbean	Middle East & North Africa	South & East Asia & the Pacific	North America (Canada, Mexico & USA)
Albania, 1							
Bosnia and Herzegovina, 1							
Estonia, 1							
Hungary, 1							
Montenegro, 1	Burundi, 1						
Romania, 2	The Gambia, 2	Greece, 1					
		Italy, 1					
Serbia, 1	Guinea, 1	Spain, 5					
Slovak Republic, 1	Mauritania, 1		Argentina, 1				
Turkey, 1	Mozambique, 1		Peru, 1	Costa Rica, 1			
Ukraine, 2	Senegal, 1		Venezuela, 2	Dominican Republic, 1	Egypt, 1	China, 1	
	Sudan, 1			Panama, 1	Yemen, 1	Indonesia, 1	

Note: The classification of the geographic regions above is based on the World Bank's regional system, available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/0,,pagePK:180619~theSitePK:136917,00.html, and also includes World Bank donor countries.

have been replaced by EU law or are no longer applicable because of the supremacy of EU law. Moreover, the European Commission considers that international arbitral tribunals are not compatible with the exclusive jurisdiction of the European Court of Justice regarding EU law. Indeed, in order to push through its views, the European Commission has repeatedly intervened as *amicus curiae* in many intra-EU and intra-ECT disputes, but fortunately none of the arbitral tribunals has followed its line of argumentation to date.

More recently and in light of its unsuccessful attempts to date, the European Commission has changed its strategy by focusing on the issue of illegal state aid. This new strategy was applied for the first time in the *Micula* case, which concerns an international arbitration dispute based on the BIT between Sweden and Rumania (this case is not energy related).

In short, the case can be summarized as follows. As of 1999 Rumania paid Micula a substantial amount of subsidies for a period of 10 years to stimulate investments in a poorly developed area of Rumania. During the accession process of Rumania to the EU, the European Commission came to the conclusion that the subsidies that were granted to Swedish investor Micula were not compatible with EU state aid law and therefore had to be terminated. Rumania terminated the subsidies accordingly, which prompted Micula to bring an international arbitration claim against Rumania. Micula won an award of 250 million US dollars. The Micula award was issued based on the ICSID arbitration rules, which require automatic recognition and allow for direct enforceability of the award.

However, during the investment arbitration proceedings, the European Commission had already intervened as *amicus curiae* and stated that any compensation to be paid to Micula would be considered as illegal new state aid, which would be incompatible with EU state aid law. Indeed, after the arbitral tribunal awarded Micula 250 million US dollars, the European Commission prohibited Romania from paying the compensation because its view was that this would violate the EU state aid rules. In the meantime, the European Commission formally confirmed its initial view, thus requesting Romania not to pay out the award. Micula, in turn, has now appealed against the European Commission's decision. Accordingly, the European Court of Justice, that is, in the first instance the General Court, will essentially rule on the legality of arbitral awards within the European legal order and, more generally, on the compatibility of intra-EU BITs with EU law.

The fact that the Micula award is an ICSID award, which does not allow any review by domestic courts, is totally neglected by the European Commission. Thus, the European Commission basically places Rumania before a conflict of laws: either Rumania violates its obligation stemming from the BIT and ICSID, or it violates EU law. This outcome, which is the result of

the actions of the European Commission, is not beneficial for any of the parties involved.

Outlook

Clearly, the biggest challenge is to maintain a high level of investment and investor protection in Europe. As long as EU law and the European Commission fail to provide that protection, the ECT and the intra-EU BITs must remain fully applicable. Access to international arbitration remains of absolute importance for European investors.

Instead of dismantling investor protection, the European Commission and the European Court of Justice should clearly state that retroactive measures are, in principle, incompatible with European constitutional law and European legal principles; and should thus be prohibited and should in any case result in full compensation for affected investors.

It is clear that in order to achieve climate change targets and the reduction of energy dependence from Russia, the production of renewable energy sources in Europe must be further expanded. This can only be achieved through the continued application of support mechanisms such as FIT, subsidies and tax breaks. At the same time, it is important to think about ways of making subsidies more flexible and applying them more intelligently to ensure that they continue to benefit investors and provide them with legal certainty for their investment planning, while giving states the flexibility to adjust them in a legally acceptable, non-retroactive manner.