Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Columbia FDI Perspectives
Perspectives on topical foreign direct investment issues by the Columbia Center on Sustainable Investment
No. 125 July 7, 2014
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Withdrawing incentives to attract FDI: Can host countries put the genie back in the bottle?

by

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Many governments offer incentives to attract foreign direct investment (FDI). For example, the renewable energy sector has benefitted from large national incentive schemes in the past decade. However, the withdrawal of such incentives can lead to investors bringing investment treaty claims against host countries. This *Perspective* looks at some claims host countries face from investors in the renewable energy sector and their implications.

Since 2010, some countries have significantly revised their energy sector incentive schemes, substantially withdrawing incentives and linking the remaining incentives to local content requirements. The alleged detrimental effects of these changes for investors in solar energy generation have been the basis of a wave of investment treaty claims. At least seven cases have been brought against the Czech Republic[1] and another seven cases against Spain.[2] A case against Italy was registered at ICSID in February 2014.[3]

Solar investors claim that their businesses are no longer viable because of these measures, which they allege are contrary to pre-reform legislative and regulatory commitments. As such, countries that have passed these measures are said to be in breach of the fair and equitable treatment (FET) standard and, possibly, treaty provisions on expropriation.

These cases—particularly those claiming that there has been a violation of the FET standard—raise a classic issue in investment arbitration, pitting foreign investors' reliance on stable regulations that provide a framework for their long-term investments against the host country's right to adapt regulations to new needs.[4] What measure of protection, as a matter of international law, should be granted to investors' expectations that they will continue to receive the same level of incentives? This might be difficult for a tribunal to determine, especially when investors' expectations arise out of legislative provisions and/or normative regulations of general application that are not shielded from subsequent amendments, and there are no specific "promises" or clear and unambiguous guarantees of stability specifically addressed to investors.[5]

In the cases against the Czech Republic, investors are challenging the introduction of a new retroactive tax on solar arrays and other sector-specific measures as contrary to the standards of protection under international investment agreements (IIAs).

Most European IIAs concluded in the 1990s did not include carve-outs for tax measures, but the Energy Charter Treaty (ECT) is a prominent exception. Cases brought under the ECT can raise questions related to the scope of the taxation carve-out in ECT Article 21. That Article begins with providing that: "[e]xcept 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." Article 21 creates an exception by providing that the most-favored-nation obligation in Article 10(7) does not apply to certain tax arrangements and measures (paragraph 3), but no exception for the FET standard. Furthermore, Article 21(5) establishes a special procedural mechanism for investors to claim the expropriatory or confiscatory nature of tax measures. Respondents in ECT cases can therefore be expected to rely on Article 21, arguing for a broad interpretation of Article 21(1) and a narrow application of the exceptions thereto.

The cases on solar energy incentives illustrate the pros and cons of national incentive programs. On one hand, generous national incentive schemes may help attract FDI; on the other hand, subsequent changes to incentive schemes affecting foreign investors might be challenged under IIAs, with host countries facing the risk of being overwhelmed with investment arbitration claims.

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[1] Under the ECT: *Voltaic Network GmbH v. Czech Republic*; *ICW Europe Investments Limited v. Czech Republic*; *Photovoltaik Knopf Betriebs-GmbH v. Czech Republic*; *WA Investments-Europa Nova Limited v. Czech Republic*; *Natland Investment Group NV and others. v. Czech Republic*; *Antaris Solar GmbH and other v. Czech Republic*; *Mr. Jurgen Wirtgen and others v. Czech Republic*.

[2] Under BITs: *Eiser Infrastructure. v. Spain* (ICSID Case No. ARB/13/36); *Antin Infrastructure Services Luxembourg v. Spain* (ICSID Case No. ARB/13/31); *RREEF Infrastructure (G.P.) Limited. v. Spain* (ICSID Case No. ARB/13/30). Under the ECT: *The PV Investors v. Spain*; *Charanne (the Netherlands) and Construction Investments (Luxembourg) v. Spain*; *Isolux Infrastructure Netherlands B.V. v. Spain*; *CSP Equity Investment S.à.r.l. v. Spain*.

[3] Under the ECT: *Blusun and others v. Italian Republic* (ICSID Case No. ARB/14/3).

[4] *See* Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford: OUP, 2012), 2nd ed., pp. 145-149. In case-law, see, *inter alia*, Total S.A. v. Argentina, ICSID Case No. ARB/04/01, Decision on Liability, December 27, 2010, paras. 115-117 and cases cited therein; and Ioan Micula and others v. Romania, ICSID Case No. ARB/05/20, Award, December 11, 2013, paras. 528-529, and 666-673.

[5] *Total S.A. v. Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, paras. 123-124, and 308-310; *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, November 30, 2012, paras. 7.77-7.78.

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