2021
Volume 3, Issue 3

Institute for Transnational Arbitration
ITA IN REVIEW

ITA IN REVIEW

The Journal of the Institute for Transnational Arbitration

ITA IN REVIEW

VOL. 3 **2021** **NO. 3**

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ITA in Review

is

a Publication of the
Institute for Transnational Arbitration

a Division of the
Center for American and International Law
5201 Democracy Drive
Plano, TX 75024-3561

REPORT ON THE PANEL "ENERGY ARBITRATIONS: DIALOGUE BETWEEN EUROPE AND THE AMERICAS"

by Konstantin Mishin

I. INTRODUCTION

At the 2021 ITA-ALARB Americas Workshop's Young Lawyers Roundtable "Energy Arbitrations: Dialogue Between Europe and the Americas," moderated by Sebastian Briceño, the Panel discussed three main topics:

1. Recent developments of the energy sector in Europe and its application in the Latin American context;

2. Comparative analysis of the Argentine arbitration saga from the crisis of 2001 and the current wave of arbitrations against Spain; and

3. Construction arbitrations related to energy facilities such as refineries, gas pipelines, generation plans and their particularities in the Latin American context.

II. RECENT DEVELOPMENTS OF THE ENERGY SECTOR IN EUROPE AND ITS APPLICATION IN THE LATIN AMERICAN CONTEXT

Santiago Bejarano [1] started his intervention by confirming that the recent developments in energy arbitration will have significant repercussions in the future. The decision of Court of Justice of the European Union (CJEU) in *Republic of Moldova v. Komstroy*[2] is one of the examples of this. It followed its 2018 ruling in *Achmea* BV *v. Slovak Republic*, [3] where the CJEU recognized that intra-EU bilateral investment treaties did not conform to EU law. *Achmea* raised a fundamental question about whether EU governing treaties have any precedence over other treaties that were similarly signed by those nations. Considering that the Vienna Convention on the

[1] Santiago Bejarano is a lawyer at Latham & Watkins LLP, New York, dual-qualified in New York and Colombia, advises clients doing business in Latin America, international arbitration and white-color matters, leading arbitration practitioner by Who's Who Legal.

[2] Judgment of the Court (Grand Chamber), Case C-741/19, *Republic of Moldova v. Komstroy, a company the successor in law to the company Energoalians*, ECLI:EU:C:2021:655, 2 September 2021.

[3] Judgment of the Court (Grand Chamber), Case C-284/16, *Slowakische Republik (Slovak Republic) v. Achmea* BV, ECLI:EU:C:2018:158, 6 March 2018.

Law of Treaties does not provide that one type of international law precedes another kind, many arbitration tribunals have already declined the *Achmea* approach concluding that the EU law takes no precedence over other international laws.

In *Komstroy*,[4] the court concluded that the dispute resolution mechanism in article 26 of the Energy Charter Treaty (ECT)[5] is incompatible with EU law following the reasoning in *Achmea*. *First*, the dispute resolution mechanism would lose the uniformity required by EU law by delegating authority over EU questions to arbitral tribunals. *Second*, since the ECT is a part of the EU law, its application entails application of EU law; and it is incompatible with the principles of the EU law for an arbitration tribunal to decide this dispute.

Another example of development related to this case is the standing to bring a claim by a non-party (Moldova) to the EU before the CJEU. The court admitted Moldova's claim because the arbitration was seated in Paris; therefore, both parties agreed to apply the EU law.

In the second part of his presentation, Santiago Bejarano explained that the fair and equitable treatment standard, particularly the notion of legitimate expectations, has significantly developed in recent years. The 1960s-1990s generation of investment treaties established a general application that provided fair and equitable investment treatment and nothing beyond this.

The early *Neer*[6] case had established a high threshold for fair and equitable treatment, and the subsequent tribunals added some content to this standard. Considering that earliest investment treaties have both a fair and equitable treatment provision and a provision for a minimum standard of treatment, the cases dealing with them have interpreted that FET has to be broader than the minimum standard of treatment.

However, based on said interpretation, many states perceived that the investment

[4] *Komstroy*, *supra* note 2 at ¶ 66.

[5] Energy Charter Treaty, Dec. 17, 1994, art. 21(1).

[6] Neer (U.S.) v. Mexico, 4 Rep. Int'l Arb. Awards 60, 61-62 (1926) (deciding that "the treatment of an alien, in order to constitute an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would recognize its insufficiency").

arbitration system tilted in favor of the investor, realizing that the FET standard is exceedingly general and lacks clear definitions of what is allowed and what is not under this standard. The recent treaties in this area, including those involving EU and the Latin American states, show that states became more careful while drafting investment treaties. The new investment agreements include specifications of what should and should not be considered a violation of the FET standard.

Finishing his presentation, Santiago Bejarano emphasized that Latin American states take an assertive approach to treaty negotiations in what regards the FET standard. For example, while negotiating a BIT with France in 2014, Colombia persuaded France to have a very specific definition of FET. It reflects the overall position of Latin American states who are guided by the practice of the early 2000s, stating that they did not intend the FET standard to go this far.

Some European states, like Spain, draft the current FET provisions more precisely, covering only the most egregious, unreasonable, and arbitrary measures. Under this new type of provisions, the FET standard cannot be used to influence the state's regulatory power.

Florencia Villaggi, commenting on the *Komstroy* topic, mentioned that, *first*, because the European Treaties guarantee the principle of supremacy of the EU law over other laws, countries that voluntarily signed up for that should comply with this, especially in the ECT cases.

Second, the CJEU in *Komstroy* highlighted that its decision does not apply to commercial arbitration. Article 344 of the Treaty on the Functioning of the European Union provides that the EU Members shall not submit its disputes concerning the interpretation or application of the EU Treaties to the outside-EU mechanism.[7] However, European states participate in commercial arbitration, including through its state-owned companies. It means that the EU Members *voluntarily* submit their commercial cases for dispute resolution to a system outside of the Treaties.

[7] The Consolidated Version of the Treaty on the Functioning of the European Union, 1957 O.J. (C 202), art. 344.

III. COMPARATIVE ANALYSIS OF THE ARGENTINE ARBITRATION SAGA FROM THE CRISIS OF 2001 AND THE CURRENT WAVE OF ARBITRATIONS AGAINST SPAIN

Florencia Villaggi[8] found a few similarities between the Argentine arbitrations that arose from the crisis of 2001 and the current wave of arbitrations against Spain. The first similarity is the history of both arbitration surges.

Argentina liberalized its economy to recover from hyperinflation, canceling many regulations and encouraging foreign investors' investment, particularly in the energy sector. One of the encouragements was the convertibility law that equaled one Argentinian peso to the US dollar.

Ten years later, a currency crisis hit Asia, Russia, and Argentina's neighbor Brazil. The Brazilian Real devaluated more than ten times, which made Argentinian exports less competitive than Brazilian exports, which caused a massive deficit in Argentina. The convertibility law precluded the government from fighting this crisis, which led to a substantial financial crisis in Argentina.

In the late 1990s, Spain launched the regulatory framework that attracted investment to the renewable sector in order to meet EU goals by 2010. Spain issued a new electricity sector law which regulated renewables, under which (1) the government subsidized over 90% of this sector's tariff, and (2) the government was selling the electricity of the renewables first, before any other, regardless of price. Many financial investors considered these conditions very attractive, and the 2010 target was reached swiftly, receiving 150% more investments in this sector than was predicted.

When Spanish economy collapsed during the 2008 global financial crisis, the GDP fell from 3.7% in 2007 to -3.6% in 2009; the unemployment rate leapt to 25%, it led to an enormous reduction in electricity demand. Considering that Spain received 150% more renewable energy investments than they predicted that these renewable energy producers had a priority in selling their energy first, and that they were 90% subsidized, consumers could not pay for this electricity, which led to a huge deficit

[8] Florencia Villaggi is Of Counsel at Herbert Smith Freehills LLP, New York, ICC YAF Representative for the North American chapter, she has been ranked as a Rising Star in international arbitration.

in this sector.

The second similarity was the issue of finding a balance between a state's right to regulate in times of economic crisis and investors' rights. Even though the measures differed, both Argentinian and Spanish measures impacted the investors' returns. Argentina had to get out of the convertibility law. The government has frozen all the investors' tariffs, and they were paid in a USD 1 = 1 Peso ratio, but they will be paid in pesos only now. On the contrary, Spain did not freeze the tariffs.

The third similarity is that the investors in Argentinian and Spanish cases claimed that governmental measures during the economic crisis violated the FET by breaching legitimate expectations.

In Argentinian cases, concession contracts that governed 99% of all investments in energy sectors had stabilization clauses, which established that convertibility law was a part of the regulatory framework under which concessions were granted. Many tribunals concluded that the government specifically committed not to change this regulatory framework of investment.

In Spain, there were no concessions; the government incentivized investors by regulations only, which are obviously subject to change. Tribunals agreed that there was no specific commitment not to modify regulatory framework; however, they sided with investors confirming that the investors had legitimate expectations under FET that the regulatory framework should not be *radically* changed.

IV. CONSTRUCTION ARBITRATIONS RELATED TO ENERGY FACILITIES SUCH AS REFINERIES GAS PIPELINES GENERATION PLANS AND THEIR PARTICULARITIES IN THE LATIN AMERICAN CONTEXT

In her opening statement, Jessica Beess und Chrostin [9] explained that ECT construction and energy arbitrations are highly dependent on the contract structure: a lump sum contract and a cost-reimbursement contract. The vast majority of the disputes arises from issues concerning the allocation of risk between an owner and a contractor when one of the following goals is not achieved: (1) schedule overruns, (2)

[9] Jessica Beess und Chrostin is a Senior Associate at King and Spalding, she represents clients in international commercial and investment treaty arbitration and inter-state arbitration, as well as in international disputes before the US courts, she is a member of the global Advisory Board of ICDR Y&I, and Secretary of the International Law Committee of the New York City Bar.

budget overruns.

The most common reason contractors bring claims against owners is (1) to recover costs that an owner disputes or (2) to determine the appropriate allocation of risk for unforeseen events.

Contracts to design and build energy infrastructure involve many elements of technical complexity: technical specifications, compliance with environmental and local regulations, energy targets, etc.

Many contractor-owner disputes nowadays concern unexpected events: government-mandated shutdowns, delays and cost overruns, new safety requirements and protocols, work hours limitations, restrictions on on-site access, supply chain interruptions, delays in obtaining permissions, or other government agency responses.

Even though these issues are not unique, Latin America has one of the poorest track records for project delays and cost overruns, so the pandemic compounds in the matters of the unforeseeable future.

In her second topic, Jessica explained that that the common law doctrine of frustration of purpose allows a party to set aside a contract, where an unforeseeable event radically changes or undermines the parties principal purpose for entering into the contract or to excuse nonperformance; the frustrated purpose should be so fundamental and essential to the contract that without it, the parties would have never entered into the transaction.

Some Latin American jurisdictions accept the approach established by the frustration of purpose. For example, Article 1090 of Argentina's Civil and Commercial Code provides that frustration of purpose may serve as a ground for termination of the contract.

The doctrine of frustration also is now recognized in Mexico.

Peru does not yet recognize this doctrine, but there has been a proposal to add the frustration of purpose to article 1372(A) of the preliminary draft reform of the Peruvian Civil Code. This shows that some Latin American jurisdictions are contemplating introducing the common law concept of frustration of purpose into

their domestic judicial system.

Similar doctrines may exist that carry different names and are conceptually distinct but ultimately allow to deal with unexpected hardships if there are similar results in the frustration of purpose. Brazil does not recognize the frustration doctrine, but it acknowledges the impossibility of performance doctrine, which is closely related to frustration. The distinction between the impossibility of performance and frustration concerns the duty specified in the contract and whether they can be performed in fact. Still, frustration affects the purpose and the reason for the party entering into a contract. Under Brazilian law, the parties can be released from the contractual obligations in limited circumstances, and the contract can be discharged when there is an impossibility of performance. So, even though frustration doesn't exist, the impossibility of performance is conceptually related to the frustration of purpose.

In conclusion, Jessica highlighted that Latin American countries tend to introduce the frustration of purpose doctrine into their legal systems. Even if this doctrine is not recognized in some jurisdictions, lawyers need to be vigilant and diligent in researching remedies because there are doctrines that might assist parties facing unexpected obstacles.

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