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Insights

International Arbitration Group

Careful Planning: Secure the International Law Protections in Investment Treaties When Investing in the Renewable Energy Sector in Southeast Asia

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Executive Summary

- Foreign direct investment (FDI) in the renewable energy sector in Southeast Asia is booming and will continue to grow.
- Countries such as Cambodia, Indonesia, Malaysia, the Philippines and Vietnam are offering economic incentives such as attractive feed-in-tariffs or tax exemptions/incentives to incentivize the flow of FDI in the renewable sector.

- Renewable energy projects are capital-intensive and require significant up-front capital; investors calculate their return on investments over the life of the project.
- Governments sometimes alter or withdraw the incentives that attracted the FDI, significantly altering the return on investment.
- Investors (sponsors and lenders) should structure their investments through jurisdictions that have executed bilateral or multilateral investment treaties with the host state of the investment.
- Such planning will ensure application of international law protections against such government misconduct, including the right to arbitrate the investment dispute directly against the host state (instead of having to go to the local courts, which may play favorites).
- After Spain, Italy and the Czech Republic changed the economic rules of the game by reducing or withdrawing certain benefits offered to investors in the renewables sector, foreign investors used applicable bilateral and multilateral investment treaties to hold the governments accountable in over 80 arbitrations.
- Investors need to plan ahead to ensure adequate treaty protection before it becomes too late (late restructuring may be an deemed an abuse of process rendering the claims inadmissible).

Introduction

Investment in renewable energy in Southeast Asia will continue to increase drastically in the coming decades as Association of Southeast Asian Nations (ASEAN) Member States strive to meet their obligations under international climate agreements, as well as the ASEAN Plan of Action for Energy Cooperation to reduce their carbon emissions and achieve net-zero status. Investments in the renewables sector require large amounts of up-front capital. ASEAN Member States are implementing measures to attract long-term foreign direct investment in the renewables sector, such as attractive feed-in-tariffs and tax incentives and exemptions. Investors will assess these incentives to determine their expected return on investments.

A serious problem arises when governments alter these fiscal and economic incentives after investors have fronted the initial capital to invest in renewable energy projects in specific countries. Spain, Italy, and the Czech Republic have been defending themselves in over 80 publicly known investment treaty arbitrations brought under bilateral and multilateral investment treaties executed by these countries. The foreign investors allege that these host States have breached their international law obligations to treat their investments fairly and equitably by applying new laws retroactively; upending the stability of the legal regime in which they invited; and reneging on specific commitments made to the investors to encourage their investment in the first place.

FDI is flowing into ASEAN Member States not only through cross-border investments made by investors in these countries in the territories of other ASEAN countries, but also FDI from investors in China, Hong Kong, India, Japan, Korea, several European countries and the United States. Investments sometimes are routed through investments made by special purpose vehicles incorporated in jurisdictions such as Mauritius and the UAE.

Investors in the renewable energy sector in Southeast Asia should consider not only the cross-border tax implications of how they structure their investments, but also determine whether they and their investments qualify for treaty protection under international law. These treaties potentially provide broad protections, such as the obligations of the host States to treat the investments fairly and equitably and to compensate an investor if the host States expropriate their investments directly or indirectly. Additionally, many of these treaties give the investor the right to bring a dispute directly against the host State in private arbitration, rather than have to fight a protracted battle in the courts of the host State, which may play favorites.

Not all investment treaties are created equally. They offer differing levels of protection to investors depending on their terms, and not all countries have executed bilateral investment treaties, meaning that gaps in protection may exist depending on where an investor is incorporated and how the investment into the host State is structured.

Investors (sponsors and lenders) in the renewable energy sector typically commit to recovering their investment over the course of at least the medium term, if not the long term. Foreign investors investing in Southeast Asia likewise should ensure they have recourse to international law protections in multilateral investment agreements, such as the ASEAN Comprehensive Investment Agreement, or bilateral investment agreements executed by the State in which the investor is incorporated and the host State of the investment. Such analysis requires exploring how to structure the investment and ensuring that the protections in any applicable treaty will be sufficiently robust should the host State improperly alter the rules of the game. This analysis should be done up front at the time of the investment; otherwise, it may end up being too late.

Foreign Investments in the Renewable Energy Sector in Southeast Asia Will Increase Drastically

Investment in renewable energy in Southeast Asia is going to increase exponentially in the coming decades. The ASEAN Member States' investment in renewable energy historically has been relatively low at the regional level, only exceeding that of Sub-Saharan Africa. However, in an effort to comply with the ASEAN Plan of Action for Energy Cooperation (APAEC) 2016-2025 Phase II: 2021-2025, some ASEAN Member States have committed to developing their renewable energy sectors. Malaysia, Indonesia, Singapore, Thailand and Vietnam intend to achieve either net-zero emissions or carbon neutrality by 2050. Cambodia plans on renewable energy constituting two-thirds of its total energy supply by 2030 with Malaysia aiming for 40% by 2034.

Development of renewable energy projects often requires large, up-front investments, which can be recouped only over a long period. Investors focus on the rate of return on their investment (ROI) when comparing different opportunities in the renewable energy sector. Given the substantial initial capital investment required, several countries have enacted schemes, such as FITs at attractive rates, to encourage long-term investment. Additionally, investors would account for tax incentives and exemptions when calculating their ROI over the long-term.

ASEAN Member States have been crafting and developing laws and regulations aimed at attracting foreign direct investment (FDI) in their renewable energy sectors so that they can meet their green objectives. Examples include:

- Cambodia enacted a new Law on Investment in 2021, with FDI incentives including 100% foreign ownership of companies, corporate tax holidays, reduced corporate tax rates, duty-free import of capital goods, and no restrictions on capital repatriation.
- Indonesia entered into a long-term partnership with the G7 countries as well as Denmark, Norway and the European Union to pursue a renewable energy transition, which aims to mobilize investments from the private energy and finance sectors and to reduce the country's reliance on coal.
- Malaysia is implementing tax incentives for a number of green initiatives, such as companies that utilize Carbon Capture Storage (CCS) technology or are part of the developing electric vehicle industry in Indonesia.
- The Philippines permits foreigners to own and control up to 100% of investments in the renewable energy sector.
- Vietnam, which already has attracted considerable FDI in solar and wind projects through attractive feed-in tariffs, enacted Power Development Plan VIII, which seeks investments in offshore wind facilities, LNG-supplied natural gas power plants and grids.

There is little doubt that FDI in the renewables sector in Southeast Asia will continue to increase drastically. The Asian Development Bank estimates revenue opportunity in Southeast Asia's low-carbon mobility and clean-power segments to be between US$90 to $100 billion by 2030. While ASEAN governments may be relatively agnostic about the sources of FDI in their renewable energy sectors, Asian investors are looking to take advantage of these incentives to invest in the renewable energy sector within Asia. For example, more than 90% of the foreign companies investing in solar and wind power in Vietnam are from Asia, including Japan, the Philippines and Thailand. That being said, FDI is also flowing into the Southeast Asian renewable energy sector from the United States and some EU Members, such as the Netherlands and Switzerland.

Foreign Investors Should Structure Their Investments in the Renewable Energy Sector to Benefit from the Protections of Investment Treaties

Foreign investors (sponsors and lenders) need to plan ahead to address the risk of the host State changing the economic rules of the game over the course of an investment's lifetime, which could adversely impact the ROI significantly. After all, it is possible that new laws and regulations will be enacted that will change the key economic inputs into calculating the ROI, such as new FITs and/or taxes. Additionally, local authorities might fail to honor their end of the bargain such that a project will not be successful. For example, governmental authorities might not approve permits in a timely manner or deny permits arbitrarily.

Foreign investors may be able to rely on protections offered by host States in bilateral or multilateral investment treaties. While the specific provisions of each investment treaty ultimately will determine the specific obligations being offered by the host state, investment treaties typically contain the following protections:

- **National treatment:** Foreign investors should be treated no less favorably than domestic investors in like circumstances. This protection may be helpful should the government prioritize domestic players in the renewables sector.
- **Most-favored-nation treatment:** Foreign investors should be treated no less favorably than investors from third countries. This protection may be helpful should the government treat third-country investors more favorably by granting their permits on an accelerated basis or offering their investments better tax or other economic incentives.
- **Fair and equitable treatment:** The host state should respect the legitimate expectations of foreign investors at the time they made their investments, and should treat foreign investors and their investments transparently, consistently, with stability, and in good faith.
- **Expropriation:** The host state may not expropriate the investment or enact measures tantamount to expropriating the investment unless done for public purpose, in a non-discriminatory manner, in accordance with due process, and with the payment of prompt, adequate and effective compensation.
- **International arbitration:** Many investment treaties permit private arbitration of disputes between an investor and the host state, thereby taking the dispute out of the national courts, which may play favorites.

Foreign investors must structure their investors carefully to ensure that they and their investments qualify for international law protections under specific treaties. Typically, an investor is a national of a state or is a company incorporated in a state that is a counterparty to a treaty with the host state where the investment is being made.

For example, the investment treaty between Malaysia and Vietnam defines an "investor" as "any natural person possessing the citizenship of or permanently residing in a Contracting Party in accordance with its laws" or "any corporation, partnership, trust, joint-venture, organization, association or enterprise incorporated or duly instituted in accordance with applicable laws of that Contracting Party" that "makes the investment."

Treaties and principles of international law may impose restrictions on who may qualify as an investor. Treaties may contain "denial-of-benefits" provisions that require an investor to not simply be incorporated in a state but actually do substantial business in that jurisdiction. Additionally, it may not be permissible for a foreign investor to avail of the protections of a treaty if it restructured its investments at a time when a dispute with the host state of the investment was underway or was reasonably foreseeable. Such restructuring may be characterized as abusive "treaty shopping." The requirements in a treaty to qualify as an investor and the timing of the structuring of the investment must be considered very carefully.

Investment Treaty Disputes in the Renewable Energy Sector are on the Rise: The Case of Three European Countries

Investment treaty disputes between foreign investors and the host states of their investments are on the rise. There are at least 80 publicly known ISDS cases related to changes in renewable energy policies, the majority of which have been brought against Spain, Italy and the Czech Republic.

Spain: The Spanish Promotion Plan for Renewable Energy, originally promulgated in 2000 and revised in 2005, provided for grants, tax incentives, soft loans, and loan guarantees for new investments in wind energy, solar (photovoltaic) energy and waste incineration. To attract long-term investment, Spain offered a FIT, which permitted owners of renewable energy plants to sell electricity at a higher rate for the first 25 years and then at a reduced rate for the plant's remaining lifetime. Beginning in 2008, the Spanish government began to reduce these incentives to address a tariff deficit, which was calculated as the difference between the amounts collected from regulated FITs and those collected from access tariffs set on the open market. Briefly, revenues from the state-subsidized prices failed to cover costs. Spain largely eliminated these incentives for new solar facilities by 2012, and the government issued decrees imposing a tax on power generation.

Foreign investors have brought over 40 arbitrations under the Energy Charter Treaty and bilateral investment treaties, alleging that the Spanish government's measures to address the tariff deficit breached international law obligations owed under applicable treaties. These aggrieved foreign investors generally allege that the measures breached their legitimate expectations that the government would maintain the FITs at the rates set when they made their investments. They also alleged that Spain's subsequent measures were unreasonable, disproportionate, or contrary to the public interest, thereby putting Spain in breach of the obligation to provide fair and equitable treatment to the investors and their investments. Foreign investors have prevailed in the majority of arbitrations that have reached final awards.

Italy: Italy implemented a FIT in 2003 that contributed to the significant growth in the Italian renewable energy sector, and the photovoltaic market, in particular. The incentive scheme proved costly. In 2012, Italy ceased to grant incentives to new plants, and, in 2014, adopted a decree that mandated a reduction in the FIT for photovoltaic plants larger than 200kW. The decree required investors to follow one of several incentive regimes, which used different means to achieve an overall reduction in investor benefits. Foreign investors have filed over a dozen investment treaty arbitrations against Italy. While some tribunals have concluded that Italy did not breach its international law obligations on the basis that Italy had not promised that its regulatory framework would remain unchanged, Italy has also lost other arbitrations depending on the specifics of the commitments made to the foreign investors and the timings of their investments.

Czech Republic: In 2005, the Czech Republic introduced a FIT for solar-generated electricity sold directly to electric grid operators and guaranteed that the tariff would not decrease by more than 5% a year. However, the Czech government sought to roll back the payments required under the FIT and also imposed a retroactive levy on revenues from solar electricity. Foreign investors in the Czech photovoltaic power sector commenced several investment arbitrations. While the Czech Republic has prevailed in several of these arbitrations, some arbitral tribunals have held that retroactive levy breached the Czech Republic's obligation to provide fair and equitable treatment to the investors and their investments.

Investment Treaty Protections Executed by ASEAN Member States for Investments Within ASEAN Member States

A number of ASEAN Member States have executed bilateral investment treaties with each other. Table 1 identifies bilateral investment treaties executed between ASEAN Member States that are identifiable in the public domain. The table does not include treaties that have been terminated or that are not in force (because one or both of the States have not yet ratified the treaty).

Data in Table 1 indicates the following:

- Brunei has not executed any investment treaties with other ASEAN Member States.
- Malaysia and Indonesia each have executed two investment treaties with other ASEAN Member States.
- Cambodia and the Philippines each have executed three investment treaties with other ASEAN Member States.
- Myanmar has executed four investment treaties with other ASEAN Member States.
- Singapore has executed five investment treaties with other ASEAN Member States.
- Thailand and Vietnam each have executed six investment treaties with other ASEAN Member States.

The limited number of treaties between and among ASEAN Member States means that there are considerable “gaps” in treaty protection should an investor from one ASEAN Member State seek the benefits of investment treaty protection on a bilateral basis for investments made in another ASEAN Member State. The absence of specific treaty protection poses risks for a long-term investor in the renewable energy sector.

Part of an explanation for the gaps may be that some Member States are of the view that their investors are sufficiently protected in cross-border investments given that the ASEAN Member States executed the ASEAN Investment Agreement in 1987, which entered into force on August 2, 1988. While this agreement terminated on March 29, 2012, it has been replaced by the ASEAN Comprehensive Investment Agreement (ASEAN IA) that opened for signature on February 26, 2009 and entered into force on February 24, 2012.

The ASEAN IA contains many of the protections routinely found in bilateral investment treaties. However, there are significant limits to the benefits afforded to investors. Specifically:

- The protections of the ASEAN IA are limited to the sectors specified in Article 3(3), which do not include the energy sector.
- The ASEAN IA does not apply to any taxation measures, except in the limited context of transfers (Article 13) and expropriation (Article 14). This suggests that taxation measures in the context of the obligation of fair and equitable treatment (Article 11) would not be covered by the agreement.
- The scope of the obligations of national treatment and most-favored-nation treatment are limited by the reservations in Article 9.
- The scope of the fair and equitable treatment obligation in Article 11 may not be as broad as is found in other bilateral investment treaties.
- The ASEAN IA contains a “denial of benefits” provision (Article 19) that limits who qualifies as an investor for the protections under the agreement depending on the nationality of the ultimate beneficial owner who owns or controls the underlying investment.

Non-ASEAN Investors May Also be Protected Through Other Investment Treaties

Considerable FDI into the renewable energy sector in Asia is flowing and will continue to flow from countries outside the ASEAN region. Studies indicate that the following countries outside of ASEAN invest significantly in the region: China, Hong Kong, India, Japan, the Netherlands, Switzerland, South Korea and the United States. Additionally, investments are sometimes routed through special purpose vehicles in tax-friendly jurisdictions such as Mauritius and the UAE.

Table 2 lists the bilateral investment treaties executed by individual ASEAN Member States with these countries that are investing heavily in the region. Again, the table is compiled from publicly available data and only lists those treaties that appear to be in force currently.

The data indicates the following:

- China has secured bilateral investment treaty protection with all ASEAN Member States except for Brunei, Indonesia and Singapore.
- India does not have investment treaty protections in place with individual ASEAN Member States, except for Myanmar. This statistic reflects India's policy to terminate its bilateral investment treaties and renegotiate more favorable treaties aimed at protecting India from being sued by foreign investors investing in India.
- European countries, such as the Netherlands and Switzerland (and also in many instances France, Germany and the United Kingdom) have executed a significant number of investment treaties with ASEAN Member States, with many of them being "first-generation treaties" dating back to the 1970s and 1980s.
- South Korea has secured bilateral investment treaty protection for its investors with a majority of ASEAN Member States.
- The United States has not executed bilateral investment treaties with any individual ASEAN Member States. Investors from these jurisdictions should consider routing their investments through special purpose vehicles incorporated in jurisdictions that have executed investment treaties (determining first whether the treaty protects such investors).

Some countries have entered into investment treaties with ASEAN as a regional bloc, in addition to or in place of investment treaties executed with individual ASEAN Member States. Examples include agreements with China, Hong Kong, Japan and South Korea. While India and the ASEAN Member States signed an investment agreement in 2014, it is not yet in force.

The protections in these bilateral and multilateral investment treaties vary greatly. Just because a treaty in force might cover an investor and its investment does not mean that the protections will be meaningful and/or that disputes may be resolved through arbitration. It is necessary to read the treaty in its entirety and to understand the precise scope of protections being offered by the host State of the investment and whether it is possible to adjudicate breaches of these protections through arbitration. This assessment needs to be done up-front at the time the investor is considering making the investment so that the investment is structured properly to benefit from treaty protection. This assessment cannot be put off until a host State government implements measures that change the rules of the game that induced the investment in the first place. At that stage, it simply might be too late to get the benefits of these international law protections.

Table 1: Bilateral investment treaties in force between ASEAN Member States

	BN	KH	ID	Laos	MY	MM	PH	SG	TH	VN
Brunei										
Cambodia								✓	✓	✓
Indonesia								✓	✓	
Laos					✓	✓		✓	✓	✓
Malaysia				✓						✓
Myanmar				✓			✓	✓	✓	
Philippines						✓			✓	✓
Singapore		✓	✓	✓		✓				✓
Thailand		✓	✓	✓		✓	✓			✓
Vietnam		✓		✓	✓		✓	✓	✓	

Table 2: Bilateral investment treaties in force between major FDI contributors and ASEAN Member States

	China	Hong Kong	India	Japan	Mauritius	Netherlands	Switzerland	South Korea	UAE	USA
Brunei								✓		
Cambodia	✓			✓		✓	✓	✓	✓	
Indonesia					✓			✓	✓	
Laos	✓				✓	✓	✓	✓		
Malaysia	✓					✓	✓	✓	✓	
Myanmar	✓			✓				✓		
Philippines	✓		✓			✓	✓	✓		
Singapore					✓	✓	✓		✓	
Thailand	✓	✓				✓	✓	✓	✓	
Vietnam	✓			✓		✓	✓	✓		

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