THE FIRST INVESTOR-STATE ARBITRATION AWARD UNDER THE 1994 ENERGY CHARTER TREATY

NYKOMB SYNERGETICS TECHNOLOGY HOLDING AB, SWEDEN ("NYKOMB") VS. THE REPUBLIC OF LATVIA

A CASE COMMENT

BY

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Introduction

An event of concern for the international arbitration community is the handing down of the first arbitral award under the 1994 Energy Charter Treaty (ECT) by an arbitral tribunal seated in Stockholm and convened under the Rules of the Stockholm Chamber of Commerce (SCC). The award by the SCC Tribunal was issued on 16 December 2003.

The author of this article was the chief counsel of the claimant investor in the arbitration proceedings. Professor Thomas W. Wälde[2] provided the principal expert opinion in the case.

The case is specifically notable because of its environmental character, which makes it stand out from most other investment treaty based disputes. This first ECT case is also notable because the investment of the foreign investor - a subsidiary established under local laws having entered into power purchase agreements (PPA) with the State Power Company (Latvenergo) - was not subject to an outright taking. There was no possession-taking of the investment enterprise or its assets, nor any interference with shareholder's rights or management control of the enterprise, other than the refusal by State Power Company to pay the price for electricity supplied that the investor assumed to be agreed upon and mandated by local energy incentive laws when making its investment. Further, the investment did not "sink", as is the case in most other investment treaty based jurisprudence, but remained a "going concern" throughout the whole dispute. This latter component, as it turned out, entailed difficult and controversial aspects on attribution of damages.

In essence, the case was about an environmental investment supported by guaranteed public subsidies in Latvia – an environmental support scheme very much similar to what is used and proposed within the EU. This support scheme became for the State Power Company

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Latvenergo perhaps to troublesome as Latvenergo preferred to go on with its imports of cheaper (nuclear) energy from neighbouring countries, such as Russia, than to pay a higher premium to a Swedish foreign investor in accordance with the at the time applicable legislative and government policy. Such government policy was intended to increase domestic generating capacity and encourage investment by independent power producers for purposes of modernising and decentralising the power production of the country and reduce dependency on energy imports, primarily from Russia. The introduction of small decentralised natural gas-fired co-gen units also served the local networks, was regarded as cost efficient and is evidently environmentally friendly.

The dispute thus became focused around one thing: A commitment the government of Latvia made, through its state-owned and controlled State Power Company, alone and in combination with general government authorities and policy, to a foreign investor to pay a higher than normal tariff in order to make the investor build a modern, natural gas-fired, environment-friendly co-gen plant. The government of Latvia at a time wanted, as evidenced by its official energy programme and the special incentive legislation, to promote in particular co-generation, to obtain investment in such efficient plants. It could not have attracted such investment had it not made the commitment because without such commitment the investment would not have made sense to any investor.

The facts of the case

The facts of the case were essentially the following.

Nykomb built, financed and still operates an environmental friendly state-of-the-art co-generation power plant in the town of Bauska, outside Riga in Latvia. Nykomb made its investment through a local subsidiary, SIA Windau, established under the laws of Latvia. Initially Nykomb took a 51 % equity position in SIA Windau, which later was extended to 100 %.

The co-gen plant was built under a co-generation incentive legislation (the 1995 Entrepreneurial Law) for surplus electricity supplied to the State Power Company, by new small co-gen plants to be built as IPP (Independent Power Producer) facilities. The 1995 Entrepreneurial Law provided for an elevated tariff for the initial eight years of production, and thus a basis to attract private investors to the state monopoly electricity sector in Latvia. The initial eight year period at the elevated tariff - understood to provide an accelerated amortizations scheme and a short pay-back time on the investment - was to be followed by a reduced tariff for the remaining 17 years of the technical plant life. The real weighted arithmetic average of the elevated Double Tariff for the initial eight years, and the reduced tariff for the remaining 17 years of the technical plant life is a tariff of 1.15. This average tariff of 1.15 corresponds to some 5.2 US Cents/kWh, which provides a project return in line with other comparable independent power producer investments in the emerging markets.

Specifically, the elevated tariff for the initial eight years was composed of two factors, an average tariff and a multiplier. The projected average tariffs were supposed to be set by the relevant public authorities in Latvia (the Public Services Regulatory Commission) and to increase with inflation, while the multiplier was fixed at two (i.e. a Double Tariff) for co-gen plants such as the Bauska plant. The Bauska plant has an installed capacity of approximately 4 MW of heat and 4 MW of electricity.

The Bauska plant that was built and still is operated was the pilot plant in a 16 plant programme. The remaining 15 plants of the programme have to date not been built.

The PPA entered into between the local investment enterprise and the State Power Company Latvenergo in relation to the disputed plant stipulated that the purchase price for surplus energy was to be determined pursuant to the 1995 Entrepreneurial Law. At the time the PPA was signed in early 1997 the Entrepreneurial Law stipulated that power plants such as the one in question was entitled to the Double Tariff. This became one of the contested issues of the case, i.e. when the PPA referred to the Entrepreneurial Law, was it then the intention that the purchase price was to be established on the basis of the Double Tariff when the operation of the plant was to start after the construction period?

The plant was ready for operation in the fall of 1999. However, at plant start-up Latvenergo refused to purchase the surplus electric power at the Double Tariff. Instead, Latvenergo argued that since the Entrepreneurial Law had been changed, and in fact replaced by a new 1998 Energy Law, which in its turn was changed and revised at a number of occasions, it only had to pay a reduced tariff – equivalent to 37,5% of the Double Tariff.

Given the equity and project finance involved, it became economically impossible for Nykomb/Windau to operate the plant at such a low tariff, and the plant obviously had to be operated at a loss from the start of operations and continuously throughout the whole dispute.

It was a fact that Latvenergo had entered into several PPA's based on the 1995 Entrepreneurial Law and was at the time paying the Double Tariff to two domestic co-generators of similar, but notably less modern and less advanced and less environmentally friendly co-gen plants. These two domestic co-generators, Latelektro Gulbene and Liepajas Siltums, was controlled by local businessmen in Latvia and thus not by foreigners. In the case of Latelektro Gulbene the double tariff contract was contested by Latvenergo in litigation in the local courts, but confirmed to be valid in all three levels of the Latvian court system, including the Supreme Court of Latvia.

Latvenergo also tried to invalidate the Double Tariff contract it had with SIA Windau in the domestic courts, as it had done in the Latelektro Gulbene case. However, the claim was withdrawn by Latvenergo at the turn of the year 2002/2003. Nykomb had then already initiated arbitration under the ECT.

Due to the blocking by Latvenergo of the Double Tariff at plant start-up in the fall of 1999, Nykomb together with its German suppliers tried to lift the issue to owner-level, i.e. to the Latvian government. The validity of the Double Tariff was due to these efforts confirmed by authoritative communications from the Prime Minister and the Cabinet of Ministers of Latvia, the latter which in November 1999 issued a resolution to the effect that SIA Windau was stated to be entitled to the Double Tariff on both statutory and contractual basis. Already in mid 1998, when Nykomb made its initial in-house analysis of the project, its financial and technical parameters as well as the statutory and contractual basis involved, the validity of the Double Tariff was confirmed by communications from the relevant government authorities, the Council for Regulation Power Supplies in Latvia.

The mentioned resolution by the Cabinet of Ministers confirming the Double Tariff was however immediately challenged by a group of members of the Latvian Parliament which

brought the issue before the Constitutional Court of Latvia. The Constitutional Court later nullified the resolution on constitutional grounds, meaning that the Cabinet of Ministers had in confirming the Double Tariff to Windau exceeded its powers.

Nykomb concluded that its investment was being squeezed to the extent that no economic benefit of any substance remained with the investor, mainly due to not easily apprehensible controversy on the domestic state/corporate level. The investment was no longer economically viable, and obviously the situation created great concerns of the lenders and vendors of the project, who's money was already invested and at risk. Nykomb had – unsuccessfully - visited the highest possible level of Latvian government to seek remedy. Nykomb therefore initiated arbitration under the ECT in December 2001 before the SCC.

The most contentious issues of the case

The case much came to focus on the fact that the 1995 Entrepreneurial Law had been changed and that the new 1998 Energy Law - entered into force in late 1998 and providing for a heavily reduced tariff compared to the Entrepreneurial Law - might be deemed to have retroactive effect in breach of the ECT. It was emphasised that the refusal of Latvenergo to pay the Double Tariff was not a commercially or contractually based decision, but the result of governmental functions. It therefore constituted a political risk within the purview of the investment protection regime of the ECT. This is particularly so since the electricity market in Latvia is a strictly regulated one, where the purchase price is regulated by the authorities and the State is in control of the market. Latvia, on the other hand, is a sovereign state empowered to change the tariffs through different governmental bodies.

The established principle of international law that a State cannot use its powers in order to change the expectations of an investor in a way that undermines or destroys the economic viability of an investment (i.e. "investment backed expectations") came to be much debated. When Latvia introduced the Double Tariff and Latvenergo entered into PPAs providing for the Double Tariff with Windau, as mandated by the 1995 Entrepreneurial Law, the purpose would have been to attract investors (domestic or foreign) to the electricity market of Latvia. Latvenergo had under this legislation a statutory obligation to take the surplus power produced and to pay the Double Tariff for an initial period of eight years. This was an essential prerequisite for the profitability of Nykomb's investment. The remaining part of the technical life of the plant would however be subject to a reduced multiplier/tariff.

Latvia argued that the dispute as to whether there was a valid and binding contract for the Double Tariff or not did not fall under the ECT, but was a commercial dispute which should be resolved before the local courts of Latvia. Also that the introduction of the new Energy Law did not constitute a violation of the ECT, since it entered into force in late 1998, whereas Nykomb's investment, i.e. the initial purchase of 51 % of the shares in Windau did not formally take place until March of 1999. The remaining 49 % of the shares in Windau was notably acquired by Nykomb during 2000. Latvia argued that Nykomb thereby had accepted any risks that could be associated with the new 1998 Energy Law, the reduction of the applicable multiplier and hence also any increase in the projected pay-back time on the investment.

The most contentious issues of the case, debated before the Tribunal, and earlier to some extent dealt with by other tribunals, were basically the following:

(a) Whether the conduct of the State Power Company could be attributed to the Latvian State, i.e. that the actions or omissions of its State Power Company is treated as if the Latvian State had acted itself under under customary international law and the ILC Draft Articles on State Responsibility. Particularly emphasised and debated in this respect was the Salini v. Morocco and the Maffezini v. Spain awards, applying the "structural-functional" test. It was also hotly debated, at least initially in the proceedings, how to interpret Article 22 (1) of the ECT (compared to Articles 5 and 8 of the ILC Draft Articles): Is Article 22 of the ECT an attribution norm with clarificatory purposes which provides for a guarantee by the State of compliance by a state enterprise with the Part III obligations of ECT, i.e. is Article 22 justiciable under the investor-state arbitration mechanism of Article 26? Or is Article 22, as was argued by Latvia, a separate and independent obligation not subject to the investor-state arbitration resolution mechanism of the ECT, and thus outside the Tribunal's jurisdiction? Article 22 does appear in Part IV of the ECT and is not among the investment disciplines located in Part III. Article 26 does notably not refer to Part IV.[3]

(b) The question if the Double Tariff contract between the State Power Company and the investment enterprise constituted a proper binding contract, and in particular if that contract constituted relevant contract for the Tribunal to examine under the investment disciplines located in Part III of the ECT. The debated Part III obligations of ECT were mainly those to observe obligations entered into ("pacta sunt servanda clause"), to provide fair and equitable treatment, the duty not to discriminate ("national treatment") and the duty not to expropriate ("regulatory expropriation" or "expropriation by financial squeeze"). It was vigorously argued by Latvia that the Tribunal could not itself decide on the issue as to whether there was a valid Double Traiff Contract, but that this issue (i.e. if there was a valid double tariff promise) had to be dealt with by the Latvian court system. Notably this was similar to the jurisdictional issues faced by the Vivendi tribunal, and in particular the subsequent Vivendi ICSID Annulment Committee[4], but also the CMS vs. Argentina, Fedax vs. Venezuela tribunals, and most recently by the SGS v Philippines and SGS v. Pakistan awards.

(c) As regards national treatment Nykomb particularly emphasised the Myers vs. Canada and Feldman vs. Mexico NAFTA awards. Further that the basic rationale and logic of the contemporary WTO analysis (particularly as evidenced by the Asbestos and Japan Alcoholic Beverage cases) could be applied also in an ECT context, i.e. that Nykomb should be compared to the best placed domestic investor in Latvia in a comparable situation, and that once Nykomb established a difference in treatment, Latvia being the host state had the burden of proof to show that the different treatment was justified in any way.

(d) Latvia focused on the fact that Nykomb had acquired control of its domestic investment enterprise Windau after the Double Tariff Contract had been signed. The issue thus became whether such awareness of the political and legislative controversy about the Double Tariff Programme could in any way negate or diminish the

[3] This issue is addressed already in 1996, in an analysis provided by T. Waelde and P. Wouters; State responsibility in a liberalised world economy: "state, privileged and sub-national authorities" under the 1994 Energy Charter Treaty, anD analysis of Articles 22 and 23, 27 Neth. Ybk IntlL 143-194 (1996).

[4] An authoritative analysis of the Vivendi case is provided by Emmanuel Gaillard, Vivendi and Bilateral Investment Treaty Arbitration, New York Law Journal, February 6, 2003

applicability of the ECT's investment disciplines. Put differently, the issue was whether the level of risk-taking by an investor is at all relevant when to decide whether obligations of contract and the ECT should be upheld or not. Latvia basically argued that Nykomb took a conscious and deliberate risk and had to face the consequences of the new 1998 Energy Law and the reduced tariff that came along with it. Nykomb basically emphasised that any and all investments entail risks and that the ECT, being foremost an instrument for economic modernisation and investment, does in fact oblige Latvia to "ensure" that such risks do not materialise. The level of risk-taking on the part of the investor should not be decisive.

(e) As regards the expropriation claim, the core issue became whether the non-payment of the Double Tariff under the PPA, and instead a de-facto payment of only 37,5 % of the Double Tariff, could be qualified as "expropriation" requiring compensation under the ECT. I.e. does a 62,5 % "financial squeeze" of purchase price and cash-flow for electric power supplied, as opposed to an outright taking of property, qualify as a measure tantamount to expropriation?

(f) On attribution of damages the theory of "economic unity" between the investor and its investment was much debated. Latvia argued that the claim brought by Nykomb in the arbitration was brought by the wrong claimant since the contractual and statutory right to the Double Tariff belonged to the local subsidiary Windau. The direct loss in reduced purchase price and cash-flow suffered by Windau was not identical to the indirect loss suffered by the investor as parent company. Nykomb basically argued that the ECT in its definition of "investment" recognises the principle of "economic unity" between the investor and its investment enterprise, and that this principle has been well established in international law and modern arbitral jurisprudence as developed since the well known and much criticized 1971 Barcelona Traction case. This is perhaps one of the most interesting aspects of this case since the attribution of damages made by the Tribunal is quite moderate, and is contrary to the perhaps very high awards on damages that have developed in recent years; notably the award handed down by the SCC tribunal in the CME vs. Czech Republic case.

The Conclusions of the Tribunal on the key issues

There were in the case additional matters in dispute than those enumerated above, e.g. the qualification of the Bauska co-gen project as "investment" and whether the change in the legislation on the Double Tariff constituted an event of force majeure under the relevant PPA. But these issues were decided without much discussion by the Tribunal.

(a) Attribution to the State itself of the conduct of the State Power Company

Article 22 of ECT constituted a potential minefield in the proceedings. Is Article 22 merely an "attribution norm" clarifying the primary investment obligations of Part III (i.e. Article 22 is accessory to the primary obligations of Part III) or is it a separate and independent obligation not subject to the Tribunal's jurisdiction? As mentioned, Latvia and its experts argued primarily for a restrictive interpretation of Article 22 and relied on the explicit limitation of the arbitration mechanism of Article 26 to an *"alleged breach of an obligation … under Part III"*, while Article 22 is undoubtedly located in Part IV. The Claimant at the later stage of the proceedings sought to focus instead on the fact that the Tribunal did not have to apply Article

22 to find attribution, but could also do so by applying customary international law as defined and commented by the ILC Draft Articles on State Responsibility.

The Tribunal took the easiest way out, and it appears as if it applied the structural-functional test applied by the Maffezini vs. Spain tribunal, i.e. analysing the ownership-control relationship of the state enterprise and the governmental character of its conduct in the case at hand. Arguably, this would mean that any conduct that was not "merely commercial", but had a significant element of governmental function, should result in attribution. Without going into any detailed discussion, the Tribunal considered the conduct of Latvenergo as attributable to the State. The Tribunal may have been convinced by the fact that Latvenergo did not negotiate commercially the PPA with Windau, but was under a legislative and government policy compulsion to do so, and that it was a nation-wide monopoly. Every independent supplier and purchaser of electricity was dependent on it. Latvenergo was by law the sole distributor of imported and domestically produced electricity through the national grid, and was for this reason in effect the sole purchaser of electricity produced by IPPs such as Nykomb/Windau. It was an uncontested fact of the case that slightly more than 25 % of the electricity consumed in Latvia was imported, mainly from Russia and Lithuania. Out of all the electricity generated in Latvia, Latvenergo produced approximately 97 % while IPPs produced the remaining 3 %. It may also have been of significance, although not addressed by the Tribunal, that Latvenergo historically emerged out of a former Soviet government department and that there was a close political inter-connection between the company and the political process. The Charter of Latvenergo, as amended, stipulated that the Supervisory Board was to be appointed by the governmental bodies. It was also the practice in Latvia that the members of the Supervisory Board were appointed among the representatives of the leading political parties. It was also established that the average sales tariff, as decided by governmental bodies, was determined "*according to the operating result*" of Latvenergo[5]. Thus, in practice, Latvenergo was setting the tariffs. The general politicisation of the dispute at the domestic and even foreign policy level prior to Nykomb's initiation of Investor-State arbitration may also have played a role in convincing the Tribunal. Particularly so since it involved communications and decisions on highest levels of Latvian government. These decisions were challenged by political fractions of the Latvian Parliament. Further, Latvenergo was explicitly designated under Latvian energy laws as an asset of "*strategical importance for the state and the national economy*" and thereby not subject to privatisation.

The Tribunal did not view the PPA entered into by Windau as a "normal commercial contract" but rather as an "administrative law contract". The reasoning of the Tribunal is not very extensive on this issue. It seems clear however that according to the Tribunal the attribution leads to a "piercing of the corporate veil" in the sense that the state monopoly enterprise Latvenergo after attribution was regarded as if it was the state itself, and its obligations to perform the Double Tariff was then considered as obligations directly incumbent on the State.

(b) Was there a Double Tariff Contract and did the Tribunal have jurisdiction to examine it? [6]

[5] Report prepared by SIDA/World Bank, September 1998, relating to the "Daugavpils District Heating Rehabilitation Project" in Latvia.

[6] Reference is made to a very authoritative paper by Bernardo M. Cremades, Clarifying the relationship between contract and treaty claims in investor-state arbitrations; based on a paper presented at a joint International Arbitration Institute – American Society of International law Conference, at Washington DC on April 1, 2003.

On the face of it, the most logical way for the Tribunal to deal with this issue would perhaps have been to use the “pacta sunt servanda” clause in Article 10 (1), last sentence of the ECT. However, it did not. Arguably, the “pacta sunt servanda” clause obligates Latvia to observe commitments “it” has entered into – and Latvenergo had become part of the “it” via attribution - with an “investment“ (SIA Windau) or the “investor” (Nykomb). The Tribunal had little difficulty in considering that there was a valid Double Tariff Contract under domestic law. The Tribunal seems to have found strong support for this conclusion in the fact that a similar double tariff contract referring to the 1995 Entreprenurial Law and the Double Tariff had been concluded between Latvenergo and the domestic co-generator Latelektro Gulbene, which contract was also contested by Latvenergo. The Latelektro Gulbene contract was confirmed in litigation to be valid in three levels of the Latvian court system. Since the Tribunal did not have any problems with the question of attribution, it does not seem to have been an issue for the Tribunal whether the word “it” in Article 10 (1), last sentence of the ECT meant the “State” only. Throughout the dispute it was aggressively argued by Latvia that it was not enough with attribution of Latvenergo’s conduct to the State under customary international law and the ILC Draft Articles, but Article 10 (1) of the ECT required also that the State had actually breached an international obligation itself – i.e. in practice meaning that the contract had to be concluded directly with the State. In this case it was a fact that only Latvenergo had entered into a contract with the investment of the investor, not the State itself.

However, Nykomb extended its legal grounds also to include that there was a contract, or at least a tacit contract, directly between the central government of Latvia and the investment enterprise Windau, by way of the governmentally induced Double Tariff Program, as evidenced by the 1995 Entrepreneurial Law and certain communications from the Council for Regulation Power Supplies in Latvia - the latter a constituent organ of the State. Nykomb/Windau was induced by this program to commit itself to construct the co-gen unit at Bauska and arrange for the necessary project finance with lenders and vendors. It is in this context notable that the 1995 Entrepreneurial Law explicitly stated that it was intended to "encourage entrepreneurial activity" in the energy sector, and thus in effect create competition to the large-scale plants run by Latvenergo, and further that tariffs were to "ensure that enterprises [IPPs] gain economically justified revenues". The investor therefore quite reasonably confided in the Latvian government to arrange for the Double Tariff as well as guidance to its instrumentality in the energy sector (Latvenergo) to abide by the obligation to pay the Double Tariff.

However, the Tribunal did not test this latter ground but instead chose the more common sense approach and found that the State had – through its instrumentality Latvenergo – concluded a valid Double-Tariff Contract. The State was therefore held responsible for it. I suggest that this was a sound position of the Tribunal. A contrary finding that the ECT - and its choice of words “*it has entered into*” in Article 10 (1) - would require not only that the alleged breach should be attributable to the State but also that the State is in breach of a state obligation it has entered into itself. This would mean that the “investment contract” always has to be entered into directly with the State for the “pacta sunt servanda” clause to be operable. For investments in the energy industry such a conclusion would render the ECT more or less useless. Few energy investment contracts are in real life entered into between on the one hand the investor and on the other hand the State directly. The energy sector throughout Europe, and in post Soviet transition countries in particular, is evidently managed by state enterprises often having a monopoly position.

Although the Tribunal did not explicitly use Article 10 (1) last sentence of the ECT, but instead preferred to rest its decision on discrimination/national treatment regime (see below), it is nevertheless a relief for the international business community that it did not ignore or try to interpret away the "pacta sunt servanda" clause, as seems to be what is done by the tribunals in the subsequent SGS vs. Pakistan and the SGS vs. Philippines awards by jurisdictional construction. The Tribunal kept out of this debate, generally unwilling to address the controversial issues and seeking safe ground wherever possible. It did find a contractual as well as statutory commitment to pay the Double Tariff (although the statutory right was revoked and replaced by the new Energy Law).

It is notable that the Tribunal did elaborate on the issue if the Double Tariff Contract's jurisdictional clause in favour of domestic courts, should be overridden by the dispute resolution mechanism of the ECT. Nykomb rested its case in this regard on the decisions of the ICSID Annulment Committee in the Vivendi/Argentina case and also the CMS vs. Argentina case. The Tribunal did recognise the fact that international law and modern investment treaties, including the ECT, have more or less excluded the traditional concept of "exhaustion of domestic remedies" and referred to the explicit wording in Article 26 (4) of the ECT, that an investor has the option to request ECT arbitration even if it has agreed to the jurisdiction of a local forum.

Although the Tribunal sought the easier way out in its determination of national treatment/discrimination, it nevertheless did find that there was a valid commitment to pay the Double Tariff and remarked, obiter dicta, that Latvia "may" have breached also other ECT disciplines put forward by Claimant, including the "pacta sunt servanda" clause.

(c) Level of risk taking – awareness of controversy on the double tariff programme in Latvia

The Tribunal concluded that it is irrelevant as to whether the risk that Nykomb assumed by investing in Latvia was to be characterised as a day-to-day commercial risk – and as such not protected by the ECT - rather than a political risk or any other type of risk. It was a fact that Windau had entered into a valid and binding PPA for the delivery of surplus electric power. Windau was entitled to the Double Tariff for eight years, and Nykomb had made its equity investment and raised project finance relying on this PPA. The Tribunal concluded that Nykomb's awareness of Latvenergo's reluctance to honour the Double Tariff before making its investment did not relieve Latvia of its obligations under the ECT. The Tribunal pointed out that a Contracting Party to the ECT cannot be relieved of its obligations "*simply by letting it be announced that legally binding commitments, upon which the foreign investor is relying, will not be honoured*".

(d) National Treatment - Discrimination

It was uncontested by Latvia in the proceedings, that the two co-gen plants run by the two domestically controlled IPPs, Latelektro Gulbene and Liepajas Siltums, were paid the Double Tariff, while the foreign investor Nykomb was not, i.e. that there was a different treatment. Latvia argued instead that these plants did not operate under "*like circumstances*". For example, Latelektro Gulbene had gone to the domestic courts and prevailed which Windau had not: Latvia thus argued that a discrimination claim under the ECT should not be possible without the investor first seeking recourse via domestic courts or other forum than that provided by the ECT.

To justify different treatment Latvia also made references to differences in business history, bargaining powers, technical data, financial position and location of the respective plant. In the case of Liepajas Siltums and Latelektro Gulbene, their Double Tariff Contracts were signed in April 1995 and in May 1997, while Windau's Double Tariff Contract was signed in March 1997. The Latelektro Gulbene litigation with Latvenergo was in this respect particularly instructive as all Latvian courts, in all three instances, had accepted a much weaker "letter of intent", combined with a reference to the applicable law at the time the contract was entered into, i.e. the 1995 Entrepreneurial Law, as evidence of a legally valid and binding double tariff contract for eight years.

Latvia submitted as evidence in the proceedings a list of some 28 domestic IPPs – alledgedly all of them co-gen plants - that did not receive the Double Tariff, but rather a wide range of lower prices for surplus electricity supplied to the national grid. The submitted list identified some basic operating information only, such as generating capacity and the multiplier/tariff that applied to each plant.

Latvia argued that it constituted justification for different treatment that the plants run by Latelektro Gulbene and Liepajas Siltums had the capacity to produce somewhat more electricity and heat than the Bauska Plant. Claimant countered this argument by simply referring to the structure of the 1995 Entrepreneurial Law itself, which explicitly referred to capacity not exceeding 12 MW as the essential parameter for qualifying for the Double Tariff rather than any other tariff. The 1995 Entrepreneurial Law did thus not differentiate between small co-gen plants as long as the production capacity did not exceed 12 MW. The Tribunal recognised this reasoning in its finding on the question as to whether the situations were comparable. The Tribunal found that little if anything had been presented by Latvia to establish e.g. the methodology used in fixing the multiplier for the various co-gen plants on the list, or to what extent Latvenergo was authorized to apply different multipliers than those listed. Since the three co-gen plants run by Windau, Latelektro Gulbene and Liepajas Siltums respectively were subject to the same laws and regulations, i.e. the 1995 Entrepreneurial Law, the Tribunal found ample evidence that the three plants were comparable. The Tribunal also accepted Claimant's position that the plants on the presented list, other than the three mentioned plants, were either not co-gen plants at all or mainly produced heat and very little electricity. The plants that did produce also some electricity, and thus could be referred to as co-gen units in the widest sense of the word, were basically part of large scale industrial complexes carrying completely different economics and technical parameters. The listed plants were old – probably all of them emanating from Soviet-times - and the investments made since long ago written-off.

Although Latvia tried to establish that good reasons for a different treatment existed, the Tribunal, without going into much detail, concluded that there was no proof of any justification for such different treatment.

It is notable that the Tribunal avoided any discussion as to whether a "discriminatory or protectionist intent" is required for a discrimination claim to be pursued successfully. Neither was such a requirement argued by Latvia at any length. The Tribunal expressly accepted that Nykomb should be compared to the best placed domestic investor in Latvia in a comparable situation, and that once Nykomb established a difference in treatment, the burden of proof shifted to Latvia to show that the different treatment was justified.

Although not expressly discussed by the Tribunal in the award, it seems likely that the Tribunal was strengthened in its ruling on discrimination by documentation presented by Nykomb from energy news services in the Baltic region (notably found on the Internet). Since the Nykomb case was for a long time hotly debated in Latvian media, Nykomb organised surveillance and translation of local media, including internet news web sites, some of which was available in the English language. Eventually a few news articles was published that clearly established that several domestic investors – basically small power producers and wind generators - were paid the Double Tariff and that both the governmental regulator of electricity tariffs in Latvia (the Public Services Regulatory Commission) as well as the State Power Company Latvenergo were not satisfied with this situation. In the news articles referred to certain officials of the regulator officially announced that they believed "*buying power from small power generators to be financially disadvantageous for the state*". The regulator had in fact carried out an analysis, referred to in the news article, of the importance of power produced by small power generators and its influence on tariffs. It was concluded that the backing of small power generators is financially disadvantageous to the state, and the tariffs had in the end to be paid by all the consumers of power. Officials within Latvenergo was also interviewed, and concurred that "*supporting small power plants with the help of Latvenergo is not the best solution*".

The analysis prepared by the regulator revealed that power produced by small power plants and wind generators accounted for about 1 % of all power generated in Latvia, and notably that "*power supplied by small power plants and wind generators cost much more than imported power*". The news articles also confirmed that the stepping up of Latvia's energy independence was the reason for promoting the development of small power generators in the first place, however, the price for power they produce is three times higher than the price for imported power. The regulator had proposed to the government that small power generators instead should be "*backed by money from regional development funds and the European Union*".

With its ruling on discrimination – as with its "lifting of the corporate veil" by the use of international customary law rather than Article 22 of the ECT - the Tribunal avoided every issue that had been theoretically contested in the case. The Tribunal sought to base its ruling on safe ground only, thereby satisfying both the investor and the host state. It kept away from any lengthy or detailed discussion on theoretically contested issues.

(e) Expropriation claim

Although the Tribunal found it enough to conclude discrimination and declined to rule on the other claims based on Article 10 of the ECT put forward by Nykomb, it did rule on the issue as to whether there was a valid expropriation claim. As it seems, the Tribunal was again seeking basis for a compromise and balanced approach, or even a politically "correct" solution to the case, making the award as acceptable to both parties as possible.

Normally, the breach of a contract to pay the agreed purchase price is unlikely to ever constitute an outright taking or expropriation. However, in this case Nykomb/Windau was utterly dependent on the nation-wide monopoly enterprise Latvenergo and was without access to the national electricity grid run by Latvenergo. Without such access, the plant investment clearly had no economic value. Since it is recognised within customary international law that

excessive taxation can become the equivalent of expropriation[7], it is not far-fetched that substantial under-payment – in this case 37,5 % only of the agreed price for power supplied – would be the economic equivalent of an additional tax of 62,5 % on the tariff revenues due to Windau under the PPA. Arguably, there was a plausible case for considering the concept of governmental measures "equivalent" to expropriation. The Tribunal, however, did not see it this way.

The Tribunal concluded that the decisive factor when analysing whether there is an expropriation or the equivalent of an expropriation at play "*must primarily be the degree of possession taking or control over the enterprise the disputed measures entail*". The Tribunal noted correctly that there was no actual possession taking of Windau or its assets, no interference with the shareholder's rights or with the management or control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production license, the off-take agreement etc. The Tribunal therefore concluded that the "*withholding of payment at the double tariff does not qualify as an expropriation or the equivalent of an expropriation*" under the ECT.

(f) Damages

Compensation for breach of contracts is usually a monetary award that puts the aggrieved party financially into the same position it would have enjoyed but for the breach. Difficult questions arise with respect to the compensation for lost profits ("lucrum cessans") in the case of cancelled long-term PPA's such as the one in this case. It entails a more or less speculative forecast of future cash flows and usually involves the application of an arbitrary discount rate to reflect the level of risk and uncertainties involved.

The issue in this case was in my mind however much simpler than the usual scenario in investment arbitration. There was a four-year track record for the Bauska plant of even production and delivery of electricity to the national grid. The problem of future cash-flow, costs or profits being "too uncertain" or "too speculative" was thus equally limited. The only issue was payment of the difference between the tariff payments actually made by Latvenergo in the past – i.e. 37,5 % of the Double Tariff - and the Double Tariff contracted for. Arguably, it should then not have been too problematic for the Tribunal to order payment of that difference for the past to either the investor Nykomb, i.e. the foreign parent, or to Windau. If awarded to Windau it would have been exposed to local taxes etc. As to the future cash-flow projections (i.e. the remaining four years of the Double Tariff period), the Tribunal had two choices:

(i) To discount the future double tariff payments (using the well established DCF-analysis) and award a lump-sum payment reflecting the net present value of future tariff payments, essentially the remaining four years of the double tariff period. This would have put an end to all disputed amounts and provided an instantly enforceable award;

(ii) To order Latvia to ensure full payment of the Double Tariff in a declaratory judgement to the investment enterprise Windau from the date of the award until the end of the double tariff period. In case of non-compliance this meant that Nykomb would be

[7] Thomas Waelde, 19 Northwestern J Int'l Law & Business, 405-424 (1999) (with Abba Kolo)

stuck with a non-enforceable award and the Tribunal would have to be re-constituted to provide a clear enforceable award for payment of specific sums.

First hand, Nykomb requested payment of 100% of the difference between what was contractually due and what was actually paid - for the past and the future - to itself. It relied on the theory of the "economic unity" of the investment enterprise and the parent investor. The explicit language in the ECT and the general recognition of this concept in modern international investment law do provide support for this position. However, this would be in rejection of the majority principle of Barcelona Traction case[8], which did not allow claims against the host state for damages of shareholders in a company having another nationality.

Analogy may also be drawn from Articles 1116 and 1117 of the NAFTA (which provides the option for claiming damages to either the domestic "investment" or the foreign "investor")[9]. Latvia opposed this request and suggested that non-payment to the domestic "investment" Windau did not produce an equivalent damage to the foreign parent Nykomb. As a fall back therefore, the Tribunal was provided with the discretion to

(i) allocate the difference between what was contractually due and what was paid to Windau (evidently not having a standing under the ECT and therefore not party to the arbitration proceedings) to Nykomb on behalf of Windau, or

(ii) (ii) to extend the *res judicata* effect of any damages award to apply to the whole of the "economic unity", i.e. including both Nykomb and its wholly-owned "investment" Windau.

The Tribunal did not make use of the discretion given to it, but chose again a compromise/political solution. It ordered Latvia – for the future (i.e. for not yet supplied electric power) – to ensure full payment of the amounts due to Windau as provided under the Double Tariff Contract. For the past supplies however, the Tribunal ordered payment only to the parent Nykomb and only 1/3 of the missing difference between what was paid and what was due. There is no substantial reasoning for this quite surprising and "settlement-like" decision in the award, other than the conclusion of the Tribunal that damages suffered by the parent are "*apparently not identical*" to those suffered by the domestic investment.

As the award stands, it is possible to argue that the Tribunal did not rule on the 2/3s of the "past claim" – leaving it open to the investor to seek recourse for the missing 2/3s elsewhere (e.g. by domestic litigation, another tribunal, challenge of the award etc.). Arguably, the res judicata effect of the award does not extend to the 2/3s of the "past claim" since it was not ruled upon by the Tribunal.

From the practitioner's perspective; since the Tribunal concluded (i) that it had the jurisdiction to entertain the claim, (ii) that there was a valid and enforceable promise for the Double Tariff and (iii) that this promise was protected by the ECT, it could from a logical perspective be expected that the attribution of damages should correspond to the Double Tariff. For the "past claim/pre-award period" the Tribunal however chose to award only the indirect damages suffered by the investor.

[8] The majority of the Court decided that it could not dispense justice on the Belgian claim against Spain because Belgium was the national State not of the Barcelona Traction company, but of its shareholders.
[9] See Mondev Award, para 84 and Pope-Talbot Award, para 80.

I propose that the ECT supports, at least implicitly by Article 1 (6) in particular, that foreign investors may claim also the direct damages suffered by its integrated corporate investment, rather than just the more or less arbitrary and hardly assessable indirect loss suffered by the investor itself. From a common sense perspective - and a reasonable assumption on the part of any foreign investor relying on the ECT before embarking on an investment project in the emerging markets – it is reasonable to assume that the whole of the investment is protected by the ECT and not just an arbitrary 1/3 representing the indirect loss of the foreign owner.

I would even suggest, in spite of the majority finding in the Barcelona Traction case, that if the applicable investment treaty contemplates that a claim is brought by a shareholder in an investment enterprise (which the ECT undoubtedly does), such investor should be allowed to recover losses for its proportionate share of damages owing to the investment enterprise for the treaty breach in question. An investor may bring a claim on behalf of an investment under any modern bilateral investment treaty, absent any evidence of the contrary in the text of the treaty in play.

Most modern arbitral awards, in particular the CMS vs. Argentina, Maffezini v. Spain, Vivendi v. Argentina, CME v. Czech Republic cases confirm as prevalent notion of international investment law that the foreign shareholder – particularly the 100 % shareholder - can claim the loss suffered by its domestic subsidiary. The well known Barcelona Traction principle as raised by many respondent governments in modern arbitral jurisprudence has been rejected, but now seems to resurface in the shape of ECT jurisprudence.

One may speculate if Nykomb would have been better off if there had in fact been an outright taking or if the investment had dropped dead as has been the usual scenario in previous investor-state disputes. Would the Tribunal then have held the future projections to be too "speculative" despite the 4 years track record of stable and efficient production and supplies of electric power and easily assessable underpayments of the agreed tariff? This does not seem likely.

An alternative explanation to the conclusions of the Tribunal, perhaps a bit on the left side, would be that the Tribunal felt that the Double Tariff was excessive and unreasonable, albeit this was not explicitly argued by Latvia. As to the argument in fact raised by Latvia, that the investor had been too adventurous in acquiring a domestic investment with a contract claim that was politically controversial and legally disputed by Latvenergo, the Tribunal expressly concluded that this was not the case. Why then knock off the price?

The most likely explanation to the Tribunal's allocation of damages seems to be that it achieved an unanimous decision by compromise among the arbitrators. The Tribunal may further, in its general tendency to seek safe ground for its conclusions, have felt reluctant to depart from the well-known Barcelona Traction principle. This is particularly so since the ECT itself does not explicitly or fully recognise the theory of "economic unity" between investor and its wholly-owned investment enterprise, nor does it provide a regime similar to Articles 1116 and 1117 of the NAFTA. In ordering the "reduced" damages for past under-payment (pre-award period) directly to the foreign investor, while declaring a right to full payment of the Double Tariff for the future (post award period) only to the domestic subsidiary, the Tribunal in effect rejected the theory of the "economic unity" between the investor and its wholly-owned investment. This may be more in conformity with the standard distinction in European corporate law between legally separate personalities. In any case it does not do justice to the ultimate intentions of the ECT which identify the foreign investor as

the ultimate object of protection. It was clearly not the intention of the ECT to force the investor to have its domestic investment enterprise to initiate simultaneous proceedings before the domestic courts if it wishes to obtain the whole of the direct (cash-flow) damages suffered, rather than just an arbitrary 1/3 thereof.

It may (perhaps naively) be for the Energy Charter Conference to see to it that the locally incorporated company is protected as investor, allowing it standing in arbitration under Article 26, treating it as a foreign national, or allowing it to claim for its damages simultaneously with the investor claiming for its damages. To date the ECT does apparently not provide explicit – albeit in my mind at least implicit - support for such a position.

Performance by Latvia on the Award

Enforcement actions never became necessary to achieve performance by Latvia of the award. After some 9 months of negotiations with the Latvian Government after the award was rendered an understanding has been reached. Latvia has performed the double tariff amounts due and also guarantees the future payments of the double tariff until the end of the eight year double tariff period. Upon late intervention of the Prime Ministers Office of Latvia, the lengthy negotiations could be successfully closed and payments effected in an expedient manner. Subject to the future double tariff payments being made, Nykomb and Windau will not pursue the loss in purchase price for the pre-award period not granted by the Award. The award is accepted by both parties.

Acknowledgement is in order for the Prime Minister’s Office of Latvia and its legal advisor, despite its late intervention in the negotiations on the performance of the award.

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