

**THE ARBITRATION INSTITUTE OF  
THE STOCKHOLM CHAMBER OF COMMERCE**

**Arbitral Award**

Rendered in Stockholm, Sweden  
on 16 December 2003

Claimant: Nykomb Synergetics Technology Holding AB, Stockholm

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The Arbitral Tribunal: Bjørn Haug, chairman  
Rolf A. Schütze  
Johan Gernandt

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# 1 Introduction

## 1.1 Overview

Nykomb Synergetics Technology Holding AB (“Nykomb”) is a joint stock company organized in 1995 under the laws of Sweden.

SIA Windau (“Windau”) is a joint stock company organized in 1991 under the laws of Latvia. Windau was originally 100 per cent owned and controlled by Latvian citizens, but Nykomb acquired 51 per cent of the share capital in March 1999 and 49 per cent in September 2000, making Windau a 100 per cent owned subsidiary of Nykomb.

The State Joint-Stock Company Latvenergo (“Latvenergo”) was organized as a state enterprise under Latvian law in 1991, and was in 1993 transformed into a joint stock company under Latvian law. The Republic of Latvia (the “Republic”) owns 100 per cent of the shares in Latvenergo. By an amendment of 3 August 2000 to the Latvian Energy Law the company is defined as “a national economy object of the State economy” that shall not be privatized. The company is actively involved in the production, purchase and distribution of electric power in Latvia.

On 24 March 1997 Latvenergo and Windau entered into an agreement called Contract No. 16/97 (the “Contract” or “Contract No. 16/97”) whereby Windau undertook to build a so called cogeneration plant in the town of Bauska, which was to produce electric power and heat on the basis of natural gas, the electric power to be purchased by Latvenergo and distributed over the national grid, and the heat to be purchased and distributed by the Bauska municipality. The plant was built and was ready to start production on 17 September 1999, but did not start until 28 February 2000 due to a dispute over the purchase price to be paid by Latvenergo. Since 28 February 2000 the Bauska plant has been delivering electric power to Latvenergo according to an interim or settlement agreement of 10 March 2000, at a price which in the Claimant’s view is less than Windau is entitled to under the Contract. The price dispute will be further explored below, but in short the delivery price stipulated in the purchase contracts entered into by Latvenergo is composed of two elements, the general tariff for average sales prices per kWh set by regulatory authorities and a multiplier set by Latvian laws or regulations. The Claimant contends that Windau was ensured for the first eight years of operation a multiplier of two (the “double tariff”), while Latvenergo considers the correct multiplier to be 0.75 of the tariff.

After unsuccessful attempts to reach an amicable settlement Nykomb on 11 December 2001 requested arbitration at the Stockholm Chamber of Commerce in accordance with Article 26.4.c of the Energy Charter Treaty of 17 December 1994 (the “Treaty” or the “ECT”). After exchanges of written briefs a preparatory meeting on 28 February 2003 and a hearing on 15 – 19 September 2003 was held in Stockholm.

## 1.2 *The Claimant's prayers for relief and legal grounds*

### 1.2.1 *The Claimant's prayers for relief*

In its Statement of Claim the Claimant made the following prayers for relief:

“Nykomb respectfully requests that the Arbitral Tribunal order the Republic:

- (i) to pay to Nykomb an amount of 667 158 Lats together with interest thereon from 17 September 1999 until actual payment at an annual rate of 6 per cent.
- (ii) to pay to Nykomb an amount of 2 311 020 Lats together with interest thereon from 28 February 2000 until actual payment at an annual rate of 6 per cent.
- (iii) to pay to Nykomb an amount of 4 119 502 Lats together with interest thereon from 16 September 2002 until actual payment at an annual rate of 6 per cent.

Nykomb respectfully requests the Arbitral Tribunal to order the Republic to compensate Nykomb for its cost of arbitration in an amount to be specified later and, as between the parties, alone to bear the responsibility for the compensation to the Arbitral Tribunal and to the Arbitration Institute of the Stockholm Chamber of Commerce.”

In its Brief No. I of 21 March 2003 the Claimant presented as secondary prayers for relief the following:

“Should the Tribunal find that compensation for future losses, i.e. compensation for the period from 30 April 2003 until 16 September 2007 as described above, may not be awarded as claimed by Nykomb in the Statement of Claim – with the exception of the applied discount rate of 6 per cent in Nykomb's present value computation or a finding of an expected yearly production of less than 24 813 MWh - Nykomb respectfully, as a secondary prayer for relief, requests the Tribunal to

- (i) order the Republic, to pay to Nykomb, an amount of 667 158 Lats together with interest thereon from 17 September 1999 until actual payment is made at an annual rate of 6 per cent;
- (ii) order the Republic, to pay to Nykomb, an amount of 2 817 591,7 Lats - or such higher amount that may follow from electricity produced and supplied during March and April 2003 - together with interest thereon from 28 February 2000 until actual payment is made at an annual rate of 6 per cent;
- (iii) confirm that the surplus electric power produced by and purchased from the Bauska Plant is to be purchased at a tariff to be calculated as twice the average electric sales tariff approved by the relevant regulatory body in the Republic of Latvia, currently  $30,28 \times 2 = 60,56$  Lats/MWh, and
- (iv) confirm that the surplus electric power so purchased shall be paid on a monthly basis.”

In its Brief No. I of 21 March 2003 the Claimant also stated:

“1.8 As a general point for the primary as well as secondary prayers for relief forwarded by Nykomb, the Tribunal may in the alternative and at its discretion decide whether any award shall be performed by the Republic on its own behalf or as principal for (on behalf of) Latvenergo, and likewise whether such performance shall be made to Nykomb on its own behalf or as principal for (on behalf of) its investment enterprise Windau.

1.9 Despite that Windau is not a party to this arbitration; it would in Nykomb's opinion not be incompatible with international law and the concept of arbitration under the Treaty to extend the res judicata effect of an award also to Windau, being wholly-owned and under direct control of Nykomb.

1.10 The Tribunal may also, as far as Nykomb is concerned, in the alternative and at its discretion, consider to ordering that any damages be paid directly to the investment enterprise Windau rather than to Nykomb as claimant investor. Such a solution is supported by arbitral jurisprudence within international investment law (see the “Mondev Award”, at para 86). “

In its Brief No. III of 9 September 2003 the Claimant amended its prayers for relief as follows:

“A. The Tribunal shall:

- (i) order the Republic, to pay to Nykomb, an amount of 667 158 Lats together with interest thereon from 17 September 1999 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (ii) order the Republic, to pay to Nykomb, an amount of 2 311 020 Lats together with interest thereon from 28 February 2000 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (iii) order the Republic, to pay to Nykomb, an amount of 4 119 502 Lats together with interest thereon from 16 September 2002 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.

B. Nykomb’s secondary prayer for relief, as submitted in Brief I dated 21 March 2003, shall be adjusted accordingly. The Tribunal shall:

- (i) order the Republic, to pay to Nykomb, an amount of 667 158 Lats together with interest thereon from 17 September 1999 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (ii) order the Republic, to pay to Nykomb, an amount of 3 019 030 Lats together with interest thereon from 28 February 2000 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (iii) confirm that the surplus electric power produced by and purchased from the Bauska Plant is to be purchased at a tariff to be calculated as twice the average electric sales tariff approved by the relevant regulatory body in the Republic of Latvia, currently 30,28 (double tariff = 60,56) Lats/MWh.
- (iv) confirm that the surplus electric power so purchased shall be paid on a monthly basis.”

### 1.2.2 Calculation of the amounts in the Claimant's prayers for relief

The specifications given in the Statement of Claim and in subsequent briefs show that the amounts in the Prayers for Relief have been arrived at as follows:

a) <u>Calculations used in the Statement of Claim Prayers for Relief</u>	
(i) <i>Deadlock period 17 September 1999-28 February 2000</i>	
Expected production (like September 2000-February 2001)	14.661.35 MWh
At double tariff 60.56 amounts to (for 163 days)	779.593 Lats
Lost income on heat	82.700 Lats
Less calculated cost of gas	<u>- 215.135 Lats</u>
Calculated net loss on electricity and heat	<u>667.158 Lats</u>
(ii) <i>Loss of income 28 February 2000-16 September 2002</i>	
Actual production in period (according to invoices)	61.057.33 MWh
Difference double-0.75 tariff (60.56-22.71) = 37.85 Lats	<u>2.311.020 Lats</u>

(iii) <i>Loss of income in rest of the 8 years' period, 16 September 2002-16 September 2007</i>	
Estimated 5 years' production (like 2001 = 25.249,62 MWh)	126.248.1 MWh
Difference double-0.75 tariff (60.56-22.71) = 37.85 Lats	4.778.491.20 Lats
Discounted at 6 percent per annum	<u>4.119.502.00 Lats</u>

b) Calculations used in the Brief No. III Prayers for Relief

**Primary Request for Relief:**

Calculations not presented, but the capital sums are identical to the calculations in the Statement of Claims (see details above).  
Claims for interest differ from the claims in the Statement of Claim.

(i) <i>Deadlock period 17 September 1999-28 February 2000</i>	
Net calculated loss on electricity and heat	<u>667.158 Lats</u>
(ii) <i>Loss of income 28 February 2000-16 September 2002</i>	<u>2.311.020 Lats</u>
(iii) <i>Loss of income 16 September 2002 – 16 September 2007</i>	<u>4.119.502.00 Lats</u>

**Secondary Request for Relief:**

(i) <i>Deadlock period 17 September 1999-28 February 2000</i>	
Net calculated loss (presumably calculated as above)	<u>667.158 Lats</u>
(ii) <i>Loss of income 28 February 2000-30 April 2003</i>	
Actual production in period (see Brief No. II page 40)	79.763 MWh
Difference double-0.75 tariff (60.56-22.71) = 37.85 Lats	<u>3.019.030 Lats</u>
(iii) <i>Order for double tariff to be paid in the future.</i>	
(This claim is not specified as to time period, but presumably relates to the period 30 April 2003 – 16 September 2007.)	

The Arbitral Tribunal notes that the primary request for relief in its final version continues to be based on a period of actual deliveries from 28 February 2000 to 16 September 2002, while the secondary request for relief has been updated to cover a period of actual deliveries from 28 February 2000 to 30 April 2003. Consequently, in both cases the third period concerning future deliveries up to 16 September 2007 includes a period up to the time of this award where deliveries have actually taken place and have been paid at 0.75 of the tariff.

The Arbitral Tribunal further notes that, apart from the claim for lost net income on heat production in the “deadlock” period, all the claimed amounts are based on the estimated or actual production of electricity at Bauska in the various periods, with calculation of the price at the double tariff, less the price at 0.75 of the tariff actually paid by Latvenergo to Windau for deliveries after 28 February 2000. In other words, the amounts claimed in the prayers for relief are equal to Windau’s alleged loss of net income for non-delivered heat and electricity in the deadlock period plus Windau’s alleged loss of income for the period

after 28 February 2000 due to the fact that Latvenergo has only paid 0.75 of the tariff for delivered electricity.

### *1.2.3 Legal grounds asserted by the Claimant*

Notwithstanding the way the Claimant calculates its losses, and notwithstanding the remarks in section 1.8-1.10 of the Claimant's brief of 21 March 2003 cited above, the Claimant does not appear to assert that it is entitled to claim payment directly to itself of the damages allegedly due to Windau for loss of net income on undelivered fuel and electricity during the deadlock period or the difference in purchase prices between the double tariff and the price actually paid to Windau for delivered electricity, nor does the Claimant appear to claim that it is entitled to pursue such a claim on behalf of its subsidiary Windau in this arbitration.

The Claimant must be understood to claim for the losses or damages it has incurred *itself* as a result of the undelivered heat and electricity during the deadlock period and as a result of the refusal of Latvenergo to pay the double tariff in the first eight years of production at Bauska. The Republic is asserted to be liable for breaches of its obligations under the Treaty, a) either directly liable on account of its own actions or lack of action, or liable because Latvenergo is a state organ or enterprise, or because Latvenergo's actions are attributable to the Republic, and b) because the non-payment of the double tariff amount to breaches of the Republic's obligations under Part III of the Treaty.

The Claimant asserts that Latvenergo's refusal to pay the double tariff:

- violates the obligation of fair and equitable treatment of investors, Article 10 (1);
- constitutes a treatment less favorable than required by international law, including treaty obligations, Article 10 (1);
- constitutes an impairment by unreasonable or discriminatory measures, Article 10 (1);
- constitutes measures having effect equivalent to expropriation, Article 13 (1).

With regard to Article 22 in Part IV of the Treaty the Claimant remarked in its closing statement:

“There was no negotiation, and there was obviously no economic motivation for Latvenergo to enter into one or several double tariff agreements, but Latvenergo had to deal with Nykomb, and others, and under conditions established by law only. There was no normal “haggling” about price as stated by Professor Wälde. Latvenergo held and still holds that position itself. It is in a monopolistic, public-service market that this transaction took place and which dominates its character from beginning to the end. This attribution – i.e. the operation by which the conduct of Latvenergo is treated as if it were an integral part of the state and by which the veil of its corporate personality is pierced (or lifted) – is based on customary international law (applicable under Art. 26 (6) of the Treaty), the State Responsibility draft of the International Law Commission as interpreted in the most recent and relevant awards, namely Maffezini I and II and in particular *Salini v. Morocco*. In addition it is also operated by operation of Art. 22 (1, 3 and 4) of the Treaty. We believe Art. 22 to be a special attribution norm for the primary obligations contained in part III of the Treaty, but whatever the legal argument about this, customary international law rules are fully sufficient for attribution and Art. 22 (1, 3 and 4) merely reinforce, by direct effect or by an indirect interpretative support, the attribution. Using a very old and in civil law established concept, Art 22 is clearly “accessory” (“akzessorisch”, “accessorisk”), to the “primary” obligations in Part III of the Treaty.”

The Claimant denies that its claims, or any part thereof, should be dismissed for lack of jurisdiction.

### *1.3 The Respondent's prayers for relief and asserted legal grounds*

In its statement of Defence of 27 November 2002 the Respondent made the following “Prayers for dismissal”:

“3.1 The Republic respectfully requests the Arbitral Tribunal:

(i) to dismiss the claim on its merits;

(ii) to order Nykomb to compensate the Republic for its costs of arbitration in an amount to be specified later; and

(iii) to order Nykomb, as between the parties, alone to be liable for the compensation to the Arbitral Tribunal and to the Arbitration Institute of the Stockholm Chamber of Commerce.

3.2 The Republic does not admit to the amount of Nykomb’s claim.

3.3 Should the Arbitral Tribunal find that Nykomb has a valid claim for damages the Republic respectfully requests the Arbitral Tribunal to limit any adjudged damages to an amount that does not exceed the loss incurred by Nykomb on its investment”.

In its Response of 4 September 2003 to Claimant’s Brief II the Respondent summed up its position as follows:

“8.2 Accordingly, Latvia respectfully requests that the Arbitral Tribunal adjudge and declare:

(i) that it lacks the jurisdiction to entertain the claim in the nature submitted by Nykomb; or

(ii) that Latvenergo’s conducts are not attributable to Latvia; and/or

(iii) that Latvia has not contravened any of its obligations under Part III of the Treaty; or

(iv) that Nykomb has not suffered any loss to warrant compensation; and

(v) that all costs of this arbitral proceedings, including legal costs, are to be borne by Nykomb”.

The Arbitral Tribunal understands these statements to the effect that the Respondent principally claims that all the Claimant’s claims should be dismissed for lack of jurisdiction, and in any event be dismissed on their merits. With respect to the Claimant’s new claims for interest at 18 per cent rather than 6 percent per annum from the time of the award, the Respondent requests that the new interest claim be dismissed for being submitted too late.

## **2 Jurisdiction**

### *2.1 The general basis for the Arbitral Tribunal’s jurisdiction*

The Claimant claims jurisdiction for this arbitration on the basis of Article 26.4.c of the Energy Charter Treaty of 17 December 1994 (the “Treaty” or the “ECT”). The article reads in part:

“ARTICLE 26 SETTLEMENT OF DISPUTES BETWEEN AN INVESTOR AND A CONTRACTING PARTY

(1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.



(2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:

- (a) to the courts or administrative tribunals of the Contracting Party party to the dispute;
- (b) in accordance with any applicable, previously agreed dispute settlement procedure; or
- (c) in accordance with the following paragraphs of this Article.

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(3) ---

(4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2) (c), the Investor shall further provide its consent in writing for the dispute to be submitted to:

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(c) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.”

“Investment” and “investor” as used in Article 26 are defined in Article 1 of the Treaty:

#### ARTICLE 1 DEFINITIONS

As used in this Treaty:

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(6) “Investment” means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

- (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
- (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
- (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
- (d) Intellectual Property;
- (e) Returns;
- (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

A change in the form in which assets are invested does not affect their character as investments and the term “Investment” includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the “Effective Date”) provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.

“Investment” refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as “Charter efficiency projects” and so notified to the Secretariat

(7) “Investor” means:

- (a) with respect to a Contracting Party:
  - (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;
  - (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party;

(b) with respect to a “third state”, a natural person, company or other organization which fulfils, mutatis mutandis, the conditions specified in subparagraph (a) for a Contracting Party.

(8) “Make Investments” or “Making of Investments” means establishing new Investments, acquiring all or part of existing Investments or moving into different fields of Investment activity.

--“

Both Sweden and Latvia are Parties to the Treaty. It is not in dispute that Nykomb, being a company organized under the laws of Sweden and having its seat in Sweden is an investor, and that its acquisition of shares in and its giving of credits to Windau constitute investments within the meaning of the Treaty.

Nor is it contested that Nykomb made attempts at an amicable settlement and made a timely request for arbitration sufficient to meet the requirements set out in Article 26 (1) and (2).

## *2.2 The claims must be relating to an investment*

Article 26 requires that claims raised in an arbitration are relating to an investment under the Treaty. The Claimant’s losses or damages are allegedly caused by the reduced income flow into Windau which affects the Claimant’s investment. The Claimant’s allegations create a clear relationship between the claims and the Claimant’s investments in Windau as required by Article 26. However, it remains to be considered in connection with the merits whether there is a causal link between the refusal of Latvenergo to pay the double tariff and the alleged losses or damages.

## *2.3 The claims must be based on obligations under Part III of the Treaty*

Article 26 further requires that the claims must be based on alleged breaches of the Republic’s obligations under Part III of the Treaty.

As summarized in section 1.2.3 above, the Claimant alleges that all its claims against the Republic are based on breaches of provisions in Articles 10 and 13, which are contained in Part III of the Treaty.

The Claimant has also referred to parts of Article 22. The Respondent has objected to the Tribunal’s jurisdiction on the ground that Article 22 is placed in Part IV of the Treaty. The Arbitral Tribunal notes, however, that the Claimant has stated that the provisions Article 22 referred to do not give rise to any separate claim, but are rather invoked as provisions which clarify the scope and contents of other treaty provisions, among them the provisions in Part III that the Claimant relies on as bases for its claims. The Tribunal finds that the interpretation and application of the relevant Articles of the Treaty, Articles 10 and 13, are best considered under the merits part of this award, and that the references to Article 22 cannot as such be dismissed as inadmissible in the form the references are relied on.

## 2.4 *Lack of jurisdiction due to jurisdiction of Latvian courts*

a) The *Respondent* requests, for several reasons all denied by the Claimant, that the Claimant's claims shall be dismissed in their entirety for lack of jurisdiction.

The Respondent notes that the Claimant's claims are based on the alleged breach of the agreements between Latvenergo and Windau, viz. Contract No. 16/97 and the agreement of 10 March 2000, and argues on that basis as follows:

- The Claimant is not party to these agreements, Windau's contract rights are not transferred to, nor can they be pursued by Nykomb even if it is a 100 per cent parent company. The claims are not owned by the Claimant;
- Both agreements contain a jurisdiction clause giving exclusive jurisdiction to Latvian courts;
- There is nothing to prevent Windau from suing for the same alleged breaches in a Latvian court, with a risk of double payment of the same claim; and
- When the Republic signed and ratified the Treaty, it did not contemplate that such claims as raised by the Claimant in this arbitration would be capable of being brought under Article 26 of the Treaty, and consequently has not agreed to this arbitration.

As for the first of these arguments, the Tribunal must agree that if the Claimant were to be understood as pursuing a contractual claim directly and exclusively based on the agreements between Latvenergo and Windau, such claims would not be admissible since Article 26 only allows arbitration of claims based on alleged breaches of the Treaty. However, as stated in section 1.2.3 above, the Claimant must be understood to claim for the losses or damages it has incurred *itself* as a result of the undelivered heat and electricity in the deadlock period and the refusal of Latvenergo to pay the double tariff during the eight year period, and such claims are alleged to constitute breaches of the Treaty.

As for the second argument, Nykomb is undeniably a legal entity separate from its subsidiary Windau. Nykomb is not a party to either of the two contracts in question and already therefore not bound by their jurisdiction clauses. Nor would Windau have any authority or power, by means of the contract clauses submitting its contracts disputes to the jurisdiction of Latvian courts, to exclude Nykomb from pursuing its own claims in an arbitration under ECT Article 26, even in a situation where Nykomb's claims are based on alleged breaches of Windau's contracts.

The risk of double payment is admittedly an effect of the establishment of an arbitration facility also for alleged losses or damages suffered indirectly by an investor, for instance through violations against its subsidiary in a country that has adhered to the Treaty. No definite remedies have been developed at this stage, but clearly the Treaty based right to arbitration is not excluded or limited in cases where there is a possible risk of double payment. This risk of double payment is only likely to be resolved through the further development of the law in this area, such as by the means of new judgements, decisions, guidance or other relevant developments.

Finally, the Tribunal notes that the Republic did not file any reservations concerning the scope or interpretation of Article 26 when adhering to the Treaty. Clearly, the Republic must then be obliged to accept Treaty arbitration with such scope as follows from a proper interpretation of that Treaty provision.

b) The *Respondent* further argues that the dispute concerning the alleged breaches of the agreements between Latvenergo and Windau must first be settled by Latvian courts. In its brief of 4 September 2003 the Respondent states:

“Furthermore, Latvia’s argument should not be understood (as do Nykomb and its expert) to advocate the principle of exhaustion of local remedies as a procedural requirement in the traditional sense of international law. Rather, Latvia’s argument regarding Nykomb’s claim for an alleged and contested breach of contract cannot be ascertained until the proper forum has first pronounced on the issue. There is no evidence to suggest that Windau has been prevented from pursuing such a course of action. It is in this sense that Latvia has presented its argument concerning the exhaustion of local remedies, which Nykomb and its legal expert persist in misunderstanding.

For the above reasons, Latvia is of the view that the Arbitral Tribunal lacks the jurisdiction to entertain Nykomb’s claim for the double tariff. Whether such a tariff is due or not is a matter of dispute, and if contested (as seems to be the case here) can only be determined by the proper forum, and in accordance with the proper law of the contracts in question.”

The *Arbitral Tribunal* understands the quoted statement to the effect that the Respondent does not claim the existence of a general obligation under the Treaty or under international law that local remedies must be exhausted before arbitration can be requested under Article 26 of the Treaty. Nonetheless the Tribunal finds it appropriate to state that in the Tribunal’s view, no such general obligation to exhaust local remedies can be derived from the Treaty or international law in general. On the contrary, according to ECT Article 26 (4) the investor has the option of requesting Treaty arbitration even if it has agreed to the jurisdiction of a local forum – which, however, it has not done in the present case. As a preliminary issue, the Tribunal has come to the conclusion that it has jurisdiction to determine, as a preliminary matter, whether there has been a breach of the contract, insofar as it is necessary for its decision in relation to the claims raised on the basis of the Treaty.

## 2.5 *Lack of jurisdiction due to limited scope of Treaty provisions*

The *Respondent* has asserted several limitations to the scope of the Treaty provisions relied on by the Claimant, which under the circumstances of this case bring the Claimant’s claims outside the jurisdiction of the Tribunal, primarily interpreted as follows:

- a) Contract No. 16/97 was entered into on 24 March 1997, before the Treaty entered into force on 17 March 1998 and at a time when Windau had only Latvian shareholders. The Treaty does not apply retroactively to situations established prior to the entry into force of the Treaty;
- b) The withdrawal of the right to the double tariff occurred before the Claimant’s investments in Windau. The Treaty does not apply retroactively to situations established prior to the Claimant’s investment;
- c) Nykomb was aware of the price dispute, or ought to have been aware of it, before it bought the shares in Windau. Nykomb took a purely business or commercial risk when

investing in Windau. The Treaty only protects against political risks and not against commercial or business risks;

- d) Also, the Contract between Latvenergo and Windau for the purchase of electric power, upon which all the Claimant's claims are based, is a commercial contract and as such not protected by the Treaty. The Treaty protection only applies to investment contracts within the meaning of the Treaty.

The *Arbitral Tribunal* finds that the scope and application of the Treaty provisions relied on by the Claimant is best considered after a general description of the background for the dispute, including the successive laws and regulations and of the purchase contracts entered into by Latvenergo. After such general description the Tribunal will decide whether a claim or a part thereof is found to fall outside the scope of a treaty provision and shall be dismissed for lack of jurisdiction, and, if found to be within the scope of the Tribunal's jurisdiction, whether it shall be dismissed on its merits. See section 4.3.3 below.

### **3 General background**

#### *3.1 Latvian public policy concerning electric power*

The Claimant has given the following account of the situation since the early 90's<sup>1</sup> which appears largely to be undisputed between the parties.

“When the Soviet Union's occupation of the Republic came to an end in 1991, the Republic needed to reduce its dependency on electricity imported from Russia, Lithuania and Estonia. In the long term, the Republic was faced with a possible shutdown of the nuclear reactors in Russia and Lithuania and a significant uncertainty regarding power generation based on oil shale in Estonia. This dependency on electricity imports was deemed to be a national security risk. If the nuclear reactors in Russia and Lithuania had been closed, or had otherwise become unavailable because of breakdowns or defects, the Republic would have been unable to satisfy its needs for electricity. Electricity from Russia and Belarus is transmitted to the Republic through a connection of the main power system of Russia with the high-voltage networks in the Republic. Russia had, however, and still has, the technical ability to disconnect the high-voltage networks from the main power system of Russia. Such a disconnection would, *inter alia*, raise the electricity costs in the Republic. At the same time, it became apparent that the domestic generating capacity was insufficient to meet the increasing demands on electricity as the Republic was rebuilding its economy. The Republic had also been left with enormous ecological problems, e.g. air pollution from usage of dirty fossil fuels in local heating plants, and needed to encourage the use of cleaner fuels to stimulate a better environment.

To increase domestic generating capacity and the use of cleaner fuels, the Republic needed to attract private investments in the electricity industry, particularly from foreign investors. However, electricity prices were very low in the Republic. This was due mainly to the low import prices charged by the Russian state electricity monopoly and by the Ignalina power plant in Lithuania. Another contributing factor to the low prices in the Republic was the prohibition on several major Latvian hydropower producers to charge the full price for their electricity. Foreign investors could, however, hardly compete on a market so strongly influenced and dependent on import dumping; i.e. the large import of cheap electricity from Russia and Lithuania. Generally, Western investors were quite reluctant at the beginning of the 1990's to risk their capital in Eastern Europe. As a result, Western investors needed a strong incentive, an economic “premium”, to invest in new power generation and co-generation capacity in the Republic.

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<sup>1</sup> See the Statement of Claim page 16.

A co-generation plant is able to produce both electricity and heat, hence co-generation. Through the combined production of electricity and heat co-generation plants are able to use more than 80 per cent of the energy contents in the fuels used. The traditional condensing power plants, which were unable to produce both electricity and heat, could only use between 30 to 40 per cent of the energy contents in the fuels used. When introducing co-generation based on natural gas in Latvia, the Republic could, *inter alia*, streamline the use of the energy contents in the fuels used and improve the ecological situation by phasing out highly pollutant fossil fuels.”

In pursuance of its policies concerning electric power production and the attraction of foreign investment in general, the Republic took the following measures: On 5 November 1994 the Republic enacted a Law on International Agreements, on 17 December 1994 signed and subsequently ratified the Energy Charter Treaty, on 13 January 1995 signed the US - Latvia Bilateral Investment Treaty (the “US-Latvia BIT”) and on 6 September 1995 enacted a law “On the Regulation of Entrepreneurial Activity in Energetics” (the “Entrepreneurial Law”). The purpose of enacting the Entrepreneurial Law was to “encourage entrepreneurial activity in this field” (cf. Article 2 of the Law). The law established, in Articles 27(9) and (10), that electricity from, *inter alia*, cogeneration plants with installed capacity from 1 to 12 megawatts was to be purchased into the national power transmission grid at a price twice as high as the average consumer price, i.e. the double tariff. In September 1997 the Parliament adopted the Latvian National Energy Programme. The main purpose of the Energy Programme was to integrate the Latvian electricity market with the European Union and to harmonize Latvian legislation with EU directives and regulations. The Energy Programme aimed to increase competition in the energy sector especially with regard to pricing and tariffs. The Energy Law of 3 September 1998 was enacted as a result of the adoption of the Energy Programme.

### 3.2 *The organization of the Latvian electricity market*

According to the Claimant<sup>2</sup>, and not contested by the Respondent, in 2000 slightly more than 25 per cent of the electricity consumed in Latvia was imported, mainly from Russia and Lithuania. Of the electricity generated in Latvia, Latvenergo produced approximately 97 per cent while independent producers such as Windau produced the remaining 3 per cent. Latvenergo is also the sole distributor of electric power through the national grid. In its capacity as the main domestic producer and the sole distributor of electricity in Latvia, Latvenergo was, and still is, holding a dominant position in the Latvian electricity market.

There are also a number of smaller domestic producers, with various capacities and various production techniques. Among the domestic producers are about 28 cogeneration plants of different sizes.

Latvenergo is by law the sole distributor of imported and domestically produced electricity through the national grid, and is for this reason in effect the sole purchaser of electricity produced by private entrepreneurs. The purchase price is derived from the electricity tariff consecutively set by public authorities in accordance with methodologies set out in laws and regulations, and from the so called multipliers which are laid down in laws and regulations. Latvenergo states that it has no authority to deviate from the officially determined tariffs and multipliers. But the purchase prices are set out, with reference to relevant tariffs and multipliers, in Latvenergo’s purchase contracts for electricity.

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<sup>2</sup> See the Statement of Claim page 15.

It follows that the part of the Latvian domestic electricity market in which Windau operates is highly regulated. There is no competition between purchasers when an entrepreneur is ready to sell energy produced in Latvia, nor is there any price competition among the domestic producers of electricity.

### 3.3 *The building and financing of the Bauska cogeneration plant*

No information has been given with respect to the activities of Windau from its incorporation in 1991 up to 1996, nor concerning its activities, if any, beside the Bauska and the other 15 cogeneration projects mentioned below.

On 1 July 1996 Windau entered into a contract with Latvenergo for the building of a cogeneration plant at Bauska. The 1996 contract was replaced by the above-mentioned Contract No. 16/97 of 24 March 1997 concerning the building of the same cogeneration plant. On the same day the parties also entered into a Contract No. 17/97 in which Windau undertook to install three cogeneration plants in the cities of Jelgava, Dobeles and Iecava. A third agreement, Contract No. 18/97 entered into on 26 March 1997, is a general agreement pursuant to which Windau undertook to install a further 12 cogeneration plants in various, not specified, cities of Latvia. In all the contracts Windau undertook to sell and Latvenergo undertook to buy any surplus electric power from the plants, that is all the electric power in excess of the power required by the plants for the purposes of their own production.

The three contracts in 1997 were all made effective as of the date of signing. It has been explained by the Claimant that Contract No. 16/97 concerning Bauska, and then presumably also the other two contracts, were signed in anticipation of a limitation of a Latvian law provision which prescribed the double tariff to be paid for a period for eight years for electric power from cogeneration plants. The law amendment was enacted in June 1997 and excluded the double tariff for plants with contracts effective after 31 May 1997. Apparently, the board of Latvenergo reacted negatively to the Windau contracts, and decided on 25 September 1997 that no further contracts were to be entered into with Windau. In a letter of 2 October 1997 to Windau, Latvenergo declared Contracts Nos. 16/97 and 17/97 invalid, *inter alia* asserting that they were signed on behalf of Latvenergo by an unauthorized person. The same claim was made against another cogeneration operator, Latelektro-Gulbene. Latelektro-Gulbene brought a court action against Latvenergo and defeated Latvenergo's contentions. Latvenergo later brought a court action in a Latvian court against Windau, and withdrew the case in January 2003. But it still refuses to pay to Windau the double tariff referred to in Contract No. 16/97.

Noell-KRC Energie- und Umwelttechnik GmbH ("Noell") was a joint stock company established under the laws of the Federal Republic of Germany and was a subsidiary of the German company Preussag AG. Noell had been engaged in supplying cogeneration plants in Germany and other locations, and the group took an interest in participating in the project of building up to 16 cogeneration plants in Latvia as contracted for by Windau. A PriceWaterhouseCoopers report of 30 October 1998 suggested an investment value of DEM 5,6 million per plant, or all in all a contract value of DEM 90 million for the 16 plants. On 19 February 1998 Noell concluded an agreement with Windau providing for mutual co-operation and the supply of turnkey facilities to the cogeneration plants to be built. The first plant was to be built in Bauska, and was to serve as the model project for

the other plants to be built. Noell was to be Windau's turnkey supplier, technical service partner and technical adviser with respect to cogeneration technology.

In mid-1998 major changes took place within the Preussag group. Preussag decided to go out of the engineering business and stop their long term engagement in engineering projects. Noell transferred its power plant business to the German company BBP Power Plants GmbH, a subsidiary of the German company Babcock Borsig AG. Babcock Borsig AG filed for insolvency on 4 July 2002.

According to the oral witness statement by Mr. Bernt Kulbe, the managing director of Noell, Noell in 1998 went looking for another equity holder in the Latvian project. Noell had been working together with Nykomb on different projects since 1996. In the spring of 1998 Noell/Borsig invited Nykomb to take over the developer role for the cogeneration project. Nykomb performed an in-house analysis of the economic and technical parameters of the project and decided in July 1998 to engage and mobilize staff resources to complete the project development process. After further investigations and analyses, including a PriceWaterhouseCoopers report and analysis of 30 October 1999, negotiations concerning financing of the Bauska project were conducted with the Vereinsbank, both with its Riga branch and with its German head office, resulting in a loan agreement dated 12 February 1999 from the Riga branch in the amount of approximately € 1.533.000. It was foreseen at the time that an investment in Bauska would amount to 1.9 million Lats, of which 1.4 million Lats was planned to be covered by loans and 0.4 million Lats by equity.

One part of the financing package was that Nykomb undertook to acquire 51 per cent of the share capital in Windau. In consequence hereof, Nykomb, by a purchase agreement of 11 March 1999 registered on 25 March 1999' bought 51 per cent of the existing shares in Windau and participated with 51 per cent in an increase of the share capital. On 7 September 2000 Nykomb acquired the remaining 49 per cent of the shares to become a 100 per cent shareholder in Windau. It is still the sole shareholder in the company.

Noell and the PreussAG/Borsig group are said to have granted considerable credits to Windau, although further details have not been given. According to a letter of 12 April 2000 from Windau to Latvenergo:

“Currently there is over Lts 2,250,000 invested in this project represented by Lts 750,000 of equity (provided as to Lts 650,000 by Nykomb), Lts 200,000 in supplier credits from Germany and Lts 1,300,000 of local bank loans backed by a strong guarantee from the parent company of Noell KRC in Germany. In addition Nykomb has invested some Lts 200,000 in upgrading the heating grid in the municipality of Ogre.”

By way of illustration, this corresponds to, in Swedish kronor (at 15/-):

	Lats	SEK
Equity	750 000	11 250 000
Supplier credits	200 000	3 000 000
Local bank loans	<u>1 300 000</u>	<u>19 500 000</u>
Investment in Bauska	<u>2 250 000</u>	<u>33 750 000</u>

Plus, as stated in the letter, “Backed by a strong guarantee from the parent company of Noell KRC”.



The Tribunal also notes that according to Windau's annual report for 2001, the managing director of Noell, Mr. Kulbe, was the chairman of the board of Windau. The German group's interest is also indicated by the fact that the German ambassador to Latvia as well as representatives of Noell participated in the meeting with the Prime Minister of Latvia on 26 October 1999, see sections 3.4 and 3.5.7 below. The legal relationship between Nykomb and the German group might have been of interest to the Tribunal when considering the alleged losses or damages incurred by Nykomb because of the reduced income flow into Windau, but this has not been further documented by the Claimant.

The Bauska cogeneration plant was completed and ready for operation on 17 September 1999, but did not start its production until 28 February 2000 due to the dispute over the purchase price for electric power as will be further dealt with below.

### *3.4 Windau's other cogeneration projects*

Preparatory work was also carried out with respect to the other 15 cogeneration plants covered by Contracts Nos. 17/97 and 18/98. Thus, licenses were obtained for two plants in the city of Ogre and for plants in two other cities. An investment was also made in upgrading the grid for distributing heat in Ogre. After the Bauska plant was ready for operation and after the price dispute at Bauska had emerged, a meeting was held on 26 October 1999 with the Prime minister, with the participation of the Swedish and German ambassadors to Latvia as well as representatives of Windau and Noell. The need for a solution of the price dispute was underscored, as was the fact that such a solution was necessary in order for the project work on the other 15 contracted plants to proceed. As will be further explored in section 3.5.7 below, the meeting resulted in a Resolution No. 67 of the Cabinet of Ministers of 30 November 1999 ordering the double tariff to be adhered to. The resolution was however later annulled by the Constitutional Court for constitutional reasons. Thereafter, work on Windau's other cogeneration projects were halted, awaiting a clarification of the purchase prices for electric power at Bauska.

### *3.5 Latvian laws and regulations concerning purchase prices for electric energy*

The Tribunal finds it practical to give a general description of the Latvian laws and regulations pertaining to purchase prices for electric power produced in domestic cogeneration plants, and a description of the parties' differing views on the contents and applicability of some of these legislative instruments.

#### *3.5.1 Regulation No. 54 of 14 March 1995*

The system of varying multipliers was first introduced by this regulation, which reads as follows:

“1. In order to promote the production of electric power in the Republic of Latvia, these Regulations provide that the state joint stock company Latvenergo shall purchase electric power from the electric station not under the authority of Latvenergo (hereafter, the “decentralized electric stations”).

2. The purchasing price for electric power produced by decentralized electric stations, except those specified in section 3 hereof, shall correspond to the average calculated tariff for electric power sale of the state joint stock company Latvenergo.

3. The purchasing price for electric power produced by such small-size electric hydroelectric power stations (*not in excess of 2 MW*), which operate or which shall be restored by 2000, shall correspond to the double average tariff for the sale of electric power for a period of eight years from the start of operation of the respective electric station.” (Emphasis added.)

### 3.5.2 *The Entrepreneurial Law of 6 September 1995*

The Law of 6 September 1995 On the Regulation of Entrepreneurial Activity in Energetics (the “Entrepreneurial Law”) replaced Resolution No. 54 and extended the group of power producers to include, *inter alia*, co-generation plants. Article 27 reads in part as follows:

“Article 27. Procedure for setting tariffs.

(1) The tariffs charged for energy supply shall be calculated by an energy supply enterprise in accordance with the methodology for tariff calculation determined by the Council.

(2) The tariffs shall provide for that enterprises gain economically justified revenues from payments received from the consumers for the coverage of justified costs of energy resources production, salaries, operational and administrative costs, as well as maintenance of existing assets and new approved investments.

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(9) Spare power which corresponds to the state power standard from renewable energy resources (minihydropower plants with installed capacity up to 2 MW and wind power plants), as well as from *little capacity cogeneration plants with installed capacity from 1 MW up to 12 MW* shall be purchased into the state power transmission grid at a higher tariff.

(10) The power purchase price from power plants mentioned in part 9 of this article shall correspond to *the double average sales tariff* of power and shall be valid for eight years from the starting day of operation of the power plant. After that the purchase price shall correspond to the average tariff of power.”(Emphasis added.)

The parties agree that the Entrepreneurial Law unequivocally provided for the double tariff to be paid for electric power from cogeneration plants with installed capacity from 1 MW up to 12 MW. There was no limitation with respect to the time when a purchase contract with Latvenergo must have been entered into or when the production must have started. Windau’s Contract No. 16/97 with Latvenergo expressly states that the price for electric power from Bauska shall be based on the Entrepreneurial Law.

### 3.5.3 *Regulation No. 23 of 10 January 1997*

On 21 December 1995, the Cabinet of Ministers submitted a draft law to the Latvian Parliament proposing to repeal, *inter alia*, Articles 27 (9) and (10) of the Entrepreneurial Law, in other words a proposal to withdraw the offer to pay the double tariff to cogeneration plants pronounced by the Entrepreneurial Law. However, the draft law was rejected by the Parliament on 25 November 1996. This notwithstanding, the Cabinet of Ministers on 10 January 1997 issued Regulation 23 with a view to amending Article 27 (9) and repealing Article 27 (10), *inter alia* to the effect that the offer to pay the double tariff contained in the Law was removed, and the authority to determine the price setting procedures was passed to the Cabinet. Upon appeal from Parliament members the Constitutional Court, by decision of 7 May 1997, found the Cabinet’s regulation to be in conflict with Article 81 of the Constitution and declared Regulation No. 23 null and void, however only as from the time of the Court’s decision. In a later decision, the Constitutional Court remarked that Regulation No. 23 was in effect when Contract No. 16/97 was signed on 25 March 1997.

### 3.5.4 Amendments of 11 June 1997 to Art. 27 (9) and (10) of the Entrepreneurial Law

Subsequent to the judgement of the Constitutional Court of 7 May 1997 the Parliament amended Articles 27 (9) and (10) of the Entrepreneurial Law to read as follows:

“(9) Produced spare power which corresponds to the state power standard from renewable energy resources (minihydropower plants with installed capacity up to 2 MW and wind power plants), as well as from *little capacity cogeneration plants with installed capacity up to 12 MW*= shall be purchased into the state power transmission grid at a higher tariff. These provisions on purchase of power from the cogeneration plants shall be applied to all physical persons and legal entities whose/which contract with the State Joint-Stock Company “Latvenergo” to be privatised on purchase of the power into the state power transmission grid from cogeneration plants has taken effect by May 31, 1997;

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(10) The power purchase price from power plants mentioned in part 9 of this article shall correspond to *double average sales tariff* of power and shall be valid for eight years from the transferring for operation of the power plant. After that the spare power, which corresponds to the power standard established by the state, shall be purchased into the state power transmission grid at the tariffs established by the Cabinet of Ministers.”

(emphasis added)

This amendment limited the general application of the double tariff to cogeneration plants where its power purchase contract with Latvenergo “has taken effect by May 31, 1997”. As will be further explored below, Latvenergo and Windau had entered into a contract on 1 July 1996 concerning the installation of a cogeneration plant at Bauska. The contract stipulated that “(t)his Contract shall come into force from the moment when the cogeneration equipment is installed and the Deed of Conveyance signed”. That contract was however replaced by the above-mentioned new Contract No. 16/97 of 24 March 1997, which stipulated that “(t)his Agreement shall take effect as of the date of its signing”. The Claimant has explained that the new contract was negotiated and signed in anticipation of the limitation enacted on 11 June 1997. The Respondent has not denied that the new contract ensured Windau’s continued right to the double tariff also under the Entrepreneurial Law as amended.

### 3.5.5 The Energy Law of 3 September 1998

The Power Industry Law (the “Energy Law”) was adopted on 3 September 1998 and came into force on 6 October 1998. It repealed the Entrepreneurial Law from the date when the Energy Law was taking effect.

The Energy Law contained no specific provision concerning the use of the double tariff. The right to the double tariff was not repeated for any category of electric power plants in the new law, nor were there any transitory provisions upholding this right for those who were ensured the double tariff under the Entrepreneurial Law as amended in 1997, hereunder the cogeneration plants which had obtained a contract with Latvenergo effective before 31 May 1997 (see section 3.5.4 above).

However, Article 41 provides as follows:

“The Cabinet of Ministers shall determine a common procedure by which licensed electric power supply enterprises must buy up surplus electric power produced which remain after usage for self-needs and in compliance with the electric power parameters determined within the state, from co-

generation stations located within the zone of activity of their license and *the exploitation of which has been started.*” (Emphasis added.)

It is undisputed that this article, authorizing the Cabinet of Ministers to determine common procedures, including price setting for electric power from cogeneration plants, draws a distinction between two categories of plants, depending on the starting point for exploitation. Thus, it is undisputed that the law authorizes the Cabinet to determine procedures for one but not for the other category of cogeneration plants.

However, the parties disagree as to the interpretation and application of Article 41. The *Claimant* contends that the provision applies only to cogeneration plants that had started production at the time of the enactment of the Energy Law, and consequently does not apply to the Bauska plant, which was only ready for production in September 1999. And since the Energy Law does not otherwise open for the determination of tariffs and multipliers this means, in the Claimant’s view, that for cogeneration plants starting after the Energy Law came into force the Entrepreneurial Law (as stipulated in Contract No. 16/97) must still regulate the purchase price-to be paid, even though the Entrepreneurial Law itself was declared to be null and void and no longer in force as from 6 October 1998.

The *Respondent* contends that the correct translation of the expression emphasized above is “the exploitation of which *has not yet started*”. It has submitted a letter dated 17 September 2003 from the legal bureau of the Latvian Parliament, citing and commenting upon the Latvian words used in the law text and in the parliamentary debate, and expressing as its opinion that according to the Latvian wording of Article 41 of the Law means to apply to cogeneration plants the operation of which will be started, *i.e.*, to new cogeneration plants.

The *Arbitral Tribunal* is satisfied, upon the presented evidence of the meaning of Article 41 in its Latvian original, that the authority of the Cabinet to determine the procedures concerning cogeneration plants according to Article 41 was limited to plants which were starting its production after the enactment (or the coming into force) of the Energy Law.

The Tribunal may add that this understanding is also supported by the logic of the choice. It appears less logical to the Tribunal that the new law should only allow for the determination of new procedures for cogeneration plants already in operation, presumably with established prices and conditions, while not authorizing the Cabinet to determine prices and procedures for new cogeneration plants coming into production after the new law. It appears more logical, taking into account that the legislators wished to limit the authority to determine procedures, that the setting of new procedures was authorized for cogeneration plants not yet in operation while the legislative authority was not extended to plants already established and operating. This limitation of the Cabinet’s power might even be seen as the legislator’s will that plants already in operation shall not be subjected to new price setting procedures.

In consequence of the Claimant’s view that Article 41 only applies to cogeneration plants having started production before the Energy Law was enacted (or came into force), the Claimant draws the conclusion that Regulation No. 425 of 31 October 1998 and Resolution No. 9 of 8 January 2002 issued pursuant to Article 41 (see sections 3.5.6 and 3.5.9 below) do not apply to the Bauska production. The Respondent draws the conclusion that Article 41 authorizes the Cabinet to determine new procedures for cogeneration plants not yet in

production, including the Bauska plant, without any limitation with regard to upholding the right to the double tariff ensured under the Entrepreneurial Law.

### 3.5.6 Regulation No. 425 of 31 October 1998

On 31 October 1998 the Cabinet of Ministers issued Regulation No. 425 pursuant to Article 41 of the Energy Law, effective as from 4 November 1998.

The Regulation reads in part:

“These Regulations stipulate:

1.1. that licenced electric power supply enterprises shall have the obligation to purchase generated surplus electric power ... from the cogeneration stations starting their operation ..., with the installed electric capacity ... *not in excess of four MW*;

1.2 the procedure in which licenced electric power supply enterprises shall purchase electric power surplus from cogeneration stations with electric capacity not in excess of four MW.

2. If electric power surplus is purchased from *cogeneration stations with capacity not in excess of four MW*, the purchase tariffs shall be determined based on the value of the average electric power sale tariff (Tv). The Purchase tariff shall change depending on the value of the average electric power sale tariff (Tv), approved by the Energy Supply Regulation Council and which has been published in the newspaper of Latvijas Vestnesis.

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4. If surplus electric power is purchased from co-generation stations with *capacity from 0,5 MW to four MW*, the purchase tariff (Tie) shall be determined depending on the type of fuel used in the technological process of the production:

4.1. Tie = 0,95 TV, if local fuel is used

4.2 Tie= 0,75 Tv, if imported fuel is used”

(Emphasis added.)

The Regulation makes no exception for cogeneration plants which had obtained agreements with Latvenergo before 31 May 1997 and therefore had been ensured the double tariff under the Entrepreneurial Law as amended. The parties agree that this Regulation by its wording expressly prescribes the use of a 0.75 multiplier for this category of cogeneration plants, and thereby expressly abolishes the mandatory use of the double tariff prescribed by the Entrepreneurial Law as amended. But the Claimant contends, as already mentioned, that this new multiplier does not apply to the Bauska plant since Article 41 of the Energy Law did not apply to cogeneration plants not yet in operation, while the Respondent contends – and for that matter procedurally admits – that the applicable multiplier in the case of Bauska was reduced from 2 to 0.75 by this legislative act by the Cabinet.

### 3.5.7 Resolution No. 67 of 30 November 1999

After a meeting on 29 October 1999 between the Prime Minister of Latvia and the ambassadors of Germany and Sweden, and representatives of Noell and Windau, the Cabinet of Ministers on 30 November 1999 issued the following Resolution:

“1. According to Clause 8, part four, of the Law “On Foreign Investment in the Republic of Latvia”, the Privatization Agency shall ensure conclusion of an agreement between the State Joint-Stock Company under Privatization “Latvenergo” and the Limited Liability Company “Windau” on purchase of surplus electric power, produced by Bauska cogeneration station and meeting electric

power parameters established in the State, transmitted to the electric power distribution grid, for *a price equal to the double average tariff* of electric power sale for eight years after the corresponding power station is commissioned.

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2. The Minister of Economy V. Makarovs shall inform the Ambassador of the Kingdom of Sweden about the decision passed.

3 The Ministers, whose Ministries organize tenders for issue of licenses, shall pay special attention to the provisions of the Law “On Foreign Investments in the Republic of Latvia.”

(Emphasis added.)

The Latvian Law on Foreign Investments is dated 5 November 1991. Clause 8.4 reads as follows:

“8.4. In the event, that future laws of the Republic worsen the investment conditions, a foreign investment shall be subject to the laws which were in effect on the date the investment was made.”

Again, the decision of the Cabinet was appealed to the Constitutional Court, which on 24 March 2000 ruled that Section 1 of the decision was null and void from the moment of its adoption. One reason given was that the first foreign investments in Windau were registered only on 24 October 1997 and that Clause 8.4 therefore could not be applied to the case. It also found that “the validity of [the agreement of 26 March 1997] is a dispute of civil legal character, which must be settled in a court of general jurisdiction”. The Tribunal notes that this attempt by the Cabinet to safeguard Windau’s rights was unsuccessful, a main reason being that the Latvian Law on Foreign Investment was inapplicable. No position appears to have been taken by the Constitutional Court as to Windau’s right to the double tariff, which obviously was the basis for the Cabinet’s action.

### 3.5.8 Amendment of 1 June 2001 to Article 41 of the Energy Law

On 1 June 2001 Article 41 of the Energy Law was amended to read as follows:

“1. The Cabinet of Ministers stipulates common requirements to co-generation plants with respect to their operation mode, reliability and efficiency, as well as the common procedure in which, depending on the type of fuel and efficiency, *the price for the surplus electricity* that is left after consumption for own needs and is purchased from co-generation plants that correspond to the requirements stipulated in this Article shall be determined.

2. The procedure stipulated in Paragraph One of the current Article shall not apply to producers who, *by 1 June 2001, have received a license for electricity generation and have commenced the operation* of these plants and equipment within the term stipulated in the license.”

(Emphasis added)

By this amendment the Cabinet’s authority under Article 41 apparently was excluded for cogeneration plants that had received a license and had commenced their operations before 1 June 2001. This wording of the law apparently excluded the Bauska plant, which had received its license on 4 April 1999 and started operation on 28 February 2000. But there is no indication in the amendment law, or other documented material, whether this new limitation of the Cabinet’s authority under Article 41 should have the effect of a corresponding limitation of Regulation No. 425 of 31 October 1998 issued under Article 41 in its original wording (see section 3.5.6 above), nor have the parties commented on this particular question. As will be seen in section 3.5.9 below, resolution No. 425 was

formally repealed on 8 January 2002, and then replaced by a provision again determining 0.75 to be the multiplier applicable to plants like the Bauska plant.

### *3.5.9 Regulation No. 9 of 8 January 2002*

Regulation No. 9 of 8 January 2002 repealed Regulation No. 425 of 31 October 1998, and stated in its section V. Price determination, *inter alia* the following:

“20. If the electrical capacity installed is more than 0.5 megawatts, but does not exceed four megawatts and fossil fuel has been utilized in its production process, the price for the purchase of surplus electricity shall be determined by applying the coefficient 0.75 to the average sales tariff in the operating area of the relevant system operator’s licence.”

This Regulation was also issued pursuant to Article 41 of the Energy Law, evidently then in its amended version. As mentioned above, the Claimant contends that this regulation is not applicable to the Bauska plant since Article 41 is not applicable.

### *3.5.10 Conclusions as to the legislative acts*

The development with regard to regulation of purchase prices for electric power from cogeneration plants bears witness of a development from an initial broad-sweeping offer in the 1995 Entrepreneurial Law of the double tariff as an investment incentive, towards a gradual limitation and eventually the abolishment of the double tariff as a mandatory incentive prescribed by statute.

There is agreement between the parties that the double tariff was unequivocally set down by the Entrepreneurial Law in 1995, with a legal obligation for Latvenergo to apply it in its purchase contracts for power plants covered by the law. With the exception of an interim period from 10 January to 7 May 1997, see section 3.5.3 above, the double tariff for certain power plants was in force at least until the Energy Law came into force on 6 October 1998. The Claimant contends that Windau continues to have the right to the double tariff, since the transitory provisions of the Energy Law and subsequent regulations emanated in pursuance of that law do not apply to cogeneration plants coming into production after the enactment of the Energy Law. The Respondent contends, and the Arbitral Tribunal accepts upon the evidence presented, that the categorical application of the double tariff was repealed by the Energy Law and replaced by the subsequent Regulation No. 425 of 31 October 1998, the latter replaced by Regulation No. 9 of 8 January 2002 again determining the multiplier to be 0.75 for plants like the Bauska plant.

### *3.6 Agreements concerning purchase prices for electric energy*

The Tribunal also finds it practical to give a description of contracts entered into by Latvenergo with Windau and others. The agreements presented in this arbitration suggest a system of specific contracts between Latvenergo and prospective producers and sellers of electric power within Latvia; first, a relatively short master agreement setting out the sellers obligation to build the plant and to sell the electric power not needed for its own production, and Latvenergo’s obligation to buy the produced electricity, always stipulating the purchase price with reference to relevant Latvian laws and regulations, and, secondly, a more detailed off-take contract, stipulating mostly technical details. According to the Respondent such off-take contracts were consistently entered into by Latvenergo only at

the point in time when the producer had completed its installations and was ready to start production.

As a general background for the dispute concerning the price and *force majeure* clauses in the Windau agreements a description is given below of such clauses in the purchase agreements documented in this arbitration.

### 3.6.1 *The Liepājas Siltums agreement of 4 April 1995*

The first purchase contract documented in this arbitration is an Agreement of 4 April 1995 between Latvenergo (referred to in the agreement as the “Energy System”) and the joint stock company Liepājas Siltums concerning a cogeneration plant with electric power of 4.9 million kWh. The Agreement contains the following clause:

“5. The Energy System shall pay to the Cogeneration Station for the balance of electric power delivered by the Cogeneration Station to the Energy System’s grid according to Regulations No. 54, issued by the Republic of Latvia Cabinet of Ministers on 14.03.95.”

On 1 January 1996, after Regulations No. 54 had been replaced by the Entrepreneurial Law (see sections 3.5.1 and 3.5.2 above), the parties entered into a supplemental agreement replacing *inter alia* the above-mentioned Clause 5:

“1. From the day of signing this Agreement, [the Parties have agreed] to change and express in the following wording the following Clauses:

Clause 5:

As from 10 January 1996 and until the end of the term of this agreement, the Energy System shall pay to the Cogeneration Station for the balance of electric power delivered by the Cogeneration Station to the Energy System’s grid according to the double calculated average sales tariff for electric power of VAS “Latvenergo” (or its legal successors).

As for 1996, the double average sales tariff for electric power of VAS “Latvenergo” has been mutually agreed in Supplement No. 1 to this Agreement of 01.01.1996, it is 0.048 Ls per 1 kWh.

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### 3.6.2 *The Windau contract of 1 July 1996 Bauska*

In the contract of 1 July 1996 between Latvenergo and Windau, the first contract concerning the Bauska plant, the price clauses read as follows:

“II. Price

Price for the electric power is defined in lats according to double average electric power sales tariffs on the basis of the Republic of Latvia Law “On Regulation of Entrepreneurial Activities in Energy Industry”.

Prices are fixed in Supplement No. 1, which is an integral part of this Contract.

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V. Liability

The Parties shall be released from liability for violation against their contractual obligations, if it has been caused by force majeure conditions – changes in the legislation and decisions of the Government, earthquake, war, floods, etc.

VI. Additional provisions

If the average electric power sales price changes, changes shall also be made in prices defined in this Contract.



--"

The Supplement No. 1 referred to reads:

"The Seller shall sell the excess electric power to the Buyer for the price 0.052 Ls/kWh."

### *3.6.3 The Windau contract No. 16/97 of 24 March 1997 Bauska*

In Contract No. 16/97 of 24 March 1997 that replaced the contract of 1 July 1996 the price clause reads as follows:

#### "II. PRICE

Price for electric power shall be stated in lats, based on of the Republic of Latvia law "On Regulation of Entrepreneurial Activity in Power Industry".

---

#### V. RESPONSIBILITY

The parties shall be released from responsibility for breach of obligations under this Agreement, if the reason for such breach is the so-called FORCE MAJEURE circumstances – changes in laws and resolutions of the Government, earthquakes, war, floods, etc.

#### VI. ADDITIONAL PROVISIONS

Upon change of average sale price of electric power, also the prices under this agreement shall be changed."

### *3.6.4 The Windau contract No. 17/97 of 24 March 1997 Jelgava, Dobele and Iecava*

In the Contract No. 17/97 of the same date as Contract No. 16/97, concerning cogeneration plants in Jelgava, Dobele and Iecava, the price clauses reads as follows:

#### "2. Contract price

The price for electric power shall be established in lats on the basis of the law "On the Regulation of Entrepreneurial Activities in the Energy Sector" of the Republic of Latvia.

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#### 5. Liability of the Parties

The Parties shall not be liable for the infringement of any provision of this Contract if such infringement is caused by force majeure, i.e. amendments to legislative regulations, government resolutions, earthquake, war, flood, etc.

#### 6. Additional conditions

If the average sales price of electric power changes, the Contract price shall be modified accordingly.

--"

### *3.6.5 The Windau contract No. 18/97 of 26 March 1997 12 cogeneration plants*

In the Contract No. 18/97 signed two days later, on 26 March 1997, concerning the set up of 12 cogeneration plants in (unspecified) towns in Latvia, the purchase price was determined as follows:

#### "2. Purchase Price

Surplus electric power shall be purchased for the price, which is effective in Latvia on the specific date of purchase."

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## 5. Force majeure

The parties shall be fully or partially released from responsibility, if Force Majeure circumstances have occurred, moreover, if such circumstances have occurred after the execution of relevant agreements and the parties could neither foresee nor influence them.

The parties acknowledge that Force Majeure circumstances include resolutions of the Parliament and the Cabinet of Ministers which eliminate or materially affect the performance of the agreements, natural catastrophes – floods, fire and rebellions. - - -“

### 3.6.6 *The Latelektro-Gulbene letter of intent of 19 May 1997*

Concerning another cogeneration plant, “Latelektro-Gulbene”, an agreement called a “letter of intent” was entered into on 19 May 1997, in which the parties *inter alia* agreed as follows:

2. ... “Latvenergo” agrees:

2.1 - - -

2.2 To pay the invoices for the electric power produced once every month according to the tariff defined in the law. ...”

The Arbitral Tribunal notes that this plant was granted its production license on 3 April 1997, the same date as the Bauska plant was granted its production license, and the letter of intent, similar to the new Contract No. 16/97 for Bauska, was entered into shortly before the adoption on 11 June 1997 of the amendment to the Entrepreneurial Law providing that only agreements being effective before 31 May 1997 would continue to benefit from the double tariff.

See also section 3.6.8 below.

### 3.6.7 *The Latvenergo – Windau agreement of 10 March 2000*

As already mentioned, the Bauska plant was ready for production on 17 September 1999, but Latvenergo refused to enter into an off-take agreement, and production was not commenced, apparently due to the dispute over the multiplier to be used in determining the purchase price. On 30 November 1999 the Cabinet had issued Resolution No. 67 in support of the double tariff. The Resolution was however appealed to the Constitutional Court, see section 3.5.7 above.

With this as a background, operation was started 28 February 2000 and on 10 March 2000, the parties entered into a detailed off-take agreement. With respect to the purchase price for electric energy this agreement provided as follows:

“2. Purchase Price and Sale Price of Electric Energy.

2.1 Latvenergo shall buy from Windau the surplus electric energy generated in cogeneration regime pursuant to requirement of the issued license, after satisfaction of Windau’s own needs (power surplus transmitted to the power system network) and which energy corresponds to parameters specified in the country, at the following price:

(a) until the judgment of the Constitutional Court in respect of the case relating to the acknowledgement as being invalid of Section of the November 30, 1999 protocol decision the Cabinet of Ministers, Latvenergo shall buy from Windau and pay for the electric energy generated at the power plant pursuant to the formula  $Tie = 0.75 Tv$  ...the difference ... shall be paid by

Latvenergo ... to the escrow account at A/S Vereinsbank Riga, which shall be used pursuant to the following conditions:

i in the event that the Constitutional Court acknowledges Section 1 of the November 30, 1999 protocol decision of the Cabinet of Ministers to be valid, this money shall be immediately transferred into the bank account of Windau at the S/S Vereinsbank Riga;

ii ...

(b) after the judgment of the Constitutional Court, Latvenergo shall buy from Windau and pay for the surplus electric energy generated at the power plant for the period of eight years after the commissioning of the Windau cogeneration plant in Bauska, in the following amount

i if by virtue of the judgment of the Constitutional Court, the November 30, 1999 decision of the Cabinet of Ministers or Section 1 thereof will remain effective, the purchase price from the cogeneration plant in Bauska shall be calculated pursuant to the formula  $Tie = 2.0 Tv$ ;

ii if by virtue of the judgement of the Constitutional Court, the November 30, 1999 protocol decision of the Cabinet of Ministers or Section 1 thereof will lose effect, the purchase price from the cogeneration plant in Bauska shall be calculated pursuant to the formula  $Tie = 0.75 Tv$ .

2.2 The parties mutually agree that irrespective of adoption of any judgment of the Constitutional Court, either party shall be entitled to submit its objections or claims in respect of the purchase price of electric energy stated in Section 2.1 (b) of this Agreement in the manner prescribed by law, and the parties agree that in the event that following the review of such objection or claim, the decision adopted by court differs from the provisions of Section 2.1.(b), the purchase price, determined pursuant to this court decision shall further be applied.

...”

#### 7. Force Majeure

7.1 The Party referring to Force Majeure circumstances as a hindrance for the performance of its obligations ... shall give notice thereof ... within three calendar days ... .

7.2 If either Party fails to perform its obligations in accordance with this Agreement due to Force Majeure, it shall be released from responsibility ... .”

The Arbitral Tribunal notes that the *force majeure* clause in this contract does not define or exemplify what is to be considered as force majeure.

#### 3.6.8 *The Latelektro-Gulbene agreement of 30 October 2001*

The Latelektro-Gulbene plant went into operation on 6 March 1998 but was disconnected from the grid in July 1998 because Latvenergo refused to pay the double tariff prescribed in the Entrepreneurial Law. In October 1998 Latelektro-Gulbene Ltd. filed a claim for the double tariff against Latvenergo in the Riga Regional Court, and won by the court's judgement of 16 December 1998. The decision was appealed, but was confirmed by an appellate court on 30 March 1999 and by the Latvian Supreme Court by a decision of 30 June 1999. All the courts found that the letter of intent of 19 May 1997 constituted a legally binding contract and that it unequivocally stipulated that the double tariff was to be paid in the eight years' period from the commissioning of the plant, by referring to the law in force at the moment of signing the contract. The Tribunal notes that all three court decisions were rendered after the Energy Law had been enacted and had come into force on 6 October 1998.

Following the Supreme Court decision Latvenergo accepted the double tariff and entered into a new agreement with Latelektro-Gulbene dated 30 October 2001. The purchase price is not specifically defined, but the double tariff in the first eight years is clearly assumed in clause 10.3:

“7. Force Majeure

7.1 None of the Parties shall be held liable if the performance of any provision hereof is delayed or made impossible by any natural or man-made calamities, by mass disorders, war, riots, as well as action of state authorities or any other condition beyond the control of the Party whose obligations are affected by it, which the Parties could not anticipate, while making this Agreement, and which the Parties are unable to prevent by using reasonable methods available to them.

7.2 The Party, which refers to force majeure conditions ... shall report about it ... not later than within three calendar days ...

- - -

10. Term of Agreement

10.1 The Parties agree that this Agreement shall be in force for an undetermined period of time, subject to Clause 10.3 hereof.

10.3 If the Parties do not agree on a new purchase price for electric power by 6 March 2006, when the duty of Latvenergo to buy electric power for the double tariff expires, then this agreement shall lose its legal force at the moment when the said term expires.”

### *3.7 The legal significance of the price and force majeure clauses*

Although the wording of the agreements varies, the purchase agreements documented in this arbitration all have the same general structure: The seller undertakes to install the power plant(s) and to sell to Latvenergo its surplus power (that is, produced power beyond what is needed by the seller for its own production), and Latvenergo undertakes to purchase the surplus power on the basis of tariffs stipulated by law.

Apart from specifying in a couple of the contracts the precise tariff to be paid in the current year, all contracts consistently refer to actual laws and regulations as determining the price to be paid and do not stipulate prices other than those deriving from legislation and administrative decrees. None of the contracts suggests that Latvenergo has had the authority or even the intention to deviate from what follows from laws and regulations, and Latvenergo has expressly denied having any such authority. Thus, in a letter to Windau of 20 March 1998 Latvenergo stated that

“...the law regulates purchase of power from cogeneration stations and it is a state regulated business. At the moment determining a different purchase price would be a violation of the given law”.

However, as may be derived from the court decisions in the Latelektro-Gulbene case, the price clauses in the purchase contracts are not merely references to Latvian laws and regulations at any time, but these clauses are deemed by the highest legal authority, the Latvian Supreme Court, to be legally binding contractual obligations under Latvian law. And specifically, the contracts are to be interpreted as fixing the multiplier in effect at the moment of signing the contract. The situation thus documented are facts interpreted by the Latvian courts concerning the Latvian legal situation that can be taken into regard by this Tribunal, without any need for the Tribunal to embark on any interpretation or application of Latvian national law on its own.

The Tribunal will add that there are several other circumstances that support the understanding of the purchase agreements set down by the Latvian Supreme Court. One is that several of the agreements make express reservations for changes of the tariff for average sale prices but not for changes of the multiplier. Such reservations would be

superfluous if the contract was to be understood merely to refer to laws and regulations at any time, and do support the impression that the multiplier was unreservedly granted for the eight years as stipulated in the Entrepreneurial Law. Another is that the offering of an investment incentive to prospective investors for a period of eight years would naturally be perceived by investors as a firm commitment for the full eight year period unless clear reservations were made to the contrary.

### 3.8 *The purchase price agreed between Latvenergo and Windau*

a) Following the legal findings of the Latvian Supreme Court in the quite similar Latelektro-Gulbene case there can be no doubt that Contract No. 16/97 of 24 March 1997 stipulated the purchase price for electric power from the Bauska plant to be the double tariff for a period of eight years from the time when Windau was ready to start production and had been commissioned.

b) However, the *Respondent* has contended that the *force majeure* clause in Contract No. 16/97 expressly makes reservations for new laws or regulations, which may alter the parties' rights or obligations under the contract. The *Claimant* denies that the clause can be read to this effect.

The *Arbitral Tribunal* considers that it would not be an evident conclusion of the unspecific reference to new legislation in the *force majeure* clause in Contract No. 16/97 that the legislator should be free to revoke the double tariff commitment, leaving the investor with no protection against a reduction or abolishment of this investment incentive. In particular, the structure of Contract No. 16/97, setting out in Article V a general reservation for changes in the legislation, immediately followed by a specific reservation in Article VI for changes of the "average sale price of electric power" (but thus not in the multiplier), strongly supports that changes affecting the price setting were not meant to be included in the *force majeure* clause. The Latvian Supreme Court decision in the Latelektro-Gulbene case, pronouncing that the purchase price (except for changes in the average tariff) is to be the one following from laws and regulations in force at the time of signing the contract, also gives strong support to the conclusion that the contractually stipulated multiplier may not be changed by means of the general reservation in the *force majeure* clause in Contract No. 16/97, even if the Gulbene letter of intent did not contain a similar general reservation against changes in the legislation. – As will be seen from the quotations above, the Latvenergo – Windau contract of 10 March 2000 does not contain any definition of *force majeure* which includes later changes in the legislation.

c) Further, the *Respondent* contends that Contract No. 16/97, including its agreement on the purchase price, was replaced by the agreement of 10 March 2000 (see section 3.6.7 above), fixing the multiplier at 0.75 after the Constitutional Court's decision. The *Claimant* contends that the 10 March 2000 agreement was a purely interim agreement, entered into under a certain degree of duress and in order to get out of the loss-producing standstill situation while waiting for the Constitutional Court's decision.

The *Arbitral Tribunal* notes that, after Windau was ready to start production on 17 September 1999 and the price dispute had emerged in full, Latvenergo sent Windau the following letter dated 27 September 1999:

"Subject: On signing the interim agreement

During the negotiations in the Privatization Agency Latvenergo orally expressed you an offer to sign an interim agreement until our disagreement in the matters related to the purchase of the produced surplus power is solved.

Taking into account the tense course of the negotiations, the oral offer as if did not receive the necessary attention.

Therefore we repeatedly offer you to sign an **interim agreement** on purchasing surplus power from the station and on supplying power to the station from Latvenergo, determining the precise term for such an agreement. ...

We understand that a station, which has been launched, has to start operating as soon as possible and this is exactly the reason for our proposal. Understanding your concern, we can include in the agreement the provision that the agreement shall not be in any way related to the previous or future relationship between Latvenergo and 'Windau Ltd'."

The Tribunal further notes that the agreement of 10 March 2000 itself does not state whether it is an interim agreement, or whether it constitutes a replacement of or a supplement to Contract No. 16/97. But the agreement states in clause 10.1 that its term of validity shall not be limited, and in clause 10.2 that the validity of the agreement shall depend on the validity of the licenses issued to the parties.

With regard to the clauses regarding the purchase price to be paid, the agreement stands out as an interim agreement concerning what payments shall be made in the period until the price dispute has been settled. The parties agree (see section 2.1 of the agreement) that up to the time of the Constitutional Court's decision payment shall be made at 0.75 of the tariff, with an immediate correction of the payment up to the double tariff if the Constitutional Court decides the issue before it in favour of the Claimant. And for the time after the Constitutional Court's decision, payments shall be at the double tariff if confirmed by the Constitutional Court but otherwise be based on the 0.75 multiplier, in both cases until such time as the price dispute is settled "in the manner prescribed by law". See section 2.2.

Section 2.2 of the agreement expressly stipulates that either party shall be entitled to submit its objections or claims in respect of the prices payable under the payment arrangement in section 2.1, irrespective of the adoption of any judgement of the Constitutional Court. This must reasonably be interpreted to mean that the price and payment clauses in the agreement constitute no change in the parties' claims and material basis with regard to the long-term price to be paid. In the Tribunal's opinion this confirms that Contract No. 16/97 was not revoked or replaced by the new agreement.

As mentioned above, for the period up to the decision of the Constitutional Court, the agreement makes it clear that the payment at 0.75 is an interim payment arrangement, with the payments to be corrected up to the double tariff if that would follow from the Court's decision. For the period from the Constitutional Court's decision up to the time when the dispute is settled "in the manner prescribed by the law", the interim payment is also to be at 0.75 of the tariff (unless otherwise determined by the Constitutional Court), but the agreement does not state expressly whether the interim payments are to be corrected, provided that the subsequent legal decision concludes that the correct payment according to Contract No. 16/97 is the double tariff. The Tribunal has considered whether the agreement must be interpreted as establishing that the interim payments shall be final. In other words, whether a legal decision establishing that Contract No. 16/97 determines the price to be the double tariff is only to take effect from the time of the legal decision, in the present case only from the time of this arbitration award. However, the agreement's clear

stipulation that the parties maintain their rights to pursue their claims under Contract No. 16/97 and obtain a legal decision without any limitation created by the agreement of 10 March 2000, leads the Arbitral Tribunal to the conclusion that also the agreement for the period after the Constitutional Court's decision is only an interim payment arrangement, with the payments to be corrected in accordance with the subsequent legal decision.

The Arbitral Tribunal therefore concludes that the agreement of 10 March 2000 is an interim agreement for the payments to be made during an unspecified period until the price dispute can be finally settled, making no changes with regard to the purchase price ultimately payable under Contract No. 16/97.

d) The *conclusion* must consequently be that the contractually agreed purchase price between Latvenergo and Windau for electric power from the Bauska plant shall be the double tariff for a period of eight years from the time when Windau was ready to start production and the plant had been commissioned.

## **4 The legal basis for the claims against the Republic**

### *4.1 Introduction*

The Claimant's claims are based on the undisputed fact that the start-up of production at the Bauska plant was delayed from 17 September 1999 until 28 February 2000, apparently due to Latvenergo's refusal to pay the double tariff for electric power from the Bauska plant, and due to the undisputed fact that all electric power delivered after the start-up on 28 February 2000 has only been paid at 0.75 of the average tariff.

The Arbitral Tribunal holds, and the parties seem to agree, that for the Republic to be held responsible in this arbitration the following conditions must be satisfied:

- a) The non-payment must be caused directly by the Republic or a state organ, or Latvenergo's actions in the contractual relationship with Windau must be attributable to the Republic;
- b) The non-payment and the circumstances around such non-payment must constitute a violation of an obligation under Part III of the Treaty; and
- c) The non-payment of the double tariff must have caused loss or damage to the Claimant's investment.

The condition under lit. c) will be dealt with under section 5 below.

### *4.2 The Republic's responsibility for the non-payment*

As concluded in sections 3.5.10 and 3.8.d above, the Arbitral Tribunal considers that Windau originally had both a statutory and a contractually established right to the double tariff for an eight year period.

It is conceded by the Respondent that the Entrepreneurial Law in force at the time of Latvenergo and Windau entering into Contract No. 16/97 on 24 March 1997 gave Windau a *statutory right* to the double tariff during the first eight years of production. The Respondent has also conceded that Windau's acquired statutory right to the double tariff was taken away by successive legislative acts, first, possibly, with the amendment to the Entrepreneurial Law of 11 June 1997 (see section 3.5.4), then definitely by the repeal of the Entrepreneurial Law by the Energy Law with effect from 6 October 1998 and the Cabinet of Ministers' Regulation No. 425 of 31 October 1998 (see sections 3.5.5 and 3.5.6 above). These are acts for which the Republic is directly responsible.

With regard to a *contractually established* right to the double tariff the Arbitral Tribunal concludes that by entering into Contract No. 16/97 Latvenergo also gave Windau a contractual right to the double tariff for eight years, see section 3.8.d above. It is not contested that Latvenergo has never paid the double tariff for electricity delivered by Windau.

No explicit explanation or documentation has been given as to the reasons for Latvenergo's refusal to pay the double tariff, but apparently the immediate reason for Latvenergo's refusal to pay was the repeal of the statutory right to the double tariff. It is in evidence that Latvenergo had no authority of its own to decide or negotiate purchase prices for electric power produced in Latvia. The average price tariff at any time was determined by regulatory authorities, and the so called multipliers were determined by law, or according to law, with an obligation for Latvenergo to apply the relevant tariff and the multipliers determined by the public authorities. Failing any indication to the contrary, it may be assumed that Latvenergo felt it to be its duty to deny Windau the double tariff after the legislators' decision to repeal Windau's established statutory right to the double tariff.

However, Latvenergo must have been aware that Windau in all likelihood had a contractual right to the double tariff. As mentioned above, the Latvian Supreme Court in a judgement of 30 June 1999 decided, in the quite parallel case of Latelektro-Gulbene, that Latvenergo had a contractual obligation to pay according to the multiplier in force at the time of entering into the agreement, regardless of later changes in the legislation. Latvenergo also signed a new contract with Latelektro-Gulbene confirming payment of the double tariff during the eight year period.

The central government of Latvia was also fully aware of Latvenergo's refusal to pay the double tariff. After a meeting with the Prime Minister on 29 October 1999 the Cabinet of Ministers on 30 November 1999 issued a Resolution ordering the double tariff to be paid to Windau (see section 3.5.7 above). As explained, the Resolution was later invalidated by the Constitutional Court for constitutional reasons, but the incident is evidence of the central government's full knowledge of Latvenergo's failure to pay the double tariff. There is no evidence of the government taking any further steps to protect Windau's rights under the contract, or to reinstate Windau's statutory right to the double tariff, for instance in accordance with the Republic's obligations to protect foreign investments under the Energy Charter Treaty, see section 4.3.2 below.

It must therefore be concluded that the breach of Windau's contractual rights was allowed to continue, and in that sense was caused, by the government's failure to act in order to correct the situation.



The Arbitral Tribunal is also of the view that in the circumstances of this case, the Republic must be considered responsible for Latvenergo's actions under the rules of attribution in international law.

Latvenergo was established in 1991 as a state enterprise, and was in 1993 transformed into a joint stock company with the Republic as a 100 per cent owner. For a while the plans were to privatize the company, and the company was administered by the Latvian Agency for Privatization. But by a change in the Energy Law on 3 August 2000 it was decreed that:

“As a national economy object of the State importance, the Joint Stock Company “Latvenergo” shall not be privatized. All shares in the Joint Stock Company “Latvenergo” are owned by the State.”

By order of the Cabinet of Ministers of 9 August 2000 the supervision of the company was transferred to the Ministry of Economy.

Both before and after these organizational changes Latvenergo held a dominant position as a major domestic producer of electric power and as sole distributor of electricity over the national grid. It was clearly an instrument of the State in a highly regulated electricity market. In the market segment where Windau operated, Latvenergo had no commercial freedom. It had no freedom to negotiate electricity prices but was bound, and considered itself to be bound, by the legislation and the regulatory bodies' determination of the purchase prices to be paid for electric power produced by cogeneration plants. Latvenergo cannot be considered to be, or to have been, an independent commercial enterprise, but clearly a constituent part of the Republic's organization of the electricity market and a vehicle to implement the Republic's decisions concerning the price setting for electric power.

For this reason, whether Latvenergo's refusal to pay the double tariff was based on a misunderstanding of the legal situation, or whether it for other reasons ignored the legal framework under which it was operating, its actions concerning the purchase price are attributable to the Republic. Consequently, the Republic must be found responsible for Latvenergo's failure to pay the double tariff. – The Tribunal will add that for this finding it is not necessary to rely on the supplemental rule in Article 22 (1) of the Treaty contended by the Claimant (see section 4.3.1 below).

### *4.3 Violations of Treaty obligations*

The *Claimant* alleges that the non-payment of the double tariff constitutes violation of several of the provisions of Article 10 of the Treaty, and also amounts to expropriation, or having an effect equivalent to an expropriation, as defined in Article 13 of the Treaty. It also relies on Article 22 (1) of the Treaty.

These Articles read in part:

“ARTICLE 10 PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS

(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favorable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such

Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favorable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

- - -

(3) For the purposes of this Article, "Treatment" means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.

- - -

(7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

- - -“

#### “ARTICLE 13 EXPROPRIATION

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date"). - - -“

#### “ARTICLE 22 STATE AND PRIVILEGED ENTERPRISES

(1) Each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of this Treaty..

- - -”

With reference to these Treaty provisions the Claimant mainly contends that:

- Windau is subject to a treatment having an effect equivalent to expropriation;
- The Republic fails to accord fair and equitable treatment of investments and constant protection and security of such investments;
- The failure to pay the double tariff represents discrimination, and a violation of the obligation to most-favoured nation's treatment; and
- Latvenergo is under both statutory and contractual obligation to purchase electric power from the Bauska plant at the double tariff, and the Republic is, pursuant to

Article 10 (1), under a duty to observe obligations that it has entered into, including obligations entered into by Latvenergo.

The *Respondent* denies for a number of reasons that the Respondent is in breach of any obligations under the Treaty, mainly contending that Latvenergo is a separate legal entity for which the Republic is not responsible, and that the scope of the asserted Treaty provisions are limited as set out in section 2.5 above.

#### 4.3.1 Expropriation

The *Claimant* does not contend that the non-payment of the double tariff amounts to a direct and formal expropriation meeting the requirements of Article 13 (1) (a)-(c), but rather that it constitutes an “indirect” or “creeping” expropriation. By taking away a substantial part of Windau's income from sales it makes the enterprise not economically viable and the Claimant's investment worthless.

The *Respondent* denies that Latvenergo’s non-payment amounts to the equivalent of an expropriation even in the wider sense developed under recent international treaty law and practice. First, no public authority is involved in Latvenergo’s action under the contract, second, there is no taking of possession or control over the enterprise, and third, the payment of 0.75 rather than 2.00 of the tariff does not result in the investment becoming worthless. The Claimant itself admits that the pay-back time is only lengthened, but that does not amount to expropriation.

The *Arbitral Tribunal* has considered the expert legal opinions and arbitral awards rendered under similar treaties presented in this case by the parties. The Tribunal finds that “regulatory takings” may under the circumstances amount to expropriation or the equivalent of an expropriation. The decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail. In the present case, there is no possession taking of Windau or its assets, no interference with the shareholder’s rights or with the management’s control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production licence, the off-take agreement, etc.

The Tribunal therefore *concludes* that the withholding of payment at the double tariff does not qualify as an expropriation or the equivalent of an expropriation under the Treaty.

#### 4.3.2 Fair and equitable treatment, discrimination etc.

The *Claimant* contends that Latvenergo’s actions, and the Republic's responsibility for such actions, constitutes violations of several of the Republic's obligations contained in or made operative by Article 10 of the Treaty, and has submitted evidence of circumstances upon which it bases its contentions.

The *Respondent* denies any violation of any international obligations contained in or referred to in Article 10, and has submitted evidence and explanations to counter the Claimant's contentions.

The *Arbitral Tribunal* notes in general that the actions for which the Republic is asserted to be responsible may qualify as a violation of various Treaty provisions. The Tribunal

further notes that the damage or loss caused by the non-payment of the double tariff is the same. Thus, in order to establish liability for the Republic it is strictly speaking sufficient to find that one of the relevant provisions has been violated.

a) *Unreasonable or discriminatory measures*

Article 10 (1) provides *inter alia* that

“...no Contracting Party shall in any way impair by ...unreasonable or discriminatory measures their [the Investor’s Investments] ...use, enjoyment or disposal”.

The *Claimant* contends that Windau has been subject to discriminatory measures by Latvenergo’s refusal to pay the double tariff. Latvenergo has been, and still is, paying SIA “Latelektro-Gulbene” and Joint Stock Company “Liepājas Siltums” the double tariff for its surplus electric power. There is no legitimate reason to treat Windau differently from the two aforementioned enterprises.

The *Respondent* does not deny the fact of the double tariff being paid to the two companies mentioned, but contends that the situations are not comparable. The Respondent has provided lists and some details concerning the 28 cogeneration power plants existing in Latvia, and asserted that they are in many respects different and therefore have been awarded different multipliers. An evaluation must take place in each case. No discrimination is demonstrated by the fact that the two above-mentioned plants have been granted the double tariff, whereas Bauska has not.

The *Arbitral Tribunal* accepts that in evaluating whether there is discrimination in the sense of the Treaty one should only “compare like with like”. However, little if anything has been documented by the Respondent to show the criteria or methodology used in fixing the multiplier, or to what extent Latvenergo is authorized to apply multipliers other than those documented in this arbitration. On the other hand, all of the information available to the Tribunal suggests that the three companies are comparable, and subject to the same laws and regulations. In particular, this appears to be the situation with respect to Latelektro-Gulbene and Windau. In such a situation, and in accordance with established international law, the burden of proof lies with the Respondent to prove that no discrimination has taken or is taking place. The Arbitral Tribunal finds that such burden of proof has not been satisfied, and therefore *concludes* that Windau has been subject to a discriminatory measure in violation of Article 10 (1).

b) *Other asserted Treaty violations*

For the reason stated above, the Arbitral Tribunal does not find it necessary to adjudge the other Treaty violations asserted in this arbitration.

#### 4.3.3 *Limited scope of the Treaty provisions allegedly breached*

As mentioned in section 2.5 above, the Respondent has asserted several limitations to the scope of the Treaty provisions relied on by the Claimant:

a) *The Treaty does not apply retroactively to contracts entered into before the Treaty entered into force:*

It is undisputed that Contract No. 16/97 was entered into on 24 March 1997 and that the Energy Charter Treaty only came into force on 17 March 1998. However, none of the Claimant's claims are based on the date of the signing of the Contract. The claims are built on the repeal of Windau's statutory right to the double tariff, which took place in September/October 1998, and on the breach of the contractual obligation to pay the double tariff, which materialized in September 1999 when the Bauska plant was ready to go into operation, and which has been maintained since then, albeit in accordance with the interim agreement of 10 March 2000. Both the changes in the law and the breach of contract occurred after the entry into force of the Treaty. There is therefore no question of retroactive effects of the Treaty in this situation.

*b) The Treaty does not apply retroactively to a withdrawal of the right to the double tariff which was effected before Nykomb's investment took place:*

It is undisputed that the Claimant's first investment in Windau occurred by the contract of 11 March 1999, registered on 25 March 1999, for the purchase of 51 per cent of the shares in Windau. The withdrawal of Windau's statutory right to the double tariff took place in September/October 1998, which was before Nykomb's investment. But as pointed out in lit. a) above, the claims for losses or damages are also based on the breach of the Contract which occurred from September 1999, which is after Nykomb's first investment was made. At least in the latter situation there is no question of the retroactive effects of the Treaty.

*c) Nykomb was aware of the price dispute, or ought to have been aware of it, and took a commercial risk not protected by the Treaty:*

The Respondent also contends that Nykomb was aware of the price dispute, or ought to have been aware of it, before it bought the shares in Windau. Nykomb took a purely business or commercial risk when investing in Windau. The Treaty only protects against political risks and not against commercial or business risks.

This contention raises the question of what Nykomb knew, or ought to have known, about Latvenergo's refusal to pay the double tariff at the time of its investment. It also invites the question of whether a Contracting State to the Treaty can free itself from its Treaty obligations simply by informing a prospective foreign investor that it has established and intends to continue a discrimination of the foreign investment which would otherwise be a violation of the Treaty.

The Tribunal will first deal with the dispute between Latvenergo and Windau concerning the validity of Contract No. 16/97. The relevant sequence of events in connection with this can be summarized as follows:

24 Mar 1997	Contract Nos. 16/97 and 17/97 entered into
26 Mar 1997	Contract No. 18/97 entered into
11 June 1997	The Entrepreneurial Law was amended, excluding contracts after 31 May 1999
25 Sep 1997	Latvenergo board decision: No further contracts with Windau
2 Oct. 1997	Latvenergo declared Contract Nos. 16/97 and 17/97 invalid
24 Oct. 1997	Dupont Aldrich Inc. and Jonathan Moseley became shareholders

19 Feb 1998	Noell turnkey and supply contract with Windau
6 Mar 1998	Windau compromise proposal to Latvenergo on invalidity dispute
20 Mar 1998	Latvenergo rejected any compromise, referring to being "bound by law"
Spring 1998	Noell invited Nykomb to take over as equity investor
8 May 1998	Windau asks for an off-take contract for Bauska
21 May 1998	Latvenergo refused, referring to board decision of 25 September 1997
29 Jun 1997	Windau letter to Council concerning the double tariff
30 Jun 1998	Council's letter to Windau confirming the double tariff
July 1998	Nykomb involved itself in project investigations
30 Oct. 1998	PriceWaterhouseCooper's financial proposal
16 Dec 1998	First instance Court decision in the Latelektro-Gulbene case
12 Feb 1999	Loan agreement between Vereinsbank and Windau
11 Mar 1999	Nykomb's purchase agreement for 51 per cent of the shares in Windau
30 Jun 1999	The Latvian Supreme Court ruling in the Latelektro-Gulbene case
11 Sep 1999	Bauska ready to start operation. Latvenergo refuses to pay double tariff
28 Feb 2000	Bauska started operation
10 Mar 2000	Windau –Latvenergo interim agreement
About Jan 2002	Latvenergo's court action against Windau on validity of Contract 16/97
11 Feb 2002	Nykomb Request for Arbitration
January 2003	Latvenergo's court action withdrawn, according to Claimant.

As will be seen, there was an ongoing dispute between Latvenergo and Windau almost from the beginning concerning the validity of Contract No. 16/97. As early as 2 October 1997 Latvenergo proclaimed that it considered the Contract invalid. As late as at the turn of the year 2001/2002, according to the Claimant, Latvenergo brought an action in the Latvian courts against Windau, claiming the invalidity of the Contract.

A similar court action had earlier been brought by the company Latelektro-Gulbene against Latvenergo. In both cases Latvenergo appears to have argued that the purchase agreements were invalid, because they were signed on behalf of Latvenergo by a person unauthorized to do so, because the price clauses (see section 3.6.3 and 3.6.6 above) were unclear and therefore not legally binding, and because the purchase price agreement had been superseded by subsequent legislation.

Latelektro-Gulbene won its case in three Latvian court instances, which culminated in the decision of the Latvian Supreme Court in June 1999 (see section 3.6.8 above). Latvenergo's court action against Windau was initiated after the Latelektro-Gulbene case had been decided and Latvenergo had entered into a new contract with Latelektro-Gulbene accepting the double tariff, see section 3.6.8 above. The case against Windau was only withdrawn in January 2003. It has not been explained why Latvenergo gave up the court case.

In the present arbitration the Respondent does not challenge the general validity of Contract No. 16/97, but contends that it does not establish a right to the double tariff for

eight years. As further developed above, the Arbitral Tribunal finds and concludes to the contrary.

But it remains to be considered whether it is of any legal significance whether Nykomb was aware of, or ought to have been aware of, Latvenergo's contentions that Contract No. 16/97 was invalid and that therefore the right to the double tariff was contended to be ineffective.

The representatives of Nykomb must clearly have been aware of the dispute between Latvenergo and Windau over the validity of Contract No. 16/97, and therefore aware of an uncertainty as to whether the whole contract would fall away, and with it Windau's right to the double tariff. This uncertainty is reflected in the PriceWaterhouseCoopers financial analysis of 30 October 1998, where calculations were made alternatively on the basis of a 1.00 multiplier (that is, ordinary tariff price for electric power) and the 2.00 multiplier according to the Contract.

The double tariff was also treated as a condition for the repurchase of shares in the agreement of 11 March 1999 whereby Nykomb bought 51 per cent of the shares in Windau. According to Clause 5.1 of the agreement the sellers were secured the right to repurchase 21 per cent of the shares, subject to several conditions, mainly,

- that Windau shall have sold all generated electricity to Latvenergo at the double tariff provided for by the Latvenergo agreements (defined in clause 2.2.9 as Contract Nos. 16/97, 17/97 and 18/97);
- that three years had expired after the commissioning of the Bauska plant; and
- that Windau had fulfilled all its liabilities and repaid all loans and covered all expenses connected with the purchase, construction and commissioning of (the 16) co-generation plants.

By clause 2.2.9 of the agreement the sellers represented and warranted that “[T]he Latvenergo Agreements are in full force and effect and enforceable in accordance with its terms”, compare in relation to this the Council's letter of 30 June 1998 confirming the double tariff.

It must therefore be concluded that Nykomb was fully aware of the uncertainty and risk deriving from Latvenergo's position, but took its precautions in the share purchase agreement and took the risk that the Contract was valid and invested in the Windau shares.

Whether or not one would characterize the risk Nykomb was taking as a commercial risk, is in the Tribunal's view immaterial. It is the Tribunal's conclusion that Windau had entered into a purchase contract for the delivery of electric power that was, and is, legally valid and binding and gave Windau the right to the double tariff for eight years. Nykomb made its share investment relying on this contract. Latvenergo's contentions that Contract No. 16/97 was invalid and did not establish the right to the double tariff were legally unfounded. Nykomb's awareness of Latvenergo's contentions does not relieve the Republic of its obligations under the Treaty resulting from Latvenergo's refusal to pay the double tariff. Generally, a Contracting Party to the Treaty cannot be relieved of its obligations

under the Treaty simply by letting it be announced that legally binding commitments, upon which the foreign investor is relying, will not be honored.

d) *The Claimant's claims are based on a commercial contract not protected by the Treaty*

Finally, the Respondent contends that the Contract between Latvenergo and Windau for the purchase of electric power, upon which all the Claimant's claims are based, is a commercial contract and as such not protected by the Treaty. The Treaty protection only applies to investment contracts within the meaning of the Treaty.

It follows from the remarks above that the Arbitral Tribunal cannot regard the purchase contract as purely commercial, nor can the action to refuse payment of the double tariff under the contract be considered as purely commercial.

As for the objection that the purchase contract is not an investment contract within the meaning of the Treaty, it suffices to note that such a contract clearly falls within the definition of investments in Article 1 of the Treaty.

#### 4.3.4 Conclusion

In consequence of the above findings the *Arbitral Tribunal concludes* that the Respondent is found to be liable under the Treaty for the losses or damages incurred by the Claimant.

## 5 Assessment of losses or damages

### 5.1 Legal principles of assessment

Article 13 (1) of the Treaty spells out the principles of compensation in the special case of investments being nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation. As concluded in section 4.3.1 above, the Tribunal does not find that the refusal to pay the double tariff amounts to expropriation or the equivalent of an expropriation within the meaning of Article 13 (1). The Tribunal considers that the principles of compensation provided for in Article 13 (1) are not applicable to the assessment of damages or losses found to be caused by violations of Article 10, as in the present case.

Another assessment rule is contained in Article 26 (8), which provides that the awards of arbitration according to Article 26 may include an award of interest. The question of interest will be dealt with below.

The Arbitral Tribunal holds, and it seems to be agreed between the parties, that the question of remedies to compensate for losses or damages caused by the Respondent's violation of its obligations under Article 10 of the Treaty must primarily find its solution in accordance with established principles of customary international law. Such principles have authoritatively been restated in The International Law Commission's Draft Articles on State Responsibility adopted in November 2001 (hereinafter referred to as the "Articles ILC").



According to Articles 34 and 35 ILC restitution is considered to be the primary remedy for reparation. Article 35 states:

“A State responsible for an internationally wrongful act is under an obligation to make restitution, that is, to re-establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:

- (a) is not materially impossible;
- (b) does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.”

Restitution in the present case is conceivable, either through a juridical restitution of provisions of Latvian law ensuring Windau’s right to the double tariff as it was ensured under the Entrepreneurial Law, or through a monetary restitution to Windau of the missing payments of the difference between the contractually established double tariff and 0.75 of the tariff actually paid. But even if damage or losses to an investment may be inflicted indirectly through loss-creating actions towards a subsidiary in the country of a Contracting State, restitution must primarily be seen as an appropriate remedy in a situation where the Contracting State has instituted actions directly against the investor. An award obliging the Republic to make payments to Windau in accordance with the Contract would also in effect be equivalent to ordering payment under Contract No. 16/07 in the present Treaty arbitration. The Arbitral Tribunal therefore finds the appropriate approach, for the time up to the time of this award, to be an assessment of compensation for the losses or damages inflicted on the Claimant's investments. For the time after this award see section 5.2, last paragraph, below.

## 5.2 *Assessment of losses or damages suffered by the Claimant*

a) As already pointed out (see section 1.2.2 above) the Claimant requests a relief equal to Windau's alleged loss of net income on heat and electric power in the “dead-lock” period 16 September 1999 – 28 February 2000 and Windau’s alleged loss of sales income on electric power for the rest of the eight years’ period to 16 September 2007, namely the difference between the double tariff and the 0.75 of the tariff actually paid, or expected to be paid.

The *Respondent* has argued, and the *Arbitral Tribunal* must agree, that the reduced flow of income into Windau obviously does not cause an identical loss for Nykomb as an investor. If one compares this with a situation where Latvenergo would have paid the double tariff to Windau, it is clear that the higher payments for electric power would not have flowed fully and directly through to Nykomb. The money would have been subject to Latvian taxes etc., would have been used to cover Windau's costs and down payments on Windau's loans etc., and disbursements to the shareholder would be subject to restrictions in Latvian company law on payment of dividends. An assessment of the Claimant's loss on or damage to its investment based directly on the reduced income flow into Windau is unfounded and must be rejected.

b) However, there can be no doubt that the non-payment of the double tariff to Windau has caused a substantial reduction of the economic value and security of the Claimant's investments in the Windau enterprise.

A primary measurement of an investment is the capitalized earnings value. A substantial reduction of Windau's earnings as demonstrated in this case must be considered as

convincing evidence that a substantial damage to or loss on the Claimant's investment has been suffered. A reduction of the tariff multiplier from 2.00 to 0.75 represents a 62.5 per cent reduction of the sales income from electric power. Furthermore, if one takes as illustrative the relationship between Windau's gross income on electricity and heat sales suggested by the Claimant's calculation for the "dead-lock" period, the reduction of the tariff multiplier results in a reduction of the total income from sales by about 57 per cent, more than half of Windau's total income as compared with a situation where the double tariff would be paid.

It is also clear that the higher income flow would have served to consolidate Windau's financial position, provided means for paying back bank loans and other credits, and ensured a quicker pay-back on the investments in the cogeneration plant. For Nykomb as an investor the effect would be increased security for its investments in credits, shares and subordinated loans. From another perspective, the Claimant has pointed out that the reduced liquidity caused by the refusal to pay the double tariff may lead to the consequence that Windau shall not be able to pay back the loan to Vereinsbank that is due for payment in January 2004.

But the loss or damage suffered by Nykomb as an investor is difficult to quantify. The difficulty is also increased by the fact that the Claimant has submitted rather limited documentation concerning the financial and economic situation of Windau and the circumstances concerning its own investment, for instance the relationship between Nykomb and Noell and the Noell group.

At the hearing the Claimant submitted a list of "capital requirements" for the Bauska plant 1999-2003, including the situation at the end of 2000 (for illustration, SEK at 15/- is added here):

		End 2000	
		Lats	SEK
NYKOMB			
	Shares	250 000	3 750 000
	Loans	380 000	5 700 000
	Owner costs	439 000	6 585 000
		<u>1 069 000</u>	<u>16 035 000</u>
NOELL/BBP	1 495 000	22 425 000	
VEREINSBANK	622 000	9 330 000	
SUM TOTAL		<u>3 186 000</u>	<u>47 790 000</u>

This statement concerning the Claimant's total investment would appear to suggest a maximum of what the Claimant stands to lose on account of Latvenergo's non-payment of the double tariff. But the loss of Windau's future earning potential, and the conceivable consequential loss for Nykomb as a 100 per cent owner of the enterprise, must also be considered. As for this last element the Tribunal has little material upon which to base an assessment, apart from various submitted financial analyses and Windau's accounts for the last few years.

Faced with the lack of further specifics, together with the undeniable finding that Nykomb as an investor has suffered economic loss or damage on its investment, the Arbitral Tribunal is compelled to make an assessment, taking into regard the requirements under applicable customary international law of causation, foreseeability and the reasonableness of the result.

The Tribunal finds that the best available basis for such an assessment is the calculated loss of electricity production in the “dead-lock” period and the actual production of electric energy up to the time of this award. The Tribunal does not consider the asserted loss of heat production in the “dead-lock” period to be helpful in connection with this, nor is it substantiated in any sufficient degree what net loss has been suffered on the non-production of heat. The only cost deducted in the Claimant's calculation of the net loss is the cost of natural gas required for the production.

The Tribunal considers that in the circumstances a discretionary award of one third of the estimated loss in purchase prices of electricity up to the time of this award may serve as a reasonable basis for quantification of the Claimant's assumed losses up to the time of this award, due to the Respondent's violations of its Treaty obligations.

To develop the chosen basis for the Arbitral Tribunal's assessment the Tribunal has added, to the Claimant's figures for electricity production up to 30 April 2003, an estimated figure for power production from 1 May 2003 up to the time of the award, based on the figures for power production up to 30 April 2003. It has also been found reasonable to include in the estimate a 6 per cent simple interest, reckoned for practical reasons for each of the periods in question from the mid point of the respective periods up to the time of the award.

On this basis the Arbitral Tribunal assesses a reasonable compensation in the sum of Lats 1.600.000. In view of the Claimant's use of the Latvian currency in its requests for relief the same currency is used in this assessment.

As specifically regards the asserted losses on delivery of electric power to Latvenergo for the remainder of the eight year period, the Tribunal considers this potential loss to be too uncertain and speculative to form the basis for an award of monetary compensation. But the Tribunal considers it to be a continuing obligation upon the Republic to ensure the payment at the double tariff for electric power delivered under the Contract for the rest of the eight year period, and therefore gives an order for the Republic to fulfill its obligation under the Treaty to protect the Claimant's investment.

### *5.3 Payment of interest*

The *Claimant* has claimed interest on the claimed amounts in the various periods, from the beginning of each of the designated periods until payment. In its first requests for relief, and in its calculations of net present values of future losses on the sale of electric power, the Claimant claimed for an annual interest rate of six per cent, stating that this is the prevailing interest rate in Latvia. In its Brief No. III of 9 September 2003 (see section 1.2.1 above) the Claimant claimed for an annual interest rate of six per cent up to the date of the award, and 18 per cent from that date until payment. The Claimant contends that it has the

right to claim 18 per cent which is the stipulated interest rate in the Contract between Windau and Latvenergo in the event of late payment.

The *Respondent* has not objected to the statement regarding the prevailing interest rate in Latvia of six per cent per annum, but has objected to the Claimant's asserting a right to the interest rate in the Windau – Latvenergo contract.

According to Article 26 (8) of the Treaty an arbitration award may include the award of interest. The *Arbitral Tribunal* finds it appropriate in the present case to award interest.

As mentioned above, the Tribunal has, for the periods up to the time of the award, included an interest element at six per cent per annum as a basis for the assessment of the Claimant's accumulated losses by the time of the award.

As for the time after the award the Tribunal finds it appropriate to award six per cent per annum on the awarded amounts, from the time of the award until payment is effected. This interest rate must be seen as accepted by the parties to be the prevailing rate in Latvia.

The Claimant has no right to claim in this arbitration the interest rate agreed between Windau and Latvenergo. The interest to be considered under the Treaty is a compensation related to the compensation to the Claimant for its own damages or losses. The interest clause in the Windau – Latvenergo contract is related to late payments under the contract and clearly includes a penalty element not applicable in the present case.

## **6 Allocation and allowability of costs**

### *6.1 The Parties' arguments*

The *Claimant* claims compensation for its own costs, which amount to SEK 8.354.000. The Claimant also requests the Arbitral Tribunal to order the Respondent to pay all the costs and expenses of this arbitration.

The *Respondent* claims compensation for its own costs, which amounts to SEK 6.435.270 and LAT 229.174. The Respondent also requests the Arbitral Tribunal to order the Claimant to pay all the costs and expenses of this arbitration.

The only comment from the parties in relation to costs is from the Respondent saying that it is not reasonable that the Republic should bear the increase in the Claimant's costs which must have been the result of a new counsel for the Claimant coming in at a late stage in the proceedings.

### *6.2 In general*

According to Article 41 of the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, the Arbitral Tribunal may, unless the parties have agreed otherwise, at the request of a party in the Award, order the losing party to compensate the other party for legal representation and other expenses for presenting its case. An arbitral tribunal may

apportion such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.

The Claimant has to a certain extent been successful in its claim and is therefore, in principle, entitled to an award ordering the Respondent to bear part of the costs for this arbitration.

### *6.3 The fees and costs of the Arbitral Tribunal and the Arbitration Institute*

The fees and costs of the arbitrators amount to the following.

The fee of the chairman of the Arbitral Tribunal, Mr. Bjørn Haug, amounts to € 90.000. His costs amount to € 7.677.

The fee of Mr. Rolf A. Schütze amounts to € 49.500. His costs amount to € 10.475.

The fee of Mr. Johan Gernandt amounts to € 49.500. His costs amount to € 2.763.

Value Added Tax (“VAT”) at a rate of 25 per cent for Mr. Johan Gernandt (Swedish VAT) and 16 per cent for Mr. Rolf A. Schütze (German VAT) is to be imposed on charges for legal services.

The fee of The Stockholm Chamber of Commerce Arbitration Institute amounts to € 20.946. Value Added Tax (“VAT”) at a rate of 25 per cent is to be imposed on the part of the administrative fee payable by the Swedish party.

As follows from section 6.1 and 6.2 above, and considering the other circumstances of the case, the Arbitral Tribunal concludes that it is reasonable to apportion the costs of the arbitration (except for the parties’ own costs) equally between the parties.

Consequently, the costs of the arbitration, notably the fees, charges and disbursements of the Arbitral Tribunal and the Arbitration Institute shall be paid by the Claimant with 50 per cent and by the Respondent with 50 per cent. The Arbitral Tribunal will so award.

### *6.4 The costs for legal representations and expenses*

The Claimant has, as also stated above, to a certain extent been successful in its claim and is therefore, in principle, entitled to an award ordering the Respondent to bear some part of the Claimant’s costs for this arbitration.

The Arbitral Tribunal notes that the major part of the work involved in presenting the Claimant’s claim has, in the opinion of the Arbitral Tribunal, been devoted to the difficult legal issue of whether or not the Respondent is liable for the claim, in which the Claimant has been successful. However, the Arbitral Tribunal finds reason to make some adjustment of the Claimant’s monetary claim. The Arbitral Tribunal concludes that the amount requested by the Claimant, i.e. SEK 8.354.000, is high, that the Claimant has changed its counsel, which normally leads to additional costs, and that a reasonable sum to be awarded in favour of the Claimant to be paid by the Respondent, considering the circumstances and the outcome of the case, is SEK 2,000,000. The Arbitral Tribunal will so award.

## 7 Arbitral Award

For the reasons stated above, the Arbitral Tribunal unanimously renders the following

### Arbitral Award

1. a) The Republic of Latvia is ordered to pay to Nykomb Synergetics Technology Holding AB, Stockholm, Lats 1,600,000 –onemillionsixhundredthousand Lats – plus interest at the rate of 6 (six) per cent per annum from the date of the award until full payment is effective.  
b) The Republic of Latvia is ordered to ensure the payment of the double tariff to Windau SIA, Riga, for electric power delivered from Windau's cogeneration plant at Bauska in accordance with Contract No. 16/97 for the period from the date of this award until 16 September 2007.
2. The Republic of Latvia is ordered to pay to Nykomb Synergetics Technology Holding AB, Stockholm, as compensation for its costs incurred in connection with this arbitration SEK 2,000,000 –twomillion SEK.
3. In accordance with the decision of the Arbitration Institute of the Stockholm Chamber of Commerce, the arbitrators and the said Arbitration Institute shall be entitled to fees and compensation for expenses in the following amounts:

a) Bjørn Haug, chairman,	
fees	€ 90.000
costs	€ 7.677
	€ 97.677
b) Rolf A. Schütze, arbitrator,	
fees	€ 49.500
costs	€ 10.475
16 per cent VAT on fees and costs	€ 9.596
	€ 69.571
c) Johan Gernandt, arbitrator,	
fees	€ 49.500
costs	€ 2.763
25 per cent VAT on fees and costs	€ 13.066
	€ 65.329
d) The Arbitration Institute,	
administrative fee	€ 20.946
Sum total	€ 253.523

As between the parties, Nykomb Synergetics Technology Holding AB shall be responsible for 50 per cent and the Republic of Latvia for 50 per cent of the amounts due in this arbitration to the arbitrators and the Arbitration Institute.

In relation to the arbitrators and the Arbitration Institute the parties shall be jointly and severally liable for the payment of the amounts due to the arbitrators and the Arbitration Institute.

- Nykomb Synergetics Technology Holding AB shall also pay 25 per cent VAT on its part of the administrative fee to the Arbitration Institute, i.e. (25 per cent of €20.946/2) = € 2.618.

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Stockholm, 16 December 2003.

Rolf A. Schütze (s)

Bjørn Haug (s)

Johan Gernandt (s)