Case summary
Nykomb Synergetics Technology Holding AB (Sweden) v. Latvia

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## 1. Key Facts of the Arbitration

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| **Claimant:** | **Nykomb Synergetics Technology Holding AB (Sweden)** |
| **Respondent:** | **The Republic of Latvia** |
| **Forum of arbitration** | **Stockholm (Sweden)** |
| **Arbitral Institution** | **Arbitration Institute of the Stockholm Chamber of Commerce** |
| **President of the Tribunal** | **Bjorn Haug** |
| **Arbitrator appointed by the Claimant:** | **Rolf A. Schütze** |
| **Arbitrator appointed by the Respondent:** | **Johan Gernandt** |
| **Commencement of arbitration** | **Request for arbitration registered on 11th December 2001** |
| **Decision and date** | **Award rendered on 16th December 2003** |
| **Value of claim:** | **7.097.680 Lats + 6 % p.a** |
| **Relief granted:** | **Restitution of 1.600.000 Lats + 6% p.a.**<br>**Respondent to ensure compliance by State owned company with its contractual obligations**<br>**Respondent to reimburse Claimant of legal fees of SEK 2.000.000**<br>**Arbitration costs of 253.523 EUR to be equally borne by the parties** |

## 2. Introduction

The award in the investor-state arbitration Nykomb Synergetics Technology Holding AB (as the "Claimant") vs. The Republic of Latvia (the "Respondent") was rendered on 16th December 2003 and is the first published award dealing with foreign investment protection accorded by part III. of the Energy Charter Treaty (the "ECT"). The investor's claim arose out of a dispute over the purchase price to be paid under a contract entered into between claimant's subsidiary and a State enterprise for the building of a cogeneration plant in Latvia. According to the claimant Latvia allegedly expropriated Nykomb Synergetics Technology Holding AB, breached Fair and Equitable Treatment (including denial of justice), and adopted arbitrary, unreasonable and discriminatory measures. The Tribunal found that Latvia breached the Energy Charter Treaty (the "ECT") by adopting arbitrary, unreasonable and discriminatory measures, and ordered Latvia to compensate the investor in the amount of 1.60 million LVL (2.90 million USD).

## 3. Summary of Facts

The Claimant is a company organized under Swedish law that acquired 51% of the share capital in March 1999 and 49% in September 2000 in SIA Windau ("Windau"). Windau is a company incorporated and operating in Latvia. The latter had previously entered into Contract No. 16/97 of 24th March 1997 (the "16/97 Agreement") with Latvenergo. Latvenergo is a 100% state owned company

engaged in the production of electricity, and exclusively purchasing and distributing electric energy in Latvia.

In virtue of the 16/97 Agreement, Windau undertook the construction and operation of a cogeneration plant in the town of Bauska (the "Bauska Plant" or the "Plant"). The construction of the Plant was finalized in September 1999, however the operation of the plant could not commence until 28th February 2000, since the parties disagreed on the purchase price of electric energy and heat to be paid by Latvenergo. Under the 16/97 Agreement, the pricing mechanism stipulated between the parties for electricity generated in the Bauska Plant was composed of two elements: the general tariff for average sales prices per kWh set by regulatory authorities and a multiplier set by Latvian law and regulations. The contested issue evolved around the precise factor of the multiplier. The 1998 Energy Law and the Regulation No. 425/1998 repealed the double tariff and determined the multiplier to be 0.75 (Award, ¶ 3.5.10). As of 28th February 2000, electricity production started to be purchased by Latvenergo with a multiplier of 0.75, pursuant to an interim agreement between the parties in March 2000. However, Windau claimed that in virtue of the 16/97 Agreement, it was entitled to a multiplier of 2.0 *i.e.* to a double tariff. Latvia on the contrary contended, with reference to its national legislation that the multiplier of the purchase price owed to Windau was 0.75 (Award, ¶ 1.1).

Despite the fact that the pertinent national legislation underwent numerous amendments from 1995 to 2002 (C.f. section 3.5 on pages 15-20 of the award ), the Tribunal nevertheless established that the stipulated purchase price for electricity generated in the Bauska plant was double tariff (Award, ¶ 3.8 d).

## 4. Contentions of the Parties and Prayer for Relief

The Claimant's claims are based on the fact that within the deadlock period from September 1999 until 28th February 2000 the Bauska Plant did not operate due to the Latvenergo's refusal to pay the double tariff. Furthermore, as of 28th February 2000, Windau was only paid a reduced purchase price at 0.75 of the average tariff. The Claimant therefore asserts that Latvenergo's refusal to pay double tariff constitutes a breach of Respondent's obligation to accord the Claimant:

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

On this basis, the Claimant made a prayer for the following relief:

- compensation for losses in income from 17 September 1999 until 28 February 2000 based on the expected production of electricity and heat (less the costs of gas) at the double tariff;
- compensation for losses in income from 28 February 2000 until 16 September 2002 based on the actual production at the difference between 0,75 and the double tariff;
- compensation for losses in income from 16 September 2002 until 16 September 2007 based on the estimated production or, in the alternative, order to pay double tariff for future production.

The Respondent mainly asserted, that the claim lacked jurisdiction, that Latvenergo conducts were not attributable to Latvia, that the claim was without merit and that the Claimant has not suffered any loss.

## 5. Findings of the Tribunal

After having clarified the rules applying to the purchase price for electricity between Latvenergo and Windau, the Tribunal established its jurisdiction and found that the Respondent had breached its obligations under part III of the ECT.

### 5.1 The Regulatory and Contractual Regulation of the Purchase Price for Electricity between Latvenergo and Windau

#### 5.1.1 Windau's Statutory Right to the Double Tariff

The development of regulation of purchase prices for electric power from cogeneration plants started from an initial broad-sweeping offer in the 1995 Entrepreneurial Law of the double tariff as an investment incentive. Later on, this moved towards a gradual limitation and finally the abolishment of the double tariff as a mandatory incentive prescribed by statute.

However, the parties agreed 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, the double tariff for certain power plants was in force at least until the Energy Law came into force on 6 October 1998. (Award, ¶ 3.5.10).

### 5.1.2 Windau's Contractual Right to the Double Tariff

Under the purchase agreements, the seller undertook to install the power plant and to sell to Latvenergo its surplus power (that was, produced power beyond what was needed by the seller for its own production), and Latvenergo undertook to purchase the surplus power on the basis of tariffs stipulated by law. It has also to be noted that almost all of these contracts consistently referred to actual laws and regulations as determining the price to be paid. Moreover, the price clauses in the purchase contracts were deemed by the Latvian Supreme Court to be legally binding contractual obligations under Latvian law.

In this regard, according to the Latvian Supreme Court in the quite similar Latelektro-Gulbene case, it resulted from the Contract No. 16/97 of 24 March 1997 that 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. However, the Respondent contended that there was a force majeure clause in Contract No. 16/97 which expressly made reservations for new laws or regulations, and thus altered the parties' rights or obligations under the contract. The Claimant denied that the clause can be read to this effect. However, as the Contract No. 16/97 did not provide any specific reference to new legislation in the force majeure clause, the Arbitral Tribunal considered that it was not evident to conclude 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. This was supported by the Latvian Supreme Court decision in the Latelektro-Gulbene case, pronouncing that the purchase price must be the one following from laws and regulations in force at the time of signing the contract (Award, ¶¶ 3.7, 3.8).

Furthermore, the Respondent maintained that Contract No. 16/97, including its agreement on the purchase price, was replaced by the agreement of 10 March 2000 fixing the multiplier at 0.75 after the Constitutional Court's decision. The Claimant alleged that the 10 March 2000 agreement was a purely interim agreement entered into in order to get out of the loss-producing standstill situation while waiting for the Constitutional Court's decision. However, the Arbitral Tribunal upheld the Claimant's assertion that the agreement of 10 March 2000 was 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.

Given the above, the Tribunal found 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 (Award, ¶¶ 3.7, 3.8).

### 5.2 Findings on Jurisdiction

The objections to jurisdiction raised by the Respondent can be divided into two sets of arguments: (1) the Arbitral Tribunal lacks jurisdiction due to jurisdiction of Latvian courts (Award, ¶ 2.4), and (2) the Tribunal lacks jurisdiction due to the limited scope of Treaty provisions (Award, ¶ 2.5).

#### 5.2.1 Lack of jurisdiction due to jurisdiction of Latvian courts

To substantiate its claim that the Arbitral Tribunal lacks jurisdiction due to jurisdiction of Latvian courts, the Respondent produced following arguments.

Firstly, the Respondent contended that the claims concerned belonged to Windau, consequently the claims are not owned by the Claimant, notwithstanding its 100% shareholding in Windau. The Tribunal dismissed this argument on the ground that the claim must be understood to redress losses the Claimant incurred itself as foreign Swedish investor operating in Latvia as a shareholder and a investor of the Latvian company Windau, and not losses incurred by the Latvian legal entity (Award, ¶ 2.4).

Furthermore, the Respondent asserted that 16/97 Agreement and the Interim Agreement contained jurisdiction clauses, which referred the dispute exclusively to Latvian courts. This argument was dismissed. The Tribunal found that the Claimant and Windau are distinct legal entities, neither of them empowered to rescind jurisdiction with effect on the other entity. Accordingly, a jurisdiction clause in the agreement between Windau and Latvenergo could not be construed to be legally binding for the Claimant (Award, ¶ 2.4).

In addition, the Respondent raised its concern that a Treaty claim raised by the Claimant entailed the risk of double recovery, since nothing prevented Windau from remedying its losses in front of national courts. While the Tribunal acknowledged that no definite remedies had been developed to avoid double recovery, it did not consider this argument to be an objection to its jurisdiction. Instead, it contended that further development of the law in this area was necessary to counter the risk of double recovery.

Finally, the Arbitral Tribunal found that the Respondent had made no reservations under Art. 17 of the ECT concerning the scope of Art. 26 of the ECT, that the investor has the right to recourse to arbitration even if it has contractually agreed to domestic jurisdiction. Therefore, a change in the Respondent's motivation had to be left unconsidered (Award, ¶ 2.4(b)).

Lastly, the Respondent asserted that by adhering to the ECT, it had not contemplated that claims as those raised by the Claimant would be eligible for investor-state arbitration. The Respondent argued that Claimant's claim for contractual breach could not be ascertained until the proper domestic forum has

first pronounced on the issue (Latvian courts). The tribunal stated that in its 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 Article 26 (4) of the ECT 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.

### 5.2.2 Lack of jurisdiction due to limited scope of Treaty provisions

To substantiate its argument that the Arbitral Tribunal lacked jurisdiction due to limited scope of Treaty provisions, the Respondent relied on four arguments.

The Respondent raised the point that the ECT had come only into force on 17th March 1998 and had not have retroactive effect to apply to the 16/97 Agreement signed on 24th March 1997. This objection was dismissed by the Arbitral Tribunal. The material date to determine jurisdiction *ratione temporis* was the date Windau's entitlement to double tariff ceased to be effective. As anticipated, statutory rights were repealed in September/October 1998, and contractual rights were breached in September 1999, when the Bauska Plant was ready to operate. Both events occurred after the ECT came into force (Award, ¶ 4.3.3(a)).

Moreover, the Respondent contested the Tribunal's jurisdiction by asserting that the Claimant had started its investment in Windau in March 1999, after its entitlement to double tariff had been repealed. While the Tribunal acknowledged that the repeal of statutory rights to the double tariff had taken place in the fall of 1998, i.e. before the Claimant commenced its engagement in Windau on 25th March 1999, the breach of contractual rights had taken place in September 1999, and therefore, after the Claimant's investment had taken place (Award, ¶ 4.3.3(b)).

In addition, the Respondent contended that jurisdiction had been barred because the Claimant had been, or ought to have been, aware of the purchase price dispute at the time of making the investment. In the Respondents view, this constituted a commercial risk, rather than a political risk, not covered under the scope of the ECT. The Tribunal found that even if the Claimant had been aware of the uncertainty and risks that Windau had been facing due to the dispute with Latvenergo (including the Latvian court decisions enforcing double tariff against Latvenergo in 1999), it could rely on the double tariff under the 16/97 Agreement. Generally speaking, the Tribunal held that Latvenergo's contentions as to the invalidity of the agreement had not diminished the Claimant's claim: "*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*." (Award, ¶ 4.3.3(c)).

Finally, the Respondent objected that Windau's agreement with Latvenergo had constituted merely a commercial contract, hence not a covered asset by the

foreign investment protection afforded by the ECT. However, this contention did not persuade the Tribunal. It held that the definition of investment provided by Art. 1 of the ECT had encompassed commercial contracts and upheld its jurisdiction (Award, ¶ 4.3.3 d)).

### 5.3 Findings on Merits

The Arbitral Tribunal considered whether Latvia was responsible for the non-payment of the double tariff (1); whether the non-payment constituted a breach of an obligation under Part III of the ECT (2,3,4).

#### 5.3.1 Attribution

In its analysis of the merits of the case, the Tribunal found that the actions taken by Latvenergo were attributable to the Respondent. This finding was primarily based on the dominant position of Latvenergo in the Latvian electricity market and the complete absence of commercial freedom in Latvenergo's actions, being bound by the legislation and regulatory bodies. Therefore, Latvenergo was to be considered a "constituent part of the Republic's organization". Nevertheless, the Tribunal expressively pointed out that its finding on attribution did not rely on Art. 22 of the ECT, but rather on not further specified considerations of general international law (Award, ¶ 4.2).

#### 5.3.2 Indirect Expropriation Art. 13 (1) of the ECT

The Tribunal recalled that regulatory takings may, under the circumstances, amount to expropriation contrary to Art. 13 of the ECT. The claim based on the alleged indirect expropriation according to Art. 13 (1) of the ECT was dismissed. In the Tribunal's view, the degree of interference did not amount to the extent of dispossessing the Claimant of its assets. Instead, neither the Claimant lost its title to Windau, or to any of its assets, not were shareholder rights or management control over Windau infringed (Award, ¶ 4.3.1).

#### 5.3.3 Protection against unreasonable and discriminatory measures Art. 10 (1) of the ECT

The Tribunal held that Latvenergo's refusal to apply double tariff constituted an unreasonable and discriminatory measure by the Respondent.

Failing any proof to the contrary, the Tribunal noted that Latvenergo was not authorized to apply multipliers other than those documented in the arbitration. On the other hand, based on the evidence submitted, the Tribunal was persuaded by the Claimant's case that Latvenergo was applying the double tariff to electricity generated by a foreign competitor of the Claimant, operating a cogeneration plant under the same regulatory framework, i.e. "in like circumstances".

The fact that the Claimant was not paid the double tariff purchase price triggered, according to the Tribunal, a shift of the burden of proof to the Respondent. The Tribunal relied its finding on general international law, however without specifying any authorities. Accordingly, once the Tribunal established a differential treatment of the Claimant in comparison to a suitable competitor, the Respondent had to rebut the assumption that the Claimant was not discriminated by not receiving the double tariff purchase price, while its competitor did. This burden was not discharged by the Respondent. Consequently, under the given circumstances, the Tribunal deemed the refusal to pay the Claimant the double tariff purchase price to be discriminatory (Award, ¶ 4.3.2 a)).

### 5.3.4 Further claims base on Art. 10 (1) of the ECT

Having established a breach of the protection against unreasonable and discriminatory measures, the Tribunal concluded that it was unnecessary to further adjudge other ECT violations asserted by the Claimant (Award, ¶ 4.3.2 b)).

## 6. Remedies and Financial Aspects of the Award

The Arbitral Tribunal considered whether any losses were caused by the non payment of the double tariff and the remedy granted to the investor.

### 6.1 Remedies

The Tribunal recalls the established principle of customary international law, as restated in the 2001 ILC Draft Articles on State Responsibility, that the restitution is the primary remedy for reparation of an international wrongful act.

In this case, restitution is possible either by a juridical restitution of Windau's statutory right to the double tariff or through a monetary restitution to Windau. Considering that Latvia has instituted actions directly against the investor, the Arbitral Tribunal holds appropriate to assess compensation for the losses suffered by the Claimants up to the time of the award (Award, ¶ 5.1).

The Tribunal considered potential loss to be too uncertain and speculative to form the basis for monetary compensation. Therefore it orders Latvia to ensure the payment of the double tariff for the rest of the contractual duration.

### 6.2 Assessment of Losses or Damages

The Claimant's request was based on the method of the 'reduced income flow' calculated loss of electricity production in the "dead-lock" period and on the non

payment of the double tariff for the production of electric energy. The Tribunal invoked the method of 'capitalization of earnings'.

The Tribunal found that the losses suffered by the Swedish investor could not be based directly on the loss of income suffered by Windau, and should assess a reduction *based on the requirement under applicable international law of causation, foreseeability and reasonableness of the result*. This difficult exercise was supported only by limited documentation submitted by the Claimant. The Tribunal therefore came to the assessment that Claimant's losses amount to one third of the estimated losses in purchase prices of electricity suffered by Windau up to the time of the award.

To calculate the losses suffered by Windau, the Tribunal added to the Claimant's figures for electricity production up to 30th April 2003, an estimated figure for power production from 1st May 2003 up to the time of the award, based on the figures for power production up to 30th April 2003.The Tribunal left the Claimant's alleged losses with regard to heat production without contemplations because it found them unsubstantiated.

The Claimant was therefore awarded 1.600.000 Lats + 6% p.a. of the claimed 7.097.680 Lats corresponding to a ratio of 22,54 % (Award, ¶ 5.2).

### 6.3 Interests

With regard to the award of interests according to Art. 26 (8) of the ECT, the Tribunal deemed the prevailing interest rate in Latvia to be 6 % p.a., and awarded interests in this amount. Conversely, the Tribunal rejected the claim for interests amounting to 18 % p.a., equivalent to the interest rate that Latvenergo charged Windau on belated payments under the 16/97 Agreement. In the Tribunal's view the contractual interest was not applicable under Art. 26(8) which provides an compensation related to the compensation for damages (Award, ¶ 5.3).

### 6.4 Legal Fees

The Tribunal ruled in favour of the Claimant, successful in the claim of Respondent's liability, that Latvia shall bear part of the Claimant's costs for legal fees in the arbitration. Nonetheless, the Tribunal considered the amount claimed by Claimant of SEK 8,354,000.00 excessive, also in consideration of the change of its legal counsel, and reduced it to SEK 2,000,000.00 (Award, ¶ 6.4).

### 6.5 Costs of the Arbitration

The costs of the arbitrations amounted to € 253.523.00. Relying on Art. 43 of the SCC rules, the Tribunal ordered the costs of arbitration to be divided equally between both parties, since the Claimant prevailed only to a certain extent with its claim (Award, ¶ 6.3).

## 7. Allocation of the burden of proof

In various passages, the Tribunal appears to adhere to the general rule of public international law that each party has to proof the facts on which its claim relies.

The Tribunal's findings with regard to the protection against unreasonable and discriminatory measures implies the following conclusions. The tribunal held that once the investor made a prima facie case that he had been treated worse than a comparable entity, than the respondent has to rebut this assumption that it did not discriminate the investor (Award, ¶ 4.3.2 a)).

## 8. Cited Precedents

The Tribunal did not rely on any preceding investor-state award as authority.

## 9. Comment

The Tribunal's findings in relation to the Claimant's statutory and contractual rights to the double tariff are especially interesting. The Tribunal analyses in detail the Latvian energy law and policy as well as the applicable power purchase agreements in order to determine whether the investor and its Latvian vehicle had the right to the double tariff later repealed by Latvia by means of regulatory changes.

In relation to the non-discrimination claim, upon which the Tribunal finds Latvia responsible for breach of Art. 10 of the ECT because the Respondent was unable to justify its refusal to pay the Claimant the double tariff unlike its competitors. This weakness has proved fatal to the Respondent's defense.