A reflection on the Czech Republic's solar investment arbitration successes

01/10/2019

Arbitration analysis: Florian Stefan, attorney at law at Vavrovsky Heine Marth Rechtsanwälte GmbH, considers the Permanent Court of Arbitration (PCA) tribunal's awards in four related investment treaty arbitrations, concerning investments in the Czech solar power sector, which were issued to the parties in May 2019. The claimants alleged that amendments to the Czech Republic's renewable energy incentive scheme breached both the Energy Charter Treaty (ECT) and bilateral investment treaties (BITs).

Voltaic Network GmbH v Czech Republic, PCA Case No 2014-20—award dated 15 May 2019, *WA Investments Europa Nova Ltd v Czech Republic*, PCA Case No 2014-19—award dated 15 May 2019 , *Photovoltaic Knopf Betriebs GMBH v Czech Republic*, PCA Case No 2014-21—award dated 15 May 2019, *ICW Europe Investments Ltd Investments (UK) v Czech Republic*, PCA Case No 2014-22—award dated 15 May 2019

For our initial coverage, see: Czech Republic wins four arbitrations over solar energy incentives.

What was the background to the claims?

The claimants in the four coordinated cases were companies incorporated in Germany (Voltaic and Photovoltaic), Cyprus (WA Investments) and the UK (ICW Europe), who invested in photovoltaic power plants in the Czech Republic. In 2013, the four claimants submitted a single notice of arbitration, basing their claims on the ECT and BITs between their home states and the Czech Republic, and requesting the consolidation of the proceedings. The Czech Republic opposed the consolidation of the proceedings as there was no single arbitration agreement in place. Following this, the parties agreed to appoint an identical tribunal to coordinate the four proceedings.

The tribunals comprised Hans Van Houtte serving as chair, John Beechey as appointee of the claimants (after the two previous appointees Doak Bishop and Gary Born resigned) and Toby Landau as appointee of the respondent.

At the time the claimants acquired interests in photovoltaic power plants in the Czech Republic, an incentive regime promoting the operation of renewable energy plants was in place in the Czech Republic. Among others, the incentive regime provided for a feed-in tariff which was not allowed to be decreased by more than 5% of the tariff's value in the previous year. Further incentives included a five-year tax exemption and a guarantee that the investors would be able to recover their investments within 15 years, while promising them a minimum annual return of 7% during the same period.

Between the years 2008–10, the price of photovoltaic panels decreased by more than 40%, which in turn increased the level of compensation attributable to the tariff by about 30% from what had originally been intended. As a consequence, the incentive regime attracted many investors and the Czech Republic witnessed a veritable 'solar boom'. In January 2011, after a new government was elected, the incentive regime was amended in order to put an end to what was then described by government officials as an untenable subsidy system. The amendments abolished the 5% limitation for tariff reductions, withdrew all tax incentives and introduced a levy on electricity produced from solar radiation, which was originally set at 26% and later lowered to 10%.

What common issues were in dispute?

In all four cases the Czech Republic argued that the tribunals lacked jurisdiction over the solar levy as this measure allegedly is a tax under Czech law for the purposes of the ECT's tax exclusion clause set out in Article 21 of the ECT. Following the Court of Justice judgment in *Slovak Republic v Achmea*, Case C-284/16, the Czech Republic also raised an intra-EU jurisdictional objection in all four cases. Amicus curiae submissions by the European Commission (EC) in the four cases were ultimately disallowed by the arbitral tribunals as the EC refused to undertake to pay the costs resulting from its submissions.

All four cases concerned the amendment of the Czech Republic's legal, tax, and regulatory incentive regime for the promotion of renewable energy, in particular the photovoltaic sector. The claimants argued that the amendments

breached the Czech Republic's commitments under the ECT as well as under the respective BITs. The claimants submitted that the amendments to the incentive regime violated the fair and equitable treatment standard (FET), the obligation to provide full protection and security to the investments (FPS) and the prohibition of impairing the investment through arbitrary and discriminatory treatment.

What did the tribunals decide?

Jurisdictional objection

The tribunals held that the solar levy fell outside the scope of Article 21 of the ECT, and thus rejected the respective jurisdictional objection made by the respondents. The tribunals noted that the solar levy is not regarded as a tax for certain purposes under Czech law and thus does not constitute a taxation measure within the meaning of the carve-out provided for under Article 21 of the ECT.

Incentive regime

On the merits, the tribunals first analysed the incentive regime and found that while the regime guaranteed a feed-in tariff that led to a 15-year payback of the investment costs with an annual profit of 7% per year over 15 years, it did not guarantee minimum feed-in tariff payments.

FET standard

The tribunals then turned to the individual heads of claim under the FET standard. First, the tribunals dealt with the respondent's obligation to provide a stable and predictable legal framework. The tribunals confirmed that a separate obligation to provide a stable and predictable legal framework exists as part of the FET standard and that it must be considered objectively. As a general obligation of host countries under investment treaties it does not require the demonstration of any reliance on the host state's conduct on the part of the foreign investor. However, the tribunals held that the requirement of stability is not absolute and shall not be interpreted overly broadly. The tribunals found that the changes introduced by the Czech Republic to the incentive regime were part of the state's sovereign right to regulate tariffs and thus did not violate the state's obligation to provide a stable and predictable legal framework for foreign investment. The solar levy did not repeal the fundamental features of the incentive regime, since the claimants still received a stable feed-in tariff and would be able to recoup their costs in less than 15 years and receive annual returns of at least 7% in the same period.

The tribunals then proceeded to deal with the respondent's alleged violation of the claimants' legitimate expectations. The arbitrators found that the claimants did not have a legitimate expectation of stability, as neither a stable feed-in tariff had been guaranteed nor had there been a guarantee on the duration of the tax exemptions. What is more, the claimants could in any event not have reasonably relied on an expectation of stability as there had already been several apparent warning signs that ought to have precluded any such expectation on the part of the claimants. On top of this, the claimants could not have had any legitimate expectations that the incentive regime would remain in force, given that the incentive scheme could have been (and eventually was) qualified as state aid under European law.

Furthermore, the tribunals held that the respondent's actions were taken in a transparent manner and thus not in violation of the FET standard, in particular considering that there was an obvious and transparent need for the incentive regime to be changed. Taking into account that there was a political vacuum in the Czech Republic until July 2010 and that a dramatic increase of photovoltaic plant grid connections took place in the last months of 2010, the arbitrators held that the Czech Republic was as transparent as it could have been in the circumstances.

FPS standard

With regards to the FPS standard, the parties agreed that the legal test as to whether a violation of this standard had occurred in the present cases largely overlapped with the test applicable to violations of the FET standard. This was because the claimants put their case in terms of the legal, and not the physical, dimension of the FPS standard. Given the overlap in standards, the arbitrators merely referred to their earlier analysis made in the context of the FET standard and found that no violation of the FPS standard had occurred in the four cases.

Modification of the incentive regime

Lastly, the tribunals dealt with the claimants' argument that the Czech Republic acted in an arbitrary and discriminatory manner when it modified the incentive regime. The arbitrators noted that in this regard the determinative question was whether the challenged measures were promulgated in pursuit of a rational policy and were implemented in a reasonable manner. The tribunals found that both tests were met since the amendments to the incentive regime were clearly aimed at addressing a public interest matter and even after the amendments the plants were still more profitable than promised.

In sum, the tribunals dismissed all of the claimants' claims. However, while the Czech Republic was awarded its costs of arbitration, the tribunals ordered the parties to bear their own legal fees as it considered that the claimants' claims, although ultimately unsuccessful, were reasonable.

How did the tribunals deal with arguments based on Achmea?

An intra-EU jurisdictional objection was raised by the respondent only after the Court of Justice rendered its *Achmea* judgment. However, the arbitrators did not deal with the substance of the respondent state's intra-EU jurisdictional objection but held that the Czech Republic had waived its right to submit such objection.

It noted that Article 186(2) of the applicable Swiss Federal Statute on Private International Law provides that jurisdictional objections must be raised prior to submitting any defence on the merits. Similarly, Article 21(3) of the applicable United Nations Commission on International Trade Law Rules provides that a plea that the arbitral tribunal does not have jurisdiction must be raised no later than in the statement of defence or, with respect to a counter-claim, in the reply to the counter-claim.

The tribunals pointed out that the respondent specifically and repeatedly stated throughout the proceedings that it would not object to the tribunals' jurisdiction on the basis of the intra-EU nature of the dispute. Such objection was only made when the Court of Justice rendered its *Achmea* judgment, which came after the respondent had already submitted a defence on the merits. Therefore, the tribunals did not consider it necessary to deal with the application of the *Achmea* judgment to an arbitration brought under the ECT.

It is noteworthy that the tribunals originally chose Paris as seat of arbitration but later transferred the seat to Geneva upon a request of the claimants. As grounds for transferring the seat of arbitration to a non-EU country, the claimants cited the request of the EC for leave to intervene, as well as actions taken by it and EU courts in other unrelated arbitrations.

Why are the awards of interest to arbitration practitioners?

With the awards rendered by the tribunals chaired by Hans van Houtte, the Czech Republic has now prevailed in six out of seven investment treaty arbitrations brought in connection with the amendments to the incentive regime in the photovoltaic sector. Only the tribunal hearing the seventh case over the amendments held that the legislative amendments breached the FET standard set out in the ECT and various BITs (*Natland and others v Czech Republic*, PCA Case No 2013-35). However, the tribunal in that case has yet to decide on the damages claimed.

While the four awards shed further light on the legality of the Czech Republic's amendments to its renewable energy incentive system, and in fact bolstered the state's position, nothing could unfortunately be gained on the unresolved question of how to deal with intra-EU jurisdictional objections brought in the wake of *Achmea* under the ECT.

Interviewed by Susan Ghaiwal.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.