Green tariff in Ukraine: lessons from Spain and the Czech Republic

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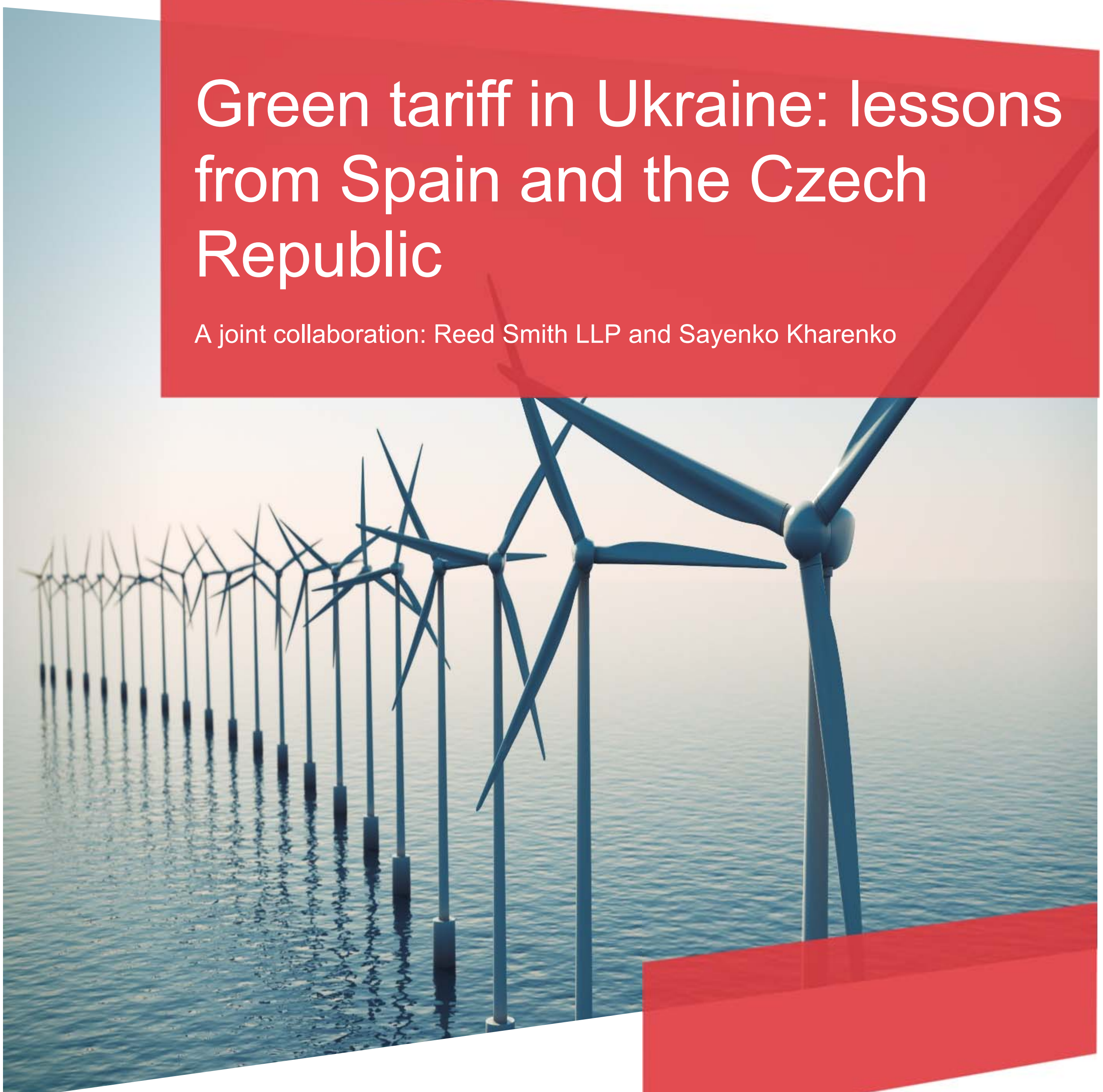

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Introduction

The environmental benefits of renewable energy, which includes photovoltaic[1] (PV) and other solar energy, as well as thermal, wind and other technologies, are indisputable. However, at their early stage of development and until fairly recently, renewable energy facilities and installations were not able to compete with conventional electricity generators using fossil fuels due to high capital requirements. In their desire to promote the development of renewable energy, states often grant various forms of subsidies to investors, the most widely known of which is a feed-in tariff.[2]

However, as the renewables market in their country matures, governments face changing circumstances and other challenges, which make them reconsider their policies and frameworks. Ukraine is currently going through such a stage. This paper is a high-level analysis, from the perspective of international law and treaty protections offered to foreign investors, of the consequences of changes made by governments responding to those challenges. In particular, we analyze the experiences of two countries, Spain and the Czech Republic, which have encountered issues similar to those which Ukraine now faces.

As we explain below, Ukraine is in a difficult position but its strategy is clearly designed to minimize exposure to investment arbitration claims by using mediation and direct negotiations with the parties involved.

The paper will be structured as follows. First, we consider the renewable energy regime as it exists in Ukraine and the challenges it currently faces. In the second and third parts, we will look at the legislative frameworks in the renewable energy sectors of Spain and the Czech Republic, respectively, and the conclusions reached by investment tribunals in relation to changes made to those countries' green energy frameworks, from which close parallels can be drawn with what is happening in Ukraine. Finally, we put together a number of lessons from the experiences of Spain and the Czech Republic, which may be useful when assessing a state's potential liability to international investors if it changes its renewable energy regime.

[1] A method for generating electric power by using solar cells to convert energy from the sun into a flow of electrons.
[2] The feed-in tariff is the price at which the state promises to buy electricity produced by renewable energy generators.

I. Green tariff in Ukraine

Foreign investors[3] have invested around $3 billion[4] into Ukraine's renewable energy market over several years, helping Ukraine toward a 25 percent benchmark for renewable energy by 2035, and reducing its dependency on imported fuels.[5] Many investors rely on funding provided by foreign funds and organizations (e.g., EBRD, IFC, FMO, NEFCO and SWEDFUND).

The quantity of green energy produced in Ukraine is constantly growing, most recently from 2 percent of total energy produced in 2018 to 4 percent in 2019.

The renewables market is dominated by several big players, including DTEK Renewables (owned by an entity registered in the Netherlands), Vindkraft Ukraina (which has Swedish and Cypriot investors), and Chinese CNBM.[6]

Legislative framework

- *Green tariff*

A green tariff is currently the main incentive offered to foreign investors operating in Ukraine's renewable energy market. The promotion of renewable energy in Ukraine goes back to the introduction of a feed-in ("green" in Ukraine) tariff in a 2008 amendment to the 1997 Law of Ukraine "On the Electric Power Industry". The amendment gave producers of renewable energy[7] the right to sell the energy to the state at the green tariff rate for the period from 2009 to the end of 2029. Currently, the green tariff is regulated by the 2003 Law of Ukraine "On Alternative Sources of Energy" and 2017 Law of Ukraine "On the Energy Market," which reinforce the government's obligation to maintain the green tariff until the end of 2029.

Green tariff rates are calculated as follows: the basic tariff (representing the retail tariff for consumers of the second voltage class fixed as of January 2009 (UAH 0.5846 per kWh)) multiplied by a green coefficient, whose amount depends on the type of energy produced and the capacity of the plant producing it.[8] Green coefficients for new facilities are set to decrease gradually over time depending on the date of commission of the facility.[9]

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[3] Including from France, Germany, Luxembourg, Liechtenstein, Switzerland, Austria, Belgium, the United States, China, Norway, Denmark, Sweden, Spain, Turkey, Cyprus, Korea, the UK, Lithuania, Poland and Romania.

[4] "Share of Foreign RES Investors to be More Than 30%, Investment Could Reach EUR 2.5 bln by Summer 2020 – Experts," Interfax-Ukraine, Ukraine News Agency, May 7, 2020, at https://en.interfax.com.ua/news/economic/660680.html. By the end of 2019, almost $10 billion in total had been invested (including by local investors) in renewable energy ($6.2 billion in 2018-2019 alone), making it one of the top five sectors for investment in the Ukrainian economy; see Kozakevich, O., "Why Ukraine's once thriving renewable energy sector could be at dire risk of failure," *Renewable Energy World*, April 30, 2020, at https://www.renewableenergyworld.com/2020/04/30/why-ukraines-once-thriving-renewable-energy-sector-could-be-at-dire-risk-of-failure/#gref.

[5] *Id.*

[6] Zaika, B. "Kings of the Green Tariff: Top 10 of the Largest Investors into the Renewable Energy of Ukraine and the Beneficiaries of the 'Green' Tariff," *Liga.net*, at https://project.liga.net/projects/greentariff_kings/?fbclid=IwAR1D-n6XKyEQyWaZty31j3L3-27Hr7OUmFzdBlE0kwZD1-7nIPhSbd99jrU.

[7] Includes geothermal, hydrothermal, aerothermal, solar, wind, wave, tidal energy, hydropower energy not exceeding 10 MW capacity, biomass and biogas.

[8] In addition, a premium is paid in the amount of 5 percent to 10 percent of the applicable green tariff rate to those renewable energy facilities that use equipment of Ukrainian origin, with the percentage depending on the share of such use.

[9] Initially, the law provided for three stages for decreasing the green coefficients for facilities commissioned in 2015, 2020 and 2025. However, due to financial concerns, the decrease scheduled for coefficients for some types of energy (e.g., PV energy) in 2013, 2015 and 2019 was moved forward by introducing additional stages, while applying the green coefficients to further types of energy facilities and slightly changing some coefficients.

The green tariff is linked to the euro (making it independent of the stability of the Ukrainian currency) and its rates are revised every three months based on the official currency exchange rates. It is among the highest in Europe and has been considered by investors as attractive.

The payback period for renewable energy projects is currently assessed to be from three to five years (by state officials) and about seven years (by investors).[10]

To benefit from the green tariff, producers must participate in the electricity market and sign contracts with a state enterprise buying and selling electricity on a "day-ahead" basis (the Guaranteed Buyer). The electrical power is then sold by the Guaranteed Buyer on the wholesale market at the market price, and the difference between the green tariff price paid by the Guaranteed Buyer and the market price is compensated by another state enterprise, Transmission System Operator. This compensation is part of the electricity transmission tariff paid by the transmission system's end users.

The green tariff applies to those producers of renewable energy who either (a) commissioned (put into operation) their facilities by January 1, 2020 or (b) entered into a preliminary contract with the Guaranteed Buyer on the condition that the commissioning takes place within a certain fixed period following the signing of the contract (two years for solar energy projects and three years for all other sources of energy).[11]

Current Ukrainian legislation contains the following incentives guaranteed to producers of renewable energy:

- the application of the same incentives for the production of renewable electricity that were in place on the date of commissioning of their facilities. Where there are legislative changes to such incentives, producers may choose the incentive package contained in the new legislation;[12]
- the guaranteed purchase, for the entire period of the application of the green tariff, of electricity at the green tariff prices in the volumes, and in accordance with the procedure, prescribed in Article 65 of the 2017 Law "On the Energy Market"; and
- timely payment of the green tariff in full and in cash.

- *Green auctions*

For those renewable energy facilities which do not have contracts with the Guaranteed Buyer for the purchase of their energy at the green tariff rate, state support will be provided by way of so-called "green auctions." Green auctions will be required for all such wind facilities with a capacity exceeding 5 MW and solar facilities with a capacity exceeding 1 MW. All other types of renewable energy sources can participate in green auctions voluntarily. Green auctions have been introduced to reduce the costs of renewable energy for consumers. The winners of green auctions will receive

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[10] See Zaika, B.,"Veto for Akhmetov. Zelensky Rejected a Memorandum With 'Green' Business: Two Scenarios," *Liga News*, May 26, 2020, at https://ua-news.liga.net/economics/articles/veto-dlya-ahmetova-zelenskiy-vidhiliv-memorandum-iz-zelenim-biznesom-dva-stsenarii.

[11] The green tariff will also be applicable to wind energy facilities with less than 5 MW capacity, and solar energy facilities with less than 1 MW capacity, which were put into operation after January 1, 2020.

[12] See Article 17-1 of the 1997 Law of Ukraine "On Electric Power Industry," and Article 9-1 of the 2003 Law of Ukraine "On Alternative Sources of Energy" ("The State shall guarantee that for economic entities producing electricity from alternative energy sources at commissioned electricity facilities, the procedure for stimulating the production of electricity from alternative energy sources established in accordance with the provisions of this Article on the date of commissioning of the facilities, including commissioning of the construction queues of power plants (start-up complexes), shall apply. In the event of legislation changes related to the procedure for stimulating the production of electricity from alternative energy sources, businesses may choose a new procedure for stimulation.").

state support in the form of a quota, i.e., a volume of electrical power which the state guarantees to buy from them at the winning price. The maximum winning price should not exceed the relevant green tariff rate.

The green auctions were planned to run from April 1, 2020, but have been postponed for an indefinite period of time.

Current issues

In 2019, the government declared that the green tariff had become too burdensome financially and started discussing a possible decrease of the green tariff rates. The situation has led to mediation proceedings, primarily between large investors and the government, under the auspices of the ECT Secretariat. Meanwhile, the Ukrainian energy regulator[13] reduced the transmission tariff rate from September 2019, causing a drop in the level of compensation which the Guaranteed Buyer would otherwise contribute toward payment of the green tariff. The amount remaining due in payment of the green tariff to producers continued to grow in 2020.[14]

In early 2020, it was announced that the Ukrainian energy sector was in crisis due, in particular, to a fall in energy consumption following a slowdown in industrial production, a warm winter in 2019-2020 and then the COVID-19 lockdown.

On May 4, 2020, the Ukrainian government set up an Anti-Crisis Energy Taskforce chaired by the prime minister with, among others, the following tasks and goals: conclusion of a memorandum with investors to reduce the green tariff rates, prohibition of the construction of new wind and solar power plants, and a switch to the system of green auctions.

On May 18, 2020 the acting Minister of Energy and Environmental Protection confirmed that the government's aim was to reduce the green tariff rates without extending the period of their payment beyond 2030 and to introduce other measures which would effectively decrease the profitability of green energy.[15] No legislative changes to the original green tariff regime have been made so far.

Memorandum of Understanding

It seems that one of the goals of the Anti-Crisis Energy Taskforce is close to materializing. On June 10, 2020, the Cabinet of Ministers of Ukraine and the acting Minister of Energy and Environmental Protection signed a draft Memorandum of Understanding on the Settlement of Problematic Issues in the Renewable Energy Sector (the MoU). On the same day, the MoU was conditionally[16] signed by the European-Ukrainian Energy Agency and Ukrainian Wind Energy Association, which reportedly combine 90 percent of renewable energy producers in Ukraine.[17]

The text of the MoU is not publicly available yet, but we understand from publications and other sources that its aim is, inter alia, to resolve issues between renewable energy producers and the

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[13] National Commission Regulating the Spheres of Energy and Utilities.
[14] According to the Guaranteed Buyer's website, as of May 25, 2020 the Guaranteed Buyer had covered only 33 percent of outstanding amounts payable to renewable energy producers (https://www.gpee.com.ua/main/news?id=342 as at June 4, 2020).
[15] "The Ministry of Energy Plans to Agree to Reduce the 'Green Tariff' Without Extending the Payment Term – Buslavets," *Business Censor*, May 18, 2020, at https://biz.censor.net.ua/news/3196193/minenergo_planiruet_dogovoritsya_o_snijenii_zelenogo_tarifa_bez_prodleniya_sroka_vyplat_buslavets.
[16] We do not know what those entities' conditions are.
[17] "The Government Has Not Fully Agreed With Renewable Energy Investors – Shmygal," OilPoint, June 11, 2020, at https://oilpoint.com.ua/pravitelstvo-ne-do-koncza-dogovorilos-s-investorami-vie-shmygal/.

state in relation to potential changes in the renewables regime.[18] The MoU is envisaged as the basis for legislative changes, with the parties' specific commitments only coming into force when the respective legislative amendments come into force. It is therefore primarily an expression of the intentions of the signatories rather than a legally enforceable document.

The MoU is still due to be signed by (i) the National Energy and Utilities Regulatory Commission, (ii) other state authorities, who are not named in the MoU, (iii) the Ukrainian Association of Renewable Energy, and (iv) renewable energy producers, who again are not named. The MoU shall enter into force on the date of signature by the "state authorities" and "renewable energy producers" – given the vague and potentially long list of possible signatories required it might be hard to establish when this has happened.

We understand that under the MoU renewable energy producers agree, among other matters, to the following terms for the restructuring of the green tariff:

- for all power facilities commissioned from January 1, 2020, a decrease in green tariff rates by 2.5 percent;
- for facilities commissioned from July 1, 2015 to December 31, 2019, a decrease in green tariff rates by 15 percent (above 1 MW) and 10 percent (under 1 MW) for solar facilities, and by 7.5 percent for wind energy facilities with individual units having a capacity above 2 MW;
- for all power facilities commissioned by July 1, 2015, a cap on the green tariff rate will apply at the level of the green tariff rate for solar ground-based facilities with installed capacity exceeding 10 MW commissioned by March 31, 2013, reduced by 15 percent; and
- no prolongation of the application of the green tariff to compensate for the above reductions.

Solar energy producers also agree to accept July 31, 2020 as the cut-off date for the commissioning of new facilities entitled to benefit from the green tariff rates.

In return, the government commits:

- to amend the legislation to restructure the green tariff as per the above terms – such amendments are expected by August 1, 2020;
- to ensure repayment by the end of 2021 of the amounts owed to producers by the Guaranteed Buyer (in accordance with the schedule set out in the MoU), as well as full and timely payments in the future, after the adoption of the respective legislative amendments; and
- to fix and approve annual quotas to be awarded by way of green auctions.

It is important to note that, under the MoU, the renewables producers do not waive their right to initiate investment arbitration proceedings against the state.

The contents of the MoU pose a number of questions. One of the fundamental questions is whether the government's commitments under the MoU extend to all renewable energy producers, including those who do not sign the MoU. We expect this to be the case given that, as explained above, most of the rights and obligations of the parties to the MoU only come into force when the respective legislative changes come into force.

[18] Government Signs Memorandum with Green Energy Producers, Communications Department of the Secretariat of the CMU, June 10, 2020 – official government portal at https://www.kmu.gov.ua/en/news/uryad-pidpisav-memorandum-z-virobnikami-zelenoyi-elektroenergiyi.

Overall, the MoU can serve as potential evidence of the signatories' understanding and intentions at a certain point in time, and can be invoked for dispute settlement purposes.

What if no compromise is reached with investors?

Ukraine is a party to the Energy Charter Treaty (ECT) and to more than 65 bilateral investment treaties (BITs), which guarantee protection of foreign investors and their investments and provide for the liability of Ukraine if the required standards of protection are breached. If it fails to achieve a compromise with foreign investors, Ukraine may face investment arbitration claims. If this were to happen, lessons from other states which have encountered similar challenges may be particularly valuable.

For the purpose of this paper, we have chosen two countries hit by foreign investor claims following changes in respective legal frameworks, which were made in order to adapt to the financial strain caused by the success of their renewable energy incentives. First is Spain, which has had more cases brought against it than any other state, and most of which so far have been upheld by tribunals. Second is the Czech Republic, whose example is notable for the vast majority of cases being so far won by the state (there was only one finding of liability out of the seven concluded[19] cases of which we are aware from public sources).

II. The case of Spain

Legislative framework

From 1997 to 2008, Spain was a leader in the promotion of renewable energy technologies. In 1997 Spain enacted Law 54/1997 on the Electricity Sector, which created a special regime for facilities generating electricity from renewable energy sources (Special Regime). Under the Special Regime, qualifying facilities were entitled to receive, in addition to the market price of electricity, a premium to be set by the government. The premium was to enable producers to achieve a reasonable rate of return based on the costs of money in capital markets.[20] Following a series of legislative acts adopted over the years, the incentives regime was crystalized in 2007 (2007 Regime). Under the 2007 Regime, PV energy producers were permitted to sell electricity at a higher feed-in tariff for the first 25 years, reducing thereafter for the remainder of the project's life. Overall, generators of electricity from renewable energy sources could have expected to receive a post-tax rate of return on their investment of around 7 percent. While publicizing the adoption of the 2007 Regime, the government promised that tariffs would be reviewed every four years with future tariff revisions not applying to existing facilities, and that any new legislation would not be applied retroactively.[21]

The introduction of the new regime resulted in a boom in investment in renewable energy production in 2007 and 2008, when a record number of PV facilities, with total production capacity of 2,733 MW, were installed. This accounted for nearly 60 percent of Spain's total installed PV capacity

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[19] *Natland Investment Group N.V., Natland Group Limited, G.I.H.G. Limited, and Radiance Energy Holding S.A.R.L. v. The Czech Republic*, PCA Case No. 2013-35, Partial Award, December 20, 2017. In the claim brought under the Cyprus-Czech Republic BIT, Czech Republic-Luxembourg BIT and Czech Republic-Netherlands BIT in 2013, the tribunal of Veijo Heiskanen, Gary Born and J. Christopher Thomas found the Czech Republic liable for a breach of the BITs' fair and equitable treatment provisions. The decision on quantum (calculation of damages) has yet to follow, and so it remains unclear whether there will be any negative financial consequences for the Czech Republic.

[20] Article 30(4) of Law 54/1997 on the Electricity Sector (enacted by Spain on November 27, 1997); in accordance with Article 27 of the Law 54/1997 on the Electricity Sector, the Special Regime applied to electricity generation activities in a number of categories set out by the law, whenever they were carried out by facilities having installed capacity of no more than 50 MW.

[21] *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award, May 4, 2017, paragraph 111.

(4,714 MW) in 2018.[22] However, beginning 2008, Spain became increasingly concerned by a large and growing cumulative "tariff deficit": the financial gap between the costs of subsidies paid to renewable energy producers and revenues derived from energy sales to consumers. The incentives provided under the 2007 Regime were gradually reduced and then taken away completely with the 2007 Regime's abolishment in 2013. The new regulatory framework provided a lower post-tax rate of return and the level of subsidies paid to renewable energy producers was significantly reduced.[23]

Cases against Spain

Since 2012, no fewer than 47 claims have been filed against Spain, mostly under the ECT. Despite the fact that Spain's defense was successful in a number of cases, the value of the awards won by investors is close to €1 billion, with claims of around €10 billion still to be resolved.[24] This situation forced Spain to effectively offer an incentive to past and current claimants in exchange for their dropping/waiving claims and enforcement against the state. As a result, while the current rate of return applicable to renewable energy facilities for the period from January 1, 2020 to December 31, 2025 is 7.09 percent (with further potential revisions for the period 2026-2031), a higher rate of return of 7.398 percent[25] will apply till 2031 to those facilities in respect of which arbitral proceedings have been opened as a result of the modifications to the 2007 Regime, and which by September 30, 2020 provide (a) evidence of the termination of those arbitral proceedings, and (b) a waiver against restarting or continuing those proceedings, or against receiving compensation awarded as a result of those proceedings.[26]

The focus of most of the claims was on the frustration of the legitimate expectations of investors who, it was alleged, invested in Spain in the expectation of receiving the precise tariffs established by the 2007 Regime during the lifetime of their plants. Alternatively, some investors claimed the revised rate of return subsequently established by Spain was unreasonably low.

Spain's obligation pursuant to Article 10(1) of the ECT to create stable, equitable, favorable and transparent conditions for investors making investments in the country came under scrutiny in most of the claims.

As at 28 February 2020, there were 19 known awards related to renewable energy that concerned Spain, many accompanied by dissenting opinions.[27] The tribunals took different positions[28] on the issues of the existence of legitimate expectations and breach of fair and equitable treatment.[29] A majority of the tribunals upheld claims that the investors' expectations of tariff stability promised by

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[22] Blanco-Diez. P., Diez-Madiavilla, M., and Alonso-Tristan, C., "Review of the Legislative Framework for the Remuneration of Photovoltaic Production in Spain: A Case Study," *Sustainability*, vol. 12(3), February 2020, page 1.
[23] *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award, May 4, 2017, paragraph 149.
[24] "Spain extends premium rates for renewable energy investors to drop lawsuits," *Power Technology*, December 11, 2019.
[25] This rate of return was set for renewable energy facilities in 2013.
[26] Fernández, C., Lozano, F., and Roth, A., "The reasonable rate of return applicable from 2020 to renewable energy facilities is approved," News, Lozano Schindhelm, 2020, at https://es.schindhelm.com/en/news-jusful/news/spain-the-reasonable-rate-of-return-applicable-from-2020-to-renewable-energy-facilities-is-approved; Calviño, I., Paz, I., Ramón Mourenza, J., and Riaño, M., "Spain approves Royal Decree-Law 17/2019, of 22 November, which establishes the new rate of reasonable return for renewable energy," *Lexology*, 2019. at https://www.lexology.com/library/detail.aspx?g=2d8fd781-d750-4970-944a-bc15b5e3530d.
[27] *The PV Investors v. Spain*, PCA Case No. 2012-14, Final Award, Concurring and Dissenting Opinion of Charles N. Brower, February 28, 2020, page 3.
[28] For a detailed analysis of the potential reasons for the different approaches in tribunals' decisions, see *The PV Investors v. Spain*, PCA Case No. 2012-14, Final Award, February 28, 2020, paragraphs 554-555 and Concurring and Dissenting Opinion of Charles N. Brower, February 28, 2020, paragraphs 5 to 10.
[29] Under Article 10(1) of the ECT, the standard of fair and equitable treatment encompasses the protection of legitimate or reasonable expectations, protection against arbitrary, unreasonable, and disproportionate conduct, and the principle of transparency.

the government were reasonable and legitimate.[30] Others fully dismissed the investors' claims.[31] And, finally, a third group of tribunals have partially upheld claims by deciding that the investors could not have expectations that there would be no changes in the regulatory framework in relation to a fixed remuneration scheme; however, the expectation to receive a reasonable rate of return which was promised under the regulatory framework in place when the investors made their investments, was legitimate.[32]

The analysis of the tribunals' awards identified the following, often interlinked and sometimes contrasting, conclusions relevant to the subject matter of this paper.

1. *Investors' protection should be balanced with the sovereign right of the host state to regulate and change its legislation*

There should be the right balance between, on the one hand, the protection of investors who commit substantial resources to the environmental benefits of the host state, and, on the other hand, the host state's right to regulate and adapt its framework to changed circumstances, provided that right is exercised in a manner that is proportionate, reasonable, non-arbitrary and in the public interest (including protecting consumers against rising electricity costs).[33]

As for the notion of "proportionality," according to one of the tribunals this condition is satisfied as long as the changes are not capricious or unnecessary and do not amount to sudden and unpredictable elimination of the essential characteristics of the existing regulatory framework.[34] Regarding the standard of "reasonableness," it requires evidence that the state's conduct bears a

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[30] *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award, May 4, 2017 (the Eiser Award was very recently annulled due to the failure by one of the arbitrators, Stanimir Alexandrov, to disclose past and present connections with the investor's damages expert); *Novenergia II - Energy & Environment (SCA), SICAR v. Kingdom of Spain*, SCC Case No. 2015/063, Award, February 15, 2018; *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, ICSID Case No. ARB/14/1, Award, May 16, 2018; *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, ICSID Case No. ARB/13/31, Award, June 15, 2018; *Foresight Luxembourg Solar 1 S.Á.R.L., Foresight Luxembourg Solar 2 S.Á.R.L., Greentech Energy System A/S, GWM Renewable Energy I S.P.A and GWM Renewable Energy II S.P.A v. Kingdom of Spain*, SCC Case No. 2015/150, Award, November 14, 2018; *SolEs Badajoz GmbH v. Kingdom of Spain*, ICSID Case No. ARB/15/38, Award, July 31, 2019; *9REN Holding S.a.r.l v. Kingdom of Spain*, ICSID Case No. ARB/15/15, Award, May 31, 2019; *Cube Infrastructure Fund SICAV and others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Award, July 15, 2019; *OperaFund Eco-Invest SICAV PLC and Schwab Holding AG v. Kingdom of Spain*, ICSID Case No. ARB/15/36, Award, September 6, 2019; *InfraRed Environmental Infrastructure GP Limited and others v. Kingdom of Spain*, ICSID Case No. ARB/14/12, Award, August 2, 2019; *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, ICSID Case No. ARB/15/44, Award, January 21, 2020.

[31] Charanne B.V. and Construction Investments S.a.r.l. v. Spain, SCC Case No. 062/2012, Final Award, January 21, 2016; Isolux Infrastructure Netherlands B.V. v. Kingdom of Spain, SCC Case No. 2013/153, Award, July 12, 2016; Stadtwerke München GmbH and others v. Kingdom of Spain, ICSID Case No. ARB/15/1, Award, December 2, 2019.

[32] The PV Investors v. Spain, PCA Case No. 2012-14, Final Award, February 28, 2020, paragraph 623; RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/30, Decision on Jurisdiction or Decision on Responsibility and on the Principles of Quantum, November 30, 2018; BayWa r.e. Renewable Energy GmbH and BayWa r.e. Asset Holding GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/16, Decision on Jurisdiction, Liability and Directions on Quantum, December 2, 2019; NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v. Kingdom of Spain, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles, March 12, 2019; RWE Innogy GmbH and RWE Innogy Aersa S.A.U. v. Kingdom of Spain, ICSID Case No. ARB/14/34, Decision on Jurisdiction, Liability, and Certain Issues of Quantum, December 30, 2019.

[33] *The PV Investors v. Spain*, PCA Case No. 2012-14, Final Award, February 28, 2020, paragraphs 570, 576, 624 and 639; *Novenergia II - Energy & Environment (SCA), SICAR v. Kingdom of Spain*, SCC Case No. 2015/063, Award, February 15, 2018, paragraph 688; *9REN Holding S.a.r.l v. Kingdom of Spain*, ICSID Case No. ARB/15/15, Award, May 31, 2019, paragraph 65 and ft. 254; *Cube Infrastructure Fund SICAV and others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Award, July 15, 2019, paragraphs 305 and 409; *Charanne B.V. and Construction Investments S.a.r.l. v. Spain*, SCC Case No. 062/2012, Final Award, January 21, 2016, paragraph 535.

[34] *Charanne B.V. and Construction Investments S.a.r.l. v. Spain*, SCC Case No. 062/2012, Final Award, January 21, 2016, paragraph 517.

reasonable relationship to some rational policy,[35] such as the protection of consumers,[36] or aims at preventing the technical collapse of the system and contributes to ensure better security and better management.[37] As one of the tribunals noted:

> "Provided that there is an appropriate correlation between the policy sought by the State and the measure, the decision by a State may be reasonable under the ECT's FET standard even if others can disagree with that decision. A State can thus be mistaken without being unreasonable."[38]

2. *Arbitral tribunals are not there to second-guess the state's choices in amending the legislative framework*

An arbitral tribunal will not normally review de novo whether the choices made by the host state are well founded, nor assess whether alternative solutions would have been more suitable:

> "Governments often have to make controversial choices, which especially those directly affected may view as mistaken, based on misguided economic theory, placing too much emphasis on certain social values over others. It is not the task of an investment treaty tribunal to evaluate the policy choices that often underpin economic decisions. This being so, the margin of appreciation accorded to the State cannot be unlimited; otherwise the substantive treaty protections would be rendered wholly nugatory. […] the limits of the State's power are drawn by the principles of reasonableness and proportionality, which must guide a tribunal's assessment of the allegedly harmful changes in the legislation."[39]

3. *The manner in which the changes are implemented is important*

Tribunals take into account whether the actions of the state were drastic, radical or unexpected, as this may mean that the manner in which the changes were implemented is contrary to the obligation to provide fair and equitable treatment (FET) to investors.[40] It is therefore important for states to show that changes were communicated in a timely and transparent manner, and/or that investors were listened to and there was no breach of due process.

4. *There can be no investors' legitimate expectation that a host state will refrain from changes of legislation unless there is a specific promise*

As one of the tribunals' held, the regulatory history and the wording of the legislative acts in question will be taken into account to consider if they should have put the investors on notice that future modifications were likely.[41] Another tribunal concurred by recalling a view in a past case that:

> "[e]xcept where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of

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[35] *Isolux Infrastructure Netherlands B.V. v. Kingdom of Spain*, SCC Case No. 2013/153, Award, July 12, 2016, Unofficial translation of Award Extracts and Dissenting Opinion from Spanish, paragraph 822, citing the *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award, March 17, 2006, paragraphs 460-461.
[36] *Id.*, paragraph 823.
[37] *Charanne B.V. and Construction Investments S.a.r.l. v. Spain*, SCC Case No. 062/2012, Final Award, January 21, 2016, paragraph 538.
[38] *The PV Investors v. Spain*, PCA Case No. 2012-14, Final Award, February 28, 2020, paragraph 582, citing *Electrabel S.A. v. The Republic of Hungary*, ICSID Case No. ARB/07/19, Award, November 25, 2015, paragraphs 165 and 180.
[39] *Id.*, paragraph 583.
[40] Novenergia II - Energy & Environment (SCA), SICAR v. Kingdom of Spain, SCC Case No. 2015/063, Award, February 15, 2018, paragraph 695.
[41] *Stadtwerke München GmbH and others v. Kingdom of Spain*, ICSID Case No. ARB/15/1, Award, December 2, 2019, paragraph 261.

> insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable."[42]

5. *The host state can create legitimate expectations even without a specific commitment by enacting legislation with a clear intention to attract investments*

Somewhat in contrast with the previous conclusion, in another case a tribunal held that there is no need for a "specific commitment" (e.g., a contractual stabilization clause) for a legitimate expectation to arise, and considered that expectations are created deliberately when a regulatory regime is established with a clear intention to attract investment subject to an advantageous regulatory scheme and policy:

> "At least in the case of a highly-regulated industry, and provided that the representations are sufficiently clear and unequivocal, it is enough that a regulatory regime be established with the overt aim of attracting investments by holding out to potential investors the prospect that the investments will be subject to a set of specific regulatory principles that will, as a matter of deliberate policy, be maintained in force for a finite length of time."[43]

6. *Investors' expectations must be assessed at the time of making the investment and due diligence is a must*

The standard of protection of legitimate expectations is objective: the mere subjective belief that an investor may have had at the time of making its investment does not suffice and the "reasonableness" of the expectations will have to be assessed against the representations of the state made in order to encourage the investment.[44] Tribunals enquire whether due diligence was properly done by investors before investing and whether they sought advice on the prospects of any changes in the state's policy.[45] In this regard, those who invested early have a better chance of proving the existence of legitimate expectations of the legislative framework's stability than those who invested later, after it became obvious that modifications were required or pending.[46]

7. *The opportunity for an investor to receive a reasonable return on investments is an important benchmark in deciding on a breach of international obligations by a state*

In one of the tribunals' views, the principle of a reasonable return serves as the limit of ECT-compliant regulatory changes. If changes cross the "reasonable return" line, that is if they deprive investors of a reasonable return, the state conduct transgresses the standards contained in Article 10(1) of the ECT.[47]

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[42] *The PV Investors v. Spain*, PCA Case No. 2012-14, Final Award, February 28, 2020, paragraph 578, citing *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award, October 8, 2009, paragraph 217.
[43] *Cube Infrastructure Fund SICAV and others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum, February 19, 2019, paragraph 388.
[44] *Charanne B.V. and Construction Investments S.a.r.l. v. Spain*, SCC Case No. 062/2012, Final Award, January 21, 2016, paragraph 495.
[45] Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain, ICSID Case No. ARB/14/1, Award, May 16, 2018, paragraphs 357-369; Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/36, Award, May 4, 2017, paragraph 119; Stadtwerke München GmbH and others v. Kingdom of Spain, ICSID Case No. ARB/15/1, Award, December 2, 2019, paragraph 264.
[46] See *Isolux Infrastructure Netherlands B.V. v. Kingdom of Spain*, SCC Case No. 2013/153, Award, July 12, 2016, Unofficial translation of Award Extracts and Dissenting Opinion from Spanish, paragraph 798.
[47] *The PV Investors v. Spain*, PCA Case No. 2012-14, Final Award, February 28, 2020, paragraph 638.

III. The case of the Czech Republic

Legislative framework

On August 1, 2005, Act 180 on the Support of Electricity Generation from Renewable Energy Sources (Act 180) entered into force in the Czech Republic with the purpose of promoting the development of renewable energy sources.[48] Act 180 introduced a combination of tariff and non-tariff mechanisms which were designed to serve as incentives for renewable energy generators. The main incentives included guaranteed priority in connecting to the transmission grid (or distribution systems) and a fixed purchasing price (feed-in tariff), which was paid as a total price per unit of electricity; or, alternatively, right to receive a so-called green bonus: a premium on top of the market price. The feed-in tariffs were to be set at a level that ensured a return of the investment in 15 years and a return on investment of 7 percent per annum over 15 years (later 20 years) for facilities which satisfied the established conditions.[49]

By 2009, while investment costs decreased dramatically due to a fall in the prices of solar panels and other equipment, the feed-in tariffs, which were set on the basis of higher investment costs, could not be correspondingly reduced. This resulted in a windfall for the owners of renewable energy generators at the expense of consumers. The government started taking measures to prevent the imminent crisis with a change of the legislative framework. Government measures included:

a limiting from January 1, 2011 the support to all small PV facilities[50] subsequently connected to the grid;[51] and

b introducing a special solar levy on the electricity generated from solar energy in the period from January 1, 2011 to December 31, 2013, which was applied to PV facilities put into operation between January 1, 2009 and December 31, 2010. The solar levy rates were 26 percent of the feed-in tariff and 28 percent of green bonuses.[52]

In 2012 Act 165/2012 on Promotion of Sources of Energy and Amending Certain Acts (Act 165) was adopted, replacing Act 180, which was repealed. Act 165 incorporated the feed-in tariff as set out in Act 180 and the solar levy. Further, a solar levy at a rate of 10 percent of the applicable feed-in tariff was extended to facilities commissioned in 2010 for the entire period of time during which these facilities would have the right to government support.[53]

Cases against the Czech Republic

The Czech Republic was more successful than Spain in defending the claims brought against it by investors, mostly in 2014, under both the applicable BITs and the ECT. Only in one out of the seven awards we are aware of was the state found liable and, in that case, the amount of damages is yet to be quantified. Such unity in the tribunals' findings could largely be explained by the same tribunal

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[48] Act 180, Section 1(2) of Act 180 on the Support of Electricity Generation from Renewable Energy Sources (entered into force in the Czech Republic on August 1, 2005).
[49] Decree No. 475/2005 Coll., paragraph 4(1), ERO Methodology for Determination of Purchasing Prices and Green Bonuses. See also *JSW Solar (zwei) GmbH & Co.KG, Gisela Wirtgen, Jürgen Wirtgen, and Stefan Wirtgen v. Czech Republic*, PCA Case No. 2014-03, Final Award, October 11, 2017, paragraphs 365 and 367.
[50] With installed capacity of up to 30 kWh.
[51] Act 330/2010 dated November 3, 2010.
[52] Act 402/2010, Section 7(a). The Czech Republic provided an opportunity for individual solar producers adversely affected by the solar levy to pay it over a longer period of time; see *JSW Solar (zwei) GmbH & Co.KG, Gisela Wirtgen, Jürgen Wirtgen, and Stefan Wirtgen v. Czech Republic*, PCA Case No. 2014-03, Final Award, October 11, 2017, paragraph 403.
[53] Act 310/2013, Art. I(8)−(9), amending sections 14 and 18 of Act 165.

deciding four cases with similar underlying facts[54] and two tribunals sharing the same majority.[55] In most of the cases the investors were ordered to pay 75 percent of the costs of arbitration[56] and in one case, a share of the legal costs of the Czech Republic.[57]

Overall, tribunals found that the guarantees provided to investors under Act 180 (namely, that qualified solar energy producers would, by charging feed-in tariffs, achieve a return of investment in 15 years and an annual return on investment of at least 7 percent over 15 years) were left unchanged by the later amendments to the legislative framework.[58] One of the tribunals came to the conclusion that, even after the solar levy reduced excessive profits, PV investors still secured a more than reasonable return. While without the legislative amendments, the reference plant would have received a full payback in 7.8 years, following the amendments the payback could still be achieved in 9.9 years and was therefore well below the promised 15 years. While the return for the reference plant without the amendments would have been 11.4 percent, with the amendments the return amounted to 8.4 percent and therefore remained above the promised 7 percent return rate.[59]

The findings to note from the cases against the Czech Republic (mostly echoing the tribunals' conclusions in cases involving Spain) are as follows:

1. Legitimate expectations must be objectively reasonable: the assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host state.[60]

2. Investors have to demonstrate that they had a legitimate basis for reliance upon expectations generated by representatives of the state and that they performed proper due diligence before investing.[61]

3. Overall, the test to establish whether there has been a violation of an investor's legitimate expectations is as follows: (a) whether the state gave an assurance as to regulatory stability; (b) whether the investor effectively relied on such assurance; (c) whether this reliance was reasonable, taking into account the prevailing social and economic circumstances in the energy sector at the time; and (d) whether the state violated the investor's legitimate expectations,

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[54] Professor Dr Hans van Houtte (President) and Messrs John Beechey CBE and Toby Landau QC issued the awards in *WA Investments-Europa Nova Limited v. The Czech Republic*, PCA Case No. 2014-19; *Voltaic Network GmbH v. The Czech Republic*, PCA Case No. 2014-20; *Photovoltaik Knopf Betriebs-GmbH v. The Czech Republic*, PCA Case No. 2014-21; and *I.C.W. Europe Investments Limited v. The Czech Republic*, PCA Case No. 2014-22.

[55] Mr Gary Born and HE Judge Peter Tomka served as parties' appointed arbitrators in *Antaris Solar GmbH and Dr. Michael Göde v. The Czech Republic*, PCA Case No. 2014-01; and *JSW Solar (zwei) GmbH & Co.KG, Gisela Wirtgen, Jürgen Wirtgen, and Stefan Wirtgen v. Czech Republic*, PCA Case No. 2014-03.

[56] *WA Investments-Europa Nova Limited v. The Czech Republic*, PCA Case No. 2014-19; *Voltaic Network GmbH v. The Czech Republic*, PCA Case No. 2014-20; *Photovoltaik Knopf Betriebs-GmbH v. The Czech Republic*, PCA Case No. 2014-21; *I.C.W. Europe Investments Limited v. The Czech Republic*, PCA Case No. 2014-22; *Antaris Solar GmbH and Dr. Michael Göde v. The Czech Republic*, PCA Case No. 2014-01.

[57] *Antaris Solar GmbH and Dr. Michael Göde v. The Czech Republic*, PCA Case No. 2014-01.

[58] *JSW Solar (zwei) GmbH & Co.KG, Gisela Wirtgen, Jürgen Wirtgen, and Stefan Wirtgen v. Czech Republic*, PCA Case No. 2014-03, Final Award, October 11, 2017, paragraph 406.

[59] *Photovoltaik Knopf Betriebs-GmbH v. The Czech Republic*, PCA Case No. 2014-21, Award, May 15, 2019, paragraph 490; *WA Investments-Europa Nova Limited v. The Czech Republic*, PCA Case No. 2014-19, Award, May 15, 2019, paragraph 577; *Voltaic Network GmbH v. The Czech Republic*, PCA Case No. 2014-20, Award, May 15, 2019, paragraph 494; *I.C.W. Europe Investments Limited v. The Czech Republic*, PCA Case No. 2014-22, Award, May 15, 2019, paragraph 536.

[60] *Photovoltaik Knopf Betriebs-GmbH v. The Czech Republic*, PCA Case No. 2014-21, Award, May 15, 2019, paragraph 495, citing *Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, August 18, 2008, paragraph 340.

[61] *Id.*, paragraph 470.

bearing in mind that *de minimis* violations do not meet the necessary threshold for treaty violations.[62]

IV. Lessons from the cases in Spain and the Czech Republic

Our analysis of the Spanish and Czech cases above has identified the following main points which we think are useful to note when assessing a state's potential liability to foreign investors when changes are introduced to its renewable energy regime. If any claim is brought by investors against Ukraine, we expect to see arguments relating to whether there has been a breach of the FET standard under the ECT and/or a respective BIT and the investors' legitimate expectations that they would receive a green tariff in the amounts promised under the current legislation.

Given the limited scope of this paper, we have not performed an in-depth analysis of specific commitments made by Ukraine toward foreign investors (in legislation or elsewhere). Therefore, any views provided below are purely indicative and of a general nature, and should not be considered as legal advice.

- *Lesson one*

Given the difference in tribunals' interpretation of the relevant standards of protection and their analysis of the facts relating to investors' expectations, including, when deciding claims involving the same state, the same changes in regime and similar circumstances, the outcome of a case brought against a state by an investor is somewhat unpredictable. In this regard, the choice of arbitrators is crucial given that the presence on the panel of two arbitrators with similar views will likely guarantee a particular outcome for the case.

- *Lesson two*

Investors cannot reasonably expect that no regulatory change will occur, especially when the regulations introducing incentives clearly refer to a possibility of such changes. As discussed above, the Ukrainian legislation refers to possible legislative changes in the regime of incentives[63] so it could be difficult for investors to argue that any legislative changes in relation to such incentives would be in breach of the applicable international law standards. However, on the face of the relevant legislative provisions, investors may argue that they are entitled to the incentives that were in place as of the date of commissioning and if there are any changes in the regime of incentives, it is their right to either continue enjoying the original package or choose any of the newly offered alternatives. This would be a potential effect of the specific legislative commitments arguably made by Ukraine.

- *Lesson* three

The changes in the regulatory framework must be proportionate, reasonable, non-arbitrary and in the public interest, but not drastic or unexpected. Among the factors that will likely be considered in the assessment of the reasonableness and proportionality of measures taken by the state are:

a the imminence of a crisis if the measures are not taken; and

b the effect of extraneous factors, such as a global economic crisis or pandemic, on the state's economy.

[62] *Id.*, paragraph 496.
[63] Article 17-1 of the 1997 Law of Ukraine "On Electric Power Industry" and Article 9-1 of the 2003 Law of Ukraine "On Alternative Sources of Energy."

We note that Ukraine has declared a state of crisis in the energy market, thereby justifying potential legislative changes. Tribunals may require evidence to prove that, but for such changes, the consequences of the crisis would be worse. If the measures taken by the Ukrainian government are challenged, it may also be expected to show that other, less severe, measures were not available to avert the collapse.

In our view, the manner in which Ukraine is considering changes to the green tariff regime is unlikely to be deemed arbitrary given the long period of the negotiations between the government and interested parties, and the substantive discussion of the proposed changes with investors. The engagement of the government with the renewables sector may also be relied on to support the argument that the measures, if they are taken, cannot be considered either drastic or unexpected.

- *Lesson four*

In any event, for the state not to be found in breach of the ECT standards, any regulatory changes should not deprive foreign investors of a reasonable rate of return of and on their investments. The current assessment of the payback period for renewable energy projects (between three and seven years) seems low by international standards (for example, in the Czech Republic, 15 years' payback was considered favorable to investors). In relation to the return on investments, a proper assessment of what is a reasonable rate of return, given the status of the Ukrainian economy, will be required before assessing whether any new rate of return is reasonable or not.

- *Lesson five*

Given (a) the significant costs for both parties to investment arbitration proceedings, which in the vast majority of cases considered above lasted from three to five years, and (b) the relative unpredictability of the outcome, it is wise for both investors and the state to apply their best efforts to resolve disputes amicably. We are aware, from the most recently published statistics of ECT cases, that in all cases brought under the ECT in relation to renewables, overall, investors were awarded less than 5 percent of claimed damages (approximately €1 billion out of approximately €21 billion claimed).[64] This gives a good indication of the expected outcome.

These are the main lessons which might guide Ukraine and foreign investors through the resolution of any pending issues in the renewable energy sector. The situation at the moment is complicated and unpredictable, and there are likely to be some disappointed investors. However, we hope both Ukraine and the investors can find an amicable solution to the benefit of Ukraine's economy, the wellbeing of the Ukrainian people and the reputation of Ukraine as a country with a favorable investment climate.

June 19, 2020

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[64] Statistics of ECT Cases as of June 1, 2020, page 2, at https://www.energycharter.org/media/news/article/updated-statistics-on-investment-arbitration-cases-under-the-energy-charter-treaty/?tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1%5Baction%5D=detail&cHash=c06700cf198e364baf7f478afa580f2b.

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