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CLIENT ALERT

PV Solar Investor Claims against Italy: Update regarding recent pro-investor arbitral tribunal award in *Greentech*

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Investors in Italy's solar photovoltaic ("PV") sector will by now be well aware of the possibility of seeking compensation from the Italian Government for reductions to subsidies and incentives granted under the different *Conto Energia* regimes. That compensation can be sought from arbitral tribunals appointed pursuant to certain investment treaties, including the Energy Charter Treaty, as described in more detail below.

A recent decision by an international investment treaty arbitral tribunal in a matter brought by investors Greentech and others against the Italian Government was published in early 2019 (the "*Greentech* Award"). The *Greentech* Award sheds light on the approach taken by that arbitral tribunal in assessing reductions to subsidies and incentives as a result of the so-called *Spalma Incentivi* Decree and serves as a timely reminder for those investors with qualifying projects who have not already taken steps to claim compensation from the Italian Government to do so. This was the first decision to be published against Italy focusing on the effects of the *Spalma Incentivi* Decree, and several more cases remain pending.

This briefing discusses: the guaranteed incentives once offered by Italy to entice investment in its solar PV sector; the measures enacted by the Italian Government rolling back these incentives, in particular under the *Spalma Incentivi* Decree; the recent decision by an arbitral tribunal in the *Greentech* matter; and the potential remedies that aggrieved investors may be able to pursue against Italy under international treaties.

Background: The Incentives that Italy Offered Investors to Invest in the PV Sector in Italy

With a view to meeting its commitments under EU treaties and the Kyoto Protocol, in 2005 Italy introduced a number of measures to incentivize investment in the renewable PV electricity sector. The legal framework for these measures is often referred to as "*Conto Energia*."

The principle incentive contemplated by *Conto Energia* takes the form of a feed-in tariff ("FiT"), a guaranteed sum paid on the basis of the amount of solar electricity fed into the grid. Under *Conto Energia,* the amount of the specific, guaranteed FiT is determined on a case-by-case basis, considering a number of specific criteria in relation

to each PV power plant (including, for example, whether the installation is ground-fixed, rooftop, integrated or non-integrated, and the nominal capacity of the PV plants).

Beyond the specific amount of FiT to be paid to the owner of a given PV power plant, the FiT scheme (under *Conto Energia*) has the following characteristics:

- The relevant FiT level applicable to a specific PV power plant is guaranteed for 20 years from the date of connection of the PV power plant to the national grid;
- FiTs are paid on a monthly basis, in direct proportion to the amount of energy generated by the PV power plant;
- FiTs are to be paid by the Gestore dei Servizi Energetici S.p.A. ("GSE") (a state-owned company whose remit consists of promoting and supporting renewable energy sources in Italy); and
- PV energy producers conclude an agreement with the GSE that, among other things, guarantees the relevant FiT level for 20 years.

Italy Reduces Fits on PV Power Plants

From 2011 onwards, Italy has taken a number of measures to the detriment of solar PV investors. In March 2011, it enacted a decree that, among other things, significantly cut the guaranteed timeframe for investors to secure the incentives offered by the Italian Government (the so-called "Romani *Decree*"). Furthermore, also from 2011 onwards, Italy significantly reduced the incentives offered in the *Conto Energia* scheme to new projects (in particular, the so-called "*Quarto Conto Energia*" and the "*Quinto Conto Energia*"). Although these measures had a significant impact on the PV sector and caused numerous projects to fail, they did not affect PV power plants that were already connected to the grid.

The position dramatically changed once more with the enactment of the so-called *Spalma Incentivi* Decree (Law August 11, 2014, No. 116, published in the Italian Official Gazette No. 192/2014 on August 20,2014) that ratified (with amendments) the decree issued by the Italian Government on an urgent basis on June 24, 2014 (D.L. No. 91, published in the Italian Official Gazette No. 144/2014 on June 25, 2014).

Broadly speaking, the *Spalma Incentivi* Decree significantly reduced the FiT levels guaranteed to PV power plants with a nominal capacity exceeding 200 kW, which were already connected to the national grid and that were subject to express stabilization agreements between PV electricity producers and the GSE. The reductions set out in the *Spalma Incentivi* Decree applied from January 1, 2015. The measures contained in the *Spalma Incentivi* Decree were retrospective in nature. This unexpected change cut across the financial aspects of the project finance obtained by most solar PV projects in Italy, preventing numerous investors from servicing their debt.

A number of solar PV investors mounted a constitutional challenge against the *Spalma Incentivi* Decree before Italy's administrative courts. In May 2015, the administrative court of the Lazio Region (*Tribunale Amministrativo Regionale per il Lazio*) concluded that some elements of the *Spalma Incentivi* Decree raised serious issues of constitutionality. The administrative court, thus, referred the question of constitutionality to Italy's Constitutional Court. Unexpectedly, the Constitutional Court dismissed the constitutional challenge, thus upholding the constitutionality of the *Spalma Incentivi* Decree. This entails, in turn, that there is no further recourse under Italian domestic law to challenge the retrospective cuts in the *Spalma Incentivi* Decree. As a result, investment treaty arbitration looms as the only option available to obtain redress against Italy's measures.

The Tribunal's Analysis in *Greentech*

The majority of the *Greentech* tribunal (*i.e.*, two of its three members) found that the provisions of the *Spalma Incentivi* Decree that reduced FiTs and that forced PV solar project operators to choose between three options of reduced tariffs in late 2014, to be effective from January 1, 2015, was a breach of the Energy Charter Treaty (the "ECT"). Specifically, the *Greentech* tribunal focused on a finding that the sudden and significant reduction of FiTs

under the *Spalma Incentivi* Decree constituted a breach of the investor claimants' legitimate expectations and a breach of the obligation of a host State to afford investors "fair and equitable treatment".

In reaching this conclusion, which was specific to the facts of that case, the Tribunal considered particularly significant that contracts have been concluded with the GSE that set forth the specific tariff incentive rate that the PV operator would receive and the specific dates comprising a 20-year period during which the incentive would be paid.

In its assessment of damages as a result of the *Spalma Incentivi* Decree, the *Greentech* tribunal adopted the general principle often referred to as the "full compensation" standard; i.e., that compensation to an investor Claimant should wipe out all the consequences of the illegal act and re-establish the situation that would, in all probability, have existed if that act had not been committed.

To calculate that full compensation, the *Greentech* tribunal adopted the discounted cash flow ("DCF") method, by which quantum experts determine the diminution of the fair-market value of a PV plant by calculating the value that the PV plant(s) would have had if the relevant measure (in this case the *Spalma Incentivi* Decree) had not been enacted, versus the value of the PV plant(s) as a result of enactment of the relevant measure, in this case the *Spalma Incentivi* Decree.

The *Greentech* tribunal agreed that the DCF method would be the most appropriate way to assess damages in that case, given that PV plants have relatively predictable performance, involve foreseeable costs, and, in this case, benefited from incentive tariffs that were set in advance.

The *Greentech* tribunal therefore awarded the claimants in that case the total amount that they claimed for the reduction in incentive tariffs under *Spalma Incentivi* Decree, which for those projects in that case amounted to €11.9 million. The *Greentech* tribunal also awarded interest at a rate of LIBOR + 2%, to be applied from January 1, 2015, onwards and compounded annually.

Finally, the *Greentech* tribunal ordered Italy to pay: (a) all of the Claimant's costs of the arbitrators' fees and associated administrative fees for the case, which amounted to in that case €478,000; and (b) 50% of the Claimant's legal fees, which in that case amounted to a total of €2.8 million, 50% of which was €1.4 million.

International Investors may be Entitled to Redress

As the decision by the majority of the *Greentech* tribunal shows, the measures in the *Spalma Incentivi* Decree may entitle aggrieved international investors that invested in Italy's PV sector to obtain redress (including compensation) under some international instruments, in particular the ECT and relevant bilateral investment treaties ("BITs").

The ECT

The ECT was signed by Italy on December 17, 1994, and entered into force on April 16, 1998. In addition to Italy, there are 51 other ECT member states, including, amongst others, Cyprus, Germany, Luxembourg, Switzerland, and the UK. Italy withdrew from the ECT effective 2016, but per Article 47.3 of the ECT, the ECT's provisions still apply to Italy for a 20-year period after 2016.

The ECT is a multilateral investment treaty that establishes a legal framework for the protection of investments in the energy sector. Among other things, it permits qualifying investors to file arbitration claims directly against a host State for violations of the protections under the ECT. To qualify for protection, in general, an investor has to have the nationality, or be organized in accordance with the law, of an ECT member state.

Further, the investor has to have a qualifying investment for the purposes of the ECT. The definition of the term "investment" in the ECT is broad: it means every kind of asset, owned or controlled directly or indirectly, by a qualifying investor. In particular, as set out in the ECT, "investment" includes all types of property and property rights; a company, shares, stocks, other forms of equity participation, bonds and debt; claims to money; amounts derived

from or associated with a qualifying investment; and any right conferred by law or contract to develop activities in the energy sector.

Under the ECT, member States must accord fair and equitable treatment ("FET") and full protection to investments, must not engage in discriminatory treatment, nor expropriate investments without just compensation. A number of arbitral tribunals have concluded that the FET protection obliges a host State to safeguard an investor's legitimate expectations and provide a stable legal environment.

The ECT also contains a provision under which the breach of an agreement between an investor and a host State may amount to a breach of the treaty (a so-called "umbrella clause").

Investors from ECT member States who made investments allured by the Incentives, may have the right to commence arbitral proceedings against Italy to obtain compensation for the harm they have suffered as a result of the measures enacted by Italy.

Prior to commencing ECT arbitral proceedings, an investor should give Italy notice of, and an opportunity to settle, the dispute. If the dispute is not settled within three months from notice (often referred to as a "cooling-off period"), an investor will have three options to pursue arbitration against Italy, namely:

a. Arbitration before the World Bank's International Centre for Settlement of Investment Disputes ("ICSID");

b. Ad hoc arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL"); or

c. Arbitration before the Arbitration Institute of the Stockholm Chamber of Commerce ("SCC").

BITs

Italy has signed dozens of BITs, more than 70 of which are currently in force. These BITs have been concluded with countries from all parts of the world, including Hong Kong, India, and South Korea.

Although in general the level of protection accorded by different BITs may vary, many of them allow investors to commence proceedings for violations of guarantees similar to those in the ECT, such as FET, full protection and security and freedom from discriminatory treatment.

For example, the Italy-Hong Kong BIT resembles the ECT in respect of the definition of investment and nationality requirements. This BIT also contains FET protection and prohibitions to impose unreasonable or discriminatory measures on an investment and illegal expropriation. This BIT contemplates a six-month cooling off period and vests qualifying investors with the right to pursue arbitration against the host State under the UNCITRAL Arbitration Rules. As such, under this BIT, aggrieved Hong Kong investors that invested in the PV solar sector in Italy are entitled to commence arbitral proceedings against Italy.

Facilitated Enforcement of Resulting Awards

Depending on the applicable treaty and the type of arbitration pursued by a party, a resulting arbitral award may be enforceable in and outside Italy under the Convention on the Settlement of Investment Disputes of 1965 or the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.

These two conventions facilitate the enforcement of arbitral awards and would permit a successful claimant to collect the monies awarded by an arbitral tribunal against some assets of the Italian State in most countries in the world.

Additional State Measures against PV Plant Operators May Give Rise to Claims

Beyond the reduction to FiTs—which will generally have had the most significant financial impact on PV plant operators—there have been additional measures that will have had a financial impact on PV plant operators in Italy.

These measures, individually or collectively, might also form the basis of a claim against the Italian government, and include the following by way of example:

- Modification of the payment mechanism under the *Spalma Incentivi* Decree;
- Increase to administrative fees payable to the GSE pursuant to the *Spalma Incentivi* Decree;
- Exclusion of PV facilities over 100kWh in capacity from the minimum guaranteed prices scheme ("MGP scheme," also referred to as the *prezzi minimi garantiti*).

Third Party Funding

As a result of Italy's measures, some investors may not have the funds necessary to pursue investment treaty arbitration. In such circumstances, it may be possible to secure partial or full funding for such costs from a third party.

Broadly speaking, third party funding involves a funder providing financing for some or all of the legal fees and expenses a party incurs when pursuing litigation or arbitration. If the funded party is defeated, the third party funder loses all of its investment. In exchange for this risk, a funder will expect a fee if the case succeeds and monies are recovered. There are different approaches to the determination of the fee, which may vary depending on the characteristics of the claim. For example, the fee could be a multiple of the funds provided—often three to five times the amount furnished by the funder. Other funders may want a percentage of what is recovered—often between 25 and 50%. Some funders may seek a combination of these two approaches.

The availability of funding ultimately depends on a series of factors; the perceived strength of the case being one of the most important. In addition, funders take into account the ratio between estimated proceeding costs and the anticipated (realistic) damages. Many funders will consider a case with a 1:10 costs to damages ratio, but some may be willing to fund cases with a lower level of anticipated damages.

Our Experience

Winston & Strawn is a premier dispute resolution and international arbitration firm. Our attorneys have been involved in some of the most significant investment treaty arbitrations in recent years, including renewable energy disputes under the ECT. In particular, we are representing a claimant in a significant ECT arbitration against Italy arising from some of the measures described in this briefing (Eskosol S.p.A. in liquidazione v. The Italian Republic, ICSID Case No. ARB/15/50).
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