

ARBITRATION INSTITUTE OF THE
STOCKHOLM CHAMBER OF COMMERCE
SCC ARBITRATION No. 118/2001

NYKOMB SYNERGETICS TECHNOLOGY HOLDING AB

-Claimant-

AND

THE REPUBLIC OF LATVIA

-Respondent-

Opinion of

Prof. Ove Bring

and

Dr. Richard Happ

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A.
INTRODUCTION

1. We have been asked by Mr. Fred Wennerholm of Setterwalls Advokatbyrå, Stockholm, to give an opinion on certain issues of public international law which are relevant to this case. We have also seen copies of the following documents:

- Claimant's Request for Arbitration of 11 December 2001,
- Respondent's Reply to the Request for Arbitration of 15 May 2002,
- Claimant's Statement of Claim of 16 September 2002,
- Respondent's Statement of Defence of 27 November 2002,
- Claimant's Reply to the Statement of Defence of 18 February 2003,
- Claimant's Brief of 21 March 2003;
- Respondent's Rejoinder to Claimant's Reply of 4 April 2003,
- Claimant's Brief II and Final Statement of Evidence of 3 June 2003,
- Legal Opinion of Prof. Thomas Wälde of 6 June 2003.

2. We have been asked to examine the following issues:

- The nature and scope of the Present Dispute;
- Whether the state responsibility of the Republic of Latvia ("Latvia") is incurred by the facts of this case;
- Nykomb's claim for compensation.

B.
THE NATURE AND SCOPE OF THE PRESENT DISPUTE

I.
THE INTERNATIONAL LAW NATURE OF THIS CASE

3. It is common ground between the parties that this Tribunal has to decide this dispute in accordance with the provisions of the Energy Charter Treaty ("ECT") and applicable rules and principles of international law. Furthermore, the legal relationships between the parties are governed by public international law. This case is a public international law case, including not only matters of treaty interpretation, but also of international law principles relevant to issues of state responsibility.

4. It is worth noting that in contrast to this international law nature of the case, the essence of the claim submitted by Claimant is an alleged breach of a contract subject to the law of Latvia and with its own jurisdiction clause. However, a claim submitted under Article 26 ECT must be a claim based on breach of the obligations under Part III of the Treaty.
5. Consequently, whether Latvia is in breach of her obligations under the ECT, and, if so, what consequences follow from such breach, must be determined by reference to international law and not by reference to Latvian law. Whether there is a breach of the ECT and whether there has been a breach of the Contract 16/97 are different questions, and each of these claims needs to be determined by reference to its own proper law. From the viewpoint of international law, national laws are considered to be mere facts.¹
6. It is furthermore to be noted that Latvia's economic policy is not an issue in this proceeding. As the ICSID tribunal in *CMS Gas Transmission Company v. The Republic of Argentina* said, "investment treaties cannot prevent a country from pursuing its own economic choices. These choices are not under the Centre's jurisdiction and ICSID tribunals cannot pass judgement on whether such policies are right or wrong. Judgement can only be made in respect of whether the rights of investors have been violated."²

II.

THE RELATIONSHIP BETWEEN INTERNATIONAL LAW AND THE ESSENCE OF THIS CASE

1. THE NATURE AND SCOPE OF THE CLAIM SUBMITTED

7. The essence of this case is a dispute between Windau and Latvenergo, two independent Latvian private law entities, concerning a contract subject to the domestic law of Latvia. Neither of them is a party to this dispute. This

¹ Permanent Court of International Justice ("PCIJ"), *Case of Certain German Interests in Polish Upper Silesia (1926)*, PCIJ Ser. A, no. 7, p. 19.

² *CMS Gas Transmission Company and the Republic of Argentina*, Decision of the Tribunal on Objections to Jurisdiction of 17 July 2003 (Vicuna, Lalonde, Rezek), para. 29 [hereinafter *CMS Gas Transmission*].

has certain fundamental legal implications on the international law level which determines this dispute.

A) THE NATURE OF THE CLAIM SUBMITTED

8. Under the facts of this case, Nykomb asserts a claim owned not by itself, but by its subsidiary. The claim, as presently formulated, is for damages which only Windau could claim. The damages are claimed for breach of contract 16/97 to which only Windau is a party.
9. Admitting such a claim would circumvent the general rule that claims of national companies against their own governments are normally not admissible under international law. Although there are a few exceptions to the rule, they do not apply in this case: the first exception is ICSID-proceedings. Pursuant to Article 25 (2) (b) ICSID-Convention, the parties may explicitly agree to treat the local company as a “foreign national” for purposes of jurisdiction.³
10. The second exception is proceedings under the NAFTA. It is surprising to note that Prof. Wälde, when applying the *Mondev*- and *Pope&Talbot Damages*-awards to the ECT, omits to mention that these claims have been brought under the NAFTA. NAFTA carefully distinguishes between claims by investors on their own behalf (Art. 1116) and claims by investors on behalf of enterprises (Art. 1117).⁴
11. In both *Mondev* and *Pope&Talbot*, the differentiation was an issue. The *Mondev*-Tribunal, while accepting that *Mondev* has standing under Art. 1116, noted: “*In the Tribunal’s view, it is certainly open to Mondev to show*

³ Article 26 (7) ECT contains such a general agreement. If the investor chooses ICSID-jurisdiction, a local company controlled by him will be considered as a “foreign investor”.

⁴ Article 1117 reads as follows:

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Subchapter a claim that the other Party has breached:
 - (a) a provision of Subchapter A; or
 - (b) Article 1502 (3)(a) (Monopolies and State Enterprises) or Article 1503(2) (State Enterprises) where the alleged breach pertains to the obligations of Subchapter A;and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach

that it has suffered loss or damage by reason of the decision it complains of, even if loss or damage was also suffered by the enterprise itself, LPA.”⁵

12. Additionally, in the *Pope&Talbot Damages* award, the tribunal also considered it necessary that the investor claimed its own damages under Article 1117:

“ ...,it is plain that a claim for loss or damage to its interest in that enterprise/investment may be brought under Article 1116. It remains of course for the investor to prove that loss or damage was caused to its interest, and that it was causally connected to the breach complained of.”⁶

13. The ECT does not provide for claims of foreign investors on behalf of their subsidiaries. Thus, the claim for damages calculated on basis of the alleged breach of Contract 16/97 is not within the scope of the Energy Charter Treaty.

B) THE SCOPE OF THE CLAIM SUBMITTED

14. It is worth recalling that Article 26 ECT relates only to disputes between a Contracting Party to the ECT and an investor of another Contracting Party to the ECT relating to the alleged breach of an obligation of the former under Part III of the ECT.
15. The essence of the claim submitted is an alleged breach of Contract No. 16/97 by Latvenergo. This Contract is governed by the law of Latvia and contains a jurisdiction clause, which reads as follows:

“The parties shall settle all disputes by way of negotiations or through court in accordance with the laws of the Republic of Latvia”

⁵ *Mondev International Ltd. v. United States of America*, Award of October 11, 2002 (Stephen, Crawford, Schwebel), para 83 [hereinafter *Mondev*]. The dispute arose out of a commercial real estate development contract concluded in December 1978 between the City of Boston, the Boston Redevelopment Authority (“BRA”) and Lafayette Place Associates (“LPA”), a limited ownership owned by Mondev International Ltd. After having lost both breach of contract claims against Boston and the BRA, Mondev filed a claim under NAFTA.

⁶ *Pope & Talbot Inc. v. Government of Canada*, Award in Respect of Damages of 31 May 2002 (Lord Dervaird, Belman, Greenberg), para. 80 [hereinafter *Pope&Talbot Damages*].

Nykomb is not a party to this contract. Neither is Latvia. Consequently, Nykomb can only bring a claim under the Energy Charter Treaty.

16. As said before, the essence of this case is a breach of contract claim. The jurisdictional clause in the Contract 16/97 prevents this Tribunal from any determination of whether there is a breach of the contract. The *Aguas de Aconquija* case cited by Prof. Wälde⁷ does not contradict this proposition. Prof. Wälde especially misapplies the annulment decision. The annulment committee based its holding that the jurisdictional clause could not prevent the Tribunal's jurisdiction on the fact that the international claim was not for breach of contract. However, it considered that:

"In a case where the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract", citing the *Woodruff* case of 1903 submitted to an international claims commission⁸. The Tribunal further noted: *"The commission accordingly dismissed the claim 'without prejudice on its merits, when presented to the proper judges', on the ground that 'by the very agreement that is the fundamental basis of the claim, it was withdrawn from the jurisdiction of this Commission'.*

In the light of the *Aguas de Aconquija* annulment decision, it is clear that this tribunal must give effect to the jurisdiction clause in Contract 16/97. The essential basis of Nykomb's claim is breach of Contract 16/97. Whether such a breach exists is for the Latvian courts to decide.

2. THE SCOPE OF "INVESTMENT" UNDER THE ENERGY CHARTER TREATY

17. It is also necessary to determine whether Claimant can bring a claim relating to an investment. Article 26 Energy Charter Treaty requires a dispute relating to an 'Investment' of an investor of a Contracting Party. Nykomb would have standing before this tribunal and could present a claim it owns, if it can show that the dispute relates to an 'Investment'.

⁷ Legal Opinion of Prof. Dr. Thomas Wälde of 6 June 2003, para. 152 [hereinafter *Wälde-opinion*]

⁸ *Compania de Aguas de Aconquija S.A. and Vivendi Universal (formerly Compagnie Générale des Eaux) v. Argentina*, Decision on Annulment of 18 June 2002 (Fortier, Crawford, Rozas), para 98 [hereinafter *Vivendi-Annulment Decision*].

18. Pursuant to the chapeau of Article 1 (6) ECT, investments are all “assets” owned or controlled directly or indirectly by an investor. As Prof. Wälde correctly points out, an ‘asset’ is an item of property or a proprietary right of some value.⁹ In order for contractual ‘claims to money’, Article 1 (6) (c), to qualify thus as an asset, the claims must be specific and enforceable enough to be a proprietary right. The other ‘investments’ listed in Article 1 (6) (a)-(f) ECT, especially property and property rights, companies and shares or stock in them, intellectual property and ‘rights conferred by law’ are such proprietary rights, characterized by being specific, clear and enforceable. Consequently, claims to money must be specific, clear and enforceable.¹⁰ International law in general does not support alleged and dubious rights. This proposition is supported by the case law of the Iran-US Claims Tribunal. In various decisions, the Iran-US Claims Tribunal has dismissed claims where the terms of alleged contracts were too vague or imprecise to give rise to enforceable contractual obligations.¹¹ *In Sea-Land Service, Inc. v. Iran*, the tribunal considered that the alleged content of the obligation “*never crystallized into a sufficiently precise formulation to constitute an enforceable contract obligation*” and dismissed the claim.¹²
19. Whether Windau has a right to a double tariff or not cannot be determined exclusively from the contract, but only by reference to Latvian law. It is not only that Contract 16/97 contains a force majeure clause the scope and effect of which is unclear. Windau and Latvenergo have also concluded a ‘settlement agreement’, the content and relationship of which to Contract 16/97 is also disputed. The scope of rights of Windau under Contract 16/97 can only be determined by a decision of the competent courts.
20. It is thus doubtful whether the alleged right to the double tariff does constitute an ‘asset’ and an investment under the Treaty. Consequently, Claimant cannot bring a claim in relation to the alleged breach of contract.

⁹ Wälde-Opinion, para. 50.

¹⁰ Pursuant to the *ejusdem generis* rule of interpretation, general words followed by specific words must be interpreted by the genus of those specific words. As to this rule, cf. *Robert Jennings / Arthur Watts* (eds), *Oppenheim’s International Law*, 9th ed, vol. I/2-4, § 633.

¹¹ cf. *George H. Aldrich*, *The Jurisprudence of the Iran-United States Claims Tribunal*, 282 (1996).

¹² *Sea-Land Service, Inc. v. The Islamic Republic of Iran*, Award No. 135-33-1 of June 20, 1984, 6 Iran-US Claims Tribunal Reports p. 149, 162.

C.
STATE RESPONSIBILITY

I.
THE ELEMENTS OF STATE RESPONSIBILITY

21. The claim submitted can only succeed on the merits if Latvia's international responsibility is engaged under the facts of this case. For the international responsibility of a state to be engaged, there must be an act which is attributable to the state (II.) and which is not in conformity with an obligation of the state (III).

II.
ATTRIBUTION OF CONDUCT OF LATVENERGO TO LATVIA

22. The first requirement for international responsibility of a State is that the conduct in question is attributable to the State under international law. It must be noted that 'attribution' is a normative operation which must be clearly distinguished from characterization of an act as in breach. Its concern solely is to establish that there is an act of the State.

1. RULES OF ATTRIBUTION

23. To begin with, the UN International Law Commission ("ILC") in its Reports on State Responsibility considered it a generally accepted principle

*"that the acts of private persons or of persons acting in private capacity are in no circumstances attributable to the State."*¹³

This holds true also with respect to enterprises with an independent legal personality from the State. The ILC recalled at its 53rd session in 2001 that *"international law acknowledges the general separateness of corporate entities at the national level [...]"*¹⁴.

¹³ *International Law Commission*, First Report on State Responsibility by Mr. James Crawford, Special Rapporteur, 22 July 1998, UN Doc. A/CN.4/490/Add.5, para. 245.

¹⁴ *International Law Commission*, Commentaries to the Draft Articles on Responsibility of States for internationally wrongful acts, November 2001, page 107 [hereinafter *ILC-Commentary*].

24. International tribunals have recognized this separateness even with regard to federal provinces which have their own legal personality. We draw the Tribunal's attention to the recent ICSID-annulment decision in the case *Compania de Aguas de Aconquija S.A. and Vivendi Universal v. the Argentine Republic*. Claimants had entered into a Concession contract with the Argentine province of Tucumán, and the annulment committee held:

“By contrast, the state of Argentina is not liable for the performance of contracts entered into by Tucumán, which possesses separate legal personality and is responsible for the performance of its own contracts.”¹⁵

25. We understand Claimant's submissions as assuming that Latvenergo's refusal to pay to Claimant the double tariff is attributable under international law to Latvia. Latvenergo being a 100% state-owned corporation, the question naturally arises whether its conduct is attributable to the state.
26. The recognized rules of attribution are set out in Part One of the ILC Draft Articles on State Responsibility. They offer three bases under which Latvenergo's conduct could be attributed to Latvia: Article 4 (conduct of organs of a state), Article 5 (Conduct of persons or entities exercising elements of governmental authority) and Article 8 (Conduct directed or controlled by a State).

A) ATTRIBUTION PURSUANT TO ART. 4 ILC DRAFT ARTICLES

27. The relevant part of Article 4 reads as follows:

“The conduct of any State organ shall be considered an act of that State under international law, [...]”

Article 4 presupposes, however, that an organ has acted in its official capacity as the organ. As the ILC explains, acts which an organ undertakes in its private/commercial capacity are not attributable to the state¹⁶.

28. It must be noted that Prof. Wälde misapplies both *Salini* and *Maffezini* to this case when trying to argue that a majority state-owned company, for

¹⁵ *Vivendi-Annulment Decision*, para. 96.

¹⁶ *ILC-Commentary*, Art. 4 para. 13.

purposes of attribution, is an organ of the state.¹⁷ Both were only jurisdictional awards. The difference was clearly explained by the *Maffezini*-Tribunal. With respect to the conduct of the state enterprise SODIGA, the tribunal noted that:

“75. Accordingly, the Tribunal has to answer the following two questions: first, whether or not SODIGA is a State entity for the purpose of determining the jurisdiction of the Centre and the competence of the Tribunal, and second, whether the actions and omissions complained of are imputable to the state. While the first issue is one that can be decided at the jurisdictional stage of these proceedings, the second issue bears on the merits of the dispute and can be finally resolved only at that stage.”¹⁸

29. In determining whether conduct of the state enterprise SODIGA was attributable to Spain, the tribunal in its final award held:

“52. In dealing with these questions, the Tribunal must again rely on the functional test, that is, it must establish whether specific acts or omissions are essentially commercial rather than governmental in nature or, conversely, whether their nature is essentially governmental rather than commercial. Commercial acts cannot be attributed to the Spanish State, while governmental acts should be so attributed.”¹⁹

Then, the *Maffezini* - tribunal analyzed the various acts which the investor had complained about and considered several of them to be of commercial nature and not attributable to Spain.

B) ATTRIBUTION PURSUANT TO ART. 5 ILC DRAFT ARTICLES

30. Article 5 of the Draft Articles reads as follows:

“The conduct of a person or entity which is not an organ of the State under article 4, but which is empowered by the law of that State to exercise

¹⁷ *Wälde-Opinion*, para. 83.

¹⁸ *Emilio Agustín Maffezini v. The Kingdom of Spain*, Decision of the Tribunal on Objections to Jurisdiction of 25 July 2000 (Vicuna, Bürgenthal, Wolf), para. 75 [hereinafter *Maffezini-Jurisdiction*].

¹⁹ *Emilio Agustín Maffezini v. The Kingdom of Spain* Spain, Final Award of 13 November 2000 (Vicuna, Bürgenthal, Wolf), para. 52 [hereinafter *Maffezini-Final Award*].

elements of governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.”

31. It is not decisive that a person or entity is empowered to exercise governmental authority. What is decisive is that the specific incriminating conduct concerns the exercise of governmental authority. The ILC has summarized this in the following words:

“If it is to be regarded as an act of the State for purposes of international responsibility, the conduct of the entity must accordingly concern governmental authority and not other private or commercial activity in which the entity may engage. Thus, for example, the conduct of a railway company to which certain police powers have been granted will be regarded as an act of the State under international law if it concerns the exercise of those powers, but not if it concerns other activities (e.g. the sale of tickets or the purchase of rolling-stock).”²⁰

C) ATTRIBUTION PURSUANT TO ART. 8 ILC DRAFT ARTICLES

32. Article 8 of the Draft Articles reads as follows:

“The conduct of a person or a group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction and control of, that State in carrying out the conduct.”

33. In determining whether a state enterprise acted under the instructions of a State or under its direction and control, one must bear in mind the general separateness of corporate entities. As the ILC puts it:

“Since corporate entities, although owned by and in that sense subject to the control of the State, are considered to be separate, prima facie their conduct in carrying out their activities is not attributable to the State.”²¹

²⁰ ILC-Commentary, page 94.

²¹ ILC-Commentary, page 107.

Thus, for purposes of attribution it is necessary to show that the company acted on direct and specific instructions of the State and that the State used its ownership interest in controlling the corporation specifically in order to achieve a specific result. The instructions of the State must relate to the conduct which is said to have amounted to an internationally wrongful act.

2. THE CONDUCT OF LATVENERGO IN THE LIGHT OF THE ATTRIBUTION RULES

34. Both Claimant and Prof. Wälde analyse in detail the structure of Latvenergo, its private and –possibly- governmental tasks and functions and whether it is empowered to exercise elements of governmental authority. While this analysis is highly interesting and instructive, its value for the case is rather limited. As we have explained, the conduct of an enterprise, even if its owned by the state, can only be attributed to the state if the enterprise exercises governmental authority and acted in that capacity, or if it acted on direct instructions of the government.
35. While it could be argued that Latvenergo exercises certain governmental functions, we consider it very difficult, if not impossible, to argue that the refusal to pay the double tariff is an exercise of governmental authority. The dispute between Latvenergo and Windau concerns the interpretation of the contract 16/97 and lacks any governmental elements. The facts made available to us indicate that Latvenergo acted in its commercial capacity, considering itself no longer obliged to pay the double tariff. Latvenergo's conduct thus cannot be attributed to Latvia pursuant to Draft Article [4 or 5](#).
36. We also find it extremely difficult to argue that Latvenergo, when refusing to pay the double tariff, acted on instructions of Latvia. The facts made available to us indicate that, quite to the contrary, the Latvian Government tried to instruct Latvenergo to pay the double tariff. Latvenergo sought the protection of the Latvian courts against this interference, and in its judgment of 24 March 2000, the Constitutional Court of the Republic of Latvia confirmed that the Cabinet of Ministers could not lawfully order Latvenergo to pay the double tariff (cf. Statement of Claim, para. 4.9.2). Thus, Article 8 of the ILC Draft Articles is no basis to attribute Latvenergo's conduct to Latvia.
37. Consequently, the conduct of Latvenergo cannot be attributed to Latvia.

III. BREACH OF INTERNATIONAL OBLIGATIONS

38. The second requirement of state responsibility is that conduct found to be attributable to the State is in breach of an international obligation of that State. The obligation must also be in force for the State at the time of the breach.
39. The ECT obliges its Contracting Parties to accord the investments of investors of other Contracting Parties certain treatment. The obligations under Part III of the ECT apply only to such investments. Consequently, Nykomb can have a claim under the ECT only if it is able to show that acts which are attributable to Latvia constitute a breach of Latvia's obligations towards Nykomb. Any such acts must occur after the ECT entered into force and after Nykomb had made its investment.
40. Claimants cause of action is unclear. In its Statement of Claim, Claimant relies on the enactment of the Energy Law as the alleged breach of the ECT (cf. Statement of Claim, para. 7). However, the Energy Law was enacted on 6 October 1998 and thus before Nykomb made its investment in Windau in March 1999 (Cf. Statement of Claim, para 4.8.13). Consequently, the Enactment of the Energy Law cannot have been in breach of Latvia's obligations under the ECT.

1. LATVIA'S OBLIGATION UNDER ARTICLE 10 (1) LAST SENTENCE ECT

41. The last sentence of Article 10 (1) ECT reads as follows:

"Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."

The ordinary meaning of the last sentence of Article 10 (1) ECT in its proper context is – in our opinion – of extreme clarity. Each Contracting Party to the ECT shall observe any obligations it – the Contracting Party to the ECT – has entered into with an Investor or an Investment of an Investor of any other Contracting Party to the ECT.

42. Claimant argues that Latvenergo's refusal to pay the double tariff constitutes a breach of this obligation. This is clearly not the case. Irrespective of whether Latvenergo's conduct can be attributed to Latvia, there is no obligation entered into by Latvia with Nykomb or Windau. Contract No. 16/97 has been concluded between Windau and Latvenergo. Neither Latvia nor Nykomb are a party to the contract.
43. Claimant's additional argument that Latvia – by virtue of the Entrepreneurial law, the granted licences and “*the other authoritative communications referred to in this case*” - had made an offer which Claimant accepted by investing (para 4.5.1 – 4.5.3 of Claimants Brief II), is interesting, but does not support its claim.

The content of any obligation which Latvia allegedly had entered into herself is such that no breach exists. Unlike the ‘Pyramids’ award²², where Egypt had itself promised to arbitrate, Latvia never promised that it would itself pay the double tariff to an investor for eight years. Latvia has created a legal framework pursuant to which a double tariff had to be paid to certain power producers and has not changed this framework. It is common ground between the parties that the Energy Law is not retroactive. Latvia has not prevented Windau from seeking confirmation and enforcement of its alleged right through the Latvian courts. As the case of the Gulbene power-plant shows, such protection could have been successful. However, Windau has chosen not to seek such available protection.

2. LATVIA'S OBLIGATION UNDER ARTICLE 13 ECT (EXPROPRIATION)

44. To begin with, it is to be noted that the ECT does not prohibit expropriation of foreign investments, provided certain requirements are fulfilled and compensation is paid. The relevant part of Article 13 (1) ECT reads as follows:

“Investments of Investors of a Contracting Party in the Area of another Contracting Party shall not be nationalized, expropriated or subjected to

²² The ‘Pyramids’-Award is the ICSID-case of *Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt*. Prof. Wälde most likely refers to the Decision on Jurisdiction of November 27, 1985 (Arechaga, El Mahdi, Pietrowski).

measures having equivalent effect to nationalization or expropriation, unless [requirements of Article 13 (1) (a)-(d)]”.

45. The investment of Nykomb has not been formally nationalized or expropriated. No governmental measure has deprived Nykomb of its legal title to the shares in Windau or, if Contract No. 16/97 is to be regarded as the investment, of the alleged right to a double tariff under the contract. As has been explained above, the alleged right to a double tariff is not specific enough to constitute an enforceable right.

THE CONCEPT OF REGULATORY TAKING

46. Claimant submits that the alleged right to a double tariff has been subjected to a regulatory taking. The concept of regulatory takings refers to measures enacted by the state for the regulation of the economy and which, as a side effect, affect the investment. Such measures are not **as a rule** considered to constitute an expropriation. In the recent *S.D. Myers* case, which arose under the North American Free Trade Agreement (“NAFTA”), the tribunal held:

“The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs.”²³

This holding has been shared by subsequent NAFTA-tribunals. The *Feldman*-tribunal held:

“To paraphrase Azininan, not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110”.²⁴

47. This opinion is shared by writers such as *Prof. Brownlie*, who states: “*State measures, prima facie a lawful exercise of powers of governments, may*

²³ *S.D. Myers, Inc. and Government of Canada*, Partial Award of November 13, 2000 (Schwartz, Hunter, Chiasson), para. 282, www.naftaclaims.com.

²⁴ *Marvin Feldman v. Mexico*, Award of 16 December 2002 (Kerameus, Bravo, Gantz), para. 112 (hereinafter *Feldman*).

affect foreign interests considerably without amounting to expropriation.”²⁵
Professor *M. Sornarajah* has noted that there has come “*into existence a category of regulatory takings which are compensable on an internal standard devised by the regulation alone and are not the concern of any external or international standard*”.²⁶ The practice of states supports this view. The 160 member states of the “Convention Establishing the Multilateral Investment Guarantee Agency” (MIGA), among them Latvia and Sweden, consider regulatory measures not to be compensable expropriations. Article 11 (a) (ii), dealing with the insurance coverage against expropriation, makes an exception for:

“non-discriminatory measures of general application which the governments normally take for the purpose of regulating economic activity in their territories.”

HAS NYKOMB’S INVESTMENT BEEN SUBJECTED TO A REGULATORY TAKING ?

48. Having reviewed Claimant’s submissions, it is not entirely clear to us which actions are to constitute the regulatory taking. In its Statement of Claim, it argued that the imposition of the 0,75 tariff on the basis of the Energy Law was a measure equivalent to expropriation (*Id.*, para. 7.7). In its Reply to the Statement of Defence, Claimant argued that the incriminating act was the refusal of Latvenergo to pay the double tariff (*Id.*, para 5.2.1). We understand Claimant’s latest Brief as reiterating this argument.
49. We have already explained that the Energy Law and the Cabinet Regulation No. 425 were enacted before Nykomb made its investment and thus cannot have effected the expropriation of its investment. Furthermore, the Energy Law and Cabinet Regulation No. 425 do not amount to a regulatory taking of Claimant’s investment. It is not only that Latvia has confirmed that the Energy Law is not retroactive. We consider them also to be non-discriminatory measures of general application taken for the further liberalization of the Latvian energy sector. This also seems to be uncontested by Claimant. Thus, the effect of these measures cannot be considered equivalent to an expropriation under the Energy Charter Treaty..

²⁵ *Ian Brownlie*, Principles of Public International Law, 5th ed., p. 535.

²⁶ *M. Sornarajah*, The International Law on Foreign Investment, Cambridge 1994, p. 322.

50. We have explained above that the acts of Latvenergo are not attributable to Latvia. In refusing to pay the double tariff, Latvenergo neither acted in governmental authority nor on direct instructions of Latvia. These acts thus cannot constitute an expropriation under Article 13 ECT.
51. The *Metalclad*-award cited by Nykomb is not really supportive for its position. In *Metalclad*, the tribunal found an expropriation to exist as the investor was denied the construction permit necessary for the operation of the landfill. This denial “*effectively and unlawfully prevented the Claimant’s operation of the landfill*”.²⁷ Windau, however, is not prevented from operating as a power plant nor has Nykomb been deprived of the operation of Windau.
52. It is also extremely difficult to find an expropriation as there is no clear, specific and enforceable right to a double tariff. In the NAFTA case of *Feldman v. Mexico*, the tribunal was faced with similar difficulties. It was extremely unclear whether the investor had a right to certain tax rebates under the applicable Mexican law (IEPS) denied by Mexican authorities. In dismissing the claim for expropriation, the tribunal held:

“Under the circumstances, therefore, the Claimant would have been wise to seek a formal administrative ruling on the applicability of Article 4 of the IEPS, and court review if the ruling were adverse, [...], but for whatever reason he chose not to do so. [...] Regardless of the results of the ruling process the Claimant would have been better off. If he had received a favourable ruling on Article 4, it would have been much easier for him to defend his rights under Mexican law and before this tribunal.”

53. Finally, this tribunal might find it instructive to consider also the *Mondev*-award. Faced with a claim where the investor alleged continuing expropriation of contractual rights of its subsidiary LPA, the tribunal held:

“All that was left thereafter were LPA’s in personam claims against Boston and BRA for breaches of contracts or torts arising out of a failed project. Those claims arose under Massachusetts law, and the failure (if failure there was) of the United States courts to decide those cases in accordance

²⁷ *Metalclad Corporation v. The United Mexican States*, Award of 25 August 2000 (Lauterpacht, Civiletti, Siqueros), para. 106 [hereinafter *Metalclad*].

with existing Massachusetts law, or to act in accordance with Article 1105, could not have involved an expropriation of those rights”²⁸

3. LATVIA’S OBLIGATION UNDER ART. 10 (1) ECT (FAIR AND EQUITABLE TREATMENT)

54. It is generally accepted that the purpose of this clause is “to provide a basic and general standard which is detached from the host state’s domestic law.²⁹ Similar clauses are found in nearly every bilateral and multilateral investment treaty and have first appeared in the 1948 Havana Charter. However, the exact content of the obligation is quite unclear and disputed among international lawyers and tribunals.
55. This obligation prescribes the “international minimum standard” of treatment of aliens. It has been rightly pointed out that – in the light of the development of the customary international law on the protection of the individual - the fairness standard under a modern investment treaty should not be interpreted according to precedents of 1926.³⁰ Nevertheless, a high threshold has recently been required by the tribunal in the *S.D. Myers*-arbitration arising under NAFTA:

“The Tribunal considers that a breach of Article 1105³¹ occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that it is unacceptable from an international perspective. That determination must be made within the light of the high measure of deference that international law generally extends

²⁸ *Mondev*, para. 61. For the facts of the case, see *supra*.

²⁹ *Rudolf Dolzer / Margret Stevens*, *Bilateral Investment Treaties*, p. 58. On this obligation generally see *Stephen Vasciannie*, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, BYIL, vol. 70, 1999, p.99-164.

³⁰ *Mondev*, para. 116: “In the light of these developments, it is unconvincing to confine the meaning of “fair and equitable treatment” and “full protection and security” of foreign investments to what those terms – had they been current at the time – might have meant in the 1920s when applied to the physical security of an alien. To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious.”

³¹ NAFTA Article 1105: Minimum Standard of Treatment

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”

to the right of domestic authorities to regulate matters within their own borders.”³²

56. It is more than surprising to note that Claimant (at para 4.7.2) and its expert Prof. Wälde rely on the *Metalclad*-award as a precedent for “fair and equitable treatment” (para. 118). The *Metalclad*-tribunal had interpreted the the ‘fair and equitable treatment’ obligation in the light of the ‘transparency’-principle of NAFTA and concluded that Mexico’s failure to provide a transparent legal framework amounted to unfair and inequitable treatment. However, the *Metalclad*-award has been partially annulled in a Canadian court exactly due to this interpretation of ‘fair and equitable treatment’³³ and thus cannot serve as a precedent for the ECT.
57. In trying to give ‘fair and equitable treatment’ a specific content, Prof. Wälde suggests to fill it with the jurisprudence of the European Court of Justice and “common principles of European constitutional and administrative law” (para. 116). He thus makes the same mistake as the *Metalclad* tribunal. The task of interpretation is to deduce the common intention of the parties to a treaty. It is not possible to deduce the common intentions of the ECT’s 52 Contracting Parties and signatories from Eastern Europe, the CIS and Asia from certain highly specialized regional practices of only 15 Contracting Parties.
58. Under the facts of this case, it is difficult to conclude that Nykomb has been treated unfair or inequitable. Nykomb itself submits that it has relied on governmental laws and regulations to invest in Latvia. Latvia has confirmed that the Energy Law of 1998 has no retroactive effect. Nykomb’s subsidiary Windau is in a dispute with Latvenergo about the tariff to be paid for the produced surplus electricity. Latvenergo had a similar dispute with the Gulbene Power Plant, which was resolved by the competent courts. So far, Windau has chosen not to seek recourse with the local courts. We cannot see that these facts constitute a breach of the Treaty standard of fair and equitable treatment.

³² *S.D. Myers*, para. 263.

³³ *Supreme Court of British Columbia, The United Mexican States v. Metalclad Corporation*, Judgement of 2 May 2001, para. 70: “In the present case, however, the Tribunal did not simply interpret the wording of Article 1105. Rather, it misstated the applicable law to include transparency obligations and it then made its decision on the concept of transparency.”

4. LATVIA'S OBLIGATIONS UNDER ARTICLE 10 (1) ECT (NON-DISCRIMINATION)

59. Prof. Wälde's treatment of the concept of discrimination is quite interesting. However, it is difficult to find a discrimination on the facts of the case. Claimant submits that the payment of the double tariff to Gulbene and Liepajas Siltums is evidence that Windau is being discriminated against. However, we note that Gulbene has successfully claimed its rights to a higher tariff in the Latvian courts, and that Latvenergo thus acts under a legal obligation in paying the double tariff.
60. Whether Windau has a right to a double tariff is unclear at best. As we have explained, it is for the Latvian courts to decide whether Windau has that right. Consequently, no like circumstances can be considered to exist, in which Windau has been treated differently. We thus consider that Latvia is not in breach of her obligation under Article 10 (1) ECT.

IV.

THE RELATIONSHIP OF STATE RESPONSIBILITY TO THIS DISPUTE

61. To give the Tribunal a clear picture, we need to point out that international law – under specific circumstances - accepts private conduct as a basis for state responsibility. Claimant would have a cause of action against Latvia under the ECT if Windau (after Claimant's investment) had been denied justice in the Latvian courts. While the conduct of an entity such as Latvenergo is not attributable to the state, the state can be held responsible if state organs breach an obligation of the state to protect against that private conduct. Bearing in mind that the alleged injury results from an alleged failure of Latvenergo to fulfill its contractual duties, the only way Latvia would have been able to protect Windau and Nykomb would have been through its courts. That would have required Windau to file a lawsuit in the courts. Latvia would only have been in breach of its obligation in case of a denial of justice.
62. Accordingly, should Latvian courts refuse to hear Windau's claim for the double tariff, or should their decision be manifestly unjust, that conduct would not have been in conformity with the obligations of Latvia under international law. As Claimant submits, Latvian Courts up to the Latvian

Supreme Courts have decided in allegedly similar cases in favour of a double tariff and obliged Latvenergo to pay it. Thus, the Latvian Courts were open to Windau. However, Claimant chose not to let Windau initiate proceedings in the Latvian courts. Thus, Latvia had no possibility to protect Claimant's investment and has not failed to do so. Consequently, there is no act or omission from the side of Latvia and no international responsibility is incurred on this ground.

D.
MOST-FAVOURLED-NATION TREATMENT

63. Having reviewed Nykomb's submission that Latvia is in breach of the most-favoured-nation clause in Article 10 (3) Energy Charter Treaty, we fail to see its basis in law and fact. Article 10 (3) obliges Latvia to treat Swedish investors not less favourable than the treatment accorded to other investors. We cannot see that Nykomb as a Swedish Investor has been treated less favourable than other investors. There is no indication that the protection offered under the Latvia - U.S. Bilateral Investment Treaty ("BIT") is more favourable than the protection offered under the ECT. As Latvia is not in breach of any of her obligations under the ECT, there is no indication that she might be in breach of her obligations under the Latvian – U.S. BIT.

E.
REMEDIES

64. We have explained that the refusal of Latvenergo to pay the double tariff is not attributable to Latvia. We furthermore explained that Latvia is not in breach of her obligations under the Energy Charter Treaty. This notwithstanding, we have been asked to explain the remedies available under public international law (I.) and to examine Nykomb's claim for damages from that viewpoint (II.).

I.
REMEDIES UNDER PUBLIC INTERNATIONAL LAW

65. The remedies available under the international law of state responsibility are set out in Part Two of the Draft Articles. Article 28 reads as follows:

“The international responsibility of a State which is entailed by an internationally wrongful act in accordance with the provisions of Part One involves the legal consequences as set out in this Part.”

As the ILC explains, the “core legal consequences of an internationally wrongful act set out in Part Two are the obligations of the responsible State to cease the wrongful conduct (article 30) and to make full reparation (article 31).”³⁴

66. The content of the obligation of reparation, now codified in Articles 31 and 34 of the draft articles, has been aptly described by the Permanent Court of International Justice in the *Chorzow-Factory Case* in 1928:

*[R]eparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if **this** is not possible, payment of a sum corresponding to the value which a restitution in kind would bear [. . .] if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in*

³⁴ ILC-Commentary, p. 213.

place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.”³⁵

1. CESSATION

67. Article 30 ILC-Draft lays down the principle that a State found responsible for an internationally wrongful act is under an obligation to cease that act, if continuing. Cessation of the conduct found to be in breach of an international obligation is, as the ILC explains, *“the first requirement in eliminating the consequences of wrongful conduct. With reparation, it is one of the two general consequences of an internationally wrongful act.”³⁶*

2. RESTITUTION

68. Article 35 of the Draft Articles describes the obligation of restitution and reads as following:

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

(a) Is not materially impossible;

(b) Does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.”

3. COMPENSATION

69. As far as the damage caused by the internationally wrongful act is not made good by restitution, the State responsible for that act is under the duty to provide compensation. Article 36 of the ILC Draft Articles reads as follows:

“1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.”

³⁵ PCIJ, *Case concerning the Factory at Chorzow*, Merits, 1928, PCIJ Series A, No. 17, p. 47.

³⁶ ILC-Commentary, p. 217.

70. As has been explained above, it is necessary that a party invoking state responsibility proves that itself has suffered damage through the wrongful act. Claims asserted for damage suffered by a subsidiary are – as a general rule - not permissible in international law. In its award on damages, the *Pope & Talbot* Tribunal has stated that *“It remains of course for the investor to prove that loss or damage was caused to its interest, and that it was causally connected to the breach complained of.”*³⁷

71. The compensation claimed must also have been caused by the specific wrongful act. The ILC explains with respect to the general duty of reparation that

*“causality in fact is a necessary but not a sufficient condition for reparation. There is a further element, associated with the exclusion of injury that is too ‘remote’ or ‘consequential’ to be the subject of reparation. [...] In other words, the requirement of a causal link is not necessarily the same in relation to every breach of an international obligation.”*³⁸

This general rule is well illustrated by the recent *Feldman*-award, where the claimant had calculated compensation on the basis of an alleged expropriation. The tribunal had dismissed the expropriation claim and held that there only was a discrimination and thus a breach of Article 1102 NAFTA. With respect to the claim for the full market value of its investment, the tribunal explained

*“It follows that, in case of discrimination that constitutes a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discrimination that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to full market value of the investment which is granted by NAFTA Article 1110.”*³⁹

72. Pursuant to Article 36 (2), lost profits, insofar as established, are part of the compensation. Having reviewed the practice of international tribunals, the ILC explains:

³⁷ *Pope & Talbot Damages*, para. 80.

³⁸ *ILC-Commentary*, p. 228.

³⁹ *Feldman*, para. 194.

“Tribunals have been reluctant to provide compensation for claims with inherently speculative elements. When compared with tangible assets, profits (and intangible assets which are income-based) are relatively vulnerable to commercial and political risk, and increasingly so the further into the future projections are made.”⁴⁰

Concerning future lost profits (*lucrum cessans*), however, strict requirements must be fulfilled. In cases where lost future profits have been awarded, the ILC explains, *“it has been where an anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable.”⁴¹*

II.

THE CLAIM SUBMITTED IN THE LIGHT OF THESE RULES

73. Claimant puts forward a claim for lost profits based on the alleged breach of contract between Windau and Latvenergo. It needs to be noted that this commercial calculation has no relations whatsoever to the provisions of the Energy Charter Treaty or the international law of state responsibility. They rather ‘float in the ether’ unconnected with the subject of compensation under international law, which is to remedy wrong done to Claimant insofar as not made good by restitution or cessation.
74. As has been explained, cessation of wrongful conduct of a continuing character is the first remedy available under international law. Claimant submission is that the incriminating conduct is the refusal of Latvenergo to pay the double tariff, and that this conduct is “still ongoing”, *i.e.* continuing.⁴² Consequently, the first remedy available to Claimant is a claim for cessation of the wrongful conduct. The claim for lost future profits is unfounded as this Tribunal could in its award order Latvia to instruct Latvenergo to pay the double tariff from the date of the award onwards.
75. Latvia is only under an obligation to compensate for the loss caused to Claimant by a wrongful act thereby, insofar as such loss is not made good by restitution. In the present case, restitution would be possible in the form

⁴⁰ ILC-Commentary, p. 259.

⁴¹ Id.

⁴² Reply to Statement of Defence, para. 5.21.

of an award which orders Latvia to order Latvenergo to pay the double tariff to Windau.

76. Insofar as the Claimant's loss is not made good by restitution or cessation, he has a claim for compensation. However, the claim for compensation, as presently formulated, is not permissible. As we have explained at the beginning of this opinion, the Energy Charter Treaty does not provide for claims submitted by the investor for loss suffered by its subsidiary. Claimant does not seek compensation for loss it has suffered, but for the loss of Windau. The tribunal might find the *Maffezini*-jurisdictional decision instructive where the investor had filed a claim for damages sustained by its local subsidiary. The tribunal, while finding a standing of the investor, noted:

*"The foregoing conclusion does not mean that Claimant has in fact proved that he has made out a valid claim for damages sustained by him in his personal capacity. He will have to do that in the proceedings on the merits in order to win the case."*⁴³

77. The claim for the loss suffered by Windau is furthermore not permissible as Claimant does not seek that the compensation should be paid to Windau. Claimant seeks that the compensation is to be paid to itself. In this respect, the *Mondev*-award is again instructive. In dealing with the differences whether a claim was brought by the investor itself (Article 1116 NAFTA) or on behalf of its subsidiary (Article 1117 NAFTA), it noted: *"Having regard to the distinctions drawn between claims brought under Articles 1116 and 1117, a NAFTA tribunal should be careful not to allow any recovery, in a claim that should have been brought under Art. 1117, to be paid directly to the investor"*.⁴⁴
78. It is thus open for Claimant to prove that itself has suffered loss by reason of the refusal to pay the double tariff, even if such loss was also suffered by Windau. It is to be noted that such a calculation of losses must be connected to the losses Claimant has suffered, e.g. in the value of its shares. It furthermore would need to take into account the requirement of 'causality', i.e. be different for a claim based on discrimination than a claim based on expropriation.

⁴³ *Maffezini-Jurisdiction*, para. 69.

⁴⁴ *Mondev*, para. 86.

79. Furthermore, any claim which is based on the allegedly lost profits of Windau until 2007 should be dismissed as it seems inherently speculative in nature. The alleged right to a double tariff is not specific enough to be considered a “*legally protected interest of sufficient certainty to be compensable*”.⁴⁵ It is extremely unclear whether such a right exists at all. The claim is based on the disputed interpretation of a contract not explicitly mentioning a double tariff, and at any event, not confirming the standing of such a tariff against legislative changes described as force majeure. The existence of that right is dependent on a determination of the legal situation by the competent Latvian courts. The calculation furthermore is based on unproven assumptions. It is neither clear that the tariff which is to be doubled will not be reduced, nor that Windau will produce electricity for the next five years in the alleged amounts. Nothing would prevent Claimant from shutting down Windau after having received the amount claimed.
80. The *Karaha Bodas* award cited by Prof. Wälde (para. 158) is not really of authoritative value for the claim for lost profits. Firstly, the claim was for direct breach of contract, and, unlike this case, the parties to the dispute were also the actual contractual parties. Secondly, the *Karaha Bodas* has been heavily criticized, inter alia by Prof. Wälde, as being an example of ‘double counting’: the investor was returned his initial investment and the future return of his investment for the next years. This Tribunal should not make a similar mistake.

F.

COMPENSATION UNDER ARTICLE 13 ENERGY CHARTER TREATY

81. Article 13 (1) (d) Energy Charter Treaty provides that for expropriation of foreign property, “prompt, adequate and effective compensation” is to be paid to the investor. Article 13 further prescribes that such compensation “*shall amount to the fair market value of the Investment expropriated at the time immediately before the expropriation or impending expropriation became known in such a way as to affect the value of the investment.*”

⁴⁵ See above, para. 72.

82. It needs to be recalled that this is an international law case, and that the tribunal has to apply the provisions of the ECT and applicable rules and principles of international law. Any compensation claimed must be provided for by international law. Article 13 ECT clearly provides only for adequate compensation amounting to the fair market value of Nykomb's investment, but not for a compensation calculated on the basis of alleged speculative future profits of Windau. Consequently, the claim submitted, insofar as it might relate to the alleged expropriation, is not based on Article 13 ECT.

CONCLUSION

Based on the preceding discussions, it is our opinion

- That the scope of the claim submitted, as presently formulated, is outside the scope of Article 26 ECT;
- That Latvia is not in breach of her obligations under the Energy Charter Treaty;
- That the claim for compensation is inadmissible, as it is not based on damage suffered by Claimant, and that in any case the claim for lost profits is not justified.

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