

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

In the arbitration proceeding between

UAB E ENERGIJA (LITHUANIA)

Claimant

and

REPUBLIC OF LATVIA

Respondent

ICSID Case No. ARB/12/33

AWARD

Members of the Tribunal

Dr. Paolo Michele Patocchi, President of the Tribunal

Prof. Dr. August Reinisch, Arbitrator

Mr. Samuel Wordsworth QC, Arbitrator

Secretary of the Tribunal

Ms. Geraldine R. Fischer

Date of dispatch to the Parties: 22 December 2017

REPRESENTATION OF THE PARTIES

Representing UAB E energija (Lithuania):

From 15 August 2012 until 8 September 2017:
Mr. George Burn

As from 8 September 2017:
Mr. Mark Beeley

As from 15 August 2012:
Mr. Alexander Slade

Vinson & Elkins RLLP
20 Fenchurch Street
24th Floor
London EC3M 3BY
United Kingdom

and

As from 15 August 2012:
Mr. Agris Repšs
ZAB Sorainen
Kr. Valdemāra iela 21
LV-1010 Riga
Republic of Latvia

Representing the Republic of Latvia:

From 15 August 2012 until 21 February 2016:
Mr. Ivars Mēkons
Assistant Director, International Affairs

As from 22 February 2016:
Ms. Ilze Dubava
Legal Adviser, Legal Department

As from 28 June 2016:
Ms. Nērika Lizinska
Legal Adviser, Legal Department

State Chancellery, Latvia
Brīvības Boulevard 36
LV-1520 Riga
Republic of Latvia

TABLE OF CONTENTS

I.	INTRODUCTION AND PARTIES	1
II.	PROCEDURAL HISTORY.....	2
III.	FACTS	10
	A. Heating in Rēzekne and the 2004 Gas Supply Agreement (2004).....	10
	B. The Original Arrangements And Main Events (End Of 2004-2005)	13
	C. The Operation of the Heating System by Latgales Energija and Main Events in 2006	38
	D. The Energy Crisis Declared by the Rēzekne City Council and Other Main Events in 2007	49
	E. Main Events in 2008.....	83
	F. Main Events in 2009 and Beyond.....	97
	G. The Lithuanian Decisions Relied on by the Respondent (From 2005 to 2011).....	107
	H. The Negotiations between the Parties from 1 September 2008 Onwards	108
IV.	THE PARTIES' REQUESTS FOR RELIEF.....	113
	A. The Claimant	113
	B. The Respondent	115
V.	JURISDICTION	116
	A. The Parties' Prayers for Relief on Jurisdiction and the Respondent's "Preliminary Objections"	117
	B. The Claimant's Position on Jurisdiction.....	118
	C. The Respondent's Objections to Jurisdiction	122
	D. The Claimant's Reply to the Respondent's "Preliminary Objections" to Jurisdiction	125
	E. The Reasons for the Tribunal's Decision on Jurisdiction	130
	F. The Tribunal's Decision on Jurisdiction	146
VI.	THE RESPONDENT'S APPLICATION FOR TERMINATION, AND, ALTERNATIVELY, FOR A STAY OF THE PROCEEDINGS	146
	A. The Parties' Prayers for Relief on the Stay of Proceedings	146
	B. The Respondent's Position	147
	C. The Claimant's Position	148
	D. The Reasons for the Tribunal's Decision on the Respondent's Application for a Stay and Termination of the Proceedings	149
	E. The Tribunal's Decision the Respondent's Application for Termination, and, Alternatively, a Stay of the Proceedings.....	151
VII.	LIABILITY.....	151
	A. The Parties' Prayers for Relief on Liability	151
	B. The Claimant's Case on Liability.....	152
	C. The Respondent's Case On Liability.....	200
	D. The Reasons for the Tribunal's Decision on Liability	225
	E. The Tribunal's Decision on Liability	323

VIII. QUANTUM	323
A. The Parties’ Prayers for Relief on Quantum	323
B. The Claimant’s Case on Quantum.....	324
C. The Respondent’s Case on Quantum.....	326
D. The Reasons for the Tribunal’s Decision on Quantum	326
E. The Tribunal’s Decision on Quantum	334
IX. COSTS	334
X. AWARD	337

i. FREQUENTLY USED ABBREVIATIONS AND ACRONYMS

BIT	The Agreement between the Government of the Republic of Lithuania and the Government of the Republic of Latvia on the Promotion and Protections of Investments dated 7 February 1996
<u>C-(...)</u>	Claimant's Exhibit No. (...) <u>C-1.1</u> means the first document in Exhibit <u>C-1</u> in case the Claimant has filed several documents in one exhibit
CEO	Chief Executive Officer
CFO	Chief Financial Officer
<u>CLA-(...)</u>	Claimant's Legal Authority No. (...) The legal exhibits filed by the Claimant attached to Cl. Rep. Tribunal, p. 18 paragraph 58 were numbered from 1 onwards; the Tribunal renumbered such exhibits from <u>CLA-46</u> (Municipalities and Local Government Act) onwards until <u>CLA-61</u> .
Council	The Rēzekne City Council
Energy Crisis Committee	The committee established by decision No. 388 (<u>C-24</u>) made by the Rēzekne City Council on 9 October 2007, see also footnote 299 below
ECT	Energy Charter Treaty
Heating Supply Development Strategy, Rēzekne	The strategy document approved by the Rēzekne City Council by decision No. 21 of 21 September 2007 <u>C-213</u>
ICSID Arbitration Rules	ICSID Rules of Procedure for Arbitration Proceedings (2006)
ICSID Convention	Convention on the Settlement of Investment Disputes Between States and Nationals of Other States dated 18 March 1965
ICSID or the Centre	International Centre for Settlement of Investment Disputes
ICSID Institution Rules	Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings
2001 ILC Articles	The International Law Commission's Articles on State Responsibility

LVL	Latvian Lats
Methodology, the	Cabinet of Ministers Regulations No. 281 of 26 June 2001, amended in 2008 (Methodology for Calculation of Tariffs for Public Utilities in the Fields Regulated by Local Municipalities) <u>C-35</u> The original 2001 text as well as the amendments made in 2008 are set out in this exhibit; the 2008 amendments are highlighted in yellow
MWh	Megawatt hour
p. (...) [page (...)]	This Award contains references to the documentary evidence – to electronic page numbering in the format “[page 1]”, and – to hard copy page numbering in the format “p. 1”.
<u>R-(...)</u>	Respondent’s Exhibit No. (...) <u>R-1.1</u> means the first document in Exhibit <u>R-1</u> in case the Respondent has filed several documents in one exhibit
RCC	Rēzekne City Council
Regulator, the	the Multi-industry Public Utility Regulator of the Latgale Municipalities
<u>RLA-(...)</u>	Respondent’s Legal Authority No. (...)
Transcript, Day dd, page/line(s)	Transcript of the Hearing on the Preliminary Objections and the Merits
Working Group	The working group established by the Rēzekne City Council to draft the strategic plan for the development of the heat supply system (Council decision No. 188 dated 11 May 2007)

ii. THE PARTIES’ SUBMISSIONS

RfA	Request for Arbitration, 15 August 2012
Cl. Mem.	Claimant’s Memorial, 6 December 2013
Resp. Obj. J. & C-Mem.	Respondent’s Memorial on Preliminary Objections [to Jurisdiction] and Request for Bifurcation and Counter-Memorial on the Merits, 18 April 2014
Resp. Req. Bifurc.	Respondent’s Clarificatory Statement on the Request for Bifurcation, 12 May 2014
Cl. Rep. Bifurc.	Claimant’s Response to the Respondent’s Request for Bifurcation, 19 May 2014

Cl. Rep.	Claimant's Reply on the Merits and Counter-Memorial on Preliminary Objections, 10 October 2014
Resp. Rej.	Respondent's Rejoinder on the Merits and Reply on Preliminary Objections, 12 December 2014
Cl. Rej. J.	Claimant's Rejoinder on Preliminary Objections, 2 January 2015
Cl. Skeleton	Claimant's Skeleton Argument, 9 February 2015
Resp. Skeleton	Respondent's Skeleton Argument, 9 February 2015
Resp. Rep. Tribunal	Respondent's Answer to Questions Put by the Tribunal Concerning Domestic Judicial Proceedings, 25 February 2015
Cl. Rep. Tribunal	Claimant's Response to Questions Raised by the Tribunal, 20 March 2015
Resp. P-H (PO8)	Respondent's Post-Hearing Submission in Response to the Tribunal's Questions Posed in Procedural Order No. 8, 20 March 2015
Resp. Rep. (PO8)	Respondent's Rebuttal Submission (Procedural Order No. 8 Dated 9 March 2015, point 2) – Respondent's Applications, 10 April 2015
Cl. Rep. P-H	Claimant's Rebuttal to Respondent's Post-Hearing Submission, 1 June 2015
Resp. Rep. (PO9)	Respondent's Response to the Tribunal's Procedural Order No. 9, 1 June 2015

iii. SHORT TITLES FOR CERTAIN AGREEMENTS

Short Title	Exhibit	Original Title
Agreement on the Settlement of Debt	<u>C-80</u>	Agreement on the Settlement of Debt dated 15 November 2005 between – Rēzeknes Siltumtīkli – Latgales Enerģija
Amended Long-Term Agreement	<u>C-16</u>	Agreement on Amendments to the Agreement for Lease, Renovation and Operation of the Long-Term Assets of 28 January 2005, dated 10 February 2006 between – Rēzeknes Siltumtīkli – Latgales Enerģija
Amendment Agreement	<u>C-173</u>	Amendment Agreement in Connection with Various Agreements Relating to Debt and Equity Investment in UAB E-enerģija dated 5 March 2008 between – UAB Enerģijos Taupymo Centras ("ETC") – UAB E Energy Invest ("EEI")

Short Title	Exhibit	Original Title
		<ul style="list-style-type: none"> – Mr. Virginijus Strioga (the “Sponsor”) – UAB E-Energija (the “Company”, and, together with ETC and EEI “the Obligors”) – European Bank for Reconstruction and Development (“EBRD”)
Amendment No. 1 to the Gas Supply Agreement	<u>C-61</u>	<p>Supplementation 1 to Agreement No. 1580 on Construction of a New Natural Gas Infrastructure for Gasification of the City of Rēzekne Due to Long-Term Supplies of Natural Gas to the User for Combustion Facilities of Various Mutually Replaceable Fuels (Natural Gas and Oil Products) dated 29 April 2004 between</p> <ul style="list-style-type: none"> – Latvijas Gāze (“LG”) – the Municipality of Rēzekne (“the RPD”) – Rēzeknes Siltumtīkli (“the User”)
Amendment No. 3 to the Gas Supply Agreement ¹	<u>C-81</u>	<p>Supplementation 3 to Agreement No. 1580 on Construction of a New Natural Gas Infrastructure for Gasification of the City of Rēzekne Due to Long-Term Supplies of Natural Gas to the User for Combustion Facilities of Various Mutually Replaceable Fuels (Natural Gas and Oil Products) dated 29 April 2004 between</p> <ul style="list-style-type: none"> – Latvijas Gāze (“LG”) – the Municipality of Rēzekne (“the RPD”) – Rēzeknes Siltumtīkli (“the User”)
2005 Assignment Agreement	<u>C-64</u>	<p>Assignment Agreement dated 4 August 2005 between</p> <ul style="list-style-type: none"> – AS “SEB Latvijas Unibanka” (“Assignor”) – AS “Lohmus, Haavel & Viisemann” (“Assignee”)
2006 Assignment Agreement	<u>C-105</u>	<p>Assignment Agreement dated 13 December 2006 between</p> <ul style="list-style-type: none"> – AS “Lohmus, Haavel & Viisemann” (“Assignor”) – Latgales Enerģija (“Assignee”)
2007 Assignment Agreement	<u>C-159</u>	<p>Assignment Agreement dated 4 December 2007 between</p> <ul style="list-style-type: none"> – Latgales Enerģija (“Assignor”) – LE Remonts (“Assignee”)
2008 Assignment Agreement	<u>C-182</u>	<p>Assignment Agreement Nr. 100/2008 0685 dated 25 June 2008 between</p> <ul style="list-style-type: none"> – Latgales Enerģija (“Assignor”) – UAB E energija (“Assignee”)
EBRD Loan	<u>C-165</u>	<p>Loan Agreement dated 18 December 2007 between</p>

¹ There is no Amendment No. 2 to the Gas Supply Agreement in evidence.

Short Title	Exhibit	Original Title
Agreement		<ul style="list-style-type: none"> – European Bank for Reconstruction and Development (“EBRD”), – UAB E enerģija (“the Borrower”)
February 2005 Agreement	<u>C-8</u>	<p>Agreement dated 10 February 2005 between</p> <ul style="list-style-type: none"> – Rēzekne City Council (“the Council”) – Latgales Enerģija (“the Operator”)
February 2006 Agreement	<u>C-17</u>	<p>Agreement on Mutual Operations with the Aim to Decrease Energy Rate in the City of Rēzekne, dated 10 February 2006 between</p> <ul style="list-style-type: none"> – Rēzekne City Council – Latgales Enerģija
Gas Supply Agreement	<u>C-40</u>	<p>Agreement No. 1580 on Construction of a New Natural Gas Infrastructure for Gasification of the City of Rēzekne Due to Long-Term Supplies of Natural Gas to the User for Combustion Facilities of Various Mutually Replaceable Fuels (Natural Gas and Oil Products) dated 29 April 2004 between</p> <ul style="list-style-type: none"> – Latvijas Gāze (“LG”) – the Municipality of Rēzekne (“the RPD”) – Rēzeknes Siltumtīkli (“the User”)
Guarantee Agreement	<u>C-43</u>	<p>Guarantee Agreement dated 30 December 2004 between</p> <ul style="list-style-type: none"> – UAB E enerģija (“Guarantor”) – AS “Latvijas Unibanka” (“Creditor”)
Investment Services Agreement	<u>C-63</u>	<p>Investment Services Agreement dated 4 August 2005 between</p> <ul style="list-style-type: none"> – AS Lohmus, Haavel & Viisemann (“LHV”) – UAB E enerģija (“the Client”)
Latvian Treasury Loan Agreement	<u>R-20</u> [pages 2 ff.]	<p>Loan Agreement dated 10 October 2007 between</p> <ul style="list-style-type: none"> – The Treasury of the Republic of Latvia (Lender) – Rēzekne City Council (Borrower)
Long-Term Agreement	<u>C-4</u>	<p>Agreement for Lease, Renovation and Operation of Long-Term Assets dated 28 January 2005 between</p> <ul style="list-style-type: none"> – Rēzeknes Siltumtīkli (“the Lessor”) – Latgales Enerģija (“the Operator”)
October 2007 Agreement	<u>C-26</u>	<p>Agreement between</p> <ul style="list-style-type: none"> – Latgales Enerģija (Burkovskis) – UAB E Enerģija (Burkovskis) – Rēzeknes Siltumtīkli (Mežals) – Rēzeknes City Council (Vjakse) – Rēzeknes Enerģija (Škinčs/Melnis)

Short Title	Exhibit	Original Title
Rēzeknes Enerģija Gas Supply Agreement	<u>C-151</u>	Natural Gas Delivery Agreement dated 17 October 2007 between <ul style="list-style-type: none"> – Latgales Enerģija (User) – Rēzeknes Enerģija (Supplier)
Sampo Banka Guarantee	<u>C-102</u>	Guarantee dated 30 November 2006 between <ul style="list-style-type: none"> – JSC Sampo Banka (“the Bank”) – UAB E energija (“the Guarantor”)
Sampo Banka Loan Agreement	<u>C-101</u>	Loan Agreement No. SB-26/3519 dated 30 November 2006 between <ul style="list-style-type: none"> – JSC Sampo Banka (“the Bank”) – Latgales Enerģija (“the Borrower”)
Sampo Banka Pledge	<u>C-103</u>	Commercial Pledge No. SB-26/3519/1 between <ul style="list-style-type: none"> – JSC Sampo Banka (“the Commercial Pledgee”) – UAB E energija (“the Commercial Pledgor”)
Share Purchase Agreement	<u>C-92</u>	Share Purchase Agreement (with Repo Option) dated 8 June 2006 between <ul style="list-style-type: none"> – UAB E energija – SIA Energo Sistēmas
Shareholders’ Agreement	<u>C-45</u>	Shareholders’ Agreement dated 14 January 2005 between <ul style="list-style-type: none"> – UAB E energija – Juris Vanags – Ļevs Voronovs – Mārtiņš Lauva – SIA Energo Sistēmas – SIA Latgales Enerģija

iv. DRAMATIS PERSONAE

Name	Title
1. Abramova, Dagmāra	Rēzeknes City Council, Councillor
2. AS Danske Bank	Latvian branch of Danish bank
3. AS Latvijas Gāze	Latvian company specialised in the importation, transportation, storage and sale of natural gas
4. AS Lohmus, Haavel & Viisemann	Latvian branch of Estonian investment bank
5. AS Rēzeknes Siltumtīkli	Latvian company owned by the Rēzekne Municipality
6. AS SEB Latvijas Unibanka	Latvian bank
7. Beeley, Mark	Vinson & Elkins, Partner, counsel for the Claimant as from 8 September 2017
8. Bērziņš, Intar	Energo Sistēmas), SIA Latgales Enerģija, Member of the

	Name	Title
		Management Board
9.	Briedis, Edgar	ZAB Sorainen, Attorney representing Latgales Enerģija in certain Latvian proceedings
10.	Burkovskis, Arnoldas	Latgales Enerģija, Manager
11.	Burn, George	Vinson & Elkins, Partner, counsel for the Claimant until 8 September 2017; formerly of Salans LLP
12.	Dubava, Ilze	State Chancellery, Republic of Latvia, as from 7 September 2016
13.	E Enerģija UAB	Lithuanian company, the Claimant
14.	Hansel Realty Management Spain S.L.	Spanish company
15.	Jautakis, Aleksas	UAB E Enerģija, Chief Financial Officer
16.	Klimanovs, Ilja	Rēzekne City Council, Deputy Chairman
17.	Latvenego	Latvian state-owned electric utility company
18.	LE Remonts	Latvian company
19.	Lizinska, Nērika	State Chancellery, Republic of Latvia, as from 7 September 2016
20.	Locis, Ivars	Rēzekne City Council, Deputy Executive Director
21.	Mēkons, Ivars	State Chancellery, Republic of Latvia, until 7 September 2016
22.	Meļņikovs, Sergejs	Latgales Enerģija, Member of the Management Board
23.	Melnis, Rihards	Rēzeknes Enerģija, Member of the Management Board
24.	Mežals, Aldis	Rēzeknes Siltumtīkli, Member of the Management Board
25.	Muceniece, Maija	Rēzeknes City Council, Councillors
26.	the Multi-industry Public Utility Regulator of the Latgale Municipalities (“the Regulator”)	Latvian authority
27.	Nikonovs, Vladimirs	Rēzeknes City Council, Councillor
28.	Patmalnieks, Arturs	Rēzeknes City Council, Head of the Legal Department
29.	Rēzeknes Vēstis	Local newspaper, Rēzekne
30.	Repšs, Agris	ZAB Sorainen, Attorney
31.	Rodl & Partner SIA	Audit Group
32.	Rogozina, Svetlana	Rēzeknes Siltumtīkli, Accountant
33.	Salans LLP	Law firm formerly acting for the Claimant
34.	Sampo Banka	Latvian branch of Finnish bank
35.	SIA AVT Nafta	Latvian company
36.	SIA Dinaburga Rosme	Latvian company
37.	SIA Energo Sistēmas	Latvian company
38.	SIA Latgales Enerģija	Latvian company controlled by the Claimant
39.	SIA Rēzeknes Enerģija	Latvian company owned by the Rēzekne Municipality
40.	SIA Rēzeknes Namsaimnieks	Latvian company, estate agent
41.	SIA Rēzekne Ūdens	Latvian water sewerage company
42.	SIA Rēzekne Siltumserviss	Latvian company active in heat supply and heat supply network
43.	Škinčs, Edgars	Rēzeknes Enerģija/ Rēzeknes Namsaimnieks, Member of the Management Board
44.	Slade, Alexander	Vinson & Elkins, Attorney; formerly of Salans LLP

	Name	Title
45.	Spradzenko, Gunars	Rēzeknes City Council, Member
46.	Strioga, Virginijus	E Enerģija UAB, Chief Executive Officer/General Manager
47.	Uškāne, Evisa	Latgales Enerģija, Chairman of the Management Board
48.	Vekšina, Velta	Rēzeknes City Council, Head of the Financial Department
49.	Vjaske, Juris Guntis	Rēzekne City Council, Chairperson
50.	Vanags, Juris	Latgales Enerģija, shareholder
51.	Vinsons & Elskins RLLP	Law firm acting for the Claimant in these proceedings
52.	Voronovs, Levs	Latgales Enerģija, shareholder
53.	ZAB Sorainen	Law firm acting for the Claimant in these proceedings

I. INTRODUCTION AND PARTIES

1. This arbitration concerns a dispute submitted to the International Centre for Settlement of Investment Disputes (“ICSID” or the “Centre”) pursuant to (i) the Agreement between the Government of the Republic of Lithuania and the Government of the Republic of Latvia on the Promotion and Protection of Investments dated 7 February 1996, which entered into force on 23 July 1996 (the “BIT” or “Treaty”) and (ii) the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which entered into force on 14 October 1966 (the “ICSID Convention”).²
2. The Claimant is UAB E energija (Lithuania) (“E energija” or the “Claimant”). It is a limited liability company established under the laws of the Republic of Lithuania and incorporated in Lithuania.³ E energija carries out business in the energy sector and has, in particular, a number of concessions for central heating services in Lithuania, Ukraine and Latvia.
3. E energija indirectly owns 58% of the shares in SIA Latgales Enerģija (“Latgales Enerģija”), a limited liability company established under the laws of the Republic of Latvia and incorporated in Latvia.⁴ E energija incorporated Latgales Enerģija as the entity through which it would invest in the concession for district heating in the Latvian city of Rēzekne (the “Rēzekne Project”).
4. The Respondent is the Republic of Latvia (“Latvia” or the “Respondent”).
5. The Claimant and the Respondent are hereinafter collectively referred to as the “Parties”. The Parties’ respective representatives and their addresses are listed in page (i) above.
6. The dispute relates to the rights asserted by the Claimant under the BIT against the Republic of Latvia in connection with the Rēzekne Project.

² RfA ¶ 1.

³ C-1.

⁴ RfA ¶ 5, see also paragraph 74 below.

II. PROCEDURAL HISTORY

7. On 15 August 2012 ICSID received a request for arbitration from the Claimant against the Republic of Latvia, together with Exhibits C-1 through C-33 and Legal Authorities CLA-1 through CLA-22 (the “Request” or “RfA”).
8. On 15 October 2012 the Secretary-General of ICSID registered the Request, as supplemented by letters dated 14 September 2012, 4 October 2012 and 10 October 2012, in accordance with Article 36(3) of the ICSID Convention and notified the Parties of the registration. In the Notice of Registration, the Secretary-General invited the Parties to proceed to constitute a Tribunal as soon as possible in accordance with Rule 7(d) of the Centre’s Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings.
9. In the absence of an agreement between the Parties, the Claimant elected to submit the arbitration to a three-member Tribunal, as provided in Article 37(2)(b) of the ICSID Convention.
10. On 8 March 2013 Mr. Samuel Wordsworth QC, a British national, accepted his appointment by the Claimant as arbitrator.
11. On 22 April 2013 Prof. Dr. August Reinisch, an Austrian national, accepted his appointment by the Chairman of the ICSID Administrative Council in accordance with Article 38 of the ICSID Convention.
12. On 12 June 2013 Dr. Paolo Michele Patocchi, a Swiss national, accepted his appointment as President of the Tribunal by the Chairman of the ICSID Administrative Council in accordance with Article 38 of the ICSID Convention.
13. On 12 June 2013 the Secretary-General, in accordance with Rule 6(1) of the ICSID Rules of Procedure for Arbitration Proceedings (the “ICSID Arbitration Rules”), notified the Parties that all three arbitrators had accepted their appointments and that the Tribunal was, therefore, constituted on that date. Ms. Geraldine R. Fischer, ICSID Legal Counsel, was designated to serve as Secretary of the Tribunal.
14. On 11 September 2013 the Tribunal held a first session with the Parties in London. The Parties confirmed that the Members of the Tribunal had been validly appointed.

It was agreed, *inter alia*, that: (i) the applicable Arbitration Rules would be those in effect from 10 April 2006; (ii) the procedural language would be English, and (iii) the place of the proceedings would be London, United Kingdom. The Parties agreed on a timetable for the jurisdictional/merits phase of the proceedings, including production of documents. On 10 October 2013, after consultation with the Parties, the President of the Tribunal issued Procedural Order No. 1 which embodied the Parties' agreements on procedural matters including the procedural timetable (the "Timetable", Annex A to Procedural Order No. 1).

15. In Procedural Order No. 2 of 26 November 2013 the Tribunal modified the Timetable further to the Claimant's application.
16. On 6 December 2013 the Claimant filed a Memorial with the following supporting documents:
 - Witness Statement of Mr. Virginijus Strioga ("CWS-1");
 - Witness Statement of Mr. Aleksas Jautakis ("CWS-2");
 - Witness Statement of Ms. Svetlana Rogozina ("CWS-3");
 - Witness Statement of Ms. Evisa Uškāne ("CWS-4");
 - Witness Statement of Mr. Levs Voronovs ("CWS-5");
 - Expert Report on *Quantum* from Dr. Serena Hesmondhalgh of The Brattle Group ("ER Hesmondhalgh I");
 - Factual Exhibits C-34 to C-215; and
 - Legal Authorities CLA-23 to CLA-42.
17. On 18 April 2014 the Respondent submitted its Memorial on Preliminary Objections ("Preliminary Objections") and Request for Bifurcation ("Request for Bifurcation") and Counter-Memorial on the Merits with the following supporting documents:
 - Expert Report on Valuation Quantification of Damages Prepared by Mr. Michael Peer of KPMG Baltics SIA ("ER Peer I");
 - Factual Exhibits R-1 to R-14; and
 - Legal Authorities RLA-1 to RLA-15.
18. In its Preliminary Objections and Request for Bifurcation the Respondent requested *inter alia* that the Tribunal stay the proceedings.

19. On 1 May 2014 the Claimant wrote to the Tribunal regarding the Respondent's submission of 18 April 2014, stating that such submission did not contain an application for bifurcation. The Claimant further requested confirmation that the Tribunal would proceed in accordance with the Timetable set out in Annex A of Procedural Order No. 1 of 10 October 2013 ("Applicable Timetable if Tribunal Decides to Join Preliminary Objections to the Merits").
20. On 5 May 2014 the President of the Tribunal directed the Respondent to clarify by 12 May 2014 whether it sought bifurcation, and, if so, on what basis. The Tribunal also directed the Claimant to answer the Respondent's letter of 12 May 2014 as well as the Respondent's request for a stay of proceedings by 19 May 2014.
21. On 12 May 2014 the Respondent submitted its Clarificatory Statement on its Request for Bifurcation stating that it sought bifurcation.
22. On 19 May 2014 the Claimant submitted its Response opposing the Respondent's Request for Bifurcation.
23. On 30 May 2014 the Tribunal in Procedural Order No. 3 denied the Respondent's Request for Bifurcation and joined the Respondent's "preliminary objections" to the merits, stating that a further decision setting out reasons would be sent to the Parties as soon as possible in the following weeks. The Tribunal also denied the Respondent's application for a stay of these proceedings pending a final and binding decision by the courts of Latvia on Case No. C03051107. On 21 January 2015 the Tribunal in Procedural Order No. 3*bis* gave reasons for its decision declining the bifurcation and the stay of proceedings sought by the Respondent.
24. On 18 August 2014 the Tribunal ruled on the Parties' requests for production of documents in Procedural Order No. 4.
25. On 1 October 2014 the Tribunal decided on certain document production issues and amended the Timetable in Procedural Order No. 5.
26. On 10 October 2014 the Claimant filed a Reply on the Merits and Counter-Memorial on the Respondent's Preliminary Objections with the following supporting documents:

- Second Witness Statement of Mr. Virginijus Strioga (“CWS-6”);
 - Second Witness Statement of Mr. Aleksas Jautakis (“CWS-7”);
 - Second Witness Statement of Ms. Svetlana Rogozina (“CWS-8”);
 - Second Expert Report on *Quantum* from Dr. Serena Hesmondhalgh of The Brattle Group (“ER Hesmondhalgh II”);
 - Expert Report of Dr. Dagnija Blumberga (“ER Blumberga I”);
 - Factual Exhibits C-216 to C-252; and
 - Legal Authorities CLA-43 to CLA-45.
27. On 12 December 2014 the Respondent filed a Rejoinder on the Merits and Reply on Preliminary Objections with the following supporting documents:
- Third Expert Report on Quantification of Damages prepared by Mr. Michael Peer of KPMG Baltics SIA (“ER Peer III”);⁵
 - Factual Exhibits R-15 to R-21; and
 - Legal Authorities RLA-16 to RLA-19.
28. On 2 January 2015 the Claimant filed a Rejoinder on the Respondent’s Preliminary Objections.
29. On 19 January 2015 the Tribunal held a pre-hearing organisational meeting with the Parties via telephone conference. The Tribunal then decided the points of procedure and organisation in dispute between the Parties in Procedural Order No. 6 of 16 February 2015.
30. On 9 February 2015 the Parties filed their Skeleton Arguments.
31. A hearing on the Preliminary Objections and the Merits took place from 23 to 27 February 2015 in London, United Kingdom (“Hearing”). In addition to the Members of the Tribunal, the Secretary of the Tribunal, the Hearing was attended by the following persons:

⁵ ER Peer I was filed by the Respondent on 18 April 2014, see paragraph 17 above. ER Peer III ¶ 1.2.1 mentions an ER Peer II dated 1 September 2014, which was KPMG’s re-calculation of the heating tariffs and the underlying detailed calculations obtained from the Regulator’s archive which the Respondent provided to the Claimant in the document production phase pursuant to Procedural Order No. 4 ¶ 13. ER Peer II was not filed in these proceedings.

For the Claimant:

Mr. George Burn	Vinson & Elkins
Mr. Alexander Slade	Vinson & Elkins
Ms. Ciara Ros	Vinson & Elkins
Mr. Agris Repšs	Sorainen
Mr. Martins Paporinskis	Sorainen
Ms. Žydruoje Ažukiene	UAB E energija
Ms. Raminta Barauskiene	UAB E energija
Ms. Ilinca Popescu	The Brattle Group

For the Respondent:

Mr. Ivars Mēkons	Latvian State Chancellery
Mr. Ermīns Darapovičs	Attorney, the Rēzekne Municipality

32. The following persons were examined:

On behalf of the Claimant:

Mr. Virginijus Strioga	UAB E energija
Mr. Aleksas Jautakis	UAB E energija
Ms. Evisa Uškāne	SIA Latgales Enerģija
Dr. Serena Hesmondhalgh	The Brattle Group
Dr. Dagnija Blumberga	Riga Technical University

On behalf of the Respondent:

Mr. Michael Peer	KPMG
Mr. Andris Puriņš	KPMG

33. In addition to the examination of the persons mentioned above, the Tribunal heard opening and closing arguments.
34. An audio recording and a full transcript of the Hearing was provided to the Parties.
35. During the Hearing, on 23 February 2015 the Claimant objected to the introduction of new documents by the Respondent. On the same day the Claimant nevertheless consented to the inclusion of Exhibit R-22. The Tribunal subsequently admitted Exhibit R-23.
36. On 26 February 2015 the Tribunal in Procedural Order No. 7 authorised the Respondent to file a short report setting out Mr. Peer's comments on the new points made by Dr. Hesmondhalgh at the Hearing. The Claimant was in turn authorised to file its comments on such short report.

37. On 9 March 2015 the Tribunal in Procedural Order No. 8 confirmed the directions given to the Parties at the Hearing with respect to the specific questions on which the Parties were entitled to file short submissions.
38. On 20 March 2015 the Claimant filed its submission to answer the questions set out in the Tribunal's Procedural Order No. 8 including sixteen exhibits containing English translations of Latvian statutes, which the Tribunal renumbered in accordance with applicable procedural rules as follows:
- Legal Authorities CLA-46 (first translation) to CLA-61 (last translation).
39. On the same day the Respondent filed its submission to answer the questions set out in the Tribunal's Procedural Order No. 8 with the following supporting documents:
- Fourth Expert Report on Quantification of Damages prepared by Michael Peer of KPMG Baltics SIA ("ER Peer IV");
 - Expert Report regarding Loans and Guarantees provided in the context of Damages prepared by Michael Peer of KPMG Baltics SIA ("ER Peer IVB");
 - Factual Exhibits R-22 to R-35; and
 - Legal Authorities RLA-20 to RLA-39.
40. On 26 March 2015 the Claimant pointed out in a message to the Tribunal that the Respondent had disregarded the terms of Procedural Orders No. 1 and No. 8 by submitting new evidence with its submission of 20 March 2015. On 30 March 2015 the Claimant elaborated on its objection and requested that certain Factual Exhibits (R-24, R-25, R-26, R-27, R-28, R-29, R-30, R-32, R-33 and R-35) and Legal Authorities (RLA-21, RLA-22, RLA-24, RLA-34, RLA-37 and RLA-38) be struck off the record.
41. On 10 April 2015 the Claimant filed the Third Expert Report on *quantum* from Dr. Serena Hesmondhalgh of The Brattle Group ("ER Hesmondhalgh III"). The Claimant further reiterated its request that the Tribunal strike the Respondent's unauthorised documents from the record or permit the Claimant to respond to them.

42. On the same day the Respondent sought leave to comment on the Claimant's submissions dated 20 and 30 March 2015 and filed its Rebuttal Submission in accordance with Procedural Order No. 8, together with the following supporting documents:
- Factual Exhibits R-36 and R-37.
43. On 15 April 2015 the Claimant objected to the Respondent's request to comment on its submissions of 20 and 30 March 2015 as well as to the filing of Exhibits R-36 and R-37.
44. On 13 May 2015 the Tribunal in Procedural Order No. 9 authorised the Parties to file a short rebuttal to the submissions filed on 20 March 2015 and indicated that, upon the filing of such rebuttal, no further submissions would be admitted. The Parties filed their rebuttal submissions by 1 June 2015 in accordance with Procedural Order No. 9.
45. On 21 October 2016 the Claimant informed ICSID that all the proceedings to which Latgales Enerģija had been a party before the Latvian courts had been concluded, that all funds that had been frozen had been paid out by the court and that Latgales Enerģija had not received any amount out of such funds.
46. On 11 November 2016 the Respondent replied in accordance with the Tribunal's directions of 26 October 2016 that (i) Case No. C03051107 had been concluded by a judgment of the Supreme Court of Latvia dated 30 November 2015 and made available in a full version on 12 February 2016; Latgales Enerģija had not challenged that judgment and therefore the Claimant had accepted the economic outcome of the whole dispute; (ii) on 11 August 2016 the bailiff had issued the calculation regarding the distribution of the seized funds, which was not challenged by Latgales Enerģija either; the Respondent confirmed in its letter "the fact that the Claimant has not received any amount back from the previously seized funds";⁶ contending that such

⁶ However, the Respondent further stated that "the Claimant has now, after proper local adjudication, been entitled to the previously seized funds (without prejudice to the reasonable demand that its subsidiary shall pay out its debts, and having been given the opportunity to challenge bailiff's actions with regard to the current distribution of the previously seized funds)".

circumstance could not be relied upon against it under the Treaty; and (iii) the Respondent maintained its position on double-counting.

47. On 11 November 2016 the Tribunal invited further comments from the Parties limited to five pages, and indicated that either Party was authorised to produce the 30 November 2015 judgment; the Parties' comments were received on 6 and 19 December 2016 respectively.
48. On 6 December 2016 the Claimant replied that by its previous communication it had simply intended to inform the Tribunal of the final outcome of one factual issue on which the Parties' experts had expressed an opinion, namely that there might be a double recovery in case the Claimant or Latgales Enerģija had ever recovered part of the frozen funds. The Claimant rejected the points made by the Respondent, confirming that Latgales Enerģija had not received any funds and was not entitled to receive any; it also provided a breakdown showing that the majority of the funds were paid to Rēzeknes Siltumtīkli (more precisely EUR 1,282,246.76 out of EUR 1,571,697.66).
49. On 19 December 2016 the Respondent sent its comments, to which it attached (i) the Supreme Court judgment dated 30 November 2015 in Case No. C03051107, (ii) the decision of the judge of the Chamber of Civil Cases of the Supreme Court dated 29 June 2016 dismissing Latgales Enerģija's application for cassation filed against the 30 November 2015 judgment as well as two further exhibits. The Respondent first summarised the Parties' respective cases in its submission, and then commented on the "special role attributed by the Claimant to civil case No. C03051107". The Respondent pointed out that the 30 November 2015 judgment decided that Latgales Enerģija was under a duty to pay the full price of the natural gas supplied, and not only to the extent of the latest natural gas tariff approved by the Regulator. As to the allocation of Latgales Enerģija's frozen funds decided by the bailiff, the figures indicated by the Respondent are not entirely in line with those indicated by the Claimant (according to the Respondent EUR 123,115.49 were allocated to a debt owed to JSC Lariva, the assignee of Explicit Consulting Group Ltd.; EUR 1,092,006.06 to Rēzeknes Siltumtīkli); that was said to be a normal distribution of the funds in enforcement proceedings and the funds were therefore to be regarded "under the Treaty, as released from injunction to the benefit of the Claimant". The

Respondent concluded that the Claimant by its conduct in relation to the Latvian proceedings as a whole expressed “[its] interest and willingness to abide by the final verdict in domestic civil procedure No. 03051107 (...)”.

50. On 7 September 2016 the Tribunal was informed that the Respondent was no longer represented by Mr. Ivars Mēkons but rather by Ms. Ilze Dubava and Ms. Nērika Lizinska, legal advisers with the State Chancellery of Latvia. On 8 September 2017 the Tribunal was further informed that Mr. George Burn left Vinson & Elkins who continued to be instructed in the present matter. The Claimant requested all future correspondence to be addressed to Mr. Mark Beeley and Mr. Alexander Slade.
51. The proceedings were closed on 11 October 2017.

III. FACTS

52. In this section of the present Award the Tribunal will outline the facts of the case as far as possible in chronological order from 2004 onwards. The facts of the case are uncontested to a considerable extent.

A. HEATING IN RĒZEKNE AND THE 2004 GAS SUPPLY AGREEMENT (2004)

53. The city of Rēzekne, the capital of the Latvian eastern province of Latgale, is the seventh largest city in Latvia. It had a population of approximately 25,000 inhabitants in 2004 when the Parties started their talks. Rēzekne was then in a region with a high unemployment rate, low wages, a negative migration rate and low economic activity.⁷
54. The Rēzekne Municipality, which at the relevant time controlled the body regulating district heating services in Rēzekne, acts through its decision-making body, the Rēzekne City Council (“RCC”), comprised of local politicians appointed in local elections.⁸
55. In Latvia the heating supply for a city, town or a district is centralized; heat and hot water are piped directly into homes and businesses from a number of large boiler

⁷ Resp. Obj. J. & C-Mem. ¶ 3.2. See also Gas Supply Agreement, C-40 p. 3, ¶ E. These factors are also described in the “Guidelines for the Development of the Rēzekne City Heat Supply System” submitted by Latgales Enerģija to the Municipality (see paragraph 164 below), C-44 pp. 6-9.

⁸ On the 2005 elections, see paragraphs 128 and 139 ff. below.

houses. District heating providers owned and controlled by the local municipalities and having the status of municipality undertakings supply heating to consumers and small businesses. The heating provider in any one region enjoys a monopoly in the supply of district heating.⁹

56. In 2004 the heating system ran on black oil and diesel. These were amongst the most expensive fuels used for district heating in Latvia.¹⁰
57. The Ministry of Economy of the Republic of Latvia had confirmed the need to switch from those fuels to natural gas and develop the infrastructure required in order for natural gas to be used.¹¹
58. Heating prices (“tariffs”) were regulated by the State in order to protect the interest of users.¹²
59. The body in charge of setting tariffs for district heating services for the territory of Rēzekne was the Multi-Industry Public Utility Regulator of the Latgale Municipalities (the “Regulator”) at all relevant times for the purposes of these proceedings. The Regulator had been established by 31 Municipalities and had started to work in late August 2002.¹³
60. The tariff in force when the heating system was leased to Latgales Enerģija in spring 2005 was LVL 21.50/MWh for residents and LVL 22.26/MWh for other users¹⁴ in accordance with the Regulator’s decision No. 9 dated 10 November 2003.¹⁵
61. Prior to 2015, district heating and hot water had been provided by AS Rēzeknes Siltumtīkli (“Rēzeknes Siltumtīkli”), a public limited liability company¹⁶ wholly owned by the Rēzekne Municipality.¹⁷

⁹ RfA ¶¶ 17-18.

¹⁰ RfA ¶ 22.

¹¹ See paragraph F of the Gas Supply Agreement, C-40, p. 3.

¹² See Sect. 5 of the Public Utility Regulators Act (CLA-49) and Sect. 3 of the Energy Act (CLA-48).

¹³ C-36.

¹⁴ Ms. Rogozina explains in her first Witness Statement that “other users” is a general expression including companies owned by public entities, private companies as well as individual merchants (CWS-3 ¶ 11).

¹⁵ This decision is recalled in the Regulator’s decision No. 18 of 2 November 2005 (C-77 [page 1]). See also the first Witness Statement of Ms. Rogozina, CWS-3 ¶ 15.

62. Rēzeknes Siltumtīkli had been operating the system at a loss, and, by mid-2004, it was in default with respect to its obligations to suppliers. The system was “highly subsidized and economically inefficient”¹⁸ also due to technical causes.¹⁹ Rēzeknes Siltumtīkli took out loans from AS “Latvijas Unibanka” (“Latvijas Unibanka”)²⁰ and AS “Baltic Trust Bank”²¹ (“Baltic Trust Bank”). The loans were secured by pledges granted by Rēzeknes Siltumtīkli and the Municipality over their real estate.²² There was a risk that Rēzeknes Siltumtīkli might be unable to ensure the supply of heating services during the heating season of September 2004-May 2005.²³
63. On 29 April 2004 the Rēzekne Municipality, Rēzeknes Siltumtīkli and Latvijas Gāze entered into a long-term gas supply agreement (the “Gas Supply Agreement”)²⁴ for a twenty-year period (Clause 19.2 of the Gas Supply Agreement). Under the terms of the agreement the Rēzekne Municipality undertook to purchase and pay a minimum

¹⁶ See the Long-Term Agreement, C-4 p. 4, Clause 1.1(g) and C-4 p. 7, Clause 3.2.1(a); see also the first whereas clause of the February 2005 Agreement, C-8 [page 8].

¹⁷ See the first whereas clause of the Long-Term Agreement, C-4 p. 4, the first whereas clause of the February 2005 Agreement, C-8 [page 8] and Clause 1 of the February 2006 Agreement, C-16.

Rēzeknes Siltumtīkli acknowledged that it was wholly owned by the Rēzekne Municipality in proceedings it brought before the Latvian courts, as noted by the Supreme Court of Latvia in its decision of 7 April 2014, R-8 ¶ 11.

¹⁸ Resp. Obj. J. & C-Mem. ¶ 3.1.

¹⁹ For instance, the central boiler house in Rancāna iela had been commissioned back in 1975 and heat loss in the underground heat networks reached a figure of 20% (C-44 p. 12; 14); the majority of the heating lines were installed in the 1970s and 1980s and their life cycle was of some 20 years (C-44 p. 14).

²⁰ See Clauses 2.1.1, 2.1.2 and 2.1.8 of the Guarantee Agreement, C-43, as well as Clause 3.2.2(b) of the Long-Term Agreement, C-4.

²¹ See Clause 3.2.2(b) of the Long-Term Agreement, C-4.

²² See Clause 2.1.5 of the Guarantee Agreement, C-43, and Clause 3.2.2(b) of the Long-Term Agreement, C-4. The former provision mentions “the commercial pledge and mortgage” provided by Rēzeknes Siltumtīkli whereas the latter mentions only a “mortgage”.

²³ See the second whereas clause of the February 2005 Agreement (C-8 [page 8]) which reads as follows:

whereas the Council as the Lessor’s shareholder organized a tender in 2004 on concession of the Lessor’s heating supply resources and whereas the tender results were revoked, which resulted in insufficient amount of funds at the Lessor’s disposal in the heating season 2004/2005 to settle accounts with its existing creditors, as well as to be able to provide fully-fledged heating supply services in the administrative territory of the Rēzekne city municipality.

²⁴ C-40; the full title of the agreement is “Agreement No. 1580 on Construction of a New Natural Gas Infrastructure for Gasification of the City of Rēzekne Due to Long-Term Supplies of Natural Gas to the User for Combustion Facilities of Various Mutually Replaceable Fuels (Natural Gas and Oil Products)”. This agreement was amended and supplemented by the parties on 1 June 2005, C-61, see paragraph 136 below and on 19 December 2005, C-81, see paragraph 160 below.

quantity of natural gas each year (namely 87.5% of 24 million nm³ per year),²⁵ and a failure to pay was sanctioned by a contractual penalty.²⁶

64. Clause 8.3 of the Gas Supply Agreement provides that payments for the natural gas are made by the Municipality.
65. Clause 16.1 of the Gas Supply Agreement expressly states that the Municipality's liability under the terms of the agreement is maintained in case the Municipality were "to authorise the User or another person to perform all the obligations or (...) part [of them] on behalf of the [Rēzekne] Municipality".
66. In addition to the typical sale and purchase obligations in a gas supply agreement, the Gas Supply Agreement contains further provisions relating to the infrastructure required to use natural gas. Paragraph D of the preamble states that one of the purposes of the agreement "... is [the] gasification of the City of Rēzekne requested by RPD [the Rēzekne Municipality] and the User ...". More specifically, Latvijas Gāze undertook in Clause 2.2 to "make all necessary investments in a new natural gas supply infrastructure" up to the City borders. The Gas Supply Agreement further provides in Clause 2.4 that Rēzeknes Siltumtīkli will for its part build "gas pipes and equipment regulating gas pressure" from its boiler house façade to the consumers' or other users' places.

B. THE ORIGINAL ARRANGEMENTS AND MAIN EVENTS (END OF 2004-2005)

(1) THE DECISION BY THE RĒZEKNE MUNICIPALITY TO HAVE RECOURSE TO A FOREIGN INVESTOR IN ORDER TO PROVIDE HEATING SERVICES (2004)

67. In early 2004 the Rēzekne Municipality called for tenders to improve the quality and the efficiency of the district heating system. Aside from a few indications in Mr. Strioga's first Witness Statement,²⁷ the record contains limited information in this respect. Bidders were to submit their bids by 30 March 2004, 2:00 *p.m.*; the bid opening would take place two hours later.²⁸ The committee in charge would hold a

²⁵ C-40, Clauses 3.1 and 8.3.

²⁶ C-40, Clause 3.4.

²⁷ CWS-1 ¶¶ 7-10; Mr. Strioga was E enerģija's CEO and controlling shareholder at all relevant times.

²⁸ C-223.

closed session on the following day to select a bidder.²⁹ It is common ground that, in the end, no suitable candidate emerged.³⁰

68. The Rēzekne Municipality then entered into direct negotiations with E energija and two Latvian companies, R.S. and SIA Wesemann.³¹
69. On 3 August 2004 the Rēzekne City Council adopted resolution No. 199 which authorised Rēzeknes Siltumtīkli to lease out its fixed assets, that is the heating infrastructure, for a long-term period “taking into consideration the current actual and financial status of joint stock company Rēzeknes Siltumtīkli (...)”.³²
70. On 25 November 2004 Mr. Strioga, and Mr. Arnoldas Burkovskis, E energija’s CFO, gave a presentation to the Rēzekne City Council.³³ The purpose of the presentation was to persuade the Council that the privatization of the heating system was the better option.³⁴
71. The presentation addressed in particular the investment that would be required as a matter of urgency, in an amount of EUR 7.7 million.³⁵ In his witness statement Mr. Strioga indicated that such investment “would have been made within 5 years (2006-2011)”; the investment was divided into three phases, the third phase being so-called cogeneration.³⁶
72. The presentation further dealt with Rēzeknes Siltumtīkli’s financial situation, including debts in an amount of LVL 1,190,000 and the aid from EU structural funds, which was regarded as insufficient.³⁷ The involvement of an investor was presented

²⁹ C-223.

³⁰ Resp. Obj. J. & C-Mem. ¶ 3.1. See also the second whereas clause of the February 2004 Agreement, C-8 [page 8].

³¹ CWS-1 ¶ 9.

³² R-24.1; this resolution is stated to be contained in Appendix No. 2B to the Long-Term Agreement, Art. 14 of the Long-Term Agreement, C-4 p. 37; however, such resolution is not part of Exhibit C-4 (either in the Latvian or the English language).

³³ C-41.

³⁴ CWS-1 ¶ 11.

³⁵ C-41 [page 3]; broken down as follows: (i) replacement of boilers and boiler equipment: EUR 4.1 million; (ii) modernization of heat units: EUR 3.2 million and (iii) renovation of heating mains: EUR 0.4 million.

³⁶ CWS-1 ¶ 14.

³⁷ C-41 [pages 2-3].

as one possible solution, subject to a number of different commercial and legal arrangements.

73. E energija's own proposal for the Rēzekne City Council completed the presentation. According to such proposal Rēzeknes Siltumtīkli could lease its heating infrastructure to E energija for a period of 20 to 30 years, in consideration of E energija's undertaking to invest an amount from EUR 10 to 12 million in the same period. Alternatively, the lease could relate to Rēzeknes Siltumtīkli as a whole: "lease of RS property or lease of RS itself (lease of business)".³⁸ The heating price would be reduced to 21.15 LVL/MWh from March 2005.³⁹

E energija would undertake to review the heat price taking into account changes only in the prices of gas, electricity and water as well as the impact of changes in inflation and taxation. E energija would further assume Rēzeknes Siltumtīkli's debts and treat them as rent payment. Upon expiry of the lease the value of the heating infrastructure to be returned to Rēzeknes Siltumtīkli would not be less than the value at the start of the lease period.⁴⁰

(2) THE INCORPORATION OF LATGALES ENERĢIJA (20 DECEMBER 2004)

74. Latgales Enerģija was incorporated on 20 December 2004 as a limited liability company having its registered office in Riga, Latvia.⁴¹

(3) THE GUARANTEE AGREEMENT (30 DECEMBER 2004)

75. The renegotiation of Rēzeknes Siltumtīkli's debts took place in the latter part of 2004 and required a number of meetings and discussions.⁴²
76. On 30 December 2004 E energija (as the "Guarantor") entered into a Guarantee Agreement with AS "Latvijas Unibanka" ("Latvijas Unibanka", as the "Creditor")

³⁸ C-41 [page 4].

³⁹ C-41 [page 4].

⁴⁰ C-41 [page 4].

⁴¹ C-5; as of that date, E energija was Latgales Enerģija's sole shareholder with 200 shares with a nominal value of LVL 100 each (C-5 [page 14]), duly paid in (C-42; C-55).

⁴² CWS-1 ¶ 21.

(the “Guarantee Agreement”)⁴³ to provide “guarantee and security” with respect to the obligations arising under the “Main Agreements” entered into by Rēzeknes Siltumtīkli and Latvijas Unibanka. The bank held security over Rēzeknes Siltumtīkli’s assets and would not permit them to be leased without adequate security being provided, as explained by Mr. Strioga and Mr. Jautakis.⁴⁴

77. The amounts stated to be owed by Rēzeknes Siltumtīkli as of the time of the execution of the Guarantee Agreement arose under different loans or credit lines, for a total amount of LVL 2,536,256.⁴⁵ E energija undertook to guarantee such debts, unconditionally and irrevocably, having waived its right to demand that the Creditor should first assert its right to payment as against Rēzeknes Siltumtīkli as the Debtor.⁴⁶

The amount set out above corresponded to both Rēzeknes Siltumtīkli’s short-time debts to Latvijas Unibanka mentioned in Clause 4.4.3(a) of the Long-Term Agreement and Rēzeknes Siltumtīkli’s long-time debts to Latvijas Unibanka mentioned in Clause 4.4.4(a) of the Long-Term Agreement (see paragraphs 88 and 89 below).

The Guarantee Agreement related also to the obligations of the Rēzekne City Council as the guarantor with respect to the credit agreements mentioned in Clauses 1.6 and 1.7 of the Guarantee Agreement.

⁴³ C-43. The Guarantee Agreement is set out in two-column format with the English and the Latvian texts in parallel; in case of discrepancies between the two texts, the English version shall prevail according to Clause 4.6. The Guarantee Agreement is stated to be governed by the laws of the Republic of Latvia (Clause 4.3).

⁴⁴ CWS-1 ¶ 38 and CWS-2 ¶ 23.

⁴⁵ C-43, Clauses 1.3 to 1.7. As explained by Mr. Jautakis in his first Witness Statement (CWS-2 ¶ 24), these sums were then reflected in Clauses 4.4.3(a) and 4.4.4(a) of the Long-Term Agreement (C-4) and were “taken over” by Latgales Enerģija in due course, see paragraph 88 below.

The breakdown of the total amount was as follows:

- (i) LVL 746,660 (under Credit Agreement No. RA 02155);
- (ii) LVL 921,866 (under Credit Agreement No. RA 02219);
- (iii) LVL 127,730 (under Credit Agreement No. RA 02300);
- (iv) LVL 350,000 (under Credit Agreement No. RA 03357); and
- (v) LVL 390,000 (under Credit Agreement No. RA 04454).

⁴⁶ C-43, Clauses 2.1 and 2.1.8.

(4) THE AGREEMENT FOR LEASE, RENOVATION AND OPERATION OF LONG-TERM ASSETS (28 JANUARY 2005) (THE “LONG-TERM AGREEMENT”)

78. A draft agreement was reviewed by representatives of Rēzeknes Siltumtīkli, the Rēzekne City Council and Latgales Enerģija on 27 January 2005.⁴⁷
79. On 28 January 2005 an agreement entitled “Agreement for Lease, Renovation and Operation of Long-Term Assets” was signed by Rēzeknes Siltumtīkli (as the “Lessor”) and Latgales Enerģija (as the “Operator”) (the “Long-Term Agreement”).⁴⁸ The Long-Term Agreement is stated to be governed by the laws of the Republic of Latvia (Clause 11.1). The signature of the Long-Term Agreement had been authorised on the same day by Rēzeknes Siltumtīkli’s Council upon the Board’s request.⁴⁹
80. The first clause in the recitals of the Long-Term Agreement recalls the resolution of the Rēzekne City Council to “allow Rēzeknes Siltumtīkli to lease out its fixed assets for a long-term period”. The second clause in the recitals of the same agreement mentions Latgales Enerģija’s readiness and willingness “to modernise the heating supply system” and enable “a transfer from heavy oil fuel to natural gas as a resource for heating energy production”, “increase effectiveness of use of energy resources” and “fulfil the obligations of AS Rēzeknes Siltumtīkli against its creditors”.⁵⁰
81. The subject-matter of the Long-Term Agreement is set out in Clause 2.2 as follows:⁵¹
- 2.2 The subject of the Agreement shall be lease of the Assets and investment into the Assets located in the city of Rēzekne and currently run by Lessor. By entering into the present Agreement the Lessor shall undertake to lease to the Operator the Assets, and the Operator shall undertake to use the Assets in order to operate the Business and settle accounts with the Lessor in the order and on conditions described in the Agreement.
- 2.3 The Operator does not assume any liability or obligations of the Lessor and/or the Municipality other than liabilities directly undertaken under the Agreement.

⁴⁷ R-24 [pages 3-4].

⁴⁸ C-4; the Long-Term Agreement is set out in two-column format with the English and the Latvian texts in parallel; in case of discrepancies between the two texts, the Latvian version shall prevail according to Clause 13.4.

⁴⁹ R-24 [pages 2 and 5].

⁵⁰ C-4 p. 4.

⁵¹ C-4 p. 6.

82. The term “Assets” is defined in Clause 1.1(a) of the Long-Term Agreement as “all long-term assets” owned by Rēzeknes Siltumtīkli, including land, buildings, constructions, technological equipment and machines and other fixed and intangible assets set out in Appendix No. 1 to the Long-Term Agreement. Rēzeknes Siltumtīkli represented and warranted *inter alia* that it was the owner of the assets and had all agreements and employees to carry on the Business as a going concern.⁵²
83. The term “Business” means “the heat production, supply and division business and power generation business operated by the Lessor”.⁵³
84. The Long-Term Agreement was entered into for a period of 30 years.⁵⁴
85. Upon expiry of the lease, all investments made by Latgales Enerģija as well as any improvements, modernization or rearrangement as well as any new structures would become the property of Rēzeknes Siltumtīkli pursuant to the terms of a deed to be executed by reference to the market price at the time of the transfer.⁵⁵ The Assets would be returned to Rēzeknes Siltumtīkli in accordance with Clause 7.1.5 of the Long-Term Agreement.
86. Latgales Enerģija had the right, in its own discretion, to execute all works for major or current reconstruction or repair of the Assets necessary to renovate or modernize such Assets and to use them freely and without hindrance to supply heat and/or power to the consumers,⁵⁶ all improvements to the Assets to be transferred to Rēzeknes Siltumtīkli upon expiry of the lease.⁵⁷
87. Latgales Enerģija would own all revenue and profit received during the term of the lease and would be entitled to use such revenue and profit in its own discretion.⁵⁸
88. Latgales Enerģija undertook to pay Rēzeknes Siltumtīkli an amount of LVL 5,100,000 in total including VAT, which amount included (i) the book value as

⁵² C-4, Clause 3.2.4(a).

⁵³ C-4, Clause 1.1(b).

⁵⁴ C-4, Clause 4.2.1.

⁵⁵ C-4, Clause 7.1.3.

⁵⁶ C-4, Clauses 4.3.5 and 7.1.2, 2nd sentence.

⁵⁷ C-4, Clause 4.3.6.

⁵⁸ C-4, Clause 4.3.9.

of 1 January 2005 of Rēzeknes Siltumtīkli's short-time debts to creditors in an amount of LVL 1,448,977,⁵⁹ which debts Latgales Enerģija agreed to "take over from Rēzeknes Siltumtīkli",⁶⁰ the creditors being Latvijas Unibanka, SIA "AVT Nafta" and SIA "Dinaburga Rosme", (ii) a yearly amount of LVL 200,000 to settle Rēzeknes Siltumtīkli's debts in the first three years⁶¹ and a yearly amount of LVL 85,185 for each year of lease except in the first three years,⁶² as well as (iii) a further payment by Latgales Enerģija covering depreciation and an additional five percent of the book value of the Assets upon returning such Assets to Rēzeknes Siltumtīkli.⁶³

89. In addition to Rēzeknes Siltumtīkli's short-term debts, Latgales Enerģija was "entitled" under Clause 4.4.4 to "take over" Rēzeknes Siltumtīkli's long-term debts to Latvijas Unibanka amounting to LVL 746,660 arising out of Credit Agreement No. RA 02155 and LVL 921,866 arising out of Credit Agreement No. RA 02219 (a total amount of LVL 1,668,526) as well as Rēzeknes Siltumtīkli's long-term debts to Baltic Trust Bank in an amount of LVL 680,817.
90. Latgales Enerģija further undertook to take over all of Rēzeknes Siltumtīkli's employees (set out in Appendix 3) in accordance with Latvian Law.⁶⁴
91. Clause 6 of the Long-Term Agreement deals with Rēzeknes Siltumtīkli's rights and obligations in some further detail.
92. Clause 7 of the Long-Term Agreement deals with Latgales Enerģija's rights and obligations in some further detail; in particular Latgales Enerģija undertook to invest not less than EUR 1.5 million in the heat supply facilities within three years of the date on which the Long-Term Agreement had entered into force in order to ensure that Rēzeknes Siltumtīkli could perform the duties owed to Latvijas Gāze and undertaken under the Gas Supply Agreement⁶⁵ (Clause 7.1.1), and to increase its

⁵⁹ This amount was reassessed at LVL1,220,799.50 when the Assets and the Employees were taken over by Latgales Enerģija (C-49), see paragraph 119 below. It was then increased in 2006 in the Amended Long-Term Agreement, see paragraph 166 below.

⁶⁰ C-4, Clauses 4.4.1 and 4.4.3.

⁶¹ C-4, Clause 4.4.1(a).

⁶² C-4, Clause 4.4.1(b).

⁶³ C-4, Clause 4.4.2.

⁶⁴ C-4, Clause 5.

⁶⁵ C-40, see paragraph 63 above.

share capital to LVL 500,000 within two weeks of the entry into force of the Long-Term Agreement (Clause 7.7).⁶⁶

93. Clause 8 deals with Latgales Enerģija's position as the Operator in relevant part as follows:⁶⁷

- 8.1 For the period the Agreement is valid, the Operator shall remain to be the exclusive heat supplier and shall undertake to supply heat and power energy to all the consumers who used to be supplied heat and power by means of the Assets leased according to the Agreement before the moment such Agreement has been signed.
- 8.2 The Operator shall supply heat and power to the consumers and service heat, power and hot water supply systems following the technological obligations of the Operator stated by the laws. The order and conditions for servicing heat and power energy supply and systems of each consumer shall be defined in the agreement for supply of heat and power energy, consumption and payment to be signed with each consumer.

94. The Long-Term Agreement would enter into force provided that the conditions precedent in Clause 12.4 were met, including the execution of an agreement between the Municipality and Latgales Enerģija relating to the performance of the Long-Term Agreement in accordance with Clause 12.4.3 (this agreement was entered into on 10 February 2005, see paragraph 100 below).

95. The Long-Term Agreement contains express terms under which each party is entitled to terminate it unilaterally, provided that certain requirements are met. Clause 12.5.2 deals with unilateral termination by Rēzeknes Siltumtīkli and reads as follows:⁶⁸

12.5.2 Unilaterally by the Lessor in the event

- a) the licence to perform Business is revoked due to fault of the Operator, or
- b) the Operator fails without any legal grounds to make the lease payments in the order set by the Agreement for more than three consecutive payments (months).

In such a case the Lessor shall warn and notify the Operator in writing about such default of the Agreement and fix the period of time of not less than 30

⁶⁶ Latgales Enerģija's initial share capital as of December 2004 was of LVL 20,000, see paragraph 74 above.

⁶⁷ C-4 pp. 29-30.

⁶⁸ C-4 p. 33.

(thirty) days for the Operator to cure the default. In the event the Operator fails to cure the default, the Agreement shall be deemed to have been terminated on the end of the term specified in such notification.

96. Clause 12.7 of the Long-Term Agreement states that neither party can terminate the Agreement under Clauses 12.5.2 or 12.5.3 “during the period from July 1 to the end of the heating season next year of any calendar year”.

97. Clause 12 further deals with the monetary consequences of termination under Clause 12.5.2 in Clause 12.6 which reads as follows in relevant part:⁶⁹

12.6 Settlement of accounts between the Parties and sanctions in case the Agreement is terminated prior to its term set in Clause 4.2:

12.6.1 In case the Agreement is terminated on the basis of the clauses 12.5.2 or 12.5.3, the Lessor must within 30 (thirty) days from the day the Agreement was terminated repay to the Operator all the investment the Operator has made into the assets leased (less depreciation) and take over all rights of claiming any consumers’ unpaid amounts to the Operator for the nominal value of such debts (including interest and penalties) having accumulated within one year prior to the date of termination of the Agreement.

12.6.2 In the event the Lessor terminates the Agreement on the basis of clause 12.5.2, the Operator shall pay the penalty fee to the Lessor equal to 10 (ten) per cent of the amount the Operator has invested (less depreciation) into the assets leased.

98. On 28 January 2005 the Rēzekne City Council approved the Long-Term Agreement.⁷⁰

99. The Long-Term Agreement was amended by the parties on 10 February 2006 (see paragraphs 166 ff. below).

(5) THE FEBRUARY 2005 AGREEMENT (10 FEBRUARY 2005)

100. The Rēzekne Municipality (through the Rēzekne City Council or the “Council”) and Latgales Enerģija (as the “Operator”) made an agreement on 10 February 2005 (the “February 2005 Agreement”).⁷¹ The expression “the Agreement” in the February 2005 Agreement refers to the Long-Term Agreement⁷² and the “Lessor” to Rēzeknes

⁶⁹ C-4 p. 34.

⁷⁰ R-24 [page 6].

⁷¹ C-8.

⁷² C-8 [page 8], fourth whereas clause.

Siltumtīkli.⁷³ As recalled in paragraph 94 above, the Long-Term Agreement itself contemplated the execution of a contract between the Municipality and Latgales Enerģija.

101. Under the February 2005 Agreement Latgales Enerģija undertook *inter alia* the following duties to the Council:

- (i) to provide centralized heating supply services in the city of Rēzekne (Clause 1.1);
- (ii) to maintain and repair where required the heating supply system to ensure good-quality heating supply services (Clause 1.2);
- (iii) to coordinate the reconstruction work relating to the heating infrastructure and to start construction work after obtaining the permit required to that effect (Clause 1.3);
- (iv) to take any steps as may be required, as soon as possible, to obtain the production, distribution and transfer licences from the competent authority (Clause 1.4);
- (v) to ensure that rates would be increased only due to force majeure or as a result of an increase in the prices of gas, electricity, water or other energy sources, provided that such increase had resulted in an increase of 5% in the costs of production, distribution or transfer of one unit of thermal energy, unless otherwise provided by law, rates to be adjusted in any event in accordance with Latvian law (Clause 1.6); and,
- (vi) to perform its obligations to the creditors of Rēzeknes Siltumtīkli mentioned in the Long-Term Agreement (Clause 1.7).

102. In the February 2005 Agreement the Rēzekne City Council undertook *inter alia* the following duties to Latgales Enerģija:

⁷³ C-8 [page 8], first whereas clause.

- (i) not to hinder performance of the Long-Term Agreement by Latgales Enerģija (Clause 2.2) and,
- (ii) in accordance with Latvian law, to take all decisions required so that Latgales Enerģija could perform the Long-Term Agreement fully and without delay (Clause 2.8).

103. Among the terms setting out the Rēzekne City Council's duties to Latgales Enerģija, Clause 2.10 reads as follows in relevant part:⁷⁴

2.10 The Operator is and remains the only supplier of centralised heating to all consumers who received thermal energy from the Lessor at the moment that the Agreement is concluded. The Operator has the exclusive rights to sell and supply centralised heating to residents, industrial consumers and cooperatives of residential houses in the city of Rēzekne. The Council undertakes not to adopt decisions and not to perform direct or indirect activities that would cause direct or indirect competition to the Operator's business in relation to the centralised heating supply and maintenance and servicing the heating supply networks, or any other operation undertaken by the Operator under the Agreement.

The Council undertakes to ensure that the municipality functions determined by the law with regard to provision of centralised heating services are not transferred to other persons and the municipality would not get involved in other projects of centralised heating supply, including installation of co-generation stations (...).

104. The February 2005 Agreement refers also to the Gas Supply Agreement⁷⁵ in Clause 4 which reads as follows in relevant part:⁷⁶

4. The parties agree that the Operator is entitled to enter an agreement with AS "Latvijas Gāze" on performance of Gas Purchase Agreement No 1580 [the Gas Supply Agreement, C-40]. If the mentioned agreement with AS "Latvijas Gāze" is not entered and transfer to gas heating is delayed due to the Council or third party fault resulting in failure of AS "Latvijas Gāze" to finish construction of natural gas infrastructure and preparation for operation in compliance with Gas Purchase Agreement No 1580, the Council undertakes to compensate the Operator for the losses incurred because the Operator keeps using black fuel oil instead of natural gas after the date when the natural gas infrastructure had to be constructed and prepared for operation in production of thermal energy under Gas Purchase Agreement No 1580 in the wording in force at the date of entering the Agreement.

⁷⁴ C-8 [page 10].

⁷⁵ C-40, see paragraph 63 above.

⁷⁶ C-8 [page 12].

In any case the Council is not released from obligations undertaken by Gas Purchase Agreement No 1580 on purchase of a specified amount of gas for the needs of the city of Rēzekne, and respectively – if these obligations are not performed and AS “Latvijas Gāze” claims damages from the Council or the Lessor, or the Operator and/or a contractual penalty, the Council undertakes to pay AS “Latvijas Gāze” for these losses and pay the contractual penalties.

105. The February 2005 Agreement further makes provision in Clause 6 for the remedies in case of breach of contract (damages as well as a penalty).
106. The February 2005 Agreement was supplemented on 10 February 2006 (see paragraphs 169 ff. below).

(6) E ENERGIJA’S FURTHER INVESTMENT IN THE CAPITAL OF LATGALES ENERĢIJA (FEBRUARY-MAY 2005)

107. In February 2005 E energija sold 98 out of its 200 shares in Latgales Enerģija to Levs Voronovs, Juris Vanags, Mārtiņš Lauva and SIA Energo Sistēmas, and its share in Latgales Enerģija’s capital was reduced to LVL 10,200.⁷⁷
108. Further capital was contributed by all shareholders and E energija made a further contribution in an amount of EUR 300,000 and LVL 46,022.⁷⁸ As a consequence, E energija’s share in Latgales Enerģija’s capital was equal to LVL 265,200 with a majority of 2,652 shares out of 5,200 shares as of 3 May 2005.⁷⁹

(7) LOANS BY E ENERGIJA TO LATGALES ENERĢIJA (FROM FEBRUARY 2005 ONWARDS)

109. E energija granted a number of loans to Latgales Enerģija from 18 February 2005 onwards.⁸⁰ In the year 2005, E energija granted eight loans to Latgales Enerģija (one

⁷⁷ C-5 and CWS-2 ¶ 9.

⁷⁸ C-55 [page 3] and [page 5]; CWS-2 ¶ 10.

⁷⁹ C-5 [page 15].

⁸⁰ C-51 [pages 1-43]. This exhibit contains sixteen loans and/or amendments to existing loans granted by E energija to Latgales Enerģija from 2005 to 2007 included. The original version of the loans is in the Russian language (in four cases in the Russian and Latvian language).

CWS-2 ¶ 14 with a table. The dates in the table fail to reflect the correction in handwriting for the first two loans which is March (not February, as indicated).

of which was increased from EUR 380,000 to EUR 1 million in the same year), for a total amount of EUR 2,325,000.⁸¹

110. The loans set out the borrower's duty to repay the loan with interest; they contain no provision as to their purpose or the manner in which the loan is to be used by the borrower, aside from the cases in which a loan was intended to consolidate or increase the amount of previous loans and a few other exceptions in cases where E energija would directly pay a third party. Mr. Jautakis explained in his first Witness Statement that E energija granted all of these loans in connection with Latgales Enerģija's obligations arising under the Long-Term and the February 2005 Agreements.⁸²
111. E energija granted three further loans to Latgales Enerģija in 2006,⁸³ and four further loans, or amendments to pre-existing loans, were executed in 2007.⁸⁴

(8) RĒZEKNES SILTUMTĪKLI'S ASSETS AND EMPLOYEES TAKEN OVER BY LATGALES ENERĢIJA (25 FEBRUARY 2005)

112. It is common ground that the Long-Term Agreement entered into force in February 2005. On 25 February 2005 Rēzeknes Siltumtīkli and Latgales Enerģija declared⁸⁵ that the Assets and the Employees had been transferred to Latgales Enerģija in accordance with Clause 4.3.1 of the Long-Term Agreement.⁸⁶
113. The licences required to operate the system were granted by the Regulator on 30 May 2005 (see paragraphs 129 ff. below). The record does not, however, indicate a precise date on which Latgales Enerģija started to operate the heating system.⁸⁷
114. After taking over the heating system, Latgales Enerģija provided a continuous heating service in the city based on the tariff then in force.⁸⁸

⁸¹ C-51; Cl. Mem. ¶ 43 mentions an amount of LVL 1,444,532 equal to EUR 2,055,383; however, the principal of all loans granted in 2005 is stated in EUR and the total amount is EUR 2,325,000.

⁸² CWS-2 ¶ 15.

⁸³ C-51 [pages 46-55], see also paragraph 197 below.

⁸⁴ C-51 [pages 59-69], see also paragraphs 312 ff. below.

⁸⁵ C-9.

⁸⁶ C-4.

⁸⁷ RfA ¶ 59 "the middle of the heating season 2004/2005".

⁸⁸ RfA ¶ 38.

115. The conversion of the heating system to natural gas would be ready only in November 2005 (see paragraph 156 below).
116. As explained by Mr. Strioga in his first Witness Statement, the old boilers were not replaced, but modified in order that they could burn both heavy fuel oil and natural gas, which enabled the Claimant to modernize the existing boiler houses with a comparatively small investment. The works were implemented by UAB Energijos Taupymo Centras (“Energijos Taupymo Centras” or “ETC”), the Claimant’s parent company incorporated in Lithuania, together with the Russian producers of the boilers.⁸⁹
117. Latgales Enerģija did not enter into any written agreement with Rēzeknes Siltumtīkli for the supply of natural gas. Nor did it succeed in entering into any agreement with Latvijas Gāze or adhering to the Gas Supply Agreement existing between Latvijas Gāze, the Municipality of Rēzekne and Rēzeknes Siltumtīkli.⁹⁰

The question whether Latgales Enerģija has nevertheless a duty to pay for the natural gas supplied by Latvijas Gāze is in dispute in these proceedings, as it was in dispute in proceedings before the Latvian courts. The Tribunal’s decision on this point is set out in paragraph 936 below.

118. When Latgales Enerģija started to supply heating in 2005, it applied the tariff that had been granted to Rēzeknes Siltumtīkli before the Long-Term Agreement⁹¹ and the

⁸⁹ CWS-1 ¶¶ 4; 40.

⁹⁰ C-40, see paragraph 63 above. Latgales Enerģija’s unsuccessful attempts to have a direct contract with Latvijas Gāze are referred to in Latgales Enerģija’s letter to the Regulator dated 28 October 2005, C-75; then in 2006 Latvijas Gāze declined (C-88) the novation of the agreement proposed by Latgales Enerģija (C-86).

According to Mr. Strioga’s first Witness Statement (CWS-1 ¶ 20), the Municipality was under a contractual duty to take or pay a minimum amount of 21 million nm³ a year under the Gas Supply Agreement (C-40, Clause 3.1) in consideration for the large investment to be made in the heating infrastructure and Latvijas Gāze had no interest to change its contracting parties.

In its judgment dated 7 April 2014 (R-8 ¶ 11, see also paragraph 389 below) the Supreme Court of Latvia referred to a finding made by the court of first instance whereby the defendant (Latgales Enerģija) “had not concluded an agreement with AS ‘Latvijas Gāze’”. This finding was not criticized by the Supreme Court.

The fact that Latgales Enerģija had no contract with Latvijas Gāze is also mentioned in the preamble to the Rēzeknes Enerģija Gas Supply Agreement (C-151).

⁹¹ C-4.

February 2005 Agreement⁹² were entered into (see paragraphs 60 ff. above). However, Latgales Enerģija applied for a revised tariff on 13 October 2005 (see paragraphs 152 ff. below).

119. On 25 February 2005 the book value of Rēzeknes Siltumtīkli's short-time debts to creditors as of 1 January 2005, stated to be in an amount of LVL 1,448,977 in Clauses 4.4.1 and 4.4.3 of the Long-Term Agreement, was reassessed at LVL 1,220,799.50.⁹³

(9) RĒZEKNES SILTUMTĪKLI'S SHORT-TERM DEBTS TAKEN OVER BY LATGALES ENERĢIJA (FROM FEBRUARY 2005 ONWARDS)

120. From February 2005 onwards Latgales Enerģija entered into a number of contracts to take over Rēzeknes Siltumtīkli's debts in accordance with the Long-Term Agreement (see paragraph 88 above) and the February 2005 Agreement (see paragraph 101 above). The Amended Long-Term Agreement made on 10 February 2006⁹⁴ increased the amount of Rēzeknes Siltumtīkli's indebtedness (see paragraph 167 below).

(A) RĒZEKNES SILTUMTĪKLI'S INDEBTEDNESS TO AVT NAFTA

121. On 4 February 2005 SIA "AVT Nafta" ("AVT Nafta") assigned the debt it owned against Rēzeknes Siltumtīkli to Latgales Enerģija in an amount of LVL 240,000; the assignment agreement mentions that AVT Nafta obtained a loan from Latgales Enerģija in an amount of LVL 200,000, an amount which Latgales Enerģija instructed its bank to pay on 7 February 2005.⁹⁵
122. On 22 June 2005 a second assignment agreement was executed between the same parties with respect to a debt owned by AVT Nafta against Rēzeknes Siltumtīkli in an amount of LVL 250,000, which amount included the previous amount of LVL 240,000.⁹⁶ Under Clause 3 of such second assignment, part of the price would be paid by Latgales Enerģija by setting off its claim for payment under the 4 February 2005 loan in an amount of LVL 210,000 (which included LVL 10,000 interest).

⁹² C-8.

⁹³ C-49. Latvijas Unibanka: LVL 865,420.26; AVT Nafta: LVL 226,870.33 and Dinaburga Rosme: LVL 128,509.00.

⁹⁴ C-16.

⁹⁵ C-48 [page 2].

⁹⁶ C-58.

Latgales Enerģija instructed its bank to pay the balance of LVL 40,000 on 19 June 2005.⁹⁷

123. On 27 June 2005 Latgales Enerģija and Rēzeknes Siltumtīkli then agreed that “the Company (Latgales Enerģija) (...) on 22 June 2005 settled liabilities towards SIA ‘AVT NAFTA’ in the total amount of LVL 250,000”.⁹⁸ Latgales Enerģija and Rēzeknes Siltumtīkli further agreed that Latgales Enerģija had therefore become a creditor of Rēzeknes Siltumtīkli for such amount. The agreement further contemplated that such amount would be paid by Rēzeknes Siltumtīkli under a separate agreement, under which Rēzeknes Siltumtīkli would set off its debt and consider that it had received an advance payment of the rent owed by Latgales Enerģija under the Long-Term Agreement.

(B) RĒZEKNES SILTUMTĪKLI’S INDEBTEDNESS TO DINABURGA ROSME

124. On 6 April 2005 SIA Dinaburga Rosme (“Dinaburga Rosme”) assigned the debt it owned against Rēzeknes Siltumtīkli to Latgales Enerģija in an amount of LVL 128,509.⁹⁹ Latgales Enerģija paid the same amount to Dinaburga Rosme in 14 instalments in 2005 and 2006.¹⁰⁰

(C) RĒZEKNES SILTUMTĪKLI’S INDEBTEDNESS TO LATVIJAS UNIBANKA

125. On 27 May 2005 Latgales Enerģija and Rēzeknes Siltumtīkli agreed that “the Company (Latgales Enerģija) (...) on 3 May 2005 (... and) on 26 May 2005 settled liabilities towards AS ‘SEB Latvijas Unibanka’ in the total amount of LVL 65,000 and LVL 95,777.92”, that Latgales Enerģija had made such payment on behalf of Rēzeknes Siltumtīkli pursuant to the terms of the Long-Term Agreement and that Latgales Enerģija had therefore become a creditor of Rēzeknes Siltumtīkli for such amount.¹⁰¹ The agreement further contemplated that such amount would be set off

⁹⁷ C-48 [page 1], see also the explanations in Mr. Jautakis’ first Witness Statement, CWS-2 ¶¶ 37-39.

⁹⁸ C-59.

⁹⁹ C-52.

¹⁰⁰ C-53.

¹⁰¹ C-57.

under a separate agreement against the rent owed by Latgales Enerģija under the Long-Term Agreement.¹⁰²

126. On 14 July 2005 Latgales Enerģija and Rēzeknes Siltumtīkli made a similar agreement with respect to an amount of LVL 370,000 paid by Latgales Enerģija to Latvijas Unibanka.¹⁰³ Exhibit C-56 shows that Latgales Enerģija paid Latvijas Unibanka LVL 95,777.92 and LVL 370,000, but there is no evidence of a payment of LVL 65,000. However, in the 27 May 2005 agreement Rēzeknes Siltumtīkli expressly acknowledged that Latgales Enerģija on 3 May 2005 paid LVL 65,000 to Latvijas Banka.¹⁰⁴
127. By July 2005 Latgales Enerģija had therefore settled Rēzeknes Siltumtīkli's indebtedness to Latvijas Unibanka in an amount of LVL 530,777.92.

(10) LOCAL ELECTIONS IN LATVIA (MARCH 2005)

128. In March 2005 local elections were held in Latvia. The election results in Rēzekne were cancelled due to allegations of bribery. Further elections took place in August 2005 (see paragraphs 139 ff. below).

(11) LATGALES ENERĢIJA'S LICENCES (30 MAY 2005)

129. On 30 May 2005 the Regulator granted Latgales Enerģija the licence for the production of thermal energy No. 002-05 for the period from 30 May 2005 to 29 May 2025.¹⁰⁵ The licence sets out special conditions in Appendix No. 1.
130. On the same day the Regulator granted Latgales Enerģija the licence for the transmission of thermal energy No. 003-05¹⁰⁶ for the same period of time, as well as the licence for the sale of thermal energy No. 004-05.¹⁰⁷

¹⁰² C-57.

¹⁰³ C-57.2.

¹⁰⁴ C-57.1.

¹⁰⁵ C-10.

¹⁰⁶ C-11.

¹⁰⁷ C-12.

131. Each licence sets out special conditions in its Appendix No. 1. Aside from the fact that each licence relates to a specific kind of activity, which is reflected in the Appendix of each licence, the three Appendices contain almost identical language.
132. Clause 1 of the licences sets out Latgales Enerģija's duty to provide uninterrupted and good quality public utility services of production, transfer and distribution and sale, respectively, of thermal energy in accordance with applicable laws and regulations, the "development plan of the city of Rēzekne", Regulator's decisions as well as treaties and standards applicable in Latvia.
133. Clauses 6 and 7 read as follows:¹⁰⁸
- 6. The Multi-Industry Public Utility Regulator of Latgale Municipalities determines the following tasks for SIA "Latgales Enerģija":
 - 6.1 During the licence validity term, to ensure that all the existing users of thermal energy would be equipped with measurement tools for commercial recording, to know the energy consumed by each user and to be able to predict the future consumption of heat;
 - 6.2 To decrease heat loss at the heating mains;
 - 6.3 To prepare a long-term development plan;
 - 6.4. To seek the option to participate at various tenders with projects to attract funding from the state and international financial institutions.
 - 7. **Each year**, the licence holder must **submit the following documents** to the Multi-Industry Public Utility Regulator of Latgale Municipalities:
 - 7.1 **By 31 December each year**, a plan of activities for the following year in line with the long-term development plan of SIA "Latgales Enerģija" including data about the planned amount of production, transfer and distribution, and sale of thermal energy, measures to improve service quality and safety, to ensure environment protection, improvement of the material base (general plan for all types of heating supply services licenced – production, transfer, distribution and sale).
 - 7.2 **By the end of the quarter of the year**, a report regarding the results of the previous year in provision of heating supply services in line with the priorities indicated in Clause 6 of these conditions by including the report in the general company report on fulfilment of the annual plan of operations for the previous year, as well as other information every time upon a request of the Multi-industry Public Utility Regulator of Latgale Municipalities.
134. Clause 9 states four grounds upon which the licence may be revoked.¹⁰⁹

¹⁰⁸ C-10 [page 5] (original emphasis).

135. Clause 12 states that production, distribution and transfer and sale, respectively, of thermal energy shall be performed only at the rate approved by the Regulator.

(12) THE FIRST AMENDMENT OF THE GAS SUPPLY AGREEMENT WITH LATVIJAS GĀZE (1 JUNE 2005)

136. On 1 June 2005 the Rēzekne City Council, Rēzeknes Siltumtīkli and Latvijas Gāze agreed to amend and supplement the Gas Supply Agreement¹¹⁰ (“Amendment No. 1 to the Gas Supply Agreement”).¹¹¹
137. Under Clause 3 of the amended Gas Supply Agreement the Rēzekne City Council agreed to start the commercial acceptance of natural gas according to Clause 3 of the Agreement at 9:00 *a.m.*, 15 October 2005 at the latest.
138. Latgales Enerģija, which had taken over the heating infrastructure in February 2005 (see paragraphs 112 ff. above), was not consulted.¹¹² Latgales Enerģija received a copy of the agreement on 2 November 2005.¹¹³

(13) FRESH LOCAL ELECTIONS IN RĒZEKNE (20 AUGUST 2005)

139. As the March 2005 election results in Rēzekne had been cancelled (see paragraph 128 above), further elections took place on 20 August 2005.
140. The elected Mayor (*i.e.* the chairman of the Rēzekne City Council) was Mr. Juris Guntis Vjakse.

¹⁰⁹ The parties interchangeably use the terms “cancelation”, “annulment”, “suspension” and “revocation” with reference to the revocation of the licences on 3 June 2008 (see paragraphs 337 ff. below). The Tribunal’s use of the expressions “to revoke the licences” or “the revocation of the licences” is without prejudice to the Tribunal’s findings in this case.

¹¹⁰ C-40, see paragraph 63 above.

¹¹¹ C-61. The full title of the agreement is “Supplementation 1 to Agreement No. 1580 on Construction of a New Natural Gas Infrastructure for Gasification of the City of Rēzekne Due to Long-Term Supplies of Natural Gas to the User for Combustion Facilities of Various Mutually Replaceable Fuels (Natural Gas and Oil Products)”.

¹¹² Cl. Mem. ¶ 76; CWS-1 ¶ 19; there is no specific rebuttal on the record on the Respondent’s part.

¹¹³ C-76.

(14) RĒZEKNES SILTUMTĪKLI'S LONG-TERM DEBTS TAKEN OVER BY LATGALES ENERĢIJA (FROM AUGUST 2005 ONWARDS)

(A) THE INVESTMENT SERVICES AGREEMENT (4 AUGUST 2005)

141. On 4 August 2005 E energija (as “the Client”) and AS Lōhmus, Haavel & Viisemann (as “LHV”) entered into an “Investment Services Agreement” (the “Investment Services Agreement”).¹¹⁴ The purpose of this agreement was to obtain LHV’s assistance to refinance Rēzeknes Siltumtīkli’s loans from Latvijas Unibanka contemplated by Clause 4.4.4¹¹⁵ of the Long-Term Agreement¹¹⁶ and taken over from Latvijas Unibanka.
142. LHV would in its own name take over two loans granted by Latvijas Unibanka to Rēzeknes Siltumtīkli, on the Claimant’s account, under the terms of an assignment agreement which it would execute with Latvijas Unibanka, Clause 2.2 of the Investment Services Agreement.¹¹⁷ E energija undertook to transfer a sum of LVL 1,113,895 or any other amount to LHV based on the Assignment Agreement between LHV and Latvijas Unibanka (Clause 2.1 of the Investment Services Agreement) and to pay the fees set out in Clause 3 of the same agreement.
143. LVH undertook in turn to transfer any payments received from Rēzeknes Siltumtīkli to E energija’s account (Clause 1.3 of the Investment Services Agreement).

Mr. Jautakis explained in his first Witness Statement that the reason for the resort to a third party such as LHV to take over Rēzeknes Siltumtīkli’s long-term debts was that Rēzeknes Siltumtīkli would be more likely to repay its debts.¹¹⁸

¹¹⁴ C-63.

¹¹⁵ The reference to Clause 4.4.3 of the Long-Term Agreement in Mr. Jautakis’ first Witness Statement (CWS-2 ¶¶ 46 and 47) is inaccurate, see also Cl. Mem. ¶ 60. Clause 4.4.4 of the Long-Term Agreement entitled Latgales Enerģija to take over Rēzeknes Siltumtīkli’s long-term debts to Latvijas Unibanka in a total amount of LVL 1,668,526 and Baltic Trust Bank in an amount of LVL 680,817, see paragraph 89 above.

¹¹⁶ C-4, see paragraph 89 above.

¹¹⁷ C-63, Clause 2.4 of the Investment Services Agreement refers to the two loans mentioned in Clause 4.4.4 of the Long-Term Agreement.

¹¹⁸ CWS-2 ¶ 50.

(B) THE ASSIGNMENT AGREEMENT (4 AUGUST 2005)

144. On the same day, Latvijas Unibanka and LVH executed the Assignment Agreement (the “2005 Assignment Agreement”)¹¹⁹ contemplated by the Investment Services Agreement, the amount of Latvijas Unibanka’s claim for payment against Rēzeknes Siltumtīkli being LVL 1,125,196¹²⁰ in respect of both loans under Credit Agreement No. RA 02155 (as amended by a number of covenants) and Credit Agreement No. RA 02219, Clauses 1.1 and 1.2 of the 2005 Assignment Agreement.

(C) PAYMENT BY E ENERGIJA (12 AUGUST 2005)

145. On 12 August 2005 E energija paid Latvijas Unibanka the amount of LVL 1,125,196.96 on behalf of LHV.¹²¹

(D) THE AGREEMENT ON SETTLEMENT OF DEBT (15 NOVEMBER 2005) AND REIMBURSEMENT BY LATGALES ENERGIJA OF RĒZEKNES SILTUMTĪKLI’S DEBTS UNDER THE LOANS

146. On 15 November 2005 Latgales Enerģija executed the Agreement on Settlement of Debt with Rēzeknes Siltumtīkli (the “Agreement on the Settlement of Debt”)¹²² and undertook to repay Rēzeknes Siltumtīkli’s loan debt arising under the two loans granted by Latvijas Unibanka for October, November and December 2005 as well as January and February 2006 in an amount of LVL 62,252.85 including interest (Clause 1). Clause 2 of the same agreement provides that Latgales Enerģija shall continue to pay Rēzeknes Siltumtīkli’s debts arising under those loans in accordance with the Debt Repayment Schedule attached as Appendix 1 to the Agreement on Settlement of Debt (which Appendix is not in evidence).

¹¹⁹ C-64.

¹²⁰ Clause 1.1 of the Assignment Agreement states that the claim for payment of Latvijas Unibanka against Rēzeknes Siltumtīkli as of the date of the Assignment Agreement is for an amount of LVL 1,125,196. The reasons for the decrease in amount from LVL 1,668,526 (see footnote 115 above) and the amount of LVL 1,125,196 (Clause 1.2 of the Assignment Agreement) are not explained, but no explanation is required in view of the fact that Latvijas Unibanka accepted such amount in the Assignment Agreement.

¹²¹ C-65. Mr. Jautakis’ first Witness Statement (CWS-2 ¶ 49) indicates that E energija paid Lōhmus the amount of LVL 1,125,196.96, but Exhibit C-65 indicates that the beneficiary of the payment is Latvijas Unibanka. It would seem that E energija directly paid Latvijas Unibanka the amount of LVL 1,125,196.96 which was to have been paid by LHV, thereby settling the debt for the same amount owed to LHV under the Investment Services Agreement.

¹²² C-80.

The Agreement on Settlement of Debt does not say to which entity Latgales Enerģija would make the payments contemplated by the agreement; such payments were to be made to LHV according to the Claimant,¹²³ as confirmed in due course by Clause 1.2(d) of the Amended Long-Term Agreement.¹²⁴

147. Between November 2005 and November 2006 Latgales Enerģija paid LHV a total amount of LVL 141,927.¹²⁵
148. Further arrangements would be made in 2006 (see paragraphs 199 ff. and 205 ff. below) and 2008 (see paragraphs 377 ff. below).

(15) FIRST REFERENCES TO A HEAT SUPPLY DEVELOPMENT PLAN (OCTOBER 2005)

149. The first communications mentioning a “heat supply development plan” took place in late 2005. The discussion relating to this topic continued in the following years (see paragraphs 164 ff. below for 2006).
150. On 12 October 2005 the Regulator informed the Rēzekne City Council that (i) municipalities should organise heating supply in their territory, (ii) municipalities might specify the development of heating supply within the “development plan” for their territory in coordination with the Regulator and (iii) Section 27 of the Methodology specified that the investment required was included in the calculation of the net profit for each heating supply service (production, distribution and sale) “in accordance with the heat supply system development plan as approved by the corresponding local government.”¹²⁶ The Regulator asked the Rēzekne City Council to advise whether there was “an effective and coordinated development plan of the city heating supply containing planned and already made investments of ‘Latgales Enerģija’ Ltd. in development and improvement of the city heating supply”.¹²⁷

¹²³ Cl. Mem. ¶ 62.

¹²⁴ C-16.

¹²⁵ C-83 [pages 1-12]; CWS-2 ¶ 52.

¹²⁶ C-35 [page 7].

¹²⁷ C-69.

No answer to the Regulator's enquiry is in evidence on the part of Rēzekne City Council.

151. On 27 October 2005 Rēzeknes Siltumtīkli wrote to Latgales Enerģija referring to the Regulator's 12 October 2005 letter to the City Council and asked whether Latgales Enerģija had "specified and coordinated with local government the municipal heat supply development plan including both specified and intended investments in this field".¹²⁸

Rēzeknes Siltumtīkli letter further asked when Latgales Enerģija would start to use natural gas as a fuel.

There is no answer in evidence on the part of Latgales Enerģija to the first question;¹²⁹ as to the second question, Latgales Enerģija answered on 7 November 2005 (see paragraph 156 below).

(16) LATGALES ENERĢIJA'S APPLICATIONS TO THE REGULATOR FOR A NEW TARIFF (13 OCTOBER 2005 AND 10 NOVEMBER 2005) – THE REGULATOR'S DECISIONS

152. According to a statement issued by Rēzeknes Siltumtīkli for the attention of the Regulator on 13 October 2005,¹³⁰ the prime cost of 1 MWh was in an amount of LVL 28.26 in 2004. According to the same statement issued by Latgales Enerģija on the same day,¹³¹ the prime cost of 1 MWh was in an amount of LVL 38.24 in the period from 15 February to 31 August 2005. The tariff then in force (see paragraph 60 above) no longer covered the costs for the production of heat.

¹²⁸ C-74.

¹²⁹ The Claimant alleges that the Regulator had asked Latgales Enerģija whether the heat supply development plan had been approved and "Latgales Enerģija responded that it had not", RfA ¶ 63. However, in his first Witness Statement Mr. Strioga does not confirm that allegation (CWS-1 ¶ 67).

¹³⁰ C-70.

¹³¹ C-71.

153. On 8 November 2005 Latgales Enerģija published a proposed tariff of LVL 32.96/MWh for residents and LVL 34.25/MWh for other users in the *Rēzeknes Vēstis* newspaper.¹³²
154. On 19 December 2005 the Regulator approved a new tariff of LVL 27.60/MWh for residents and LVL 29.02/MWh (without VAT) for other users in decision No. 19.¹³³
155. The Regulator's published decision was stated to be based on Section 2.1 and Section 26 of the Cabinet of Ministers Regulations No. 281 of 26 June 2001, amended in 2008 (Methodology for Calculation of Tariffs for Public Utilities in the Fields Regulated by Local Municipalities, "the Methodology").¹³⁴

The approval was based in substance on the proposition that "[t]he approved tariff will cover the most necessary costs", which addressed Latgales Enerģija's argument reported in the decision that "[t]he grounds for the increase of tariffs are the growing fuel and electric energy prices" and that "the present tariffs do not cover the company's operating costs".¹³⁵

The Regulator's decision of 19 December 2005 did not refer to a "development plan".

(17) RĒZEKNE HEATING SYSTEM CONVERTED TO USE NATURAL GAS (NOVEMBER 2005)

156. By November 2005 Latgales Enerģija had converted the heating infrastructure so that it could use natural gas. On 7 November 2005 Latgales Enerģija sent Rēzeknes Siltumtīkli and the Rēzekne City Council a notice informing them that, as of that day, they were ready to supply heating using natural gas as fuel and requesting the delivery

¹³² C-79. The figure of LVL 34.25/MWh is mistakenly indicated as LVL 22.26 in the English translation of the published decision in C-15 [page 1] (accurate in C-82 [page 1]). It is unclear, moreover, whether this publication is the actual fresh application for a new tariff made by Latgales Enerģija, as contended by the Claimant (Cl. Mem. ¶¶ 95; the Regulator's decision refers to an application by Latgales Enerģija of 10 November 2005).

¹³³ C-14; published version: C-82.

¹³⁴ C-35.

¹³⁵ C-82 [pages 1-2].

of 5 million cubic metres of natural gas in 2005 and 21 million cubic metres of natural gas in 2006.¹³⁶

157. As there was no written agreement to which Latgales Enerģija was a party with respect to the supply of natural gas (see paragraph 117 above), Rēzeknes Siltumtīkli invoiced Latgales Enerģija for the gas supplied based on the invoices received from Latvijas Gāze. Latgales Enerģija in turn paid such invoices directly to Latvijas Gāze. In an interview given on 13 September 2007, Mr. Vjaksē confirmed that this was the arrangement under which Latvijas Gāze was paid for the natural gas supplied.¹³⁷
158. It is in dispute between the Parties whether Latgales Enerģija owed Latvijas Gāze a duty to pay for the natural gas supplied (see paragraphs 586 ff. and 726 ff. below).
159. The Claimant alleges that by December 2005 Latgales Enerģija had made the investment required to convert the heating infrastructure to accept natural gas and had started to use natural gas to produce thermal energy in Rēzekne.¹³⁸

However, the actual gasification of the system was only partial as of the end of 2005, in that it related to two out of three heat sources, namely the boiler houses in Rancāna iela 1 (also often referred to as Rīgas iela) and Atbrīvošanas alejā 155a.¹³⁹

(18) THE THIRD AMENDMENT OF THE GAS SUPPLY AGREEMENT WITH LATVIJAS GĀZE (19 DECEMBER 2005)

160. On 19 December 2005 the Rēzekne Municipality, Rēzeknes Siltumtīkli and Latvijas Gāze agreed to amend and supplement the Gas Supply Agreement¹⁴⁰ (“Amendment

¹³⁶ C-78.

¹³⁷ C-134.

¹³⁸ RfA ¶ 39.

¹³⁹ C-44 p. 11: “Since November [2005] partial transition to gas heating has been carried out. (...) To eliminate these problems, Latgales Enerģija SIA at the end of 2005 carried out the transition from fuel oil to gas as fuel in two heat production sources. Therefore currently the boiler houses in Rancāna iela 1 and Atbrīvošanas alejā 155a have gas-heated boilers. However, this cannot be called a complete gasification of the heat supply system (...)”. See also C-44 p. 16, ¶ 4.1 and C-213 [Rēzekne Heating Supply Development Strategy for 2007-2013] p. 20.

Mr. Strioga indicates in his first Witness Statement (CWS-1 ¶ 93) that “the infrastructure had of course been modified to use natural gas, but only to the hot water supply” in September 2007.

¹⁴⁰ C-40, see paragraph 63 above.

No. 3 to the Gas Supply Agreement” or “Amendment No. 3”).¹⁴¹ Latgales Enerģija was neither consulted nor informed of this Amendment.¹⁴²

161. Amendment No. 3 to the Gas Supply Agreement increased the minimum amount of natural gas which the Municipality undertook to take or pay, from 87.5% (Clause 3.1 of the Gas Supply Agreement¹⁴³) to 88.16%, and replaced the amount of 21 million nm³ in the original Gas Supply Agreement with the figure of 21,157,895 nm³, thereby increasing the minimum quantity of gas to be taken by the Municipality by 157,895 nm³.¹⁴⁴
162. The Parties further agreed that Latvijas Gāze would not claim from the Municipality a penalty of LVL 227,920 with respect to the year 2005.¹⁴⁵
163. Clause 6 of the Amendment No. 3 reiterated that the Municipality retained “liability for timely and complete payment of invoices” under Clause 8.3 of the Gas Supply Agreement,¹⁴⁶ and Rēzeknes Siltumtīkli was authorised by the Municipality to pay the invoices for natural gas issued by Latvijas Gāze.

C. THE OPERATION OF THE HEATING SYSTEM BY LATGALES ENERĢIJA AND MAIN EVENTS IN 2006

(1) LATGALES ENERĢIJA’S “GUIDELINES FOR THE DEVELOPMENT OF THE RĒZEKNE CITY HEAT SUPPLY SYSTEM” (20 JANUARY 2006)

164. On 20 January 2006¹⁴⁷ Latgales Enerģija sent the Municipality a 28-page document entitled “Guidelines for the development of the Rēzekne City heat supply system”.¹⁴⁸ The Municipality received the draft “Guidelines”, since the Mayor received

¹⁴¹ C-81. The full title of the agreement is “Supplementation 3 to Agreement No. 1580 on Construction of a New Natural Gas Infrastructure for Gasification of the City of Rēzekne Due to Long-Term Supplies of Natural Gas to the User for Combustion Facilities of Various Mutually Replaceable Fuels (Natural Gas and Oil Products) Incineration Equipment”. If an Amendment No. 2 to the Gas Supply Agreement was made by the Parties, it is not in evidence.

¹⁴² Cl. Mem. ¶ 77, an allegation that was not specifically denied by the Respondent.

¹⁴³ C-40.

¹⁴⁴ C-81, Clauses 1 and 2.

¹⁴⁵ C-81, Clause 5.

¹⁴⁶ C-40, see also paragraph 64 above.

¹⁴⁷ Cl. Mem. ¶ 19; see also CWS-1 ¶ 66.

¹⁴⁸ C-44. Page 23 is missing in the Latvian original and the translation therefore contains an omission indicated by the expression “omitted text”.

comments on the draft from Ms. Adamova, Deputy Chairperson of the Council, and Mr. Zeile, Chairman of the Rēzekne City Task Force for the Supervision of Heat Energy Affairs. However, the Municipality did not acknowledge receipt of this document¹⁴⁹ and did not contact Latgales Enerģija in this regard until 3 November 2016 after the Regulator had rejected a new tariff proposed by Latgales Enerģija (see paragraph 188 below).

165. Latgales Enerģija's "Guidelines" outlined the heating system in the City of Rēzekne in their introductory part. They then identified two major problems, namely excessively high costs of heat production, broken down in nine distinct aspects,¹⁵⁰ and environmental pollution,¹⁵¹ for which they outlined possible solutions.¹⁵²

(2) THE AMENDED LONG-TERM AGREEMENT (10 FEBRUARY 2006)

166. On 10 February 2006 Latgales Enerģija and Rēzeknes Siltumtīkli executed a contract entitled "Agreement on Amendments to the Agreement for Lease, Renovation and Operation of the Long-Term Assets of 28 January 2005" (the "Amended Long-Term Agreement")¹⁵³ which varied the terms of the Long-Term Agreement.¹⁵⁴
167. The amount of the short-term debts to be taken over by Latgales Enerģija was increased from a total amount of LVL 1,448,977 to LVL 2,476,773.60 (Clause 1.2 of the Amended Long-Term Agreement varying Clause 4.4.3 of the Long-Term Agreement¹⁵⁵).¹⁵⁶ That amount included Rēzeknes Siltumtīkli's debts owed to the

¹⁴⁹ R-25 [pages 1-3].

¹⁵⁰ 1. Losses for self-consumption for heating fuel oil storage reservoirs; 2. obsolete heating failing to reach the maximum efficiency level; 3. loss of heat due to obsolete insulation of the heating lines; 4. cost of repairs for obsolete pipelines; 5. location of heating lines in underground channels and ensuing heat losses; 6. excessive diameter of certain pipeline segments and ensuing costs of electricity to operate pumping devices; 7. poor insulation of the buildings where the heating is used; 8. large amounts of electricity required to operate pumping devices and 9. increase in the price of fuel oil from January to November 2005 (Tribunal's wording).

¹⁵¹ C-44 p. 15, ¶ 3.3.

¹⁵² C-44 pp. 16-24, ¶¶ 4-5.

¹⁵³ C-16.

¹⁵⁴ C-4, see paragraphs 78 ff. above.

¹⁵⁵ See paragraph 88 above.

¹⁵⁶ As pointed out by the Claimant (Cl. Mem. ¶ 57), Clause 1.2 of the Amended Long-Term Agreement accurately sets out the total amount of Rēzeknes Siltumtīkli's debts to be taken over by Latgales Enerģija and the amount of LVL 2,472,094.80 in Clause 1.3(c) is inaccurate.

creditors mentioned in Clause 4.4.3 of the Long-Term Agreement¹⁵⁷ as well as Rēzeknes Siltumtīkli's long-term debt to LHV.¹⁵⁸

168. Clause 1.3(a) and (b) of the Amended Long-Term Agreement fixed the lease payments to be made by Latgales Enerģija in the first two years of the lease (as LVL 185,326.40 and LVL 150,000 respectively, for a total amount of LVL 335,326.40,¹⁵⁹ which brought to total amount to be paid by Latgales Enerģija to LVL 2,812,100 (Clause 1.3(c) of the Amended Long-Term Agreement). The amount of LVL 2,476,773.60 (erroneously indicated as LVL 2,472,094.80 in Clause 1.3(c) of the Amended Long-Term Agreement) was to be considered as “the security deposit for the following payments” and would be set off¹⁶⁰ under a separate agreement.

(3) THE AGREEMENT ON MUTUAL OPERATIONS WITH THE AIM TO DECREASE ENERGY RATE IN THE CITY OF RĒZEKNE (10 FEBRUARY 2006)

169. On 10 February 2006 Latgales Enerģija and the Rēzekne City Council executed a contract entitled “Agreement on Mutual Operations with the Aim to Decrease Thermal Energy Rate in the City of Rēzekne” (the “February 2006 Agreement”).¹⁶¹ The recitals of the February 2006 Agreement refer to the recent increase in the rates of thermal energy and the need to minimize social tensions in Rēzekne.¹⁶²
170. The February 2006 Agreement sets out in Clause 1 the duties undertaken by the Rēzekne City Council in its capacity as Rēzeknes Siltumtīkli's sole shareholder, in consideration of which Latgales Enerģija undertakes in Clauses 2 to 4 to decrease the thermal energy rates by the agreed amounts.
171. More specifically, the Rēzekne City Council undertook *inter alia*:

¹⁵⁷ LVL 128,509 owed to Dinaburga Rosme, LVL 250,000 owed to AVT Nafta and LVL 530,777.92 owed to Latvijas Unibanka.

¹⁵⁸ In an amount of LVL 1,567,486.68.

¹⁵⁹ As pointed out by the Claimant (Cl. Mem. ¶ 57), the sum of LVL 185,326.40 and LVL 150,000 is LVL 335,326.40 and the amount of LVL 340,005.20 in Clause 1.3(c) of the Amended Long-Term Agreement is inaccurate.

¹⁶⁰ The Tribunal accepts that the verb “written off” in the English translation of the Amended Long-Term Agreement from the original Latvian is a translation mistake as contended by the Claimant (Cl. Mem. ¶ 58).

¹⁶¹ C-17.

¹⁶² C-17 p. 1.

- (i) to review and adopt a Council decision approving the Amended Long-Term Agreement by 10 February 2006 (Clause 1);
- (ii) “to coordinate and approve the guidelines for development of heating supply system of the city of Rēzekne prepared by the Operator and the Council” (Clause 1.2);¹⁶³
- (iii) to ensure pursuant to the Long-Term Agreement that Rēzeknes Siltumtīkli should as of 10 February 2006 accept back the black fuel oil storage business and energy boiler; and to accept the resolution of Rēzeknes Siltumtīkli’s council relating to the transfer of a 1000m³ container located at Atbrīvošanas alejā 155a for use by Latgales Enerģija, free of charge, until 30 July 2008;
- (iv) to ensure pursuant to the Long-Term Agreement that Rēzeknes Siltumtīkli or a third party should take back the bath-house building as of 1 January 2006 and provide bath-house services as of 1 March 2006 and take over all employees of the bath-house preserving their social guarantees; and to ensure that Rēzeknes Siltumtīkli or the third party enter into an agreement with the Operator by 28 February 2006 for the supply of hot water in consideration of payment of the rate determined by the Regulator (Clause 1.4); and
- (v) to inform the Regulator about the content of the February 2006 Agreement (Clause 1).

172. Latgales Enerģija undertook more specifically to decrease the thermal energy rate for heating of premises by 2.05 LVL/MWh for residents and 0.43 LVL/MWh for other users in case the Council performed its obligations under Clauses 1.1, 1.4 and 1.5 of

¹⁶³ C-17, Clause 1.2 reads as follows:

(...) thus, with the aim to help the Council to minimise the potential social stress in the city of Rēzekne in relation to increase in thermal energy rates, the Parties agreed to conclude the following agreement:

- 1. The Council as the sole shareholder of AS “Rēzeknes siltumtīkli” undertakes to perform the below activities until 28 February 2006 (unless the below sub-clauses provide different terms):
 - 1.1 (...).
 - 1.2 By a Council decision, to coordinate and approve the guidelines for development of heating supply system of the city of Rēzekne prepared by the Operator and the Council;

the February 2006 Agreement (Clause 2). Further decreases were contemplated by Clause 3.

173. Clause 4 provided that in case the Council timely and fully performed the obligations undertaken under the Agreement, Latgales Enerģija would apply a further decrease in thermal energy rates until 1 October 2006 and apply a rate of LVL 25.02/MWh for residents and LVL 28.59/MWh for other users.
174. The February 2006 Agreement further contained terms dealing with the event of a breach of contract by each party. Clause 5 dealt with Latgales Enerģija's contractual rights in case the Rēzekne City Council failed to perform any of the obligations undertaken in Clauses 1.1 to 1.5;¹⁶⁴ Clause 6 dealt with the Rēzekne City Council's contractual rights in case Latgales Enerģija failed to perform the obligations undertaken in Clauses 2 to 4 of the February 2006 Agreement.
175. The Rēzekne City Council was to perform the obligations undertaken under Clauses 1.1 through 1.5 of the February 2006 Agreement by 28 February 2006 (unless otherwise expressly provided by such clauses).
176. There is no correspondence between the parties in February 2006, the month in which the Rēzekne City Council was due to perform the obligations contemplated by Clause 1 of the February 2006 Agreement, on the record, either confirming performance of

¹⁶⁴ C-17, Clause 5 reads as follows:

5. In case any of the obligations indicated in Clauses 1.1-1.5 is not performed by the Council of AS "Rēzeknes siltumtīkli", SIA "Latgales enerģija" unilaterally decreases the rent paid to AS "Rēzeknes siltumtīkli" for the period from 25.02.2006 to 24.02.2007 for the actual lost income calculated by multiplying the actual amount of sold heating and the difference between the rate approved by the Multi-industry Public Utility Regulator of Latgale Municipalities: 27.60 LVL/MWh for residents and 29.03 LVL/MWh for other users, and the actual applied rate. Likewise SIA "Latgales enerģija" is entitled to terminate this agreement at any time, but not before 01.03.2006, and claim compensation for the lost income.

The expression "the Council of AS 'Rēzeknes siltumtīkli'" in Clause 5 of the English version is ambiguous; in the Tribunal's view, it has the same meaning as "the Council" as the sole shareholder of AS "Rēzeknes siltumtīkli" in Clause 1 since Rēzeknes Siltumtīkli is not in terms a party to this agreement.

the agreement by either side or otherwise. There is no correspondence in evidence for the period immediately following either.¹⁶⁵

177. From February 2006 until 1 October 2006, Latgales Enerģija applied the rates of LVL 25.02/MWh for residents and LVL 28.59/MWh for other users, *i.e.* the rates decreased pursuant to Clause 4 of the February 2006 Agreement.¹⁶⁶
178. On 19 October 2006, after the Regulator rejected Latgales Enerģija's application for a new tariff,¹⁶⁷ Latgales Enerģija wrote to the Rēzekne City Council in relation to the performance of the February 2006 Agreement, and more specifically in relation to the "guidelines for the city heat supply system", pointing out that it had carried out all the activities required on its part to comply with Clause 1.2 of the February 2006 Agreement and that it had received no answer from the Council in spite of its reminders.¹⁶⁸ Latgales Enerģija gave notice to the Council that it would have no choice but to resort to Clause 5 of the February 2006 Agreement¹⁶⁹ unless the Council adopted the "guidelines" within the following two months.
179. It is the Claimant's case that the Rēzekne City Council failed in particular to approve the "guidelines for the development of the heating supply system", and thereby failed to live up to its side of the bargain.¹⁷⁰

¹⁶⁵ The first communications in which Latgales Enerģija took the view that the Rēzekne City Council was in breach of its contractual obligation with respect to the heat supply development plan were made later in 2006 and 2007 (see C-96 [19 October 2006] and paragraph 178 below; C-112 [2 February 2007] and paragraph 207 below; C-116 [6 March 2007] and paragraph 209 below; C-118 [19 April 2007] and paragraph 210 below; C-121 [29 May 2007] and paragraph 214 below; C-129 [13 July 2007]). Most of these communications were addressed to the Rēzekne City Council; when Rēzeknes Siltumtīkli was the addressee, the Rēzekne City Council would be copied in.

¹⁶⁶ See CWS-1 ¶ 71; CWS-3 ¶ 17, last sentence; see also C-157 and paragraph 294 below.

Ms. Rogozina was not called to be cross-examined at the Hearing, see paragraph 32 above.

¹⁶⁷ See C-19 and paragraph 184 below.

¹⁶⁸ C-96.

¹⁶⁹ Quoted in paragraph 174 above, footnote 164 as well as in Latgales Enerģija's letter.

¹⁷⁰ Cl. Mem. ¶¶ 121-122.

**(4) LATGALES ENERĢIJA'S APPLICATION TO THE REGULATOR FOR A NEW
TARIFF (12 JUNE 2006) – THE REGULATOR'S DECISION (13 OCTOBER 2006)
– THE DECISIONS BY THE LATVIAN ADMINISTRATIVE COURTS (17
NOVEMBER 2007 AND 15 APRIL 2009)**

180. From February to the end of September 2006 Latgales Enerģija applied a reduced rate in accordance with Clause 4 of the February 2006 Agreement (see paragraph 177 above).
181. In the meantime, Latvijas Gāze had been authorised by the Latvian Public Utilities Commission to raise the price of natural gas.¹⁷¹
182. On 12 June 2006 Latgales Enerģija applied to the Regulator seeking an increased tariff in an amount of LVL 33.38/MWh for residents and LVL 33.92/MWh for other users of thermal energy (from the approved rates of LVL 27.60/MWh and LVL 29.02/MWh respectively¹⁷²). In its calculations attached to its application Latgales Enerģija indicated that the new price charged by Latvijas Gāze for the natural gas had risen from LVL 83.06 to LVL 113.76 (which represented an increase of 36%), and the new price for electricity from LVL 29 to LVL 34 (which represented an increase of 17%).¹⁷³
183. On 15 August 2006 Latgales Enerģija asked the Regulator to cancel its previous application of 12 June 2006 and submitted fresh calculations for the rate applicable to residents, seeking a rate of LVL 30.91/MWh for residents, and LVL 33.92/MWh for other users of thermal energy. Ms. Rogozina explains in her first Witness Statement that such step was caused by a change in VAT rules.¹⁷⁴
184. On 13 October 2006 the Regulator denied Latgales Enerģija's application by a unanimous vote.¹⁷⁵ The reasons for this decision are discussed in paragraphs 901 ff. below.

¹⁷¹ Board Decision No. 73 of 22 March 2006, C-89; see also CWS-3 ¶ 18.

¹⁷² C-18; see also paragraph 154 above.

¹⁷³ C-18 [page 5].

¹⁷⁴ CWS-3 ¶ 19.

¹⁷⁵ Decision No. 17, C-19; R-35.1.

185. On 17 November 2006 Latgales Enerģija challenged the Regulator's decision before the Administrative District Court.¹⁷⁶
186. Since the challenge of the Regulator's 13 October 2006 decision had not been heard yet by the time the Regulator had made decision No. 12 of 11 June 2007, which was also challenged by Latgales Enerģija, on 22 June 2007 Latgales Enerģija amended its 17 November 2006 application to set aside so as to include *only* the Regulator's decision No. 12 dated 11 June 2007.¹⁷⁷ There was therefore no decision by the Administrative District Court in relation to the Regulator's decision No. 17 dated 13 October 2006. The Administrative District Court eventually made its decision on 15 April 2009.¹⁷⁸

(5) FURTHER STEPS TOWARDS A "HEAT SUPPLY DEVELOPMENT PLAN" (2006)

187. Having been notified of the Regulator's decision No. 17 rejecting the proposed tariff, on 19 October 2006 Latgales Enerģija complained to the Rēzekne City Council of the losses it was incurring due to the Council's failure to reply to the "guidelines" that had been sent (see paragraph 164 above), and threatening to decrease the lease payment under Clause 5 of the February 2006 Agreement^{179, 180}.
188. On 3 November 2006 the Rēzekne City Council replied asking Latgales Enerģija to be provided with the "heat supply development plan" for the period 2006-2007 and pointing to a number of points that such plan must include.¹⁸¹

¹⁷⁶ C-100. The application to have the Regulator's decision of 13 October 2006 set aside was based first on the proposition that the three coefficients that were not used in Latgales Enerģija calculations filed in support of the proposed new tariff could not be applied because they would be part of the heat supply development plan which the Municipality had failed to approve (C-100 ¶ 17). Moreover, Latgales Enerģija contended that the Regulator's decision No. 19 dated 19 December 2005 had not applied the three coefficients relied upon by the Regulator in the decision sought to be set aside, and the Regulator had thereby departed from its previous practice so as to make it impossible for the applicant to apply for new tariffs (C-100 ¶¶ 18-19).

Secondly, Latgales Enerģija contended that the Regulator was *bound* under Sect. 19.5 of the Public Utility Regulators Act (CLA-49) and Sect. 59 of the Administrative Procedure Act (CLA-47) to request an applicant to file missing documents to prove the costs on which a proposed tariff was to be based before a decision on a proposed tariff could be made.

¹⁷⁷ C-125 ¶¶ 9-10.

¹⁷⁸ C-192, see paragraph 392 below.

¹⁷⁹ C-17, see paragraph 169 above.

¹⁸⁰ C-96, see paragraph 178 above.

¹⁸¹ C-97.

189. On 15 November 2006 Latgales Enerģija answered and sent the Rēzekne City Council (i) a one-page “heat supply development plan” for the years 2006-2009¹⁸² and (ii) the “draft heat supply development concept” for the years 2006-2014.¹⁸³ Latgales Enerģija did not in November 2006 refer to the document previously sent to the Municipality on 20 January 2006.¹⁸⁴ The Council received Latgales Enerģija’s 15 November letter on 17 November 2006.¹⁸⁵
190. On 29 December 2006 the Rēzekne City Council acknowledged receipt of the “draft heat supply development concept 2006-2014” submitted by Latgales Enerģija.¹⁸⁶ The Council commented that the draft was not in accordance with applicable legislation and did not correspond to the actual state of heat supply in the city of Rēzekne.
191. One of the reasons given by the Rēzekne City Council was the following: “The claim that the Rēzekne City Council has transferred heat supply functions to Latgales Enerģija SIA does not correspond to the legal and actual situation”.¹⁸⁷

This statement relates to the following passage in Latgales Enerģija’s draft reading as follows: “(...) the company [Latgales Enerģija] has taken over from the City Council the duties specified in Section 15 of the Law on Local Governments, *i.e.* ensuring provision of utilities or, more particularly, heat supply. In connection with this LLC Latgales Enerģija is performing its activities and thereby also planning and development [sic] of centralised heat supply in Rēzekne City”.¹⁸⁸

192. The plan was finally approved by the City Council on 21 September 2007 under the name “Heating Supply Development Strategy” (see paragraph 228 below).¹⁸⁹

¹⁸² C-99 Enclosure 1.

¹⁸³ A 22-page document, not in evidence at the Hearing as C-99 contains only the covering letter dated 15 November 2006; this document was filed by the Respondent after the Hearing, R-31.2.

¹⁸⁴ C-44, see paragraph 164 above.

¹⁸⁵ C-99.

¹⁸⁶ C-106.

¹⁸⁷ C-106.

¹⁸⁸ R-31.2 [page 5].

¹⁸⁹ C-137; C-213.

**(6) RĒZEKNES SILTUMTĪKLI'S CLAIMS AGAINST LATGALES ENERĢIJA
RELATING TO THE DEPRECIATION OF THE LEASED ASSETS**

193. A difference of views developed in 2006 with respect to the lease payments to be made by Latgales Enerģija under Clauses 4.4.2 and 7.1.5 of the Long-Term Agreement.¹⁹⁰

According to Rēzeknes Siltumtīkli, Latgales Enerģija had to pay an amount for depreciation of the assets every month under the terms of the Long-Term Agreement, whereas Latgales Enerģija took the view that such payment had to be made upon returning the assets to the lessor at the end of the term of the lease.¹⁹¹

194. On 7 November 2006 Rēzeknes Siltumtīkli sent Latgales Enerģija a “pre-trial objection” requesting settlement of an alleged debt of LVL 563,098.69 by 20 November 2006, failing which Rēzeknes Siltumtīkli would bring proceedings to recover such amount; Rēzeknes Siltumtīkli further invoked Clause 12.5.2 of the Long-Term Agreement which entitles the lessor to terminate the agreement unilaterally in certain cases.¹⁹²
195. On 5 December 2006 Latgales Enerģija answered Rēzeknes Siltumtīkli's claim of 7 November 2006, taking the view that any amounts to which the lessor might be entitled under Clause 4.4.2 of the Long-Term Agreement were not yet due and owing. Nevertheless, Latgales Enerģija invited Rēzeknes Siltumtīkli to negotiate a solution without prejudice which could help solve the lessor's financial difficulties.¹⁹³

(7) SUPPLEMENTING CERTAIN ARRANGEMENTS MADE IN 2005

196. A number of arrangements made by the Claimant or Latgales Enerģija in 2005 were supplemented in 2006; in some respects further arrangements were made.

(A) FURTHER LOANS BY E ENERGIJA TO LATGALES ENERĢIJA

197. E energija granted three further loans to Latgales Enerģija in 2006 in connection with the Rēzekne Project for a total amount of EUR 1,150,000. This amount was not all

¹⁹⁰ C-4, see paragraphs 85 and 88 above.

¹⁹¹ See CWS-4 ¶ 7.

¹⁹² C-98.

¹⁹³ C-104 [page 3].

paid in cash; the Claimant also paid sums directly to Rēzeknes Siltumtīkli's creditor Dinaburga Rosma and to its parent company Energijos Taupymo Centras, and took over debts owed to Energijos Taupymo Centras.¹⁹⁴

(B) FURTHER INVESTMENT BY E ENERGIJA IN LATGALES ENERGIJA (8 JUNE 2006)

198. On 8 June 2006 E energija purchased 364 shares in Latgales Enerģija from Energo Sistēmas for an amount of EUR 70,000 under the terms of a Share Purchase Agreement.¹⁹⁵

(C) LOAN FROM JSC SAMPO BANKA TO LATGALES ENERGIJA – E ENERGIJA'S GUARANTEE AND PLEDGE (30 NOVEMBER 2006)

199. On 30 November 2006 JCS Sampo Banka ("Sampo Banka") granted Latgales Enerģija a loan amounting to LVL 2 million (the "Sampo Banka Loan Agreement").¹⁹⁶ According to Clause 2.1 of such agreement the purpose of the loan was to enable Latgales Enerģija to purchase LHV's claims against Rēzeknes Siltumtīkli (referred to in Clause 1.2(d) of the Amended Long-Term Agreement¹⁹⁷), and to make further investments into the modernization of the heating infrastructure of the city of Rēzekne.
200. The disbursement of the loan was subject to a number of conditions set out in Clause 5.2, including the condition that parent company guarantee be issued under which E energija would guarantee performance of Latgales Enerģija's duties to Sampo Banka under the Sampo Banka Loan Agreement.
201. The Sampo Banka Loan Agreement was subsequently amended on 26 April 2007.¹⁹⁸
202. E energija signed the Guarantee provided to Sampo Banka on 30 November 2006 (the "Sampo Banka Guarantee") and undertook to pay any amounts as may be due and payable under the Sampo Banka Loan Agreement, as a principal debtor and irrespective of the validity and legal effect of said Loan Agreement, having waived

¹⁹⁴ C-51 [pages 46 ff.]; see also paragraph 111 above.

¹⁹⁵ C-92, Clause 3.1; see also CWS-2 ¶¶ 12-13.

¹⁹⁶ C-101; part of this exhibit is illegible; the Respondent did not raise any objections.

¹⁹⁷ C-16, see paragraph 167 above.

¹⁹⁸ C-120.

“all rights of objection and defence” under the same Loan Agreement, and any right to set off, counterclaim or deduce any amounts (first and third paragraphs of the Sampo Banka Guarantee).¹⁹⁹

203. On 30 November 2006 E energija also executed a Commercial Pledge Agreement with Sampo Banka to secure any claims the bank might have under the Sampo Banka Loan Agreement, pledging all the shares owned in Latgales Enerģija up to an amount of LVL 2.6 million.²⁰⁰
204. Latgales Enerģija was eventually unable to repay the loan to Danske Bank which succeeded to Sampo Bank, and which in turn claimed payment under the Guarantee Agreement against the Claimant.²⁰¹

(D) RĒZEKNES SILTUMTĪKLI’S LONG-TERM DEBTS TAKEN OVER BY
LATGALES ENERĢIJA

205. On 13 December 2006 Latgales Enerģija took over the debt owned by LHV against Rēzeknes Siltumtīkli under the terms of an Assignment Agreement.²⁰² LHV’s claim for payment against Rēzeknes Siltumtīkli arose under the two loan agreements referred to in Clause 4.4.4 of the Long-Term Agreement (see paragraph 89 above) and was then in an amount of LVL 1,103,097.82, including cumulated interest and a premium (Clause 1.2 of the 2006 Assignment Agreement).
206. Latgales Enerģija paid that amount in two instalments in December 2006 and 2007.²⁰³

**D. THE ENERGY CRISIS DECLARED BY THE RĒZEKNE CITY COUNCIL AND OTHER
MAIN EVENTS IN 2007**

(1) FURTHER STEPS TOWARDS A “HEAT SUPPLY DEVELOPMENT PLAN” OR
“STRATEGY” (JANUARY-SEPTEMBER 2007)

207. On 2 February 2007 Latgales Enerģija answered Rēzekne City Council’s letter of 29 December 2006,²⁰⁴ and to some extent addressed the criticism voiced by the

¹⁹⁹ C-102.

²⁰⁰ C-103.

²⁰¹ Cl. Mem. ¶ 66, see also paragraph 406 below.

²⁰² C-105.

²⁰³ C-83 [pages 14-15].

Council in relation to the “draft heat supply development concept” that Latgales Enerģija had sent to the Council on 15 November 2006 (see paragraph 189 above).²⁰⁵

208. On 19 February 2007 the Rēzekne City Council indicated that it was creating a working group to resolve the matter and asked Latgales Enerģija to delegate two representatives to the meetings of the working group,²⁰⁶ which Latgales Enerģija did on 28 February 2007.²⁰⁷ The working group was not established until 11 May 2007 (see paragraph 213 below).
209. On 6 March 2007 Latgales Enerģija gave notice to the Rēzekne City Council that it would not be able to perform its obligation to invest not less than EUR 1.5 million in accordance with the Long-Term Agreement²⁰⁸ due to the Council’s failure to comply with its duty to develop a “heat supply development concept” in accordance with the February 2006 Agreement²⁰⁹ and to the absence of any reply by Rēzeknes Siltumtīkli, which was copied in, as to Latgales Enerģija’s repair and investment proposals.²¹⁰

The Arbitral Tribunal notes that the investment proposals relied upon by Latgales Enerģija are not in evidence.

210. On 18 April 2007 Latgales Enerģija gave substantially the same notice to Rēzeknes Siltumtīkli and copied in the Rēzekne City Council.²¹¹
211. On 13 July 2007 Latgales Enerģija sent Rēzeknes Siltumtīkli a further reminder that Rēzeknes Siltumtīkli’s failure to answer affected in particular (i) the installation of two heating boilers with a total capacity of 30 MW and (ii) the installation of cogeneration facilities at Rīgas iela/Rancāna iela 1 (4-5 MW) and Atbrīvošanas alejā 155a (2 MW).²¹²

²⁰⁴ C-106, see paragraph 190 above.

²⁰⁵ C-112.

²⁰⁶ C-114.

²⁰⁷ C-115.

²⁰⁸ C-4, Clause 7.1.1, see paragraph 92 above.

²⁰⁹ C-17, Clause 1.2.

²¹⁰ C-116.

²¹¹ C-118.

²¹² C-129.

212. There is no answer to either letter in evidence by the Rēzekne City Council or Rēzeknes Siltumtīkli; Latgales Enerģija sent further reminders in 2008 (see paragraphs 329 ff. below).
213. On 11 May 2007 the Rēzekne City Council established a working group (the “Working Group”)²¹³ to draft the strategic plan for the development of the heat supply system and present an interim report by 1 July 2007.²¹⁴
214. On 29 May 2007 Latgales Enerģija again reminded²¹⁵ the Rēzekne City Council that it was in breach of its contractual obligation to agree and approve “guidelines for the development plan of the heating supply system” in accordance with the February 2006 Agreement,²¹⁶ pointing out that it was entitled under Clause 5 of that agreement to decrease the lease payments to be made to Rēzeknes Siltumtīkli.²¹⁷
215. On the same day Latgales Enerģija applied for a new tariff to the Regulator (these developments will be dealt with separately in paragraphs 230 ff. below, save insofar as they are relevant to the “heat supply development plan”). On the following day the Regulator asked Latgales Enerģija to provide “information regarding the approved Rēzekne City heat supply development plan, which must be in place” in accordance with the Methodology.²¹⁸ On 6 June 2006 Latgales Enerģija answered that the approval of such plan was exclusively a matter for the Rēzekne City Council, to which the Regulator should therefore turn, adding that to the best of its knowledge the

²¹³ The Working Group consisted of the following persons (Council decision No. 188, R-30 [page 1]): three employees of the Council (Mr. I. Locis, Ms. Groce and Mr. Patmalnieks); four invited specialists, of whom two members of the Council (Mr. G. Spradzenko, Deputy of RCC and Member of the Board of SIA Rēzekne Ūdens [water sewerage company]; Mr. E. Škinčs, Member of the Board of SIA Rēzekne Namsaimnieks [estate agent]; Mr. O. Skurjats, member of the Board of SIA Siltumserviss [company active in heat supply and heat supply network] and Ms. D. Abramova, Deputy of RCC); and Ms. Viļumovska.

Further persons took part in the meetings of the Working Group. At least one representative of Latgales Enerģija (R-30 [pages 2-46]) attended the meetings of the Working Group save for the meetings of 19 July, 31 July and 11 September 2007.

According to the minutes produced by the Respondent, the Working Group had sixteen meetings from 14 May to 19 September 2007 (R-30 [pages 2-46]).

²¹⁴ Council decision No. 188, R-30 [page 1].

²¹⁵ See paragraph 178 above.

²¹⁶ C-17, Clause 1.2, see paragraph 171 above.

²¹⁷ C-121.

²¹⁸ C-122.

plan had not been adopted.²¹⁹ On 11 June 2007 the Regulator denied Latgales Enerģija's application for a new tariff.²²⁰

216. On 12 June 2007 the Rēzekne City Council answered Latgales Enerģija's 29 May 2007 letter, pointing out that the Working Group in charge of developing the "strategic plan for the development of the Rēzekne city heat supply system" had repeatedly²²¹ requested Latgales Enerģija to provide information on whether the introduction of new facilities and technologies would affect the thermal energy tariff, but had not received any answers.²²² The delay had therefore been caused by Latgales Enerģija, and Latgales Enerģija's allegation that the Council was responsible for such delay was unjustified. The Council further denied that Latgales Enerģija was entitled to reduce the amount of the lease payments owed under the Long-Term Agreement without an amendment of the same, which had to be made in writing.
217. On 4 July 2007 Latgales Enerģija claimed in a letter sent both to Rēzeknes Siltumtīkli and the Rēzekne City Council that the Regulator's refusal to approve a new tariff²²³ had been ultimately caused by the Rēzekne City Council's failure to approve a "heat supply system development plan".²²⁴ Relying on the Rēzekne City Council's obligations under Clause 1.2 of the February 2006 Agreement with particular respect to the approval of the "heat supply system development plan",²²⁵ Latgales Enerģija reiterated that it was under no obligation to decrease the heat energy tariff under the terms of the February 2006 Agreement and presented a calculation of the amount of LVL 138,069.24 which it was entitled to deduct from the lease payments owed to Rēzeknes Siltumtīkli under Clause 5 of the February 2006 Agreement.²²⁶
218. On 9 July 2007 Rēzekne City Council rejected Latgales Enerģija's complaints and claim for compensation, stating it had performed all its obligations and met all the requirements in order for the thermal energy tariff to be reduced by Latgales Enerģija,

²¹⁹ C-123.

²²⁰ C-21, see more in detail paragraph 233 below.

²²¹ The requests mentioned in this letter are not in evidence.

²²² C-124.

²²³ C-21, see more in detail paragraph 233 below.

²²⁴ C-128.1.

²²⁵ C-17, see paragraph 171 above.

²²⁶ C-128 [pages 2-3].

having recalled its criticism of the “guidelines” received from Latgales Enerģija on 17 November 2006.²²⁷ The letter addressed the tasks to be undertaken by the Council and Latgales Enerģija within the Working Group and criticised Latgales Enerģija for failing to provide sufficiently clear and detailed information, without which it was impossible to evaluate the situation and forecast the necessity and scope of the investments required for the period 2007-2013.²²⁸ A 19-page document was attached to that letter which is not in evidence.

219. On 18 July 2007 Latgales Enerģija replied that the development of the “heat supply development plan” was an obligation on the Municipality under the Energy Act (Section 51, Part 1) and the Municipality’s rejection of Latgales Enerģija’s claim for compensation was contrary to the provisions of the February 2006 Agreement.²²⁹ Latgales Enerģija did not, however, answer the Council’s criticism in relation to the alleged failures of its representatives to provide information required by the working group in charge of the “heat supply development plan”.

On 19 July 2007 the Rēzekne City Council reiterated that the Working Group had received only partial information from Latgales Enerģija, which was requested to provide the following by 24 July 2007 on five key items set out in the letter.²³⁰ The draft “strategic plan” would be submitted for approval by 14 September 2007, the letter indicated.

220. On 19 July 2007 Latgales Enerģija complained to the Council that it had been notified of a Working Group meeting on that very day at 10:20 *a.m.* after the meeting had started at 10:00 *a.m.*; adequate notice was requested for future meetings.²³¹
221. On 23 July 2007 Latgales Enerģija answered the Council’s 19 July 2007 request as follows:²³²

²²⁷ C-99, see paragraph 189-190 above.

²²⁸ C-128 [page 8].

²²⁹ C-128 [page 13].

²³⁰ C-128 [page 15].

²³¹ C-128 [page 19].

²³² C-128 [page 21].

- (i) as at July 2007 there was no updated information regarding the investments planned; a survey of the prices of potential suppliers would be required which would take between five to seven weeks, to update the information in relation to the heat supply main network, the scope of boiler reconstruction, the measures to improve energy efficiency etc.; expected prices had increased, but the volume of investment had not changed;
- (ii) there had been no changes in the schedule of the planned investments; however, the timing of the schedules depended on the timing of their approval so that if approval was delayed, completion of the works would be delayed;
- (iii) the sources of the planned investments would be as follows: up to 90% bank resources, and 10% equity capital; and
- (iv) as to the question how the planned investments would affect the energy efficiency measures, the answer was provided to Mr. Vjakse on 1 July 2007 and during the meetings of the Working Group. Within two years of obtaining the investments:
 - self-consumption in the boilers would decline to 8.1% (in 2006 it was 11.3%);
 - losses in the heat transmission network would decline to 17.2 (currently 18.1%);
 - the amount of fuel consumed for the production of 1 MWh heat would decline to 136 kg of the assumed fuel (currently 151.2 kg); and
 - the energy consumption would fall to 22.9 kWh (currently 24 kWh); the number of employees at the boiler houses would fall by 15% while the salaries will increase by 20% as employees would have to have higher qualifications; the heat energy tariff was expected to grow by 7% (at the inflation of 0 from July 2007).

222. On 30 July 2007 Latgales Enerģija sent a two-page “investment plan” covering a seven-year period starting from the date of the approval of the “Rēzekne city heat supply system development strategic plan”.²³³
223. On the following day the Council replied that the information provided by Latgales Enerģija on 23 July 2007 was insufficient as it failed to reflect essential cost items. The letter stated that an expert had been involved to develop the “Rēzekne city heat supply strategic plan” and additional information was requested.²³⁴
224. On 11 September 2007 a meeting of the Working Group took place. Latgales Enerģija had announced that it would be unable to attend.²³⁵ As indicated in the minutes of the meeting, a draft Development Plan was available by then.²³⁶

During that meeting Ms. Abramova, sitting on the Working Group as an invited specialist and a member of the City Council, suggested to make “editorial comments” to the draft Development Plan: “when talking about future development, to use the word ‘operator’, without mentioning SIA Latgales enerģija as the only possible operator of thermal energy”.²³⁷ The minutes indicate that Mr. I. Locis, head of the Working Group and Vice-Executive Director of the City Council, would make the editorial changes by 13 September 2007 and prepare the document for review.²³⁸ The record does not show whether the minutes of this particular meeting were provided to Latgales Enerģija.

225. On 13 September 2007 the Rēzekne City Council sent Latgales Enerģija a 54-page document setting out the “strategy for the development of the Rēzekne city heat supply” further to Latgales Enerģija’s request.²³⁹ Latgales Enerģija was invited to participate in an unscheduled session of the City Development, Infrastructure and Public Order Committee in the morning of the following day, and the meeting of the

²³³ C-128 [page 25].

²³⁴ C-128 [page 31].

²³⁵ R-30 [page 43].

²³⁶ R-30 [page 43].

²³⁷ R-30 [page 44].

²³⁸ R-30 [page 44].

²³⁹ C-133.

subsection of the Rēzekne City Council in the afternoon,²⁴⁰ but informed the Mayor that it was unable to attend and requested a postponement.²⁴¹ It is not clear whether a meeting took place on 14 September 2007 as there are no minutes of such a meeting on the record and it is recalled that no witnesses have been put forward by the Respondent.

226. On 17 September 2007 the Rēzekne City Council invited Latgales Enerģija to participate in the meeting of its deputies that would take place on 19 September 2007 on the “development strategy [for the] heat supply” in Rēzekne for 2007-2013.²⁴² Latgales Enerģija indicated on the very same day that it would attend.²⁴³
227. On 19 September 2007 the Working Group met.²⁴⁴ No representative from Latgales Enerģija attended. One of the items discussed was the manner in which the Development Plan in the making should refer to Latgales Enerģija. Ms. Abramova reiterated her suggestion that Latgales Enerģija should not be mentioned “as the only possible operator”;²⁴⁵ another member of the City Council, Mr. Petkevičs, concurred and suggested that Latgales Enerģija should be mentioned “only in the descriptive part, when characterising the current situation”.²⁴⁶ The record does not show whether the minutes of this particular meeting were provided to Latgales Enerģija.
228. On 21 September 2007 the Rēzekne City Council approved the heat supply development strategy for the city of Rēzekne for 2007-2013.²⁴⁷ The document entitled “Rēzekne Heating Supply Development Strategy for 2007-2013” is in evidence as Exhibit C-213.

²⁴⁰ C-133.

²⁴¹ Latgales Enerģija was unable to attend the meeting of the Working Group scheduled to take place on 14 September 2007 due to prior commitments and had applied to the Mayor for a ten-day postponement on 11 September 2007 (R-30 [page 55]); on the following day Latgales Enerģija restated its application stating that it had not received the Development Plan to be discussed (R-30 [page 56]); on 13 September 2007 the Mayor sent the Plan but maintained the date for the meeting on the following day (R-30 [page 57]).

²⁴² C-135.

²⁴³ C-135.

²⁴⁴ R-30 [pages 45-46].

²⁴⁵ R-30 [page 45].

²⁴⁶ R-30 [page 45].

²⁴⁷ Decision No. 364, C-137.

229. As the next sub-sections will recall, the finalization of the Rēzekne Heating Supply Development Strategy for 2007-2013 was not, by far, the sole event worth recalling in the second part of 2007. By 21 September 2007 a number of equally significant events had taken place:

- (i) the Regulator had denied Latgales Enerģija's application for a new tariff;
- (ii) Latvijas Gāze had stopped deliveries of natural gas;
- (iii) Rēzekne's Mayor had given an interview indicating that Latgales Enerģija might no longer be the exclusive supplier of thermal energy in spite of the express terms contained in the Long-Term Agreement and the February 2006 Agreement; and
- (iv) Rēzeknes Siltumtīkli had sued Latgales Enerģija in the Latgale Regional Court and had obtained an injunction freezing Latgales Enerģija's bank account.

The following sub-sections will deal with those developments.

(2) LATGALES ENERĢIJA'S APPLICATION TO THE REGULATOR FOR A NEW TARIFF (29 MAY 2007) AND THE REGULATOR'S DECISION (11 JUNE 2007) – LATGALES ENERĢIJA'S APPLICATION TO THE REGULATOR FOR A NEW TARIFF (5 NOVEMBER 2007) AND THE REGULATOR'S DECISIONS (9 NOVEMBER 2007 AND 7 DECEMBER 2007)

230. The tariff in force in 2007 (LVL 27.6/MWh for residents and LVL 29.02/MWh for other users) had been approved by the Regulator on 19 December 2005.²⁴⁸

From February to October 2006 Latgales Enerģija had applied a reduced tariff of LVL 25.02/MWh for residents and 28.59/MWh for other users (see paragraph 177 above) in accordance with Clause 4 of the February 2006 Agreement.²⁴⁹

On 19 October 2006 the Regulator had denied Latgales Enerģija's application for a new tariff.²⁵⁰ In 2006 the price charged by Latvijas Gāze in accordance with the decision by the Public Utilities Commission had risen by some 36%.²⁵¹

²⁴⁸ See paragraph 154 above; see also the Regulator's decision No. 12 of 11 June 2007, C-21 [page 4] and the Regulator's decision No. 28 of 9 November 2007, C-27 [page 5].

²⁴⁹ C-17, see paragraph 173 above.

231. On 28 March 2007 the Public Utilities Commission authorised Latvijas Gāze to increase the price of natural gas.²⁵² By reference to the tariff issued by the Regulator on 19 December 2005, the increase in the price of natural gas was of the order of 55% up to 129%.²⁵³
232. On 29 May 2007 Latgales Enerģija applied to the Regulator seeking a tariff ranging from LVL 32.67/MWh to LVL 41.62/MWh from 1 September 2007 onwards.²⁵⁴
233. On 11 June 2007 the Regulator denied Latgales Enerģija application by a unanimous vote.²⁵⁵ The reasons for the decision are discussed in paragraphs 904 ff. below.
234. On 22 June 2007 Latgales Enerģija challenged the Regulator's decision before the Administrative District Court in the same proceedings which it had brought against the Regulator's prior decision of 13 October 2006.²⁵⁶

²⁵⁰ C-19, see also paragraph 178.

²⁵¹ C-89, see also paragraph 182 above.

²⁵² Board Decision No. 83, C-117.

²⁵³ See CWS-3 ¶ 23.

²⁵⁴ C-20. The date in C-20 contains a spelling mistake, the year is not "2006" but "2007"; the stamp also shows that this application was received by the Regulator on 30 May 2007.

Ms. Rogozina gives the figures of LVL 33.80/MWh to LVL 42.75/MWh in her first Witness Statement, CWS-3 ¶ 23.

²⁵⁵ Decision No. 12, C-21; R-35.2.

²⁵⁶ C-125; see also paragraphs 185-186 above.

The application to set aside rests on a breach by the Regulator of Sect. 5 of the Administrative Procedure Act and Sect. 15(12) of the same Act. The first provision is to the effect that in administrative proceedings institutions and courts shall, within the scope of applicable provisions of law, protect the rights and legal interests of private persons (CLA-47). The second provision is said to embody the principle of prohibition against legal obstruction by institution and courts.

Sect. 5 of the Administrative Procedure Act (CLA-47) reads as follows:

Principle of Observance of the Rights of Persons

In administrative proceedings, especially in adopting decisions on the merits, institutions and courts shall, within the scope of the applicable norms of law, facilitate the protection of the rights and legal interests of private persons.

Sect. 15(12) of the Administrative Procedure Act (CLA-47) reads as follows:

Institutions and courts may not refuse to decide an issue on the grounds that such issue is not regulated by law or other external regulatory enactment (prohibition of legal obstruction by institutions and courts). They may not refuse to apply a norm of law on the grounds that such norm does not provide for the mechanism of application, it is not exhaustive or no other regulatory enactments have been issued which would more closely regulate the application of the relevant norm. This shall not apply only in cases where an institution, which is required to apply this norm or participate in its application in another way, has not been established or is not operating.

235. The Administrative District Court eventually made its decision on 15 April 2009 and dismissed Latgales Enerģija's application.²⁵⁷
236. On 28 September 2007 Latgales Enerģija applied again to the Regulator seeking a new tariff from 1 November 2007 onwards.²⁵⁸ The proposed tariff ranged from 35.95 LVL/MWh to 44.16 LVL/MWh depending on the natural gas rate. Reliance was placed on changes in the natural gas rates and in the minimum salary as well as other factors.
237. In the autumn of 2007 a number of significant events took place which the Tribunal will discuss in the following sub-sections of this Award:
- (i) on 11 September 2007 Latvijas Gāze stopped the supply of natural gas (see paragraph 248 below); as a consequence, Latgales Enerģija experienced difficulties in providing heating to certain areas of the city of Rēzekne;
 - (ii) on 4 October 2007 the Regulator warned Latgales Enerģija that it might revoke the three licences issued to Latgales Enerģija (see paragraph 262 below);
 - (iii) the Municipality declared an energy crisis in the city of Rēzekne on 9 October 2007 (see paragraph 264 below);
 - (iv) the heat supply development strategy for the city of Rēzekne for 2007-2013 had just been approved by the Municipality on 21 September 2007²⁵⁹ (see paragraph 228 above); and
 - (v) on 11 October 2007 the Regulator decided to take over Latgales Enerģija's zone (see paragraph 274 below).

²⁵⁷ C-192, see paragraph 392 below.

²⁵⁸ C-140.

Ms. Rogozina gives the figures of LVL 33.80/MWh to LVL 42.75/MWh in her first Witness Statement, CWS-3 ¶ 23.

²⁵⁹ Decision No. 364, C-137; C-213.

238. On 5 November 2007 Latgales Enerģija wrote to the Municipality announcing that if the Regulator approved the new tariff proposed by Latgales Enerģija, Latgales Enerģija would apply reduced rates as set out in that letter.²⁶⁰
239. On 9 November 2007 the Regulator unanimously approved new tariffs.²⁶¹ Latgales Enerģija submits that the approved tariffs would have enabled it to pay the increased prices for natural gas.²⁶²
240. However, on 7 December 2007 the Regulator revoked its previous decision No. 28 dated 9 November 2007 and dismissed Latgales Enerģija's application for a new tariff dated 18 September 2007.²⁶³ The decision does not state whether it is a majority decision or a unanimous decision.
241. The decision states that on 29 November 2007 Rēzeknes Enerģija had written a letter to the Regulator (*not in evidence*) stating that the amount of natural gas which Latvijas Gāze was to supply was 21,000 nm³ whereas Latgales Enerģija's application contained a smaller amount, which proved in the Regulator's opinion that the calculations on which Latgales Enerģija's application was based were not in accordance with "the actual situation" and that the rates submitted were therefore to the detriment of the public interest. Such information had been knowingly supplied by Latgales Enerģija and the Regulator's decision was therefore to be reviewed. The Regulator found that Latgales Enerģija had obtained a new tariff "by illegal means" and that the approved tariff was "unreasonably high".²⁶⁴
242. The decision does not state that Latgales Enerģija's comments were sought on Rēzeknes Enerģija's 29 November 2007 letter before reviewing the Regulator's decision dated 9 November 2007.
243. On 12 December 2007 Latgales Enerģija challenged the Regulator's decision before the Administrative District Court.²⁶⁵ The court dismissed Latgales Enerģija's

²⁶⁰ C-154.

²⁶¹ Decision No. 28, C-27.

²⁶² Cl. Mem. ¶ 190.

²⁶³ Decision No. 35 dated 7 December 2007, C-28.

²⁶⁴ C-28 [page 18].

²⁶⁵ C-164.

application on 30 October 2009.²⁶⁶ Latgales Enerģija appealed against that judgment and the Administrative Regional Court dismissed the appeal on 23 September 2010.²⁶⁷

244. Latgales Enerģija had started to charge users according to the revised tariffs approved by the Regulator on 9 November 2007 as it took the view that the effects of the Regulator's decision of 7 December 2007 were stayed pending the resolution of Latgales Enerģija's challenge.²⁶⁸ However, the Rēzekne City Council did not accept Latgales Enerģija's position (see paragraphs 324 ff. below).

(3) TOWARDS THE DECLARATION OF AN ENERGY CRISIS BY THE RĒZEKNE CITY COUNCIL (9 OCTOBER 2007)

245. Owing to the Regulator's refusal to approve a new tariff in 2006 (see paragraph 184 above) and in 2007 (see paragraphs 233 and 240 above) and to the increase in the gas prices charged by Latvijas Gāze allowed by the competent authority in 2006 and 2007 (see paragraphs 181 and 231 above) Latgales Enerģija felt that it would no longer be in a position to pay the amounts which Latvijas Gāze was invoicing Rēzeknes Siltumtīkli. On 2 July 2007 it informed Rēzeknes Siltumtīkli that, as of 11 June 2007, it would pay for the natural gas supplied by Latvijas Gāze in accordance with the tariff applied by the Regulator when the heating tariff was approved, namely "LVL 83.60/1000 m³".²⁶⁹
246. On 25 July 2007 Latgales Enerģija informed Rēzeknes Siltumtīkli that it paid less than Latvijas Gāze had invoiced Rēzeknes Siltumtīkli for June 2007, by some LVL 10,000.²⁷⁰

Latgales Enerģija did not pay the outstanding balance to Latvijas Gāze. Neither did Rēzeknes Siltumtīkli and the Rēzekne City Council which were the contracting parties to the Gas Supply Agreement with Latvijas Gāze.²⁷¹

²⁶⁶ R-4 ¶ 5.

²⁶⁷ R-4, see paragraph 401 below.

²⁶⁸ Cl. Mem. ¶ 199.

²⁶⁹ C-127.

²⁷⁰ C-130.

²⁷¹ C-40, see paragraph 63 above; C-61, see paragraph 136 above; and C-81, see paragraph 160 above.

247. On 29 August 2007 Latvijas Gāze warned the Rēzekne City Council and Rēzeknes Siltumtīkli that it would suspend supplies of natural gas unless the Rēzekne City Council paid in full for the natural gas supplied to Rēzeknes Siltumtīkli until the end of July 2007.²⁷² On 10 September 2007 Latvijas Gāze sent the Rēzekne City Council and Rēzeknes Siltumtīkli a second warning.²⁷³ On 11 September 2007 the Rēzekne City Council asked Latvijas Gāze not to interrupt supplies of natural gas.²⁷⁴
248. On 11 September 2007 Latvijas Gāze stopped its natural gas supply just before the beginning of the heating season.
249. In its letter to the Rēzekne City Council and Rēzeknes Siltumtīkli dated 14 September 2007 Latvijas Gāze stated that the City Council had not paid for the natural gas received in July 2007 in full and the City Council's request to maintain supplies had been rejected by its Board; the amount claimed by Latvijas Gāze was of approx. LVL 148,000 plus an advance payment of LVL 400,000 for October 2007 and interest on delayed payment, to be calculated.²⁷⁵
250. As a consequence of the interruption in the supply of natural gas, Latgales Enerģija had to switch back to its reserves of heavy fuel oil, which it did, in order to provide heating and hot water.²⁷⁶
251. On 13 September 2007 the Mayor of Rēzekne gave an interview that was published on 15 September 2007 in the local paper *Rēzeknes Vēstis*.²⁷⁷ In his answer to the question put to him²⁷⁸ the Mayor reportedly answered as follows:

First of all I want to reassure residents and to confirm that supply of hot water and heating would be provided.

And now I will explain how this difficult situation occurred. Everybody knows that the lease agreement with company Latgales enerģija is disadvantageous for

²⁷² This communication is mentioned in C-132, but is not itself in evidence.

²⁷³ C-132.

²⁷⁴ The letter is not in evidence, but is referred to in R-32.

²⁷⁵ R-32.

²⁷⁶ CWS-1 ¶ 93 and Transcript, Day 2, 68/15-24. See also Latgales Enerģija's letter to the Regulator dated 30 October 2007, C-153 ¶ 13.

²⁷⁷ C-134.

²⁷⁸ The question put to the Mayor was: "Gas supply stopped in Rēzekne. The problem with the heat supply has again run into a dead end... What should Rēzekne residents expect, how does the council intends [sic] to solve the problem?"

the city. The same can be said about the agreement with Latvijas Gāze. The agreement on gas supply has been concluded among AS Latvijas Gāze, AS Rēzeknes siltumtīkli and Rēzekne Council, instead of concluding directly with the producer of thermal energy. Latvijas Gāze issues an invoice for gas consumption to Rēzeknes siltumtīkli, and the latter, in its turn, issues an analogous invoice to Latgales enerģija that serves as the final link in the chain of payments for gas. After all, this company uses gas and receives payment from the heat consumers. However, if a single santims remains unpaid for the consumed gas, the council bears the liability, as the municipality is the guarantor for payments under the agreement with Latvijas Gāze. So far, Rēzeknes siltumtīkli prevented occurrence of debts. However, two months ago, when the Regulator rejected a project to increase the thermal energy tariffs (considering them to be unreasonably high), Latgales enerģija begun to pay only a part of the accrued amount, that is, failed to pay the difference between the current rate and the increased rate they desired, which was rejected by the Regulator. Thus, a debt of LVL 29,164 occurred.

Latgales enerģija took the following position: you, the council, hinder and cause obstacles for the Regulator to increase the tariffs.

We would like to note that the council does not determine and does not influence the tariffs, this is in the power of the Regulator, not the council. Apparently, Latgales enerģija is thus trying to impose a pressure on the Regulator...

The City Council can easily pay the debt to Latvijas Gāze. The debt amount is small. The best variant how to do it is by amending the budget in the end of the year to transfer this money to Rēzeknes siltumtīkli increasing its share capital, thereafter these funds would cover the debt. Therefore we addressed the management of Latvijas Gāze with a request to extend the payment term of the invoice for the gas until 1 January 2008. This issue will be discussed at a board meeting of AS Latvijas Gāze on Friday (14 September).

Of course, we are interested in a direct agreement between Latvijas Gāze and the operator, heating company. However, with regard to Latgales enerģija, Latvijas Gāze has a categorical position: there will be no direct agreement with this company...

The situation reached a critical point. This cannot go any further. Therefore, last week the board of AS Rēzeknes siltumtīkli made a decision to instruct board member Aldis Mežals to hire a law office from Riga to draft documents that are required to bring a claim to court against SIA Latgales enerģija.

On 14 September, a claim will be brought to the administrative court to collect the debt from Latgales enerģija at three positions: for the continued delay in payment of depreciation to akciju sabiedrība Rēzeknes siltumtīkli (in the amount of 75 thousand lats); for the failure under the agreement to take over the debt of Rēzeknes siltumtīkli, in the amount of one million lats; for failure to pay the invoices of Latvijas Gāze for the consumed gas.

I will explain that as of the beginning of operations Latgales enerģija did not pay a santims for depreciation (however, according to law, deductions should be done annually). In relation to taking over the debt of Rēzeknes Siltumtīkli, Latgales enerģija did not take it over, it assigned the debt (that is, did not take over the debt itself, but the right of claim, to collect the debt); as a result, this million lats was distributed across the entire remaining lease term and counted in the rent payment.

Therefore, company Rēzeknes siltumtīkli faced limited cash income that would allow the payment.

What will be our further steps? Tomorrow (14 September), six companies that provide heating in Latvia will receive letters with a description and analysis of the situation with the heating supply in Rēzekne and an offer to take up provision of heating in our city. I am sure, there will be persons who would want to take this up. Then we will announce a tender and choose a company that would meet our requirements. The main and mandatory condition would be: conclusion of a direct agreement between Latvijas Gāze and the operator; also requirements that the tariff of the heating in Rēzekne would not exceed 30 lats for five years.

I can tell that the future of Latgales enerģija in our city will be decided on 25 September. By this date, the regular payment for the gas should be paid, and in case Latgales enerģija fails to pay it, then I would bring a question to deputies regarding termination of the agreement with this company. In case the payment is made, then the question of gas payment is removed, and we sit down at the table of negotiations to discuss issues of heating supply in the city.

In conclusion I would like to address the residents of our city: don't panic. There will be no interruption in supply of hot water and heating. I can ensure that much has been done to solve the problem, but it has not been publicly advertised. For three months, I have been negotiating with several companies persuading them that Rēzekne has a future. And I can guarantee that in case of necessity a new company, large, serious and reliable, would appear here. Previously we did not have alternatives. Now we have them.

252. On 19 September 2007 Latgales Enerģija wrote to the Mayor with reference to the interview published in *Rēzeknes Vēstis*, asking whether it was accurate that a letter had been, or would be, sent to six Latvian heat supply companies with a proposal to supply thermal energy in Rēzekne, and whether in such case Latgales Enerģija would be able to take part in the competition.²⁷⁹ No answer to that letter is in evidence.
253. On 20 September 2007 the differences of opinion between Rēzeknes Siltumtīkli and Latgales Enerģija regarding the time when payment of depreciation was owed by Latgales Enerģija (see paragraphs 193 ff. above) suddenly came to a head. Rēzeknes Siltumtīkli sued Latgales Enerģija in the Latgale Regional Court seeking *inter alia* payment of certain amounts (see paragraph 302 below). Rēzeknes Siltumtīkli finally sought, and obtained, the attachment of Latgales Enerģija's funds held by banks and payments owed by any third parties.
254. The Claimant takes the view that the claims were spurious²⁸⁰ and the application for an attachment was calculated to prevent Latgales Enerģija's from using its bank account to make and receive payments and to disrupt Latgales Enerģija's business

²⁷⁹ C-136.

²⁸⁰ Cl. Mem. ¶¶ 155;157.

operations and create further difficulties in order for stable and uninterrupted heating to be provided just before the heating season began.²⁸¹

255. On 21 September 2007 the Latgale Regional Court granted the attachment sought to secure the claimant's claims for an amount up to LVL 880,354.02 with immediate effect.²⁸²
256. Latgales Enerģija's operations were almost completely halted by the attachment.²⁸³
257. In the week of 24 September 2007²⁸⁴ the Board of Education of the Rēzekne City Council made a request in writing to Latgales Enerģija in order that the schools and nursery schools in the city should be heated. The Social Care Directorate made a similar request in relation to the Social Care Centre for the Retired.²⁸⁵
258. On 28 September 2007 the Rēzekne City Council decided to establish SIA Rēzeknes Enerģija ("Rēzeknes Enerģija") as a Municipality-owned company according to www.rezekne.lv.²⁸⁶ The Respondent has neither denied this piece of information nor disproved it by documentary evidence filed in rebuttal.
259. On 1 October 2007 www.rezekne.lv reported that there was no heating in two secondary schools and three nursery schools of the Rēzekne Northern District.²⁸⁷ On the same day the Board of Education of the Rēzekne City Council sent the Regulator a statement complaining of the current heating problems.²⁸⁸ Latgales Enerģija has

²⁸¹ Cl. Mem. ¶¶ 160-161; 178.

²⁸² [C-138](#) [page 3].

²⁸³ [CWS-1](#) ¶ 95; [CWS-3](#) ¶ 38.

²⁸⁴ The Claimant alleges that the request in order for heating to be started was made on 1 October 2007 and the Municipality Educational Department complained to the Regulator on the same day (Cl. Mem. ¶¶ 150-151). However, the exhibit relied upon by the Claimant ([C-142](#)) indicates that the request in order for heating to be started was made in the preceding week which started on Monday 24 September 2007.

²⁸⁵ [C-142](#).

²⁸⁶ [C-142](#).

²⁸⁷ [C-142](#).

²⁸⁸ [C-22](#) [page 5] ¶ 6.

admitted that the supply of heating services was interrupted in the city of Rēzekne, especially in the northern district.²⁸⁹

260. On 2 October 2007 Rēzeknes Enerģija was incorporated by the Rēzekne City Council with a paid-in capital of LVL 2,000, subsequently increased to LVL 4,002,000 on 30 October 2007 relying on a loan from the Treasury (see paragraphs 261 and 271 below).²⁹⁰
261. On 3 October 2007 the Local Government Loan and Guarantee Control and Monitoring Council approved the decision by the Rēzekne City Council to apply for a loan from the Treasury for an amount of LVL 4 million to invest in the share capital of Rēzeknes Enerģija.²⁹¹ On 4 October 2007 the Rēzekne City Council applied to the Treasury for such loan.²⁹² On 9 October 2007 the Rēzekne City Council decided to pay an amount of LVL 4 million for Rēzeknes Enerģija's capital increase.²⁹³
262. On 4 October 2007 the Regulator sent Latgales Enerģija a warning²⁹⁴ stating that the licences were at risk of being revoked, but not before 4 January 2008.²⁹⁵ Latgales Enerģija was requested to submit explanations to the Regulator by 7 November 2007 on the breaches of the conditions of the licences mentioned in the warning;²⁹⁶ Latgales Enerģija answered the Regulator's warning on 30 October 2007.²⁹⁷

²⁸⁹ See the Claimant's Notice of Dispute, C-3 ¶ 31.4; see also the statement of Latgales Enerģija's representative Mr. Meļņikovs before the Energy Crisis Committee, C-146 [page 1] and, finally, Latgales Enerģija's answer to the Regulator's warning, C-153 ¶¶ 12-13, where the period specified by Latgales Enerģija goes from 11 September 2007 to 17 October 2007.

²⁹⁰ C-206 [page 3].

²⁹¹ R-20 [page 8].

²⁹² R-20 [page 9].

²⁹³ R-20 [page 1].

²⁹⁴ The full title of this decision is "Warning on invalidation of licences No 002-05 for production of thermal energy, No 003-05 transfer and distribution of thermal energy, No 004-05 sale of thermal energy issued to SIA 'Latgales Enerģija'".

²⁹⁵ C-22 [page 6]; see more in detail at paragraph 989 below.

²⁹⁶ C-22 [page 6].

²⁹⁷ C-153, see paragraph 297 below.

263. On 8 October 2007 the Board of Directors of the Latvian Public Utilities Commission met. According to the account made by the Mayor of Rēzekne the Commission determined that an emergency situation was to be announced.²⁹⁸
264. On 9 October 2007 the Rēzekne City Council made a unanimous decision declaring that there was an energy crisis in the city of Rēzekne and to establish an “energy crisis centre” (the “Energy Crisis Committee”).²⁹⁹
265. Latgales Enerģija was not heard or consulted before that decision was made.³⁰⁰
266. On the same day the Rēzekne City Council notified Latgales Enerģija of its decision and informed Latgales Enerģija that a meeting of the Energy Crisis Committee would take place at 5:00 *p.m.* that day, asking that a Latgales Enerģija representative attend.³⁰¹ Latgales Enerģija acknowledged receipt of that decision on 9 October 2007.³⁰²

In the same letter the Rēzekne City Council asked Latgales Enerģija to supply heating and hot water in the city within 24 hours, schools and nursery schools to be given priority.

(4) THE ENERGY CRISIS IN RĒZEKNE (FROM 9 OCTOBER 2007 ONWARDS)

267. After the Rēzekne City Council declared the existence of an energy crisis in Rēzekne on 9 October 2007, there was an acceleration of events in October 2007 as follows:

²⁹⁸ C-145 [page 2].

²⁹⁹ Decision No. 388, C-24.

The Committee was chaired and managed by the Mayor, Mr. Vjaksē, and further included Mr. G. Spradzenko (Member of RCC), Mr. E. Škinčs (Member of the Board of Rēzeknes Namsaimnieks [the largest of the four companies that were entrusted with the management of the housing facilities of the Rēzekne Municipality, C-213 p. 12]); Mr. A. Mežals (Member of the Board of Rēzeknes Siltumtīkli); Mr. I. Locis (Deputy Executive Director of the Council) and Ms. V. Vekšina (Manager of the Financial Department of RCC).

³⁰⁰ Mr. Strioga first Witness Statement, CWS-1 ¶ 98.

³⁰¹ C-144.

³⁰² C-144.

The Claimant’s allegation that Latgales Enerģija read the announcement of the energy crisis in the press because it was not notified the decision (Cl.Mem. ¶ 189; see also Mr. Voronovs’ first Witness Statement, CWS-5 ¶ 11) is therefore inaccurate.

- (i) on 9 October 2007 the members of the Energy Crisis Committee met for the first time (see paragraph 268 below);
- (ii) on 10 October 2007 Latgales Enerģija was requested again to supply heating within 24 hours to six schools and nursery schools in the Rēzekne Northern District (see paragraph 269 below);
- (iii) on 11 October 2015 Latgales Enerģija's zone was taken over by the Regulator's decision of that day (see paragraph 274 below);
- (iv) on 11 October 2007 the members of the Energy Crisis Committee met for the second time (see paragraph 272 below);
- (v) on 12 October 2007 Rēzeknes Enerģija was appointed by decision of the Rēzekne City Council as the person in charge of providing thermal energy in Rēzekne (see paragraph 275 below);
- (vi) on 13 October 2007 the members of the Energy Crisis Committee met for the third time in an enlarged meeting (see paragraph 276 below);
- (vii) on 15 October 2007 the Rēzekne City Council ordered the Municipal Police to guard the boiler houses (see paragraph 280 below);
- (viii) on 17 October 2007 Latvijas Gāze resumed the supplies of natural gas and entered into a gas supply agreement with Rēzeknes Enerģija (see paragraphs 281 and 283 below);
- (ix) on 17 October 2007 the Latgale Regional Court lifted the attachment of Latgales Enerģija's funds (see paragraph 282 below);
- (x) on 25 October 2007 Latgales Enerģija, UAB E Enerģija, Rēzeknes Siltumtīkli, the Rēzekne City Council and Rēzeknes Enerģija made an agreement setting out the action to be taken promptly by the contracting parties in order to deal with the current problems (see paragraph 286 below);
- (xi) on 26 October 2007 Rēzeknes Siltumtīkli appealed against the decision lifting the attachment (see paragraph 290 below); and

- (xii) on 30 October 2007 Latgales Enerģija answered the Regulator's warning of 5 October 2007 (see paragraph 297 below).

These events will be recalled in some detail in the following sub-sections.

(A) TOWARDS THE REGULATOR'S DECISION TAKING OVER LATGALES ENERĢIJA'S ZONE (11 OCTOBER 2007)

268. The first meeting of the Energy Crisis Committee took place on 9 October 2007.³⁰³ The meeting ended with the Mayor proposing to send Latgales Enerģija a request in writing to supply heating to the six schools and nursery schools within 24 hours as of receipt of the letter and to inform the Regulator and a number of Ministries of the decision made.
269. The request that heating be provided within 24 hours was confirmed by the Mayor in a letter dated 10 October 2007.³⁰⁴
270. On 10 October 2007 the Rēzekne City Council submitted an application to the Regulator; that application is not in evidence, but it is mentioned in the Regulator's decision No. 26 dated 11 October 2007.³⁰⁵
271. In the meantime, on 10 October 2007 the Rēzekne City Council had signed the Loan Agreement with the Treasury of the Republic of Latvia (the "Latvian Treasury Loan Agreement") which it had entered into in order to fund the increase in the share capital of Rēzeknes Enerģija (see paragraph 261 above).³⁰⁶
272. The next meeting of the Energy Crisis Committee took place on 11 October 2007.³⁰⁷ The meeting ended with a decision to apply to the Latvian Public Utilities Commission. Asked by the Mayor to comment on the situation, Mr. Meļņikovs stated that the northern boiler was not running at all, Latgales Enerģija was seeking to buy fuel without using funds and to have its bank account unblocked.

³⁰³ C-145 [page 2].

³⁰⁴ C-145 [page 1].

³⁰⁵ C-23 [pages 9 ff.].

³⁰⁶ R-20 [pages 2 ff.].

³⁰⁷ C-146.

273. On 11 October 2007 the Rēzekne City Council submitted an application to the Regulator, which is not in evidence, but is mentioned in the Regulator's decision No. 26 dated 11 October 2007.³⁰⁸
274. On 11 October 2007 the Regulator decided to take over Latgales Enerģija's zone forthwith.³⁰⁹ On 31 March 2010 Latgales Enerģija's application to have that decision set aside was dismissed by the Administrative Regional Court, then it was dismissed anew on 24 November 2011.³¹⁰
- (B) THE APPOINTMENT OF RĒZEKNES ENERĢIJA AS THE PERSON RESPONSIBLE TO PROVIDE HEATING SERVICES IN RĒZEKNE (12 OCTOBER 2007)
275. On 12 October 2007 the Rēzekne City Council appointed Rēzeknes Enerģija "as the person in charge of provision of thermal energy in in the administrative territory of Rēzekne".³¹¹
276. The third meeting of the Energy Crisis Committee took place on 13 October 2007 and lasted five hours and fifteen minutes.³¹² The meeting ended with the decision to execute the Council's decision of the previous day to delegate the task to provide heating to the Municipality to Rēzeknes Enerģija.³¹³
277. After summarizing recent events the Mayor presented two options; the minutes of the meeting do not reflect the discussion on those two options clearly,³¹⁴ but those options

³⁰⁸ C-23 [page 10].

³⁰⁹ C-23 [pages 9 ff.].

³¹⁰ R-3, see paragraph 402 below.

³¹¹ C-25. The decision is stated to be based on Sect. 15(1)(1) of the Municipalities Act (CLA-46) and Sect. 28(2) of the Public Utility Regulators Act (CLA-49).

³¹² The minutes are exhibited as C-147; in addition, an audio recording was made which is not in evidence.

The Centre was chaired and managed by the Mayor Mr. Vjaksē and further included Mr. G. Spradzenko, Ms. M. Muceniece, Mr. I. Klimanovs, Mr. M. Bartaševičs, Mr. E. Jurkāns, Ms. D. Abramova, Mr. V. Nikonovs, Mr. A. Pušņakovs (Councillors of Rēzekne City Council); Mr. I. Locis (Deputy Executive Director of the Rēzekne City Council); Ms. V. Vekšina (Head of the Financial Department of Rēzekne City Council); Mr. A. Patmalnieks (Head of the Legal Department of the Rēzekne City Council, joining at 3:00 p.m.); Ms. S. Baltace (Adviser to the Mayor); Ms. D. Zirniņa (Head of the Public Relations Department of the Rēzekne City Council). In addition, the meeting was attended by Mr. Strioga (E energija), Messrs L. Voronovs, I. Bērziņš, S. Meļņikovs (Latgales Enerģija), Mr. E. Škinčs (Member of the Board of Rēzeknes Enerģija); Mr. A. Mežals (Member of the Board of Rēzeknes Siltumtīkli).

³¹³ C-147 ¶ 16.

³¹⁴ C-147.

are clearly outlined in a document prepared by the Mayor.³¹⁵ At the hearing, only the Claimant brought witnesses to testify on what was said at that meeting.³¹⁶

278. According to Option No. 1, Latgales Enerģija's activity would be limited to the production of thermal energy; Rēzeknes Enerģija would be in charge of the transmission and distribution, as well as the sale of thermal energy. According to Option No. 2, Rēzeknes Enerģija would take over production, transmission and distribution as well as the sale of thermal energy and Latgales Enerģija would drop out of the picture altogether, save for any legal proceedings which it might bring, as such an event was expressly identified as a risk.³¹⁷
279. Both options thus excluded that Latgales Enerģija would keep the position that had been agreed upon under the agreements made with the Rēzekne City Council on the one hand (see paragraphs 100 ff. and 169 ff. above), and Rēzeknes Siltumtīkli on the other (see paragraphs 78 ff. and 166 ff. above).
280. On 15 October 2007 the Rēzekne City Council ordered the Municipal Police to guard the property of Rēzeknes Siltumtīkli in the three boiler houses.³¹⁸ This was the Municipality's reaction to an apparent belief that Latgales Enerģija had brought in private security to protect the premises, a point that was briefly discussed in the 13 October 2007 Energy Crisis Committee meeting.³¹⁹
281. On 17 October 2007 Latvijas Gāze resumed the supplies of natural gas.³²⁰
282. On 17 October 2007 the Latgale Regional Court revoked its previous decision of 21 September 2007³²¹ granting an attachment on Latgales Enerģija's assets (for more details see paragraph 305 below).³²²

³¹⁵ C-148.

³¹⁶ See in particular CWS-1 ¶¶ 102-104.

³¹⁷ C-148.

³¹⁸ C-149.

³¹⁹ C-147 ¶ 5.

³²⁰ C-153 ¶ 12.

³²¹ C-138, see paragraph 255 above.

³²² C-150.

(C) THE RĒZEKNES ENERĢIJA GAS SUPPLY AGREEMENT (17 OCTOBER 2007)

283. On 17 October 2007 Latgales Enerģija (as “the User”) entered into a gas supply agreement with Rēzeknes Enerģija (as “the Supplier”) (the “Rēzeknes Enerģija Gas Supply Agreement”).³²³
284. Clauses 2.2 and 4.2 of the Rēzeknes Enerģija Gas Supply Agreement provide that Latgales Enerģija has a duty to pay the invoices for actual consumption of natural gas issued by Rēzeknes Enerģija.

(D) THE OCTOBER 2007 AGREEMENT (25 OCTOBER 2007)

285. On 23 October 2007 a meeting took place which paved the way for the execution of a contract two days later.³²⁴
286. On 25 October 2007 an agreement was made between Latgales Enerģija, UAB E Enerģija, Rēzeknes Siltumtīkli, the Rēzekne City Council and Rēzeknes Enerģija (the “October 2007 Agreement”).³²⁵ The October 2007 Agreement contemplated the actions to be taken by each party, subdivided into three distinct stages as follows:
- (i) Stage I, covering the period from 25 October to 28 October 2007;
 - (ii) Stage II, covering the period from 25 October to 30 November 2007; and
 - (iii) Stage III, covering the period until 30 May 2008.
287. Stage I (Clauses (a) to (e)) in essence contemplated five points as follows:
- (a) the parties undertook to take all necessary actions in relation to bailiffs in order to remove the attachment of Latgales Enerģija’s accounts in the shortest possible time to ensure free flow of funds; Rēzeknes Siltumtīkli was entitled to challenge the court decisions only in order to have the attachment removed; the parties would then reach a settlement by 30 May 2008 on the claim brought by

³²³ C-151.

³²⁴ See CWS-1 ¶ 105 and Transcript, Day 2, 75-76 [Strioga].

³²⁵ C-26.

Rēzeknes Siltumtīkli; no new proceedings would be brought and no new claims would be made within the proceedings currently pending;

(b) Latgales Enerģija undertook to grant discounts to users as from the date when the Regulator would approve new rates;

(c) Latgales Enerģija would submit its calculations relating to a new rate to the Rēzekne City Council ten days before submitting them to the Regulator (see paragraph 291 below);

(d) the parties undertook to sign a statement of acceptance and delivery upon the installation and commissioning of a Witomax boiler at Atbrīvošanas alejā 155a; and

(e) Rēzeknes Siltumtīkli would give approval by 15 November 2007 in order for a sub-lease agreement to be signed with SIA “LE Remonts” (“LE Remonts”) and with SIA LE Koģenerācija (“LE Koģenerācija”) and would issue the documents required in order for an application for the installation, commissioning and operation of a cogeneration plant to be submitted to AS Latvenergo.

288. Stage II (Clauses (f) to (i)) in essence contemplated four further points as follows:

(f) Rēzeknes Siltumtīkli would agree with E energija and Latgales Enerģija on certain annotations to be cancelled in the Land Registry in relation to Rēzeknes Siltumtīkli’s assets; a separate agreement was concluded between the Claimant and Rēzeknes Siltumtīkli on 25 October 2007 to this effect;³²⁶

(g) the parties would prepare and submit to each other a list of complaints relating to the Long-Term Agreement (see also paragraph 294 below);

(h) the parties undertook to refrain from public announcements and complaints unless previous agreement had been reached in that respect; and

(i) Rēzeknes Enerģija undertook to supply natural gas to Latgales Enerģija in accordance with the Rēzeknes Enerģija Gas Supply Agreement; Rēzeknes Enerģija

³²⁶ R-33.

The Respondent contends that the purpose and the effect of this agreement goes far beyond what is contemplated by the October 2007 Agreement, see paragraph 1125 below.

and Latgales Enerģija would agree on a more detailed agreement within one month as of the conclusion of the October 2007 Agreement.³²⁷

289. Finally, Stage III (Clauses (j) to (k)) in essence contemplated two points as follows:

(j) Rēzeknes Siltumtīkli undertook to submit proposed amendments for the revision of the Long-Term Agreement by 29 February 2008; and

(k) Latgales Enerģija would submit its own suggestions and objections in relation to the proposed amendments submitted by Rēzeknes Siltumtīkli by 25 March 2008, which the parties would start to review within 15 days; the parties would coordinate their amendments to the Long-term Agreement by 30 May 2008.

290. On 26 October 2007 however, Rēzeknes Siltumtīkli filed an ancillary complaint against the Latgale Regional Court's judgment of 17 October 2007 that had revoked the attachment on Latgales Enerģija's assets^{328, 329}. As a consequence, Latgales Enerģija's bank account remained frozen. That was a breach of the October 2007 Agreement on the part of Rēzeknes Siltumtīkli and the Municipality (see more in detail paragraphs 964-967 below).

291. On 5 November 2007 Latgales Enerģija offered the Rēzekne City Council reduced rates (see paragraph 238 above).³³⁰ The reason for which Latgales Enerģija proposed reduced rates to the Rēzekne City Council rather than the Regulator lies in paragraph (c) of the October 2007 Agreement (C-26, see also paragraph 287 above), in spite of the fact that the letter does not expressly refer to the October 2007 Agreement.³³¹

292. On 7 November 2007 Latgales Enerģija wrote to the Rēzekne City Council, Rēzeknes Siltumtīkli and Rēzeknes Enerģija with respect to the performance of their obligations under the October 2007 Agreement, pointing out that funds in its bank account were still frozen by the attachment, requesting explanations as to the reasons why the

³²⁷ Clause 8.1 (in handwriting after the signature page) of the Rēzeknes Enerģija Gas Supply Agreement (C-151) seems to indicate that the parties did not have sufficient time to work out all contract terms properly.

³²⁸ C-150, see paragraph 282 above and paragraph 306 below.

³²⁹ C-152.

³³⁰ C-154.

³³¹ See also CWS-3 ¶ 26.

provisions of the October 2007 Agreement had not been complied with and expressing its concerns that it would not otherwise be able to perform its own obligations under the October 2007 Agreement.³³²

There is no answer to that letter on the record, either by the Rēzekne City Council, Rēzeknes Siltumtīkli or Rēzeknes Enerģija.

293. On 29 November 2007 Latgales Enerģija informed the Regulator that it might be unable to provide heat services.³³³ On 7 December 2007 the Regulator asked whether Latgales Enerģija's statements should be understood as an application in order for the Regulator to revoke Latgales Enerģija's licences.³³⁴ On 12 December 2007 Latgales Enerģija answered that its 29 November letter was sent simply to inform the Regulator of the existing difficulties.³³⁵
294. On 30 November 2007 Latgales Enerģija sent the Rēzekne City Council and Rēzeknes Siltumtīkli the list of its claims in relation to the Long-Term Agreement in accordance with Clause (g) of the October 2007 Agreement.³³⁶ The list included claims against the Rēzekne City Council³³⁷ and claims against Rēzeknes Siltumtīkli.³³⁸

³³² C-155.

³³³ C-158.

³³⁴ C-161.

³³⁵ C-163.

³³⁶ C-157.

³³⁷ Latgales Enerģija presented four claims against the Rēzekne City Council:

- (i) a claim for compensation of losses in an amount of LVL 138,069.24 arising from the lower rates applied by Latgales Enerģija from 1 February to 1 October 2006 in spite of the fact that the Rēzekne City Council had not approved the heat supply development plan by 28 February 2006 as contemplated by the February 2006 Agreement (C-157 ¶ 1.1);
- (ii) a claim for compensation of losses in the period from 11 September to 17 October 2007 due to the need to use more expensive fuels and more expensive electricity to provide heating (C-157 ¶ 1.2);
- (iii) a claim in order that the Rēzekne City Council sign the acceptance, delivery and commissioning documents relating to the Witomax boiler (C-157 ¶ 1.3); and
- (iv) a claim for compensation of the legal costs incurred in the administrative proceedings (C-157 ¶ 1.4).

³³⁸ Latgales Enerģija presented four claims against Rēzeknes Siltumtīkli:

- (i) a claim for the compensation of the losses incurred due to Rēzeknes Siltumtīkli's failure to comply with the October 2007 Agreement with respect to the revocation of the attachment of Latgales Enerģija's bank account (C-157 ¶ 2.1);

On 30 November 2007 Latgales Enerģija wrote to Rēzeknes Enerģija that it was under no obligation for the time being to pay for the natural gas supplied since its bank account had been attached and the Rēzekne City Council, Rēzeknes Enerģija and Rēzeknes Siltumtīkli were in breach of their contractual duties under the October 2007 Agreement,³³⁹ in particular with respect to the duty to lift the attachment. Reliance was placed by Latgales Enerģija on Article 1591 of the Latvian Civil Code.³⁴⁰

The letter is not in evidence; it was referred to in Rēzeknes Enerģija's statement of claim before the Riga Regional Court³⁴¹ and the judgment made by the same court on 2 March 2010.³⁴²

No answer to those letters is in evidence either on the part of Rēzeknes Enerģija.

Rēzeknes Enerģija's position in this respect is summarised in the judgment by the Riga Regional Court dated 2 March 2010.³⁴³ Rēzeknes Enerģija took the view that the sole provision of the 2007 October Agreement which gave rise to a contractual duty binding on it was Clause 1, Stage II (i)³⁴⁴ with which Rēzeknes Enerģija had complied; Latgales Enerģija was not entitled to rely on the alleged breach of contract of other contracting parties to withhold performance of a duty owed to Rēzeknes Enerģija.

295. On 10 December 2007 the Rēzekne City Council replied to Latgales Enerģija's letter dated 30 November 2007 pointing out that on 28 February 2006 "the Council did not have any document that could have been approved" as Latgales Enerģija had sent the

-
- (ii) a claim to obtain Rēzeknes Siltumtīkli's permission in order for Latgales Enerģija to enter into a sub-lease agreement with RE Remont and LE Koģenerācija with respect to the cogeneration plant (C-157 ¶ 2.2);
 - (iii) a claim for compensation of the legal costs incurred in connection with the proceedings brought by Rēzeknes Siltumtīkli on 20 September 2007 (C-157 ¶ 2.3); and
 - (iv) a claim for the payment of interest on a loan (C-157 ¶ 2.4).

³³⁹ C-26.

³⁴⁰ CLA-55, *exceptio non adimpleti contractus*.

³⁴¹ C-225 [page 2].

³⁴² C-239 [page 2]; see also paragraph 382 below.

³⁴³ C-239 [page 4].

³⁴⁴ C-239 [page 4], erroneously mentions Clause I, Stage II,(g) in the English translation; the original Latvian refers to Clause I, Stage II,(i) of the October 2007 Agreement (C-26).

Council its proposed guidelines only on 19 December 2006 and that “[u]pon such conditions” the Council began to hold meetings of the Working Group for the development of the strategic plan.³⁴⁵

296. In a letter to Rēzeknes Siltumtīkli dated 27 December 2007 Latgales Enerģija pointed out that Rēzeknes Siltumtīkli had failed to comply with its obligations under the October 2007 Agreement by filing its complaint against the decision of the Latgale Regional court on 26 October 2007 (see paragraph 290 above and paragraph 306 below). Latgales Enerģija asked Rēzeknes Siltumtīkli to tell the court at the hearing scheduled to take place on 3 January 2008 that it did not maintain its complaint as far as the revocation of the attachment of Latgales Enerģija’s bank account was concerned.³⁴⁶

(E) LATGALES ENERĢIJA’S ANSWER TO THE REGULATOR’S WARNING (4 OCTOBER 2007)

297. On 30 October 2007 Latgales Enerģija answered the Regulator’s warning dated 4 October 2007³⁴⁷ explaining the situation and applying for a discharge of the warning (see more in detail at paragraph 990 below).³⁴⁸

(F) THE 2007 ASSIGNMENT AGREEMENT (4 DECEMBER 2007)

298. On 4 December 2007 Latgales Enerģija assigned its claims for payment for heating and hot water supplied to Rēzekne residents to LE Remonts (the “2007 Assignment Agreement”),³⁴⁹ one of the Claimant’s wholly-owned subsidiaries according to the Claimant.³⁵⁰ The assignment related to an amount of LVL 379,480.94 owed to Latgales Enerģija for heating and hot water supplied to Rēzekne residents in the period from 1 to 20 November 2007.

The purpose of such assignment was to enable Latgales Enerģija to continue to operate and supply heat despite the attachment affecting its bank account.

³⁴⁵ R-29 [page 18].

³⁴⁶ C-156 [page 7].

³⁴⁷ C-22, see paragraph 262 above.

³⁴⁸ C-153.

³⁴⁹ C-159.

³⁵⁰ Cl. Mem. ¶ 197.

299. On 11 December 2007 the Regulator took the view that Latgales Enerģija was in breach of the conditions of the licence and the applicable law and requested Latgales Enerģija to explain the situation.³⁵¹
300. On 19 December 2007 Latgales Enerģija answered the Regulator's letter denying any breach.³⁵²

(5) THE PROCEEDINGS BROUGHT BY RĒZEKNES SILTUMTĪKLI AGAINST LATGALES ENERĢIJA (20 SEPTEMBER 2007) AND THE ATTACHMENT OF LATGALES ENERĢIJA'S BANK ACCOUNT (21 SEPTEMBER 2007)

301. Differences of opinion between Rēzeknes Siltumtīkli and Latgales Enerģija regarding the time when payment of depreciation was owed by Latgales Enerģija had emerged in 2006 as recalled in paragraphs 193 ff. above. In his interview given on 13 September 2007 the Mayor had referred to that dispute in some detail, indicating that Rēzeknes Siltumtīkli had instructed counsel from Riga the week before in order to sue Latgales Enerģija.³⁵³
302. On 20 September 2007 Rēzeknes Siltumtīkli brought an action against Latgales Enerģija before the Latgale Regional Court³⁵⁴ under the terms of the Long-Term Agreement³⁵⁵ seeking payment of the amounts of LVL 778,415.41 for the lease of the assets, LVL 72,774.20 for a contractual penalty and LVL 29,164.41 for an outstanding debt for gas delivered, in total LVL 880,354.02 and recovery against Latgales Enerģija.³⁵⁶

Rēzeknes Siltumtīkli further sought a declaration that the Long-Term Agreement was terminated as of the date of the judgment to be made and that Rēzeknes Siltumtīkli was entitled to recover the possession of the leased assets, as well as a declaration that Latgales Enerģija was bound to pay in full the invoices presented by Latvijas Gāze.

³⁵¹ C-162, see more in detail paragraph 993 below.

³⁵² C-166, see paragraph 994 below.

³⁵³ C-134, see paragraph 251 above.

³⁵⁴ The document instituting the proceedings is not in evidence, but its content is summarised in C-138 p. 2.

³⁵⁵ C-4.

³⁵⁶ C-138 [page 2].

Finally, Rēzeknes Siltumtīkli sought the attachment of Latgales Enerģija's assets and funds in cash held by banks and payments owed by any third parties.

303. On 21 September 2007 the Latgale Regional Court granted Rēzeknes Siltumtīkli's application and attached funds held in Latgales Enerģija's bank account, including debts owed by third parties to Latgales Enerģija, for an amount up to LVL 880,354.02, with immediate effect.³⁵⁷
304. On 5 October 2007 Latgales Enerģija applied to the Latgale Regional Court to have the attachment cancelled.³⁵⁸
305. On 17 October 2007 the Latgale Regional Court revoked its decision granting the attachment dated 21 September 2007, upheld Latgales Enerģija's jurisdictional objection and transferred the case to the Riga Regional Court on jurisdictional grounds.³⁵⁹
306. On 26 October 2007 Rēzeknes Siltumtīkli brought an ancillary complaint against the Latgale Regional Court's judgment of 17 October 2007 before the Supreme Court, asking the Supreme Court to set aside the judgment revoking the attachment of Latgales Enerģija.³⁶⁰

³⁵⁷ C-138 [page 3].

³⁵⁸ C-143.

The application sought a review of the attachment decision (C-138) as a matter of urgency on the basis that the heating season would start by the following week according to the previous practice, and Latgales Enerģija would increasingly need to use its money to purchase the fuel required for its operations; if the attachment was maintained for more than two weeks, the city of Rēzekne might be left without heating and hot water (C-143 ¶¶ 5-7). Latgales Enerģija raised an objection to the jurisdiction of the court relying on the fact that its registered office was in Riga, but asked nonetheless the Court to cancel the attachment decision as a matter of urgency (C-143 ¶¶ 16; 19-21; 54).

³⁵⁹ C-150 [page 3].

³⁶⁰ C-152.

Rēzeknes Siltumtīkli contended that the judgment by the Latgales Regional Court should be set aside and a decision should be made on the merits. It argued that the subject-matter of Rēzeknes Siltumtīkli's action was the possession of the leased facilities including the immovable property since Rēzeknes Siltumtīkli had sought the termination of the Long-Term Agreement. Rēzeknes Siltumtīkli further contended that the Latgales Regional Court had jurisdiction on the basis that the assets in dispute were in Rēzekne and that jurisdiction lay also with the courts of the place where damage to the property in dispute had been caused. The losses suffered by Rēzeknes Siltumtīkli could be caused by a breach of contract, not only by a tort as found by the Latgales Regional Court.

307. This complaint was filed one day after the October 2007 Agreement³⁶¹ was executed. The Claimant contends that this was a breach of the October 2007 Agreement by the Rēzekne City Council and Rēzeknes Siltumtīkli.³⁶²
308. As a result of that complaint, Latgales Enerģija's bank account remained blocked.³⁶³ The Supreme Court made its decision on 3 January 2008 upholding Rēzeknes Siltumtīkli's appeal, so that the attachment remained in force.³⁶⁴
309. The first decision on the merits was made by the Riga Regional Court on 9 July 2009.³⁶⁵

(6) THE PROCEEDINGS BROUGHT BY RĒZEKNES ENERĢIJA AGAINST LATGALES ENERĢIJA (27 DECEMBER 2007)

310. On 27 December 2007 Rēzeknes Enerģija brought an action against Latgales Enerģija in the Riga Regional Court seeking payment of an amount of LVL 810,819 plus interest, and post-judgment interest, for deliveries of natural gas made to, and accepted by, Latgales Enerģija.³⁶⁶ Rēzeknes Enerģija further sought the attachment of Latgales Enerģija's movable assets, an injunction restraining Latgales Enerģija from dealing in emission allowances and the registration of a prohibition in the greenhouse gas emission register with respect to Latgales Enerģija's allowances for 2008-2012.³⁶⁷ Rēzeknes Enerģija rested its claim on the Gas Supply Agreement entered into with Latgales Enerģija.³⁶⁸
311. Rēzeknes Enerģija supplemented and increased its claim in 2008 (see paragraph 368 below) and in 2009 (see paragraph 381 below).

³⁶¹ C-26, see paragraph 286 above.

³⁶² Cl. Mem. ¶ 180.

³⁶³ Cl. Mem. ¶ 181; CWS-4 ¶ 11.

³⁶⁴ CWS-4 ¶ 11; the decision is not in evidence.

³⁶⁵ C-194, see paragraph 386 below.

³⁶⁶ C-225 [page. 5].

³⁶⁷ C-225 [page 5].

³⁶⁸ C-151, see paragraph 283 above.

(7) SUPPLEMENTING CERTAIN ARRANGEMENTS MADE IN 2005 AND 2006 – NEW ARRANGEMENTS

(A) FURTHER LOANS BY E ENERGIJA TO LATGALES ENERĢIJA

312. On 21 January 2007 E energija amended the loan granted to Latgales Enerģija on 21 August 2006 by extending the date of reimbursement.³⁶⁹
313. On 16 October 2007 E energija granted a further loan to Latgales Enerģija in an amount of EUR 150,000.³⁷⁰ Then on 1 December 2007 E energija agreed to extend the date of reimbursement of this loan.³⁷¹
314. On 16 November 2007 E energija granted a further loan to Latgales Enerģija in an amount of LVL 100,000.³⁷²

(B) RESTRUCTURING OF E ENERGIJA'S LOANS TO LATGALES ENERĢIJA (24 AUGUST 2007)

315. At the end of September 2006 the amounts owed by Latgales Enerģija to the Claimant under various loans amounted to EUR 1,454,864 including interest.³⁷³ On 24 August 2007 the loan was restructured and was taken over by Sampo Banka.³⁷⁴ This arrangement lasted only a few months according to Mr. Jautakis' evidence, since the loan was transferred back from Sampo Banka to the Claimant in February 2008.³⁷⁵ The Claimant's allegations and the explanations contained in Mr. Jautakis' first Witness Statement were not challenged by the Respondent; Mr. Jautakis was not cross-examined at the Hearing.³⁷⁶

³⁶⁹ C-51 [page 59].

³⁷⁰ C-51 [page 61].

³⁷¹ C-51 [page 66].

³⁷² C-51 [page 68].

³⁷³ See also CWS-2 ¶ 17; C-119 [page 24] ¶ 24 (EUR 974,256 + EUR 434,481 + EUR 46,127 = EUR 1,454,864).

³⁷⁴ See CWS-2 ¶ 18.

³⁷⁵ See CWS-2 ¶ 19; see also paragraph 377 below.

³⁷⁶ Transcript, Day 2, 82/14.

(C) CONTRACTS BETWEEN THE CLAIMANT AND THE EUROPEAN BANK FOR
RECONSTRUCTION AND DEVELOPMENT (SEPTEMBER/DECEMBER 2007)

316. A Subscription Agreement was entered into by E energija and the European Bank for Reconstruction and Development (“the Subscription Agreement”) on 26 September 2007.³⁷⁷
317. The Claimant further relies on a Loan Agreement it concluded with the European Bank for Reconstruction and Development (“EBRD”) on 18 December 2007 (“the EBRD Loan Agreement”).³⁷⁸
318. Both exhibits contain an unsigned version of such agreements.³⁷⁹ It is not in dispute, however, that the Claimant concluded these agreements with the EBRD.³⁸⁰
319. According to Section 2.01 of the EBRD Loan Agreement, an amount of EUR 3.189 million was allocated for the Rēzekne Project.³⁸¹
320. The Claimant drew on the loan in 2008,³⁸² but admits that it did not draw on the loan in connection with the Rēzekne Project.³⁸³

(D) THE AGREEMENT BETWEEN THE CLAIMANT AND RĒZEKNES
SILTUMTĪKLI (25 OCTOBER 2007)

321. An agreement was entered into by the Claimant and Rēzeknes Siltumtīkli on 25 October 2007 pursuant to Clause (f) of the October 2007 Agreement^{384 385}.

³⁷⁷ C-139.

³⁷⁸ C-165; see also Cl. Mem. ¶ 80.

³⁷⁹ The Claimant does not indicate the date on which such agreements were signed (Cl. Mem. ¶ 80). In his first Witness Statement, Mr. Strioga indicates that the EBRD Loan Agreement was eventually signed in “December 2007” (CWS-1 ¶ 55).

³⁸⁰ In particular, the Respondent relies on the fact that the EBRD is one of the Claimant’s shareholders (see paragraph 471 below; Resp. Letter dated 5 October 2012 and Resp. Obj. J. & C-Mem. ¶ 4.7), which the Managing Director of the EBRD for Central and South Eastern Europe confirmed in his letter dated 22 April 2010 (C-240). See also CWS-2 ¶ 73; Mr. Jautakis gave evidence but was not cross-examined at the Hearing, see Transcript, Day 2, 82/14.

³⁸¹ C-165, for details and the breakdown of such amount in 2007 and 2008, see C-165 [page 72]: Exhibit F at F-3; see also CWS-2 ¶ 68.

³⁸² See CWS-1 ¶ 56; CWS-2 ¶ 74; see paragraph 374 below.

³⁸³ See paragraph 375 below.

³⁸⁴ C-26, see paragraphs 285 ff. above.

³⁸⁵ R-33.

322. The purpose of this agreement was to free Rēzeknes Siltumtīkli's property in the Land Register from the encumbrances then recorded for the benefit of the Claimant in consideration of payment by Rēzeknes Siltumtīkli of the debt owed to the Claimant (Clauses 1 and 2 of the October 2007 Agreement).
323. It is the Respondent's case that Clause 3 of this agreement contains a general waiver of "any commercial claim directly and indirectly (including, through its subsidiary Latgales Enerģija) against Rēzeknes Siltumtīkli".³⁸⁶

E. MAIN EVENTS IN 2008

(1) TOWARDS THE REVOCATION OF LATGALES ENERĢIJA'S LICENCES BY THE REGULATOR (3 JUNE 2008)

(A) THE DISPUTE AS TO THE APPLICABLE RATES

324. Latgales Enerģija in fact continued to provide heating despite the Regulator's decision taking over its zone and the appointment of Rēzeknes Enerģija as the person in charge of providing heating services (11/12 October 2007, see paragraphs 274 ff. above). After mid-December 2007 Latgales Enerģija had started to charge users in accordance with the revised tariff approved by the Regulator on 9 November 2007 as it took the view that the effects of the Regulator's decision of 7 December 2007 were stayed due to Latgales Enerģija's application for review (see paragraph 244 above).

In January 2008 the Rēzekne City Council wrote to users indicating (i) that the rate applicable was the tariff approved on 19 December 2005 (see paragraph 154 above) and (ii) that this was the sole rate which Latgales Enerģija was entitled to apply.³⁸⁷ The same information was provided in the press.³⁸⁸

325. There was widespread confusion in the public as to the applicable rates. The local newspaper echoed users' anger and frustration.³⁸⁹

³⁸⁶ Resp. P-H (PO8) ¶ 23; see the Tribunal's finding on this point in paragraphs 1130 ff. below.

³⁸⁷ C-184.2.

³⁸⁸ C-169.

³⁸⁹ C-170 and C-171.

In spite of the apparently neutral stance of the Rēzekne City Council (C-169), the press reported that the Council had stated "unofficially" that the rates applied by Latgales Enerģija were "illegal" (C-170), and

326. The Mayor himself received the inhabitants and answered question on the recalculation of rates according to the local newspaper.³⁹⁰ The Claimant alleged that the Municipality provided template letters for consumers to write to Latgales Enerģija refusing to pay Latgales Enerģija's invoices.³⁹¹ This allegation is based solely on Ms. Uškāne's Witness Statement;³⁹² however, the Claimant has not referred to or produced any specific templates or letters based on such templates. The Tribunal finds that the Claimant has failed to prove such allegation.
327. On 25 January 2008 Latgales Enerģija issued a press release answering the criticism to which it had been subjected in the press and elsewhere and recapitulated the difficulties in having new rates approved.³⁹³
328. On 31 March 2008 the Rēzekne City Council asked Latgales Enerģija to invoice the Rēzekne residents in accordance with the rates approved by the Regulator on 19 December 2005 (see paragraph 154 above) and to recalculate the invoices issued in the previous months.³⁹⁴ On 7 April 2008 Latgales Enerģija objected.³⁹⁵
- (B) THE WIDER DISPUTE BETWEEN LATGALES ENERĢIJA, THE RĒZEKNE CITY COUNCIL AND THE COMPANIES CONTROLLED BY THE COUNCIL
329. On 16 April 2008 Latgales Enerģija reminded the Mayor that Rēzeknes Siltumtīkli still had not granted the permit for the reconstruction of the Northern boiler house at Atbrīvošanas alejā 155a in accordance with the Heating Supply Development Strategy³⁹⁶ approved by the Rēzekne City Council on 21 September 2007.³⁹⁷ No answer to that letter is in evidence.

that the Mayor had told the press that the Council's Reception Centre would show users how to calculate the rates according to the December 2005 tariff (C-170).

³⁹⁰ C-171.

³⁹¹ Cl. Mem. ¶ 201.

³⁹² CWS-4 ¶ 24.

³⁹³ C-172.

Whereas it is Latgales Enerģija's case that it was entitled to rely on the rates approved by the Regulator on 9 November 2007, this exhibit states *inter alia* that "... the rate approved on 09.11.2007 has no legal effect or legal foundation". This does not seem to be a translation mistake.

³⁹⁴ C-174.

³⁹⁵ C-175.

³⁹⁶ C-213.

330. On 25 April 2008 Latgales Enerģija wrote again to the Mayor, copying in the Regulator, reiterating its request that the permit for the reconstruction be issued.³⁹⁸ No answer to that letter is in evidence.
331. On 6 May 2008 Latgales Enerģija asked Latvijas Gāze to issue technical specifications for gas supply in the Northern boiler.³⁹⁹ No answer to that letter is in evidence.
332. These reminders followed up earlier reminders sent to Rēzekne City Council⁴⁰⁰ and Rēzeknes Siltumtīkli⁴⁰¹ back in 2007. Whereas in 2007 the investment relating to the Northern boiler was hampered by the absence of a “heat supply development plan”, in 2008 the “Heating Supply Development Strategy”⁴⁰² had been in place for more than six months; yet the permit for the works had not been delivered.
333. On 15 May 2008 Rēzeknes Siltumtīkli wrote to the Regulator pointing out that Latgales Enerģija had failed to invest a minimum of EUR 1.5 million in the first three years in which the Long-Term Agreement⁴⁰³ had been in force in breach of Clause 7.1.1 of such agreement and complaining about the condition of the heating infrastructure.⁴⁰⁴
- Latgales Enerģija was not copied in on this letter.
334. On 19 May 2008 the Regulator wrote to the Rēzekne City Council that Latgales Enerģija had failed to comply with the conditions of the licences⁴⁰⁵ and that the

³⁹⁷ C-176.1. For the year 2008, out of a total investment of LVL 1.4 million, the Heating Supply Development Strategy allocated an investment of LVL 1.3 million to the boiler house at Atbrīvošanas alejā 155a (also known as the Northern boiler house), C-213 p. 23.

³⁹⁸ C-176.2.

³⁹⁹ C-176.4.

⁴⁰⁰ C-116, see paragraph 209 above.

⁴⁰¹ C-118 and C-129, see paragraph 210 above.

⁴⁰² C-213.

⁴⁰³ C-4.

⁴⁰⁴ C-231.

⁴⁰⁵ C-10; C-11; C-12.

licences could therefore be revoked as a consequence. The letter is not in evidence, but it is referred to in the Council's letter to Latgales Enerģija dated 20 May 2008.⁴⁰⁶

335. On 20 May 2008 the Rēzekne City Council wrote to Latgales Enerģija pointing out “several circumstances” which in its view called into question Latgales Enerģija’s ability to “solve issues concerning the heat supply”.⁴⁰⁷ The letter referred on the one hand to the Regulator’s letter of 19 May 2008 and the opinion expressed therein by the Regulator (see paragraphs 334 ff. above) and, on the other, to difficulties reported to the Council by Rēzeknes Siltumtīkli⁴⁰⁸ and Rēzeknes Enerģija.⁴⁰⁹

The letter stated that the Council did not wish to interfere with the process of heat production and distribution, and ended with an invitation to Latgales Enerģija to establish a constructive partnership with Rēzeknes Siltumtīkli and Rēzeknes Enerģija.

336. On 2 June 2008 Latgales Enerģija rejected the criticism expressed in the Council’s letter.⁴¹⁰

**(2) THE REVOCATION OF LATGALES ENERĢIJA’S LICENCES BY THE
REGULATOR (3 JUNE 2008)**

337. On 3 June 2008 the Regulator revoked Latgales Enerģija’s three licences to produce, transmit and sell thermal energy⁴¹¹ in its decision No. 10.⁴¹² The decision stated that it would come into force as of its adoption, that it should be enforced as a matter of urgency and that its enforceability would not be prevented in case an application for judicial review had been filed against it. The reasons for this decision are discussed in paragraph 996 below.

⁴⁰⁶ C-178.

⁴⁰⁷ C-178.

⁴⁰⁸ As to Rēzeknes Siltumtīkli’s view, the Council in essence restated the content of Rēzeknes Siltumtīkli’s letter of 15 May 2008 (C-231, see paragraph 332 above).

⁴⁰⁹ As to Rēzeknes Enerģija’s view, the Council referred to the debt owed by Latgales Enerģija to Rēzeknes Enerģija and stressed that Rēzeknes Siltumtīkli doubted Latgales Enerģija’s ability to pay its debts.

⁴¹⁰ C-179.

⁴¹¹ C-10; C-11; C-12.

⁴¹² C-29 [page 15].

338. On 5 June 2008 Latgales Enerģija challenged the Regulator's 3 June 2008 decision.⁴¹³ The District Court of Administrative Cases dismissed the application on 16 June 2009.⁴¹⁴ A further appeal by Latgales Enerģija was dismissed on 6 May 2010.⁴¹⁵
339. On 5 June 2008 Rēzeknes Siltumtīkli sent Latgales Enerģija a notice requesting Latgales Enerģija to rectify its breaches of contract within thirty days, failing which the Long-Term Agreement would be "deemed terminated".⁴¹⁶ The notice mentioned a breach of Clause 7.3 of the Long-Term Agreement⁴¹⁷ and added that an accurate account of the violations of laws and regulations was provided in the Regulator's decision revoking the licences. Rēzeknes Siltumtīkli's notice of termination followed on 10 September 2008.⁴¹⁸
- (3) THE RĒZEKNE CITY COUNCIL'S TEMPORARY APPOINTMENT OF RĒZEKNES SILTUMTĪKLI AND RĒZEKNES ENERĢIJA AS THE PRODUCER AND THE DISTRIBUTOR/SELLER OF THERMAL ENERGY (13 JUNE 2008)**
340. On 13 June 2008 the Rēzekne City Council appointed its deputy executive director, Mr. Ivars Locis, as the person in charge of organising the provision of heating in the city of Rēzekne.⁴¹⁹
341. On the same day Mr. Locis, acting as the person in charge under the Council's decision No. 270, appointed (i) Rēzeknes Siltumtīkli as the temporary new producer of thermal energy and (ii) Rēzeknes Enerģija as the temporary new provider, distributor and seller of thermal energy; the decision is stated to have been made as a matter of urgency.⁴²⁰
342. The decision further stated that as from 3 June 2008 Latgales Enerģija was no longer entitled to provide any services of thermal energy, including hot water supply and heating.

⁴¹³ R-2 p. 1.

⁴¹⁴ R-2 p. 4; see paragraph 390 below.

⁴¹⁵ R-2, see paragraph 391 below.

⁴¹⁶ C-180.

⁴¹⁷ C-4.

⁴¹⁸ C-185, see paragraph 356 below.

⁴¹⁹ Decision No. 270, C-30.

⁴²⁰ Decision No. 1, C-181.

343. The Claimant alleges that decision No. 1 by Mr. Locis was communicated to Latgales Enerģija in a letter dated 27 June 2008.⁴²¹ The Claimant alleges that it appealed both 13 June 2008 decisions on 4 July 2008.⁴²² Such appeal is not in evidence; neither are any decisions as may have been made further to such appeal.

(4) RĒZEKNE CITY COUNCIL’S REQUEST TO HAVE THE LEASED ASSETS TRANSFERRED TO RĒZEKNES SILTUMTĪKLI AND RĒZEKNES ENERĢIJA (27 JUNE 2008)

344. On 27 June 2008 Mr. Locis, acting as the person in charge, wrote to Latgales Enerģija.⁴²³ The letter first recapitulated Mr. Locis’ decision No. 1 of 13 June 2008 (see paragraph 341 above), adding that a new provider of heating services would have to be appointed by 1 November 2008.
345. Having reiterated that Latgales Enerģija had been no longer entitled to provide heating services as from 3 June 2008, Mr. Locis requested Latgales Enerģija to appoint a representative by 7 July 2008⁴²⁴ “to transfer the assets (premises, boilers and others)” to Rēzeknes Siltumtīkli and Rēzeknes Enerģija “to ensure the function of thermal energy provision”.
346. On 7 July 2008 Latgales Enerģija answered Mr. Locis’ letter of 27 June 2008 explaining that it did not see any grounds to transfer the property leased from Rēzeknes Siltumtīkli; having challenged in judicial proceedings both the Regulator’s decision of 3 June 2008⁴²⁵ and Mr. Locis’ decision No. 1 of 13 June 2008,⁴²⁶ Latgales Enerģija explained that it saw no reason to comply with Mr. Locis’ decision of 27 June 2008; any attempt to enforce such decision in the circumstances would be unlawful.⁴²⁷

⁴²¹ RfA ¶ 108; C-31.

⁴²² RfA ¶¶ 109; 111; Cl. Mem. ¶ 262(12), see also C-3 ¶ 48.

⁴²³ C-31.

⁴²⁴ C-31 states “7 June 2008”; this is a translation mistake.

⁴²⁵ C-29, see paragraph 337 above.

⁴²⁶ C-181, see paragraph 341 above.

⁴²⁷ C-32.

(5) RĒZEKNE CITY COUNCIL'S ORDER THAT LATGALES ENERĢIJA PROVIDE ACCESS TO THE BOILER HOUSES AND SURRENDER THE LEASED ASSETS (14 JULY 2008)

347. On 7 July 2008 Mr. Locis, a Board Member of Rēzeknes Siltumtīkli and a bailiff went to Latgales Enerģija's offices in Rēzekne and demanded that Latgales Enerģija hand over the leased assets. Latgales Enerģija admits that it refused to do so,⁴²⁸ but that no enforcement took place there and then.⁴²⁹
348. Latgales Enerģija alleges that it received on 11 July 2008 the court decision ruling that the court did not have jurisdiction to review either the Rēzekne City Council's decision of 13 June 2008⁴³⁰ or the decision made by the person in charge of providing thermal energy in Rēzekne on the same day⁴³¹.⁴³² The court decision is not in evidence.
349. On 14 July 2008 the Rēzekne City Council ordered Latgales Enerģija immediately to provide access to all assets at all three boiler houses and transfer all other means required for the provision of heating to Rēzeknes Siltumtīkli and Rēzeknes Enerģija.⁴³³
350. On or about 24 July 2008 Latgales Enerģija applied to the Administrative District Court to have this decision set aside;⁴³⁴ the court decided on 25 May 2010.⁴³⁵

(6) THE CLAIMANT'S NOTICE OF DISPUTE (1 SEPTEMBER 2008)

351. On 1 September 2008 the Claimant sent the Respondent a Notice of Dispute under Article 7(1) of the BIT⁴³⁶.⁴³⁷

⁴²⁸ RfA ¶ 110; Cl. Mem. ¶ 265(12); Latgales Enerģija's refusal is confirmed by the Council's decision No. 316 of 14 July 2008 (C-33 [pages 15-16]).

⁴²⁹ Notice of Dispute, C-3 ¶ 50; RfA ¶ 110.

⁴³⁰ C-30.

⁴³¹ C-181.

⁴³² RfA ¶ 111; Cl. Mem. ¶ 265(13); C-3 ¶ 51.

⁴³³ Decision No. 316, C-33; see also paragraphs 1038 ff. below.

⁴³⁴ R-5 ¶ 1-2.

⁴³⁵ R-5, see paragraph 397 below.

⁴³⁶ BIT, CLA-1, this provision is reproduced in paragraph 497 below.

⁴³⁷ C-3.

352. In the Notice of Dispute, the Claimant contended that the requirement of a dispute concerning investment between one of the Parties to the BIT and the investor of the other Party was met. The Notice added that there were no temporal issues regarding the applicability of the BIT in the present case.
353. Claimant relied on five principles under the BIT: (i) Article 4(1) on expropriation, (ii) Article 3(1) on fair and equitable treatment, (iii) Article 3(1) on full protection and security, (iv) Article 3(2) on arbitrary or discriminatory measures and (v) the most-favoured nation clause in Article 3(3) in connection *inter alia* with Articles 2(2) and 3(1) of the Latvia-Romania BIT.⁴³⁸
354. The Notice of Dispute contains a statement of facts subdivided in four parts, setting out (i) the situation of heating services in Rēzekne before the Claimant's investment, (ii) the individualised invitation made by the Rēzekne Municipality to the Claimant with the long-term legal guarantees surrounding the investment, (iii) the result of the Claimant's investment on the heating services provided and (iv) the *volte-face* by the Rēzekne Municipality and its instrumentalities when they saw the emergence of an efficient and profitable business, and the concerted effort of the Rēzekne Municipality, its instrumentalities, the police and the bailiffs to drive out the investor and take over its business.
355. As to *quantum*, the Claimant argued that the breach of international law caused a damage in an amount of LVL 7,141,757.08, as well as lost profits in an amount of LVL 5,018,252, amounting to LVL 12,160,009.08 altogether.⁴³⁹

**(7) TERMINATION OF THE LONG-TERM AGREEMENT BY RĒZEKNES
SILTUMTĪKLI (10 SEPTEMBER 2008)**

356. On 10 September 2008 Rēzeknes Siltumtīkli sent Latgales Enerģija a notice of termination under Clause 12.5.2 of the Long-Term Agreement^{440 441}.

⁴³⁸ Latvia-Romania BIT, CLA-22.

⁴³⁹ C-3 [page 37].

⁴⁴⁰ C-4, see paragraph 95 above.

⁴⁴¹ C-185.

(8) THE TAKING OVER OF THE LEASED ASSETS BY RĒZEKNES SILTUMTĪKLI AND THE FURTHER COURSE OF THE DISPUTE

(A) RĒZEKNE CITY COUNCIL'S DECISION AUTHORISING THE USE OF FORCE TO ENFORCE THE 14 JULY 2008 DECISION (15 SEPTEMBER 2008)

357. On 15 September 2008 the Rēzekne City Council authorised the use of force to enforce the 14 July 2008 Council's decision,⁴⁴² with which Latgales Enerģija refused to comply of its free will (see paragraph 1041 below).⁴⁴³

The decision was stated to be enforceable forthwith, and any appeal would not operate so as to stay its enforceability.

(B) THE FORCIBLE RECOVERY OF THE LEASED ASSETS (16 SEPTEMBER 2008)

358. On 16 September 2008 Latgales Enerģija's administrative building (unlike the customer service centre) was taken over, as well as the boiler houses. All assets of Latgales Enerģija were taken over including those leased to Latgales Enerģija under the Long-Term Agreement. Latgales Enerģija challenged this decision without success (see paragraph 396 below).
359. Personal assets were handed back on 6 October 2008 (see paragraph 362 below).
360. Latgales Enerģija's personnel were able to continue to work from the customer service centre for a few days.⁴⁴⁴
361. From 16 September 2008 onwards, Latgales Enerģija's assets as well as the leased assets came into possession of Rēzeknes Siltumtīkli and Rēzeknes Enerģija which started to operate the heating system. They have remained the operators of the heating system ever since.⁴⁴⁵

⁴⁴² C-33, see paragraph 349 above.

⁴⁴³ Decision No. 449, "Execution order on application of direct force", C-186.

⁴⁴⁴ See CWS-3 ¶ 49.

⁴⁴⁵ RfA ¶ 115. The Respondent did not specifically deny this allegation.

(C) THE DEED OF 6 OCTOBER 2008

362. On 6 October 2008 two Rēzeknes Siltumtīkli representatives and certain Latgales Enerģija representatives signed a document entitled “Deed” reading as follows:⁴⁴⁶

Drawn up in the presence of AS Rēzeknes Siltumtīkli reg. No 40003215480 and SIA Latgales Enerģija reg. No 40003717325 representatives confirming that SIA Latgales Enerģija has received all the property located in the office at Rīgas iela 1, in Rēzekne and all the property belonging to SIA Latgales Enerģija, including all the documents, computer hardware, fixed assets and low value items.

SIA Latgales Enerģija verifies that all the property is received and SIA Latgales Enerģija has claims neither of material character, nor of legal character against AS Rēzeknes Siltumtīkli regarding the transfer of property located [at] the office at Rīgas iela 1, in Rēzekne.

This Deed is drawn up in 2 counterparts.

(D) THE FIRST MEETING BETWEEN THE PARTIES (5 DECEMBER 2008)

363. On 5 December 2008 a first meeting took place between the Parties in order to seek an amicable solution to the dispute. Further meetings would take place in 2009 and 2010, and a final meeting took place on 1 April 2011.⁴⁴⁷

(9) THE PROCEEDINGS BROUGHT BY RĒZEKNES SILTUMTĪKLI AGAINST LATGALES ENERĢIJA

364. On 4 June 2008 Rēzeknes Siltumtīkli increased the amount of its original claims (see paragraph 302 above) against Latgales Enerģija. Such amendments are not in evidence, but are referred to in the decision by the Riga Regional Court⁴⁴⁸ and the Supreme Court of Latvia.⁴⁴⁹

(10) THE PROCEEDINGS BROUGHT BY RĒZEKNES ENERĢIJA AGAINST LATGALES ENERĢIJA

365. On 3 January 2008 the Riga Regional Court granted an attachment on Latgales Enerģija’s moveable property for an amount up to LVL 815,690.51 and enjoined Latgales Enerģija to refrain from dealing with any emission quotas as Latgales

⁴⁴⁶ C-188.

⁴⁴⁷ RfA ¶ 11; see Respondent’s letter to the Secretary-General dated 6 September 2012.

⁴⁴⁸ C-194 p. 4.

⁴⁴⁹ C-246 p. 6.

Enerģija may have been allocated.⁴⁵⁰ Such interim relief was granted further to Rēzeknes Enerģija's application of 27 December 2007, which had been made in connection with the action brought to claim payment of unpaid invoices relating to the delivery of natural gas.⁴⁵¹

366. On 11 February 2008 Latgales Enerģija sought a declaration by way of counterclaim that the Rēzeknes Enerģija Gas Supply Agreement⁴⁵² was null and void. The counterclaim is not in evidence, but it was referred to in the decision of 16 April 2008 (see paragraph 369 below).
367. On 27 February 2008 Latgales Enerģija applied to the Riga Regional Court to have the 3 January 2008 decision set aside;⁴⁵³ the application was supplemented on 3 April 2008 on the point of emission quotas.⁴⁵⁴
368. On 10 April 2008 Rēzeknes Enerģija supplemented its statement of claim; the amount of the debt sought to be enforced was increased to LVL 2,528,766.10 excluding interest based on further deliveries of natural gas made and invoiced by Rēzeknes Enerģija after 27 December 2007.⁴⁵⁵ A further supplement was filed in 2009 (see paragraph 381 below).
369. On 16 April 2008 the Riga Regional Court granted Latgales Enerģija's application in part, revoking the 3 January 2008 injunction relating to the emission quotas; the application to have the attachment revoked altogether was dismissed.⁴⁵⁶ Latgales Enerģija's counterclaim for a declaration that the Rēzeknes Enerģija Gas Supply Agreement was null and void was held in abeyance pending payment of the full court fee.

⁴⁵⁰ C-168 [page 3].

⁴⁵¹ C-225, see paragraph 310 above.

⁴⁵² C-151, see paragraph 283 above.

⁴⁵³ C-226.

⁴⁵⁴ C-228.

⁴⁵⁵ C-229.

⁴⁵⁶ C-230.

370. On 1 July 2008 the Riga Regional Court extended the attachment to Latgales Enerģija's bank accounts, including the accounts with AS Hansabanka and AS Parexbanka, for an amount up to LVL 2,534,237.10.⁴⁵⁷

(11) THE PROCEEDINGS BROUGHT BY RĒZEKNES SILTUMTĪKLI AGAINST LATGALES ENERĢIJA AND THE CLAIMANT (13 AUGUST 2008)

371. On 13 August 2008 Rēzeknes Siltumtīkli brought an action against Latgales Enerģija and the Claimant before the Riga Regional Court. The document initiating the proceedings is not in evidence; Rēzeknes Siltumtīkli's claims are summarised in the judgment made by the Supreme Court of Latvia on 7 March 2013.⁴⁵⁸

Rēzeknes Siltumtīkli sought a declaration that its duties and its debts arising under Credit Agreement Nos. RA 02155 and 02219 (as amended by several covenants) signed with Latvijas Unibanka (and referred to in the Guarantee Agreement⁴⁵⁹ and Long-Term Agreement⁴⁶⁰) had been discharged⁴⁶¹ and that the pledges registered in the Land Registry pursuant to such agreements had therefore also been discharged as a consequence, and any entries in the Land Registry in relation to such pledges were to be deleted; and, finally, a declaration that the 2008 Assignment Agreement⁴⁶² was invalid.⁴⁶³

372. The Riga Regional Court dismissed the action on 23 September 2010. The judgment is not in evidence, but its reasons and findings are summarised in the judgment by the Latvian Supreme Court of 7 March 2013.⁴⁶⁴

⁴⁵⁷ C-183 = C-232 [page 3].

⁴⁵⁸ R-10 pp. 1-6, ¶ [1], see also paragraph 404 below.

⁴⁵⁹ C-43, see paragraph 76 above.

⁴⁶⁰ C-4, see paragraph 89 above.

⁴⁶¹ The translation in R-10.1 ¶¶ 1 and (2) says "terminated".

⁴⁶² C-182, see also paragraph 378 below.

⁴⁶³ Rēzeknes Siltumtīkli's statement of claim is summarised in R-10 (pp. 1-6, ¶ [1]). Latgales Enerģija's and E enerģija's answer is summarised in R-10.1 ¶ 2.

⁴⁶⁴ R-10 p. 7, ¶ 3, see also paragraph 404 below.

(12) SUPPLEMENTING CERTAIN ARRANGEMENTS MADE IN THE 2005-2007 PERIOD – NEW ARRANGEMENTS

(A) CONTRACTS BETWEEN THE CLAIMANT AND THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

373. The Claimant alleges that the EBRD loan (see paragraphs 317 ff. above) “would have ensured that Latgales Enerģija could make the further necessary investments in the heating system”.⁴⁶⁵
374. Mr. Strioga explains in his first Witness Statement that the EBRD loan was drawn in 2008,⁴⁶⁶ which is confirmed by Mr. Jautakis’ first Witness Statement.⁴⁶⁷
375. However, the Claimant further states that the part of the loan marked for Rēzekne was never drawn, and the planned investments were never made; it is also admitted that the Claimant did not pay interest to the EBRD on this part of the loan.⁴⁶⁸ The Claimant alleges that nevertheless a considerable portion of the expense of organising and negotiating the loan from the EBRD was incurred in relation to the part allocated to Rēzekne.⁴⁶⁹
376. On 5 March 2008 the Amendment Agreement in Connection with Various Agreements Relating to Debt and Equity Investment in UAB E Enerģija (the “Amendment Agreement”) was entered into by ETC, UAB E Energy Invest (“EEI”, a company incorporated in Lithuania), Mr. Virginijus Strioga (the “Sponsor”), UAB E-Enerģija (the “Company”, and, together with ETC and EEI “the Obligors”) and the EBRD.⁴⁷⁰ This agreement amended *inter alia* the Subscription Agreement⁴⁷¹ and the EBRD Loan Agreement.⁴⁷² EBRD’s shareholding in the Claimant was increased to 23,5%.⁴⁷³

⁴⁶⁵ Cl. Mem. ¶ 81.

⁴⁶⁶ CWS-1 ¶ 56.

⁴⁶⁷ CWS-2 ¶ 74, according to which two tranches of the loan were received on 23 July 2008 and 19 September 2008, and a third tranche on 24 December 2009.

⁴⁶⁸ RfA ¶ 40; CWS-1 ¶ 56.

⁴⁶⁹ RfA ¶ 40.

⁴⁷⁰ C-173.

⁴⁷¹ C-139.

⁴⁷² C-165.

⁴⁷³ Sect. 2.01(b) of the Amendment Agreement; see also CWS-2 ¶ 73.

Exhibit C-173 contains an unsigned version of the Amendment Agreement. The Respondent raised no objections in this respect.

(B) RĒZEKNES SILTUMTĪKLI'S LONG-TERM DEBTS TAKEN OVER BY THE CLAIMANT (25 JUNE 2008)

377. In February 2008 the Claimant took over from Sampo Banka the loan granted by the bank to Latgales Enerģija on 24 August 2007 (see paragraph 315 above) in an amount of LVL 1,135,028.⁴⁷⁴
378. On 25 June 2008 Latgales Enerģija assigned to the Claimant the debt of Rēzeknes Siltumtīkli, which it had purchased from LHV in 2006 (see paragraph 205 above), under the terms of an assignment agreement (“the 2008 Assignment Agreement”).⁴⁷⁵ The amount which Latgales Enerģija owed the Claimant under the outstanding loan was set off against the purchase price which the Claimant owed Latgales Enerģija under the 2008 Assignment Agreement under the terms of an agreement of even date (the “Supplement to the Assignment Agreement dated 25 June 2008”).⁴⁷⁶
379. On 13 August 2008 Rēzeknes Siltumtīkli challenged the validity of the 2008 Assignment Agreement before the Latvian courts (see paragraph 371 above). On 7 March 2013 the Supreme Court held, on appeal, that the 2008 Assignment Agreement was valid, but it also decided that Latgales Enerģija no longer owned a debt against Rēzeknes Siltumtīkli on the basis that Latgales Enerģija owed itself a debt to Rēzeknes Siltumtīkli under the Long-Term Agreement which gave rise to a merger of rights and liabilities.⁴⁷⁷ Mr. Jautakis in his first Witness Statement refers to a Latvian decision of 2009 holding that the assignment was invalid, but no such decision is in evidence.⁴⁷⁸
380. Further arrangements were made in 2009 (see paragraph 411 below).

⁴⁷⁴ C-141 [page 25], Sect. 21; CWS-2 ¶ 19.

⁴⁷⁵ C-182.

⁴⁷⁶ C-182; see also CWS-2 ¶ 19.

⁴⁷⁷ R-10 p. 1, see paragraphs 404 ff. below.

⁴⁷⁸ CWS-2 ¶ 20.

F. MAIN EVENTS IN 2009 AND BEYOND

(1) THE CIVIL PROCEEDINGS BROUGHT BY RĒZEKNES ENERĢIJA AGAINST LATGALES ENERĢIJA

381. On 14 January 2009 Rēzeknes Enerģija filed a second supplement to its claims against Latgales Enerģija.⁴⁷⁹ The supplemented claim takes into account supplies of natural gas made by the plaintiff and the payments made by the defendant, the plaintiff claiming payment of an amount of LVL 2,434,423.01 excluding interest.
382. On 2 March 2010 the Riga Regional Court made a judgment for Rēzeknes Enerģija and dismissed Latgales Enerģija's counterclaim.⁴⁸⁰ Latgales Enerģija appealed this decision, but the appeal was dismissed;⁴⁸¹ neither the appeal nor the decision on the appeal is in evidence.

(2) THE CIVIL PROCEEDINGS BROUGHT BY RĒZEKNES SILTUMTĪKLI AGAINST LATGALES ENERĢIJA

383. Rēzeknes Siltumtīkli had brought an action against Latgales Enerģija on 20 September 2007 and the Latgale Regional Court had granted an attachment on Latgales Enerģija's funds on the following day (see paragraphs 301 ff. above).

Rēzeknes Siltumtīkli had not applied to the court in order that the attachment should be lifted despite the undertakings contained in the October 2007 Agreement and Latgales Enerģija's complaints.⁴⁸²

384. Rēzeknes Siltumtīkli amended its claims on the merits twice, first on 4 June 2008⁴⁸³ and then on 17 June 2009.⁴⁸⁴
385. On 30 June 2009 Latgales Enerģija filed its answer to Rēzeknes Siltumtīkli's statement of claim.⁴⁸⁵

⁴⁷⁹ C-233; for the original claim filed on 18 December 2007, see C-225 and paragraph 310 above; for the first supplement, see C-229 and paragraph 368 above.

⁴⁸⁰ C-239.

⁴⁸¹ Cl. Rep. ¶ 67.

⁴⁸² C-26, see paragraphs 286 ff. above.

⁴⁸³ C-246 p. 6.

⁴⁸⁴ C-246 p. 6.

386. On 9 July 2009 the Riga Regional Court granted Rēzeknes Siltumtīkli's claims in substantial part as follows:⁴⁸⁶ (i) the court "revoked" the Long-Term Agreement;⁴⁸⁷ (ii) the court awarded the claim for payment of the lease with respect to depreciation⁴⁸⁸ as well as (iii) the claim for payment of gas delivered and used. However, the court dismissed (iv) the claim for payment of a contractual penalty and (v) the request for a declaration that Latgales Enerģija was bound to pay the invoices issued by Latvijas Gāze.⁴⁸⁹
387. On 29 July 2009 Latgales Enerģija appealed against this judgment before the Supreme Court of Latvia.⁴⁹⁰
388. On 20 April 2012 the Court Panel for Civil Matters of the Supreme Court of Latvia dismissed Latgales Enerģija's appeal.⁴⁹¹
389. Latgales Enerģija filed an application to have this judgment set aside in cassation proceedings. On 7 April 2014 the Supreme Court allowed the application, set the

⁴⁸⁵ C-234.

Latgales Enerģija answered Rēzeknes Siltumtīkli's claim for unpaid rent contending that the Long-Term Agreement (C-4) was still in force and that the part of the rent relating to the depreciation of the assets would be payable at the time the assets had to be returned to the plaintiff; therefore, Latgales Enerģija was not in default (C-234 [pages 1-2]). It also followed that there were no grounds upon which the Long-Term Agreement could be terminated (C-234 [page 3]).

Rēzeknes Siltumtīkli's notice of termination of the Long-Term Agreement (C-180, see paragraph 339 above) was inconsistent with the terms of the Long-Term Agreement and it could therefore have no effects whatsoever (C-234 [page 3]).

Finally, Latgales Enerģija answered that it was not bound to pay the invoices issued by Latvijas Gāze to Rēzeknes Siltumtīkli for the natural gas supplied (C-234 [pages 3 ff.]). This was so on the basis that the plaintiff did not have a licence to sell natural gas.

⁴⁸⁶ C-194.

⁴⁸⁷ It is unclear whether the court declared that Rēzeknes Siltumtīkli's notice of termination was effective and the Long-Term Agreement had terminated pursuant to such notice, or whether the Long-Term Agreement was revoked by virtue of the judgment of the court.

⁴⁸⁸ The court held that the part of the lease payments owed for depreciation under Clause 4.4.2(a) of the Long-Term Agreement was not payable until such time when the leased infrastructure would be transferred back to the lessor, and Latgales Enerģija's argument was accepted in this respect. As a consequence, the claim for a contractual penalty was dismissed. However, payment of the part of the lease relating to depreciation was ordered since the Long-Term Agreement was no longer in force according to the court.

⁴⁸⁹ C-194 [page 10 (penultimate paragraph)], contains a typo in the original (the original text in Latvian could not be checked as it was cut off in the pages filed attached to the translation) or a translation mistake; "invoices issued by JSC Latgales Enerģija" should read "invoices issued by Latvijas Gāze".

⁴⁹⁰ C-235.

⁴⁹¹ The court stated that the judgment by the Riga Regional Court was "correct and sufficiently substantiated"; the court therefore agreed with the court below and did not need to repeat the reasons given by the Riga Regional Court (C-246 p. 15).

judgment aside and remitted the case to another court of appeal in order for a fresh decision to be made.⁴⁹² On 30 November 2015 the Chamber of Civil Cases of the Supreme Court of Latvia found that the Long-Term Agreement had been unilaterally terminated on 16 September 2008 and awarded Rēzeknes Siltumtīkli its claim for payment of the rent and for unpaid gas (judgment filed by the Respondent in this arbitration on 19 December 2016).⁴⁹³

(3) DISMISSAL OF LATGALES ENERĢIJA'S CHALLENGE AGAINST THE REGULATOR'S DECISION TO REVOKE THE LICENCES (3 JUNE 2008) AND THE JUDGMENT OF 16 JUNE 2009 (6 MAY 2010)

390. On 16 June 2009 the Administrative District Court dismissed Latgales Enerģija's application⁴⁹⁴ to have the Regulator's decision No. 10 dated 3 June 2008⁴⁹⁵ set aside by which the Regulator had revoked the three licences granted to Latgales Enerģija.⁴⁹⁶ Latgales Enerģija appealed against that decision.⁴⁹⁷

⁴⁹² R-8.

⁴⁹³ The court found that Latgales Enerģija was under an obligation to pay for the gas supplied by Latvijas Gāze in the amounts invoiced by Latvijas Gāze. The judgment considers the provisions of the Long-Term Agreement, but not the February 2005 Agreement.

⁴⁹⁴ Latgales Enerģija's application is not in evidence, but it is summarised in the Administrative Court of Appeal decision in R-2. Latgales Enerģija made the following arguments.

First, the licences could be revoked only subsequent to a decision suspending them in accordance with Sects. 17 to 19 of Regulation No. 664 on the Licensing of Public Utilities (CLA-56) and imposing a time limit in order for the service provider to cure the breach(es) which caused the suspension. In the present case the Regulator had failed to suspend the licences and fix a time limit in order for Latgales Enerģija to cure any alleged breaches.

Secondly, a licence may be revoked provided, however, that a prior warning has been given to the service provider at least three months in advance; the licence may be revoked within the month following the expiry of the three-month time limit; a failure to comply with the one-month time limit requires the whole procedure to be repeated. In the present case the licences were revoked almost five months after the expiry of the notice period. Latgales Enerģija's right to a stable and predictable legal position had been breached.

Thirdly, the licences were revoked on a basis other than that which had been mentioned in the Regulator's warning of 4 October 2007 (C-22, see paragraph 262 above).

The Regulator opposed that both of the time limits relied upon by Latgales Enerģija were not applicable to the revocation of a licence by the Regulator, and that Latgales Enerģija had been given an opportunity to be heard and had failed to comply with the Regulator's decisions.

⁴⁹⁵ C-29, see also paragraph 337 above.

⁴⁹⁶ R-2 ¶ 3.

Latgales Enerģija's application to set aside was dismissed on 16 June 2009 on the basis that (i) the law did not require that a decision revoking a licence should be preceded by one suspending the licence; (ii) the Regulator had proceeded in accordance with the provisions of the Public Utility Regulators Act (CLA-49); (iii) the Regulator was bound to give the utilities provider a three-month notice prior to revoking a licence; (iv) however, the Regulator was not bound to make a decision within a month as from the day on which the three-month time limit had expired as the Regulator was entitled to proceed on a

391. On 6 May 2010 the Administrative Regional Court⁴⁹⁸ dismissed Latgales Enerģija's appeal against the 16 June 2009 decision.⁴⁹⁹

**(4) DISMISSAL OF LATGALES ENERĢIJA'S CHALLENGE AGAINST THE
REGULATOR'S DECISION NO. 12 DATED 11 JUNE 2007 (15 APRIL 2009)**

392. On 15 April 2009 the Administrative District Court dismissed Latgales Enerģija's application⁵⁰⁰ to have the Regulator's Decision No. 12 dated 11 June 2007⁵⁰¹ set aside (by which the Regulator had rejected the new tariffs proposed by Latgales Enerģija on 29 May 2007⁵⁰²).⁵⁰³ The reasons given by the court are recalled and discussed in paragraph 906 below.
393. On 14 May 2009 Latgales Enerģija appealed against the 15 April 2009 decision by the Administrative District Court and applied to the court in order to be granted a fresh time limit in which to bring its appeal. The appeal and the application are not in evidence.⁵⁰⁴
394. On 27 May 2009 Latgales Enerģija's application was denied and the appeal was dismissed. This decision is not in evidence.⁵⁰⁵

case-by-case basis and it was not necessary, therefore, to repeat the procedure as contended by the applicant; and (v) the breaches of paragraphs 7.1, 7.2 and (indirectly) 6.2 of the licences had been substantiated in the Regulator's decision and the applicant had been notified in previous correspondence and had been provided with an opportunity to cure such breaches. The Regulator's decision was therefore in accordance with law and the application to set aside was to be dismissed.

⁴⁹⁷ R-2 ¶ 4.

⁴⁹⁸ The translation filed by the Respondent (R-2) indicates the name of the court as "the Regional Court of Administrative Cases", the Respondent's exhibit list as the "Latvian Administrative Appeal court" (*Administratīvā apgabaltiesa* is the name in the original decision).

⁴⁹⁹ The reasons for dismissal of the appeal are set out in four paragraphs as the Administrative Court of Appeal held that the judgment by the court below was accurate and the Court of Appeal concurred with the court below.

⁵⁰⁰ C-100, see paragraph 185 above, as amended in C-125 (see paragraphs 186 and 234 above).

⁵⁰¹ Originally the decision sought to be set aside was the Regulator's decision No. 17 dated 13 October 2006 (C-19, see paragraph 184 above); the Regulator's decision No. 12 dated 11 June 2007 (C-21, see paragraph 233 above) was also challenged with the amended application, and Latgales Enerģija limited its challenge to the latter decision in its amended application (see paragraph 186 above).

⁵⁰² C-20, see also paragraph 232 above.

⁵⁰³ C-192.

⁵⁰⁴ See R-1 p. 1.

⁵⁰⁵ See, however, R-1 p. 1.

395. Latgales Enerģija appealed against the decision of 27 May 2009, and the appeal was dismissed on 24 September 2009.⁵⁰⁶

(5) DISMISSAL OF LATGALES ENERĢIJA'S COMPLAINT AGAINST THE ENFORCEMENT OF THE COUNCIL'S DECISION NO. 316 OF 14 JULY 2008 BY FORCIBLE MEANS (2 JULY 2009)

396. On 2 July 2009 the Administrative District Court dismissed Latgales Enerģija's complaint against the Rēzekne City Council and the State Police that the enforcement of Rēzekne City Council's decision No. 316 dated 14 July 2008⁵⁰⁷ by forcible means was unlawful.⁵⁰⁸ Latgales Enerģija's complaint is not in evidence.

⁵⁰⁶ R-1. It is unclear whether the appeal was denied by the Latvian Administrative Appeal Court, as stated in the Respondent's exhibit list, or the Administrative District Court, as stated in the translation of Exhibit R-1; the name of the court in Latvian is *Administratīvā rajona tiesa*. The Tribunal takes it that it is the Administrative District Court.

⁵⁰⁷ C-33, see paragraph 349 above.

⁵⁰⁸ R-6.

The court stated that its decision related solely to the question whether the procedure of enforcement by forcible means was lawful, not the question whether the decision to be enforced was itself lawful (R-6 ¶ 5). The court considered that the decision to be enforced had come into force and had not been executed voluntarily by Latgales Enerģija (R-6 ¶ 10). The court found that the decision to be enforced was not final and enforceable, but an exception to the rule applied where the decision to be enforced stated that enforcement was required as a matter of urgency to avert a danger to State security, public order, the life or the health or property of citizens. The court found that there was a risk in the present case that the supply of heating in the city of Rēzekne could not be ensured unless the heating infrastructure was taken over, and that the decision to be enforced contained sufficient indications as to the need to ensure that heating services should continue to be provided (R-6 ¶ 10). This was so in spite of the fact that the decision to be enforced had been made on 14 July 2008 and the warning preceding enforcement was dated 15 September 2008 (R-6 ¶ 10).

The court further found that the warning contained all the indications required by law, including a direction to the addressee to comply with the decision voluntarily; Latgales Enerģija's objections raised on that basis were without foundation (R-6 ¶ 11).

The court went on to examine whether the 15 September 2008 (C-186) warning of enforcement by forcible means contained an advance notice which was in accordance with the Administrative Procedure Act, since enforcement by forcible means had been announced for the following day, when enforcement in fact took place. The court found that the warning was lawful considering the urgency and the need to protect the health and property of the city inhabitants (R-6 ¶ 12).

The court found that Latgales Enerģija had not argued that the use of force was disproportionate and that there were no elements on the record suggesting that direct force had been applied at all, or had been applied inappropriately (R-6 ¶ 13).

The court dismissed Latgales Enerģija's complaint also insofar as it was directed against the State Police, having found that Latgales Enerģija argued that the police officers had not applied physical force "but their presence was sufficient to give an impression that the use of such force was real". Considering that Latgales Enerģija could reasonably be expected to resist the enforcement of the decision by forcible means, the presence of police officers was lawful and justified (R-6 ¶ 14).

The court finally considered Latgales Enerģija's complaint that it had been denied access to its property left in the building as a consequence of the fact that it was denied access to its offices. The court found that Rēzeknes Siltumtikli had drawn up a notice to Latgales Enerģija requesting the offices premises to

(6) DISMISSAL OF LATGALES ENERĢIJA'S CHALLENGE AGAINST THE COUNCIL'S DECISION NO. 316 OF 14 JULY 2008 (25 MAY 2010)

397. On 25 May 2010 the Administrative District Court dismissed Latgales Enerģija's challenge against the Rēzekne City Council's decision No. 316 dated 14 July 2008⁵⁰⁹ (by which the Council had decided that Latgales Enerģija was immediately to provide access to all assets at all three boiler houses and transfer all other means required for the provision of heating to Rēzeknes Siltumtīkli and Rēzeknes Enerģija).⁵¹⁰
398. The Administrative District Court considered that the Regulator's decision revoking the licences had to be enforced as a matter of urgency as the Rēzekne City Council had a duty to decide how to organise the heat supply services for the residents of the city. The Council's assessment was reasonable in that the restriction of Latgales Enerģija's private rights had to give way to the public interest represented by the interest of the 25,000 residents of Rēzekne to be provided with heat supply services.
399. The Court finally dismissed Latgales Enerģija's complaint that the Council's decision amounted to a forced taking of Latgales Enerģija's property which was not based on law and did not provide for a fair compensation; the Court stated that it was true that the Council had not considered the issue of the value of Latgales Enerģija's investment in its decision, and Latgales Enerģija was therefore entitled to proceed in accordance with the terms of the Long-Term Agreement and claim the market price of the investments made.

vacated on 16 September 2008 and asking Latgales Enerģija personnel to return on 22 September 2008 to receive their personal belongings and vacate the premises. Latgales Enerģija maintained that it had received such notice only on 22 September 2008. Rēzeknes Siltumtīkli then sent Latgales Enerģija a letter on 29 September 2008 stating that Latgales Enerģija's belongings would be transferred on 6 October 2008. The Court concluded that Rēzeknes Siltumtīkli therefore had taken possession of Latgales Enerģija's belongings for some time, but had taken prompt action to return them. That was a breach of procedure, but its importance was not sufficient to cause the whole enforcement procedure to be unlawful (R-6 ¶ 15).

⁵⁰⁹ C-33, see paragraph 349 above.

⁵¹⁰ R-5.

**(7) DISMISSAL OF LATGALES ENERĢIJA'S CHALLENGE AGAINST THE
REGULATOR'S DECISION NO. 35 DATED 7 DECEMBER 2007 AND THE
JUDGMENT DATED 30 OCTOBER 2009 (23 SEPTEMBER 2010)**

400. On 12 December 2007 Latgales Enerģija had challenged the Regulator's decision No. 35 of 7 December 2007⁵¹¹ by which the Regulator had annulled its previous decision of 9 November 2007 approving the draft tariffs proposed by Latgales Enerģija; the challenge was dismissed by a decision of the Administrative Regional Court of 30 October 2009^{512, 513}.
401. Latgales Enerģija appealed against that judgment; the appeal was dismissed by the Administrative Regional Court on 23 September 2010.⁵¹⁴

**(8) DISMISSAL OF LATGALES ENERĢIJA'S CHALLENGE AGAINST THE
REGULATOR'S DECISION NO. 26 DATED 11 OCTOBER 2007 AND THE
JUDGMENT DATED 31 MARCH 2010 (24 NOVEMBER 2011)**

402. On 31 March 2010 the Administrative District Court dismissed Latgales Enerģija's application to have the Regulator's decision No. 26 of 11 October 2007⁵¹⁵ set aside.⁵¹⁶ Latgales Enerģija appealed against this judgment. The appeal was dismissed by the Administrative Regional Court on 24 November 2011.⁵¹⁷
403. The Administrative Regional Court stated that it was not in dispute that Latgales Enerģija had failed to provide heat supply to the entire Northern housing estate of Rēzekne including six schools.⁵¹⁸ The court then considered Latgales Enerģija's defence that the failure to provide heat supply had been caused by coordinated action on the part of the Rēzekne City Council and Rēzeknes Siltumtīkli, which it dismissed as unproven. The court dealt with three distinct points.

⁵¹¹ C-28, see paragraph 240 above.

⁵¹² The decision is not on the record, but it is summarised in R-4 ¶¶ 1 and 5.

⁵¹³ C-164.

⁵¹⁴ R-4.

⁵¹⁵ C-23, see paragraph 274 above.

⁵¹⁶ R-3. The translation filed by the Respondent (R-3 p. 1) indicates the name of the court as "the Administrative Regional Court"; however, the Latvian original text refers to the decision of the *Administratīvās rajona tiesa* of 31 March 2010, the decision was therefore made by the Administrative District Court (same inaccuracy in the translation in R-3 ¶ 4).

⁵¹⁷ R-3 ¶ 4.

⁵¹⁸ R-3 ¶¶ 9-10.

First, the court found that it was Latgales Enerģija's failure to pay in full the amounts for which Latvijas Gāze issued invoices to Rēzeknes Siltumtīkli in June, July, August and September 2007 which gave rise to the Council's debt to Latvijas Gāze and the suspension by Latvijas Gāze of the natural gas supply. As a consequence, the Council announced the energy crisis which was the basis for the Regulator's decision.⁵¹⁹

Secondly, the court held that Latgales Enerģija's argument that the Regulator's decision was affected by a conflict of interest on the basis that deputies of the Council had taken part in its making was without foundation.⁵²⁰

Thirdly, the court examined Latgales Enerģija's defence that the attachment of funds obtained by Rēzeknes Siltumtīkli on Latgales Enerģija's bank account (see paragraphs 253 to 255 above) was the cause of Latgales Enerģija's inability to pay. The court found that such might have been the case; however, even in such case Latgales Enerģija was not released from its duty to provide its services on a continuous basis throughout the period of validity of the licences and in accordance with the terms thereof.⁵²¹

(9) THE CIVIL PROCEEDINGS BROUGHT BY RĒZEKNES SILTUMTĪKLI AGAINST LATGALES ENERĢIJA AND THE CLAIMANT

404. Rēzeknes Siltumtīkli appealed against the judgment made by the Riga Regional Court on 23 September 2010 dismissing the action brought against Latgales Enerģija and the Claimant on 13 August 2008 (see paragraph 371 above).

405. On 7 March 2013 the Latvian Supreme Court allowed the appeal.⁵²²

⁵¹⁹ R-3 ¶ 12.

⁵²⁰ R-3 ¶ 13.

⁵²¹ R-3 ¶ 14.

⁵²² R-10.

The court decided as follows: (i) Rēzeknes Siltumtīkli's obligations and debts under the two credit agreements were terminated; (ii) the pledges registered pursuant to such agreements were discharged; (iii) the entries relating to such pledges in the Land Registry were to be deleted; (iv) Rēzeknes Siltumtīkli's was released from the duty to comply with the decision of the court below; and (v) Rēzeknes Siltumtīkli's claim that the assignment between Latgales Enerģija and UAB be declared to be invalid was dismissed.

(10) SUPPLEMENTING CERTAIN ARRANGEMENTS MADE IN THE 2005-2008 PERIOD – NEW ARRANGEMENTS

(A) PAYMENT BY THE CLAIMANT UNDER THE PARENT COMPANY GUARANTEE DELIVERED TO SAMPO BANKA/DANSKE BANK

406. On 30 June 2009 Danske Bank (formerly Sampo Banka⁵²³) requested the Claimant to pay an amount of LVL 1,218,056.16 under the Sampo Banka Guarantee^{524, 525}. Danske Bank stated in its request to the Claimant that Latgales Energija had failed to pay its debt under the Sampo Banka Loan Agreement.⁵²⁶ According to Mr. Jautakis' first Witness Statement, the Claimant paid the principal amount (LVL 1,118,056.16) as well as interest (LVL 184,091.68), and thus a total amount of LVL 1,302,147.84 to Danske Bank. Reliance is placed on Exhibit C-196.⁵²⁷
407. On 5 August 2009 Danske Bank and the Claimant agreed on a repayment schedule contemplating ten instalments;⁵²⁸ the repayment schedule was amended twice, first under the terms of an agreement dated 17 May 2010⁵²⁹ and then under the terms of an agreement dated 26 April 2011.⁵³⁰
408. On 9 November 2012 Danske Bank confirmed to the Claimant's auditors that the Claimant had no outstanding obligations to the bank.⁵³¹
409. The payment by the Claimant of a total amount of LVL 1,302,147.84 to Danske Bank was alleged by the Claimant in its first memorial of 6 December 2013;⁵³² such evidence was not disputed by the Respondent in its first Counter-Memorial. Mr. Jautakis' evidence was not challenged by the Respondent at the Hearing (see paragraph 315 above). However, the Respondent challenged that there was evidence

⁵²³ The merger between JSC Sampo Banka and Danske Bank A/S took effect on 30 June 2008, C-193 and C-195, Preamble, Clause 2.

⁵²⁴ C-102, see paragraph 202 above.

⁵²⁵ C-193.

⁵²⁶ C-101, see paragraph 199 above.

⁵²⁷ CWS-2 ¶ 61.

⁵²⁸ C-195.

⁵²⁹ C-203.

⁵³⁰ C-204.

⁵³¹ C-208.

⁵³² Cl. Mem. ¶¶ 62, 70, 361(4) and confirmed by CWS-2 ¶ 61.

that the Claimant paid the amount of the guarantee to Danske Bank for the first time in a post-Hearing submission on March 2015.⁵³³

410. The Tribunal dismisses that objection based on the documents in evidence in relation to the guarantee provided by the Claimant to Danske Bank, as amended, and Danske Bank's request for payment.⁵³⁴ If the Respondent intended to challenge the statement made by Danske Bank to the Claimant's auditors,⁵³⁵ it should have raised this point in its pleadings and called the auditors and cross-examined them at the Hearing.

(B) ARRANGEMENTS FOLLOWING THE 2008 ASSIGNMENT AGREEMENT

411. The circumstances in which the 2008 Assignment Agreement was made are summarised in paragraphs 377 ff. above.
412. Mr. Jautakis' first Witness Statement⁵³⁶ explains that the Latvian courts held in 2009 that the 2008 Assignment Agreement between the Claimant and Latgales Enerģija was invalid; however, no such decision is in evidence, as noted in paragraph 379 above. In the same passage of his first Witness Statement, Mr. Jautakis refers to Exhibit C-190, which states that on 30 June 2009 the Claimant and Latgales Enerģija "cancelled the agreement and cession was left in SIA Latgales Enerģija".⁵³⁷ That allegation is not supported by documentary evidence.
413. Mr. Jautakis further explains in his first Witness Statement that the Claimant then assigned its right to claim from Latgales Enerģija to Hansel Realty Management Spain S.L., a Spanish company.⁵³⁸ This assignment refers to a debt of Latgales Enerģija in an amount of EUR 1,386,967.69 (without interest and penalties) arising under a loan agreement dated 30 June 2009 which is not in evidence. Mr. Jautakis explains that no monies have been recovered to date from Latgales Enerģija in spite of a judgment by the Vidzeme Urban District Court of the city of Riga.⁵³⁹

⁵³³ Resp. P-H (PO8) ¶ 22.

⁵³⁴ C-102; C-193; C-195; C-203; C-204.

⁵³⁵ C-208.

⁵³⁶ CWS-2 ¶ 20.

⁵³⁷ C-190, Sect. 17.

⁵³⁸ CWS-2 ¶ 20; C-197.

⁵³⁹ CWS-2 ¶ 20; C-198.

(C) THE EBRD LOAN (29 OCTOBER 2009)

414. On 29 October 2009 the EBRD Loan Agreement⁵⁴⁰ was renegotiated.⁵⁴¹ Mr. Jautakis explains that this revision was made upon the EBRD's request, and the interest rate charged on tranche 2 was increased from 1.95% to 5% per annum.⁵⁴²

G. THE LITHUANIAN DECISIONS RELIED ON BY THE RESPONDENT (FROM 2005 TO 2011)

415. The Respondent contends that the Claimant should have taken certain precautions before entering into the Long-Term Agreement in order to avoid contentious issues, such as the question of who was responsible to devise a "heat supply development plan".

Reliance is placed by the Respondent on Exhibit R-19 which includes news published in Lithuania as well as twelve decisions made by Lithuanian judicial authorities, in support of the allegation that "it is actually Claimant's (its ultimate beneficiary—Mr. Virginijus Strioga's) common practice to enter into deals with high potential that serious contentious issues will later arise (mainly, due to lack of precisely defined rules of cooperation) and subject to tedious litigation proceedings (...) rather than properly arranging for future cooperation in advance by all involved parties".⁵⁴³

416. The Tribunal will examine that aspect in due course in light of Exhibit R-19 and the Parties' pleadings (see paragraphs 547 ff. below).⁵⁴⁴

⁵⁴⁰ C-165.

⁵⁴¹ C-199.

⁵⁴² CWS-2 ¶ 86.

⁵⁴³ Resp. Rej. ¶ 33.

⁵⁴⁴ Exhibit R-19 contains the following:

I. Articles and Publications in Printed and Online Media

- (i) M. Jokūbaitis, *Lietuvos Rytas*, 10 June 2010, "Will They Follow the Ukmergė Example?"
- (ii) L. Laikraštis, 21 October 2010, *The News*, "The Kubilius-Sekmokas Caucus Are Working for Gangsters"
- (iii) *BNS News Service*, 23 October 2014, [untitled]
- (iv) www.15min.lt, 8 May 2012, "The Supreme Court: Termination of Heating Supply Contract with Miesto Energija by Ukmergė Authorities Was Legitimate"
- (v) *BNS News Service*, 4 July 2013, printed from www.vz.lt, "Scaent Baltic, E Energija and Lemminkainen Lietuva Avoid Publicity"

H. THE NEGOTIATIONS BETWEEN THE PARTIES FROM 1 SEPTEMBER 2008 ONWARDS

417. The present account of the negotiations between the Parties is based *inter alia* on the correspondence filed by the Respondent with the ICSID Secretary-General attached to its letter dated 6 September 2012 by way of two attachments (filed electronically as “Enclosure 1” and “Enclosure 2”). Such correspondence was not re-filed before the Tribunal in accordance with the requirements of Procedural Order No. 1 and it will therefore be identified simply by reference to the original electronic file in which it was filed designated by the expressions “Enclosure 1” and “Enclosure 2”.
418. The Claimant’s Notice of Dispute dated 1 September 2008 was received by the Respondent on 25 September 2008.⁵⁴⁵ On 24 November 2008 the State Chancellery of Latvia invited Mr. Strioga to a meeting with Mr. Mēkons, the representative of the State Chancellery in charge of the matter.⁵⁴⁶ The meeting took place on 5 December 2008; thereafter, Mr. Mēkons put a number of questions to the Claimant’s representatives,⁵⁴⁷ which the Claimant answered on 22 December 2008.⁵⁴⁸

(vi) <http://ekonomika.balsas.lt>, article first appeared on 6 September 2011, [untitled]

II. Documents of Lithuanian Judicial Authorities

- (i) Decision of the Court of Appeal of Lithuania, 4 December 2007, No. 124/2007
- (ii) Decision of the Court of Appeal of Lithuania, 5 December 2011, No. 2A-1472/2011
- (iii) Decision of the Court of Appeal of Lithuania, 17 December 2007, No. 2A-453/2007
- (iv) Decision of the Supreme Administrative Court of Lithuania, 13 June 2006, No A-469-1065-06
- (v) Decision of the Supreme Administrative Court of Lithuania, 14 August 2008, No A-39-1439-08
- (vi) Decision of the Supreme Administrative Court of Lithuania, 10 October 2011, No A-858-419-1
- (vii) Decision of the Supreme Administrative Court of Lithuania, 13 November 2007, No A-143-1044-07
- (viii) Ruling of the Public Prosecutor’s Office Of Ukmergė District County, 29 April 2005, No. 88-2-0002-05
- (ix) Ruling of the Public Prosecutor’s Office Of Ukmergė District County, 23 March 2005, No. 88-2-0002-05
- (x) Decision of the Vilnius County Administrative Court, September 2006
- (xi) Decision of the National Commission For Energy Control And Prices, 26 October 2006, No. O3-79
- (xii) Ruling of the Supreme Court of Lithuania, 19 December 2007, No. 3K-3-97/2007.

⁵⁴⁵ Respondent’s letter dated 25 September 2008, Enclosure 1.

⁵⁴⁶ Respondent’s letter dated 24 November 2008, Enclosure 1.

⁵⁴⁷ Respondent’s email dated 10 December 2008, Enclosure 2.

⁵⁴⁸ Claimant’s email dated 22 December 2008, Enclosure 2.

419. The Parties then agreed between the end of 2008 and the beginning of January 2009 to have a conference call for further discussions which took place on 9 January 2009, as confirmed by Mr. Mēkons' email of the same date.⁵⁴⁹
420. On 11 March 2009 Latvia's Prime Minister Mr. Ivars Goldmanis informed the Claimant that the suggested action plan prepared by the State Chancellery would be transferred to the new Prime Minister, once appointed, which was not to be construed as an acknowledgement that any applicable provisions of law had been breached by the Republic of Latvia.⁵⁵⁰
421. On 27 April 2009 Latvia's Prime Minister Valdis Dombrovskis informed the Claimant that the Government had asked a third neutral party having knowledge of the circumstances in dispute to give his views about particular aspects of the Notice of Dispute, which was not to be construed as an acknowledgment of any liability on the part of the Respondent.⁵⁵¹
422. The Parties agreed to meet again on 27 August 2009, but they failed to reach agreement.⁵⁵²
423. On 23 September 2009 Mr. Mēkons sent the Government's proposal to counsel for the Claimant and Mr. Strioga,⁵⁵³ which the Claimant rejected on 29 September 2009, calling it a "zero compensation proposal" and pointing out that it was entitled "to move the dispute to international arbitration".⁵⁵⁴
424. A meeting was then scheduled for 1 October 2009⁵⁵⁵ and a further meeting for 19 October 2009.⁵⁵⁶

⁵⁴⁹ Respondent's email dated 9 January 2009, Enclosure 2.

⁵⁵⁰ Respondent's letter dated 11 March 2009, Enclosure 1.

⁵⁵¹ Respondent's letter dated 27 April 2009, Enclosure 1.

⁵⁵² Respondent's email dated 24 August 2009 and Mr. Strioga's answer dated 25 August 2009, Enclosure 2.

⁵⁵³ Respondent's email dated 23 September 2009, Enclosure 2.

⁵⁵⁴ Claimant's letter dated 29 September 2009, Enclosure 1.

⁵⁵⁵ Respondent's email dated 30 September 2009, Enclosure 2.

⁵⁵⁶ Respondent's email dated 15 October 2009, and the Claimant's answer dated 16 October 2009, Enclosure 2.

425. On 27 October 2009 the Respondent made a further proposal for a settlement involving no monetary compensation.⁵⁵⁷ That communication is relevant to the interpretation of the Claimant's Board Minutes dated 1 December 2009 and will therefore be quoted verbatim:⁵⁵⁸

Dear Aleksas [Mr. Jautakis],

As I expressed to you this morning, and, in line with last week's discussion, I wish to outline in writing the view of the Rēzekne municipality concerning the settlement model.

The Rēzekne municipality, after carefully [sic] analysis of the financial position of SIA "Latgales Enerģija", namely, the claims of the creditors and different charges and interest over the assets of the company, **considers that a fair solution would be a solution not involving additional payment from any of the parties.**

In addition to waiver of claims against the company, all assets of SIA "Latgales Enerģija" attached for the benefit of the Rēzekne municipality would be lifted by virtue of an application of the Rēzekne municipality to the relevant court, thus releasing the frozen funds of the company. As a reciprocal commitment from SIA "Latgales Enerģija" and UAB "E energija", we expect all claims against the State and the Rēzekne municipality to be waived accordingly.

If, unfortunately, you deem such a solution unacceptable, the State Chancellery will immediately put forward its alternative proposal for the settlement model, namely, the mediation pursuant to the Latvian-Lithuanian BIT. As a dispute pursuant to a BIT emanates from a certain set of factual circumstances (no BIT contains abstract obligations of the State apart from actual State behaviour within its territory), we consider it proper to bring to the attention of the mediator or the mediation panel all claims surrounding the circumstances (that is, claims of E energija and claims of the Rēzekne municipality). With due regard to international practice, the State Chancellery is of the view that mediation is an expedite, confidential and cost-efficient solution.

426. The Claimant rejected the Respondent's proposal on 6 November 2009. That communication is also relevant to the interpretation of the Claimant's Board Minutes dated 1 December 2009 and it reads as follows:

Dear Mr. Ivars Mēkons,

Referring to your proposal sent by e-mail correspondence dated 27th October 2009, we are informing that such resolution is not acceptable to us, because, as we understand it, the resolution proposal does not include monetary compensation to us.

As indicated in our claim and through all the subsequent communication, we are of a position that our investment in Latvia was expropriated without proper compensation for the incurred losses of the investor. Consequently, fair

⁵⁵⁷ Respondent's email dated 27 October 2009, Enclosure 2 (original emphasis).

⁵⁵⁸ C-247.

resolution of the dispute cannot in our view be achieved if no compensation is offered.

As far as mediation is concerned, we could have seen its benefit at the early stage of our attempts to resolve the dispute amicably. However, taking into consideration that our intensive mutual attempts to reach a settlement already last 14 months and have not resulted in any approximation of the positions of the parties, we do not see how at this stage the mediation procedure can lead to the settlement of the dispute.

Based on that, regretfully we have to conclude that we are left with no other alternative but to bring this matter to arbitration.

427. On 25 November 2009 the Respondent took note of the rejection of its proposal by the Claimant and suggested mediation again in the following terms:⁵⁵⁹

(...)

Therefore, as I already explained to you, as an alternative to a “zero-zero payments” solution, **as a feasible alternative I deem the mediation process, whereby the parties, pursuant to the BIT, would have an impartial professional evaluation on the merits of their claims.** Mediation, of course, generally is not binding and the parties are free to accept or reject the proposals from the mediation panel. **However, and the practice increasingly confirms this, especially in the BITs disputes, that the disputing parties can beforehand freely enter into a contractual commitment to abide by the resolution of the mediation panel.** *As the mediation panel should be chosen from the pool of arbitrators and energy experts, the mediation package which I propose is actually akin to the arbitration process with much more efficient (the merits would be considered from both legal and professional aspects), expedite and cheaper solution.*

(...)

In my last email I did not have the opportunity to explain in details the mediation package. Therefore, I would indeed appreciate if you consider this and engage in further talks regarding this proposal.

428. On 27 November 2009 the Respondent answered two questions from the Claimant in relation to the proposed mediation, indicating (i) that the Republic of Latvia would enter into “a legally binding agreement on the process of settlement ...” and (ii) that the ICSID Conciliation Rules could be used.⁵⁶⁰
429. It is in this context which the Claimant’s Board made the resolution evidenced by the Board Minutes dated 1 December 2009.⁵⁶¹

⁵⁵⁹ C-236 (original emphasis).

⁵⁶⁰ Respondent’s email dated 27 November 2009, Enclosure 2.

⁵⁶¹ C-247.

430. On 25 January 2010 the Respondent made a further proposal for a settlement,⁵⁶² which the Claimant rejected on 5 February 2010.⁵⁶³ On the same date, the Claimant answered a further email by the Respondent, indicating what its minimum requirements for a settlement would be in financial terms,⁵⁶⁴ whereupon the Respondent proposed that the Parties turn again to the mediation proposal.
431. On 8 February 2010 the Claimant answered as follows: “As we informed [the] State Chancellery by our letter dated on 6/11/2009 No. 186, we do not see how at this stage the mediation procedure can lead to the settlement of the dispute. We do not have ground on changing our decision [sic]”.⁵⁶⁵
432. On 25 February 2010 the Respondent volunteered to draft “a settlement agreement as regards mediation”.⁵⁶⁶ No answer to that email is in evidence.
433. On 25 June 2010 the Claimant enquired with the Respondent whether all the possibilities to resolve the dispute amicably had been exhausted in light of the fact that their upcoming Board meeting would have the investment dispute on the agenda.⁵⁶⁷
434. On 14 July 2010 the Deputy Director of the State Chancellery answered suggesting a meeting in person or a conference call to be attended by the Claimant, the State Chancellery and the Rēzekne municipality and asking the Claimant to contact Mr. Mēkons.⁵⁶⁸
435. Thereafter, negotiations halted. The final meeting took place on 1 April 2011 which followed a meeting on 18 March 2011.⁵⁶⁹ The following correspondence was exchanged by email between the Parties after the 18 March 2011 meeting.
436. On 21 March 2011 the Claimant wrote the following to the Respondent:⁵⁷⁰

⁵⁶² Respondent’s email dated 25 January 2010, Enclosure 2.

⁵⁶³ Claimant’s email dated 5 February 2010 11:36:15 *a.m.* GMT+2, Enclosure 2.

⁵⁶⁴ Respondent’s email dated 5 February 2010 12:19:23 *p.m.* GMT+2, Enclosure 2.

⁵⁶⁵ Claimant’s email dated 8 February 2010, Enclosure 2.

⁵⁶⁶ Respondent’s email dated 25 February 2010, Enclosure 2.

⁵⁶⁷ C-242.

⁵⁶⁸ C-241.

⁵⁶⁹ Claimant’s email dated 21 March 2011, Enclosure 2.

Following your meeting with Mr. Virginijus Strioga, E energija CEO last Friday, I am writing to agree on the date and time convenient for you for the meeting in Riga this week to further discuss the Rēzekne case and potential international arbitration.

(...)

437. The Legal Adviser to the Latvian Prime Minister followed up with her own email confirming the meeting for 1 April 2011 and had pointed out the following in her email to the Claimant:⁵⁷¹

Let me also emphasise that this meeting shall not be considered as a meeting under the auspices of the Latvian-Lithuanian investment protection treaty. For certain factual and legal reasons the Republic of Latvia sees the investment dispute as closed, and, consequently, the meeting shall be deemed solely as a good faith effort of Latvia outside the scope of the State's international obligations and with no negative legal or financial consequences arising out of it to Latvia.

438. The Claimant's answer confirms its intention to attend the meeting of 1 April 2011. It does not express any agreement or disagreement with the passage set out in the preceding paragraph.

IV. THE PARTIES' REQUESTS FOR RELIEF

A. THE CLAIMANT

439. In its Request for Arbitration the Claimant seeks the following relief:⁵⁷²

(...) the Claimant respectfully requests the Arbitral Tribunal to:

- (a) declare that the Respondent has breached Articles 4(1), 3(1) and 3(2) of the BIT;
- (b) order the Respondent to pay damages for the material loss incurred in an amount to be established, but which the Claimant currently estimates will represent in excess of EUR 7 million, an amount which the Claimant reserves the right to quantify at a subsequent stage in this arbitration by expert evidence;
- (c) order the Respondent to pay the costs of this arbitration, including all expenses that the Claimant has incurred or shall incur herein in respect of the fees and expenses of the arbitrators, the International Centre for the Settlement of Investment Disputes, legal counsel, experts and consultants, as well as its own internal costs;

⁵⁷⁰ Claimant's email dated 21 March 2011, Enclosure 2.

⁵⁷¹ Respondent's email dated 24 March 2011, Enclosure 2.

⁵⁷² RfA ¶ 169.

- (d) order the Respondent to pay interest at a rate to be established on the amount of the award; and
- (e) order such other and further relief as the arbitrators shall deem just and proper.

440. In its first Memorial the Claimant amended the relief originally sought on three points:⁵⁷³

- (i) the amount in point (b) in the preceding paragraph was increased to EUR 9,820,000; and
- (ii) point (d) on interest, set out in the preceding paragraph, was replaced by two paragraphs reading as follows:
 - (d) order the Respondent to pay interest, compounded quarterly, at the rates set out in paragraph 366 above on the amount of the damages awarded from the date of expropriation until the date of the award;
 - (e) order the Respondent to pay interest, compounded quarterly, at the rates set out in paragraph 366 above on the amount awarded from the date [of] the award until payment by the Respondent; and

441. In its Reply on the Merits and Counter-Memorial on Preliminary Objections the Claimant requests that the Tribunal deny the Respondent's "preliminary objections" to jurisdiction. The Claimant decreased the amount sought on the merits to EUR 8,300,000,⁵⁷⁴ then increased such amount to EUR 8,390,000 in its Skeleton Argument.⁵⁷⁵

442. In its Response to Questions Raised by the Tribunal the Claimant seeks an award of costs in a total amount of EUR 3,083,279.25, which includes a success fee.⁵⁷⁶ The breakdown of such amount is as follows:

- (i) EUR 1,835,005.31 for legal fees and expenses of Salans/Vinson & Elkins (including a success fee of EUR 1,298,900);
- (ii) EUR 604,768.73 for legal fees and expenses of Sorainen;

⁵⁷³ Cl. Mem. ¶ 370.

⁵⁷⁴ Cl. Rep. ¶ 178.

⁵⁷⁵ Cl. Skeleton ¶ 22.

⁵⁷⁶ Cl. Rep. Tribunal ¶¶ 67 ff.

(iii) EUR 263,474.72 for expert costs (Brattle Group and Dr. Blumberga); and

(iv) EUR 380,030.49 for ICSID/Tribunal costs.

443. In the alternative, should the Tribunal consider that success fees should not be awarded as part of any award on costs, the Claimant seeks an award of costs in a total amount of EUR 1,688,928.85.⁵⁷⁷ The breakdown of such amount is as follows:

(i) EUR 744,945.98 for legal fees and expenses of Salans/Vinson & Elkins;

(ii) EUR 300,477.66 for legal fees and expenses of Sorainen;

(iii) EUR 263,474.72 for expert costs (Brattle Group and Dr. Blumberga); and

(iv) EUR 380,030.49 for ICSID/Tribunal costs.

B. THE RESPONDENT

444. In its Memorial on Preliminary Objections and Request for Bifurcation, and Counter-Memorial on the Merits the Respondent seeks the following relief:⁵⁷⁸

(...) the Respondent kindly requests the Tribunal to:

1) declare that, in accordance with Article 41(6) of the ICSID Arbitration Rules, the dispute is not within the competence of the Tribunal because of aspects mentioned in Section 4.1) and 4.2) of this document;

or

2) declare that, in accordance with Article 41(6) of the ICSID Arbitration Rules, this arbitration proceeding is to be suspended pending the final and binding adjudication in Latvian courts of the local judicial civil proceeding No. C03051107,

or

3) declare that the Respondent has not breached the Treaty; *and*

4) deny all Claimant's requests for relief (as specified in the Claimant's Memorial, paragraphs 370 to 371):

but, in any case,

⁵⁷⁷ Cl. Rep. Tribunal ¶¶ 67 ff.

⁵⁷⁸ Resp. Obj. J. & C-Mem. ¶ 5.

- 5) order the Claimant to compensate all expenses incurred by the Respondent pertaining to this arbitration proceeding (together with the Latvian statutory interest rate of 6% a year until payment), as well as the fees and expenses of the Honorable Members of the Tribunal.

445. The Respondent's Rejoinder on the Merits does not contain a section setting out the relief sought.
446. The Respondent maintains in its Skeleton Argument that it sought the dismissal of all of the Claimant's claims and an award of costs covering its fees, costs and expenses as well as the Tribunal's fees, costs and expenses, and that it sought the stay or the termination of the proceedings (and an award of costs also in such case).
447. In its Post-Hearing Submission in Response to the Tribunal's Questions the Respondent seeks an award of costs in an amount of no less than EUR 162,556.28.⁵⁷⁹ The breakdown of such amount is as follows:
- (i) EUR 12,247.27 for the legal fees and expenses of the State Chancellery;
 - (ii) EUR 114,035 for consultancy fees (in connection with the expert report);
 - (iii) EUR 17,069.86 for translation costs;
 - (iv) EUR 2,121.37 for courier services; and
 - (v) EUR 17,082.78 for the legal fees and expenses of the Rēzekne Municipality.
448. In its Response to the Tribunal's Procedural Order No. 9 the Respondent increased the amount claimed for legal fees and expenses from EUR 12,247.27 to EUR 16,246.27 and therefore the Respondent seeks an award of costs in an amount of no less than EUR 166,555.28.⁵⁸⁰

V. JURISDICTION

449. The Tribunal will summarise the Parties' submissions before stating the reasons for its decision on the Respondent's "preliminary objections" to jurisdiction.

⁵⁷⁹ Resp. P-H (PO8) ¶ 24.

⁵⁸⁰ Resp. Rep. (PO9) ¶ 39.

A. THE PARTIES' PRAYERS FOR RELIEF ON JURISDICTION AND THE RESPONDENT'S "PRELIMINARY OBJECTIONS"

(1) THE RESPONDENT

450. In its Memorial on Preliminary Objections and Request for Bifurcation, and Counter-Memorial on the Merits the Respondent seeks the following relief:⁵⁸¹

Considering the above mentioned factual and legal description of the situation, the Respondent kindly requests the Tribunal to:

- 1) declare that, in accordance with Article 41(6) of the ICSID Arbitration Rules, the dispute is not within the competence of the Tribunal because of aspects mentioned in Section 4.1) and 4.2) of this document;

or

- 2) declare that, in accordance with Article 41(6) of the ICSID Arbitration Rules, this arbitration proceeding is to be suspended pending the final and binding adjudication in Latvian courts of the local judicial civil proceeding No. C03051107;

or

(...)

451. The Respondent's Reply on Preliminary Objections does not set out a prayer for relief.

452. In its Skeleton Argument the Respondent requests the Tribunal "under the Tribunal's discretionary competence, to suspend or terminate the proceedings on grounds enumerated in Respondent's pleadings".⁵⁸²

(2) THE CLAIMANT

453. In its Reply on the Merits and Counter-Memorial on Preliminary Objections the Claimant requests the following relief:⁵⁸³

The Claimant therefore respectfully requests the Arbitral Tribunal to:

- (a) deny the requests for relief set out by the Respondent in section 5 of the Counter-Memorial on the Merits and Preliminary Objections on Jurisdiction;

⁵⁸¹ Resp. Obj. J. & C-Mem. ¶ 5.

⁵⁸² Resp. Skeleton p. 4.

⁵⁸³ Cl. Rep. ¶ 178.

(b) (...)

454. In its Rejoinder on Preliminary Objections the Claimant restates substantially the same relief.⁵⁸⁴

B. THE CLAIMANT’S POSITION ON JURISDICTION

(1) JURISDICTION RATIONE PERSONAE

455. In its Memorial the Claimant refers to the arguments made in its Request for Arbitration regarding the Tribunal’s jurisdiction *ratione personae* in which the Claimant submitted the following:⁵⁸⁵

- (i) both Parties have consented to arbitration in accordance with the ICSID Convention and the BIT;
- (ii) the Claimant is an “investor” under the BIT, and
- (iii) the Claimant is a national of the Republic of Lithuania.

(A) CONSENT OF BOTH PARTIES TO ICSID ARBITRATION

456. The Claimant submits that both the Republic of Lithuania and the Republic of Latvia are Contracting States to the ICSID Convention as they signed and ratified the ICSID Convention on 6 July 1992 and 7 September 1997 respectively.⁵⁸⁶

457. The Claimant contends that the Respondent consented to ICSID jurisdiction under Articles 7(1) and 7(2) of the BIT⁵⁸⁷ on 23 July 1996 when the BIT entered into force.⁵⁸⁸

458. The Claimant further submits that it attempted to settle the dispute with the Respondent amicably on several occasions through written correspondence and meetings held with the Respondent’s representatives of Respondent after the written

⁵⁸⁴ Cl. Rej. J. ¶ 13.

⁵⁸⁵ Cl. Mem. ¶¶ 224-228; RfA ¶ 8.

⁵⁸⁶ RfA ¶ 9.

⁵⁸⁷ BIT, CLA-1; this provision is reproduced in paragraph 497 below.

⁵⁸⁸ RfA ¶ 10.

Notice of Dispute⁵⁸⁹ given in accordance with the BIT was served on the Respondent on 2 September 2008. No amicable settlement could be reached despite all efforts on the part of the Claimant.⁵⁹⁰

(B) CLAIMANT AS AN INVESTOR UNDER THE BIT

459. The Claimant contends that it is an investor within the meaning of Article 1(2)(a)(ii) of the BIT⁵⁹¹ as it is a “company constituted under the laws of the Republic of Lithuania and registered in the territory of Lithuania in conformity with its laws and regulations”.⁵⁹²

(C) CLAIMANT AS A NATIONAL OF THE REPUBLIC OF LITHUANIA

460. The Claimant further contends that it is “a national of another Contracting State” within the meaning of Article 25(2)(b) of the ICSID Convention since it is a legal entity and registered tax payer incorporated in, and a national of, Lithuania on the date that the Request was submitted.⁵⁹³

(2) JURISDICTION RATIONE MATERIAE

461. In its Memorial the Claimant refers to the argument set out in its Request for Arbitration with respect to the Tribunal’s jurisdiction *ratione materiae*, in which the Claimant made the following submissions on the Tribunal’s jurisdiction *ratione materiae*:⁵⁹⁴

- (i) the Claimant made an “investment” within the meaning of the BIT;
- (ii) the Claimant made an “investment” within the meaning of Article 25 of the ICSID Convention;
- (iii) the dispute between the Claimant and the Respondent constitutes a “dispute” within the meaning of the BIT; and

⁵⁸⁹ C-3.

⁵⁹⁰ RfA ¶ 11.

⁵⁹¹ BIT, CLA-1.

⁵⁹² RfA ¶ 12.

⁵⁹³ RfA ¶ 13.

⁵⁹⁴ Cl. Mem. ¶¶ 224-228; RfA ¶¶ 14 ff.

- (iv) such dispute constitutes a “legal dispute arising directly out of an investment” within the meaning of Article 25 of the ICSID Convention.

(A) AN “INVESTMENT” WITHIN THE MEANING OF THE BIT

462. The Claimant submits that it made an “investment” within the meaning of Article 1(1) of the BIT,⁵⁹⁵ which investment includes the following in the present case:⁵⁹⁶

- (i) the shares in Latgales Enerģija (Article 1(1)(b) of the BIT);⁵⁹⁷
- (ii) the provision of loans to Latgales Enerģija to fund Latgales Enerģija’s operations (Article 1(1)(c) of the BIT);⁵⁹⁸
- (iii) the guarantee of a loan to Rēzekne Municipality (Article 1(1)(c) of the BIT);⁵⁹⁹
- (iv) the guarantee of a loan to Latgales Enerģija to fund Latgales Enerģija’s operations (Article 1(1)(c) of the BIT);⁶⁰⁰
- (v) the know-how and expertise in heating services which the Claimant provided to Latgales Enerģija (Article 1(1)(d) of the BIT);⁶⁰¹ and
- (vi) the provision of operational management expertise (Article 1(1)(d) of the BIT).⁶⁰²

463. In its Request for Arbitration the Claimant substantiated the allegation of the investment made in Latvia by relying on a number of further elements, in addition to those summarised in the preceding paragraph.⁶⁰³ However, the Claimant did not maintain these elements in its Memorial.

⁵⁹⁵ BIT, CLA-1.

⁵⁹⁶ Cl. Mem. ¶¶ 227-228; see also Transcript, Day 1, 18-22.

⁵⁹⁷ RfA ¶¶ 28-29; Cl. Mem. ¶¶ 39-41; 227.

⁵⁹⁸ Cl. Mem. ¶¶ 42-47; 227.

⁵⁹⁹ Cl. Mem. ¶¶ 67-69; 72; 227.

⁶⁰⁰ Cl. Mem. ¶¶ 62; 66; 70-72; 227.

⁶⁰¹ Cl. Mem. ¶¶ 88; 227.

⁶⁰² Cl. Mem. ¶ 227.

⁶⁰³ RfA ¶ 46.

(B) AN “INVESTMENT” WITHIN THE MEANING OF ARTICLE 25 OF THE ICSID CONVENTION

464. The Claimant contends that it has made an “investment” also within the meaning of Article 25 of the ICSID Convention as it made both a long-term⁶⁰⁴ and substantial⁶⁰⁵ commitment to take over the Municipality-owned district heating system, which required an assumption of risk⁶⁰⁶ and was significant for the development of the Republic of Latvia.⁶⁰⁷

(C) A “DISPUTE CONCERNING INVESTMENT” WITHIN THE MEANING OF THE BIT

465. The Claimant contends that its dispute with the Respondent constitutes a “dispute concerning investment” within the meaning of Article 7(1) of the BIT⁶⁰⁸ as such dispute concerns breaches of the BIT that arose directly out of the Claimant’s investment, such as the expropriation of Claimant’s investment, the breach of the fair and equitable treatment obligation, the breach of the full protection and security obligation, the arbitrary and discriminatory treatment of Claimant’s investment and the breaches of the most-favoured nation treatment obligation.⁶⁰⁹

(D) A “LEGAL DISPUTE ARISING DIRECTLY OUT OF AN INVESTMENT” WITHIN THE MEANING OF ARTICLE 25 OF THE ICSID CONVENTION

466. Finally, Claimant submits that its dispute with the Respondent constitutes a “legal dispute arising directly out of an investment” within the meaning of Article 25 of the ICSID Convention as such dispute concerns the existence of legal rights and

Such additional elements are as follows:

- (i) the right to provide heating services in Rēzekne for thirty years under the Long-Term Agreement (RfA ¶ 46; see also RfA ¶ 32);
- (ii) the assumption, and repayment, of the debts owed by Rēzeknes Siltumtīkli (RfA ¶¶ 46; 41-43; Cl. Mem. ¶¶ 48-66; Cl. Rep. ¶¶ 157-158);
- (iii) the “monetary investments” into the heating supply infrastructure (RfA ¶¶ 46; 36; 38-40; Cl. Mem. ¶¶ 73-86);
- (iv) the licences and other required permissions and certificates granted to Latgales Enerģija for the provision of heating services in Rēzekne (RfA ¶¶ 35; 46); and
- (v) “other investments” (RfA ¶ 46).

⁶⁰⁴ RfA ¶ 49.1.

⁶⁰⁵ RfA ¶ 49.2.

⁶⁰⁶ RfA ¶ 49.3.

⁶⁰⁷ RfA ¶¶ 48-50, especially ¶ 49.4.

⁶⁰⁸ BIT, CLA-1; this provision is reproduced in paragraph 497 below.

⁶⁰⁹ RfA ¶¶ 51-52.

obligations as well as the breaches of the BIT by the Respondent which relate to the investment made by Claimant in Latvia.⁶¹⁰

C. THE RESPONDENT’S OBJECTIONS TO JURISDICTION

(1) JURISDICTION *RATIONE PERSONAE*

467. The Respondent has not specifically challenged the Claimant’s submissions on jurisdiction *ratione personae*.

(2) THE PARTIES’ CONSENT TO ICSID ARBITRATION

468. In its Memorial on Preliminary Objections the Respondent submits its “preliminary objections to jurisdiction”.⁶¹¹ Further to the Claimant’s comment that such objections were “probably issues of admissibility rather than jurisdiction”, the Respondent replies that Article 41 of the ICSID Arbitration Rules covers both issues of jurisdiction and admissibility.⁶¹²

469. The Respondent’s “preliminary objections” are as follows.

(A) LACK OF A CONDITION PRECEDENT FOR THE SUBMISSION OF THE REQUEST FOR ARBITRATION

470. The Respondent objects that the Claimant’s decision dated 1 December 2009⁶¹³ allegedly authorising the Request for Arbitration requires mediation to be started prior to arbitration; such condition precedent is not met in the present case.⁶¹⁴

The Respondent states that such a document has legal effects for potential respondents; any ambiguities in such documents are to be interpreted and construed in the interest of the party which did not draft the documents.⁶¹⁵

⁶¹⁰ RfA ¶¶ 53-54.

⁶¹¹ Resp. Obj. J. & C-Mem. ¶¶ 4.1 ff.

⁶¹² Resp. Rej. ¶ 39.

⁶¹³ C-247.

⁶¹⁴ Resp. Obj. J. & C-Mem. ¶¶ 4.2-4.4.

⁶¹⁵ Resp. Obj. J. & C-Mem. ¶¶ 4.2-4.4.

(i) *Lack of Consent by the European Bank for Reconstruction and Development*

471. The Respondent objects that all actions required in order for the Request for Arbitration to be filed were not completed since the Claimant's internal document dated 1 December 2009⁶¹⁶ allegedly authorising the Request for Arbitration required approval by the EBRD as a shareholder; such approval is not in evidence.⁶¹⁷

(3) JURISDICTION *RATIONE MATERIAE*

(A) LACK OF A DISPUTE WITHIN THE MEANING OF ARTICLE 25 OF THE ICSID CONVENTION

472. The Respondent submits that there is a lack of a dispute within the meaning of Article 25 of the ICSID Convention relying on the international law principles of acquiescence, extinctive prescription and estoppel, as well as the Claimant's bad faith.⁶¹⁸

473. The Respondent contends that the pursuit of an international investment claim is barred if there is undue delay or if a potential claimant by its clear conduct induced a potential respondent to rely on the fact that a potential claim would no longer be pursued; reliance is placed on a number of awards on the principles of acquiescence, estoppel and prescriptive extinction^{619, 620}.

The Respondent argues that by its voluntary and unconditional conduct the Claimant caused the Republic of Latvia to rely on the fact that the investment claims would not be pursued beyond negotiations since:

⁶¹⁶ C-247.

⁶¹⁷ Resp. Obj. J. & C-Mem. ¶¶ 4.5- 4.8.

⁶¹⁸ Resp. Obj. J. & C-Mem. ¶¶ 4.9 ff., especially ¶ 4.11.

⁶¹⁹ *M.C.I. Power Group L.C. and New Turbine Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6, Award, 31 July 2007, RLA-11; *Grand River Enterprises Six Nations Ltd. et al. v. United States of America*, UNCITRAL, Decision on Objections to Jurisdiction, 20 July 2006, RLA-12; *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL, Interim Award, 26 June 2000 ("*Pope & Talbot v. Canada*"), RLA-13/CLA-43.

⁶²⁰ Resp. Obj. J. & C-Mem. ¶¶ 4.9-4.12.

- (i) 42 months lapsed after the expiry of a time limit after which a claim may be brought to ICSID under Article 7(2) of the BIT;⁶²¹
- (ii) the Claimant did not send the Respondent any communication after negotiations had been conducted from 1 September 2008 to 14 June 2010, the date of the latest letter by the State Chancellery of Latvia calling on the Claimant to proceed with the negotiation in case the Claimant deemed that any of its rights had been breached; and
- (iii) there had been isolated communications on 21, 24 and 28 March 2011 and 1 April 2011, in which the Government of Latvia expressly stated that such communications would be made outside the investment protection treaty and that the Government regarded the Claimant's claims as time barred; the Claimant confirmed its participation in the 1 April 2011 meeting, but no further communication followed;⁶²²

474. According to the Respondent, the submission of the Claimant's Request for Arbitration 42 months after a period authorised in the BIT, 25 months after the Claimant did not respond to the Respondent's express request to proceed with the negotiation process and 17 months after the Claimant agreed to participate in a meeting held outside the investment protection treaty shows the Claimant's bad faith.⁶²³

475. The Respondent objects that there is a "reasonable doubt" that the Claimant brought this arbitration in good faith to influence the Lithuanian authorities or show that certain legal remedies lie in case of an expropriation of the Claimant's assets in light of the fact that two municipalities in Lithuania, Prienų and Ukmergė, terminated their cooperation with the Claimant in connection with district heating services to be provided by the Claimant relying on the Claimant's improper conduct and a "series of

⁶²¹ BIT, CLA-1; this provision is reproduced in paragraph 497 below.

⁶²² Resp. Obj. J. & C-Mem. ¶ 4.13.

⁶²³ Resp. Obj. J. & C-Mem. ¶ 4.14.

events” which took place between 2010 and 2012; reliance was placed by the Respondent on Exhibits R-11 to R-14.⁶²⁴

(B) LACK OF A DISPUTE CONCERNING INVESTMENT WITHIN THE MEANING OF THE BIT

476. In its first letter to the ICSID Secretariat dated 27 August 2012 the Respondent takes the view that the basis for the claims asserted by the Claimant in its Request for Arbitration was not the alleged breach of a bilateral investment protection treaty, but the alleged breach of a private contract.

477. This objection was elaborated upon by the Respondent in due course and the Respondent argues in particular that the Claimant “loads the Tribunal with typical **commercial issues** that, according to the *Vivendi doctrine* (...), are essentially contractual claims outside the scope of international investment law”.⁶²⁵

D. THE CLAIMANT’S REPLY TO THE RESPONDENT’S “PRELIMINARY OBJECTIONS” TO JURISDICTION

(1) GENERAL COMMENTS ON THE RESPONDENT’S “PRELIMINARY OBJECTIONS”

478. The Claimant contends that the Respondent does not challenge (i) consent under the BIT and the ICSID Convention, (ii) that the Claimant is an investor of Lithuania under the BIT and a national of Lithuania for the purposes of the ICSID Convention, (iii) that the Claimant has made an investment for the purposes of the BIT and the ICSID Convention, and (iv) that there is a dispute within the meaning of the BIT and the ICSID Convention.⁶²⁶

479. Therefore, the Respondent does not, in the Claimant’s view, challenge “the Tribunal’s standing to consider claims brought by E energija under the terms of the BIT and the ICSID Convention”; Latvia rather argues that the Tribunal is precluded from considering the claims which it otherwise has jurisdiction to entertain.⁶²⁷ The

⁶²⁴ Resp. Obj. J. & C-Mem. ¶ 4.15. At the Hearing the Respondent relied on the same circumstances, not in support of an objection to jurisdiction or admissibility, but as a ground for a stay of the proceedings or the termination of the proceedings (Transcript, Day 1, 149/3-5).

⁶²⁵ Resp. Obj. J. & C-Mem. ¶ 2.1(4) (original emphasis).

⁶²⁶ Cl. Rep. ¶ 128.

⁶²⁷ Cl. Rep. ¶ 129.

Respondent's objections go to the admissibility of such claims rather than the Tribunal's jurisdiction.⁶²⁸

480. According to the Claimant, the Respondent has the burden of proving that its objections prevent the Tribunal from considering the Claimant's claims and the threshold must be a high one; for example, see the interim award in *Chevron v. Ecuador*^{629, 630}.

(2) THE CLAIMANT'S REPLY TO THE RESPONDENT'S OBJECTION BASED ON THE LACK OF INTERNAL AUTHORISATION

481. The Claimant submits (i) that the jurisdiction of this Tribunal is governed solely by Article 25 of the ICSID Convention, the requirements of which are met in the present case, (ii) that Article 36(2) of the ICSID Convention and ICSID Institution Rules 2(1)(f) and 2(2) do not deal with the jurisdiction of ICSID or the Tribunal and (iii) that a failure to comply with Article 36(2) and Institution Rules 2(1)(f) and 2(2) could, at the most, constitute only a procedural defect in the Request for Arbitration, but not a bar to jurisdiction.⁶³¹

482. The Claimant's argument may be summarised as follows:

- (i) the Request for Arbitration complies with ICSID Institution Rule 2 as it was filed with the power of attorney appointing Salans LLP and Sorainen as the counsel acting for the Claimant, signed by the Claimant's CEO Mr. Strioga,⁶³² which meets the requirements of Institution Rules 2(1)(f) and 2(2); that was the only "necessary internal action" required;⁶³³
- (ii) moreover, Mr. Strioga subsequently confirmed in his letter dated 3 October 2012⁶³⁴ that "all necessary internal actions" had been taken "to authorise the

⁶²⁸ Cl. Rep. ¶ 130.

⁶²⁹ *Chevron Corporation and Texaco Petroleum Corporation v. Republic of Ecuador*, UNCITRAL, Interim Award, 1 December 2008 ("*Chevron v. Ecuador*"), CLA-44 ¶¶ 138-139; 143.

⁶³⁰ Cl. Rep. ¶ 131.

⁶³¹ Cl. Rep. ¶ 132.

⁶³² C-2.

⁶³³ Cl. Rep. ¶¶ 134-135.

⁶³⁴ C-247.

filing of the Request for Arbitration”, and that is in itself sufficient, since Mr. Strioga has authority to act alone on behalf of the Claimant as recorded in the Register of Legal Entities in Lithuania;⁶³⁵

(iii) no board decision was required;⁶³⁶ the minutes of the Claimant’s Board meeting of 1 December 2009 attached to Mr. Strioga’s letter of 3 October 2012 were provided “by way of further support”,⁶³⁷ but they need not be examined since they are irrelevant in order to decide whether the Claimant authorised the filing of the Request for the purposes of Institution Rules 2(1)(f) and 2(2);⁶³⁸

(iv) in any event, the Claimant contends that the Respondent misreads the minutes of the Claimant’s Board meeting of 1 December 2009 in two respects:⁶³⁹

(1) the Respondent relies on the minutes of the Claimant’s Board meeting of 1 December 2009, in particular on the sentence “Decided: Apply to international arbitrage in case Latvian Government rejects the proposed UAB E energija scenario: SIA ‘Latgales Enerģija’ cash should be released from the executor’s account then the case would be brought to the mediation panel” and concludes that resort to mediation was a condition precedent to the institution of arbitration proceedings; and

the Respondent’s construction of that sentence is inaccurate; that sentence indicates that the Claimant would apply to arbitration in case Latvia rejected a certain proposal made by the Claimant; such proposal contemplated a resort to mediation in case Latgales Enerģija’s funds, which had been attached, had been released;⁶⁴⁰ however, those funds

⁶³⁵ C-1.

⁶³⁶ Cl. Rep. ¶ 137.

⁶³⁷ Cl. Rep. ¶ 136.

⁶³⁸ Cl. Rep. ¶¶ 136-137.

⁶³⁹ C-247.

⁶⁴⁰ Cl. Rep. ¶ 140.

were not in fact released⁶⁴¹ and the Board's decision to commence arbitration was, and remains, valid;⁶⁴² and

- (2) the Respondent relies on the minutes of the Claimant's Board meeting of 1 December 2009⁶⁴³ to object that arbitration could be commenced only with the EBRD's approval; and

the Respondent's submission is without foundation as no Board decision was required to bring this arbitration; in any event, the reference to the EBRD is not contained in the part of the minutes that sets out the decision, but in a "commentary";⁶⁴⁴ the EBRD was in fact approached by the Claimant "for support in relation to an arbitration", which it provided in the form of a letter to Latvia;⁶⁴⁵ Ms. Göransson, the EBRD representative on the Claimant's Board, attended the Board meeting of 1 December 2009 and approved the decision.⁶⁴⁶

(3) THE CLAIMANT'S REPLY TO THE RESPONDENT'S OBJECTIONS BASED ON ESTOPPEL, ACQUIESCENCE AND EXTINCTIVE PRESCRIPTION

483. The Claimant's reply to the Respondent's objections may be summarised as follows:

- (i) *on estoppel*: the Claimant disputes that it is estopped from asserting its claims; reliance is placed on *Pope & Talbot v. Canada* with respect to the three ingredients of estoppel;⁶⁴⁷ the Claimant replies (i) that the Respondent has failed to show that the Claimant ever made any statement that it would not pursue the claims set out in the Notice of Dispute,⁶⁴⁸ and (ii) that the Respondent failed to show any reliance on its part on such alleged statement,

⁶⁴¹ Transcript, Day 1, 77/7.

⁶⁴² Cl. Rep. ¶ 141.

⁶⁴³ C-247.

⁶⁴⁴ Cl. Rep. ¶ 143.

⁶⁴⁵ Cl. Rep. ¶ 144; C-237; C-240.

⁶⁴⁶ C-247; see also Mr. Strioga's second Witness Statement, CWS-6 ¶ 34.

⁶⁴⁷ *Pope & Talbot v. Canada*, RLA-13/CLA-43 ¶ 111.

⁶⁴⁸ C-3.

and any detriment suffered as a consequence of such alleged reliance; no issue of estoppel can therefore arise;⁶⁴⁹

- (ii) *on acquiescence*: the Claimant submits that the doctrine of acquiescence has two constituent elements, namely (i) inaction on behalf of a State or a failure to assert a claim, (ii) such failure must have extended over a certain period of time, and (iii) there must have been circumstances that would have required action (reliance was placed by the Claimant on the commentary on *The Law of International Responsibility*⁶⁵⁰); the Claimant submits that cogent evidence of a tacit intention to withdraw a claim must be required in a case, such as the present case, in which the investor has submitted a Notice of Dispute;⁶⁵¹

in the Claimant's view, the Respondent has provided no evidence that the circumstances required action on the part of the Claimant in the present case; the BIT contains no time limits in order for claims to be brought and the Claimant submitted a detailed Notice of Dispute^{652,653} and

in particular, the Claimant argues that Latvia's letter of 12 July 2010⁶⁵⁴ answered the Claimant's letter of 15 June 2010;⁶⁵⁵ in its 15 June 2010 letter the Claimant had informed the Respondent that it contemplated arbitration proceedings since amicable negotiations had failed; the Respondent answered proposing a meeting or a telephone conference; admittedly, the Respondent's letter was followed by a few months in which the negotiations between the Parties halted; however, the circumstances at the time did not require action by the Claimant and the Claimant was under no obligation to bring an arbitration immediately, and the Respondent has failed to show that the duration of the silence on the part of the Claimant was sufficient to amount to an

⁶⁴⁹ Cl. Rep. ¶¶ 149-150.

⁶⁵⁰ J. Crawford, A. Pellet, S. Olleson (eds.), *The Law of International Responsibility*, Oxford 2010, CLA-45 p. 1042.

⁶⁵¹ Cl. Rep. ¶¶ 151-152.

⁶⁵² C-3.

⁶⁵³ Cl. Rep. ¶ 153.

⁶⁵⁴ C-241.

⁶⁵⁵ C-242.

abandonment of the claims set out in the Notice of Dispute and that the circumstances required action on the part of the Claimant;⁶⁵⁶

- (iii) *on extinctive prescription*: the Claimant acknowledges that prescriptive extinction may apply even if a State has not acquiesced in the extinction of a claim, but replies (i) that the BIT does not contain any time limits within which a claim is to be brought, (ii) that there is no general agreement as to any actual time limits in international law and (iii) that the mere lapse of time is not sufficient to extinguish a claim; extinctive prescription has been applied only where the lapse of time has put the respondent at a disadvantage (reliance was placed by the Claimant on the commentary on *The Law of International Responsibility*⁶⁵⁷);⁶⁵⁸ the overall delay of less than 4 years between the Notice of Dispute and the Request for Arbitration is not an unreasonable period such as to bar a claim and the Respondent has suffered no prejudice;⁶⁵⁹ and
- (iv) *on bad faith*: the Claimant denies that it brought the present arbitration against Latvia in bad faith to in order to influence the Lithuanian authorities in relation to the termination of district heating concessions in two Lithuanian municipalities and wonders how proceedings brought against one State could possibly influence the authorities of another State.⁶⁶⁰ The Claimant further points out that, on the one hand, the concession in Prienų had not been terminated, and, on the other, the Ukmergė concession was terminated after the local authorities attempted to negotiate an agreed termination with the Claimant; those facts therefore bore no relation to the present dispute.⁶⁶¹

E. THE REASONS FOR THE TRIBUNAL'S DECISION ON JURISDICTION

484. The Claimant contends that the Tribunal has jurisdiction under the BIT and the ICSID Convention, whereas the Respondent raised the following “preliminary objections” to

⁶⁵⁶ Cl. Rep. ¶¶ 153-155.

⁶⁵⁷ CLA-45 p. 3.

⁶⁵⁸ Cl. Rep. ¶¶ 157-158.

⁶⁵⁹ Cl. Rep. ¶ 159.

⁶⁶⁰ Cl. Rep. ¶ 161.

⁶⁶¹ Cl. Rep. ¶ 162.

the Tribunal's jurisdiction, which the Tribunal joined to the merits in Procedural Order No. 3*bis*:

- (i) lack of the Claimant's internal authorisation for instituting these proceedings ("First Objection"); and
- (ii) lack of "dispute" under Article 25(1) of the ICSID Convention ("Second Objection").⁶⁶²

485. In this section of the present Award the Tribunal will examine (1) its jurisdiction *ratione personae*, (2) the Parties' consent to ICSID arbitration (including the Respondent's First Objection) and (3) its jurisdiction *ratione materiae* (including the Respondent's Second Objection).

(1) JURISDICTION *RATIONE PERSONAE*

486. The Republic of Lithuania signed and ratified the ICSID Convention on 6 July 1992 which entered into force in the Republic of Lithuania on 5 August 1992.⁶⁶³

487. The Republic of Latvia signed and ratified the ICSID Convention on 8 August 1997 which entered into force in the Republic of Latvia on 7 September 1997.⁶⁶⁴

488. The BIT⁶⁶⁵ was ratified by the Republic of Lithuania on 19 July 1996⁶⁶⁶ and by the Republic of Latvia pursuant to an Act of the Latvian Parliament dated 2 May 1996.⁶⁶⁷

489. The BIT entered into force on 23 July 1996.⁶⁶⁸

490. Article 1(2) of the BIT reads as follows:

Article 1
Definitions

For the purposes of this Agreement:

⁶⁶² Resp. Obj. J. & C-Mem. ¶¶ 4.1 ff.; Procedural Order No. 3*bis*.

⁶⁶³ CLA-5.

⁶⁶⁴ CLA-5.

⁶⁶⁵ BIT, CLA-1.

⁶⁶⁶ CLA-2.

⁶⁶⁷ CLA-3.

⁶⁶⁸ BIT, CLA-1.

1. (omitted)
2. The term “investor” means:
 - a) in respect of the Republic of Lithuania:
 - (i) natural persons who are nationals of the Republic of Lithuania according to the laws of the Republic of Lithuania;
 - (ii) any entity constituted under the laws of the Republic of Lithuania and registered in the territory of the Republic of Lithuania in conformity with its laws and regulations;
 - (...) (omitted)

491. The Claimant is a limited liability company incorporated in Lithuania and having its registered office in Vilnius, Lithuania.⁶⁶⁹ The Claimant is therefore an “investor” of Lithuania within the meaning of Article 1(2)(ii) of the BIT.

492. Article 25(2)(b) of the ICSID Convention provides:

- (2) “National of another Contracting State” means:
 - (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration....

493. As a limited liability company incorporated in Lithuania and having its registered office in Lithuania on the date the Request was submitted to ICSID, the Claimant is also a “juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration” within the meaning of Article 25(2)(b) of the ICSID Convention.

494. The Respondent has not challenged these points.

495. The Tribunal therefore finds that there is no lack of jurisdiction *ratione personae* under the BIT and the ICSID Convention.

⁶⁶⁹ C-1.

(2) THE PARTIES' CONSENT TO ICSID JURISDICTION

496. The Tribunal will determine whether (i) the Parties consented to ICSID jurisdiction under Article 7 of the BIT and Article 25(1) of the ICSID Convention and (ii) whether the alleged lack of compliance by the Claimant with its internal requirements to initiate these proceedings has any effects on the Claimant's consent to ICSID jurisdiction.

497. Article 25(1) of the ICSID Convention reads as follows:

Chapter II
Jurisdiction of the Centre

Article 25

- (1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

498. Article 7 of the BIT reads as follows:

Article 7
Disputes between One Contracting Party and an Investor of the Other
Contracting Party

1. Notice of a dispute concerning investment between one of the Parties and an investor of the other Party shall be given in writing. This shall include a detailed statement by the investor to the Contracting Party in whose territory the investment was made. The Parties shall, if possible, endeavour to settle their differences by means of a friendly agreement.
2. If such dispute cannot be settled amicably within six months from the date of the written notification provided in paragraph 1, the dispute, at the request of either party and at the choice of the investor, shall be submitted to:
 - an ad hoc court of arbitration, for arbitration in accordance with the Arbitration Rules issued in 1976 by the United Nations Commission on International Trade Law (UNCITRAL); or to
 - the International Center for the Settlement of Investment Dispute (ICSID) established under the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, for arbitration under ICSID Rules of Procedure for Arbitration Proceedings if both of the Contracting Parties have acceded to the Convention.

3. The arbitral decisions shall be final and binding on both parties to the dispute. Each Contracting Party shall execute them in accordance with its laws and in accordance with the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), if the Contracting Parties are members of that Convention. The arbitration shall take place in a State that is a party to the New York Convention.

(footnotes omitted)

(A) THE PARTIES' CONSENT TO ICSID JURISDICTION

499. The Tribunal finds that the Respondent offered to submit certain disputes to ICSID arbitration under Article 7 of the BIT provided (i) that the investor gave the host State a notice of dispute in writing including a detailed statement (Article 7(1) of the BIT), and (ii) that the Parties endeavoured to settle their dispute amicably in the six months following the notification of the notice of dispute (Article 7(2) of the BIT).
500. The Respondent did not dispute that these requirements were met.
501. The Tribunal concludes that the two requirements in Article 7(1) and 7(2) of the BIT were met in the present case. First, the Claimant delivered its Notice of Dispute on 2 September 2008 to the Respondent, thereby complying with Article 7(1) of the BIT. Secondly, the Respondent accepts that negotiations with the Claimant started on 1 September 2008⁶⁷⁰ and continued until 14 July 2010 with a final meeting on 1 April 2011 without any settlement being reached.⁶⁷¹ The Parties therefore tried to settle their dispute amicably for more than six months before the Claimant submitted the dispute to ICSID, as required by Article 7(2) of the BIT.
502. The Tribunal also finds that the Claimant accepted the Respondent's offer contained in the BIT to settle the dispute by ICSID arbitration by filing its Request for Arbitration on 15 August 2012. The Tribunal therefore concludes that the requirement of consent under Article 7(2) of the BIT was met, as was the requirement of "consent in writing" under Article 25(1) of the ICSID Convention.

This conclusion, however, is subject to the determination by the Tribunal of the Respondent's First Objection that the Claimant's internal documents authorising the

⁶⁷⁰ See the letter by the State Chancellery to the ICSID Secretary-General dated 6 September 2012.

⁶⁷¹ RfA ¶ 11; Cl. Rep. ¶ 153; Resp. Obj. J. & C-Mem. ¶¶ 4.13(2); 4.13(3); see also the letter by the State Chancellery to the ICSID Secretary-General dated 6 September 2012.

request show an alleged lack of compliance with a condition precedent (*i.e.* mediation) and a failure to obtain the required EBRD approval before instituting these proceedings.

(B) THE RESPONDENT’S FIRST OBJECTION – LACK OF INTERNAL
AUTHORISATION TO INITIATE THESE PROCEEDINGS

503. As part of the Secretary-General’s screening process, the ICSID Secretariat requested the Claimant’s confirmation that it had “taken all necessary internal actions to authorise the request” pursuant to ICSID Institution Rule 2(1)(f). In a letter dated 3 October 2012 the Claimant confirmed that “UAB ‘E energija’ has taken all necessary internal actions to authorise the filing of the Request” and attached UAB’s Board Meeting Minutes dated 1 December 2009.⁶⁷²
504. The Respondent’s First Objection is based on these Board Minutes. According to the Respondent, such Minutes demonstrate a “[l]ack of compliance with Article 36(2) of the ICSID Convention [and] ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings, Rule 2(1)(f) and Rule 2(2)”.⁶⁷³ No other authorities aside from these provisions are relied upon by the Respondent in support of this preliminary objection.
505. In the Tribunal’s view, whether the authorising documents provided by the Claimant in the present case were such as to warrant the registration of the request is a matter for the ICSID Secretary-General.
506. Article 36(2) of the ICSID Convention (and Institution Rule 2) deal with the registration procedure, not with the jurisdiction of a tribunal constituted under the ICSID Convention. Jurisdiction is dealt with in Article 25 of the ICSID Convention. Insofar as the Respondent’s “preliminary objection” is based on Article 36(2) of the ICSID Convention and Institution Rule 2, such objection must therefore fail.
507. As the Claimant argues that it consented to ICSID arbitration by filing the Request, a lack of authorisation to file the Request, if established, could operate so as to taint the Claimant’s consent in the Tribunal’s view. The Tribunal will therefore examine the

⁶⁷² C-247.

⁶⁷³ Resp. Obj. J. & C-Mem. ¶¶ 4.4; 4.8.

Respondent's contention that the Board Minutes contain conditions precedent to the initiation of arbitration that were not met, which vitiated the Claimant's consent.

508. The passage of the Claimant's Board Minutes⁶⁷⁴ relied upon by the Respondent reads as follows:

5. Discussed. Decision to apply with SIA "Latgales enerģija" case to arbitration.

Decided: Apply to international arbitration in case Latvian Government rejects the proposed UAB E enerģija scenario: SIA "Latgales enerģija" cash should be released from the executor's account then the case would be brought to the mediation panel.

Commentary. UAB E enerģija will issue letter to the Latvian government regarding the decision of the board. E enerģija will also apply to EBRD regarding approval of the decision to apply to international arbitration.

(i) *Board Minutes – The Reference to Mediation*

509. Based on the wording of the Board Minutes, the Tribunal finds that this resolution by the Claimant's Board, made on 1 December 2009, is a decision to apply to international arbitration in case the Government of Latvia rejected a proposal made by the Claimant in order that the Claimant's funds be released.
510. In its submissions, the Claimant explained the meaning of the sentence set out above after "Decided" (see paragraph 482 above), and the Respondent did not specifically challenge that explanation.⁶⁷⁵
511. Having considered the Parties' position in this respect, the Tribunal determines that in order for mediation to take place, the Government of Latvia would have had to accept the proposal made by the Claimant, on any plain reading of the resolution set out in paragraph 508 above.

⁶⁷⁴ C-247, attached to the Claimant's 3 October 2012 letter to Mr. Burn (original emphasis).

⁶⁷⁵ The Respondent accepts that it was the Party that proposed mediation (Transcript, Day 1, 147/15-16). The Respondent offered mediation on 27 October 2009 (see paragraph 425 above) after the Claimant had indicated on 23 September 2009 that it would "move the dispute to international arbitration" (see paragraph 423 above). The Claimant rejected the Respondent's mediation proposal on 6 November 2009 (see paragraph 426 above), whereupon the Respondent made a further attempt at proposing mediation on 25 November 2009 (see paragraph 426 above). When the Claimant's Board made its resolution on 1 December 2009, the Respondent's mediation proposal dated 25 November 2009 (C-236) had been neither accepted nor rejected by the Claimant. The Respondent's mediation proposal was rejected by the Claimant on 8 February 2010.

512. The Tribunal concludes that the Respondent has failed to discharge its burden of proof with respect to the allegation that mediation was a condition precedent to arbitration.⁶⁷⁶

(ii) *Board Minutes – The Reference to EBRD Approval*

513. The Respondent further contends that approval by the EBRD was a condition precedent to the Claimant commencing arbitration, which the Claimant denies. The passage relied upon by the Respondent in the Claimant’s Board Minutes dated 1 December 2009 is reproduced in paragraph 508 above.

514. In the Tribunal’s view, the operative part of the Claimant’s Board Minutes of 1 December 2009 is set out after the word “Decided”. The two sentences set out after the word “Commentary” appear to indicate what the Board would do, the decision to go to arbitration having been adopted.

515. If approval by the EBRD had been a condition precedent to the institution of these arbitration proceedings pursuant to arrangements made by the EBRD, the reference to the EBRD would likely not have been inserted under the “Commentary” section.

516. In the Tribunal’s opinion, the Claimant’s Board Minutes of 1 December 2009 are insufficient to prove that the EBRD’s approval was a condition precedent to arbitration, and the Respondent has failed to discharge its burden of proof in this respect. The Respondent’s “preliminary objection” based on the EBRD’s lack of approval must therefore be dismissed.

517. As a general note, the Tribunal finds that general denials (such as that contained in the Respondent’s Rejoinder on the Merits and Reply on Preliminary Objections⁶⁷⁷) are insufficient and must fail.

⁶⁷⁶ See *e.g. Chevron v. Ecuador*, CLA-44 ¶¶ 138-139.

⁶⁷⁷ Such general denial inserted at Resp. Rej. ¶ 40 reads as follows: “As a final general comment, if Respondent has not commented expressly on a certain Claimant’s position in any of previous Claimant’s pleadings, it does not mean that Respondent agrees with such statements or allegations of fact or law. Respondent has attempted to position its viewpoint clearly without duplicate or tedious reiterations or denials. Respondent reserves its right to supplement its position in due time (including, invoking additional evidence or witnesses)”.

The Tribunal therefore finds that (i) the Respondent has failed to discharge its burden of proof in relation to any alleged conditions to the Claimant's consent and the First Objection is therefore dismissed, and that (ii) the Parties consented to ICSID arbitration, the Claimant met the notice and amicable settlement requirements in Article 7 of the BIT and there was therefore valid written consent for the purposes of Article 25(1) of the ICSID Convention.

(3) JURISDICTION *RATIONE MATERIAE*

518. In this section the Tribunal will deal with the Respondent's Second Objection and determine whether it has jurisdiction *ratione materiae* under the BIT and the ICSID Convention. Specifically, the Tribunal will decide (i) whether there is a "dispute concerning an investment" under Articles 1(1) and 7(1) of the BIT; (ii) whether there is a "legal dispute arising directly out of an investment" according to Article 25(1) of the ICSID Convention or (iii) whether there is no "dispute" under Article 25(1) of the ICSID Convention having regard to the principles of estoppel, acquiescence, extinctive prescription and good faith (Second Objection).

(A) ARTICLES 1(1) AND 7(1) OF THE BIT – A "DISPUTE CONCERNING INVESTMENT"

519. Article 1(1) of the BIT reads as follows:

Article 1
Definitions

For the purposes of this Agreement:

1. The term "investment" shall mean every kind of asset, invested by an investor of one Contracting Party in the territory of the other Contracting Party, provided that the investment has been made in accordance with the laws and regulations of the other Contracting Party, and shall include in particular, though not exclusively:
 - a) movable and immovable property as well as any other property rights, such as mortgages, liens and pledges, and similar rights;
 - b) shares, bonds and other kinds of interest in companies;
 - c) claims to money which has been used to create an economic value or claims to any performance having an economic value;
 - d) copyrights, industrial property rights (such as patents, trade marks, industrial designs and models, trade names), know-how and good-will;

- e) any right to conduct economic activities conferred by state authorities, including concessions to search for, extract and exploit natural resources.

(...)

520. It is undisputed that the Claimant made an investment in the territory of Latvia in accordance with the local laws and regulations. The Respondent called no fact witnesses to challenge Mr. Jautakis' first Witness Statement, which contains detailed explanation as to the various transactions forming part of the Claimant's investment, and Mr. Jautakis was not cross-examined at the Hearing.⁶⁷⁸ The Respondent also expressly acknowledged the existence of an investor and an investment as part of its argument advanced that the Energy Charter Treaty should apply.⁶⁷⁹

521. Specifically, after reviewing the documentary evidence, the Tribunal concludes as follows:

- (i) the shares and statutory capital in Latgales Enerģija constitute an investment under Article 1(1)(b) of the BIT;
- (ii) the loans provided by the Claimant to Latgales Enerģija to fund Latgales Enerģija's operations in Rēzekne; the guarantee provided in relation to the loans granted by Latvijas Unibanka to the Rēzekne Municipality and the guarantee provided in relation to a loan granted by Sampo Banka to Latgales Enerģija constitute an investment under Article 1(1)(c) of the BIT;⁶⁸⁰ and
- (iii) the know-how and expertise in heating services⁶⁸¹ as well as the operational management expertise⁶⁸² provided by the Claimant constitute an investment under Article 1(1)(d) of the BIT.

Latgales Enerģija is not an investor for the purposes of Article 1(1) and 1(2) of the BIT and is also not a "national of another Contracting State" within the meaning of Article 25 of the ICSID Convention as there is no agreement between the Parties that

⁶⁷⁸ Transcript, Day 2, 82/14.

⁶⁷⁹ See Resp. Obj. J. & C-Mem. ¶ 3.29.

⁶⁸⁰ See *e.g.* C-43; C-102.

⁶⁸¹ CWS-1 ¶ 40 (citing technical solutions found to enable the old boilers to run on natural gas).

⁶⁸² CWS-1 ¶ 42 (discussing Mr. Strioga's operational expertise).

it should be treated as the investor. As such, Latgales Enerģija's assets are not, therefore, "the investment"; it does not follow, however, that they are irrelevant, since for example the value of the shares in Latgales Enerģija depends on the value of such assets that include *inter alia* the right to operate the heating system in the city of Rēzekne under the Long-Term Agreement and the three licences.

522. Moreover, the Tribunal finds that the Claimant's invocation of various BIT breaches meets the condition of a "dispute concerning investment" under Article 7(1) of the BIT.

523. The Tribunal emphasizes again that general denials, such as those contained in the Respondent's Rejoinder on the Merits and Reply on Preliminary Objections, are insufficient in the Tribunal's view.⁶⁸³

524. The Tribunal therefore finds that it has jurisdiction *ratione materiae* under the BIT.

(B) ARTICLE 25(1) OF THE ICSID CONVENTION – "A LEGAL DISPUTE ARISING DIRECTLY OUT OF AN INVESTMENT"

525. The Tribunal notes that the Respondent has not challenged the Claimant's submission that its investment qualifies as an investment under Article 25(1) of the ICSID Convention (quoted in paragraph 497 above) as understood by analysing the features discussed in Prof. Schreuer's commentary.⁶⁸⁴ Nor has the Respondent denied the relevance of those features. Moreover, the Respondent has itself contended that there is an investment in the present case, albeit with reference to the Energy Charter Treaty as the Tribunal has just recalled in paragraph 520 above.

526. After examining the features of an investment discussed in Prof. Schreuer's commentary, with the understanding that they are not meant to be taken as a list of jurisdictional requirements, the Tribunal concludes that they are met in this case.

527. In particular, the Tribunal finds there was a long-term investment as, among other factors, the Long-Term Agreement was entered into for a period of thirty years,⁶⁸⁵ and

⁶⁸³ Resp. Rej. ¶ 40, reproduced in footnote 677 above.

⁶⁸⁴ C. Schreuer, L. Malintoppi, A. Reinisch, A. Sinclair, *The ICSID Convention. A Commentary*, 2nd ed., Cambridge 2009, CLA-6 pp. 128-129.

⁶⁸⁵ C-4, Clause 4.2.1.

the February 2005 Agreement was entered into for the same period as the Long-Term Agreement.⁶⁸⁶ Moreover, the Claimant alleges to have made a significant monetary investment that includes LVL 3.4 million and EUR 2.821 million investments in 2005 and 2006,⁶⁸⁷ which the Tribunal deems to be a substantial monetary commitment. The Tribunal further finds that the investment was not devoid of risk, a circumstance on which the Respondent has expressly relied by contending that the Claimant failed to conduct a proper risk assessment prior to its decision to invest.⁶⁸⁸ Finally, the Tribunal concludes that the project was significant for the development of the Republic of Latvia due to the importance of district heating and the supply of hot water as a critical public service, and to the need to switch from expensive and polluting fuels to natural gas, as acknowledged by the Respondent.

528. It is plain from all the above that the Claimant made an investment in Latvia for the purposes of Article 25 of the ICSID Convention.

529. As the Claimant has alleged various breaches of the BIT in relation to Latvia's treatment of its investment, the Tribunal finds that there is a "legal dispute arising directly out of an investment" as required by Article 25(1) of the ICSID Convention, subject to the Tribunal's decision on the Respondent's Second Objection.

(C) THE RESPONDENT'S SECOND OBJECTION – LACK OF A "DISPUTE" UNDER ARTICLE 25(1) OF THE ICSID CONVENTION

530. The Tribunal will now consider the Respondent's challenge that there is no dispute under Article 25(1) of the ICSID Convention due to estoppel, acquiescence, prescriptive extinction and due to the Claimant's alleged bad faith.

(i) *Estoppel*

531. Both Parties have relied on the *Pope & Talbot* interim award.⁶⁸⁹ According to this decision, estoppel requires three elements: (i) "a statement of fact which is clear and unambiguous"; (ii) a statement that "must be voluntary, unconditional and

⁶⁸⁶ C-8, Clause 11.

⁶⁸⁷ RfA ¶ 49(2).

⁶⁸⁸ Resp. Obj. J. & C-Mem. ¶ 1.1.

⁶⁸⁹ *Pope & Talbot v. Canada*, RLA-13/CLA-43. The Respondent specifically relied on ¶ 11 of this interim award.

authorised”; and (iii) that “there must be reliance in good faith upon the statement either to the detriment of the party so relying on the statement or to the advantage of the party making the statement”.⁶⁹⁰

532. The Tribunal has reviewed the Parties’ correspondence relating to their negotiations subsequent to the Notice of Dispute.⁶⁹¹ The Respondent relies on the Claimant’s alleged “voluntary and unconditional conduct” which is said to be “of such a nature as to cause a reasonable reliance in Latvia that the investment claims, as outlined in the Request, will not be pursued beyond negotiations (...)”.⁶⁹² However, no relevant conduct or statement by the Claimant has been shown to exist. To the contrary, the communication sent by the Claimant to the Respondent immediately prior to the Parties’ last meeting to discuss settlement opportunities expressly mentioned the “potential international arbitration”.⁶⁹³ Reliance on a mere lapse of time is insufficient to give rise to a preclusion based on estoppel.

533. The Respondent has failed to discharge its burden of proof with respect to the first factual requirement of an estoppel defence. The Respondent has also failed to show its reliance on the Claimant’s alleged conduct or statement that the investment claims would not be pursued beyond negotiations. The Tribunal therefore finds that no issue of estoppel arises on the facts of this case.

(ii) *Acquiescence*

534. The Tribunal considers that the Respondent has not shown that the time which lapsed after the Claimant sent the Respondent its Notice of Dispute is such that the Claimant must be deemed to have accepted by conduct that its claims were extinguished.

535. Neither Article 7 nor any other provisions of the BIT contains a time limit by which a claimant must bring arbitration proceedings. It was therefore entirely a matter for the Claimant to decide when to bring arbitration proceedings.

⁶⁹⁰ *Pope & Talbot v. Canada*, RLA-13/CLA-43 ¶ 111.

⁶⁹¹ See paragraphs 418 ff. and 501 above.

⁶⁹² Resp.Obj. J. & C-Mem. ¶ 4.13.

⁶⁹³ See paragraph 436 above.

536. The fact that the Claimant took part in the 1 April 2011 meeting after receipt of the Respondent's email dated 24 March 2011 stating that the meeting would not be held "under the auspices of the Latvian-Lithuanian investment protection treaty" on the basis that the Government of Latvia regarded "the investment dispute as closed" does not give rise to acquiescence, not least since such communication was preceded by a communication by the Claimant indicating that the objective of the meeting would be "to further discuss the Rēzekne case and potential international arbitration".⁶⁹⁴ Moreover, the Claimant did not express any agreement to the proposition that the investment dispute was "closed". The Respondent's objection based on acquiescence must therefore be dismissed in such circumstances.

(iii) *Extinctive Prescription*

537. The Respondent's objections based on prescriptive extinction are rested on the same bases as the Respondent's estoppel and acquiescence objections.

538. The Respondent did not rebut the Claimant's reply that the BIT contained no time limits (see paragraph 483 above). Similarly, the Respondent did not rebut the Claimant's contention that prescriptive extinction had been applied in cases in which the respondent had been put at a disadvantage by the lapse of time and that the Respondent had shown no disadvantage in the present case.

539. The Tribunal therefore concludes that the absence of a time limit in the BIT is dispositive in the present case and that the lapse of less than four years from the date when the Notice of Dispute dated 1 September 2008 was sent to the Respondent to the date of the Request for Arbitration dated 15 August 2012 is insufficient to attract the application of the doctrine of prescriptive extinction.

540. The Respondent's objection based on prescriptive extinction must therefore be dismissed.

⁶⁹⁴ See paragraph 436 above.

(iv) *Bad Faith – Reasonable Doubt as to a Lack of Good Faith*

541. The burden of proof in relation to allegations of bad faith on the part of the Claimant is squarely on the Respondent.⁶⁹⁵ The Tribunal takes the view that the standard of proof should be appropriately high considering, first, that as a general matter *bona fide* conduct must be presumed in principle;⁶⁹⁶ secondly, that the Respondent's allegations include matters and parties which are not before this Tribunal; and, thirdly, that such allegations are based mostly on news reports. The Respondent appears to acknowledge the difficulty in discharging its burden of proof as it stops short of making an allegation of bad faith and states that there is "reasonable doubt" that the Claimant acted in good faith.
542. The Tribunal has considered the documentary evidence relating to the events in Prienų and Ukmergė initially filed by the Respondent (Exhibits R-11 to R-14).
543. Exhibit R-11, dated 5 October 2010, is another similar printout stating that the Regulator suspended the licence of Miesto energija pending the state of emergency and that the contract with Miesto energija was terminated by the Municipality due to high prices.
544. Exhibit R-12, dated 4 November 2010, is the printout from a news portal quoting another news service, *Lietuvos rytas*. As a consequence of the Claimant's decision to raise heating prices again, the Prienų authorities reportedly decided to take over district heating, following the example of Ukmergė. The report does not exclude a political motivation for the decision in both cities, since entrepreneurs are quoted in Exhibit R-12 as saying that "the politicians of Ukmergė and Prienų are simply preparing for municipal elections".
545. Exhibit R-13, dated 12 January 2012, is also a printout from a news portal quoting *Lietuvos rytas*. One concrete element in this report about Prienų relates to the negotiations that were underway between the local authorities and the operator. This exhibit also mentions the city of Ukmergė, reportedly the only one in Lithuania to have taken over heating completely from the private operator in charge.

⁶⁹⁵ See e.g. *Chevron v. Ecuador*, CLA-44 ¶¶ 137-138.

⁶⁹⁶ See e.g. *Chevron v. Ecuador*, CLA-44 ¶ 143.

546. Exhibit R-14, dated 17 October 2012, reports that E energija will seek compensation in an amount of 15 million litas before the courts against the Ukmergė municipality; the present arbitration proceedings are recalled in the closing paragraph.
547. The Tribunal further considered the documentary evidence subsequently filed by the Respondent (namely Exhibit R-19) attached to its Rejoinder on the Merits and Reply on Preliminary Objections. The Tribunal takes the view that the filing by a party of an exhibit containing one hundred odd pages attached to a submission in which the exhibit is not discussed in any detail is of very little assistance to it.
548. In fact, Exhibit R-19 is mentioned only once in the whole submission⁶⁹⁷ in support of one allegation relating to what could be briefly described as Mr. Strioga's reckless way of doing business in the eyes of the Respondent.
549. The Tribunal has taken the various press reports⁶⁹⁸ contained in Exhibit R-19 into consideration, some of which were briefly referred to by counsel for the Respondent in its opening argument.⁶⁹⁹ However, the Tribunal will not embark, unassisted by counsel on both sides, on an analysis of the Lithuanian decisions in Exhibit R-19, none of which were referred to in the pleadings.
550. The Tribunal is driven to the conclusion that the Respondent has not discharged its burden of proof in relation to the allegation that the Claimant brought these arbitration proceedings to influence the authorities in Lithuania. The Respondent's objection based on the Claimant's alleged bad faith, or the reasonable doubt that the Claimant may not have acted in good faith, must therefore be dismissed.
551. As far as concerns the Respondent's allegation that it is the Claimant's and Mr. Strioga's common practice to enter into deals without defining clear rules of cooperation, the Tribunal considers that the Respondent has not discharged its burden of proof by filing documents relating to the Claimant's contractual arrangements with certain Lithuanian municipalities and the difficulties which arose out of such

⁶⁹⁷ Resp. Rej. ¶ 33.

⁶⁹⁸ For a list of the various Lithuanian news reports and judgments see footnote 544 above.

⁶⁹⁹ Transcript, Day 1, 149-156.

contracts. Moreover, the Claimant's alleged common practice has not been shown to be relevant to the Tribunal's jurisdiction.

552. Therefore, the Tribunal concludes that Respondent's objection based on an absence of good faith must be dismissed.

F. THE TRIBUNAL'S DECISION ON JURISDICTION

553. The Tribunal has jurisdiction to hear the Claimant's claims under Article 25 of the ICSID Convention and Article 7 of the BIT. The Respondent's "preliminary objections" are dismissed.

VI. THE RESPONDENT'S APPLICATION FOR TERMINATION, AND, ALTERNATIVELY, FOR A STAY OF THE PROCEEDINGS

554. The Respondent's application to have these arbitration proceedings stayed was first filed on 18 April 2014 as part of the Memorial setting out the Respondent's objection to the Tribunal's jurisdiction (see paragraph 450 above).

A. THE PARTIES' PRAYERS FOR RELIEF ON THE STAY OF PROCEEDINGS

(1) THE RESPONDENT

555. In its Memorial on Preliminary Objections and Request for Bifurcation, and Counter-Memorial on the Merits the Respondent seeks the following relief:⁷⁰⁰

Considering the above mentioned factual and legal description of the situation, the Respondent kindly requests the Tribunal to:

- 1) (...)

or

- 2) declare that, in accordance with Article 41(6) of the ICSID Arbitration Rules, this arbitration proceeding is to be suspended pending the final and binding adjudication in Latvian courts of the local judicial civil proceeding No. C03051107;

or

- (...)

⁷⁰⁰ Resp. Obj. J. & C-Mem. ¶ 5.

556. In its Skeleton Argument the Respondent requests the Tribunal “under the Tribunal’s discretionary competence, to suspend or terminate the proceedings on grounds enumerated in Respondent’s pleadings”.⁷⁰¹

(2) THE CLAIMANT

557. In its Reply on the Merits and Counter-Memorial on Preliminary Objections the Claimant requests the following relief:⁷⁰²

The Claimant therefore respectfully requests the Arbitral Tribunal to:

- (a) deny the requests for relief set out by the Respondent in section 5 of the Counter-Memorial on the Merits and Preliminary Objections on Jurisdiction;
- (b) (...)

558. In its Rejoinder on Preliminary Objections the Claimant restates substantially the same relief.⁷⁰³

B. THE RESPONDENT’S POSITION

559. The Respondent rested its original application for a stay on the 7 April 2014 judgment by the Supreme Court of Latvia, allowing Latgales Energija’s application for review against a judgment dated 20 April 2012 and remitting the case to a new court of appeal for a fresh decision.⁷⁰⁴ The Respondent argues that the Tribunal should “follow the Vivendi doctrine and allow adjudication of the underlying civil dispute by Latvian courts ...”.⁷⁰⁵ The Respondent contends that Latgales Energija’s conduct should be attributed to the Claimant and regarded as an acknowledgment by the Claimant of the fact that the Latvian courts were properly dealing with the matter pending these arbitration proceedings; the Claimant’s attempt at forum shopping trivialized both these proceedings and the Latvian proceedings in which Latgales Energija had actively and selectively sought procedural remedies. The Respondent suggests that the Tribunal could only gain from allowing the Latvian courts to hear all

⁷⁰¹ Resp. Skeleton p. 4.

⁷⁰² Cl. Rep. ¶ 178.

⁷⁰³ Cl. Rej. J. ¶ 13.

⁷⁰⁴ R-8, see paragraphs 388 ff. above.

⁷⁰⁵ Resp. Obj. J. & C-Mem. ¶ 4.17; RLA-1.

factual and legal issues, which were numerous and technical, in relation to the termination of the Long-Term Agreement (referred to as the “Concession Agreement” by the Respondent); reliance is placed by the Respondent on *Impregilo v. Argentina*^{706 707}.

560. In its Clarificatory Statement on Bifurcation the Respondent goes a step further, arguing that the Claimant has pursued the same issues in the Latvian courts and these arbitration proceedings.⁷⁰⁸

561. In its Skeleton Argument the Respondent also seeks a termination of the proceedings on procedural grounds, submitting that the Tribunal had discretion to decide whether to stay the proceedings or terminate them on procedural grounds.⁷⁰⁹

C. THE CLAIMANT’S POSITION

562. The Claimant’s position may be summarised as follows:

- (i) the Latvian proceedings relied upon by the Respondent in support of its application for a stay of proceedings were brought by the Municipality through Rēzeknes Siltumtīkli against Latgales Enerģija in September 2007; the argument that these arbitration proceedings should be stayed pending proceedings brought by Latvia itself against the Claimant’s investment in Latvia cannot be sustained and the accusation that Latgales Enerģija has in bad faith engaged in forum shopping to the detriment of the Respondent is similarly without foundation;⁷¹⁰ the Respondent appears to suggest that Latgales Enerģija should not defend itself against Latvian proceedings lest this get in the way of the Claimant’s claims under the BIT, which is a flawed argument;⁷¹¹ and

⁷⁰⁶ *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award, 21 June 2011 (“*Impregilo v. Argentina*”), RLA-14.

⁷⁰⁷ Resp. Obj. J. & C-Mem. ¶¶ 4.17-4.19.

⁷⁰⁸ Resp. Req. Bifurc. ¶ 3(3).

⁷⁰⁹ Resp. Skeleton pp. 3-4; see also Transcript, Day 1, 149/3-9; 155/14-156/23.

⁷¹⁰ Cl. Rep. ¶¶ 165-166.

⁷¹¹ Cl. Rep. ¶ 167.

- (ii) in any event, Latgales Energija's defences in the Latvian proceedings relied upon by the Respondent and the Claimant's claims in these arbitration proceedings are entirely different since the claims presently under consideration arise out of the BIT; the outcome of the Latvian proceedings is irrelevant to the Tribunal's mission since the value of the Claimant's investment in Latvia has already been irreparably destroyed; a Latvian decision on whether the Long-Term Agreement was properly terminated could make no difference to such value and could not determine whether Latvia is in breach of any of its obligations under the BIT, and the issues of lease payments and gas debt are not part of the Claimant's case in these arbitration proceedings;⁷¹² the Respondent's reliance on the distinction made in *Impregilo*⁷¹³ between legitimate expectations and contractual rights is unclear;⁷¹⁴ the Claimant is not a party to the Latvian proceedings, it is not a party to the contracts forming the basis of those proceedings and the Claimant's claims in these arbitration proceedings are not claims for breach of contract so that there is no reason for the Tribunal to stay these proceedings as a consequence of the Latvian proceedings.⁷¹⁵

D. THE REASONS FOR THE TRIBUNAL'S DECISION ON THE RESPONDENT'S APPLICATION FOR A STAY AND TERMINATION OF THE PROCEEDINGS

563. The Respondent's application was denied by the Tribunal in Procedural Order No. 3bis dated 21 January 2015 (see paragraph 23 above).
564. The Respondent made a fresh application to have these proceedings stayed or terminated on procedural grounds in its Skeleton Argument dated 9 February 2015 referring to the "grounds enumerated in the Respondent's pleadings" (see paragraph 452 above).
565. The point was then argued at the Hearing by both Parties.⁷¹⁶

⁷¹² Cl. Rep. ¶¶ 168-169.

⁷¹³ *Impregilo v. Argentina*, RLA-14 ¶¶ 292-294.

⁷¹⁴ Cl. Rep. ¶ 172.

⁷¹⁵ Cl. Rep. ¶¶ 173-174.

⁷¹⁶ Transcript, Day 1, 72-85 [Claimant]; 145-158 [Respondent].

566. In the Tribunal's view the Respondent's application for a stay is without foundation, as the Tribunal has already found in Procedural Order No. 3*bis*.
567. First, the parties to the Latvian proceedings and the parties to these arbitration proceedings are not the same. The Latvian proceedings relied upon by the Respondent in support of its application for a stay were brought by Rēzeknes Siltumtīkli against Latgales Enerģija (see paragraphs 302 ff. above).
568. Secondly, the issues arising in these proceedings are not the same as those arising in the Latvian proceedings. The proceedings relied upon by the Respondent in support of its application for a stay were brought under the Long-Term Agreement. They do not relate to the standards of protection under the BIT with which this Tribunal is concerned; that much has been expressly admitted by the Respondent and such admission contradicts the Respondent's contention that the issues pending before the Latvian proceedings and this Tribunal are the same.
569. Thirdly, the fact that there may be an overlap between contract claims and treaty claims is not sufficient *per se* to warrant a stay of proceedings.
570. Fourth, this Tribunal has already observed in Procedural Order No. 3*bis* that the Respondent's complaint that the Claimant has been actively and selectively seeking procedural remedies in the Latvian courts is without foundation, since the Latvian proceedings relied upon by the Respondent were brought by Rēzeknes Siltumtīkli. Other proceedings were subsequently brought by Rēzeknes Enerģija against Latgales Enerģija (see paragraphs 310 ff. above), and by Rēzeknes Siltumtīkli against Latgales Enerģija and the Claimant (see paragraphs 371 ff. above).
571. There are therefore in the Tribunal's opinion no sound and cogent reasons to stay these arbitration proceedings.
572. As there are no reasons to stay these proceedings pending the outcome of the Latvian proceedings, there are, *a fortiori*, no reasons to terminate these proceedings.

E. THE TRIBUNAL’S DECISION THE RESPONDENT’S APPLICATION FOR TERMINATION, AND, ALTERNATIVEY, A STAY OF THE PROCEEDINGS

573. Therefore, the Respondent’s application for termination, and, alternatively, for a stay of proceedings must be denied.

VII. LIABILITY

574. In this section, the Tribunal will restate the Parties’ prayers for relief on liability (A) before summarizing the respective cases on liability submitted by the Claimant (B) and the Respondent (C). The Tribunal will then state the reasons for its decision on liability (D) before issuing its decision (E).

A. THE PARTIES’ PRAYERS FOR RELIEF ON LIABILITY

(1) THE CLAIMANT

575. In its Memorial, the Claimant requests the following relief:⁷¹⁷

The Claimant therefore respectfully requests the Arbitral Tribunal to:

- (a) declare that the Respondent has breached Articles 4(1), 3(1) and 3(2) of the BIT,
- (b) (...)

576. In its Reply on the Merits and Counter-Memorial on Preliminary Objections, the Claimant requests substantially the same relief.

(2) THE RESPONDENT

577. In its Memorial on Preliminary Objections and Request for Bifurcation, and Counter-Memorial on the Merits the Respondent seeks the following relief:⁷¹⁸

Considering the above mentioned factual and legal description of the situation, the Respondent kindly requests the Tribunal to:

(...)

or

⁷¹⁷ Cl. Mem. ¶ 370.

⁷¹⁸ Resp. Obj. J. & C-Mem. ¶ 5.

- 3) declare that the Respondent has not breached the Treaty; *and*
- 4) deny all Claimant's requests for relief (as specified in the Claimant's Memorial, paragraphs 370 and 371);

but, in any case,

- 5) (...)

578. The Respondent's Rejoinder on the Merits does not set out a prayer for relief.

B. THE CLAIMANT'S CASE ON LIABILITY

579. The Claimant submits that Respondent has breached Articles 3(1), 3(2) and 4(1) of the Lithuania-Latvia BIT.

580. Some of the Claimant's claims under the BIT are contingent upon certain specific issues that are in dispute between the parties.

581. The Tribunal will summarise the Claimant's arguments relating to these issues (see paragraphs 582 ff. below) and will then summarise the Claimant's position regarding Latvia's liability under the Treaty in the following order:

- (i) attribution (*i.e.* whether the conduct of the Municipality, the Regulator, Rēzeknes Siltumtīkli and Rēzeknes Enerģija can be attributed to the Respondent as a matter of international law, see paragraphs 621 ff. below);
- (ii) expropriation (*i.e.* whether the Respondent is liable for unlawfully expropriating the Claimant's investment without compensation, see paragraphs 648 ff. below);
- (iii) fair and equitable treatment (*i.e.* whether the Respondent breached the standard of fair and equitable treatment, see paragraphs 663 ff. below);
- (iv) full protection and security (*i.e.* whether the Respondent breached the standard of full protection and security, see paragraphs 691 ff. below);
- (v) arbitrary or discriminatory measures (*i.e.* whether the Respondent took arbitrary and discriminatory measures against the Claimant, see paragraphs 694 ff. below); and

- (vi) breaches of the most favoured nation clause (*i.e.* whether the Respondent breached an obligation on which the Claimant is entitled to rely by virtue of the most favoured nation clause, see paragraphs 706 ff. below).

(1) SPECIFIC ISSUES

582. The Tribunal will in turn summarise the Claimant’s position relating to the following issues:

- (i) the application of the Principles of European Contract Law, UNIDROIT Principles of International Commercial Contracts and TransLex Principles advocated by the Respondent (see paragraphs 583 ff. below);
- (ii) the functional and legal independence between the different parts of the “concession arrangement” (see paragraphs 585 ff. below);
- (iii) the duty to pay for the natural gas supplied by Latvijas Gāze (see paragraphs 586 ff. below);
- (iv) the outstanding lease payments (see paragraphs 590 ff. below);
- (v) the risk allegedly assumed by the Claimant (see paragraph 593 below);
- (vi) the influence allegedly brought to bear by the Municipality on the Regulator (see paragraphs 594 ff. below);
- (vii) the review of the tariffs by the Regulator (see paragraphs 599 ff. below);
- (viii) the development plan (see paragraphs 607 ff. below);
- (ix) the revocation of Latgales Enerģija’s licences to produce, transmit and sell thermal energy (see paragraphs 617 ff. below).

**(A) THE APPLICATION OF PRINCIPLES OF EUROPEAN CONTRACT LAW,
UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS
AND TRANSLEX PRINCIPLES**

583. The Claimant argues that the Principles of European Contract Law (“PECL”) prayed in aid by the Respondent are inapplicable to the present dispute as such Principles do not constitute general principles of law recognized by civilized nations within the

meaning of Article 38(1)(c) of the Statute of the International Court of Justice.⁷¹⁹ The Claimant submits that, in any event, such Principles could not excuse the Respondent's breaches of the BIT.⁷²⁰ Moreover, the Long-Term Agreement is expressly stated to be governed by Latvian law in its Clause 11 of the Long-Term Agreement, which operates so as to exclude the application of the PECL to that agreement.⁷²¹

584. The Claimant does not specifically address the Respondent's invocation of the UNIDROIT Principles of International Commercial Contracts and the TransLex Principles.

(B) THE FUNCTIONAL AND LEGAL INDEPENDENCE BETWEEN THE
DIFFERENT PARTS OF THE "CONCESSION ARRANGEMENT"

585. The Claimant criticises the distinction between private and public agreements relied upon by the Respondent as being erroneous and misleading, since the organisation of district heating is within the jurisdiction of the Municipality; reliance is placed on Section 15 of the Municipalities Act.⁷²² All contracts entered into by Latgales Enerģija with the Municipality or its wholly-owned companies relating to the provision of district heating "represent" the Municipality's exercise of public powers and cannot be considered "commercial contracts" as argued by the Respondent.⁷²³

(C) THE DUTY TO PAY FOR THE NATURAL GAS SUPPLIED BY LATVIJAS
GĀZE

586. The Claimant strenuously denies that Latgales Enerģija was bound to pay Latvijas Gāze for the natural gas delivered, since Latgales Enerģija never entered into a direct contractual relationship with Latvijas Gāze and did not assume the Municipality's obligation to pay Latvijas Gāze for natural gas deliveries under the Gas Supply Agreement;⁷²⁴ reliance is placed on Clause 2.3 of the Long-Term Agreement,⁷²⁵

⁷¹⁹ Cl. Rep. ¶¶ 88-90.

⁷²⁰ Cl. Rep. ¶ 90.

⁷²¹ Cl. Rep. ¶ 85.

⁷²² Cl. Rep. ¶¶ 13; 17.

⁷²³ Cl. Rep. ¶¶ 18; 92.

⁷²⁴ C-40, see paragraph 63 above.

⁷²⁵ C-4, see paragraph 80 above.

Clause 4 of the February 2005 Agreement⁷²⁶ and the whereas clause of the Rēzeknes Enerģija Gas Supply Agreement^{727, 728}

587. The Claimant asserts that the Municipality was, and remained, bound to pay Latvijas Gāze for the natural gas despite the fact that Latgales Enerģija had paid for the invoices issued by Latvijas Gāze to Rēzeknes Siltumtīkli; reliance is placed on Clauses 4.1 and 16.1 of the Gas Supply Agreement,⁷²⁹ Clause 6 of Amendment No. 3 to the Gas Supply Agreement⁷³⁰ and the interview with Mr. Vjaksē published in *Rēzeknes Vēstis* on 15 September 2007^{731, 732}. Latgales Enerģija paid the invoices directly to Latvijas Gāze only in order to avoid any difficulties as might otherwise be caused by Rēzeknes Siltumtīkli's financial standing, not because it assumed any liability towards Latvijas Gāze.⁷³³
588. Furthermore, the Claimant submits that the Long-Term Agreement did not constitute a transfer of an undertaking ("*Betriebsübergang*") as a matter of Latvian law, but rather constituted a lease of certain assets which the Long-Term Agreement clearly identified;⁷³⁴ similarly, the Long-Term Agreement identified those debts of Rēzeknes Siltumtīkli which Latgales Enerģija agreed to assume; all of which would not have been necessary, by definition, if the Long-Term Agreement had been a transfer of an undertaking.⁷³⁵ Only Rēzeknes Siltumtīkli's employees were taken over by Latgales Enerģija under the terms of the Long-Term Agreement; that amounted to a transfer of an undertaking under the Labour Code (*not in evidence*) and not under the Commercial Code.⁷³⁶ Finally, the Claimant submits that the concept of

⁷²⁶ C-8, see paragraphs 100 ff. above.

⁷²⁷ C-151, see paragraphs 283-284 above.

⁷²⁸ Cl. Mem. ¶ 138; Cl. Rep. ¶ 44; Cl. Rep. Tribunal ¶ 48.

⁷²⁹ C-40, see paragraph 65 above.

⁷³⁰ C-81, see paragraph 163 above.

⁷³¹ C-134, see paragraph 251 above.

⁷³² Cl. Mem. ¶¶ 144-146; Cl. Rep. ¶ 43; Cl. Rep. Tribunal ¶¶ 44; 50.

⁷³³ Cl. Mem. ¶ 139; Cl. Rep. Tribunal ¶ 42.

⁷³⁴ Cl. Rep. ¶¶ 40-41; 80; Cl. Rep. Tribunal ¶¶ 46-47.

⁷³⁵ Cl. Rep. Tribunal ¶¶ 48-49.

⁷³⁶ Cl. Rep. Tribunal ¶¶ 47-48.

Betriebsübergang is not applicable in Latvia or to the transfer of contractual obligations other than employment rights.⁷³⁷

589. The Claimant concludes that it was therefore the Municipality's obligation to pay Latvijas Gāze for the outstanding invoices when Latgales Enerģija was no longer in a position to pay the full amount to Latvijas Gāze owing to the insufficient funds it could charge and receive from its customers through the applicable tariffs.⁷³⁸

(D) THE OUTSTANDING LEASE PAYMENTS

590. The Claimant contends that Rēzeknes Siltumtīkli sued Latgales Enerģija under the Long-Term Agreement on 20 September 2007 solely to obtain the attachment of Latgales Enerģija's bank accounts with a view to disrupting Latgales Enerģija's operation of the heating system.⁷³⁹
591. The Claimant asserts that, in monetary terms, the most significant part of Rēzeknes Siltumtīkli's claim was based on Latgales Enerģija's alleged obligation to make monthly payments for the depreciation of the leased assets under Clause 4.4.2 of the Long-Term Agreement.⁷⁴⁰ However, the depreciation was to be paid by investing in the heating infrastructure "so that by the end of the lease term the book value of the assets handed back was no less than the book value of the assets handed over at the start, plus 5%".⁷⁴¹ The Latvian courts eventually confirmed that Latgales Enerģija's position in this respect was correct as a matter of Latvian law.⁷⁴²
592. According to the Claimant, Rēzeknes Siltumtīkli's claim is significant because of its timing, as it was brought at a time when the gas supply had been suspended by Latvijas Gāze one day before the Municipality approved the heat supply development plan.⁷⁴³

⁷³⁷ Cl. Rep. ¶ 80.

⁷³⁸ Cl. Mem. ¶¶ 141-143; Cl. Rep. ¶¶ 46; 72; Cl. Rep. Tribunal ¶¶ 42-43; 71.

⁷³⁹ Cl. Mem. ¶¶ 155; 160-161; Cl. Rep. ¶ 56.

⁷⁴⁰ Cl. Mem. ¶ 157.

⁷⁴¹ Cl. Mem. ¶ 157.

⁷⁴² Cl. Mem. ¶ 159; Cl. Rep. ¶ 61; Cl. Rep. Tribunal ¶ 6.

⁷⁴³ Cl. Mem. ¶ 160; Cl. Rep. ¶ 56, see paragraph 254 above.

The Tribunal notes the Claimant's distinction between the "city plan", the "heat supply development plan" and the "operator's plan". The Tribunal's use of these terms in the summary of the Claimant's

(E) THE RISKS ALLEGEDLY ASSUMED BY THE CLAIMANT

593. The Claimant rejects the Respondent's contention that it assumed certain risks and it contends that it could not have anticipated the "change in approach" on the part of the Municipality and the Regulator.⁷⁴⁴ Specifically, the Claimant submits that it did not assume:

- (i) the risk that the Municipality would fail to devise and approve a heat supply development plan;
- (ii) the risk that the Municipality would fail to comply with its own contractual duties to Latvijas Gāze, thereby causing the suspension of the natural gas supply;
- (iii) the risk that the Municipality would actively seek to replace Latgales Enerģija as the heat supply operator well before Latvijas Gāze suspended the supply of natural gas;
- (iv) the risk that the Municipality would declare an energy crisis relying on a situation it had itself brought about;
- (v) the risk that the Municipality would prevent Latgales Enerģija from obtaining increased tariffs despite the increase in the price of natural gas;
- (vi) the risk that the Municipality would misrepresent the content of confidential letters to the Regulator, that would in turn base its own allegations concerning Latgales Enerģija's breaches of the licence requirements on such misrepresentations;
- (vii) the risk that the Municipality would seek to persuade consumers not to pay Latgales Enerģija's invoices;

position is without prejudice to the Tribunal's finding regarding the existence of different plans and the respective duties attached thereto.

⁷⁴⁴ Cl. Rep. ¶ 96.

- (viii) the risk that the Municipality (acting through Rēzeknes Siltumtīkli and Rēzeknes Enerģija) would seek to obtain an attachment of Latgales Enerģija's bank accounts;
- (ix) the risk that the Regulator would change its practice, whereby it had granted tariff increases despite the absence of a heat supply development plan; or
- (x) the risk that the Regulator would revoke Latgales Enerģija's licences based on a situation that was not only caused by the Municipality and the Regulator, but that had been addressed and explained by Latgales Enerģija in its letters to the Regulator.⁷⁴⁵

(F) THE INFLUENCE BROUGHT TO BEAR BY THE MUNICIPALITY ON THE REGULATOR

594. It is the Claimant's case that the Municipality brought influence to bear on the Regulator "to follow its political wishes".⁷⁴⁶ The Claimant relies on the following circumstances to show the Municipality's influence over the Regulator:⁷⁴⁷

- (i) the Regulator's decision of 7 December 2007⁷⁴⁸ revoking its previous decision of 9 November 2007 approving new tariffs;⁷⁴⁹ the 7 December 2007 decision relied on a letter sent by Rēzeknes Enerģija to the Regulator on 29 November 2007 (see paragraph 241 above) stating that Latgales Enerģija had used the wrong amount of natural gas in its calculations submitted in support of its proposal for a new tariff;
- (ii) the Regulator's letter to Latgales Enerģija dated 11 December 2007,⁷⁵⁰ which relied on a confidential letter sent by Latgales Enerģija to Rēzeknes Siltumtīkli on 6 December 2007;⁷⁵¹ and

⁷⁴⁵ Cl. Rep. ¶ 97.

⁷⁴⁶ Cl. Rep. ¶ 21.

⁷⁴⁷ Cl. Mem ¶¶ 194; 207-208; Cl. Rep. ¶¶ 20; 54.

⁷⁴⁸ Decision No. 35, C-28, see paragraph 240 above.

⁷⁴⁹ Decision No. 28, C-27, see paragraph 239 above.

⁷⁵⁰ C-162, see paragraph 299 above.

⁷⁵¹ C-160.

- (iii) Rēzeknes Siltumtīkli's letter to the Regulator dated 15 May 2008⁷⁵² stating that Latgales Enerģija had failed to meet its investment commitments; this letter was sent before the Rēzekne City Council sent another letter to Latgales Enerģija on 20 May 2008⁷⁵³ which essentially made the same accusations and before Latgales Enerģija responded to these accusations in a letter sent to the Rēzekne City Council on 2 June 2008.⁷⁵⁴
595. According to the Claimant, the Regulator's disregard for the information and the explanations provided by Latgales Enerģija is further proof of the Municipality's influence over the Regulator.⁷⁵⁵
596. The Claimant further refers to the Municipality's power to appoint and dismiss the members of the executive body of the Regulator as proof of the Municipality's influence over the Regulator.⁷⁵⁶
597. According to the Claimant, it was well-known in Latvia that local authorities unlawfully influenced municipal regulators; reliance is placed on a report by the "Society for Transparency" (Delna),⁷⁵⁷ Ms. Uškāne's Witness Statement,⁷⁵⁸ Mr. Strioga's Witness Statement⁷⁵⁹ and the fact that the Latvian government abolished local regulators in 2009.⁷⁶⁰
598. Finally, the Claimant submits that the Municipality through its actions created situations in which the Regulator could adopt decisions that were technically legal, but caused considerable damage to Latgales Enerģija's business.⁷⁶¹

⁷⁵² C-231, see paragraph 333 above.

⁷⁵³ C-178, see paragraph 335 above.

⁷⁵⁴ C-179, see paragraph 336 above.

⁷⁵⁵ Cl. Rep. ¶ 20.

⁷⁵⁶ Cl. Mem. ¶ 219; Cl. Rep. ¶ 20.

⁷⁵⁷ C-205.

⁷⁵⁸ CWS-4 ¶¶ 33-34.

⁷⁵⁹ CWS-1 ¶ 133.

⁷⁶⁰ Cl. Mem. ¶ 219; Cl. Rep. ¶ 20.

⁷⁶¹ Cl. Rep. ¶ 22.

(G) THE REVIEW OF TARIFFS BY THE REGULATOR

599. The Claimant submits that Latgales Enerģija was entitled to request a review of the heating tariffs provided that the cost of natural gas had increased by more than 5%; reliance is placed on the 2001 Methodology⁷⁶² and Clause 1.6 of the February 2005 Agreement^{763 764}.
600. In the Claimant's view, Latgales Enerģija was therefore entitled to obtain new tariffs in light of the applicable Methodology (i) after the Public Utilities Commission decided on 22 March 2006 to increase the price of natural gas by 36 % from 1 May 2006 onwards and the price of electricity had increased by about 17 % (see paragraph 181 above), and (ii) after the Public Utilities Commission decided on 28 March 2007 further to increase the price of natural gas from 1 May 2007 (see paragraph 231 above).⁷⁶⁵ However, the Regulator refused to grant new tariffs in both instances.
601. The Claimant rejects the grounds on which the Regulator refused to authorise new tariffs in its decisions of 13 October 2006⁷⁶⁶ and 11 June 2007.⁷⁶⁷
602. The Claimant states that (i) the missing list of employees, (ii) the missing VAT calculation, and (iii) the missing key to the lease payment for fixed assets relied upon by the Regulator to deny the proposed increase in tariff were minor issues that "could have been easily rectified".⁷⁶⁸
603. Concerning the operator's plan on which the Regulator also rested its decisions to decline the tariffs proposed by Latgales Enerģija, the Claimant submits that Latgales Enerģija had submitted investment plans in its applications for a new tariff in 2005, 2006 and 2007; reliance is placed on attachment No. 26 to Latgales Enerģija's letter to the Regulator dated 28 September 2007^{769 770}. The Claimant states that Latgales

⁷⁶² C-35.

⁷⁶³ C-8, see paragraphs 100 ff. above.

⁷⁶⁴ Cl. Mem. ¶ 96.

⁷⁶⁵ Cl. Mem. ¶¶ 96-98; 127 ff.

⁷⁶⁶ Decision No. 17, C-19, see paragraph 184 above.

⁷⁶⁷ Decision No. 12, C-21, see paragraph 233 above.

⁷⁶⁸ Cl. Mem. ¶ 100.

⁷⁶⁹ C-140 (*attachments not in evidence*).

⁷⁷⁰ Cl. Rep. Tribunal ¶ 41.

Energija had explained to the Regulator that it was not possible to devise a “meaningful” operator’s plan in the absence of a heat supply development plan.⁷⁷¹

604. Regarding the coefficients which Latgales Energija admittedly failed to use in its proposed calculation for new tariffs, the Claimant contends that such coefficients were all dependent on the existence of a heat supply development plan which the Municipality had a duty to devise and approve (see paragraphs 607 ff. below); reliance is placed on the decision by the Administrative District Court of 15 April 2009^{772, 773}.
605. The Claimant further submits that Latgales Energija was entitled to rely on the Regulator’s practice, whereby a new tariff had been approved despite the absence of an approved heat supply development plan;⁷⁷⁴ reliance is further placed on the “principle of confidence in the legality of an institution’s actions”, Section 1 of the Constitution of the Republic of Latvia and Section 10 of the Administrative Procedure Act.⁷⁷⁵
606. It is the Claimant’s case that the Regulator’s willingness to approve new tariffs despite the lack of a heat supply development plan, “thereby permitting the operator to recover its costs properly”, was part of the investment regime which the Claimant entered into.⁷⁷⁶

(H) THE DEVELOPMENT PLAN

607. It is the Claimant’s case that there are three different plans relevant for present purposes:⁷⁷⁷
- (i) the overall city development plan (the “city plan”);
 - (ii) the heat supply development plan; and

⁷⁷¹ Cl. Rep. Tribunal ¶ 41.

⁷⁷² C-192, see paragraph 392 above.

⁷⁷³ Cl. Mem. ¶¶ 100; 131.

⁷⁷⁴ Cl. Mem. ¶¶ 111; 113; 114.

⁷⁷⁵ Cl. Mem. ¶¶ 114-116.

⁷⁷⁶ Cl. Rep. ¶ 29; Cl. Rep. P-H ¶ 23.

⁷⁷⁷ Cl. Rep. Tribunal ¶ 19.

- (iii) the heat supply operator's development plan (the "operator's plan").
608. The Claimant contends that the Municipality breached (i) its legal obligation to devise and approve the heat supply development plan already when the investment was made and throughout the duration of the investment⁷⁷⁸ and (ii) its obligations under the February 2006 Agreement, by delaying to devise and approve the heat supply development plan.⁷⁷⁹ The Municipality approved the heat supply development plan only as late as 21 September 2007,⁷⁸⁰ by which time Latgales Enerģija's bank accounts had been attached and the Municipality "had already decided to install a new operator".⁷⁸¹
609. In the Claimant's submission, the coefficients required by the Methodology to calculate the heating tariffs are all derived from the heat supply development plan, not the operator's plan.⁷⁸²
610. The Claimant submits that the Municipality had the following responsibilities:
- (i) sole responsibility to devise and approve the City Plan; reliance is placed on Section 14(1) of the Municipalities Act;⁷⁸³ and
 - (ii) responsibility to devise and approve the heat supply development plan which is "specified in light of the overall scope of municipal development outlined in the City Plan"; reliance is placed on Section 15(1) of the Municipalities Act, Section 51 of the Energy Act, Section 17 and Section 23(3) of the Methodology in force at the relevant time as well as the decision of 15 April 2009 by the Administrative District Court (see paragraphs 392 ff. above).⁷⁸⁴
611. The Claimant admits that Latgales Enerģija "had a role to play" in the preparation of the heat supply development plan as contemplated by Clause 1.2 of the February 2006

⁷⁷⁸ Cl. Mem. ¶ 134.

⁷⁷⁹ Cl. Mem. ¶¶ 109; 117 ff.; Cl. Rep. ¶ 25; Cl. Rep. Tribunal ¶ 38.

⁷⁸⁰ C-213, see paragraphs 192 and 228 above.

⁷⁸¹ Cl. Mem. ¶¶ 134; 155; 182-187; Cl. Rep. ¶ 27; Cl. Rep. Tribunal ¶ 40.

⁷⁸² Cl. Rep. ¶ 34; Cl. Rep. Tribunal ¶ 25.

⁷⁸³ Cl. Rep. Tribunal ¶ 20.

⁷⁸⁴ Cl. Rep. Tribunal ¶¶ 6; 21-27.

Agreement⁷⁸⁵.⁷⁸⁶ However, the responsibility to “coordinate and approve” the heat supply development plan remained with the Municipality.⁷⁸⁷

612. By contrast, Latgales Enerģija was responsible to devise only the operator’s plan, a document that differed from the heat supply development plan; reliance is placed on Clauses 1, 6.3 and 7.1 of the licences to produce, transmit and sell thermal energy⁷⁸⁸ and Section 8 of the Energy Act.⁷⁸⁹
613. According to the Claimant, the Municipality was not entitled to delegate the responsibility to devise and approve the heat supply development plan to Latgales Enerģija in accordance with applicable law; reliance is placed on Section 41(2) of the Public Administration Act,⁷⁹⁰ neither the licences⁷⁹¹ nor the provisions of the Long-Term Agreement⁷⁹² operated so as to bring about such delegation.
614. In its rebuttal to one of the Respondent’s arguments, the Claimant denies that Latgales Enerģija undertook or accepted the responsibility to devise the heat supply development plan in its correspondence with the Municipality and Rēzeknes Siltumtīkli.⁷⁹³ According to the Claimant, the Guidelines for the development of the Rēzekne City heat supply system submitted to the Municipality on 20 January 2006,⁷⁹⁴ the one-page heat supply development plan for the years 2006-2009⁷⁹⁵ and the draft heat supply development concept for the years 2006-2014⁷⁹⁶ submitted to the Municipality on 15 November 2006 were not draft heat supply development plans, but rather documents intended to provide the Municipality with a basis to devise and approve the heat supply development plan.⁷⁹⁷

⁷⁸⁵ C-17.

⁷⁸⁶ Cl. Rep. ¶ 26.

⁷⁸⁷ Cl. Rep. ¶¶ 25; 28-29.

⁷⁸⁸ C-10; C-11; C-12.

⁷⁸⁹ Cl. Rep. Tribunal ¶¶ 28-30; 33.

⁷⁹⁰ Cl. Rep. Tribunal ¶ 32.

⁷⁹¹ Cl. Rep. Tribunal ¶ 33.

⁷⁹² Cl. Rep. Tribunal ¶ 34.

⁷⁹³ Cl. Rep. Tribunal ¶ 40; Cl. Rep. P-H ¶ 20.

⁷⁹⁴ C-44, see paragraph 164 above.

⁷⁹⁵ C-99 Enclosure 1.

⁷⁹⁶ C-99 contains only the covering letter dated 15 November 2006, see R-31, see paragraph 189 above.

⁷⁹⁷ Cl. Rep. Tribunal ¶¶ 37; 39.

The Municipality accepted such a position when it organised a working group in order to devise and approve the heat supply development plan; reliance is placed on the Municipality's letter to Latgales Enerģija on 19 February 2007⁷⁹⁸.⁷⁹⁹

615. The Claimant contends that Latgales Enerģija, in its correspondence with the Municipality, had repeatedly pointed out the Municipality's obligation to devise and approve the heat supply development plan, and even invoked the penalty clause in Clause 5 of the February 2006 Agreement in case the Municipality failed to act; reliance is placed on Latgales Enerģija's letters sent to the Municipality on 10 May 2006,⁸⁰⁰ 19 October 2006,⁸⁰¹ 2 February 2007,⁸⁰² 4 July 2007⁸⁰³ and 18 July 2007⁸⁰⁴.⁸⁰⁵

616. The Claimant argues that in its letter to Latgales Enerģija of 27 October 2005⁸⁰⁶ Rēzeknes Siltumtīkli misrepresented the Regulator's letter to the Municipality of 12 October 2005⁸⁰⁷.⁸⁰⁸ The Regulator had asked the Municipality whether there was an "effective and coordinated" heat supply development plan in place which contained Latgales Enerģija's "planned and already made investments", not whether Latgales Enerģija had "specified and coordinated" the heat supply development plan.⁸⁰⁹

(I) THE REVOCATION OF LATGALES ENERĢIJA'S LICENCES TO PRODUCE,
TRANSMIT AND SELL THERMAL ENERGY

617. The Claimant does not submit that the Regulator's decision of 3 June 2008 (see paragraph 337 above) revoking Latgales Enerģija's licences to produce, transmit and sell thermal energy was made in breach of Latvian law.⁸¹⁰ However, it is the

⁷⁹⁸ C-114, see paragraph 208 above.

⁷⁹⁹ Cl. Rep. Tribunal ¶ 39.

⁸⁰⁰ C-91.

⁸⁰¹ C-96, see paragraph 187 above.

⁸⁰² C-112, see paragraph 207 above.

⁸⁰³ R-26.

⁸⁰⁴ R-26.

⁸⁰⁵ Cl. Rep. Tribunal ¶¶ 38-39; Cl. Rep. P-H ¶ 19.

⁸⁰⁶ C-74, see paragraph 151 above.

⁸⁰⁷ C-69, see paragraph 150 above.

⁸⁰⁸ Cl. Rep. Tribunal ¶ 36.

⁸⁰⁹ Cl. Rep. Tribunal ¶ 36.

⁸¹⁰ Cl. Mem. ¶¶ 209-210; Transcript, Day 1, 37/10-14.

Claimant's case that the Regulator was bound under Latvian law first to issue a warning and grant Latgales Enerģija the opportunity to rectify a situation amounting to a breach of the licences before revoking them.⁸¹¹

618. The Claimant further argues that the grounds on which the Regulator revoked the licences were “illusory” or “just plain wrong”.⁸¹² Latgales Enerģija had extensively addressed all the issues raised by the Regulator in its correspondence with the Regulator; however, the Regulator hardly took any of these explanations into account; reliance is placed on the letter sent to the Regulator by Latgales Enerģija on 30 October 2007.^{813 814}
619. According to the Claimant, the grounds on which the Regulator revoked Latgales Enerģija's licences were the same grounds on which the Regulator issued a warning on 4 October 2007.⁸¹⁵ In particular, the Claimant submits that:
- (i) Latgales Enerģija was unable to submit an operator's plan and yearly reports in the absence of the Municipality's heat supply development plan;⁸¹⁶
 - (ii) Latgales Enerģija's failure to provide uninterrupted good-quality heating services in September and October 2007 was due to (i) the Municipality's failure to pay Latvijas Gāze for the natural gas supplied, (ii) the Municipality's failure to adopt the heat supply development plan (which was necessary for the approval of higher tariffs) and (iii) the attachment of Latgales Enerģija's bank accounts sought by Rēzeknes Siltumtīkli;⁸¹⁷
 - (iii) Latgales Enerģija's assignment of claims to LE Remonts (see paragraph 298 above) was necessary to avoid money being paid into bank accounts that had been attached and to continue the operation of the heating system;⁸¹⁸

⁸¹¹ RfA ¶ 89; Cl. Mem. ¶ 209.

⁸¹² Cl. Mem. ¶ 209.

⁸¹³ C-153, see paragraph 297 above.

⁸¹⁴ Cl. Mem. ¶ 211; Cl. Rep. ¶¶ 53-54.

⁸¹⁵ C-22, see paragraphs 262 ff.; Cl. Mem. ¶¶ 209; 211; Cl. Rep. ¶ 54.

⁸¹⁶ Cl. Rep. ¶ 52; Transcript, Day 1, 36/12-14; see also Cl. Rep. Tribunal ¶ 41.

⁸¹⁷ Cl. Mem. ¶¶ 154-155; Cl. Rep. ¶ 52; Transcript, Day 1, 36/15-17.

⁸¹⁸ Transcript, Day 1, 36/18-22; see also Cl. Mem. ¶ 197.

- (iv) Latgales Enerģija's challenge of the Regulator's decision of 7 December 2007⁸¹⁹ revoking its previous decision of 9 November 2007 approving new tariffs⁸²⁰ prevented the Regulator's decision of 7 December 2007 from coming into force and thus the tariffs originally approved remained applicable; reliance is placed on Section 185(1) of the Administrative Procedure Act;⁸²¹ and
- (v) Latgales Enerģija was unable to invest more than EUR 1.2 million into the heating infrastructure due to (i) the Municipality's failure to adopt the heat supply development plan and (ii) Rēzeknes Siltumtīkli's refusal to approve the installation of new equipment; reliance is placed on letters sent to the Rēzekne City Council by Latgales Enerģija on 6 March 2007,⁸²² 18 April 2007,⁸²³ 13 July 2007,⁸²⁴ 16 April 2008⁸²⁵ and 25 April 2008⁸²⁶.⁸²⁷

620. Lastly, the Claimant submits that the revocation of Latgales Enerģija's licences to produce, transmit and sell thermal energy served as a pretext in order for Rēzeknes Siltumtīkli to seek the termination of the Long-Term Agreement.⁸²⁸

(2) ATTRIBUTION

621. The Claimant argues that the conduct of the Municipality (paragraphs 622 ff. below), the Regulator (paragraphs 625 ff. below), Rēzeknes Siltumtīkli and Rēzeknes Enerģija (paragraphs 629 ff. below) is attributable to the Respondent.

⁸¹⁹ Decision No. 35, C-28, see paragraph 240 above.

⁸²⁰ Decision No. 28, C-27, see paragraph 239 above.

⁸²¹ Cl. Mem. ¶ 196; CWS-4 ¶ 15; Transcript, Day 1, 36/23-25; 37/1-2.

⁸²² C-116, see paragraph 209 above.

⁸²³ C-118, see paragraph 210 above.

⁸²⁴ C-129, see paragraph 211 above.

⁸²⁵ C-176 [page 1]; C-177, see paragraph 329 above.

⁸²⁶ C-176 [page 3], see paragraph 330 above.

⁸²⁷ Cl. Mem. ¶¶ 84-85; 204; 208; Transcript, Day 1, 37/3-9.

⁸²⁸ Transcript, Day 1, 37/21-22; see also Cl. Mem. ¶ 212.

(A) THE MUNICIPALITY

(i) *The Principles*

622. The Claimant contends that in order for an act to be attributable to a State under international law, the act must have been carried out by an organ of such State; reliance is placed on Article 4(1) of the 2001 ILC Articles on Responsibility of States for Internationally Wrongful Acts (the “ILC Articles”).⁸²⁹

(ii) *The Principles Applied*

623. The Claimant submits that the Municipality of Rēzekne (represented by and acting through the Rēzekne City Council) is a branch of local government and constitutes part of the executive branch of the Republic of Latvia.⁸³⁰ The Municipality was representing the Republic of Latvia in its “administrative and regulatory activities” and enjoyed certain autonomy while remaining under the supervision of the Cabinet of Ministers of the Republic of Latvia.⁸³¹

624. The Claimant submits therefore that the Municipality is an organ of the Republic of Latvia within the meaning of Article 4(1) of the ILC Articles and that the Municipality’s conduct is attributable to the Respondent.⁸³²

(B) THE REGULATOR

(i) *The Principles*

625. In addition to the principle contained in Article 4 of the ILC Articles (see paragraph 622 above), the Claimant argues that the Respondent was required to ensure that any state enterprise that it maintains or establishes act in a manner that is not inconsistent with the Claimant’s obligations under the BIT; reliance is placed on the MFN clause contained in Article 3(2) of the BIT in connection with Article 2(2)(b) of the US-Latvia BIT.⁸³³

⁸²⁹ ILC Articles, CLA-7.

⁸³⁰ Cl. Mem. ¶ 233.

⁸³¹ Cl. Mem. ¶¶ 233-234.

⁸³² Cl. Mem. ¶ 234.

⁸³³ US-Latvia BIT, CLA-25; Cl. Mem. ¶¶ 237-238.

(ii) *The Principles Applied*

626. First, the Claimant argues that the Regulator was the body of competent jurisdiction in Latvia to set the heating tariffs for the provision of district heating services in the territory of Rēzekne.⁸³⁴ According to the Claimant, the Regulator existed to exercise administrative and regulatory functions with respect to the supply of heat as a public function entrusted to the Municipality.⁸³⁵ Its finances were at all material times administered by the Municipality, together with other municipalities, through the taxation of service providers.⁸³⁶
627. In the Claimant's view, it follows that the Regulator is an organ of the Republic of Latvia within the meaning of Article 4(1) of the ILC Articles; the Regulator's conduct is therefore attributable to the Respondent.⁸³⁷
628. Secondly, the Claimant argues that the Respondent was responsible for the conduct of the Regulator as it was a State enterprise established by the Respondent within the meaning of Article 2(2)(b) of the US-Latvia BIT.⁸³⁸

(C) RĒZEKNES SILTUMTĪKLI AND RĒZEKNES ENERĢIJA

629. The Claimant advances three arguments to support its claim that the Respondent was responsible for the conduct of Rēzeknes Siltumtīkli and Rēzeknes Enerģija.

(i) *The Principles*

630. The Claimant contends that Rēzeknes Siltumtīkli's and Rēzeknes Enerģija's conduct is attributable to the Respondent, first, by virtue of Article 8 of the ILC Articles;⁸³⁹ secondly, by virtue of Article 5 of the ILC Articles;⁸⁴⁰ and, thirdly, by virtue of Article 2.2(b) of the US-Latvia BIT read in conjunction with the MFN clause contained in Article 3(2) of the BIT.⁸⁴¹

⁸³⁴ Cl. Mem. ¶ 232.

⁸³⁵ Transcript, Day 1, 38/7-11.

⁸³⁶ Cl. Mem. ¶ 232.

⁸³⁷ Cl. Mem. ¶ 234.

⁸³⁸ Cl. Mem. ¶¶ 239-241.

⁸³⁹ Cl. Rep. Tribunal ¶¶ 8-10.

⁸⁴⁰ Cl. Rep. Tribunal ¶¶ 8; 13; Cl. Rep. P-H ¶¶ 5-6.

⁸⁴¹ Cl. Mem. ¶ 238.

(ii) *The Principles Applied*

631. First, the Claimant contends, relying on Article 8 of the ILC Articles, that the Respondent is responsible for the actions of Rēzeknes Siltumtīkli and Rēzeknes Enerģija since the Municipality was the sole shareholder in such companies and, in this capacity, the Municipality instructed, directed and controlled all of the operations of such companies at all relevant times.⁸⁴² Rēzeknes Siltumtīkli and Rēzeknes Enerģija were therefore no more than an extension of the Municipality.⁸⁴³
632. Consequently, the Claimant submits that the conduct of Rēzeknes Siltumtīkli and Rēzeknes Enerģija is attributable to the Respondent based on nine factual circumstances.⁸⁴⁴
633. The Municipality authorised all of Rēzeknes Siltumtīkli's actions and assumed the responsibility therefor.⁸⁴⁵ To the Claimant, Rēzeknes Siltumtīkli was interchangeable with and controlled by the Municipality "such that the Municipality must have

⁸⁴² Cl. Mem. ¶ 234; Cl. Rep. P-H ¶ 14.

⁸⁴³ Cl. Mem. ¶ 234.

⁸⁴⁴ The circumstances relied upon by the Claimant are as follows:

- (i) the members of the boards of Rēzeknes Siltumtīkli and Rēzeknes Enerģija were appointed by the chairperson of the Municipality in accordance with Latvian law (Cl. Rep. Tribunal ¶ 9);
- (ii) while Rēzeknes Siltumtīkli owned and operated the district heating system, the tender for a private operator could be called only by the Municipality and the Long-Term Agreement could be signed only with the permission of the Municipality (Cl. Rep. Tribunal ¶ 12; Transcript, Day 1, 38/12-17; Transcript, Day 4, 32/15; 19-21; 55/10-20);
- (iii) the Municipality remained under the obligation to pay for natural gas deliveries even though the gas was received by Rēzeknes Siltumtīkli (Cl. Rep. Tribunal ¶ 12; Transcript, Day 4, 32/24-25; 33/1-3; 37/13-25; 38/1-3);
- (iv) the Municipality proposed to pay the debt owed to Latvijas Gāze by increasing the share capital of Rēzeknes Siltumtīkli, instead of paying Latvijas Gāze directly or letting Rēzeknes Siltumtīkli decide how to pay its debt (Cl. Rep. Tribunal ¶ 12; Transcript, Day 4, 33/4-7);
- (v) the Municipality (and not Rēzeknes Siltumtīkli) called a tender and eventually chose a company capable of meeting its requirements (Cl. Rep. Tribunal ¶ 12);
- (vi) the Municipality (and not Rēzeknes Siltumtīkli) proposed to terminate the Long-Term Agreement through an agreement of the Council deputies (Cl. Rep. Tribunal ¶ 12);
- (vii) the Municipality (and neither Rēzeknes Siltumtīkli nor Rēzeknes Enerģija) suggested solutions to solve the heat supply crisis in October 2007 involving the use of Rēzeknes Siltumtīkli and Rēzeknes Enerģija to operate the heating system (Cl. Rep. Tribunal ¶ 12);
- (viii) the decision by Rēzeknes Siltumtīkli to commence litigation in September 2007 was taken under the direction or control of the Municipality with the sole purpose to put pressure on Latgales Enerģija's business and to obtain a transfer of heating operations to Rēzeknes Enerģija (Cl. Rep. Tribunal ¶ 12); and
- (ix) the Municipality signed the October 2007 Agreement "despite it not containing any express terms relating to the Municipality" (Transcript, Day 4, 32/21-23).

⁸⁴⁵ Cl. Rep. Tribunal ¶ 9.

assumed responsibility for it”.⁸⁴⁶ By controlling the provision of district heating services Rēzeknes Siltumtīkli exercised a public function and the control over Rēzeknes Siltumtīkli was used by the Municipality to achieve a particular result.⁸⁴⁷

634. In response to the Respondent’s argument that the Municipality did not play a role in the execution of the Long-Term Agreement, the Claimant states that the Municipality exercised control over Rēzeknes Siltumtīkli and Rēzeknes Enerģija at least starting from the change in political leadership in Rēzekne onwards (see paragraphs 128 and 139-140 above) and used such companies to achieve its goal to regain control over the heating system.⁸⁴⁸ Furthermore, the Claimant argues that the February 2005 Agreement is irrelevant to the question whether Rēzeknes Siltumtīkli’s conduct is to be attributed to the Respondent under international law.⁸⁴⁹
635. Secondly, the Claimant contends, relying on Article 5 of the ILC Articles, that Rēzeknes Siltumtīkli and Rēzeknes Enerģija have been exercising delegated governmental authority to run the district heating system and their actions are therefore attributable to the Respondent since the supply of district heating services is “a public power” and the responsibility of the local municipality and thus a “governmental action” or “public function”; reliance is placed on Section 15(1) of the Municipalities Act.⁸⁵⁰
636. The Claimant further contends that the Municipality’s creation of Rēzeknes Siltumtīkli and the delegation of the supply of district heating services to Rēzeknes Siltumtīkli were based on the Municipalities Act; reliance is placed on Section 14(1) and Section 15(3) of the Municipalities Act and Section 40 of the Public Administration Act in force between 2003 and 2009.⁸⁵¹
637. According to the Claimant, the Respondent misconstrues Section 15 of the Municipalities Act.⁸⁵² The Claimant agrees that Section 15 of the Municipalities Act

⁸⁴⁶ Cl. Rep. Tribunal ¶ 11.

⁸⁴⁷ Cl. Rep. Tribunal ¶ 11.

⁸⁴⁸ Cl. Rep. P-H ¶ 15.

⁸⁴⁹ Cl. Rep. P-H ¶ 16.

⁸⁵⁰ Cl. Rep. Tribunal ¶ 13; Cl. Rep. P-H ¶ 10; Transcript, Day 4, 33/8-16.

⁸⁵¹ Cl. Rep. P-H ¶¶ 10-11.

⁸⁵² Cl. Rep. P-H ¶ 7.

does not specify the means for supplying district heating services.⁸⁵³ However, the Claimant contends that Section 15 of the Municipalities Act does provide for the Municipality's obligation to organise district heating services.⁸⁵⁴

638. In the Claimant's view, the Respondent has admitted that the Municipality delegated such public power to Latgales Enerģija by wrongly arguing that Rēzekne Siltumtīkli had delegated to Latgales Enerģija the duty to devise the heat supply development plan through the Long-Term Agreement; the Claimant contends that Rēzeknes Siltumtīkli delegated the day-to-day operation of the heat supply system to Latgales Enerģija under the terms of the Long-Term Agreement and Rēzeknes Siltumtīkli was in a position to delegate such public power since the Municipality had delegated such power to Rēzeknes Siltumtīkli in the first place.⁸⁵⁵
639. In the Claimant's opinion, the Municipality could have passed on the Regulator's query regarding the status of the heat supply development plan to Rēzeknes Siltumtīkli⁸⁵⁶ only provided that Rēzeknes Siltumtīkli had the authority to deal with such issue on behalf of the Municipality.⁸⁵⁷
640. In response to the Respondent's contention that no governmental power had been delegated regarding the contractual obligations towards the Claimant and Latgales Enerģija, the Claimant states that the claims under the BIT relate to Rēzeknes Siltumtīkli's conduct in its exercise of governmental authority more broadly and not only to the performance of the Long-Term Agreement.⁸⁵⁸
641. Furthermore, the Claimant argues that Rēzeknes Siltumtīkli's decision to commence litigation against Latgales Enerģija in September 2007 was based on considerations regarding the overall control of the supply of district heating rather than commercial considerations; the Claimant refers in particular to the context of the energy crisis during September and October 2007 and Rēzeknes Siltumtīkli's delegated power to

⁸⁵³ Cl. Rep. P-H ¶ 7.

⁸⁵⁴ Cl. Rep. P-H ¶ 7.

⁸⁵⁵ Cl. Rep. Tribunal ¶ 13; Cl. Rep. P-H ¶ 7.

⁸⁵⁶ Regulator's letter to the Municipality of 12 October 2005, C-69, see paragraph 150 above.

⁸⁵⁷ Cl. Rep. P-H ¶ 8.

⁸⁵⁸ Cl. Rep. P-H ¶ 9.

organise the heating system.⁸⁵⁹ The Claimant submits that other actions were also taken in the context of Rēzeknes Siltumtīkli's delegated governmental authority such as the interference with the decisions of the Regulator.⁸⁶⁰

642. It is the Claimant's case that Rēzeknes Siltumtīkli continued to perform the Municipality's supervisory role over the operation of the heating system.⁸⁶¹ The Claimant contends that Rēzeknes Siltumtīkli's consent was required in order for works to be undertaken on public heating assets.⁸⁶² In light of the nature of works and the assets involved, such decisions could be made only by a company exercising the Municipality's public powers.⁸⁶³
643. Thirdly, the Claimant argues that the Respondent was responsible for the conduct of the Rēzeknes Siltumtīkli and Rēzeknes Enerģija as they were State enterprises maintained or established by the Respondent within the meaning of Article 2(2)(b) of the US-Latvia BIT.⁸⁶⁴
644. The Claimant argues that the Municipality wholly owned, financed and controlled Rēzeknes Siltumtīkli as well as Rēzeknes Enerģija.⁸⁶⁵
645. The Claimant refers to its argument based Articles 5 and 8 of the ILC Articles summarised in footnote 844 above to argue that Rēzeknes Siltumtīkli and Rēzeknes Enerģija were exercising administrative or governmental authority in the field of heat supply delegated to them by the Municipality.⁸⁶⁶ Furthermore, Rēzeknes Siltumtīkli and Rēzeknes Enerģija were involved in approving commercial transactions and the imposition of fees, quotas or charges through "their involvement in and the signing of the October 2007 Agreement which contained an agreement as to tariffs".⁸⁶⁷

⁸⁵⁹ Cl. Rep. Tribunal ¶ 15.

⁸⁶⁰ Cl. Rep. Tribunal ¶ 15.

⁸⁶¹ Cl. Rep. Tribunal ¶ 14.

⁸⁶² Cl. Rep. Tribunal ¶ 14.

⁸⁶³ Cl. Rep. Tribunal ¶ 14.

⁸⁶⁴ Cl. Mem. ¶¶ 239-241.

⁸⁶⁵ Cl. Mem. ¶ 239.

⁸⁶⁶ Cl. Rep. Tribunal ¶ 16.

⁸⁶⁷ Cl. Rep. Tribunal ¶ 16; Transcript, Day 4, 34/22-25; 35/13.

646. The Claimant argues that the Respondent was therefore under an obligation to ensure that Rēzeknes Siltumtīkli and Rēzeknes Enerģija act in a manner consistent with the obligations that the Respondent owed to the Claimant.⁸⁶⁸

(D) LATGALES ENERĢIJA

647. In response to the Respondent's argument that Latgales Enerģija's conduct is attributable to the Claimant "for the purposes of the concession", the Claimant submits that international law does not provide for attribution of the conduct of a subsidiary to the parent company in the absence of any reason warranting a lifting of the corporate veil.⁸⁶⁹ Therefore, the relationship between the Respondent and the Claimant is not "defined" by any of the other agreements entered into by Latgales Enerģija and the Municipality and its wholly-owned companies.⁸⁷⁰

(3) EXPROPRIATION

648. The Claimant contends that it was expropriated by the Respondent in breach of Article 4(1) of the BIT.⁸⁷¹

(A) THE PRINCIPLES

649. The Claimant argues that Article 4(1) of the BIT prohibits the expropriation, nationalization and taking of similar measures "against investments of investors of the other Contracting Party" and submits that the term "investments" refers to "every kind of asset", including "claims to money which have been used to create an economic value or claims to any performance having an economic value", "any right to conduct economic activities conferred by state authorities"⁸⁷² and contractual rights.⁸⁷³

650. Emphasis is placed by the Claimant on a widely accepted principle whereby an expropriation may occur outright or in stages.⁸⁷⁴ When an expropriation takes place

⁸⁶⁸ Cl. Mem. ¶¶ 240-241.

⁸⁶⁹ Cl. Rep. ¶ 16.

⁸⁷⁰ Cl. Rep. ¶ 16.

⁸⁷¹ BIT, CLA-1, quoted in paragraph 1070 below.

⁸⁷² Cl. Mem. ¶ 252.

⁸⁷³ *Rudloff Case*, American-Venezuela Mixed Claims Commission, Decision on Merits, 9 Reports of International Arbitral Awards 244, CLA-13 p. 250; *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, 8 December 2000 ("*Wena Hotels v. Egypt*"), CLA-14 ¶ 98.

⁸⁷⁴ RfA ¶ 124; Cl. Mem. ¶ 243.

in stages, the terms “creeping expropriation” and “indirect expropriation” can be used interchangeably;⁸⁷⁵ reliance is placed on a number of decisions recognizing creeping expropriation such as *Generation Ukraine v. Ukraine*,⁸⁷⁶ *Tradex Hellas v. Albania*,⁸⁷⁷ *Siemens v. Argentina*⁸⁷⁸ and *BG Group v. Argentina*^{879, 880}. It is therefore sufficient for the Tribunal to find that the cumulative effect of the acts complained of by the Claimant was expropriatory.⁸⁸¹

(B) THE CLAIMANT’S COMPLAINTS

651. The Claimant submits that its investment was unlawfully expropriated by the Respondent both outright (paragraphs 653 ff. below) and gradually over time (paragraphs 658 ff. below).⁸⁸²
652. In the Claimant’s view, unlawful expropriation in the present case is not limited to the expropriation of tangible assets, but extends to the taking or destruction of all kinds of investments by the Respondent.⁸⁸³

(i) “Outright, Indirect and Unlawful Expropriation”

653. The Claimant contends that the forcible taking of Latgales Enerģija’s business on 16 September 2008 amounts to an “outright indirect unlawful expropriation” of its investment by the Respondent.⁸⁸⁴ On that day the Municipality’s executive decisions were enforced by armed local and state police and personnel forcibly entering the

⁸⁷⁵ RfA ¶ 126; footnote 42.

⁸⁷⁶ *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003 (“*Generation Ukraine v. Ukraine*”), CLA-30 ¶¶ 20.22; 20.26.

⁸⁷⁷ *Tradex Hellas S.A. v. Republic of Albania*, ICSID Case No. ARB/94/2, Award, 29 April 1999 (“*Tradex Hellas v. Albania*”), CLA-26 ¶ 191.

⁸⁷⁸ *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007 (“*Siemens v. Argentina*”), CLA-11 ¶ 263.

⁸⁷⁹ *BG Group Plc. v. Argentine Republic*, UNCITRAL, Award, 24 December 2007 (“*BG Group v. Argentina*”), CLA-12 ¶¶ 260-269.

⁸⁸⁰ RfA ¶ 129; Cl. Mem. ¶ 249.

⁸⁸¹ Transcript, Day 1, 40/20-25; 41/1-3.

⁸⁸² Cl. Mem. ¶ 243.

⁸⁸³ Cl. Mem. ¶¶ 251-252.

⁸⁸⁴ Cl. Mem. ¶ 246.

premises of Latgales Enerģija, having expelled Latgales Enerģija's employees and appropriated all of Latgales Enerģija's assets used to operate the heating system.⁸⁸⁵

654. According to the Claimant, the Municipality was aware that it infringed upon Latgales Enerģija's property rights as acknowledged in its decision of 14 July 2008;⁸⁸⁶ the authorities in Rēzekne showed a "total disregard for the Claimant's property" when issuing the decisions and orders that required Latgales Enerģija to surrender the assets it had lawfully leased or purchased pursuant to the Long-Term Agreement without any proper legal procedure.⁸⁸⁷
655. The Claimant contends that its investment was indirectly expropriated as the actions summarised above destroyed the value of Latgales Enerģija, rendered its shares worthless, and caused the loss of the value of loans and guarantees issued in support of Latgales Enerģija's business, all without prompt, adequate and effective compensation.⁸⁸⁸
656. The Claimant argues that it was not in the public interest to "displace" an operator that had already invested substantial sums, planned a EUR 3.5 million investment program over the following two years and had arranged for the EBRD to provide further funds.⁸⁸⁹
657. Finally, the Claimant takes the view that the expropriation was discriminatory as it was directed solely at Latgales Enerģija's business.

(ii) *"Gradual or Creeping, Unlawful Expropriation"*

658. It is the Claimant's case that its investment has also been gradually expropriated through a series of acts and omissions by the Municipality, the Regulator, Rēzeknes Siltumtīkli and Rēzeknes Enerģija that culminated in the events of 16 September 2008.⁸⁹⁰ These actions and omissions destroyed Latgales Enerģija's business and

⁸⁸⁵ RfA ¶ 124; Cl. Mem. ¶ 244.

⁸⁸⁶ Cl. Mem. ¶ 244.

⁸⁸⁷ RfA ¶ 124; Cl. Mem. ¶¶ 244-245.

⁸⁸⁸ RfA ¶¶ 125, 165; Cl. Mem. ¶¶ 245, 266, 342-344, 347, 354.

⁸⁸⁹ RfA ¶ 124; Cl. Mem. ¶ 245.

⁸⁹⁰ RfA ¶ 125; Cl. Mem. ¶ 247; Transcript, Day 1, 40/1-6.

thereby the value of the Claimant's shares in Latgales Enerģija.⁸⁹¹ The loss of Latgales Enerģija's business in turn caused the indirect expropriation of the Claimant's right to reimbursement of the loans granted to Latgales Enerģija and its right to recover money it had paid to Latgales Enerģija's creditors under a guarantee agreement as the Respondent's acts and omissions caused Latgales Enerģija's inability to pay back any such sums.⁸⁹²

659. The Claimant's specific complaints are as follows:

- (i) the Municipality did not prepare and approve the heat supply development plan as required by Latvian Law and Clause 1.2 of the February 2006 Agreement until after it had decided to take back the heating system;⁸⁹³
- (ii) on 22 March 2006 and 28 March 2007 the Public Utilities Commission of Latvia adopted decisions increasing the price that Latvijas Gāze was entitled to charge for the supply of natural gas which in turn resulted in price increases for Latgales Enerģija of 36 % as from May 2006 and 22 % as from May 2007 respectively;⁸⁹⁴
- (iii) on 13 October 2006 and 11 June 2007 the Regulator rejected Latgales Enerģija's application for a revision of its tariffs to account for the increase in the wholesale price of natural gas, having reversed its prior practice;⁸⁹⁵
- (iv) the Municipality failed to pay Latvijas Gāze for the deliveries of natural gas, in breach of the February 2005 Agreement and the Gas Supply Agreement;⁸⁹⁶ as a result, Latvijas Gāze stopped supplying gas to Latgales Enerģija and Latgales Enerģija was forced to switch back to black fuel in September 2007, which caused a short interruption of heat supply at the start of the heating season 2007-2008;⁸⁹⁷

⁸⁹¹ Transcript, Day 1, 40/4-6.

⁸⁹² Transcript, Day 1, 40/6-13.

⁸⁹³ RfA ¶ 131; Cl. Mem. ¶¶ 255-256; 265; Transcript, Day 1, 41/7-8.

⁸⁹⁴ Cl. Mem. ¶ 265.

⁸⁹⁵ RfA ¶ 131; Cl. Mem. ¶¶ 255; 257; 265; Transcript, Day 1, 41/9-11.

⁸⁹⁶ Cl. Mem. ¶¶ 258; 265; Transcript, Day 1, 41/12-15.

⁸⁹⁷ RfA ¶ 131; Cl. Mem. ¶¶ 258; 265.

- (v) the Municipality's wholly-owned companies brought unjustified claims against Latgales Enerģija; they sought and obtained an attachment of Latgales Enerģija bank accounts; such actions and decisions were carried out with the intention to replace Latgales Enerģija with a Municipality-owned company and ultimately to re-nationalize the heating system;⁸⁹⁸
- (vi) the Regulator issued warnings putting Latgales Enerģija on notice that its licences were at risk of being revoked;⁸⁹⁹ according to the Claimant, the Regulator issued unwarranted warnings to Latgales Enerģija under the influence of the Municipality, which had created the crisis situation in the first place and actively sought to influence consumers to pay less than the full amount of their invoices or not to pay anything at all to Latgales Enerģija;⁹⁰⁰
- (vii) the Municipality declared an energy crisis, which was a crisis of its own making; then it refused to solve the crisis through the release of Latgales Enerģija's bank accounts in violation of its contractual obligation and Rēzeknes Siltumtīkli's contractual obligation to do so;⁹⁰¹
- (viii) the Regulator decided to take over the zone of Latgales Enerģija's licences in circumstances where the crisis situation had been created by the Municipality itself;⁹⁰²
- (ix) on 12 October 2007 the Municipality adopted a decision appointing Rēzeknes Enerģija as "the person in charge of providing thermal energy in Rēzekne"; Rēzeknes Enerģija was then a newly-incorporated limited liability company, wholly-owned by the Municipality;⁹⁰³
- (x) on 7 December 2007 the Regulator annulled its previous approval of new tariffs dated 9 November 2007 based on Rēzeknes Enerģija's indications as to

⁸⁹⁸ Cl. Mem. ¶¶ 259; 260; 262; Transcript, Day 1, 41/16-20; 43/7-14.

⁸⁹⁹ Cl. Mem. ¶¶ 261; 265.

⁹⁰⁰ Cl. Mem. ¶ 261; Transcript, Day 1, 41/21-24; 43/4-6.

⁹⁰¹ Transcript, Day 1, 41/25; 42/1-3; 15-17.

⁹⁰² Transcript, Day 1, 42/7-11.

⁹⁰³ Cl. Mem. ¶ 265; Transcript, Day 1, 42/12-14.

the volume of natural gas Latgales Enerģija would use, rather than on Latgales Enerģija's own calculations;⁹⁰⁴

- (xi) the Municipality attempted to persuade Latgales Enerģija's employees to quit their jobs and join Rēzeknes Siltumtīkli;⁹⁰⁵
- (xii) the Regulator wrongly stated that Latgales Enerģija was in breach of the law because of an erroneous report received from Rēzeknes Siltumtīkli which misrepresented the assignment agreement between Rēzeknes Siltumtīkli and Latgales Enerģija that had no bearing on the heat supply;⁹⁰⁶
- (xiii) on 3 June 2008 the Regulator unlawfully revoked Latgales Enerģija's licences to produce, transmit and sell thermal energy relying on spurious breaches of the licence conditions, all of which had been previously "addressed and explained" by Latgales Enerģija and that had been caused by the actions of the Municipality and the Regulator; the Regulator thereby disregarded the required three-month waiting period in breach of Section 28(1) of the Public Utility Regulators Act and the fact that Latgales Enerģija had resumed a steady supply of thermal energy to Rēzekne;⁹⁰⁷ according to the Claimant, the revocation of the licences was the culmination of a series of acts that destroyed Latgales Enerģija's business;⁹⁰⁸
- (xiv) on 13 June 2008 the Municipality and its deputy executive director, acting as "the person in charge of organising the provision of heating in the city of Rēzekne", decided to appoint Municipality-owned companies temporarily to produce and sell thermal energy in Rēzekne; that decision required Latgales Enerģija to hand over the assets necessary for the provision of heating services that it had leased from Rēzeknes Siltumtīkli;⁹⁰⁹

⁹⁰⁴ Transcript, Day 1, 42/18-22.

⁹⁰⁵ Transcript, Day 1, 42/4-6.

⁹⁰⁶ Transcript, Day 1, 42/23-25; 43/1-3.

⁹⁰⁷ RfA ¶ 131; Cl. Mem. ¶¶ 264; 265.

⁹⁰⁸ Transcript, Day 1/19-22.

⁹⁰⁹ Cl. Mem. ¶ 265.

- (xv) these decisions of 13 June 2008 entered into force despite the appeal filed by Latgales Enerģija;⁹¹⁰ on 7 July 2008 Rēzeknes Siltumtīkli and a bailiff went to Latgales Enerģija's offices and requested Latgales Enerģija to hand over its assets, which it "reasonably" refused to do;⁹¹¹
- (xvi) on 14 July 2008, after the court declined its jurisdiction to hear Latgales Enerģija's appeal against the decisions of 13 June 2008, the Municipality adopted a decision requiring Latgales Enerģija to provide access to the assets leased under the Long-Term Agreement, including the assets Latgales Enerģija had purchased or upgraded as a result of Claimant's investment;⁹¹² Latgales Enerģija's appeal did not suspend the effects of the decision;⁹¹³
- (xvii) on 16 September 2008 the Municipality's decision of 14 July 2008 was enforced by armed local and state police and personnel from Rēzeknes Siltumtīkli; Latgales Enerģija's employees were forcibly evicted from their office building; Rēzeknes Siltumtīkli's personnel took over Latgales Enerģija's offices, boiler houses and other premises and appropriated all of Latgales Enerģija's assets, including assets that were leased to Latgales Enerģija for 30 years under the Long-Term Agreement and assets belonging to Latgales Enerģija;⁹¹⁴ according to the Claimant, this effectively terminated the 30-year Long-Term Agreement;⁹¹⁵ and
- (xviii) before and throughout this whole period the Municipality had refused to consent to necessary investments in the heating system, particularly in connection with the cogeneration facilities.⁹¹⁶

660. In response to the Respondent's reliance on the findings of the Latvian courts relating to the present case, the Claimant states that no denial of justice claim was

⁹¹⁰ Cl. Mem. ¶ 265.

⁹¹¹ Cl. Mem. ¶ 265.

⁹¹² Cl. Mem. ¶ 265.

⁹¹³ Cl. Mem. ¶ 265.

⁹¹⁴ RfA ¶ 131; Cl. Mem. ¶¶ 264; 265.

⁹¹⁵ RfA ¶ 131.

⁹¹⁶ Cl. Mem. ¶ 263; Transcript, Day 1, 43/15-18.

submitted.⁹¹⁷ The Tribunal will have to make a finding regarding the Respondent's compliance only with the BIT and not Latvian law, a proposition on which the Claimant has relied more generally in support of all of its claims.⁹¹⁸

661. The Claimant argues that the acts that led to the destruction of Latgales Enerģija's business were politically motivated and "sprang from the realisation that the Claimant had turned around the supply of district heating by investing its money and expertise to make the business profitable and stable".⁹¹⁹ In the Claimant's view, it was an attractive "proposition" to bring the now profitable business back under the Municipality's control by manufacturing a crisis.⁹²⁰

662. The Claimant finally submits that no proper legal procedure "existed" with regard to the cumulative and discriminatory acts and omissions that eventually resulted in the destruction of Latgales Enerģija's business and seizure of its assets and that no compensation was ever paid.⁹²¹

(4) FAIR AND EQUITABLE TREATMENT

663. The Claimant contends that the Respondent has failed to provide fair and equitable treatment to its investment in breach of Article 3(1) of the BIT.⁹²²

(A) PRELIMINARY OBSERVATIONS

664. The Claimant submits that the exact scope of the fair and equitable treatment standard is "purposefully left to the determination of the tribunal"; reliance is placed on the awards in *Mondev v. United States of America*⁹²³ and *Waste Management v. United Mexican States*⁹²⁴.⁹²⁵ The Claimant contends that tribunals have not looked just at individual acts, but also at the "cumulative effect of a number of different measures"

⁹¹⁷ Cl. Rep. ¶ 93.

⁹¹⁸ Cl. Rep. ¶ 95.

⁹¹⁹ RfA ¶ 125.

⁹²⁰ RfA ¶ 125.

⁹²¹ Cl. Mem. ¶ 266.

⁹²² Cl. Mem. ¶ 298.

⁹²³ *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002, CLA-40 ¶ 118.

⁹²⁴ *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004 ("*Waste Management v. Mexico*"), CLA-15 ¶¶ 98-99.

⁹²⁵ RfA ¶ 133; Cl. Mem. ¶ 268.

in order to assess the state's compliance with the fair and equitable treatment standard; reliance is placed on the award in *El Paso v. Argentina*^{926, 927} With reference to the award in *El Paso*, the Claimant submits that the Respondent's actions outlined in the previous sub-section on expropriation also constitute, at a minimum, a creeping violation of the fair and equitable treatment standard.⁹²⁸

665. It is the Claimant's case that various acts of the Municipality, the Regulator, Rēzeknes Siltumtīkli and/or Rēzeknes Enerģija nevertheless constitute separate breaches of the fair and equitable treatment standard "in their own right".⁹²⁹
666. In the Claimant's view, the Regulator's decisions may well comply with Latvian law from a strictly technical point of view; however, viewed in context and as a whole, the Regulator's decisions and the Municipality's conduct amount to breaches of the fair and equitable treatment standard.⁹³⁰ The Municipality's and the Regulator's actions were directed "specifically and solely" at the Claimant's investment and were not, therefore, part of a general exercise of the Respondent's "sovereign right to regulate or form policy".⁹³¹
667. The Claimant relies on specific aspects of the fair and equitable treatment standard as follows:
- (i) the need for transparent and consistent state conduct to promote a stable legal environment and protect the investor's legitimate expectations;
 - (ii) freedom from harassment;
 - (iii) procedural propriety and due process; and
 - (iv) good faith.
668. The Tribunal will follow this outline in its summary of the Claimant's position.

⁹²⁶ *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011 ("*El Paso v. Argentina*"), CLA-39 ¶¶ 515; 518.

⁹²⁷ Cl. Mem. ¶ 270.

⁹²⁸ Cl. Skeleton ¶ 15; Transcript, Day 1, 44/3-8.

⁹²⁹ Transcript, Day 1, 44/9-12.

⁹³⁰ Transcript, Day 1, 44/16-25.

⁹³¹ Transcript, Day 1, 45/1-4.

(B) TRANSPARENCY AND THE INVESTOR'S LEGITIMATE EXPECTATIONS

669. The Claimant contends that the Respondent breached the Claimant's legitimate expectations.⁹³²

(i) *The Principles*

670. The Claimant submits that the fair and equitable treatment standard requires the host State to act in a transparent manner and ensure (i) that there are no ambiguities in the legal framework regarding the investment and (ii) that any decision taken by it affecting the investment is traceable to such legal framework⁹³³ consisting of treaties and legislation as well as on "any undertakings and representations made explicitly or implicitly by the host state", which may be contained in decrees, licences and similar executive statements as well as contractual undertakings.⁹³⁴

671. The Claimant further submits that where the host State goes back on assurances giving rise to legitimate expectations on the part of an investor, such conduct violates the fair and equitable treatment standard;⁹³⁵ reliance is placed on the award in *Tecmed v. Mexico*^{936, 937}.

672. In addition to transparency and absence from ambiguity in the legal regime, the fair and equitable treatment standard requires a degree of consistency in the State's conduct; reliance is placed on the award in *Tecmed*,⁹³⁸ and on the award in *MTD v. Chile*⁹³⁹ which followed the approach in *Tecmed*.⁹⁴⁰

⁹³² Cl. Mem. ¶ 279; Cl. Skeleton ¶ 16(1).

⁹³³ RfA ¶ 135; Cl. Mem. ¶ 273.

⁹³⁴ Cl. Mem. ¶ 274.

⁹³⁵ Cl. Mem. ¶ 274.

⁹³⁶ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003 ("*Tecmed v. Mexico*"), CLA-17 ¶ 164, specifically on the statement that the refusal by the State to renew a permit was a pretext to "permanently close down a site whose operation had become a nuisance due to political reasons relating to the community's opposition expressed in a variety of forms, regardless of the company in charge of the operation and regardless of whether or not it was being properly operated".

⁹³⁷ RfA ¶ 136; Cl. Mem. ¶ 275.

⁹³⁸ *Tecmed v. Mexico*, CLA-17 ¶ 154, with specific reference to the statement that the investor "also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities".

⁹³⁹ *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004 ("*MTD v. Chile*"), CLA-18 ¶ 113.

673. According to the Claimant, arbitral practice has extended the fair and equitable treatment standard to include an obligation for the host State “to provide a predictable framework for investment and protection of an investor’s legitimate expectations”; reliance is placed on the decision in *LG&E v. Argentina*^{941 942}.
674. Finally, the Claimant submits that a breach by the host State of a contractual undertaking towards an investor may amount to a breach of the fair and equitable treatment standard; reliance is placed on the award in *Rumeli v. Kazakhstan*^{943 944}.

(ii) *The Claimant’s Specific Complaints*

675. The Claimant argues that its legitimate expectations breached by the Respondent were as follows:
- (i) the expectation that the Municipality and the entities it controlled would abide by their contractual obligations;⁹⁴⁵
 - (ii) the expectation that Latgales Enerģija would be able to use the assets and create new assets for the production, transmission and distribution of thermal energy for 30 years, recover the investments made and earn a profit, as provided in the Long-Term Agreement;⁹⁴⁶
 - (iii) the expectation that the Municipality would not take steps, either by action or omission, to frustrate Latgales Enerģija’s performance under the Long-Term Agreement;⁹⁴⁷

⁹⁴⁰ RfA ¶¶ 136-137.

⁹⁴¹ *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006 (“*LG&E v. Argentina*”), CLA-31 ¶ 131.

⁹⁴² Cl. Mem. ¶ 276.

⁹⁴³ *Rumeli Telekom A.S. and Telsim Mobil Telekomünikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award, 29 July 2008 (“*Rumeli v. Kazakhstan*”), CLA-34 ¶ 615. The Claimant contends that in this case the tribunal held that the use of a state organ’s prerogatives to terminate a contract constituted a breach of the fair and equitable treatment standard.

⁹⁴⁴ Cl. Mem. ¶ 277.

⁹⁴⁵ Transcript, Day 1, 45/12-14; Day 4, 50/14-18.

⁹⁴⁶ RfA ¶ 143; Cl. Mem. ¶ 278.

⁹⁴⁷ RfA ¶ 143; Cl. Mem. ¶ 278.

- (iv) the expectation that the Municipality would not seek to influence the Regulator to Latgales Enerģija's detriment;⁹⁴⁸
- (v) the expectation that the Municipality would not engage in other projects concerned with the provision of heating services;⁹⁴⁹
- (vi) the expectation that the Municipality would not actively seek to replace Latgales Enerģija as the operator of the heating system and regain control over the heating system;⁹⁵⁰
- (vii) the expectation that the Municipality would consent to the investments required in order for the heating system to be improved and overhauled by Latgales Enerģija;⁹⁵¹
- (viii) the expectation that the licences to produce, transmit and sell heating granted to Latgales Enerģija would not be withdrawn in a non-transparent manner, in bad faith and due to circumstances created by the Municipality and the Regulator themselves;⁹⁵²
- (ix) the expectation that the Municipality would perform its duties under the February 2006 Agreement and establish and approve a heat supply development plan so that a new heating tariff could be calculated;⁹⁵³
- (x) the expectation that the Regulator would not reverse its previous practice and approve tariffs that were calculated using the same methodology for the tariffs that had previously been approved by the Regulator in circumstances where no heat supply development plan existed;⁹⁵⁴

⁹⁴⁸ Cl. Mem. ¶ 278.

⁹⁴⁹ RfA ¶ 143.

⁹⁵⁰ Cl. Mem. ¶ 278; Transcript, Day 1, 45/15-17.

⁹⁵¹ Cl. Mem. ¶ 278.

⁹⁵² RfA ¶ 143; Cl. Mem. ¶ 278; Transcript, Day 1, 45/22-23.

⁹⁵³ RfA ¶ 143; Cl. Mem. ¶ 278.

⁹⁵⁴ RfA ¶ 143; Cl. Mem. ¶ 278; Transcript, Day 1, 45/18-19.

- (xi) the expectation that previously approved tariffs would not be cancelled in non-transparent conditions, and “wrongly”, as a result of interference by the Municipality;⁹⁵⁵
- (xii) the expectation that Latgales Enerģija would receive natural gas to be able to provide heating services and that the Municipality would honour its contractual obligations in relation to the supply of that natural gas, including its obligation to pay Latvijas Gāze for the natural gas supplied;⁹⁵⁶
- (xiii) the expectation that the Municipality would not actively prevent Latgales Enerģija from operating its business by seeking the attachment of Latgales Enerģija’s bank accounts, and would comply with the undertaking to remove such attachment;⁹⁵⁷ and
- (xiv) the expectation that Latgales Enerģija would not be required to hand over the assets necessary for other Municipality-owned companies to provide heating services.⁹⁵⁸

676. These expectations arose mainly from the undertakings contained in the contracts which governed the investment, in particular the Long-Term Agreement and the February 2005 Agreement; reliance is placed by the Claimant on three whereas clauses and Clause 2.3 of the Long-Agreement as well as Clauses 2, 2.2, 2.4, 2.10, 3 and 4 of the February 2005 Agreement.⁹⁵⁹

677. In addition, the Claimant relies on the context in which the investment was made, in particular the initial tender (including the relevant documentation contained in Exhibit C-38) and the different investment structures contemplated by Mr. Strioga’s presentation given on 25 November 2004^{960,961} the structure of the investment which was eventually adopted was based on the expectations recalled above. Without such

⁹⁵⁵ RfA ¶ 143; Cl. Mem. ¶ 278.

⁹⁵⁶ RfA ¶ 143; Cl. Mem. ¶ 278; Transcript, Day 1, 45/20-21; Day 4, 43/18-25; 44/1.

⁹⁵⁷ Cl. Mem. ¶ 278.

⁹⁵⁸ Cl. Mem. ¶ 278.

⁹⁵⁹ Transcript, Day 4, 48/14-25; 49/1-25; 50/1-25; 51/1; 8-25; 52/1-22.

⁹⁶⁰ C-41.

⁹⁶¹ Transcript, Day 4, 45/24-25; 46/1-25; 47/1-25; 48/1-13.

expectations the Claimant would not have made the investment at all, or would have structured the investment differently, for instance through a joint venture with the Municipality.⁹⁶²

678. As to the time when certain representations were made to the Claimant, the Claimant submits that it would be too narrow to consider only 28 January 2005 as the critical date when the investment was made;⁹⁶³ admittedly, certain representations relied upon were made after 28 January 2005.⁹⁶⁴ However, such representations are part of a sequence of events that took place within a relatively short period of time, and must be properly taken into account, since the making of the investment was a process: the Claimant made its appearance in November 2004 in a critical situation in Rēzekne; the Claimant then immediately made pledges to Unibanka and others without any “contractual cover” and subsequently the Long-Term Agreement and the February 2005 Agreement were executed.⁹⁶⁵

(C) FREEDOM FROM HARASSMENT

679. The Claimant further contends that the Respondent breached the fair and equitable treatment standard as a result of a number of “harassing actions” directed against the Claimant’s investment.⁹⁶⁶

(i) *The Principles*

680. The Claimant submits that the fair and equitable treatment standard also applies “in situations of harassment directed at the investor by the host State” and that the host State must grant the investor freedom from harassment by its own regulatory

⁹⁶² Transcript, Day, 4, 48/3-13.

⁹⁶³ Transcript, Day 4, 53/9-11; 54/3-7.

⁹⁶⁴ Transcript, Day 4, 52/23-25; 52/8.

⁹⁶⁵ Transcript: Day 4, 53/12-25; 54/1-7.

⁹⁶⁶ RfA ¶ 145; Cl. Mem. ¶ 285; Cl. Skeleton ¶ 16(2).

authorities.⁹⁶⁷ Reliance is placed on the tribunal's finding in *Tecmed*;⁹⁶⁸ on the award in *Desert Line v. Yemen*⁹⁶⁹ and on tribunal's finding in *Pope & Talbot*^{970, 971}

(ii) *The Claimant's Specific Complaints*

681. The Claimant contends that the Municipality and the Regulator harassed the Claimant's investment "until it reached the point where the Regulator believed that Latgales Enerģija had committed breaches of the licence conditions that justified the cancellation of those licences".⁹⁷² The Claimant submits that the harassment by the Municipality and the Regulator of which it complains consists of the following:

- (i) the Municipality's failure to respond to Latgales Enerģija's attempts to advance the approval of the heat supply development plan and the delay in the approval of such plan;⁹⁷³
- (ii) the Regulator's refusal to calculate heating tariffs based on its previous consistent practice in circumstances where increased tariffs were economically critical as a result of factors outside of Latgales Enerģija's control;⁹⁷⁴
- (iii) the Municipality's breaches of numerous contractual obligations which could only have been calculated adversely to affect Latgales Enerģija's business;⁹⁷⁵
- (iv) Rēzeknes Siltumtīkli's and Rēzeknes Enerģija's claims brought against Latgales Enerģija before the Latvian courts with the intention to obtain an attachment of Latgales Enerģija's bank accounts and paralyse the company's

⁹⁶⁷ RfA ¶ 138; Cl. Mem. ¶ 280.

⁹⁶⁸ *Tecmed. v. Mexico*, CLA-17 ¶ 163. The Claimant contends that in this case a licence of unlimited duration was replaced with one of limited duration, and the tribunal found that the denying the renewal of the permit's renewal was a means designed to force the investor to relocate to a new site and bear the risks and costs associated with such relocation.

⁹⁶⁹ *Desert Line Projects LLC v. Republic of Yemen*, ICSID Case No. ARB/05/17, Award, 6 February 2008, CLA-33 ¶ 179.

⁹⁷⁰ *Pope & Talbot Inc v. Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, 10 April 2001, CLA-27 ¶ 181.

⁹⁷¹ Cl. Mem. ¶¶ 280-282.

⁹⁷² Cl. Mem. ¶ 284.

⁹⁷³ Cl. Mem. ¶ 284.

⁹⁷⁴ RfA ¶ 145; Cl. Mem. ¶ 284.

⁹⁷⁵ Cl. Mem. ¶ 284.

ability to conduct its business; and their subsequent refusal to permit the lifting of such attachment;⁹⁷⁶

- (v) the actions by the Municipality, in particular in September and October 2007, in anticipation of, or with deliberate intent to cause, Latgales Enerģija's removal as the operator of the heating system, and to appoint a Municipality-owned company or another investor;⁹⁷⁷
- (vi) the Regulator's decision of 11 October 2007 regarding the takeover of the zone under the licences, which was premature and based on circumstances created by actions of the Municipality and the Regulators previous unjustified decisions;⁹⁷⁸
- (vii) the Municipality's unjustified interference with the Regulator's decision to approve new tariffs so that the Regulator revoked that decision "on a basis that was inconsistent with the tariff calculation Methodology";⁹⁷⁹
- (viii) the Regulator's unjustified objection to Latgales Enerģija's financial arrangements put in place in order to receive payments from consumers and make payments to suppliers, including for natural gas;⁹⁸⁰
- (ix) the Municipality's attempts to dissuade consumers from paying Latgales Enerģija's invoices in full;⁹⁸¹
- (x) the Municipality's refusal to consent to works being carried out on the heating system and the installation of cogeneration facilities which, together with the refusal to approve the heat supply development plan, signified that Latgales Enerģija was unable to invest the full amount of EUR 1.5 million into the heating system in the first three years of the lease, as required by the Long-

⁹⁷⁶ RfA 145; Cl. Mem. ¶ 284; Transcript, Day 1, 46/11-13.

⁹⁷⁷ Cl. Mem. ¶ 284; Transcript, Day 1 46/2-16.

⁹⁷⁸ RfA ¶ 145; Cl. Mem. ¶ 284.

⁹⁷⁹ Cl. Mem. ¶ 284.

⁹⁸⁰ Cl. Mem. ¶ 284.

⁹⁸¹ Cl. Mem. ¶ 284.

Term Agreement, and was instead permitted to invest only EUR 1.2 million;⁹⁸²

- (xi) the Municipality's multiple attempts to appoint other individuals and its own entities to provide heating services instead of Latgales Enerģija;⁹⁸³ and
- (xii) the Municipality's decision requiring Latgales Enerģija to hand over the leased assets necessary for the provision of heating services and the enforcement of that decision by armed local and state police and personnel from Rēzeknes Siltumtīkli.⁹⁸⁴

(D) PROCEDURAL PROPRIETY AND DUE PROCESS

682. The Claimant contends that the Respondent has failed to treat the Claimant's investment with procedural propriety and due process, thereby breaching its obligations under the fair and equitable treatment standard.⁹⁸⁵

(i) *The Principles*

683. The Claimant submits that procedural fairness "is an elementary requirement of the rule of law and a vital element of fair and equitable treatment" and that tribunals have consistently held that "the absence of a fair procedure or serious procedural shortcomings were important elements in a finding of a violation of the fair and equitable treatment standard";⁹⁸⁶ reliance is placed by the Claimant on the awards in *Waste Management*⁹⁸⁷ and *Tecmed*^{988 989}.

⁹⁸² Cl. Mem. ¶ 284.

⁹⁸³ RfA ¶ 145; Cl. Mem. ¶ 284.

⁹⁸⁴ RfA ¶ 145; Cl. Mem. ¶ 284.

⁹⁸⁵ Cl. Mem. ¶¶ 290-291; Cl. Skeleton ¶ 16(3).

⁹⁸⁶ RfA ¶ 139; Cl. Mem. ¶ 286.

⁹⁸⁷ *Waste Management v. Mexico*, CLA-15 ¶ 98. The Claimant submits that the tribunal concluded that there was a breach of the fair and equitable treatment standard where the conduct attributable to the State and harmful to the claimant "involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process".

⁹⁸⁸ *Tecmed v. Mexico*, CLA-17 ¶ 162. The Claimant contends that the tribunal found that Mexico had breached the fair and equitable treatment standard *inter alia* on the basis that the regulatory authority had revoked the claimant's licence to operate a landfill and had failed to notify the claimant of its intention to do so, thereby depriving the claimant of an opportunity to state its case.

⁹⁸⁹ RfA ¶ 140.

684. Finally, the Claimant states that whereas denial of justice has been traditionally associated with the administration of justice in local courts, the tribunal in *Rumeli*⁹⁹⁰ held that “[c]ourts are not the only State organs the conduct of which can amount to a denial of justice. Administrative organs can also engage the State’s international responsibility by denying justice”.⁹⁹¹ The Claimant points out that to reach its conclusion, the tribunal in *Rumeli*⁹⁹² had cited the finding in *Amco II* to the effect that there was “no provision of international law that makes impossible a denial of justice by an administrative body”.⁹⁹³

(ii) *The Claimant’s Specific Complaints*

685. The Claimant submits that the Latvian authorities failed to treat its investment with procedural propriety and due process and thereby violated the fair and equitable treatment standard under the BIT as follows:

- (i) when the Municipality attempted to appoint other entities to provide heating services: on the first occasion, the effect of the decision to take over the zone of Latgales Enerģija was suspended and therefore a precondition to appoint a person in charge of providing thermal energy in Rēzekne was not met; on the second occasion, the preconditions to appoint a person in charge of providing thermal energy in Rēzekne were not met and the person in charge had no authority to issue any decision directing Latgales Enerģija to return the heating system to Rēzeknes Siltumtīkli;⁹⁹⁴
- (ii) the legal claims filed against Latgales Enerģija by various Latvian entities aimed principally at having Latgales Enerģija’s bank accounts attached in order to paralyse Latgales Enerģija’s commercial activities;⁹⁹⁵
- (iii) Latgales Enerģija was not granted any time to remedy any alleged breaches of the licence conditions before its licences were revoked, contrary to the

⁹⁹⁰ *Rumeli v. Kazakhstan*, CLA-34 ¶ 623.

⁹⁹¹ Cl. Mem. ¶ 288.

⁹⁹² *Rumeli v. Kazakhstan*, CLA-34 ¶ 623.

⁹⁹³ Cl. Mem. ¶ 289.

⁹⁹⁴ RfA ¶ 146; Cl. Mem. ¶ 290; Transcript, Day 1, 47/5-8.

⁹⁹⁵ RfA ¶ 146; Cl. Mem. ¶ 290; Transcript, Day 1, 47/12-14.

requirements of Latvian law; the Regulator should have issued a warning regarding the possible revocation of the licences and could have revoked the licences only provided that the warning went unheeded;⁹⁹⁶

- (iv) when deciding to revoke Latgales Enerģija's licences, the Regulator took into account "events and circumstances" that Latgales Enerģija had previously shown not to constitute breaches of its licence requirements in response to queries from the Regulator, the substance of which the Regulator failed to address;⁹⁹⁷ and
- (v) the Municipality used its "public law powers" to circumvent the established procedure involving the person in charge of providing thermal energy in Rēzekne when issuing its decision to hand over the leased assets to the municipally-owned company; the Municipality used its "public law powers" effectively to terminate the Long-Term Agreement and regain control over the heating system.⁹⁹⁸

(E) GOOD FAITH

686. The Claimant contends that the Municipality and the Regulator failed to act in good faith towards its investment and therefore violated the fair and equitable treatment standard under the BIT.⁹⁹⁹

(i) *The Principles*

687. The Claimant argues that the requirement of good faith is inherent in public international law and the fair and equitable treatment standard and that tribunals have long recognized the role which good faith plays in the fair and equitable treatment obligation towards investors.¹⁰⁰⁰ Reliance is placed by the Claimant on the awards in *Genin v. Estonia*,¹⁰⁰¹ *Sempra v. Argentina*¹⁰⁰² and *Waste Management*^{1003, 1004}.

⁹⁹⁶ RfA ¶ 146; Cl. Mem. ¶ 290; Transcript, Day 1, 46/21-25.

⁹⁹⁷ Cl. Mem. ¶ 290; Transcript, Day 1, 47/1-4.

⁹⁹⁸ RfA ¶ 146; Cl. Mem. ¶ 290; Transcript, Day 1, 47/9-11.

⁹⁹⁹ Cl. Mem. ¶ 297; Cl. Skeleton ¶ 16(4).

¹⁰⁰⁰ RfA ¶ 141; Cl. Mem. ¶ 292.

¹⁰⁰¹ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. Republic of Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001 ("*Genin v. Estonia*"), CLA-28 ¶ 367 with specific reference to the

688. The Claimant submits that the fair and equitable treatment standard is an “objective standard”; proof of bad faith is not required in order to establish a breach of the applicable standard, as held by the *Tecmed* tribunal¹⁰⁰⁵ and the tribunal in *Biwater Gauff v. Tanzania*^{1006, 1007}

(ii) *The Claimant’s Specific Complaints*

689. The Claimant submits that the Municipality and the Regulator acted in bad faith, and the fair and equitable treatment standard was thereby breached by them as follows:

- (i) by the Municipality’s refusal to comply with the February 2005 Agreement, the February 2006 Agreement and the October 2007 Agreement; in particular the Municipality’s refusal to comply with its obligation not to frustrate the performance of the Long-Term Agreement by Latgales Energija and to adopt the decisions required by Latvian law in order that Latgales Energija could properly perform the Long-Term Agreement;¹⁰⁰⁸
- (ii) the Regulator’s refusal to calculate new tariffs in accordance with its previous practice “in the absence of a reasonable basis”, especially in light of the increase in the price of natural gas;¹⁰⁰⁹
- (iii) the Municipality’s attempt to attract a new operator in summer of 2007;¹⁰¹⁰

tribunal’s statement that “[a]cts that would violate this minimum standard [of fair and equitable treatment] would include...subjective bad faith”.

¹⁰⁰² *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, CLA-32 ¶¶ 297-299, as authority for the proposition that good faith is “the common guiding beacon” under the fair and equitable treatment standard and “permeates the whole approach” to investment protection.

¹⁰⁰³ *Waste Management. v. Mexico*, CLA-15 ¶ 138. The Claimant submits that the tribunal found that the obligation to act in good faith was a basic obligation under the fair and equitable treatment standard and a deliberate conspiracy by government organs to destroy or frustrate an investment would constitute a breach of that standard.

¹⁰⁰⁴ RfA ¶ 142; Cl. Mem. ¶¶ 293-294.

¹⁰⁰⁵ *Tecmed v. Mexico*, CLA-17 ¶ 153.

¹⁰⁰⁶ *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008 (“*Biwater Gauff v. Tanzania*”), CLA-36 ¶ 602.

¹⁰⁰⁷ RfA ¶ 141; Cl. Mem. ¶¶ 294-295.

¹⁰⁰⁸ RfA ¶ 147; Cl. Mem. ¶ 296.

¹⁰⁰⁹ RfA ¶ 147; Cl. Mem. ¶ 296; Transcript, Day 1, 48/15-18.

¹⁰¹⁰ Transcript, Day 1, 47/19-20.

- (iv) the Municipality's attempt to regain control of the heating system by incorporating Rēzeknes Enerģija before declaring an energy crisis;¹⁰¹¹
- (v) the attachment of Latgales Enerģija's bank accounts upon request by the Municipality, Rēzeknes Siltumtīkli's and/or Rēzeknes Enerģija and their refusal to have the attachment of those accounts lifted, knowing that this would effectively paralyse the operation of Latgales Enerģija's business;¹⁰¹²
- (vi) the announcement by the Rēzekne City Council on 9 October 2007 of an energy crisis, which was a crisis of the Municipality's own making, and the refusal to take action to remedy that crisis by having the attachment of Latgales Enerģija's bank accounts lifted;¹⁰¹³
- (vii) the Municipality's decisions to appoint two persons in charge of providing thermal energy in Rēzekne to take over the leased assets;¹⁰¹⁴
- (viii) the Municipality's actions to encourage consumers not to pay Latgales Enerģija's invoices in full, which, at the most, would have been an issue for the Regulator, not the Municipality;¹⁰¹⁵
- (ix) the Regulator's decision to cancel Latgales Enerģija's licences on grounds that Latgales Enerģija had previously shown not to constitute breaches of the licence conditions, in circumstances in which the events and the breaches complained of by the Regulator had been caused solely by the actions of the Municipality and the Regulator itself;¹⁰¹⁶ in the Claimant's view, the cancellation was based on an intention to replace Latgales Enerģija before the new heating season;¹⁰¹⁷ and

¹⁰¹¹ Transcript, Day 1, 47/21-24.

¹⁰¹² Cl. Mem. ¶ 296; Transcript, Day 1, 48/5-9.

¹⁰¹³ RfA ¶ 147; Cl. Mem. ¶ 296.

¹⁰¹⁴ RfA ¶ 147.

¹⁰¹⁵ Transcript, Day 1, 48/10-14.

¹⁰¹⁶ RfA ¶ 147; Cl. Mem. ¶ 296.

¹⁰¹⁷ Transcript, Day 1, 48/19-24.

- (x) the Municipality’s decision requiring Latgales Enerģija to hand over the leased assets to Municipality-controlled companies once Latgales Enerģija’s heating services had become profitable.¹⁰¹⁸

690. The Claimant submits that the Municipality and the Regulator have acted in bad faith towards its investment “as from the time that Mr. Vjaks became Mayor of Rēzekne” and therefore the Respondent violated its obligations to the Claimant under the fair and equitable treatment standard.¹⁰¹⁹

(5) FULL PROTECTION AND SECURITY

691. The Claimant contends that the Respondent had failed to provide full protection and security within the meaning of Article 3(1) of the BIT.¹⁰²⁰

692. The Claimant argued at the Hearing that the Respondent had an obligation to protect the Claimant’s investment “in light of the actions taken by local authorities in Rēzekne”.¹⁰²¹ The Respondent had knowledge of these actions.¹⁰²² The Claimant as well as Latgales Enerģija had complained of such actions to various state agencies on numerous occasions, to no avail.¹⁰²³ The Claimant contends that while the Respondent is responsible for the actions of the Rēzekne authorities, it is itself “culpable” for failing to provide full protection and security to Respondent’s investment by failing to prevent the destruction of Latgales Enerģija’s business.¹⁰²⁴ According to the Claimant, the Respondent had a separate and distinct obligation under the BIT in this respect.¹⁰²⁵

693. In its Skeleton Argument, the Claimant refers to the finding of the tribunal in *Azurix v. Argentina*¹⁰²⁶ to submit that the Respondent had failed to ensure “the stability

¹⁰¹⁸ RfA ¶ 147; Cl. Mem. ¶ 296.

¹⁰¹⁹ Cl. Mem. ¶¶ 297-298.

¹⁰²⁰ Cl. Mem. ¶ 300; Cl. Skeleton ¶ 17.

¹⁰²¹ Transcript, Day 1, 49/5-8.

¹⁰²² Transcript, Day 1, 49/8.

¹⁰²³ Transcript, Day 1, 49/8-11.

¹⁰²⁴ Transcript, Day 1, 49/11-16.

¹⁰²⁵ Transcript, Day 1, 49/16-17.

¹⁰²⁶ *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006 (“*Azurix v. Argentina*”), CLA-19 ¶ 408.

afforded by a secure investment environment” and permitted the Claimant’s investment to be rendered worthless.¹⁰²⁷

(6) ARBITRARY OR DISCRIMINATORY MEASURES

694. The Claimant submits that the actions of the local authorities in Latvia towards the Claimant’s investment were both arbitrary and discriminatory and impaired the management, maintenance, use and enjoyment of the Claimant’s investment.¹⁰²⁸

(A) THE PRINCIPLES

695. The Claimant complains of a breach of Article 3(1), second paragraph, of the BIT.

696. The Claimant submits that it is sufficient to show that a measure was either arbitrary or discriminatory; reliance is placed on *Azurix*¹⁰²⁹ and *Siag v. Egypt*^{1030 1031}.

697. The Claimant states that tribunals had adopted different approaches as to the meaning and scope of the concept of an “arbitrary measure”.¹⁰³² Some tribunals such as the UNCITRAL tribunal in *Lauder v. Czech Republic*,¹⁰³³ *Occidental v. Ecuador*¹⁰³⁴ and *CMS v. Argentina*¹⁰³⁵ relied on the ordinary meaning of the adjective “arbitrary” which they defined as “founded on prejudice or preference rather than on reason or fact”.¹⁰³⁶ Other tribunals relied on the finding of the International Court of Justice in *ELSI (United States of America v. Italy)*¹⁰³⁷ that contrasted arbitrary measures with the

¹⁰²⁷ Cl. Skeleton ¶ 17.

¹⁰²⁸ RfA ¶ 158; Cl. Mem. ¶ 312; Cl. Skeleton ¶ 19.

¹⁰²⁹ *Azurix v. Argentina*, CLA-19 ¶ 391.

¹⁰³⁰ *Waguih Elie George Siag and Clorinda Vecchi v. Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award, 1 June 2009 ¶ 457 (available at: https://www.italaw.com/sites/default/files/case-documents/ita0786_0.pdf).

¹⁰³¹ Cl. Mem. ¶ 303.

¹⁰³² Cl. Mem. ¶ 304.

¹⁰³³ *Ronald S. Lauder v. Czech Republic*, UNCITRAL Award, 3 September 2001 (“*Lauder v. Czech Republic*”), CLA-29 ¶ 221.

¹⁰³⁴ *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA Case No. UN3467, Award, 1 July 2004, ¶ 392 (available at: <https://www.italaw.com/sites/default/files/case-documents/ita0571.pdf>).

¹⁰³⁵ *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, 12 May 2005 (“*CMS v. Argentina*”), RLA-30 ¶ 291.

¹⁰³⁶ Cl. Mem. ¶ 304.

¹⁰³⁷ *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, p. 15 (“*ELSI*”), CLA-24 ¶ 76.

rule of law and defined them as a “wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety”.¹⁰³⁸ The Claimant further relies on the findings in *National Grid v. Argentina*,¹⁰³⁹ *Saluka v. Czech Republic*¹⁰⁴⁰ and *LG&E*¹⁰⁴¹.¹⁰⁴²

698. Moreover, reliance is placed by the Claimant on the award in *AES v. Hungary*¹⁰⁴³.¹⁰⁴⁴ The Claimant concludes that use by a State of its governmental powers to meddle with the contractual rights of an investor can constitute arbitrary and discriminatory measures under the BIT.¹⁰⁴⁵

699. As to the definition of discriminatory measures, the Claimant relies on the tribunal’s finding in *Lauder* to submit that a measure need not violate domestic law in order to be discriminatory; a provision of domestic law could in fact itself be found discriminatory.¹⁰⁴⁶ The non-discrimination standard requires “a rational justification of any differential treatment of a foreign investor”; reliance is placed on *Saluka*¹⁰⁴⁷.¹⁰⁴⁸

700. The Claimant finally contends that a measure may be found to be discriminatory irrespective of whether the State acted with an intention to discriminate, as found by the tribunal in *Siemens v. Argentina*¹⁰⁴⁹.¹⁰⁵⁰ However, the Claimant states that

¹⁰³⁸ Cl. Mem. ¶ 304.

¹⁰³⁹ *National Grid p.l.c. v. Argentine Republic*, UNCITRAL, Award, 3 November 2008, CLA-35 ¶ 197.

¹⁰⁴⁰ *Saluka Investments B.V. v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 (“*Saluka v. Czech Republic*”), CLA-21 ¶ 460.

¹⁰⁴¹ *LG&E v. Argentina*, CLA-31 ¶ 158.

¹⁰⁴² RfA ¶ 156; Cl. Mem. ¶¶ 305-306.

¹⁰⁴³ *AES Summit Generation Limited and AES-Tisza Erömi Kft. v. Republic of Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010 (“*AES v. Hungary*”), CLA-38 ¶¶ 10.3.12-10.3.13. The Claimant states that in this case the tribunal had to deal with the reintroduction by Hungary of “price decrees” which the tribunal found to constitute unreasonable or discriminatory measures on the basis that such measures lowered the prices the claimants received pursuant to a contractually agreed formula.

¹⁰⁴⁴ Cl. Mem. ¶ 307.

¹⁰⁴⁵ Cl. Mem. ¶ 308.

¹⁰⁴⁶ Cl. Mem. ¶ 309.

¹⁰⁴⁷ *Saluka v. Czech Republic*, CLA-21 ¶ 460.

¹⁰⁴⁸ RfA ¶ 157.

¹⁰⁴⁹ *Siemens v. Argentina*, CLA-11 ¶ 321.

¹⁰⁵⁰ Cl. Mem. ¶ 310.

evidence of a discriminatory intention on the part of the State is relevant to determine whether the measures are discriminatory, as found by the *LG&E* tribunal¹⁰⁵¹.¹⁰⁵²

(B) THE CLAIMANT'S SPECIFIC COMPLAINTS

701. According to the Claimant, the following acts and omissions constituted arbitrary measures:

- (i) the Municipality's "undue delay" to devise and approve the heat supply development plan; reliance is placed on *National Grid*;¹⁰⁵³
- (ii) the Municipality's failure to comply with the February 2005 Agreement and the February 2006 Agreement; reliance is placed on *National Grid*;¹⁰⁵⁴
- (iii) the Regulator's reversal of its previous practice and its refusal to approve new tariffs in the absence of an approved heat supply development plan; reliance is placed on *Lauder* and *National Grid*;¹⁰⁵⁵
- (iv) Rēzeknes Siltumtīkli's and Rēzeknes Enerģija's lawsuits against Latgales Enerģija and the ensuing attachment of Latgales Enerģija's bank accounts; reliance is placed on *National Grid*;¹⁰⁵⁶
- (v) the Municipality's refusal to permit the attachment of Latgales Enerģija's bank accounts to be lifted; reliance is placed on *National Grid*;¹⁰⁵⁷
- (vi) the Regulator's decision of 11 October 2007 to take over Latgales Enerģija's zone without waiting for Latgales Enerģija response to the Regulator's warning of 4 October 2007; reliance is placed on *Lauder*;¹⁰⁵⁸

¹⁰⁵¹ *LG&E v. Argentina*, CLA-31 ¶ 146. The Claimant submits that in this case the tribunal found the measure in dispute to be discriminatory based on the effect of the measure; however, a measure will be in breach of Art. 3(1) of the BIT provided that it has been shown to be discriminatory in its effect or to be based on an intention to discriminate.

¹⁰⁵² Cl. Mem. ¶ 311.

¹⁰⁵³ Cl. Mem. ¶ 313; Transcript, Day 1 49/23-25; 50/1-7.

¹⁰⁵⁴ RfA ¶ 158; Cl. Mem. ¶ 313; Transcript, Day 1 49/23-25; 50/1-7.

¹⁰⁵⁵ RfA ¶ 158; Cl. Mem. ¶¶ 313-314; Transcript, Day 1 49/23-25; 50/1-7.

¹⁰⁵⁶ RfA ¶ 158; Cl. Mem. ¶ 313; Transcript, Day 1 49/23-25; 50/1-7.

¹⁰⁵⁷ Cl. Mem. ¶ 313; Transcript, Day 1 49/23-25; 50/1-7.

¹⁰⁵⁸ Cl. Mem. ¶ 314.

- (vii) the Municipality's decision of 12 October 2007 to appoint Rēzeknes Siltumtīkli and Rēzeknes Enerģija as "the persons in charge of providing thermal energy in Rēzekne";¹⁰⁵⁹
- (viii) the Municipality's campaign "directed at reducing the sums paid by consumers"; reliance is placed on *National Grid*;¹⁰⁶⁰
- (ix) the Regulator's decision of 7 December 2007 to revoke the decision of 9 November 2007 approving new tariffs;¹⁰⁶¹
- (x) the Regulator's "warnings and queries", based on factually or legally incorrect assertions by the Municipality, that later served as a basis for the revocation of Latgales Enerģija's licences; reliance is placed on *Lauder*;¹⁰⁶²
- (xi) the Regulator's decision of 3 June 2008 to revoke Latgales Enerģija's licences to produce, transmit and sell thermal energy without seriously considering the explanations provided by Latgales Enerģija; reliance is placed on *Lauder*;¹⁰⁶³ and
- (xii) the Municipality's decision of 27 June 2008 requiring Latgales Enerģija to hand over the leased assets required to provide heating services.¹⁰⁶⁴

702. The Claimant contends in particular that the Municipality and the Regulator used their governmental and regulatory powers to create a crisis situation between September and October 2007 in a deliberate attempt to regain control over the heating system and force Latgales Enerģija (*i*) to relinquish its right to operate the heating system for 30 years under the Long-Term Agreement; reliance is placed on *Lauder* and *AES*¹⁰⁶⁵ and (*ii*) "to abandon its contractual right to tariff increases as a result of increased costs" through the combination of the Regulator's refusal to grant tariff increases based on

¹⁰⁵⁹ RfA ¶ 158.

¹⁰⁶⁰ Cl. Mem. ¶ 313; Transcript, Day 1 49/23-25; 50/1-7.

¹⁰⁶¹ RfA ¶ 158.

¹⁰⁶² Cl. Mem ¶ 314.

¹⁰⁶³ Cl. Mem. ¶ 314.

¹⁰⁶⁴ RfA ¶ 158.

¹⁰⁶⁵ Cl. Mem. ¶¶ 315; 317.

the absence of a heat supply development plan and the Municipality's delay in approving such a plan; reliance is placed on *AES*.¹⁰⁶⁶

703. Finally, the Claimant argues that the Municipality and the Regulator used their governmental and regulatory powers between September 2007 and June 2008 to create a situation which would paralyse Latgales Enerģija's operation of the heating system and eventually constituted the ground for the revocation of Latgales Enerģija's licences; reliance is placed on *AES*.¹⁰⁶⁷
704. According to the Claimant, these actions were also discriminatory because they were directed only at the business of Latgales Enerģija.¹⁰⁶⁸
705. The Claimant contends that the use and enjoyment of its investment was irreparably impaired as a result of these actions and that it could no longer "sell or maintain" the investment.¹⁰⁶⁹ The cumulative effect of these arbitrary and discriminatory measures was to destroy the value of the Claimant's investment.¹⁰⁷⁰

(7) BREACHES OF THE MOST FAVOURED NATION CLAUSE

(A) THE PRINCIPLES

706. The Claimant relies on Article 3(2) of the BIT and prays in aid Articles 2(2) and 3(1) of the Latvia-Romania BIT; the latter provision states that when a Contracting Party has admitted an investment in its State territory in accordance with its laws, it shall *inter alia* "grant the necessary permits in connection with such investment"¹⁰⁷¹.¹⁰⁷²

(B) THE CLAIMANT'S SPECIFIC COMPLAINTS

707. The Claimant submits that the Municipality failed to issue the required heat supply development plan and, consequently, the Regulator failed to authorise Latgales Enerģija to charge the revised heating tariffs even though these tariff increases were

¹⁰⁶⁶ Cl. Mem. ¶ 316; Transcript Day 1, 51/13-20.

¹⁰⁶⁷ Cl. Mem. ¶ 317.

¹⁰⁶⁸ Cl. Mem. ¶ 312.

¹⁰⁶⁹ Cl. Skeleton ¶ 20.

¹⁰⁷⁰ Cl. Skeleton ¶ 21.

¹⁰⁷¹ Latvia-Romania BIT, CLA-22.

¹⁰⁷² Cl. Mem. ¶¶ 321-322.

necessary in order for Latgales Enerģija's business to continue to operate due to the consecutive increases in the price of gas charged by Latvijas Gāze.¹⁰⁷³ To the Claimant, tariff changes were an essential part of its investment as it is impossible for a heat supply operator to function without tariffs that accurately reflect the costs of the business in accordance with the provisions of the tariff methodology.¹⁰⁷⁴

708. In addition, the Regulator unreasonably refused to maintain Latgales Enerģija's licences to produce, transmit and sell thermal energy in Rēzekne in breach of its own regulations.¹⁰⁷⁵ This impaired the management, maintenance and use of the Claimant's investment.¹⁰⁷⁶
709. The Claimant submits that the Respondent therefore breached the MFN clause contained in Article 3(2) of the BIT in connection with Articles 2(2) and 3(1) of the Latvia-Romania BIT¹⁰⁷⁷ as the local authorities failed to grant the necessary authorisations or permits in connection with the Claimant's investment.¹⁰⁷⁸

C. THE RESPONDENT'S CASE ON LIABILITY

710. The structure of the Respondent's defence does not mirror the outline of the Claimant's statement of case. On the one hand, the Respondent has advanced certain arguments which are not directly related to any specific treatment standard; on the other, the Respondent's discussion of the applicable standards has been brief on most aspects. The Respondent's position may be summarised as follows:
- (i) general denial and overall response to the Claimant's position (see paragraphs 711 ff. below);
 - (ii) specific issues (see paragraphs 717 ff. below);
 - (iii) attribution (see paragraphs 749 ff. below); and

¹⁰⁷³ Cl. Mem. ¶ 323; Transcript, Day 1, 52/2-6.

¹⁰⁷⁴ Transcript, Day 1, 82/11-17.

¹⁰⁷⁵ Cl. Mem. ¶ 324.

¹⁰⁷⁶ Cl. Mem. ¶ 324.

¹⁰⁷⁷ Latvia-Romania BIT, CLA-22.

¹⁰⁷⁸ RfA ¶ 163; Cl. Mem. ¶ 325.

(iv) no violation of the BIT (see paragraphs 763 ff. below).

(1) GENERAL DENIAL AND OVERALL RESPONSE TO THE CLAIMANT’S POSITION

711. In its Counter-Memorial on the Merits, the Respondent denies and objects to all allegations of any breach of the BIT made by the Claimant and all prayers for relief submitted by the Claimant including the request for payment of damages or compensation for the involvement of experts and counsel.¹⁰⁷⁹
712. The Respondent argues that the Claimant’s case is based on inaccurate facts and is misleading insofar as it predicates that the Claimant suffered the loss of its business. The Claimant’s case is presented in a highly selective and subjective manner in point of fact and law, rests on an oversimplification of the matter in dispute and discards important aspects; the Claimant’s complaints rest on witness statements signed by persons directly interested in the outcome of this case.¹⁰⁸⁰
713. Finally, the Claimant has put purely commercial issues before the Tribunal which are outside the scope of international investment law.
714. According to the Respondent, the damage allegedly suffered by the Claimant is based on inflated future dividends and losses due to the failure to obtain the repayment of loans; the Long-Term Agreement was demonstrably unsuitable to generate any cash flows, as confirmed by the Respondent’s expert report submitted by KPMG Baltics SIA.¹⁰⁸¹
715. The Rēzekne Municipality, the Respondent argues, wished to improve the quality and economic performance of its district heating system, to transpose the existing, highly subsidized and economically inefficient system into a business-orientated system “with consideration of the social interest at large”.¹⁰⁸² After the initial tender yielded no suitable results, the Claimant and the Municipality reached agreement on a “concession arrangement” regarding the district heating assets in Rēzekne.¹⁰⁸³

¹⁰⁷⁹ Resp. Obj. J. & C-Mem. ¶ 1.4; see also Resp. Rej. ¶¶ 5-7.

¹⁰⁸⁰ Resp. Obj. J. & C-Mem. ¶ 3.33.

¹⁰⁸¹ Resp. Obj. J. & C-Mem. ¶ 2.2.

¹⁰⁸² Resp. Obj. J. & C-Mem. ¶ 3.1.

¹⁰⁸³ Resp. Obj. J. & C-Mem. ¶ 3.1.

Rēzekne is a major city in Latgale, a region with “highest social sensitivity” due to widespread unemployment, low salaries, a negative migration rate and low economic activity; any fluctuation in the continuity, stability, service level or price of basic public utility services can cause serious social unrest and resistance.¹⁰⁸⁴

716. The Respondent contends that an overall analysis of its conduct shows such conduct to be “consistent and predictable”; only the Claimant’s conduct led to the adverse effects of which the Claimant has complained.¹⁰⁸⁵

(2) SPECIFIC ISSUES

717. The Tribunal will summarise the Respondent’s arguments relating to these specific issues as follows:

- (i) the application of the Principles of European Contract Law, UNIDROIT Principles of International Commercial Contracts and TransLex Principles (see paragraphs 718 ff. below);
- (ii) the functional and legal independence between the different parts of the “concession arrangement” (see paragraphs 719 ff. below);
- (iii) the duty to pay for the natural gas supplied by Latvijas Gāze (see paragraphs 726 ff. below);
- (iv) the outstanding lease payments (see paragraphs 733 ff. below);
- (v) the influence allegedly brought to bear by the Municipality on the Regulator (see paragraphs 734 ff. below);
- (vi) the review of the tariffs by the Regulator (see paragraphs 743 ff. below);
- (vii) the development plan (see paragraphs 736 ff. below); and
- (viii) the revocation of Latgales Enerģija’s licences to produce, transmit and sell thermal energy (see paragraphs 743 ff. below).

¹⁰⁸⁴ Resp. Obj. J. & C-Mem. ¶ 3.2.

¹⁰⁸⁵ Resp. Obj. J. & C-Mem. ¶ 3.9.

(A) THE APPLICATION OF PRINCIPLES OF EUROPEAN CONTRACT LAW,
UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS
AND TRANSLEX PRINCIPLES

718. As the “concession arrangement” was “basically spelled out in commercial agreements”, the Respondent invokes the application of the Principles of European Contract Law,¹⁰⁸⁶ the 2010 UNIDROIT Principles of International Commercial Contracts and the Trans-Lex Principles which may be considered as general principles of law recognised by civilized nations within the meaning of Article 38(1)(c) of the Statute of International Court of Justice,¹⁰⁸⁷ contending that the application of such principles is suitable where specific issues are to be decided and gaps are found to exist in the abstract principles set out in an investment treaty.¹⁰⁸⁸

(B) THE FUNCTIONAL AND LEGAL INDEPENDENCE BETWEEN THE
DIFFERENT PARTS OF THE “CONCESSION ARRANGEMENT”

719. The Respondent argues that the “concession arrangement” consisted of the following commercial contracts:¹⁰⁸⁹

- (i) the Long-Term Agreement;¹⁰⁹⁰
- (ii) the February 2005 Agreement;¹⁰⁹¹
- (iii) the Amended Long-Term Agreement;¹⁰⁹²
- (iv) the February 2006 Agreement;¹⁰⁹³ and
- (v) the October 2007 Agreement.¹⁰⁹⁴

720. The Respondent argues that these are typically commercial contracts, despite the fact that the Long-Term Agreement relates to the lease of public assets; hence Latgales

¹⁰⁸⁶ R-3.

¹⁰⁸⁷ RLA-3.

¹⁰⁸⁸ Resp. Obj. J. & C-Mem. ¶¶ 3.10-11; Resp. Rej. ¶¶ 18- 20.

¹⁰⁸⁹ Resp. Obj. J. & C-Mem. ¶¶ 3.4-3.5; Resp. Obj. J. & C-Mem. ¶ 3.4.

¹⁰⁹⁰ C-4, see paragraphs 78 ff. above.

¹⁰⁹¹ C-8, see paragraphs 100 ff. above.

¹⁰⁹² C-16, see paragraphs 166 ff. above.

¹⁰⁹³ C-17, see paragraphs 169 ff. above.

¹⁰⁹⁴ C-26, see paragraphs 286 ff. above.

Enerģija's duty to cooperate to seek ways to reduce the heating tariffs for Rēzekne's inhabitants.¹⁰⁹⁵ With reference to Sections 4 and 14(2) of the Latvian Municipalities Act, the Respondent further states that Latvian law distinguishes between the public functions of local governments and their "commercial functions in carrying out their public functions".¹⁰⁹⁶

721. On the other hand, the "concession arrangement" consisted of Latgales Enerģija's licences issued by the Regulator for the production, transmission and sale of thermal energy in Rēzekne.¹⁰⁹⁷ According to the Respondent, these licences were issued in the "public (administrative) law sphere".¹⁰⁹⁸
722. A further distinguishing factor between the two parts of the "concession arrangement" is the legal, functional and financial independence of the Regulator in line with the requirements of European law.¹⁰⁹⁹
723. The Respondent refutes the Claimant's argument that all the contracts concluded between Latgales Enerģija and the Municipality represent exercise of public power by the Municipality.¹¹⁰⁰ The treatment of the Long-Term Agreement and related agreements as commercial contracts is therefore in accordance with the "sense and meaning" of the Treaty and the applicable Latvian law.¹¹⁰¹
724. The Respondent further contends that "State contracts (...) of commercial (economic) nature (...) (for example, privatization agreements, joint venture agreements, concession agreements)" are subject to international law as a general rule.¹¹⁰² While such contracts may contain "sovereign promises", they are still treated as commercial agreements; reliance is placed on the *ad hoc* award in *Texaco v. Libya*^{1103, 1104}

¹⁰⁹⁵ Resp. Obj. J. & C-Mem. ¶ 3.5.

¹⁰⁹⁶ Resp. Obj. J. & C-Mem. ¶ 3.5.

¹⁰⁹⁷ Resp. Obj. J. & C-Mem. ¶ 3.4.

¹⁰⁹⁸ Resp. Obj. J. & C-Mem. ¶ 3.6.

¹⁰⁹⁹ Resp. Obj. J. & C-Mem. ¶ 3.7, see paragraph 734 below.

¹¹⁰⁰ Resp. Rej. ¶¶ 13 ff.

¹¹⁰¹ Resp. Rej. ¶ 15.

¹¹⁰² Resp. Rej. ¶ 16.

¹¹⁰³ *Texaco Overseas Petroleum Company v. Government of the Libyan Arab Republic, ad hoc Award*, 19 January 1977, [RLA-17](#).

¹¹⁰⁴ Resp. Rej. ¶ 16.

725. The Respondent finally argues that the October 2007 Agreement gives rise only to best-effort duties as it was concluded at a time when the proceedings in the Latvian courts reached their peak and it dealt with a number of aspects, including the steps required in order to have the attachment of Latgales Enerģija's bank account lifted, in order for the parties to agree on the key points of disagreement regarding the Long-Term Agreement and to reach agreement on amendments to the Long-Term Agreement.¹¹⁰⁵

The Respondent asserts that this is confirmed by the fact that no party “has ever challenged the non-performance of this agreement in court”.¹¹⁰⁶ According to the Respondent, all involved parties understood that the October 2007 Agreement was simply an agreement to cooperate in good faith and was not a “contractually binding agreement with exactly spelled out rights and obligations”.¹¹⁰⁷ Reliance is placed by the Respondent on Articles 1:302, 5:102 and 5:105 of the PECL “as general principles of international law”; an analysis of the October 2007 Agreement under Latvian law would yield the same result.¹¹⁰⁸

(C) THE DUTY TO PAY FOR THE NATURAL GAS SUPPLIED BY LATVIJAS
GĀZE

726. The Respondent contends that the Long-Term Agreement is to be characterised as a contract for the lease of a business, *i.e.* the whole heating service business in Rēzekne (*Betriebsübergang*); accordingly, the lessee stepped into the shoes of the lessor in the lessor's relationship with third parties, including Latvijas Gāze.¹¹⁰⁹
727. In reply to the Claimant's submission that the German legal concept of *Betriebsübergang* is inapplicable in the present case, the Respondent submits that it used the expression *Betriebsübergang* “to denote the specific mode of mergers and acquisitions”, in particular the acquisition of a business as a whole as opposed to a share deal or an asset deal limited to certain assets; reliance was placed by the Respondent on Sections 18 and 20 of the Latvian Commercial Code and Clause 5.1 of

¹¹⁰⁵ Resp. Obj. J. & C-Mem. ¶ 3.16; Resp. Rej. ¶ 23.

¹¹⁰⁶ Resp. Rej. ¶ 23.

¹¹⁰⁷ Resp. Rej. ¶ 23.

¹¹⁰⁸ Resp. Rej. ¶ 24.

¹¹⁰⁹ Resp. Obj. J. & C-Mem. ¶ 3.13.

the Long-Term Agreement, which expressly provides for the transfer of all of the lessor's employment contracts to the lessee.¹¹¹⁰

728. The Respondent rejects the Claimant's argument that no *Betriebsübergang* took place on the basis that all assets were not transferred; reliance is placed on Section 20(1) of the Latvian Commercial Code whereby it is permissible to transfer only certain assets.¹¹¹¹
729. The Respondent rejects the Claimant's contention that Latvian civil law gives preference to a literal rule of interpretation and construction.¹¹¹² Rather, Latvian civil law is based on the civil law tradition "where similar aspects are construed reasonably and the main actual form of construction of contracts is [to determine] what the other party objectively could understand".¹¹¹³
730. The Respondent contends the following:
- (i) on 27 October 2005 Latgales Enerģija was given an opportunity to acquaint itself with the content of the Gas Supply Agreement, which provided for the exact amount of gas that had to be supplied to the Municipality as well as the sums to be paid thereunder; reliance is placed by the Respondent on Clause 4 of the February 2005 Agreement^{1114,1115};
 - (ii) Latgales Enerģija by its subsequent conduct acknowledged its obligation to pay for the natural gas supplied, *e.g.* as the Claimant submitted that it had received and paid Latvijas Gāze's invoices;¹¹¹⁶
 - (iii) the Claimant attempts to show that it was entitled to pay a lower price, but the Claimant does not deny that it accepted, and at least in part paid, such invoices;¹¹¹⁷ and

¹¹¹⁰ Resp. Rej. ¶ 22; Resp. P-H (PO8) ¶¶ 17-20.

¹¹¹¹ Resp. Rep. (PO9) ¶ 37.

¹¹¹² Resp. Rep. (PO9) ¶ 38.

¹¹¹³ Resp. Rep. (PO9) ¶ 38.

¹¹¹⁴ C-8.

¹¹¹⁵ Resp. Obj. J. & C-Mem. ¶ 3.14.

¹¹¹⁶ Resp. Obj. J. & C-Mem. ¶ 3.14; see also Transcript, Day 4, 129/7-21.

- (iv) Latgales Enerģija was therefore aware of, and fully understood, its duty to pay for the natural gas supplied.¹¹¹⁸

In the Respondent's view, it is therefore impossible to conclude that, due to a lack of specific and clear provisions to the contrary, the lessor should pay something to the lessee in the presence of a business lease; only Latgales Enerģija itself was fully responsible to pay for all of the natural gas delivered.¹¹¹⁹

731. The Respondent alleges that the Municipality did its utmost best to persuade Latvijas Gāze to continue to supply natural gas despite Latgales Enerģija's refusal to pay for the outstanding invoices; however, Latvijas Gāze turned down the Municipality's request.¹¹²⁰ The Respondent's efforts belie the Claimant's argument that the Municipality intended to harm the "Concession Project".¹¹²¹

732. The Respondent further argues that the Claimant misconstrues the February 2005 Agreement and October 2007 Agreement.¹¹²² Clause 4, paragraph 2 of the February 2005 Agreement, read as a whole in conjunction with the fourth recital of the same agreement and the Long-Term Agreement, means that the contracting parties intended to hold the Municipality liable towards Latgales Enerģija in case the Municipality decided to cancel the gasification of the area or request Latvijas Gāze to deliver a smaller amount of gas than it had originally undertaken to buy.¹¹²³

(D) THE OUTSTANDING LEASE PAYMENTS

733. Rēzeknes Siltumtīkli considered that Latgales Enerģija failed to make the lease payments under the Long-Term Agreement. To request such payments, Rēzeknes Siltumtīkli sent a "notice of warning" to Latgales Enerģija in November 2006.¹¹²⁴

¹¹¹⁷ Resp. Obj. J. & C-Mem. ¶ 3.14.

¹¹¹⁸ Resp. P-H (PO8) ¶¶ 17-20.

¹¹¹⁹ Resp. Obj. J. & C-Mem. ¶ 3.15.

¹¹²⁰ R-32.

¹¹²¹ Resp. P-H (PO8) ¶ 21.

¹¹²² Resp. Obj. J. & C-Mem. ¶ 3.16.

¹¹²³ Resp. Obj. J. & C-Mem. ¶ 3.16.

¹¹²⁴ Transcript, Day 4, 130/21-25; 131/1-18.

(E) THE INFLUENCE ALLEGEDLY BROUGHT TO BEAR BY THE MUNICIPALITY
ON THE REGULATOR

734. According to the Respondent, the Regulator was a legally, functionally and financially independent entity that made its decisions based “only on strict grounds prescribed” by the Public Utility Regulators Act, and was financed solely through fees paid by the providers of public utilities such as Latgales Enerģija; reliance is placed on Sections 8(6), 8(7), 8(8), 11 and 29 of the Latvian Public Utility Regulators Act¹¹²⁵ in force at the relevant time.¹¹²⁶ The Regulator’s legal status, governance, operation and competence were entirely separate from the Municipality and its decision-making process.¹¹²⁷ The Respondent contends that the Claimant’s allegations are completely unwarranted and not proven by any evidence; reliance is placed on the decisions made by the Latvian courts denying Latgales Enerģija’s complaints with respect to the manner in which the Regulator had applied the law^{1128, 1129}.
735. The Respondent denies that the local authorities in Latvia and the entities they own and control attempted to evict the Claimant from its business in a concerted plan.¹¹³⁰ According to the Respondent, there is no evidence on the record supporting such a claim other than mere allegations, assumptions, emotional language and requests from the Claimant in order that the Tribunal draw adverse inference.¹¹³¹

(F) THE DEVELOPMENT PLAN

736. The Respondent contends that the parties had a “mutual cooperative obligation (...) to do their utmost to achieve a mutually acceptable outcome” under Clause 1.2 of the February 2006 Agreement; it was not a matter solely for Latgales Enerģija to decide “what is acceptable in order for the Development Plan to be adopted”.¹¹³² Considering the Claimant’s experience in various similar projects, it is “the logical and fair construction” that the Claimant had “accepted the risk that the Development

¹¹²⁵ CLA-49, see paragraph 38 above; RLA-2.

¹¹²⁶ Resp. Obj. J. & C-Mem. ¶¶ 3.7-3.8.

¹¹²⁷ Resp. Obj. J. & C-Mem. ¶ 3.8.

¹¹²⁸ R-1, R-2, R-3, R-4, R-5; R-6.

¹¹²⁹ Resp. Obj. J. & C-Mem. ¶ 3.8.

¹¹³⁰ Resp. Rej. ¶ 34.

¹¹³¹ Resp. Rej. ¶ 34.

¹¹³² Resp. Obj. J. & C-Mem. ¶ 3.12.

Plan shall be developed together with the Rēzekne municipality” and that both parties would therefore determine the acceptable content of such plan.¹¹³³ Latgales Enerģija had assumed the risk of the mutual cooperation in the development of the Plan;¹¹³⁴ it was a matter for the Claimant (through Latgales Enerģija) to come up with a proper draft.¹¹³⁵ It is admitted by the Respondent that it was the Municipality which remained ultimately responsible for devising the plan.¹¹³⁶

737. The Respondent further states that the issues relating to the adoption of the development plan fall into four categories as follows:¹¹³⁷

- (i) the Parties’ conduct and their understanding as to whose legal duty it was to devise the development plan in light of the particular arrangements;
- (ii) the timing and circumstances in which Latgales Enerģija came up with the allegations concerning the lack of a development plan;
- (iii) the Respondent’s conduct after it turned out that Latgales Enerģija was unable to provide a proper development plan; and
- (iv) the reasonable risk any prudent investor would have been deemed to have assumed considering the lack of a development plan.

738. On the *first point*, the Respondent contends that “subsequent practice” plays a paramount role in public international law, that Latgales Enerģija understood that it had been delegated the duty to devise a concrete text and submit it to the Municipality for approval, as shown the “consistent development of events” since Latgales Enerģija did not disclaim its duty provide a draft development plan and that Latgales Enerģija is therefore not entitled to rely on the Municipality’s ultimate responsibility to devise the development plan to avoid its own duty.¹¹³⁸ Finally, the Administrative District

¹¹³³ Resp. Obj. J. & C-Mem. ¶ 3.12.

¹¹³⁴ Resp. Obj. J. & C-Mem. ¶ 3.23.

¹¹³⁵ Resp. P-H (PO8) ¶ 11.

¹¹³⁶ Resp. P-H (PO8) ¶ 11.

¹¹³⁷ Resp. P-H (PO8) ¶ 10.

¹¹³⁸ Resp. P-H (PO8) ¶ 11.

Court stated *inter alia* that the Municipality was entitled to delegate this obligation “freely to any private individual or entity”.¹¹³⁹

739. On the *second point*, the Respondent contends that Latgales Enerģija suddenly changed its approach to its obligations after undertaking them, that Latgales Enerģija has not been “sufficiently persistent” in making its complaint that the Municipality’s failure to devise a development plan amounted to a breach of the Municipality’s duties to the Claimant, and, finally, that Latgales Enerģija, having threatened to sue on four occasions relying on the absence of a development plan for the City and other alleged breaches,¹¹⁴⁰ eventually failed to do so.¹¹⁴¹
740. On the *third point*, the Respondent submits that the Municipality in good faith invited Latgales Enerģija to participate in the drafting of a “proper” development plan after it had appeared most likely that Latgales Enerģija would not be in a position to submit a “proper document” and the Municipality took the matter in its own hands.¹¹⁴²
741. On the *fourth and final point*, the Respondent contends that Clause 1.6 of the February 2005 Agreement expressly provides that tariffs would be adjusted in line with the applicable provisions of law, that there was therefore no representation or warranty relating to the situation in which there was no development plan in place, nor was there any waiver on the part of the Municipality for the benefit of the Claimant.¹¹⁴³ Moreover, Clause 1.2 of the February 2006 Agreement expressly provided that Latgales Enerģija should devise a draft of the development plan which the Municipality would then “*formally validate*”, with the clear implication that such draft would have to comply with the law.¹¹⁴⁴ Clause 5 of the February 2006 Agreement specifically provided that Latgales Enerģija was entitled to claim damages for the Municipality’s failure to comply with its duties under the Agreement; Latgales Enerģija did not enforce such contract term.¹¹⁴⁵ The Respondent further notes that the licences issued shortly after the conclusion of the Long-Term Agreement contained

¹¹³⁹ Transcript, Day 1, 113/5-12.

¹¹⁴⁰ R-26; R-27; R-28; R-29.

¹¹⁴¹ Resp. P-H (PO8) ¶ 13.

¹¹⁴² Resp. P-H (PO8) ¶ 14.

¹¹⁴³ Resp. P-H (PO8) ¶ 15.

¹¹⁴⁴ Resp. P-H (PO8) ¶ 15.

¹¹⁴⁵ Resp. P-H (PO8) ¶ 15.

various obligations that were dependent on the existence of a development plan, and that were not challenged by the Claimant.¹¹⁴⁶

742. Therefore, the Claimant is not entitled to rely on the Regulator's previous practice or the first approval of the tariffs following the issuance of the licences to Latgales Enerģija.¹¹⁴⁷ The Regulator's first approval of Latgales Enerģija's tariffs should rather be regarded as a "good faith gesture" rather than the continuation of an alleged previous practice.¹¹⁴⁸ Finally, and in any event, Latgales Enerģija's draft development plan of 15 November 2006¹¹⁴⁹ did not include any verifiable explanations of the figures it contained.¹¹⁵⁰

(G) THE REVIEW OF THE TARIFFS BY THE REGULATOR

743. The Respondent submits that (i) Latgales Enerģija applied to the Regulator for the approval of increased heating tariffs on no less than four occasions,¹¹⁵¹ (ii) the Regulator approved an increase in the tariff by decision no. 19 of 19 December 2005,¹¹⁵² (iii) the Regulator then denied Latgales Enerģija's further requests on the basis that Latgales Enerģija had failed to show "objective business necessity" for a further increase in the tariff as required by law and (iv) the Regulator on 7 December 2007 revoked its decision no. 28 of 9 November 2007 increasing the tariff on the basis that Latgales Enerģija had falsely represented the gas supply costs¹¹⁵³.¹¹⁵⁴
744. According to Respondent, the Claimant misconstrues the applicable Latvian law in that it contends that applications for a new tariff could have been submitted only provided that a development plan had been adopted.¹¹⁵⁵ The Respondent submits that "the Claimant could have relied, logically, on more general development documents

¹¹⁴⁶ Resp. P-H (PO8) ¶ 15.

¹¹⁴⁷ Resp. P-H (PO8) ¶ 15.

¹¹⁴⁸ Resp. P-H (PO8) ¶ 15.

¹¹⁴⁹ R-31.

¹¹⁵⁰ Resp. P-H (PO8) ¶ 16.

¹¹⁵¹ Resp. Obj. J. & C-Mem. ¶ 3.18.

¹¹⁵² C-14.

¹¹⁵³ C-28.

¹¹⁵⁴ Resp. Obj. J. & C-Mem. ¶ 3.19.

¹¹⁵⁵ Resp. Obj. J. & C-Mem. ¶ 3.20.

and still submit its own business scenario” since Section 17 of the Methodology¹¹⁵⁶ expressly states that the utilities provider “makes up its own plan in accordance with a Development Plan **or other planning document** of the municipality”.¹¹⁵⁷ Reliance is placed by the Respondent on the Textbook for Regulatory Implications of District Heating^{1158 1159}.

745. The Respondent further argues that the Claimant’s arguments relating to the Regulator’s prior practice are without foundation since the approval of the first request for a new tariff cannot amount to a “practice”;¹¹⁶⁰ the Claimant should have realized that the “concession arrangement” opened a new page in administrative practice and the previous administrative practice relating to the heat supply in Rēzekne would be history.¹¹⁶¹

(H) THE REVOCATION OF LATGALES ENERĢIJA’S LICENCES TO PRODUCE,
TRANSMIT AND SELL THERMAL ENERGY

746. The Respondent contends that Latgales Enerģija has been in continuous breach of its duties under the licences¹¹⁶² and the applicable law to the detriment of the Rēzekne inhabitants in that (i) Latgales Enerģija failed to submit regular yearly review reports for the previous heating season and forecasts for the future, (ii) Latgales Enerģija failed to submit a “proper” development plan as required by its licences and (iii) Latgales Enerģija failed at the start of the heating season 2007/2008 to provide any heating to the northern district of Rēzekne, three kindergartens and provided insufficient heating to six schools.¹¹⁶³ As a result, the Regulator issued the following decisions:

- (i) on 4 October 2007 the Regulator issued a warning to Latgales Enerģija recalling the operator’s duty to submit regular reports for the previous period

¹¹⁵⁶ C-35.

¹¹⁵⁷ Resp. Obj. J. & C-Mem. ¶ 3.20 (original emphasis).

¹¹⁵⁸ R-7.

¹¹⁵⁹ Resp. Obj. J. & C-Mem. ¶ 3.20.

¹¹⁶⁰ Resp. Obj. J. & C-Mem. ¶ 3.40.

¹¹⁶¹ Resp. Rej. ¶ 31.

¹¹⁶² C-10; C-11; C-12.

¹¹⁶³ Resp. Obj. J. & C-Mem. ¶ 3.21.

as well as forecasts for the upcoming heating seasons and to submit the required development plan^{1164,1165}

- (ii) on 11 October 2007 the Regulator suspended Latgales Enerģija's licences^{1166,1167} and
- (iii) on 3 June 2008 the Regulator revoked Latgales Enerģija's licences because "instead of delivering a new and proper solution, [Latgales Enerģija] continued blaming the Rēzekne municipality for what had happened" and there was a risk that the same situation could occur again in the following heating season;¹¹⁶⁸ the Respondent contends that the Claimant acknowledged its failure to submit the relevant regulatory documentation and to provide heating services in Rēzekne as facts when it argued denying its liability before the Regulator^{1169, 1170}.

747. The Respondent submits that the Municipality ultimately had to appoint an interim provider for heating services in Rēzekne under the applicable law and therefore requested Latgales Enerģija to return the leased assets on 14 July 2008;¹¹⁷¹ the Municipality was left with no choice but to enforce the decision with the help of the police forces as the heating season was about to start and Latgales Enerģija continued to refuse to return the heating assets.¹¹⁷²

748. The Respondent further argues that (i) the Claimant is not entitled to rely on the "formal duty" of the Municipality to devise and approve the development plan and the "alleged duty" of the Municipality to pay for the delivered gas in case Latgales Enerģija did not make a sufficient profit, (ii) the Municipality needed to avoid subsidizing the district heating system, which was clearly understood by the Claimant, (iii) the Claimant's argument that the Municipality had assumed the risk to cover the

¹¹⁶⁴ C-22.

¹¹⁶⁵ Resp. Obj. J. & C-Mem. ¶ 3.21.

¹¹⁶⁶ C-23.

¹¹⁶⁷ Resp. Obj. J. & C-Mem. ¶ 3.21.

¹¹⁶⁸ Resp. Obj. J. & C-Mem. ¶ 3.21.

¹¹⁶⁹ C-153.

¹¹⁷⁰ Resp. Obj. J. & C-Mem. ¶ 3.21.

¹¹⁷¹ C-33.

¹¹⁷² Resp. Obj. J. & C-Mem. ¶ 3.22.

price difference in case of an unforeseen rise in the supply costs was contrary to the very purpose of inviting private capital, (iv) a prudent risk management by the Claimant should have taken into account the factors that are typically involved in the district heating business and resolved them before undertaking the duties arising out of the concession (see paragraphs 781 ff. below) and, finally (v) there was no duty on the Municipality to guarantee the solvency and viability of the business, which was a risk to be borne by the Claimant.¹¹⁷³

The Respondent submits that the Municipality reasonably exercised its discretion so as to involve another entity in order to have heating supplied under such circumstances, bearing in mind that Latgales Enerģija had expressed its dissatisfaction with the performance of the Long-Term Agreement from the outset of the Project, had blamed the Municipality for everything and had hardly a caring attitude, so that the Municipality's decision to proceed with the enforcement of its previous decision directing Latgales Enerģija to "return" the leased assets was a logical outcome in the circumstances.¹¹⁷⁴ That said, the Respondent points out that actual force was never used and that the Claimant had never adduced any evidence in that regard.¹¹⁷⁵

(3) ATtribution

749. The Tribunal will summarise the Respondent's arguments relating to attribution in the following order:

- (i) the Municipality (see paragraph 750 below);
- (ii) the Regulator (see paragraphs 751 ff. below);
- (iii) Rēzeknes Siltumtīkli and Rēzeknes Enerģija (see paragraphs 753 ff. below);
and
- (iv) Latgales Enerģija (see paragraphs 762 ff. below).

¹¹⁷³ Resp. Obj. J. & C-Mem. ¶ 3.23.

¹¹⁷⁴ Resp. Obj. J. & C-Mem. ¶ 3.25.

¹¹⁷⁵ Resp. Obj. J. & C-Mem. ¶ 3.25.

(A) THE MUNICIPALITY

750. The Respondent does not contest the attribution of the Municipality's conduct to itself.

(B) THE REGULATOR

751. As for the Regulator, the Respondent argues that the Rēzekne Municipality's direction and control over the Regulator cannot be inferred based on the sole fact that the Municipality (together with 31 other Municipalities) appointed the members of the Regulator or that the Municipality, Rēzeknes Siltumtīkli and the Regulator interacted with one another.¹¹⁷⁶

752. The Respondent argues that the Claimant has failed to discharge its burden of proof with respect to the allegations that the Municipality influenced, or sought to influence, the Regulator.¹¹⁷⁷

(C) RĒZEKNES SILTUMTĪKLI AND RĒZEKNES ENERĢIJA

753. The Respondent contends that Rēzeknes Siltumtīkli and Rēzeknes Enerģija do not come within the purview of Articles 5 and 8 of the ILC Articles. Both entities were incorporated as commercial entities subject to private law.¹¹⁷⁸

754. The Respondent explains that the Latvian State and Local Government-Owned Corporations Act¹¹⁷⁹ determines the rules applicable to commercial entities owned by public authorities; the corporate governance of such entities and the public shareholder's authority over such entities follows the provisions in the Latvian Commercial Code. These principles are restated also in the Municipalities Act¹¹⁸⁰.¹¹⁸¹

755. Article 5 of the ILC Articles is not applicable to Rēzeknes Siltumtīkli and Rēzeknes Enerģija. The Respondent relies on the following succession of events:¹¹⁸²

¹¹⁷⁶ Transcript, Day 4, 97/6-25; 98/1-22.

¹¹⁷⁷ Transcript, Day 1, 121/22-25; 122/1-9, see also paragraphs 734 ff. above.

¹¹⁷⁸ Resp. P-H (PO8) ¶¶ 8 ff.

¹¹⁷⁹ RLA-29.

¹¹⁸⁰ C-34.

¹¹⁸¹ Resp. P-H (PO8) ¶ 8; Resp. Rep. (PO9) ¶ 14.

¹¹⁸² Resp. P-H (PO8) ¶ 8; Resp. Rep. (PO9) ¶ 17.

- (i) on 3 August 2004 the Municipality issued “a general conceptual consent with reference to [the] Municipality’s overall obligation under the law to *organise* the heat supply”;¹¹⁸³ such permission by the Municipality to lease the assets was given upon request of Rēzeknes Siltumtīkli pursuant to Section 15(1) of the Municipalities Act; such permission by the Municipality signalled respect on the part of the Municipality for Rēzeknes Siltumtīkli’s “corporate interests, decisions and plans”;
- (ii) then the draft Long-Term Agreement submitted by Latgales Enerģija was discussed under the auspices of Rēzeknes Siltumtīkli;¹¹⁸⁴
- (iii) the Management Board of Rēzeknes Siltumtīkli approved such draft;¹¹⁸⁵
- (iv) the Supervisory Council of Rēzeknes Siltumtīkli then in turn approved the draft;¹¹⁸⁶ and
- (v) whereupon on 28 January 2005 the Municipality approved the Long-Term Agreement,¹¹⁸⁷ which decision was also made pursuant to Section 15(1) of the Municipalities Act and the previous decisions of the bodies of Rēzeknes Siltumtīkli.

756. Neither Rēzeknes Siltumtīkli nor Rēzeknes Enerģija have been delegated any public function according to the Respondent.¹¹⁸⁸ According to Latvian law, in particular Section 40(2) of the Public Administration Act¹¹⁸⁹ as well as Section 15(3) of the Municipalities Act¹¹⁹⁰ a public function may be delegated only by contract or law;¹¹⁹¹ however, no delegation agreement was ever concluded between the Municipality and Rēzeknes Siltumtīkli and the Claimant fails to show which legal provision provided

¹¹⁸³ Resp. P-H (PO8) ¶ 8 (original emphasis); R-24 [page 1].

¹¹⁸⁴ R-24 [pages 2-3].

¹¹⁸⁵ R-24 [page 2].

¹¹⁸⁶ R-24 [page 5].

¹¹⁸⁷ R-24 [page 6].

¹¹⁸⁸ Resp. P-H (PO8) ¶ 8; Resp. Rep. (PO9) ¶ 14.

¹¹⁸⁹ RLA-20.

¹¹⁹⁰ C-34.

¹¹⁹¹ Resp. P-H (PO8) ¶ 8; Resp. Rep. (PO9) ¶ 11.

for a delegation of a public function to either Rēzeknes Siltumtīkli or Rēzeknes Enerģija.¹¹⁹²

757. The Long-Term Agreement is a commercial contract and Rēzeknes Siltumtīkli executed such contract acting in its “private commercial capacity”, as shown for instance by the Preamble and Clause 2.1.1 of the said agreement.¹¹⁹³
758. Article 8 of the ILC Articles is not applicable to Rēzeknes Siltumtīkli and Rēzeknes Enerģija since neither company has acted “as an extended arm of the Municipality” at least in respect of the contractual duties owed to the Claimant and Latgales Enerģija.¹¹⁹⁴

There needs to be a “sufficiently serious involvement” of the State in the business of the company it owns, and it is not enough for a State to be involved “sporadically in certain important aspects of the matter” or “to care or [show] interest for the process or the outcome”.¹¹⁹⁵

759. In the present case the Municipality permitted (but did not mandate) Rēzeknes Siltumtīkli to conclude the Long-Term Agreement with a particular operator upon Rēzeknes Siltumtīkli’s request, the terms of the Long-Term Agreement were freely discussed without the Municipality’s involvement and a separate agreement was made between the Municipality and Latgales Enerģija subsequent to the execution of the Long-Term Agreement; therefore, Latgales Enerģija understood that Rēzeknes Siltumtīkli’s (and later Rēzeknes Enerģija’s) conduct was not attributable to the Municipality.¹¹⁹⁶ In particular, Rēzeknes Siltumtīkli acting in a commercial setting, through commercial means and on at an arm’s length basis, (i) came up with the idea of the Long-Term Agreement, (ii) was free to influence the main points of the Long-Term Agreement, (iii) initiated local civil proceedings against Latgales Enerģija on its own in order to claim damages for breach of the said agreement and (iv) terminated

¹¹⁹² Resp. P-H (PO8) ¶ 8; Resp. Rep. (PO9) ¶ 13.

¹¹⁹³ Resp. Rep. (PO9) ¶ 17.

¹¹⁹⁴ Resp. P-H (PO8) ¶ 9.

¹¹⁹⁵ Resp. Rep. (PO9) ¶ 15.

¹¹⁹⁶ Resp. P-H (PO8) ¶ 9.

the agreement on its own, rather than acting upon request of the Municipality or the Regulator.¹¹⁹⁷

760. The Respondent denies the Claimant's allegation that Rēzeknes Siltumtīkli and Rēzeknes Enerģija were involved in "imposing fees, quotas or charges" because they signed the October 2007 Agreement.¹¹⁹⁸ If all the parties privy to the October 2007 Agreement were attempting to lower tariffs, that was only to ease potential social tension.¹¹⁹⁹
761. Finally, the Respondent did not present additional arguments regarding the Claimant's submission with regard to the application of Article 2(2)(b) of the US-Latvia BIT pursuant to the MFN Clause contained in Article 3(2) of the BIT since, in the Respondent's view, Article 2(2)(b) of the US-Latvia BIT fits well into Article 5 of the ILC Articles and does not represent "an addition to the general rules of attribution existing under customary international law".¹²⁰⁰

(D) LATGALES ENERĢIJA

762. The Respondent contends that Latgales Enerģija was the Claimant's vehicle through which it operated "the concession" and therefore Latgales Enerģija's conduct is attributable to the Claimant "for the purposes of the concession".¹²⁰¹

(4) THE RESPONDENT'S ARGUMENTS WITH RESPECT TO THE ALLEGED BREACHES OF THE BIT

(A) NO BREACH OF THE BIT

763. The Respondent submits that its treatment of the Claimant's investment does not constitute a violation of the BIT.
764. The Claimant's claims are in essence based on three points: (i) the Municipality was bound to pay the full price for the natural gas supplied, (ii) the Municipality was bound to prepare a heat supply development plan for the City, and its failure to

¹¹⁹⁷ Resp. Rep. (PO9) ¶ 18.

¹¹⁹⁸ Resp. Rep. (PO9) ¶¶ 19-20.

¹¹⁹⁹ Resp. Rep. (PO9) ¶ 20.

¹²⁰⁰ Resp. Rep. (PO9) ¶ 9.

¹²⁰¹ Resp. Obj. J. & C-Mem. ¶ 3.3; Resp. Rej. ¶ 11.

comply with such duty caused the Regulator to dismiss the new tariffs proposed by Latgales Enerģija's and (iii) the Municipality and the Regulator conspired to drive Latgales Enerģija out of business.

765. The Respondent has already shown (i) that the duty to pay for the natural gas supplied was only on Latgales Enerģija (see paragraphs 726 ff. above), (ii) that it was Latgales Enerģija's obligation to provide the development plan (see paragraphs 736 ff. above) and (iii) that the Regulator applied Latvian law properly, as confirmed by the decisions made by the Latvian courts that are entitled to due deference; there is, moreover, no evidence of any collusion or conspiracy between the Municipality and the Regulator (see paragraph 734 above).
766. Regarding the Claimant's expropriation claim, the Respondent asserts that it is contradictory for the Claimant to make a claim for outright and gradual expropriation at the same time.¹²⁰² The Respondent contests the Claimant's allegation that Latgales Enerģija was actually insolvent and the contention that Latvian law prevented the liquidation of the company due to pending litigation.¹²⁰³
767. The Respondent contends that the Claimant's complaint of a breach of its expectations due to the Municipality's alleged failure to devise a development plan of its own motion must be considered under international law, since a breach of national law does not automatically entail a breach of international law and the position under Latvian law cannot therefore be dispositive.¹²⁰⁴ However, as an experienced and prudent manager, the Claimant could not have been surprised by the sharp increase in the gas supply costs and should have taken all precautions required "to avoid contentious issues" under the circumstances, such as carrying out risk management and, for example, requiring guarantees from the Municipality regarding the development plan before it entered into the "concession arrangement"; but the only guarantee Latgales Enerģija obtained was contained in Clause 1.2 of the February 2006 Agreement.¹²⁰⁵

¹²⁰² Transcript, Day 1, 136/10-25; 137/1-9.

¹²⁰³ Transcript, Day 1, 137, 137/14-25; 138/1-13.

¹²⁰⁴ Resp. Rej. ¶ 32.

¹²⁰⁵ Resp. Rej. ¶ 32; Resp. Rep. (PO9) ¶¶ 28-29.

768. In such circumstances, it is fair to conclude, according to the Respondent, that the sole obligation on the State is not to adopt decisions that are arbitrary or “prejudiced decisions”.¹²⁰⁶ In the present case, the Respondent actively sought solutions considering the interests of the inhabitants of Rēzekne at large, and not only the commercial interests of the Claimant.¹²⁰⁷ The Respondent submits that in “[s]ocially vulnerable business areas” such as district heating services, the investor’s expectations cannot be the same as in “wider, general business undertakings” because a “social element plays a substantial role”.¹²⁰⁸ According to the Respondent, Latgales Energija was involved in the whole process to devise the development plan and its representatives participated in 12 out of 16 meetings of the Working Group; the correspondence contained in R-30 showed the Municipality to be interested in finding common ground.¹²⁰⁹
769. The Respondent further points out that neither the Municipality nor Rēzeknes Siltumtīkli promised that the opportunity to have new tariffs approved without the existence of a development plan would continue for an indefinite period of time.¹²¹⁰
770. According to the Respondent, the same test applies to the legal question whether the Respondent had breached the Claimant’s expectations by failing to procure that Latvijas Gāze should not suspend the deliveries of natural gas.¹²¹¹
771. The Respondent submits that public international law is not “simply a supreme adjudicator” and that the Tribunal must not consider “whether Latvian courts have properly applied Latvian domestic law” in the present case; the Tribunal is called upon to determine only whether international law rules and provisions pertinent to this case were observed properly.¹²¹²

¹²⁰⁶ Resp. Rep. (PO9) ¶ 32.

¹²⁰⁷ Resp. Rep. (PO9) ¶ 32.

¹²⁰⁸ Resp. Rep. (PO9) ¶ 32.

¹²⁰⁹ Resp. Rep. (PO9) ¶ 33.

¹²¹⁰ Resp. Rep. (PO9) ¶ 34.

¹²¹¹ Resp. Rej. ¶ 32.

¹²¹² Resp. Obj. J. & C-Mem. ¶ 3.31.

772. The Respondent has acted in a predictable and transparent manner;¹²¹³ the commercial agreements were performed on a commercial basis in accordance with their terms and there was no sovereign interference to alter or terminate the terms and conditions of those agreements.¹²¹⁴
773. The Respondent states that the Claimant has advanced the same arguments before the Latvian courts and in these proceedings: the Claimant attempts to show in its Memorial why Latgales Enerģija did not have to pay for the gas and why the development plan was the sole responsibility of the Municipality; however, the documents and/or the facts must be read otherwise.¹²¹⁵ The decisions of the Latvian courts with respect to the “commercial part” of the “concession agreements”¹²¹⁶ and the “public or administrative part” of the licences and other “sovereign decisions”¹²¹⁷ clearly show that Latgales Enerģija’s arguments made in the Latvian proceedings are essentially the same as the arguments advanced in the Claimant’s Memorial in these proceedings.¹²¹⁸ In the Respondent’s view, there was no apparent or clear disregard of the facts or the law in violation of the BIT, let alone any intention to harm the Claimant.¹²¹⁹
774. The Respondent points out that the Claimant through Latgales Enerģija selectively decided which judicial decisions to appeal in the Latvian courts; particularly with regard to the “concession agreements” and the licences, the Claimant did not appeal the decision ordering Latgales Enerģija to pay its outstanding debt for the natural gas delivered as well as the decisions to suspend the licences and to enforce the “return of the assets”.¹²²⁰
775. The Respondent submits that the whole treatment afforded to the Claimant and Latgales Enerģija was reasonable and that they were able to raise all of their

¹²¹³ Resp. Rej. ¶¶ 27-30.

¹²¹⁴ Resp. Rej. ¶ 28 [table].

¹²¹⁵ Resp. Obj. J. & C-Mem. ¶ 3.32.

¹²¹⁶ R-8; R-9; R-10.

¹²¹⁷ R-1; R-2; R-3; R-4; R-5; R-6.

¹²¹⁸ Resp. Obj. J. & C-Mem. ¶ 3.32.

¹²¹⁹ Resp. Obj. J. & C-Mem. ¶ 3.32.

¹²²⁰ Resp. Obj. J. & C-Mem. ¶ 3.35.

arguments “at all times”; reliance is placed by the Respondent on the award in *Arif v. Moldova*¹²²¹.¹²²²

776. As to the Regulator, the Respondent asserts that it requested performance of the licence conditions, not of the commercial agreements.¹²²³ According to the Respondent, the Claimant was aware of the terms of the licences, in particular, the obligation to submit regular reports and forecasts, and did not challenge them in court; the Claimant cannot consider such terms as invalid simply by alleging that the Respondent did not perform some obligations.
777. The Respondent further submits that the Claimant had a duty to restructure the existing business in order to ensure a sustainable supply of heat; that in turn required the operator to be proactive in submitting information to the State authorities.¹²²⁴
778. The Respondent contends that the Regulator put Latgales Enerģija on notice of the breach of various licence conditions, proceeding gradually from the 4 October 2007 warning, the 11 October 2007 suspension and then the revocation of the licences on 3 June 2008. The revocation of the licences by the Regulator was therefore the ultimate sanction against Latgales Enerģija’s repeated failure to comply with the licence conditions, the most important of which were the failure to provide good-quality uninterrupted heating services, and Latgales Enerģija’s refusal to pay the full price of the natural gas.¹²²⁵
779. In the Respondent’s view, Latgales Enerģija’s argument that the Municipality had to cover the price difference arising out of an unforeseen rise in the costs of natural gas was tantamount to saying that the Municipality had to subsidise the Claimant’s investment; aside from running counter to the basic purpose of inviting private

¹²²¹ *Mr. Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award, 8 April 2013, RLA-23, ¶ 453.

¹²²² Transcript, Day 1, 123/7-22.

¹²²³ Resp. Rej. ¶ 28.

¹²²⁴ Resp. Rej. ¶ 31.

¹²²⁵ Resp. Obj. J. & C-Mem. ¶¶ 3.21; 3.23.

capital, such a proposition had no basis in the contracts signed by Latgales Energija.¹²²⁶

780. Finally, the evidence is, according to the Respondent, that it is the Claimant's or Mr. Strioga's common practice to enter into deals having a potential for serious issues to arise and litigation to take place in due course due to a lack of "precisely defined rules of cooperation"; reliance is placed by the Respondent on Exhibit R-19 containing a number of press reports by the Lithuanian press and judgments by Lithuanian authorities.¹²²⁷

(B) THE RISKS ASSUMED BY THE CLAIMANT VS. THE CLAIMANT'S
LEGITIMATE EXPECTATIONS

781. The Respondent submits that the investor's own conduct should be taken into account to determine the Respondent's liability under the BIT; reliance is placed on the awards in *Azinian v. United Mexican States*,¹²²⁸ *MTD*¹²²⁹ and *Noble Ventures v. Romania*¹²³⁰.¹²³¹ According to the Respondent, these cases all dealt with various "substantial bad faith conducts by [the] investor itself" such as improper due diligence, non-submission of relevant information and "causing the events for revocation of licence".¹²³²

The Respondent submits that all these factors are pertinent in the present case.¹²³³

782. In the Respondent's view, a more reasonable and prudent investor than the Claimant would have considered the risks typically linked to the provision of district heating services in countries such as Latvia before making the investment.¹²³⁴
783. In particular, the Respondent submits that the Claimant should have taken into account the following risks:

¹²²⁶ Resp. Obj. J. & C-Mem. ¶ 3.23, see also paragraphs 726 ff. above.

¹²²⁷ See the Tribunal's index of this exhibit in footnote 544 above; Resp. Rej. ¶ 33.

¹²²⁸ *Robert Azinian, Kenneth Davitian & Ellen Baca v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award, 1 November 1999 ("*Azinian v. Mexico*"), RLA-8.

¹²²⁹ *MTD v. Chile*, CLA-18.

¹²³⁰ *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005, RLA-9.

¹²³¹ Resp. Obj. J. & C-Mem. ¶ 3.34; Transcript, Day 4, 82/6-25; 83/1-25; 84/1-7.

¹²³² Resp. Obj. J. & C-Mem. ¶ 3.34.

¹²³³ Resp. Obj. J. & C-Mem. ¶ 3.34.

¹²³⁴ Resp. Obj. J. & C-Mem. ¶ 3.23; Transcript, Day 4, 87/10-15.

- (i) the general risk inherent in the fact that the Claimant did not have a comprehensive legal, financial or technical due diligence carried out;¹²³⁵
- (ii) the risk which the Claimant assumed due to the non-existence of a heat supply development plan for the City when the Long-Term Agreement was executed, due *inter alia* to the fact that it was common practice for an operator to be the main entity devising and proposing major improvements and developments of the district heating system;¹²³⁶
- (iii) the risk inherent in the “mutual cooperation obligation” to devise a development plan that had to be accepted by both parties (Latgales Enerģija and the Municipality) as well as the risk inherent in the absence of a timeline relating to the preparation of such plan;¹²³⁷
- (iv) the risk of possible increases in the price Latvijas Gāze would be allowed to charge for the natural gas delivered;¹²³⁸
- (v) the risk that an increase in the tariff Latgales Enerģija was allowed to charge had to rest on objective business needs rather than the sole fact that there had been an increase in the price of gas or electricity;¹²³⁹
- (vi) the risk that the business may not be profitable;¹²⁴⁰ and
- (vii) the general risk of adverse events.¹²⁴¹

784. According to the Respondent, however, Latgales Enerģija in fact “acted like in a non-regulated sphere of business and simply demanded a trust from all involved persons and institutions”.¹²⁴²

¹²³⁵ Respondent’s Closing Argument, Slide 11.

¹²³⁶ Resp. Obj. J. & C-Mem. ¶¶ 3.24; 3.34; Resp. Rep. (PO9) ¶ 34.

¹²³⁷ Resp. Obj. J. & C-Mem. ¶¶ 3.12; 3.23; Resp. Rep. (PO9) ¶ 34.

¹²³⁸ Resp. Obj. J. & C-Mem. ¶ 3.24.

¹²³⁹ Resp. Obj. J. & C-Mem. ¶ 3.24.

¹²⁴⁰ Resp. Obj. J. & C-Mem. ¶ 3.23.

¹²⁴¹ Resp. Obj. J. & C-Mem. ¶ 3.24.

¹²⁴² Resp. Obj. J. & C-Mem. ¶ 3.24.

(C) CHANGE OF CIRCUMSTANCES

785. In the alternative, the Respondent submits that there has been no breach of the BIT due to a change of circumstances.¹²⁴³
786. To that end, the Respondent again makes reference to Article 6:111 of the PECL, in particular subparagraphs (b) and (c).¹²⁴⁴
787. The Respondent argues that the Regulator largely based its decision to revoke Latgales Enerģija's licences on Latgales Enerģija's failure to procure a "safe, continuous and reliable" delivery of district heating services in Rēzekne.¹²⁴⁵ According to the Respondent, even assuming that Latgales Enerģija was entitled to rely on the assumption that there would be permanent and continuous delivery of natural gas and that it would not have to prepare for emergency measures in case of a disruption of the delivery of natural gas, Latgales Enerģija "directly caused and was responsible for the circumstances that led to the revocation of the [l]icences".¹²⁴⁶ When it withheld payments to Latvijas Gāze, Latgales Enerģija should have realized that Latvijas Gāze was not bound to procure a "safe and sound business" to Latgales Enerģija and that Latvijas Gāze could therefore suspend or stop the delivery of natural gas.¹²⁴⁷
788. Such circumstances represent a risk to be addressed by Latgales Enerģija and which Latgales Enerģija was not entitled to shift to the Municipality.¹²⁴⁸

D. THE REASONS FOR THE TRIBUNAL'S DECISION ON LIABILITY

789. The Tribunal will deal with the issues in the following order:
- (i) the applicable law (see paragraphs 790 ff. below);
 - (ii) whether the alleged conduct and breaches of the BIT complained of by the Claimant can be attributed to the Respondent insofar as the Municipality, the

¹²⁴³ Resp. Obj. J. & C-Mem. ¶ 3.37.

¹²⁴⁴ Resp. Obj. J. & C-Mem. ¶ 3.37.

¹²⁴⁵ Resp. Obj. J. & C-Mem. ¶ 3.38.

¹²⁴⁶ Resp. Obj. J. & C-Mem. ¶ 3.38.

¹²⁴⁷ Resp. Obj. J. & C-Mem. ¶ 3.38.

¹²⁴⁸ Resp. Obj. J. & C-Mem. ¶ 3.39.

Regulator and the two companies Rēzeknes Siltumtīkli and Rēzeknes Enerģija are concerned (see paragraph 794 ff. below);

- (iii) the claim for breach of Article 3(1) of the BIT (see paragraph 831 below);
- (iv) the claim for expropriation under Article 4(1) of the BIT (see paragraph 1067 below); and
- (v) the claim for breach of the MFN under Article 3(2) of the BIT (see paragraph 1102 below).

(1) APPLICABLE LAW

790. The Tribunal has decided that the present dispute is an investment dispute within its jurisdiction according to the provisions of the BIT and the ICSID Convention. As an ICSID Tribunal it has to turn to the Convention's provisions in order to determine the applicable law.

791. Article 42 of the ICSID Convention reads as follows:

Article 42

- (1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

792. In the Tribunal's view, acceptance of the offer to arbitrate in Article 7 of the BIT establishes an implicit agreement that the applicable law consists primarily of the standards of protection contained in the BIT, but that recourse may be had to general international law as well as to the domestic law of Latvia.

793. The Tribunal finally notes that it is not in dispute that (i) Article 1(1) of the BIT refers to Latvian laws and regulations, (ii) such laws and regulations apply to the actions of Latvian executive and judicial authorities and (iii) the agreements entered into by Latgales Enerģija with the Municipality, Rēzeknes Siltumtīkli and Rēzeknes Enerģija are governed by such laws and regulations. As follows from the preceding paragraph, the Tribunal considers that it is empowered by Article 42(1) of the ICSID Convention

to interpret and apply such laws and regulations in so far as necessary to determine the dispute that has been referred to it.

(2) THE ISSUE OF ATTRIBUTION

794. As reflected in Article 2 of the ILC Articles:¹²⁴⁹

Article 2 Elements of an internationally wrongful act of a State

There is an internationally wrongful act of a State when conduct consisting of an action or omission:

- (a) is attributable to the State under international law; and
- (b) constitutes a breach of an international obligation of the State.

795. The issue for the purposes of the present Award is the threshold question whether the conduct of which the Claimant complains is attributable to the Respondent under international law. The Tribunal will examine the case of the Municipality, the Regulator and the two companies Rēzeknes Siltumtīkli and Rēzeknes Enerģija.

(A) THE MUNICIPALITY

796. There can be no doubt—nor did the Respondent appear to contest (see paragraph 750 above)—that the Municipality’s conduct is attributable to the Respondent.

797. The relevant rule is stated in Article 4 of the ILC Articles:

Article 4 Conduct of organs of a State

1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State.
2. An organ includes any person or entity which has that status in accordance with the internal law of the State.

798. As paragraph 3 of the ILC’s Commentary to that article observes, the rule which it embodies “has long been recognized in international judicial decisions”.¹²⁵⁰

¹²⁴⁹ ILC Articles, CLA-7.

799. Paragraph 6 of the Commentary elaborates that the rule “extends to organs of government of whatever kind or classification, exercising whatever functions, and at whatever level in the hierarchy, including those at provincial or even local level”. The rule therefore encompasses an organ of local government such as the Municipality, which is given the status of part of the Latvian State by the Municipalities Act.¹²⁵¹
800. Provided that the acts in question are performed in an official capacity, they are attributable to the State. There is no dispute that the acts of the Municipality in this case were performed in an official capacity.
801. All of the actions of the Municipality at issue in this case are therefore attributable to the Respondent.

(B) THE REGULATOR

802. The Claimant’s allegations concern both the Regulator’s refusal to grant Latgales Energija’s applications for revised tariffs on 13 October 2006¹²⁵² and on 11 June 2007,¹²⁵³ as well as its annulment on 7 December 2007¹²⁵⁴ of a prior decision to grant Latgales Energija’s application for revised tariffs¹²⁵⁵ and ultimately, on 3 June 2008, its revocation of Latgales Energija’s licences¹²⁵⁶ following the warning of Latgales Energija on 4 October 2007¹²⁵⁷ and the decision to take over Latgales Energija’s zone on 11 October 2007.¹²⁵⁸

¹²⁵⁰ The Commentary is not on the record, but both Parties relied on it in the submissions filed after the Hearing (Cl. Rep. Tribunal ¶¶ 9-11 and Resp. P-H (PO8) ¶ 9). Moreover, during the Hearing Mr. Wordsworth invited them to comment on a passage in that commentary (paragraph 6 on Art. 8) (Transcript, Day 4, 79/23-25; 80/1-15) and in the submissions to be filed after the Hearing (Transcript, Day 4, 125/7-18). Further to that request the Parties briefly referred to that commentary during the Hearing (Transcript, Day 4, 91/21-25; 92/1-10 for the Claimant; Day 4, 179/7-13 for the Respondent). The Commentary is available at:

http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf.

¹²⁵¹ CLA-46.

¹²⁵² C-19.

¹²⁵³ C-21.

¹²⁵⁴ C-28.

¹²⁵⁵ C-27.

¹²⁵⁶ C-29.

¹²⁵⁷ C-22.

¹²⁵⁸ C-23.

803. The arguments as to the attribution of this conduct were not well developed on either side. Nonetheless, the material which has been put before the Tribunal readily justifies the conclusion that such conduct is attributable to the Respondent.
804. In the Tribunal’s view, the nature of the Regulator as a State organ as understood under Article 4 of the ILC Articles may be inferred from provisions of the Public Utilities Regulators Act which contain a number of relevant indications:
- (i) whether the Regulator is a central body or is part of local government, it must “operate independently and autonomously” in performing the functions determined by the Public Utilities Regulators Act “when taking decisions and issuing administrative acts in order to protect the interests of users and to promote the development of providers of public utilities in accordance with the principles of justice, transparency, neutrality, equality and proportionality”;¹²⁵⁹
 - (ii) exceptions apart, a body such as the Regulator bound to act in accordance with the “principles of justice” may be presumed to be a State organ, and the further principles mentioned by Section 5 of the same Act are simply general principles of administrative law recognized in most jurisdictions;
 - (iii) the Regulator’s individual decisions are in the nature of administrative acts “binding upon specific providers and users of public utilities”;¹²⁶⁰ and
 - (iv) both an administrative act or an actual action of the Regulator may be challenged before an Administrative Regional.¹²⁶¹
805. To the extent that the acts of the Regulator were not attributable to the Respondent under Article 4 of the ILC Articles, they would be attributable as a matter of Article 5. Article 5 of the ILC Articles reads as follows:

Article 5
Conduct of persons or entities exercising elements of governmental authority

¹²⁵⁹ CLA-49, Section 5, see also Sections 7(2), 11(1).

¹²⁶⁰ CLA-49, Sections 6(1), 7(3).

¹²⁶¹ CLA-49, Section 11(4).

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 elements of the 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.

806. Like Article 4, Article 5 of the ILC Articles merely codifies a well-established rule of international law.

807. There are thus three aspects to the analysis:

- (i) the Regulator must have exercised elements of governmental authority;
- (ii) it must have been empowered by the Respondent's law to do so; and
- (iii) it was acting in that capacity in regulating tariffs and granting or revoking licences.

808. As to the first aspect, paragraph 6 of the commentary to Article 5 of the ILC Articles explains:

Article 5 does not attempt to identify precisely the scope of "governmental authority" for the purpose of attribution of the conduct of an entity to the State. Beyond a certain limit, what is regarded as "governmental" depends on the particular society, its history and traditions. Of particular importance will be not just the content of the powers, but the way they are conferred on an entity, the purposes for which they are to be exercised and the extent to which the entity is accountable to government for their exercise. These are essentially questions of the application of a general standard to varied circumstances. 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 elements of the 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.

809. Article 5 thus directs the Tribunal to consider a range of factors, each of which may be relevant to differing extents. But in this case the Respondent accepted (indeed, insisted) that the Regulator's function relating to its decisions, including as to licences, was of a public nature, financed solely from fees levied from utility companies.¹²⁶² There can be little doubt that it was the exercise of an element of governmental authority as classically understood. The same can be said of the Regulator's function of approving the tariffs applicable to the licenced activity. It is also notable that, as the Respondent points out, the Regulator's decisions were subject

¹²⁶² Resp. Obj. J. & C-Mem. ¶¶ 3.7-3.8; see also CLA-49, Section 29.

to review in the administrative rather than civil courts.¹²⁶³ Both the licensing and tariff-approval functions were therefore the exercise of an element of governmental authority.

810. As to the second aspect of the analysis, the Regulator was empowered to exercise that function by statutory authority, in the form of the Public Utilities Regulators Act. The manner of that empowerment only reinforces the conclusion that the Regulator was an entity exercising an element of governmental authority.

811. As to the third aspect, since all of the Regulator's actions at issue in this case concerned the exercise of that authority, the Tribunal concludes that they are attributable to the Respondent.

(C) THE COMPANIES RĒZEKNES SILTUMTĪKLI AND RĒZEKNES ENERĢIJA

812. The Claimant founds its case to a limited degree on the conduct of Rēzeknes Siltumtīkli and Rēzeknes Enerģija, both of which are wholly owned by the Municipality: in particular, on Rēzeknes Siltumtīkli's bringing a civil suit against Latgales Enerģija on 20 September 2007 which resulted in a freezing order being granted against Latgales Enerģija the following day, and on a further suit by Rēzeknes Enerģija brought on 27 December 2007 to the same effect. The Claimant's case, put broadly, is that these litigations were orchestrated by the Municipality to further its aim of removing Latgales Enerģija from the supply of heating to Rēzekne.

813. The question of the attribution of these actions is more complex than that of the acts of the Municipality and the Regulator. Accordingly, by Procedural Order No. 8 the Tribunal invited the Parties to file "a short submission on the question whether acts by Rēzeknes Siltumtīkli and/or Rēzeknes Enerģija [were] attributable to the Respondent".

814. The Claimant submits that the actions of Rēzeknes Siltumtīkli and Rēzeknes Enerģija were attributable to the Respondent on three bases:¹²⁶⁴

¹²⁶³ See *e.g.* C-14; Resp. Obj. J. & C-Mem. ¶ 3.7.

¹²⁶⁴ Cl. Rep. Tribunal ¶¶ 8 ff.

- (i) Rēzeknes Siltumtīkli and Rēzeknes Enerģija exercised delegated governmental authority, in the form of delegated authority to run the district heating system, thereby falling within Article 5 of the ILC Articles;
- (ii) Rēzeknes Siltumtīkli and Rēzeknes Enerģija exercised delegated administrative or governmental authority, thereby falling within Article 2(2)(b) of the US-Latvia BIT, imported into the BIT by the MFN provision in Article 3(2) of the Lithuania-Latvia BIT; and
- (iii) Rēzeknes Siltumtīkli and Rēzeknes Enerģija acted under the control and direction of the Municipality, thereby falling within Article 8 of the ILC Articles.

815. In its Post-Hearing Brief the Respondent denies that Rēzeknes Siltumtīkli's and Rēzeknes Enerģija's actions were attributable to it on the basis of either Article 5 or Article 8 of the ILC Articles.¹²⁶⁵

(i) *Article 5 of the ILC Articles*

816. The short answer to this argument appears to be that, even if Rēzeknes Siltumtīkli and Rēzeknes Enerģija had been empowered to exercise any element of governmental authority, they were not exercising such authority “in the particular instance”, as Article 5 requires.

817. As the Respondent observes, both litigations were brought in the civil courts, on the basis of purely commercial agreements.¹²⁶⁶ As a matter of first principles – and contrary to the Claimant's contention¹²⁶⁷ – the mere fact that the Municipality was responsible for organising district heating is not enough to transform the consequent provision of such heating (whether by private or semi-private entities) into an exercise of governmental authority.

(ii) *MFN in Article 3(2) of the BIT*

818. The next strand of the Claimant's case is as follows:

¹²⁶⁵ Resp. P-H (PO8) ¶¶ 7 ff.

¹²⁶⁶ Resp. Obj. J. & C-Mem. ¶ 5.

¹²⁶⁷ See *e.g.* Cl. Rep. ¶ 18.

- (i) Rēzeknes Siltumtīkli's and Rēzeknes Enerģija's conduct would be attributable to the Respondent under article 2(2)(b) of the US-Latvia BIT; and
- (ii) by virtue of the MFN provision in article 3(2) of the (Lithuania-Latvia) BIT, the Claimant is entitled to have its claim determined by reference to that provision of the US-Latvia BIT.

819. Article 2(2)(b) of the US-Latvia BIT¹²⁶⁸ provides:

Article II

2.

a. (...)

b. Each Party shall ensure that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under this Treaty *wherever such enterprise exercises* any regulatory, administrative or *other governmental authority* that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions, or impose quotas, fees or other charges.

820. It appears doubtful that this provision adds anything to the Claimant's case on Article 5 of the ILC Articles. Even if "regulatory" or "administrative" authority were in isolation capable of bearing a broader meaning than "governmental authority", it appears from the use of "other" that those terms are to be read *eiusdem generis* with "governmental authority" as generally understood. Further, although the list of examples of such authority which follows is merely illustrative, it appears to leave little scope to suppose that the terms were intended to bear a broader meaning than the "governmental authority" referred to in Article 5 of the ILC Articles.

821. For the same reasons discussed above in relation to Article 5 of the ILC Articles, there appears to be nothing to establish that either Rēzeknes Siltumtīkli or Rēzeknes Enerģija was exercising any such authority when it engaged in the conduct at issue. Article 2(2)(b) of the US–Latvia BIT would therefore appear inapplicable on the current facts.

822. On this basis, it would be unnecessary to reach a view on whether the MFN provision in the BIT is capable in principle of applying in the present case.

¹²⁶⁸ US-Latvia BIT, CLA-25.

(iii) *Article 8 of the ILC Articles*

823. The final issue is whether Rēzeknes Siltumtīkli's and Rēzeknes Enerģija's conduct is attributable to the Respondent under the test expressed in Article 8 of the ILC Articles.¹²⁶⁹ This provides:

Article 8
Conduct directed or controlled by a State

The conduct of a person or 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 or control of, that State in carrying out the conduct.

824. Paragraphs 6 and 7 of the Commentary to that article are pertinent enough to be worth quoting in full:

Questions arise with respect to the conduct of companies or enterprises which are State-owned and controlled. If such corporations act inconsistently with the international obligations of the State concerned the question arises whether such conduct is attributable to the State. In discussing this issue it is necessary to recall that international law acknowledges the general separateness of corporate entities at the national level, except in those cases where the "corporate veil" is a mere device or a vehicle for fraud or evasion. The fact that the State initially establishes a corporate entity, whether by a special law or otherwise, is not a sufficient basis for the attribution to the State of the subsequent conduct of that entity. 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 unless they are exercising elements of governmental authority within the meaning of article 5. This was the position taken, for example, in relation to the *de facto* seizure of property by a State-owned oil company, in a case where there was no proof that the State used its ownership interest as a vehicle for directing the company to seize the property. On the other hand, where there was evidence that the corporation was exercising public powers, or that the State was using its ownership interest in or control of a corporation specifically in order to achieve a particular result, the conduct in question has been attributed to the State.

It is clear then that a State may, either by specific directions or by exercising control over a group, in effect assume responsibility for their conduct. Each case will depend on its own facts, in particular those concerning the relationship between the instructions given or the direction or control exercised and the specific conduct complained of. In the text of article 8, the three terms "instructions", "direction" and "control" are disjunctive; it is sufficient to establish any one of them. At the same time it is made clear that the instructions, direction or control must relate to the conduct which is said to have amounted to an internationally wrongful act.

825. It is therefore clear that it is not enough to meet the test set out in Article 8 of the ILC Articles that Rēzeknes Siltumtīkli and Rēzeknes Enerģija were State-owned. Nor is it

¹²⁶⁹ ILC Articles, CLA-7.

enough that they may in general have been subject to the Municipality's control (as the Claimant argued in its closing submissions). Rather, the specific question to be addressed in this case is whether the Respondent instructed, directed or controlled Rēzeknes Siltumtīkli's or Rēzeknes Enerģija's bringing of the litigation which resulted in Latgales Enerģija's bank accounts being frozen.

826. There is a dearth of direct evidence as to any such instruction, direction or control in this case. That is partly a consequence of the Respondent's failure to tender any witnesses of fact for cross-examination and partly a consequence of the fact that the Respondent produced only few documents further to Procedural Order No. 4.¹²⁷⁰ As to the Claimant's allegation that the Municipality directed the companies' actions, the Respondent says that the suggestion is "at the best, worth a big and healthy smile".¹²⁷¹
827. The Tribunal finds that there is, however, a body of circumstantial evidence which, taken as a whole, permits the inference that the Municipality (as an organ of the Respondent) must have instructed Rēzeknes Siltumtīkli and Rēzeknes Enerģija to bring the claims against Latgales Enerģija and must have instructed Rēzeknes Siltumtīkli not to comply with the October 2007 Agreement.
828. The evidence giving rise to such an inference so far as Rēzeknes Siltumtīkli is concerned is as follows:
- (i) although the Municipality's sole ownership of the companies is not by itself sufficient to found an inference of direction, it is a significant background factor;
 - (ii) against that background is to be considered the newspaper interview given by the Mayor of the Municipality (Mr. Vjakse) on 13 September 2007. Among the key points emerging from the interview were these:¹²⁷²

¹²⁷⁰ In Procedural Order No. 8 the Tribunal ordered the Respondent to state whether there were any documents responsive to the Claimant's requests for production granted by the Tribunal in Procedural Order No. 4 and, further to a renewed verification of its files, to produce any responsive documents by 20 March 2015.

¹²⁷¹ Resp. Rej. ¶ 27.

¹²⁷² C-134, reproduced in paragraph 251 above.

- the Municipality or the mayor himself had been in private negotiations “for three months” to identify “alternatives” to Latgales Enerģija;
 - Latgales Enerģija’s future as an operator in Rēzekne was said to depend on whether it paid Latvijas Gāze;
 - despite that, the Mayor stated unconditionally that “[W]e will announce a tender and choose a company that would meet our requirements”; and
 - the Mayor also stated, “the future of Latgales enerģija in our city will be decided on 25 September. By this date, the regular payment for the gas should be paid, and in case Latgales enerģija fails to pay it, then I would bring a question to deputies regarding termination of the agreement with this company”;
- (iii) shortly before the interview, and following the Mayor’s alleged private negotiations with Latgales Enerģija’s competitors, the Municipality-owned Rēzeknes Siltumtīkli had (absent any other explanation for its timing)¹²⁷³ decided to bring the civil claim against Latgales Enerģija on 20 September 2007 seeking an attachment which was granted on 21 September 2007¹²⁷⁴ and which prevented Latgales Enerģija from being able to pay Latvijas Gāze;
 - (iv) on the same day, the Municipality adopted a Development Plan;¹²⁷⁵
 - (v) the name of Latgales Enerģija which featured in the draft was deleted and replaced by the word “operator” further to the suggestions made by representatives of the City Council during two meetings of the Working Group in the absence of Latgales Enerģija (see paragraphs 224 and 227 above); and
 - (vi) finally, it is significant that when the lifting of the attachment of Latgales Enerģija’s bank account was agreed upon as a measure to be taken as a matter of urgency pursuant to the October 2007 Agreement (see paragraph 287

¹²⁷³ The bulk of the sum claimed was represented by amounts allegedly owed for depreciation of assets and the dispute between Rēzeknes Siltumtīkli and Latgales Enerģija in this respect went back to the previous year (see paragraphs 193 ff. above).

¹²⁷⁴ C-138, see paragraph 255 above.

¹²⁷⁵ C-137, see paragraph 228 above.

above), such undertaking was assumed also by the City Council, which was one of the parties privy to that agreement, and not only by Rēzeknes Siltumtīkli;¹²⁷⁶ this could only mean that the City Council would be bound to give Rēzeknes Siltumtīkli any directions as may be required.

829. The sequence of events which followed suggests an intention on the Municipality's part then to use Rēzeknes Enerģija as an instrument in connection with Latgales Enerģija's removal, which culminated in Rēzeknes Enerģija's bringing its claim for a freezing order against Latgales Enerģija on 27 December 2007:

- (i) on 28 September 2007 the Municipality decided to establish Rēzeknes Enerģija;¹²⁷⁷
- (ii) Rēzeknes Enerģija was incorporated by the Municipality on 2 October 2007 and, immediately thereafter, Rēzeknes City Council applied for a loan in an amount of LVL 4 million which was arranged in the first week of October 2007 (see paragraphs 260 ff. above);
- (iii) on 4 October 2007 the Regulator warned Latgales Enerģija that the licences might be revoked;¹²⁷⁸
- (iv) one week later, on 9 October 2007, the Municipality declared an energy crisis;¹²⁷⁹
- (v) the Regulator took over Latgales Enerģija's zone on 11 October 2007;¹²⁸⁰
- (vi) on 12 October 2007, the Municipality adopted a decision appointing Rēzeknes Enerģija as the "person in charge" of the provision of heating services in Rēzekne;¹²⁸¹ and

¹²⁷⁶ C-26, see paragraph 286 above.

¹²⁷⁷ C-142; see also paragraph 258 above.

¹²⁷⁸ C-22, see paragraph 262 above.

¹²⁷⁹ C-24, see paragraph 264 above.

¹²⁸⁰ C-23, see paragraph 274 above.

¹²⁸¹ C-25, see paragraph 275 above.

- (vii) at a meeting the same day attended by the Mayor, representatives of Latgales Enerģija, and representatives of Rēzeknes Siltumtīkli and Rēzeknes Enerģija, the Mayor made the following, telling remark: “In the light of the crisis situation, in the name of the new company [i.e. Rēzeknes Enerģija], we are claiming that before 14 October, 6:00 P.M. [Latgales Enerģija] to deliver the service activity area and to ensure that the people from Rēzeknes Enerģija can start fulfilment of the obligations as defined by the Regulator and the [Municipality]”.¹²⁸²

830. These facts are sufficient in order for the Tribunal to conclude, on the balance of probabilities, that the Respondent did direct Rēzeknes Siltumtīkli and Rēzeknes Enerģija to bring their respective claims against Latgales Enerģija. In reaching such a conclusion, the Tribunal takes into account the Respondent’s failure to offer any witness of fact for cross-examination on this point.

(3) CLAIMS FOR BREACH OF ARTICLE 3(1) OF THE TREATY (FAIR AND EQUITABLE TREATMENT, FULL PROTECTION AND SECURITY; NO ARBITRARY OR DISCRIMINATORY MEASURES WITH RESPECT TO THE INVESTMENT)

831. Article 3(1) of the BIT reads as follows:

Article 3
Protection and Treatment of Investments

1. Each Contracting Party shall at all times ensure fair and equitable treatment of the investments made by investors of the other Contracting Party as well as their full security and protection in its territory.

Neither Contracting Party shall by arbitrary or discriminatory measures impair the management, maintenance, use, enjoyment or disposal of investments made by investors of the other Contracting Party.

(A) THE APPLICABLE STANDARD OF TREATMENT

832. Fair and equitable treatment is the first standard of investment protection mentioned in the first sub-paragraph of Article 3(1) of the BIT.

¹²⁸² C-147, page 12 (emphasis supplied).

833. There has been considerable debate as to the content of this standard, including as to whether it confers protection going beyond the minimum standard of treatment required as a matter of customary international law.
834. The Tribunal considers that, as is now recognized in multiple awards, the standard is concerned with “[p]rotection of legitimate expectations (...); [g]ood faith (...) [and] [t]ransparency, consistency, non-discrimination”, as was noted by the *Biwater Gauff* tribunal.¹²⁸³ In *Saluka* the tribunal concluded on the standard of fair and equitable treatment as follows: “A foreign investor whose interests are protected under the Treaty is entitled to expect that the Czech Republic will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (*i.e.* unrelated to some rational policy) or discriminatory (*i.e.* based on unjustifiable distinctions)”.¹²⁸⁴ Although made in the specific context of NAFTA, the views expressed by the *Waste Management* tribunal have been influential, and have frequently been referred to both with respect to NAFTA claims and claims under treaties that refer solely to an obligation to accord fair and equitable treatment, *i.e.* without any reference to the customary international law minimum standard of treatment. That tribunal stated that the NAFTA standard of fair and equitable treatment is breached

(...) by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying that standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.¹²⁸⁵

835. One important element of the standard of fair and equitable treatment is the protection of the investor’s legitimate expectations. The Tribunal considers, in line with the views expressed by various other tribunals, that for the investor’s expectations to be protected by the standard of fair and equitable treatment:

¹²⁸³ *Biwater Gauff v. Tanzania*, CLA-36 ¶ 602.

¹²⁸⁴ *Saluka v. Czech Republic*, CLA-21 ¶ 309.

¹²⁸⁵ *Waste Management v. Mexico*, CLA-15 ¶ 98.

- (i) the investor's expectations must be "legitimate";¹²⁸⁶ indeed "reasonable and legitimate";¹²⁸⁷
- (ii) more is required than a "basic expectation", as has been referred to in various cases, including *Biwater Gauff*;¹²⁸⁸
- (iii) there must have been reliance by the investor with respect to making the investment;¹²⁸⁹ and
- (iv) that reliance must be reasonable.¹²⁹⁰

836. Whereas stability and predictability of the legal environment have been regarded as concrete renderings of the fair and equitable treatment standard in a number of decisions,¹²⁹¹ these cannot be absolute requirements, and have often been weighed against further criteria, and most notably the right of the host State to exercise its general legislative power and enforce laws and regulations to protect the public interest. Thus, the *Saluka* tribunal noted that "[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged";¹²⁹² the *El Paso* tribunal went a step further, holding that it was unable to follow the line of cases in which fair and equitable treatment had been viewed as implying the stability of the legal and business framework.¹²⁹³

837. The Tribunal considers that reasonableness on the part of the investor in relying on representations by the State means *inter alia* that it is a matter for the investor to evaluate the risk inherent in the proposed investment taking into account all relevant circumstances; investment tribunals have held that the investor would in principle have to take the consequences following from its own failure in this respect.¹²⁹⁴

¹²⁸⁶ *Saluka v. Czech Republic*, CLA-21 ¶ 302; *El Paso v. Argentina*, CLA-39 ¶ 359.

¹²⁸⁷ *Rumeli v. Kazakhstan*, CLA-34 ¶ 609; *Biwater Gauff v. Tanzania*, CLA-36 ¶ 602.

¹²⁸⁸ *Biwater Gauff v. Tanzania*, CLA-36 ¶ 602.

¹²⁸⁹ *Biwater Gauff v. Tanzania* CLA-36 ¶ 602.

¹²⁹⁰ *Waste Management v. Mexico*, CLA-15 ¶ 98.

¹²⁹¹ See e.g. *CMS v. Argentina*, RLA-30 ¶¶ 274; 276.

¹²⁹² *Saluka v. Czech Republic*, CLA-21 ¶ 305.

¹²⁹³ *El Paso v. Argentina*, CLA-39 ¶ 352

¹²⁹⁴ *MTD v. Chile*, CLA-18 ¶ 164; *Biwater Gauff v. Tanzania*, CLA-36 ¶ 601.

838. Moreover, the breach by a State of a representation made in a contract may not suffice to give rise to a breach of the standard of fair and equitable treatment since a distinction must be made between pure contract claims and treaty claims. The Tribunal considers that, as a general rule, a breach of contract is unlikely on its own to amount to a breach of the standard of fair and equitable treatment, and the State would have to have acted in its sovereign capacity.¹²⁹⁵

839. Good faith is generally regarded as a fundamental part of the fair and equitable standard of protection. The Tribunal considers that a breach of good faith does not require proof of an intention to harm the investment or the investor,¹²⁹⁶ but such an intention or motive, if found to exist, may be relevant.¹²⁹⁷ The Tribunal considers that the following finding by the *Saluka* tribunal is of assistance: the host State is required to implement its policies

(...) *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment.¹²⁹⁸

840. Full protection and security is the second standard of investment protection mentioned in the first sub-paragraph of Article 3(1) of the BIT. The Tribunal considers that the standard of full protection and security seeks specifically to protect the physical integrity of the investment against the use of force.¹²⁹⁹ Full protection and security does not provide for strict liability,¹³⁰⁰ but rather requires the host State to exercise due diligence in the treatment of the investment.¹³⁰¹ The Tribunal notes that certain decisions have held that the standard did not protect only the physical integrity of the investment, but had a broader scope which includes the investor's rights.¹³⁰² The

¹²⁹⁵ See e.g. *Waste Management v. Mexico*, CLA-15 ¶ 115.

¹²⁹⁶ *El Paso v. Argentina*, CLA-39 ¶ 357.

¹²⁹⁷ See e.g. *Waste Management v. Mexico*, CLA-15 ¶ 138.

¹²⁹⁸ *Saluka v. Czech Republic*, CLA-21 ¶ 307.

¹²⁹⁹ *Saluka v. Czech Republic*, CLA-21 ¶ 484.

¹³⁰⁰ *Tecmed v. Mexico*, CLA-17 ¶ 177; *Saluka v. Czech Republic*, CLA-21 ¶ 484.

¹³⁰¹ *Saluka v. Czech Republic*, CLA-21 ¶ 484.

¹³⁰² *ELSI*, CLA-24 ¶¶ 109-111; *Azurix v. Argentina*, CLA-19 ¶¶ 406, 408; *Siemens v. Argentina*, CLA-11 ¶ 303; *AES v. Hungary*, CLA-38 ¶ 13.3.2.

Biwater Gauff tribunal mentioned the stability of the investor's environment, including the commercial and legal environment.¹³⁰³

841. The protection against arbitrary and discriminatory measures which impair the management, maintenance, use, enjoyment or disposal of investments is the third standard of investment protection established in Article 3(1) of the BIT. The Tribunal considers that a measure may be characterized as arbitrary if it is “founded on prejudice or preference rather than on reason or fact”¹³⁰⁴ or constitutes a “willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety”.¹³⁰⁵ The Tribunal considers that a measure which is arbitrary or discriminatory is likely also to violate the fair and equitable treatment standard considering the elements of the fair and equitable treatment set out above (see paragraphs 832 and 834 above). For there to be a breach of this limb of Article 3(1), there must be not only one or more arbitrary or discriminatory measures but also impairment to the management, maintenance, use, enjoyment or disposal of an investment. This is a familiar formulation, but the Tribunal nonetheless notes the broad scope of what is prohibited in terms of impairment.

(B) WHETHER THE RESPONDENT IS IN BREACH OF ARTICLE 3(1) OF THE BIT

842. The Tribunal will examine (i) the claim rested on a breach of the Claimant's expectations based on the Long-Term Agreement (see paragraphs 844 ff. below), (ii) the claim based on the Municipality's delay in approving the heat supply development plan for the City (see paragraphs 855 ff. below), (iii) the claim based on the Municipality's refusal to consent to the Claimant's investments in the heating system (see paragraphs 888 ff. below), (iv) the claims based on the Regulator's refusal to set a new tariff (see paragraphs 899 ff. below), (v) the claims based on the Municipality's and the Regulator's conduct in connection with the energy crisis (see paragraphs 923 ff. below), the claims based on the Regulator's warning and the revocation of the licences by the Regulator (see paragraphs 988 ff. below) and the claims based on the Municipality's conduct subsequent to the revocation of the licences (see paragraphs 1028 ff. below). The Tribunal will finally consider the cumulative effect of the

¹³⁰³ *Biwater Gauff v. Tanzania*, CLA-36 ¶ 729.

¹³⁰⁴ *Lauder v. Czech Republic*, CLA-29 ¶ 221; see also *El Paso v. Argentina*, CLA-39 ¶ 319.

¹³⁰⁵ *ELSI*, CLA-24 ¶ 128; *Siemens v. Argentina*, CLA-11 ¶ 318; *El Paso v. Argentina*, CLA-39 ¶ 319.

measures taken by the Regulator and the Municipality (see paragraphs 1060 ff. below).

843. The Tribunal’s finding on whether the Respondent acted in breach of Article 3(1) of the BIT is set out in paragraph 1066 below.

(i) *The Claim Rested on a Breach by the Respondent of the Claimant’s Expectations Based on the Long-Term Agreement*

844. The Claimant relies on a number of expectations, and most notably the expectation that Latgales Enerģija would recover the investment made by the Claimant and earn a profit as provided in the Long-Term Agreement (see paragraph 675 above). The Tribunal dismisses this claim.

845. The Claimant emphasised, in replying to the Respondent’s arguments, that its claims are Treaty claims,¹³⁰⁶ pointing out that the rights asserted in these arbitration proceedings are not “mere contractual claims” and are distinct from the claims asserted by Latgales Enerģija in the Latvian courts based on the contracts or the licences.¹³⁰⁷

846. The Tribunal finds that its role is to determine whether the Claimant is entitled to assert a claim for breach of the standards of protection in Article 3(1) of the BIT, not whether it is liable in contract under the terms of the Long-Term Agreement. However, the claim that Latgales Enerģija would be entitled to use the assets, create new assets and make a profit as provided by the Long-Term Agreement is in substance a contractual claim brought under the veil of a breach of the investor’s legitimate expectations.

847. The Tribunal notes that the Respondent did not, in particular, guarantee the profitability of the investment under Article 3(1) of the BIT; neither did the terms of the Long-Term Agreement for that matter, contrary to the Claimant’s submission. The Claimant could not therefore reasonably have such an expectation when the Long-Term Agreement was made on 28 January 2005.

¹³⁰⁶ Cl. Rep. ¶ 77.

¹³⁰⁷ Cl. Rep. ¶¶ 94-95.

848. Investment tribunals have consistently found that BITs are not an insurance against business risks.¹³⁰⁸
849. In the present case the Claimant, a company active *inter alia* in the heating business, was aware of certain risks inherent in the investment and must be deemed to have assumed them unless they were expressly excluded; its investment in Latvia related to activities which the Claimant has been carrying out in its own country according to the representations made to the Respondent.¹³⁰⁹ Whereas both Lithuania and Latvia had gradually embraced a system of market economy after regaining independence in the early 1990s, the privatization of district heating utilities was a new page of history for the City of Rēzekne when the Claimant decided to invest there, as contended by the Respondent. When the Claimant summarised the current position of the heating system in Rēzekne in the PowerPoint presentation made to the Municipality on 25 November 2004, it identified by the same token some of the specific risks possibly affecting the profitability of the investment under consideration, in particular the fact that the infrastructure would have to be replaced and a change in the type of fuel had to be introduced.¹³¹⁰
850. The Claimant has provided no precise answer to the Respondent's allegation that its due diligence was at best insufficient and its decision to invest "overconfident"; when asked whether any due diligence had been made to assess the legal, financial and technical risks, Mr. Strioga answered that his company had hired local lawyers to obtain advice on Latvian law, but he could not remember whether any due diligence report had been received.¹³¹¹ The Tribunal notes that due diligence by the Claimant was contemplated as a possible condition precedent to the entry into force of the February 2005 Agreement by Clause 5 of the same agreement.¹³¹²
851. Moreover, the Claimant does not contend that it received any specific assurances by the Latvian authorities regarding the review of the tariff. The Regulator's and the

¹³⁰⁸ In the context of the fair and equitable treatment standard, see *e.g.* *MTD v Chile*, CLA-18 ¶ 178 and *Biwater Gauff v. Tanzania*, CLA-36 ¶ 601 referring to *Waste Management v. Mexico*, CLA-15.

¹³⁰⁹ See the Claimant's PowerPoint presentation of 25 November 2004, C-41 [page 1].

¹³¹⁰ C-41 [pages 2-3].

¹³¹¹ Transcript, Day 1, 29/13-30/9.

¹³¹² C-8.

Municipality's conduct in relation to the tariffs proposed by Latgales Enerģija in 2006 and 2007 will be examined in due course (see paragraphs 899 ff. below).

852. Certain specific complaints made by the Claimant are dealt with in the following sections of the present Award: (i) the complaint that the Respondent disappointed the Claimant's legitimate expectation that the Regulator would not depart from its 2005 practice is dealt with in paragraphs 910 ff. below; (ii) the complaint that the Respondent disappointed the Claimant's legitimate expectation that the Municipality would pay for the natural gas is dealt with in paragraphs 925 ff. below; (iii) the complaint that the interview given by the Mayor and the Municipality's attempts to attract a new operator in the summer of 2007 disappointed the Claimant's legitimate expectation that the Municipality would not actively seek to replace Latgales Enerģija is dealt with in paragraphs 938 ff. below; (iv) the complaint that the Respondent disappointed the Claimant's expectations that the Municipality would not actively prevent Latgales Enerģija from operating its business and would comply with the undertaking to have the attachment lifted is dealt with in paragraphs 950 ff. below; (v) the complaint that the Respondent disappointed the Claimant's legitimate expectation that Latgales Enerģija would be able to use the assets for the production, transmission and distribution of thermal energy for 30 years is dealt with in paragraph 1044 below; (vi) the complaint that the Respondent disappointed the Claimant's legitimate expectation that Latgales Enerģija would not be required to hand over the leased assets to Municipality-owned companies is dealt with in paragraph 1048 below.
853. Finally and in any event, the Tribunal considers that the expectations relied upon by the Claimant (see paragraph 675 above) relate to mere contractual obligations¹³¹³ and/or represent in essence an alternative way to plead arbitrary conduct or conduct contrary to good faith.¹³¹⁴ Insofar as the Claimant has relied on mere contractual obligations, such complaints must be dismissed for the reason set out in paragraph 846 above. Insofar as the Claimant has presented other alleged breaches of Article 3(1) of the BIT clothed as breaches of the investor's legitimate expectations, such attempts must fail under the heading of a breach of the investor's legitimate

¹³¹³ See paragraph 675 above, in particular: (i); (iii) and (xiii) in that the Claimant's complaint may be understood as referring to a breach of the February 2005 Agreement; and (v); (vi); (vii); (ix); (xii) and (xiv).

¹³¹⁴ See paragraph 675 above, in particular (iii), (iv), (v), (vi), (viii), (x), (xi), (xii), (xiii) and (xiv).

expectations; the Tribunal will examine the substance of the complaint and determine whether the Respondent has acted in breach of Article 3(1) of the BIT in the following sections of the present Award.

854. The Tribunal's Conclusion and Finding. The Tribunal therefore dismisses this claim.

(ii) *The Claim Based on Delay by the Municipality in the Adoption of a Heat Supply Development Plan for the City of Rēzekne*

855. The Claimant claims that the delay by the Municipality in the adoption of a heat supply development plan for the City is a breach of the fair and equitable treatment standard, both *per se* and because the non-existence of such a plan caused the Regulator to deny Latgales Enerģija's applications for a new tariff in 2006 and 2007; the Claimant further contends that the Regulator's and the Municipality's conduct amount to an abuse of power amounting to arbitrary measures that resulted in its investment being irreparably impaired. The Tribunal will examine only the delay claim in this section; the Regulator's decisions will be examined in the following subsection of this Award (see paragraph 899 below). The Respondent alleges that the delay was caused by the Claimant's failure to prepare a proper draft for the heat supply development plan with due dispatch and the Claimant's refusal to provide relevant information to the Municipality as to the planned investments.

856. The issues arising for determination are as follows:

- (i) Whose duty was it to establish and adopt a heat supply development plan for the City of Rēzekne as a matter of Latvian law?
- (ii) Was there any delay in the establishment and adoption of such plan that is attributable to the Municipality?
- (iii) If a finding of delay is made, does such delay on the part of the Municipality amount to a breach of Article 3(1) of the BIT?

The Tribunal's finding is set out in paragraph 887 below.

857. The Claimant contends in these arbitration proceedings that the establishment and approval of a heat supply development plan for the City of Rēzekne was the duty of

the Municipality, whereas the Respondent submits that such duty was delegated by the Municipality to Latgales Enerģija.

858. The Tribunal finds that it was the duty of the Municipality to prepare and approve a heat supply development plan for the City of Rēzekne; Latgales Enerģija had a duty to cooperate and provide the information required, as contemplated by the February 2006 Agreement, in order that the heat supply development plan be complete.

859. The regulatory context consists of the following enactments: the Energy Act,¹³¹⁵ the Municipalities Act,¹³¹⁶ the Public Utility Regulators Act¹³¹⁷ and the Methodology for Calculation of Tariffs for Public Utilities in the Fields Regulated by Local Municipalities¹³¹⁸ enacted pursuant to the Public Utility Regulators Act. The Public Administration Act¹³¹⁹ contains provisions relevant to the issue of delegation. The provisions of these enactments relevant for present purposes are as follows:

- (i) Section 51 of the Energy Act,¹³²⁰ as it was in force when the Long-Term Agreement and the February 2005 Agreements were made, provided that the Municipality had to determine the development of heating supply.¹³²¹ The Respondent has not contested the application of this particular provision. Neither Party has contended that the change in the subsequent versions of Section 51(2) of the Act from the expression “Local governments (...)”

¹³¹⁵ CLA-48, see paragraph 38 above.

¹³¹⁶ CLA-46, see paragraph 38 above.

¹³¹⁷ CLA-49, see paragraph 38 above.

¹³¹⁸ C-35.

¹³¹⁹ CLA-52, see paragraph 38 above.

¹³²⁰ CLA-48, see paragraph 38 above. The provisions of the Energy Act relevant for present purposes cover the licensing of energy supply merchants (Sections 5 ff.), the natural gas supply system (Sections 41 ff.), the heating supply system (Sections 46 ff.), increase of energy efficiency (Sections 53 ff.) and energy crisis (Sections 59 ff.).

¹³²¹ Section 51 of the Energy Act reads as follows:

- (1) Local governments, when performing their permanent functions as prescribed by law, shall organise heating supply in the administrative territory thereof, as well as promote competition in the heating supply and fuel market.
- (2) Local governments, within the scope of the development plan of their administrative territory, determine the development of heating supply and coordinate it with regulator taking into account the provisions of the environmental protection and the protection of cultural monuments, as well as the possibilities to use local energy resources and evaluating the safety of heating supply and long-term marginal costs.

determine (...)” to the expression “Local governments (...) may determine (...)” has any particular consequences in the present case.¹³²²

- (ii) Section 14(2)(1) of the Municipalities Act¹³²³ provides that in order to perform their functions, local governments have “the duty” to prepare a development programme for the territory of the relevant local government and to ensure the implementation of the territorial development plan. Section 15(1) further specifies the functions of local governments, the first item of which is “to organise for residents the provision of utilities (water supply and sewerage; supply of heat (...)) irrespective of the ownership of the private property”.
- (iii) Section 16(6) of the Public Utility Regulators Act¹³²⁴ provides that the “Municipal regulator, issuing the licence to the public service provider shall take into account the development plans for the administrative territory of relevant municipality in the context of the development of regulated sectors as well as the regulations of the municipality”.
- (iv) The Methodology¹³²⁵ deals with the calculation of the thermal energy tariffs (Clauses 3 ff.). Clause 17 provides that the forecasted thermal energy consumption balance shall be drawn up “in accordance with the heat supply system development plan (concept) of the corresponding local government”. Clause 23.3 provides that “[e]fficiency changes in the boiler room (Dhk.) are determined based on the investments used for this purpose in accordance with the approved heat supply system development plan of the corresponding local government”. Clause 27 refers to the same plan in relation to the necessary investment.

860. The licences granted to Latgales Enerģija and the contracts signed by the Municipality and its wholly-owned companies with Latgales Enerģija mention more than one type of development plan.

¹³²² CLA-48 p. 22.

¹³²³ CLA-46.

¹³²⁴ CLA-49.

¹³²⁵ C-35.

- (i) The licences mention “the development plan of the City of Rēzekne” in Clause 1 (see paragraph 132 above); then in Clause 7.1 they mention “the long-term development plan of SIA “Latgales Enerģija”” (see paragraph 133 above). These provisions point to the existence of two different plans, one issued by the Municipality for the City of Rēzekne, another by the operator.

The clear language of the licences shows that one is therefore dealing with two distinct concepts of a long-term development plan. The Parties’ submissions have not taken that distinction into account until after the Hearing.

The Regulator’s 3 June 2008 decision revoking the licences refers to Clause 7 of the licences and states that the long-term development plan mentioned therein is “the company’s long-term development plan”.¹³²⁶ This is clearly a plan other than “the development plan of the City of Rēzekne” mentioned in Clause 1 of the licences.

- (ii) The February 2005 Agreement contains no mention of any development plan of any kind. The February 2006 Agreement contains an express term in Clause 1.2 (see the verbatim quotation in paragraph 171 footnote 163 above). Under this provision it was the Council’s duty “to coordinate and approve the guidelines for development of heating supply system of the city of Rēzekne prepared by the operator and the Council”.

It is common ground between the Parties that despite the use of the word “guidelines” this expression refers to the heat supply development plan for the City contemplated by the provisions mentioned above of the Public Utility Regulators Act and the Methodology.

861. There is no doubt that it was the responsibility of the Rēzekne City Council to prepare a development plan for the City of Rēzekne. When the Long-Term Agreement and the February 2005 Agreement were entered into by Latgales Enerģija, no such plan was in existence and the Rēzekne City Council had therefore a general duty to act, as confirmed by the Regulator’s letter of 12 October 2005 to the Rēzekne City Council enquiring into whether there was “an effective and coordinated development plan of

¹³²⁶ C-29 [page 6], ¶ 9.

the city heating supply containing planned and already made investments of ‘Latgales Enerģija’ Ltd. in development and improvement of the city heating supply”.¹³²⁷

862. The Claimant would have been entitled to make its decision to invest in Rēzekne conditional upon the adoption of such a plan, but it did not. The failure to do so is a risk undertaken by the Claimant, as pointed out by the Respondent.
863. However, the position fundamentally changed in 2006 when the Municipality and Latgales Enerģija executed the February 2006 Agreement.¹³²⁸ Under Clause 1.2 of the February 2006 Agreement (see the verbatim quotation in paragraph 171 footnote 163 above) the Rēzekne City Council undertook a duty to coordinate and approve such plan and Latgales Enerģija undertook to cooperate in good faith with the Council because Clause 1.2 of the February 2006 Agreement must be read against the background of the general principle of Latvian law whereby contracts are to be performed in good faith.¹³²⁹
864. It is in dispute between the Parties whether the main duty to provide a heat development plan for the City of Rēzekne lay on the City Council or Latgales Enerģija; the Respondent has contended at the Hearing that such a duty had been delegated to Latgales Enerģija in accordance with Section 15(3) of the Municipalities Act¹³³⁰ and Section 40 and Section 41 of the Public Administration Act¹³³¹.¹³³²

¹³²⁷ C-69.

¹³²⁸ C-17.

¹³²⁹ Latvian Civil Code, CLA-55, Art. 1. This provision deals with good faith in general and reads as follows:

Rights shall be exercised and duties performed in good faith.

¹³³⁰ CLA-46, see paragraph 38 above. Sect. 15(3) reads as follows:

The local government may delegate the tasks arising from each autonomous function of the administration to a private individual or another public person. Procedures for, types and restrictions of the delegation of the administration tasks shall be determined by State Administration Structure Law [*i.e.* the Public Administration Act].

¹³³¹ CLA-52, see paragraph 38 above. Sects. 40 and 41 of the Public Administration Act read as follows:

Section 40. Basic Provisions for Delegation

(1) A public person may delegate a private individual and another public person (hereinafter – authorised person) such tasks that include administrative decision making. Such delegation is authorised only if the authorised person can perform the relevant task more effectively.

865. The Tribunal finds that the Rēzekne City Council did not delegate the task to prepare, coordinate, let alone approve, the heat supply development plan for the City of Rēzekne to Latgales Enerģija.
866. First, the Respondent has failed to show that the requirements of Section 40 and Section 41 of the Public Administration Act were met, and that there was any enactment or contract that provided for such delegation. Clause 1.2 of the February 2006 Agreement (quoted in paragraph 171 footnote 163 above) did not delegate this task to Latgales Enerģija. Neither did the licences, since all licences expressly refer to “the development plan of the City of Rēzekne” in Clause 1 (see paragraph 132 above) and then refer to a different document to be prepared by Latgales Enerģija in Clause 7.1 (see the verbatim quotation in paragraph 133 above), as a comparison between Clause 1 and Clause 7.1 shows.
867. Secondly, the conduct of the Rēzekne City Council from 2006 onwards can be consistent only with the proposition that the Council had not delegated to Latgales Enerģija the task to prepare the heat supply development plan for the City; had there

(2) An administration task may be delegated to a private individual by an external regulatory enactment or by an external regulatory enactment or contract made by public person.

(3) Administration tasks may be delegated to another public person in cases laid down in law. In such case, the provisions of this Chapter shall be applied, insofar as the special legal norms of other laws do not lay down otherwise.

Section 41. Subject-matter of Delegation

(1) A public person may delegate administration tasks, the performance of which is in the competence of such public person or its institution. When delegating administration tasks, the relevant public person shall be responsible for the performance of the function as a whole.

(2) The following administration tasks may not be delegated:

- 1) sectoral policy-making and development planning;
- 2) co-ordination of the activities of the sector;
- 3) supervision of institutions and administrative officials;
- 4) approval of the budget of public persons, distribution of financial resources at the level of programmes and sub-programmes, and control of financial resources.

(3) In addition to that referred to in Paragraph two of this Section the following may not be delegated to a private individual:

- 1) issuance of administrative acts, except cases when it is provided for in an external regulatory enactment;
- 2) administration tasks related to the performance of the functions of the external and internal security of the State, except cases when it is provided for in law;
- 3) other administration tasks, which by their nature may be performed only by State institutions.

¹³³² Respondent's Closing Argument, Slides 13-14.

been such a delegation in place, the Council would not have seen the need for a number of the actions that it took.

When Latgales Enerģija on 15 November 2006 sent the Council its 44-page draft¹³³³ as a contribution to the preparation of the heat supply development plan, this text contained a sentence suggesting that the performance of certain Municipality functions had been delegated to Latgales Enerģija;¹³³⁴ the Council reacted to the point, denying that it had ever transferred any heat supply functions to Latgales Enerģija.¹³³⁵

Then some six months later the Rēzekne City Council set up a Working Group to produce the heat supply development plan for the City.¹³³⁶ It is relevant in this context that the Working Group was set up by a formal decision of the Rēzekne City Council and was presided over by Mr. Ivars Locis, the Council's Deputy Executive Director.¹³³⁷

It is finally also relevant that the heat supply development plan for the City was formally adopted by a decision of the Rēzekne City Council on 21 September 2007.¹³³⁸

¹³³³ R-31.

¹³³⁴ R-31 [page 5]: "Considering that based on the agreement regarding lease of the local government heat supply systems entered into with the Rēzekne City Council and the reference included therein regarding the duty of LLC Latgales Enerģija to provide for heat supply to the objects connected to the centralised heat supply system of the city according to the agreement and the requirements of legal acts, the company has taken over from the City Council the duties specified in Section 15 of the Law on Local Governments [The Municipalities Act]. i.e. ensuring provision of utilities or, more particularly, heat supply. In connection with this LLC Latgales Enerģija is performing its activities and thereby also planning and development [sic] of centralised heat supply in Rēzekne City".

¹³³⁵ C-106: "The submitted document does not meet the provisions of the applicable legislation and does not correspond to the actual state of heat supply in the city of Rēzekne, as follows: 1. (...); 2. (...); 3. The claim that the Rēzekne City Council has transferred heat supply functions to Latgales enerģija SIA does not correspond to the legal or the actual situation; 4. (...)"

¹³³⁶ In its letter dated 9 July 2007 the City Council described the respective contribution of the Municipality and the operator as follows: "Rēzekne City Council (...) has set up a work group for formulation of the city development strategy, where it would be necessary to include the chapter of the strategy on heating supply system prepared by the Operator. For the purposes of more successful and efficient cooperation and to help the Operator to prepare its chapter of the strategy, the representatives of the Operator are being invited to the meetings of the said work group" (C-128 [page 8]).

¹³³⁷ R-30 [page 1].

¹³³⁸ C-137.

868. Having determined that the Rēzekne City Council was in charge of preparing, coordinating and approving the heat supply development plan for the City, and in fact carried out such responsibilities, and that Latgales Enerģija had a contractual obligation to cooperate in good faith with the Council in order to reach that objective, the Tribunal turns to the question whether there was any delay on the part of the Municipality, taking into account, amongst other things, the manner in which Latgales Enerģija cooperated with the Municipality.
869. The Tribunal's analysis will focus on the period from 20 January 2006, when Latgales Enerģija sent its first draft to the Rēzekne City Council, until 21 September 2007, the date when the heat supply development plan for the City was finally approved by the Rēzekne City Council. It took twenty months in order for the heat supply development plan for the City to be made. Considering that the February 2006 Agreement made on 10 February 2006 provided in its Clause 1.2 that the plan would have to be approved by 28 February 2006, something clearly went wrong.
870. On 20 January 2006 Latgales Enerģija sent the Rēzekne City Council its draft "Guidelines for the development of the Rēzekne City heat supply system"¹³³⁹ (see paragraph 164 above). The Council in fact received this draft,¹³⁴⁰ but did not acknowledge receipt of it to Latgales Enerģija; so Latgales Enerģija sent the Council two reminders on 10 May 2006 and 19 October 2006;¹³⁴¹ no answer by the Council is in evidence to either reminder.

The Rēzekne City Council studied Latgales Enerģija's 44-page draft: Ms. Abramova, Deputy Chair of the City Council, first wrote to the Mayor on 27 January 2006 suggesting that the draft Guidelines received from Latgales Enerģija should undergo wider consultation;¹³⁴² the Mayor's answer to this formal communication (if any) is not in evidence. Then on 19 May 2006 the Chairman of Rēzekne City Task Force for the Supervision of Heat Energy Affairs Mr. Zeile wrote to the Mayor stating *inter alia* that whereas "in principle" the guidelines proposed by Latgales Enerģija "are correct

¹³³⁹ C-44.

¹³⁴⁰ R-25 [page 1].

¹³⁴¹ C-91; C-96.

¹³⁴² R-25 [page 1].

(...), they must be supported by figures and justified”.¹³⁴³ In this communication Mr. Zeile set out five proposals, including the need for a feasibility study on the heat supply options for the City, and he concluded that it would be necessary to develop a short-term and a long-term concept of heat supply for the City. Apart from the comment that Latgales Enerģija’s proposal must be supported by figures, the Chairman of the Task Force expressed no criticism as to Latgales Enerģija’s draft Guidelines in its communication to the Mayor. There is no evidence that Mr. Zeile’s comments to the Mayor were in any way relayed to Latgales Enerģija or that Latgales Enerģija was contacted by the Rēzekne City Council in May 2006 or afterwards, before November 2006.

871. Clause 1.2 of the February 2006 Agreement contemplated the approval by the Municipality of the heat supply development plan of the City by 28 February 2006. It is common ground that no plan was discussed and approved by 28 February 2006.
872. There is no evidence on the record that the Rēzekne City Council promptly informed Latgales Enerģija that the draft Guidelines submitted by Latgales Enerģija in January 2006 were not a sufficient basis in order for work to start on the part of the Municipality. The Mayor was not called by the Respondent to give evidence as a witness; neither were Ms. Adamova or Mr. Zeile for that matter.
873. The Council did not contact Latgales Enerģija with respect to the heat supply development plan for the City until after Latgales Enerģija had written to the Council on 19 October 2006.¹³⁴⁴ In this letter Latgales Enerģija relied on Clause 5 of the February 2006 Agreement (quoted in paragraph 174 above footnote 164) and indicated that, unless the heat supply development plan for the City was adopted within two months, Latgales Enerģija would deduct the whole amount corresponding to the reduction on the tariffs that it had granted pursuant to the February 2006 Agreement from the rent owed to Rēzeknes Siltumtīkli. This letter followed, and was probably prompted by, the Regulator’s decision of 13 October 2006 by which the Regulator had refused to accept the new tariff proposed by Latgales Enerģija since

¹³⁴³ R-25 [pages 2-3].

¹³⁴⁴ C-96; the 10 May 2006 reminder was not answered.

one of the reasons for that decision was, in substance, that there was no heat supply development plan in place in the City of Rēzekne.¹³⁴⁵

874. The Rēzekne City Council started to criticise Latgales Enerģija's conduct of early 2006 with respect to the heat supply development plan almost two years after receiving the draft Guidelines in January 2006. Thus, in a letter of 15 November 2007 to the Ministry for Regional Development and Local Government Affairs the Council stated that it had no document to approve by 28 February 2006¹³⁴⁶ and that Latgales Enerģija sent its first drafts to the Council only on 15 November 2006.¹³⁴⁷ However, the Council's explanations to the Ministry were factually inaccurate in that they failed to mention that the Council had received Latgales Enerģija's first draft Guidelines on 20 January 2006.

The same inaccuracy is contained in Rēzekne City Council's letter to Latgales Enerģija dated 10 December 2007.¹³⁴⁸

875. The Tribunal finds that by 20 January 2006 the City Council had received draft Guidelines by Latgales Enerģija on which it was possible to work, as confirmed both by Ms. Adamova and Mr. Zeile to the Mayor of Rēzekne, which conclusion is further supported by the fact that the Rēzekne City Council and Latgales Enerģija agreed on 10 February 2006 (Clause 1.2 of the February 2006 Agreement) that the heat supply development plan for the City would be approved by the Council by 28 February 2006.
876. As the heat supply development plan for the City was not approved by 28 February 2006, Latgales Enerģija did not immediately complain to the Municipality.
877. On 10 May 2006 Latgales Enerģija wrote to the Rēzekne City Council seeking comments on its 20 January 2006 draft Guidelines. No answer by the Council is in evidence. On 19 May 2006 Mr. Zeile wrote to the Mayor about Latgales Enerģija's draft Guidelines and gave his own proposals. No answer by the Mayor is in evidence. Then the first communication in which Latgales Enerģija complained of a breach of

¹³⁴⁵ C-19, see also paragraph 184 above and paragraph 901 below.

¹³⁴⁶ R-28 [page 4].

¹³⁴⁷ R-28 [page 2].

¹³⁴⁸ R-29 [page 18].

the February 2006 Agreement by the Municipality is dated 19 October 2006,¹³⁴⁹ followed by further letters.¹³⁵⁰

878. On 3 November 2006 the Mayor requested Latgales Enerģija to provide the Council with “the heat supply development plan for the 2006-2009 period”; the letter specifically mentioned important points which had to be specified in such plan, but omitted any reference to the draft Guidelines received in January 2006.¹³⁵¹
879. On 15 November 2006 Latgales Enerģija sent the Council two drafts: a one-page draft for the period 2006-2009¹³⁵² and a 22-page draft for the period 2006-2014.¹³⁵³
880. On 29 December 2006 the Rēzekne City Council criticised the drafts received from Latgales Enerģija in a one-page letter setting out eight comments.¹³⁵⁴ The letter mentioned the existence of a working group that had met to review Latgales Enerģija’s drafts of 15 November 2006.
881. In 2007 the Rēzekne City Council decided to constitute the Working Group and the implementation of that decision took five months: announced on 29 December 2006,¹³⁵⁵ then again on 19 February 2007,¹³⁵⁶ the Working Group was in fact constituted only on 11 May 2007¹³⁵⁷ despite the fact that its president and a significant number of other members were members of the City Council (see paragraph 213 above).
882. On 30 May 2007 the Regulator requested Latgales Enerģija to provide “information regarding the approved Rēzekne City heat supply development plan” by 8 June 2007.¹³⁵⁸ The Regulator, which had sent its previous enquiry to the Rēzekne City

¹³⁴⁹ C-96.

¹³⁵⁰ C-121.

¹³⁵¹ C-97.

¹³⁵² C-99.

¹³⁵³ R-31.2.

¹³⁵⁴ C-106; see paragraph 190 above.

¹³⁵⁵ C-106.

¹³⁵⁶ C-114.

¹³⁵⁷ R-30.1.

¹³⁵⁸ C-122.

Council in 2005,¹³⁵⁹ did not explain the reasons for which it now addressed its request to Latgales Enerģija. On 6 June 2007 Latgales Enerģija replied asking the Regulator to turn to the Municipality in accordance with the provisions of the Municipality Act and the Energy Act.¹³⁶⁰

883. The first meeting of the Working Group took place on 14 May 2007.¹³⁶¹ After the Working Group was constituted, it met at regular intervals from May to September 2007; Mr. Ivars Pauris was called in as an expert at the end of July 2007. The heat supply development plan for the City was finalised in less than five months.
884. In this period, the Rēzekne City Council had repeatedly to request information from Latgales Enerģija. The discussion between the parties was complicated by the dispute relating to whose primary responsibility it was to produce a heat supply development plan for the City. In addition, Latgales Enerģija complained that its repair and investment proposals had not been answered by Rēzeknes Siltumtīkli.
885. Aside from these aspects, the finalisation of the heat supply development plan for the City was delayed to an extent also by Latgales Enerģija's apparent reluctance to provide the Working Group with all the information required, as shown by the repeated requests which the Rēzekne City Council had to send to Latgales Enerģija.¹³⁶² However, the Respondent has not provided concrete evidence in these proceedings as to the delay caused by Latgales Enerģija.

¹³⁵⁹ C-69, see paragraph 150 above.

¹³⁶⁰ C-123.

¹³⁶¹ R-30.1.

¹³⁶² See C-124 of 12 June 2007 [mentioning prior repeated requests without any precise indication].

C-128 [pages 7 ff.] of 9 July 2007, to which a 19-page document was attached which is not in evidence.

This letter complains in strong terms that Latgales Enerģija is reluctant to provide information and refers to the minutes of the Working Group in general terms. The Working Group concluded in fact on 31 July 2007 at a meeting not attended by Latgales Enerģija that the information requested from the operator had not been provided (R-30 [page 29]), a point disputed by Latgales Enerģija's representative at the 8 August 2007 meeting (R-30 [page 32]).

C-128 [page 15] of 19 July 2007, requesting Latgales Enerģija to provide the missing information by 24 July 2007.

C-128 [page 15] mentions the following:

- (i) the planned investments in developing the city's heat supply system infrastructure (heating pipelines, boiler houses, scope of reconstruction, energy efficiency measures), updated information as of July 2007;

886. The Tribunal's Conclusion and Finding. The better part of the year 2006 and almost half of 2007 were characterised by the Rēzekne City Council's inaction and delay with respect to the establishment of the heat supply development plan for the City. As from 13 October 2006, when the Regulator refused to approve a tariff proposed by Latgales Enerģija relying *inter alia* on the absence of an approved heat supply development plan for the City, it became clear that the Municipality's delay would in fact prevent the Regulator from accepting any new tariff proposed by Latgales Enerģija until such a plan had been approved.

The Tribunal does not accept the Respondent's contention that Latgales Enerģija could have relied on "more general development documents and relied on its own business scenario" since the Regulator's decision did not mention that Latgales Enerģija had failed to do so.

Considering the position adopted by the Regulator, it must have been clear to the Municipality that, confronted with ever rising prices of natural gas, Latgales Enerģija's position would become ever more difficult. Yet the Municipality's inaction continued and further significant delay accrued. Any delay as may have been caused by Latgales Enerģija's failure promptly to provide the Working Group with all the information required is insignificant by comparison to the delay caused by Rēzekne City Council.

-
- (ii) the time schedule relating to the planned investments and repair and overhaul of the heat supply system;
 - (iii) the planned sources of financing for the necessary investments (own funds, credit); and
 - (iv) information as to how the planned investment will affect energy efficiency measures, thermal energy production and supply tariff.

C-128 [page 31] of 31 July 2007 requesting Latgales Enerģija to provide information still outstanding.

C-128 [page 31] requests the following:

- (i) updated capacities of boiler houses;
- (ii) heat loads: by district, in winter and summer;
- (iii) the potential for developing heat loads;
- (iv) suggestions for the centralised heat supply zone (CHS), requirements for consumers in such zone;
- (v) the load on networks (how many MWh/km? should such networks be retained?); and
- (vi) how suited the existing diameters of the existing piping to consumer load were.

Latgales Enerģija was also asked to describe the self-cost of thermal energy generation and provide information as to current tariffs and actual costs as well as measures to reduce self-costs.

The Respondent's complaint that Latgales Enerģija belatedly contacted the Rēzekne City Council in May 2006 after sending its proposal in January 2006 is devoid of any foundation; upon receipt of such proposal, it was a matter for the Council to react and contact Latgales Enerģija, which the Council failed to do.

887. The Tribunal finds that the Council's conduct, in the circumstances recalled above, appears to be founded on prejudice or preference rather than on reason or fact, *i.e.* it was arbitrary and falls short of the duties further outlined in paragraphs 841 ff. above with respect to Article 3(1) of the BIT.

(iii) *The Claim Based on the Municipality's Refusal to Consent to Investments into the Heating System*

888. The Claimant claims that the Municipality breached its expectations that it would comply with requests to provide consent for the making of investments into the heating system and that Latgales Enerģija could modernise and improve the system; that the Municipality's refusal to provide consent to investments (including as to cogeneration) was an act of harassment, and that Latgales Enerģija was thereby unable to invest the full amount of EUR 1.5 million into the heating system in the first three years of the lease. The Respondent opposed this claim in contemporaneous correspondence, denying that the investments to be made by Latgales Enerģija were sufficient.

The Tribunal's finding is set out in paragraph 898 below.

889. This complaint includes two points: (i) the Municipality's refusal to consent to investments to be made by Latgales Enerģija to the Assets, and (ii) the Claimant's failure to comply with the minimum investment required in the first three-year period of the lease in accordance with Clause 7.1.1 of the Long-Term Agreement (see paragraph 92 above).
890. The Claimant has filed three documents in support of this claim: Latgales Enerģija's letter to the Mayor of Rēzekne dated 6 March 2007,¹³⁶³ Latgales Enerģija's letter to Rēzeknes Siltumtīkli dated 18 April 2007¹³⁶⁴ and Latgales Enerģija's letter to

¹³⁶³ C-116.

¹³⁶⁴ C-118.

Rēzeknes Siltumtīkli dated 13 July 2007¹³⁶⁵ as well as Mr. Strioga's first Witness Statement.¹³⁶⁶

The first letter refers to repair or investment proposals allegedly made by Latgales Enerģija and it points out that the Rēzekne City Council's and Rēzeknes Siltumtīkli's failure to answer will result in the investment made by Latgales Enerģija to fall short of the minimum amount contractually agreed of EUR 1.5 million.

The second letter restates the content of the first letter without reference to the amount of EUR 1.5 million; in addition, it mentions Rēzeknes Siltumtīkli's failure to grant permission for the installation of cogeneration equipment as well as new boilers at Rīgas iela and Atbrīvošanas alejā 155a.

The third letter refers to four previous letters by Latgales Enerģija to Rēzeknes Siltumtīkli or the Rēzekne City Council that have allegedly remained unanswered; none of those letters is in evidence. One of such letters is said to have requested permission for the installation of the cogeneration facility and two 30 MW water boilers.

891. Almost one year later, on 15 May 2008 Rēzeknes Siltumtīkli wrote to the Rēzekne City Council and the Regulator pointing out that Latgales Enerģija had failed to invest the minimum amount of EUR 1.5 million in the first three years of operation in breach of Clause 7.1.1 of the Long-Term Agreement.¹³⁶⁷ Five days later the Rēzekne City Council made the same point, amongst other things, in a letter to Latgales Enerģija.¹³⁶⁸ In its answer dated 2 June 2008 Latgales Enerģija restated *inter alia* that Rēzeknes Siltumtīkli had withheld its consent to the building of the cogeneration station.¹³⁶⁹
892. The burden of proof is on the Claimant as to (i) Latgales Enerģija's alleged proposals for repairs to and investments into the heating system, (ii) the alleged refusal by Rēzeknes Siltumtīkli and the Rēzekne City Council to approve Latgales Enerģija's

¹³⁶⁵ C-129.

¹³⁶⁶ CWS-1 ¶¶ 14; 60-64.

¹³⁶⁷ C-231.

¹³⁶⁸ C-178.

¹³⁶⁹ C-179 [page 2].

proposals and (iii) the reason(s) for which Rēzeknes Siltumtīkli's and/or the Rēzekne City Council's approval was required. The Respondent has not answered this claim.

893. The Tribunal has already noted that Latgales Enerģija's proposals are not in evidence (see paragraph 209 above); Mr. Strioga's evidence fails to provide details as to the proposed investments, apart from cogeneration which is specifically mentioned.

894. Cogeneration has been dealt with in a patchy manner in the pleadings. One must first determine whether cogeneration was part of the Rēzekne Project or was simply a possible option. Clause 2.10 of the February 2005 Agreement (quoted in paragraph 103 above) provides that the Municipality will not get involved in the installation of cogeneration stations with third parties. Clause 7.1.1 of the Long-Term Agreement does mention cogeneration,¹³⁷⁰ but it does so by reference to the Gas Supply Agreement.

In its first comprehensive memorial of 6 December 2013 the Claimant contended that cogeneration had been an important part of the investment ever since the beginning¹³⁷¹ and it referred to the "cogeneration project",¹³⁷² but it also stated that cogeneration was simply a "possibility" according to the Gas Supply Agreement.¹³⁷³ In its Reply the Claimant then contended that "the Municipality's requirement for cogeneration was contractually recognised in the Long Term Agreement".¹³⁷⁴

895. The witness evidence and the scant documentary evidence on cogeneration does not justify the conclusion that the Municipality was under an obligation to Latgales Enerģija to adopt a cogeneration project.

¹³⁷⁰ Art. 7.1.1 of the Long-Term Agreement (C-4) reads as follows:

The Operator within three years as of the Agreement entering into force undertakes to invest into the Heat supply facilities either in the Assets or new assets in the amount not less than EUR 1,500,000 (one million and five hundred thousand Euros) in order to background obligations against AS „Latvijas Gaze” assumed by the Lessor concerning gasification and cogeneration according to an agreement no. 1580 dated 23 April 2004.

¹³⁷¹ Cl. Mem. ¶ 83.

¹³⁷² Cl. Mem. ¶ 85.

¹³⁷³ Cl. Mem. ¶ 20.

¹³⁷⁴ Cl. Rep. ¶ 116(5).

Mr. Strioga's evidence on cogeneration is to the effect that all permissions required were received.¹³⁷⁵ However, only Latvenergo's statement is in evidence, and it is dated 22 February 2006,¹³⁷⁶ Latgales Enerģija's proposal (if any) is not in evidence. The Tribunal further notes that Mr. Jautakis refers more generally to a "plan" in his first Witness Statement.¹³⁷⁷

Cogeneration was a much-discussed item within the Working Group for the preparation of the heat supply development plan for the City, and the final plan of 21 September 2007 expressly mentions cogeneration.¹³⁷⁸

The plan for the City was issued in the middle of the energy crisis at a time when the investor and the Municipality's differences had grown into a full-blown dispute. Whereas the Claimant complains of a lack of approval on the part of the Municipality of offers allegedly made, the Municipality in turn complained of a lack of information as to planned investments on the part of Latgales Enerģija.¹³⁷⁹

896. The Tribunal finds that the Claimant has failed to prove that the Municipality was under an obligation to Latgales Enerģija to realise a cogeneration project. It follows that until and unless a specific project had been agreed upon by the Municipality and Latgales Enerģija, Latgales Enerģija had no right to carry out a cogeneration project. In the circumstances that have been recalled, the Tribunal cannot conclude in the absence of sufficient documentary evidence that the Claimant's alleged offers were offers proper which called for a decision on the part of the Municipality, rather than "a plan", as stated by Mr. Jautakis in his evidence. Such offers, if final and sufficiently detailed, would have been contained in documents, especially insofar as investments were concerned.
897. The Tribunal further finds that the Claimant's reminders in Exhibits C-116, C-118 and C-129 are insufficient to prove Latgales Enerģija's alleged proposals as to repairs and investments.

¹³⁷⁵ Transcript, Day 2, 12/13-19.

¹³⁷⁶ C-87.

¹³⁷⁷ CWS-2 ¶ 79.

¹³⁷⁸ C-213 p. 22.

¹³⁷⁹ C-128 [page 15].

898. The Tribunal's Conclusion and Finding. The Tribunal finds that the Claimant has failed to prove its claim that Rēzeknes Siltumtīkli and/or the Rēzekne City Council dismissed or failed to answer Latgales Enerģija's proposals for repairs and investment, including as to cogeneration, and dismisses such claim.

As to the Claimant's claim that Rēzeknes Siltumtīkli and/or the Rēzekne City Council's alleged refusal caused Latgales Enerģija's failure to comply with the minimum investment required under Clause 7.1.1 of the Long-Term Agreement, such point is relevant only in the context of the revocation of the licences by the Regulator; the Tribunal will examine such point in that context (see paragraphs 1021 ff. below).

(iv) *The Claims Based on the Regulator's Repeated Refusals to Set a new Tariff*

899. The Regulator's decisions as to the tariff relevant for the purposes of this Award are as follows:

Date	Exh.	¶ in this Award	Summary	Court decisions			
				Date	Exh.	¶ in this Award	Summary
19.12.05	C-14 C-15 C-82	154	Decision No. 19 new tariff: LVL 27.60/29.02/MWh ¹³⁸⁰				
13.10.06	C-19 R-35	184	Decision No. 17 <i>denying</i> the application for a new tariff	No decision made on the challenge, see ¶ 186 above			
11.06.07	C-21	233	Decision No. 12 <i>denying</i> the application for a new tariff	15.04.09	C-192	392	Application to set aside <i>dismissed</i>
				24.09.09	R-1	395	Application for a fresh time limit to be set for a final appeal <i>denied</i>
09.11.07	C-27	239	Decision No. 28 new tariff: LVL 33.90 to LVL 42.40/MWh ¹³⁸¹				
07.12.07	C-28	240	Decision No. 35 <i>revoking</i> Decision No. 28 of 09.11.07	30.10.09	<i>Not in evidence</i>	243, 400	Application to set aside <i>dismissed</i>
				23.09.10	R-4	401	Appeal <i>dismissed</i>

900. The Claimant complains that its expectations were breached by the Respondent in that (i) the Regulator, having reversed its previous practice, refused to set new tariffs relying on the absence of a Development Plan, and that (ii) the Regulator revoked on 7 December 2007 the tariff approved on 9 November 2007 in non-transparent

¹³⁸⁰ The lower tariff is for residents, the other for other users.

¹³⁸¹ This is a uniform tariff for all users, the values indicated in this table are the lowest and the highest rate.

conditions and wrongly, as a result of the Municipality's interference; the 7 December 2007 decision was arbitrary and discriminatory; more generally, the Respondent breached the standard of fair and equitable treatment due to the Regulator's arbitrary and discriminatory refusal to calculate a new tariff where a new tariff was critical due to factors outside the operator's control, especially in light of the increase in the price of natural gas. The Respondent denies that the Municipality interfered with the Regulator and contends that the Regulator acted independently within the scope of its duties and prerogatives; in the period from 2005 to 2007 Latgales Enerģija applied four times for a new tariff and the Regulator issued a new tariff in 2005.

The Tribunal's findings are set out in paragraphs 903, 911, 918 and 922 below.

901. The Regulator's Decision of 13 October 2006. The Regulator's decision of 13 October 2006 refusing the tariff proposed by Latgales Enerģija rested on two grounds: (i) the rates proposed by Latgales Enerģija did not show changes in boiler house efficiency in line with investments and the plan of heating supply development approved by the Municipality and (ii) the proposed rates were not based on costs fully substantiated (*e.g.* the salaries to be paid by Latgales Enerģija) as required by Section 19 of the Public Utility Regulators Act.¹³⁸² The Claimant's complaints relate only to the first reason given by the Regulator; the Claimant has not contested the second reason on which the Regulator's decision is based.
902. The Tribunal finds that the Regulator's refusal to approve a new tariff was therefore stated to be due also to Latgales Enerģija's failure to substantiate its own costs. In such circumstances, the Regulator was entitled to refuse to approve the tariff proposed by Latgales Enerģija on that ground alone. The decision was based on principles of law, the most fundamental of which was the principle whereby the Regulator must ensure that the new rates proposed by an operator must be based on costs that have been duly substantiated. This is far from an outlandish concern as it is the Regulator's duty to protect end-users.
903. The Tribunal's Conclusion and Finding. The Tribunal finds that the Regulator's decision of 13 October 2006 cannot therefore be characterised as arbitrary or as

¹³⁸² CLA-49, see paragraph 38 above.

frustrating the investor's legitimate expectations since the investor was under a duty to provide the required information to the Regulator in accordance with Latvian law and failed to do so.

904. The Regulator's Decision of 11 June 2007. The Regulator's decision of 11 June 2007 refusing the tariff proposed by Latgales Enerģija is based on the following grounds: (i) Latgales Enerģija failed to provide an accurate calculation of the fuel costs in accordance with Clause 23(1) of the Methodology in two respects: *first*, the balance sheet of the predictable thermal energy consumption must be prepared in accordance with the heat supply development plan approved by the Municipality (Section 17 of the Methodology) and no such plan existed in the City of Rēzekne; such plan was necessary to determine expected changes in house boiler efficiency (the "Dhk" coefficient) and such coefficient had not been included in Latgales Enerģija's calculation; *secondly*, two further coefficients (the boiler house net efficiency index "hnetokm" and the index of expected changes of heating network "Dhst.") had not been included by Latgales Enerģija; and (ii) Latgales Enerģija failed to provide the Regulator both with the long-term development plan required by Clause 6.3 of the licences and the prospective one-year plan of operation to be provided every year under Clause 7.1 of the licences (see paragraphs 133 above). In an *obiter* the Regulator added that the development plan had not been approved "due to the applicant's fault".
905. As a consequence, the Regulator found that the rates submitted by Latgales Enerģija failed to comply with the requirements of Clauses 17, 23(1), 23(2), 23(3) and 23(6) of the Methodology (C-35) and Latgales Enerģija's proposal must therefore be dismissed *inter alia* under Sections 1, 9(1)(1) and (3), 9(2), 19(1) and (4) of the Public Utility Regulators Act.
906. The Regulator's decision was upheld on appeal by the Administrative District Court on 15 April 2009.¹³⁸³ On the issue of coefficients, the court noted that there was no dispute that three coefficients¹³⁸⁴ prescribed by the Methodology were not used by Latgales Enerģija due to the fact that "the city of Rēzekne [had] not developed and

¹³⁸³ C-192.

¹³⁸⁴ Dhk, hnetokm and Dhst.

approved [a] heating system development plan”,¹³⁸⁵ thereby accepting a point argued by Latgales Enerģija in its application to set aside,¹³⁸⁶ namely that all three coefficients depended on the existence of a development plan. However, the court went on to find that the three coefficients were prescribed by the Methodology; a failure to apply them in the calculation of the tariff meant that a tariff so calculated was inaccurate, and therefore unacceptable, since such tariff would give rise to undue costs for end-users.¹³⁸⁷ On Latgales Enerģija’s complaint that the Regulator’s reversal of its prior practice was unlawful, the court accepted that the Regulator had set a new tariff in 2005 without applying the three coefficients in dispute. However, Latgales Enerģija’s reliance on the 2005 tariff could be protected only provided that the situation in 2005 and in 2007 was the same. The court found that such was not the case, holding (i) that the Regulator had already rejected a tariff proposed by Latgales Enerģija in 2006 and (ii) “(...) that in 2005 the situation of heat supplies in Rēzekne was different and namely, in 2005 a different heat supply operator (the Applicant) has commenced their operations in the city and it was necessary to ensure the heat to the city. Without approval of the tariffs, there was a risk that the city is left without heat supply”.¹³⁸⁸

907. The Regulator’s 11 June 2007 decision raises two main issues, namely whether the fair and equitable treatment standard is breached by a decision which requires the operator to calculate a proposed new tariff by using coefficients which are not available due to no fault of the operator, and whether the Regulator was bound by its previous practice.
908. Not without hesitation, the Tribunal concludes that the Regulator’s decision is neither arbitrary nor discriminatory *per se* insofar as it puts end-user protection first and requires compliance with coefficients which would have been available if the heat supply development plan for the City had been approved by the Municipality.

The Regulator’s *dictum* stating that the non-existence of the plan was due to the operator’s fault is nevertheless unwarranted because it was not for the Regulator to

¹³⁸⁵ C-192 ¶ 23.7.

¹³⁸⁶ C-125.

¹³⁸⁷ C-192 ¶ 23.7.

¹³⁸⁸ C-192 p. 209, ¶ 9.

express an opinion on a dispute between the Rēzekne City Council and Latgales Enerģija; it is significant that the Administrative District Court did not repeat such statement in its decision.

909. Whether the reversal of the Regulator's 2005 practice was lawful is first and foremost a matter of Latvian law. It was examined by the Administrative District Court, which found that the situation in 2007 was not the same as in 2005. The Tribunal considers that the reason given by the court based on the distinction between the situation in 2007 and in 2005 recalled in paragraph 906 above is not compelling; yet the Tribunal is mindful of the fact that it is not for an investment tribunal to second guess the courts of the host State, although this Tribunal has reached this conclusion not without reluctance in the present case as it would seem to be almost self-evident that it was vital to ensure that heating could be provided to the City in 2007 as it was in 2005.
910. The Claimant has contended that it relied on the fact that the Regulator would not change its 2005 practice, *i.e.* that the Regulator would continue to consider and accept proposals for a new tariff, if need be, despite the absence of a heat supply development plan for the City. However, the Long-Term Agreement and the February 2005 Agreements were entered into by Latgales Enerģija in January and February 2005 respectively, and the Regulator's decision setting a new tariff was made in December 2005. There is no evidence of any specific representations or assurances by the Regulator to the Claimant or Latgales Enerģija that new tariffs could still be adopted despite the fact that there was no heat supply development plan in place for the City; the Claimant has not discharged its burden of proof in this respect.
911. The Tribunal's Conclusion and Finding. The Regulator's 11 June 2007 decision is ultimately based on the Regulator's duty to protect end-users and it cannot be said to amount to bad faith, wilful disregard of due process of law, to be founded on preference or prejudice rather than reason or fact, or not to bear any reasonable relationship to some rational policy or otherwise to be in breach of Article 3(1) of the BIT.
912. The Regulator's Decisions of 9 November and 7 December 2007. The Regulator's decision of 9 November 2007 set a new tariff upon Latgales Enerģija's proposal; in

the meantime the Municipality's heat supply development plan for the City had been adopted on 21 September 2007 (see paragraph 228 above).

On 7 December 2007 the Regulator revoked its 9 November 2007 decision on the grounds that: (i) that it had received a letter by Rēzeknes Enerģija indicating an amount of natural gas planned to be supplied by Latvijas Gāze that was different from the amount indicated by Latgales Enerģija in its application for a new tariff, (ii) that the tariff approved on 9 November 2007 was not calculated in accordance with the actual situation in accordance with Clause 22(1) of the Methodology and (iii) that Latgales Enerģija had "knowingly submitted (...) false information" and obtained a new tariff "by illegal means", as a consequence of which its conduct was "unlawful".

The 7 December 2007 decision did not set out the applicable tariff further to the revocation of the Regulator's 9 November 2007 decision.

913. On 23 September 2010 the Administrative Regional Court dismissed Latgales Enerģija's appeal against the decision of the Administrative Regional Court of 30 October 2009, upholding the Regulator's decision of 7 December 2007; the 23 September 2010 decision confirms that the reasons stated in the 30 September 2009 decision were sound as a matter of Latvian law.¹³⁸⁹ Only the 23 September 2010 decision is in evidence, but the 30 October 2009 decision is summarised therein; both decisions deal with the amount of natural gas that was properly to be taken into consideration for the purposes of the Methodology and the consequences which such amount would have on the price of gas sold by Latvijas Gāze, which are both highly technical matters.
914. Latgales Enerģija was not heard before the 7 December 2007 decision was made. This decision was not made purely on technical grounds since the Regulator found that Latgales Enerģija had deliberately submitted information known to be false, to the detriment of the public interest, and that its conduct was therefore unlawful.
915. The Tribunal finds that the fact that Latgales Enerģija was accused of such wrongdoing in the decision without being heard amounts to a procedural irregularity, all the more so in a case in which such accusation rested on information unilaterally

¹³⁸⁹ R-4.

provided by Rēzeknes Energija to the Regulator. However, the Tribunal considers that it is relevant that the Regulator's 7 December 2007 decision was subject to judicial review before two successive Latvian courts, which upheld the Regulator's decision, and as to which it is not suggested that there was any denial of justice. The Tribunal considers that the irregularity in the procedure of the Regulator should be weighed alongside the existence of an avenue of appeal and, not without reluctance, the Tribunal finds that such irregularity is not serious enough to give rise to a breach of due process amounting to a breach of Article 3(1) of the BIT.

916. The Tribunal further dismisses the Claimant's complaint that the Regulator's 7 December 2007 decision was arbitrary and/or discriminatory. The issue in dispute went to the question whether the rates proposed by Latgales Energija for a particular user group were based on an accurate calculation. The Regulator's decision involved the determination of technical issues under the Methodology as well as the quantity of natural gas that had to be purchased from Latvijas Gāze as it purported to correct a mistake in the 9 November 2007 decision due to the inaccurate quantity of natural gas taken into account by Latgales Energija.
917. The Tribunal considers that the Claimant has failed to show that the Regulator's 7 December 2007 decision was based on prejudice or preference rather than reason or fact.
918. The Tribunal's Conclusion and Finding. The Tribunal therefore dismisses the Claimant's complaints that the Regulator's decision of 7 December 2007 constitutes a breach of due process, that it is arbitrary and it was made in bad faith, in breach of Article 3(1) of the BIT.
919. The Regulator's Alleged Failures to Set a New Tariff Taking into Account the Increase in Electricity and Natural Gas Prices. The Tribunal must finally consider the Claimant's complaint that the Regulator breached the standard of fair and equitable treatment by refusing to set a new tariff in circumstances in which a new tariff was critical due to factors outside the operator's control, especially in light of the increase in natural gas and electricity prices.
920. The Regulator's 11 June 2007 decision was not arbitrary in itself, as the Tribunal has found in paragraph 911 above. However, as found in paragraph 886 above, the

Municipality bears responsibility for the fact that there was no heat supply development plan in place for the City when the Regulator made this decision.

921. When the Public Utility Commission authorised an increase in the price of natural gas on 28 March 2007 (see paragraph 231 above), the price of natural gas had increased by between 55% and 129% from the rate included in the December 2005 tariff calculations according to the Claimant. The Respondent has not specifically challenged these figures.

Owing to the absence of a heat supply development plan for the City, Latgales Enerģija was effectively deprived of its statutory right to propose a new tariff where the costs of the heat supply had increased by more than 5% for factors beyond its control (Clause 13 of the Methodology). This was actually so regardless of the tariff that Latgales Enerģija might propose to the Regulator. The situation was all the more unfair to the Claimant because Latgales Enerģija had in fact consented to decreasing the rates charged to end-users under the February 2006 Agreement in consideration *inter alia* for the Municipality's undertaking to have the heat supply development plan for the City approved by the end of February 2006 (see paragraphs 173, 177 and 180 above).

Having said this, the Tribunal has already found in paragraph 886 above that the Municipality's delayed approval of the heat supply development plan for the City prevented a review of the tariffs by the Regulator. Responsibility for such a state of affairs lies with the Municipality, not the Regulator.

922. The Tribunal's Conclusion and Finding. The Tribunal therefore dismisses this claim.

(v) *The Claims Based on the Municipality's and the Regulator's Conduct in Connection with the Energy Crisis*

923. There are multiple claims made by the Claimant in relation to the Municipality's and the Regulator's conduct in connection with the energy crisis of September/October 2007. The following table provides a synoptic view of the main events in chronological order.

[Page intentionally left blank in part]

LE = Latgales Enerģija/LG = Latvijas Gāze/RCC = Municipality/RE = Rēzeknes Enerģija/RS = Rēzeknes Siltumtīkli						
Date	Exh.	See ¶ above	Regulator's conduct -- Summary	RCC's conduct -- Summary	LE's conduct -- Summary	Conduct by others Summary
11.06.07	C-21	233	Decision No. 12 <i>denying</i> LE's application for a new tariff			
25.07.07	C-130	246			LE informs RS that it has not paid the full invoiced amount	
11.09.07	C-153, ¶¶ 12-13	237(i), 259			LE has difficulties in providing heating as from this day	LG stops supply of natural gas
13.09.07	C-134	251		Mayor's interview		
21.09.07	C-137 C-213	192, 228		Heating Supply Development Strategy approved by RCC		
	C-138 [page 3]	255, 303				RS obtains the attachment on LE's movable property and bank account
28.09.07	C-142	258		RCC's decision to establish RE		
02.10.07	C-206	260		RE incorporated by RCC		
03.10.07	R-20 [page 8]	261				Local Government Loan and Guarantee Control and Monitoring Council <i>supports</i> RCC's decision to apply for a loan from the Treasury in an amount of LVL 4 million to be paid for the increase in RE's capital
04.10.07	R-20 [page 9]	261		RCC's application to the Treasury for a loan of LVL 4 million for the increase in RE's share capital		
	C-22	262	Regulator's warning to LE (licences may be revoked)			
09.10.07	R-20 [page 1]	261		RCC's decision No. 393 It is decided to invest funds in the amount of LVL 4 million for the increase in RE's capital		
	C-24	264		RCC's decision No. 388 Declaration of an energy crisis		
	C-145 [pages 2-6]	268		Energy Crisis Committee First Meeting		
10.10.07	C-145 [page 1]	269		RCC directs LE to provide heating within 24 hours		
11.10.07	C-23	274	Regulator's decision No. 26 It is decided to take over LE's zone (appeals by LE <i>dismissed</i> on 30.03.10 and 24.11.11, R-3)			
12.10.07	C-25	275		RCC's decision No. 425 It is decided to appoint RE as the person in charge of providing thermal energy in the territory of Rēzekne		
13.10.07	C-147	276		Energy Crisis Committee Third Meeting		
17.10.07	C-150	282				Latgale Regional Court <i>revoking</i> the decision of 21.09.07 on attachment
25.10.07	C-26	286		October 2007 Agreement by the Claimant, LE, RCC, RS and RE		
26.10.07		290				RS challenges the decision of 17.10.07
09.11.07	C-27	239	Regulator's decision No. 28 <i>approving</i> a new tariff			
07.12.07	C-28	240	Regulator's decision No. 35 <i>revoking</i> the decision of 09.11.07 (appeals by LE <i>dismissed</i> On R-4)			
11.12.07	C-162	299	Regulator's objection to the assignment by LE to LE Remonts			

924. The Tribunal will examine the Claimant's claims in relation to the following circumstances: (i) the failure by the Municipality to pay the balance of Latvijas Gāze's invoices to Rēzeknes Siltumtīkli prior to mid-September 2007; (ii) the interview given by the Mayor of the City of Rēzekne on 13 September 2007; (iii) the steps taken by the Municipality to set up Rēzeknes Enerģija and obtain a loan from the Treasury in an amount of LVL 4 million from 28 September 2007 onwards; (iv) the attachment of Latgales Enerģija's assets obtained by Rēzeknes Siltumtīkli and the failure by the Rēzekne City Council and Rēzeknes Siltumtīkli to have the attachment lifted in accordance with the October 2007 Agreement; (v) the declaration of an energy crisis by the Rēzekne City Council on 9 October 2007; (vi) the Regulator's decision to take over Latgales Enerģija's zone on 11 October 2007; and (vii) the appointment of Rēzeknes Enerģija by the Rēzekne City Council as the person in charge of providing thermal energy on 12 October 2007.

a. The failure by the Municipality to pay the balance of Latvijas Gāze's invoices to Rēzeknes Siltumtīkli prior to mid-September 2007

925. The Claimant complains of a breach of its legitimate expectations that Latgales Enerģija would receive natural gas to be able to provide heating services and the Municipality would abide by the contractual arrangements in relation to the supply of such natural gas, and would in particular pay Latvijas Gāze. Relying on different legal theories the Respondent contends that only Latgales Enerģija had a duty to pay for the natural gas delivered.

The Tribunal's finding is set out in paragraph 937 below.

926. The Claimant rests its legitimate expectations on a combined reading of Clause 2.3 of the Long-Term Agreement¹³⁹⁰ and Clause 4 of the February 2005 Agreement.¹³⁹¹

927. The Respondent contends that Clause 4 of the February 2005 Agreement deals only with cases of delay in the completion of the infrastructure for the use of natural gas by Latvijas Gāze and does not avail the Claimant's case. It is the Respondent's case that

¹³⁹⁰ C-4, quoted in paragraph 80 above.

¹³⁹¹ C-8, quoted in paragraph 104 above, as amended by Clause 6 of Amendment No. 3 to the Gas Supply Agreement (C-81).

Latgales Enerģija undertook to pay for the gas for a number of reasons: first, because the Long-Term Agreement is to be characterised as the transfer of a business as a whole as a matter of Latvian law (*Betriebsübergang*); and, secondly, because Latgales Enerģija tacitly undertook such an obligation to pay.

928. The Claimant's argument is based on Clause 4 of the February 2005 Agreement. Each paragraph of Clause 4 contemplates a specific case. According to the first paragraph, the Municipality shall indemnify Latgales Enerģija of the losses incurred in case the completion of the natural gas infrastructure by Latvijas Gāze has been delayed due to the fault of the Municipality or a third party and Latgales Enerģija has therefore had to use heavy fuel oil rather than natural gas. According to the second paragraph, the Municipality shall pay Latvijas Gāze any losses and/or contractual penalties which Latvijas Gāze may claim from (*inter alios*) Latgales Enerģija based on the Municipality's obligations undertaken under the Gas Supply Agreement "on purchase of a specified amount of gas for the needs of the city of Rēzekne".
929. The Municipality had undertaken a minimum purchase obligation under Clauses 3.1 ff. of the Gas Supply Agreement,¹³⁹² the breach of which was sanctioned by a contractual penalty according to Clause 3.4 of the same agreement.
930. The Tribunal finds that the reference by Clause 4, second paragraph, of the 2005 February Agreement to the "purchase of a specified amount of gas" is to be read against the background of the take-or-pay obligations undertaken by the Municipality under the Gas Supply Agreement with Latvijas Gāze. It follows that the interpretation and construction of Clause 4 of the February 2005 Agreement advanced by the Claimant is inconsistent with a plain reading of the express terms of the provision under consideration.
931. Whether the second paragraph of Clause 4 of the February 2005 Agreement is capable of applying each year, or is related to the first year of operation in which a delay has occurred with respect to the date of completion of the natural gas infrastructure, as contended by the Respondent, is irrelevant for present purposes. The Tribunal finds that what is relevant is the absence of an express term in the February 2005

¹³⁹² C-40.

Agreement to the effect that Latgales Enerģija would have no duty to pay for the natural gas used on the basis that such duty was solely on the Municipality.

932. The Respondent argues that Latgales Enerģija was bound to pay for the gas on the basis that the Long-Term Agreement is to be characterised as a contract making provision for a transfer of business as a whole (*Betriebsübergang*).
933. The Tribunal finds that such argument is unsound because it is contradicted by the negotiations between the Parties and the express terms of the Long-Term Agreement. The Long-Term Agreement is stated to be a contract between a lessor (Rēzeknes Siltumtīkli) and an operator (Latgales Enerģija) relating to certain assets (as defined in Clause 1.1(a)) of the same agreement). Moreover, the Claimant's PowerPoint presentation of 25 November 2004 made an express distinction between a "lease of RS property" and "lease of RS itself ('lease of business')".¹³⁹³ The Long-Term Agreement was made as a lease of Rēzeknes Siltumtīkli's assets and the legal concept of a *Betriebsübergang* prayed in aid by the Respondent, which corresponds to a "lease of RS itself ('lease of business')", is therefore the concept which the parties eventually discarded, as proved by the express terms of the Long-Term Agreement.
934. The Respondent's final argument is based on an alleged tacit agreement by Latgales Enerģija. When the gas started to be supplied from 7 November 2005 onwards, no contract in writing was made between Rēzeknes Siltumtīkli and/or the Municipality on the one hand, and Latgales Enerģija on the other, despite the fact that Latgales Enerģija would start to use the natural gas. Even subsequently, when it became clear that Latvijas Gāze had no interest in having a direct contractual relationship with Latgales Enerģija, Rēzeknes Siltumtīkli and/or the Municipality and Latgales Enerģija did not enter into a contract in writing in relation to the natural gas used by Latgales Enerģija. It is common ground that Rēzeknes Siltumtīkli invoiced Latgales Enerģija on the basis of invoices received from Latvijas Gāze. Latgales Enerģija paid such invoices directly to Latvijas Gāze until May 2007 without raising any objections as to the tariff underlying Latvijas Gāze's invoices. These facts are described in

¹³⁹³ C-41 [page 4].

Ms. Rogozina's first Witness Statement¹³⁹⁴ on which the Respondent has itself relied;¹³⁹⁵ such facts are therefore common ground.

935. A contract relating to the natural gas used by Latgales Enerģija, not reduced to writing, has thereby come into being between Latgales Enerģija and Rēzeknes Siltumtīkli, to whose installations the natural gas was supplied by Latvijas Gāze. For the purposes of this Award, which is not concerned with the determination of the respective contractual rights and duties of Rēzeknes Siltumtīkli, the Rēzekne City Council and Latgales Enerģija, it is irrelevant whether Latgales Enerģija's duty to pay for the natural gas used ultimately arises under an amendment of the Long-Term Agreement, as found by the Latvian courts, or is the term of an independent contract not reduced to writing between Rēzeknes Siltumtīkli and Latgales Enerģija which arose out of a consistent, continuous and uncontested course of dealing.
936. The Tribunal finds that neither the Long-Term Agreement nor the February 2005 Agreement contains any terms determining which party is liable for the payment of natural gas as between the Municipality and Rēzeknes Siltumtīkli on the one hand, and Latgales Enerģija on the other. As these are the main contracts pursuant to which the investment was made, it follows that the Claimant could not, at the time of the investment, reasonably expect, based on such contracts, that the Municipality would pay for the natural gas supplied by Latvijas Gāze, considering in particular that (i) Latgales Enerģija would in fact use the gas to provide heating services and (ii) Latgales Enerģija would therefore have to be reasonably expected to pay for the gas used.
937. The Tribunal's Conclusion and Finding. The Municipality's failure to pay the balance outstanding for the natural gas supplied by Latvijas Gāze is not, therefore, a breach of Article 3(1) of the BIT in itself.

¹³⁹⁴ CWS-3 ¶¶ 31 ff.

¹³⁹⁵ Respondent's Closing Argument, Slide 15; see also Cl. Mem. ¶ 139; Cl. Rep. Tribunal ¶ 42.

b. The interview given by the Mayor of the City of Rēzekne on 13 September 2007 and the Municipality's alleged attempts to attract a new investor in the summer of 2007

938. The Claimant complains that the Municipality breached its expectation that the Council would not actively seek to replace Latgales Enerģija as the operator, and took steps in anticipation of, or with the deliberate intent to cause, Latgales Enerģija's removal. The Claimant further claims that the Municipality's attempt to attract a new operator in the summer of 2007 is a breach of Article 3(1) of the BIT.

The Tribunal's finding is set out in paragraphs 943 and 946 below.

939. On 13 September 2007 the Mayor of Rēzekne gave an interview to explain the situation two days after Latvijas Gāze had stopped supplying natural gas.¹³⁹⁶

940. The interview purported to explain the current difficulties and allay the fears of the population.¹³⁹⁷ However, in the process, Latgales Enerģija was vilified in the public eye; it was portrayed as a company that had failed to comply with its obligations whilst benefitting from a contract detrimental to the City's interests, and a company whose conduct had been improper in its attempted contacts with the Regulator.¹³⁹⁸

941. The Tribunal finds that the interview was misleading in content as it was imbalanced in tone, and the fact that the interview was given in difficult circumstances for the Municipality is no excuse. The overall tone of the interview raises an inference that the Mayor of Rēzekne took the view that Latgales Enerģija was part of the problem.

942. Moreover, the reference made by the Mayor to a new company ready to appear if need be may raise an inference that the replacement of Latgales Enerģija was already

¹³⁹⁶ C-134, quoted in paragraph 251 above.

¹³⁹⁷ "The City Council can easily pay the debt to Latvijas Gāze. The debt amount is small (...) Tomorrow (14 September), six companies that provide heating in Latvia will receive letters (...) and an offer to take up provision of heating in our city (...) much has been done to solve the problem, but it has not been publicly advertised. For three months, I have been negotiating with several companies persuading them that Rēzekne has a future (...) in case of necessity a new company, large, serious and reliable, would appear here".

¹³⁹⁸ "Everybody knows that the lease agreement with the company Latgales enerģija is disadvantageous for the City (...) Latgales Enerģija is thus trying to impose a pressure on the Regulator (...) as of the beginning of operations Latgales Enerģija did not pay a santims for depreciation (...) [i]n relation to taking over the debt of Rēzeknes siltumtīkli, Latgales enerģija did not take it over (...)".

part of the Municipality's agenda, a point which the Tribunal will discuss in paragraph 944 below.

943. The Tribunal's Conclusion and Finding. In his interview of 13 September 2007 the Mayor of Rēzekne publicly displayed an utter lack of even-handedness towards Latgales Enerģija. Nevertheless, the Tribunal finds that such event does not reach the threshold of a breach of Article 3(1) of the BIT.

944. As to the specific claim that the Municipality attempted to attract a new operator in the summer of 2007, the Tribunal finds that such a claim is not supported by any evidence and must be dismissed.

The burden of proof is on the Claimant. The interview, given in circumstances which were difficult also for the Mayor, is not sufficient evidence in itself. The primary purpose of the interview was to reassure the public. The statement that the Mayor had been in contact with a number of companies for some three months may have been used to this effect, and may or may not be accurate, and would therefore need to be confirmed by further and more compelling evidence. However, there are no further elements on the record warranting a finding that the Municipality in fact attempted to attract a new operator in the summer of 2007.

945. The same is true of the offers which, the Mayor indicated, would be sent to several companies on 14 September 2007; nothing in the record confirms such declaration.

946. The Tribunal's Conclusion and Finding. The Tribunal finds that the Claimant's claim that the Municipality attempted to attract new investors in the summer of 2007, and would send offers to several companies in September 2007 is unproven in point of fact.

c. The steps taken by the Municipality to set up Rēzeknes Enerģija and to obtain a loan from the Treasury in an amount of LVL 4 million (28 September/9 October 2007)

947. In addition to the complaint mentioned in paragraph 938 above, the Claimant claims that the Municipality attempted to regain control of the heating system by incorporating Rēzeknes Enerģija before declaring an energy crisis, which is a breach of good faith. The Respondent answered at the Hearing that as Latgales Enerģija had

indicated that it had paid for the gas less than had been invoiced, there was a risk that Latgales Enerģija could end up in bankruptcy. Therefore the Municipality had a duty to adopt an alternative plan as a precaution and, accordingly, it went on to establish Rēzeknes Enerģija.¹³⁹⁹

The Tribunal's finding is set out in paragraph 949 below.

948. On 28 September 2007 the Rēzekne City Council reportedly took the decision to establish Rēzeknes Enerģija;¹⁴⁰⁰ the Respondent did not challenge the information contained in this exhibit. On 2 October 2007 Rēzeknes Enerģija was incorporated.¹⁴⁰¹ The Rēzekne City Council applied to the Local Government Loan and Guarantee Control and Monitoring Council, seeking approval of its decision to apply to the Treasury for a loan of LVL 4 million in order that Rēzeknes Enerģija's capital could be increased; the Council granted the approval sought by the Municipality on 3 October 2007.¹⁴⁰² On 4 October 2007 the Rēzekne City Council applied to the Treasury¹⁴⁰³ which granted the loan on the following day.¹⁴⁰⁴ On 9 October 2007 the Rēzekne City Council decided to apply the loan to the capital increase of Rēzeknes Enerģija.¹⁴⁰⁵
949. The Tribunal's Conclusion and Finding. The Tribunal finds that the establishment of Rēzeknes Enerģija is not in itself a breach of Article 3(1) of the BIT, but the Claimant could succeed if it proved that such step was taken to pave the way for actions that contravene Article 3(1) of the BIT; this is a point which the Tribunal will examine in paragraphs 968 ff. below.

¹³⁹⁹ Transcript, Day 1, 118-119.

¹⁴⁰⁰ C-142, see paragraph 258 above.

¹⁴⁰¹ C-206.

¹⁴⁰² R-20 [page 8].

¹⁴⁰³ R-20 [page 9].

¹⁴⁰⁴ R-20 [page 10].

¹⁴⁰⁵ R-20 [page 1].

d. The attachment of Latgales Enerģija's assets obtained by Rēzeknes Siltumtīkli (21 September 2007) and the failure by the Rēzekne City Council to have the attachment lifted

950. The Claimant complains that the Respondent breached its expectations that the Municipality would not actively prevent Latgales Enerģija from operating its business and would comply with the undertaking to have the attachment lifted; that the attachment was an act of harassment on the part of Rēzeknes Siltumtīkli and later, in addition, by Rēzeknes Enerģija; that due process was denied as the attachments were intended to paralyse Latgales Enerģija's commercial activities; and, finally, that applying for the attachments and refusing to have them lifted was an act of bad faith, was arbitrary and discriminatory. The Respondent replies that the lawsuits brought by Rēzeknes Siltumtīkli and Rēzeknes Enerģija against Latgales Enerģija for (*inter alia*) unpaid natural gas were based on two commercial agreements entered into by two commercial companies which were not the arm of the Municipality; such lawsuits were the consequence of Latgales Enerģija's failure to pay the full amount due for the natural gas received and used.

The Tribunal's finding is set out in paragraph 952 below.

951. The Claimant has contended that Rēzeknes Siltumtīkli's claim was unfounded and that the bulk of the claim was represented by a dispute that had been simmering since 2006; the timing of Rēzeknes Siltumtīkli's action was calculated to disrupt Latgales Enerģija's operations. The Respondent answered at the Hearing that after Latgales Enerģija had indicated that it had paid for the gas less than had been invoiced, there was a risk of bankruptcy.¹⁴⁰⁶ Rēzeknes Siltumtīkli is a commercial company and not an arm of the Municipality which, as the sole shareholder, is entitled to act only in line with commercial principles, as opposed to political considerations.¹⁴⁰⁷

952. The Tribunal's Conclusion and Finding. The Tribunal finds that the fact that Rēzeknes Siltumtīkli applied for an attachment to secure its claims for payment against Latgales Enerģija arising under the Long-Term Agreement is not in itself a breach of Article 3(1) of the BIT; neither is, in itself, the fact that Rēzeknes Siltumtīkli applied for the attachment to be reinstated in breach of the undertaking

¹⁴⁰⁶ Transcript, Day 1, 118-119.

¹⁴⁰⁷ Respondent's Closing Argument, Slide 8.

contained in the October 2007 Agreement. However, the Tribunal will also have to determine whether these circumstances call for a different conclusion when considered as part of the wider context of the energy crisis (see paragraphs 964 ff. below).

e. The declaration of an energy crisis by the Rēzekne City Council on 9 October 2007

953. In addition to the first complaint mentioned in paragraph 938 above the Claimant claims that the energy crisis was of the Municipality's own making and it was therefore declared in bad faith; moreover, the Municipality refused to have the attachment lifted, which would have enabled Latgales Enerģija to provide heating to the City. Finally, the energy crisis was declared on 9 October 2007 before Latgales Enerģija had an opportunity to answer the Regulator's warning of 4 October 2007. The Claimant complains that the Municipality's actions in September and October 2007 were arbitrary and discriminatory, and the crisis was a tool used by the Municipality in an attempt to force Latgales Enerģija into relinquishing some or all of the heating system.

The Respondent takes the view that Latgales Enerģija caused the crisis by its own failure to pay for the natural gas used, and the Municipality had little choice but to act to protect the public interest in accordance with Latvian law.

The Tribunal's finding is set out in paragraphs 961 and 973 below.

954. The energy crisis was declared by decision No. 388 of the Rēzekne City Council on 9 October 2007, which established the Energy Crisis Committee, chaired by the Mayor.¹⁴⁰⁸ The decision is stated to be based on Sections 59(1), 62(1) and 70(1) of the Energy Act;¹⁴⁰⁹ it does not contain any findings of fact, but simply sets out the statutory requirement set out in Section 59(1) of the Energy Act. This provision states that an energy crisis is declared when the supply of energy or fuel to energy supply merchants or energy users is jeopardized or disturbed to such an extent that energy supply merchants cannot forecast and eliminate such a danger or disturbance in the ordinary course of business.

¹⁴⁰⁸ C-24.

¹⁴⁰⁹ CLA-48.

The investor alleges that Latgales Enerģija was not heard before the energy crisis was declared; decision No. 388 does not state otherwise; the Respondent has not rebutted the Claimant's allegation in this respect.

955. The first meeting of the Energy Crisis Committee took place on 9 October 2007 in the afternoon. The Mayor asked Latgales Enerģija's representative, Mr. Meļņikovs, whether Latgales Enerģija would be able to supply heating within 24 hours;¹⁴¹⁰ Latgales Enerģija answered that it needed to have the attachment lifted,¹⁴¹¹ whereupon the Mayor requested Latgales Enerģija to supply heating within 24 hours, or the Municipality would apply to the Regulator to have Latgales Enerģija's licences transferred to the Municipality. According to the minutes, Mr. Meļņikovs reiterated that the bank account must be unblocked.¹⁴¹²

During this meeting the Mayor announced that the Municipality was ready to provide heat supply through Rēzeknes Enerģija, the company that the City Council had just set up and endowed with a capital of LVL 4 million loaned from the Treasury a few days beforehand (see paragraphs 258 and 948 above; see also paragraph 968 below).

956. On 10 October 2007 the Mayor confirmed in writing the Municipality's ultimatum in order that Latgales Enerģija provide heating within 24 hours.¹⁴¹³
957. The Municipality's decision declaring an energy crisis was not challenged by Latgales Enerģija before the Latvian courts.
958. The Tribunal must first determine whether it was a reasonable course of action for the Municipality to declare an energy crisis.
959. The Claimant has confined itself to contending that the Municipality had requested the start of the heating season on 1 October 2007 in Rēzekne whereas the Municipality of Livani had started three days later, but there is no evidence that the

¹⁴¹⁰ C-145 [page 4].

¹⁴¹¹ Mr. Meļņikovs appears to refer to a "counter-claim" in C-145 [page 5]; however, that was the application for the discharge or the setting aside of the attachment, C-143, see also paragraph 304 below.

¹⁴¹² C-145 [page 6].

¹⁴¹³ C-145 [page 1].

decision to start the heating season in Rēzekne was arbitrary or otherwise taken in bad faith.

960. There is hardly any direct evidence as to the concrete effects of the interruption of heating services on the population. The period for which Latgales Enerģija's difficulties have lasted (*i.e.* from 11 September to 17 October 2007) is based on an admission made by Latgales Enerģija (see paragraph 259 footnote 289 above) which was not challenged by the Respondent, which confined itself to alleging "non-procurement by SIA 'Latgales enerģija' at all or in substantially insufficient service level of heat to kindergartens, schools and the largest area of the Rēzekne city (and so, affecting adversely a huge population)".¹⁴¹⁴ The decision declaring an energy crisis¹⁴¹⁵ provides no information in this respect; the Regulator's warning of 4 October 2007¹⁴¹⁶ refers to information as to insufficient heating provided by the administration, *i.e.* the local Board of Education.
961. The Tribunal's Conclusion and Finding. The Tribunal finds that the declaration of an energy crisis by the Municipality is not, in itself, an arbitrary decision, contrary to the Claimant's submissions. When it was declared on 9 October 2007, heating services had been insufficient as from 11 September 2007 and the Municipality's duty to act cannot therefore be reasonably doubted. The Claimant has failed to indicate in particular what other actions by the Municipality would have been more reasonable or appropriate under the circumstances.
962. The Tribunal must next determine whether the energy crisis was declared in good faith and whether the Municipality complied with Article 3(1) of the BIT in that difficult situation. To answer those questions the Tribunal must consider three specific points: (*i*) the ultimatum issued to Latgales Enerģija on 9/10 October 2007, (*ii*) the fact that Latgales Enerģija's bank accounts were attached further to Rēzeknes Siltumtīkli's proceedings brought against Latgales Enerģija and (*iii*) the sudden emergence of Rēzeknes Enerģija.

¹⁴¹⁴ Resp. Obj. J. & C-Mem. ¶ 3.25.

¹⁴¹⁵ C-24.

¹⁴¹⁶ C-22.

963. During the 9 October 2007 meeting of the Energy Crisis Committee Latgales Enerģija was summoned to provide heating within 24 hours. That was a measure that would hardly solve anything as Latgales Enerģija had stated during the meeting that it was unable to provide heating services unless its bank account could be freed and used again.

This calls for an examination of the attachment on Latgales Enerģija's bank account and the rise of Rēzeknes Enerģija.

964. The fact that Rēzeknes Siltumtīkli had obtained an attachment on Latgales Enerģija's bank account on 21 September 2007 needs to be carefully considered in the context of the Municipality's ultimatum of 9/10 October 2007. The question is whether the Municipality could in good faith request Latgales Enerģija to provide heating within 24 hours whilst it was aware of the fact that Latgales Enerģija's bank account had been attached further to the proceedings brought by the Municipality's wholly-owned Rēzeknes Siltumtīkli and Latgales Enerģija would be unable to provide heating unless it was able to use its bank account.

965. It should be recalled that the Tribunal has already concluded that the Municipality directed Rēzeknes Siltumtīkli to bring a suit against Latgales Enerģija in paragraph 830 above. The Tribunal considers that it follows that the Municipality's ultimatum was not issued in good faith on 9/10 October 2007.

The Tribunal further considers that the breach of good faith on the part of the Municipality is compounded by the fact that on 25 October 2007 the Municipality and Rēzeknes Siltumtīkli executed the October 2007 Agreement, which provided in its first clause that the attachment had to be lifted (or the decision lifting the attachment should not be challenged) as a matter of urgency.¹⁴¹⁷

966. The Tribunal finds that the Respondent's contention that the October 2007 Agreement did not give rise to enforceable obligations, but only to best-effort duties,¹⁴¹⁸ is without foundation as far as the duty to have the attachment lifted in accordance with

¹⁴¹⁷ C-26, Clause (a).

¹⁴¹⁸ Resp. Rej. ¶ 23.

Clause (a) is concerned. Such a contractual obligation was binding on the Municipality and Rēzeknes Siltumtīkli in the Tribunal's view.¹⁴¹⁹

967. The Tribunal considers that it is relevant that Rēzeknes Siltumtīkli acted in breach of the October 2007 Agreement almost immediately after 25 October 2007 by challenging the court decision that had discharged the attachment (see paragraph 290 above).

Such conduct is evidence of the Municipality's readiness to take steps capable of harming the investor's position in Rēzekne.

The Respondent's contention that no party brought any proceedings in the Latvian courts relating to the breach of the October 2007 Agreement is without merit.

968. Finally, the Tribunal must consider the sudden emergence of Rēzeknes Enerģija, the Municipality's newly-constituted and wholly-owned subsidiary (see paragraphs 258 and 948 above). The Municipality announced in the afternoon of 9 October 2007 that "[t]he Municipality has a mechanism to ensure heat supply – we are ready to provide heat supply with the intermediation of municipality SIA Rēzeknes Enerģija".¹⁴²⁰

969. The Respondent explains that resort to Rēzeknes Enerģija was simply a precaution (see paragraph 947 above) intended by the Municipality to offer Latgales Enerģija an opportunity to continue the business (paragraph 991 below) and a measure which was within the Municipality's discretion as a matter of Latvian law.

This is not, however, the more plausible explanation for the Municipality's conduct in the Tribunal's view. One must consider, on the one hand, that the Municipality had endowed Rēzeknes Enerģija with a capital of LVL 4 million a few days before it

¹⁴¹⁹ The October 2007 Agreement was made in a situation of crisis by all interested parties and it contemplated the course of action to be followed; the first series of actions was to be taken within a week of its date of execution ("Phase I") and having the lifting of the attachment was the first item contemplated by the October 2007 Agreement, Clause (a). Insofar as the Respondent contends that the October 2007 Agreement made provision for further steps in Phase III which possibly included amendments to be made to the Long-Term Agreement, that contention is accurate in itself, but it is not dispositive in the present case, as the parties expressly agreed that the lifting of the attachment was the first thing to be made; such duty was on Rēzeknes Siltumtīkli as the party having obtained the attachment and on the Municipality as Rēzeknes Siltumtīkli's sole shareholder, which was privy to the October 2007 Agreement.

¹⁴²⁰ C-145 [page 3].

declared the energy crisis, and, on the other hand, that the Municipality's conduct in relation to the attachment on Latgales Enerģija's bank account disclosed an intention towards the investor that was hostile. The decision to fund Rēzeknes Enerģija with a capital of LVL 4 million represented a "serious financial burden" according to the Respondent's own words.¹⁴²¹ The establishment of Rēzeknes Enerģija was not, therefore, simply a precaution; it was part of the Municipality's plan to have another company ready to take over Latgales Enerģija's position practically at the same time when the Regulator issued its warning to Latgales Enerģija that the licences might be revoked.

970. The Tribunal finally considers that the Respondent has failed to explain in these proceedings how a newly-established company devoid of any track record could be considered as the most appropriate solution to bring the energy crisis to an end; all employees of Rēzeknes Siltumtīkli had in fact been taken over by Latgales Enerģija in 2005 (see paragraph 112 above). The Respondent did not call any witnesses from the Municipality or Rēzeknes Enerģija to explain when the decision to incorporate Rēzeknes Enerģija was first considered and to explain the policy pursued by the Municipality before and during the energy crisis.

971. One aspect of the discussions that preceded the finalisation of the heat supply development plan for the City further confirms that the Rēzekne City Council had considered replacing Latgales Enerģija before the energy crisis was declared, when two representatives of the Council suggested "editorial changes" in order to ensure that Latgales Enerģija should be mentioned by name only once in the heat supply development plan for the City, and that any further reference should be made anonymously to the "operator" (see paragraphs 224 and 227 above).

This circumstance raises yet another inference that the Rēzekne City Council had already considered replacing Latgales Enerģija in or about early September 2007, and that such prospect was concrete enough to influence the wording of the draft heat supply development plan for the City as early as 11 September 2007.

¹⁴²¹ Respondent's Opening Argument, Slide 17.

972. When the declaration of an energy crisis was made on 9 October 2007 heating in some schools had not been provided by almost a week. The Tribunal finds that the fact that the Municipality declared an energy crisis without waiting until Latgales Enerģija had answered the Regulator's warning of 4 October 2007 is not *per se* a breach of Article 3(1) of the BIT.
973. The Tribunal's Conclusion and Finding. The Tribunal finds that the Municipality breached Article 3(1) of the BIT in October 2007, and especially after 25 October 2007, on the basis that the attachment of Latgales Enerģija's bank account, considered in the context of the energy crisis, and Rēzeknes Siltumtīkli's repudiation of its duty to have such attachment discharged (or not to challenge a decision lifting the attachment) are attributable to the Municipality; the ultimatum issued by the Municipality to Latgales Enerģija on 9/10 October 2007 was a measure inconsistent with good faith and the announcement that its newly-established, wholly-owned subsidiary Rēzeknes Enerģija was henceforth ready to provide heating services in the middle of the energy crisis appears to have been founded on prejudice or preference rather than on reason or fact, *i.e.* was arbitrary in a manner inconsistent with Article 3(1) of the BIT.

f. The Regulator's decision taking over Latgales Enerģija's zone (11 October 2007)

974. The Claimant complains that the Regulator's decision of 11 October 2007 to take over Latgales Enerģija's zone was based on circumstances created by the Municipality and the Regulator's previous unjustified decisions; that such a decision was an act of harassment against the investor; that such a decision was arbitrary and discriminatory and amounts to a denial of due process insofar as the Regulation did not wait until Latgales Enerģija had been able to answer the Regulator's warning of 4 October 2007. The Respondent takes the view that this decision was the consequence of Latgales Enerģija's inability to provide good-quality, uninterrupted heating services and that such a decision was in accordance with Latvian law.¹⁴²²

¹⁴²² The Respondent regards this as a "decision to suspend" the licences (Resp. Obj. J. & C-Mem. ¶ 3.21(2)). This is inaccurate; a decision to suspend the licence is based on Sect. 18(7) of the Energy Act whereas a decision to take over the territorial area of a service provider is based on Sect. 28 of the same Act; the Regulator's decision is stated to be based on the latter provision.

The Tribunal's finding is set out in paragraph 982 below.

975. On 11 October 2007 the Regulator decided to take over Latgales Enerģija's zone under Section 28(1)(3) of the Public Utility Regulators Act¹⁴²³.¹⁴²⁴ The decision indicated that the Ministry or the Municipality in charge would have to appoint a person responsible for the utility under consideration in accordance with Section 28(2) of the Public Utility Regulators Act. As stated in the decision, such appointment is temporary according to this provision. The Regulator's decision is based on the Rēzekne City Council's application of the same day informing the Regulator that Latgales Enerģija had been unable to provide heating to six schools and/or kindergartens upon the Council's request of the previous day and that the Regulator had therefore to decide whether to take over the zone; that decision called for the respective interests of the public and Latgales Enerģija to be weighed, and the scales came down in favour of the public interest.

¹⁴²³ Sect. 28 of the Public Utility Regulators Act reads as follows (CLA-49):

- (1) The Regulator shall take a decision on the necessity to take over the territorial area of the licence of a provider of public utilities:
 - 1) if the licence of the provider of public utilities is to be cancelled (revoked);
 - 2) if the term of validity of the licence of a provider of public utilities expires in six months and the provider of utilities does not wish to continue the provision of such public utilities for which a new licence is required; or
 - 3) if a provider of public utilities for some reason is unable to ensure continuous, safe and qualitative public utilities.
- (2) If the Regulator takes a decision to take over the territorial area of a licence of a provider of public utilities, the Regulator shall, within 10 working days, notify the responsible ministry of the relevant regulated sector or the relevant local government thereof. The responsible ministry of the relevant regulated sector or the local government in whose territory the provider of public utilities is located shall appoint temporarily a person responsible for the public utilities determined in the licence of the provider of public utilities in order to take the measures to encourage merchants to take over the provision of public utilities in the territorial area of the licence.
- (3) In order to ensure the realisation of the activities determined in this Section, the person responsible for the public utilities determined in the licence of a provider of public utilities shall inform the Regulator or the local government regarding the performance of his or her tasks and is entitled to choose the methods for tendering, competition or selection of applicants.

¹⁴²⁴ C-23.

976. Latgales Enerģija's applications to have that decision set aside were dismissed by the Latvian courts.¹⁴²⁵
977. The Tribunal finds that the Claimant's contention that the Regulator should have waited until it had received Latgales Enerģija's answer to the warning of 4 October 2007 may have some merit, but it is not dispositive. The Regulator's 4 October 2007 warning did not relate to the taking over of Latgales Enerģija's zone and the Claimant's argument is not, therefore, compelling in the Tribunal's view.
978. Latgales Enerģija was not heard before the 11 October 2007 decision was made, which is a procedural irregularity in the Tribunal's view.
979. The decision to take over a licensee's zone is a measure that has considerable effects on the operator as a matter of Latvian law. This is shown not only by the requirements which have to be met under Section 28(1) of the Public Utility Regulators Act, which relate to situations in which the public interest is affected, but also by the consequences which follow from such a decision, as the licensee is replaced by another provider on a temporary basis. Such temporary appointment is made according to Section 28(2) of the Public Utility Regulators Act "in order to take the measures to encourage merchants to take over the provision of public utilities in the territorial area of the licence".
980. The Tribunal finds that although the Regulator's decision amounts to a significant interference with the operator's position, it is relevant that two successive Latvian courts dealt with Latgales Enerģija's appeal or application for judicial review. The Tribunal therefore finds that the Regulator's 11 October 2007 decision does not amount to a breach of due process amounting to a violation of Article 3(1) of the BIT.
981. The Tribunal further finds that the Regulator's 11 October 2011 is neither arbitrary nor discriminatory and does not amount to a breach of good faith. It is relevant that Latgales Enerģija expressly admitted that the provision of heating was interrupted and/or that it was insufficient from 11 September to 14 October 2007, as the Tribunal

¹⁴²⁵ R-3, see paragraphs 402 ff. above.

has recalled.¹⁴²⁶ Such circumstances squarely fall within Section 28(1)(3) of the Public Utility Regulators Act.

982. The Tribunal's Conclusion and Finding. The Tribunal denies the Claimant's complaint that the Regulator's 11 October 2011 decision amounts to a breach of Article 3(1) of the BIT.

g. The Rēzekne City Council's decision to appoint Rēzeknes Enerģija as the person in charge of providing thermal energy (12 October 2007)

983. The Claimant complains that the appointment of Rēzeknes Enerģija was made in breach of good faith and due process, was arbitrary and discriminatory and was an act of harassment on the part of the Municipality. The Respondent replies that it was a reasonable decision to make under the circumstances, and one which was within the statutory discretion of the Municipality as a matter of Latvian law.

The Tribunal's finding is set out in paragraph 987 below.

984. On 12 October 2007 the Rēzekne City Council appointed Rēzeknes Enerģija as the person in charge of providing heating services in the City of Rēzekne.¹⁴²⁷ The appointment was temporary according to Section 28(2) of the Regulatory of Public Utilities Act.¹⁴²⁸
985. The appointment of Rēzeknes Enerģija must be considered in the context of the energy crisis declared by the Municipality taking into account the Municipality's conduct as a whole. The Tribunal has found, first, that the Municipality's conduct on 9 and 10 October 2007 was not in accordance with Article 3(1) of the BIT (see paragraph 973 above); secondly, that the announcement in the middle of the energy crisis that its newly-established Rēzeknes Enerģija was henceforth ready to take over the heating services was likewise not in accordance with Article 3(1) of the BIT (see paragraphs 973 above).

¹⁴²⁶ See paragraph 960 above.

¹⁴²⁷ C-25.

¹⁴²⁸ CLA-49, quoted in paragraph 975 footnote 1423 above.

986. The appointment of Rēzeknes Enerģija by the Municipality is the continuation and achievement of measures that were not in accordance with Article 3(1) of the BIT. It follows that such appointment is likewise not in accordance with Article 3(1) of the BIT.

987. The Tribunal's Conclusion and Finding. The Tribunal finds that the Municipality's appointment of Rēzeknes Enerģija is a breach of Article 3(1) of the BIT.

(vi) *The Claims Based on the Warning and the Revocation of the
Licences by the Regulator (4 October 2007/3 June 2008)*

988. The Claimant claims that the Regulator ought to have suspended the licences and granted Latgales Enerģija an opportunity to remedy any breaches of the licences as may have been suspected before issuing a warning; instead the Regulator issued a warning and then revoked the licences, which is a breach of due process. The Claimant asserts that the Regulator revoked the licences in bad faith as the revocation was based on events which did not amount to a breach of the licence conditions and had, in any event, been caused by the Municipality. Finally, the Claimant argues that the revocation of the licences was arbitrary and discriminatory. The Respondent replies that Latgales Enerģija was sanctioned for its failure to provide continuous and reliable heating services, and in accordance with the provisions of an investment regime which it had accepted; the Claimant has only itself to blame for its failure to carry out a proper due diligence with respect to the regulatory and commercial risks inherent in the investment it made.

The Tribunal's findings are set out in paragraphs 1000, 1004, 1024 and 1027 below.

989. On 4 October 2007 the Regulator sent Latgales Enerģija a warning stating that the licences might be revoked after 4 January 2008.¹⁴²⁹ The Regulator's warning

¹⁴²⁹ C-22. See also paragraphs 266 ff. above. The Regulator recalled that the licence holder had the following duties under the conditions of the licences:

- (i) *Clause 1*: to provide uninterrupted and good-quality public utility services (C-22 ¶1);
- (ii) *Clause 7.1*: by 31 December of each year, to submit a plan of activity for the following year in accordance with its long-term development plan, including data about the planned amount of production, transfer, distribution and sale of thermal energy and measures to improve quality and safety (C-22 ¶ 2);
- (iii) *Clause 7.2*: by 31 March of each year, to submit a report regarding the results of the previous year (C-22 ¶ 3);
- (iv) *Clause 6.3*: to prepare a long-term development plan (C-22 ¶ 4).

summoned Latgales Enerģija to provide explanations by 4 November 2007 on the following breaches:

- (i) Latgales Enerģija had failed to submit the plan of operations for 2006 and 2007 in accordance with Clause 7.1 of the licence conditions;
- (ii) Latgales Enerģija had failed to submit the results of 2005 and 2006 in accordance with Clause 7.2 of the licence conditions;
- (iii) the draft guidelines submitted to the Municipality on 19 December 2006 were found to be incomplete and had not been approved, as a consequence of which Latgales Enerģija had also failed to comply with Clause 6.3 of the licence conditions; and
- (iv) the Municipality and the Board of Education had stated that there was no heating in three school institutions and heating problems in six other institutions.

990. On 30 October 2007 Latgales Enerģija answered the Regulator's warning contending that the proceedings initiated with the warning should be brought to an end, vigorously denying that the first three points set out above amounted to a breach, but admitting in point of fact that it had experienced difficulties in providing uninterrupted heating services from 11 September to 17 October 2007.¹⁴³⁰ Such difficulties could, however, be explained by the attachment obtained by the Municipality and by Rēzeknes Siltumtīkli on its bank account which was a deliberate action.

991. The Regulator's warning was sent on 4 October 2007 in the middle of the energy crisis; Latgales Enerģija's answer was sent on 30 October 2007 after the supply of natural gas had been resumed on 17 October 2007. The October 2007 Agreement was made on 25 October 2007.

It is common ground that Latgales Enerģija in fact continued to provide heating services despite the Regulator's decision to take over Latgales Enerģija's zone on 11

¹⁴³⁰ C-153.

October 2007 and the appointment of Rēzeknes Enerģija as the person in charge of providing those services on the following day. At the Hearing the Respondent explained that Latgales Enerģija was given an “opportunity (...) to continue the business” as Rēzeknes Enerģija had been set up only to make sure that a solution would be available in case there had been further problems in the supply of heating services or Latgales Enerģija went bankrupt.¹⁴³¹ The Tribunal has already noted in paragraph 969 above that the Municipality’s alleged intention to give Latgales Enerģija an opportunity to continue with the business was in fact contradicted by the Municipality’s apparent readiness to take actions adversely affecting the investment in breach of good faith.

992. On 29 November 2007 Latgales Enerģija informed the Regulator that it might find itself in a situation in which providing heating services would be difficult or even impossible due to the proceedings brought against it by Rēzeknes Siltumtīkli which had resulted in an attachment of its bank account.¹⁴³²
993. On 4 December 2007 Latgales Enerģija assigned its claims for payment against end-users to LE Remonts (see paragraph 298 above). On 11 December 2007 the Regulator objected to such assignment and requested Latgales Enerģija to explain the situation, pointing out that several laws and regulations had been breached on the basis that the invoices issued by Latgales Enerģija in November 2007 did not indicate Latgales Enerģija’s bank account.¹⁴³³ A further complaint related to the failure by Latgales Enerģija to maintain accurate payment records. The Regulator pointed out that such violations of applicable laws and regulations amounted to a further breach of the licence conditions and could be a further ground upon which the licences could be revoked. Latgales Enerģija’s failure to provide its long-term development plan was pointed out again by the Regulator. Finally, the Regulator took the view that Latgales Enerģija had transferred profits to its parent company in breach of Clause 5 of the licences.

¹⁴³¹ Transcript, Day 1, 118-119; 119/3-8.

¹⁴³² C-158, see paragraph 293 above.

¹⁴³³ C-162.

994. On 19 December 2007 Latgales Enerģija denied being in breach of any laws and regulations in a detailed letter.¹⁴³⁴
995. On 20 May 2008 the Rēzekne City Council put Latgales Enerģija on notice, *inter alia*, that it had failed to invest the minimum amount of EUR 1.5 million in the first three years of operation;¹⁴³⁵ Rēzeknes Siltumtīkli had directed the Rēzekne City Council's and the Regulator's attention to such circumstance on 15 May 2007.¹⁴³⁶ Latgales Enerģija replied that the Council's letter was incomprehensible if account was taken of the fact that Rēzeknes Siltumtīkli had not yet consented to the construction of the building of a cogeneration station.¹⁴³⁷
996. On 3 June 2008 the Regulator revoked the licences as a matter of urgency.¹⁴³⁸ The decision recalled the Regulator's warning of 4 October 2007¹⁴³⁹ and was stated to be based on the reasons set out therein and a dismissal of the explanations provided by Latgales Enerģija on 30 October 2007, in particular that the difficulties in providing uninterrupted heating services had been caused by third parties.¹⁴⁴⁰
997. In addition, the Regulator rested its decision to revoke the licences on the following reasons:
- (i) Latgales Enerģija had continued to pay only part of the invoices for the gas used, which warranted the conclusion that Latgales Enerģija's performance fell short of its duty to provide good-quality and uninterrupted heating services;¹⁴⁴¹
 - (ii) Latgales Enerģija had sold heating services at non-authorised rates;
 - (iii) Latgales Enerģija's invoice to the end-users indicated a bank account of a third party, which was a breach of the terms of the contract with end-users and of

¹⁴³⁴ C-166.

¹⁴³⁵ C-178.

¹⁴³⁶ C-231, see also paragraph 891 above.

¹⁴³⁷ C-179 [page 2].

¹⁴³⁸ C-29.

¹⁴³⁹ C-22, see paragraph 989 above.

¹⁴⁴⁰ C-153.

¹⁴⁴¹ C-29 ¶¶ 10.1; 12.1.

the Regulations on the Supply and Use of Thermal Energy [*not in evidence*] and gave rise to multiple breaches of Latvian law; and

- (iv) Latgales Enerģija had failed to invest the minimum amount of EUR 1.5 million as stated in Rēzeknes Siltumtīkli's letter of 15 May 2008.¹⁴⁴²

It was therefore necessary to revoke the licences as a matter of urgency to protect the end-users' interest.

998. On 5 June 2008 Latgales Enerģija brought proceedings to have the Regulator's decision set aside; on 6 May 2010 Latgales Enerģija's application was finally dismissed.¹⁴⁴³
999. On the Claimant's *first complaint* based on *breach of due process*, the Tribunal notes, as a preliminary point, that the revocation of a licence is the most radical sanction contemplated by the Public Utility Regulators Act¹⁴⁴⁴ which makes a clear distinction between suspension (Section 18(7)) and revocation of a licence (Section 18(3)). Further to the 4 October 2007 warning the Regulator directly imposed the revocation of licences on 3 June 2008.¹⁴⁴⁵

¹⁴⁴² C-231, see paragraph 333 above.

¹⁴⁴³ R-2, see paragraphs 390 ff. above.

¹⁴⁴⁴ CLA-49.

¹⁴⁴⁵ Sect. 18 of the Public Utility Regulators Act (CLA-49) reads as follows:

- (1) A substantiated proposal to make amendments to the conditions of a licence issued or to cancel (revoke) a licence shall be submitted by a provider of public utilities to the Regulator in accordance with the procedure determined by the Cabinet.
- (2) The Regulator shall amend the conditions of a licence issued if:
 - 1) amendments to the regulatory enactments concerning the type of regulated public utilities have come into force;
 - 2) economically substantiated provision of public utilities cannot be ensured in another way in the territorial area of the licence; and
 - 3) a provider of public utilities has submitted a substantiated proposal.
- (3) The Regulator shall cancel (revoke) a licence issued to a provider of public utilities if the provider of public utilities:
 - 1) fails to comply with or violates the conditions of the licence issued to it;
 - 2) fails to comply with or violates the requirements for providing the public utilities determined by regulatory enactments;
 - 3) has been declared as being subject to liquidation;
 - 4) has submitted a substantiated proposal; or
 - 5) within 12 months from the day of issue of the licence has not commenced provision of public utilities (if the commencement

However, it is relevant, and indeed dispositive in the Tribunal's view that Latgales Enerģija's complaint was considered and dismissed by two successive Latvian courts.¹⁴⁴⁶

1000. The Tribunal's Conclusion and Finding. The Tribunal finds that insofar as the Regulator's decision to revoke the licences is based on reasons stated in the Regulator's warning, there was no breach of due process as Latgales Enerģija was put on notice of the Regulator's position on 4 October 2007.

1001. A further point must be addressed at this juncture since the Regulator rested its decision to revoke the licences on further grounds than those set out in the warning (see paragraphs 997 and 989 above) and the Claimant regards this too as a breach of due process. In the Tribunal's view, it is relevant, again, that the Regulator's decision was reviewed by the Latvian courts. In addition, the Tribunal notes the following.

-
- date for the provision of public utilities has not been determined in the licence).
- (4) The Regulator shall give a provider of public utilities a written warning notice regarding the amendments to the conditions of a licence at least 30 days in advance. In the case determined in Paragraph two, Clause 3 of this Section the Regulator shall determine the warning time period.
 - (5) The Regulator shall give a provider of public utilities a written warning notice regarding the cancellation (revocation) of a licence at least three months in advance. In the cases determined in Paragraph three, Clauses 3, 4 and 5 of this Section, as well as, when cancelling (revoking) the licence in accordance with the Administrative Procedure Law, the Regulator shall determine the warning time period.
 - (6) If a licence is cancelled (revoked), the State fee for the regulation of public utilities paid by the provider of public utilities in accordance with Section 30 of this Law shall not be reimbursed.
 - (7) The Regulator shall suspend the validity of a licence issued if there are justified suspicions regarding the fact that the provider of public utilities fails to comply with or violates the conditions of the licence issued to it or the requirements for provision of public utilities determined in regulatory enactments.
 - (8) The time period restrictions for the revocation of a lawful administrative act determined by the Administrative Procedure Law shall not be applied when making amendments to a licence or cancelling (revoking) a licence in accordance with this Law.
 - (9) The Regulator shall take a decision regarding the issue of a licence, cancellation (revocation) of a licence granted, refusal to grant a licence, regarding the amendments to the conditions of a licence or suspension or renewal of the validity of a licence within a month following the day of the receipt of the submission and all the documents determined in regulatory enactments or all the information necessary for taking the decision.

¹⁴⁴⁶ R-2, see paragraphs 390 ff. above.

1002. Basic requirements of transparency and fairness require in principle that the Regulator should set out the ground(s) on which it may ultimately revoke a licence in its warning in a comprehensive manner; this is all the more so where the Regulator decides not to suspend a licence and not to give the operator time to remedy a breach, but issues a warning that may directly result in the operator's licence being revoked. If further grounds of revocation are then added by the Regulator in informal correspondence, due process may be breached where the operator reasonably fails fully to appreciate the significance of such correspondence or is not given an opportunity to put its position before the Regulator as to such additional grounds for revocation.
1003. Having considered the detailed correspondence exchanged between the Regulator and/or the Municipality on the one hand, and Latgales Enerģija on the other, in the period between the warning and the revocation of the licences, the Tribunal must examine two questions, namely (i) whether the operator was adequately informed by the Regulator of any additional grounds capable of giving rise to the revocation of the licences and (ii) whether the operator was given an opportunity to put its case before the Regulator as to such additional grounds before the licences were revoked.
1004. The Tribunal's Conclusion and Finding. Subsequent to the Regulator's warning Latgales Enerģija put its case to the Regulator in a detailed manner.¹⁴⁴⁷ The Tribunal therefore finds that the Regulator's decision to revoke the licences was not made in breach of due process as Latgales Enerģija was given an opportunity to answer the Regulator's letters as well as the Municipality's criticism. In addition, Latgales Enerģija had an opportunity to put its case against the Regulator's decision before two successive Latvian courts.
1005. The Tribunal must now turn to the Claimant's *second complaint* that the Regulator's decision to revoke the licences was made in *breach of good faith*, which calls for an examination of the reasons given by the Regulator for the revocation of the licences.
1006. The *first reason* given by the Regulator in its decision revoking the licences, already set out in the Regulator's warning, is the breach by Latgales Enerģija of its duty to

¹⁴⁴⁷ C-162; C-166; C-174; C-175; C-231, C-178; C-179.

provide the Regulator with the plans contemplated by Clauses 7 and 6 of the licences. There is no doubt that the Regulator has a duty to revoke a licence where the operator is found to be in breach of the licence conditions (Section 18(3)(1) of the Public Utility Regulators Act¹⁴⁴⁸) and that the operator is bound to comply with the licence conditions and provide the Regulator with the information required by such conditions. The Regulator has also a duty to monitor compliance by the operator with the licence conditions (Section 16(5) of the same Act).¹⁴⁴⁹

1007. The licences were granted by the Regulator on 30 May 2005 and the information that Latgales Enerģija had to provide to the Regulator was in principle due by 31 December of each year (Clause 7.1 of the licences) and by the first quarter of the year (Clause 7.2 of the licences). Clause 6 of the licences does not set a time limit in relation to the operator's long-term development plan.

It is not in dispute that Latgales Enerģija failed to provide the Regulator with any of the plans required by the licence conditions in 2005 and 2006. However, the Regulator did not ask Latgales Enerģija to comply with the licence conditions, either in 2005 or in 2006. The year 2005 was significant also because on 19 December 2005 the Regulator set a new tariff further to Latgales Enerģija's application. Yet the Regulator did not mention Latgales Enerģija's failure to provide the plans contemplated by the licences until the 4 October 2007 warning.

1008. The Tribunal takes this to be an indication that the Regulator did not regard Latgales Enerģija's failure to provide the plans contemplated by the licences as a breach which would be sufficient *per se* to attract the revocation of the licences, but that such a failure was regarded as relevant only in the wider context of Latgales Enerģija's failure to provide uninterrupted heating services from 11 September to 17 October 2007.

1009. In any event, the Regulator's complaint, contained in the 4 October 2007 warning, that Latgales Enerģija failed to provide the operator's long-term development plan

¹⁴⁴⁸ CLA-49, quoted in paragraph 999 footnote 1445 above.

¹⁴⁴⁹ Sect. 16(5) of the Public Utility Regulators Act (CLA-49) reads as follows:

(5) The Regulator shall supervise the fulfilment of licence conditions and the conformity of public utilities with licence conditions.

under Clause 6 of the licences appears unreasonable if account is taken of the fact that the Municipality had issued its own development plan for the City only on 21 September 2007, with a delay which the Tribunal has found to be in breach of Article 3(1) of the BIT. Latgales Enerģija was entitled to be granted reasonable time after 21 September 2007 in order to provide the Regulator with its long-term development plan. Latgales Enerģija's failure to provide a long-term plan could not, therefore, reasonably be considered on 4 October 2007 to be a ground upon which the licences could be revoked.

1010. Latgales Enerģija's failure to provide the Regulator with the documents contemplated by the licence conditions is therefore insufficient, in the circumstances described above, to warrant the revocation of the licences.
1011. The *second reason* given by the Regulator in its decision revoking the licences, already set out in the Regulator's warning, is Latgales Enerģija's failure to provide uninterrupted heating services. The warning contains limited factual information as to the extent of the interruption in the heating services¹⁴⁵⁰ and so does the revocation decision.¹⁴⁵¹
1012. After the Regulator's warning of 4 October 2007 Latgales Enerģija had in fact provided heating services for seven months and a half without any interruption, from 17 October 2007 onwards, until the licences were revoked on 3 June 2008 as a matter of urgency.

The Tribunal concludes that the Regulator did not regard the interruption in the provision of heating services, which was the main potential ground for revocation set out in the warning, as a reason sufficient to revoke the licences; Latgales Enerģija would not otherwise have been allowed to continue to provide heating services for a period of seven months and a half.

It is therefore necessary to examine the further reasons, not set out in the Regulator's warning, on which the Regulator rested the decision to revoke the licences.

¹⁴⁵⁰ C-22 ¶ 6.

¹⁴⁵¹ C-29 ¶ 10.

1013. The *first reason* for the revocation not mentioned in the warning is that Latgales Enerģija had continued to pay and was still paying only part of the price for the natural gas used, which had resulted in an interruption of the heating services and which might be the cause of further interruptions in the future (see paragraph 997(i) above).
1014. The Tribunal finds that this was a ground on which the Regulator was reasonably entitled to revoke the licences.
1015. As found in paragraphs 935 and 936 above, the duty to pay for the natural gas delivered was on Latgales Enerģija. The energy crisis had been directly caused by Latgales Enerģija's failure to pay the full price for the natural gas received and used from June 2007 onwards.¹⁴⁵² Latgales Enerģija did not deny that it had failed to pay the full amount; it argued in its correspondence with the Regulator that the matter was pending in court and the arrangement in place for the supply of natural gas was illegal *inter alia* on the ground that Rēzeknes Enerģija had not been licenced to sell natural gas.¹⁴⁵³
1016. In June 2008 the Regulator was therefore justifiably insecure as to whether Latgales Enerģija would be able, ready and willing to pay the full price for the natural gas.
1017. The *second reason* relied upon by the Regulator that was not set out in the warning was that Latgales Enerģija had been selling heating services at non-authorised rates on the ground that the tariff approved by the Regulator on 11 November 2007 had been revoked on 7 December 2007 and the 9 November 2007 tariff was therefore inapplicable (see paragraph 997(ii) above).
1018. The Tribunal dismissed the Claimant's complaint that the Regulator's 7 December 2007 decision was made in breach of due process and was arbitrary and contrary to good faith in paragraphs 915 and 916 above. The Tribunal therefore finds that reliance by the Regulator on such decision cannot amount to a breach of Article 3(1) of the BIT.

¹⁴⁵² C-130.

¹⁴⁵³ C-179 p. 3.

1019. The *third reason* relied upon by the Regulator in its decision revoking the licences that was not mentioned in the warning was that Latgales Enerģija's invoices to the end-users indicated a bank account of a third party, which was a breach of applicable regulations in itself, and caused a number of further technical breaches of Latvian law (see paragraph 997(iii) above).
1020. The Tribunal finds that the Regulator's position based on an alleged technical breach of Latvian law is not consistent with *bona fide* reliance on a rational policy. Latgales Enerģija's assignment to LE Remonts was an attempt to overcome the effects of the attachment of its bank account which the Municipality and Rēzeknes Siltumtīkli had refused to have lifted, unreasonably and contrary to good faith as the Tribunal found in paragraphs 964, 967 and 973 above, in order to continue to provide heating services. The Regulator's position was tantamount to endorsing, if not indirectly supporting, the Municipality's and Rēzeknes Siltumtīkli's unreasonable conduct and could not therefore be a sound basis for a decision made in good faith and based on a rational policy.
1021. The *fourth reason* relied upon by the Regulator in its decision revoking the licences that was not mentioned in the warning was that Latgales Enerģija had failed to invest the minimum amount of EUR 1.5 million as stated in Rēzeknes Siltumtīkli's letter of 15 May 2008.¹⁴⁵⁴
1022. The Tribunal finds that the Regulator's decision falls short of the requirements of *bona fide* reliance on a rational policy since this was a purely contractual matter between Latgales Enerģija and Rēzeknes Siltumtīkli.¹⁴⁵⁵ In addition, the Regulator's decision does not indicate how such a failure would be relevant under the applicable law; nor does it indicate whether the Regulator made any findings of fact of its own and the basis for such findings of fact, as the decision simply quotes from a letter by Rēzeknes Siltumtīkli.
1023. To sum up, the Regulator was entitled to revoke the licences on 3 June 2008 on the basis of at least one sound reason, namely that Latgales Enerģija had failed to pay the full price for the natural gas used in the past twelve months. This is a separate and

¹⁴⁵⁴ C-231, see paragraph 333 above.

¹⁴⁵⁵ See Clause 7.1.1 of the Long-Term Agreement, C-4.

independent ground for revocation,¹⁴⁵⁶ therefore the Regulator's decision does not amount to a breach of Article 3(1) of the BIT.

Latgales Enerģija does not deny that it was still not paying the entire price charged for the natural gas in its letter to the Regulator of 2 June 2008. Such a failure had already been one of the main causes of the 9 October 2007 energy crisis. There was no reason for the Regulator to believe that such a failure could not trigger a new crisis again.

1024. The Tribunal's Conclusion and Finding. The Tribunal finds that Latgales Enerģija's failure to pay the full price of the natural gas received and used was a sufficient reason upon which the Regulator was entitled to revoke the licences without infringing the requirements of good faith. The revocation of the licences is not therefore a breach of Article 3(1) of the BIT in itself. The Claimant's claim must therefore be dismissed.
1025. The Claimant finally argues in a *third complaint* that the Regulator's decision to revoke the licences was *arbitrary and discriminatory*.
1026. The Tribunal dismisses this claim. The Regulator was entitled to revoke the licences, as found in paragraph 1023 above, on the basis that Latgales Enerģija's failure to pay the full price for the natural gas represented a risk likely to give rise to further problems and disruption in the following winter season. That reason was clear and sound; the Claimant's complaint of arbitrariness and discrimination is without merit.
1027. The Tribunal's Conclusion and Finding. The Claimant's complaint that the Regulator's decision revoking the licences was arbitrary and discriminatory is dismissed.

(vii) *The Claims Based on the Municipality's Conduct Subsequent to the Revocation of the Licences (From 3 July 2008 Onwards)*

1028. The Claimant complains that the Municipality's conduct subsequent to the Regulator's decision to revoke the licences is in breach of Article 3(1) of the BIT. The Tribunal will consider (i) the appointment of Mr. Locis by the Rēzekne City

¹⁴⁵⁶ See the approach of the NAFTA tribunal in *Azinian v. Mexico*, RLA-8 ¶ 104, in which the tribunal found that certain Mexican judgments having annulled a concession were not arbitrary on the basis that the cause of nullity could be rested on one ground.

Council as the person in charge of organising district heating, and the appointment by Mr. Locis of Rēzeknes Enerģija as the person temporarily in charge of the transmission, distribution and sale, and of Rēzeknes Siltumtīkli as the person temporarily in charge of the production of thermal energy, (ii) the Municipality's decision directing Latgales Enerģija to provide immediate access to the assets, (iii) the decision authorising the forcible recovery of the assets, and (iv) the forcible recovery of the buildings and the boilers.

a. The appointment of Mr. Locis by the Municipality as the person in charge of organising district heating (13 June 2008) and the appointment of Rēzeknes Siltumtīkli and Rēzeknes Enerģija as the temporary producer, respectively provider and seller of thermal energy (13 June 2008)

1029. The Claimant complains that the Municipality's attempts to appoint other individuals or entities it owned to provide heating services in place of Latgales Enerģija were acts of harassment and a breach of the Claimant's expectations that the Municipality would not seek to replace Latgales Enerģija and take over the heating system. The preconditions for the appointment of Rēzeknes Enerģija were not met and such decision was made in breach of due process and in bad faith. The Respondent has not commented in detail on the different measures taken by the Municipality subsequent to the revocation of the licences; however, emphasis was placed by the Respondent on the fact that the Municipality was under a duty ultimately to appoint an interim provider for the heating in Rēzekne.

The Tribunal's findings are set out in paragraphs 1034 and 1036 below.

1030. On 13 June 2008 the Rēzekne City Council appointed its deputy executive director, Mr. Ivars Locis, as the person in charge of organising the provision of heating in the city of Rēzekne.¹⁴⁵⁷ The decision indicated that such appointment was temporary, pending the appointment of a new provider.

1031. On the same day Mr. Locis, acting as the person in charge under the Council's Decision No. 270, made a decision (decision No. 1) as a matter of urgency and appointed (i) Rēzeknes Siltumtīkli as the person temporarily in charge of the

¹⁴⁵⁷ Decision No. 270, C-30.

production of thermal energy and (ii) Rēzeknes Enerģija as the person temporarily in charge of the transmission, distribution and sale of thermal energy.¹⁴⁵⁸ The decision stated that it would take effect forthwith and an application for judicial review would not stay its enforceability.

1032. There is no evidence that those decisions were challenged by Latgales Enerģija (see paragraph 343 above).
1033. The Municipality's decision to appoint the person in charge of the provision of heating supply in the City of Rēzekne was stated to be based on Section 28(2) of the Public Utility Regulators Act¹⁴⁵⁹ and was the consequence of the revocation of the licences, which is not in itself a breach of Article 3(1) of the BIT.
1034. This decision does not, therefore, in itself constitute a violation of Article 3(1) of the BIT.
1035. The appointment of Rēzeknes Siltumtīkli and Rēzeknes Enerģija by Mr. Locis was not only, however, one of the consequences following from the revocation of the licences.¹⁴⁶⁰ It represents the extension and the further formalisation of the Municipality's initiative taken back in September 2007 to replace the investor by a local entity under the Municipality's control (see paragraphs 968-969 and 973 above). However, the Tribunal considers that since the decision to revoke the licences does not constitute a breach of Article 3(1) of the Treaty, the measures taken by the Municipality in June 2008 to implement that decision are not in themselves a breach of this provision.
1036. Tribunal's Conclusion and Finding. The Tribunal dismisses the Claimant's claim.

b. The decision ordering Latgales Enerģija to provide immediate access to the leased assets (14 July 2008)

1037. The Claimant complains that the Respondent breached its expectations that Latgales Enerģija would not be required to hand over the leased assets to the Municipality-owned companies. The Claimant complains that the Municipality's decision ordering

¹⁴⁵⁸ C-181.

¹⁴⁵⁹ CLA-49, see paragraph 975 footnote 1423 above.

¹⁴⁶⁰ C-181.

Latgales Enerģija to hand over the assets represented an act of harassment; and that that decision was also made in bad faith. Finally, the decision was made by circumventing the procedure involving the “responsible person” and the Municipality relied on its public law powers to that effect, in breach of due process, with a view to regaining control over the heating system. The Respondent has not commented in detail on the different measures taken by the Municipality subsequent to the revocation of the licences; however, emphasis was placed by the Respondent on the fact that the revocation of the licences and the appointment of interim providers for the heating services meant that Latgales Enerģija had to return the assets.

The Tribunal’s finding is set out in paragraph 1047 below.

1038. On 14 July 2008 the Rēzekne City Council ordered Latgales Enerģija immediately to provide access to the boiler houses to Rēzeknes Siltumtīkli and transfer any other materials required for the production of heating to Rēzeknes Siltumtīkli and Rēzeknes Enerģija.¹⁴⁶¹
1039. The Rēzekne City Council referred to Rēzeknes Siltumtīkli and Rēzeknes Enerģija as the “lawful providers of heating services” and recalled that Latgales Enerģija was no longer entitled to provide heating services further to the Regulator’s decision revoking the licences and no longer able to perform the Long-Term Agreement, for the termination of which Rēzeknes Siltumtīkli had sent a thirty-day termination notice on 28 June 2008. On 27 June 2008 Mr. Locis had requested Latgales Enerģija to transfer all leased assets on 7 July 2008 to Rēzeknes Siltumtīkli and Rēzeknes Enerģija, but Latgales Enerģija had refused to comply with that decision.

The Council concluded that, on the one hand, it followed from its duty to ensure public heating that it had to ensure access to the heating supply system if the interests of the residents of Rēzekne were jeopardised. On the other hand, the rights of use relating to public assets granted to Latgales Enerģija under the Long-Term Agreement were not absolute and could be limited in certain cases, provided that such limitation was justified by the public interest and complied with the principle of proportionality. The Court found that the existence of a direct threat to the public interest made it

¹⁴⁶¹ Decision No. 316, C-33, see also paragraph 349 above.

unnecessary to hear Latgales Enerģija on the basis that heating had been stopped on 3 June 2008, and both Latgales Enerģija's views and prior conduct indicated that Latgales Enerģija was opposed to the idea that Rēzeknes Siltumtīkli and Rēzeknes Enerģija should be allowed to run the heating system.

1040. The decision came into force forthwith, it was to be complied with as a matter of urgency and it expressly stated that any application for judicial review filed with the administrative courts would not stay its enforceability.
1041. It is common ground that Latgales Enerģija refused to comply with this decision of its free will.¹⁴⁶²
1042. Latgales Enerģija's application to have the 14 July 2008 decision set aside was dismissed by the Administrative District Court on 25 May 2010.¹⁴⁶³
1043. The Municipality decision of 14 July 2008 is not in itself contrary to Article 3(1) of the BIT; the Tribunal dismisses the Claimant's claim.
1044. The Claimant received no unqualified assurance from the Municipality that the Long-Term Agreement would last for a period of 30 years; the Long-Term Agreement contains in particular express terms under which it could be terminated by Rēzeknes Siltumtīkli. Similarly, the Claimant received no unqualified assurance from the Regulator that the licences would be in force for 20 years as they contained express conditions and were stated to be governed by certain Latvian laws and regulations; both the law and the express licence conditions contemplated events which might result in the licences ceasing to be effective before the expiry of the 20-year period. On this basis, the Claimant did not receive any unqualified assurance that the leased assets would not be taken over before such periods had expired. The Claimant's claim must therefore be dismissed insofar as it is rested on a breach of the Claimant's legitimate expectations.

¹⁴⁶² See also CWS-4 ¶ 30.

¹⁴⁶³ R-5, see paragraph 397 above.

1045. The 14 July 2008 decision appears to be one of the consequences ultimately following from the Regulator’s decision to revoke the licences. The Municipality did not act in bad faith in making that decision.
1046. The Claimant’s complaint that the Municipality sought to bypass the prerogative of the “person in charge” is without merit: by its decision of 27 June 2008 the “person in charge”¹⁴⁶⁴ had in fact ordered Latgales Enerģija to transfer all assets to Rēzeknes Siltumtīkli and Rēzeknes Enerģija, to which the Municipality’s decision presently under consideration refers. Latgales Enerģija expressly declined to comply with that decision as stated in its letter of 7 July 2008 on the basis that it had challenged both the Regulator’s decision to revoke the licences and the Regulator’s decision to take over its zone.¹⁴⁶⁵
1047. The Tribunal’s Conclusion and Finding. The Tribunal dismisses the Claimant’s claim.

c. The Municipality’s decision authorising the forcible recovery of the assets (15 September 2008)

1048. The Claimant complains that the Respondent breached its expectations that Latgales Enerģija would not be required to hand over the leased assets to the Municipality-owned companies and the Municipality’s decision authorising the enforcement of such decision amounted to harassment in breach of Article 3(1) of the BIT.

The Tribunal’s finding is set out in paragraph 1050 below.

1049. On 15 September 2008 the Rēzekne City Council authorised the enforcement of its decision of 14 July 2008 by forcible means.¹⁴⁶⁶ The Council rested its decision on Section 66 of the Administrative Procedure Act, stating that the use of force was necessary due to Latgales Enerģija’s refusal to comply with the 14 July 2008 decision of its free will, and considering that such was the only means to access the assets leased to Latgales Enerģija under the Long-Term Agreement; there were no other less intrusive means, and the resort to force was therefore proportionate.

¹⁴⁶⁴ C-31.

¹⁴⁶⁵ C-32.

¹⁴⁶⁶ C-186.

1050. The Tribunal's Conclusion and Finding. The Tribunal dismisses the Claimant's complaint for the same reasons that are stated in paragraphs 1043-1045 above, *mutatis mutandis*. The Municipality's decision authorising the enforcement of its 14 July 2008 decision by forcible means is not in itself tainted by any breach of Article 3(1) of the BIT, and it relates to a decision which is unobjectionable in itself.

d. The forcible recovery of the buildings and boilers (16 September 2008)

1051. The Claimant contends that the use of armed police to enforce the Council's decision was an excessive and inappropriate exercise of public powers, especially considering the fact that the decision to be enforced had been appealed; such excess amounts to a breach of the standard of full protection and security under Article 3(1) of the BIT.¹⁴⁶⁷

The Respondent counters that Latgales Enerģija had refused to comply with a decision ordering that the assets be transferred and the Respondent was therefore left with no choice but to enforce that decision; no actual force was used and no evidence was provided by the Claimant as to the alleged use of force.¹⁴⁶⁸

The Tribunal's finding is set out in paragraph 1058 below.

1052. Latgales Enerģija complained to the Administrative District Court that the forcible enforcement of the 14 July 2008 decision was unlawful; the complaint was dismissed.¹⁴⁶⁹

1053. The Claimant alleged that its personnel was forcibly evicted from Latgales Enerģija's premises¹⁴⁷⁰ and that "these executive decisions were enforced by armed local and state police and the Municipality (through its wholly-owned company), who, on 16 September 2008, forcibly entered Latgales Enerģija's premises, expelled its employees and appropriated all of Latgales Enerģija's assets used to operate the heating system".¹⁴⁷¹ Counsel for the Claimant in his closing statement simply

¹⁴⁶⁷ RfA ¶ 114.

¹⁴⁶⁸ Resp. Obj. J. & C-Mem. ¶ 3.25.

¹⁴⁶⁹ R-6, see paragraph 396 above.

¹⁴⁷⁰ RfA ¶ 119.

¹⁴⁷¹ Cl. Mem. ¶ 244.

recalled that Latgales Enerģija's employees were "forced off the premises, and you heard Ms. Uškāne speak to that".¹⁴⁷²

The Tribunal notes, first of all, that such allegation was not made in the proceedings challenging the legality of the enforcement of the Rēzekne City Council's decision No. 316 by forcible means.¹⁴⁷³

1054. Ms. Uškāne was able to give evidence at the Hearing only as to the events in the main administrative building and the customers' services centre, not the boilers.

The main administrative building was taken over by police early in the morning before the employees arrived for work; the locks were changed and the employees were not allowed into the building.¹⁴⁷⁴

The customers' service centre was taken over a few days later when the employees were working within and a representative of Rēzeknes Enerģija ordered them to leave the building immediately, or the police would evict them on the same day.¹⁴⁷⁵ The employees were able to liaise with management and decided to lock the building and leave before the police arrived.¹⁴⁷⁶

In her Witness Statement Ms. Uškāne further stated that the employees working at the customers' service centre were able to recover their belongings as well as documents from their office a few days later ("... they allowed us peacefully and in a calm way to take out our property and documents from the building").¹⁴⁷⁷

1055. Ms. Uškāne's Witness Statement mentions that the police officers carried guns ("...the police were already there, with guns, preventing us from going into the building...").¹⁴⁷⁸ Asked in cross-examination whether any guns were showing, Ms. Uškāne answered that she was told so, and then referred to what she saw a couple of

¹⁴⁷² Transcript, Day 4, 12/19-21.

¹⁴⁷³ R-6 ¶ 14, see also paragraph 396 above.

¹⁴⁷⁴ CWS-4 ¶ 35; confirmed at the Hearing, Transcript, Day 2, 88/1-8.

¹⁴⁷⁵ CWS-4 ¶ 37; confirmed at the Hearing, Transcript, Day 2, 88/1-8.

¹⁴⁷⁶ CWS-4 ¶ 37; confirmed at the Hearing, Transcript, Day 2, 88/1-8.

¹⁴⁷⁷ CWS-4 ¶ 37.

¹⁴⁷⁸ CWS-4 ¶ 35.

weeks later, when she drove by the customer service centre and saw a man standing before the entry and carrying a gun or a weapon akin to a gun.¹⁴⁷⁹

At the Hearing, however, Ms. Uškāne did not confirm that she had seen police officers carrying guns.¹⁴⁸⁰

There is no allegation in Ms. Uškāne's Witness Statement that any threats were made against her, or any other employee, by any police officer showing a gun or removing a gun from its duty holster. In cross-examination Ms. Uškāne confirmed that she was not threatened with a gun.¹⁴⁸¹

Ms. Uškāne added that that had been an unpleasant moment with the police¹⁴⁸² and that they filed a complaint with the prosecutor's office.¹⁴⁸³

1056. The Tribunal notes that the forcible recovery of buildings and boilers was made pursuant to two decisions of the Municipality, made on 14 July and 15 September 2008, which the Tribunal found to be unobjectionable in themselves (see paragraphs 1043 and 1050 above), after Latgales Enerģija declined to comply with the decision ordering that the assets should be returned to the Municipality.
1057. The Tribunal finds that the intervention by the Latvian police was peaceful. The Respondent has not challenged the Claimant's allegation that police officers were armed. No threats were made against any employee. Although it is understandable that such an experience may have alarmed, and perhaps frightened, law-abiding citizens not used to being confronted by police, the Tribunal finds that there is no evidence of an excessive exercise of public powers. On the evidence before the Tribunal, the forcible recovery of buildings and boilers remained entirely within the confines of reasonable law enforcement.

¹⁴⁷⁹ Transcript, Day 2, 93/25-94/20.

¹⁴⁸⁰ See Respondent's Closing Argument, Slide 22.

¹⁴⁸¹ Transcript, Day 2, 98/8-12.

¹⁴⁸² Transcript, Day 2, 98/17-18.

¹⁴⁸³ Transcript, Day 2, 98/24-99/4.

1058. The Tribunal's Conclusion and Finding. The forcible recovery of buildings and boilers does not, in itself, infringe the full protection and security standard of Article 3(1) of the BIT. The Tribunal dismisses the Claimant's claim.

1059. At this juncture the Tribunal will consider whether the Municipality's conduct in 2007 and 2008, considered as a whole including those individual measures which the Tribunal found unobjectionable, amounts to a breach of Article 3(1) of the BIT.

(viii) *The Cumulative Effects of the Respondent's Individual Actions*

1060. The Claimant claims that if the cumulative effect of the individual measures taken by the Latvian authorities and the Municipality-owned companies is considered, the Tribunal should make a finding of a creeping breach of Article 3(1) of the BIT. The Respondent's defence is based on the proposition that the Claimant decided to make the investment without any thorough due diligence and must therefore be taken to have assumed identifiable risks in relation to certain aspects of the investment.

1061. The enquiry advocated by the Claimant by definition includes acts and measures which, seen in isolation, are not a breach of Article 3(1) of the BIT.¹⁴⁸⁴

1062. In the present case, the first acts and measures considered by the Tribunal, following the chronology, were found to be inconsistent with the obligations under Article 3(1) of the BIT (in particular the delay by the Municipality to coordinate and approve a heat supply development plan for the City, see paragraphs 886 ff. above; the Municipality's failure to direct Rēzeknes Siltumtīkli to have the attachment on Latgales Enerģija's bank account lifted, see paragraph 973 above; the Municipality's ultimatum in order that Latgales Enerģija provide heating services within 24 hours, see paragraph 973 above and the establishment of a new wholly-owned subsidiary with the intention to replace Latgales Enerģija, see paragraph 987).

However, other measures were found by the Tribunal to be unobjectionable under Article 3(1) of the BIT as long as they were considered in isolation; the most important measure is the revocation of the licences (see paragraphs 1004 and 1024

¹⁴⁸⁴ *El Paso v. Argentina*, CLA-39 ¶¶ 515 ff.

above) and the decisions taken subsequently to implement the revocation and have the Assets returned to Rēzeknes Siltumtīkli.

1063. The Tribunal finds that the approach advocated by the Claimant is appropriate as a matter of law and that it is therefore appropriate to revisit the facts according to a more global approach.
1064. However, subject to the following paragraph, having considered the evidence as a whole, the Tribunal is disinclined to find a global breach of Article 3(1) of the BIT in the present case, as the Regulator's final decision to revoke the licences was based on a concern to protect the public interest and rested on at least one sound ground.
1065. The Claimant is nevertheless entitled to succeed on its claim that the Municipality's actions justifying the claims which the Tribunal granted in paragraphs 887, 973 and 987 above amount to arbitrary measures impairing the management, maintenance, use, enjoyment or disposal of its investment. In the above paragraphs, the Tribunal has found that the conduct of the Respondent was arbitrary in a manner inconsistent with Article 3(1) of the BIT. As to impairment of the management, maintenance, use, enjoyment or disposal of the Claimant's investment (as defined in paragraph 521 above) the conduct for which the Respondent is responsible is one of the principal causes that ultimately resulted in the Claimant being unable to recover loans granted to Latgales Enerģija and having to pay a guarantee in respect of Latgales Enerģija's unpaid debts to third parties. The Tribunal finds that such conduct and measures on the part of the Municipality amount to arbitrary measures impairing the use, enjoyment or disposal of the Claimant's investment in breach of Article 3(1), second paragraph, of the BIT.

(C) THE TRIBUNAL'S FINDING

1066. The Tribunal therefore concludes that the Respondent has breached Article 3(1) of the BIT based on the specific findings in paragraphs 887, 973, 987 and 1065 above.

(4) CLAIM FOR EXPROPRIATION UNDER ARTICLE 4(1) OF THE TREATY

1067. The Claimant complains that the Municipality of Rēzekne combined with the Regulator, Rēzeknes Siltumtīkli and Rēzeknes Enerģija to give rise to an energy crisis, for which the Regulator and the Municipality then sanctioned Latgales Enerģija

over a period of some twelve months, the ultimate sanction being the revocation of the licences followed by the forcible recovery of buildings and boilers and the termination of the Long-Term Agreement. These actions destroyed the value of the Claimant's investment. In addition, the Claimant complains of an outright expropriation on 16 September 2008 as the Respondent forcibly took over the leased infrastructure. The Respondent denies any breach of the BIT; it replies that the recovery of buildings and boilers of 16 September 2008 was the lawful enforcement required after Latgales Enerģija had declined to comply with the 14 July 2008 decision and surrender the assets.

The Tribunal's finding is set out in paragraph 1101 below.

1068. The Claimant's definition of its investment covers two main points:

- (i) the shares in Latgales Enerģija, whose value was rendered worthless by the Respondent's actions and omissions; and
- (ii) the loans and guarantees provided to Latgales Enerģija, which were not reimbursed, as well as the payment of Rēzeknes Siltumtīkli's debts and the transfer of know how.

1069. The Claimant contends that its investment in Rēzekne was expropriated by the Respondent in breach of Article 4(1) of the BIT without prompt, adequate and effective compensation; such expropriation was not in the public interest and was discriminatory.

1070. Article 4 of the BIT reads as follows:

Article 4
Expropriation and Compensation

1. Neither Contracting Party shall expropriate, nationalize or take similar measures (hereinafter referred to as "expropriation") against investments of investors of the other Contracting Party in its territory, unless:
 - a) such expropriation is in the public interest and legal procedure is applied;
 - b) such expropriation is carried out without discrimination;
 - c) prompt, adequate and effective compensation is given.

2. The compensation mentioned in point (c) of the paragraph (1) of this Article shall be equivalent to the market value of the expropriated investments immediately before the expropriation occurred or the impending expropriation became public knowledge and shall be paid without undue delay. The compensation shall include interest calculated on the LIBOR basis from the date of expropriation. The compensation shall be effectively realizable and freely transferable.
3. Investors, whose assets are being expropriated, have a right to prompt review by the appropriate judicial or administrative authorities of the expropriating Contracting Party to determine whether such expropriation, and any compensation therefor conforms to the principles of this Article and the laws of the expropriating Contracting Party.
4. Investors of one Contracting Party who suffer losses in respect of their investments in the territory of the other Contracting Party owing to war, a state of national emergency, insurrection, riot or other similar events, shall be accorded by the other Contracting Party, treatment no less favourable than that accorded to investors of any third State. Any resulting compensation shall be paid without undue delay and shall be freely transferable.

1071. The Tribunal has to determine whether the Respondent expropriated the Claimant's investment directly, on 16 September 2008, or indirectly, in breach of Article 4(1) of the BIT.

(A) THE APPLICABLE STANDARD OF TREATMENT

1072. A State may expropriate an investment directly under Article 4(1), by transfer of title ("outright taking"), or indirectly, by measures that fall short of a direct taking. This last point is made clear by the expression "or similar measures" in Article 4(1).

1073. The Tribunal considers that Article 4(1) offers protection in the case of so-called "creeping expropriation", where the host State achieves "the same result" as with an outright taking of property.¹⁴⁸⁵ As the *Generation Ukraine* tribunal observed, such form of expropriation takes place in a situation where "a series of acts attributable to the State *over a period of time* culminate in the expropriatory taking of such property".¹⁴⁸⁶

¹⁴⁸⁵ American Law Institute, *Restatement (Third) Foreign Relations of the United* (1987) as quoted in: C. McLachlan, L. Shore, M. Weiniger, *International Investment Arbitration: Substantive Principles*, Oxford 2007, CLA-8 ¶ 8.78.

¹⁴⁸⁶ *Generation Ukraine v. Ukraine*, CLA-30 ¶ 20.22 (original emphasis).

1074. Indirect expropriation requires a *certain degree of interference with the investment* on the part of the State. Commentators have used various formulae to express this requirement: in order to amount to expropriation, such interference has to be unreasonable, to cause the investment to be neutralized or useless and to cause the investor to be practically deprived, in whole or in significant part, of the use and enjoyment of its investment.¹⁴⁸⁷
1075. The arbitral decisions involving indirect expropriation have similarly focussed on the degree of State interference.¹⁴⁸⁸ The test adopted by the *Tecmed* tribunal was whether the investor “was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto (...) had ceased to exist (...) the measures adopted by a State, whether regulatory or not, are an indirect de fact expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that “... any form of exploitation thereof” has disappeared”.¹⁴⁸⁹ The *Tecmed* tribunal added a statement which is relevant to shareholders’ claims: “Under international law the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent (...)”.¹⁴⁹⁰
1076. Tribunals have found that no indirect expropriation could be found to exist (i) where the State’s interference with the investor’s business was reasonable¹⁴⁹¹ or (ii) where the investor was still able to operate and benefit from its investment.¹⁴⁹² This approach was followed in the *BG Group* award.¹⁴⁹³
1077. In any event, the fact that an investment has become worthless does not *per se* mean that there was an act of expropriation since investment always entails risk as observed by the *Generation Ukraine* tribunal.¹⁴⁹⁴

¹⁴⁸⁷ L.Y. Fortier and S. Drymer, “Indirect Expropriation and the Law of International Investment: I Know It When I See It”, 19 ICSID Review 293, CLA-10 p. 305.

¹⁴⁸⁸ *Pope & Talbot v. Canada*, RLA-13/CLA-43 ¶¶ 99-104, especially ¶ 102.

¹⁴⁸⁹ See *Tecmed v. Mexico*, CLA-17 ¶¶ 115-116; see also *Siemens v. Argentina*, CLA-11 ¶¶ 267-273.

¹⁴⁹⁰ *ibidem*.

¹⁴⁹¹ *Genin v. Estonia*, CLA-28 ¶ 363; see also paragraph 1080 below on “regulatory expropriation”.

¹⁴⁹² *Pope & Talbot v. Canada*, RLA-13/CLA-43 ¶¶ 99-104, especially ¶¶ 100-102.

¹⁴⁹³ See *BG Group v. Argentina*, CLA-12 ¶¶ 270-271.

¹⁴⁹⁴ *Generation Ukraine v. Ukraine*, CLA-30 ¶ 20.30.

1078. Certain tribunals have highlighted as a further aspect of the degree of State interference the *duration* of such interference.¹⁴⁹⁵
1079. In order to determine whether the measures taken by a State amount to expropriation, the *effect* of such measures on the investment is often regarded as a crucial test. Whereas it has been said that “[t]he government’s intention is less important than the effect of the measures on the owner of the assets”, some relevance must be attached to *intention*, as observed by the Tribunal in paragraph 829 above, and any evidence of expropriatory intention should be carefully weighed.¹⁴⁹⁶
1080. States have often raised the defence that where a general regulation enacted in the public interest interferes with an investment, it is within the State’s “police powers” and it does not amount to an expropriation under international law provided that it is not discriminatory. Such a defence has been raised by the host State both in cases in which the measure was in the form of a general regulation (such as in *Pope & Talbot*) and in cases in which it is an individual decision made in relation to one particular investor, such as a decision to revoke a licence or an authorisation (as in *Tecmed*).
1081. The tribunal in *Genin v. Estonia* found that the revocation of a banking licence, although it was stated to be based on very technical grounds, was neither arbitrary nor discriminatory and was justified considering the serious and reasonable misgivings expressed by the Central Bank of Estonia regarding the investor’s management, its operations and its investments; the investor’s claims made under the US-Estonia BIT were rejected, including a claim for unlawful expropriation.¹⁴⁹⁷
1082. The NAFTA tribunal in *Feldman v. Mexico* stated that:¹⁴⁹⁸

[I]t is much less clear [than defining direct expropriation] when governmental action that interferes with broadly-defined property rights – an “investment” under NAFTA, Article 1139 – crosses the line from valid regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.

¹⁴⁹⁵ *Wena Hotels v. Egypt*, CLA-14; *Tecmed v. Mexico*, CLA-17 ¶ 116.

¹⁴⁹⁶ *Tecmed v. Mexico*, CLA-17 ¶ 116.

¹⁴⁹⁷ *Genin v. Estonia*, CLA-28 ¶¶ 361, 363, 365, 369-371.

¹⁴⁹⁸ *Marvin Feldmann v. Mexico*, ICSID Case No. ICSID Case No. ARB(AF)/99/1, 16 December 2002, RLA-5 ¶ 100 (no expropriation found).

1083. In spite of this difficulty, investment tribunals, in particular since *Saluka* and *Methanex*, have endorsed the principle that legitimate regulatory action cannot be regarded as compensable “expropriation”. In this respect, in the *Saluka* case, the tribunal held with reference to the BIT between the Netherlands, the Czech Republic and the Slovak Republic that:¹⁴⁹⁹

It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.

1084. It further found that:¹⁵⁰⁰

[T]he principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are “commonly accepted as within the police power of States” forms part of customary international law today.

1085. As a consequence, the tribunal focused on the permissibility of the regulatory State action which, in its view, removed it from the ambit of an indirect expropriation even though in effect it destroyed the value of the investment affected.¹⁵⁰¹ As a result, the forced administration of a bank in which the Dutch investor had invested was not considered a breach of the prohibition against expropriation contained in the applicable BIT.

1086. The *Saluka* tribunal largely relied on the reasoning of the NAFTA tribunal in the *Methanex* case which had held that:¹⁵⁰²

[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.

¹⁴⁹⁹ *Saluka v. Czech Republic*, CLA-21 ¶ 255.

¹⁵⁰⁰ *Saluka v. Czech Republic*, CLA-21 ¶ 262.

¹⁵⁰¹ *Saluka v. Czech Republic*, CLA-21 ¶ 276: “(...) in imposing the forced administration of IPB on 16 June 2000 the Czech Republic adopted a measure which was valid and permissible as within its regulatory powers, notwithstanding that the measure had the effect of eviscerating Saluka’s investment in IPB”.

¹⁵⁰² *Methanex Corporation v. United States of America*, NAFTA Arbitral Tribunal, Final Award on Jurisdiction and Merits, 3 August 2005, RLA-31 Sect. IV D, ¶ 7.

1087. The Tribunal also notes that certain investment tribunals have considered that a balancing of interests may be required. For instance, in *LG&E* the tribunal held:¹⁵⁰³

In order to establish whether State measures constitute expropriation (...), the Tribunal must balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies.

1088. However, it then added (albeit, invoking a proportionality test, which is controversial):¹⁵⁰⁴

With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed. The proportionality to be used when making use of this right was recognized in *Tecmed*, which observed that "whether such actions or measures are proportional to the public interest presumably protected thereby and the protection legally granted to investments, taking into account that the significance of such impact, has a key role upon deciding the proportionality.

(B) WHETHER THE RESPONDENT IS IN BREACH OF ARTICLE 4(1) OF THE BIT

1089. The Tribunal will first consider the Claimant's claim that the investment was expropriated on 16 September 2008 in breach of Article 4(1) of the BIT.

The Tribunal's finding is set out in paragraph 1098 below.

1090. The recovery of the buildings and boilers by personnel of Rēzeknes Siltumtīkli and local police that took place on 16 September 2008 cannot be viewed in isolation as it was based on the Rēzeknes City Council's decision No. 449 of 15 September 2008¹⁵⁰⁵ that allowed the enforcement of the Council's previous decision of 14 July 2008¹⁵⁰⁶ ordering Latgales Enerģija to surrender the assets; this decision was in turn based on the Regulator's 3 June 2008 decision to revoke the licences.¹⁵⁰⁷ The Claimant has itself relied on the date of 3 June 2008 as the "primary date for the expropriation of its investment" in support of its claim for damages.¹⁵⁰⁸ One must therefore consider

¹⁵⁰³ *LG&E v. Argentina*, CLA-31 ¶ 189.

¹⁵⁰⁴ *LG&E v. Argentina*, CLA-31 ¶ 195.

¹⁵⁰⁵ C-186.

¹⁵⁰⁶ C-33.

¹⁵⁰⁷ C-33.

¹⁵⁰⁸ Cl. Mem. ¶ 344.

these decisions before deciding whether the 16 September 2008 events amount to an unlawful expropriation.

1091. The Tribunal finds that Latgales Enerģija was deprived of the right to provide heating services in the City of Rēzekne as a consequence of the Regulator's 3 June 2008 decision;¹⁵⁰⁹ the subsequent decisions were required simply to implement that decision as Latgales Enerģija declined to surrender the assets of its own will. The question is therefore whether the Regulator's 3 June 2008 decision was valid and permissible as being within the Regulator's regulatory police powers despite the effects that it had on the Claimant's investment. The Respondent has not rested its defence on the concept of "regulatory expropriation"; however, that is in substance the defence advanced by the Respondent when it argues that the Municipality and the Regulator were entitled, as a matter of Latvian law, to take the measures they took due to Latgales Enerģija's failure to comply with the licence conditions and that such measures do not amount to an unlawful expropriation contrary to Article 4(1) of the BIT.
1092. The Regulator's 3 June 2008 decision revoking the licences, discussed in paragraphs 1006 ff. above, is based on six main reasons. The Tribunal has found that the revocation of the licences was not against good faith and that the Regulator was entitled to revoke the licences on the basis that (i) Latgales Enerģija had failed to pay the full price of the natural gas from June 2007 onwards, which is an admitted fact, and (ii) Latgales Enerģija had a duty to pay for the natural gas used. The Regulator's finding that such a failure to pay could give rise to further interruptions in the provision of heating services was not a breach of Article 3(1) of the BIT.
1093. The reasons for which the Regulator's 3 June 2008 decision does not amount to a breach of Article 3(1) of the BIT apply *mutatis mutandis* when one turns to the question whether this decision amounts to a breach of Article 4(1) of the BIT.

¹⁵⁰⁹ The Council's 14 July 2008 decision states the following (C-33 [page 12]): "Thus, as it results from Regulator's decision No 10 of 3 June 2008, together with cancellation of the licences the Operator has lost not only the legal grounds to provide heating, but it also cannot perform the activities included in the subject of the Agreement". The Claimant relies on this date too as the primary date for the expropriation of its investment, Cl. Mem. ¶ 344.

Having considered Latgales Enerģija's failure to pay the full amount for the natural gas over a twelve-month period, the Regulator was justifiably insecure that there would be no further interruptions in heating services in the future. The Tribunal therefore finds that the Regulator's 3 June 2008 revoking the licences does not amount to a breach of Article 4(1) of the BIT.

1094. The Tribunal has already noted that the Regulator's 3 June 2008 decision is stated to be based on a number of further reasons which the Tribunal finds not to be persuasive; the presence of such reasons in the Regulator's decision does not affect the validity of the reason which this Tribunal finds to be a sufficient and valid ground upon which the licences could be revoked.
1095. The decisions made by the Municipality further to the Regulator's 3 June 2008 decision revoking the licences, in particular the Council's 14 June 2008 and 15 September 2008 decisions, are mere implementation measures which do not constitute a breach of Article 4(1) of the BIT. The Rēzekne City Council's decision of 14 June 2008 ordering Latgales Enerģija to surrender the assets is stated to be based on the Regulator's 3 June 2008 decision revoking the licences¹⁵¹⁰ and the 15 September 2008 decision¹⁵¹¹ orders the enforcement of the 14 June 2008 decision.
1096. The Claimant's submission that Latgales Enerģija's shares were rendered worthless by the actions of the local Latvian authorities is unproven in the Tribunal's opinion. This submission is based mainly on the proposition that Latgales Enerģija was stripped of its licences and of its 30-year concession.¹⁵¹² However, the Tribunal has found the revocation of the licences not to be inconsistent with Articles 3(1) and 4(1) of the BIT. The burden on the Claimant is to prove (i) that Latgales Enerģija's shares are "worthless" despite the continued existence of this company, and (ii) that such value is the result of the Respondent's actions which the Tribunal has found to be in breach of Art. 3(1) of the BIT. The Tribunal finds that the Claimant has failed to discharge that burden.

¹⁵¹⁰ C-33 pp. 1, 3.

¹⁵¹¹ C-186.

¹⁵¹² Cl. Mem. ¶¶ 342-343.

1097. The Claimant's contention that the Respondent's action caused the loss of the value of the loans and guarantees issued in support of Latgales Enerģija's business has been dealt with by the Tribunal as a matter of Article 3(1) of the BIT (see paragraph 1140 below) and there is therefore no need to discuss this matter under the separate head of expropriation.
1098. The Tribunal's Conclusion and Finding. The Regulator acted within its statutory discretion when it revoked the licences. The Respondent's measures did not therefore constitute an unlawful expropriation contrary to Article 4(1) of the BIT on 16 September 2008 when buildings and boilers were taken over, on 15 September 2008 when the forcible enforcement of the 14 July 2008 decision was ordered, on 14 July 2008 when Latgales Enerģija was ordered to surrender the infrastructure or on 3 June 2008 when the licences were revoked.
1099. The Tribunal further dismisses the Claimant's claim for unlawful expropriation insofar as it is based on an alleged creeping expropriation.
1100. The Claimant has relied on the measures taken by the Municipality and/or the Regulator, through action or inaction, from the beginning of 2006 until 16 September 2008. As the Tribunal found that the Regulator's 3 June 2008 decision revoking the licences and the Municipality's 14 June and 15 September 2008 decisions do not constitute a violation of Arts. 3(1) and 4(1) of the BIT, it may be doubtful whether there is any scope left, as a matter of law, in order for the Claimant to argue that the measures taken by the Respondent, considered as a whole, amount to a creeping expropriation. The Municipality's conduct in 2006 and 2007 and the Regulator's conduct in 2007 were unfair and inequitable in a number of respects and amount, in any event, to arbitrary measures impairing the enjoyment of the Claimant's investment. Such breaches did not, however, have an expropriatory effect; in particular, the Regulator's 13 October 2006 decision dismissing the new rates proposed by Latgales Enerģija was based *inter alia* on Latgales Enerģija's failure to substantiate its costs. If the Tribunal considers the Municipality's and the Regulator's conduct in the wider context of a period ending on 16 September 2008, the conclusion is the same.

(C) THE TRIBUNAL'S FINDING

1101. The Tribunal dismisses the Claimant's claim based on a breach of Article 4(1) of the BIT.

(5) CLAIMS FOR BREACH OF THE MOST FAVOURED NATION CLAUSE UNDER ARTICLE 3(2) OF THE TREATY

1102. The Claimant finally complains of a breach by the Respondent of Article 2(2) and Article 3(1) of the Latvia-Romania BIT¹⁵¹³ which it considers applicable as a result of the Treaty's MFN Clause contained in Article 3(2) of the BIT.

1103. Article 3(2) of the BIT reads as follows:

Article 3
Protection and Treatment of Investments

2. Each Contracting Party, subject to its laws and international agreements, shall accord to the investments made by investors of the other Contracting Party treatment no less favourable than that accorded to the investments made by investors of any third State.

1104. The relevant provisions of the Latvia-Romania BIT read as follows:¹⁵¹⁴

Article 2
Promotion, Admission

- (1) (...)
- (2) When a Contracting Party shall have admitted an investment in its State territory, it shall, in accordance with its national laws and regulations, grant the necessary permits in connection with such an investment, including authorisations for engaging top managerial and technical personnel of their choice, regardless of citizenship, on a non-discriminatory basis.

Article 3
Protection, Treatment

- (1) Each Contracting Party shall protect within its State territory investments made in accordance with its national laws and regulations by investors of the other Contracting Party and shall not impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments. In particular, each Contracting Party or its competent authorities shall issue the necessary authorisations mentioned in Article 2, paragraph (2) of this Agreement.

¹⁵¹³ Latvia-Romania BIT, CLA-22.

¹⁵¹⁴ Latvia-Romania BIT, CLA-22.

1105. According to Article 2(2) and Article 3(1) of the Latvia-Romania BIT, the duty on the host State to grant the necessary permits in connection with an admitted investment is based on the law of the host State. Investment tribunals have interpreted similar provisions contained in BITs as meaning that “[a]ll that an investor may expect is that the law be applied”.¹⁵¹⁵
1106. The Tribunal dismisses the Claimant’s claim based on the Latvia-Romania BIT.
1107. First, it is doubtful that the concept of a “necessary permit” or “necessary authorisation” “in connection with the investment” is to be interpreted and construed so as to include the heat supply development plan for the City of Rēzekne, which is part of the management and planning duties of the Municipality; this document was not, in any event, issued by the Municipality as a permit and does not represent an authorisation allowing any particular action on the part of the Operator.
1108. Secondly, it is similarly doubtful that the Regulator’s decisions approving a new tariff proposed by Latgales Enerģija falls in the category of permits contemplated by the provisions prayed in aid by the Claimant. The Claimant’s position has not been substantiated in this respect.
1109. Thirdly, any necessary permits have to be granted by the host State only “in accordance with its national laws and regulations”. Therefore, the granting or issuing of permits has to be made only provided that it is in accordance with national law.
1110. Finally, the Tribunal has found that the Regulator was entitled to revoke the licences as a matter of Latvian law and that such decision does not amount to a breach of Article 3(1) and Article 4(1) of the BIT.
1111. Thus, the Tribunal does not have to examine whether the MFN clause of the Treaty may be read so as to allow the Claimant to invoke Article 2(2) and Article 3(1) of the Latvia-Romania BIT.
1112. The Parties have abstained from addressing this issue and the Tribunal notes that, although the question does not concern the controversial *Maffezini* issue whether and

¹⁵¹⁵ *MTD v. Chile*, CLA-18 ¶ 205.

to what extent procedural benefits can be imported via an MFN clause, the specific formulation of the MFN clause making a host State's obligation to grant MFN treatment "subject to its laws and international agreements" casts doubt whether it can be relied upon to import standards contained in other treaties at all because it may be limited to *de facto* treatment under national law.

E. THE TRIBUNAL'S DECISION ON LIABILITY

1113. The Tribunal finds that the Respondent has breached of Article 3(1) of the BIT as found by the Tribunal in paragraph 1066 above.

VIII. QUANTUM

1114. In this section, the Tribunal will first restate the Parties' prayers for relief on *quantum* (A) before summarizing the respective cases on *quantum* submitted by the Claimant (B) and the Respondent (C). The Tribunal will then state the reasons for its decision on *quantum* (D) before setting out its decision (E).

A. THE PARTIES' PRAYERS FOR RELIEF ON QUANTUM

(1) THE CLAIMANT

1115. The Claimant sought damages in an amount of EUR 8,390,000.¹⁵¹⁶ After the Hearing the Claimant filed a third Expert Report in which this amount was reduced to EUR 7,800,000 (in case the appropriate control premium was found to be 20%), or, alternatively, EUR 7,440,000 (in case the appropriate control premium was found to be 10%), excluding pre-judgment interest.¹⁵¹⁷ This amount is broadly in line with the minimum amount set out in the Request for Arbitration (EUR 7,000,000);¹⁵¹⁸ the Claimant's submissions filed subsequent to the Request for Arbitration contain claims for higher amounts (EUR 9,820,000¹⁵¹⁹ and EUR 8,380,000¹⁵²⁰).

¹⁵¹⁶ Cl. Skeleton ¶ 22.

¹⁵¹⁷ CES-4 ¶ 6.

¹⁵¹⁸ RfA ¶ 169.

¹⁵¹⁹ Cl. Mem. ¶ 370.

¹⁵²⁰ Cl. Rep. ¶ 178.

(2) THE RESPONDENT

1116. The Respondent seeks the dismissal of the Claimant's claim for damages.

B. THE CLAIMANT'S CASE ON *QUANTUM*

1117. The Parties have approached *quantum* with expropriation and expropriatory breaches in mind.

(1) THE PRINCIPLES

1118. The Claimant submits that Latvia's expropriation of its investment was unlawful according to the provisions of the BIT, which does not deal with compensation for unlawful expropriation. Recourse must therefore be had to the principles of customary international law and reliance is placed on the decision of the PCIJ in the *Factory at Chorzów* case and on Articles 31 ff. of the 2001 ILC Articles. Because the BIT prohibits *prima facie* any expropriation and the Claimant's investment has been expropriated unlawfully, it follows that the compensation must not be limited to the value of the undertaking; the Claimant is entitled to "full reparation" for the injury caused by the Respondent's internationally wrongful acts.¹⁵²¹

(A) CALCULATION OF THE CLAIMANT'S LOSS DUE TO UNLAWFUL EXPROPRIATION

1119. The Claimant submits that its investment in Latvia has been rendered worthless by Latvia's breaches of the BIT, as a consequence of which Latgales Enerģija was stripped of its licences and its 30-year concession under the Long-Term Agreement. The measure of the loss is represented by the difference between the value of Latgales Enerģija, had those breaches not occurred, and Latgales Enerģija's market value as at 3 June 2008 (or, alternatively, as at 16 September 2008).

1120. The Claimant relies on Dr. Hesmondhalgh's Expert Reports, based on a DCF analysis in order to value E energija's investment as at 3 June 2008; the total compensation for the expropriation of the Claimant's investment was of EUR 9,460,000 according to Dr. Hesmondhalgh's first Expert Report.¹⁵²² Dr. Hesmondhalgh reviewed Mr. Peer's

¹⁵²¹ Cl. Mem. ¶¶ 326 ff.

¹⁵²² Cl. Mem. ¶¶ 342 ff.

first Expert Report and revised her estimate of damages downwards from EUR 9,240,000 to EUR 7,970,000 (when using a 10% control premium) in her second Expert Report; the amounts set out in Dr. Hesmondhalgh's third Expert Report are EUR 7,800,000 (when using a 20% control premium) and EUR 7,440,000 (when using a 10% control premium).

1121. The Claimant made a number of specific points in its Reply Memorial on *quantum*. On the repayment of the loans, it contended that even if Latgales Enerģija had made no profits after June 2008, the loans would have been repaid in the ordinary course of business since the repayments were provided for by the heat tariffs.¹⁵²³ In relation to the “ongoing administrative costs”, they would not have been incurred if Latgales Enerģija had been permitted to continue with its business and operate the system. In its Memorial the Claimant explained that such costs were incurred because it was “not possible to initiate insolvency proceedings”,¹⁵²⁴ an explanation which was not restated in the Claimant's Reply.¹⁵²⁵

(2) DAMAGE CAUSED BY BREACHES OTHER THAN EXPROPRIATION

(A) THE PRINCIPLES

1122. Reliance is placed by the Claimant on Article 36 of the ILC Articles as the BIT does not contain any provisions on compensation for a breach of Article 3(1).¹⁵²⁶

(B) CALCULATION OF THE CLAIMANT'S LOSS DUE TO OTHER BREACHES OF THE BIT

1123. The amount calculated by Dr. Hesmondhalgh's first Expert Report is of EUR 9,820,000 (calculation with a 20% control premium) and EUR 9,240,000 (calculation with a 10% control premium); the calculation is the same as that relating

Dr. Hesmondhalgh's first Expert Report calculates the full amount of compensation at EUR 9,820,000 and the amount of damages arising from the Regulator's refusal to accept a new tariff at EUR 320,000. The first Expert Report determined the market value of the Claimant's 58% shares in Latgales Enerģija at EUR 5,280,000 (based on a 20% control premium); in addition, compensation should include (i) the revenue attributable to the sale of excess carbon credits (EUR 70,000), (ii) compensation for the written-off loans and the called-upon guarantee in an amount of EUR 1,310,000 and EUR 1,860,000 respectively and (iii) the costs to keep Latgales Enerģija in existence (EUR 940,000).

¹⁵²³ Cl. Rep. ¶ 102.

¹⁵²⁴ Cl. Mem. ¶ 356.

¹⁵²⁵ Cl. Rep. ¶ 105.

¹⁵²⁶ Cl. Mem. ¶ 358.

to the damages for unlawful expropriation, to which an amount of EUR 360,000 (calculation with a 20% control premium) is added for loss of revenue due to Latvia's breach of the provisions of the BIT before the date of expropriation with respect to the heat supply development plan for the City and the Regulator's refusal to set a new tariff in 2006.¹⁵²⁷ Dr. Hesmondhalgh reviewed Mr. Peer's first Expert Report and revised her estimate of damages downwards from EUR 9,240,000 to EUR 7,970,000 (when using a 10% control premium) in her Second Expert Report.

C. THE RESPONDENT'S CASE ON *QUANTUM*

1124. The Respondent submits that the overwhelming part of the damages claimed by the Claimant are based on inflated alleged future cash flows as the Long-Term Agreement was capable of generating nil in cash flow; the Claimant has failed to prove that its business was profitable at all.¹⁵²⁸ Reliance is placed on Mr. Peer's First and Second Expert Reports. The Respondent further submits that the Claimant has failed to show that the remaining part of the alleged damage was caused by the alleged breach of the BIT, and objects that the Claimant's approach is further flawed by attempts at double-counting and a disregard for the mitigation duty binding on any claimant.¹⁵²⁹ The Respondent has not further dealt with the Claimant's case on *quantum* and has referred to KPMG's First and Second Expert Reports.
1125. In a Post-Hearing Brief the Respondent submitted that the dispute had been finally settled under the terms of a Settlement Agreement entered into by the Claimant and Rēzeknes Siltumtīkli on 25 October 2007.¹⁵³⁰

D. THE REASONS FOR THE TRIBUNAL'S DECISION ON *QUANTUM*

(1) THE PRINCIPLES

1126. The Tribunal found that there is no compensable expropriation in the present case, but that the Respondent has breached Article 3(1) of the BIT¹⁵³¹ in a number of respects.¹⁵³²

¹⁵²⁷ Cl. Mem. ¶¶ 358 ff.

¹⁵²⁸ Resp. Rej. ¶¶ 35-36.

¹⁵²⁹ Resp. Obj. J. & C-Mem. ¶¶ 2.1 ff.

¹⁵³⁰ R-33; Resp. P-H (PO8) ¶ 23.

1127. The provisions of the BIT deal with compensation in relation only to expropriation (Article 4(1) and (2) of the BIT); they are silent, in particular, as to compensation for breaches of Article 3(1) of the BIT.

The Respondent's breaches of Article 3(1) of the BIT amount to an internationally wrongful act as this provision gives rise to an international obligation on the Respondent and the Tribunal has found the breaches of this provision to be attributable to the Respondent (Article 2 of the ILC Articles¹⁵³³).

Under Article 31 of the ILC Articles the State responsible for an internationally wrongful act must make "full reparation for the injury caused" by such act; that is also the principle set out by the PCIJ in the *Factory at Chorzów* decision.¹⁵³⁴ In the present case it is common ground that reparation must take the form of financial compensation or damages.

1128. Financial compensation of the damage caused by an internationally wrongful act "shall cover any financially assessable damage including loss of profits insofar as it is established" (Article 36(2) of the ILC Articles).
1129. In order to be recoverable, the damage must have been caused by the State's internationally wrongful act complained of by the investor, Article 31 of the ILC Articles. Causation is, similarly, a requirement in the PCIJ decision in the *Factory at Chorzów* decision as expressed by the formula "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".¹⁵³⁵ The requirement of

¹⁵³¹ BIT, CLA-1.

¹⁵³² The most important breaches are as follows: (i) the delayed approval of the heat supply development plan for the City in the period from 20 January 2006 to 20 September 2007; (ii) the Regulator's inability to consider Latgales Enerģija's proposals for a new tariff in 2007 caused by the delayed approval of the heat supply development plan for the City; (iii) certain aspects of the Municipality's conduct during the October 2007 energy crisis.

¹⁵³³ ILC Articles, CLA-7.

¹⁵³⁴ *Factory at Chorzów*, 13 September 1928, PCIJ Series A, No. 17 ("*Chorzów*"), CLA-23.

¹⁵³⁵ *Chorzów*, CLA-23 p. 47 (emphasis supplied).

causation has been applied in a number of awards in investment disputes.¹⁵³⁶ The burden of proof in relation to causation is on the Claimant.¹⁵³⁷

(A) THE PRINCIPLES APPLIED

1130. The Tribunal must first deal with the Respondent’s contention that the “financial differences” between the Parties were finally settled under the terms of a Settlement Agreement made by the Claimant and Rēzeknes Siltumtīkli on 25 October 2007.¹⁵³⁸ The Tribunal dismisses the Respondent’s defence.
1131. This agreement states that Rēzeknes Siltumtīkli shall pay the Claimant an amount of some LVL 600,000 and that five days upon receipt of such payment the Claimant shall cancel certain notes registered in the Land Registry with respect to the real estate owned by Rēzeknes Siltumtīkli. Clause 3 of this agreement provides that following such payment the Claimant “shall have no claims to property” of Rēzeknes Siltumtīkli.

The Respondent’s contention that the Parties settled all their differences “under legal documents concluded up to that date” and that this agreement “gives a wide reference to settling all claims in general”¹⁵³⁹ is based on an impermissible reading of such agreement that does not contain any expression to the effect that all claims between the Claimant and Rēzeknes Siltumtīkli had been finally settled. The Agreement of 25 October 2007 has a subject-matter which is expressly and narrowly defined in relation to a payment intended to permit the cancellation of a note (akin to a charge, a lien or a mortgage) relating to land, and it settles any claims that the Claimant may have had against property of Rēzeknes Siltumtīkli. There is no connection between this agreement and the claims made by the Claimant against the Respondent in this arbitration.

1132. The expert opinions relied upon by the Claimant are entirely based on the proposition that the Claimant was the victim of an unlawful expropriation in June 2008. The

¹⁵³⁶ See *e.g. Tradex Hellas v. Albania*, CLA-26 ¶ 200, referring to *ELSI*, CLA-24; *Saluka v. Czech Republic*, CLA-21 ¶ 480; *Biwater Gauff v. Tanzania*, CLA-36 ¶¶ 778 ff., similarly referring to *ELSI*, CLA-24 ¶ 786.

¹⁵³⁷ See *e.g. Tradex Hellas v. Albania*, CLA-26 ¶ 200; *Biwater Gauff v. Tanzania*, CLA-36 ¶ 787.

¹⁵³⁸ R-33.

¹⁵³⁹ Resp. P-H (PO8) ¶ 23 (original emphasis).

Tribunal finds that this approach is accordingly of little assistance given the finding that the revocation of the licences was justified and does not amount to a compensable expropriation.

The non-expropriatory damage was dealt with as a fraction of the overall damage caused by the alleged unlawful expropriation and the Regulator's refusal to accept a new tariff in the period from October 2006 to October 2007, corresponding to an amount of EUR 360,000 according to the Dr. Hesmondhalgh's first Expert Report.

1133. The Tribunal must next consider the Claimant's contentions that "Latvia is in breach of various treaty obligations, all of which stem from the same set of facts and produce the same end result: E energija's investment in Latvia has been rendered completely worthless by the actions of the local Latvian authorities"¹⁵⁴⁰ and that, with specific reference to Latvia's breaches of the BIT provisions other than Article 4(1), "the damages flowing from the expropriation of E energija's investment overlap to a large degree with those flowing from Latvia's other breaches of the BIT"¹⁵⁴¹ and that "Latvia's breaches of the Fair and Equitable Treatment standard, including the obligation of full security and protection, and its application of arbitrary and discriminatory measures all resulted in the same outcome: Latgales Energija's licences were stripped from it and the Long-Term Agreement terminated".¹⁵⁴²
1134. The Claimant thereby contends in essence that the damage it suffered is the same, whether the Tribunal finds that there was an unlawful expropriation or a creeping breach of the fair and equitable treatment standard having expropriatory effects, the assumption being that the Tribunal will find at least one or the other. The Tribunal finds this approach to be inconsistent with its findings whereby the Regulator's revocation of the licences was justified and whereby only certain actions or omissions of the Respondent breached Article 3(1) of the BIT; the Tribunal did not, in particular, find that the Respondent's actions were expropriatory if their cumulative effect was considered.

¹⁵⁴⁰ Cl. Mem. ¶¶ 342-344.

¹⁵⁴¹ Cl. Mem. ¶ 358.

¹⁵⁴² Cl. Mem. ¶ 359.

1135. It is a matter for the Claimant to prove the damage caused by the Respondent's breaches of Article 3(1) of the BIT.

1136. The Tribunal will first examine whether the Claimant has established that the Respondent's breaches of Article 3(1) caused its alleged lost profits.

The Tribunal has considered in particular the following facts: (i) the infrastructure of the heating system in Rēzekne was old and dilapidated (Mr. Strioga characterised the Rēzekne situation as being a "terrible technical situation");¹⁵⁴³ (ii) Latgales Enerģija admittedly did not replace the "Soviet-type old boilers" in Rēzekne,¹⁵⁴⁴ apart perhaps from the installation of one new Viessmann boiler, but concentrated essentially on repairs and maintenance;¹⁵⁴⁵ (iii) the Municipality's heat supply development plan for the City contemplated the reconstruction of boiler houses, but spelled out that the operator's "investment into the reconstruction of heating boilers should not affect the increase in tariffs" as it was the Municipality's expectation that gas consumption for generation and auxiliary heating consumption would drop significantly after the reconstruction;¹⁵⁴⁶ (iv) the Long-Term Agreement and the February 2005 had opened a new page in the history of local administration which had not ever dealt with a private investor before 2005, and the contracts signed by Latgales Enerģija contained few specific assurances with respect to the Claimant's investment on the part of the Municipality, and none on the part of the Regulator that was not privy to such contracts; and (v) cogeneration was not covered by the contracts signed by Latgales Enerģija and the terms of such contracts do not warrant a finding that the Municipality was under a contractual duty to Latgales Enerģija to proceed with a cogeneration project, as the Tribunal has found.

Having considered the evidence as a whole, the Tribunal is satisfied that the Claimant has not discharged its burden of proof in relation to the existence of future profits. The Tribunal has also found that the Claimant has failed to discharge its burden of proof in relation to the allegation that Latgales Enerģija's shares have become

¹⁵⁴³ Transcript, Day 2, 8/1-7.

¹⁵⁴⁴ Transcript, Day 2, 8/4-9/17 [Strioga].

¹⁵⁴⁵ As acknowledged in the 30 October 2007 letter to the Regulator, C-153 p. 6, ¶ 21.

¹⁵⁴⁶ C-213 p. 24.

worthless due to the breaches of Article 3(1) of the BIT found by the Tribunal (see paragraph 1096 above).

1137. The Tribunal finds that the Claimant is entitled to compensation for the actual proven losses (*damnum emergens*) suffered as a consequence of the Respondent's breaches of Article 3(1) of the BIT.
1138. The Tribunal rejects the claim relating to the "administrative costs" to maintain Latgales Enerģija after 3 June 2008 or 16 September 2008. The Claimant has failed to give a compelling explanation for what appears to be essentially a commercial decision made in its own interest to continue to fund Latgales Enerģija, rather than a decision dictated by requirements of Latvian law; if any such requirements dictated such decisions, the Claimant has failed to discharge its burden of proof in this respect.
1139. The Claimant has considered the damage caused by the Respondent's breaches of Article 3(1) of the BIT separately from the damage caused by the alleged unlawful expropriation only to a limited extent, namely under the heading of the "2006/2007 damages".¹⁵⁴⁷ These damages are to compensate the Claimant for the losses allegedly suffered as a consequence of the Regulator's 13 October 2006 decision denying Latgales Enerģija's proposal for a new tariff. However, the Tribunal found that the Regulator's 13 October 2006 decision does not amount to a breach of Article 3(1) of the BIT. The Tribunal therefore dismisses this claim.
1140. The Tribunal must next consider the amount of EUR 3,170,000,¹⁵⁴⁸ represented by loans made to Latgales Enerģija in an amount of EUR 1,310,000,¹⁵⁴⁹ and a guarantee paid to Danske Bank in respect of Latgales Enerģija's debts, in an amount of EUR 1,860,000.¹⁵⁵⁰ These figures were not challenged by the Respondent or the Respondent's expert.¹⁵⁵¹ The Respondent has objected that Latgales Enerģija would not have been able to repay the loan based on Mr. Peer's revised cash flow

¹⁵⁴⁷ ER Hesmondhalgh I p. (iv), ¶¶ 11 ff.; 63.

¹⁵⁴⁸ ER Hesmondhalgh I p. iv ¶¶ 2(iii); p. 18 ¶ 64; ER Hesmondhalgh II p. (viii) ¶ 16; p. 28.

¹⁵⁴⁹ Cl. Mem. ¶¶ 355; 361(3); ER Hesmondhalgh I p. 18, ¶ 64; ER Hesmondhalgh II p. viii.

¹⁵⁵⁰ Cl. Mem. ¶¶ 355; 361(4); ER Hesmondhalgh I pp. 18-19, ¶ 65.

¹⁵⁵¹ ER Peer III ¶ 5.2.2.

estimates¹⁵⁵² and that there was no evidence that the Claimant had paid the amount of the guarantee to Danske Bank.

1141. The Tribunal regards such figures as representing an actual loss suffered by the Claimant and finds that they are therefore recoverable in principle. The Respondent's first objection is therefore without merit insofar as it fails to take into account the distinction between actual losses and lost profits.
1142. As to the Respondent's second objection relating to the payment by the Claimant of the amount of the guarantee provided to Danske Bank, such objection has already been dismissed by the Tribunal (see paragraph 410 above).
1143. The Tribunal must now determine whether the Claimant is entitled to a sum of EUR 3,170,000 in consideration of the fact that, on the basis of the totality of the evidence before the Tribunal, such loss arises from a conjunction of different causes. Whereas the Tribunal has found that the Municipality significantly contributed to the difficult situation in which Latgales Enerģija found itself, and did so deliberately and in breach of Article 3(1) of the BIT, the Tribunal has also found that the Claimant's losses were caused by the fact that Latgales Enerģija's heating business came to an end due to its decision to stop paying the full price for the natural gas used and the revocation of the licences by the Regulator that followed, which the Tribunal found not to amount to a breach of Latvia's obligation under the BIT.
1144. The Tribunal must therefore determine to what extent the Claimant's actual loss was caused by the Respondent's breaches of Article 3(1) of the BIT. Having weighed all the evidence examined in the present Award, the Tribunal finds that the Claimant and the Respondent have contributed to the losses suffered by the Claimant to an extent that is, all in all, broadly equivalent and that the Claimant should therefore be awarded 50% of the actual losses mentioned above.
1145. The Tribunal therefore awards the Claimant a sum of EUR 1,585,000 (50% of EUR 3,170,000) as financial compensation for the damage caused by the Respondent's internationally wrongful act.

¹⁵⁵² ER Peer I ¶ 6.5.1.

(2) INTEREST

(A) THE CLAIMANT'S POSITION

1146. The Claimant contends that the Tribunal should depart from Article 4(2) of the BIT insofar as this provision contemplates a calculation of interest based on the LIBOR basis with respect to the compensation to be paid by the Respondent for a lawful expropriation; the Claimant argues that a departure from this provision is justified on the basis that its claim is for unlawful expropriation.
1147. The date from which interest should be awarded is the date of expropriation¹⁵⁵³ or the date on which the loss was incurred.¹⁵⁵⁴
1148. The Claimant argues that the LIBOR rate has dropped so considerably after 2008 as to be inappropriate for the calculation of interest. The Claimant suggests a rate of interest that reflects the interest that it must pay on its borrowings, to be compounded quarterly. Interest should be awarded at the following yearly rates and should be compounded quarterly: 6.58% for 2008, 4.36% for 2009, 3.73% for 2010, 4.13% for 2011 and 2.56% for 2012 until the date of the final award, and at the rate of 2.56%, compounded quarterly, from the date of the award until payment by the Respondent.¹⁵⁵⁵

(B) THE RESPONDENT'S POSITION

1149. The Respondent has not answered the Claimant's case on interest.

(C) THE TRIBUNAL'S REASONS

1150. The Tribunal finds that interest on the sum awarded is due and the Tribunal is satisfied that the rates claimed by the Claimant are more appropriate than the LIBOR rate; the Respondent has not challenged those rates. In any event, the LIBOR rate applies to expropriation under Article 4(2) of the BIT and the Tribunal has found that there is no compensable expropriation in the present case, so that there would be no compelling reason to apply a LIBOR-based interest in the present case.

¹⁵⁵³ Cl. Mem. ¶ 364.

¹⁵⁵⁴ Cl. Skeleton ¶ 23(3).

¹⁵⁵⁵ Cl. Mem. ¶¶ 363 ff.; Cl. Skeleton ¶ 23.

1151. The Claimant's case for compound interest has remained unchallenged throughout these proceedings. The Tribunal finds that simple interest would not represent reparation for the injury caused. The Tribunal will therefore award compound interest. The Tribunal notes, however, that the Claimant has not provided any substantive reasons in support of its claim that interest should be compounded quarterly other than the proposition that "any interest should be compounded quarterly, since to award simple interest would not reflect commercial reality".¹⁵⁵⁶ In the absence of any reason that justifies granting quarterly compounding, the Tribunal takes the view that annual compounding would be appropriate in view of recent trends in investment arbitration.
1152. The date from which interest is awarded is 1 January 2008 as the Claimant has failed to indicate any interest rate for the year 2007.

(D) TRIBUNAL'S FINDING ON INTEREST

1153. The Tribunal awards interest on the sum of EUR 1,585,000 as from 1 January 2008, to be compounded annually, at the following rates: 6.58% for 2008, 4.36% for 2009, 3.73% for 2010, 4.13% for 2011 and 2.56% for 2012 until the date of the final award, and at the rate of 2.56%, compounded annually, from the date of the award until payment by the Respondent.

E. THE TRIBUNAL'S DECISION ON *QUANTUM*

1154. The Tribunal awards the Claimant a sum of EUR 1,585,000 (one million five hundred eighty-five thousand Euro) with interest thereon as from 1 January 2008, to be compounded annually, at the following rates: 6.58% for 2008, 4.36% for 2009, 3.73% for 2010, 4.13% for 2011 and 2.56% for 2012 until the date of the final award, and at the rate of 2.56%, compounded annually, from the date of the award until payment by the Respondent.

IX. COSTS

1155. The Claimant's prayer for relief with respect to its costs is set out in paragraphs 442 and 443 above. The Claimant sought an award of costs in a total amount of

¹⁵⁵⁶ Cl. Mem. ¶ 365.

EUR 3,083,279.25, including a success fee, or, alternatively, an award of costs in a total amount of EUR 1,688,928.85, without a success fee.

1156. The Respondent's prayer for relief with respect to its costs is set out in paragraphs 447 and 448 above. The Respondent sought an award of costs in an amount of no less than EUR 166,555.28.

1157. The Article 61(2) of the ICSID Convention provides:

In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.

1158. Article 47(1)(j) of the ICSID Arbitration Rules states that the award shall contain any decision of the Tribunal regarding the cost of the proceedings.

1159. Absent agreement between the Parties, the Tribunal has broad discretion under these provisions to decide which Party bears the costs of the arbitration and to which extent.

1160. The Tribunal must exercise its discretion judicially and consider the Parties' positions as a whole. Prof. Reinisch has set out the criteria which a tribunal should take into account in the exercise of its discretion in his dissenting opinion and the Tribunal is broadly in agreement with the presentation of such criteria. The main question arising for determination in the present case is not, however, what such criteria should be, but how they should be applied to the circumstances of the present case.

1161. The Claimant succeeded with its claim for a breach of Article 3(1) of the BIT, but its claim for breach of Article 4(1) of the BIT as well as all other claims were dismissed. All claims were made to seek compensation for one and the same alleged damage. The Claimant's success on its Article 3(1) claim was clear-cut, especially in so far as the Municipality's delay in dealing with the heat supply development plan was concerned. The further aspects of this claim required a number of facts to be disentangled and analysed in relation to the conduct of the Municipality in the context of the October 2007 energy crisis, but the breach of Article 3(1) of the BIT by the Municipality found by the Tribunal was similarly a clear breach.

1162. The assistance which the Respondent provided to the Tribunal was limited, not only due to the brief pleadings which discussed the documentary evidence in the most perfunctory manner, but also to the absence of any witnesses presented by the Respondent to explain the Municipality's conduct.
1163. The Claimant succeeded with its claim for damages only to an extent of approximately 15-22% (depending on whether one considers the amount of the original claim for EUR 7 million or the higher claim for EUR 9.82 million, excluding the claim for costs).
1164. Each Party has defended its case in good faith in these proceedings.
1165. In these circumstances and considering that the claims were not frivolous, were pursued and defended in good faith and with all due expedition, the Tribunal considers that the Claimant is in principle entitled to be awarded costs and finds that the Respondent should be ordered to pay a fair share of the Claimant's costs. The Tribunal determines that such fair share shall be 50% of the costs incurred by the Claimant, to the exclusion of any success fee, subject to an examination of the amounts claimed.
1166. The costs of the arbitration, including the fees and expenses of the Tribunal and ICSID's administrative fees and direct expenses, amount to (in USD):

Arbitrators' fees and expenses	
Dr. Paolo Michele Patocchi	439,869.94
Prof. Dr. August Reinisch	105,052.24
Mr. Samuel Wordsworth QC	54,372.88
ICSID's administrative fees	160,000.00
Direct expenses	83,645.35
Total	842,940.41

1167. The above costs have been paid out of the advances made by the Parties in equal parts.¹⁵⁵⁷ As a result, each Party's share of the costs of arbitration amounts to USD 421,470.21.

1168. The Tribunal finds that the Claimant shall be entitled to 50% of the amounts of EUR 744,946 (legal fees and expenses of Salans/Vinson & Elkins), EUR 300,478 (legal fees and expenses of Sorainen), EUR 29,462 (Dr. Blumberga's Expert Opinion) and its share of the costs of the arbitration USD 421,470.21 (ICSID/Tribunal) plus the lodging fee (USD 25,000); *i.e.* a total amount of EUR 1,074,886.00 and USD 446,470.21. The Tribunal makes no award of costs with respect to the Expert Reports of Dr. Hesmondhalgh. This amount in turn represents 43% of the amount of costs and fees claimed by the Claimant excluding any success fee.

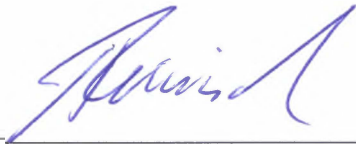
X. AWARD

For the reasons set out above, the Tribunal decides as follows:

- (1) The Respondent's objections to jurisdiction are denied; the Tribunal has jurisdiction to hear the Claimant's claims under Article 25 of the ICSID Convention and Article 7(2) of the BIT.
- (2) The Respondent breached Article 3(1) of the BIT.
- (3) The Respondent shall pay the Claimant compensation in the amount of EUR 1,585,000 (one million five hundred eighty-five thousand Euro).
- (4) The Respondent shall pay the Claimant compound interest on the amount of EUR 1,585,000.00, compounded annually, at the following rates: 6.58% for 2008, 4.36% for 2009, 3.73% for 2010, 4.13% for 2011 and 2.56% for 2012 until the date of the present Award; and at the rate of 2.56%, compounded annually, from the date of the present Award until payment by the Respondent.

¹⁵⁵⁷ The remaining balance will be reimbursed to the parties in proportion to the payments that they advanced to ICSID.

- (5) The Respondent shall pay the Claimant an amount of EUR 1,074,886.00 for the Claimant's costs and fees.
- (6) The Respondent shall pay the Claimant an amount of USD 446,470.21 for the Claimant's share of the costs of the arbitration plus the lodging fee.
- (7) All other claims are dismissed.



Prof. Dr. August Reinisch
Arbitrator

Date: 17 December 2017



Mr. Samuel Wordsworth QC
Arbitrator

Date: 14 December 2017



Dr. Paolo Michele Patocchi
President of the Tribunal

Date: 21 December 2017