Ukraine's Reduction in Renewable Energy Feed-In Tariffs: A Preview of Coming Disputes

December 18, 2020

To promote the production of clean energy, many countries have introduced incentives to encourage investment in the renewable energy sector. These incentives have often included feed-in tariffs ("FiTs"), which generally involve long-term contracts providing for certain guaranteed payments to producers of renewable electricity (*e.g.*, solar and wind power plants). Incentives such as FiTs have attracted substantial foreign investment in the renewable energy sector since the early 2000s.

Particularly after the global financial crisis, however, some governments have failed to comply with their FiT regimes or have sought to change their regulatory frameworks to reduce or eliminate FiTs in the renewable energy sector. In some cases, there have been sizeable differences between the FiTs owed by governments to renewable electricity producers and the prices utilities could charge for electricity. Some of the measures taken by governments have resulted in significant disputes, and foreign investors have brought claims against a number of States in which they have relied on protections under bilateral and multilateral investment treaties. More than sixty such cases have been brought against European States, most notably Spain, Italy, the Czech Republic, and Romania.

Over the past year, Ukraine has faced similar issues with its FiT regime. In light of the Ukrainian State-owned offtaker's inability to pay the established FiTs to renewable energy producers, the Ukrainian government substantially reduced the FiTs applicable to both existing and new facilities. Ukraine is continuing to take steps to resolve these issues, but there is a significant risk for investors that Ukraine will not be able to fully and fairly resolve the problems with its FiT regime. We discuss below these recent changes to Ukraine's FiT regime in the renewable energy sector, the disputes that other States have faced in similar contexts, and the potential claims that could be brought against Ukraine.

Foundations of Ukraine's Renewable Energy Market

Ukraine introduced a FiT regime and other incentives for the development of renewable energy over a decade ago. In July 2019, new legislation governing the electricity market (including the

RES Auction Law[1] and the Electric Energy Market Law[2]) entered into force. Under this legislation, the market began to transition from a model with a single offtaker to a competitive system. The State-owned entity Guaranteed Buyer ("GB") was designated as the offtaker responsible for payment of FiTs to renewable energy producers.[3]

The new regulatory regime contemplated that GB would have several sources of revenue. GB would sell electricity purchased from renewable energy producers in the market; the transmission system operator ("TSO") would compensate GB for the difference between the market price and the price at which GB purchased the electricity from the producer. GB would also sell electricity produced by the State-owned nuclear energy and hydroelectric energy producers.[4]

Importantly, since 2009, the relevant legislation included a limited stabilization clause, pursuant to which Ukraine promised renewable energy producers that the FiT rate in place on the date a facility was commissioned would remain applicable for that facility until 2030. In the event subsequent legislative changes provided for different incentives, the stabilization clause also allowed producers to choose which regime would apply.[5]

Ukraine Amends the Feed-in Tariff Regime

In the months following the new regulatory regime's enactment, it became evident that the system was not working as intended. The FiT substantially exceeded market prices, and by late 2019, GB lacked sufficient funds to make FiT payments to electricity producers. In November 2019, Ukraine's TSO restricted the generation of electricity by renewable energy producers due to an electricity surplus. GB ultimately suspended FiT payments to producers, who have not been paid in full since March 2020. Between March and August 2020, GB paid, on average, 5% of the amount of FiT payments it owed to producers each month.

Beginning in December 2019, the Ukrainian government and key energy industry associations negotiated potential reforms to the FiT regime. These negotiations came to a standstill in early 2020, after the government initially proposed retroactively reducing the FiT for renewable energy producers. Negotiations resumed after the President of Ukraine formed a new government. In June 2020, the Ukrainian government and industry associations representing some – but not all –

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[1] Law of Ukraine No. 2712-VIII "On Amending Certain Laws of Ukraine related to Ensuring Competitive Conditions for Production of Electric Energy from the Alternative Energy Sources", dated 25 April 2019.

[2] Law of Ukraine No. 2019-VIII "On Electric Energy Market", dated 13 April 2017.

[3] The Transmission System Operator, Private Joint Stock Company "National Power Company Ukrenergo," is required to dispatch electricity produced by renewable energy producers at a higher priority than other producers' electricity, subject to operational security considerations. The new regime also requires producers to be compensated at the FiT price for the cost of electricity not delivered as a result of the Transmission System Operator's despatch instructions ordering a reduction in output (except where such instructions are the result of force majeure). However, the law does not provide a payment mechanism for such compensation. Regulations addressing payment mechanisms and the methodology used to calculate non-supplied reduced generation were adopted in November 2020.

[4] Resolution of CMU No. 483 dated 5 June 2019 Regarding Approval of the Situation on Assignment of Special Duties on Participants of the Electricity Market for Maintenance of General Public Interests in the Course of Functioning of the Electricity Market.

[5] Law of Ukraine "On Electric Power Industry" No.575/97-BP, Article 17-1, dated 16 October 1997 (Amended on 22 April 2009) and Article 9-1 of the 2003 Law of Ukraine "On Alternative Energy Sources" ("The State shall guarantee that for economic entities producing electricity from alternative energy sources at commissioned electricity facilities, the procedure for stimulating the production of electricity from alternative energy sources established in accordance with the provisions of this Article on the date of commissioning of the facilities, including commissioning of the construction queues of power plants (start-up complexes), shall apply. In the event of legislation changes related to the procedure for stimulating the production of electricity from alternative energy sources, businesses may choose a new procedure for stimulation.").

investors and producers of renewable energy signed a Memorandum of Understanding (the "MoU"), the primary goal of which was to solidify GB's financial position by reducing the FiT for renewable energy producers, among other measures. The MoU contemplated that the FiT would be reduced by between 2.5%-15%, depending on the type of renewable energy facility (*i.e.*, solar or wind power), the date the facility commenced operation, and the facility's electric output capacity. The Ukrainian government, in turn, undertook to ensure GB's timely payment of the (reduced) FiT and gradually repay the existing debt to renewable energy producers that had accrued since the beginning of 2020.

In August 2020, Ukraine enacted the FiT Restructuring Law, which aimed to implement the MoU.[6] With respect to existing plants, the FiT Restructuring Law provides for the FiT to be reduced by 15% for solar power facilities and 7.5% for wind power facilities.[7] With respect to solar power facilities commissioned after 31 October 2020, the law provides for the FiT to be reduced by 60% (for plants with an output capacity exceeding 75MW) or 30% (for plants with an output capacity less than 75MW). While the Ukrainian government also increased the tariffs of the TSO to enable it to fund GB, it remains unclear whether this increase will allow GB to satisfy its payment obligations to renewable energy producers.

Following the enactment of the FiT Restructuring Law, GB has reported that it has fully paid its obligations to renewable energy providers for electricity purchased in August and September 2020. However, GB has not begun repaying the debt that accrued from March to July 2020.

Potential Investment Disputes Arising Out of the FiT Restructuring Law

The recent changes to Ukraine's FiT regime could give rise to a range of disputes. Renewable energy producers who have not received payment from GB may commence commercial arbitration against GB pursuant to the arbitration clause in the relevant power purchase agreements.[8] Further, investors in the renewable energy sector whose investments have been adversely affected by the regulatory changes may consider seeking remedies under international law.

In particular, Ukraine is a Contracting Party to the Energy Charter Treaty ("ECT"), a multilateral treaty that provides a framework for the protection of foreign investments in the energy sector and allows foreign investors to bring claims directly against host States in international arbitration. Ukraine has also entered into more than seventy bilateral investment treaties that extend protections to foreign investors and may provide for the resolution of investor-State disputes through international arbitration.

The ECT and many bilateral investment treaties include an obligation for host States to provide "fair and equitable treatment" ("FET") to foreign investments. The FET obligation has often been interpreted to impose a duty on the host State to create stable conditions for foreign investment; to act in a consistent, transparent, and proportionate manner; and to refrain from frustrating investors' legitimate expectations regarding the regulatory framework.

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[6] Law "On Amendments to Certain Laws of Ukraine on Improving Conditions for Supporting Renewable Energy Production" No. 3658 dated 21 July 2020. Certain provisions changing the procedure for providing compensation to renewable energy producers for non-supplied electricity (due to electricity curtailment pursuant to the despatcher's instructions) will become effective from 1 January 2021.

[7] The FiT for wind power plants put into operation after 1 January 2020 will be 5.88-5.15 Eurocent (for output capacity ranging from 0.6-2 MW) and 8.82-7.72 Eurocent (for output capacity over 2 MW) from 2020 through 2029.

[8] These power purchase agreements typically provide for disputes to be resolved through arbitration under the rules of the International Chamber of Commerce. Although GB is fully State-owned enterprise, under Ukrainian law it does not have sovereign or similar immunity from legal actions, claims, or attachments or from the enforcement of a judgment or arbitral award against it on sovereignty grounds.

In recent years, several European States have faced investment arbitration claims arising from their changes to the incentive framework offered to renewable energy producers. Tribunals assessing whether those changes violated the State's FET obligation have reached differing conclusions, in part due to distinctions in the specific facts of each case, the particular investment treaty involved, and differing views regarding the content and scope of the FET obligation.

For example, beginning in 2005, the Italian government enacted a series of decrees, known as the *Conto Energia* regime, under which qualifying solar power plants were entitled to receive certain incentive FiT payments for a period of twenty years after the plant was put into operation (*i.e.*, the average conventional useful life of a solar power plant). However, in the context of high costs for consumers, Italy began reforming its FiT regime in 2011. While the initial regulatory changes reduced the incentives granted to new plants, Italy's 2014 *Spalmaincentivi* decree reduced the FiT rates already in force for existing plants under the relevant *Conto Energia* decrees.

The *Spalmaincentivi* decree and other changes to Italy's FiT regime have been the subject of a number of investment arbitration claims. Tribunals addressing these measures have reached divergent conclusions, as demonstrated by two recent arbitral awards summarized below.

In *ESPF Beteiligungs GmbH v. Italy* ("*ESPF*"), German and Austrian investors challenged various measures by the Italian government that had altered the incentives for which the investors' solar power plants had previously qualified. The 2014 *Spalmaincentivi* decree was the principal measure at issue.

In an award issued in September 2020,[9] an arbitral tribunal hearing the investors' claim under the ECT explained that, "if a change in legislation fails to take into consideration that an investor's legitimate expectations must be protected, although the legislation may be validly amended as a matter of domestic law, the State may incur international liability." The tribunal considered that the *Conto Energia* decrees established an *ex ante* regulatory regime entitling qualifying solar power producers to specific and fixed incentive tariff rates that would remain unchanged for the twenty-year term. As a result, at the time of their investments, the investors had an enforceable legitimate expectation that their plants would benefit for twenty years from the specific tariffs set out in the relevant *Contro Energia* decrees, so long as the investors' plants complied with the decrees' pertinent requirements. In the *ESPF* tribunal's view, this legitimate expectation arose in part from the decrees' "clear and specific guarantee" stating, without reservation, that electricity produced by qualifying solar power plants would be "entitled" to the relevant incentive tariff. The tribunal concluded that, by unilaterally decreasing the tariffs for which the investors' solar power plants qualified, Italy's *Spalmaincentivi* decree violated the investors' legitimate expectations and therefore breached Italy's obligation under the ECT to provide fair and equitable treatment.

The *ESPF* tribunal's conclusion differed from the result in *Belenergia S.A. v. Italy* ("*Belenergia*"), in which the arbitral tribunal held that the *Spalmaincentivi* decree did not constitute a breach of the ECT.[10] In an award issued in August 2019, the *Belenergia* tribunal concluded that the investor could not have derived legitimate expectations from its contracts with the *Gestore dei Servizi Energetici* ("GSE"), the Italian State-owned entity overseeing renewable energy support schemes, which specified the applicable *Conto Energia* and FiT for each plant. The tribunal found that the amount and duration of the FiT set out in the investor's contracts with the GSE did not constitute a specific commitment to the investor because these components were "set forth in Italian legislation and were not personally addressed to Belenergia."

The *Belenergia* tribunal further emphasized that "an investor cannot legitimately expect that the legal and regulatory framework will not change when any prudent investor could have anticipated this change before making its investment." In the tribunal's view, at the time Belenergia invested in Italy (between 2011-2013), Italian laws and regulations "suggest[ed] a clear trend toward incentives' reduction." As a result, the *Belenergia* tribunal considered that the reduction in FiT

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[9] *ESPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH, and InfraClass Energie 5 GmbH & Co. KG* v. Italian Republic, ICSID Case No. ARB/16/5, Award dated 14 September 2020.

[10] *Belenergia S.A. v. Italian Republic*, ICSID Case No. ARB/15/40, Award dated 6 August 2019.

implemented under the 2014 *Spalmaincentivi* decree was “not surprising” and therefore could not have breached the investor’s legitimate expectations.

In the *ESPF* award, the tribunal also considered the fact that some of the investments in question were made after Italy had begun to decrease the FiTs for new plants in 2011. The *ESPF* tribunal noted that the *Belenergia* tribunal had considered this fact to be significant. In contrast, *ESPF* tribunal placed less weight on this fact, observing that “the legislative regime … was designed to attract early investment in a developing sector in part by decreasing the applicable tariffs over time,” and that a “key feature of the regime was the grandfathering of qualifying existing investments as it evolved.”

Italy is not alone among European countries facing claims that regulatory reforms in the renewable energy sector violated the State’s commitments under the ECT. Spain, the Czech Republic, and Romania have also faced investment arbitrations relating to changes to those countries’ regulatory frameworks. Spain’s experience is particularly illustrative. From 2010-2013, Spain enacted several legislative amendments rolling back a regime of incentives and subsidies for solar energy producers. Spain then introduced a completely new regulatory regime in 2014. These measures have been the subject of more than fifty investment arbitrations against Spain to date. The outcomes of these arbitrations have varied based on differences in the facts of each case, including the timing of investments, and divergent approaches to the interpretation and/or application of the FET obligation. Nonetheless, awards rendered against Spain in relation to regulatory changes in the renewable energy sector have totaled more than €860 million.

In response to this surge of arbitration claims and mounting liability to investors, Spain enacted a law in late 2019 offering investors with pending or concluded investment treaty claims relating to the renewable energy reforms certain economic incentives, such as a higher rate of return on investments, that are conditioned on the investors discontinuing pending investment arbitration proceedings or waiving their right to compensation under existing awards. To date, the Czech Republic has prevailed in six of the seven arbitrations concerning changes to its FiT regime for solar power plants, due in part to certain aspects of the Czech Republic’s historical incentive scheme for renewable energy producers that some arbitral tribunals considered did not create an expectation of a stable FiT. Romania is currently facing two pending arbitrations relating to changes in its incentive scheme for renewable energy investments.

Despite its attempt to establish a consensus with renewable investors through the MoU, Ukraine may face similar claims in light of its recent changes to the FiT regime. Among other issues, the FiT Restructuring Law sharply reduced the FiTs for existing renewable energy facilities, and investors in early-stage projects may also have been forced to delay construction and commissioning of plants in light of the significantly reduced FiTs for new facilities. Foreign investors may have the right to recover such losses if Ukraine’s measures violate its FET obligation under the ECT and/or applicable bilateral investment treaties. For instance, investors may point to the stabilization provisions in the legislation in effect at the time of their investment to argue that Ukraine’s recent reduction in FiT rates breached the investors’ legitimate expectations that they would receive the FiT established in the prior regulatory regime through 2030.

Wilmer Cutler Pickering Hale and Dorr LLP and INTEGRITES have significant experience in advising and representing clients in international investment disputes, including in particular in the energy sector, and can provide more detailed advice on recent and new developments in Ukraine relating to the issues discussed in this alert.

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