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CLIENT ALERT

Italy's Constitutional Court Endorses Constitutionality of Retrospective Cuts to Incentives to Investment in Italy's Solar Photovoltaic Sector

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On December 7, 2016 it was announced that Italy's Constitutional Court dismissed a challenge against the so-called "*Spalma Incentivi* Decree", that retrospectively cut the incentives once offered by Italy to entice investment in its solar photovoltaic ("PV") sector. While the full reasoning of this decision is yet to be published, this turn of events is likely to lead to numerous investment treaty claims against Italy (a situation similar to that faced by Spain for a number of years).

Against this background, this briefing discusses the guaranteed incentives once offered by Italy to entice investment in its solar PV sector, the measures enacted by the Italian Government rolling back these incentives, as well as the potential remedies that aggrieved investors may be able to pursue against Italy under international treaties.

Background: The incentives that Italy offered investors to invest in the PV sector in Italy

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

The principal incentive contemplated by *Conto Energia* takes the form of a feed-in tariff ("FiT"); a guaranteed sum paid on the basis of the amount of solar electricity fed into the grid. Under *Conto Energia* the amount of the specific guaranteed FiT is determined on a case-by-case basis considering a number of specific criteria in relation to each PV power plant (including, for example, whether the installation is ground-fixed, rooftop, integrated, or non-integrated, and the nominal capacity of the PV plants).

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

- The relevant FiT level applicable to a specific PV power plant is guaranteed for 20 years from the date of connection of the PV power plant to the national grid;

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

Italy Reduces FiTs on PV Power Plants

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

The position dramatically changed with the enactment of the *Spalma Incentivi* Decree (Law August 11, 2014, No. 116, published in the Italian Official Gazette No. 192/2014 on August 20, 2014) that ratified (with amendments) the decree issued by the Italian Government on an urgent basis on June 24, 2014 (D.L. No. 91, published in the Italian Official Gazette No. 144/2014 on June 25, 2014). Broadly speaking, the *Spalma Incentivi* Decree significantly reduced the FiT levels guaranteed to PV power plants already connected to the national grid and that were subject to express stabilization agreements between PV electricity producers and the GSE. Thus, the measures contained in the *Spalma Incentivi* Decree are retrospective in nature. This unexpected change cut across the financial aspects of the project finance obtained by most solar PV projects in Italy, preventing numerous investors from servicing its debt.

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

International investors may be entitled to redress

The measures in the *Spalma Incentivi* Decree may entitle aggrieved international investors that invested in Italy's PV sector to obtain redress (including compensation) under some international instruments, in particular the Energy Charter Treaty (the "ECT") and relevant bilateral investment treaties ("BITs").

The ECT

The ECT was signed by Italy on December 17, 1994 and entered into force on April 16, 1998. In addition to Italy, there are 51 other ECT member states which include, amongst others, Cyprus, Germany, Luxembourg, Switzerland, and the UK.

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

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

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

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

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

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

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

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

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

BITs

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

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

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

Facilitated Enforcement of Resulting Awards

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

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

Third Party Funding

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

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

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

Our Experience

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

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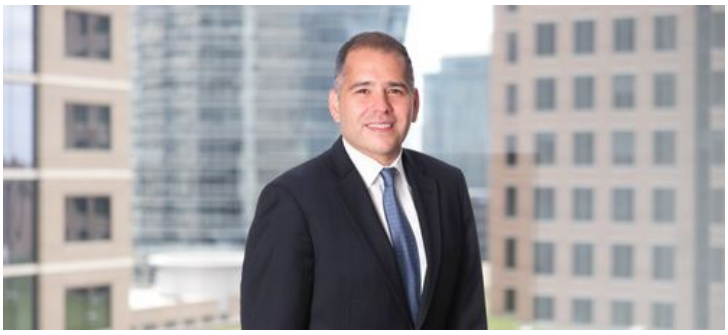

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