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A Battle on Two Fronts: Vattenfall v. Federal Republic of Germany

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Swedish state-owned power energy company Vattenfall operated two nuclear power plants located in Brunsbüttel and Krümmel, Germany. Vattenfall owns a 50% interest in the Krümmel plant, and a 66.6% interest in the Brunsbüttel plant. In August 2011, against the backdrop of the nuclear disaster in Fukushima, Japan, the German Parliament amended the Act on the Peaceful Utilization of Atomic Energy and the Protection against its Hazards (the "**Atomic Energy Act**") to abandon the use of nuclear energy in the country by 2022 (the amendment is known as the 'Thirteenth Amendment').

The Thirteenth Amendment statutorily accelerated fixed end dates for the operation of nuclear power plants without any compensation – and therefore cut short the operational lifetimes of the nuclear power plants that had just been fixed in 2010 by means of the Eleventh Amendment. Consequently, Vattenfall's licenses to operate both plants were immediately withdrawn and operations in both plants were shut down.

Vattenfall adopted a two-front battle against the German State's measures: the filing of a constitutional challenge with the German Federal Constitutional Court (the "**Court**"), and the initiation of an investment arbitration against Germany under the Energy Charter Treaty ("**ECT**") (the "**ECT Arbitration**").

The Constitutional Litigation in Germany

In February 2012, Vattenfall Europe Nuclear Energy GmbH and Kernkraftwerk Krümmel GmbH & Co. oHG (the "**Petitioners**") filed a constitutional complaint regarding the Thirteenth Amendment before the Court for violation of their property rights. On December 6, 2016, the Court issued a first judgment (the "**2016 Judgment**") finding that the Thirteenth Amendment was incompatible with the German Constitution "insofar as it [did] not include any provision for a settlement for investments that were made in legitimate expectation of the additional electricity output allowances allocated in 2010, but were devalued by the Amendment."

First, the Court recognized that the State enjoys broad powers in determining which aspects of the common good to prioritize, and how to protect public interests such as life and health (at ¶ 283). In

this particular case, the Court found that the State enjoyed particularly broad powers to design its atomic energy law, given the high-risk nature of this activity.

Nonetheless, the Court held that such broad regulatory powers are not absolute, as the State is still obliged to preserve the legitimate expectations of investors (at ¶ 372). The Court found that, in this case, legitimate expectations arose from the Eleventh Amendment because it extended permissions for nuclear power plants and encouraged investors to undertake investments in plants, and it was not foreseeable that the German legislature would shift its energy policy within the same legislative period (at ¶¶ 375-377). By enacting the Thirteenth Amendment just a few months later, the German State unreasonably limited the investors' property by devaluing the investments that were made following the Eleventh Amendment. The Court found that this amounted to a violation of the investors' legitimate expectations, and therefore the State should have provided appropriate compensation (at ¶¶ 372-73, 375-80). (A previous discussion of the decision is available here).

In light of the above, the Court ordered that the Thirteenth Amendment could remain in effect until the legislature adopted a new amendment to correct the violations of the German Constitution, which was to occur no later than June 30, 2018 (at ¶¶ 399-406).

To comply with the Court's mandate, on July 10, 2018, the German legislature enacted the Sixteenth Amendment to the Atomic Energy Act. This amendment was to enter into force one day after the European Commission ("**EC**") authorized it, or declared that no state-aid authorization was necessary (*see* Article 3). Applied to the Petitioners' case, the amendment provided that (i) the Petitioners were entitled to compensation, but only if they had previously made a good faith effort to sell residual energy to third companies at a reasonable price; and (ii) if compensation was paid, it was limited to 2/3 of the residual energy for Brunsbüttel and 1/2 of the residual energy for Krümmel. Given that Vattenfall's partner was in a position to use all of its residual energy internally, it was not entitled to compensation (*see* § 7f(1)).

The Petitioners filed another constitutional complaint regarding the Sixteenth Amendment, and on September 29, 2020, the Court rendered a second judgment (the "**2020 Judgment**").[1)] The Court found that the Sixteenth Amendment never entered into force because it was contingent upon approval from the EC. However, the EC had neither approved the Sixteenth Amendment, nor issued a binding communication that such an approval was not required (at ¶¶ 53-69) Therefore, the Court found that the violation of the Petitioners' rights persisted given that no other remedial provision had been enacted.

In addition, the Court also held that the content of the newly enacted regulation would still infringe upon the Petitioners' constitutional rights. The Court found that the fact that the amendment tied compensation to an obligation to make efforts to transfer compensable electricity volumes to other companies under adequate conditions was unreasonable (at ¶ 71). In particular, it was unreasonable because, at the time they were to start negotiating the transfer of electricity, the Petitioners would not know whether the transfer conditions would meet the § 7f(1) criteria, and if the criteria weren't met the Petitioners would risk not receiving compensation at all (at ¶¶ 74-76).

The Petitioners also complained about the proposed reduction of their compensation under the Sixteenth Amendment. Without opining on the amount of compensation provided, the Court held that this aspect of the amendment would also be unconstitutional. In particular, In particular, the amendment lacked sufficient specificity to determine compensation in circumstances where two corporations were shareholders in an affected investment (*i.e.* Vattenfall and PreussenElektra), but

only one corporation was entitled to compensation pursuant to the 2016 Judgment (*i.e.* Vattenfall) (at ¶¶ 77-81).

Accordingly, it is clear from this latest decision that the German State still remains obligated by the 2016 Judgment to enact new provisions as soon as possible in order to remedy the violations of the Petitioner's constitutional rights (at ¶ 84).

The ECT Arbitration

On May 14, 2012, Vattenfall and its German subsidiaries initiated an international arbitration under the ECT against Germany, claiming EUR 4.7 billion due to losses allegedly suffered from Germany's decision to accelerate the phase-out of nuclear energy under the Thirteenth Amendment. The International Center for the Settlement of Investment Disputes ("**ICSID**") is administering the arbitration (*see Vattenfall AB and others v. Federal Republic of Germany* (ICSID Case No. ARB/12/12)). Hearings on jurisdiction, merits, and quantum were held in 2016, however, a final decision is still pending.

In a Q&A public statement, Vattenfall explained that it decided to pursue the constitutional litigation *and* the ECT Arbitration as "it was not an option for Vattenfall to await the multi-year procedure at the German Federal Constitutional Court before appealing to ICSID." Ironically, Vattenfall obtained a quicker decision from the German judiciary (in December 2016) than the ICSID tribunal which continues hearing the case to date. However, the path towards remedying the violations to the Petitioners constitutional rights under German law is not finished yet as the German legislative power still needs to comply with the 2016 Judgment through the adoption of new legislative measures.[2)]

Impact of the 2020 Judgment on the Ongoing ECT Arbitration

Back in 2016, Nikos Lavranos discussed the impact of the 2016 Judgment in favor of the Petitioners on the ECT Arbitration. He anticipated that the arbitral tribunal would perform a comprehensive balancing between the regulatory powers of the German State and the protection of the legitimate expectations and property rights of the investor. The 2020 Judgment does not seem to alter that assessment.

While the parties' written submissions in the ECT Arbitration are not public, from November 21, 2020 to November 27, 2020 the Tribunal held public hearings on certain quantum issues – with the parties also being invited to make submissions on the impact of the 2020 Judgment on the arbitration proceedings. On this issue, the Claimants submitted that the 2020 Judgment:

1. removed any relevance of the Sixteenth Amendment on the arbitration proceedings (since Germany had argued that such amendment rendered the Claimants' claims moot), and
2. showed precisely why the Claimants had to bring the ECT Arbitration: ten years after the constitutional challenge was brought, Germany still had failed to compensate Claimants.[3)]

On its side, Respondent alleged that Claimants were inflating its damages claim, among others,

because:

1. while in the constitutional litigation Vatenfall is not claiming damages and the Court does not deal with damages – rather the Court held that sales of electricity volumes could not amount to compensation – in the arbitration, the Claimants' quantum analysis takes into consideration *ex ante* prices to calculate higher damages; and
2. while German constitutional law focuses on individual property rights (in this case, the individual power plants and individual assets), the ECT Arbitration focuses on Vatenfall's investment in an energy company which one of its lines of business was nuclear energy.[4)]

While judicial decisions do not constitute a binding precedent for an international investment arbitration tribunal, they can provide support to arguments such as those advanced by Vattenfall, as well as other investors facing similar energy bans without compensation from a host state. It will be interesting to see how the arbitral tribunal in the ECT Arbitration deals with the Court's judgments in its final award (in particular, the reasoning in the 2016 Judgment regarding the violation of the investors' legitimate expectations and property rights).

In turn, this decision will certainly be an important precedent for other cases where investors have resorted to international arbitration against States for similar legislation seeking to accelerate the decommissioning of coal-fired power plants, without compensating foreign investors. For instance, in 2018, Westmoreland Coal Company initiated arbitration against Canada following the Government of Alberta's 2015 plan to eradicate coal-based energy by 2030. Likewise, in September 2019 Uniper expressed its intention to file a claim against The Netherlands after the Dutch parliament passed a bill in 2016 which set forth a 55% cut in GHG emissions by 2030. On February 2, 2021, ICSID registered an ECT claim against the country arising out of those measures brought by German energy company RWE AG. Finally, on January 31, 2021, Australian mining company Berkeley also announced it is considering resorting to international arbitration if an amendment to Spain's climate change bill, that proposes banning the mining of uranium in the country, is passed.

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References

?1 According to the Constitutional Court's official press release the 2020 Judgment was made public on November 12, 2020 and is currently available in German language only.

?2 According to a statement by the spokesman for the Federal Ministry of Environment, Stephan Haufe, the required changes to the Atomic Energy Act to comply with the Court's judgement will be implemented in the course of this year.

?3 *See Vattenfall AB and others v. Federal Republic of Germany* (ARB/12/12), Hearing on Tribunal Question 8 (November 21, 2020), Claimants' Opening Statement.

?4 *Id.*, Respondent's Opening Statement.

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