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International Arbitration Case Law

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**HRVATSKA ELEKTROPRIVREDA D.D. v. THE REPUBLIC OF
SLOVENIA
(ICSID CASE NO. ARB/05/24)
AWARD**

Case Report by María Lucila Marchini**
Edited by Ignacio Torterola ***

An Award rendered on December 17, 2015, under the “Agreement between the Government of the Republic of Croatia and the Government of the Republic of Slovenia on Regulation of the Status and Other Legal Relations Regarding the Investment, Use, and Dismantling of Nuclear Power Plant Krsko”, and in accordance with the ICSID Convention and Arbitration Rules.

Tribunal: Mr David A. R. Williams, Q.C. (President), The Hon. Charles N. Brower, Professor Jan Paulsson, Q.C.

Claimant’s counsel: Mr Josip Lebegner (Principal Representative), and Mr Robert W. Hawkins, Mr Stephen M. Sayers, Ms Julie M. Peters, Mr Leo Andreis, HUNTON & WILLIAMS LLP

Defendant’s Counsel: Mr Mark Levy, Mr James Freeman, Mr Rishab Gupta, Ms Katrina Limond, ALLEN & OVERY LLP

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Digest

1. *Facts of the Case*

Claimant is Hrvatska Elektroprivreda, d.d. (“Claimant” or “HEP”), a national electric company of Croatia. From 1994 to the present time, all shares in HEP have been owned by the Government of Croatia. Its claim against the Republic of Slovenia (“Slovenia” or “Respondent”) concerned the ownership and operation of Krško Nuclear Power Plant (the “Krško NPP”), located in Slovenia.

In 1974, the national electricity companies of Croatia and Slovenia established a limited liability company, Nuklearna Elektrana Krško (“NEK”), as joint venture to build and operate the Krško NPP. The latter was designed and constructed using funds contributed equally by the national power industries of the Socialist Republics of Slovenia and Croatia at a time when both were still part of the former Yugoslavia. The financing, construction, operation, management and use of the Krško NPP were regulated by four agreements between the Governments of Croatia and Slovenia between 1970 and 1984 (“the Governing Agreements”). The basis of the Governing Agreements was the principle that the co-investors were to be equal partners in all aspects related to the plant (“parity principle”).

In 1991, Slovenia and Croatia declared independence. Over the following years, the Slovenian Government adopted a series of measures that were viewed by HEP as being inconsistent with the parity principle and the basic provisions of the Governing Agreements. On 30 July 1998, Slovenia disconnected electricity lines from the Krško NPP to Croatia, terminated all electricity deliveries to HEP, and issued a Governmental “Decree” which HEP claimed affected its rights as a 50 percent owner and manager of the plant.

Because of Slovenia’s displacement of HEP’s rights, the Governments of the two countries entered into negotiations. A settlement was agreed following the Deputy Prime Minister of Croatia’s proposal. Accordingly, all of the parties’ claims up to 30 June 2002 were to be waived and, on that agreed date, deliveries of electricity to HEP from the Krško NPP were to be restored. These agreements were recorded in the “Agreement between the Government of the Republic of Croatia and the Government of the Republic of Slovenia on Regulation of the Status and Other Legal Relations Regarding the Investment, Use, and Dismantling of Nuclear Power Plant Krško” (the “2001 Agreement”).

Slovenia did not ratify the 2001 Agreement until late February of 2003, and it did not resume deliveries of electricity from the Krško NPP to HEP until 19 April 2003.

In the meanwhile, on 24 June 2002, NEK presented to HEP an offer for the supply of electricity for the six month period 1 July 2002 – 31 December 2002 (the “June 2002 Offer”). The June 2002 Offer included a charge for decommissioning. Slovenia assumed that if it offered to supply electricity to HEP, even if this was done outside the framework of the still-to-be-ratified 2001 Agreement, that would eliminate any risk that Croatia or HEP would bring a damages claim against Slovenia or NEK. HEP did not accept the June 2002 Offer.

On 13 November 2002, NEK again offered to sell to HEP 50% of the electricity production of the Krško NPP, this time from 1 January 2003 to 31 December 2003 (“the November 2002 Offer”, and together with June 2002 Offer, “the 2002 Offers”). HEP rejected the November 2002 Offer.

Since Slovenia failed to restore HEP’s rights as a 50 percent owner of the Krško NPP or to resume electricity deliveries from the plant by 30 June 2002, Claimant initiated an arbitration proceeding before ICSID, filing a Request for Arbitration on November 4, 2005.

HEP advanced two independent legal bases for its claim. On the one hand, it alleged that Slovenia’s termination of electricity deliveries to HEP on 30 July 1998, together with the issuance of the Decree removing HEP’s rights as a 50 percent owner of the Krško NPP, violated HEP’s rights as an investor under Articles 10(1) and 13 of the Energy Charter Treaty (the “ECT Claims”). HEP contended that these violations continued until deliveries of electricity were restored to HEP on 19 April 2003. HEP emphasized that although it had agreed to waive its ECT claims accruing up to 30 June 2002, it had not waived those ECT claims that accrued between the period dating 1 July 2002 to 19 April 2003.

As an alternative argument, HEP claimed for breach of Slovenia’s obligation under the 2001 Agreement to restore electricity deliveries to HEP from the Krško NPP by 30 June 2002.

The Tribunal had issued a Decision on the Treaty Interpretation Issue, dated 12 June 2009, which confirmed the Tribunal’s jurisdiction and determined liability under the 2001 Agreement. In particular, it had declared that Slovenia was liable to Claimant for the financial value to HEP of 50 percent of the electrical power produced by NEK throughout the period 1 July 2002 until 19 April 2003; and that

HEP and NEK had waived certain claims to each other. In addition, the Tribunal had dismissed all claims asserted by HEP against Slovenia arising under the Energy Charter Treaty.

Nevertheless, certain matters remained for determination, and were discussed in the present Award.

2. *Legal Issues Discussed in the Decision*

(a) *Whether the 2002 Offers made by Slovenia meet its obligations and whether they should have been accepted by HEP (paras. 177-218)*

Respondent argued that in making the 2002 Offers, it complied with its obligations under the 2001 Agreement to supply electricity, and therefore, should not be held liable for any loss HEP incurred in rejecting the offers and sourcing electricity elsewhere¹. In turn, HEP alleged that the 2002 Offer did not constitute full or partial compliance by Slovenia with its obligations under the 2001 Agreement, since they were materially different from the requirements of the said Agreement².

The Tribunal concluded, recalling the appointed expert's findings, that the 2002 Offers differed materially from the deal agreed in the 2001 Agreement in several respects: "(a) *The Offers were based on budget costs without any reconciliation to actual costs; (b) The cost included contributions to the dismantling fund; (c) The cost included depreciation calculated on an accounting basis; (d) The cost included NLB loan interest in 2003 but not in 2002; (e) The Offers were expressed in euros at a predefined rate for the whole period, rather than being expressed in Slovenian Tolar (SIT) and converted to Croatian Kuna (HRK) on a month by month basis*" , and "*there was a variance in relation to transmissions costs*"³.

Thus, due to the substantially differences between the 2001 Agreement and the 2002 Offers, the Tribunal affirmed that in making said offers, Slovenia had not complied with its obligations under the 2001 Agreement.

The Tribunal also found that HEP was not required to accept the 2002 Offers so as to mitigate its losses under international law since it was reasonable for HEP to reject them due to the material variances.

Slovenia therefore remained liable for any loss suffered by Claimant as a result of its breach.

(b) *Whether HEP pass on any additional costs to consumers and therefore suffer no loss (paras. 219- 245)*

The expert appointed to the proceedings had suggested a "pass-on defence": that

¹ Award, ¶178.

² Award, ¶180.

³ Award, ¶¶ 207, 208.

HEP would likely have recovered any increase in costs from consumers through price adjustment and thereby have recovered through its revenues any potential loss incurred as a result of replacing the Krško power⁴. The consequence of the argument would be that Claimant had suffered no loss and therefore cannot recover any damages.

Even though Respondent did not raise this defence, it relied on the suggestion made by the expert, emphasizing that if HEP was able to pass its increased costs of supply to its customers, it already recovered any losses it suffered due to non-delivery of electricity⁵. Claimant alleged that the pass-on defence had to be rejected since it was based on assumption and speculation, and that no evidence was provided in this regard⁶. It added that even if it was to be considered, the defence was only available in cases where those who suffered the harm (which in this case would be the Croatian consumers) were able to bring a direct suit against the wrongdoer to recover their losses. HEP stated it was legally impossible⁷.

The Tribunal decided to consider the pass-on defence within the framework of compensation in international law. It affirmed that Claimant could only recover in compensation the loss that it had actually suffered, because the purpose of damages is to compensate the injured party and not to punish the wrong-doer.

It also added that the burden of proving such defence lied with the party asserting this fact. Then, it was Respondent who had to prove the allegation. Since no evidence had been adduced by either party or by the expert that would allow the Tribunal to conclude that the cost of replacing Krško power was recovered from consumers, the Tribunal was not in a position to conclude that no loss occurred.

(c) *Calculation of damages (paras. 246 - 518)*

HEP and Slovenia approached compensation using the same basic calculation, and the Tribunal used it in order to calculate the damages: “X minus Y”, being “X” the figure that represented the factual scenario (the cost HEP incurred replacing the electricity it would have received from the Krško NPP), and “Y” the figure that represented the counterfactual scenario (the cost that HEP would

⁴ Award, ¶232.

⁵ Award, ¶229.

⁶ Award, ¶223.

⁷ Award, ¶226.

have incurred had it received 50% of the electricity produced by the Krško NPP).

Firstly, as regards “Y”, both parties initially accepted the appointed expert’s calculation. However, later on, Claimant relied on its own experts’ reports, which excluded certain elements from the calculation (e.g. certain decommissioning expenses and loan servicing costs)⁸.

The Tribunal found that, in the counterfactual scenario, the cost of Krško electricity to HEP would have been €55,647,000. It relied entirely on the appointed expert’s calculation. It assessed the cost of the Krško NPP electricity, looking at the actual costs for the second half of 2002 and for the entirety of 2003. The Tribunal also took into account the depreciation, assessed upon actual expenditure on investments during the 1 July 2002 to 18 April 2003. It also considered the cost of transmission by including a transmission charge on the price of electricity at the station busbars.

Secondly, regarding the “X” factor, the parties diverged considerably on the appropriate approach. On the one hand, Claimant adopted a so-called “replacement cost” approach, while Respondent adopted a so-called “market value” model⁹.

The Tribunal emphasized that many factors may influence an entity’s dispatch decisions to replace the electricity, so one of the key issues is whether the entity acted reasonably in making the decisions that it took.

In this sense, the Tribunal focused its analysis by recalling some basic principles of compensation in international law, which required that HEP be placed in the same situation which would, in all probability, have existed had it received electricity from the Krško NPP from 1 July 2002, while also providing “damages for loss sustained”. The damage actually incurred, therefore, represented the upper limit of the amount of damages, since HEP could not recover damages that it did not suffer.

Consistent with these principles, the preferred approach to calculate the “X” factor, according to the Tribunal, was the “replacement cost approach”. Said approach achieved what is required by international law as it allowed the Tribunal to analyse the factual matrix to determine what HEP actually did to replace the electricity it would have received from the Krško NPP and to

⁸ Award, ¶352.

⁹ Award, ¶360.

determine whether its actions were reasonable.

What HEP actually did to replace electricity from the Krško NPP was a combination of imports and TPPs. After a detail analysis of the actions took by HEP, it was the Tribunal's view that it acted reasonably in making these decisions, in response to legitimate and genuine security of supply concerns.

Having complied with the international law standard, the Tribunal calculated the costs related to TPPs and imports, finding that the "factual" scenario X factor was €77,205,000.

The figures were then inserted into the X – Y calculation to reach the final sum of €21,558,000 (i.e., €77,205,000 – €55,647,000 = €21,558,000), which amounts to what the Tribunal found was the measure of damages to which Claimant was entitled subject to any deduction.

Lastly, the Tribunal included a deduction which took account of benefits that HEP received in the factual scenario. HEP submitted that the Tribunal should disregard the calculation made by the expert, since it contended that it made basic errors in its calculation. It concluded that if a benefit-to-HEP theory were to be applied, the correct benefit to apply would be an immaterial €150,000¹⁰.

According to the Tribunal's view, HEP did indeed receive a benefit as shareholder between 1 July 2002 and 18 April 2003. This benefit was derived from the fact that NEK sold the Krško energy that should have been supplied to HEP under the 2001 Agreement to other Slovenian buyers at a higher price than it would have received from HEP, thus increasing its own revenue.

The Tribunal found that the benefit HEP received during the relevant period was €1.571.000, and was to be deducted from the overall loss of €21,558,000.

(d) *Calculation of interest (paras. 520 - 560)*

HEP contended that interest should accrue from the "date when the State's international responsibility became engaged", i.e., from 1 July 2002. As to the rate, HEP argued it should be based on "the one-month EURIBOR rate, with an appropriate risk premium ranging from 1.75–5.5%". HEP submitted interest should be compounded monthly¹¹. In turn, Respondent alleged that any interest awarded should run from the date on which the obligation to pay the principal

¹⁰ Award, ¶¶476-480.

¹¹ Award, ¶¶521-525.

sum arose – being the date of an award by the Tribunal requiring Slovenia to pay a sum to HEP. In the alternative, Slovenia argued that interest may only be charged from 12 June 2009, that being the date of the Tribunal’s Decision on the Treaty Interpretation Issue. If its two prior submissions as to the date from which Slovenia’s obligation ran were not accepted by the Tribunal, the earliest date that interest could possibly run from was 11 March 2003, that being the date of entry into force of the 2001 Agreement. It also stated that the correct rate was the rate of deposit that would have been received by HEP had it been able to re-invest its funds. Lastly, Slovenia submitted that interest awarded should be simple rather than compound¹².

The principle of full reparation, provided in Art. 38(1) of the ILC Draft on State Responsibility, guided the Tribunal in making its finding on interest. It recalled the Commentary to the Articles on State Responsibility, which states that “*an injured State is entitled to interest on the principal sum representing its loss, if that sum is quantified as at an earlier date than the date of the settlement of, or judgment or award concerning, the claim and to the extent that it is necessary to ensure full reparation*”¹³.

As regards the date from which interest should run, since the purpose of interest is to ensure that HEP receives full compensation, the interest had to be applied from the time at which damage occurs until any compensation paid is due. Thus, interest should be calculated from 1 July 2002, which is when its damages first started to accrue, until the debt is satisfied by Respondent.

In relation to the rate of interest, the Tribunal affirmed that it must be reasonable and fair, approximating the return the injured party might have earned if it had had the use of its money over the full period of time. The Tribunal concluded to tie the interest rate to the average six-month EURIBOR, because “*it represents an objective, market-orientated rate, well suited to ensuring that the consequences of the breach are indeed wiped out*”¹⁴. The Tribunal considered also to add a small premium of 2% because of the relative risk associated with different countries, and to incentivise parties to honour their liability under an award in an expedient manner.

In relation to the question whether the interest should be simply or compound, the Tribunal considered that the latter was appropriate, commercially sensible, and consistent with modern international practice.

¹² Award, ¶¶526-529.

¹³ Award, ¶539.

¹⁴ Award, ¶553.

Lastly, the Tribunal found that interest should be compounded at six-month intervals (semi-annually), which was more common in practice.

(e) *The Tribunal is not entitled to revisit Claimant's ECT Claims (paras. 561-583)*

Claimant had based its claim in two arguments: a single claim for compensation on the basis of interpretation and application of the 2001 Treaty, and claims under the ECT. In its Decision on the Treaty Interpretation Issue¹⁵, the Tribunal had dismissed all claims asserted by HEP against Slovenia as arising under the ECT.

Then, Claimant had asked to reconsider the decision. HEP emphasised that it had not waived its ECT Claims and that the Tribunal had not ruled that it had done so¹⁶. In contrast, Slovenia submitted that HEP had been forewarned by the Tribunal of the dismissal of the ECT Claims, and even if the ECT Claims had not been dismissed, they were factually irrelevant, as HEP had not claimed anything under the Energy Charter Treaty that it had not claimed under the 2001 Agreement¹⁷.

The Tribunal said that leaving aside the issue of whether or not the ICSID Tribunal has, or does not have, the power to reconsider (and clearly no viable basis for the requested reconsideration existed), since HEP achieved the "single claim for compensation" on the basis of interpretation and application of the 2001 Treaty, the alternative ECT Claim for such compensation necessarily was fallen away. Claimant was not deprived of nothing by the dismissal of its alternative ECT Claim.

(f) *Costs (paras. 584 - 613)*

Claimant had submitted that it should be awarded its full costs since Slovenia's jurisdictional objections and certain issues raised by Respondent were meritless and were dismissed by the Tribunal and thus, the case was prolonged by a number of years with consequent increase in costs. It also asserted that HEP prevailed on its liability claims under the 2001 Agreement¹⁸. In turn, Slovenia submitted that the costs follow the event principle should apply and that it should be regarded as the successfully party if the 2002 Offers had absolved it of

¹⁵ Tribunal's Decision on the Treaty Interpretation Issue of 12 June 2009.

¹⁶ Award, ¶¶562-564.

¹⁷ Award, ¶¶566-572.

¹⁸ Award, ¶588.

liability, or if Claimant had suffered no loss and therefore were awarded no damages. It submitted that if Claimant were to be regarded as the successful party, the above principle should not apply and the parties should bear their own legal costs¹⁹.

The Tribunal found that being Claimant the successful party, it was therefore entitled to recover costs. However, in the Tribunal's view, Claimant's pursuance of the ECT Claims after the Treaty Interpretation Decision and the unnecessary delays and expenses, had to be considered in assessing the amount to be awarded, as will the overall reasonableness of the costs claimed.

The Tribunal also considered that both parties should be equally liable for expert's fees, since he became necessary because neither party's experts provided a clear nor convincing damages case. As the parties have already paid these fees in equal shares, the expert have been removed from the overall costs considerations and Claimant's cost claim was therefore reduced to US\$13,177,041.52.

Taking into account the HEP's attempt to revive the ECT Claims, the behaviour of the parties in providing information to the tribunal expert and the reasonableness of the costs claimed, the Tribunal found that Claimant was entitled to recover costs in the amount of US\$10 million plus interest according to section (d).

3. *Decision*

The Tribunal found Respondent shall pay to HEP compensation for the breach of the 2001 Agreement in the sum of €19,987,000.

As regards the costs, Slovenia shall reimburse Claimant for their costs of the arbitration and for their legal and other reasonable costs incurred in connection with the arbitration, in the amount of US\$10,000,000.

In addition, it shall pay to Claimant interest on the sum awarded at a rate of EURIBOR plus 2%, compounded semi-annually, from 1 July 2002 until the date of payment in full.

¹⁹ Award, ¶¶591,593.