

Prague November 10th, 2010

Dear Sirs,

As you will be aware, substantial changes to the current legal framework regarding photo-voltaic power plants are currently being put into effect by the Czech government.

The underlying reason for these changes is of course the fact that the current level of subsidies, being the highest in Europe, has caused a boom to an extent that obviously was not expected by the Czech government. Financial effects arising hereof are regarded as unbearable. In addition, public pressure for changes has recently become very strong due to media painting a picture of steeply increasing electricity prices to be expected.

Hereinafter, we will try to outline the current and also planned status of the draft laws as well as inform you about a basic concept of measures, which can be implemented as defence against the planned changes. The following text is meant as an initial introduction to the topic and does not constitute legal advice in an individual case. Please also note that the situation still keeps changing. Please do not hesitate to contact us, we will be happy to provide you with updated information.

1. Legal situation

1.1. Act no. 180/2005 Coll., on promotion of use of renewable energy resources

On Tuesday, November 9th, 2010 the Chamber of Deputies of the Czech parliament in the third reading passed the amendment of Act no. 180/2005 Coll., on promotion of use of renewable energy resources (the "Act"), by which the following amendments would be implemented to the Act (the "Amendment"):

- 1.1.1. Abolishment of any subsidies for new photo-voltaic power plants ("PVP") with the exception of PVP's with an output of up to 30 kW placed on roofs or facades of buildings. PVP's that do not fulfil the conditions for allocating grants pursuant to the current legal regulations by February 28th, 2011 shall be considered as new;
- 1.1.2. Abolishment of subsidies for PVP's operated without connection to the electric grid (stand-alone systems), unless they are connected to the grid by December 31st, 2011 at the latest.

The above-described changes continue the previous amendment of the Act, carried out by Amendment no. 137/2010 Coll., which allowed a drop in tariffs by more than 5% from year to year, if the economic return on investments for renewable resources falls below 11 years. This previous amendment of the Act

and the Amendment did not determine the upper limit for such a reduction; which may be defined from the viewpoint of other provisions of the Act only by the requirement for a 15-year economic return.

1.2. Tax law

In addition to the above changes, new taxes on proceeds from the operation of PVPs during the period of January 1st, 2011 until December 31st, 2013 that will amount to 26% of the energy purchase price and 28% of the green bonus were also introduced within the framework of the Amendment. These taxes shall be levied on all PVPs put into operation in 2009 and 2010, with the exception of PVPs with an installed output of up to 30 kWp that are mounted on rooftops or walls of one building having permanent foundations and being registered in the land register.

Also of importance in the area of taxes is a proposed amendment of the Income Tax Act, which has already been passed by the Chamber of Deputies in first reading. This amendment shall abolish tax holidays for renewable energy resources in general and determine depreciation over 20 years. The Senate is supposed to discuss this particular draft law in its session on November 12th, 2010.

2. Consequences of the proposed legislative changes

The following consequences result from the above:

2.1. Conditions for obtaining the feed-in tariff

Despite the Amendment, the issue of what conditions a PVP has to fulfil by a certain date in order to receive a grant pursuant to the Act is not satisfactorily solved.

In this regard the current practice of the Energy Regulation Authority ("ERU") is not, in our opinion, in accordance with the actual wording of the Act or its wording after the Amendment. According to the published interpretation of the ERU it is not enough for obtaining a tariff rate valid for a particular year to put the PVP into operation (i.e. to at least officially start test operations), but it is also necessary to, during the given year, get a licence, conclude a contract with an energy distributor for a grant for the energy produced by a given PVP (feed-in price or green bonus) and actually commence deliveries to the power grid at least in the test operation mode.

According to a statement of ERU dated October 29th, 2010, the date of putting into operation is to be understood as the date, on which the following conditions are fulfilled cumulatively: (i) the licence obtained legal force, and (ii) the PVP started producing electricity and (iii) is feeding it into the grid.

These conditions are also reflected in the ERU's latest decision on prices no. 2/2010 dated November 8th, 2010, where "putting a plant into operation" is defined as being fulfilled under the following conditions: (i) the licence obtained legal force, and (ii) the plant is connected to the electric grid.

Since the Act for determining the tariff of a given PVP requires only that the PVP must be put into operation during the determined period, in our opinion the above stated standpoint of the ERU as well as the practice of the electricity distributors are in conflict with the Act.

The philosophy of the Act is built on the economic return of investments for particular renewable sources of energy ("RSE"). Therefore the Act puts the level of subsidies in relation to energy sources, into which investments have already been made, whereas the investment i.e. the construction costs of the energy source ends at the moment when the plant is physically completed and, from a technical perspective, ready to be put into operation. Therefore the Act determines putting the energy source into operation as the moment decisive for determining the tariff rate. According to the relevant building regulations the moment of putting a PVP into operation is deemed the moment, when the test operation of the PVP was approved by the relevant building authority or another competent authority, in particular by obtaining the building acceptance

Insofar as the ERU also requires a licence and the supply of electric energy into the electric grid, these are requirements regarding the entrepreneurial activity of producing electric energy, which are contrary to the Act. The Act determines the amount of subsidy in relation to the construction costs of certain energy sources during a certain period. Other facts associated with the production of electric energy as an entrepreneurial activity are irrelevant according to its wording.

Pursuant to the clear wording of the Act it would be in principle possible to put a PVP or other RSE into operation and during the relevant period neither produce nor deliver to the electric system one single kWh (for example because the PVP is not connected to the electric grid, there is no production licence or the entrepreneur simply decided to commence his activities later).

During the period when a PVP is not producing energy naturally no subsidies are paid, since they always apply to produced energy.

However, in case the PVP commences its supplies to the electric system in the future, the grant for the produced energy should, according to the Act, be determined in the amount valid for plants put into operation in the year when the particular PVP was put into operation in the above mentioned sense. The tariff valid for the year when delivery into the grid actually commenced is in our opinion not decisive.

To support our view that the interpretation of the Act by the ERU is not in harmony with the law we may give as an example that no licence for producing electric energy is required at all for a PVP, that is operated exclusively for someone's own consumption within the framework of associated business operations – energy production in this sense does not constitute a separate entrepreneurial activity. And since 100% of the produced energy is consumed by the operator of the PVP it is also unnecessary to connect it to the electric grid. The statutory subsidies according to the Act do apply to such plants without any doubt which leads us to the conclusion that the requirements made by ERU as well as the energy distributors regarding obtaining of a licence for producing electric energy and supplying it into the electric grid go beyond the framework of the Act and are therefore illegal.

In view of the above, it is in our opinion sufficient for obtaining the right to claim subsidies that the PVP is put into operation in accordance with the relevant building regulations by February 28th, 2011.

2.2. Rate of feed-in tariff

On one hand the Amendment gives a right to subsidies for a PVP if it satisfies the conditions for the grant pursuant to the current regulations by February 28th, 2011 (see the previous paragraph), on the other hand it does not determine what tariff rate should be applied.

Already according to the amendment of the Act published in the Collection of Acts under no. 137/2010 Coll. in spring of 2010, the tariff rate may be lowered yearly by more than the previous 5% if the return on investment for PVPs falls below under 11 years. According to the ERU's recently published decision on prices, the feed-in tariff for PVPs with an output of more than 100 kWp for 2011 dropped more than 55% as compared to the actual tariff rate.

If therefore the Amendment maintains an entitlement to grants for plants fulfilling the legal conditions February 28th, 2011, it at the same time stipulates that for energy sources put into operation in 2011, the tariff for 2011 shall apply, which, in case of PVPs with an output of more than 100 kWp, is over 55% lower than the one for 2010.

2.3. Island systems

Until recently there was uncertainty about whether a grant could be applied for at all under the Act for stand-alone systems unconnected to the grid, i.e. the so-called island systems. The Amendment at least clarifies this matter, because when it sets a deadline, by which the island systems must be connected to the electric system to maintain the entitlement to grants, we must come to the conclusion that until

now subsidies did apply to island systems, since otherwise it would be unnecessary to determine a transition period for connection.

In the current situation, when the state is clearly declaring its determination to reduce costs for electric energy produced by PVPs, in our opinion the Amendment may not be interpreted in such way that it actually extends grants to such types of PVPs to which grants did not apply until now.

2.4. Taxation

The new tax regulations threaten every PVP financed by bank loans with the usual rate of own funds (20-30%) with immediate financial ruin.

Thus the impact of the additional taxation will not only affect the actual operators of PVPs, but also those parties who provided financing, in particular banks and leasing companies.

If the discussed 26% (resp. 28%) tax is launched, this will in our opinion bring about dramatic changes in the Czech photo-voltaic market, because the majority of investors will not have sufficient own funds available to cover the dramatic drop in the cash-flow of their projects. The only possible solution for quality projects solids to sell them to investors with lower expectations on investment return, in other cases bankruptcy will likely be the outcome.

In view of the extent of legal uncertainty caused by the Czech government in the area of renewable resources, the issue is whether it will be possible to find new investors, even for quality projects, at all.

If projects cannot be restructured within a realistic period of time, huge losses could be incurred in the financial sector, because the failure of projects will affect in particular banks and other parties providing external financing. Taking into account the recent financial crisis, from which our economy is slowly recovering, the government's current non-systematic approach to RSE is really startling.

3. Practical aspects

The logical consequence of the above described legal changes is that investors will seek to protect their investment against its unexpected devaluation.

In this respect there are, in our opinion, different options according to whether international investments or purely national investments are involved. All PVP projects that have a share of foreign funds in their property structure can be deemed as foreign investments, regardless of the percentage of foreign funds involved. Typically this will apply to investments where foreign natural persons or foreign legal entities are partners or shareholders in the company operating or building the PVP.

In addition available legal remedies differ according to what particular change in the legislation affects the given project. Abolishment of grants logically applies only to new plants (at least when the concept of the Amendment will be maintained), on the other hand the new taxation and cancellation of tax holidays will also affect existing plants.

Possible remedies are further divided according to whether a realized investment (i.e. a functioning PVP) or an investment that could not be realized at all because of the legislation changes is involved. In this respect we would consider the changing of the municipal plan or possibly the legal force of the building permit for the PVP as the decisive moment for the entitlement to legal protection. In our opinion these are the first moments when the "idea" for a new entrepreneurial activity materializes into an investment, in relation to which protection can be considered.

3.1. National Investments

Unfortunately, in the case of purely national investments, only few legal tools are available to protect them, while none of them has clear and foreseeable prospects of success and their application within the framework of Czech law is complicated. With regard to this we would like to point out, without deeper legal analysis, some aspects, which could serve as the argumentative base for legal claims against the state from the position of a national investor.

As regards the cancellation of grants for new plants, the difference between the interpretation of law applied by the ERU and the jurisprudentially correct interpretation of the Act regarding the decisive moment for the putting into operation of a PVP, as described above in paragraph 2.1, may serve as a starting point.

A marginal problem is further the manner of calculating the tariff in association with the increase of income from PVP, when according to the current methodology ERU in principle takes into account only the bare realization costs and disregards the costs of financing. The Act itself does not determine the methodology for calculating the tariff; it only operates with the term 'rate of return on investments'. However, an internationally accepted item for calculating the rate of return on investments is also the cost of financing, which should therefore also be included in the ERU's calculation. This should lead to increased tariffs or, as the case may be, a lesser decrease in the tariff than was actually decided.

A separate subject, which should be analysed in detail, is the impact of taxation on the rate of return on investments – it could be logically expected that the rate of return on investments must be calculated from the actual cash flow. If the state from this deducts an additional 26% as it is now planned by the government, there is no doubt that this must also be reflected in the tariff rate, because a decrease in the real income of PVPs necessarily affects their rate of return on investments.

With regard to changes in tax law it could possibly also be argued with the unconstitutionality of the newly considered 26% tax, however this cannot be analysed in more detail before the particular amendment is accepted.

In any case, however, the above described variants must be applied on the national level and the issue is whether Czech courts, as the state authorities that will finally decide on this matter, will in fact interpret the Act according to its wording and not according to political agendas.

We can summarize that for purely national investments legal means of protection exist, but they are clearly limited in scope and their successful application appears quite uncertain.

If a Czech entrepreneur in photo-voltaics has the possibility to relocate his investments abroad or, as the case may be, transfer them to foreign subjects, we recommend this approach in order obtain the protection of international treaties on the protection of investments, as further described in brief below. The result of eventual arbitration proceedings against the Czech Republic is naturally always uncertain, but it is definitely better to have the possibility to commence such proceedings than not to have such an option at all.

3.2. Foreign investments

Compared to the purely national investment a foreign investor has one important additional instrument in the form of protection through international treaties on protection of investments that stipulate the option of commencing international arbitration proceedings against the Czech Republic, should the Czech Republic not satisfy a claim resulting from the international treaty out of court.

This protection differs according to the contents of the particular, usually bilateral treaty between the Czech Republic and the domestic state of the foreign investor. The extent of protection or if this protection exists at all depends on whether there is such a treaty between the foreign investor's home country and the Czech Republic and if yes, in what manner and to what extent the protection is determined.

The advantage of international arbitration proceedings from the viewpoint of the investor is particularly that state authorities do not decide about the dispute and, at least theoretically, the arbitration senate cannot be influenced by the government policies of one country.

Another significant advantage is that the rules for calculating compensation are not as rigid as under the Czech legal system (Among others the Czech legal system allows for compensation when the damage was caused by incorrect proceedings of state authorities. However legislative changes do not fall within this category, so

that accordingly no compensation of damages due to the changes in legislation can be considered at all).

In international arbitration proceedings claims can be enforced independently of the national laws or, as the case may be, a change to the national legislation itself often entitles an investor to commencement of arbitration proceedings.

From the viewpoint of international protection of investments and with regard to the already existing or expected changes in the legislation on photo-voltaic projects claims for compensation of damages, may be considered in particular for the following reasons:

- 3.2.1. Abolishment of the limitation of tariff rate drops to a maximum of 5% per year (already existing change), if the investment at least partly took place before the relevant change of legislation;
- 3.2.2. Abolishment of grants for PVPs with an output higher than 30 kWp, and this in regard of projects that were not completed to the cancellation of grants as well as of projects not commenced at all for this reason. In our opinion, an important aspect here is also the extremely short transition period, during which a PVP has to be completed in order to maintain entitlement to the grants (no limit pursuant to the current laws / deadline February 28th, 2011 pursuant to the Amendment);
- 3.2.3. Discriminating taxation of income from production at photo-voltaic power plants. This problem will require a deeper analysis to determine if this constitutes a discriminating tax, against which protection is guaranteed by the bilateral treaties on protection of investments, which bind the Czech Republic.

Subsequently a special chapter is calculating amounts that can be claimed within the framework of investment protection. In principle, in our opinion, two models may be considered, i.e. revenue compensation or compensation of part of the basic value of the investment, so that together with the remaining part of the investment the expected revenue is produced. On this point, it will particularly depend on at what stage of the investment the protection is applied (the project is already completed / investment was not realized at all).

3.3. What to do – preparing for arbitration proceedings

It is almost impossible for a normal investor to influence the legislation process, in particular when the target would be to stop the proposals that have already been discussed in parliament, and hinder their acceptance.

Therefore an investor can only concentrate on preparing for the worst case by creating the basic conditions for protecting its investments to the maximum possible extent.

As already stated above, foreign investments enjoy a higher level of protection. Depending on the investor's home country, however, there are differences in the legal tools that are available.

Therefore, we recommend that investors analyse their investment structure and check whether they are in fact under the jurisdiction that provides the broadest protection of their investments. If this is not this case, the logical solution would be to try to relocate investments to a better locality.

Relocation of investments also concerns purely national investments for whom a move abroad or, as the case may be, their take-over by a foreign entity whose domicile is under a suitable jurisdiction is the matter of a few days and will principally improve the chances of avoiding the impending disaster brought about by the government for Czech businesses.

At this point we consider it necessary to point out that in our opinion there is not much time for restructuring of investments. In our opinion protection of investments may only be enjoyed in regard to the effects of legislative changes that took place AFTER restructuring. It is difficult to present arguments on the loss of value of a project, if investments were made only after the new legislation, which decreases its economic value, was passed.

For example, in our opinion it will not be possible to successfully claim protection against an increase in the yearly decrease of the tariff rate, if the foreign investor invested into the project only at the beginning of November, when the legal change allowing the tariff rate to be decreased has already been valid since May.

It would surpass the framework of this memorandum, to discuss whether it is not too late already to relocate investments at a time when it is almost certain that the laws will be changed. Naturally, it is better to have at least a theoretical possibility to apply international protection of investments and to only in the framework of the process of enforcing protection solve the other problems than to leave investments on a purely national level and thus waive any such possibility at all.

3.4. What to do – other cases

Apart from the international protection of investments, there is very little we can do at this moment.

In previous sections of this memorandum we have outlined certain discrepancies between practice and the statutory law in particular in relation to determining the tariff rate or, as the case may be, the applicability of the tariff rate to particular

PVPs. In principle, this will be the only way in which it will be possible to proceed if a project does not run according to schedule (the majority of PVP projects at the construction stage have planned completion and connection dates by the end of 2010).

The only meaningful activity in this respect is to concentrate on completing the project according to the time schedule and, should this not be possible, to see if it is at all possible to satisfy at least the minimum requirements for obtaining the grant pursuant to the Act, i.e. putting the plant into operation by the end of the year. Even if it is not possible to carry out other actions leading to complete termination and commencement of production for some reason (ERU does not issue the licence, the distribution company uses the maximum time for connecting the PVP to the electric grid or for concluding the feed-in contract), it is absolutely essential to have the power output actually installed and at least the permit for the trial operation. The other problems can then be solved consecutively.

If the output is not actually installed and operation is not officially approved, at least in the test operation mode, we cannot in our opinion hope for success in the sense of maintaining the tariff rate for 2010. The new tariff rate for 2011 has been already announced by the ERU and is no positive news.

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