THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

J U D G E M E N T

on Behalf of the Republic of Latvia

in Case No. 2014-12-01

3 July 2015, Riga

The Constitutional Court of the Republic of Latvia comprised of: chairperson of the court hearing Aldis Laviņš, Justices Kaspars Balodis, Kristīne Krūma, Gunārs Kusiņš, Uldis Ķinis, Sanita Osipova and Ineta Ziemele,

having regard to the constitutional complaint submitted by the limited liability company "AD Biogāzes stacija" and other 89 legal persons (hereinafter, jointly – Applicants),

with the participation of the Applicants' authorised representatives – sworn attorneys-at-law Egīls Radziņš, Sandis Bērtaitis, Justīne Haka, Māris Logins, Kaspars Zeme, Linda Štrause, Jānis Vaits, assistant to a sworn attorney-at-law Rihards Niedra and board member of Ltd. "NERETAS DZIRNAVAS" Viktors Lelis,

and the authorised representative of the institution, which adopted the contested act, the Saeima of the Republic of Latvia, Kārlis Piģēns,

and the secretaries of the court hearing Elīna Kursiša and Gunta Barkāne,

on the basis of Para 1 of Section 16 and Para 11 of Section 17(1) of the Constitutional Court Law,

on 19, 27 and 29 May and 4 June 2015 in Riga examined at an open court hearing the case

"On Compliance of Para 1 and Para 2 of Section 3 and Para 1 of Section 4 and Section 5 of the Subsidized Energy Tax Law with Article 1 and Article 105 of the Satversme of the Republic of Latvia".

The Facts

1. on 6 November 2013 the Saeima adopted the Subsidized Energy Tax Law (hereinafter – SET Law), which entered into force on 1 January 2014.

Para 1 and Para 2 of Section 3 of SET Law provide:

"Income obtained from the following shall be taxable (hereinafter – taxable income):

1) electricity sold within the scope of mandatory procurement;

2) guaranteed payment received for the electric capacity installed in a cogeneration unit or power plant."

Para 1 of Section 4 of SET Law provides:

"Taxpayers are producers of electricity who have the following rights:

1) to sell electricity within the scope of mandatory procurement."

Whereas Section 56 of SET Law provides:

"(1) Tax rate in the amount of 15 per cent shall be applied to taxable income from:

1) electricity sold within the scope of mandatory procurement, in the production of which fossil energy resources were used;

2) from guaranteed payment for the electric capacity installed in cogeneration installations, in which fossil energy resources are used.

(2) Tax rate in the amount of 10 per cent shall be applied to taxable income from:

1) electricity sold within the scope of mandatory procurement, in the production of which renewable energy resources were used;

2) from guaranteed payment for the electric capacity installed in electricity production units, in which renewable energy resources are used;

3) from guaranteed payment for the electric capacity installed in cogeneration installations, in which renewable energy resources are used.

(3) Tax rate in the amount of 5 per cent shall be applied to taxable income from electricity sold within the scope of mandatory procurement, if the following criteria are met concurrently:

1) electricity was produced in high efficiency cogeneration units with installed electric capacity not exceeding 4 megawatts in cogeneration units of natural gas, or without restriction of installed electric capacity in cogeneration units of renewable energy resources;

2) the taxpayer sells at least 70 per cent of thermal energy obtained as a result of cogeneration process during a taxation year as a heating system transmission or distribution merchant licensed by the Public Utilities Commission (hereinafter – the Regulator) or transfers to another heating system transmission or distribution merchant licensed by the Regulator or local government that provides services of centralised heating system.

(4) Tax rate in the amount of 5 per cent shall be applied to taxable income from electricity sold within the scope of mandatory procurement, if the following criteria are met concurrently:

1) electricity was produced in high efficiency cogeneration units with installed electric capacity not exceeding 4 megawatts;

2) not less than 30 per cent of by-products or derived products of animal origin have been used for the production of electricity;

3) not less than 70 per cent of the total raw materials has been ensured by the taxpayer or it has purchased the necessary raw materials from a producer who owns not less than 50 per cent of the equity capital shares of the taxpayer;

4) the taxpayer uses the produced thermal energy for the production of its produce or sells to a producer which is considered the related party in relation to

the taxpayer within the meaning of Section 1, Clause 18, Sub-clause “a”, “b”, “c”, “d” or “e” of the Law On Taxes and Fees and which uses it for the production of its produce.

(5) Tax rate in the amount of 5 per cent shall be applied to taxable income from electricity sold within the scope of mandatory procurement, if the following criteria are met concurrently:

1) electricity was produced in high efficiency cogeneration units with installed electric capacity not exceeding 4 megawatts;

2) electricity is produced from wood biomass;

3) the taxpayer uses not less than 70 per cent of the thermal energy obtained as a result of cogeneration, which is remaining after energy consumption of the main units producing or transforming energy, for the production of its produce or sells to a producer which is considered the related party in relation to the taxpayer within the meaning of Section 1, Clause 18, Sub-clause “a”, “b”, “c”, “d” or “e” of the Law On Taxes and Fees and which uses it for the production of its produce.

(6) Tax rate in the amount of 5 per cent shall be applied to taxable income from electricity sold within the scope of mandatory procurement, if the following criteria are met concurrently:

1) electricity was produced in high efficiency cogeneration units with installed electric capacity not exceeding 4 megawatts in cogeneration units of natural gas, or without restriction of installed electric capacity in cogeneration units of renewable energy resources;

2) electricity was produced from fossil energy resources (natural gas) or biogas;

3) the taxpayer uses not less than 70 per cent of the thermal energy obtained as a result of cogeneration, which is remaining after energy consumption of the main units producing or transforming energy, for ensuring the plant vegetation process in covered areas, the total area of which is not less than 5000 square metres, or supplies to a producer which is considered the related party in relation to the taxpayer within the meaning of Section 1, Clause

18, Sub-clause “a”, “b”, “c”, “d” or “e” of the Law On Taxes and Fees and which uses the produced thermal energy for ensuring the plant vegetation process in covered areas, the total area of which is not less than 5000 square metres.”

2. The Applicants:

1) Ltd. “AD Biogāzes stacija”, Ltd. “BIO Auri”, Ltd. “Daile Agro”, Ltd. “BIOPAB” and Ltd. “Agro Iecava” (Application No. 44/2014);

2) Ltd. “Arsenal Energy”, Ltd. “EcoZeta”, Ltd. “ENERCOM PLUS”, Ltd. “Ošmaļi Energy”, Ltd. “Piejūra Energy”, Ltd. “Winergy”, Ltd. “Zemgales enerģijas parks” and Ltd. “Zemgaļi JR” (Application No. 70/2014);

3) Ltd. “KEGO”, joint-stock company „Residence Energy”, Ltd. “SGC” and Ltd. “Uni-enerkom” (Application No. 75/2014);

4) Ltd. “AGRO 3”, Ltd. “Agro Lestene”, Ltd. “Bērzi Bio”, Ltd. “BIODEGVIELA”, Ltd. “BIOPLUS”, Ltd. “BIO ZIEDI”, Ltd. “EKORIMA”, Ltd. “International Investments”, Limbaži region Zaiga Treimane’ farm “JAUNDZELVES” , Jelgava region Vinter’s farm “LĪGO”, Ltd. “RIGENS”, Ltd. “RZS ENERGO”, Ltd. “Sidgunda Bio”, Ltd. “LATVIJAS LAUKSAIMNIECĪBAS UNIVERSITĀTES MĀCĪBU UN PĒTĪJUMU SAIMNIECĪBA “VECAUCE””, Ltd. “Zaļās Zemes Enerģija” and Ltd. “ZEMTURI ZS” (Application No. 79/2014);

5) Ltd. “Lielmežotne” and Ltd. “STRELĒCIJA” (Application No. 88/2014);

6) Ltd. “LENKAS ENERGO”, Ltd. “ETB”, Ltd. “Rietumu elektriskie tīkli”, Ltd. “W.e.s.1”, Ltd. “W.e.s.2”, Ltd. “W.e.s.3”, Ltd. “W.e.s.4”, Ltd. “W.e.s.5”, Ltd. “W.e.s.6”, Ltd. “W.e.s.7”, Ltd. “W.e.s.8”, Ltd. “W.e.s.9”, Ltd. “W.e.s.10”, Ltd. “W.e.s.11”, Ltd. “W.e.s.12”, Ltd. “W.e.s.13”, Ltd. “W.e.s.15”, Ltd. “W.e.s.16”, Ltd. “W.e.s.17” and Ltd. “W.e.s.18” (Application No. 89/2014);

7) Ltd. “NERETAS DZIRNAVAS” (Application No. 95/2014);

8) Ltd. “UniEnergy” (Application No. 98/2014);

9) Joint-stock company “OLENERGO” (Application No. 100/2014);

10) Ltd. “Olainfarm enerģija” (Application No. 106/2014);

11) Ltd. “BK Enerģija” and Ltd. “Energy & Communication” (Application No. 107/2014);

12) Ltd. “Elektro bizness” (Application No. 108/2014);

13) Ltd. “Sal-Energo” (Application No. 109/2014);

14) Ltd. “Dienvidlatgales Īpašumi”, Ltd. “RB Vidzeme”, SIA „B-Energo”, Ltd. “BIOSIL” and Ltd. “LATNEFTEGAZ” (Application No. 110/2014);

15) Joint-stock company “Sātiņi Energo LM”, Ltd. “Brocēnu Enerģija”, Ltd. “Preiļu siltums” and Ltd. “SM Energo” (Application No. 111/2014);

16) Ltd. “BALTENEKO” (Application No. 117/2014);

17) Ltd. “SSR” and Ltd. “TEK 1” (Application No. 118/2014);

18) Ltd. “Priekules BioEnerģija” (Application No. 119/2014);

19) Ltd. “JUGLAS JAUDA” (Application No. 120/2014);

20) Ltd. “VANGAŽU SILDSPĒKS” (Application No. 121/2014);

21) Ltd. “HIDROLATS” of Liepāja Special Economic Zone (Application No. 122/2014);

22) Ltd. “Saldus siltums” (Application No. 123/2014);

23) Ltd. “GTG 1” (Application No. 124/2014);

24) Ltd. “BIO FUTURE” and Ltd. “GAS STREAM” (Application No. 125/2014);

25) Joint-stock company “Graanul Invest”, Ltd. “Graanul Invest”, Ltd. “Incukalns Energy” and Ltd. “Graanul Pellets Energy” (Application No. 126/2014);

26) Ltd. “ĒRBERĢES HES”, Ltd. “IU CEĻŠ” and Ltd. “KRĪGAĻU DZIRNAVAS” (Application No. 127/2014)

request the Constitutional Court to recognise Para 1 and Para 2 of Section 3, Para 1 of Section 4 and Section 5 of SET Law (hereinafter, jointly – the contested norms) as being incompatible with Article 1 and Article 105 of the Satversme of the Republic of Latvia (hereinafter – the Satversme).

2.1. In the case under review 26 applications have been combined, the claims and the legal basis that they comprise differ to a certain extent; for

example, these apply to the compatibility of Section 3 and Section 4, Section 3 and Section 5 or Section 3, Section 4 and Section 5 of SET Law with the norms of the Satversme. However, in the section of Facts the considerations presented by all Applicants shall be reflected as uniform argumentation, without characterising the considerations of each particular Applicant.

2.2. Allegedly the Applicants are merchants, whose activities are aimed at producing electricity. The majority of the Applicants have obtained the right to sell the produced energy within the scope of mandatory procurement. Ltd. "JUGLAS JAUDA", in its turn, is said to receive the guaranteed payment for installed electric capacity.

Mandatory electricity procurement means that the producer has been granted a guaranteed possibility for a certain period of time to sell certain amount of produced electricity for a price that exceeds the average electricity market price. These costs allegedly are covered by all end users of electricity, by paying the mandatory procurement component (hereinafter – MPC) in their electricity bills, proportionally to their electricity consumption. The difference between the price of electricity sold in the scope of mandatory procurement and the market price allegedly has been established with the aim to compensate to the producer the increased electricity production costs and to ensure commensurate profit. The mandatory procurement is said to have the effect of an incentive; i.e., the mandatory procurement has an impact upon an investor's behaviour – making an investment that it would not make in the absence of mandatory electricity procurement.

Whereas the guaranteed payment is said to mean that the producer has been granted the right to receive a fixed amount of money for a longer period of time for the electric capacity installed in a cogeneration plant, if it exceeds the amount established in legal acts. The guaranteed payment, similarly to the mandatory electricity procurement allegedly ensures to the producer foreseeable revenue. These both mechanisms of aid are said to have a shared objective – covering the costs of investments and ensuring commensurate profit.

2.3. The Applicants note that Article 1 of the Satversme comprises the principle of legal security and legal certainty. The principle of legal security is said to impose upon the State the obligation to ensure certainty and stability of legal relationships. Whereas the principle of legal certainty is said to impose upon the state institutions the obligation to act consistently with regard to legal acts that they adopt and to abide by the legal certainty that persons might develop in connection with a particular legal norm. When amending legal regulation the State should take into consideration those rights with regard to retaining or exercising of which a person might have developed legal, valid and reasonable certainty.

It is said that the mandatory procurement of electricity creates a special basis for legal certainty, since it functions as a measure for attracting investments and as a facilitator of project implementation. The Applicants, in investing into construction or restoring of power plants, had relied on the stability of legal regulation and the possibility to recover the invested resources. The Applicants could forecast their long-term income and, on the basis of these estimates, took the decision to attract monetary resources to invest them into construction of power plants and electricity production.

The Ministry of Economics had granted to the Applicants the right to sell the produced electricity in the scope of mandatory procurement. At the time when the Applicants made the necessary preparatory work for constructing their power plants and selling electricity in the scope of mandatory procurement, allegedly, no legal act or policy planning document envisaged applying tax to the income gained by selling electricity in the scope of mandatory procurement. Therefore it is contended that the Applicants had the right to expect that the significant restrictions would not be applied to the mandatory procurement, *inter alia*, no new tax would be applied.

At the time when the Applicants adopted the decision to develop projects of electricity production, the State of Latvia did not restrict the development of this sector and had not warned of possible re-examination of state aid at a later stage. Thus, the State for a number of years had continually and purposefully facilitated

the use of renewable energy resources in electricity production. As the result of this policy the Applicants had developed legal certainty with regard to retaining the legal regulation. Moreover, data had confirmed that Latvia had been unable to ensure the share of energy from renewable sources established by Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (hereinafter – Directive 2009/28/EC) and the action plan approved by the Cabinet of Ministers; therefore the Applicants had been certain that restrictive measures would not be applied at least until the time, when the share defined in Directive 2009/28/EC would be reached. Thus, the Applicant's legal certainty that the regulation would not be changed had been valid and reasonable.

SET Law was adopted on 6 November 2013, and within almost two months the application of subsidised energy tax (hereinafter – SET) to producers of electricity started. The Applicants hold that a period that is so short cannot be recognised as being sufficient for adapting the business model and adjusting to the expected changes. Likewise, the legislator had not envisaged any mechanisms of compensation that would compensate for the damage caused by the contested norm. Allegedly, the legislator did not ensure lenient transition to the new legal regulation either.

2.4. The Applicants underscore that Article 105 of the Satversme protects contractual rights with economic value and various economic interests, as well as various claims, the enforcement of which can be demanded in the presence of clear legal grounds. Future income should also be recognised as property, if it has been already earned or if a claim that can be satisfied exists.

The right to receive the aid promised by the State should be recognised as being the object of the right to own property, whereas the contested norms and the obligation to pay SET should be considered as a restriction upon the right to own property. Moreover, it is alleged that the legislator has no right to impose a tax on the production of subsidized electricity, since, on its merits, it should be

equalled to decrease of subsidies. SET rate is said to be exceedingly high and endangering the possibility to continue successive business activities.

The Applicants recognise that the restriction upon fundamental rights had been established by law; however, they note that the Saeima, in adopting the SET Law in urgent procedure, did not sufficiently assess the validity of the restriction upon fundamental rights and had not taken into consideration the objections to the introduction of SET expressed by the representatives of the sector. Thus, the procedure for adopting SET Law could be questioned.

The application of SET and the contested norms are said to have a legitimate aim – protection of public welfare and other persons' interests, which is manifested by restricting the growth of the total electricity price and promoting the competitiveness of economy. However, it is said that this aim had been set on the basis of erroneous assumptions and without initial impact assessment. Some of the Applicants also note that the true aim for which SET was introduced was not deduction of tax and ensuring state budget revenue, but decreasing the payments to be made in the scope of mandatory procurement for electricity purchased from producers of subsidized electricity.

The measures chosen by the legislator are said to be inappropriate for reaching the legitimate aim. The largest part of MPC is allegedly formed by the large cogeneration plants owned by the joint-stock company "Latvenergo" and not by the small cogeneration plants owned by the Applicants, and their impact upon MPC is said to be minimal. Thus, the legislator's opinion that small power plants significantly foster the growth of MPC is said to be unsubstantiated. Moreover, to reach the aim set by the legislator, the resources gained by collecting SET should be channelled for subsidies to public trader for decreasing MPC. However, Section 57 of the law "On the State Budget for 2014" establishes a restriction that prohibits the Ministry of Economics from compensating to the public trader the difference between the actual MPC rate and the approved fixed MPC rate until a confirmation from the European Commission has been received that SET complies with the legal acts of the European Union (hereinafter – the EU). Allegedly, such confirmation has not

been received yet, and, thus, the contested norms do not reach the aim set by the legislator.

The legitimate aim of the restriction upon fundamental rights could be reached my measures less restrictive upon the Applicants' fundamental rights. Allegedly, the Saeima, in adopting the contested norms, was not using rational considerations to substantiate why SET should not be paid from profit, but from the turnover, i.e., all income gained from selling the produced electricity. It is said that SET, together with other taxes, forms a significant tax burden, as the result of which electricity produced from renewable energy resources or by cogeneration cannot not be cheap, and this facilitates growing prices of electricity and thermal energy.

It is contended that the benefit gained by society does not exceed the violation of the Applicants' rights. Allegedly, the legislator in adopting SET Law did not assess the consequences of introducing SET in interconnection with its impact upon society; i.e., not only electricity, but also thermal energy is produced in cogeneration. The thermal energy produced in cogeneration plants is said to be comparatively cheap, therefore it can be offered to consumers for a lower price, and thus, the costs of thermal energy become significantly lower for consumers. If SET is imposed upon electricity producers, then the price of heating increases due to growing production costs. Hence, the savings from decreasing the growth of electricity price would be much smaller than the increase of thermal energy costs covered by consumers.

At the court hearing the Applicants' representatives sustained the claim regarding incompatibility of the contested norms with Article 1 and Article 105 of the Satversme.

3. The institution, which adopted the contested act, – the Saeima of the Republic of Latvia – holds that the contested norm complies with Article 1 and Article 105 of the Satversme.

In the framework of the aid mechanism the producers of subsidized electricity allegedly had the possibility not only to sell the produced electricity in

scope of mandatory procurement for a higher tariff, but also to receive investment aid from other aid programmes, for example, from the European Regional Development Fund or the Rural Development Programme implemented by the Rural Support Service. The system of higher tariff for purchasing electricity (*feed-in*) that has been introduced in Latvia envisages certain payment for each unit of electricity, produced by using renewable energy resources or in highly effective cogeneration, fed into the electric grid of common use.

The SET is said not to infringe in any way upon the right granted to Applicants to sell the produced electricity in the scope of mandatory procurement or the right to receive the guaranteed payment for installed electric capacity. The introduction of SET changed neither the terms for producing electricity, nor the amount or price of electricity sales.

The Applicants' references to the fact that they had not been sufficiently involved in the drafting of SET Law and their opinion had not been taken into consideration are said to be legally irrelevant. Neither the Satversme, nor the Saeima Rules of Procedure establish a mandatory pre-requisite for adopting legal norms consultations with the possible addressees of these norms.

The aim of SET Law is to restrict the growth of the total electricity price, to promote competitiveness of economy and not to increase the fuel poverty of households, as well as to ensure additional revenue to the state budget, which, in turn, would allow to provide finances for support measures for electricity users. Likewise, SET Law is said to have the aim of promoting competitive production of electricity from renewable energy resources and in efficient cogeneration, creating incentive for using the most efficient type of production and ensuring that in the future only competitive technologies enter the market. Protection of other persons' rights and public welfare is said to be a legitimate aim that is compatible with the interests of the whole Latvian society and justifies the establishment of a restriction.

SET has been introduced for the period until the end of 2017, envisaging decreasing or eliminating it in case, if actual decrease of the amount of subsidies to be paid out in the scope of MPC is achieved. In adopting SET Law, persons

had been informed in due time about the time when the their obligation to pay SET would arise and when this obligation would be revoked. Thus, merchants could plan investments to be made in the future.

Allegedly, the right to own property is not violated if the State imposes upon a person public law obligations to make monetary payments, which are not an excessive burden upon the person and do not leave a significant impact upon its financial status. In the process of drafting and adopting SET Law, considerations regarding merchants' cash flow had been assessed. Comparison of the intensity of aid applied to producers in the scope of mandatory procurement with the tariffs of other EU member states leads to the conclusion that the intensity of aid established in Latvia is among the highest. If the investment aid is higher than the admissible, then the producers of electricity lack motivation to decrease other costs related to electricity production and project implementation. In the process of drafting SET Law, the calculations, data and conclusions included in the study "Evaluation of the aid for electricity produced from renewable energy recourses and in cogeneration, and recommendations for improving the aid" had been taken into consideration. Thus, it can be concluded that merchants had sufficient resources at their disposal for paying SET and that there had been no doubts about their solvency and usefulness of SET.

During the court hearing the representative of the Saeima Kārlis Piģēns expressed the opinion that the contested norms were compatible with Article 1 and Article 105 of the Satversme.

4. The summoned person – the Ministry of Economics of the Republic of Latvia – holds that the contested norms comply with Article 1 and Article 105 of the Satversme.

The Ministry of Economics, essentially, upholds the considerations presented by the Saeima regarding the legitimate aim of the contested norms. SET has been introduced for the period of time until the end of 2017, envisaging decreasing or terminating it if actually a decrease in the amount of subsidies to be paid out in the scope of MPC had been achieved. It is said that after 2017 those

merchants, whose term of aid has expired, would withdraw from the mandatory procurement mechanism, thus decreasing impact upon MPC.

In the contemporary society all taxes should be commensurate, so that the taxpayer would be able to pay it honestly and would have no wish to evade the duty of paying it. The said circumstances had been assessed in the process of drafting the law, the basic rate of SET was established in the amount of 15%, and the reduced rate – in the amount of 10% un 5% for a certain range of subjects to ensure that the tax burden was not disproportional. I.e., the SET rate is established by taking into account the type of energy resource used at the plant.

The Ministry of Economics notes that the principle of legal certainty does not exclude the possibility for the State to amend the existing legal regulation but only requires the State to observe a reasonable balance between a person's certainty and those interests, for the ensuring of which the regulation is amended. The principle of legal certainty is said also to provide that the rights, once acquired by an individual, cannot exist for an unlimited period of time. I.e., this principle does not give the grounds to believe that the once established legal situation would never change. The principle of legal certainty is said to ensure to an individual legal protection only within the period of transition established by the legislator. It does not guarantee to an individual permanent *status quo,* i.e., it does not give the right to a permanent state of exception in the framework of a new legal regulation. In the field of applying taxes the test of legal certainty is said to be applicable even more narrowly, since the State has more extensive discretion compared to restricting other property rights. Therefore no merchant may expect that the tax system in the state will never be changed in a way that might leave a negative impact upon its business activities.

The Ministry of Economics has concluded that the existing aid mechanisms had not been effective enough and the impact of MPC upon the total electricity price until the period 2020 might seriously influence the solvency of all electricity users. SET is said to be a legally appropriate solution that ensures in the state budget resources that are needed for stopping, in a sufficiently fast and effective way, increase of MPC, already starting with 2014, preventing the

increase of the total electricity price that would leave a negative impact upon the development of Latvian economy in general and upon inhabitants' solvency.

The rights established in Article 105 of the Satversme, allegedly, do not guarantee a certain amount of state aid. SET, like any other new tax in a certain field of business activities affects a person's right to own property. I.e., introduction of a new tax or increasing the already established taxes leaves an impact upon merchants' profit estimates and might indirectly influence also merchants' competitiveness. However, the State, in providing for social justice and economic welfare, is said to enjoy broad discretion and it may restrict the right to own property. Moreover, the State's discretion in acting and taking decisions is said to be broader in particular with regard to restricting an increase of a person's property that is expected in the future. The public need for a balanced budget and evenly distributed tax burden is said to be a legitimate aim for restricting a person's right to own property.

At the court hearing, Jurijs Spiridinovs, the representative of the Ministry of Economics, noted that SET was one of the most systemic measures for ensuring the development of competitive economy. Economic development was said to be impossible without effective and balanced energy policy and, *inter alia*, acceptable electricity price. MPC, in turn, is one of the factors influencing electricity price. The introduction of SET dealt also with the issue of the support needed by low-income families. Thus, SET is said to be aimed at protecting public welfare.

The fact that the State provides certain aid to merchants does not mean that the State has no right to change the amount of this aid. It was said that in the future the amount of this aid would depend upon the decision by the European Commission. In the process of drafting SET Law, various alternative solutions had been assessed, *inter alia*, the possibility to reduce the amount of aid. However, if the aid were decreased, then it would no longer be possible to increase it. Thus, in the long term this situation could leave a negative impact upon the very activities of electricity producers, but SET did not have this aim.

Whereas applying SET to another object, for example, profit, would make this tax difficult to administrate.

5. The summoned person – the Ministry of Finance of the Republic of Latvia – has submitted to the Constitutional Court the findings that it prepared and submitted to responsible institutions at the time when SET Law was drafted.

The findings of the Ministry of Finance comprise references to the need to introduce various adjustments in the draft law. These proposals are related to the procedure for calculating, collecting and administering SET, as well as harmonising SET Law with other legal acts. However, these are not directly linked to the constitutionality of the contested norms and other issues to be examined in the case under review.

At the court hearing, the representatives of the Ministry of Justice Andrejs Tihomirovs, Jolanta Krastiņa and Dace Berkolde noted that that SET complied with the definition of a tax included in the law "On Taxes and Fees" and described the involvement of the Ministry of Finance in the drafting of SET Law, as well as the procedure for receiving approval for the state aid from the European Commission.

6. The summoned person – the Ministry of Justice of the Republic of Latvia – notes that the obligation to pay a tax always means a restriction upon the right to own property. However, the State enjoys broad discretion in establishing and implementing its taxation policy. In assessing the compatibility of draft SET Law with general legal principles, the Ministry of Justice had not identified a breach of the principle of legal certainty. The Satversme had granted *expressis verbis* authorisation to the legislator to adopt the state budget, thus, to define the revenue and expenditure of the state. Hence, the Satversme authorises the legislator to implement such fiscal policy that would ensure to the state necessary revenue. Since the State uses fiscal policy to regulate changing economic processes, a person has no grounds to be certain that the State, when responding to particular social and economic circumstances, would not introduce

a new tax. Otherwise, the obligation of the State to ensure that human rights are respected would be under endangered.

At the court hearing, the representative of the Ministry of Justice Laila Medina noted that the economic impact of SET upon the producers of subsidized electricity had been assessed in the process of drafting the law. Taxes *per se* are a restriction upon the right to own property; however, application of a tax in commensurate amount should not be assessed as being unlawful infringement upon the right to own property. The state aid to electricity producers is to be considered and an exceptional case in the field of business activities, and a person may not have legal certainty regarding interminable receipt of aid.

7. The summoned person – Public Utilities Commission (hereinafter – the Regulator) – notes that currently the decision No. 1/5 of 26 February 2014 is in force – "Methodology for Calculating the Mandatory Procurement Component". This methodology establishes the obligation of a public trader to submit data and the terms for making calculations, but does not influence the amount of aid to be provided to electricity producers, nor the costs to be covered by the end users of electricity. MPC, essentially, is the outcome of such mathematical calculations that are based on objective, facts-based indicators, and its meaning is to compensate for a public trader's additional expenditure incurred as the result of mandatory procurement and payments disbursed for the installed electricity capacity.

Section 28(5), Section 28^1 (4), Section 29^1 (4) and Section 30 of the Electricity Market Law provide that in the calculation of costs to be compensated for to a public trader the state budget subsidy established in the law on the state budget for the current year is taken into consideration to decrease the calculation of the mandatory procurement components. In difference to the opinion held by some Applicants, the calculation of MPC established in the methodology cannot be interpreted as being such that guarantees constancy of MPC. The methodology is said to ensure that a public trader accurately reflects the amount

of subsidy in calculations, decreasing accordingly the part of mandatory procurement costs that must be covered by electricity end users.

The Regulator holds that the regulation that SET Law comprises should be examined in interconnection with the informative report prepared by the Ministry of Economics that was approved at the sitting of the Cabinet of Ministers on 9 April 2013 "Action Plan for Limiting the Risks of Growing Total Electricity Plan"; i.e., the need identified in this action plan to eliminate excessive subsidizing of electricity producers. This is said to apply both to those electricity producers, who receive aid from various financial instruments and support mechanisms, and to those electricity producers, who commenced their operations prior to 1 January 2005 and continue receiving state aid.

The Regulator's representative, sworn attorney-at-law Jānis Junkers, during the court hearing referred to the Regulator's functions in protecting consumers' interests. The public trader of electricity had requested the Regulator, in setting the electricity price for end users, to take into consideration the subsidy envisaged in the budget for restricting the increase of electricity price. Hence, the Regulator, in view of the need to protect consumers' interests, had no valid grounds to act otherwise. The fact that some electricity producers work with losses *per se* does not meant that SET should be blamed for that, since a company's profit may be influenced by different factors that depend upon the company itself and the operational strategy it has chosen.

8. The summoned person – the Ombudsman of the Republic of Latvia (hereinafter – the Ombudsman) – holds that the contested norms are incompatible with Article 105 of the Satversme.

SET should be separated from the state aid in the form of mandatory procurement. With the introduction of SET neither was the state aid discontinued, nor its amount changed. Allegedly, SET in no way infringes upon the rights granted to the Applicants to sell produced electricity in the scope of mandatory procurement or the right to receive guaranteed payment for installed electric capacity. Likewise, SET does not change the terms for producing

electricity, the sold amounts and the price. Even though SET influences the amount of income that the merchant gains from the electricity produced and sold in the scope of mandatory procurement, the contested norms, allegedly, change neither the amount of state aid, nor the terms of it. Hence, there are no grounds to consider that the principle of legal certainty has been infringed upon.

The case under review does not contain a dispute regarding the fact that the restriction upon the right to own property has been established by a law adopted in due procedure.

This restriction is said to have a legitimate aim – protection of public welfare and other persons' interests, which is manifest as restricting the growth of the total electricity price and promoting the competitiveness of economy.

The State, in establishing and implementing taxation policy, is said to enjoy broad discretion. It comprises the right to choose the tax rates and the categories of persons that these apply to, as well as the right to set out the details of the respective regulation. However, tax regulation should be based upon objective and rational considerations. The legislator's decision regarding which tax would be commensurate and necessary is an issue of policy and expediency.

However, the legislator should see to it that the tax payment is not an excessive burden and that a balance between public interests and a person's right to own property is ensured.

The legislator notes that, judging by the information provided by the Applicants, SET may cause valid insolvency threats and should be considered as being incommensurate burden, since a reasonable balance between public interests and the damage caused to the Applicants is not ensured. No transitional period has been envisaged in introducing SET. Thus, the Applicants did not have the possibilities to review or change their business strategy. Likewise, the legislator, allegedly, did not considered more lenient measures for reaching the legitimate aim, for example, taxing the merchant's profit, not the income.

At the court hearing, the Ombudsman's representative Elīna Birģele noted that the application of SET was incompatible with the principle of proportionality, since a more lenient transition to the new legal regulation had not

been ensured, and the possibility of applying more lenient measures had not been examined, and SET should be recognised as being an excessive burden upon electricity producers.

9. The summoned person – association "Latvian Federation of Renewable Energy" (hereinafter – Federation of Renewable Energy) – holds the opinion that the contested norms are incompatible with the Satversme. The situation in the subsidized energy market had gradually deteriorated, starting with 2011, when the Cabinet of Ministers prohibited granting the right to sell electricity produced from renewable energy resources within the scope of mandatory procurement. In the subsequent years other restrictions upon the aid to producers of subsidized energy had been introduced. However, SET and natural resources tax should be considered as being the most significant restrictions. These are said to be incommensurate measures used to restrict the legal interests of the producers of renewable energy.

SET is said to be a measure by which the State obviously breached its commitment to pay to electricity producers a definite and foreseeable sum of remuneration within a set period. Almost all electricity producers that sell electricity in the scope of mandatory procurement gain the greatest part of their income from the electricity sold in the scope of mandatory procurement. Mandatory procurement is a support mechanism that, allegedly, comprises also legal certainty that requires special protection. The State, by establishing the system of mandatory procurement, had provided incentives to producers for investing resources into the construction of power plants, promising, in turn, foreseeable financial aid in a longer term. The producers had been certain that the legal regulation would not significantly change for worse and that they would be able to sell electricity for the price that was established by the legal acts that had been in force at the moment when these activities were conducted.

The aim of SET Law defined by the legislator – to promote competitive production of electricity – allegedly cannot be reached by applying SET. Among the producers, which sell electricity in the scope of mandatory procurement,

essentially, there is no competition in the classic understanding of it, whereas new producers cannot even enter the electricity market, since the State has prohibited granting the right of selling electricity in the scope of mandatory procurement. Selling electricity outside the mandatory procurement, in turn, is not economically profitable, since production costs exceed the income from selling electricity for market price.

At the court hearing, the representative of the Federation of Renewable Energy Stepanovs noted that in the process of drafting SET Law the opinion of the sector, as well as indicators of capital adequacy and profit had not been taken into consideration. The SET rates, established by the legislator, make the production of electricity from renewable energy resources economically unprofitable. After deduction of SET, many power plans operate with losses. Thus, the application of SET should be recognised as being a disproportional restriction of fundamental rights enshrined in Article 105 of the Satversme.

10. The summoned person – Riga Technical University, Faculty of Engineering Economics and Management, professor at the Department of Customs and Taxes *Dr. oec.* Kārlis Ketners – notes that SET is one of the possible solutions for restricting the increase of subsidies and electricity price. Its aim is to restrict the increase of the total electricity price to ensure the competitiveness of economy and not to increase the fuel poverty of households. Likewise, SET ensures additional revenue to the state budget, which, in turn, allows implementing support measures for electricity users. Indirectly, SET also promotes competitive production of electricity from renewable resources and in efficient cogeneration, providing incentives to produce electricity in the most effective way.

Other countries have taxes of similar nature, based upon the theory of economic rent of resources. If identical subsidies are granted to all electricity producers, excessive compensations can develop for some electricity producers. In view of different technologies and costs of resources that are used, some states attempt to decrease these differences by using taxes. For example, Norway, with

the aim to decrease excessive subsidies, taxes the profit of power plants, not the whole income. Moreover, tax recovery is envisaged in case if the power plant works with losses. Thus, proportionality to the income that a person would gain in regular business activities, unsupported by the state, is ensured.

Annotation to the draft SET Law comprises reference to a tax that has been established in the Chez Republic for producing electricity by using solar energy. The aim of this tax is to prevent unfounded excessive profit for the recipients of the aid and decrease state expenditure for providing aid. Such tax has been recognised as being compatible with the constitution, since it retains return on equity and depreciation. Whereas the tax applied in Spain is attributed to all electricity producers. In Latvia an analogous tax to it would be the electricity tax that is in force in Latvia, applicable to all electricity fed into the grid. Thus, it is alleged that SET Law cannot be substantiated by foreign experience and practice, since SET is not comparable to taxes existing in foreign countries.

SET Law establishes the obligation of electricity producers to pay SET; however, it does not take into consideration such aspects as the costs of business operations and depreciation of investments. Such regulation is said to be inappropriate for protecting other persons' rights and public welfare. Deficiencies in aid system cannot serve as the grounds for introducing a tax payment, since the most important aspect in establishing taxes is said to be solvency and the existence of a taxation source. However, the State enjoys discretion in the field of applying taxes, and no merchant can expect that the tax burden would not be changed or that new taxes would not be introduced.

At the court hearing, Kārlis Ketners brought attention to the fiscal aim of SET, i.e., ensuring income for the state budget. Latvia basically has not "earmarked taxes", the revenue from which would be used only for reaching particular aims. SET revenue is paid into the state budget, and following that the legislator established various subsidies, *inter alia*, also for restricting increase of electricity price. No person may feel certain that the state aid that has been granted will be retained for ever and that its terms would not be changed.

Applying SET to the subsidies to be disbursed is the simplest mechanism for administering the tax.

11. The summoned person –Dr. iur. Jānis Grasis, associate professor of BA School of Business and Finance – holds that the contested norms are incompatible with Article 1 and Article 105 of the Satversme.

Allegedly, the case does not contain a dispute, whether the Applicants' right to own property have been infringed upon, but whether this restriction has a legitimate aim and whether it is proportional. The State has the right to establish the obligation to pay taxes, and such obligation *per se* does not infringe upon a person's fundamental rights. However, even recognising the broad discretion that the State enjoys in the field of taxation, it is clear that the tax cannot be excessive to the extent that it threatens the taxpayer's financial stability.

The system of premium tariff for procuring electricity that has been implemented in Latvia envisages a certain payment for each unit of electricity fed into the electric grid of shared use, if it has been produced by using renewable energy resources or in highly efficient cogeneration.

Basically, the support mechanism consists of the rights that have been administratively granted by the Ministry of Economics to the producers to be supported to sell the produced electricity in the scope of mandatory procurement for a price that exceeds the market price of electricity. The mandatory procurement of electricity should be recognised as being a mechanism for attracting investments, guaranteeing continuous and foreseeable income after investing substantial financial resources to start production. The State used the legal regulation as impetus for the Applicants to invest significant resources into construction of power plants. This is taken into account also by credit institutions, which grant loans for constructing the plants, taking into consideration the producers' ability to repay these loans in longer term. Under different circumstances, the Applicants would not have invested resources into constructing and equipping power plants, since without state guaranteed aid they would not be profitable.

The restriction upon the right to own property that has been established by the contested norms is said to be disproportional, since application of SET influences the solvency of electricity producers. Financial accounts prepared by the Applicants prove that as the result of applying SET the costs of producing electricity exceed the revenue gained from its sale. Thus, in the future this business activity will cause losses, and electricity producers will be unable to meet their financial commitments vis-à-vis creditors and suppliers, and their future business operations will be endangered.

Allegedly, the note included in the annotation to draft SET Law – "it is envisaged that SET will be introduced for the period until the end of 2017, envisaging decreasing or eliminating it in case, if actual decrease of the amount of subsidies to be paid out in the scope of MPC is achieved" points to the legislator's true aim. It is not deducting the tax to ensure income to the state, but to decrease the payment for the procured electricity to be disbursed to merchants in the scope of mandatory procurement. SET Law is said to endanger the solvency of many electricity producers, and such restriction upon the right to own property is said to be disproportional.

At the court hearing, Jānis Grasis drew attention to the consequences of deducting SET, by noting that electricity producers were not gaining sufficiently large revenue to cover the costs of producing electricity. A totally different situation would develop if SET would be applied to the profit of the electricity producer; i.e., that part of the revenue, which exceeds the production costs of electricity. However, it would more difficult for the State Revenue Service to administer such system. If the State is of the opinion that the state aid to the producers of subsidized energy is too large, then such a tax that does not influence the solvency of electricity producers should be applied.

12. The summoned person – the former special adviser on energy issues at the European Commission Juris Ozoliņš – holds that the contested norm is incompatible with the Satversme.

J. Ozoliņš notes that fossil energy resources are not at all available in Latvia and that local energy production can be based only upon renewable energy. This means that the security of electricity supply and linking the economy with obtaining and transforming of resources is closely linked to renewable resources. In the case of wind, solar and hydro energy the costs of the resource is zero; however, the costs of biomass energy are also twice lower that the costs of natural gas. The costs of electricity produced from renewable resources are high, since they are linked to the costs on production equipment and comparatively large initial investments – setting up the territory, constructing new electrical transmission network; moreover, these power plants cannot be as effective as the large power plants that use fossil energy.

MPC, as to its essence, is only an accountancy value that serves to report on the additional payment imposed upon the electricity consumed by the end user. Irrespectively of the introduction of SET, the end consumers continue paying the whole MPC component. Even though the State allocates budget subsidies to the public trader to compensate for further increase of MPC, it is not directly connected to the case under review.

Latvia is said to be one of those countries, for which utilisation of renewable and local resources in the energy balance is important from the vantage point of supply security and employment, not from the perspective of environment protection and climate change. Struggling with the accountancy value MPC does not help to solve most important issues in the energy sector that pertain to security of supply, development of infrastructure and technology transfer. The procedure of drafting SET Law in no way can be recognised as being a model of transparency and honest information.

SET applied to the Applicants has already decreased their revenue, thus, it endangers loan servicing and does not promote quality in operating production facilities. In longer term it will also affect the operations of resource suppliers. However, it is difficult to judge about it on the basis of financial accounts annexed by the Applicants, and even less so – from the materials submitted by the Saeima that are of very low informative value. Elimination of SET, allegedly,

would not leave a significant impact upon the state budget and economy of Latvia, but would allow starting "from a scratch", allowing, in much better investment climate and mutual relationships, to align legal acts with the interests of security.

At the court hearing, Juris Ozoliņš noted that in Latvia not a single power plant has been built without the state aid. In this context the legislator's actions seem to be peculiar – on the one hand, subsidizing electricity production, and, on the other hand, imposing a tax upon the same persons, i.e., producers, for fiscal purposes. To a certain extent the legislator has deviated from its promises, and this endangers the investment environment. Attracting private equity is important for the development of energy sector; therefore the resources collected by SET are not worth the damage that this tax causes to the investment climate in the state.

The Findings

13. The Applicants hold that the contested norms are incompatible with the right to own property established in Article 105 of the Satversme, as well as with the principles of legal certainty and legal security that follow from Article 1 of the Satversme.

The contested norms define the taxable object (Section 3 of SET Law), taxpayers (Section 4 of SET Law), as well as tax rates (Section 5 of SET Law). The object, the payer and the rate of the tax form a totality of legal norms that sets out the obligation to pay the tax. The contested norms, as a uniform regulation, influence the scope and content of each individual norm, since all of them together define the obligation to pay SET.

Thus, the Constitutional Court, in examining the compatibility of the contested norms with norms of higher legal force, will review them as a uniform regulation.

14. Article 105 of the Satversme provides: "Everyone has the right to own property. Property shall not be used contrary to the interests of the public. Property rights may be restricted only in accordance with law. Expropriation of property for public purposes shall be allowed only in exceptional cases on the basis of a specific law and in return for fair compensation."

The Constitutional Court usually reviews the legal norms linked to the obligation of paying taxes as a restriction to the right to own property and not as a forced expropriation of property (*see, for example, Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007-01-01, Para 19, and Judgement of 25 March 2015 in Case No. 2014-11-0103, Para 15*). In the case under review it is not disputed, whether the obligation to pay a tax is expropriation of property for public purposes in the meaning of the fourth sentence in Article 105 of the Satversme. Therefore in the case under review the legality of the restriction upon the right to own property must be examined in the meaning of the first three sentences of Article 105 of the Satversme.

14.1. Article 105 of the Satversme provides for unhindered exercise of the right to own property, as well as the right of the State to restrict the use of property in public interests. Article 105 of the Satversme establishes comprehensive guarantees for property rights. "The right to own property" should be understood as all property rights, which a person can exercise in his own behalf and which a person may use according to his own will (*see, for example, Judgement of 27 October 2010 by the Constitutional Court in Case No. 2010-12-03, Para 7, and Judgement of 3 November 2011 in Case No. 2011-05-01, Para 15.2*).

The Applicants are merchants, who are engaged in electricity production. In accordance with the provisions of legal acts the Ministry of Economics has granted to them the right to sell the produced electricity in the scope of mandatory procurement or the right to receive the guaranteed payment for the installed electric capacity. The Applicants, exercising the right granted by the Ministry of Economics, have concluded contracts with the joint stock company

"Enerģijas publiskais tirgotājs", which administers the mandatory procurement of electricity and ensures disbursement of subsidies to producers.

The Constitutional Court has recognised that property rights comprise also the contractual right with economic value (*see Decision of 20 April 2010 by the Constitutional Court on terminating legal proceedings in Case No. 2009-100-03, Para 8.2*). Very diverse claims can be considered to be property, i.e., such claims the enforcement of which can be requested, if clear legal basis exists for it. Future income can be recognised as being property, if it has already been earned or a claim that can be satisfied exists (*see, Judgement of 27 October 2010 by the Constitutional Court in Case No. 2010-12-03, Para 7, and Judgement of 3 November 2011 in Case No. 2011-05-, Para 15.2*).

The administrative acts adopted by the Ministry of Economics and the contracts concludes with the joint stock company "Enerģijas publiskais tirgotājs" grant to the Applicants the right to sell the produced electricity for a higher price or the right to receive guaranteed payment for the installed electric capacity. Such contractual right has economic value, and thus the Applicants have the right to claim their implementation.

Thus, the Applicants' right to receive the payments envisaged in the contract must be recognised as being an object of property rights in the meaning of Article 105 of the Satversme.

14.2. Article 1 of the Satversme provides that Latvia is an independent democratic republic. An insight has been enshrined in the case law of the Constitutional Court that the obligation of the State to abide in its activities by the basic principles of a judicial state follows from the concept of a democratic republic that this Article comprises, *inter alia*, the principle of legal certainty and legal security (*see, Judgement of 19 June 2010 by the Constitutional Court in Case No. 2010-02-01, Para 4*).

In accordance with the principle of legal certainty, state institutions in their activities must be consistent with the legal acts that they have adopted and must abide by legal certainty that persons may develop in accordance with a particular legal norm (*see Judgement of 19 March 2002 by the Constitutional Court un*

Case No. 2001-12-01, Para 3.2 of the Findings). Whereas the principle of legal security imposes the obligation upon the State to ensure security and stability of legal relations, as well as to abide by the principle of legal certainty to facilitate a person's trust in the State and the law (*see, Judgement of 25 October 2004 by the Constitutional Court in Case No. 2004-03-01, Para 8*). The Constitutional Court has recognised that the principle of legal certainty essentially comprises also the principle of legal certainty in broader understanding of it (*see Judgement of 19 June 2010 by the Constitutional Court in Case No. 2010-02-01, Para 4*). Therefore, in the case under review the Constitutional Court will examine the compatibility of the restriction upon fundamental rights with the principle of legal certainty in the broadest meaning thereof.

With regard to the possible violation of the principle of legal certainty, the Applicants have noted in their written statements and their representatives noted at the court hearing that on the basis of the administrative acts adopted by the Ministry of Economics and the contracts concluded with the joint stock company "Enerģijas publiskais tirgotājs", the Applicants had developed protectable legal certainty that they would receive a certain amount of monetary resources from the electricity sold within the scope of mandatory procurement or from the guaranteed payment for the installed electric capacity. The already acquired rights are said to be property in the meaning of Article 105 of the Satversme. Whereas the application of SET is said to be incompatible with the principle of legal certainty, since it decreases the economic value of the acquired rights and the possibility to gain reasonable profit. Accordingly, the Applicants link the principle of proportionality and the principle of legal certainty that follow from Article 1 of the Satversme with the rights protected by Article 105 of the Satversme (*see, for example, transcript of the court hearing in Case Materials, Vol. 23, pp. 116, and Vol. 24, pp. 38 and 56*). Thus, the Applicants may have developed legal certainty with regard to contractual rights with economic value referred to in Para 14.1 of this Judgement, the enforcement of which can be demanded, if clear legal grounds exist, and the Applicants' legal certainty might

follow from property rights included in legal norms and concluded agreements, i.e., the right to receive the promised material benefit.

The principle of legal certainty does not exclude the possibility for the State to amend the existing legal regulation. In amending legal regulation, the State should take into account those rights, with regard to keeping or exercising of which a person might have developed legal certainty. The principle of legal certainty requires the State, in amending legal regulation, to ensure a reasonable balance between a person's certainty and those interests that are ensured by amending regulation (*see Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 4*). Moreover, the principle of legal certainty may manifest itself differently in different fields of law. If the compatibility of regulation adopted in the field of taxation with both Article 105 of the Satversme and with the principle of the legal certainty is contested, then the compatibility of the contested norm with Article 1 of the Satversme must be reviewed in interconnection with Article 105 of the Satversme (*see, Judgement of 13 April 2011 by the Constitutional Court in Case No. 2010-59-01, Para 4*). This methodology must be used also in the case under review.

Thus, in this case the compatibility of the contested norms with Article 1 of the Satversme must be examined in interconnection with Article 105 of the Satversme.

14.3. In a democratic judicial state the right to own property is not absolute. First, the right to own property comprises also the owner's social obligation towards society – property may not be used contrary to public interests. Secondly, the right to own property may be restricted in accordance with law. Thus, the right to own property can be restricted if these restrictions have been established by law for a legitimate aim and are commensurate with this aim (*see, for example, Judgement of 26 April 2007 by the Constitutional Court in Case No. 2006-38-03, Para 12, and Judgement of 10 October 2014 in Case No. 2014-04-03, Para 7.2.*).

The Constitutional Court has recognised that the obligation to pay a tax always means restricting the right to own property (*see, for example, Judgement*

of 8 June 2007 by the Constitutional Court in Case No. 2007-01-01, Para 19, and Judgement of 25 March 2015 in Case No. 2014-11-0103, Para 15).

Since 1 January 2014, the contested norms are applied to the Applicants and other producers of subsidized electricity and define their obligation to pay SET. The income gained from electricity sold in the scope of mandatory procurement and the guaranteed payment for the electric capacity installed in a cogeneration station or electric plant is an object of taxation in the meaning of Section 3 of SET Law. The application of the tax causes decrease of income gained by the Applicants, and, thus, the application of SET must be seen as a restriction upon the right to own property.

Thus, the contested norms restrict the Applicants' fundamental rights established in Article 105 of the Satversme.

15. To establish, whether the restriction upon the Applicants' right to own property imposed by the contested norms is justifiable, the Constitutional Court must examine:

1) whether the restriction upon fundamental rights has been established by law;

2) whether the restriction has a legitimate aim;

3) whether the restriction is proportional to its legitimate aim (*see, for example, Judgement of 20 May 2002 by the Constitutional Court in Case No. 2002-01-03, Findings).*

16. The Constitutional Court has repeatedly noted that the procedure for adopting a legal norm is a pre-requisite for the validity of a legal norm. To examine the compatibility of the restriction upon fundamental rights that the contested norms comprise with Article 105 of the Satversme, first of all it must be verified, whether the restriction upon the Applicants' right to own property has been established by a law adopted in due procedure, i.e.:

1) whether the law has been adopted in accordance with the procedure established in legal acts;

2) whether the law has been promulgated and is publicly accessible in accordance with the requirements set in legal acts;

3) whether the law has been worded with sufficient clarity so that a person would be able to understand the content of the rights and obligations that it defines and to forecast the consequences of its application, as well as whether the law ensures protection against arbitrary application thereof (*see Judgement of 8 April 2015 by the Constitutional Court in Case No. 2014-34-01, Para 14*).

The Applicants' objections against the procedure in which the contested norms were adopted, essentially, are linked to the fact that draft SET law was included in the package of draft budget laws and were adopted in urgent procedure, and also that the representatives of the sector were not sufficiently heard and that the objections that were voiced were not taken into consideration.

The Constitutional Court has recognised that the procedure established in the Saeima Rules of Procedure for reviewing the draft law of annual state budget and the draft laws that establish or amend the state budget differs from the procedure for examining other draft laws. Since the planning of state financial resources is based upon estimates of state income and expenditure, the legislator has the right and, simultaneously, also an obligation to include into the state budget law and accompanying package of laws only such issues that pertain to the respective fiscal year and are closely linked to using financial resources (*see Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 18, and Judgement of 25 March 2015 in Case No. 2014-11-0103, Para. 18.1*). To ensure a balanced state budget, the use of budget resources must be linked to the planned budget revenue. A new tax was introduced by SET Law, which ensures state budget revenue; thus, there are no doubts that SET Law pertains to the state budget and could have been included into the package of draft budget laws.

On 17 October 2013, the Saeima, with the majority vote, recognised the draft SET Law as being urgent (*see transcript of the sitting of the Saeima of the Republic of Latvia on 17 October 2013)*. The Constitutional Court notes that pursuant to Article 75 of the Satversme and Para 92 of the Saeima Rules of Procedure the legislator has the right to consider the expediency of reading a certain draft law in urgent procedure.

It follows from the minutes and the audio recordings of the meetings of the Saeima Budget and Finance (Taxation) Committee included in the case materials that the representative of the producers of subsidized electricity had participated in the Committee sittings and that they had had the opportunity to express their opinion on the predictable impact of SET Law upon the producers of subsidized electricity (*see, for example, Case Materials, Vol. 20, p. 167, 173 or 187*). The Constitutional Court has recognised that the participation of stakeholders in the process of reviewing a draft legal act may facilitate adoption of an unbiased decision and balancing of diverse interests; however, the opinion held by a particular group of persons is not binding upon the legislator. Neither the Satversme, nor the Saeima Rules of Procedure define the hearing of the addressees of the legal norms as a mandatory pre-requisite for adopting legal norms (*see Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 18.1, and Judgement of 26 November 2009 in Case No. 2009-08-01, Para 17.2*).

No considerations follow from the explanations provided by the Applicants and from the case materials that would show that in adopting the contested norms the procedure established in legal acts had been violated, or that they had not been promulgated in due procedure or that the content of rights and obligations that follow from them would not be sufficiently clear.

Thus, the restriction upon the fundamental rights has been established by law.

17. All restrictions upon fundamental rights must be founded upon circumstances and arguments regarding their necessity; i.e., the restriction must

be established for the sake of important interests – a legitimate aim (*see, Judgement of 22 December 2005 by the Constitutional Court in Case No. 2005-19-01, Para 9*). In the procedure before the Constitutional Court the obligation to identify the legitimate aim first of all falls upon the institution, which has adopted the contested act (*see Judgement of 25 October 2011 by the Constitutional Court in Case No. 2011-01-01, Para 13.2*).

The Saeima notes that SET Law has the aim to restrict the growth of the total electricity price, to promote the competitiveness of economy and not to increase the fuel poverty of households, as well as to ensure additional revenue for the state budget that would provide finances for implementing support measures for supporting electricity users. It is also said that the aim of the law is to promote competitive production of electricity, providing impetus for using the most efficient type of production and ensuring that competitive technologies enter the marker. The protection of other persons' rights and public welfare (the impact of MPC increase upon decreasing electricity prices and preventing significant price increase, as well as establishing a mechanism of social support and financing for compensation for MPC increase) is said to be a legitimate aim that complies with the interests of the Latvia's society in general and justifies the introduction of the restriction upon rights (*see, Case Materials, Vol. 1, p. 157*).

Also at the court hearing the representative of the Saeima underscored that imposing a tax was not an end in itself, but a measure that the State might use to gain additional financial resources that give it the possibility to perform social functions. SET aim is to ensure competitiveness of economy and decrease fuel poverty, which is directly linked to protection of public welfare (*see transcript of the court hearing, Case Materials, Vol. 23, p. 138*). Whereas the Applicants' representatives noted at the court hearing that SET was "an exotic" tax and that its aim was not increasing the general budget, but decreasing the total electricity price for the end user (*see transcript of the court hearing, Case Materials, Vol. 23, p. 120).*

It has been recognised in the case law of the Constitutional Court that the regulation that envisages payment of a tax must be examined as a restriction that

has been established in the taxation legal relations to ensure formation of the state and local government budgets (*see, Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007-01-01, Para 22*). Taxes are introduced to ensure public welfare (*see, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 9*). SET, as any other tax, ensures state budget revenue, which further on may be used for the protection of public welfare.

Thus, the legitimate aim of the restriction upon fundamental rights is the protection of public welfare.

18. Upon establishing the legitimate aim of the restriction upon fundamental rights, its compliance with the principle of proportionality must be examined. Whereas the principle of legal certainty demands balancing persons' legal certainty with regard to acquired rights with public interests. Also in this regard, the fact, whether the principle of proportionality has been complied with, is of decisive importance (*see, Judgement of 26 November 2009 by the Constitutional Court in Case No. 2009-08-01, Para 25, and Judgement of 27 October 2010 in Case No. 2010-12-03, Para 15*).

18.1. In assessing the proportionality of a restriction upon fundamental rights, the Constitutional Court examines:

1) whether the chosen measures are appropriate for reaching the legitimate aim or whether the legitimate aim can be used by the chosen measure;

2) whether such action is necessary or whether the legitimate aim could not be reached by measures less restrictive upon an individual's rights;

3) whether the restriction is appropriate or whether the benefit gained by society exceeds the damage caused to the individual.

If, upon examining a legal norm, it is recognised that it is incompatible with even one of these criteria, then it is incompatible with the principle of proportionality and is illegal (*see, for example, Judgement of 16 May 2007 by the Constitutional Court in Case No. 2006-42-01, Para 11, and Judgement of 18 March 2011 in Case No. 2010-50-03, Para 12*).

18.2. In the framework of the case under review, the compatibility of the restriction upon the right to own property that follows from the obligation to pay the tax with the Satversme is examined. The Constitutional Court consistently follows the practice to assess the proportionality of a restriction upon the right to own property in accordance with the criteria referred to above.

However, in assessing the proportionality of a restriction upon fundamental rights established in taxation field, it must be taken into consideration that in this field the same requirements to the legislator as, for example, in the field of the protection and ensuring civic and political rights, cannot be set (*see, for example, Judgement of 13 April 2011 by the Constitutional Court in Case No. 2010-59-01, Para 9*). The State, in establishing and implementing its taxation policy, enjoys broad discretion (*for example, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010-70-01, Para 9*). It comprises the right to choose tax rates and the categories of persons they apply to, as well as to set out the details of the respective regulation. In assessing the limits of a legislator's discretion with regard to establishing a tax for a particular object, it must be taken into consideration that the Satversme *expressis verbis* authorises the legislator to adopt the state budget, thus, also to determine the revenue and the expenditure of the state. The Satversme authorises the legislator to implement such fiscal policy that would ensure the revenue that the state needs (*see, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 10*). The legislator's decision on which tax would be commensurate and necessary is an issue of policy and expedience. Thus, with regard to implementation of taxation policy the scope of constitutional review is narrower (*see, for example, Judgement of 30 April 2008 by the Constitutional Court in Case No. 2007-23-01, Para 7 and Para 11*).

However, the legislator, even when adopting decisions in the field of tax law, must exercise its discretion in compliance with the provisions of the Satversme.

Thus, in examining restrictions upon the right to own property that follow from the obligation to pay a tax, the legislator's discretion must be taken into consideration.

19. In assessing, whether the chosen measures are appropriate for reaching the legitimate aim, the Constitutional Court verifies, whether the legitimate aim can be reached by the chosen measures.

The Constitutional Court has recognised that it cannot verify, whether the measures selected by the legislator are economically substantiated. However, regulation in taxes should be based upon objective and rational considerations. Therefore, to conclude, whether the restriction upon fundamental rights caused by the obligation to pay the tax is appropriate for reaching its legitimate aim, the Constitutional Court must verify, whether the tax payers, the taxable object and the principle for calculating the tax have not been established arbitrarily and whether the procedure for calculating the tax is such that would allow calculating the tax mathematically (*see, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010-70-01, Para 9, and Judgement of 25 March 2015 in Case No. 2014-11-0103, Para 24.1*).

19.1. Both the Saeima and the Applicants analyse the application of SET in interconnection with the state budget subsidy envisaged for restricting the increase of electricity price, as well as other support measures for the end users of electricity. Thus, the parties to the case link the revenue that the SET ensures to the state budget with the use of these resources for reaching particular aims. The persons summoned in the case have also expressed similar considerations. For example, the representatives of the Ministry of Economics and the Regulator at the court hearing characterised the impact of the subsidy envisaged in the state budget upon limiting the increase of electricity price (*see, for example, Case Materials, Vol. 24, p.93, and Vol. 25, p. 31).*

The Constitutional Court has recognised that the legislator, insofar the Satversme and the international commitments of the state do not provide otherwise, has the right to decide on defining the priority expenditure for the state and society and channel resources gained from tax payments for this

expenditure. The legislator's obligation to cover by the revenue from a particular tax solely the expenditure of particular fields does not follow from the Satversme (*see, Judgement of 3 February 2012 by the Constitutional Court in Case No. 2011-11-01, Para 13*). Thus, the legislator does not have the obligation to channel the revenue from particular taxes for the attainment of particular aims. The summoned person Kārlis Ketners also noted during the court hearing that the purpose of applying SET should predominantly be linked with the fiscal function of this tax. All tax revenue is paid into the state budget, and special budgetary funds are not formed (*see transcript of the court hearing, Case Materials, Vol. 25, p. 61*). The only exception to this is the social insurance budget, since pursuant to Para 2 of Section 3(2) of the law "On State Social Insurance" the basic principle of social insurance is using social insurance resources only for social insurance services in accordance with law. This is the only case in Latvian taxation system, where a legal link between the particular tax revenue and the purpose for which it is spent exists.

Thus, it can be concluded that all tax revenue, insofar legal acts do not provide otherwise, is part of the state budget as a uniform whole. Neither the contested norms, not SET Law comprises the legislator's obligation to channel the collected resources exactly for decreasing electricity price or other support measures for electricity users. Therefore, in the case under review, the measures for protecting public welfare for which the legislator decides to use the collected SET resources will not be examined separately. For the same reason the Applicants' considerations regarding the use of subsidy envisaged in the budget will not be examined either.

19.2. It follows from the minutes of the sittings of the Saeima Budget and Finance (Taxation) Committee included in the Case Materials that the Saeima had examined the impact of SET upon the solvency of producers of subsidized electricity, the possible tax rates, as well as the possibility to apply different tax rates, depending upon the type of electricity production (*see, for example, Case Materials, Vol. 20, pp. 175 – 180*). In accordance with the contested norms all

producers of subsidized electricity pay the tax. Whereas are all payments that comprise the state subsidy, i.e., income from the electricity sold in the framework of mandatory procurement and guaranteed payment for installed electric capacity are the taxable object. Thus, the contested norms differentiate the tax rate depending upon the type of electricity production, as well as other circumstances that could influence the production costs and the price for the end consumers (*see, transcript of the court hearing, Case Materials, Vol. 24, p. 77*). In accordance with the methodology for calculating the tax rate established in SET Law, this rate is proportional and is calculated from the sum of money to be disbursed to the producer of subsidized electricity. There are no doubts that such procedure of calculation allows determining accurately the amount of tax to be paid. Several of the summoned persons also, among them K.Ketners, J. Grasis and the representative of the Ministry of Economics J. Spiridonovs, noted at the court hearing that the method for calculating the tax, chosen by the legislator, was the simplest solution from the perspective of administering the tax (*see transcript of the court hearing, Case Materials, Vol. 24, p. 106 and Vol. 25, pp. 66 – 67, and p. 126*). Thus, there are no grounds to consider that the taxpayer, taxable object or the principle of calculation had been chosen arbitrarily.

Pursuant to Section 9 of SET Law, the tax is paid into the state budget. The resources paid into the state budget can be channelled, according to the legislator's opinion, for various expenditures in sub-programmes of the budget, *inter alia*, also for measures aimed at limiting the increase of electricity price or other support measures for the end users of electricity. The Ministry of Economics notes that in 2014 30 429 768.35 euros were collected through SET into the state budget (*see Case Materials, Vol. 23, p. 1 – 21)*. Therefore there are no doubts that the application of SET to the producers of subsidized electricity ensures revenue for the state budget, which can be used for protecting public welfare.

Thus, in the particular case, the measures chosen for reaching the legitimate aim of the restriction upon the fundamental rights are based upon objective and rational considerations.

Hence, the chosen measures are appropriate for reaching the legitimate aim.

20. In assessing, whether the chosen measures are necessary for reaching the legitimate aim, the Constitutional Court verifies, whether the legitimate aim cannot be reached by measures that are less restrictive upon an individual's rights.

The Applicants note that the it would be possible to reach the legitimate aim of the restriction upon fundamental rights by alternative measures, *inter alia*, defining another taxable object, establishing differential SET rates, establishing a longer transitional period, levelling the aid among all producers or finding other resources in the state budget for limiting the increase of electricity price, for example, by channelling the profit of joint stock company "Latvenergo" for this purpose (*see, for example, transcript of the court hearing, Case Materials, Vol. 23, pp. 123 – 125*).

In examining, whether the legitimate aim could be reached in a more lenient way, the Constitutional Court takes into consideration the fact that a more lenient measure cannot be just any other measure, but such that allows reaching the legitimate aim in the same quality (*see Judgement of 13 May 2005 by the Constitutional Court in Case No. 2004-18-0106, Para 19, and Judgement of 6 December 2010 in Case No. 2010-25-01, Para 10.2*). The Constitutional Court already found that the aim of applying SET is to ensure state budget revenue, which later can be used for protecting public welfare. Choosing another taxable object, lower tax rates or another procedure for calculating it could leave a negative impact upon the amount of resources to be collected. Such solutions should be considered as being such that could prohibit from reaching the legitimate aim of the restriction upon fundamental rights in at least the same quality (*compare to Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 25.2*).

The Constitutional Court may not substitute the legislator's discretion with its opinion on a more rational solution (*see Judgement of 19 December 2011 by*

the Constitutional Court in Case No. 2011-03-01, Para 20). In particular in analysing, whether more lenient measures for reaching the legitimate aim do not exist, the Constitutional Court must abide by the limits of review that follow from the nature of tax law (*see, for example, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010-70-01, Para 16 and Judgement of 25 March 2015 in Case No. 2014-11-0103, Para 25.2*). In view of the legislator's broad discretion in developing taxation policy, the choice of the solution should be recognised as being the legislator's political decision, which cannot be reviewed by methods of constitutional review.

Thus, the chosen measures are necessary for reaching the legitimate aim.

21. In assessing, whether the restriction upon fundamental rights complies with its legitimate aim, the Constitutional Court verifies, whether the benefit gained by society exceeds the restriction upon an individual's rights.

21.1. SET performs a fiscal function, since it ensures revenue for the state budget. Thus, in the case under review the benefit gained by society should be characterised as state budget revenue, which further can be used to protect public welfare. I.e., the Satversme *expressis verbis* authorises the legislator to adopt the state budget and determine the revenue and expenditure of the state budget. Hence, the legislator must implement such fiscal policy that ensures the necessary income in the state budget. The Constitutional Court has already noted that, with the purpose of ensuring public welfare, a person has a constitutional obligation to pay taxes established in due procedure (*see, for example, Judgement of 13 April 2011 by the Constitutional Court in Case No. 2010-59-01, Para 9 and 10).* In 2014 SET brought more than 30 million euros into the state budget. These resources constitute part of the state budget and may be used for various measures aimed at protecting public welfare, *inter alia*, also to limit the increase of electricity price and for other support measures targeting end users of electricity.

21.2. When reviewing the legality of restricting fundamental rights in tax cases, the Constitutional Court predominantly examines, whether the tax payment is not an excessive burden for the addressee. In assessing, whether the tax payment is not an excessive burden for the addresses, it must be assessed, *inter alia*, whether the applied tax is not confiscatory as to its nature (*see, Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 20*).

The SET rate *per se* does not indicate that this rate would be confiscatory in nature. The contested norms do not restrict the right granted to the Applicants to sell the produced electricity in the scope of mandatory procurement, nor the right to receive guaranteed payment for the installed electric capacity. I.e., the introduction of SET does not change the terms for producing electricity, nor the amount of sales and price; likewise, exercise and use of the Applicants' rights that follow from the awarded right to sell the produced electricity in the scope of mandatory procurement is not restricted.

The restriction upon the Applicants' fundamental rights manifests itself as the obligation to pay the tax in the amount defined in SET Law. When turning to the Constitutional Court, the Applicants noted that application of SET to producers of subsidized electricity might drive them into insolvency.

SET is applied from 1 January 2014 until 31 December 2017. Hence, the Applicants have the possibility to adjust and to plan their actions in a way to reduce the possible negative consequences caused by the obligation to pay the tax.

Producers of subsidized energy differ, depending upon the period during which they have already received state aid and the extent to which they have been able to recover their investments, as to the profit indicators of the chosen business model, the type of electricity production, connection with the production of thermal energy in cogeneration process, costs of resources and similar factors. Therefore the Constitutional Court will not analyse the effectiveness of business operations and SET impact upon profit indicators for each particular producer of subsidized energy.

The Applicants have not advanced such arguments that would allow concluding that SET is a confiscatory tax as to its nature. Neither do case materials confirm that in the case under review SET could be recognised as being confiscatory.

To ensure that the tax burden is commensurate, the Saeima has established differential SET rates, depending upon the type of energy resource used to produce electricity. The basic SET rate is 15 per cent, whereas the decreased rate is 10 per cent or 5 per cent. Hence, individualisation of tax rates is ensured. I.e., energy producers that use fossil energy resources and cause negative impact upon environment must pay SET in the amount of 15 per cent, whereas those energy producers that use renewable energy resources – in the amount of 10 per cent. Such differentiated tax rates facilitate the use of renewable energy resources. Thus, differential SET rates are aimed at developing the production of electricity from environmentally friendly energy resources. Simultaneously it could also promote sustainable development of the energy sector and, thus, ensure competitiveness of economy. I.e., effective use of energy resources ensures growth of national economy. At the court hearing the representative of the Ministry of Economics J. Spiridonovs also underscored that SET was one of the tools for ensuring the development of competitive economy.

21.3. Each tax is part of the taxation policy implemented by the legislator, and usually every person has the obligation to pay a number of taxes. Each tax has different aims, objects, rate, procedure of calculation and application. Likewise, each of the Applicants also pays a number of taxes. Moreover, the obligation to pay taxes and the financial impact caused by it is different, depending upon the Applicants' legal status, type of operations, contractual commitments and other circumstances. Thus, the Constitutional Court has no grounds to conclude that it is the application of SET that leaves a negative impact upon the producers of subsidized electricity, since it is linked also with the obligation to pay other taxes, costs of resources and the strategy of business operations chosen by electricity producers themselves.

Thus, the Constitutional Court has no grounds to conclude that it is the application of SET specifically that should be considered as being an excessive burden for the tax addressees or would cause insolvency threats for the Applicants.

In the case under review, it is also important that the contested norms introduced a new obligation, i.e., the obligation to pay SET. The Constitutional Court has already noted that in the case, where the legislator establishes the obligation to pay a new tax, a person's legal certainty must not be protected to the same extent as in other cases, when the right to own property is restricted (*see, Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 21*). Therefore a merchant cannot develop protected legal certainty that the national taxation system will not be changed in a way that might have a negative impact upon its business activities. Article 105 of the Satversme does not define legal protection for a person's possibilities to gain profit, since such abstract possibility cannot be regarded as the object of property rights (*see Judgement of 3 November 2011 by the Constitutional Court in Case No. 2011-05-01, Para 15.2*).

The restriction established by the contested norms is planned as a fixed-term measure. The Saeima has included in the Transitional Provisions of SET Law a permanent control mechanism. Pursuant to Para 3 in the Transitional Provisions of SET Law, the Cabinet of Minister, in preparing the budget proposal for the current year, must submit to the Saeima an assessment of the possibilities to reduce the tax rates set out in Section 5 of SET Law. Thus, in accordance with legal regulation, the amount of SET must be regularly reviewed.

Hence, the benefit that society gains from SET exceeds the restrictions that the contested norms impose upon taxpayers.

Hence, the contested restriction complies with the principle of proportionality and, thus, the contested norms comply with Article 1 and Article 105 of the Satversme.

The Substantive Part

On the basis of Section 30 – 32 of the Constitutional Court Law, the Constitutional Court

held:

To recognise Para 1 and Para 2 of Section 3, Para 1 of Section 4 and Section 5 of the Subsidized Energy Tax Law as being compatible with Article 1 and Article 105 of the Satversme of the Republic of Latvia.

The Judgement is final and not subject to appeal.

The Judgement enters into force at the moment of its pronouncement.

Chairperson of the court hearing A. Laviņš