

RECENT DEVELOPMENTS IN ESTONIAN ENERGY SECTOR

LEGAL UPDATE

OCTOBER 2009

Unbundling of the Estonian Electricity Transmission System Operator Approved

In August 2009, the Government of Estonia has approved the unbundling of OÜ Elering, the electricity transmission system operator in Estonia, from its parent company Eesti Energia AS.

Eesti Energia AS is a state-owned company currently engaged in the production, sale and transmission of electric and thermal power. Its subsidiary OÜ Elering is responsible for the operating reliability of the entire Estonian power system and it connects Estonia's biggest power plants, distribution networks and major consumers with the energy systems of the Baltic States, Nordic countries and Russia.

The sale of OÜ Elering is considered to be the quickest and most effective way from the legal standpoint to comply with the requirements of directive 2009/72/EC so that the transmission system operator would be independent from production and sales activities. The transaction is also intended to establish the conditions for the creation of an electricity exchange in Estonia.

OÜ Elering will be sold to the Government of Estonia. The Minister of Economic Affairs and Communications has been authorized to purchase OÜ Elering from Eesti Energia AS for approximately 134 million euros. The price of the shares of OÜ Elering was based on the company's book value of net assets as on 31 July 2009.

The transaction will also have to be approved by Eesti Energia AS. The Supervisory Board of Eesti Energia AS has already given its conditional approval to the transaction. The transaction is expected to be completed by the end of the year provided that necessary approvals are received from the European Investment Bank and the Nordic Investment Bank.



TLS ALLIANCE

Tark & Co
Roosikrantsi 2, 10119 Tallinn, Estonia
Tel. +372 6110 900
www.tarkco.com

Grunte & Cers
Brivibas 43, 2nd floor, Riga, LV-1010, Latvia
Tel. +371 6788 9999
www.gruntecers.eu

Sutkiene, Pilkauskas & Partners
Didžioji 23, LT-01128 Vilnius, Lithuania
Tel. +370 5251 4444
www.spp.lt

After the transaction, OÜ Elering will own all the 330-110 kV electricity lines and substations. OÜ Elering will also cease to purchase accessory services from Eesti Energia AS.

Estonian National Electricity Production Company Planning an IPO

Eesti Energia AS is currently a state-owned vertically integrated energy company engaged in the production, sale and transmission of electric and thermal power. The main source for energy production – oil shale – is extracted from mines owned by the company. Eesti Energia AS and its subsidiaries are also involved in the construction and maintenance of energy systems.

Recently many financial experts have come to the opinion that the Government should consider listing Eesti Energia AS on the stock exchange. Listing the company is regarded as one of the best ways to include additional capital currently needed. It is envisaged that the Government could sell a minority holding of up to 49% of the shares of the company as a result of the potential IPO.

The oil shale technology Eesti Energia AS utilizes is something that could be of interest to international investors. Keeping that in mind, it has been argued that the Government is already taking steps to secure the success of the potential IPO. For example, draft amendments to the Electricity Market Act prescribe subsidies of up to approximately 77 million euros per year for 20 years as of 2013 for an electric power producer that establishes at least 300 MW blocks which generate electric power from oil shale. In practice, only Eesti Energia AS would be able to build such blocks in such time. Eesti Energia AS needs such support because it will have to shut down its old production blocks in 2016 the latest due to the requirements of Directive 2001/80/EC and thus the subsidies will help to secure supply of electric power also after 2016. The subsidies would be paid by Elering OÜ which the Government plans to purchase from Eesti Energia AS by the end of the year to separate the production and sales activities from transmission activities. The Government is considering to cover the subsidies from funds raised from trading with CO₂ emission quotas. However, approval of the European Commission will have to be obtained for providing such state aid. Also, a debate over the respective amendments to the Electricity Market Act discussed above can be expected in the Parliament although the Government has approved the amendments.

Substantial Amendments of the Estonian Electricity Market Act To Be Made

In September 2009, the Government of Estonia has approved a draft act that includes several noteworthy amendments of the Electricity Market Act. The amendments will still have to be adopted by the Parliament before coming into force.

The proposed amendments prescribe establishment of an electricity exchange for trading with electric power. The exchange will allow to effectively determine the economically justifiable market price of electric power. Furthermore, the exchange is also expected to increase the liquidity of the electricity market. There are to be three different electricity exchanges: the first for trading with the next day's supply, the second for trading with the same day's supply and the third for trading with supply within an hour. To facilitate trading on the exchange no license is required to import electricity for the purpose of selling it on the exchange.

According to the draft act, Estonia's major consumers who together use 35% of the electric power will have to purchase their electric power from the electricity exchange as of April 1, 2010. The obligation will affect about 300 biggest consumers who will no longer have the option to buy electric power at a regulated price. The requirement is necessary to ensure the performance of the electricity exchange which is a precondition for building a direct current connection between Estonia and Finland (Estlink 2). While bigger consumers are required to purchase electric power on the exchange, smaller consumers (e.g. households) will not be allowed to purchase electric power on the exchange.

The opening up of the electricity market is thought to raise the price of electric power by about 40%. The association of the major consumers has submitted a joint petition to the Parliament to implement a 9-month transition period so that the market price would stabilize and the consumers could gain some trading experience.

The draft act also prescribes an increase of the amount of electric power generated from wind for which producers receive subsidies. Today, the state pays subsidies for up to 400 GWh of wind power and the amount is to be increased to 600 GWh. Existing wind parks are expected to produce 270 GWh of wind power this year, 400 GWh is expected to be reached in 2010 or 2011. However, developers already have plans to build additional wind parks and even after the implementation of the amendment an estimated 40% of wind power would not receive subsidies. The Ministry of Economic Affairs and Communications has stated that it will only support wind power in a reasonable amount so that the state would not pay subsidies for electric power that is actually being exported.

Gas Terminals Planned To Be Constructed in Estonia

Estonia does not have any natural gas resources. There are currently also no gas terminals or gas storage facilities in Estonia. Today gas is imported to Estonia via pipelines from Russia and Latvia. AS Eesti Gaas, a gas undertaking in a dominant position in Estonia, has concluded an agreement with Gazprom for the supply of gas from Gazprom's gas storage facility located in Latvia. However, to secure supply of gas more sufficiently, a gas storage facility would need to be constructed in Estonia and recently, several investors are considering to build either a LNG or LPG terminal in Estonia.

According to the action plan of the Memorandum of Understanding on the Baltic Energy Market Interconnection Plan concluded between the leaders of the Baltic Sea region and the European Commission on 17 June 2009, a LNG terminal is expected to be completed in Estonia by 2015. A number of investors are interested in building gas terminals that would include gas storage facilities. According to public information, these projects foresee the construction of either a LNG or LPG terminal to one the ports on the north coast. For example, LNG Estonia AS is planning to construct a LNG terminal which would include two 165,000 m³ tanks, exceeding Estonia's annual supply by three times. AS Nord Gas is planning to construct a LPG terminal with the planned capacity of 100,000 m³ for gas storage and Balti Gaas OÜ together with Pakrineeme Sadama OÜ is considering building a LNG terminal that would include four storage tanks.

Currently there is no specific legislation in force that would apply to gas storage facilities. Of course the planning and building of gas storage facilities has to comply with the general requirements established for planning and building any structure. Also, a gas storage facility would be deemed an object with significant environmental impact and therefore, the environmental impact assessment rules should be followed by choosing the location for a gas storage facility. General requirements applicable to gas undertakings would also apply to gas terminals. However, statutory legislation should be amended to create unambiguous legal framework for developing and operating gas storage facilities.

Please do not hesitate to contact us should you have any questions on the above matters.

Your contact persons for energy law in Tark & Co, Estonia are:

Risto Vahimets
Partner

Imbi Jürgen
Attorney at Law

Tark & Co
Roosikrantsi 2
10119 Tallinn, Estonia
Phone +372 6110 900

www.tarkco.ee

E-mail:

risto.vahimets@tarkco.ee

imbi.jurgen@tarkco.ee

tarkco@tarkco.ee