

GETTING THE DEAL THROUGH

# Electricity Regulation

in 31 jurisdictions worldwide

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# Estonia

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## Policy

- 1** What is the governmental policy and legislative framework for the electricity sector?

The Estonian governmental policy and legislative framework for the electricity sector are very much shaped by the policies and legislation of the European Union. Estonia is moving from a very concentrated and regulated electricity market towards an open and more liberal market model. At the same time, greenhouse gas emissions need to be reduced. The government has spoken of improvement of energy sustainability, significant investments in effective technology and energy-related research and development activities. The policy also promotes increase of the share of renewable energy and participation in nuclear energy projects.

In general, Estonia has implemented the EU Gas and Electricity Directives. The key legislative provisions pertaining to the electricity sector are set out in the Electricity Market Act (EMA), adopted in 2003 and amended significantly in 2007. There are numerous regulations specifying the provisions of the EMA, including the Grid Code.

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## Organisation of the market

- 2** What is the organisational structure for the generation, transmission, distribution and sale of power?

The Estonian electricity market is very small and mostly relies on a single fuel. In 2006 the load peaked at 1537MW, with an annual production of 8.7TWh (6.9TWh domestic consumption). 93 per cent of electricity is generated from oil shale, whereas the share of natural gas in 2006 was 5.3 per cent and the share of renewable sources (including wind, hydropower, biomass, land-fill gas, etc) and peat only 1.2 per cent.

The market is dominated by the state-owned energy group Eesti Energia, which produced 95.3 per cent of Estonian electricity in 2006 and owns the producer of oil shale, Eesti Põlevkivi. OÜ Põhivõrk, being the only transmission network operator and transmission system operator (TSO), having an exclusive right to perform power transmission and system services, is also a 100 per cent affiliate of Eesti Energia. The exclusive right principle is applied to distribution network operators as well, whereas an exclusive service area, determined by geographical coordinates, is assigned for each operator. There are 42 distribution network operators and the largest, with a market share of 85 per cent, is OÜ Jaotusvõrk, belonging to Eesti Energia. Currently, there is no effective electricity sales market in Estonia. The largest electricity seller is also Eesti Energia with an evaluated market share close to 100 per cent in wholesale and approximately 88 per cent in retail market.

The Estonian electricity system is part of a common synchronised system including Russia, Belarus, Latvia and Lithuania. In addition to the strong transmission infrastructure between the Baltic countries, at the end of 2006 a 350MW undersea cable between Estonia and Finland began operation.

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## Regulation of electricity utilities – power generation

- 3** What governmental or administrative authorisations are required to construct and operate generation facilities?

In order to generate electricity, except for generation by one producer using generating installations with a net capacity under 100kW, an activity licence is required. Licences are issued by the Energy Market Inspectorate (EMI). A building permit, issued by the local municipality, is required for construction of generation facilities. In most cases, planning procedures and an environmental impact assessment are prerequisites for issuance of the building permit. Generating installations using nuclear energy may be constructed and electricity may be generated by such installations only on the basis of a resolution of the Estonian parliament.

- 4** What are the policies with respect to interconnection of generation to the transmission grid?

Pursuant to the EMA, the transmission network operator has the obligation to connect to the network, upon request, any electrical installation that conforms to the relevant requirements. The operator shall observe the principle of equal treatment of market participants and shall elaborate an action plan for the equal treatment measures. According to OÜ Põhivõrk's action plan, a standard connection agreement form is used with all generators and an internal procedure for connecting has been established. The grounds for refusal from connecting to network are listed in the EMA, including the lack of necessary transmission capacity. In the latter case, the EMI shall also be notified of refusal. The applicant shall be put to a waiting list and, if possible, a connection offer for maximum available capacity will be made. When additional capacity becomes available, the earliest application gets a connecting offer first.

- 5** Does the governmental policy or legislation foster power generation based on alternative energy sources such as renewable energies or combined heat and power?

There is a strong support system for electricity production from renewable energy sources (RES-E). The producers are entitled to sell RES-E to a seller appointed by the TSO and the latter has corresponding obligation to buy the RES-E at a fixed price. As

an alternative, the producers are entitled to sell RES-E and apply for a subsidy paid by the TSO. The support system is limited to producers up to 100MW. The fixed tariff is currently about twice as high as the market price of electricity. However, the system of subsidies encourages producers to sell RES-E at market price and apply for subsidy, which is significantly more profitable than selling at the fixed tariff.

The fixed price and subsidy system (with lower tariffs) is also applicable to electricity produced either in efficient cogeneration regime (if waste, peat or oil-shale processing retort gas is used as a source of energy) or in combined heat and power plants established instead of an existing power station supplying customers with heat (with capacity up to 10MW).

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#### Regulation of electricity utilities – transmission

**6** What governmental or administrative authorisations are required to construct and operate transmission networks?

In order to operate transmission networks, an activity licence, issued by the EMI, is required. The activity licence grants the holder the right to apply for a building permit for the construction of the transmission network. Building permits are issued by the local municipalities. Environmental impact assessment would be a prerequisite in most cases.

**7** Who is eligible to obtain transmission services and what requirements must be met to obtain access?

The regulation set forth in the EMA ensures provision of network services to all market participants and third party free access to the network. A network operator shall observe the principle of equal treatment of market participants. Possibilities of refusal to provide network services, including transmission services, are limited to the following cases:

- the electrical installations of the user of network services do not conform to the requirements of legislation or to the technical conditions established by the network operator;
- the provision of network services is not possible for any other reason dependent on the user of network services or on reasons independent of the network operator; or
- the network lacks the necessary transmission capacity for provision of network services.

A network operator shall provide the reasons and legal basis for any refusal. Pursuant to the EMI, in practice no cases of refusal have been recorded.

**8** Are there any governmental incentives to encourage expansion of the transmission grid?

There are currently no governmental incentives to encourage expansion of the transmission grid.

**9** Is there any tariff or other regulation regarding the rates and terms for the provision of transmission services?

The EMA prescribes the principles of the terms for provision of network services as well as the bases for calculating network charges for both transmission and distribution network. The network charges include charges for connection; amendment of consumption or generation conditions; use of a network connection; transmission; and extra services directly related to network services.

The charges shall be established on transparent criteria in compliance with the principle of equal treatment, and the security of supply and efficiency shall also be taken into account. Transmission charges and charges for the use of a network connection within the service area of a network operator shall not be subject to the location of the market participant, but a network operator has the right to form groups of market participants and to apply different network charges and any other conditions for the provision of network services for such groups. The charges have to enable network operators to perform the obligations arising from legislation and the conditions of the activity licence and to ensure justified profitability of investments.

The EMI shall prepare and publish uniform methods for the calculation of justified network charges based on the weighted average capital cost. Network operators shall seek approval from the EMI for:

- charges for using a network connection, transmission charges and charges for extra services directly related to network services;
- methods for the calculation of connection charges and charges for amendment of conditions; and
- the standard conditions for the provision of network services.

The network charges as well as standard service conditions shall become valid only after long-term advance notice published in at least one daily national newspaper.

**10** Which entities are responsible for assuring reliability of the transmission grid and what are their authorities and responsibilities?

The system responsibility, ie, the obligation to ensure security of supply and balance of the system at any moment in time, is borne by the TSO. The TSO is obliged to exercise the corresponding rights and perform the corresponding obligations in accordance with the principle of equal treatment with regard to all market participants, with the aim of achieving the best economic results for the whole system within the framework of existing technical and security of supply requirements.

The TSO is entitled to demand (by issuing mandatory orders) that generators increase or reduce generation or that customers reduce consumption, and to increase or reduce generation or consumption itself. The TSO is also authorised to establish justified technical restrictions on the use of the system and to demand that generators and network operators enter into a system interoperability contract under reasonable conditions and taking account of the principle of equal treatment. The market participants shall submit information to the TSO, if it is necessary for the performance of the TSO's obligations.

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#### Regulation of electricity utilities – distribution

**11** What governmental or administrative authorisations are required to construct and operate distribution networks?

In order to operate distribution networks, an activity licence issued by the EMI is required. The activity licence grants the holder the right to apply for a building permit for the construction of the distribution network in the distribution area specified by the activity licence. Building permits are issued by the local municipalities.

**12** Who is eligible to obtain access to the distribution grid and what requirements must be met to obtain access?

See question 8.

**13** Is there any tariff or other regulation regarding the rates or terms for the provision of distribution services?

See question 9.

#### Regulation of electricity utilities – sales of power

**14** What governmental or administrative authorisations are required for the sale of power to customers and which authorities grant such approvals?

In order to sell electricity, an activity licence must be granted to the seller by the EMI, excluding the following cases:

- electricity sold within premises entirely in the possession of the seller, solely to persons who use the premises, provided that the sale of electricity is not the principal activity of the seller; or
- a non-profit association selling electricity solely to its members for supplying electricity to apartments, dwelling houses, cottages, etc, belonging to the members.

**15** Is there any tariff or other regulation regarding power sales?

Pursuant to the Treaty of Accession 2003, Estonia has been granted a transitional period for opening the electricity market until 2013. Until 2009 the market is open only by 10 per cent, and from 2009 to 2013 by 35 per cent. Until full opening of the market, non-eligible customers may buy electricity only from the serving network operator or from a seller designated by the operator. The serving network operators have corresponding obligation to sell (in person or by designating another seller) electricity to the non-eligible customers at regulated price.

The sellers shall seek approval from the EMI for the limit for the weighted average price of the electricity sold within the framework of the selling obligation. The sellers are entitled to form different tariffs for different customer groups within this weighted average limit. The EMI has elaborated and disclosed unified methodology for calculation of a justified weighted average price limit for performing of selling obligation. The price limits shall be such as to cover the presumed average purchase price of electricity purchased for the performance of the selling obligation and the expenses incurred in the performance of the obligations established for the sale of electricity and of any other obligations prescribed by legislation or the conditions of the activity licence in connection with the selling obligation and to ensure justified profitability.

**16** To what extent are electricity utilities that sell power subject to public service obligations?

See question 15 for the selling obligation and price regulation.

The standard terms and conditions applicable to the sale of electricity within the selling obligation shall be approved by the EMI. The latter shall not grant its approval if the content of the terms and conditions does not correspond to the balance of rights and obligations between seller and purchaser where such balance was the basis for approval of the limit for the weighted average price or if a standard term or condition causes unfair harm to the other party.

#### Regulatory authorities

**17** Which governmental or administrative authorities determine regulatory policy with respect to the electricity sector?

The regulatory policy with respect to the electricity sector is determined by parliament, the government, the Ministry of Economic Affairs and Communications, and the EMI.

**18** What is the scope of each regulator's authority?

Parliament adopts laws regulating the electricity sector and long-term development plans for energy sector. The government approves long-term development plans for electricity sector. The Ministry of Economic Affairs and Communications has overall responsibility for the energy sector, whereas both the government and the Ministry may adopt regulations for implementation of laws regulating the electricity sector.

The powers of the EMI in the electricity sector include:

- approval of prices for electricity network services, methodologies for connecting with electricity networks, weighted average price for electricity sold to non-eligible customers, and standard terms and conditions of contracts for electricity network services and electricity supply for non-eligible customers;
- issuing and revocation of activity licences for provision of network services, generating and sale of electricity;
- monitoring the adequacy of prices for the balance energy sold by the TSO and the conditions of balance contract;
- supervising of compliance with regulations by market participants (eg, fulfilment of unbundling obligations, disclosure of information, third-party access, etc);
- extra-judicial settlement of disputes between market participants; and
- issuing precepts and initiation of misdemeanour procedures in cases of violation of law.

**19** How is each regulator established and to what extent is it considered to be independent of the regulated business and of elected officials?

The EMI is a governmental agency within the administration of the Ministry of Economic Affairs and Communications, financed from the state budget. The EMI is considered to be independent both politically and from energy undertakings, guided exclusively by law. Neither the government nor the Ministry can revoke its decisions, nor give guidelines in the decision-making process. The director general of the EMI is appointed by the Minister of Economic Affairs and Communications.

**20** To what extent can decisions of the regulator be challenged or appealed, and to whom? What are the grounds and procedures for appeal?

The EMI issues decisions (eg, approval of prices, issuing of licences) and precepts (upon violations of law by market participants). Decisions and precepts of the EMI can be challenged with an administrative court in 30 days. Decisions of an administrative court can in return be appealed with a district court and the decisions of the district court with the Supreme Court.

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**Acquisition and merger control – competition**

- 21** Which governmental body or bodies have the authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of utility assets?

The mergers, other acquisitions of control and, in certain cases, acquisitions of assets are subject to control by the Estonian Competition Board (CB). If the merger falls within the scope of the EU merger regulation, notification to the European Commission is required.

- 22** What criteria and procedures are applied with respect to the review of mergers, acquisitions and other transfers of control? How long does it typically take to obtain a decision approving or disapproving the transaction?

Pursuant to the Competition Act (CA), concentration is deemed to arise where:

- previously independent undertakings merge, or parts of undertakings are merged;
- an undertaking acquires control of the whole or a part of another undertaking, or of several undertakings or parts thereof;
- undertakings jointly acquire control of the whole or a part of another undertaking, or of several undertakings or parts thereof;
- a natural person already controlling at least one undertaking acquires control of the whole or a part of another undertaking, or of several undertakings or parts thereof; or
- several natural persons already controlling at least one undertaking jointly acquire control of the whole or a part of another undertaking, or of several undertakings or parts thereof.

According to the CA, a concentration shall be subject to control in case the turnovers in Estonia of the parties to a concentration together exceed 100 million kroons (approximately €6.4 million) and the turnovers in Estonia of each of at least two parties to a concentration exceed 30 million kroons (€1.9 million).

The CB shall be notified of a concentration subject to control before the entry into force of the concentration, and, as a general rule, after:

- entry into a merger agreement or performance of a transaction or other act for acquisition of parts of the undertaking;
- performance of a transaction or other act for acquisition of control;
- performance of a transaction or other act for acquisition of joint control; or
- announcement of a public bid for securities.

The CB shall make its decision on the concentration within 30 days. In certain cases, supplementary proceedings may be initiated and the decision-making process may be extended to additional four months.

A transaction is subject to notification to the EU Commission if thresholds set forth in the Council Regulation 139/2004/EC on the control of concentrations between undertakings are exceeded.

- 23** Which governmental or administrative authorities have the power to prevent or prosecute anti-competitive or manipulative practices in the electricity sector?

Both the EMI and the CB are authorised to prevent and prosecute anti-competitive or manipulative practice in the electricity sector. In practice, the EMI primarily supervises and controls the activities of network operators, whereas the EMI and the CB have entered into an agreement regulating the supervision of the activities of electricity generators and sellers.

- 24** What substantive standards are applied to determine whether conduct is anti-competitive or manipulative?

Anti-competitive conduct includes agreements, concerted practices and decisions by associations of undertakings which restrict competition as well as abuse of dominant position. Such conduct may consist of, inter alia:

- imposing unfair purchase or selling prices or other unfair trading conditions;
- limiting production, service, goods markets, technical development or investment;
- sharing of goods markets or sources of supply;
- exchanging of information that restricts competition;
- offering or applying dissimilar conditions to equivalent agreements with other trading parties, thereby placing some of them at a competitive disadvantage;
- making entry into an agreement subject to acceptance by the other parties of supplementary obligations that have no connection with the subject of such agreement; or
- unjustified refusal to sell or buy goods.

- 25** What authority does the governmental body have to preclude or remedy anti-competitive or manipulative practices?

Both the EMI and the CB are authorised to issue mandatory precepts to market participants and in the event of failure to perform the obligation imposed by the precept, a penalty payment may be imposed. Revocation of activity licence by the EMI is possible in certain cases.

The Estonian Penal Code enacts a penalty payment of up to 250 million kroons (€16 million) for companies for competition law offences, including prohibited agreements, decisions and concerted practices. The possible punishments for competition offences include also misdemeanour sanctions, including a fine of up to 500,000 kroons (€32,000). The misdemeanour procedure is initiated for example in cases of abuse of dominant position. If the same offender commits the offence again, the criminal procedure and relevant sanctions apply. The criminal and misdemeanour sanctions are imposed by the court, not by the CB or EMI.

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**International**

- 26** Are there any special requirements or limitations on acquisitions of interests in the electricity sector by foreign companies?

There are no special requirements or limitations to foreign companies in the electricity sector.

- 27** What rules apply to cross-border electricity supply, especially interconnection issues?

The conditions for cross-border exchanges in electricity provided for in Regulation (EC) No. 1228/2003 are applicable to cross-border electricity supply.

**Update and trends**

The most pressing issue in electricity regulation in Estonia is currently the third package of measures adopted by the European Commission (proposals for amendment of EU regulations and directives governing electricity and gas sectors) in September 2007, which may have a significant impact on the Estonian electricity market. Among the

numerous amendment proposals, the contemplated ownership unbundling requirements have raised the most intense discussions, as these requirements may result in creation of an independent TSO outside the vertically integrated Eesti Energia group.

**Transactions between affiliates****28** What restrictions exist on transactions between electricity utilities and their affiliates?

Electricity utilities must follow the principle of equal treatment of market participants, meaning that transactions between electricity utilities and their affiliates must be made at average market prices and other competitive market terms. The electricity utilities must not abuse their dominant position or special or exclusive rights and must follow the regulation of the CA and in certain cases, the Public Procurement Act.

**29** Who enforces the restrictions on utilities dealing with affiliates and what are the sanctions for non-compliance?

The EMI and, in certain cases, the CB are authorised to enforce the restrictions on utilities dealing with affiliates. Both the EMI and the CB are authorised to issue mandatory precepts to market participants and in the event of failure to perform the obligation imposed by the precept, a penalty payment may be imposed. See also question 25.

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