

LATVIA

RECENT DEVELOPMENTS IN THE LATVIAN ENERGY MARKET

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Agreement on the Baltic Energy Market Interconnection Plan

Eight Baltic Sea Member States (Denmark, Estonia, Finland, Germany, Lithuania, Latvia, Sweden and Poland) and the European Commission President, Jose Manuel Barroso, signed a Memorandum of Understanding on the Baltic Energy Market Interconnection Plan on 17 June 2009. The signature of the memorandum launched the implementation of an action plan for the necessary infrastructures to create a fully functioning and integrated energy market and to strengthen energy security in the Baltic Sea Region. Several of the proposed infrastructure projects are part of the European Economic Recovery Programme which potentially means energy infrastructure projects in this region will receive €1billion in additional support.

Changes in the oil products emergency stocks requirements

Due to the implementation of Council Directive 2009/119/EC in Latvia, as from 1 September 2010 economic operators engaged in commercial activities with oil products or importing oil products for their own consumption are no longer required to maintain oil product emergency stocks. The relevant obligation now lies with the Ministry of Economics as the central stockholding entity. In future, oil products emergency stocks will be purchased by the Ministry from economic operators selected as a result of open tenders. The funds necessary to purchase the emergency stocks will be raised through a levy.

An LNG terminal project

On 14 December 2010, the government of Latvia indicated that it was in favour of an LNG terminal project in Latvia and instructed the state-owned AS Latvenergo to carry out an initial feasibility study of the project by mid-2011. It is believed that there are a number of advantages in constructing the terminal in Latvia as opposed to elsewhere in the region; the most important of these is the relatively well developed existing gas infrastructure in Latvia. The possibility to expand the storage capacity of the existing Incukalna underground gas storage facility up to a capacity of 3.2bcm could make significant cost savings. It is thought that the construction of the terminal will contribute to diversifying

the routes of supply of natural gas, and creating competition to the current supplier of natural gas, and strengthening the energy independence of the country.

Visagina nuclear power plant: still searching for the strategic partner

Although it was planned that the Lithuanian government would select a strategic partner for the construction of the Visagina nuclear power plant by the end of 2010, this has been made impossible by the South Korean state energy firm Korea Electric Power Corp (KEPCO) revoking its bid to build the plant. Nevertheless, the countries involved in the project seem to have retained their optimism for the project, as the governments of the Baltic States and Poland expressed their support to for a nuclear power plant in Lithuania at a meeting held on 5 December 2010. It is planned that negotiations will continue with other potential bidders, with an aim to accomplish the project by 2018-2020. The expected investment in the project amounts to €3 – 5 billion.

OVERVIEW OF THE LEGAL AND REGULATORY FRAMEWORK

A. ELECTRICITY

A.1 INDUSTRY STRUCTURE

The overall supervision of the electricity industry is performed by the Ministry of Economics. The tariffs and market conditions in the electricity industry are regulated by the Public Utilities Commission, which is the institution in charge of the issuance of licences for the provision of public services in the electricity industry.

The basic legislative framework of the electricity industry consists of the Energy Law, the Electricity Market Law, the Law on Regulators of Public Services, and a series of subordinated regulations from the Cabinet of Ministers and the Public Utilities Commission. The Electricity Market Law implements the Second Electricity Directive. The implementation of the New Electricity Directive is still pending.

The generation, transmission, distribution and supply of electricity are regulated activities and are therefore subject to obtaining a licence issued by the Public Utilities Commission. A licence is required where the volume of the relevant activities exceeds the thresholds stipulated by the Regulations on Types of Regulated Public Services issued by the Cabinet of Ministers. Electricity generation, transmission and distribution licences are issued for a period of 20 years, while electricity supply licences are issued for a period of five years.

Whilst the Latvian electricity market has undergone some liberalisation in line with the requirements of the Second Electricity Directive, it is still dominated by the state-owned AS Latvenergo which is the major electricity producer and before implementation of the Second Electricity Directive, was also the sole electricity transmission and distribution operator in Latvia. The unbundling requirements of the Second Electricity Directive were implemented in Latvia by creating two subsidiaries of AS Latvenergo:

AS Augstsprieguma Tīkls, the electricity transmission system operator and AS Sadales Tīkls, the electricity distribution system operator.

According to the Energy Law, AS Latvenergo must remain the property of the state and therefore may not be privatised or otherwise alienated. Furthermore, the power plants and the electricity transmission and distribution grid and equipment may not be used as collateral, or transferred to any entities other than those fully owned by the state or AS Latvenergo.

Due to the vertically integrated structure of the participants in the Latvian electricity market, the Latvian government objected to the initiative of the European Commission on ownership unbundling in the electricity and natural gas sectors. The Latvian Ministry of Economics expressed an opinion that, since the Latvian electricity market is small and has its own specific features, such an approach would not be in the interests of Latvia, as such measures in the power sector would cause the sector to become more fragmented.

It is apparently due to this position of the Latvian government that Latvia has not yet implemented the New Electricity Directive. Due to the existing structure, it is not very likely that the Latvian legislator will opt for full ownership unbundling or for the independent system operator model but, more realistically, will apply the less stringent independent transmission system operator model.

A.2 ELECTRICITY TRADING

Electricity trading is regulated in Latvia by the Grid Code which provides for various trading mechanisms, including pooling. Electricity trading is, however, considerably encumbered in Latvia by the inadequate availability of generation capacities and the insufficient number of market participants.

Ensuring the system balance is the responsibility of the TSO. The TSO provides balancing services to the users, electricity generators and DSOs connected directly to the transmission system. The users, electricity generators and other DSOs connected to the distribution system receive the balancing service from the DSO.

Generally, electricity can be traded in the balancing market. By way of exception from a general prohibition to engage in electricity trading, the TSO is entitled to engage in electricity trading for the purposes of balancing.

The supply of electricity to customers is regulated by the Electricity Trade and Usage Regulations issued by the Cabinet of Ministers, which provides detailed regulations regarding the relationship between electricity suppliers and customers. The supply of electricity to captive customers (ie, those electricity users which have not exercised their right to freely select the electricity supplier) is subject to the tariffs approved by the Public Utilities Commission. The tariffs are calculated in accordance with the methodologies approved by the Public Utilities Commission.

A.3 THIRD PARTY ACCESS REGIME

The Electricity Market Law generally provides for the right of market participants to use the transmission and distribution systems at the tariffs approved by the Public Utilities Commission. Access to the transmission and distribution systems is subject to the market participants complying with the technical requirements of the system operator. The system operator may refuse such access where it lacks the necessary capacity, giving duly substantiated reasons to the market participant within 30 days of receipt of its application.

A.4. USE OF SYSTEM

The use of electricity transmission and distribution networks is subject to the tariffs approved by the Public Utilities Commission. The tariffs are calculated in accordance with the methodologies approved by the Public Utilities Commission.

A.5 MARKET ENTRY

As mentioned above, electricity generation, transmission, distribution and supply are all subject to obtaining a licence issued by the Public Utilities Commission unless the applicable thresholds are not exceeded. The issuance of the licence is normally decided within one month. However, that period may, in exceptional cases, be extended to four months.

Where the entrant intends to use the existing transmission and/or distribution system for transportation of the electricity, an agreement needs to be entered into with the operator of the relevant system(s).

In addition, entities intending to engage in electricity supply are subject to requirements relating to the relationship with the electricity end-users, as stipulated by the Electricity Trade and Usage Regulations issued by the Cabinet of Ministers.

A.6 PUBLIC SERVICE OBLIGATIONS

The Electricity Market Law imposes certain obligations on the so-called 'public trader' which is to be established by the entity as having the distribution licence with the largest area of operation and the largest number of users switched to its networks. Among other things, the public trader is under an obligation to supply electricity to all captive customers in the entire territory of Latvia, as well as to purchase electricity generated in the cogeneration process and from renewable energy resources.

A. 7 CROSS-BORDER INTERCONNECTORS

Latvia is not yet linked to the European grid, and is still only connected to the Russian/CIS electricity system.

B. OIL & GAS

B.1 INDUSTRY STRUCTURE

The Latvian natural gas market has so far been purely monopolistic, the only entity licensed to transport, distribute, store and supply natural gas being AS Latvijas Gaze which is owned by E.ON Ruhrgas International AG (47.23%), AAS Gazprom (34%), SIA Itera-Latvija (16%) and several minority shareholders (2.77%).

Because of the limited sources of supply of natural gas, Latvia had previously exercised its rights under Article 28(2) of the Second Gas Directive which permits Member States qualifying as emergent markets (which, because of the implementation of the Second Gas Directive, would experience substantial problems) to derogate from a series of articles of the Second Gas Directive until the relevant Member State no longer qualifies as an emergent market. According to the transitory provisions of the Latvian Energy Law, it was decided that the natural gas market will remain closed until 1 January 2010.

On 3 December 2009, the Latvian parliament amended the transitory provisions of the Energy Law to further postpone the liberalisation of the Latvian natural gas market until 4 April 2014. Such postponement has been made possible by Article 49 of the New Gas Directive. The date of 4 April 2014 has been determined based on the fact Latvia received the first commercial supply of natural gas on 5 April 2004 under its first long-term natural gas supply contract entered on 18 July 2003.

This decision was motivated by the fact that Latvia is not connected to the interconnected system of any other Member State and has only one main external supplier, AAS Gazprom. In addition, it has been argued that the nature of the gas supply industry in the region, and current gas supply agreements, effectively exclude the possibility of access by any third party to the Incukalna underground gas storage facility. Furthermore, it is argued that the capacity of the Valday – Pskov gas pipe is insufficient to ensure supply of gas to the Baltic States and North-West Russia during the winter period.

In a similar structure to that of the electricity market, the overall supervision of the gas industry is performed by the Ministry of Economics. The tariffs and market conditions in the gas industry are regulated by the Public Utilities Commission, which is the institution in charge of issuance of licences for the provision of public services in the gas industry.

The basic legislative framework of the gas industry consists of the Energy Law, the Law on Regulators of Public Services, and a series of subordinated regulations of the Cabinet of Ministers and the Public Utilities Commission. Subject to the derogation referred to above, the Energy Law implements the Second Gas Directive.

The transportation, distribution, storage and supply of natural gas as well as the supply, distribution, storage and refilling of liquid natural gas are regulated activities and are therefore subject to obtaining a licence, which is issued by the Public Utilities Commission. The transportation, distribution and storage licences are issued for a period of 20 years, while supply licences are issued for a period of five years.

Since the Latvian natural gas market is monopolistic, no product sharing regime exists for the time being.

On 7 July 2010 the parliament of Latvia passed amendments to the Energy Law which implemented Council Directive 2009/119/EC of 14 September 2009, imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products. The Ministry of Economics has been appointed the central stockholding entity for the purposes of acquisition, maintenance and sale of the oil stocks. The oil stocks are purchased from economic operators (1) authorised to engage in commercial activities with oil products in Latvia or a Member State of the EEA or (2) which import oil products into Latvia for their own consumption, in each case selected as a result of an open tender procedure.

B.2 GAS TRADING

Natural gas is supplied to customers only by AS Latvijas Gaze. Supply of natural gas to customers is regulated by the Gas Supply and Usage Regulations issued by the Cabinet of Ministers, which provides detailed regulations concerning the relationship between the gas supplier and customers. Supply tariffs of natural gas are established by the Public Utilities Commission and are calculated in accordance with the methodologies approved by the Public Utilities Commission.

B.3 THIRD PARTY ACCESS REGIME TO GAS TRANSPORTATION NETWORKS

The natural gas transportation and distribution networks are operated by AS Latvijas Gaze. Due to the monopolistic character of the Latvian natural gas market, no third party access to the gas transportation and distribution networks is guaranteed by Latvian law.

B.4 LNG

Currently, there are no LNG terminals in Latvia. The government of Latvia has, however, recently undertaken research to assess the possibility of constructing an LNG terminal in Latvia with capacity to serve the Baltic countries.

B.5 THIRD PARTY ACCESS TO LNG TERMINALS AND STORAGE FACILITIES

Natural gas in Latvia is stored in Incukalns Underground Gas Storage Facility with capacity of 4,400bcm of natural gas (of which 2,145bcm is cushion gas and 2,255bcm is active gas). The Incukalns Underground Gas Storage Facility is operated by AS Latvijas Gaze. Due to the monopolistic character of the Latvian natural gas market, no third party access to the storage facilities is guaranteed by Latvian law.

B.6 USE OF SYSTEM

As noted above, no third party access to the gas transportation and distribution networks is guaranteed by Latvian law.

B.7 MARKET ENTRY

Since the transitory provisions of the Energy Law provide for the Latvian natural gas market to remain closed until 4 April 2014, entry to the Latvian natural gas market is not possible until that time.

B.8 PUBLIC SERVICE OBLIGATIONS

This section is not applicable in Latvia.

B.9 CROSS-BORDER INTERCONNECTORS

Latvia's gas transportation system is connected with the transportation systems of Lithuania, Estonia and Russia. However, this is of little importance as both Estonia and Lithuania are, in turn, only connected to the Russian system.

C. CLIMATE CHANGE AND SUSTAINABILITY

C.1 CLIMATE CHANGE INITIATIVES

In most regards, implementation of the EU Climate Change Package is still pending in Latvia. While the New EU ETS Directive has been implemented in Latvia in order to comply with those requirements which were to be implemented by 31 December 2009, the legislative acts necessary to implement the Renewable Energy Directive and the Biofuel Directive have not yet been finally adopted.

C.2 EMISSION TRADING

The legislative framework for emission trading is provided by the Law on Pollution and the Regulations on Activities with Emission Allowances and Organisation of Pools of Installations issued by the Cabinet of Ministers, which implements the relevant provisions of the Directive 2003/87/EC. The emission allowances are allocated by the Ministry of Environment, while the Latvian Environment, Geology and Meteorology Agency operate and maintain the issue and the register of allowances. No national emission trading schemes are available in Latvia that would operate in addition to the EU ETS.

C.3 CARBON CAPTURE AND STORAGE

Currently there are no existing carbon capture and storage projects in Latvia. There are no laws, or guidelines issued by the State regulating this issue. Taking into account the costs and complexity of this new technology, the private sector needs economic incentives to apply it. If the cost of this technology is not reduced, it is most likely that these kinds of projects will not be used in Latvia in the near future.

C.4 RENEWABLE ENERGY

The Energy Law generally defines renewable energy resources as wind, solar, geothermal, tidal, and hydro-energy, waste landfill site and sewage treatment plant gas, biogas and biomass (ie biologically degradable fraction in products, industrial and household waste, agricultural, as well as forestry and

similar section residual materials). In practice, the two of the most exploited renewable energy resources are wood-pulp and hydro-resources, with wind energy and biogas also being used but in considerably smaller volumes.

The share of energy from renewable sources has always been high in relation to the gross final consumption of energy in Latvia and constituted 29.7% in 2007 and 29.9% in 2008. The target of using 40% energy from renewable sources by 2020, as provided by the Renewable Energy Directive is, however, considered to be ambitious and not easily achievable.

The Electricity Market Law provides that a certain percentage of the total energy consumption by end-users shall be electricity produced from renewable energy resources. The Electricity Market Law requires that the percentage of electricity produced from renewable energy resources is gradually increased so that by 31 December 2010 it is not less than 49.3% of the total electricity consumption.

The Electricity Market Law also requires the public trader (as defined in section A.6. above) to purchase a certain amount of electricity generated from renewable energy resources. The price of such electricity and the amount to be purchased by the public trader are determined by the Cabinet of Ministers each year. Entities producing electricity by using renewable energy resources may acquire the right to sell the produced electricity to the public trader, provided that they have received a special permit from the Ministry of Economy. Such a permit also confirms that the electricity has been produced by using renewable energy resources.

A draft of a new Renewable Energy Resources Law has been set into the legislative process which aims to implement the Renewable Energy Directive. It is not yet known when the new Renewable Energy Resources Law will be finally adopted.

C.5 BIOFUEL

Production and sale of biofuel is regulated by the Biofuel Law which sets the responsibilities of the government in relation to the production and sale of biofuel, as well as the requirements applicable to economic operators engaged in the biofuel industry. The Ministry of Economics annually assigns a financial aid quota for the minimum amount of biofuel that must be produced during the respective year.

Amendments to the Biofuel Law have been set into the legislative process with an aim to implement the Biofuel Directive, but it is not yet known when such amendments will be finally adopted.

D. NUCLEAR ENERGY

No nuclear energy is generated in Latvia. The only Latvian research reactor, a pool-type IRT-2000 research reactor with a 5000kVt capacity, was shut down in 1998.

The Visagina nuclear power plant project, which is a joint effort of Lithuania, Latvia, Estonia and Poland, is progressing, although recently some sceptical opinions have been expressed over the feasibility of this project. It is planned that the new power plant should be put into operation by 2018-2020.

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