

ENERGY LAW IN LATVIA

RECENT DEVELOPMENTS IN THE LATVIAN ENERGY MARKET

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Further liberalisation of the electricity market

As from 1 July 2007, households have been allowed to choose alternative electricity suppliers. No household has yet exercised such right, apparently due to lack of offers of cheaper electricity than that currently provided by AS Latvenergo. Nevertheless, the liberalisation of the electricity market has resulted in the entry into the Latvian market of SIA E.Energy, a fully owned subsidiary of Eesti Energia AS, which is becoming more active in selling electricity to Latvian corporate customers. In addition, another electricity supplier, the Swedish company Scaent AB, has announced that it intends to start operations in the Baltic states.

The Latvian electricity supplier, AS Latvenergo, has in turn established its subsidiary, Latvenergo Kaubandus OÜ, in Estonia. The new company has entered an electricity balancing agreement with the Estonian transmission system operator Pohivork OÜ which enables it to provide balancing services in the Estonian electricity market and to purchase electricity from independent producers. It is planned that Latvenergo Kaubandus OÜ will also offer electricity for sale in the Estonian market.

In addition, as from 1 July 2007, all functions of electricity distribution system operator were taken over from AS Latvenergo by AS Sadales Tikls, a fully owned subsidiary of AS Latvenergo. This restructuring was due to the requirement of the Electricity Market Law that, as from 1 July 2007, the distribution system operator must be legally separated from entities engaged in generation, transmission and supply of electricity. AS Sadales Tikls currently ensures the provision of electricity to more than a million users, covering more than 99% of the territory of Latvia.

Latvia objects against ownership unbundling in the electricity and natural gas sectors

Although the Energy Commissioner, Andris Piebalgs, had previously stated that the new EU energy market liberalisation package presented by the European Commission at the end of September 2007 will be favourable to the Baltic States, the Latvian government has objected to the initiative of the European Commission on ownership unbundling in the electricity and natural gas sectors. The Latvian Ministry of Economics has expressed an opinion that, since the Latvia's electricity market is small and has its own specific features, such approach is not in the interests of Latvia as the power sector will become more fragmented. The government's opinion is supported by AS Latvenergo, the major player in the Latvian electricity market.

Action against emission quota allocation

The Latvian Cabinet of Ministers has decided to bring action against the European Commission at the European Court of Justice with regard to the emission quota allocations for 2008 – 2012. Such a step was triggered by the decision of the European Commission to allocate Latvia emission quotas of 3.43 million tonnes, when it was asked to allocate 6.25 million tonnes. Latvia considers that the European Commission has violated the subsidiarity principle and has ignored the sovereign competence of Member States in energy policy that is not an area of exclusive Community competence. It is claimed that the amount of emission quotas allocated might impede the development of the Condensed Power Plant project, construction of a new cement factory and leave a negative impact on the overall development of industry.

Infringement procedures against Latvia

On 17 October 2007, the European Commission launched an infringement procedure against Latvia and other member States for failure to notify their national Energy Efficiency Action Plan by 30 June 2007, as required by the Energy End-Use Efficiency and Energy Services Directive¹. The Action Plans should present national strategies on how to achieve a 9% energy savings target by the end of 2016 as well as how Member States comply with a number of other provisions of the Directive.

Also on 17 October 2007, the European Commission sent its Reasoned Opinion to Latvia for failure to notify whether it had implemented the measures required by the Energy Performance of Buildings Directive². The measures in question should have been transposed by 4 January 2006.

The infringement procedures initiated by the European Commission against Latvia on 10 April 2006 for an alleged incompliance with Directives 2001/77/EC and 2003/54/EC are also still ongoing. The government has provided the European Commission with the latest information and the description of the activities conducted with regard to these infringement procedures. The European Commission has not yet come up with any new initiatives.

Ignalina nuclear power plant project slow in progress

Due to various reasons, the expected operational start of the new nuclear power plant in Ignalina is still uncertain. The negotiations between the countries involved in the project, i.e., Estonia, Latvia, Lithuania and Poland, have not yet materialised into a partnership agreement. Completion of the assessment is planned for 2008, and it is most likely that no political decisions will be taken by the time the assessment is finalised. Pursuant to the latest estimates, more time will be needed for the construction of the new nuclear power plant and it might be finished between 2017 and 2020. Meanwhile, the old Ignalina nuclear power plant is expected to be closed down in 2009, which will create a certain shortage of generating capacities in the region.

¹ Directive 2006/32/EC of the European Parliament and of the Council of 5 April 2006 on the energy end-use efficiency and energy services

² Directive 2002/91/EC of the European Parliament and of the Council of 16 December 2002 on the energy performance of buildings

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, while the objects and equipment of entities operating in the electricity market are under the technical control of the State Energy Inspection. The tariffs and market conditions in the electricity 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 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 as well as a series of subordinated regulations by the Cabinet of Ministers and the Public Utilities Commission. The Electricity Market Law implements The Second Electricity Directive.

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, 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 5 years.

While almost 80 licences have been issued by the Public Utilities Commission for entities to operate in the Latvian electricity market, the dominant role in that market undoubtedly belongs to the state owned AS Latvenergo which is the major electricity producer and supplier in Latvia. The transmission system is operated by AS Augstsprieguma Tikls which is a fully owned subsidiary of AS Latvenergo. The largest share of the distribution network belongs to AS Sadales Tikls, another fully owned subsidiary of AS Latvenergo.

According to the Energy Law, AS Latvenergo as well as the shares of AS Latvenergo must remain the property of the state and may not therefore 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.

Even though the Electricity Market Law has provided the general legal framework for liberalisation of the electricity market, the market participants have not yet been active to benefit from such liberalisation. Several companies which do not own distribution networks have been licensed to supply electricity, however there are few cases of actual sales until now.

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 transmission system operator. The

transmission system operator provides balancing services to the users, electricity generators and distribution system operators connected directly to the transmission system. The users, electricity generators and other distribution system operators connected to the distribution system receive the balancing service from the distribution system operator.

Generally, electricity can be traded in the balancing market. By way of exception from a general prohibition to engage in electricity trading, the transmission system operator 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, providing a detailed regulation of the relationship between the 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.

The Electricity Market Law imposes certain obligations on the so-called public trader which is to be established by the entity 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 by using the renewable energy resources.

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. The access to the transmission and distribution systems is subject to compliance by the market participants 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 are 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 be extended in exceptional cases 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 with the operator of the relevant system(s).

Entities intending to engage in electricity supply are additionally subject to the requirements relating to the relationship with the electricity users stipulated by the Electricity Trade and Usage Regulations issued by the Cabinet of Ministers.

A.6 CROSS-BORDER INTERCONNECTORS

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

B. GAS

B.1 INDUSTRY STRUCTURE

The Latvian natural gas market is purely monopolistic, the only entity licenced to transport, distribute, store and supply natural gas being AS Latvijas Gaze. It is owned by E.ON Ruhrgas International AG (47.23%), AAS Gazprom (34%), SIA Itera-Latvija (16%) and several minority shareholders (2.76%). The transportation, distribution and storage licences of AS Latvijas Gaze are valid until 10 February 2017 while its supply licence is valid until 10 February 2012.

Since currently natural gas is imported only from two external suppliers, AAS Gazprom and SIA Itera-Latvija, liberalisation of the natural gas market is hardly possible in the near future. In the light of this, Latvia has exercised its rights under Article 28(2) of The Second Gas Directive permitting Member States qualifying as emergent markets, (who, 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 Member State no longer qualifies as an emergent market. According to the transitory provisions of the Energy Law, the natural gas market will remain closed until 1 January 2010.

Non-exclusive licences for supply, distribution, storage and refilling of liquid natural gas have been issued to around 70 entities.

Similarly to the electricity market, the overall supervision of the gas industry is performed by the Ministry of Economics, while objects and equipment of entities operating in the gas market are under the technical control of the State Energy Inspection. 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 as well as 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 of licence 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 5 years.

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

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, providing a detailed regulation of 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.

Liquid natural gas is supplied by around 70 licenced entities which are not bound by any tariffs approved by the Public Utilities Commission. It is planned that trading with liquid natural gas will be excluded from the list of regulated activities by amendments to the Regulations of the Cabinet of Ministers On Types of Regulated Public Services.

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 THIRD PARTY ACCESS TO LNG TERMINALS AND STORAGE FACILITIES

Natural gas in Latvia is stored in Incukalns Underground Gas Storage Facility with capacity of 4,400 billion cubic metres of natural gas (of which 2,145 billion cubic metres is cushion gas and 2,255 billion cubic metres of 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.5 USE OF SYSTEM

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

B.6 MARKET ENTRY

Since the transitory provisions of the Energy Law provide for the Latvian natural gas market to remain closed until 1 January 2010, entry to the Latvian natural gas market is not possible until that time. The government of Latvia is currently holding negotiations with AS Latvijas Gaze regarding the limitation of operation of the exclusive licences issued to AS Latvijas Gaze for the period until 1 January 2010.

Any entities wanting to trade in liquid natural gas are required to obtain a licence issued by the Public Utilities Commission. The issuance of a licence is normally decided within one month, however that period may be extended in exceptional cases to four months.

B.7 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. ENVIRONMENTAL ISSUES

C.1 EMISSION TRADING

The legislative framework of 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 issuing and the register of allowances. Despite initial difficulties in launching the registry, it is now fully operational. No emission trading schemes are available in Latvia that would operate nationally in addition to the European Union Emission Trading Scheme.

C.2 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 costs of this technology are not reduced, it is most likely that these kind of projects will not be used in Latvia in the near future. At the moment Latvia is concentrating on carbon sinks projects.

C.3 RENEWABLE ENERGY

The Energy Law generally defines renewable energy resources as wind, sun, geothermal, tidal, and water energy, waste landfill site and sewage treatment plant gas and biogas as well as biomass (biologically degradable fraction in products, industrial and household waste, agricultural, as well as forestry and similar sector production residual materials). In practice, the two of the most exploited renewable energy resources are wood-pulp and hydroresources, wind energy and biogas being used in considerably smaller volumes.

The Electricity Market Law provides that a certain percentage of the total consumption of the electricity 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 to purchase a certain amount of the electricity produced by using 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.

D. NUCLEAR ENERGY

D.1 NUCLEAR ENERGY

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

There has been a preliminary agreement reached between Lithuania, Estonia, Latvia and Poland on the construction of a new third generation power plant in Lithuania. It is currently planned that Lithuania will hold 34% of shares in the enterprise, while Estonia, Latvia and Poland will own 22% each. In accordance with the research conducted by experts from Baltic power plant companies, the new nuclear power plant may have capacity of 3400 MW and construction costs might exceed 2.4 billion Euros. It is planned that the new power plant should be put into operation by 2020.