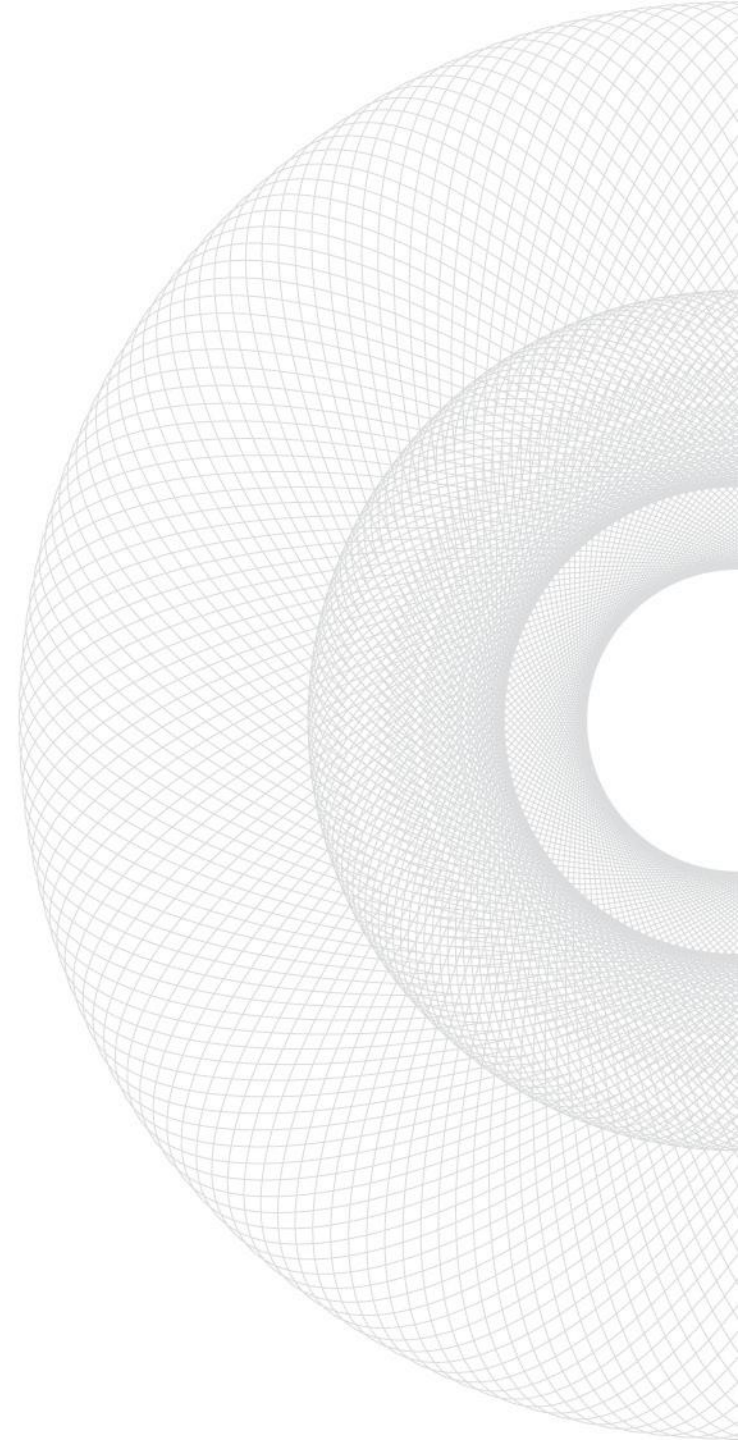


Emerging Europe's Energy Sector: A Period of Change

Energy Law Update

KINSTELLAR

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Preface



EMERGING EUROPE'S ENERGY SECTOR – A PERIOD OF CHANGE

Kinstellar's Energy Law Update provides a timely overview of recent developments in energy policy and energy market regulation in Central, Eastern and Southern Europe, Turkey and Central Asia. Content is contributed by our energy law experts in the Czech Republic, Hungary, Kazakhstan, Romania, Serbia, Slovakia and Turkey.

In addition to regulatory updates, reports on market and legislative developments, our Energy Law Update also presents our experts' views gained from their deep knowledge of the energy markets in Emerging Europe and Central Asia. As such, it has an element of subjectivity – which we hope will make it interesting for our readers.

If you have any questions or comments regarding this newsletter, please do not hesitate to contact us.

This newsletter provides concise information on certain topics. Its content is not necessarily exhaustive and should not be considered as legal advice. If you have any questions in relation to the content of this newsletter, please feel free to contact us and we will be more than happy to assist you.

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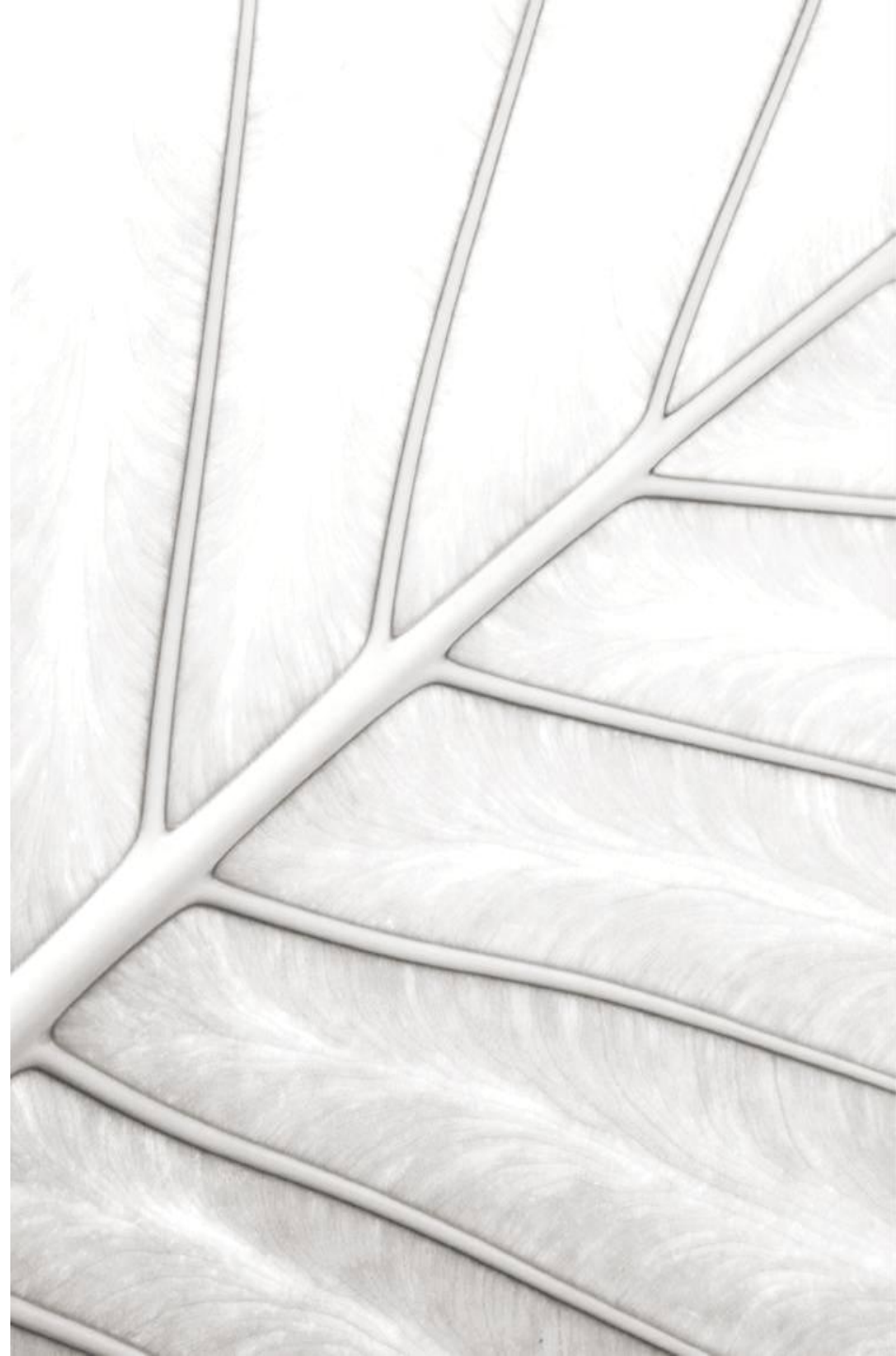
Czech Republic

Major changes to solar energy subsidies

An amendment to the renewable energy subsidies law was recently approved, introducing significant changes from 1 January 2014, including:

- (i) the end of subsidies for solar energy produced in facilities opened after 31 December 2013;
- (ii) the termination of subsidies for facilities whose ownership structure is non-transparent (i.e. Czech companies with anonymous shares or foreign companies that fail to disclose the identity of their beneficial owners);
- (iii) the extension of the period of validity of the special tax on sale by energy producers (but not re-sellers) of solar energy produced in facilities opened before 31 December 2010, though the rate will be decreased from 26 to 10 per cent.

The amendment will also bring important changes to subsidies for facilities using other sources of renewable energy, such as wind, water or biomass.



Czech Republic

Energy regulator pushes for change in price-setting methodology

In the Czech Republic, gas and electricity transmission and distribution prices are regulated by the national Energy Regulatory Office (“**ERO**”) based on “regulatory periods”, each subject to a specific set of rules. There have been three such regulatory periods since market liberalization (one three-year and two five-year periods), each laying out the parameters for price-setting applicable during the relevant timeframe.

With a view to achieving a decrease in energy prices for consumers and a reduction in profit margins for energy market participants, the ERO has been working since late 2012 on changing the current methodology, though without success. It recently presented its proposed draft methodology for the next regulatory period (January 2015 to December 2019) for public consultation.

As far as the gas sector is concerned – unlike in the previous regulatory periods – the proposed methodology seems to lack consistency and a systematic approach. The method for price regulation appears incomplete insofar as not all parameters of the pricing formula are defined.

For instance, though the ERO states that profits are to be calculated in a manner similar to the one used in the current regulatory period, it does not further specify which regulatory method should apply (i.e. price-cap, revenue-cap or other regulatory method).

Moreover, the ERO aims at regulating the gas transmission activity by way of an annual evaluation and revision of the parameters. It justifies this approach on the basis of the anticipated instability in the gas transmission market and the impossibility of maintaining a fixed regulation for a period longer than one year.

Despite the ERO’s goals, however, the lack of transparency and predictability in the price-setting mechanism (if approved as proposed) may, in the coming regulatory period, lead to instability, an increase in financing costs and increased risk in the sector as a whole.



Hungary

Hungary adopts new legislation enforcing EU Regulation on wholesale energy market integrity and transparency (REMIT)



On 23 September 2013 the Hungarian Parliament adopted an act amending the Electricity Act and the Natural Gas Act (the “**Enforcement Act**”) in connection with the implementation of Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency (“**REMIT**”).

On 27 September, the governmental and ministerial decrees (the “**Enforcement Decrees**”) were adopted and promulgated in the official gazette.

The adoption of REMIT in 2011 was an important milestone in the development of the EU internal energy markets. For the first time, REMIT introduced a single and unified EU-wide legal framework for the regulation of market manipulation and insider trading on the EU wholesale electricity and natural gas markets.

Its primary objective being to detect and deter market manipulation, REMIT also creates the legal basis for the implementation of a centralised monitoring system aimed at the regular review of the EU energy markets by the Agency for the Cooperation of Energy Regulators.

Though most provisions of REMIT have been directly applicable since it entered into force in 2011, Member States had to adopt national legislation to establish effective enforcement and sanction mechanisms relating to the obligations and prohibitions resulting from REMIT.

Our experience shows that many Hungarian market participants have yet to focus their attention on preparing for the full application of REMIT. Their relaxed attitude until now probably stems from knowing that, as long as Hungary had not adopted implementing legislation, REMIT’s otherwise strict rules could not be effectively enforced in the country.

However, following the adoption of the Enforcement Act and the Enforcement Decrees, the Hungarian implementation of REMIT has taken place and its full application has now become a reality in Hungary.

Hungary (cont.)

Consequently, it is high time that Hungarian market participants get prepared for actually complying with the detailed rules of REMIT. This is even more compelling as it appears from a review of the Enforcement Act and Decrees that:

- when implementing certain obligations resulting from REMIT, the Hungarian legislator went beyond what would have been strictly necessary under REMIT; and
- Hungarian market participants may face severe financial sanctions if they fail to comply with their obligations under REMIT as implemented by the Hungarian legislator: up to approximately EUR 33,000 in case of a breach of the obligation to publish inside information relating to energy wholesale products, and up to EUR 1.6 million for a breach of the prohibition of insider trading with such inside information.

When preparing for REMIT, Hungarian market participants are well-advised to take into account the specifics of the Hungarian implementation rules.



Kazakhstan

The new gas law revisited: Tightening control over gas infrastructure

It is now almost two years since Kazakhstan's new Law on Gas and Gas Supply (the "**Gas Law**") came into force on 29 January 2012. The most significant piece of legislation since the 2010 Subsurface Law, the Gas Law overhauled the legal regime of Kazakhstan's gas sector.

The Gas Law established a Unified System for Supply of Commercial Gas ("**USSCG**"), which includes the majority of Kazakhstan's gas infrastructure, and created a National Operator to supervise the USSCG and exercise the State's priority right to purchase commercial gas and gas infrastructure. The Gas Law also established a new public private partnership, and expanded the powers of the Ministry of Oil and Gas (the "**MOG**"). These new legislative changes were meant to strengthen the Government's grasp over the sale and transport of Kazakhstan's gas.

Under the Gas Law, however, much of the gas infrastructure is now placed under the supervision and control of the USSCG, regardless of ownership. The USSCG includes all main gas pipelines, gas distribution systems, gas storage facilities, gas compressor stations, industrial consumers of natural gas, and other technological facilities dedicated to production, transportation, storage, sale and consumption of commercial gas. Only field pipelines, household and domestic consumers and some facilities dedicated to LNG and LPG are not included in the USSCG.

A legal entity appointed by the Government "to ensure in the area of gas supply the objective of meeting Kazakhstan's internal requirements for commercial gas", the National Operator (Kaztransgas JSC) controls the USSCG as its central dispatcher and through its exercise of pre-emptive rights to purchase commercial gas and gas infrastructure.

The National Operator has a pre-emptive right of purchase over: (i) USSCG facilities; (ii) shares in a right of common ownership of USSCG; and (iii) shares (participating interest) in the owners of the USSCG facilities.

Under the 2010 Subsurface Law, all associated gas is owned by the State unless otherwise stated in the subsurface use contract. The Gas Law introduces the concept of a "Public Private Partnership in the Area of Gas Supply" ("**PPP**"), an agreement between the State and a private investor under which the investor processes the associated gas owned by the State. Under the Gas Law, such gas can now only be transferred either to a PPP or to the National Operator by a decision of the MOG.



Romania

New cuts contemplated in green certificates for renewable energy

Following on the recent amendment to the Romanian green certificates (“GCs”) support scheme in June 2013, which provided mainly for the suspension from 1 July 2013 to 31 March 2017 of a specific number of GCs granted to wind, hydro and solar producers, the Government recently introduced another legislative proposal aimed at further reducing the Romanian GC support scheme.

The new proposal, published on the website of the Ministry of Economy, has been subject to public debates for a 10-day period (the “**Draft Proposal**”).

The Draft Proposal incorporates the conclusions of the 2012 GC Market Monitoring Report published by the Romanian Energy Regulator (ANRE) on 29 March 2013. ANRE proposed a reduction in the number of GCs granted to several producers of energy from renewable sources (including wind, hydro and solar producers) justified on the basis of overcompensation having occurred in 2012.

The Draft Proposal sets out the following reductions in the number of GCs per MWh of energy generated by producers using renewable energy sources and accredited after the entry into force of the Draft Proposal:

- for new micro hydro-plants (up to 10 MW installed capacity): 0.7 GC
- for wind producers: 0.5 GC until 2017 and 0.25 GC thereafter
- for solar producers: 3 GCs.

Thus, if the Draft Proposal were to be enacted in the form published for debates, the total number of GCs per MWh would be:

- for new micro hydro-plants (up to 10 MW installed capacity): 2.3 GCs
- for wind producers: 1.5 GCs until 2017 and 0.75 GC thereafter
- for solar producers: 3 GCs.



Serbia

New regulation in the field of renewable energy

In January 2013, the Serbian parliament adopted a set of rules related to production of energy from renewable sources, setting forth the conditions for obtaining the status of a privileged producer and temporary privileged producer of renewable energy. It also introduced a range of incentives in relation to such producers.

Under the Decree on Conditions and Proceedings of Acquiring the Status of a Privileged Producer of Electricity (the “**Decree**”), the status of privileged producer may be granted to legal entities and entrepreneurs which are electricity producers in the following main types of power plants: **hydroelectric power plants** with an installed capacity up to 30 MW, as well as biomass, biogas, wind, waste, solar and geothermal power plants.

The total maximum installed capacity of **solar power plants** in relation to which an investor may acquire the status of temporary privileged producer and/or privileged producer is limited to 10 MW for the entire territory of Serbia, of which:

- 2 MW is reserved for power plants using solar power on separate power units of up to 30 kW;
- 2 MW is reserved for power plants using solar power on separate power units from 30 kW to 500 kW; and
- 6 MW is reserved for power plants using solar power on the ground.

According to the Decree, due to changes in investment costs of solar power plants, the maximum installed capacity for such power plants is to be (re)determined each year.

With respect to **wind power plants**, the total maximum installed capacity is limited throughout Serbia to 500 MW for the purposes of acquiring the status of temporary privileged producer. The same limit applies to acquiring the status of privileged producer until the end of 2020.

In order to benefit from these incentives, a privileged producer must enter into a PPA with a public supplier for all energy to be produced during the incentive period. Temporary privileged producers may conclude a preliminary PPA.

In July 2013, the Ministry of Mining and Energy adopted a Rulebook on Establishing the Standard PPA and Preliminary PPA, which sets forth the terms and conditions for PPAs and preliminary PPAs. The parties may deviate from the prescribed model with the Ministry's written consent.



Slovakia

Electricity producers will have to pay a G-fee for access to electricity system as of 2014

The summer was not as quiet as usual. It witnessed the arrival of what is being called the G-fee, a fee that electricity producers will have to pay from the beginning of 2014 to access the transmission and distribution system. The level of the G-fee is linked to a producer's reserved system access capacity.

Slovakia's largest electricity producer, Slovenske elektrarne (a subsidiary of Enel), which allegedly will have to pay G-fees of as much as EUR 70 million, has already signaled a potential lawsuit to challenge it. The G-fee has also drawn the attention of the European Commission ("EC"), as EU law prescribes a EUR 0.5/MWh limit on such fee. In a letter addressed to the chairman of the Slovak regulatory authority RONI, the EC notes that no CEE country applies a G-fee, and expresses the concern that implementation of such fee may lead to market distortions. However, in an explanatory letter sent to the EC, the RONI chairman assured that the regulation implementing the G-fee is in line with all EU law limitations.

Slovenske elektrarne is not the only energy producer voicing its discontent with recent developments in the energy regulatory framework. Representatives from photovoltaic power plants have already raised concerns about the planned introduction of a special tax on photovoltaic power plants. In Slovakia, the support for the photovoltaic industry is reflected in the average household final electricity bill by about 4.5%, while investors were initially promised support for 15 years.

However, the Slovak government has already started working on the instruments that would axe support to the photovoltaic industry. In doing so, it may be tempted to look for inspiration to the neighboring Czech Republic, where the government has implemented a 26% special tax on PV plants that came into operation in 2009 and 2010. The Czech Constitutional Court has declared the tax constitutional, stating that it does not amount to discrimination since the unequal treatment was justified by the lower costs of constructing the plants. Investors have reportedly already filed claims under the relevant bilateral investment protection treaties.

The courts have also contributed to the summer's activity. Following a lawsuit filed by Greenpeace, the Supreme Court quashed a decision from the Nuclear Regulatory Authority ("NRA") approving a change of structure in connection with the building of Unit 3 and 4 of the Mochovce Nuclear Power Plant.

The Court found that NRA's decision violated the rights of Greenpeace as a party to the proceedings, protected under the Aarhus Convention. The NRA will have to conduct the proceedings on change of the building permit again. However, the Supreme Court ruling should not have a detrimental effect on the interests of the investor as the NRA allowed the construction works to continue pending the outcome of the new proceedings.

Turkey

Recent developments in the electricity and gas markets

A major change took place on the regulatory side of the Turkish **electricity market** following the enactment of the Electricity Market Law No. 6446 on 30 March 2013, which replaced the former law No. 4628.

The law features a pre-license mechanism and the creation of an electricity stock exchange, the Energy Market Operation Company ("EPIAŞ"), responsible for the operation of the wholesale market and the financial settlement of activities in the electricity market. The pre-license mechanism is expected to increase investment in the electricity market, particularly the renewable electricity generation.

The EPIAŞ is based on the European Energy Exchange model. The Turkish Energy Market Regulatory Authority (EMRA) hosted a meeting on 19 July 2013 to review the main charter of the EPIAŞ. Its shareholder structure will be as follows: 30% allocated to the state-owned Turkish Electricity Transmission Company (TEİAŞ), 30% to Istanbul Stock Exchange and a 40% allocation to private energy companies.

Looking ahead, once the Turkish Supreme Planning Council decision to name TEİAŞ as a shareholder is made, private energy companies will officially be invited by EMRA to apply for a shareholding in EPIAŞ. The EPIAŞ is expected to start operations by 2014.

The Turkish **natural gas market** is also expecting some major changes. In September 2012 the Turkish Ministry of Energy and Natural Resources proposed a new gas market liberalization bill calling for the state-owned Petroleum Pipeline Corporation (BOTAŞ) to be unbundled. Now the bill is with the Turkish Prime Ministry office awaiting approval to be introduced to the Turkish Council of Ministers.

The proposal is for BOTAŞ to be unbundled into three distinct entities: an LNG trading group, a gas transmission system operator and a storage facility operator. Gas import and export rights would be transferred to private companies under this new bill. Other proposals include the establishment of a balancing and settlements market similar to the Market Financial Settlement Centre (PMUM) in the Turkish electricity market, and LNG investment incentives to private companies wishing to invest.

Finally, the most anticipated privatization of the Turkish natural gas market is expected to be announced soon. Istanbul Gas Distribution Company (IGDAŞ) is Turkey's largest gas distribution company. IGDAŞ is a highly sought after asset by Turkish and international investors, the Azerbaijani State Oil Company SOCAR and the Turkish Akfen Holding having already shown interest. IGDAŞ holds the largest customer base of the gas distribution companies in Turkey and is the only one yet to be privatized.

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