

Ex-ante impact assessment report (abstract) of the Cabinet regulation “Amendments to Cabinet Regulation No. 221 “Regulations Regarding Electricity Production and Price Determination upon Production of Electricity in Cogeneration” adopted on 10 March 2009”

| I. The Necessity of the Regulation | | |
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| 1. | Justification | <p>Article 13 of priority axis “Strengthening of Economy” of the Declaration of the Intended Activities of the Cabinet of Ministers Headed by Māris Kučinskis, which prescribed that <i>we will review the existing renewable energy resource support policy and develop a new, sustainable and economically justified support mechanism.</i></p> <p>Cabinet regulation “Amendments to Cabinet Regulation No. 221 “Regulations Regarding Electricity Production and Price Determination upon Production of Electricity in Cogeneration” adopted on 10 March 2009” (hereinafter referred to as the regulation) was prepared to comply with §58 Item 2 of minutes No. 67 of the Cabinet meeting of 15 December 2015: “By the end of January 2016, the Ministry of Economics together with the Ministry of Agriculture and farmers’ organizations shall prepare proposals for amendments to the system of support established in Cabinet Regulation No. 221 “Regulations Regarding Electricity Production and Price Determination upon Production of Electricity in Cogeneration” of 10 March 2009 (hereinafter referred to as Cabinet Regulation No. 221) and Cabinet Regulation No. 262 “Regulations Regarding the Production of Electricity Using Renewable Energy Resources and the Procedures for the Determination of the Price” of 16 March 2010 (hereinafter referred to as Cabinet Regulation No. 262), and the Minister of Economics shall submit the proposals to the Cabinet for review”.</p> <p>The regulation has also been prepared to take account of the conditions that the European Union (hereinafter referred to as the EU) Member States must comply with regarding the compliance with the EU’s single market principles, including when developing support mechanisms for promotion of renewable energy. Thus, preventing the things stated by the European Commission (hereinafter referred to as the EC) in relation to coordination of the State Aid Scheme SA.43140 (2015/NN) – <i>Aid to Electricity Producers</i> – and preparation of the EC decision regarding compliance of conditions of the above-mentioned State aid with the conditions of the EU internal market.</p> <p>The regulation implements Article 13 of the protocol decision of Cabinet meeting of 5 January 2016 (No. 1, §28) that prescribes developing of amendments to laws and regulations to ensure the effective communication between an institution and an individual via e-address.</p> |

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| 2. | The current situation and challenges, for the solution of which the regulation has been developed; the purpose and nature of the legal framework | <p>1. <u>Eliminating the risk of overcompensation.</u></p> <p>Based on §156 Item 7 of minutes No. 44 of the Cabinet meeting of 13 August 2013, pre-notification process was prepared and commenced on 17 December 2013 within the framework of the EC State Aid Scheme SA.37970 (2013/PN) – <i>Aid to Energy Producers</i>. Taking into account the conditions for state aid and formal and informal consultations held with the EC, notification process was launched on 22 September 2015 within the framework of the State Aid Scheme SA.43140 (2015/NN) – <i>Aid to Electricity Producers</i>.</p> <p>On 22 July 2015, the EC urged Latvia in an electronic letter to submit a proposal on the prevention of overcompensation for power plants, where it is established. Latvia submitted such a proposal on 22 September 2015 by launching a notification process within the framework of the State Aid Scheme SA.43140 (2015/NN) – <i>Aid to Electricity Producers</i>.</p> <p>Within the framework of informal consultations with the EC and receiving EC letter No. B2/AV/DB/D*2015/138244 of 14 December 2015, the EC once again pointed out that it expects Latvia to submit a specific proposal for eliminating overcompensation by submitting an approved and detailed description regarding how Latvia will prevent overcompensation for power plants, where it is established during the entire period of receiving aid. Consequently, <u>in order to receive the EC decision on adequacy of the aid measures for the EU's internal market, it is necessary to introduce a mechanism for establishing and preventing overcompensation of the beneficiary's project.</u> In view of the above, the Ministry of Economics has prepared amendments to Cabinet Regulation No. 221 and Cabinet Regulation No. 262.</p> <p>Preparation and implementation of the said mechanism is a prerequisite for the EC to decide on the compliance of the State Aid Scheme SA.42854 (2015/N) <i>Aid to the Energy-intensive Manufacturing Merchants</i> submitted by Latvia with the EU internal market conditions.</p> <p>If Latvia does not develop and agree upon a mechanism for preventing overcompensation in case of merchants producing electricity from renewable energy sources or in high-efficiency cogeneration, proceedings are taken against Latvia for illegally granted state aid in accordance with the EC procedures. As a result the merchant should repay the funds that exceed the difference between electricity production costs and market price of electricity and were allocated under the mandatory procurement or the guaranteed payment for the installed electric capacity as of the first day of paying the aid, with accumulated penalty interest for the corresponding period In</p> |
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| | <p>addition, given that foreign investors from other EU Member States and third countries have invested in such power plants, there is a risk that these investors will turn against Latvia in international courts to recover their investments.</p> <p>The right of a merchant to receive a fixed income under the mandatory procurement shall be considered the right to property. Thus, the protection of this right is provided for in Article 105 of the Constitution, which provides for a free exercise of property rights, as well as the right of the government to limit the use of property in the public interest.</p> <p>According to requirements of laws and regulations, the Ministry of Economics has granted merchants the right to sell electricity produced within the framework of the mandatory procurement or the right to receive the guaranteed payment for the installed electric capacity. Using the rights granted by the Ministry of Economics, merchants have entered into agreements with JSC “Enerģijas publiskais tirgotājs” administering the mandatory purchase of electricity and ensuring the payment of grants to producers. The Constitutional Court has recognized that property rights also include the right to a contract with an economic value (<i>see Paragraph 8.2 of the Constitutional Court’s decision of 20 April 2010 on the termination of the proceedings in case No. 2009-100-03</i>). Property can include different claims, namely, such claims, the performance of which may be demanded if there is a clear legal basis. Future revenue shall also be considered property if it has already been earned or there is a claim that can be satisfied (<i>see Paragraph 7 of the Constitutional Court’s judgement in case No. 2010-12-03 of 27 October 2010 and Paragraph 15.2 of judgement in case No. 2011-05-01 of 3 November 2011</i>). According to administrative acts issued by the Ministry of Economics and agreements entered into with JSC “Enerģijas publiskais tirgotājs” grant merchants the right to sell electricity produced for a higher price or the right to receive the guaranteed payment for the installed electric capacity. Such contractual rights have an economic value, and merchants have the claim rights to exercise them.</p> <p>The right to property is not absolute in a democratic law-based state. First of all, the right to property includes the owner's social responsibility towards society – the property shall not be used contrary to the public interest. Secondly, the right to property may be restricted by law. Thus, the right to property can be restricted if the restrictions have been imposed by law for a legitimate aim and are commensurate with this objective (<i>for example, see Paragraph 12 of the Constitutional Court’s judgement of 26 April 2007 in case No. 2006-38-03 and</i></p> |
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| | | <p><i>Paragraph 7.2 in the judgement of 10 October 2014 in case No. 2014-04-03).</i></p> <p>The Constitutional Court has concluded that, when changing the legal framework, public authorities must be consistent in their activities with regard to the laws and regulations passed and they must respect the legitimate expectations, which may arise to persons in accordance with a specific legal provision. The principle of legitimate expectations requires, inter alia, to protect the expectations that a person has regarding the retention or exercise of their specific rights, and includes the obligation of the state to fulfil the commitments it has undertaken towards people. Otherwise, the confidence of people in the state and law would be diminished. However, to ensure the state's ability to respond to changing conditions of life, this principle does not prevent the state from amending the existing legal framework. The principle of legitimate expectations also requires that the state, when changing the regulatory framework, observes a reasonable balance between the person's confidence and the public interest, for the sake of ensuring which the framework is being changed (see Paragraph 3.2 of the conclusion part the Constitutional Court's judgement of 19 March 2002 in case No. 2001-12-01 and Paragraph 7.1 of the judgement of 19 March 2014 in case No. 2013-13-01).</p> <p>In the present case, electricity producers' legitimate expectations regarding the permanence of the legal situation and the rights to gain the maximum profit from their property are consistent with the interests of public well-being.</p> <p>The legitimate aim of the provision, inter alia, is the promotion of public well-being in the form of limiting the costs of the mandatory procurement component and efficient use of the state aid funds, while preserving the benefits provided to people by electricity production from RES and its consumption. This will cut the government spending, preventing overcompensation and achieving a more efficient operation of the energy market.</p> <p>Introduction of the mechanism for preventing overcompensation is a prerequisite for the EC to decide on the State Aid Scheme SA.42854 (2015/N) <i>Aid to the Energy-intensive Manufacturing Merchants</i> submitted by Latvia. In accordance with Cabinet Regulation No. 395 "Procedure, According to which the Energy-intensive Manufacturing Companies are Granted the Right to a Reduced Participation in the Payment of the Mandatory Procurement Component" of 14 July 2015 (hereinafter referred to as Cabinet Regulation No. 395). In accordance with Paragraph 32 of Cabinet Regulation No. 395, these regulations shall enter into force once the EC has taken a decision on adequacy of the measure for the EU internal market. Thus, introduction of the overcompensation</p> |
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| | <p>mechanism is a prerequisite for assessing the state aid to Latvian energy-intensive companies.</p> <p>In view of the above, the amendments submitted ensure that the electricity producers gain reasonable profit and recover their investments and, at the same time, competitiveness of the economy is ensured and energy poverty of households is not increased.</p> <p>Taking into account the aforesaid, the public benefit from the fact that electricity producers are motivated to improve their operational efficiency and national budget funds are used sparingly is greater than the interest of individual electricity producers in profit. So the public interest in maintaining the competition of electricity producers, in principle, takes precedence over the energy producers' interest in being protected from competition, namely, to acquire the right to sell the electricity produced under the mandatory procurement and the right to receive the guaranteed payment and, moreover, to do so at a price exceeding the current market price of electricity and also representing a significant oversubsidization of merchants.</p> <p>Accordingly, the beneficiaries (merchants) from the very beginning had to understand that, first of all, the distortion of competition can not be unlimited in time or be disproportionately long. Secondly, even if there is a public interest for some time to promote the use of renewable resources and the introduction of high-efficiency cogeneration, it takes precedence over the public interest in competition, and there was no reason to anticipate that the balance of the public interest and, therefore, the regulatory framework distorting the competition will not change. Thirdly, EU regulations, which restrict the state aid to merchants (Article 107 of the Treaty on the Functioning of the European Union), may be violated in case of receiving disproportionate state aid.</p> <p>In assessing the means, by which the overcompensation can be reduced, it is established that the alternative means are repayment of the aid unjustifiably received as a result of overcompensation or cancellation of state aid payments.</p> <p>Given that the mechanism for preventing overcompensation provided for in the amendments lets to maintain the state aid to some of the merchants and reduces the aid for other merchants, the chosen mechanism is the most considerate mechanism for preventing overcompensation and affects the smallest number of merchants.</p> <p>1) The total capital investment internal rate of return.</p> <p>The values of calculation methods and benchmarks of the total capital investment internal rate of return (hereinafter referred to as IRR) and price differentiation coefficient for preventing overcompensation are established in the procurement</p> |
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| | <p>“Development of Proposals for Methodological Guidelines for Calculation of the Internal Rate of Return to Eliminate Overcompensation for Merchants that have been Granted the Right to Sell Electricity Under the Mandatory Procurement or the Guaranteed Payment” of the Ministry of Economics executed on contractual basis by limited liability company “Prudentia Energy Markets” that will be available on the website of the Ministry of Economics.</p> <p>Some positions have been changed in the regulation compared to the information obtained within the framework of the procurement, taking into account the additional information obtained in the coordination process from the Ministry of Agriculture and industry representatives regarding the constant own consumption for biogas production (to 8000h), a larger amount of manure in the volume of biogas raw materials (the price of biogas changed), and including net heat capacity calculation (according to the average ratio of gross and net heat energy produced by cogeneration units, which, according to the statistics, was 97% in the period from 2007 to 2014). In addition, taking into account the objection of the Public Utilities Commission, the annual number of working hours of natural gas cogeneration units was changed.</p> <p>The public funding granted and actually received (in EUR) for the merchant’s power plant, including payments from the national or local government budget, credit interest rate subsidies and other financial assistance that has been granted or provided from the national, local government or the European Union budget funds and foreign financial aid resources, that is taken into the account in the IRR calculation, does not include the reduced rates of the subsidized electricity tax as they are taken into account in a separate calculation position.</p> <p>In order to ensure equal approach to all merchant projects that have received aid, the regulation provides for assessment of the total capital investment IRR of the projects, using fixed benchmarks. Such an approach will promote more efficient operations of power plants.</p> <p>In determining the IRR rate applicable to merchants, the existing rate of return of the Latvian energy sector was evaluated. According to decision No. 142 of the Public Utilities Commission (hereinafter referred to as the Regulator) of 19 November 2015, a 5% rate of return on capital was established for developing the draft tariffs of the electricity distribution system services. At the same time, according to the Regulator’s decision No. 83 of 18 May 2015, a 6.1% rate of return on capital was established for preparing the tariff calculation project for natural gas transmission, storage, distribution and marketing services of JSC “Latvijas Gāze”. The maximum IRR value of</p> |
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| | <p>project profitability index established in the cogeneration tariff calculation methodology¹ developed by the Regulator and study of February 2016 conducted by the Fraunhofer-Institut² was 9%. After assessing this, the maximum IRR rate applicable to merchants is set at 9%.</p> <p>If the IRR calculated exceeds 9%, the project overcompensation is established according to the level that was previously used in assessing projects of the same industry. At the same time, if the project's IRR does not exceed 9%, no price differentiation coefficient will be applied to the project.</p> <p>In case project overcompensation is established, a decreasing coefficient will be applied to the future aid – the price differentiation coefficient for preventing overcompensation, ensuring that the total level of the project's IRR does not exceed 9% at the end of the period of receiving aid.</p> <p>Given that the a part of the head produced in the cogeneration process is sold to ensure district heating in Latvian municipalities, the condition of the IRR calculation does not apply to the merchants for whom the price of heat energy produced is established or approved by the Regulator in accordance with the Regulator's methodology.</p> <p>Implementing the mechanism for preventing overcompensation will not concern power plants to whom the aid will cease in 2017. These are 22 cogeneration units providing public service of district heating in municipalities. Hence the revenues of these units from selling electricity under the mandatory procurement are taken into account upon determining tariff for district heating in respective municipalities.</p> <p>2) Calculating the IRR.</p> <p>Latvian merchants have been granted the right to sell electricity produced within the framework of the mandatory procurement or receive the guaranteed payment for the installed electric capacity. Methodology of IRR calculation is different for each of the said types.</p> <p>Given that so far the IRR calculation has not been carried out for projects developed with the aim to produce electricity from renewable energy resources, the regulation provides for adding a new annex to Cabinet Regulation No. 221, setting out a formula for calculating the IRR with the explanations of variables included in the formulae, constants and the process of calculation. Since electricity from renewable sources is produced in Latvia using a variety of technologies (wind farms, hydroelectric power stations, biogas cogeneration, biomass</p> |
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¹ <http://likumi.lv/doc.php?id=208283>

² <http://diacore.eu/images/files2/WP3-Final%20Report/diacore-2016-impact-of-risk-in-res-investments.pdf>

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| | <p>cogeneration), the IRR calculation takes into account the peculiarities of the technologies, and a different calculation model is offered for individual variables and constants.</p> <p>In order to ensure benchmark evaluation of the technology projects, benchmarks are used for certain variables based both on research conducted in the EU Member States³ on establishing the reference costs when producing electricity from renewable energy sources and research conducted in Latvia⁴. Thus, eliminating the possibility that the IRR can vary considerably in power plants with the same technologies that are in a similar situation. In addition, the use of benchmarks in the IRR calculation will ensure that merchants, who plan the operations of their power plant efficiently, integrating them into a complete operating cycle (for example, a biomass cogeneration unit is located next to a pellet manufacturing company that consumes the heat produced in the unit and provides it with biomass left over from the production of pellets) are not in a worse legal position than merchants, who do not plan their power plant efficiently.</p> <p>In order to ensure correspondence of the IRR calculated to the actual situation, as well as to take account of actual value of individual variables, such as prices of natural gas or changes in the subsidized electricity tax rates, the IRR will be calculated on a monthly basis.</p> <p>For power plants receiving aid in form of the guaranteed payment for the installed electric capacity, the IRR will be calculated on the basis of actual and prospective operating costs.</p> <p style="text-align: center;">3) Price differentiation coefficient</p> <p>The price differentiation coefficient for preventing overcompensation will be applied to and calculated for the merchants, whose project's IRR at the end of the aid period (namely, during the last calendar year of the aid period) exceeds the level specified in the regulation – 9%.</p> <p>The price differentiation coefficient is not calculated and applied to merchants, whose power plant project's IRR is equal to or lower than the level specified in the regulation.</p> <p>For merchants, whose project IRR exceeds the specified level – 9% –, the coefficient will be calculated and applied to the aid received as of the first date of the following full calendar month</p> |
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³ For example, Methodology for Determining Reference Costs of Electricity Generated from Renewable Resources, Slovenia, 2009

⁴ For example, Evaluation of the Support to Electricity Produced from Renewable Energy Sources and in Cogeneration and Proposals for Improvement of the Support. The second deliverable, Riga, 2013

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| | <p>after the entry into force of the decision of the Ministry of Economics on establishing the overcompensation coefficient.</p> <p>The price differentiation coefficient for preventing overcompensation is calculated individually for the power plant or cogeneration unit of each merchant and determined to the nearest thousandth (namely, three digits after the decimal point).</p> <p>The price differentiation coefficient is set at a level that ensures that the IRR of the merchant's project in the final year of the project is equal to the IRR rate set by the Cabinet – 9%.</p> <p>In cases, when recalculating the IRR of merchants' projects, according to the time schedule established in the regulations, the IRR of the merchant's project, for which a price differentiation coefficient was calculated and applied initially, deviates (namely, becomes higher or lower than the level set by the Cabinet), a new price differentiation coefficient is calculated and applied so that the IRR is equivalent to the level set by the Cabinet – 9% – during the last year of the project aid.</p> <p>4) Introduction mechanism</p> <p>In order not to create an additional administrative burden for the merchants, the calculation of the total capital investment IRR of the plant will be carried out by the Ministry of Economics as far as the existing human and financial resources allow.</p> <p>Calculation of the IRR for merchants producing electricity from renewable energy sources will be carried out after the first five full calendar years, namely, from the moment when the merchant receives the mandatory procurement or guaranteed payment for the installed electric capacity. Within two months after submission of the annual report of the power plant, the Ministry of Economics shall calculate the IRR for the entire period of receiving aid. In case it is established during the IRR calculation that the IRR exceeds 9%, a price differentiation coefficient is applied, notifying the merchant, public trader and system operator about this.</p> <p>Regulation enables the merchant to ask the Ministry of Economics to perform IRR calculation before the power plant or cogeneration unit has been operating for a period of five full calendar years. In addition, in cases of establishing a change of circumstances affecting the IRR of the power plant, the Ministry of Economics, on its own initiative or at the request of the merchant, may recalculate the IRR of the power plant and the price differentiation coefficient.</p> <p>In order to ensure that the merchant has to submit the necessary information to the Ministry of Economics once, it is planned to</p> |
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| | <p>clarify Annex No. 5 of Cabinet Regulation No. 221 in relation to gross / net installed electric and heat capacity.</p> <p>Should the merchant not agree with the IRR calculated by the Ministry of Economics, it may submit an alternative calculation approved by a sworn auditor and supplemented with supporting documentation. This provision provides the merchants with an opportunity to utilize the actual values of revenues and expenditures.</p> <p>For the IRR assessment purpose of their power plant, the Ministry of Economics will provide the merchants with MS Excel tool suitable for provisional calculations by making it available on the website of the Ministry of Economics.</p> <p><u>2. Fixing the final tariff for trade of natural gas in the formulae of mandatory procurement prices of electricity</u></p> <p>The mandatory procurement price of electricity is based on a price formula. One of the elements of the price formula is the tying to the final tariff for trade of natural gas approved by the Regulator without value added tax, which changes on a monthly basis and depends on the level of natural gas sales price.</p> <p>It was concluded in the study “Evaluation of the Support to Electricity Produced from Renewable Energy Sources and in Cogeneration and Proposals for Improvement of the Support”⁵ conducted by limited liability company “Ekodoma” in 2013 (hereinafter referred to as the study of LLC “Ekodoma”) that the evaluation of validity of the formulae of mandatory procurement prices of electricity shows that tying the existing aid to natural gas price of the power plants using renewable energy sources and biomass and biogas cogeneration units is not valid.</p> <p>Fixing the natural gas price component included in the formulae for calculation of the prices of electricity procured under the mandatory procurement at the level of natural gas sales tariff of March 2014 would mean establishing the maximum limit of the final tariff for trade of natural gas for Latvian producers of electricity, which would limit the increase in aid provided to electricity producers, ensuring certainty for investors. As of February 2013, a fall in the sales price of natural gas can be observed – in case of a further fall, the</p> |
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⁵ Page 118 of the study “Evaluation of the Support to Electricity Produced from Renewable Energy Sources and in Cogeneration and Proposals for Improvement of the Support”. The study is available on the website of the Ministry of Economics: (https://www.em.gov.lv/files/energetika/SIA_Ekodoma_atskaite.pdf).

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| | <p>mandatory procurement price of electricity will not cover the actual operating costs of power plants, including fixed costs.</p> <p>In addition, after the opening of the natural gas market, the Regulator's approved final tariff for trade of natural gas without value added tax in accordance with the actual calorific value of natural gas (EUR / thousand n.m³) will no longer be in force. Therefore, it is necessary to unlink the formulae of mandatory procurement prices of electricity from the final tariff for trade of natural gas.</p> <p>In order to ensure the mandatory procurement prices not falling below the level necessary to ensure the operation of the supported power plants as a result of a decrease in the natural gas sales tariff, and adapt the existing framework for opening the natural gas market, a planned aim of the regulation is to fix the component included in the formulae for establishing the mandatory procurement price of electricity, namely, the sales price of natural gas, in Cabinet Regulation No. 221 by setting it at the level of 234.77 euro / thousand n.m³, which was the average natural gas sales price for the period from August 2007, when Cabinet Regulation No. 503 "Regulations Regarding the Production of Electricity Using Renewable Energy Resources" of 24 July 2007 entered into force, until September 2012, when merchants were no longer eligible to qualify for the acquisition of the right to sell electricity produced within the framework of the mandatory procurement and acquisition of the right to receive a guaranteed payment for the electric capacity installed at the cogeneration power plant (as of 10 September 2012) pursuant to Cabinet Regulation No. 221.</p> <p>In order to make the formulae used in Cabinet Regulation No. 221 easier to perceive, the component $\frac{T_g \times k}{9,3}$, which is multiplied by the constant included in the formulae till now (3.4 or 4.5, depending on the energy sources used), shall be replaced by the coefficient k_{AER}, and its values shall be included in table of Annex No. 6. The values of coefficient k_{AER} have been calculated as a quotient of the Regulator's approved final tariff for trade of natural gas without value added tax at the natural gas sales price of 234.77 euro / thousand n.m³ and the constant 9.3 included in the formulae till now, which is multiplied by the constant included in the formulae till now (3.4 or 4.5, depending on the energy sources used) and the price differentiation coefficient k, approximating the result to the number with three decimal places.</p> <p><u>3. Entry into force of the regulation</u></p> <p>Amendments to Cabinet Regulation No. 221 and Cabinet Regulation No. 262 must be communicated within the</p> |
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| | <p>framework of EC State Aid Scheme SA.43140 (2015/NN) – <i>Aid to Electricity Producers</i>.</p> <p>Consequently, the regulation and Cabinet protocol decision include a clause (as a transitional provision) that the regulation shall take effect on the first day of the following full calendar month after receipt of the EC decision, as it eliminates the risk of overcompensation, and it is a prerequisite for the EC to decide on the compliance of the State Aid Scheme SA.42854 (2015/N) <i>Aid to the Energy-intensive Manufacturing Merchants</i> submitted by Latvia with the EU internal market conditions.</p> <p>The state aid mechanism consists mainly of the right granted by the Ministry of Economy to the producers supported to sell electricity produced to the public trader of electricity under the mandatory procurement for the tariff that is higher than the market price of electricity. A contract between the public trader and the merchant for procurement of electricity under the mandatory procurement is the tool of enforcing the administrative act of the Ministry of Economics. Namely, the contract is a part of the state aid mechanism through which the merchant directly receives aid for the electricity produced from renewable energy sources. Thus, the subject of the contract is located in the area of public law (see decision of the Administrative Affairs Department of the Supreme Court of 11 February 2016 in the administrative case No. A420353113).</p> <p>According to Paragraph 24 of Cabinet Regulation No. 221, the mandatory procurement shall be implemented on the basis of a contract by and between a public trader and a merchant or an authorised person thereof.</p> <p>According to Paragraph 36 of Cabinet Regulation No. 221, payment for the electric capacity installed in a cogeneration unit shall be performed on the basis of a contract by and between a transmission service operator and a merchant, which has been entered into for a period of time not exceeding 15 years from the putting into operation of the cogeneration unit or a cogeneration installation of such unit, in accordance with a permit issued by the system operator to connect the cogeneration unit to the system.</p> <p>In view of the above, after the decision made by the Ministry of Economics, the public trader and the system operator have an obligation to enter into a public law contract with the respective producer of electricity, when others conditions provided for in Cabinet Regulation No. 221 are satisfied.</p> <p>In order to ensure the possibility of communication between an individual and an institution through an e-address, the amendments prescribe that the Ministry of Economics shall send the adopted administrative act to the addressee and parties</p> |
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| | | involved in enforcement of the administrative act electronically. The regulation provides for sending the administrative act to the public trader and the system operator, whose networks the power plant has been connected to, since both the public trader and the system operator are involved in enforcement of the administrative act, thus they need these administrative acts to enforce the administrative act and conclude or terminate a public law contract. |
| 3. | Institutions involved in the development process | The regulation does not affect this area. |
| 4. | Other information | None. |

| II. The impact of the regulation on society, economic development and the administrative burden | | |
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| Target groups of society, which the legislation affects or could affect | Producers that have acquired the right to sell the electricity produced within the framework of the mandatory procurement or receive the guaranteed payment for the installed electric capacity. | |
| Impact of the legal framework on the economy and the administrative burden | <p>The amendments will result in a reduced risk of an increase in the mandatory procurement component, at the same time reducing the risk of bankruptcy as a result of a fall of natural gas price for merchants, for whom the mandatory procurement price of electricity was dependent on the natural gas sales price, but the production costs do not depend on natural gas costs.</p> <p>In addition, by deciding on introduction of the overcompensation prevention mechanism in Latvia, the risk that the EC can bring an action against Latvia for granting unlawful state aid to merchants producing electricity from renewable energy sources or in high-efficiency cogeneration is minimized. It can result not only in returning the aid received by merchants under the mandatory procurement to the state budget, but also in returning the investment aid granted from the EU budget programmes to the EU budget. Taking into account the fact that investors from the EU Member States and third-countries have made investments in Latvian power plants, making of such a decision by the EC may result in international investment disputes.</p> <p>The administrative burden on the Ministry of Economics is increased in relation to the duties related to calculation of IRR and revaluation coefficient for power station projects, for which the producers that have acquired the right to sell the electricity produced within the framework of the mandatory procurement or receive the guaranteed payment for the electric capacity installed at the plant. The administrative</p> | |

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| | burden does not change for merchants, whose cogeneration power plant electric capacity does not exceed 4 MW. At the same time, the merchants, whose cogeneration power plant installed electrical capacity exceeds 4 MW, have to additionally submit a calculation of the total capital investment internal rate of return (IRR) of the cogeneration unit approved by a sworn auditor. |
| Monetary evaluation of the administrative costs | <p>Estimated annual administrative costs of the Ministry of Economics are up to 4,500 euro (the costs created by the legal framework in connection with the duties related to calculation of the IRR and overcompensation coefficient and exchange of information with the merchants). It is planned to cover the costs using the existing financial resources.</p> <p>Administrative costs (in monetary terms) of the merchants, whose cogeneration power plant installed electrical capacity exceeds 4 MW, is up to 2000 euro (the cost of preparing a single calculation approved by a sworn auditor for one cogeneration unit of the merchant) at least once during the entire period of receiving aid.</p> |
| Other information | None. |

| III. The impact of the regulation on the state budget and municipal budgets | | | | | |
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| Indices | 2016 | | The next three years (euro) | | |
| | in accordance with the state budget for the current year | changes in the current year, compared with the state budget for the current year | 2017 | 2018 | 2019 |
| | | | changes, compared to the current (n) year | changes, compared to the current (n) year | changes, compared to the current (n) year |
| 1 | 2 | 3 | 4 | 5 | 6 |
| 1. Budget revenues: | 0 | 0 | 0 | 0 | 0 |
| 1.1. state basic budget, including the revenue from paid services and other own revenue | 0 | 0 | 0 | 0 | 0 |
| 1.2. state special budget | 0 | 0 | 0 | 0 | 0 |
| 1.3. municipal budget | 0 | 0 | 0 | 0 | 0 |

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| 2. Budgetary expenditure: | Cannot be calculated precisely | Cannot be calculated precisely | Cannot be calculated precisely | Cannot be calculated precisely | Cannot be calculated precisely |
| 2.1. state basic budget | Cannot be calculated precisely | Cannot be calculated precisely | Cannot be calculated precisely | Cannot be calculated precisely | Cannot be calculated precisely |
| 2.2. state special budget | 0 | 0 | 0 | 0 | 0 |
| 2.3. municipal budget | 0 | 0 | 0 | 0 | 0 |
| 3. Financial implications: | 0 | 0 | 0 | 0 | 0 |
| 3.1. state basic budget | 0 | 0 | 0 | 0 | 0 |
| 3.2. special budget | 0 | 0 | 0 | 0 | 0 |
| 3.3. municipal budget | 0 | 0 | 0 | 0 | 0 |
| 4. Financial resources for financing additional costs (compensatory spending cuts are indicated by a “+” sign) | X | | | | |
| 5. Specified financial implications: | X | | | | |
| 5.1. state basic budget | | | | | |
| 5.2. special budget | | | | | |
| 5.3. municipal budget | | | | | |
| 6. A detailed statement of income and expenditure (if necessary, a detailed statement of income and expenditure can be annexed to the abstract): | | | | | |
| 6.1. a detailed statement of income | | | | | |
| 6.2. a detailed statement of expenditure | | | | | |
| 7. Other information | <p>Since there is currently no way to specify the number of merchants, who will be applied the price differentiation coefficient when it is established during the calculation of the IRR that the IRR is greater than 9%, and thus the price of electricity will be reduced, for which the public trader will procure electricity from a particular merchant. In addition, the IRR will be calculated for merchants only after the first full calendar years of operation as of the moment of receiving aid. Thus, is it not possible to establish specific fiscal impact of the overcompensation prevention mechanism at the moment.</p> | | | | |

| <p>By drawing up the current conceptual report (in accordance with Cabinet Decree No. 567 of 17 September 2015⁶), the Ministry of Economics will update the forecasts of the amount of the state budget subsidy to retain the mandatory procurement component in the amount of 26.79 euro / MWh as provided by the Cabinet Decree No. 567 of 17 September 2015, Declaration of the Intended Activities of the Cabinet of Ministers Headed by Māris Kučinskis⁷ and the Government Action Plan⁸ (approved by the Cabinet Decree No. 275 of 3 May 2016). When updating the forecasts of the amount of the state budget subsidy to retain the mandatory procurement component in the amount of 26.79 euro / MWh, the Cabinet decision taken on the framework of the overcompensation prevention mechanism and fixation of the final tariff for trade of natural gas in the mandatory procurement formulae will be taken into account.</p> <p>The indicative impact of the amendments to Cabinet Regulation No. 221 and Cabinet Regulation No. 262 on the state budget in relation to the amount of subsidies earmarked in the medium-term budget is as follows:</p> | | |
|--|--|--|
| Year | Subsidy for reducing the mandatory procurement component in the budget base, million EUR | Indicative subsidy for reducing the mandatory procurement component, fixing the natural gas price at 234.77 EUR / thousand m ³ and introducing the IRR of 9%, million EUR |
| 2017 | 81.05 | 77.07* |
| 2018 | 89.89 | 70.11 |
| 2019 | 100** | 75.18 |
| <p>* There will be practically no impact of the overcompensation response mechanism on the state budget of 2017, taking into account the fact that there is a possibility in 2016 that it no calculations of the IRR will be carried out, using the preliminary schedule for assessment.</p> <p>** Specific calculations will be provided in conceptual report on composite measures for development of electricity market.</p> | | |

IV. The impact of the regulation on the existing legal system

⁶ Available at: (<http://likumi.lv/ta/id/276625-par-konceptualo-zinojumu-kompleksi-pasakumi-elektroenerģijas-tirgus-attistibai>) [Viewed on 14.05.2016]

⁷ Available at:

(http://www.pkc.gov.lv/images/vald%C4%ABbas_deklar%C4%81cijas/2016/20160210_MKucinskis_vald_prior_GALA_VERS.pdf) [Viewed on 14.05.2016]

⁸ Available at:

(http://www.pkc.gov.lv/images/vald%C4%ABbas_deklar%C4%81cijas/2016/VRP/Copy_of_1_2_10_11_280416_VRP_pielikum.xls) [Viewed on 14.05.2016]

| | | |
|----|------------------------------|--|
| 1. | Required related legislation | The regulation is advanced together with the related amendments to Cabinet Regulation No. 262. |
| 2. | Responsible institution | Ministry of Economics |
| 3. | Other information | None |

| V. Compliance with the regulation with the international obligations of the Republic of Latvia | | |
|---|--|---|
| 1. | Obligations towards the European Union | The regulation does not affect this area. |
| 2. | Other international obligations | The regulation does not affect this area. |
| 3. | Other information | The regulation complies with the provisions laid down in the EC communication “Guidelines on State aid for environmental protection” (hereinafter referred to as the Guidelines) (Official Journal C/82, 01.04.2008) in relation to the state aid in the field of environmental protection. See the annex of the abstract for evaluation of compliance of the items of the regulation with the items of the Guidelines. |

| VI. Public involvement and communication activities | | |
|--|---|--|
| 1. | The planned public involvement and communication activities related to the regulation | Members of the public are informed about the regulation through the website of the Ministry of Economics, its official Twitter account and a press release published on May 11. After adopting the regulation, it is planned to send explanatory information to the media. |
| 2. | Public involvement in the development process | When drafting the regulation, the Ministry of Economics worked together with the Latvian Renewable Energy federation, Latvian Biogas Association, Cogeneration association, Latvian Association of Heat Enterprises, Latvian Agricultural Organization Cooperation Council, commercial banks “Nordea” and “Citadeles banka”. The draft regulation was discussed with the Latvian Chamber of Commerce and Industry and Latvian Association of Building Material Producers. |
| 3. | Results of public participation | Within the framework of the informal harmonisation, opinions were received from the Small Hydropower Association, Wind Energy Association, Latvian Biogas Association, Latvian Association of Heat Enterprises, and commercial bank “Nordea”. Objections and proposals expressed in the opinions have been partly taken into account by adjusting the regulation. |
| 4. | Other information | None. |

| VII. Ensuring execution of the regulation and its impact on institutions | | |
|---|--|------------------------|
| 1. | Institutions involved in the implementation of the project | Ministry of Economics. |

| | | |
|----|--|---|
| 2. | Impact of the execution of the project on the government functions and institutional structure. Establishment of new institutions, liquidation or reorganisation of existing institutions, their impact on human resources of the institution | By approving the regulation no new public institutions are established. The regulation improved the existing mandatory procurement system for electricity. It is planned to use the existing human resources for additional duties. |
| 3. | Other information | Execution of the regulation will be ensured within the framework of functions of the existing public institutions. |

Deputy Prime Minister,
Ministry of Economics

A. Ašeradens