

Subject: State aid case SA.43140 (2015/NN) - Subsidised Energy Tax and RES and CHP support in Latvia

Dear Sir, Madam,

Latvia has prepared the answers to the Commission questions from 14 October 2016, letter No B2/AV/LS/ 2016/099315 regarding the state aid case SA.43140 (2015/NN).

Amendments adopted in order to avoid any overcompensation

1) Latvia has prepared examples of calculations for all technologies. Please see Excel files in attachment (Annexes 1 to 10). Calculations take into account the different levels of Subsidised Energy Tax (SET) and the timeframe of its applicability.

2) The values of the benchmarks are based on the study “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”¹ procured by the Ministry of Economics. The Ministry of Economics does not have real installations’ data available. All benchmarks was calculated using reliable data sources (statistical data, information from equipment manufacturers and maintenance companies, studies in this field) and was discussed with the industry.

Benchmarks for labour costs are determined using data from the Central Statistical Bureau (table “Monthly labour costs per employee by kind of activity” activity – “Electricity, gas, steam and air-conditioning supply”) Labour costs include all related taxes, including the employer's share of social tax. For the calculation of labour costs for the periods starting from 2016, labour costs level of 2015 and the inflation forecast are used.

Benchmarks for inflation up to 2015 are obtained based on the Central Statistical Bureau data. For the period between 2016 and 2019 benchmarks are set according to the forecast of the Ministry of Finance². For the years ahead inflation forecast is based on the European Central Bank data³.

Historical natural gas sales prices are obtained on the basis of monthly natural gas prices published in the “Latvian Journal”. Natural gas excise tax on the use of natural gas as a fuel is determined as follows: for the period from 1 July 2010 to 30 June 2011 (inclusive): 22.20 EUR/thousand. nm³; for the period from 1 July 2011 onwards – 17.07 EUR/thousand. nm³. Natural gas sales price for the future period is determined based on the 9-month average Brent oil financial contract quotations for the future months⁴.

Benchmarks of the price of wood chips is assumed as biomass fuel price. The price level of Wood chips for 2007 to 2016 is set on the basis of JSC “Latvijas Valsts meži” and Ltd. “Meža un koksnes produktu pētniecības un attīstības institūts” data and conversion factors. The price levels in the vicinity of Riga region was used to determine benchmarks for the biomass price. For the calculation of biomass costs for the periods starting from 2017, biomass costs level of 2016 and the inflation forecast are used.

¹ https://www.em.gov.lv/files/energetika/irr20_05%202016.pdf

² http://www.fm.gov.lv/en/s/macroeconomics/main_macroeconomic_indicators/

³ European Central Bank. Inflation forecasts

https://www.ecb.europa.eu/stats/prices/indic/forecast/html/table_hist_hicp.en.html

⁴ ICE Futures Europe. Brent crude futures. <https://www.theice.com/products/219/Brent-Crude-Futures/data>

Benchmarks for biogas price is calculated based on the average raw material mix according to data from the Ministry of Agriculture and raw material prices that are determined on the basis of various raw materials supplier survey made in 2016⁵. Raw material prices for 2008 to 2015 and for future period have been calculated on the basis of 2016 data and the inflation rate.

Benchmarks for investment and operation and maintenance costs are calculated using information from equipment manufacturers and maintenance companies, studies in this field and was discussed with the industry.

3) Please see the examples of calculations for the large CHP plants, illustrating how the proposed methodology is applied to avoid overcompensation in attachment (Annex 11). For calculations actual data (till 2015) and estimations (starting from 2016) are used. When the IRR will be calculated for such plants all data (actual and prospective costs and revenues) will be approved by a sworn auditor. **Please note that all information in the Annex 11 is confidential and has restricted access as it contains business secrets of the merchant.**

4) In order to receive the guaranteed payment for electric capacity installed in the large CHP plant the number of hours of use of the electric capacity installed in this CHP plant should be at least 3000 hours per year. In addition the Transmission System Operator stops paying for the electric power installed in CHP plant if the CHPP or equipment of this station is not able to operate more than six months without interruption.

There is only one merchant ("Fortum Latvia" Ltd.) who receives the guaranteed payment for the electric capacity installed in the CHP plant. The number of hours of use of the electric capacity installed in this CHP plant with the installed electric power of 23 MW was launched on 24 September 2013 and in 2014 it operated 4598 hours and in 2015 4542 hours.

For CHP plants which are connected to a transmission system and have received the right to sell the produced electricity within the framework of the mandatory procurement and the installed electric capacity of which is greater than 4 megawatts (such as "Fortum Latvia"), the number of utilisation of the installed electric capacity of the CHP plant thereof is at least 1200 hours per year.

There are 4 such CHP plants (JSC "Latvenergo" CHP plants TEC-1 and TEC-2, JSC "Rīgas siltums" CHP plant "Imanta", LLC "Juglas jauda"). The number of utilisation of the installed electric capacity of these CHP plant is given in the table below:

	2013	2014	2015
JSC "Latvenergo" TEC-1	2823 h	3384 h	3224 h
JSC "Latvenergo" TEC-2	1863 h	1395 h	1875 h
JSC "Rīgas siltums" "Imanta"	2127 h	1202 h	1254 h
LLC "Juglas jauda"	3154 h	1224 h	1220 h

5) As it was mentioned in the replies submitted by the Latvian authorities on 7 March 2016 according to qualification criteria set out in Cabinet Regulation No.262 of 16 March, 2010 „Regulations Regarding the Production of Electricity Using Renewable Energy Sources and the Procedures for the Determination of the Price” to receive a guaranteed payment for the installed electric capacity the number of hours of the use of the installed electric capacity of biogas or biomass power plant must operate at least 8 000 hours per year. Latvia stresses that there is no and will not be power plants that qualified for the support according to aforementioned criteria.

⁵ Research made by Civitta Latvia "Costs of Electricity Produced in Latvian Biogas Plants", 2016
<http://www.civitta.com/>; <https://issuu.com/civitta/docs/biogazes-projekts-pasizmaksa-27-apr>

The only biomass CHP plant who receives the guaranteed payment for the installed electric capacity is “Fortum Latvia” Ltd. (see the answer to the question 4 above).

6) Please see concrete examples of heat tariffs calculations by the Regulator in attachment (Annex 12 to 14). **Please note that all information in the Annex 12 to 14 is confidential and has restricted access as it contains business secrets of the merchants.**

7) Please see concrete examples of the calculations demonstrating that there is no case in which the remaining support period is too short for correcting any past overcompensation in attachment (Annex 1 to 8). We have used the installations for which the highest overcompensation risk was identified (hydro power plants, biogas power plants, biomass power plants with shorter remaining time of the support and additional investment support and high efficiency natural gas cogeneration installations with shorter remaining time of the support).

8) Latvia confirms that the investment aid (public funding granted and actually received 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 may have been received by supported installations will be taken into account within the new calculation methodology ensuring the absence of overcompensation (Annexes 1 to 10).

9) For installations that started receiving aid in 2007 or in any case more than 5 years ago the IRR shall be calculated within two month from the day when the adopted regulations on the assessment of the IRR take effect. The adopted regulations shall take effect on the first day of the following full calendar month after the European Commission has adopted a decision on compliance of the state aid conditions with the European Union’s internal market conditions within the framework of the State Aid Scheme SA.43140 (2015/NN) “Aid to Electricity Producers”.

10) Latvia confirms that no aid is given after the full depreciation of the relevant plant. The normal depreciation period for the different categories of power plants receiving aid under the support scheme is 20 years. According to Law On Enterprise Income Tax annual depreciation of buildings and structures is 5%, so the full depreciation period is 20 years.

Future framework for RES and CHP support

11) The SET is taken into account in the calculations in the period from 01.01.2014.till 31.12.2017. The actual monthly SET value of each power plant in this period is used in the calculation (see the answer to the question 1 above and practical application in Annex 1 to 10).

12) Latvia confirms that the application of the merchants for the RES support scheme under assessment ended on 26 May 2011 (from this period Ministry has not and shall not organize tenders for the acquisition of the right to sell electricity produced in biomass, biogas, solar or wind power plants within the scope of mandatory procurement, and the producer may not qualify for selling electricity within the scope of mandatory procurement and for acquisition of the right to receive a guaranteed payment for the installed electric capacity). The last right to receive aid was granted on 9 December 2011. In addition several decisions were revised because of ongoing court proceedings about unjustified rejection to grant aid (on the basis of a court decision the last right was granted on 29 April 2015).

The application of the merchants for the CHP support scheme under assessment ended on 10 September 2012 (from this period a merchant is not entitled to qualify for the acquisition of the right to sell the electricity produced within the framework of the mandatory procurement and for the acquisition of the right to receive a guaranteed payment for the installed electric

capacity of the CHP unit). After evaluation of submitted applications, the last right to receive aid was granted in 12 December 2012.

Latvia confirms that no new aid was granted after 1 July 2014 and the aid was granted when the beneficiary entered into the scheme, as once entered into the scheme the beneficiary is entitled to receive support for.

Latvia confirms that the aid is granted for 20 years (for RES), 15 years (for CHP above 4 MW), 10 years (for CHP below 4 MW) from the date of commencement of operation of the supported power plant.

13) According to our estimations (made in August 2016) future costs over the market price of the RES support and CHP support scheme under assessment for the next 10 years will be as follows:

	Costs over the market price, mln. EUR	...of wich RES, mln. EUR	...of wich CHP, mln. EUR
2016	238,45	97,68	140,77
2017	257,55	116,38	141,17
2018	262,68	125,10	137,59
2019	265,34	131,06	134,28
2020	255,96	129,24	126,72
2021	233,10	123,89	109,21
2022	210,31	110,59	99,73
2023	183,85	90,58	93,28
2024	172,57	83,44	89,13
2025	158,02	70,58	87,44

Also currently a new support scheme for the production of electricity from RES is under discussion. It should be able to respond to market signals, to facilitate certainty, to reduce costs, avoid over-compensation of energy producers and be open to other EU member states producers when an intergovernmental agreement would be signed. The objective is to create new support scheme which will be transparent and understandable for both energy users and producers. More clarity and predictability of the planned support scheme for energy production from renewable energy sources will give investors a clear long-term vision. Taking into account that burden of the existing support costs for electricity consumers is relatively high, initiation of a new support instrument is planned for 2018.

Large cogeneration plants

14) Latvia has one large CHP plant with a resulting cogeneration electricity capacity exceeding 200 MW. It is TEC-2 owned by JSC "Latvenergo".

The electric power of the TEC-2 CHP plant increased in 3 steps and the aid also was granted in 3 steps:

- 1) on 28 May 2007 for the TEC-2 CHP plant with a resulting cogeneration electricity capacity 330 MW;
- 2) on 30 December 2008 for the TEC-2 CHP plant with a resulting cogeneration electricity capacity 633,3 MW;
- 3) on 13 September 2010 for the TEC-2 CHP plant with a resulting cogeneration electricity capacity 832,5 MW.

So, the aid for the TEC-2 CHP plant with a resulting cogeneration electricity capacity exceeding 200 MW originally was granted before the entry into force of the 2008 Guidelines (1 April 2008).

However, if the Commission considers that it should be individually notified, Latvia confirms its willingness to do so.

Compliance with Articles 30 and 110 of the TFEU

15) After a two year period of political coordination, during the European Council meeting on 15-16 October 2008 a political decision was made to create a Baltic Energy Market interconnection plan. It was taken in the spirit of creating a common EU energy market and eliminating Baltic state's energy island situation. This plan was adopted on 17 June 2009 and renewed on 8 June 2015. The main aim of this plan is the creation of a regional energy (focusing on electricity and gas) market. Consequently a list of coordinated stepwise actions was set up and implemented in order to ensure electricity market opening and integration, while developing the necessary cross border infrastructure. These actions included:

- removing cross-border restrictions to the trade of energy;
- reducing electricity congestion across borders and establishing common energy reserves;
- removing regulated energy tariffs;
- fully opening the retail market and establishing a common power exchange in the Nordic and Baltic areas.

Latvia at a political level has from the very beginning of the adoption of the action plan advocated for finding solutions, especially at the EU level, for the missing part of the financing for all of the regionally important infrastructure projects that are necessary for ending the energy isolation of the Baltic states. While implementing the action plan significant investments were made to regionally important electricity projects in the Latvian territory.

To address the Commission's concerns about the potential discrimination Latvia is planning to change the way of collection of the mandatory procurement component. Corresponding amendments in Electricity Market Law are currently under the consideration of the Latvian Parliament. It is planned that the new system of charging the mandatory procurement component that covers costs of the aid for the large CHP plants (costs of the guaranteed payment for the installed electrical power) will be independent of the amount of electricity consumption by the customers and will instead involve billing of this component as a part of the total electricity price in terms of a single payment similar to the fixed part of the tariffs for electricity distribution system services (in EUR/MW of connected output for high voltage and extra high voltage levels, a payment in EUR/A of the input protection appliance for customers of the low voltage level). Provisionally the new system will enter into force from January 1, 2018.

Therefore while assessing the potential discrimination (about 23.2 m EUR), one should take into account the political dedication, regulatory and market improvements, as well as the significant investments into cross border interconnections during the timeframe of the potential discrimination.

The potential annual discrimination amount is calculated according to the average amount of guarantees of origin of electricity that would be able to take part in the support scheme (RES power plants – except large hydropower plants with the installed capacity over 5 MW, and high efficient CHP plants) which was issued in another European Union Member State and was used in Latvia during the aid granting period (2007-2011 for RES and 2007-2012 for high efficient CHP plants). It is assumed that all the certificates of origin issued in other European Union Member State and used in Latvia, corresponds to the amount of imported green electricity. The amount of imported electricity that was potentially discriminated is multiplied with the mandatory procurement component for RES and the mandatory procurement component for CHP. The period of the potential discrimination is calculated from the first day of application of the mandatory procurement components till 2020, when it is planned to finish the third Latvian-Estonian electricity interconnection project (see Annex 15. **Please note that information in the Annex 15 about the amount of guarantees of origin issued in another**

European Union Member State and used in Latvia in the period 2007-2012 is confidential and has restricted access.

Moreover to address the Commission's concerns about the potential discrimination Latvia will make new investments into interconnectors and improvement of the regional import capacities in the future:

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Please note that information about the amount of investments is confidential and has restricted access.

The broad spectrum of actions taken to integrate Latvia into a common electricity market should be seen as balancing the potential discrimination and the further planned and new investments should be seen as a remedy for the historical potential discrimination under Articles 30 and 110 of the treaty. This is in line with the approach taken by the European Commission when looking at similar remedy to a potential breach of Articles 30 and 110 of the treaty (case SA.37345).

This commitment shouldn't be perceived as recognition of discrimination from Latvia.