Translation from Latvian

Prime Minister
Ms Laimdota STRAUJUMA

On the Informative report on the natural gas market reform
to be reviewed at the Cabinet meeting of 24.02.2015

On February 24, 2015, the Joint Stock Company "Latvijas Gāze" (hereinafter – Latvijas Gāze) was notified by the Ministry of Economy that the latter had submitted the Informative report on the natural gas market reform, a draft protocol decision of the Cabinet meeting and a Note on the objections raised in the opinions regarding the Informative report on the natural gas market reform (hereinafter – the Project) for urgent review at the Cabinet meeting to be held on February 24, 2015.

On January 21, 2015, Latvijas Gāze submitted to the Ministry of Economy objections regarding the Informative report on the natural gas market reform, and on February 9, 2015 it submitted to you and Minister of Economy Ms Dana Reizniece-Ozola a letter No.01-7/409 „On the natural gas market liberalisation" appealing to observe the international normative acts binding to Latvia, the Latvian laws and the liabilities committed to by the state of Latvia. Having gotten acquainted with the Project, Latvijas Gāze once again draws your attention to the Project's incompliance with the international liabilities undertaken by the state of Latvia, the European Energy Charter ratified by the Parliament on September 13, 1995 and the Agreement between the Republic of Latvia and the Federal Republic of Germany on the promotion and mutual protection of investments, and the Share sale-purchase agreement signed on April 2, 1997 among the SJSC NPO „Privatizācijas aģentūra" as one party, the PJSC „Latvijas Gāze" as a second party and Ruhrgas AG and PreussenElektra AG as a third party and the Share sale-purchase agreement signed on April 2, 1997 among the SJSC NPO „Privatizācijas aģentūra" as one party, the PJSC „Latvijas Gāze" as a second party and the OJSC „Gazprom" as a third party (both agreements hereinafter – Privatisation agreements), the Commercial Law, the Financial Instrument Market Law, the Energy Law, the law „On Public Utility Regulators" and other normative acts.

Both Latvijas Gāze and its shareholders have accurately fulfilled the Privatisation agreements over the past years and are ready to meet their liabilities assumed under the said agreements in the future as well. Furthermore, since the conclusion thereof they have invested

more than 410 million euros in the Latvian natural gas supply infrastructure alone turning Latvijas Gāze into a modern enterprise. The state of Latvia, for its part, has undertaken the respective liabilities and guarantees:

1) Article 8.5 of the agreement, the annexes thereto and the core provisions of privatisation of the SJSC „Latvijas Gāze" referred to in the agreement oblige the state to keep Latvijas Gāze as a single entity and to issue licenses of natural gas transmission, storage, distribution and sale till 2017 exclusively to Latvijas Gāze;

2) Article 9.2 of the agreement "Political Control" states that the JSC „Latvijas Gāze" shall be able to operate as a standalone undertaking without undue political control and influence by the Republic of Latvia.

The said exclusive rights of Latvijas Gāze also comply with the norms contained by the Treaty establishing the European Community, including the one stating that undertakings based in Member States and entrusted with services of general economic interest may be granted exclusive rights.

Hence, in order to avoid violation of the Privatisation agreements, the unbundling of Latvijas Gāze cannot legally begin before April 2, 2017.

Under the Agreement between the Republic of Latvia and the Federal Republic of Germany on the promotion and mutual protection of investments and the detailed explanation of the term "investment", it is prohibited to apply to investments any measures that resemble to expropriation or nationalization in their nature, unless taken in the interests of general welfare and only with compensation.

Article 10(1) of the European Energy Charter Treaty (hereinafter – the ECT), signed in Lisbon on December 17, 1994 and approved on behalf of the European Communities with 98/181/EC, ECSC, Euratom: the Council and Commission Decision of 23 September 1997 on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects (OJ 1998, L 69, p.1), states that *each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such*

Investments be accorded treatment less favourable than that required by international law, including treaty obligations.

On September 13, 1995, the Parliament adopted the law "On the European Energy Charter Treaty" whereby the protection of investments applies to any investments related to economic activities in the energy sector. Thus, the state of Latvia has committed to promote and create stable, fair, favourable and clear conditions in compliance with the goals and principles of the ECT and the law and the provisions of the ECT for investors to be able to invest in the territory of Latvia.

Such stance has also been taken by the Court of Justice of the European Union with its judgment of September 15, 2011 in Case C-264/09 by stating that under the first paragraph of Article 307 EC investments protected by international treaties and the Energy Charter cannot be affected by legal norms of the European Union.

According to information available in the media, in a reply to the letter by the Estonian Minister of Economic and Communication Affairs Juhan Parts regarding reforms in the Estonian gas market the European Energy Commissioner Guenther Oettinger has noted that the way of liberalizing its gas market is *„Estonia's choice"* and the European Commission will respect it, but Estonia must be ready to face the consequences: *„the achievement of this goal involves complicated negotiations where the rights of investors must be protected, including the rights to a fair compensation"*.

Under Article 105 of the Constitution, *everyone has the right to own property. Property rights may be restricted only in accordance with law. Expropriation of property for public purposes shall be allowed only in exceptional cases on the basis of a specific law and in return for fair compensation*. Under Article 10 of Paragraph One of Section 268 of the Commercial Law ***only a meeting of stockholders has a right to take decisions regarding the reorganisation of a joint-stock company***, and under Paragraph Two of Section 284 of the Commercial Law ***decisions on the reorganisation of a joint-stock company shall be taken by a meeting of stockholders if not less than three quarters*** *of the stockholders with voting rights present vote for them, if the articles of association do not specify a larger number of votes*.

According to the Constitutional Court judgment dated February 4, 2009 „On compliance of Paragraph Two of Section 142 and Paragraph Two of Section 284 of the Commercial Law with Articles 1 and 105 of the Constitution", *the Ombudsman states that the belonging of shares to a physical or legal entity, as found in the practice of the European Court of Justice (hereinafter – ECJ), forms the content of property rights. Only shareholders as owners of shares are entitled to take the decisions referred to in Paragraph Two of Section 284 of the Commercial*

Law. The kinds of decisions referred to in this norm have a direct influence on the company's assets and thus indicate the shareholder's interest in property rights.

Although as at December 31, 2014 the state of Latvia was in possession of 117 shares of Latvijas Gāze, the total number of shares of Latvijas Gāze is 39,900,000 and the state alone is not entitled to make a decision on behalf of all shareholders.

Please also be advised that as at December 31, 2014 shares of Latvijas Gāze were held by physical and legal entities from at least 17 countries: the USA, Australia, Austria, Czech Republic, Greece, Estonia, Italy, Canada, Russia, Latvia, the United Kingdom, Lithuania, the Netherlands, Norway, Finland, Germany and Sweden. The nationality of 76 shareholders is unknown.

Thus, although the Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (hereinafter – the Directive) entitles the state of Latvia to decide on the ownership unbundling model applicable to the unbundling of transmission system operator, neither the judicature of the European Union nor the Latvian normative acts bestow it with the right to solely decide on the reorganisation of Latvijas Gāze.

Latvijas Gāze draws your attention to the fact that the process of reorganising a joint-stock company whose shares are quoted in public trading is lengthy because one must observe not only the provisions of the Commercial Law, but also the requirements of the Financial Instrument Market Law and of the respective stock exchange. With most shares of Latvijas Gāze being quoted at a stock exchange, in particular – the JSC „NASDAQ OMX Riga", the shareholders would have to take a number of decisions stipulated in the normative acts and in the Privatisation agreements.

Moreover, according to calculations of Latvijas Gāze, the development and adoption of the relevant amendments to the Energy Law under the Rules of Procedure of the Cabinet of Ministers and of the Parliament would take least seven months.

Only when amendments to the Energy Law or a Natural Gas Market Law has taken effect the shareholders of Latvijas Gāze will be able to decide on the actions to be taken to ensure the fulfilment of the said laws and the Public Utility Commission (hereinafter – the Regulator) will be able to develop and adopt the new methods of calculation of natural gas service tariffs, which are necessary for setting new capital return rates and for approving new tariffs.

At least 10 months would be necessary to begin the reorganisation of Latvijas Gāze and, if necessary, establish new entities to perform specific functions. The said period results from the

fact that a decision on the beginning of reorganisation of Latvijas Gāze, the approval of a reorganisation prospect and the completion of reorganisation may only be taken by the shareholders or Latvijas Gāze and the Commercial Law specifies the deadlines that must be observed to ensure protection of the creditors' and shareholders' interests. An enterprise quoted at a stock exchange does not know its shareholders, but as at December 31, 2014 there were 6850 physical and legal entities holding shares of Latvijas Gāze, and 2582 of them (37.7% of the total count) have their shares registered only in the initial register of shares, which effectively means that there is no chance of 100% of shareholders voting for a decision of reorganisation and thus accelerating the process. However, if the decision of reorganisation passed by the shareholders' meeting is contested, the said 10-month period is extended indefinitely – i.e., until the court judgment takes effect.

The European Commission, too, has admitted that the reorganisation of an enterprise is a time-consuming process. According to the Directive and the Commission-approved Explanatory notes on the Directive No.2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC and Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC „Procedure of unbundling", the restructurisation of vertically integrated enterprises may take up to 30 months.

In order for the newly established entities to be able to provide the services of natural gas supply, they have to undergo the procedure of certification, receive licenses and have their service tariffs approved.

As can be read in the law „On Regulators of Public Utilities" and the Cabinet Regulations No.664 of September 15, 2005 „Rules of Licensing of Public Utilities", a license is only issued to a merchant registered in the Commercial Register. Consequently, a licensing application can be submitted to the Regulator only when the newly established entities have been registered in the Commercial Register. It should be noted that the procedure of reception of licenses is governed not only by the Latvian normative acts, but also by those of the European Union, in particular – the Directive and the Regulation (EC) No.715/2009 of the European Parliament and of the Council (July 13, 2009) on conditions for access to the natural gas transmission networks and repealing the Regulation (EC) No.1775/2005. It follows from the said legislation that at least 10 calendar months are necessary for a transmission system operator to become licensed.

As concerns the determination of tariffs, Section 19 of the law „On Regulators of Public Utilities" stipulates that a tariff is set for each public service provider for each regulated public service and a tariff set for a service provided by one merchant is not applied to a service provided by another merchant. Only upon reception of a proper certification and licence it

becomes possible to draw up and submit to the Regulator the documents required for setting a new tariff. Under the law „On Regulators of Public Utilities", the minimum period necessary for the approval and coming into force of tariffs is 7 months.

Given the above, Latvijas Gāze finds that an entity formed as a result of reorganisation would be able to start working no earlier than on July 1, 2019 provided that none of the decisions of the shareholders' meeting and the Regulator is contested.

Under Paragraph Three of Section 6 of the Energy Law, *an energy supply merchant, which supplies energy to captive consumers shall sell energy to them in the necessary or specified quality and the quantity demanded at the tariff specified by the regulator or for tariffs, which have been specified by the relevant service provider in accordance with the tariff calculation method specified by the regulator if a permit has been obtained from the regulator*. Under Article 2 of Paragraph One of Section 9 of the law „On Regulators of Public Utilities", *the Regulator shall determine the methodology for calculation of tariffs*. Hence, the statement in Table 3 of the Informative report on the natural gas market reform – that the system operator has to develop a methodology of natural gas storage service tariffs and a methodology of natural gas transmission service tariffs – is contrary to the aforementioned laws, and the issue of methodologies of natural gas distribution and natural gas sale services, as well as the issue of sale end-user tariffs are not addressed at all.

Please also be advised that, unlike stated in the Note on the objections raised in the opinions regarding the Informative report on the natural gas market reform, Latvijas Gāze was not invited and took no part in the coordination meeting and the updated Informative report was not sent to Latvijas Gāze for electronic approval, and the previous objections of Latvijas Gāze have not been taken into account.

Yours sincerely,

Chairman of the Board A.Dāvis