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editorial

François d'Ornano
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PROMOTION OF RENEWABLE ENERGY SOURCES IN EU AND NON-EU COUNTRIES OF THE SEE REGION

One of the current European Union headline goals is the promotion of energy from Renewable Energy Sources ("**RES**"). The Directive 2009/28/EC on the promotion of the use of energy from renewable sources establishes a common framework for the promotion of energy from renewable sources in the EU. It also sets mandatory national targets for the overall share of energy from renewable sources in gross final consumption of energy and for the share of energy from renewable sources in transport.

According to this Directive, each EU member state, including those in South-East Europe (Croatia, Czech Republic, Greece, Hungary, Slovakia, Slovenia) is required to increase the share of energy from renewable sources to a certain target percentage of its gross final energy consumption by 2020.

As members of the Energy Community, non-EU countries in the South East Europe region (Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro and Serbia) are subject to the same rules and objectives. Indeed, by signing the Treaty Establishing the Energy Community on 25 October 2005, they agreed to implement the *acquis communautaire* on electricity, gas, environment, competition and renewables to create a regional gas and electricity market within South East Europe.

Thus, in the SEE region, both EU and non-EU countries are putting in place a national legal framework - further detailed in this Newsletter - to comply with the targets set out below:

	Country	Share of energy from RES in gross final energy consumption 2005	**Targeted share of energy from RES in gross final energy consumption 2020**
EU member states	CROATIA	12.6%	**20%**
	CZECH REPUBLIC	6.1%	**13%**
	GREECE	6.9%	**18%**
	HUNGARY	4.3%	**13%**
	SLOVAKIA	6.7%	**14%**
	SLOVENIA	16%	**25%**
Non-EU member states	ALBANIA	31.2%	**38%**
	BOSNIA AND HERZEGOVINA	34%	**40%**
	KOSOVO	18.9%	**25%**
	MACEDONIA	21.9%	**28%**
	MONTENEGRO	26.3%	**33%**
	SERBIA	21.2%	**27%**

The European Union has not only set targets, it is also providing significant means to support the countries of the SEE region in achieving these goals. For instance, the Western Balkans Sustainable Energy Efficiency Facility II ("WeBSEFF II"), a large-scale 75 million euro project, is being launched this year to provide credit lines to local banks in Albania, Bosnia and Herzegovina, Croatia, Macedonia, Kosovo, Montenegro and Serbia.

This framework should ensure an effective allocation of funds through the EBRD, which grants loans to local banks, these local banks in turn granting funds to investors in the energy sector. In line with the WeBSEFF I launched in 2009, which allowed the funding of 123 new energy efficiency and renewable energy projects, WeBSEFF II should further contribute to maximizing the energy-saving potential and opening up new markets in the SEE region.

Special focus is given throughout this Newsletter to the dynamics of the energy market in the SEE region. While the promotion of RES has led to the development of a specific legal framework and created investment opportunities in Croatia, Greece, Montenegro and Slovenia, concern over high energy prices also represents an important change factor on the energy market in the Czech Republic and Slovakia. In addition, this issue will also present relevant recent developments and challenges relating to the business environment in Macedonia, Serbia, and Slovenia.

BOSNIA AND HERZEGOVINA

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Increasing investments in energy projects in BIH encouraged by the EU financial support

Whereas war had destroyed 56% of the total installed capacity to produce energy in Bosnia during the 1990s, by 2002 Bosnia's energy sector had already surpassed its pre-war capacity. This potential to expand domestic energy production, together with its geography and interesting resources, has made Bosnia one of the three energy exporters in the Balkans (together with Romania and Bulgaria) and a central player in future energy planning in South East Europe.

European interest for Bosnian projects

This potential is also supported by the European Bank for Reconstruction and Development (EBRD) which has invested in July this year 5 million euro in the Bosnian subsidiary of the Swiss bank Raiffeisen, to allow on-lending to private and public BIH companies investing in renewable energy projects.

More recently, on 30 October 2013, the EBRD granted a 35 million euro loan to EPBiH, the largest power and energy utility in the country, for the expansion of hydro power generation in Bosnia and Herzegovina. This brings EBRD's investments in Bosnia and Herzegovina to 1.6 billion euro, spread among 110 projects.

These last investments are part of the 75 million euro Western Balkans Sustainable Energy Financing Facility (WeBSEFF II) that the EBRD launched this October to support selected private and municipal sub-borrower undertakings' investments in energy efficiency and renewable energy in the Western Balkans region, including Albania, Bosnia & Herzegovina, Croatia, FYR Macedonia, Montenegro and Serbia. WeBSEFF II is the successor of WeBSEFF I, the first round of financing launched in April 2009 which resulted in over 123 energy efficiency projects (of which 55 for BIH) and 55 million euro of loans (of which 15 for BIH).

Financial and technical support

In addition to the 75 million euro provided by the EBRD, 11.5 million euro are granted by the European Union for technical cooperation programs and investment incentives for borrowers, who can benefit from consultations and advice such as free energy audits. The cooperation is funded by the European Union through the Western Balkans Investment Framework. In order to ensure this financial and technical support, the EBRD engages project and verification consultants who provide implementation support to the participating financial institutions, sub-borrowers and local experts. This support includes in particular the following measures: an awareness campaign, project pipeline development, energy audits to sub-borrowers and implementation support for sub-projects. An independent verification consultant performs eligibility verifications. Local commercial banks, leasing companies and other credit institutions operating in the Western Balkans are eligible for the support program.

The new programme also features improvements like opening up the market to the municipal energy efficiency projects and stepping up policy dialogue to set up the necessary regulatory framework and support the emergence of European Energy Service Companies (ESCO) market.

This favors the attractiveness of the investment market and creates new opportunities for foreign companies since the financial risk is supported at a European institutional level and assistance during the project is provided. Finally, the broadcasting of teasers for the second 38 km road PPP to be tendered in the country, in which the EBRD could take part, seems to confirm the interest of European financial institutions in more than one sector and the place of BIH as the first beneficiary of WeBSEFF II.

CROATIA

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Overview of the legal framework for electricity production from renewable energy sources

A white paper setting the guidelines for the “Energy Strategy of the Republic of Croatia” was adopted by the Croatian Government in 2009 to set the foundations of a general framework for future development in the energy sector. In addition, Croatia has since 2007 been developing projects and legislation to comply with the EU energy policies and encourage the production of electricity from renewable energy sources (“RES”) and cogeneration.

Correspondently, as member of the Energy Community and now of the European Union, Croatia has exceeded an obligation to increase the share of electricity generated from RES and cogeneration to 17.6% by the end of 2020 (the 20% target set out in the Editorial being the overall target RES share, including fuel and other types of energy in addition to electricity).

As a result, the production of electricity from RES is becoming an increasingly interesting investment area on the Croatian market. In order to get into the business of RES electricity production, it is important that companies be aware of the requirements and characteristics of the Croatian energy sector, as presented below.

System based on mandatory off-take agreements and feed-in tariff prices

The Croatian system to promote the production of electricity from RES and cogeneration is based on two incentives: mandatory off-take agreements and special feed-in tariff prices. In order to benefit from these incentives, companies must be authorized to carry out their activity and obtain a special license in this respect.

- Authorizations and licensing:

The following documents, authorizations and licenses must be established prior to the performance of electricity production activities:

- Environmental Impact Study and Ecological Network Impact;
- Location Permit and Preliminary Energy Consent;
- Energy Permit;
- Building Permit;
- Preliminary Decision on Eligible Producer Status;
- Agreement on the Purchase of Electricity (Off-take Agreement);
- Power Consent and Network Use Contract;
- Occupancy Permit;
- License for Performing Energy Activity;
- Decision on the Eligible Producer Status.

Although obtaining these documents can be a strenuous process, this inconvenience is widely outbalanced by the benefits of the feed-in tariff prices and off-take agreements.

- Benefits deriving from mandatory off-take agreements and special feed-in tariff prices:

Off-take agreements give eligible electricity producers the guarantee that all delivered electricity will be purchased at the feed-in tariff price determined in the off-take agreement, for a period of 14 years. Off-take agreements are concluded with HROTE, the Croatian Energy Market Operator. HROTE is entirely owned by the State and its main purpose is to perform activities related to the organization of the electricity market and to stimulate the production of electricity from RES and cogeneration.

Feed-in tariff prices are regulated in the "Tariff System for Electricity Generation from Renewable Energy Sources and Cogeneration" (Official Gazette No. 63/2, 120/12, 121/12, 144/12) and currently range from 0.07€/KWH to 0.42€/KWH (average electricity production price for tariff buyers in the household category, "APP"). These prices are determined according to the type of power plants and sources used for electricity generation. They can be multiplied by the correction factor reflecting the contribution of the project to the local community, employment, development, etc., the maximum increase in that respect being of 15%.

The feed-in tariff price which is stated in the off-take agreement will remain the same throughout the whole period on which the off-take agreement is concluded and will be indexed only in order to reflect inflation. In any event, it cannot be reduced below the APP. The new Tariff System for Electricity Generation from Renewable Energy Sources and Cogeneration is expected to come into force on January 1, 2014.

Special regulations for solar and hydro power plants

- Quotas for solar power plants:

With regard to solar energy, HROTE is obliged to enter off-take agreements only if the total installed capacity of the solar power plant reaches certain quotas related to the type of power plant. Thus, for non-integral solar power plants (plants that are built as separate facilities and are therefore not installed on existing buildings, roofs etc.), HROTE can only enter off-take agreements if the filed requests reach the total capacity of 10 megawatt (MW), whereas for integral solar power plants (plants that are built on the existing building) off-take agreements can be concluded for a total capacity of up to 15 MW.

At present, the above-mentioned quotas have already been reached and HROTE will not conclude any new agreements.

For other types of RES power plants (wind power plants, hydro power plants etc.), no special quotas are provided.

- Special regulations regarding hydro power plants:

The aforementioned legislative framework also applies to hydropower plants, in particular with regard to the benefit from off-take agreements and feed-in tariff prices. However, certain specific regulations apply to hydro power plants, due to their particular characteristics.

Since water resources are under special protection of the State and because hydropower plants have a significant impact on the environment, Croatian legislation on public waters and concessions must be abided by. In addition, hydropower plants are defined as a separate category of buildings that are of special interest for the Republic of Croatia, and therefore must be managed accordingly. This implies the observation of special rules regarding for example wastewater management, water maintenance, the construction of water structures and more generally the respective local and regional regulations in the area of a hydropower plants.

As a result, along with the above-mentioned permits and documentation, the construction of a hydropower plant requires the following licenses and documents:

- Water Conditions;
- Water Conditions Certificate;
- Permit for Wastewater Discharge;
- Special Conditions for Connection on Communal Water Structures;
- Certificate on Special Conditions for Connection on Communal Water Structures.

Finally, the production of energy from a hydro power plant may take the form of a concession from the State for use of water power in accordance with the respective concession legislation.

Conclusion

Given that electricity production from renewable sources must increase significantly by 2020 (wind energy must be multiplied by 5, solar by 6.5 and hydro by 75), investments in production of energy from RES is a great opportunity for companies of this sector, regardless of the new Tariff System for Electricity Generation from Renewable Energy Sources and Cogeneration.

CZECH REPUBLIC

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Major changes in subsidies for renewable energy sources

The Czech parliament has recently adopted a major amendment to Act No. 165/2012 Coll. on Subsidized Energy Sources, which is a fundamental legal regulation in the area of subsidies available for the production of energy from renewable energy sources (“RES”).

The amendment was signed by the President and will therefore enter into force on January 1, 2014, very widely limiting the subsidies available for the production of energy from RES.

Subsidized electricity is considered to have inflated energy prices in the country and proponents of the law hope that the end of subsidies will mean falling energy prices for consumers. With this in mind, the following changes for heat and electricity producers are being introduced:

- Abolition of the subsidies available for the production of electricity from renewable sources for facilities put into operation as of January 1, 2014. This measure applies in principle to all types of renewable sources. Exceptions have however concern electricity produced from wind, biomass and hydroelectric and geothermal power plants, all of which remain eligible for subsidies as long as the two following conditions are met:
  (i) a building permit or authorization (for energy outputs of up to 100 kW) is obtained from the Ministry of Industry and Trade by January 1, 2014 (i.e. before the amendment enters into effect), allowing the construction of an electrical production plant; and

  (ii) the electrical production facility is put into operation by December 31, 2015.
- Introduction of a new condition in order for joint stock companies to receive subsidies: their shares must be dematerialized, i.e. registered in the Central Securities Depository. This requirement necessitates either changing the company's articles of association or converting to a limited liability company. This condition comes into effect on July 1, 2014.
- Reduction of the fee supported by consumers and aimed at funding RES subsidies, from 583 CZK / MWh in 2013 to a maximum of 495 CZK / MWh from 2014 onwards.
- Extension of the solar (withholding) tax on power plants put into operation in 2010 for the duration of the right to the subsidy. This withholding tax will apply to power plants put into operation between January 1 and December 31, 2010, but not to those put into operation prior to December 31, 2009 and after January 1, 2011. The new rate will amount to 10% of the purchase price and 11 % of sales (in the case of a subsidy in the form of green bonuses.

In reaction to these measures, the two industry advocacy groups, CZEPHO and the Alliance for Energy Self-Sufficiency, have formed RESolar, a non-profit collective that combats the new laws and brings down recycling and other operating costs for photovoltaic owners.

Finally, the energy companies conditionally excluded from the cut to subsidies - wind, hydroelectric, geothermal power plants and biomass energy - should continue to attract investments over the next few years.

GREECE

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Challenges faced on the electricity market - measures taken regarding photovoltaic stations

The electricity market in Greece is currently facing several challenges, some of them with far-reaching effects. The most obvious is the impact of the financial crisis, and it lies not only in the inability of consumers to pay their electricity bills but also in heavy taxes/levies imposed upon energy players. This has resulted in a domino effect, which extends beyond electricity suppliers to natural gas-fired generators and all the way to the natural gas supply market.

Another aspect of the problem leading to the lack of cash in the electricity market is the large deficit of the Renewable Levy Fund which is used to pay the fixed feed-in tariffs to renewable energy producers in Greece. The deficit of this Fund has increased throughout the last years and has reached a debt exceeding 550 million euro (according to information published in the press). The said debt is a result of high feed-in tariffs, insufficient levies and other income directed to the Fund, as well as other inherent deficiencies of the Greek energy market including the lack of a long term energy policy.

While the Government has undertaken the obligation vis-à-vis its lenders to reduce this deficit by the end of 2014, several measures already taken to that effect have not proven sufficient. In an attempt to reduce the deficit, new measures were recently taken, in particular regarding the photovoltaic market, as follows :

Increase in the rate of "solidarity contribution" payable by photovoltaic stations

In the past, photovoltaic generation enjoyed very high feed-in tariffs guaranteed for 20 years. Although such tariffs had already been reduced twice in 2012, in the same year the Government introduced a levy on the turnover of the photovoltaic stations, the "solidarity contribution", which effectively constituted a further decrease in the said feed-in tariffs. In 2013, the solidarity contribution was increased to 37% for photovoltaic stations whose operation was commissioned between January 1, 2013 and June 30, 2013 (their feed-in tariff corresponds to the price applicable before February 2012), and to 34% for photovoltaic stations whose operation was commissioned/energized during the same period (their feed-in tariff corresponds to the prices applicable between February 2012 and August 9, 2012). This contribution applies retroactively to power sales which took place from January 1, 2013 onwards. Similarly, the rate of the solidarity contribution is increased to 42% for photovoltaic stations whose operation is commissioned after July 1, 2013 (their feed-in tariff corresponds to the price applicable before February 2012) and to 40% for photovoltaic stations whose operation is commissioned after 1 July 2013 (their feed-in tariff corresponds to the prices applicable between February 2012 and 9 August 2012). Photovoltaic stations belonging to professional farmers and those located on non-interconnected islands are exempt from this levy.

Photovoltaic stations of professional farmers and photovoltaic stations located in non-interconnected islands are exempt from this levy.

Further reductions in the feed-in tariffs for new photovoltaic stations

	Month/Year	Old Prices €/MWh	**New Prices €/MWh**
for photovoltaic stations of a capacity exceeding 100 kW	February 2013	171.90	**95.00**
	August 2013	164.16	**95.00**
	February 2014	156.78	**90.00**
	August 2014	149.72	**90.00**
for photovoltaic stations of a capacity below or equal to 100 kW	February 2013	214.88	**120.00**
	August 2013	205.21	**120.00**
	February 2014	195.97	**95.00**
	August 2014	187.15	**95.00**
for photovoltaic stations located in the non–	February 2013	214.88	**100.00**
	August 2013	205.21	**100.00**
	February 2014	195.97	**95.00**

	Month/Year	Old Prices €/MWh	**New Prices €/MWh**
interconnected system, regardless of their capacity	August 2014	187.15	**95.00**

Suspension in the conclusion of new connection agreements

Furthermore, the conclusion of new grid connection agreements for photovoltaic stations (including stations located on non-interconnected islands) is suspended until the end of 2013. The same applies to the conclusion of new power purchase agreements (PPAs). Certain exemptions nevertheless apply.

Other measures?

Other measures aiming to streamline the operation of the photovoltaic licensing market include the introduction of a Letter of Guarantee for the conclusion of new Connection Agreements and an annual fee on the preservation of rights stemming from generation licenses.

More generally, further measures to address the deficit of the Renewable Levy Fund are under discussion, as the many measures already taken have not proven sufficient. Such measures include the ones stated above, but also a recent increase of the Renewables Levy (“ETMEAP”) to an average rate of €14.96/MWh, the cost of which for household consumers is as high as €20.80/MWh. The Government tried to reach an agreement with renewable operators and banks regarding a voluntary reduction of feed-in tariffs for renewables together with an extension of their duration. The solution regarding the feed-in tariffs is still unknown despite the recent submission to Parliament of a new electricity bill.

Restructuring of the wholesale electricity market

Substantial changes are to be expected in the operation of the wholesale electricity market in Greece, which currently operates as a day-ahead mandatory pool where generators and suppliers submit their bids. The Greek Energy Regulator, RAE, announced several transitional changes in that respect. These measures will be short-term (until the end of September 2014) and are implemented as a transitional step towards the eventual integration of the Greek market into the unified European wholesale electricity market ("EU Target Model") which should take place by 2015. It should be noted here that the transition to the EU Target Model constitutes an obligation of the Greek State to its Lenders.

The measures are the following:

- The existing cost recovery mechanism will be abolished from 1 July 2014 and the margin of 10% will be reduced to 0% after the implementation of these measures.
- The existing rule that power generating units can submit offers below cost for up to 30% of their capacity will be abolished with effect from 1 January 2014.
- The existing Capacity Certificates Mechanism will change radically in two ways: (i) certain power units of the Greek Public Power Corporation (“PPC”) of a total capacity of 1249 MW, which are “practically non-operating”, will not benefit from it and (ii) natural gas-fired power plants of a total capacity of 3998 MW will have the right to issue not one but two Capacity Certificates, thus increasing their financial support. Under the current framework, suppliers are obliged to pay for Capacity Certificates issued by power units at €56,000/MW per year based on the actual consumption of their clients.

In putting forward the above measures, RAE has outlined its current views of the Greek electricity market. It notes that the power market is historically in the hands of PPC, which has the most competitive fuel mix (including lignite and the largest hydro in the country) and vertically integrated operations, but does not allow for a level playing field. This is exacerbated by the fact that the independent power producers are mainly gas-fired plants which face high natural gas prices as well as high fuel taxation. The quick but unbalanced introduction of renewable generation into the country's energy mix complicates the picture and removes the ability of thermal generation to operate on a steady basis. Therefore, RAE sees a future for unbundled energy products (ancillary services etc.) which will be offered in view of the intermittent operation of renewable plants. It stresses that the new measures are necessary to preserve the very delicate balance of the energy market during the current financial crisis and to secure the existence of infrastructure in operation or under development, thus ensuring electricity supply in the country.

RAE notes that the new measures do not eliminate existing market problems, but "substantially reduce their negative impact" giving the necessary time to prepare and implement new measures.

MONTENEGRO

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Use of energy from renewable sources - development and potential

In recent years, Montenegro has shown a great interest in developing the use of energy from renewable energy sources ("RES") and making this sector attractive to potential investors. In its quality as contracting party of the Energy Community Treaty, the country is also bound by the mandatory RES targets set in October 2012 by the Ministerial Council of the Energy Community. Pursuant to these objectives, 33% of Montenegro's final gross energy consumption must be derived from RES by 2020.

Promoting utilization of RES therefore represents a priority in the Montenegrin energy policy. Most of the strategic documents establishing a general framework for the development of renewable energy have already been adopted, and their concretization is expected by the end of this year.

General strategy for the development of renewable energy

As part of the general framework for the development of the renewable energy sector and the achievement of the RES target, the Government recently adopted the Strategy for Energy Sector Development until 2025, which sets the following goals:

- Creating a favorable environment for the development and utilization of RES to achieve the targeted RES share in the final gross energy consumption;
- Promoting continued research on RES potential and exploration of possibilities to use remaining available RES potential;
- Increasing the share of RES utilization in transport in order to secure the targeted RES share in overall consumption of energy in transport, in accordance with state obligations.

In order to carry out this general strategy for the energy sector, concrete programs and implementation instruments to promote RES are in the course of being established.

Concretization of the energy strategy

A number of concrete measures are being created in order to encourage the development of the renewable energy sector, their funding originating from fees supported by all electricity consumers. The major instruments introduced recently are the following:

- Feed-in tariffs for RES: this policy mechanism offers long-term contracts to renewable energy producers: energy suppliers pay the energy producers a set rate for each unit of generated electricity. Unfortunately, the design of these contracts does not so far encourage project development, especially given the pervasiveness of institutional barriers and the lack of a clear and stable legal framework.
- Preferential electricity producer status: this status, which was introduced by the Energy Law, allows the preferential producer status for a period of 12 years. The energy is sold on the market under the same conditions and regulations as applicable to any other producer, and the incentive prices for electricity produced are paid on a monthly basis by the market operator to the preferential producer on the basis of a power purchase agreement.

Potential for further progress

There is room for progress in terms of use of energy from RES in Montenegro, the country presenting geographical characteristics that are favorable to the development of the following energy sectors :

- Solar energy: this energy source is considered to be economically viable in three regions of Montenegro: along the coast, near Skadar Lake and Podgorica, with up to 2,500 hours of direct sunlight per year in these regions, while the figures for the southern cities (Ulcinj and Bar) are even greater. Solar panels are used by some hotels and resorts, with a total installed area of 11,000 square meters for a capacity of about 5.5 MW. The main obstacle to more significant use of photovoltaic systems is the high installation cost ranging between 4,000 and 6,000 EUR/kW, while their conversion efficiency is relatively small. Until 2025 therefore, the direct use of solar energy for heating, hot water, and other low temperature processes, mostly in the service sector, including tourism and households, will be encouraged, rather than the use of solar energy for generation of electricity for distribution through a network.
- Small Hydropower Plants: in the current plans, gross hydro potential is estimated at 800-1,000 GWh, out of which the exploitable potential of small hydropower plants (HPP) amounts to 400 GWh. Additional research is necessary in order to fully assess the realistically achievable potential of small HPP and the optimization of resources.
- Wind Energy: there is good potential for exploitation of wind energy on locations along the Adriatic sea, in the Rumija mountain area, between Bar and Skadar Lake, where the average wind speed reaches 6-7 m/s. Other areas with high wind energy potential are those located on hills behind Petrovac and on mountains between Herceg Novi and Orahovac. Another interesting area is located in a continental area around Nikšić (5.5-6.5 m/s). The current and future measures stated above should enable the development of the wind power market in Montenegro and a better exploitation of this natural resource.

Montenegro is going to great lengths to develop energy from renewable sources. The adoption of a strategic plan encouraging the use of RES, together with the first implementation measures aimed at concretizing this strategy, send a positive message to investors in this sector. In addition, the attractiveness of the energy sector in Montenegro is enhanced by the country’s potential in terms of renewable energy sources, promising much progress to come.

SLOVAKIA

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Cheap gas in Slovakia thanks to state monopoly?

The Slovak government announced its plan to acquire 100% of gas company Slovenský plynárenský priemysel, a.s. (Slovak Gas Industry, "SPP") before the end of 2013. The government's main argument supporting the planned acquisition is that it should allow complete control of the State over gas prices. This is a particularly sensitive issue in Slovakia, which is the second country in Europe after the Netherlands in terms of energy usage fuelled by natural gas and has a market of almost 1.4 million residential gas users. The planned acquisition of SPP was met with harsh criticism, giving rise to allegations that the government is favouring private undertakers closely linked to its members and misusing public funds, instead of protecting public interests. This article attempts to set out the changes involved with the envisaged transaction and its potential consequences.

Current position of SPP on the Slovakian gas market

SPP is a company specialized in the sale of gas to both residential and industrial gas users. Its gas selling business is currently generating heavy losses. The main reason for these results is that the State regulated gas price[1] for households has been set below the price paid by SPP for gas supplies. The Slovakian State has indeed imposed low distribution prices so that consumers can continue to afford gas in the context of the financial crisis. SPP however is party to a long-term gas supply contract with Russian gas supplier Gazprom, which was concluded prior to the crisis. According to this contract, SPP must continue to buy the pre-crisis agreed gas volume at the pre-crisis price, even though local demand and prices have dropped. As a result, residential gas sales in 2012 alone have generated a loss of EUR 76 million, and the profit made from industrial gas sales - for which the price is not State-regulated - is not sufficient to cover these losses.

Next to its unprofitable gas selling business, SPP holds 100% of shares in two highly profitable companies: SPP – distribúcia , a.s and Eustream, a.s., both of which were established in the wake of EU "unbundling" legislation obliging energy monopolies to separate their sales and distribution activities. Contrary to SPP which does not own any significant assets, these companies own the gas distribution pipelines, allowing them to rake in the profits from various contracts authorising the use of these pipelines for gas distribution and transmission. The dividends from these companies' profits wipe out the losses from SPP's gas-selling business. Thanks to these dividends, SPP's financial results in 2012 were an overall profit of EUR 365 million.

Planned change in SPP's shareholder structure

Under its current shareholder structure, SPP is owned by the State (51 % share) and by the private company Slovak Gas Holding B.V. (49 % share). Slovak Gas Holding is owned by Energetický a průmyslový holding, a.s. ("EPH"), which is itself controlled by a group of Czech and Slovak entrepreneurs[2] . On the basis of the shareholders' agreement, EPH holds a majority in the board of directors and thus exercises managerial control over the company.

[1] The prices are set by the State authority *Úrad pre reguláciu sieťových odvetví* (Energy sector regulation authority)
[2] One member of the group is J&T group which became unpopular following a series of controversial dealings and connections with some members of government

However, the State holds majority in the general assembly and it is thereby, among other things, able to block the board's proposals for gas price increase.

With the planned transaction, the State intends to acquire 100% of the shares of SPP and thus obtain full managerial control over the loss-making company. The Sate's share in the profitable companies SPP – distribúcia and Eustream will however remain at 49%. Full ownership of these companies will pass to a newly established holding company called SPP Infrastructure, a. s., in which the State and EPH will maintain the current 51-to-49 % share ratio.

Consequences of the transaction

The crucial argument put forward in favour of the acquisition is that it will enable the State to gain full control over the gas prices. The government has already declared that if it acquires full control over SPP, it will suggest maintaining gas prices at the current level in 2014, despite the anticipated loss of EUR 40 million in the households segment.

Although the State is already able to significantly influence the prices under the current regime by blocking proposals for price change, complete control is not possible at present due to the threat of legal proceedings. SPP could indeed sue the State to recover profit losses caused by excessively harsh price regulation.

Since the State regulated gas price has been set below the market price, it is likely that the courts would consider this as violation of constitutional rights and freedoms, entitling SPP to claim damages incurred by unlawful price setting by the State authority. Previous private shareholders of SPP had already initiated such action against the State, claiming EUR 200 million of lost profit. EPH withdrew these actions following its takeover of the SPP minority share in 2011, but has threatened to reinitiate such claims if the regulated price does not increase in 2014. If SPP became fully owned by the State, this significant financial threat would cease to exist.

The planned takeover has been heavily criticized. It is mainly argued that full control over the company by State-nominated managers will provide room for corruption and bad management, as it has happened many times in the past, especially in the second half of the '90s. Concerning in particular SPP's industrial gas selling business, which is based on individual contracts negotiated separately with each undertaker, there are serious concerns that the State-nominated managers may provide preferential treatment (i.e. grant lower to loss-making prices) to selected undertakers.

Concerning residential gas selling, the State will take over the full financial burden of the loss-making business. While under the current regime the losses are shared between the State and the private owner, if the State becomes the sole shareholder, it will have to bear all the losses on its own. However, the government is hopeful that it will be able to renegotiate or amend the existing supply contract with Gazprom and thus limit the losses.

For all of these reasons, there are serious concerns that SPP's value and its profit-making potential will decrease as the result of the transaction.

Outlook and conclusion

The planned acquisition is accompanied by many further controversies which go beyond the scope of this article. Many economists warn that the last time SPP was State-controlled, the results were alarming. Indeed, in the late '90s the Mečiar government used the State-owned SPP to gain political points. Long-term State regulated gas prices, because they did not follow the market evolution, contributed to a distorted gas market, which in the end led to the necessary privatization of the business.

With the Slovakian presidential elections coming up in 2014, there are strong feelings that the acquisition is motivated politically rather than economically. Many commentators assert that a gas price increase during the election year may have significant impact on its outcome. The current prime minister - who is widely expected to run for president - is therefore considered to be motivated by not allowing gas prices to increase.

SLOVENIA

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Investment opportunities in the Slovenian energy sector

Recent changes in the Slovenian energy sector indicate a strong likelihood of opportunities for investors.

Firstly, the purchase of shares in Slovenian companies active in the energy sector can be considered by investors as Slovenia has entered a second wave of privatizations. The State is indeed likely to sell shares in some key companies that it currently controls, either directly or indirectly.

At a national level, three companies in particular are highly likely to play a significant role in the energy sector:

Petrol d.d. is the leading Slovenian energy company, in which the state holds a 28.02% share. It is the principal strategic supplier of oil and other energy products to the Slovenian market. The core area of operations is oil-trading activities while its main area of development is the introduction of new energy activities.

Geoplin d.o.o. is the biggest supplier of natural gas in Slovenia, in which the State holds a 40.45% share. The company’s activities include trade, representation and mediation in the natural gas market in Slovenia, as well as in some other countries.

Nafta Lendava d.o.o. is a 100% Slovenian State-owned company, engaged in the refining of petroleum products. The company is the owner of Slovenia's sole oil refinery Nafta Lendava.

At a regional level, the State is selling its 49.30% share in Energetika Črnomelj d.o.o. and Toplotna oskrba d.o.o., which are suppliers of gas, oil and other energy-generating products for households and other local infrastructures. Due to their current or expected strong economic position, these companies could also be strategic targets for investors.

Secondly, the sale of products and the provision of services to improve or maintain the energy efficiency of buildings is a potential investment sector in Slovenia. The announced adoption of the new Energy Act, which is envisaged to replace the existing act governing energy policy, could lead to changes in the field of renewable energy sources and energy efficiency. As a result of the new legislation, it is to be expected that the investments in photovoltaic energy will shrink as it has been established that this field has grown disproportionately in comparison with other potential sources of energy. To balance the reduction of public support to photovoltaic energy, the State intends to support investments improving the energy efficiency of buildings and other infrastructure. In accordance with the government proposal, the new legislation shall oblige public sector organizations to source at least 3% of their yearly energy consumption on land and buildings from renewable energy sources, in order to enable a significant reduction in energy consumption. As a consequence of this legislative evolution, investment and business opportunities should arise for companies selling products or offering services related to building restoration and focused on improving energy efficiency.

Finally, it is worth mentioning that the main finding of the strategic meeting “Energy Innovation 2013” was that biomass remains mainly unused as a source of energy in Slovenia. According to experts, the use of biomass and of natural wood shall increase in the coming years. These energy sources constitute an interesting investment sector.

MACEDONIA

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Foreign direct investments in Macedonia - the courting of foreign companies

In the last few years, the overall business climate in the Republic of Macedonia has been showing constant progress, resulting in a major scaling up of foreign investments. According to the Doing Business Publication of the World Bank and the IFC, Macedonia is currently ranked seventh for the ease of starting a business.

An increasingly attractive procedural framework

- Administrative simplification

Some of this constantly improving ranking is due to the one-stop-shop system which was introduced in 2006 and which applies to the company establishment procedure. The one-stop-shop system allows companies to have a single point of contact where all formalities are carried out, consequently transforming what was once a long arduous process into an efficient administrative procedure which in most cases can be completed in one day. The upgrade of the one-stop-shop system continued in 2013, and the intention of the current reforms is to allow for complete electronic registration of companies.

- Pro-foreign investments laws: openness to private investments, freedom of establishment and incentives

The complete legal system of the Republic of Macedonia has been undergoing systematic changes with the purpose of harmonization with the EU legislation. Beyond this, the country has enacted legislation that not only provides roughly equal footing for foreign investors as compared with their domestic counterparts, but also provides numerous incentives to attract such investment. The Constitution of the Republic of Macedonia guarantees equal position for all entities in the market and provides for free transfer and repatriation of investment capital and profits for foreign investors. Moreover, both the Law on Customs and the Law on Profit Taxes offer incentives to foreign investors. Under these laws, foreign investors are eligible for profit tax exemptions for (i) profits generated during the first three years of operation in proportion with the amount of foreign investment; (ii) all profits reinvested in the company; (iii) profits invested in environmental protection; and (iv) profits invested in "underdeveloped" regions of the country. In addition, companies with at least 20 percent foreign capital are exempt from customs duties for the first three years after their registration.

Foreign investors are not required to purchase from local sources or to export all of their production. There are also no requirements for the government to be a partner in an enterprise. Commercial agreements determine which entity retains control over the investment revenue.

Furthermore, there are no requirements for reducing foreign equity over time or for technology transfer.

Macedonia's privatization process is nearing completion and private capital is dominant on the market. The government is trying to sell the remaining four loss-making companies through international tenders. There are less than 15 state-owned companies, primarily public utilities. The government is considering selling a minority share in only one of them – the power-generating company ELEM. Under Macedonian law, foreign and domestic investors have equal opportunity to participate in the privatization of remaining state-owned assets..

Wide scope of opportunities

- Continuing increase in investments

This policy appears to be working given the number of foreign investments these last few years. Thus, for instance, the Belgian company Van Hool, a family-owned bus manufacturer, started works in Macedonia this year and is expected to invest over 15 million euros. This means that Macedonia is now exporting buses again, after a stop in this export sector these last few years. Similarly, Kromberg & Schubert, the German leading automotive parts manufacturer, recently opened a new production plant in Macedonia, expecting to create over 2500 new jobs. Another example of recent foreign direct investment in Macedonia is that of a Turkish company specialized in medical equipment production which concluded this October an agreement with the Macedonian State for the construction of a plant in Bunardzik 1 industrial zone. The 9 million- euro investment is expected to create 250 jobs over a two-year period.

European companies are not the only ones to be interested in investing in Macedonia. Since both China and Macedonia announced this 22 October a pledge to further enhance their relations and substantial cooperation in all areas, China is also considering further investments in Macedonia and has already offered 783 million euros in loans for highways in the country. Additionally, Macedonia has successfully concluded a new air transport agreement with Canada. This first-time bilateral air transport agreement should help develop air travel markets between these two countries by providing full flexibility for airlines to offer air services using the flights of other airlines, and should provide more commercial opportunities for Canadian companies.

As per the information published by the National Bank in the Republic of Macedonia, foreign investments in the first eight months of 2013 have increased 83.8 million euro as compared with 2012.

- Greenfield and brownfield projects as part of the supported investments sectors

The focus of most State measures in the past few years was placed on greenfield investments, most of which applied to the technological industrial development zones (TIDZ) , presented in more detail in the second issue of the SEE Group Newsletter published last June. In these zones, foreign companies are awarded a set of very enticing financial incentives and tax exemptions for the first ten years of presence in the country. As a result, recently published data now shows that exports alone from companies operating in TIDZs represent over 20% of the total export of Republic of Macedonia.

The latest information from State authorities dealing with foreign investments is that the focus of investment promotion measures should turn to brownfield investments. The period of transition and privatization in Macedonia resulted in over 400 capacities that are potential locations for such brownfield investments. In the upcoming period, it is announced that a list of all such capacities would be compiled, along with detailed data on locations, in order give investors an overview of brownfield investment opportunities.

It remains to be seen whether this will result in attracting new players into the Macedonian market. The initial impression is that the foreign direct investments have the capacity to improve conditions on the otherwise often ineffective market with seriously distorted competition. A strategy however needs to be put in place so that the positive impression sent by these measures to foreign investors coming to Macedonia are not outbalanced by the mixed signals sent by heavy bureaucracy.

SERBIA

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Serbia on the path to political and economic recovery - new wave of economic reforms

The past few years brought many serious challenges for Serbia, from dealing with the very sensitive Kosovo issue to fulfilling its obligations and starting its EU accession path. The great efforts made by the government have allowed most of the major political issues to finally be resolved in a mutually satisfying manner for both Serbia and its international partners. Having ultimately succeeded in leaving behind burdens of the past, Serbia is heading strong on the path of economic recovery and regaining its position as a driving force in the South East Europe region.

Last September, the Serbian government was rebuilt within the same political majority. Whilst one could have expected the changes brought by this new government to be mainly cosmetic, it seems a clear signal is being given that a change of course and pace of development in the country should take place. A strong emphasis is being put on economic recovery and development-oriented solutions with the intention of delivering short and mid-term results. One of the most evident signals is the fact that the economic situation is for the first time being communicated in all transparency to the wider public and support for the necessary difficult actions is being asked – both showing seriousness in approach and willingness to deal with the most important issues.

The most significant steps and actions which were announced and are currently being implemented by the new government include the restructuring of the public sector, liberalization of labor relations and strengthening of the rule of law. All these measures aim to strengthen Serbia's ability to attract both foreign and local investors and ease the business climate for those already present on the market.

All reform measures presented below give reasonable assurance that the year ahead will bring many positive changes to the political and business climate in Serbia.

Public sector

The public sector is a strong historical reminder of the communist era in the Serbian society. Its influential and monopolistic position has often prevented free market competition and represented a major budgetary burden, creator of public debt and subject to political maneuvers. The new government considers that the public sector still represents an obstacle preventing the country from entering a faster paced development path, especially considering that budgetary spending and public debt are particularly high compared with other countries of a similar level of development. Therefore, the government is currently implementing spending cut-backs, restructuring public enterprises by introducing corporate governance rules, finding joint venture partners in domestic or foreign successful companies, reducing budgetary deficits and increasing export capacities.

What remains to be seen is whether this new government will have the necessary strength to see through such an intention or whether the announced measures will be of limited extent. Also, a serious tax reform remains untackled for the moment, although it was often quoted as one of the major issues for doing business in Serbia.

Labor market

The current labor market situation is fairly rigid in terms of options for employment, making it very difficult for companies in a post-economic-crisis to create jobs, and contributing to sustain the grey economy. Taking this reality into account, the new government is moving towards a liberalization of the labor market. A new and more liberal legal framework is to be provided to labor relations in the months to come, introducing a necessary flexibility and allowing better management of human resources. At the time of writing, a new draft labor legislation is being circulated to the major players in the sector, i.e. unions, associations of employers and foreign investors, thus enchasing the social dialogue on the subject which has been ongoing for quite some time now. We expect that with this reform, the labor legislation will be up-to-date with trends in other developed countries and will leave room for flexible solutions, ultimately creating employment.

The Rule of law

In the past few years, major international investors were often reluctant to consider Serbia as a serious investment destination due to corruption, lack of transparent procedures, slow judiciary system and strong presence of de facto monopolies with practically no competition protection. Since last September, the new government has demonstrated a strong will to deal with these crucial issues and maintains a very strong position when it comes to the Rule of law. Concerning the corporate business climate, it should be noted that commercial, litigation and execution procedures have become far more efficient. Regarding competition law, many investigations concerning some of the biggest monopolies have been ongoing for some months now, while corruption is being prosecuted on all levels. Although implementing the Rule of Law to its full extent is a long and arduous process, the efforts put into place so far are already fruitful and should encourage investors to consider increasing transactions in Serbia.

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New act on taxation of real property and effects on the business environment

On 17 October 2013 the Government of the Republic of Slovenia approved the draft of the new Act on Property Tax (the "Draft Act"), which is to be submitted for adoption to the National Assembly of the Republic of Slovenia under the urgent legislative procedure.

The Draft Act introduces a new property tax which applies to all types of real estate: residential, business, industrial, agricultural and forest. The new tax will replace the former real estate taxation based on the compensation for the use of urban building land, tax on property, wealth tax and charges incurred on forest ownership.

The amount of the new tax is based on the generalized market value of the real estate. The Draft Act provides different rates for different types of real estate:

- 0.75% for commercial and industrial real estates - among which energy-efficient real estate would be taxed at 0.4%,
- 0.3% for agricultural facilities,
- 0.5% for buildings for public use and for other general use,
- 0.07% for forests,
- 0.15 % to 0.75 % for residential real estate, depending on the use of the property and the real estate's generalized market value.

The Draft Act would increase the tax obligations of legal persons and entrepreneurs. The calculations of the Chamber of Craftsmanship and Small Businesses of Slovenia show that tax liability for individual businesses may increase on average by 200% compared with the current obligations to pay property tax and compensation for the use of building land. For companies, the obligations may increase by as much as 400% compared with the current taxation of real property ownership.

It is therefore estimated that the Draft Act will have a negative impact on the operations of certain companies, particularly of businesses which require extensive ownership of real estate due to the nature of their activities. Thus, industrial companies, agricultural companies and companies in the tourist industry are likely to be affected the most.

However, it is worth noting that the current level of real estate taxation is considered very low, with increases in tax obligations in connection with the ownership of real estate having been expected for some time now.

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