

REGULATORY CHANGES IN THE BULGARIAN ELECTRICITY SECTOR

March 2018

SUMMARY OF PROPOSED CHANGES

On March 16, 2018, the Bulgarian Government announced set of changes to the energy legislation, with the aim to continue the complete energy market liberalization in line with its commitments towards the European Union. The proposals will materially change the regulations applicable to operation of renewable energy and co-generation producers. They aim to integrate renewable energy producers (**“RES Producers”**), which currently operate under long-term power purchase agreements and enjoy feed-in-tariffs to the liberalized market. Part of these changes are dictated by the recommendations of the World Bank from 2016 and 2017.

Following a significant delay, the Government plans to force adoption of these changes in March/April 2018 and enforce them from 01 July 2018.

The announced proposals for changes affect not only RES Producers, but also have material effect on the relations between all market participants. The Government plans to remove the “single-buyer model”, i.e. the National Electricity Company (**“NEK”**), will no longer be acting as the single off-taker paying the produced energy at feed-in-tariffs (**“FIT”**).

The power purchase agreements (**“PPAs”**) with the affected producers will be terminated and replaced by Contracts for Premium (**“CP”**).

These changes will affect all power plants using renewable energy and co-generation with installed capacity of 4 MW and higher. The plants below the threshold will continue to operate under the existing system of FiT and be paid by NEK.

The CPs will be signed between the producers and the Energy Security Fund (**“ESF”**).

The obligation of NEK, EVN, Energo Pro and CEZ to purchase the energy output of these producers under the existing PPAs will cease to apply from 01 July 2018. The affected producers (RES and co-generation) will sell their energy output to the Independent Bulgarian Energy Exchange (**“IBEX”**).

IBEX has three platforms for sales:

- (i) Bilateral contracts platform: Sellers and buyers organize tenders for sale/purchase of energy. The participant sets the terms of the tender, period for sales and quantities and the contract is concluded with the winning bidder;
- (ii) Day-ahead platform: The platform operates on the basis of production/consumption hourly schedules, which are submitted for the next day. The price is determined on the basis of bids; and
- (iii) Intraday platform: The intraday market platform operates on the same principle, but schedules are submitted within the day of delivery. Most likely, the trading will be for hour ahead periods and bids will close one hour to 45 minutes prior to the hour of delivery.

RES Producers will not be limited to use one or more of the platforms.

The ESF will pay to the affected producers premium under the CPs. RES Producers will sell their energy to IBEX and receive premium equal to the difference between a reference price and the applicable FiT, irrespective of the market price. The premium will be paid on the basis of the actual produced energy output, proven by certificates for origin.

If the RES Producer achieves market price higher than the reference price, it will keep the positive difference - i.e., it will receive gross income higher than the FiT. If the sale price is lower than the reference price, the RES Producer will not be compensated for the difference between the reference price and the achieved market price. In this case, it will effectively receive gross income lower than the FiT.

The reference price will be set annually by the Bulgarian energy regulator – EWRC. It will be different for the different types of technology (wind, PV, hydro, co-generation, etc.). There will be no individual prices for single plants. The reference prices will be updated on annual basis, taking into consideration the available market data and are expected to represent the average weighted annual price on the market applicable to the different time-slots (peak or off-peak hours), when the respective RES Producer has highest output. EWRC is also considering to take into account the specific

historical data for the time when the respective RES Producer is producing its electricity (different seasons, quarterly statistics, etc.).

The premium will be paid by the ESF on monthly basis.

LIQUIDITY OF THE ESF

Ensuring the liquidity of the ESF is primary goal of the Government and key element for the success of the proposed changes.

At present, the ESF is funded by the 5% fees levied to all producers, traders and distribution companies, as well as sales of carbon quotas. ESF's main expense is payments to NEK for covering its tariff deficit.

With the proposed changes, the fee "Obligation to society" ("OS Fee") will no longer be paid to NEK, but directly to the ESF. The ESF will pay portion of the income to NEK as compensation for the tariff deficit on RES Producers below 4 MW, which will remain operating under the present FiT structure. The purpose of this change is to avoid any potential problems with the collection of the OS Fee.

According to the announced by the Chairman of the ESF information, for the period 2015-2018, the ESF has generated income in the amount of BGN 1.138 billion.

In order to guarantee the liquidity of the ESF, the Government plans to impose to all traders obligation for submission of bank guarantees (or deposits) equal to the one-month OS Fee – as security for the timely payment of these fees to the ESF. The Government does not plan to provide State guarantee or other additional guarantees to the ESF and/or NEK, but simply try to tighten the payments to the ESF. It is not clear yet, whether the changes will introduce an obligation for submission of bank guarantee or deposit for the 5 % fee, which is collected from all producers; traders; the Transmission System Operator (over the revenues from access and transmission fees); as well as the gas operators.

In addition, the government is considering additional payments to the ESF from penalties for market manipulation imposed by the EWRC, which will become the market watchdog on the electricity market.

LIQUIDITY OF THE MARKET

According to the preliminary calculations of the Government, the above changes will increase the total

annual energy output, offered for sale at IBEX with c. 4 – 4.4 TWh.

In order to guarantee demand and liquidity of the market, the Government proposes that the Transmission System Operator – i.e. Electricity System Operator EAD ("ESO"), and the three Distribution System Operators (CEZ, EVN and Energo-Pro) will have to purchase the needed quantities for grid technological losses from IBEX.

At present, these quantities have been purchased at regulated prices, which were significantly lower than the market prices and secured by the Kozloduy Nuclear Power Plant.

The estimated increase of demand for energy from this change is c. 4 – 4.5 TWh. ESO and the Distribution Operators will be allowed to buy this electricity from any of IBEX's platforms, i.e. via bilateral contracts, day-ahead or intraday market. This measure is expected to secure enough demand for the RES Producers' energy output, which will be offered for sale at IBEX.

TERMINATION OF THE PPAs

The PPAs will not be terminated, but as of 01 July 2018, the statutory obligation of NEK and the other off-takers to purchase the energy output of RES Producers under FiTs will be terminated. RES Producers, which enjoyed PPAs and FiT will be offered to execute CPs with the ESF by 01 July 2018 to benefit from the above changes.

TERM FOR IMPLEMENTATION OF THE CHANGES

The Government plans are to adopt all of the above changes and start their application from 01 July 2018.

The statutory proposals are published on the web-page of the World Energy Forum <http://www.wec-bulgaria.org/index.php?cid=2> on 16 March 2018 and are open for proposals by March 23 2018.

The proposed changes will be notified by the Bulgarian Government to the EU Commission, prior to its adoption.

Due to the very short time-frame, we expect that the Government will adopt the changes prior to approval of the aid by the EU Commission.

INCREASE OF THE EWRC'S POWERS

The proposals include extension of EWRC' monitoring and control powers, as it is expected that the new responsibilities of EWRC will be to:

- Supervise and monitor the wholesale market, including investigating cases of "information leakage", manipulation of the market and market abuse; as well as to
- Impose material financial sanctions, including dissuasive and proportionate sanctions/penalties for market manipulation.

The purpose of these changes is to fully implement the REMIT requirements, as well as EWRC to be "guarantor" for achieving fair and reasonable market prices.

However, despite the will to increase the powers of the EWRC and convert it into energy market "watchdog", the proposals do not currently include any powers of the EWRC to regulate the actions and prices of IBEX. Following the proposed changes, IBEX would have natural monopoly over the energy market in Bulgaria. However, it sets its own fees, internal market rules, etc., without any intervention or regulation by the State or the EWRC.

BALANCING GROUPS AND BALANCING CHARGES

RES Producers will be able to participate in standard balancing groups and sell their energy through the balancing group coordinators or individually. These changes will reduce the present high balancing costs of wind and solar producers, because they will allow these producers to sell/buy energy imbalances on the intraday market through the coordinator.

This creates potential risk of abuse of this position by increase of the fees for participation in the exchange.

HOW WILL THESE CHANGES AFFECT RES PRODUCERS?

RES Producers will no longer have guaranteed off-take of 100% of the produced energy and will have to engage efforts and personnel to sell their energy at the market.

The main risk for RES Producers is whether they will be able to sell their full energy output and the uncertainty on the market prices. If part of the energy output is not sold, the producer will only receive the premium. If

market prices fall constantly below the reference price, this will lead to reduction of the annual income of the producers.

Respectively, if market prices are higher, producers will generate gross income, higher than the present fixed income they have.

However, the ability to sell/buy energy in the intraday market is expected to significantly reduce the balancing costs of wind and solar plants.

RES Producers will no longer be dependent of NEK for their monthly income and will receive regular cash-flow from the IBEX and the ESF thus solving long-term historical relations with NEK.

RES Producers cannot enforce claims against the ESF and cannot set-off its receivables from the ESF with their receivables against the ESF.

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For more information please contact:

Iliya Grozdanov – Partner iliya.grozdanov@drp-legal.com

tel: +359 (0)2 943 4350/ 903 01 01