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1 Policy and law

What is the government policy and legislative framework for the electricity sector?

The power industry is of special (national) importance in Croatia. The general guidelines of Croatia's government policy regarding the electricity sector are set out in the new Strategy of Energy Development (Official Gazette No. 130/09) (the Strategy). The new Strategy was adopted due to the fact that Croatia became a candidate for EU membership, that it has ratified the Kyoto Protocol and that there have been great energy price fluctuations on the world market during the past few years. According to the Strategy, Croatia's main aim is to adjust and prepare the energy sector in general, which includes the electricity sector, for accession into the EU and participation in the single EU market, but at the same time to preserve Croatia's national interest. The strategy is to achieve a balance between the liberalisation of the electricity market and necessary government intervention, to enhance energy efficiency and to use more alternative energy sources and technologies that protect the environment. Croatia's further aim is to achieve security of supply (especially in import of electricity), competitiveness in the international market and sustainable energy development.

The relevant legislation governing the electricity sector is as follows: the Energy Act (Official Gazette Nos. 68/01, 177/04, 76/07, 152/08 and 127/10), the Energy Activities Regulations Act (Official Gazette Nos. 177/04 and 76/07) and the Electricity Market Act (Official Gazette Nos. 177/04, 76/07, 152/08, 14/11 and 59/12).

Since 2006, Croatia has been a party to the Energy Community Treaty (Official Gazette International Treaties No. 6/06). According to the Croatian Constitution, international agreements take priority over domestic laws and form an integral part of Croatian legislation.

With the accession negotiation finished and the date of full membership to the EU being set for 1 July 2013, Croatia has to integrate the third EU energy package into the domestic electricity legal framework.

2 Organisation of the market

What is the organisational structure for the generation, transmission, distribution and sale of power?

Croatian law regulates five electricity activities: generation, transmission, distribution, sale of power and electricity market organisation. Traditionally, all activities were performed exclusively by the Croatian national electricity utility, HEP Grupa (HEP Group). However, through the process of liberalisation and opening of the electricity sector to market competition, certain electricity activities became market activities, while others remained as HEP's exclusive activity. Thus, generation and supply (including sale) of electricity to eligible customers, as well as trading on the electricity market, are performed as market activities (price and quantity of delivered power is freely negotiated). This means that besides HEP Group, interested

third parties may perform the aforementioned activities. However, generation of electricity for tariff customers, transmission and distribution of electricity, electricity market organisation and supply for tariff customers are regulated activities and are performed as public service obligations. These activities are performed exclusively by HEP Group.

HEP Group consists of the Hrvatska elektroprivreda dd as parent company and several subsidiaries, which each perform regulated and market activities:

- HEP-Operator prijenosnog sustava d.o.o. (HEP-TSO), which is the Croatian transmission system operator;
- HEP-Operator distribucijskog sustava d.o.o. (HEP-DSO), which is the Croatian distribution system operator;
- HEP-Proizvodnja d.o.o., which performs electricity generation activities; and
- HEP-Opskrba d.o.o., which performs electricity supply activities.

HEP Group was in the process of being privatised, but because of the world financial crisis, this was postponed by the government. It is not known when the privatisation process will be restarted. Due to the obligation of implementation of the third EU energy package, Croatia is obliged to finish the unbundling of the HEP Group. So far, all three models (OU, ISO and ITO) are still being considered.

Regulation of electricity utilities – power generation

3 Authorisation to construct and operate generation facilities

What authorisations are required to construct and operate generation facilities?

There are two types of licence necessary to construct and operate generation facilities: licences for the performance of electricity generation activities and licences for the construction of generation facilities.

The licence for electricity generation is issued by the Croatian Energy Regulatory Agency (HERA) in accordance with the Rules on Energy Licences (Official Gazette Nos. 118/07 and 107/09).

The licence for construction of generation facilities is granted by the Ministry of Economy, Labour and Entrepreneurship (the Ministry) pursuant to the Electricity Market Act. The Ministry also grants licences for the construction of renewable energy generation facilities in accordance with the Regulation on Renewable Energies and Combined Heat and Power (Official Gazette No. 88/12). Other construction, location and environmental licences are issued by authorised administrations or ministries in accordance with the respective legislation.

If and when it finds it is necessary, HERA or the government (subject to the capacity of generation facility) may decide on construction of additional electricity generation facilities through a public tender procurement process in the interest of safety of supply, environment protection and promotion of energy efficiency.

4 Interconnection policies

What are the policies with respect to interconnection of generation to the transmission grid?

Under the Electricity Market Act, HEP-TSO is due to provide non-discriminatory access to the transmission grid according to the regulated third-party access regime. Any new generator should file a request for interconnection to the transmission grid, which the HEP-TSO must accept if all the prerequisites set out in the General Conditions of Electricity Supply and the Grid Code are met. HEP-TSO may only deny access to the transmission grid in the case of limited technical or operating capabilities of the grid. Upon issuing consent for interconnection to the grid, an agreement is concluded between HEP-TSO and the new grid user. A new generator whose access to the grid was denied may appeal against HEP-TSO's decision to HERA. HERA's decision is final but the unsatisfied party may file a claim with the Croatian Administrative Court.

5 Alternative energy sources

Does government policy or legislation encourage power generation based on alternative energy sources such as renewable energies or combined heat and power?

The use of alternative energy sources (water, wind, sun, geothermal sources, combined heat and power (CHP), etc) is one of Croatia's strategic plans as outlined in the Strategy. According to the Strategy, Croatia has great natural and technical potential, especially in the production of solar and wind energy.

The Energy Act also expressly states that use of alternative energy sources and CHP is in Croatia's interest (article 14). According to the Electricity Market Act, any generator that uses renewable energy sources will be awarded 'eligible producer status'. This status gives producers of renewable energy the right to a feed-in tariff that the market operator pays for the purchase of power. Eligible producer status is regulated by the Regulation on Gaining of Eligible Producer Status (Official Gazette No. 88/12), while generation of renewable energies is outlined in the Regulation on Renewable Energies and Combined Heat and Power (Official Gazette No. 88/12).

6 Climate change

What impact will government policy on climate change have on the types of resources that are used to meet electricity demand and on the cost and amount of power that is consumed?

Environmental protection has a great impact on Croatia's policy in the electricity sector, as outlined in the Strategy. In this regard, Croatia encourages the use of natural gas and renewable energy sources, while in the future it plans to accept nuclear and hydrogen technology only if the aforementioned technologies prove to be safe and acceptable to the environment. Renewables are not only encouraged because they are less harmful energy sources and better for the environment, but also because national fossil energy sources are insufficient for the steady increase in electricity demand. Furthermore, Croatia has natural potential for the production of 'green energy'.

Generally speaking, because Croatia is an importer of energy, the use of renewable energy sources causes an increase in generation costs and consequently, electricity prices.

7 Government policy

Does government policy encourage or discourage development of new nuclear power plants? How?

Croatia does not have nuclear power plants on its territory; however, HEP is a co-owner of Krsko nuclear plant in Slovenia. Because of this, government policy encourages their development. Croatia recognised the necessity of the use of nuclear energy in the future and therefore adopted a nuclear energy programme outlined in the new Strategy.

According to the Strategy, the preparatory work for rendering a decision on the construction of a new nuclear plant will be made in accordance with IAEA (International Atomic Energy Agency) methodology. The preparatory work will also include public debates and environmental due diligence. Namely, the greatest concern in construction of a new nuclear plant is its influence on the environment.

Regulation of electricity utilities – transmission

8 Authorisations to construct and operate transmission networks

What authorisations are required to construct and operate transmission networks?

The national transmission networks are owned and operated by the national transmission system operator, HEP-TSO (see question 2). Since electricity transmission is a regulated, non-market activity, HEP-TSO, has the sole power to construct and operate transmission networks.

In accordance with the Electricity Market Act, HEP-TSO, with prior approval from HERA, passed a three-year transmission system development and construction plan. The plan was passed pursuant to the Strategy.

HEP-TSO was granted a licence for electricity transmission activities, issued by HERA.

9 Eligibility to obtain transmission services

Who is eligible to obtain transmission services and what requirements must be met to obtain access?

Pursuant to the Electricity Market Act, HEP-TSO must provide non-discriminatory access to the transmission grid to all grid users, based on the regulated third-party access regime, in accordance with the General Conditions for Electricity Supply and the Grid Code. To obtain access to the transmission grid, new generators and customers are obliged to obtain consent from HEP-TSO to connect to the grid. HEP-TSO may deny access only in the case of limited technical or operating capabilities of the grid. Any new generator or customer whose access to the grid is denied may appeal against the HEP-TSO's decision to HERA. HERA's decision is final, but the unsatisfied party may file a claim with the Croatian Administrative Court.

10 Government incentives

Are there any government incentives to encourage expansion of the transmission grid?

According to the Strategy, Croatia has a transmission grid that is more than 7,000km long. There are no government incentives to encourage expansion of the transmission grid.

11 Rates and terms for transmission services

Who determines the rates and terms for the provision of transmission services and what legal standard does that entity apply?

Transmission services rates are set by the Croatian government based on the Tariff System for Electricity Transmission, Rates Excluded (Official Gazette Nos. 143/06, 26/10, 34/10 and 49/12) (the tariff system).

The tariff system was rendered by HERA and outlines basic principles and methods for calculating rates for electricity transmission. It adopts a rate-of-return method and 'post-stamp' principle meaning that the price per unit of electricity transmitted is fixed and all-inclusive.

The current rates are set by the government's decision of 12 June 2008 and are applicable from 1 July 2008.

12 Entities responsible for assuring reliability

Which entities are responsible for assuring reliability of the transmission grid and what are their powers and responsibilities?

HEP-TSO is responsible for the reliability of the transmission grid, as the sole TSO in Croatia with the licence to carry out electricity transmission as a public service (see question 2). HEP-TSO's main responsibility is to transmit electricity and to maintain and develop the transmission network for the purpose of the reliable supply of electricity for customers at the lowest cost and the protection of the environment.

The maintenance of the transmission network includes maintenance of overhead lines and underground cables, primary and secondary equipment, auxiliary plants, telecommunications equipment and building structures in substations and switchyards.

Regulation of electricity utilities – distribution**13 Authorisation to construct and operate distribution networks**

What authorisations are required to construct and operate distribution networks?

Croatian distribution networks are owned, constructed and operated by HEP-DSO. Since distribution is also a regulated energy activity, all principles that apply to the transmission network also apply to the distribution network (see question 8).

14 Access to the distribution grid

Who is eligible to obtain access to the distribution grid and what requirements must be met to obtain access?

The regulated third-party access regime that applies to the transmission grid also applies to access to the distribution grid. Therefore, the same rules applicable to access to the transmission grid apply also to the access to distribution grid (see question 9).

15 Rates and terms for distribution services

Who determines the rates or terms for the provision of distribution services and what legal standard does that entity apply?

Rates for distribution services are also set by the Croatian government under the same terms and conditions as in relation to transmission services (see question 11).

The relevant by-law regulating the tariff system for electricity distribution is also set by HERA in a Tariff System for Electricity Distribution, Rates Excluded (Official Gazette Nos. 143/06, 26/10, 34/10 and 49/12) and is based on the same principles as for transmission services (see question 11).

Regulation of electricity utilities – sales of power**16 Approval to sell power**

What authorisations are required for the sale of power to customers and which authorities grant such approvals?

The Electricity Market Act differentiates between suppliers of eligible customers and suppliers of tariff customers. The supplier of eligible customers supplies power under market terms while the supplier of tariff customers is obligated by law to supply customers as a public service at a regulated price.

Both types of suppliers have to obtain their energy licences for supply of power to customers from HERA.

17 Power sales tariffs

Is there any tariff or other regulation regarding power sales?

The relevant legislation regarding power sales is the following: Electricity Market Act, General Conditions on Electricity Supply (Official Gazette No. 14/06) and the Tariff System for Electricity Supply with Exception of Eligible Customers, Rates Excluded (Official Gazette Nos. 143/06, 34/10 and 49/12).

Croatia's power sales market has been fully open since 1 July 2008, meaning that all customers have acquired 'eligible customer status'. This means that all customers have the legal right to choose their electricity supplier and freely contract the quantity and price of the supplied electricity. Small customers (households and legal entities that employ fewer than 50 people and whose total income is less than approximately €10 million) who do not want to use the acquired right of eligible customer can retain their status of tariff customer.

18 Rates for wholesale of power

Who determines the rates for sales of wholesale power and what standard does that entity apply?

Croatia does not regulate rates for sales of wholesale power; it is a market activity and all prices are freely negotiated. HEP dd is negotiating power wholesale rates with other electricity companies in the region through tenders.

19 Public service obligations

To what extent are electricity utilities that sell power subject to public service obligations?

Public service obligations exist with regard to tariff customers. Since 1 July 2008, all customers are eligible customers except small customers who may choose to continue to use public services and regulated tariffs provided by the government (see question 17).

HEP dd, through regional local subsidiaries, provides the public service in respect of power sales.

Regulatory authorities**20 Policy setting**

Which authorities determine regulatory policy with respect to the electricity sector?

The regulatory policy with respect to the electricity sector is determined by the Ministry and to a certain extent by HERA. HERA is both a regulatory and supervisory body.

21 Scope of authority

What is the scope of each regulator's authority?

The Ministry prepares strategy and legislation with respect to the electricity sector and implements electricity laws enacted by the Croatian parliament. The Ministry also enacts different electricity by-laws and regulations. Furthermore, it supervises and reviews economic measures affecting the status of electricity undertakings, carries out activities relating to the construction of electricity facilities, proposes measures for the efficient organisation of electricity activities, etc.

HERA is a partially regulatory and partially supervisory body (see question 20). As a regulatory body, HERA grants different licences for the performance of energy activities, participates in electricity policy design, organises and carries out tender procedures, settles disputes related to carrying out of regulated energy activities, etc. As supervisory body, it supervises performance of different energy activities (generation, transmission, distribution, supply of electricity and the organisation of the electricity market), the quality of services provided by energy undertakings, the application of all tariff systems, the degree of transparency of market competition, etc.

22 Establishment of regulators

How is each regulator established and to what extent is it considered to be independent of the regulated business and of governmental officials?

The Ministry, as a government body, is independent of the electricity business and industry. However, in the process of preparation of electricity legislation, the Ministry follows and accepts proposals from electricity specialists.

HERA is an independent, non-profit institution established to regulate energy activities, and was founded in accordance with the Energy Activities Regulations Act. HERA is also independent from the electricity industry since members of the HERA Management Board (and members of their family) cannot be owners of any company in the energy business or perform any other activity in that sector that may lead to a conflict of interest. They are also independent of government officials since they cannot be members of parliament, members of local representative bodies or of the political parties' main bodies.

23 Challenge and appeal of decisions

To what extent can decisions of the regulator be challenged or appealed, and to whom? What are the grounds and procedures for appeal?

HERA's decisions are either final or appealable to the Ministry, depending on the matter in question. If HERA's decision is final, it can only be challenged before the Croatian Administrative Court. The Ministry's Appellate Decision can also be challenged before the Croatian Administrative Court.

The Ministry's decisions are usually final. If the decision is final, it can only be challenged before the Croatian Administrative Court. Exceptionally, if it is provided by the law, the Ministry's decisions may be appealed back to the same Ministry, but also to the Appeal Senate as the second instance authority.

Acquisition and merger control – competition

24 Responsible bodies

Which bodies have the authority to approve or block mergers or other changes in control over businesses in the sector or acquisition of utility assets?

The Croatian Competition Agency (CCA) and Croatian Financial Services Supervisory Agency (HANFA) are responsible for acquisition and merger control in general, including the electricity sector (see question 25). HERA controls the eligibility of parties participating in acquisitions and applies a system of measures for protection of market competition (see question 26).

HEP dd, the national electricity company, was in the process of privatisation that was postponed by the Croatian government. It is the government that determines when the privatisation process will be restarted, controls the process and reports to Parliament.

25 Review of transfers of control

What criteria and procedures apply with respect to the review of mergers, acquisitions and other transfers of control? How long does it typically take to obtain a decision approving or blocking the transaction?

Procedures, criteria and time limits for review of transfers of control are set out in the Competition Act (Official Gazette No. 79/2009) and the Act on the Takeover of Joint-stock Companies (Official Gazette Nos. 109/07 and 36/2009).

Pursuant to the Competition Act, the review procedure is performed by the CCA. The procedure is initiated ex officio or upon the request of any party having a legal or economic interest. Upon carrying out the procedure provided for by the Competition Act, the CCA issues a decision by which it either approves or refuses a transaction.

The CCA will block a transaction in the case of a prohibited concentration, referring to those undertakings that can significantly influence the prevention, restriction or distortion of competition. The CCA should issue a decree within three to eight months of the day the proceeding was initiated, depending on the type and complexity of the case in hand.

HANFA supervises the takeover of joint-stock companies and the application of the Act on the Takeover of Joint-stock Companies. If takeover irregularities were identified, HANFA may impose measures provided for by law such as declaring the takeover bid invalid or to instructing revision, supplementation or withdrawal of the takeover bid.

26 Prevention and prosecution of anti-competitive practices

Which authorities have the power to prevent or prosecute anti-competitive or manipulative practices in the electricity sector?

HERA, in establishing and implementing the system of regulation of activities that are performed as public services, is due to apply measures for protection of basic rights of consumers in accordance with special laws. HERA is also due to apply the rules and a system of measures for protection of market competition with regard to electricity matters. It is authorised to supervise, *inter alia*, the degree of transparency and market competition, and, where necessary, demand implementation of specific measures.

27 Determination of anti-competitive conduct

What substantive standards are applied to determine whether conduct is anti-competitive or manipulative?

There are no specific criteria that apply to the energy sector that define 'anti-competitive' or 'manipulative' conduct. Regulated energy activities are regulated on the principles of transparency, objectivity and non-discrimination, while market energy activities are regulated according to the principles of market competition. Therefore, the Competition Act applies to market energy activities. The Competition Act prohibits entering into agreements that directly or indirectly fix purchase or selling prices or any other trading conditions, limit or control the market, share markets or sources of supply, etc. Furthermore, abuse of a dominant market position is also prohibited as well as concentration of undertakings.

It should be kept in mind that the Croatian electricity market is not fully liberalised due to HEP Group's special position in the market.

28 Preclusion and remedy of anti-competitive practices

What authority does the regulator (or regulators) have to preclude or remedy anti-competitive or manipulative practices?

HERA has the power to withdraw licences for the performance of energy activities, for instance, if the supplier does not apply the prices set by the tariff system. Furthermore, HERA has the power to request the HEP-TSO or HEP-DSO to change its conditions and rules if it is necessary to ensure their non-discriminatory application. HERA also issues other legally binding decisions in accordance with the law.

The Electricity Market Act prescribes fines for any misconduct, including anti-competitive or manipulative practices (for instance, if the HEP-TSO or HEP-DSO unlawfully denies access to the transmission grid). The fines are imposed by the State Inspector's Office. In the case of recidivism, energy undertakings may be suspended from carrying out licensed activities for up to a year.

According to competition law, the CCA issues legally binding decisions by which it prohibits anti-competitive conduct. Finally, the CCA is authorised to instigate misdemeanour court proceedings in the case of violation of the Competition Act.

HANFA is also authorised to instigate misdemeanour court proceedings in case of takeover irregularities.

Update and trends

During the last few years and especially during 2012, the hottest topic in the Croatian electricity sector concerns the construction of a coal-fired power station with a capacity of 500MW known as the Plomin-C (Plomin 3) Coal-Fired Thermal Power Plant. It is one of the biggest energy projects in Croatia worth €800 million. In July 2012, HEP dd, the national electricity company, announced a 'Notification of Requests for Expressions of Interest' for the participation of a strategic partner in the design, engineering, financing, construction, operation and maintenance of the plant. Seven leading international companies placed their bids, but, surprisingly, not the German RWE, a strategic partner in the Plomin 2 project. Despite the efforts of the local green activists, the Plomin 3 project has been approved by the Slovenian environmental authority and Croatian environmental and construction authorities. It is expected that the strategic partner will be selected by the end of the first quarter of 2013 and the project

finalised between 2015 and 2017.

Many public debates, discussions and controversies have recently been raised about the planned 68MW underground hydropower plant near Dubrovnik. This rather experimental project has even been brought into question due to possible feasibility and environmental problems. Thus, two new environmental studies were ordered and should be finalised by the end of September 2012. One for the investor HEP dd and the other for EBRD, which are likely to finance this €130 million project. However, despite the above issues, the government is very keen to put this project into realisation in early 2013.

Apart from Plomin C and the Ombla project, HEP has announced that it will invest approximately €450 million in existing facilities; €150 million in modernisation of existing hydropower plants and €300 million in transmission and distribution networks.

International

29 Acquisitions by foreign companies

Are there any special requirements or limitations on acquisitions of interests in the electricity sector by foreign companies?

There are no special requirements or limitations in the electricity sector regarding acquisitions by foreign companies.

The only limitation concerns privatisation of HEP. Namely, the government may sell HEP's shares only in accordance with Croatian privatisation acts that regulate the privatisation procedure, control mechanisms, a portion of shares that may be sold on the capital market, etc.

30 Cross-border electricity supply

What rules apply to cross-border electricity supply, especially interconnection issues?

Pursuant to the Electricity Market Act, cross-border electricity supply is governed by international agreements binding upon the Republic of Croatia. The HEP-TSO must carry out the transit of electricity through the transmission network according to the terms and conditions stipulated in those agreements, and the technical capacity of interconnections.

Croatia has been a party to the treaty establishing the Energy Community since 1 July 2006. The treaty abolishes customs duties and quantity restrictions and creates a legal and institutional framework for a free transport and trade in electricity and gas. It also allows a single mechanism to be created for cross-border transmission or transport of interconnected energy for the whole of Europe. This

treaty enabled Croatia to become part of the European energy market.

Based on the Energy Community treaty, the HEP-TSO has adopted the Rules on Allocation and Use of Cross-border Transfer Capacities.

Transactions between affiliates

31 Restrictions

What restrictions exist on transactions between electricity utilities and their affiliates?

Croatian law does not prescribe explicit restrictions on transactions between electricity utilities and their affiliates. However, under the Electricity Market Act, the parent company (HEP dd) approves the annual financial plans of the HEP-TSO and HEP-DSO, as daughter companies, and sets the limits of their possible debt, but cannot give instructions relating to their everyday operation. The HEP-TSO and HEP-DSO are independent from one another and have to keep separate business records to prevent cross-subsidisation among generation, transmission, distribution and supply. Cross-subsidisation of companies engaged in regulated activities and those engaged in market activities, and cross-subsidisation of activities within the same company is prohibited by the Electricity Market Act.

32 Enforcement and sanctions

Who enforces the restrictions on utilities dealing with affiliates and what are the sanctions for non-compliance?

None specifically, but HERA supervises all activities mentioned in question 31 and may demand their implementation.

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