

Wikborg Rein's Renewable Energy

Update

Norway 2009



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NEW OPPORTUNITIES IN THE NORWEGIAN RENEWABLES SECTOR

As displayed through the variety of subjects covered in this Update, the Norwegian regulatory framework for renewable energy has during recent years undergone, and is still undergoing, substantial change. The policy debate focuses on the reduction of climate gas emissions, sustainable use of domestic energy sources, national control of hydropower resources, and overall security of energy supply in Norway.

Historically, large scale hydropower developments have been the basis for Norwegian electricity supply. Due to environmental concerns, new investments in hydro power mainly consist of small and medium scale projects. The development of small scale hydropower production portfolios has in recent years proven popular with the major domestic power producers, resulting in a competitive environment and considerable interest in attractive development prospects. New incentive schemes aimed at renewable development projects may sustain that interest in the years to come.

Upgrades in existing hydropower facilities are also expected to contribute to increased power production levels in coming years. New investments are, in combination with the anticipated reduction in electricity demand from domestic energy-intensive industries, expected to contribute to Norway becoming a considerable exporter of renewable energy to continental Europe. The newly established NorNed interconnector between Norway and the Netherlands has provided opportunities for arbitrage between the Norwegian all-hydro power based production environment and coal and gas fired European markets, and have paved the way for investments in additional interconnectors.

Due to regulatory uncertainty, the M&A market for hydropower assets have been at a stand still over the last 5-6 years. Recently adopted amendments to the Norwegian Industrial Concession Act have however provided a firm legislative framework, spurring new activity in this market. Even if the gist of the framework is to secure ownership of hydropower rights in public hands, investment opportunities are expected to open up for private and foreign interests, as further outlined in this Update. The incentives for sale of hydropower assets from private to public owners have already proven effective, evidenced by the recently concluded NOK 6 billion (EUR 720 million) sale of hydropower assets by industrial conglomerate Orkla ASA.

Currently, domestic investments in alternative renewable energy sources are hampered by the absence of adequate subsidy schemes. In Norway, wind power is expected to be the most likely contender for electricity generation purposes. There has been no lack in interest and project planning among domestic power producers and other investors, but previous attempts to put in place a viable subsidy scheme, making such plans commercially viable, have been restricted in part by EC state subsidy concerns.

In this respect, the Norwegian and Swedish governments recently announced by way of a joint policy statement the setting out of an ambition to establish a joint green certificate market from 2012. Sweden's domestic green certificate market has developed over the past several years, ensuring value transfer from consumers to renewable energy producers. Based on the Swedish experience, a joint Norwegian-Swedish certificate market is likely to unlock material new investments in renewable energy. Whether the details of this can be successfully agreed before 2012, remains to be seen.

In any event, there are ample opportunities for investors looking to invest profitably in renewable energy in Norway. Investors looking to take part in the expected future investment in hydro power, wind and bio-energy had best start preparing sooner rather than later. We hope this Update provides useful insight into the key legal issues.

Enjoy your reading!

Jarle Erik Sandvik and Jon Rabben



Jarle Erik Sandvik



Jon Rabben

PUBLIC OWNERSHIP TO NORWEGIAN HYDROPOWER RESOURCES

The Norwegian Industrial Licensing Act was amended as of 26 September 2008. The amendments introduced a new ownership regime to Norwegian hydropower production rights and hydropower stations, which secures and strengthens public ownership of hydropower resources in Norway. This new regime provides that only public undertakings may be granted future licences for acquisition of waterfalls

Introduction

The new ownership regime for hydropower resources in Norway was prompted as a result of an EFTA court judgment of 26 June 2007. The EFTA Court found that the then prevailing licensing regime under the Industrial Licensing Act (the ILA) infringed Articles 31 and 40 of the EEA Agreement on the freedom of establishment and the free movement of capital.

In short, the EFTA Court found that the licensing regime indirectly and disproportionately discriminated against Norwegian private undertakings and undertakings from contracting parties to the EEA Agreement, as such undertakings were only granted time-limited licenses for acquisition of waterfalls. Such licenses furthermore required the licensee to surrender the waterfall and related installations to the Norwegian state with full ownership rights, and without compensation, at the expiry of the license period (so-called reversion). Norwegian public undertakings, on the other hand, benefitted from licenses granted for unlimited periods of time. The Norwegian government's argument that the licensing regime promoted public ownership, a legitimate exception from EU non-discriminatory rules, was not upheld by the Court.

The judgment rendered by the EFTA Court forced the Norwegian government to adopt amendments to the ILA. The EFTA Court stated that Norway may legitimately pursue the objective of public ownership to hydropower resources insofar as public ownership is pursued in a non-discriminatory and proportionate manner. In order to comply with EEA obligations, the Norwegian government has strengthened public ownership of hydropower resources.

This article highlights the new public ownership regime. Most important, the regime promotes business opportunities, as the private undertakings currently holding licenses will have to adapt to the new system. Private investment possibilities are discussed in this Update under the headings "Private investment opportunities under the new ownership regime" and "New long term lease regime for Norwegian hydropower".

Acquisition of waterfalls by public undertakings

The newly introduced public ownership regime provides that only public undertakings may be granted licenses to acquire ownership or other rights to waterfalls (except waterfalls with a power production potential of ≤ 3 MW). This applies for

both direct acquisition of waterfall rights and in case of acquisition of more than 9/10 of the ownership interests in private companies or more than 1/3 of the ownership interests in public companies holding such rights. The possibility for share transfers is further discussed under a separate heading in this Update on private investment opportunities.

Pursuant to Section 2 of the ILA, enterprises organised according to the Act relating to state-owned enterprises, Norwegian municipalities and Norwegian county municipalities may be granted licenses to acquire ownership to waterfalls. Licenses will be granted for unlimited periods of time.

Licenses may also be granted to limited liability companies, public limited liability companies, co-operative societies and other associations which are directly or indirectly owned by enterprises organised according to the Norwegian Act relating to state-owned enterprises or one or more Norwegian municipalities or county municipalities, provided that the enterprise, municipality or county municipality separately or together (i) own at least two-thirds of the capital and vote rights of the company or association and (ii) the



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organization is such that the public ownership of the particular company or association is a reality.

The reality of public ownership will be assessed in individual cases and at each level of the ownership structure. Of special relevance are shareholders' agreements, articles of association and partnership agreements which favour the private owner through exceptions from declaratory company legislation in terms of voting rights, board representation and right to dividends as such agreements derogate the reality of public ownership.

The new regime effectively blocks the granting of new licenses to Norwegian and foreign private undertakings. For such undertakings, the new regime also prevents the renewal of licenses already granted, whether through lease back or sale back arrangements following reversion of rights to the state.

Reversal of time-limited licenses

Under the new regime, upon a transfer of assets or rights from a private party to a public party, the public party will have a right to renew the license without any

time limitation or the requirement to transfer the assets to the state. The ability of a public owner to obtain a new license applies equally to direct acquisitions of hydropower assets and to acquisitions of ownership interests in a company which holds hydropower rights.

New restrictions on lease of waterfalls

The previous right of public and private undertakings to acquire licenses for long terms lease of waterfalls (in excess of 15 years) is repealed.

Pursuant to Section 4 of the ILA, undertakings which have been granted licenses for lease of waterfalls under the previous regime may apply for an extension of such licenses already granted. Such licenses may be extended for a period of up to 30 years. Extensions will only be granted for the benefit of the existing licensee.

Section 4 further stipulates that Norwegian authorities may consent to assignment of licences for lease of waterfalls granted prior to 26 September 2008 to third parties. Consent presupposes that the acquirer is a public undertaking

pursuant to Section 2 of the ILA and that assignment takes place in connection with reorganization and structural changes. The licensing authorities' practice with respect to assignment will further determine the practical implications of this assignment provision.

As a consequence of the repeal of the previous system for lease of waterfalls, a new lease regime has been adopted. This new regime allows for lease periods of up to 15 years. The new regime is discussed under a separate heading in this Update, refer the article on "New lease regime for Norwegian hydropower".

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PRIVATE INVESTMENT OPPORTUNITIES UNDER THE NEW HYDROPOWER OWNERSHIP REGIME

The introduction of a new public ownership regime for hydropower in Norway limits the possibility for private investment in hydropower production rights. However, as discussed in this article, opportunities for private investment still remain. This includes investment in existing private hydropower rights, investment in off-take rights and various forms of public-private partnerships.

Background

As covered under separate heading in this Update, the Norwegian Industrial Licensing Act 1917 (the ILA) was amended in 2008, introducing an ownership regime whereby only the state, municipalities and public entities are allowed to acquire hydropower production rights, save for rights related to small scale hydropower (≤ 3 MW). Despite the changes in 2008, any established private rights will continue to exist for the remaining period of the license, previously granted for a period of 60 years.

The Norwegian municipalities (local municipalities and county municipalities) have largely organized their ownership interest in hydropower production through limited companies. Such limited companies will be regarded as public entities to the extent that 2/3 or more of the shares and votes are controlled by the municipalities (Qualified Entities) and where it is evident that genuine public ownership exists (the latter addresses situations where public control is weakened through shareholder agreements, etc). Qualified Entities may also be controlled by state undertakings, as is the case for Statkraft AS, the dominant Norwegian

hydropower producer. Other entities will be regarded as private entities, including foreign public interests making investments in Norway.

Investment in established private hydropower rights

Out of Norway's total annual hydropower production of approx. 120 TWh, some 12% is privately owned. Of this 12%, 5.5% was established prior to the introduction of public ownership control, meaning that these rights can be enjoyed without time limit. The remaining 6,5 % are subject to license terms providing a limitation of 60 years time, after which the rights revert to the State (such reversion to take place without further compensation).

In principle, the ILA imposes few restrictions on investments in private limited companies holding hydropower rights, save for investments whereby the acquirer takes control over all or close to all shares and votes in such companies.

The acquisition of 20 % or less of the shares and/or votes of a limited power company is not subject to license requirements pursuant to the ILA, and such acquisitions may normally be undertaken

without public oversight.

Further, subject to a share ownership concession from the Ministry of Petroleum and Energy, private investors may acquire up to and including 90% of the shares and/or votes in a private limited power company. Historically, the government has not attached any burdensome conditions to such share transfer approvals. Recent transactions indicate the government has not changed its practice in this respect due to the new public ownership regime.

Investors considering this type of acquisition should be aware that the concessions held by such private limited companies will continue on existing terms, including the maximum term of 60 years and reversion rights in favour of the state. Nevertheless, it will be possible to change a company from a private entity into a Qualified Entity by establishing 2/3 public ownership at any point in time before the end of the concession period. If so converted, such concession would no longer be limited to a term of 60 years (please refer to our further comments below in respect of public-private partnerships).



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Public-private partnerships

The new ownership regime does allow for private investors to acquire minority ownership of a Qualified Entity and thereby a minority interest in hydropower rights that are not limited to the 60 year maximum term. However, as mentioned above, strict requirements in respect of majority public control apply, meaning that any such investment will remain a minority investment.

As discussed under a separate heading in this Update, new regulations allowing a private party to lease hydropower rights and facilities from public owners were introduced in the ILA in June 2009. Such lease arrangements may be entered into for a period of up to 15 years. Such lease arrangements may also be combined with direct or indirect investments into the Qualified Entity holding such hydropower rights (limited to 1/3 of the shares and votes). This means private investors, within the context of a public-private partnership, could contribute capital and receive in return both a minority ownership interest and actual control over all operating assets (the latter limited to a term of 15

years and without any right of renewal).

Off-take rights

Prior to the introduction of the public ownership model, the public restrictions applied under the ILA were related to ownership rights, lease rights and long term rights of disposal in hydropower production. Few restrictions applied to short and medium term rights of disposal, below 15 years, allowing, for example, for the establishment of off-take rights, which included hydrological/operational risk elements without public oversight.

With effect from September 2008, private domestic and foreign investors are no longer entitled to acquire ownership to, or “other rights to”, waterfalls. The term “other rights to” encompasses any right which provides influence or control over hydropower production facilities or general rights over the power produced therein.

In consequence, all future private off-take rights will have to be constructed within the parameters of the new hydropower lease regulations discussed in a separate article in this Update.

The applicable restrictions apply as well to financially settled arrangements to the extent such arrangements provide the private investor with a right to:

- influence the physical operation of the power production plants and the waterways, or
- influence the physical handling of all or a defined share of the power produced in the plants.

Traditional power contracts, where the transfer of price risk is the dominant feature, are not regulated by the ILA.

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NEW LEASE REGIME FOR NORWEGIAN HYDROPOWER

The Norwegian Government has introduced a new regime for lease of hydropower rights in order to promote private sector participation within the parameters of the public ownership regime for hydropower. Such lease arrangements give rise to attractive business opportunities in hydropower in Norway for both public and private players.

Introduction

During the process of enacting the 2008 amendments to the Industrial Licensing Act (the ILA), which introduced a public ownership regime, the government acknowledged the benefit of allowing private participation within the hydropower sector through lease arrangements. Private participation in Norwegian hydropower contributes to an efficient and flexible hydropower market, development of expertise and innovation within this sector as well as industrial co-operation and more efficient operation of power plants.

Consequently, on 19 June 2009, the Norwegian Parliament adopted further amendments to the ILA, which will permit the private sector to participate in the operation of, and sale of electricity from, hydropower facilities through a long term lease structure. These new amendments will, however, not enter into force until the Norwegian Ministry of Energy and Petroleum (the MPE) has adopted appropriate regulations governing the conditions for such lease agreements. More important, lease agreements cannot be entered into before the regulations have entered into force.

The new regime

Under the new regime, public owners may lease hydroelectric power plants to private entities acting in the capacity either as operators or as lessees. While an operator normally would serve only as a technical service provider, a lessee would control the operation of the power plant and hold all of the rights to the electricity generated by such plant for the lease period. Under the new regime, leases of hydropower facilities cannot exceed 15 years and subleases are not permitted.

Each lease is subject to the government's approval, and the public owner is required to retain the license. The public owner will therefore remain primarily responsible to the government for complying with the conditions in the license, including matters relating to a licensee's obligations for management of natural resources and compliance of the power plant and associated installations with technical requirements. The lease agreement must therefore also provide the public owner with sufficient control over the operation of the power plant to ensure that the public owner complies with its license obligations.

The regulations to be adopted by the MPE

will necessarily include requirements as to the public owner's competence and organization, and the distribution of responsibilities between the owner and the lessee concerning operation, maintenance and emergency preparedness. To deal with the public owner's extensive obligations in this respect, public owners and lessees could enter into purely financial leases, in which the power plant owner (which could be a publicly owned power producer with an extensive technical organization) provides the necessary operational services to the lessee.

Furthermore, the public owner will remain responsible for tax payments. Hydropower production is subject to a special tax regime in Norway, and tax payments include both ordinary taxation of 28 % of net income and an additional resource rent tax of 30 %, which is levied on the production of hydropower calculated by multiplying actual hydropower production by the spot market price recorded at the Nord Pool power exchange.

A new opportunity

We view this legislative development as an attractive opportunity for municipal owners, new market entrants and project lenders. The lease-based public-private



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partnership will allow municipal owners to (i) hedge themselves against forward electricity price risk by replacing variable revenue from electricity sales with stable and predictable, fixed lease payments, (ii) shift the financial responsibility for funding a major rehabilitation or expansion of an existing project, and potentially even new green field projects, to the private sector, and (iii) realize meaningful gains in operation and maintenance efficiency through private sector participation, in each case without surrendering the public sector's long term ownership or control over the development and exploitation of its water resources.

For the private sector, the lease structure (i) offers new market entrants an opportunity to gain a foothold in the Nordic power

market and enhance their renewable energy credentials, (ii) provides the operating flexibility for the private sector to take full benefit of arbitrage opportunities in such market, and (iii) allows the private sector to leverage their investment with limited recourse debt financing.

For project lenders, the lease structure opens a meaningful window to participate in Norway's power generation sector for the first time. Lenders can make limited-recourse debt financing available to new market entrants that gain long term access (through a government sanctioned public-private partnership program) to hydropower projects with long operating histories and strong cash flows, secured by debt service reserves and liens on the lessee's leasehold interest as well as

project cash flows and project cash flow accounts. We expect the scope and contents of liens allowed in the lease agreements will be resolved in the regulations yet to be issued by the government.

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EU RENEWABLE POLICY AND LEGISLATIVE DEVELOPMENTS

The European Union recently introduced new legislation promoting the use of renewable energy, covering both the industrial and transportation sectors. The new legislative framework sets legally binding targets for member states' use of renewable energy but allows each state to tailor the incentives for new investment and activity in the renewable sector.

New EC policy

On 23 April 2009, the European Parliament and the Council adopted Directive 2009/28/EC on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (the "Renewable Directive").

The Renewable Directive establishes a common framework for the promotion of energy from renewable sources. It sets mandatory national targets for the overall share of energy from renewable sources in the gross energy balance as well as in transport. It lays down rules relating to statistical transfers between member states, joint projects between member states and with third countries, guarantees of origin, administrative procedures, information and training, and access to the electricity grid for energy from renewable sources. It establishes sustainability criteria for biofuels.

The Norwegian renewable policy is closely entangled with EU policy through the EEA (European Economic Area) Treaty and the new Renewable Directive will be implemented in Norway in accordance with Norway's EEA obligations.

Renewable targets

The Directive introduces a mandatory target of a 20 % share of energy from renewable sources in overall Community energy consumption by 2020. The renewable energy potential and the energy mix of each member state vary. Therefore, to allocate the Community 20 % fairly considering each member state's starting point and potential, individual targets have been set for each member state.

The required total increase in the use of energy from renewable sources is shared between the member states on the basis of an equal increase in each member state's share adjusted for their GDP, starting point and past efforts. In practice, this means that all member states have to increase their share. For example, the Directive requires Sweden to increase its current 39,8% renewable energy share to 49% by 2020. The Norwegian Water Resources and Energy Directorate estimates that Norway must increase its current 60% share to around 70-74%.

By contrast, the 10 % target for energy from renewable sources in transport is set at the same level for each member state in order to ensure consistency in transport

fuel specifications and availability. Because transport fuels are traded easily, member states with low endowments of the relevant resources will easily be able to obtain biofuels from elsewhere.

National implementation

The Renewable Energy Directive provides the member states with significant flexibility in the implementation of their national targets. Member states may, inter alia, apply support schemes and measures of cooperation between different Member States and with third countries.

In consequence of the Directive, among other things, a renewed effort has been launched to establish a common Norwegian-Swedish market for electricity certificates, covered elsewhere in this Update. According to the industry and NGOs, such a common market may unlock Norway's potential in wind power and small-scale hydropower, currently hampered by inadequate support schemes.

Otherwise, as usual, the devil is in the detail. For example, those who consider investing in hydropower should note that electricity produced from water that has previously been pumped uphill is not



considered as produced from renewable energy sources under the Directive.

Those who consider investing in biofuel production should carefully study the Directive's sustainability criteria for biofuels eligible for incentives.

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A COMMON SWEDISH-NORWEGIAN MARKET FOR ELECTRICITY CERTIFICATES

With 60 percent of total energy consumption coming from renewable sources and a well established hydro electric industry delivering some 99 percent of electricity production, the development of new renewable energy production in Norway has hitherto been slow. An often cited reason for the limited development is the lack of efficient state support systems for renewable energy. The implementation of the Renewable Directive has, however, spurred renewed negotiations and agreement on some main principles with Sweden concerning the establishment of a common market for electricity certificates.

Introduction

Through the EEA Agreement, Directive 2009/28/EC on the promotion of the use of energy from renewable sources (the Renewable Directive) will be made part of Norwegian law, and impose legally binding targets for the share of renewable energy in Norway's energy balance. The Norwegian Water Resources and Energy Directorate has estimated that this may require an increase in renewable energy from today's share of 60 per cent to around 70-74 per cent.

To reach this target the Norwegian state will in part need to devise an efficient support system for new renewable energy. The Swedish system for electricity certificates has proven successful, with an increase in renewable energy production of more than 6.5 TWh/y since 2002.

Individual systems for electricity certificate markets exist in a number of EU member states as well as in some US states, but details of the systems vary and the certificates are not interchangeable. An efficient electricity certificate market, however, requires a certain volume, and

while Sweden has established a national market, Norway has been deemed too small to support a national electricity certificate market.

Main principles for a common market

On 7 September 2009, the Swedish and Norwegian governments entered into an agreement concerning the main principles for the further development of a common electricity certificate market. The future common system will be aligned with the requirements and obligations of the EU Renewable Directive.

The Swedish system in use today is, with a few exceptions, technology neutral and does not discriminate between technologies (hydropower, wind, biofuel etc.). The agreement between the two governments state that a common electricity certificate market should also pursue such neutrality. Norway will negotiate with the EU over adjustments to the Renewable Directive before adapting it, but the Norwegian Government is prepared to undertake targets equally ambitious as Sweden's, which is aiming at an increase of 25

TWh/y from renewable sources between 2002 and 2020. In the agreement, the governments also stress the importance of equal conditions of competition to advance the understanding and acceptance of a common electricity certificate market.

All Norwegian renewable power plants where construction commenced after 7 September 2009, and hydropower plants with 1 MW or less installed capacity where construction commenced after 1 January 2004, will be eligible for the scheme. Participation in the scheme is subject to refund of any previously received subsidies.

The final principles and details of the common market require further studies and research before the Norwegian government will initiate the legal drafting process, now expected in the fourth quarter of 2010. Details that will require clarification include the duration of certificates, definition of eligible production, as well as the participating countries' final targets for renewable production. An important political issue for both parties will be to ensure an equal burden on the end



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Electricity certificates is a market-based support system aimed at increasing the development of new capacity for renewable electricity production: Producers of renewable electricity are awarded electricity certificates by the State for every unit of electricity they generate. Typically one certificate represents generation of 1 MWh of electricity. In order to create demand for these electricity certificates, it is mandatory for electricity suppliers and for certain electricity users, such as electricity-intensive companies, to purchase a certain proportion (quota) of electricity certificates in relation to their electricity delivery/electricity consumption. By selling awarded certificates the producers of renewable energy receive a premium on top of the market price for electricity. The cost of the certificates is evened out with the cost of all electricity sold in the relevant market, contributing to a small increase in the market price for electricity paid by the end consumer. In an illustration of the system, published by the Norwegian Ministry of Petroleum and Energy on 7 September 2009 the estimated cost for the consumers is 0,0048 NOK/kWh (approximately 0,056 cEUR/kWh) in the first year of the scheme, rising to 0,043 (approximately 0,5 cEUR/kWh) in year eight.

consumers in both countries. However, since the Swedish system is already well established, major changes to Sweden's system are not expected. The parties aim at establishing the common electricity certificate market by 1 January 2012.

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GOVERNMENT BOOST TO BIO-ENERGY CONSUMPTION IN NORWAY

The Norwegian government aims to increase domestic bio-energy consumption to 14TWh by 2020, focusing mainly on energy consumption for heating purposes in commercial buildings and private households. The means applied include a ban on new fuel oil heaters and public support schemes covering research and development, new infrastructure and pilot projects using bio-energy waste.

Introduction

A new overall strategy for bio-energy is intended to play a key role in Norway's efforts to reach its climate targets. In April 2008, the Norwegian Ministry of Petroleum and Energy released a strategy document on bio-energy, following up the previously released Climate Report for Norway ("*Klimameldingen*"). The strategy document sets out a target for increased use of bio-energy, with the aim of reaching a domestic consumption of 14TWh within 2020, totaling twice today's consumption. The strategy may also contribute to Norway fulfilling its obligations under the EC Renewables Directive to increase the share of energy from renewable sources, discussed elsewhere in this Update.

According to the strategy document, there is a great unused potential with respect to the use of bio-energy for heating purposes in Norway, especially by replacing electricity and oil based heaters with heaters based on waste from the logging industry. The government's initiative seeks to enhance use of bio-energy, including to reduce greenhouse gas emissions, establish new jobs in rural areas, strengthen security of energy

supply, maintain an open and cultivated landscape through forestry, and increase Norway's export of renewable energy (adding to its existing hydropower based electricity export to the European continent).

The objectives set out will be pursued in major part through the development of efficient new infrastructure and a bio-energy supply chain, including the facilitation of a viable market for bio-energy fuels. Enova, the state owned enterprise established to promote environmentally friendly energy consumption and generation in Norway, plays an important role in the implementation of this strategy. Government agencies at all levels will however be involved in order to implement ambitious renewable energy standards for the real estate industry and private households.

Scope of state subsidy scheme

Substantial state funds will be allocated to Enova for the purpose of bio-energy related subsidy schemes. This includes a NOK 100 million (approx. EUR 11 million) strengthening of existing financial support programs for implementing energy saving measures in private households

and encouraging investments in wood pellet boilers, heat pumps, waterborne heating etc. Further, a NOK 300 million (approx. EUR 33 million) allocation has been made for the purpose of pilot projects and new initiatives providing enhanced energy efficiency. A renewed support regime for district heating will also be introduced, including a simplification of formal procedures, allowing applicants to tender for support throughout the year.

Further, a budget increase of NOK 300 million has been added to existing subsidy schemes targeting research on Carbon Capture and Storage (CCS) and renewable energy, encompassing research on bio-energy related technologies. By way of organizational measures, the Ministry has established a bio-energy forum (led by the minister of Petroleum and Energy) to secure qualified exchange of information among industry players and the authorities.

Legislative measures

Following up on suggestions made in the strategy document for bio-energy, a new legislative initiative was adopted 5 June 2009, removing the grid tariff discount for interruptible customers (change of



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regulation no. 302 11/03/1999). The previous discount of approximately 10-15 øre/kWh to consumers combining electricity and oil based fuels for heating purposes was thereby eliminated, in order to secure a level playing field for suppliers of new renewable energy sources.

The Government has also proposed new and stricter renewable energy standards in the new Technical Regulation to the Planning and Building Act. Buildings exceeding 500 square meters will be required to source at least 60-80 percent of their total energy consumption from renewable energy. Further, the installation of new fuel oil boilers in new or existing buildings will be prohibited. Based on the new Technical Regulation, a strategy document on energy requirements in public owned buildings will be prepared by Statsbygg, the state owned entity who acts on behalf of the Norwegian government as property manager and advisor in construction and property affairs.

With effect from 1 July 2009, the depositing of biologically decomposable waste in landfills was prohibited, encouraging better exploitation of such waste, through for example recycling or use for bio-heating purposes.

From a planning perspective, all Norwegian municipalities have been obliged to develop energy strategies and climate plans before 1 January 2010, such tasks to be undertaken in close cooperation with Enova. Enova will further explore the costs of installing waterborne heating in local municipalities, and consider measures on how to increase the development of district heating infrastructure. Enova is also required to focus on competence building and knowledge mapping in the bio-energy market and explore the potential for use of bio-gas. Further, the Ministry of Petroleum and Energy will evaluate the Energy Act with the aim of further developing the bio-energy market and helping to establish better data and statistics on bio-fuel and bio-energy plants.

New opportunities

The government's bio-energy strategy opens up new opportunities for the energy industry. In particular, anyone contemplating investments in district heating facilities, as well as suppliers of bio-energy based heating systems and energy saving measures in private households, would be well advised to take a closer look at the new opportunities offered.

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WIND POWER - THE CURRENT LEGISLATIVE REGIME AND NEW OPPORTUNITIES

Norway has great natural potential for windpower, although there are some particular technical difficulties. In this article, we outline the current regime and new opportunities provided by recent developments.

Untapped potential

With strong winds along much of its 2500 kilometers of coastline, Norway has great natural potential for wind power. By the end of 2008, installed wind power capacity in Norway was only 428,9 MW, but on average, its output per unit of installed capacity exceeded the European average by some 50 per cent. The enormous potential for windpower offshore Norway could be opened up as new technology and legislation allow private developers to install wind power in deeper waters.

Current projects and legal framework

Currently, 18 existing and 15 planned wind farms with a total capacity of 1807,5 MW have obtained licenses pursuant to the Energy Act. License applications for 123 projects with a planned total capacity of 21935 MW are pending.

Enova, a Norwegian state enterprise established to promote environmentally friendly energy consumption and production, administers a construction support scheme for wind farms. Wind farm projects with both a license and documented access to the grid can apply for support. The most cost-efficient projects, as determined based on an 8 per cent rate of return, estimated power production

potential and forward power prices, will receive state support.

Major Norwegian power producer, Statkraft, operates Europe's largest on-shore wind farm at Smøla in western Norway. Statkraft secured financing for the second stage of this development, including a USD 82 million loan backed by a guarantee from the Danish state export guarantee fund, EKF. Statkraft had obtained earlier financing backstopped by a purchase agreement with a Dutch power producer for "green certificates" from the wind farm. However, due to changes in legislation, these green certificates were no longer accepted for tax levy purposes in the Netherlands, and the purchase agreement was terminated in 2005.

Challenges to development and financing

As in other areas of power development, the government could reject wind farm license applications on environmental and other issues of local concerns. During recent years, the government has rejected 14 license applications, several of which have raised environmental concerns. In some instances, local communities have opposed planned wind-farm projects due to concerns about the impact on local wildlife and cultural heritage.

In the wind power industry, government support has been unstable and insufficient to support development efforts, according to the Norwegian wind power industry. In particular, Enova has constantly changed its assumptions for cost-efficiency calculations when determining eligibility for state support. According to bankers, attempts to finance development of new wind farms are complicated by unreliable production forecasts owing to the turbulence over Norway's rugged coastal terrain and offshore waves.

(We discuss specific issues affecting the loan structure of wind farm developments in Norway elsewhere in this Update.)

New legislative initiatives and new opportunities

Encouraged by the new EC Renewable Energy Directive, Norway and Sweden have, as outlined elsewhere in this Update, agreed on main principles for the development of a common electricity certificate market, which is expected to provide more stable support for renewable energy developments, including wind power. Previous recipients of construction support under today's state support regime may get an option to refund the construction support previously received and thereby become eligible under the



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newer electricity certificates scheme. On 26 November 2009, the Government announced that this will apply to all power plants where construction commenced after 7 September 2009.

In June 2009, the Norwegian Government submitted a draft Act on Offshore Renewable Energy Production to the Norwegian Parliament, providing a legal framework, among other matters, for wind power farms offshore Norway. The draft Act introduces a non-discriminatory license

regime inspired by Norway's license regime for offshore petroleum production, as explained in more detail elsewhere in this Update.

The above developments could provide new opportunities for the development of wind power in Norway. The electricity certificate system would encourage new projects by helping to provide stable cash flows to backstop financing. Due to recent legislative initiatives, investors and lenders could develop wind power offshore

with less political risk than in current on-shore projects.

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BANK FINANCING OF WIND-FARM DEVELOPMENTS

The successful development of wind farms is not only dependent on efficient technology and available wind resources. In the current market price scenario for electricity, and as discussed under separate heading in this Update, the availability of sufficient subsidies will be a key parameter. Further, the availability of project financing from investors and banks will be a main prerequisite. As discussed in this Article, project financing of wind farm developments poses particular challenges which need to be dealt with in an adequate manner.

Introduction

Wind farm developments have a long horizon, are capital-intensive, and entail a range of risk elements. These projects require authorizations and often financial support from public authorities, who then become part of the stakeholder group in such projects. Future production volumes and power prices are difficult to estimate and fluctuate widely, making it difficult to estimate revenues and cashflow for servicing debt. On the positive side, however, public support schemes could reduce the funding requirements, thereby reducing risks for equity providers and lenders.

Financing structure

As for development projects in general, the financing of wind farm developments must be tailored based on the features of the individual project, taking into account specific capital requirements and project specific challenges. In some cases, the financing may be based on the balance sheet of the developer, possibly including the balance sheet of the group of companies to which the developer belongs. In our experience, however, most wind farm projects will be structured based on

project specific financing. Regularly, the development company is established as a single purpose company (SPC).

The project SPC will often be owned by two or more individual investors, of which at least one possesses technical knowledge and project experience while the others will be financial investors providing the bulk of required funding. As in other project financings, a certain level of equity contribution or investor loans will be required before bank financing will be available.

Security for lenders

Lenders will normally be able to protect their investment by requiring security from the SPC against the assets of the company. In order to maintain project value in an insolvency situation, lenders require liens on all production critical assets. The security package will normally include security against the company's owned or leased real estate rights, inventory, machinery and plant and insurances. The project requires transmission lines for the transfer of power to the market, and lenders will investigate whether these

assets can be used to secure their loans. In Norway, high voltage transmission lines are registered in a separate asset register allowing for separate establishment of security rights in such assets.

Other project critical factors will be project contracts with suppliers (during the development phase) and power off-take arrangements with customers (in the production phase). Where assignable under the laws of the relevant jurisdiction, lenders will take collateral assignments in such contracts. To mitigate future price risk, the lenders could require the SPC to enter into power price hedging agreements. Lenders will also typically take a security interest in the SPC's bank accounts and claims for receivables, as well as liens over all shares in the SPC.

In addition to such security rights, lenders could require guarantees from the investors for specific risks in the development phase, for example, to ensure equity financing of potential cost overruns or to mitigate other specific project-related risks.



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Further, where several loan facilities will be established, whether investor loans or bank loans, such investors and banks must coordinate their respective rights, for example, by use of separate coordination agreements.

For wind power developments, public consent could be required to enforce security rights in an insolvency situation. This issue cannot always be bypassed by enforcing a pledge of SPC shares rather than security interest in project assets. In a Norwegian context, requirements for public consent could apply both in respect of outstanding public grants and in respect of the further operation or divestiture of secured assets. In our experience, however, the risks related to public consent requirements can be mitigated.

Drawdown requirements

A typical wind farm project demands cash during the development phase and only generates cash flow after start up of the production phase. Drawdowns on

loan financing will normally be subject to the fulfilment of certain conditions, such as evidence of milestone achievements or the documenting of project cost. Further, lenders would be willing to finance only a percentage of the development costs under the loan facility. If the project has obtained public support, the loan drawdowns could also be linked to the availability of such funds. Finally, the establishment of required security and corporate/project authorisations will be a condition precedent to all drawdowns under any loan facility.

Repayment during the production phase

After successful completion of the development phase, the SPC enters the production phase and starts earning revenues. At this stage, the loan will be repaid pursuant to an agreed repayment plan, tailored for the relevant project and the forecasted cash flow. The repayment plan should take account of operating and maintenance costs as well as any

necessary capital expenditures during the life of the power plant. The lenders will want to control the receipt and disbursement of cash, normally through a cash sweep account, in which reserves would be established to cover the operating expenses and debt servicing costs.

During the production phase, an SPC is most likely to default due to inadequate production volumes or power prices, but the loan agreement should also be tailored to meet more extraordinary events, such as turbine damage, lapse of consents or public authorisations, and the lapse of long-term off-take/hedging arrangements.

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A NEW LEGISLATIVE FRAMEWORK FOR OFFSHORE RENEWABLE ENERGY PRODUCTION

With the draft Act on Offshore Renewable Energy Production, submitted to the Norwegian Parliament (Stortinget) in June 2009, the Government takes an important first step in facilitating offshore renewable energy production. The Act is intended to provide a unified legal framework for the construction and operation of facilities for offshore power production from renewable energy resources in Norwegian territorial waters and on and above the Norwegian Continental Shelf.

Introduction

According to a study prepared for Enova, the Norwegian state enterprise set up to promote renewable energy consumption and production, Norwegian territorial waters and the Norwegian continental shelf hold an untapped technical potential for offshore wind power of a staggering 14 000 TWh/y (almost 14 times the energy value of annual Norwegian gas export). Norwegian offshore renewable energy production has hitherto been limited to experimental production and testing of prototypes. The limited development is mainly due to the high cost of offshore renewable energy production compared to land based hydro electric production as well as production from land based wind turbines. Another factor is the currently fragmented and rudimentary legal framework for such activities. The draft Act on Offshore Renewable Energy Production seeks to mend the legislative problem.

A flexible and non discriminatory regime

Apparently inspired by Norway's successful license regime for offshore petroleum

production, the draft Act requires a government license for the construction and operation of facilities for offshore power production, as well as for related facilities for transformation and transmission.

The extent and nature of future development of offshore energy production depend on a number of yet unknown factors and circumstances. Thus, the draft Act aims to provide an overall framework with central principles, allowing for more detailed regulation in secondary legislation (regulations). The draft Act does not distinguish between different renewable technologies; offshore wind, wave and current power, as well as other possible renewable technologies, are encompassed.

The draft Act establishes procedures for the opening of offshore areas for power production and for the award of production licenses and transmission licenses. The license regime does not discriminate between public and private entities, or between Norwegian entities and entities established and registered in EEA

agreement member states. Detailed requirements and conditions for the awarding of licenses will be established by regulations. Licenses may be granted for a period of up to 30 years from commissioning of the facilities, with a possibility for a subsequent extension of the license period.

Protecting the environment and third parties

The draft Act provides for developer to conduct extensive impact assessments according to detailed impact assessment procedures divided into two stages. First, before new areas can be made available for offshore power production, the authorities must ensure a strategic assessment of environmental and social impacts of renewable power production in the relevant area, including its effects on other users, such as shipping and fisheries. Developers must also conduct a specific impact assessment before applying for a license or as part of the detailed plan for development and operation of facilities. Before an impact assessment can be approved by the government, the developer



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must submit its impact assessment program to the relevant authorities for public consultation and approval.

The draft Act addresses the potential negative effect of offshore renewable power production on fisheries in particular detail. To the extent that activities pursuant to the Act take place in a fishing ground and thus fully or partially obstruct fishing activities, the state must provide compensation to adversely affected parties. A licensee, on the other hand, will only be liable for loss due to its obstruction of fishing activities to the extent the loss could have been limited or prevented by appropriate mitigation measures. However, a licensee will be strictly liable for damage caused by pollution or waste from its activities, according to the draft Act, regardless of fault. The liability also includes costs related to reasonable measures to avert or limit such damage or loss. Claims for compensation will be resolved

by a committee to be established by the Ministry of Petroleum and Energy.

Finally, the draft Act establishes additional provisions on a number of issues: safety and safety zones around facilities, decommissioning and removal of facilities, appointment of a transmission system operator, area fee to be paid to the state, financial guarantee for obligations and liability in connection with activities under the Act, supervision by relevant authorities, administrative sanctions for violations of the Act, and provisions on the Ministry's right to revoke a license if it was awarded based on incorrect or incomplete information or for material breach of the Act, relevant regulations under the Act or conditions stipulated in the license.

Remaining challenges for offshore hydropower

A legislative framework is only one step

towards full scale offshore energy production from renewable resources. With the technology currently available, offshore energy production is not commercially viable. Consequently, the state must also create a sensible and efficient support or subsidy system to stimulate development of renewable energy production. (More on this in another article in this Update)

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AMENDMENTS TO THE NORWEGIAN ENERGY ACT; INCREASED EMPHASIS ON RENEWABLE ENERGY PRODUCTION AND GRID INVESTMENTS

On 19 June 2009, the Norwegian Parliament adopted amendments to the Norwegian Energy Act which, among other things, are expected to facilitate renewable energy projects and grid investments. The amendments will become effective 1 January 2010.

Introduction

The Norwegian Energy Act 1990 establishes the organizational framework for Norway's power supply system. The Act principally distinguishes between production and marketing of power, which is exposed to competition, and grid operation, which is a natural monopoly and not open for competition.

The newly adopted amendments to the Energy Act sets out, among other things, to achieve better coordination between investments in new production capacity and investments in grid reinforcements. The overall purpose is to facilitate new investments and to secure a balanced development of the Norwegian power supply system. The adopted amendments include new and extended grid access rights for producers and off-takers of power.

The new access regime is also expected to facilitate new renewable power developments such as small hydropower and wind power. Such investments are dependent on a combination of available natural resources and reasonable grid access, which often proves difficult to achieve due to restrictions in grid capacity.

Under the new regime, the obligations of the grid owner to facilitate such investments are more clearly set out.

Transmission grid access for producers and off-takers of power

The Energy Act generally provides for regulated third party access to the electricity transmission grid. The newly adopted amendments to the act include a general right for producers and off-takers to connect new installations to the grid as well as a general obligation for grid owners to invest in grid reinforcements where necessary in order to allow for such new facilities to be connected. Similar requirements apply for expansion projects in existing installations for production or off-take of power.

The Norwegian transmission grid is divided into three levels; the central grid, which also encompasses cross-border transmission, the regional grid and the distribution grid (the local grid). The grid access obligation is put on licensees on all three levels of the transmission system. In respect of new off-take, the new requirements imply that regional and central grid licensees, including Statnett, which is the

Norwegian transmission system operator and main owner of the central grid, are obliged to facilitate grid access.

The practical implication of the new and extended access requirements is that grid companies could be instructed to carry out grid investments if grid capacity is insufficient to connect new, or expanded, production or off-take needs. The premise is that the individual production or off-take project, or expansion project, are socio-economically profitable. Profitability will be assessed based on a cost-benefit analysis in the individual case. Grid companies may request the Norwegian Water Resources and Energy Directorate (the NVE) to be exempted from the obligation to provide access if the project is not considered socio-economically profitable by such company.

The overall responsibility for the development of the grid transmission system will nevertheless rest with the grid companies, implying that the grid company is required to investigate, at first hand, whether or not, and to what extent, planned production or off-take projects require grid investments.



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In order to secure effective compliance with the access obligation, the licensing processes for grid investments and reinforcements and planned production or off-take projects must take place simultaneously. The NVE will play a substantial role in coordinating the licensing process.

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NEW GUARANTEE SCHEME FOR INDUSTRY POWER SUPPLY

A new state guarantee scheme has been put in place, supporting the Norwegian energy-intensive industries' effort to secure long term power supplies on sustainable terms. The overall objective is to maintain and develop a competitive environment for energy-intensive industrial operations in Norway.

Historically, the Norwegian energy-intensive industries have benefited from publicly regulated power supply arrangements, providing a reliable source of supply and foreseeable prices. These arrangements were phased out following Norway's accession to the EEA Treaty in 1994, implementing EC restrictions on state subsidies. The bulk of state regulated power supply contracts have expired or will expire during the next couple of years.

This development has led to increasing political pressure on the Norwegian government from, among others, industry and labor organizations, demanding the introduction of new policy instruments securing sustainable power supply for energy-intensive industries.

In response to this, the Norwegian government has, among other things, proposed a new scheme where long-term power commitments undertaken by energy-intensive industries may be backed by financial guarantees offered by the Norwegian state. NOK 20 billion has been allocated to the scheme, and financial guarantees are to be offered on commercial terms.

Industries eligible under the guarantee scheme are the timber trade, wood processing, chemical products and metals. The individual applicant must consume annually energy in excess of 10 GWh and hold eligible power supply contracts for the supply of energy for a minimum period of seven years. In view of applicable EEA regulations, the state guarantee will not cover more than 80 % of the contract volume. Power volumes delivered under the guarantee and other assets of the power purchasing entity may be required as security for the obligations of the State under the guarantee.

The guarantee scheme is not yet in operation, but the arrangement will be submitted to the EEA Surveillance Authority for clearance under applicable state aid rules, indicating that some time will pass before the scheme is operative. Further details with respect to the practical handling of the guarantee scheme will also have to be put in place before start up.



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INTERCONNECTORS BETWEEN NORWAY AND EUROPE - NEW DEVELOPMENTS IN THE WAKE OF THE NORNE D CABLE

In May 2008, the Dutch and Norwegian grid operators, Tennet and Statnett, commenced commercial operation of the NorNed electricity interconnector between Norway and the Netherlands. The NorNed interconnector has proven successful in exploiting the difference in production profiles between all-hydroelectric Norway and thermal, nuclear and wind powered North-west Europe, spurring the interest for further interconnector investments in Norway.

A competitive environment

Following the success of the NordNed cable, a boost of new interconnector projects have been launched on the public arena, involving a variety of regulated and unregulated market participants in Norway and abroad. Among the publicly referenced projects are the NorGer project, a cooperation between large regional Norwegian power producers Agder Energi and Lyse Energi, and the Swiss-based European energy trading group EGL AG, and the NORD.LINK project involving Statnett and German E.ON Netz, both concerning interconnectors between Norway and Germany.

Statnett also has plans for additional interconnectors to Denmark, Sweden and the Netherlands, as well as an interconnector to the UK, the latter in cooperation with UK TSO National Grid. According to Statnett, simulations made for the period 2002 – 2008 showed that such interconnectors would have been very profitable, and further development of variable wind power would make power exchange between markets and therefore

interconnectors even more profitable. Further, Statnett recently requested additional capital in an amount of NOK 4 billion (approximately EUR 470 million) from its owner, the Norwegian State, inter alia to finance possible interconnector developments. Recently published plans indicate that the interconnectors may be taken into use between 2014 and 2020.

In view of this seemingly increased interest among market participants, the further development of interconnectors between Norway and Europe is expected to include an element of competition among cable projects. The competitiveness of each individual project will, among other things, depend on its ability to fulfil Norwegian regulatory requirements and public preferences and its compatibility with Norwegian grid development plans.

Main parameters of the Norwegian regulatory framework

The first and in many respects main set of rules governing the establishment of interconnectors to/from Norway are the Norwegian statutory law pertaining to the

production, transportation and marketing of electricity, the Energy Act 1990 and related regulations. The actual laying of the cable on the sea floor will be subject to the United Nations Convention on the Law of the Sea of 10 December 1982.

The main regulatory hurdle for the establishment of an interconnector to/from Norway is the grant of an export/import license pursuant to Section 4-2 of the Energy Act. Export/import licenses are granted by the Ministry of Petroleum and Energy (MPE) based on an overall assessment of the relevant project, including, but not limited to, an overall assessment of the socio-economic effects of the project, security of supply issues and the overall functioning of the Norwegian central transmission system ("Central Grid").

EC law principles concerning interconnectors, in particular the Second Electricity Directive (2003/54/EC) and the Cross-Border Regulation (1228/2003/EC) are incorporated into Norwegian law. The Third Electricity Directive (2009/72/EC) and the Second Cross-Border Regulation



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(2009/714/EC) will presumably be similarly incorporated, and may influence policy also before formally incorporated.

In line with the policies set out by relevant EC regulations, the expressed preference for the Norwegian government is for new interconnector projects to be organised as regulated cables with full market opening through implicit auction. The existing NorNed cable is a regulated cable with full market access, but due to market interface issues between Nord Pool in Norway and APX in the Netherlands the deadline for implementing power exchange based on implicit auction has been postponed. For the time being, NorNed capacity trading is based on explicit auction organized via www.norned-auction.org.

In addition to the MPE, main premise providers for the assessment of an export/import license application, as well as the assessment of underlying public requirements, are the Norwegian Water Resources and Energy Directorate (NVE), which is the governmental agency in charge of technical and operational aspects of Norwegian electricity operations, and Statnett, the TSO which is responsible for the development of the Central Grid.

The relevant legislation does not require participation from Norwegian entities in interconnector projects. However, a close cooperation with Statnett will be required for practical reasons, and participation by Statnett or other Norwegian market participants may strengthen the competitiveness of a cable project compared with alternative cable projects.

General considerations

The discretionary nature of the Norwegian licensing regime for interconnectors, as well as rapid developments in EC/EEA law, mean that the scope of public considerations applied to interconnector projects may be a moving target. In particular, a number of issues regarding how an interconnector should be organized and



run may largely depend on the Norwegian Government's current policy within the scope for discretion provided by Norwegian and relevant EC law.

Therefore, those who contemplate a Norwegian-European interconnector project, should as a point of departure consider informal consultations with relevant authorities and state agencies, including Statnett, the MPE and/or the NVE, in order to further clarify the Norwegian Government's preferences regarding future interconnector projects.

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PENSIONS AND ENERGY IN NORWAY

As a consequence of the financial crisis, many Norwegian and foreign life insurance companies have earned less than their long term obligations towards their customers. Thus, life insurance companies have a need for long term investments which balance the companies' customer obligations. Some have argued that production of energy and/or infrastructure is well suited for pension savings. Since the investment requirements of the Norwegian energy production and infrastructure are substantial and financing is now scarcer than prior to the financial crisis, these propositions deserve examination.

Introduction

The new regulatory framework governing investments in Norwegian energy production and infrastructure will affect the life insurance industry by providing additional opportunities for long-term investments well suited to life insurance companies' long-term obligations. New laws and regulations affecting power plants and power grid in the hydropower sector, producing installations and transportation infrastructure in the oil and gas sector, and production facilities in the renewable energy sector, all provide new opportunities for investment by life insurance companies.

Hydropower

The Norwegian Industry Licensing Act stipulates that only so called publicly owned companies may own hydro power plants beyond a certain minimum size. A publicly owned company is a company in which public bodies or entities, e.g. one or more municipalities, directly or indirectly, own at least two thirds of the capital and voting rights.

A life insurance company therefore cannot own a hydro power plant or a part

thereof, but it could be a minority shareholder in a publicly owned company doing so. As publicly owned companies are not listed, such minority shareholdings by insurance companies would constitute illiquid investments. Nevertheless, an insurance company could earn steady dividend income, necessary for the life insurance company to meet the guaranteed return on the life insurance contracts it issues. The stability of the dividend income would depend, in turn, on how well the managers carried on the hydropower company's business and on the decisions of the majority shareholders.

The power grid, on the other hand, is operated by companies licensed under the Norwegian Energy Act. Under the act, the government regulates the return received by investors in the power grid. Although newly adopted amendments to the Norwegian Energy Act have introduced licensing requirements on power grid owners, there are exceptions permitting strictly financial investments in the power grid to remain an attractive possibility. Those grid companies large enough to be of interest to life insurance companies are, however, owned by holding

companies with indirect ownership interests in hydropower plants. The holding companies must therefore be publicly owned companies. So far, none of the holding companies have opened up for financial investors to participate directly in the grid company, presumably because such investment would restrict the holding company's use of the funds generated by the grid company.

Oil and gas

A life insurance company could invest in producing installations based on proven reserves acquired from one or more exploration companies unable or unwilling to procure financing themselves. A person seeking to own producing installations on the Norwegian continental shelf would be subject to the licensing requirements in the Norwegian Petroleum Act. Under the Petroleum Act, any transfer of ownership in oil and gas reserves would be subject to approval by the Norwegian Ministry of Petroleum and Energy and the Ministry of Finance. A production license may be owned by a legal entity established in accordance with Norwegian law and registered in the Norwegian Register of Business Enterprises. In addition, a



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licensee must be able to manage the petroleum activities to be conducted in Norway. In many ways, this is similar to the way life insurance companies organize themselves through wholly owned companies to invest in real property.

Although life insurance companies would not be permitted to directly invest in majority stakes in hydropower plants on land, they would be permitted to directly invest in oil and gas producing facilities and also in transportation infrastructure offshore, provided that certain formal and organizational requirements are met.

Renewables

Although life insurance companies (and

other private investors) would be permitted to invest in renewable energy generation, such investments are unprofitable at present due to low energy price levels and dependence on government subsidies. Subsidy schemes could change, as recent developments regarding a possible common Swedish-Norwegian subsidy scheme for renewable energy investments might indicate.

Concluding observations

In the energy field, investments in oil and gas producing installations and transportation infrastructure could be suitable for pension savings. Norwegian and foreign life insurance companies should work to effect changes in the regulatory

frameworks to make such investments feasible.

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REPORT FROM THE NORWEGIAN COMPETITION AUTHORITY ON STATUS IN THE NORWEGIAN POWER MARKETS

On 19 February 2009, the Norwegian Competition Authority published its latest report regarding the status of competition in Norway. The Norwegian power market is one of a selected few markets which the report subjects to closer scrutiny due to what is identified as “important challenges” to the competitive structure. The report suggests several competition enhancing remedies, the most controversial of which is splitting the Norwegian state owned incumbent power producer, Statkraft.

Introduction

According to the report, competition in the wholesale power market is reduced by cross-ownership, bottlenecks and integrated companies. The Competition Authority is concerned that consumers as a consequence pay higher prices in the end user market. In addition, market concentration and insufficient customer switching are identified as concerns in the end user market.

Electrical power is a central energy carrier in most areas except for transport, and about half of the total Norwegian energy consumption depends on power. Lack of sufficient competition in the power markets could therefore have significant negative economic effects.

Concentrated markets, bottlenecks and integrated companies

The report identifies the lack of sufficient competition in the wholesale power market as a primary competition concern. The Norwegian wholesale market for power is

dominated by Statkraft, which is the largest owner of power production capacity in Norway. Although Statkraft has several competitors, the intertwined ownership of Norway’s hydropower plants reduces the competitive pressures in the market. Recently enacted legislation which prevents controlling private ownership of hydropower plants, discussed elsewhere in this Update, further reduces competition. The report estimates that Statkraft controls about half of the Norwegian power production capacity.

Lack of sufficient transmission capacity further reduces the competitive pressures, as Norway during significant periods of time is divided into at least two different price areas. During such periods, the market concentration increases further as power producers in one price area are unable to exert competitive pressure on power producers in the other price area. As a consequence, the market concentration and the ability of the power producers to charge uncompetitive prices increase.

The report also points to integrated companies that offer both transmission services and power, as a cause for concern. Transmission companies have a monopoly on power transmission in their respective areas. When these companies also offer power to customers in competition with other power producers, their monopoly position in the transmission market could provide them with unfair advantages, as well as a risk of illegal cross-subsidization. Unfair advantages could also be connected to information systems, billing and customer service.

Recommendations

The report recommends increasing competition in the Norwegian power market by implementing a number of measures. First, the Competition Authority recommends that the power purchasers in the end user market should be stimulated to seek out and switch to the cheapest power supplier available. Second, the market concentration in the wholesale market should be reduced, preferably by splitting



Energy consumption per capita is higher in Norway than in most other countries. Power constitutes approximately 50 % of all energy consumed and is the most important source of energy in most sectors other than transport. Of the power produced in Norway, 99 % is produced in hydropower plants.

Transmission capacity allows for power exchanges with neighbouring countries where power is produced by other means. The Norwegian power market is also a part of the Nordic power market. Nevertheless, the central role played by domestic hydropower production in Norwegian energy consumption, implies that distortions of competition in the power market have important repercussions for Norwegian consumers and industry alike.

Statkraft and dismantling the intertwined ownership structure of Norway's hydropower plants. Third, the report recommends that further development of the transmission system should take into account the need to avoid separate price areas due to lack of transmission capacity. Lastly, the report recommends that

common ownership of both transmission and power production should be prohibited or, alternatively, that the current condition of legal separation be expanded.

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TRADING CLIMATE QUOTAS IN NORWAY

Norway operates an emissions trading scheme which, after some teething trouble, is fully integrated in the EU scheme. The combination of a carbon-intensive offshore petroleum industry and ambitious emission reduction targets makes Norway a major purchaser of emission allowances.

Norway's approach to climate reduction

Norway has signed and ratified the Kyoto protocol, and is obliged to stabilize its emissions at 101% of the 1990 level or approximately 50 million tonnes of CO₂ equivalents by 2012. Norway intends to over-fulfil its Kyoto obligations by 10 per cent. The Government has estimated that emissions will increase to 59.2 million tons by 2010 if no measures are taken. The increase is mainly due to increased CO₂ emissions from the petroleum industry, shipping and road traffic. Emissions of other greenhouse gases, mainly from the process industry, have been significantly reduced since 1990.

One of the measures introduced to ensure compliance with Norway's Kyoto obligations is an emissions trading scheme ("ETS"). Norway first established a national ETS for the period 2005 to 2007, implemented through the Emissions Trading Act. The national ETS was designed to be broadly compatible with the EU emissions trading scheme ("EU-ETS").

Applying the EU element

On 26 October 2007, the EEA Joint Committee decided to make the EU-ETS Directive (Directive 2003/87/EC) part of

the EEA Treaty. The Norwegian Storting (parliament) ratified this decision on 18 December 2007, and Norway is affiliated with the EU-ETS in the 2008-2012 Kyoto period. After complaints from industry, the EFTA Surveillance Authority (ESA) required further adjustments to the Norwegian scheme. Following such adjustments, the Norwegian ETS was approved by ESA on 27 February 2009. The ETS allows for use of emission allowances issued under the EU-ETS to fulfil allowance quota obligations in Norway. The Norwegian National Registry allows for external transfers of allowances to/from other national registries within/affiliated with the EU-ETS, and EU-ETS allowances may be retired in the National Registry in order to fulfil quota obligations. Also Clean Development Mechanism (CDM) credits, except credits from nuclear and forest planting projects, are accepted to fulfil quota obligations in Norway.

Scope of the Norwegian ETS

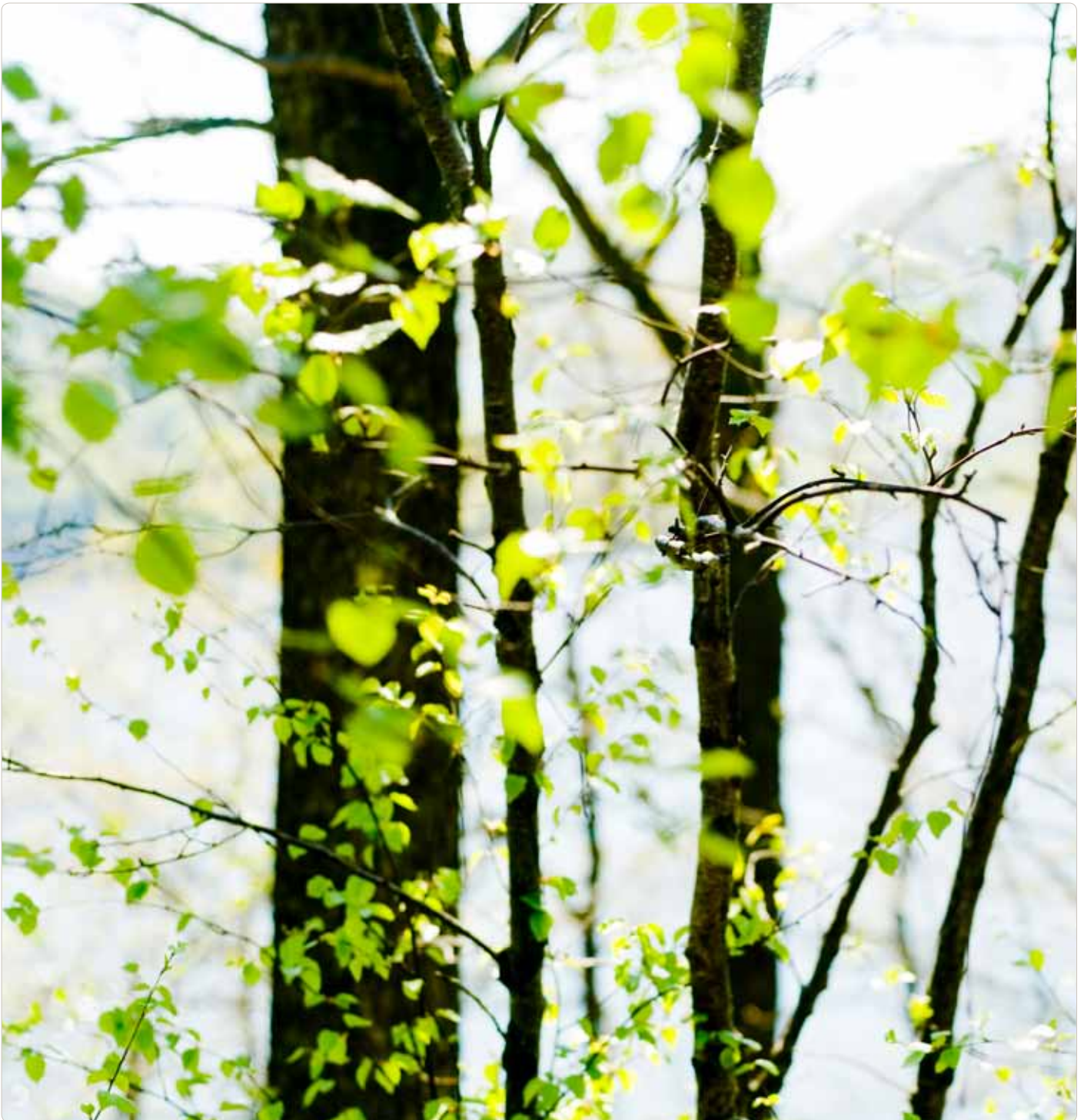
The Norwegian National Allocation Plan ("NAP") for 2008 – 2012 allocates allowances for approximately 15 million tonnes/year, of which approximately 7.65 million tonnes/year are estimated to be allocated free of charge. Around 1 million tonnes per year are allocated to

installations which did not have emissions in 1998 – 2001, while the new entrant pool encompasses around 0.84 million tonnes/year.

Allowances for approximately 7.35 million tonnes/year are sold at market conditions. Allowances are not targeted at Norwegian buyers. From May 2009 until 13 November 2009, Norway will sell regular volumes of emission allowances, on a daily basis, through a combination of spot and December 2009 deliveries.

The ETS covers 35-40 percent of the greenhouse gas emissions from Norwegian sources. The petroleum sector, which represents about 60 percent of the emissions covered by the ETS, does not receive any allowances free of charge. It follows that the Norwegian petroleum sector will have to purchase a significant amount of allowances, also outside of Norway.

Similarly, to achieve its Kyoto targets, the Norwegian state has become a major purchaser of foreign allowances. The Ministry of Finance is authorized by the Storting to contract delivery of carbon credits (Certified Emission Reductions, CER, and Emission Reduction Units, ERU)



from the CDM and Joint Implementation, JI. The combined authorization and appropriation for 2009 is 7 billion Norwegian kroner, or about 600 million euro. The Ministry plans to contract some 30 to 35 million tons for delivery during 2008-2012.

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WIKBORG REIN'S ENERGY & NATURAL RESOURCES GROUP

Wikborg Rein's Energy and Natural Resources group assists both Norwegian and foreign clients engaged in enterprises involving energy and natural resources. The unique problems and challenges in these fields are often complicated further by political concerns and control. Our lawyers have experience with all aspects of these fields, including a detailed knowledge of the local administration.



Examples of the group's activities:

Oil and gas:

- Purchase and sale of licence interests and exploration and production companies on the Norwegian continental shelf, stock listings
- Alternative models for the purchase of natural gas from the Norwegian continental shelf
- Review of gas contracts
- Financing of exploration activities and field development
- Cooperation between joint undertaking participants, regulatory matters

Electricity/Renewables:

- Purchase and sale of shares in power companies (marketing/net/production)
- Agreements regarding supplies of electricity – physical and financial
- Green field/brown field development projects
- Agreements regarding power cables between Norway and the Continent
- Aspects of private law and public law regarding commodity derivatives
- Trading and clearing of power contracts through Nord Pool
- Regulatory matters

Aquaculture:

- Purchase of enterprises with companies in several jurisdictions
- Mergers and restructuring
- Public concessions

Fisheries:

- Questions regarding quota and regulation in connection with public authorities
- Purchase of quotas in foreign countries
- Licences
- Vessel sale and purchase

A total of 20 lawyers form the firm's Natural Resources practice group, which is headed by Jarle Erik Sandvik.

WIKBORG REIN'S GLOBAL PROJECTS TEAM

From major hydro-electric projects in the Philippines to bioethanol projects in Brazil, from wind farm projects in Chile to run-of-the-river hydroelectric projects in Uganda, Wikborg Rein's Global Projects Team advises on important renewable energy projects in every corner of the world, providing project sponsors with seamless support in the following areas:



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Equity/Joint Venture Matters

- survey of applicable bilateral investment treaties
- equity holding structures
- shareholder documentation
- corruption mitigation strategies
- joint development agreements
- public-private partnerships
- diligence on local partners and other major project participants
- political risk policies
- equity bridge loans

Regulatory Matters

- grid access
- project licenses
- political interference with rate setting mechanisms
- wheeling rights
- water rights/use restrictions
- relocation of indigenous peoples
- catchment rights
- watershed conservation rights
- emission restrictions
- environmental permits
- other permit requirements
- distribution franchise
- foreign exchange conversion/repatriation foreign investment incentives

Host Government Matters

- power purchase agreements
- concession agreements
- implementation agreements
- performance undertakings/payment guarantees

Construction Matters

- split offshore/onshore tax mitigation structures
- FIDIC-based documentation
- competitive bidding procedures
- new technology risk mitigation
- EPC agreements – negotiation and documentation support
- performance bonds
- payment guarantees, and other credit enhancement mechanisms
- change order negotiations
- dispute management

Project Financing

- limited/non-recourse finance structures
- project analysis for bankability issues

Competitive Spot Markets

- trading of power and relevant derivative instruments
- contract for differences-regulatory analysis

Portfolio Acquisitions

- project due diligence
- financing due diligence
- acquisition financing
- regulatory matters
- corporate governance analysis
- joint venture structures
- corporate social responsibility
- lender consent solicitation processes

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