Mr Märt Ots
Competition Authority
Auna 6
10317 Tallinn

Your ref: 28.02.2011 No 9.1-2/10-0448-030
and 18.03.2011 No 9.1-2/10-0448-037

Our ref: 31.03.2011 No 6/1103534-16

Dear Mr. Ots,

This present letter is in response to your letter dated 28 February 2011 to instigate supervision proceedings on the current tariffs being charged by AS Tallinna Vesi in Tallinn and Saue. I take this opportunity to remind you that the tariffs currently being charged were approved as of 1 January 2010 as per the tariff mechanism contained in the Services Agreement we have with the City of Tallinn. The Services Agreement is one of the agreements contained within the fully legal privatisation contract that came into force from January 2001, which ASTV and its owners have always honoured. ASTV was privatised via a competitive market led mechanism with clear bid award criteria that were laid down by the City, with the support of the National Government of Estonia.

We find it extremely surprising that you should start supervisory proceedings regarding our 2010 tariffs based on the data that we submitted to you along with and to support our 2011 tariff application and, indeed, while the 2011 tariff application proceedings are still being discussed. Your letter regarding the supervision proceedings was sent to us on 28.02.2011, on the same day as but BEFORE we received your letter that contained a preliminary rejection of our 2011 tariff application. This action seems to indicate that you may have already prejudged the outcome of our 2011 tariff application and clearly signal that with these supervision proceedings you are heading towards the path of imposing temporary prices regardless of our 2011 tariff application.

As we have explained to you on numerous occasions, the CA is adopting a completely different view of regulatory principles from those proposed by the World Bank, other European regulators, ASTV, and most importantly the economic terms and conditions of our privatisation contract. Without any discussion with the company and without considering the effect that your decisions may have on destroying the value that the privatisation of ASTV brought to the Estonian environment and economy, with these supervision proceedings you are clearly signalling to the company and its investors that you do not intend to honour the state's and the local municipality's part of the privatisation bargain. Instigating supervisory proceedings that could potentially lead to imposing temporary prices goes severely against the legitimate expectations the investors had on privatisation. These legitimate expectations were – if the investor delivers the required quality and environmental improvements necessary at the lowest possible tariff increases, then the investor would be allowed to earn a justified profit for their investment throughout the agreed life of the privatisation contract.

May we also remind you that when, mid-way through the 20-year privatisation contract, the tariffs are being reviewed with the aim of the state prescribing to drop them considerably and this is done solely based on the CA's own in-house analysis, which has not been verified by any international or even local external economic or legal experts, such actions are unreasonable bordering on the arbitrary,

disproportionate, discriminatory and in utter breach of not only the Estonian constitution, but also of fundamental principles of EU law.

You have made the following statement regarding our tariff application: "***Agreements concluded between the City of Tallinn and ASTV do not possess a stronger legal power than the PWSSA,*** *which the CA follows in its tariff approval process. … Therefore the CA is obligated to follow only the PWSSA when analyzing ASTV's tariff application…*". We have carefully investigated the PWSSA and we would like to insist that according to our best analysis none of the paragraphs of the PWSSA require for the CA to use the net book value of the assets (as opposed by the invested capital as proposed by ASTV following the best practise regulatory principles for privatised companies), neither does the PWCCA prohibit the CA to use inflation to calculate the WACC or to index the assets as thoroughly discussed in our letter to CA on 29.03.2011, which supports our legally concurrent tariff application and also explains why there are no discrepancies between the PWSSA and our contract.

Your 28.02.2011 letter We would, once again, like to draw your attention to certain important legal aspects. It seems that From the CA is about to issue a decision not approving the price of water services for Tallinn and Saue City for 2011 and that you are targeting on inspecting our 2010 tariffs as well because the CA does not believe this price to be justified, without taking into consideration our privatisation contract and the recent EU Commission intervention on the matter.

The fact that you have decided to ignore ASTV's privatisation and the legally binding Services Agreement, which was part and parcel of that privatisation is clear from pages 26-27 and section 5.1. on page 9 of your 28.02.2011 response to our tariff application for 2011. Such actions unilaterally break the privatisation agreement and Services Agreement. This is further clarified on page 9 of this letter, where you state that "***Agreements concluded between the City of Tallinn and ASTV do not possess a stronger legal power than the PWSSA,*** ….". It seems that you use the amended PWSSA as the ultimate authority in justifying why you have decided to completely and explicitly discard ASTV's privatisation agreement and the Services Agreement.

By following such approach, we believe that the CA is ignoring the value of the equity price paid by the investor at the time of the Company's privatisation, so depriving them of their legitimate return on their investments. This is a unilateral modification of the legal and economic conditions set by the same Estonian authorities in view of ASTV's privatization.

Such approach actually overturns the legal and economic "platform" on the basis of which foreign companies decided to invest in the privatised business. As a result, the current position of the CA is infringing well-established EU principles, according to which when privatising companies, Member States shall abide by "*objective and stable criteria which are known in advance*" and, in order to avoid circumvention of that principle, Member States should also refrain from arbitrarily modifying, *ex post facto*, the legal rules and criteria established for the purpose of a privatisation process.

We would also add that the CA position on ASTV's monopolistic position and the consequent need to avoid excessive profit in prejudice of consumers is particularly unjustified in the case at stake, since the existing contracts set at the time of the privatisation, in line with the national sector regulation, took due account of such public interest needs. Indeed, the set of contracts and criteria defined for ASTV privatisation were **conceived and shaped in view of controlling tariff increase**, ensuring quality enhancements, guaranteeing both stable long-term relationships between the parties and maximum benefits from privatisation, while ensuring an adequate return for the investors. The bidding criteria elaborated at that time (in particular, the main criteria concerning the K coefficient) reflected

the public need of protecting consumers from monopolistic attempt of excessive profits by keeping tariffs at the lowest maximum level.

Under such circumstances, the CA position is violating the freedom of movement of capital and freedom of establishment, which are fundamental freedoms, enshrined in art 49 and 63 of the Treaty on the Functioning of the European Union (TFEU).

A final remark is addressed to your letter rejecting ASTV request for postponement. In particular, we have to restate that the pending procedures before the CA is closely linked with the object of the Commission's request for information and that this is why we asked the CA to take time in order not to interfere with, and to pre-empt, the Commission assessment on the State measures tackled by ASTV Complaint. It is evident that should the CA adopt final decisions on ASTV tariffs before the Estonian authorities reply to the EU Commission, this will end up jeopardising the *effet utile* of the Commission initiative, which is in stark contrast to the principle of loyal cooperation between Member States and the Commission.

We would like to remind the CA, once again, that ASTV made its application for a 3.5% tariff increase from 1st January 2011 in accordance with the Services Agreement, which embodies the terms and conditions for the provision of EU-level service as well as returns to be made at the lowest possible tariff increase which were agreed at the time of ASTV's privatisation in 2001. In our original tariff application as well as in our 29.03.2011 response letter to CA's statements we have submitted supportive evidence, which enables the CA to ascertain that ASTV's tariff application is not contrary to PWSSA.

Our 2011 tariff application was made and the 2010 tariffs were set based on the tariff mechanism agreed on privatisation. These contracts are fully in line with the then applicable PWSSA and EU law. In order to demonstrate the correctness of this contract and the decisions made at the time of privatisation, as well as the Company's performance against what had been agreed, a detailed and independently verified analysis accompanied our application. This independently verified analysis was submitted to assist the Competition Authority with its analysis of the tariff application, and to illustrate that the returns made since privatisation (i.e. from the period 2001 to 2010) were fully in accordance with those made by other privatised utilities when using internationally acceptable principles (see World Bank Resetting Price Controls for Privatized Utilities to which you yourself refer to in your 28.02 letter footnote 4). This independently verified analysis clearly demonstrates that the returns made by the company and UUTBV since privatisation have not been excessive. Furthermore, in view of ensuring that the CA can make a fully informed decision by having access to all the key financial and operational terms and conditions of the privatisation and regarding the Company's performance since privatisation, within the file sent to the CA on 09.11.2010 (electronic copies submitted on a CD on 10.11.2010) ASTV included all parts the Services Agreement **as well as key privatisation documents**.

Notwithstanding our comprehensive submission re: 2011 tariffs, we have to remark that you have chosen to completely ignore the opinion of internationally renowned and accepted experts as well as our building blocks analysis, as you have not referred to either of them in a single instance in your 28.02.2011 letter re: our 2011 tariff application and are, therefore, likely to adopt such an approach also when reviewing our 2010 tariffs. Analogously, your analysis contained in your 28.02.2011 letter does not refer to any parts of either the Services Agreement or any key privatisation documents.

ASTV considers that such approach is inadmissible and represents a further confirmation that the CA is acting in contrast with consolidated principles of EU Law.

However in order to be a good partner and engage in a transparent and professional dialogue on regulatory principles we have included all the information you requested in your letter dated 28 February 2011. We very much look forward to an open discussion on any points that require clarification and further discussion, in particular regarding **the unilateral breaking of the Services Agreement and ASTV's privatisation agreement, which will occur, should the CA continue to pursue this course of action**. Should this happen, the Company is prepared to take any legal action necessary international and local to protect its rights and the rights of its shareholders.

Sincerely,

Ian John Alexander Plenderleith
Chairman of the Management Board