Mr Märt Ots
Competition Authority
Auna 6
10317 Tallinn

Your ref: 10.05.11 No 9.2-5/11-0090-007
and 30.05.11 No 9.2-5/11-0090-009

Our ref: 08.07.2011 No

Dear Mr. Ots,

This present letter is in response to your statements dated 10 May 2011 regarding the current tariffs being charged by AS Tallinna Vesi (ASTV) in Tallinn and Saue. It is particularly disappointing that despite the thorough explanation of the terms and conditions of the privatization agreement in our letter dated 31 March 2011 in the course of the parallel processing of ASTV's tariff application, the Competition Authority (CA) has once again chosen to completely ignore ASTV's Privatisation Contract that complies with Estonian and EU legislation.

With such an approach the CA is in breach of the Administrative Proceedings Act that requires the administrative authority to consider the legitimate interests when applying the discretion right (§ 4 (2)[1]). Furthermore, to ignore the privatisation contract in such a way is unethical and demonstrates a total disregard for rights of those who invested into Estonia with the legitimate expectation that their investments would be protected, not unilaterally divested.

As you have narrowly applied your own recommended and unproven methodology without any analysis of the privatization contract and the legitimate interests, I have to reiterate the key aspects of the privatization contract that have to be considered when doing any analysis of ASTV's justified returns and tariffs:

- Current tariffs were set based on the tariff mechanism agreed on privatisation.
- These contracts were and are fully in line with the applicable PWSSA and EU law.
- ASTV was privatised via a competitive market led mechanism with clear bid award criteria that were laid down by the City and the 15-year contract period was authorised by the National Government of Estonia.
- The investors were expected quickly to deliver considerable increase in quality of water services with the lowest possible increase in real tariffs. At the same time the investors were encouraged to pay the highest reasonable price above the nominal value of the shares of the company.
- During the first 10 years of the contract the investors have fully honoured the contract and have delivered all the required and even higher than required service standards to the citizens of Tallinn. In return the investors are entitled to earn the reasonable justified return on all their investments during the whole contract period.
- 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

[1] Extract. *The right of discretion shall be exercised in accordance with the limits of authorisation, the purpose of discretion and the general principles of justice, taking into account relevant facts and considering legitimate interests*

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.

- The set of contracts and criteria defined for ASTV privatisation were **conceived and shaped in view of controlling the 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 interest of protecting consumers from monopolies earning excessive profits by keeping tariffs at the lowest maximum level

- Finally, to reiterate the point, the CA's 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. As the CA has not considered or analysed the privatisation contracts, then the CA's comments are entirely baseless.

We have thoroughly analysed your statements as presented on 15 May 2011 and we consider it regrettable that the CA has narrowly considered only the changes in the PWSSA that were enforced from 1 November 2010 and its own unproven, recommended methodology. Furthermore, the CA has limited its analyses to the changed paragraphs of the PWSSA despite the fact that ASTV has repeatedly and thoroughly explained and justified the bases for establishing the price of the water service and provided all the required explanations regarding its economic activities in accordance with the requirements of § 14^2 (7) of the PWSSA.

In addition, to ensure that the CA can make a fully informed decision based upon all the key financial and operational terms and conditions of the privatisation, and the Company's performance since privatisation, ASTV sent to the CA on 09.11.2010 (electronic copies submitted on a CD on 10.11.2010) a file that included all parts the Services Agreement **as well as key privatisation documents**. To date, the CA has not considered or analysed any of this supplementary information sent in support of our 2011 tariff application.

Considering CA's 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, the market led mechamism to establish the lowest real tariff increases, and the considerable improvements made to the service levels since 2001, and as such is 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 an approach overturns the legal and economic "platform" that was the basis on 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.

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 comment that "*the decision of the European Commission does not in any extent impact the actual costs, revenues and value of fixed assets reflected in the accounting to*

be submitted on ASTV regarding 2010." We would like to insist here that ASTV turned to the European Commission as it was concerned that the terms and conditions of theprivatization contract were being ignored by the Estonian Authorities when processing our 2011 tariff application. With the statements sent to ASTV on 10.05.2011, the CA has not only ignored the privatisation contract, but is now retroactively applying its own unproven recommended methodology to tariffs established in prior years. Therefore, we consider it even more important to await the ruling from the European Commission before unilaterally damaging the interest of the investors who have made the investment into Estonia in good faith based on the same privatisation contract in 2001 and during and after the IPO in 2005.

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 EU Commission has ruled on our complaint, 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.

In addition, you know that AS Tallina Vesi has disputed your 02.05.2011 decision of non-approval of our 2011 tariff application in Tallinn Adminsitrative court. Your analysis of our current (2010) tariffs is almost identical to your analysis of our 2011 tariff application. In our 29.03.2011 letter as well as in our complaint made to the administrative court on 01.06.2011, we have disputed almost all the points raised in your analysis of our 2011 tariff application in your 02.05.2011 decision as; they do not comply with Estonian law; they do not take into account any aspect of the fully legal privatisation contract; the principles you have used in your recommended methodology are inconsistently applied and do not comply with your own regulatory objectives or best regulation practices. As you analysis is near identical in the case of both, 2011 and 2010 tariffs, our response to your analysis of our current (2010) tariffs would highlight the same issues. Therefore, ASTV strongly believes that the administrative proceedings regarding our current (2010) tariffs should at the very least be halted at this point in time as the Competition Authority does not yet know whether its view of our contract, Estonian law, and its own methodology are fit for purpose.

We kindly ask you to terminate the investigation of current tariffs as per information, explanations and supporting evidence provided by ASTV based on the § 63^4 (2) of the Competition Act. If you still do have any hesitations based on Change of Law from 1 November 2011 we request you to suspend the current supervision proceedings based on the § 63^3 (1) of the Competition Act[2].

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

[2] Extract: *The Competition Board may, by a decision, suspend the proceedings if administrative proceedings, administrative court proceedings, civil proceedings, misdemeanour proceedings or criminal proceedings are pending that are relevant for making a decision in the matter and are related to the matter.*