

Fortum's Annual Report 2014

Fortum is an energy company highly committed to sustainability. We strive to respond to the needs of our customers by generating, selling and distributing low-carbon electricity and heat and by offering energy-sector expert services.

Russian market development

Development of Russia's electricity market

Liberalisation of the Russian wholesale electricity market has been completed, but retail prices are still regulated. During 2014, Fortum sold approximately 80% of its power production at a liberalised electricity price.

The Russian electricity market has been geographically divided into two independently operating zones: the First price zone (European and Urals part of Russia) and the Second price zone (Siberia). While western Europe and the Nordic countries use a pricing model based on area pricing, Russia uses the so-called nodal pricing. This means that the electricity price is determined for each nodal point of the power grid. This pricing model is commonly used in countries where transmission distances are long.

In January–December 2014, Russia consumed 1,021 (2013: 1,026) TWh of electricity. The corresponding figure in Fortum's operating area in the First price zone (European and Urals part of Russia) was 777 (2013: 772) TWh.

Capacity Supply Agreements (CSA)

The generation capacity built after 2007 under the capacity supply agreements receives guaranteed capacity payments for a period of 10 years. Prices for capacity and the period are defined in order to ensure a sufficient return on investments. If the new capacity is delayed or if the agreed major terms of the capacity supply agreement are not otherwise fulfilled, a fine may be imposed on the energy company. The issue of prolonging CSA payments from 10 to 15 years has been under discussion in the Russian Government; however, no official decisions have yet been made.

The received capacity payments will differ depending on the age, location, size and type of the plants, as well as on seasonality and availability. CSA payments can vary somewhat annually because they are linked to Russian Government long-term bonds with 8 to 10 years maturity. In addition, three years and six years after the commissioning of a plant, the regulator will review the payments guaranteed by the capacity supply agreement. Earnings from electricity sales will be taken into consideration in the review and could potentially revise the CSA payments.

Capacity payments for old capacity built before 2008 are determined in an annual auction.

Development of Russia's heat markets

Reforming the Russian district heating system is a complex but necessary step to improving the security of supply and the efficiency. The reform aims to attract investments in the modernisation of the ageing production and transmission system and to support investments in combined heat and power production.

Very few residential buildings in Russia have meters for tracking heat consumption. This significantly slows investments in modernising the heat network. Household-specific meters are not even being considered for old buildings, because they would be too expensive and technically difficult to install. Instead, quickly deploying building-specific regulation substations and automated metering throughout the country would help in the development of the district heating infrastructure. This would also enable consumption-based billing and, at the same time, encourage reductions in waste heat and efficiency in heat production.

Heat market reform

In 2014, the Russian Government approved heat market reform and a roadmap for a new market model. The aim of the new market model is to ensure the transition to economically justified heat tariffs and to attract investments in the heat market.

The heat reform roadmap describes the heat market from 2015 onward. The aim is to complete the reform in 2020 in major industrial cities with populations of over 100,000 and in cities that have functioning combined heat and power production. During the transition period, the full liberalisation of prices for the end customers within the heat price-cap defined on the basis of the heat-only boiler principle should be secured. In smaller cities, the reform will be done by 2023 at the latest.

Russia's natural gas market

Electricity price in Russia is largely based on natural gas price development. Because the electricity market is largely dependent on gas-fired power production, a functioning natural gas market is a prerequisite for a functioning electricity market.

Russia's regulated natural gas prices for industrial customers remained unchanged during 2014. Natural gas price indexing was not done in October 2014. Despite this, natural gas prices are estimated to increase by 3.5% in 2015. According to the Ministry of Economic Development of the Russian Federation, the 2014 price level will remain until the beginning of July 2015, when prices will be indexed by 7.5%, which will bring an annual increase of 3.5% compared to 2014.

A presidential natural gas directive issued in October 2014 reopened natural gas trading in St. Petersburg's International Mercantile Exchange. The natural gas trading is limited to month-ahead physical deliveries.