

Handling of issues related to rape and bio-diesel fuel by the Government

Audit report No. OSIV-2-6/06/25 28.04.2006

Summary

The SAO audited the activities of government bodies aimed at increasing the share of bio-fuels in the consumption of vehicle fuels, promoting the local production of bio-fuels and cultivating rape plants needed for the production of bio-diesel fuel. The bio-fuels used in transport include mainly liquid and gaseous fuels produced from biomass, including bio-diesel fuel and bio-ethanol.

The Parliament has given the Government the mandate to implement the necessary measures to considerably increase the use of bio-fuels in Estonia. The Long-Term National Development Plan for Fuel and Energy Industry adopted in December 2004 and the Environmental Strategy adopted in October 2005 set the objective of achieving, for bio-fuels, a share of 2 % in vehicle fuels by 2005 and a share of 5.75 % by 2010. Increasing the share of bio-fuels is a priority on the EU level as well. Reducing the share of fossil fuels does not have merely economical or environmental protection implications, but also serves an economic policy objective, as the establishment of a new type of fuel increases the security of supply. There are businesses in Estonia (like AS ATKO Grupp) who have announced that they intend to start producing bio-diesel fuel from rape-seed oil and using it in their own vehicles.

Rape has assumed an important position in agriculture and industry. Over the recent years, rape crops have covered about one tenth of all land under cultivation. Until now, rape-seeds have been used to produce mainly cooking oil and oilcakes suitable for animal feed. Also, crude oil has been exported. The major rape processor has been AS Werol Tehased with nearly all the shares owned by the government.

In the opinion of the SAO, the Ministry of Economic Affairs and Communications has failed to take effective measures to promote the use of bio-fuels in transport. Likewise, the Ministry of Agriculture has failed to organise the processing of rape effectively (referring to the activities of AS Werol Tehased).

Main observations

None of the Ministries finds that it has the responsibility for increasing the use of bio-fuels in transport. Four Ministries have dealt with the issues related to bio-fuels: the Ministry of Environment (ME), the Ministry of Economic Affairs and Communications (MEAC), the Ministry of Agriculture (MA) and the Ministry of Finance (MF). The ME has been responsible for the application of the European Parliament and Council Directive and the MEAC has been responsible for the obligation under the Directive, i.e. setting the objective of increasing the share of bio-fuels in transport. Although it seems that at least two Ministries are responsible for achieving this objective, none of the Ministries has a specific action plan for completing this task. The MEAC and the ME are of the opinion that, in addition to the excise duty exemption already established, the government should take no further active measures to guide the businesses towards decisions which facilitate the objectives set by the government. However, they admit that without such measures the achievement of the objective is doubtful.

The objective set by the Parliament and the Government for 2005 – to achieve a share of 2 % of bio-fuels in vehicle fuels – was not achieved. None of the filling stations in Estonia was selling bio-fuels. It is not clear whether and how the relevant objective set for 2010 will be accomplished. The objective of starting to use fuels of biological origin in vehicles was set without prior in-depth examination of the expected economic, environmental and social impact of the production and use of such fuels. Furthermore, it has not been analysed whether it is reasonable to produce bio-ethanol in Estonia to be added to petrol.

To promote the use of bio-fuels, these have been exempted from excise duty and the EU standards for 5 % and 100 % bio-diesel fuel have been transposed. But this has not been enough to influence the businesses towards using bio-fuels in vehicles. Many business operators believe that fuels with bio-additives may damage vehicle engines and fuel systems

and they doubt whether fuel suppliers are able to ensure that the quality of bio-fuels conforms to the standards. On the Estonian market, there is currently no considerable demand for bio-fuels suitable for use in transport.

Production of bio-diesel fuel from the rape cultivated in Estonia is economically and environmentally reasonable only if the rape yield per hectare increases at least by two hundred kilograms. There are no short-term perspectives of rapid progress in terms of yield. In Estonia, rape yield is the lowest among the EU countries. Estonia does not have high-persistence varieties of winter rape which provide a high yield – the government has not promoted winter rape breeding. However, thanks to government support, rape cultivation has been one of the growing lines of agricultural production.

The Supervisory Board of AS Werol Tehased failed to accomplish its tasks in 2004. The Supervisory Board and the Management Board did not have an agreement as to the vision and business plan of the company. The Supervisory Board did not react quickly enough to the Management Board's plan to expand operations substantially and lost control over the latter's activities. In 2004, a number of mistakes were made in the management of the plant, leading to a loss of EEK 42 million for the financial year 2004/2005. Werol purchased more rape seed than the budget funds allowed, and some of it above the market price. Since the plant was unable to process the excessive stocks of seed itself, it was resold at disadvantageous prices. The loans related to these operations were not repaid in timely manner and the fines for delays led the company to payment difficulties in 2005. Werol did not comply with the rape oil supply contract made with AS Biodiesel, and the parties have failed to come to an agreement on the amount or the payment of the resulting contractual penalty. The Minister of Agriculture has not made an assessment as to the activities of Werol's Supervisory Board in 2004.

Main proposals

To the Government of the Republic

- To designate the Ministry, which is responsible for increasing the share of bio-fuels in transport, co-ordinates the activities of government authorities in this field and, where appropriate, initiates the implementation of further measures. It is necessary to designate the responsible entity, since the Parliament and the Government have set and objective for 2010 which cannot be achieved by market mechanisms alone.

To the Minister of Economic Affairs and Communications

- To commission studies for determining the problems related to introducing bio-fuels (including bio-ethanol) in vehicles in Estonia, and for finding the solutions. The studies should include an analysis of the environmental, economic and social impact of producing (also from imported primary products) and using bio-fuels in Estonia.
-
- To inform the general public of the commissioning and results of such studies. Reliable information on the possible solutions to the technical and financial problems related to the production and introduction of bio-fuels provides the government agencies with a basis for adopting the decisions necessary for increasing the use of bio-fuels.
-
- To take measures to apply the standards necessary for extending the use of bio-fuels in transport and to build the capacities of laboratories certifying bio-fuels. Bio-fuels need to be certified to build the consumers' confidence in the quality of the marketed fuels.
-
- To make proposals to the Government of the Republic as regards the methods of persuading government agencies and persons benefiting from government support for transport to prefer vehicles propelled by bio-fuels and carriers using such fuels. Creating the demand provides an incentive to the suppliers to offer vehicles suitable for using bio-fuels and to the fuel suppliers to market bio-fuels, and, in turn, the demand for bio-fuels is the driving force behind the production and import thereof.

To the Minister of Agriculture

- To consider commissioning to Jõgeva Plant Breeding Institute to breed high-yield winter rape varieties suited for cultivation in the soil and climate conditions of Estonia. The

cultivation of rape is cost-effective only if the rape yield grows considerably and if the crops are harvested earlier.

-
- To decide whether the hold the Members of the Supervisory Board of AS Werol Tehased liable for inadequate supervision of the activities of the company's Management Board which lead to causing serious proprietary damage to the government.

In his response, the **Minister of Economic Affairs and Communications** dealt with the possibilities of establishing standards necessary for using bio-fuels. The Minister did not adopt a position as to the proposal to take measures for persuading government agencies and persons benefiting from government support for transport to prefer vehicles propelled by bio-fuels and carriers using such fuels.

In his response, the **Minister of Agriculture** analysed the problems related to rape cultivation and did not challenge the data or assessments provided by the SAO. The SAO proposals to analyse the advantages and disadvantages of different energetic crops and to determine the most suitable crops are to be taken into account in preparing the "Development Plan for Promoting the Use of Biomass", which is included in the working plan for 2006. What comes to the liability of the Supervisory Board of AS Werol Tehased, the Minister finds that the final position can be adopted once the scope and basis of the responsibilities of the former Chairman of the Management Board of the company have been ascertained.

The SAO is of the opinion that, regardless of whether and to what extent the law enforcement authorities ascertain the guilt of the Chairman of the Management Board of the company as regards causing extensive damage to the company, the Minister can and must express his clear position regarding the Supervisory Board's joint liability for the company's situation as at the end of 2004. The SAO sent the draft audit report for opinion also to the **Minister of Environment** and the **Chairman of the Supervisory Board of AS Werol Tehased**.

The Minister of Environment did not communicate his opinion to the SAO. The Chairman of the Supervisory Board of AS Werol Tehased did not agree to some conclusions made in the report. In his opinion, Werol's Supervisory Board has complied with its diligence obligation concerning the management of the company within the limits foreseen by the law.

The full texts of the responses from the Minister of Agriculture, the Minister of Economic Affairs and Communications and the Chairman of the Supervisory Board of AS Werol Tehased have been annexed to the audit report.

This audit report is also communicated to the Government of the Republic.

Olav Lüüs
Chief Auditor
Audit Department IV