

Reply to questions from Mr Shmatko on the Third package
29 June 2010

Introduction

The present document provides answers to questions related to the provisions of the Third package. The Third package consists of two Directives (Directive 2009/72/EC and Directive 2009/73/EC) and three Regulations (Regulation (EC) No 713/2009, Regulation (EC) No 714/2009 and Regulation (EC) No 715/2009). The Directives must be transposed by EU Member States into their national laws by 3 March 2011. The Regulations apply directly as from 3 March 2011.

It should be noted that in addition to these specific legislative acts, the provisions of the Treaty on the Functioning of the EU ("TFEU") - including the prohibition to enter into anti-competitive agreements or to abuse a dominant position pursuant to Article 101 and 102 TFEU - apply to all energy companies active within the EU¹.

The present document is not legally binding. Giving binding interpretation of EU law is ultimately the role of the European Court of Justice. The present document does not create any new legislative rules. It merely sheds light on DG Energy's current understanding of how certain provisions of the Third package are to be interpreted.

I. Unbundling of vertically integrated undertakings

1. Which EU Member States are considering to apply which models for unbundling of vertically integrated undertakings?

The Directive of the Third package relating to gas (Directive 2009/73/EC, hereafter the Gas Directive) must be transposed into the national laws of the Member States by 3 March 2011. It is too early to tell, at this stage, which EU Member States will apply which models for unbundling of their vertically integrated undertakings. Ownership Unbundling may be the preferred model for some Member States, while the ITO model is being considered by a number of other Member States as well. Based on the information currently at our disposal the ISO model seems to be less in demand. A more complete picture should emerge in the coming months.

2. Should a Member State apply the chosen model to all vertically integrated undertakings on its territory or the model may be chosen individually for each and every undertaking?

Member States can offer different unbundling models to companies located on their territory, subject to the following restrictions:

¹ The application of EU rules on competition is not further discussed in this document.

The ISO and ITO models can only be chosen for a specific TSO if on entry into force of the Directives, 3 September 2009, the transmission system belonged to a vertically integrated undertaking (see Article 9(8) of the Gas Directive)². It is not possible to go from a situation of ownership unbundling to an ISO or an ITO if on entry into force of the Directives the transmission system did not belong to a vertically integrated undertaking. For Member States having several TSOs, only in situations where the transmission system was part of a vertically integrated undertaking on entry into force of the Directives, can the ISO or ITO model be chosen. New transmission systems, in particular systems which did not yet exist on 3 September 2009, will have to follow the ownership unbundling regime.

Furthermore, a Member State cannot prevent a vertically integrated undertaking from complying with the requirements of ownership unbundling. At the same time, where a Member State has opted for ownership unbundling, either in general or as regards a specific TSO, the vertically integrated undertaking does not have the right to set up an ISO or ITO. A Member State having several TSOs is free to opt for several models for different TSOs. However, once a choice has been made for a specific TSO to apply one of the unbundling models - ownership unbundling, ISO or ITO - all the elements of that model have to be complied with.

3. Is the requirement for legal and ownership unbundling set up in Article 9(1) applicable to all new transportation systems built in the EU after September 3, 2009, (i.e., in particular, to those parts of Nord Stream and South Stream that will be built on the territory of the EU)? In particular:

- **Do EU Member States have the right to implement alternative unbundling models (ITO and ISO) in relation to new transportation systems or to the existing transportation systems as of September 2009 only?**
- **Is the requirement for legal and ownership unbundling for new transportation systems applicable from the moment it is transposed into the law of the Member States, deadline for which is 3 March 2011 (Article 54(1)) or from 3 March 2012 (Article 9(1))?**
- **What legal regime is applied to new transportation systems before the requirements in question are transposed into the law of the Member States?**

The Gas Directive of the Third Package applies on the territory of all Member States. Gas pipelines originating from a Third country and entering the territory of a Member State are subject to the rules of the Gas Directive on the territory of this Member State, unless the legal framework is amended by a valid public law agreement (see below).

In relation to new transportation systems which did not yet exist on 3 September 2009, Member States cannot apply the ISO or ITO unbundling model. For these transportation systems the ownership unbundling model will have to be applied.

The rules on unbundling of TSOs must be implemented by Member States by 3 March 2011, and transmission system owners and operators must take all the required steps to fully comply with these rules by 3 March 2012.

² The term "vertically integrated undertaking" is defined in Article 1(21) of the E-Directive and in Article 1(20) of the G-Directive.

Until 3 March 2011 and as long as a Member State has not transposed the Gas Directive of the Third package into national law, the rules on unbundling of Directive 2003/55/EC will apply.

4. Recital 8 envisages that production or supply undertakings should be able to have a minority shareholding in a transmission system operator or transmission system. At the same time Article 9 says that an undertaking performing any of the functions of production or supply may not exercise any right over a transmission system operator or a transmission system. Could the Commission clear up this inconsistency and define the rights (including the definition of the minority shareholding) which an undertaking may exercise over a transmission system operator or over a transmission system. In particular:

- **May an undertaking performing any of the functions of production or supply exercise the rights of a non-controlling shareholder of a transmission system operator?**
- **May an undertaking performing any of the functions of production or supply exercise contract rights in relation to the transportation system, including shipper rights under the transportation agreement?**

Recital 8 of the Gas Directive envisages that production or supply undertakings should be able to have a minority shareholding in a transmission system operator or transmission system. At the same time Article 9 of the Gas Directive says that an undertaking performing any of the functions of production or supply may not exercise any right over a transmission system operator or a transmission system. There is no inconsistency between recital 8 and Article 9, as is explained in the following.

Under the ownership unbundling model of Article 9, an undertaking performing any of the functions of production or supply may not exercise control or any rights over a transmission system operator.

The definition of the term "control" in Article 2(36) of the Gas Directive is taken from Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)³ and should be interpreted accordingly (recital 10 of the Gas Directive). For further guidance in this regard, reference is made to the Commission notices and the guidelines on the Merger Regulation⁴.

The concept of "person" covers private individuals, companies, or any other public or private entities. Typically, the person referred to in Article 9(1)(a) of the Gas Directive will be either the company having the supply or network operation activity or a parent company having subsidiaries acting as suppliers or network operators. Control is acquired by persons or undertakings which:

- (a) are holders of the rights or entitled to rights under the contracts concerned; or*
- (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving there from.*

³ OJ L 24, 29.1.2004, p. 1.

⁴ They are available at:
<http://ec.europa.eu/competition/mergers/legislation/legislation.html>

The concept of "rights" used in Article 9(1)(b) of the Gas Directive is further explained in paragraph 2 of that Article which provides for a non limitative list of these rights. These are, firstly the power to exercise voting rights, secondly the power to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking, and thirdly the holding of a majority share.

The requirements relating to voting rights and appointment of board members imply that the shareholding can only provide financial rights, i.e. the right to receive dividends, but cannot confer any right to take part in the decision making process of the company or exercise any influence on the company. The concept of voting rights refers to any voting rights, no matter how limited, including voting rights which do not amount to control.

It is emphasised that the list of "rights" provided in Article 9(1)(b) of the Gas Directive is not exhaustive. However, it goes without saying that an undertaking performing any of the functions of production or supply may be entitled to exercise shipper rights under a transportation agreement it has concluded with the transmission system operator, provided that these shipper rights are customary, available to all shippers (actual and potential) on the same terms, and do not amount to control, directly or indirectly. This will have to be assessed on a case by case basis.

For completeness sake it is recalled that Article 9(4) of the Gas Directive allows for a derogation until 3 March 2013 from the rules on ownership unbundling in points b) and c) of Article 9(1) of the Gas Directive, provided that transmission system operators are not part of a vertically integrated undertaking.

5. Does Article 9 relate to undertakings residing in one EU-Member State, all EU Member States or regardless of their whereabouts? In particular:

- **May a person controlling an undertaking performing the functions of production of gas in Hungary exercise control over a transmission system operator in Austria (provided that the above person does not exercise control over an Austrian undertaking performing any of the functions of production or supply?)**
- **May a person controlling an undertaking performing the functions of a transmission system operator in Russia exercise control over an undertaking performing the functions of gas supply in France (provided that the above person does not exercise control over a French transmission system operator?)**

The rules on unbundling in Article 9 of the Gas Directive imply that a person performing the functions of production of gas in one Member State cannot exercise control over a transmission system operator in another Member State.

If the transmission system operator or the transmission system is located in a third country, e.g. the Russian Federation, an envisaged taking control by this transmission system operator of an undertaking performing the functions of gas supply in an EU Member State could be compatible with the rules on unbundling of the Gas Directive. However, the circumstances of the individual case need to be taken into account.

Member States are entitled to take safeguard measures pursuant to Article 47 of the Gas Directive to ensure a level playing field, provided that the conditions of this provision are met. Furthermore, in the event of a sudden crisis in the energy market or where the physical

safety or security of persons, apparatus or installations or system integrity is threatened, Member States may temporarily take safeguard measures on the basis of Article 46 of the Gas Directive.

6. Article 9 prohibits exercising control both over an undertaking performing the functions of a transmission system operator and an undertaking performing any of the functions of production or supply. In this respect, what is meant by "an undertaking performing any of the functions of production or supply" and how does it differ from "supply and production activities"?

In particular:

- **May a person supplying gas to Belgium (provided that the above person does not exercise control over any Belgian undertaking performing any of the functions of production or supply) exercise control over a Belgian transmission system operator?**

Under the ownership unbundling model of the Gas Directive, a person supplying gas to a particular Member State is not allowed to take control of a transmission system operator in that Member State. This rule also applies in the event the person supplying the gas is located in another Member State or in a third country and does not exercise control over a company performing any of the functions of production or supply established in the Member State concerned. As a consequence, a person supplying gas to a particular Member State, even if this person does not exercise control over any undertaking performing any of the functions of production or supply in that Member State, is not entitled to exercise control over a transmission system operator in that Member State.

Again, it is recalled that Member States are entitled to take safeguard measures pursuant to Article 47 of the Gas Directive to ensure a level playing field, provided that the conditions of this provision are met. Furthermore, in the event of a sudden crisis in the energy market or where the physical safety or security of persons, apparatus or installations or system integrity is threatened, Member States may temporarily take safeguard measures on the basis of Article 46 of the Gas Directive.

7. May the envisaged Article 36 exemption from unbundling in relation to new infrastructure be requested for new pipelines connecting EU with third countries, taking into account that, literally, they are not falling under the definition of interconnectors?

In particular:

- **May the exemption under Article 36 be requested for a pipeline coming from Russia (not an EU Member State), crossing the territory of Bulgaria and extending to Serbia (not an EU Member-State)?**

The provisions of the Gas Directive, including the obligation to provide third party access, apply to gas pipelines on the territory of Member States. Only in specific circumstances, in particular in case of major new gas infrastructure, including interconnectors, is it possible to obtain a derogation from the provisions of the Gas Directive.

Article 36(1) of the Gas Directive provides for the possibility of requesting a derogation from i.a. unbundling rules, in case of new interconnectors. An interconnector is defined in Article 2(17) of the Gas Directive as a transmission line which crosses or spans a border between

Member States for the sole purpose of connecting the national transmission systems of those Member States. If this definition is not met, the abovementioned procedure of Article 36 cannot be invoked.

Whether a pipeline coming from Russia, crossing the territory of a Member State and extending to a non-EU Member State can qualify as an interconnector, will inter alia depend on whether the non-EU Member State is a Contracting Party to the Energy Community Treaty and has implemented the relevant provisions of Community law correctly and fully. If so, it could be argued that the pipeline crossing the territory of a Member State and extending to a non-EU Member State which is a Contracting Party to the Energy Community Treaty qualifies as an interconnector within the meaning of Article 36 of the Gas Directive, provided that all the relevant conditions are fulfilled. If not, the definition of interconnector does not apply and an exemption cannot be granted for the pipeline. It should be underlined that this issue is legally complex and must be further assessed on the basis of the concrete facts of any case.

8. In order to receive the exemption under Article 36 for a new pipeline crossing the territories of several EU Member States, is it necessary to approach all national regulators in relevant countries? Could the Commission describe an appropriate process of submitting applications in relation to South Stream (Russia – Bulgaria – Serbia – Hungary – Slovenia – Austria (northern line), Russia – Bulgaria – Greece – Italy (southern line)?

In order to obtain an exemption under Article 36 of the Gas Directive for a new pipeline crossing the territories of several EU Member States, it is necessary to approach all national regulators in the Member States concerned. As there may be a need to coordinate efforts of the various national regulators involved with a view to achieving a uniform legal regime for the pipeline, national regulatory authorities may request the newly set up Agency for the Cooperation of Energy Regulators ("the Agency") to exercise the tasks conferred on them. This would ensure a coordinated approach. Reference is made to the relevant rules of procedure established in Article 36 of the Gas Directive.

It is of course conceivable that national regulators coordinate their positions even before the Agency becomes operational while maintaining a close contact with the Commission. The important role of the Commission in this process should be underlined, both before and after the Agency becomes operational.

As long as a non-EU Member State which is a contracting party to the Energy Community has not implemented the Third package provisions, including Article 36 of the Gas Directive, coordination between Member States regulatory authorities and the authorities of the non-EU Member State concerned may face a number of legal and practical difficulties for which appropriate solutions need to be found.

9. Article 36 stipulates that exemption is provided for a defined period of time but neither the minimum nor the maximum period is defined. What does the Commission believe to be an appropriate method of defining said period? In particular:

- **May the unbundling period differ from the third parties access exemption period?**

- Is it possible in principle to receive a third parties access exemption for 100% of capacity of a new pipeline?
- Is it possible to prolong the exemption period due to changes of market conditions (for example, due to high inflation and price rise influencing return on investment period) and include such an option into the decision to grant the exemption?

In order to obtain an exemption on the basis of Article 36 of the Gas Directive, a number of conditions have to be fulfilled. The investment concerning major new gas infrastructure must enhance competition in gas supply and enhance security of supply; the level of risk attached to the investment must be shown to be such that the investment would not take place unless an exemption was granted; the infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built; charges must be levied on users of that infrastructure and the exemption must not be detrimental to competition or the effective functioning of the internal market in natural gas, or the efficient functioning of the regulated system to which the infrastructure is connected.

The duration of the exemption will be determined in view of the criteria mentioned here above. Varying exemption periods for different parts of the exemption (tariff, third party access, unbundling) remain a possibility, but practice so far has shown that exemption periods for the different aspects are the same.

Third party access exemption for 100% of the capacity of a new pipeline is a possibility but various factors make it likely that pipeline access will normally be shared between several users which are independent from each other. Firstly, as a general rule, project promoters are required to test market demand before they can obtain an exemption and should take into account the capacity requests as apparent from the market test. Secondly, the stronger the benefiting parties' market position the more likely there are conditions to the exemption requiring a degree of third party access.

In the case of the Nabucco pipeline, which obtained an exemption, the third party access principle continues to apply to at least 50% of the capacity. In this case, the project promoters have committed to the regular testing of market demand by performing open season procedures, thus making available to third parties additional transportation capacity to meet the effective demand. The project promoters are in principle obliged to take into account all binding capacity requests originating from the Open Seasons provided that the sum of these requests adds up to at least 1 bcm/year.

Including an option in the exemption decision to prolong the duration of the exemption decision in view of changes of market conditions (for example due to changing inflation rates and price fluctuations influencing the return on investment period) has not been accepted in exemption decisions.

10. If an undertaking has already been granted exemption from third party access in accordance with Article 22 of the Second Gas Directive, should it apply for a new exemption in accordance with Article 36 of the third Gas Directive?

Exemptions for new infrastructure which have already been granted pursuant to Article 22 of Directive 2003/55/EC continue to apply until the expiry date foreseen in the exemption decision, also after entry into force of the Gas Directive (see recital 35 of the Gas Directive). Unless provided otherwise in the exemption decisions themselves, such exemptions should not be altered by application of the provisions on new infrastructure provided for in Article 36 of the G-Directive.

11. What happens after the exemption period expires? Should the vertically integrated company upon such an expiry diversify the transportation system in question or decrease its shareholding in the transmission system operator to the required minimum?

After the exemption period related to the unbundling provisions expires, the rules on unbundling will have to be complied with. How this must be done depends on the specific set up that is in place and the unbundling model that is applicable.

12. If a transportation system has received an exemption from the requirement for legal and ownership unbundling, should alternative unbundling models (ITO and ISO) be implemented?

If a major new gas infrastructure has received an exemption from the requirement for legal and ownership unbundling, there is no obligation per se to implement the alternative unbundling models (ITO and ISO). However, in order to meet the requirements of Article 36 of the Gas Directive, notably the requirements related to competition, it may indeed be necessary not only to free the infrastructure concerned from the obligation to implement the ownership unbundling model, but also to require it to make use of the provisions of the ITO or ISO model instead. This will be particularly relevant for new transportation systems which did not exist on 3 September 2009, as for these systems the provisions of the Gas Directive only foresee the application of the ownership unbundling model, and do not allow for the ITO or ISO model.

II. Special rules of certification of transmission system operators controlled by investors from countries outside the EU

1. While evaluating whether certification of the transport system operator puts at risk the security of supply the Directive recommends to take into account, first of all, the rights and obligations of the Community with respect to that Third country; secondly, the rights and obligations of the Member State with respect to that third country arising under agreements concluded with it "insofar as they are in compliance with Community law" and thirdly, "other specific facts and circumstances of the case and the third country concerned". The above criteria are not completely comprehensive and defined, which leaves much room for subjective judgement of law enforcement bodies and negatively affects predictability of their application

In particular:

- **If, as directive can be literally interpreted, the criteria should be applied as a whole (and not separately), what are the consequences of absence of any of them**

(for example, a third country does not have an agreement with the EU, which would give rights to as well as impose obligations on the Community)?

- Why should agreements with third countries be taken into account "insofar as they are in compliance with Community law" (how will the bilateral international agreements signed by a Member State with a third country before entering the EU, which might contain provisions different from EU law, be dealt with?)?
- What is meant by "other specific facts and circumstances" (for instance, do they include energy supply interruptions due to transit problems?)

In order to assess whether granting certification will not put at risk the security of energy supply of the Member State and the EU, the Gas Directive requires several issues to be taken into account, in particular (i) the rights and obligations of the EU with respect to that third country or third countries arising under international law, including an agreement concluded with one or more third countries to which the EU is a party and which addresses the issues of security of energy supply (ii) the rights and obligations of the Member State with respect to that third country arising under agreements concluded with it, insofar as they are in compliance with EU law and (iii) other specific facts and circumstances of the case and the third country or third countries concerned. These issues have to be assessed taken together.

If in a specific case a third country does not have an agreement with the EU, which would give rights to and impose obligations on the EU, the assessment referred to above will logically have to be made on the basis of the other criteria. In this regard an agreement between the EU and the third country concerned would clearly be the best basis allowing to come to the conclusion that granting certification will not put at risk the security of energy supply of the EU.

Agreements of Member States with third countries should be taken into account "insofar as they are in compliance with EU law". This is an expression of the primacy of EU law. In practice, provisions from bilateral international agreements between a Member State and a third country, insofar as they are not compatible with EU law (and cannot be interpreted in an EU compatible manner), should be sought to be amended by the Member State that entered into the agreement in question: reference is made, for instance, to article 351 TFEU which puts Member States under the obligation to take "all appropriate steps to eliminate the incompatibilities established". Reference is also made to Article 4(3) Treaty on European Union. Ultimately, the Member State in question may be under the obligation to denounce the bilateral agreement in question.

"Other specific facts and circumstances" are any facts and circumstances which are relevant for the assessment whether granting certification will not put at risk the security of energy supply of the Member State and the EU. This could for instance be the level of dependence of the EU or an individual Member State on energy supplies from a third country, the factual treatment of both domestic and foreign trade and investment in energy in a particular third country, or the market behaviour of natural gas undertakings controlled by a person or persons from a third country and supplying gas to customers in the EU. These are examples, and do not form an exhaustive list.

The Commission has the possibility to provide further interpretative guidance to the provision of Article 11 of the G-Directive, in particular by means of a Staff Working Paper or by means of Guidelines as mentioned in Article 11(10) of the G-Directive.

2. What are the legal consequences of a refusal of certification of a transmission system operator controlled by investors from countries outside the EU?

National regulatory authorities must ensure compliance of transmission system operators with the provisions on unbundling and certification of the Third package. To do this, national regulatory authorities have the power to impose fines on the company concerned, as well the right to take binding decisions in order to ensure compliance, including i.a. the power to assign all or specific tasks of the transmission system operator in the ITO model to an independent system operator.

III Compliance of provisions of the Third package regarding unbundling and certification with international investments obligations of the EU and its Member States

1. To what extent does the introduction of special requirements for certification of transmission system operators controlled by foreign investors (i.e. requirements that are not imposed on transmission system operators controlled by EU investors) comply with Articles 10(1) and 10(7) of the Energy Charter Treaty, Article 28 of the Partnership and Cooperation Agreement between Russia, the EU and its Member States, as well as bilateral investment agreements between the EU Member States and third countries?

The certification requirements of the Gas Directive which are applicable to transmission system operators controlled by foreign investors are in compliance with the Energy Charter Treaty and with the Partnership and Cooperation Agreement between Russia, the EU and its Member States. As far as any bilateral investment agreements between EU Member States and third countries are concerned, reference is made to the reply under point II.1. above.

2. To what extent does the introduction of retroactive requirements for unbundling of vertically integrated undertakings, which make investors partially or completely cede control over gas transmission systems, comply with international investment obligations of the EU and its Member States towards undertakings controlled by foreign investors? In particular:

- May requirements for unbundling be interpreted as having the same effect as expropriation, entailing the necessity of a prompt, adequate and effective compensation to the investor?***

Requirements for unbundling do not have the same effect as expropriation. As these requirements do not have the same effect as expropriation, there is no foundation on which to raise the issue of compensation.