

Opinion 2/22

pursuant to Article 3(1) of Regulation (EC) No. 715/2009 and Article 10(6) of Directive 2009/73/EC – Georgia – Certification of GGTC

On 25 May 2022, the Georgian National Energy and Water Supply Regulatory Commission (hereinafter “GNERC”) notified the Energy Community Secretariat (hereinafter “the Secretariat”) of a preliminary decision on the certification of the transmission system operator (hereinafter “TSO”) *LLC Georgian Gas Transportation Company* (hereinafter “GGTC”) as an independent system operator (hereinafter “ISO”). The Preliminary Decision was adopted on 28 April 2022,¹ based on Article 50 of the Energy Law,² as well as the Certification Rules adopted by GNERC.³

Pursuant to Article 10 of Directive 2009/73/EC⁴ (hereinafter “the Gas Directive”) and Article 3 of Regulation (EC) No. 715/2009⁵ (hereinafter “the Gas Regulation”), the Secretariat is required to examine the notified Preliminary Decision and deliver its opinion to GNERC as to the compatibility of such a decision with Articles 9(8) and 14 of the Gas Directive (hereinafter “the Opinion”).

I. Background

1. The previous certification procedure

On 10 June 2021, GGTC submitted an application for certification as TSO under the ISO unbundling model to GNERC. On 2 September 2021, GNERC adopted a preliminary decision.⁶ On 10 November 2021, the Secretariat issued an opinion on that preliminary decision (hereinafter “Opinion 3/21”), concluding that GGTC was not unbundled in line with the ISO unbundling model as required by Article 14 of the Gas Directive.⁷ Most notably, GGTC was still directly and indirectly controlled by the same public body controlling also the public companies active in generation and/or supply of natural gas or electricity, and the lack of lease agreement with the Transmission Network Owner (hereinafter “TNO”) precluded GGTC from having at its disposal the necessary technical and physical resources to perform the tasks of a TSO. Finally, independence of the TNO from *LLC Georgian Oil and Gas Corporation* (hereinafter “GOGC”) was not fully ensured due to the lack of compliance programme. On 11 November 2021, GNERC adopted a final decision on the certification of GGTC (hereinafter “Final Decision of 11 November 2021”).⁸ In the Final Decision of 11 November 2021, GNERC took into account the Secretariat’s Opinion 3/21 and refused

¹ GNERC Decision No. 18/1, adopted on 28 April 2022.

² Law of Georgia on Energy and Water Supply of 27 December 2019, No. 5646-rs, as amended.

³ GNERC, Certification Rules, Resolution No. 9 of 27.03.2020.

⁴ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, as incorporated and adapted by Decision 2011/02/MC-EnC of the Ministerial Council of the Energy Community of 6 October 2011.

⁵ Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, as incorporated and adapted by Decision 2011/02/MC-EnC of the Ministerial Council of the Energy Community of 6 October 2011.

⁶ GNERC, Decision No. 38/2, 2 September 2021.

⁷ Secretariat’s Opinion 3/21 of 10 November 2021, GGTC.

⁸ GNERC Decision No. 48/4, adopted on 11 November 2021.

certification of *GGTC*.

On 4 February 2022, *GGTC* re-submitted an application for certification to GNERC. On 28 April 2022, GNERC adopted a Preliminary Decision rejecting the certification of *GGTC*. This new Preliminary Decision was submitted to the Secretariat and is subject to the present Opinion.

2. The applicant *GGTC*

GGTC is a limited liability company established under Georgian law. It transports natural gas on the territory of Georgia on the basis of the only license issued in Georgia for that purpose.⁹

GGTC was established in December 1999 as the subsidiary of the predecessor of *GOGC*. *GOGC* is active in the production, supply and trade of natural gas as well as generation of electricity through its subsidiaries *LLC Gardabani Thermal Power Plant* and *LLC Gardabani Thermal Power Plant 2*.

The shares of *GOGC* are owned by the *JSC Partnership Fund*, established and controlled by the Government, while the rights and obligations associated with the shareholding are exercised by the Ministry of Economy and Sustainable Development of Georgia (hereinafter “the Ministry”).

In 2011, the shares in *GGTC* were transferred from *GOGC* to direct ownership of the State, exercised by the Ministry. Based on an agreement concluded in 2019, the National Agency of State Property (hereinafter “State Property Agency”), an agency subordinated to the Ministry, transferred management rights to the Ministry.

GGTC does not legally own the physical assets used for the transmission of gas (in particular pipelines and (two currently inactive) compressor stations). They are owned by *GOGC*. On 29 April 2021, *GOGC* founded *LLC Georgian Natural Gas Transmission Owner* (hereinafter “TNO”) and transferred ownership over the transmission system assets to it. The 2011 lease agreement regarding the rent of the main gas pipelines and related infrastructure between *GGTC* and *GOGC* expired on 1 January 2022; a new lease agreement was concluded between *GGTC* and *TNO* on 3 February 2022 and approved by GNERC.

3. State activities in generation and supply of electricity

In addition to *GGTC* and *GOGC*, the State also fully owns the shares in undertakings active in the electricity sector. Those undertakings are: the generation company *Enguri HPP* (which in turn owns the shares of *Vardini HPP Cascade*), the wholesale trading and supply company *Electricity System Commercial Operator*, the electricity TSO *JSC Georgian State Electrosystem* and the wholesale trading company *Karchal Energy* (registered in Turkey). Furthermore, it owns 50% of the shares in the electricity TNO *Sakrusenergo* (with the remaining 50% being owned by the *Federal Grid of the United Energy System JSC* registered in the Russian Federation), and the *JSC Georgian Energy Development Fund*, which is active in renewable energy project development. The shares in all these companies are formally held by the National Agency for State Property.

⁹ License No. 004, series 22, issued by Decision N10/2 of GNERC dated 9 June 2004, the validity was extended for an unlimited duration by Decision N21/1 of GNERC dated 10 December 2009.

II. Description of the notified Preliminary Decision

In the Preliminary Decision, GNERC comes to the conclusion that *GGTC* cannot be certified and refuses the preliminary certification of *GGTC*.

The operative part of the Preliminary Decision requires *GGTC* to take all measures necessary to comply with the requirements for unbundling and in particular, it requires the managing rights for the energy undertakings to be reallocated in order to separate the control over the TSO from the control over the electricity and gas generation and supply companies by 1 July 2022. *GGTC* is also required to send a list of documents to GNERC by 8 July 2022 as a proof of the completed unbundling.

III. Assessment of the Preliminary Decision

1. The ISO model of unbundling

The Secretariat recalls that the unbundling provisions were designed to separate, in vertically integrated undertakings,¹⁰ control over transmission system operation as a natural monopoly, on the one hand, and over production and supply activities as competitive activities, on the other hand. The purpose of unbundling is to eliminate actual and potential conflicts of interest between transmission and other activities performed by vertically integrated undertakings.¹¹ In particular, the rules on unbundling thus aim to prevent vertically integrated undertakings from using their privileged position as operators of a transmission network by obstructing access of network users other than their affiliated companies to their network or other conduct affecting fair and undistorted competition, market integration or infrastructure investment.

Against this background, the ISO model enshrined in Articles 14 and 15 of the Gas Directive envisages that the transmission network is not managed by the vertically integrated undertaking, including any of its subsidiaries, but by an operator which is fully independent from supply and production interests in the vertically integrated undertaking and at the same time effectively performs all TSO functions required by the Gas Directive and the Gas Regulation, most notably operation, development and maintenance of the system. As a precondition, it must be ensured that the ISO has the necessary powers and resources to operate the system independently from the vertically integrated undertaking.

In particular, an ISO may only be certified by a national regulatory authority if it fulfils all requirements listed in Article 14(2) of the Gas Directive. Only under these conditions may the VIU still retain the ownership of the network. As system owner, the vertically integrated undertaking's activities must be limited to enabling the ISO to carry out its tasks by fulfilling the obligations laid down in Article 14(5) of the Gas Directive.¹² Article 15 of the Gas Directive further requires legal and functional unbundling of the TNO from the other activities of the vertically integrated undertaking.

¹⁰ A VIU is defined in Article 2(20) of the Gas Directive as "a natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas".

¹¹ Secretariat Opinions 1/16 of 3 February 2016, *TAP AG*; 1/17 of 23 January 2017, *OST*.

¹² See Commission's Opinion on certification of *Trans Austria Gasleitung GmbH*, C(2013) 649, 04.02.2013.

In the conditions of the present case, where the separation is to take place between different public bodies pertaining to the same administrative entity, the Government of Georgia, these criteria do not only apply to the relations between the ISO (*GGTC*) and the vertically integrated undertaking (*GOGC*) but also to and between different bodies within the Government as the framework within both the ISO and the system owner (continue to) operate.

2. Separation of control

Article 14(2)(a) of the Gas Directive determines that an ISO may be designated only where it complies with Articles 9(1)(b), (c) and (d). These provisions aim at establishing the independence of the system operator by separating the exercise of control over or any rights in production and supply activities, on the one hand, and transmission activities on the other hand. The term 'control' is defined in Article 2(36) of the Gas Directive as "*any rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by: (a) ownership or the right to use all or part of the assets of an undertaking; (b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking.*"¹³ The rights include in particular the power to exercise voting rights, the holding of a majority share and the right to act as, as well as the power to appoint members of the TSO's corporate bodies and those legally representing the TSO (Article 9(2) of the Gas Directive). This applies across activities in the gas sector as well as in the electricity sector, thereby prohibiting joint influence over an electricity generator or supplier and a natural gas TSO, or a natural gas producer or supplier and an electricity TSO¹⁴ (Article 9(3) of the Gas Directive).

The rules on unbundling apply equally to private and public entities. For the purpose of the rules on ownership unbundling, Article 9(6) of the Gas Directive provides that two separate public bodies shall be deemed not to be the same person(s) within the meaning of Article 9(1) of the Gas Directive, and may therefore exercise control over a TSO, on the one hand, and over undertakings performing any of the functions of generation or supply, on the other hand. The objective of these provisions is to ensure an effective separation of control between the two public bodies in question capable of potential and actual conflicts of interest within the State structures controlling different energy activities.¹⁵

As described above, *GGTC*'s shares are owned by the State, represented by the National Agency of State Property, which in turn is controlled by the Ministry. Moreover, the Ministry directly exercises the rights and obligations of the shareholder within *GGTC*'s governance structures. This amounts to full and unfettered control over the TSO within the meaning of Article 2(36) of the Gas Directive. At the same time, *GOGC*'s shares are owned by the *Partnership Fund* which is turn is controlled by the Ministry, thereby conferring to the Ministry control over *GOGC* as well. *GOGC* is active in gas production and supply, as well as in electricity generation. The Ministry also controls other significant electricity generation facilities, namely the hydropower generators *Enguri HPP* and *Vardanili Cascade HPP*, as well as the wholesale and retail supplier *Electricity System Commercial Operator* and the trading company *Karchal Energy*. Therefore, control over *GGTC* as well as other undertakings active in generation and/or supply of electricity or natural gas listed above is exercised

¹³ This definition is taken from the Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings and should be interpreted accordingly (recital 10 of the Gas Directive).

¹⁴ Commission Opinion on certification of *Elering AS*, C(2016) 8255, 02.12.2016.

¹⁵ Secretariat Opinion 1/17 of 23 January 2017, OST.

by the Ministry by way of majority shareholding. The Ministerial Order of 2 December 2020 provided for different departments within the Ministry to exercise the rights and obligations associated with shareholding in the TSO, on the one hand, and in the other undertakings active in generation and/or supply of electricity or natural gas, on the other hand.¹⁶ However, the Order expired on 31 December 2021. No measures have been adopted for ensuring that two truly separate public bodies exercise control over the TSO, on the one hand, and over the electricity or gas generation and/or supply undertakings, on the other hand. The Ministry remains the public body exercising full and unfettered control over the TSO as well as over the undertakings active in electricity or gas generation and/or supply.

It follows that the Ministry – and hence the same public body within the meaning of Article 9(6) of the Gas Directive – exercises control within the meaning of Article 9(1)(b) and (c) of the Gas Directive over the gas transmission system operator *GGTC* as well as a number of undertakings active in production/trade/supply of gas and electricity. Therefore, the status of *GGTC* does not comply with Article 14(2)(a) of the Gas Directive, and cannot be certified as an ISO.

In the Preliminary Decision, GNERC therefore concluded that *GGTC* fails to comply with the requirements on independence and unbundling.

The Secretariat agrees that separation of control within the State in line with Article 9(6) read in conjunction with Article 9(1)(b) and (c) of the Gas Directive has not taken place even in its most basic requirement: the designation of two public bodies. The formal separation of competences between public bodies constitutes a *sine qua non* for unbundling of a state-owned TSO.¹⁷ In similar cases, the Secretariat has held that a TSO cannot be certified as compliant with the Third Package.¹⁸ Without any separation in control over *GGTC* and the other companies active in generation and/or supply of electricity or gas, one of the main objectives of the Gas Directive's unbundling provisions, the elimination of an interest by the body in charge of the TSO in discriminating in favour of generation and supply companies controlled by it, is likely to be frustrated.

The Secretariat therefore agrees with GNERC's assessment and conclusions that *GGTC* does not comply with the requirement of separation of control under Article 9(1)(b),(c),(d),(2),(3),(6),(7) and (12) of the Gas Directive.

IV. Conclusion

Based on the information displayed in the Preliminary Decision, the Secretariat concludes that *GGTC* does not comply with the unbundling provisions due to the State as sole shareholder also controlling companies active in production/supply in the gas/electricity sectors. Most notably, *GGTC* is still directly and indirectly controlled by the same public body controlling also the public companies active in generation and/or supply of natural gas or electricity.

¹⁶ Minister's Order N1-1/521 on "Establishing a Different Rule for Assigning and Reallocation of the Functions among the Divisions of the Ministry of Economy and Sustainable Development of Georgia", 02.12.2020.

¹⁷ Secretariat Opinion 1/17 of 23 January 2017, *OST*.

¹⁸ Secretariat Opinions 3/17 of 15 June 2017 *EMS*; 6/19 of 11 October 2019, *Moldelectrica*; 1/20 of 5 February 2020, *Ukrenergo*.

Against this background, the Secretariat agrees with the Preliminary Decision of GNERC and suggest that GNERC in its final decision refuses certification of *GGTC* under the current circumstances.

The Secretariat welcomes the requirement included in GNERC's Preliminary Decision for *GGTC* to comply with the unbundling requirements by 1 July 2022 and to submit to GNERC all documents required to prove compliance by 8 July 2022. It recalls that the operation of a gas network by a TSO which is not unbundled and certified amounts to a breach of Energy Community law by the Republic of Georgia on which the Secretariat would need to follow up.

Pursuant to Article 3 of the Gas Regulation, GNERC shall take the utmost account of the above comments of the Secretariat when taking its final decision regarding the certification of *GGTC*. GNERC shall also communicate its final decision to the Secretariat and publish its decision together with the Secretariat's Opinion.

The Secretariat will publish this Opinion on its website. The Secretariat does not consider the information contained therein to be confidential. GNERC is invited to inform the Secretariat within five working days following receipt of this opinion whether and why it considers that this document contains confidential information which it wishes to have deleted prior to such publication.

Vienna, 24 June 2022



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