

**ENERGY COMMUNITY SECRETARIAT
PROPOSED TREATY CHANGES
FOR THE MINISTERIAL COUNCIL ON 14 OCTOBER 2016**

I. Introduction

Following the submission of the report by the High Level Reflection Group chaired by Jerzy Buzek, public consultation and further analytical work carried out by the Secretariat and the European Commission, the Ministerial Council in October 2015 embarked on a process of reforming the Energy Community. The main objective of this reform is to adapt the Energy Community to the new challenges faced by European and international energy policy, and to ensure that the Community can deliver successfully on its promise to reform the Parties' energy sectors in line with European law. At the meeting in 2015, the Ministerial Council adopted procedural rules related to its own procedures, the better involvement of the civil society, improved dispute settlement and the introduction of Parliamentary Plenum meetings. At the same time, the Ministerial Council adopted a General Policy Guideline whereby it committed to discussing further reform proposals during 2016 and 2017.

The experience made during 2015 clearly shows that reforming the Energy Community through secondary legislation reached its limits and that a few key upgrades need to be introduced through Treaty changes. The following list contains the Secretariat's proposals with some explanatory notes. It needs to be emphasized that amending the Treaty is common in the Energy Community's legal practice and has happened regularly over the last years. In its proposal, the Secretariat made sure that the proposed changes remains within the confinements of Article 100 of the Treaty (i.e. concerning only Titles I to IV) and thus do not trigger ratification by the Parties. Upon consultation with the European Commission, the Secretariat also made sure that the Treaty changes do not lead to the creation of new institutions but, where necessary, only to giving existing bodies a basis in the Treaty.

II. Proposed amendments based on Article 100 EnC

1. Revision of Article 13

Wording

“The Parties recognize the importance of the Kyoto Protocol and the Paris Agreement. The Energy Community shall implement them in line with the European Union’s policy.”

Explanation

Following the Paris Agreement concluded at the COP21 in December 2015, international climate policy for the period after 2020 has been defined. Unlike under the Kyoto Protocol, the Contracting Parties participate on the same level as the European Union and its Member States. In the run-up to the COP21 as well as in bilateral agreements with the European Union, the Contracting Parties

committed to follow the Union's policy related to climate change, and submitted individual INDCs to the UNFCCC Secretariat.

In the context of the Energy Community, however, there is at the moment a considerable gap between the *acquis* related to climate change applicable in the European Union and the commitments made by the Contracting Parties. This poses risks to homogeneity in the pan-European energy sectors (production, supply, consumption), the greatest contributors to climate change. The actual Article 13 of the Treaty never gained practical relevance. This is not in line with the general European and global development of regarding energy and climate policy as being inseparably linked.

While the Secretariat does not propose to incorporate new substantial pieces of *acquis* at this point (with the exemption of the so-called MMR Regulation proposed by the European Commission), it suggests to update the Treaty in line with the international and European developments. This is of particular importance at a moment when the European Union starts to reflect about its post-2020 climate change *acquis*.

This proposal takes into account comments by the Contracting Parties and by the European Commission by deleting the reference to EU legislation which may have been seen as prejudging the necessary decisions by the Ministerial Council under Article 25 of the Treaty.

2. New paragraph in Article 18

Wording

“(3) The competent authorities of the Contracting Parties shall inform the Secretariat of all systems of aid existing in the Contracting Parties as well as of any notification received of plans to grant new aid and any decisions taken.”

Explanation

The High Level Reflection Group's report, the Analytical Paper as well as all other assessments concur in the view that application of the *acquis* related to competition and State aid in the energy sectors is non-functional in the Energy Community. It is equally clear that the energy markets in the Contracting Parties are seriously distorted due to extensive subsidization schemes. The main problem with State aid law enforcement in the Energy Community is the lack of a central authority monitoring the granting of State aid as well as the lack of transparency associated with it.

The Secretariat's proposal to mitigate this situation is conservative in the sense that it does not suggest to grant the Secretariat executive enforcement powers. Instead, and after having taken into account the comments by the European Commission as well as Contracting Parties, the Secretariat changed its original proposal based on the procedures applied in the context of the Third Package to a mere information duty for competent authorities about existing aid, new aid notified to them as well as the subsequent decisions taken. This change does not only exclude any (quasi-)decision-making powers for the Secretariat but also any duty for national authorities to take the Secretariat's opinion into account, including the implicit stand-still obligation (as originally envisaged). Their competences will thus not be affected by the proposed provision. The proposal also does not create any frictions with the bilateral agreements many Contracting Parties already concluded with the European Union (SAA and AA). In any event, Article 103 of the Treaty clarifies that “any obligations under an agreement between the European Community and its Member

States on the one hand, and a Contracting Party on the other hand shall not be affected by this Treaty.” The Secretariat further recalls that publication of State aid decisions by national authorities in national media does not increase effectiveness and transparency of the rules in place, as the main problem is and remains the lack of any such decisions, at least in the energy sectors.

3. A new Article after current Article 41

Wording

“1. To the extent affecting Network Energy within the Energy Community, restrictions on the free movement of capital shall be prohibited between the Parties.

2. The provisions of this Article and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health.”

Explanation

This proposal comes back to the Secretariat’s proposal during 2015 to complement the free movement of goods in the Treaty by the other fundamental freedoms under the EU Treaty. The High Level Reflection Group’s Report and the Analytical Paper provide ample explanation of the problems the lack of those freedoms create, as well as a justification for such a proposal. These reasons are still valid. Fundamental freedoms support market participants from all Parties and thus boost further pan-European market integration. The original proposals envisaging the introduction of the free movement of capital, freedom of establishment as well as services (with an appropriate safeguard clause to control the free movement of persons) have been supported by the Contracting Parties. The Secretariat’s updated proposal, however, anticipates and takes into account concerns expressed inside the European Union.

4. A new Article after current Article 42”

Wording

“Article xx

The Energy Community shall aim at creating equal conditions in the relations between authorities, market participants and infrastructure projects of Member States of the European Union and of the Contracting Parties in accordance with Article 7. For this purpose, the Ministerial Council may adopt a Decision based on Article 42.”

Explanation

1. The regime applicable to energy flows, infrastructure and cross-border cooperation on the interface between EU Member States and Contracting Parties has long been an issue of concern and may be considered the biggest obstacles to pan-European energy market integration. The reason for the regulatory gap on these borders is that, on the one hand, adaptations made under Title II of the Treaty (Article 24) only extends the *acquis communautaire* to Contracting Parties’ part of the interface and not the Member States’ and that, on the other hand, the Treaty requires non-

discriminatory treatment in terms of rights and obligations also on this interface. The alternative option, extending *acquis* to the Energy Community under Titles III or IV of the Treaty, turned out to be barred on account of the European Union's Decision 500/2006. Past attempts to tackle this problem through an Interpretation under Article 94 of the Treaty also proved to be ineffective.

Finding a solution for this problem is of importance and urgency for both existing and future *acquis* (such as network codes). The Secretariat considers the introduction of a general reciprocity clause in the Treaty as most suitable for ensuring legal certainty and non-discrimination. In the alternative, the Secretariat fully supports the so-called "switch-on clause" recently proposed by the European Commission for the new Regulation on Security of Gas Supply which eventually could become a general principle under the Treaty. Contracting Parties' reactions to the original proposal by the Secretariat support this approach.

Given that the important discussion on reciprocity inside the European Union has just started and may very well yield tangible results, the Secretariat at this point in time refrains from proposing changes to the Treaty with legally binding effect. With existing Articles 7 and 42 of the Treaty as well as the new clause suggested, the Ministerial Council has at its disposal all necessary legal instruments to decide about how to ensure reciprocity best at its meeting in 2017.

2. The originally proposed changes related to expanding the competences of ACER to the territories of the Contracting Parties have been withdrawn following comments by the European Commission and Contracting Parties. These comments essentially point out (1) that amendments to the Treaty in this area require changes to Regulation No. 713/2009 which is currently under revision inside the European Union and (2) that addressing the regulatory gap is ancillary to the greater challenge of addressing the lack of reciprocity. These proposals could be discussed again in the context of the Decision to be adopted under Article 42 of the Treaty.

5. In Article 63, the word "Two" is deleted.

Explanation

The limitation to two Fora (gas and electricity) does not correspond to the reality any longer.

6. In Article 66, a new sentence is added:

Wording

"The Security of Supply and Infrastructure Development Forum shall meet in Kyiv."

Explanation

This change to the Treaty is proposed by Ukraine.

7. A new paragraph 4 in Article 76

Wording

"A Decision incorporating a Regulation adopted by the European Union shall be binding in its entirety and directly applicable in all Contracting Parties it addresses."

Explanation

The existing Treaty contains a major difference in terms of the effect of *acquis communautaire* between the European Union on the one hand and the legal orders of the Contracting Parties on the other, namely the lack of direct effect of Regulations in the latter. This deficiency creates major problems in the implementation of *acquis*. As long as Regulations did not yet play a central role in European energy legislation and, where they existed, were of rather general and limited scope, the lack of direct effect could still be tolerated. With Third Package, however, Regulations became a major tool of European energy legislation, for instance in the area of security of supply and most importantly, network codes. Given their dense and detailed content, any transposition by Contracting Parties in their national legal order risks destroying their systematic consistency and thus endangers the goals they pursue. Transposition also entails major delays.

The Secretariat believes that giving direct effect to Regulations also in the Energy Community is the only way to make network codes equally effective for Contracting Parties and ensure homogeneity in the pan-European market. It notes that the proposed Treaty change will not pose problems for the legal order of Contracting Parties which generally follow a monist approach to international law already.

In its revised proposal, the Secretariat took into account comments from Ukraine. At the same time it notes that the binding nature of decisions taken by the Ministerial Council follows already from existing Article 76 of the Treaty. It does not require consensus within the decision-making institutions, as Articles 81 and 83 of the Treaty show. In fact, the proposed changes would only set aside the requirement of transposition for (incorporated) EU Regulations, not the requirement to implement them by the competent national authorities and market players. Changes to Articles 89 and 90 of the Treaty are thus not necessary.

The Secretariat would also like to clarify that despite the direct effect of the Decision incorporating an EU Regulation, this decision can still determine its entry into force, thus setting an implementation deadline in the same way this has been done until now. The same goes for potential adaptations under Article 24 of the Treaty which remain possible and necessary.

8. A new paragraph 3 in Article 91

Wording

“The Ministerial Council shall set out the reasons for its decisions in writing.”

Explanation

The reform of the dispute settlement procedure last year resulted in an amended Procedural Act on Dispute Settlement Procedures, which among others, strengthened the role of the Advisory Committee as the body counter-balancing, to some extent, the discretionary political decision-making in the Ministerial Council with neutral legal expertise. Any more far-reaching reforms of the decision-making at the Ministerial Council in enforcement cases had to be postponed on account of a lack of basis in the Treaty. The amended Procedural Act in its Article 47 requires a review of the system already in 2016.

Following discussions with the European Commission which pointed to the legal challenges inside the EU of any changes to the institutional provisions of the Treaty by establishing the Advisory Committee as a body or an institution of the Treaty, the Secretariat withdrew this proposal and amended it based also on comments by the Contracting Parties.

The present proposal does thus not affect the institutional dimension of the Treaty any more but is limited to one additional element increasing the legitimacy, transparency and ultimately acceptance of the Ministerial Council's decision-making in enforcement cases, the requirement to motivate any decision taken.

9. A new Article before current Article 92

Wording

"1. Contracting Parties shall be required to take the necessary measures to comply with the decision of the Ministerial Council.

2. If a Party, the Secretariat or the Regulatory Board considers that the Contracting Party concerned has not taken the necessary measures to comply with the decision of the Ministerial Council, it may bring the case before the Ministerial Council after giving that Contracting Party the opportunity to submit its observations. It shall specify the amount of the lump sum or penalty payment to be paid by the Contracting Party concerned which it considers appropriate in the circumstances.

The calculation of the penalty payment shall take account of the seriousness of the infringement, having regard to the importance of the rules breached and the impact of the infringement on general and particular interests, its duration and the Contracting Party's ability to pay, with a view to ensuring that the penalty itself has a deterrent effect. The Permanent High Level Group shall adopt a Procedural Act establishing the method as well as the macroeconomic data used for the calculation of lump sums or penalty payments.

If the Ministerial Council finds that the Contracting Party concerned has not complied with its decision it may impose a lump sum or penalty payment on it. The Ministerial Council shall decide in accordance with Article 91(1).

3. When a Party, the Secretariat or the Regulatory Board brings a case before the Ministerial Council on the grounds that the Contracting Party concerned has failed to fulfil its obligation to notify transposition of Measures, it may, when it deems appropriate, specify the amount of the lump sum or penalty payment to be paid by the Contracting Party concerned which it considers appropriate in the circumstances.

If the Ministerial Council finds that there is an infringement it may impose a lump sum or penalty payment on the Contracting Party concerned not exceeding the amount specified by a Party, the Secretariat or the Regulatory Board. The payment obligation shall take effect on the date set by the Ministerial Council in its decision.

4. Any proceeds from lump sums or penalty payments shall be used to support Projects of Energy Community Interest and Projects of Mutual Interest in accordance with a Procedural Act to be adopted by the Ministerial Council.

Explanation

The High Level Reflection Group as well as the European Commission's analytical paper concluded that the current political approach to sanctions does not satisfy the standards of an Energy Community based on the rule of law. The sanction regime lies at the heart of the weakness of the Energy Community's enforcement system. This conclusion has been confirmed by recent experience: A Contracting Party which does not rectify a breach declared by the Ministerial Council cannot be held accountable other through a highly politicized procedure of symbolic nature rather than being effective and deterrent, and depending on unanimity. The lack of a routine similar to

Article 260 TFEU negatively affects implementation by Contracting Parties, it paralyzes Ministerial Council meetings by blending the legal with the political and it creates unequal enforcement standards privileging Contracting Parties over EU Member States. For these reasons, the Ministerial Council, in its General Policy Guidelines of 2015 as well as in the amended Procedural Act on Dispute Settlement, requested proposals for an improved sanction regime.

The Secretariat considers that Article 260 TFEU should indeed be the yardstick for enforcement measures also for Contracting Parties and proposes to incorporate this clause in the Treaty for any “normal” non-compliances identified by the Ministerial Council. For all “qualified” (i.e, serious and persistent) breaches by a Parties to the Treaty, Article 92 could be kept in its existing form. It is to be expected that a functioning regime for “normal” cases will make resorting to Article 92 a rare exemption rather than the default procedure it is now in the absence of any alternatives.

The calculation of penalties under Article 260 TFEU, the model for the Secretariat’s proposal, is based on transparent mathematical formulas consisting of objectively defined elements, it could be easily transposed also to the Energy Community. As the sanction regime in the EU takes into account the capacity to pay of the state concerned, the relative low GDP in Contracting Parties would become a relevant factor in the formula. The revenues from penalties paid by individual Contracting Parties could be used e.g. for decreasing all Parties’ budget contributions accordingly. It could also feed special funds for dedicated purposes, such as environmental, energy efficiency, infrastructure investments etc.

The Secretariat took into account comments by Contracting Parties when amending its proposals in three key aspects, namely (1) aligning the wording of this proposal with the wording of Article 90 of the Treaty and broadening the range of initiators beyond the Secretariat only, (2) ensure that the methodology and macroeconomic data used for the calculation of penalties and lump sums are established by the Permanent High Level Group and thus be binding on the Secretariat or any other initiator, and (3) to earmark any revenue obtained under this new Article for the promotion of infrastructure in the Energy Community.

Done in Sarajevo, on 14 October 2016

For the Ministerial Council

.....
Presidency