

## Opinion 4/19

pursuant to Article 3(1) of Regulation (EC) No 715/2009 and Articles 10(6) and 11(6) of Directive 2009/73/EC – Ukraine – Certification of *GTSO*

On 22 November 2019, the National Commission for State Regulation of Energy and Public Utilities of Ukraine (hereinafter “NEURC”) notified the Energy Community Secretariat (hereinafter “the Secretariat”) of a preliminary decision (hereinafter “the Preliminary Decision”) on the certification of the transmission system operator (hereinafter “TSO”) *Gas Transmission System Operator of Ukraine LLC* (hereinafter “*GTSO*”) as an independent system operator (hereinafter “ISO”). The Preliminary Decision was adopted on the same date and based on Articles 24 and 27 to 29 of the Law on Gas Market of Ukraine of 2015, as well as on NEURC’s Procedure on Certification of the Gas Transmission System Operator of 2016.

Pursuant to Articles 10 and 11 of Directive 2009/73/EC<sup>1</sup> (hereinafter “the Gas Directive”) and Article 3 of Regulation (EC) No. 715/2009<sup>2</sup> (hereinafter “the Gas Regulation”), the Secretariat is required to examine the notified Preliminary Decision and deliver its opinion to NEURC as to the compatibility of such a decision with Articles 9(8), 11 and 14 of the Gas Directive (hereinafter “the Opinion”).

### I. Background and framework for unbundling

As described in the Preliminary Decision, *GTSO* was established on 5 February 2019 as a subsidiary of the joint stock company *Ukrtransgaz*. As a limited liability company, *GTSO* operates under the Law on Limited and Additional Liability Companies and its own company statutes. The current statutes date from 4 February 2019. They were adopted by the sole shareholder, *Ukrtransgaz*, which has also appointed the current director of *GTSO*.

*Ukrtransgaz* currently exercises the functions of the (only) TSO for gas in Ukraine, and operates the gas storage sites in the country. *Ukrtransgaz* is a 100% subsidiary of the vertically integrated gas undertaking *Naftogaz of Ukraine* (hereinafter “*Naftogaz*”). Besides transmission and storage, *Naftogaz* and its (other) subsidiaries are also active in the production and supply of natural gas, as well as in electricity generation and supply. As sole member of *Ukrtransgaz*’ general shareholders’ meeting, *Naftogaz* decides on any matter, except those falling under the exclusive competence of the supervisory board by law or by statute. *Ukrtransgaz*’ statutes do not envisage a supervisory board.

*Naftogaz* is a joint stock company with the Ukrainian state as the only shareholder. The shareholders’ rights in *Naftogaz* are exercised by the Cabinet of Ministers, the government of Ukraine, under the Law on Management of State Property Objects and *Naftogaz*’ statutes. As sole member of the company’s general shareholders’ meeting, the Cabinet of Ministers exclusively determines the main

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<sup>1</sup> 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.

<sup>2</sup> 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.

directions of the company's business, adopts of the company's strategy and mission, appoints the members of the supervisory board as well as the members and chairperson of the executive board.

According to the information provided in the Preliminary Decision, the Cabinet of Ministers also exercises the state's shareholders' rights in other undertakings also active in the energy sector, namely *Ukrzaliznytsia*, the Ukrainian railways company supplying electricity via a subsidiary, and *Ukroboronprom*, the state-owned defence conglomerate, which also is engaged in the supply of electricity via subsidiaries.

Besides the Cabinet of Ministers, individual ministries have also been mandated to exercise the state's shareholding rights in public energy companies. According to the information provided in the Preliminary Decision, this includes the Ministry of Economic Development, Trade and Agriculture, the Ministry of Infrastructure and the State Property Fund of Ukraine. Most notably, the Ministry of Energy and Environmental Protection (formerly: the Ministry of Energy and Coal Industry) exercises such rights over the state-owned electricity generators *Energoatom* (nuclear power) and *Ukrhydroenergo* (hydro power).

With a view to unbundle the transmission system in Ukraine in line with the Gas Directive and the Law on Gas Market, the state-owned joint stock company *Mahistralni Gazoprovody Ukrainy* (hereinafter "*MGU*") was created. Originally, under Cabinet of Minister's Resolution No 496 of 1 July 2016 (hereinafter "*Resolution No 496*"), it was foreseen that *MGU* becomes the TSO. This Resolution has never been implemented. According to the current version of the statute of *MGU*, adopted on 7 November 2019 by the Ministry of Finance, the company's purpose and activities include generating profit from and promoting the activities of gas transmission system operation, developing of the system and facilitating investments, and enhancing energy security and gas market integration.

The state's shareholding rights in *MGU* were originally exercised by the Ministry of Energy and Coal Industry. On 18 September 2019, and in line with the Cabinet of Minister's Resolution No 840 on Unbundling of the Natural Gas Transmission Activity and Ensuring the Gas Transmission System Operator's Activity of the same date (hereinafter "*Resolution No 840*"), the exercise of the state's shareholders' rights in *MGU* was transferred to the Ministry of Finance. The supervisory board appoints the members and chairperson of the executive board, which in turn controls the activities of subsidiaries and appoints their management. The Ministry of Finance is not engaged in activities or controls companies active in the production and supply of electricity or natural gas.<sup>3</sup>

The actions envisaged by Resolution No 840 also comprise the signature of (a) an agreement on sale and purchase of the share in the authorized capital of GTSO between *Ukrtransgaz* and *MGU* (hereinafter "*the share-purchase agreement*"), and (b) an agreement on transfer under economic management right of state-owned property which is used in the process of natural gas transmission activities through main pipelines between the Ministry of Finance and *GTSO* (hereinafter "*the economic management agreement*"). The terms and conditions of the latter were approved by Cabinet of Minister's Resolution No 942 of 15 November 2019. According to the Preliminary Decision, the economic management agreement was signed on 21 November 2019, and the share-purchase agreement on 22 November 2019. The actual transfer of the shares and assets respectively formally require the signature of a statement of acceptance and transfer of property, as

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<sup>3</sup> By contrast, the Ministry of Finance controls the national transmission system operator for electricity, *Ukrenergo*.

well as registration. In the respective agreements, the parties commit to signing the statements of acceptance still on 1 January 2020.

- (a) Under the share-purchase agreement, the entire share capital of *GTSO* is transferred by *Ukrtransgaz* to *MGU* with effect of 1 January 2020, if the following condition precedents are met by 27 December 2019: adoption of a final certification decision by NEURC based on the Opinion of the Secretariat, the conclusion of the economic management agreement, the entry into force of a Law on Unbundling,<sup>4</sup> the approval of the transaction by the Ukrainian competition authority under the domestic merger control rules,<sup>5</sup> and the transfer by *Ukrtransgaz* to *GTSO* of assets other than the assets subject to the economic management agreement. The price for the purchase is based on the results of the activity of *GTSO* according to a formula agreed by the parties and with payments deferred over a period of 15 years.

The share-purchase agreement is deemed irreversible and may not be terminated by either party. With the entry into force of the share-purchase agreement, *MGU* will be the sole shareholder of *GTSO*. In this capacity it will immediately need to adopt a new statute for the company, the draft of which has been submitted in the course of the certification procedure. The draft statute describes the company's purpose, namely the functions related to the operation of the gas transmission system, and establishes the corporate governance, including a compliance programme and a compliance officer.

- (b) Under Ukrainian legislation, namely the Law on Pipeline Transport, ownership in state-owned assets used for the transmission of natural gas, most notably the main pipelines and compressor stations assets, is and needs to remain with the state. It can neither be alienated nor pledged by the user. According to Article 116(5) of the Constitution, state property is managed by the Cabinet of Ministers. In 1999, the State Property Fund had granted *Naftogaz* and subsequently *Ukrtransgaz* so-called economic management rights over the state-owned transmission assets. Based on Article 136 of the Commercial Code, an economic management right granted by the owner establishes a right of usage for specified commercial purposes. Following Decree of the Cabinet of Ministers No 1087-p of 15 November 2019, the state is represented in its ownership function over the transmission assets by the Ministry of Finance. The economic management rights agreement between the Ministry of Finance and *GTSO* constitutes the title for usage of the transmission assets for a period of 15 years for the purpose of transmission system operation, and sets out the rights and obligations of the signatories. Its entry into force and the transfer of assets envisaged for 1 January 2020 depend on the adoption of a final certification decision by NEURC based on the Opinion of the Secretariat and *GTSO*'s right to carry out gas transmission activities. According to Resolution No 840, the economic management rights granted to *Naftogaz* and *Ukrtransgaz* in 1999 on transmission assets will be terminated once the new agreement with *GTSO* has entered into force.

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<sup>4</sup> According to the Law on Unbundling adopted on 31 October 2019, the Law entered into force on the day following the day of publication.

<sup>5</sup> According to the Secretariat's information, approval by the competition authority of both the acquisition by *MGU* of *GTSO*'s shares and the acquisition of control by *GTSO* over transmission related assets has been granted by the time of issuing this Opinion.

Complementary to the establishment of an economic management right over state-owned assets for GTSO, the Preliminary Decision notes that Naftogaz, by decision of 21 November 2019, allowed its subsidiary Ukrtransgaz to transfer other transmission-related assets owned by itself to GTSO's capital.

On 31 October 2019, a Law on Amendments to Certain Laws of Ukraine in Relation to Separation of Natural Gas Transportation Activities (hereinafter "the Law on Unbundling") was adopted by the Verkhovna Rada of Ukraine.

## II. The Preliminary Decision

The Law on Gas Market, in its Articles 27 to 29, transposes the ISO model enshrined in Articles 14 and 15 of the Gas Directive. On 4 October 2019, GTSO submitted an application for certification under the ISO model to NEURC. On 22 November 2019, NEURC adopted the Preliminary Decision, of which a translated version was sent to the Secretariat on 26 November 2019.

In its Preliminary Decision, NEURC comes to the conclusion that GTSO can be certified preliminarily, but conditioned final certification on a number of measures to be taken and evidence to be submitted by GTSO by 17 December 2019. The Preliminary Decision is based on a compliance assessment which falls in three parts. For the sake of easier reference, the Secretariat's own assessment follows that structure.

Under the heading "*Unbundling of the natural gas transmission activities from production, distribution, supply of natural gas, and wholesaler's activities*", NEURC deems that "*the adoption of the final decision on certification is possible exclusively subject to submission to NEURC of the following:*

*1) duly executed Statement of acceptance-transfer of property with the date of acceptance and transfer, drafted in accordance with Agreement on the transfer under economic management right of state-owned property and used in the process of carrying out natural gas transmission activities through main pipelines dated 21 November 2019 No. 13010-05/197;*

*2) in connection with the concluded Agreement on purchase and sale of share in the authorized capital of a LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE" in the amount of 100 percent of the authorized capital between JOINT STOCK COMPANY UKRTRANSGAZ and JOINT STOCK COMPANY "MAHISTRALNI GAZOPROVODY UKRAINY" from 22 November 2019 No. 1911000192:*

*- copy of the permission of the Antimonopoly Committee of Ukraine for the concentration in connection with the transfer to the LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE" under economic management right of state-owned property used in the process of carrying out natural gas transmission activities through main pipelines and acquisition by the JOINT STOCK COMPANY "MAHISTRALNI GAZOPROVODY UKRAINY" of a share in the authorized capital of the LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE";*

- *the duly executed Statement of acceptance and transfer of a share in the authorized capital of the LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE", indicating the date of acceptance and transfer;*

Under the heading "*Compliance of LLC Gas TSO of Ukraine with the requirements of subparagraph 2 of paragraph 3 Article 27 of the Law regarding the disposal of the required financial, technical, physical and human resources to carry out its tasks under Article 28*" NEURC deems that "*the adoption of the final decision on certification is possible exclusively subject to submission to NEURC of the following:*

- 1) information and documents confirming the increase in the authorized capital of the LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE" through alienation by JOINT STOCK COMPANY UKRTRNSGAZ of own non-current and current tangible assets used in the process of natural gas transmission activities through main pipelines, including Statement of acceptance and transfer of these assets, indicating the date of acceptance and transfer;*
- 2) information and documents confirming the replacement of the party to contracts for the purchase of goods, works and services from the JOINT STOCK COMPANY UKRTRNSGAZ to the LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE" in order to ensure the uninterrupted functioning of the gas transmission system objects, indicating the date of such replacement;*
- 3) information and documents confirming the transfer from the JOINT STOCK COMPANY UKRTRNSGAZ to the LIMITED LIABILITY COMPANY "GAS TRANSMISSION SYSTEM OPERATOR OF UKRAINE" of all employees necessary to carry out natural gas transmission activities efficiently."*

Under the heading "*Relations between the Applicant and the gas transmission system owner*" NEURC deems that "*the adoption of the final decision on certification is possible exclusively subject to submission to NEURC of the following:*

- 1) copies of documents confirming the termination of obligations of JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAS OF UKRAINE" and JOINT STOCK COMPANY UKRTRNSGAZ in part concerning the return of objects that have been transferred to such business entities or to the entities whose successors they are, by concluding additional agreements to the Agreement on the use of state property that is not subject to privatization of 4 February 1999 No. 76 and the Agreement on the use of state property that is not subject to privatization of 17 June 1999 No. 19/275;*
- 2) a copy of the compliance program approved by the Ministry of Finance of Ukraine, which determines measures to avoid discriminatory actions and influence on activities of the gas transmission system operator and monitoring the implementation of such measures, functional responsibilities of its employees to achieve these goals."*

### III. Assessment of the Preliminary Decision

#### 1. The ISO model of unbundling

At the outset, the Secretariat recalls that the unbundling provisions were designed to separate, in vertically integrated undertakings,<sup>6</sup> 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, to eliminate potential conflicts of interest between transmission and other activities performed by vertically integrated undertakings.<sup>7</sup> 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.

By contrast, the ISO model enshrined in Article 14 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.

By Resolution No 840 of 18 September 2019, the Cabinet of Ministers selected the ISO model for the unbundling of the gas transmission system operator. To unbundle the gas TSO under the ISO model was not the first choice by Ukrainian authorities. In 2016, under Resolution No 496 of 1 July 2016, the Cabinet of Ministers opted for the ownership unbundling model, yet failed to carry out the necessary measures to implement that Resolution.

Under the Gas Directive, *GTSO* is eligible for unbundling under the ISO model. The transmission system belonged to a vertically integrated undertaking, *Naftogaz*, on 6 October 2011, the cut-off date set by Article 14(1) of the Gas Directive. In a situation such as the present one, where the candidate TSO cannot own the transmission system, ownership unbundling as the only other model transposed by the Law on Gas Market is ruled out because *GTSO* cannot comply with Article 9(1)(a) of the Gas Directive. This makes the ISO model, where ownership and operation are separated, currently the only available model.

The purpose of the certification procedure in these circumstances is to make sure the requirements by the Directive are being complied with. In the conditions of the present case, that does not only apply to the relations between the ISO and the vertically integrated undertaking but also with and between different bodies within the government of Ukraine as the framework within both the ISO and the system owner (continue to) operate.

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<sup>6</sup> A vertically integrated undertakings 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”.

<sup>7</sup> Secretariat’s Opinion 2/17 of 22 April 2017 on certification of *Yugorosgaz Transport*.

## 2. Independence of the transmission system operator

According to Article 14(2)(a) of the Gas Directive, an ISO may be designated only where it complies with Articles 9(1)(b), (c) and (d) of the Gas Directive. 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. Article 9(3) of the Gas Directive stipulates that the independence requirements apply also across the natural gas and electricity markets, thereby prohibiting joint influence over an electricity generator or supplier and a natural gas TSO, or over a natural gas producer or supplier and an electricity TSO.<sup>8</sup> Under the conditions of Article 9(6) of the Gas Directive, two separate public bodies exercising control over a transmission system operator on the one hand, and over an undertaking performing any of the functions of production or supply on the other hand, may be deemed to be independent from one another.

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.*”<sup>9</sup> The rights include in particular the power to exercise voting rights, the holding of a majority share and the right to act as, and the power to appoint members of the TSO's corporate bodies and those legally representing the TSO (Article 9(2) of the Gas Directive).

It is evident from the Preliminary Decision that *GTSO* itself is not engaged in any activities related to the production or supply of network energy.

Yet its current sole shareholder, *Ukrtransgaz*, is a 100% subsidiary of *Naftogaz*, a vertically integrated undertaking which is active in the production and supply of natural gas and, to a lesser extent, electricity. In this situation, the Secretariat agrees with the Preliminary Decision that “*as of the date of the submission of certification request*”, *GTSO* is under the direct control of *Ukrtransgaz* which in turn is directly controlled by *Naftogaz*. *GTSO* thus forms part of a vertically integrated undertaking which is not in line with Article 9(1) of the Gas Directive.

Moreover, the Secretariat agrees with the Preliminary Decision that the Cabinet of Ministers, in exercising control over *Naftogaz*, also indirectly controls the activities of *GTSO*. The Cabinet of Ministers is a public body within the meaning of Article 9(6) of the Gas Directive. As established by the Preliminary Decision, it also indirectly controls other public undertakings active in electricity supply such as the Ukrainian Railways. Furthermore, other ministries such as the Ministry of Energy and Environmental Protection exercise control over companies active in production or supply of network energy.

The Constitution of Ukraine establishes the Cabinet of Ministers as the highest body within the executive branch of the state. As a collegial body, it comprises, *inter alia*, the Prime Minister and the Ministers. According to Article 116(9) of the Constitution, the Cabinet of Ministers directs and coordinates the operation of ministries. Article 21(2) of the Law on the Cabinet of Ministers stipulates

<sup>8</sup> Secretariat's Opinion 2/17 of 22 April 2017 on certification of *Yugorosgaz Transport*.

<sup>9</sup> 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).

that individual ministries are accountable to the Cabinet of Ministers and under its control. According to Article 21(6) of the same Law, the Cabinet of Ministers can repeal acts of the ministries. This relation of subordination between the Cabinet of Ministers and the Ministry of Finance does not satisfy the notion of separate public bodies in Article 9(6) of the Gas Directive without additional safeguards.

By consequence, the assessment of *GTSO*'s current structure under corporate law and constitutional law confirms that it is not separate from production and supply activities as required by Article 14(2)(a) of the Gas Directive.

At the same time, the Secretariat also concurs with the finding by the Preliminary Decision that the share-purchase agreement signed on 22 November 2019 between *Ukrtransgaz* and *MGU* triggers a change in control over *GTSO*. By this transaction, once in effect, 100% of the share capital in *GTSO* are transferred to *MGU* in an irreversible manner. Hence the current chain of control over *GTSO* from *Ukrtransgaz* to *Naftogaz* to the Cabinet of Ministers is severed and a new control line is put in place. The Secretariat also notes that the share-purchase agreement explicitly commits *Ukrtransgaz* from refraining from any political or economic influence over *GTSO* and its activities.

*GTSO*, based on the draft statute which *MGU* committed to adopt, will be under tight control of *MGU* as sole shareholder. The parent company will be called upon to decide on or approve decision on a broad range of issues, including the main directions of the TSO's activities, individual transactions of a certain significance as well as loans, appointment of the executive board (currently one director) and the supervisory board (currently non-existent) etc. In principle, tight control by *MGU* is non-problematic, as the parent is not active in let alone control any energy production and supply activities.

Within the corporate governance of *MGU*, its executive board will control the subsidiary *GTSO*, inter alia by appointing its management or by approving its investment programmes. The executive board is accountable to the general shareholders meeting and the supervisory board. The general shareholder, consisting of the Ministry of Finance, is the supreme decision-maker within *MGU*. As such, the Ministry of Finance exercises direct control within the meaning of Article 2(36) of the Gas Directive over *MGU* and indirect control over *GTSO*, which is reinforced by the fact that the Ministry of Finance also represents the state as the owner of the transmission assets, made available to *GTSO* via economic management rights.

The control exercised by the Ministry of Finance in itself does not entail the risk of any conflict of interest, as that Ministry does not control energy production or supply activities. Yet from the constitutional perspective, the Ministry of Finance forms part of the government and could thus be exposed to conflicts of interests with respect to the Cabinet of Ministers' control over *Naftogaz* and individual ministry's control over energy production and supply activities. As explained above, the Cabinet of Ministers, the Ministry of Finance and other ministries are public bodies within the meaning of Article 9(6) of the Gas Directive, and need to be truly separate from one another. This is not evident within the framework established by the Constitution and the Law on the Cabinet of Ministers.

Yet, the Secretariat in its assessment found a number of safeguards built in the corporate structure and on the legislative level which limit the control of the Ministry of Finance over *GTSO*, on the one hand, and eliminate control of the Cabinet of Ministers over the Ministry of Finance in its capacity as holding entity of *MGU* and indirectly *GTSO*. Based on this assessment, the requirements of Article



14(2)(a) of the Gas Directive may indeed be considered complied with once the share-purchase agreement enters into effect.

Firstly, while the Ministry of Finance as sole member of the general shareholders' assembly is indeed *MGU's* supreme organ in line with Ukrainian corporate law and the company's statute, *MGU's* supervisory board acts as a significant counterbalance. *Ukrtransgaz*, the current parent company of *GTSO*, does not have a supervisory board. *MGU's* supervisory board appoints the executive board members (which in turn appoint the organs of *GTSO*) and supervises its activities. The supervisory board of *MGU* also adopts the statutes of *GTSO*. While the supervisory board's members are evidently appointed by the general shareholders' meeting, i.e. the Ministry of Finance, a majority of its members must be and are independent from the state administration and have been selected through a competitive procedure. In practice, the independent members of the supervisory board are senior energy experts from outside Ukraine.

Having said that, the Secretariat has been made aware of the fact that among the current members of *MGU's* supervisory board, one member sits also on the supervisory board of *Ukrzaliznytsia*, the Ukrainian railways company which, via a subsidiary, also supplies electricity. While Article 9(1)(d), read in conjunction with Article 9(3) of the Gas Directive, does not explicitly rule out such double function, it would indeed do so if membership in the supervisory board amounts to the exercise of control within the meaning of Article 9(1)(b) of the Gas Directive. This – as well as any stricter incompatibility rules under Ukrainian law – should be verified by NEURC in its final decision, taking into account *MGU's* statutes as well as any other relevant circumstances of law and of fact.

Secondly, the Secretariat notes that the statutes explicitly prevent *MGU's* shareholder from interfering in the company's operational and commercial activities, and commit *MGU* to respect the tasks of its subsidiary *GTSO* in line and compliance with the ISO model. Furthermore, the Secretariat notes that both the statutes of *GTSO* and *MGU* envisage the adoption of compliance programmes and the appointment of compliance officers, which are tasked to implement a compliance programme with measures to avoid discriminatory behaviour and conflicts of interest.

Thirdly, the Preliminary Decision emphasizes that unlike in their constitutional functions, ministries in their capacity as exercising shareholders' rights in joint stock companies such as *Naftogaz* and *MGU* act within the sphere of corporate law and the relevant ministries' regulations. They are not dependent on or subordinate to other public bodies as they may be in the political sphere. This is also reflected by the Law on Management of State Property Objects which defines and delineates the management authorities of the Cabinet of Ministers and the individual ministries. In similar constellations, the Secretariat has acknowledged that a ministry as a body of state administration and member of another collegial public body, the government may qualify as separate public bodies within the meaning of Article 9(6), provided that the separation of control between the two public bodies in question is effective and ensures the full independence of both public bodies. In this respect, the Secretariat considered "*the legally protected ownership position of the Ministry [...] under corporate law, and the exclusive control rights resulting from that position, as an important element supporting the assumption of effective separation between the Ministry and the Government, and the absence of conflicts of interest.*"<sup>10</sup>

Fourthly, and maybe most importantly, the recent amendments introduced by the Law on Unbundling significantly enhanced the independence of *GTSO* vis-à-vis the Ministry of Finance and enshrined it

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<sup>10</sup> See, for instance, Secretariat's Opinion 3/19 of 17 June 2019 on certification of *MEPSO*.

in primary law, namely by amending the Commercial Code, the Law on Pipeline Transport, and the Law on Management of State Property Objects. Article 11(3) of the latter Law, for instance, was complemented by the following clear wording:

*“The management of the corporate rights of the state, as well as the establishment of management bodies in the economic entities operating in the field of electricity and natural gas transmission, or in the economic entities owning the corporate rights in such economic entities, shall be carried out in accordance with the requirements for the unbundling and independence of such economic entities set forth by the law.”*

What is more, the Law on Unbundling also modified the hierarchical relation between the Cabinet of Ministers and the Ministry of Finance through amendments to the Law on the Cabinet of Ministers. Article 21(6) of that Law was complemented by the following wording:

*“The indicated powers of the Cabinet of Ministers of Ukraine [the right to repeal acts of ministries] do not extend to decisions of the ministries and other central executive bodies issued by them in the course of exercising managing powers regarding corporate rights belonging to the state in the share capital of economic entities operating on the basis of a license to conduct natural gas transmission activity, as well as legal entities possessing corporate rights in such entities.”*

The newly introduced Article 44(6) of the same Law reads:

*“3. The Ministry exercising direct or indirect control over the economic entities operating based on the license for carrying out the natural gas transmission activity or based on the license for carrying out the electricity transmission activity, shall exercise the powers related to management of corporate rights belonging to the state with regard to such economic entities or economic organizations owning corporate rights with regard to such economic entities, individually and independently, under the principles of openness and transparency, responsibility for the decisions made. These rights shall not extend to management and allocation of capacities nor to investment planning, which shall be the competence of the economic entities conducting electricity or natural gas transmission activity.*

*Solely upon approval of the Cabinet of Ministers of Ukraine, the decisions shall be made as regards management of corporate rights belonging to the state and pertaining to:*

*reorganization (merger, acquisition, splitting, spin-off) or winding-up of such economic entities or economic organizations;*

*transactions that may result in termination of the right of economic management for the property used in the process of carrying out the natural gas transmission activity, of such economic entities or economic organizations;*

*introduction to the charter of such economic entities or economic organizations of amendments that pertain to the objective, scope, main areas of activity thereof;*

*approval of the part of net profit of such economic entities or economic organizations that has to be allocated for payment of dividends.*

*Interference with the exercise by the Ministry of powers set forth by this part, shall be prohibited.*

*4. The Cabinet of Ministers of Ukraine, the Prime Minister of Ukraine, the Minister heading the Ministry exercising control over the activity of production or supply in the electricity market and natural gas*

*market, according to the requirements for unbundling and independence of the electricity and natural gas transmission system operator as set forth by law, shall not coordinate and control economic entities acting based on the license for carrying out the activity of electricity or natural gas transmission, as well as not appoint members of management bodies of such economic entities.”.*

With these safeguards, the independence of *GTSO* and its parent company vis-à-vis the Ministry of Finance on the corporate level and the independence between the Ministry of Finance and the Cabinet of Ministers in matters pertaining to representation of the state as shareholder in the parent company of *GTSO* has been increased to an extent that the exercise of control by the Cabinet of Ministers over gas transmission activities on the one hand, and energy production and supply activities on the other hand, has been made all but impossible. Remaining risks of conflicts of interest should be able to be addressed through the companies' compliance programmes. The compliance programmes should also ensure respect to the confidentiality requirements in Article 16 of the Gas Directive, which the Law on Gas Market fails to ensure.

As the statute of *GTSO* has not been approved yet, and its effectiveness in preventing conflicts of interest depends on its application in practice, the Secretariat suggests that NEURC envisages a review once adopted. This review should be extended to *MGU*'s statutes as well as the compliance programmes (to be) established on all levels of the chain of control. , The Secretariat also notes that adverse changes to these documents in the future may entail the opening a certification procedure.

Subject to the preceding remarks and the proposed conditions below, the Secretariat's assessment supports the findings of the Preliminary Decision from the perspective of Article 14(2)(a) of the Gas Directive.

### **3. Disposal by the transmission system operator of the required financial, technical, physical and human resources to carry out its tasks**

Article 14(2)(b) of the Gas Directive provides that an ISO may be designated only where it has demonstrated that it has at its disposal the required financial, technical, physical and human resources to carry out its tasks under Article 13 of the Gas Directive. Article 13 of the Gas Directive lists the core tasks of TSOs, namely to:

- operate, maintain and develop under economic conditions secure, reliable and efficient transmission, storage and/or LNG facilities to secure an open market with due regard to the environment, ensure adequate means to meet service obligations;
- refrain from discriminating between system users or classes of system users, particularly in favour of its related undertakings;
- provide any other transmission system operator, any other storage system operator, any other LNG system operator and/or any distribution system operator, sufficient information to ensure that the transport and storage of natural gas may take place in a manner compatible with the secure and efficient operation of the interconnected system; and
- provide system users with the information they need for efficient access to the system.

Similarly, Article 14(4) of the Gas Directive requires that the ISO shall be responsible for “*granting and managing third-party access, including the collection of access charges and congestion charges, for operating, maintaining and developing the transmission system, as well as for ensuring the long-term ability of the system to meet reasonable demand through investment planning. When developing the transmission system the independent system operator shall be responsible for*

*planning (including authorisation procedure), construction and commissioning of the new infrastructure.”*

Moreover, Article 14(2)(e) of the Gas Directive requires the candidate ISO to demonstrate its ability to comply with its obligations under the Gas Regulation. Under the Gas Regulation, TSOs shall:

- Third-party access services: ensure that they offer services on a non-discriminatory basis to all network users (Article 14(1)(a)), provide both firm and interruptible third-party access services (Article 14(1)(b)), offer to network users both long and short-term services (Article 14(1)(c)),
- Capacity allocation and congestion management: implement and publish non-discriminatory and transparent capacity-allocation mechanisms (Article 16(2)), implement and publish non-discriminatory and transparent congestion management procedures which facilitate cross-border exchanges in natural gas (Article 16(3)), regularly assess market demand for new investment and when planning investments, assess market demand and take into account security of supply (Article 16(5)),
- Transparency requirements: make public detailed information regarding the services it offers and the relevant conditions applied, together with the technical information necessary for network users to gain effective network access (Article 18(1)), publish reasonably and sufficiently detailed information on tariff derivation, methodology and structure (Article 18(2)), make public information on technical, contracted and available capacities on a numerical basis for all relevant points including entry and exit points on a regular and rolling basis and in a user-friendly and standardised manner (Article 18(3)), disclose this information in a meaningful, quantifiably clear and easily accessible manner and on a non-discriminatory basis (Article 18(5)), make public ex-ante and ex-post supply and demand information, based on nominations, forecasts and realised flows in and out of the system (Article 18(6)), make public measures taken as well as costs incurred and revenue generated to balance the system (Article 18(6));
- Balancing: provide sufficient, well-timed and reliable on-line based information on the balancing status of network users (Article 21(2));
- Trading of capacity rights: take reasonable steps to allow capacity rights to be freely tradable and facilitate such trade in a transparent and non-discriminatory manner (Article 22).

At the outset, the Secretariat recalls that currently, *GTSO* does not perform any of the functions attributed by the Gas Directive and the Law on Gas to a TSO. By the date of issuing the present Opinion, the sole entity licensed for and actually performing the functions of a transmission system operator is *Ukrtransgaz*. The fact that *GTSO*, currently a subsidiary of *Ukrtransgaz*, assist the latter in exercising some of these functions under a service-level agreement valid until 1 January 2020 does not make *GTSO* a transmission system operator.

Yet once bound by the Law on Gas Market, the economic management agreement as well as the company's draft statute, i.e. as from 1 January 2020, the functions and tasks attributed by the Gas Directive to a TSO will have to be performed by *GTSO* for which it needs to have at its disposal the necessary resources.

In terms of human resources, it is to be noted that *GTSO* already today employs some 10,000 permanent staff members, mostly recruited from *Ukrtransgaz* in the process of establishing *GTSO* as an entity within the *Naftogaz* group. This number is expected to grow to 11,500 by 1 January 2020. The Secretariat has no reasons to doubt the assumption in the Preliminary Decision that the

number and qualification of these employees is sufficient to carry out the functions of a TSO to the extent the other preconditions are fulfilled.

As regards the legal capability of *GTSO* to perform TSO functions after 1 January 2020, it is to be noted that the recently adopted Law on Unbundling introduced changes to the applicable laws to ensure that *GTSO* can use *Ukrtransgaz*' existing license for up to one year before a new license is required, and *GTSO* can continue to use existing permits. Resolution No 840 moreover envisages that contracts required for performing transmission system operation are transferred from *Ukrtransgaz* to *GTSO* by 1 January 2020. The Secretariat supports that NEURC conditions certification on evidence provided in that respect.

With regard to access and usage of the transmission assets, it is to be recalled that the economic management agreement grants *GTSO* the title needed to operate the state-owned gas transmission system as from 1 January 2020. The economic management right entails that the state-owned assets used by *GTSO* are carried in the latter's books as its assets. The Secretariat also understands that *GTSO* has already started allocating transmission capacity to be used as from 1 January 2020, subject to obtaining the certification and TSO license, whereas existing capacity contracts concluded with *Ukrtransgaz* will be terminated.

Moreover, transmission-related assets currently in private ownership of *Ukrtransgaz* apparently have been transferred to *GTSO* already. Based on the condition imposed, NEURC will verify this in the final decision. The Secretariat notes that besides the transmission assets in state ownership, the Preliminary Decision is silent about other assets and services necessary for effective transmission system operation. It only refers to point 11 of Resolution No 840 which envisages that contracts for the purchase of goods, works and services necessary to ensure the uninterrupted functioning of gas transmission assets are transferred from *Ukrtransgaz* to *GTSO* by 1 January 2020. In this respect, the Secretariat recalls that assets and services which are essential to the operation of the transmission network, should be possessed or carried out by the ISO.<sup>11</sup> This concerns, first and foremost, operation, maintenance and development of the network and should be verified by NEURC. Assets and services required for these tasks may include line pack, IT equipment, services and licenses, equipment necessary for measuring gas flows and dispatching the system, equipment related to diagnostics, repair and maintenance, etc. To what extent they have actually been transferred from *Ukrtransgaz*, or procured and/or established independently, and whether and to what extent *GTSO* still relies on services provided by the *Naftogaz* group should be verified by NEURC either in the final decision, or after reviewing the opening balance.

As regards the availability of sufficient financial resources, the Preliminary Decision notes that *GTSO* currently has limited financial resources of some four million EUR, which result mostly from the provision of services under the service-level agreement with *Ukrtransgaz*. With the commencing of transmission system operation functions by *GTSO* as from 1 January 2020, the company's main source of revenue will be income from gas transmission services paid by the users and based on the tariffs set by NEURC. The exclusive reliance on regulated transmission tariffs is a direct consequence of unbundling, and requires the recognition of costs associated with the TSO functions. The Law on Unbundling, in amending the Law on Gas Market, underlines this by requiring that transmission tariffs need to cover costs including for approved investments, and must include a profit. In the Preliminary Decision, NEURC refers to its own methodology for the determination and

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<sup>11</sup> See, to that effect, Commission's Opinion on certification of *Augstsprieguma tikls*, C(2012) 9108, 03.12.2012; Commission's Opinion on certification of *Trans Austria Gasleitung GmbH*, C(2013) 649, 04.02.2013.

calculation of tariffs for natural gas transmission services for entry points and exit points on the basis of multi-year incentive regulation of 2015. This methodology was changed recently by NEURC, while NEURC's decision to approve the transmission tariff based on that methodology is imminent. The Secretariat assumes that NEURC will align the actual tariff with the tariff-setting principles in the legislation, and hence ensure *GTSO's* financial viability.

For the purpose of the assessment of financial viability in the context of the present certification, NEURC should also take into account the risk of accumulating debts from so-called unauthorized gas offtakes by district heating companies and distribution system operators. While the latter take off gas from the transmission system to compensate for losses of their own, the nature of which is disputed, the former cannot find a supplier on account of their financial difficulties and cause costs to the TSO incurred from non-paid balancing. In both respects, the regulatory framework in Ukraine may need improvements either by design or enforcement. The unauthorized offtakes and the related costs may indeed affect *GTSO's* capability to cover its operational expenses. The Secretariat invites NEURC, in its final decision, to address this problem and its possible solutions, which should be implemented to the extent they are within NEURC's competences. With regards to the financial losses caused by the distribution system operators, NEURC could ensure that allowed revenues of distribution system operators actually cover costs of losses at an appropriate level, in line with the methodology, and monitor and enforce the distribution system operators' obligations towards *GTSO*. .. With regard to the losses caused by district heating companies, addressing unauthorized offtakes may go beyond NEURC's competences and require changes to the current public service obligations regime adopted pursuant to Article 11 of the Law on Gas Market by the Cabinet of Ministers. The Secretariat suggests a review of the situation once *GTSO* has become operational as a formally independent ISO.

In addition to this, it cannot be ruled out at this point in time that *GTSO's* financial viability and its capacity to invest into the network are affected by implementation of the payment provisions of the share-purchase agreement. The agreement includes an earn-out clause envisaging regular payments from *GTSO's* revenue to *Ukrtransgaz*. As a consequence of this clause, only depreciation and return on newly obtained assets (i.e. after the share transfer takes place) are retained by *GTSO*. Taking into consideration the lifecycles of transmission assets and dynamics of infrastructure investments, depreciation and return of new assets may not suffice as a funding source of investments in the first years of *GTSO's* operations. The impact of the earn-out payment reduction envisaged by the agreement as a possible fund for investments (interest in the form of amortization of debt plus the rate of return on the non-paid debt) is also not yet clear. This may affect *GTSO's* own resources for financing as well as its capacity to attract loans. The Secretariat suggests that NEURC closely monitors the calculation of earn-out payments under the share-purchase agreement, and its impact on *GTSO's* financial viability.

Moreover, an unstable financial situation may also lead to a dependency of *GTSO* in procuring gas for technical purposes from the incumbent *Naftogaz* group, as no supplier may offer gas to *GTSO* on purely commercial terms given its financial condition. It is further noted that the safeguards for *MGU's* independence introduced in Article 44(6) of the Law on the Cabinet of Ministers do not cover procurement of gas, balancing and other activities performed by the TSO. In this respect, the Secretariat recalls that the unbundling provisions as introduced by the Gas Directive are not goals in themselves but aim to support the Directive's overall objectives of increased market opening, transparency and fairness.<sup>12</sup> The Secretariat suggests that NEURC reviews the consequence of

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<sup>12</sup> See Secretariat's Opinion 1/16 of 3 February 2016 on certification of *Trans Adriatic Pipeline*.

such dependence together with the competition authority and the Secretariat in line with the experience gained after a certain period of operation and completion of the current procurement procedures for line pack.

Subject to the preceding remarks and the proposed conditions below, the Secretariat's assessment supports the finding of the Preliminary Decision from the perspective of Article 14(2)(b), (2)(e) and (4) of the Gas Directive.

#### **4. The role of the transmission system owner**

At the outset, the Secretariat recalls that the system owner'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.<sup>13</sup>

To that end, Article 15 of the Gas Directive requires legal and functional unbundling of the transmission system owner. Legal unbundling requires that the network is owned by a company separate from the other activities not related to transmission and must be responsible for all the decisions assigned to the transmission system owner under the Gas Directive. Functional unbundling requires that this company is independent in terms of its organisation and decision making from other activities not related to transmission. In particular, Article 15(2) of the Gas Directive sets the following minimum criteria:

- Persons responsible for the management of the transmission system owner shall not participate in company structures of the integrated natural gas undertaking responsible, directly or indirectly, for the day-to-day operation of the production and supply of natural gas;
- Appropriate measures shall be taken to ensure that the professional interests of persons responsible for the management of the transmission system owner are taken into account in a manner that ensures that they are capable of acting independently;
- The transmission system owner shall establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored.

In applying these criteria to the Ministry of Finance, the Secretariat agrees that a ministry can be considered an equivalent to a separate legal entity which – in accordance with the assessment carried out under point 2. above – is also functionally independent from other entities within the government performing or controlling energy production or supply activities. That extends, to the Secretariat's best knowledge, also to the persons responsible within the Ministry of Finance.

Moreover, the Secretariat recalls that the Ministry of Finance acts in a dual function in the present set-up, namely as the body representing the state as owner of the transmission system as well as the body controlling the operator of that system, *GTSO*. Beyond the measures designed to separate the Ministry in the latter function from the Cabinet of Ministers controlling *Naftogaz* and other ministries with energy-related activities, the Law on Unbundling also introduced additional safeguards meant to reduce the influence of the Ministry in its function as transmission system owner over the ISO.

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<sup>13</sup> See Commission's Opinion on certification of *Trans Austria Gasleitung GmbH*, C(2013) 649, 04.02.2013.

In particular, Article 136 of the Commercial Code was amended to the effect that *GTSO* “*shall be fully independent in deciding on the use, operation, maintenance, planning and development of such state-owned property and its financing*” from the state as system owner and grantor of the economic management right. Similarly, the new Article 44(6) of the Law on the Cabinet of Ministers quoted above limits the Ministry of Finance’s control rights in the manner that “*such rights shall not be exercised in respect of operation and allocation of capacity and investment planning that falls under the competence of economic entities conducting natural gas transmission activities.*” The prohibition to interfere with the activities of the ISO is further reinforced by the economic management agreement.

Besides, the economic management agreement requires *GTSO* to adhere to the network development plan approved by NEURC, and assigns the responsibility for its implementation exclusively to *GTSO* in line with Article 28(1) of the Law on Gas Market. The ISO’s obligation to elaborate and submit annually for approval to the regulatory authority a ten-year network development plan, as required by Article 41(3)(c) of the Gas Directive, follows from Articles 22(2) and 30 of the Law on Gas Market. Under law and contract, *GTSO* is fully and solely responsible for its long-term planning and the implementation (in particular constructing and commissioning new infrastructure) of these plans, as required by Article 14(4) of the Gas Directive. The importance of the full and sole responsibility of the ISO in this respect has been underlined by the European Commission.<sup>14</sup> The Secretariat also notes that Resolution No 840 as well as the economic management agreement envisage that *GTSO* steps in to the contracts for ongoing investments still signed by *Ukrtransgaz*.

Article 14(2)(c) of the Gas Directive, however, also requires that a candidate ISO has undertaken to comply with a ten-year network development plan monitored by the regulatory authority. The Secretariat understands that *GTSO* has already proposed such a plan to NEURC for approval. NEURC is invited to confirm this in the final decision.

Based on these considerations, the Secretariat concurs with the Preliminary Decision that these measures significantly limit the possibilities of the transmissions system owner, the Ministry of Finance, to intervene in the transmission system operation performed by *GTSO*, despite the fact that it exercises indirect control over the latter through its shareholding in *MGU*.

Any remaining risk of conflict of interests within the Ministry of Finance in the exercise of its dual role can be addressed by implementing the compliance programme required by Article 15(2) of the Gas Directive. Article 29(2) of the Law on Gas Market requires the Ministry of Finance in its capacity as transmission system owner to develop and implement such a compliance programme. The economic management agreement reiterates and reinforces that obligation. According to the Preliminary Decision, the Ministry of Finance has not submitted the required compliance programme yet. The Secretariat supports the condition imposed by NEURC in that respect. The compliance programme should be designed in a manner so as to ensure that the persons responsible within the Ministry of Finance for the transmission system owner enjoy a sufficient level of independence of the political leadership of the Ministry and the Cabinet of Ministers.

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<sup>14</sup> Opinion on certification of *Gaz-System* as the operator of the Polish section of *Yamal-Europe Pipeline*, C(2015) 2008, 19.03.2015.



Furthermore, Article 14(2)(d) of the Gas Directive requires that the transmission system owner has demonstrated its ability to comply with its obligations under Article 14(5) of the Gas Directive, namely to

- provide all the relevant cooperation and support to the ISO for the fulfilment of its tasks (Article 14(5)(a));
- finance the investments decided by the ISO and approved by the regulatory authority or give its agreement to financing by any interested party including the ISO (Article 14(5)(b));
- provide for the coverage of liability relating to the network assets (Article 14(5)(c)); and
- provide guarantees to facilitate financing any network expansions (Article 14(5)(d)).

The relation between the transmission system owner – the state represented by the Ministry of Finance – and the ISO – *GTSO* – is currently defined by law and, once it enters into effect, the economic management agreement. The latter defines the roles, obligations and rights of both parties. The economic management agreement explicitly recognizes the owner's duties under Article 14(5) of the Gas Directive. It also stipulates an obligation on the Ministry of Finance to facilitate the performance by *GTSO* of its tasks as a transmission system operator.

As regards the coverage of liability relating, the Gas Directive requires the network owner to cover liability resulting from the technical condition of the network, but not from the management of the network.<sup>15</sup> The Law on Gas Market transposes Article 14(5)(c) correctly. The economic management agreement refers to the system owner's obligation under the Law and copies it, while allowing *GTSO* to take out property insurance. Yet it is not clear as to how the Ministry of Finance fulfils its duty to cover the liability relating to the network assets as required by the Gas Directive. The Secretariat proposes that NEURC in its final decision assesses this in more detail.

As regards financing of the investments to be decided by *GTSO* and approved by NEURC, Article 14(5) of the Gas Directive envisages two options, either financing by the transmission system owner – the state represented by the Ministry of Finance – or the latter's agreement to financing by any interested party including *GTSO* itself. The Law on Unbundling selects the second option. The amendments to Article 136 of the Commercial Code stipulate that the Ministry of Finance "*may not refuse financing ... by the gas transmission system operator ... or by other interested parties*". The economic management agreement explicitly expresses the Ministry of Finance's consent in that respect. In this case, the duty of the transmission system operator to provide guarantees for financing of network expansions under Article 14(5)(d) of the Gas Directive does not apply.

Finally, Article 41 of the Gas Directive stipulates a set of additional powers and duties for the national regulatory authority related to the transmission system owner in case of the ISO model. They consist of

- monitoring the transmission system owner's compliance with its obligations under Article 14 of the Gas Directive, and issuing penalties for non compliance (Article 41(3)(a));
- monitoring the relations and communications between the transmission system owner and the ISO, and in particular approve contracts and act as a dispute settlement authority between the transmission system owner and the ISO (Article 41(3)(b));

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<sup>15</sup> European Commission Staff Working Paper of 22 January 2010 – The Unbundling Regime.

- ensuring that network access tariffs collected by ISO include remuneration for the network owner or network owners, which provides for adequate remuneration of the network assets and of any new investments made therein, provided they are economically and efficiently incurred (Article 41(3)(d));
- having the powers to carry out inspections, including unannounced inspections, at the premises of the independent system operator (Article 41(3)(e)).

In this respect, the Secretariat observes that Article 4(4) of the Law on Gas Market transposes Article 41(3)(a), (b) and (d) of the Gas Directive in the national law of Ukraine. NEURC's role in monitoring the conduct of public bodies as transmission system owner, as well as its capacity in approving contracts and settling disputes between a public body as transmission system owner and the ISO was further reinforced by the Law on Unbundling, which amends the Law on the National Commission for State Regulation of Energy and Public Utilities in several aspects. If properly implemented, these requirements can indeed be considered fulfilled.

Subject to the preceding remarks and the proposed conditions below, the Secretariat's assessment supports the finding of the Preliminary Decision from the perspective of Articles 14(2)(c), 14(2)(d) and (5), 15 and 41(3) of the Gas Directive.

## 5. Conditions imposed

According to the formulation used by NEURC, („*the adoption of the final decision on certification is possible exclusively subject to ...*”), the conditions listed by the Preliminary Decision seem to be meant by NEURC not necessarily as conditions to be imposed by the final decision, but as (pre-)conditions to be fulfilled by *GTSO* before issuing the final decision. While the Secretariat agrees with all conditions, it believes that they should not only be verified before adoption of NEURC's final decision, but also be imposed by the final decision. Moreover, it calls upon NEURC to request a number of additional assessments, reviews and conditions, as specified below.

The conditions imposed with regard to the *independence of the transmission system operator* (point 2. above) essentially require *GTSO* to provide evidence for the effective entry into effect of the change in regime of control, referring essentially to the conditions precedents set by the share-purchase agreement and the economic management agreement respectively. The Secretariat supports these conditions and calls upon NEURC to apply them also to the final decision, unless they have been complied with before the date of issuing that decision. Moreover, the Secretariat requests the following to be reflected in the final decision:

- An assessment, and if need be, a condition of whether the person sitting on the supervisory boards of both *MGU* and *Ukrzaliznytsia* exercises control within the meaning of the Gas Directive;
- A review of the statutes of *GTSO* and *MGU* as well as the relevant compliance programmes within a period of not more than six months upon adoption of the final certification decision, with the possible support of the Secretariat.

The conditions imposed with regard to the *disposal by the transmission system operator of the required financial, technical, physical and human resources to carry out its tasks* (point 3. above) essentially require *GTSO* to provide evidence for the availability of assets and human resources. The Secretariat supports these conditions and calls upon NEURC to apply them also to the final

decision, unless they have been complied with before the date of issuing that decision. Moreover, the Secretariat requests the following to be reflected in the final decision:

- A review of whether *GTSO* has at its disposal all assets and services needed to perform the essential functions of a transmission system operator, within a period of not more than three months upon adoption of the final certification decision, with the possible support of the Secretariat;
- An assessment of the actual impact of external circumstances on the financial viability of *GTSO* after 1 January 2020, in particular with regard to
  - o unauthorized offtakes, and
  - o earn-out payments under the share-purchase agreement

and proposals for adequate solutions within a period of not more than six/twelve months upon adoption of the final certification decision, with the possible support of the Secretariat;

- An assessment of the degree of dependency of *GTSO* on the *Naftogaz* group and proposals for adequate solutions, within a period of not more than six months upon adoption of the final certification decision, with the possible support of the Antimonopoly Committee and the Secretariat.

The conditions imposed with regard to *the role of the transmission system owner* (point 4. above) essentially require *GTSO* to provide evidence for the termination of the economic management rights currently held by *Naftogaz* and *Ukrtransgaz* as well as the compliance program to be implemented by the Ministry of Finance. The Secretariat supports these conditions and calls upon NEURC to apply them also to the final decision, unless they have been complied with before the date of issuing that decision. Moreover, the Secretariat requests the following to be reflected in the final decision:

- An assessment, and if need be, a condition, whether *GTSO* has undertaken to comply with a ten-year network development plan;
- An assessment, and if need be, a condition as to whether and how the Ministry of Finance effectively assumes and covers liability for the condition of the transmission network.

#### **IV. Conclusion**

Based on the information displayed in the Preliminary Decision and all other information obtained in the course of the present procedure, the Secretariat concludes that *GTSO* can be certified as envisaged by the Preliminary Decision, subject to the conditions, reviews and assessments mentioned in the previous chapter.

Pursuant to Article 3 of the Gas Regulation, NEURC shall take utmost account of the above comments of the Secretariat when taking its final decision regarding the certification of *GTSO*. NEURC 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. NEURC is invited to inform the Secretariat within

one working day 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, 17 December 2019



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