

Energy Community Secretariat

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Mr. Dejan Popović
President of the Council
Energy Agency of the Republic of Serbia
Terazije 5/V
11000 Belgrade
Serbia

Vienna, 18 December 2019
ECS-5/19/O/18-12-2019

Ref: Opinion 5/19 on certification of Gastrans

Dear Mr. Popović,

Please find attached the Energy Community Secretariat's Opinion 5/19 on AERS Preliminary Decision of 15 August 2019 on the certification of Gastrans given in accordance with Article 3(1) of Regulation (EC) No. 715/2009 and Articles 10(6) and 11(6) of Directive 2009/73/EC.

Sincerely,



Janez Kopač
Director



Dirk Buschle
Deputy Director/Legal Counsel

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Opinion 5/19

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

On 22 August 2019, the Energy Agency of the Republic of Serbia (hereinafter “AERS”) notified the Energy Community Secretariat (hereinafter “the Secretariat”) of a preliminary decision (hereinafter “the Preliminary Decision”) on the certification of *GASTRANS LLC, Novi Sad* (hereinafter “*Gastrans*”) as a transmission system operator (hereinafter “TSO”).

The Preliminary Decision was adopted on 15 August 2019,¹ based on Article 49(3) in connection with Article 232 of the Energy Law of Serbia,² Articles 20-23 of the Rulebook on Energy Licence and Certification,³ item 24(1) of the Decision of AERS on Exemption of New Natural Gas Interconnector (hereinafter “the Exemption Decision”),⁴ as well as Article 12 of the Statute of AERS.⁵

Pursuant to Articles 10 and 11 of Directive 2009/73/EC⁶ (hereinafter “the Gas Directive”) and Article 3 of Regulation (EC) No 715/2009⁷ (hereinafter “the Gas Regulation”), the Secretariat is required to examine the notified Preliminary Decision and deliver its opinion to AERS as to the compatibility of such a decision with Article 9 of the Gas Directive (hereinafter “the Opinion”).

On 10 December 2019, the Secretariat was informed that the Energy Community Regulatory Board did not raise any specific comments on the Preliminary Decision.

I. *Gastrans* and the pipeline project

The *Gastrans* natural gas pipeline project (hereinafter “the Project”) consists of a natural gas transmission line which is planned to pass through the territory of Serbia in the approximate length of 400 km, and to connect the Serbian natural gas transmission system with those of Bulgaria and Hungary. It aims at transporting natural gas from Turkey, using capacities of the so-called TurkStream pipeline⁸ and Bulgaria, where a new pipeline is to be built. The projected technical

¹ AERS Decision No. 311.02/2019-C-I, adopted on 15 August 2019.

² Energy Law, Official Gazette of RS No. 145/14 and 95/18.

³ Rulebook on Energy Licence and Certification, Official Gazette of RS No. 87/15.

⁴ AERS Decision No. 40/2018-D-03/62, adopted on 5 March 2019, Official Gazette of RS No. 15/19.

⁵ Official Gazette of RS No. 52/05.

⁶ 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.

⁷ 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.

⁸ TurkStream is a natural gas pipeline project directly connecting, through its offshore segment under the Black Sea, the Russian and Turkish natural gas systems. The pipeline has two lines with a total capacity of 31.5 bcm annually. The

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capacity of the new pipeline is 13.88 bcm annually. Originally, the completion of construction activities to enable the start of the pipeline's commercial operation ("COD") was foreseen for 1 January 2020.

The promoter of the Project envisaged as the future operator of the new pipeline is *Gastrans*, the successor of *South Stream d.o.o. Novi Sad* which was originally founded on 30 April 2012 for the construction of the Serbian branch of the South Stream pipeline project. The company was re-established on 26 January 2018, and the company's name was changed to *Gastrans* as of 1 February 2018. *Gastrans* is fully owned by *South Stream Serbia AG*, which is registered in Switzerland and owned by *PJSC Gazprom Transgaz Krasnodar* (51%), a subsidiary of the Russian natural gas holding *PJSC Gazprom* (hereinafter "*Gazprom*"), and *Srbijagas* (49%).

Both *Gazprom* and *Srbijagas*, the ultimate shareholders of *Gastrans*, are dominant players on the Russian and Serbian gas markets respectively. *Gazprom* possesses more than 72% of Russia's proven natural gas reserves and accounts for 68% of the national natural gas output. *Srbijagas*, a 100% state-owned Serbian natural gas incumbent, is engaged in gas transmission, distribution and supply activities and dominates the market both at wholesale and retail levels.⁹

II. The Preliminary Decision

The Serbian Energy Law of 2014 requires unbundling of transmission system operators (hereinafter "TSOs") according to one of the three models envisaged by the Gas Directive: ownership unbundling, independent system operator or independent transmission operator (hereinafter "ITO").¹⁰ Under Article 239 of the Energy Law, certification is a prerequisite for obtaining a license.

On 25 June 2019, *Gastrans* submitted an application for certification of the TSO in line with Article 24(1) of the Exemption Decision.

The Exemption Decision exempts the Project, and in particular the operation and use of the new pipeline within the territory of Serbia, for a period of up to 20 years from the new pipeline's commercial operation date from: (i) the unbundling of the pipeline's system operator; (ii) regulated third-party access up to 75% of the pipeline's capacity;¹¹ and (iii) setting of regulated tariffs for the transmission of natural gas through the new pipeline. The exemption is subject to *Gastrans'* compliance with conditions set by AERS.

In particular, the Exemption Decision exempts *Gastrans* from the mandatory obligation to unbundle from any other activities and interests in the energy sector pursuant to Article 9 of the Gas Directive. For this exemption to be effective, the Exemption Decision establishes a number of mandatory

offshore part of the pipeline being complete in November 2018, it is expected to become operational by the end of 2019. The TurkStream project is implemented by *South Stream Transport B.V.*, a subsidiary of *Gazprom*.

⁹ Energy Community Secretariat, Annual Implementation Report 2019, p. 154-155.

¹⁰ Article 223 of the Energy Law.

¹¹ In more detail: 70% of the technical capacity at entry point "Zaječar" for a period not exceeding 20 years; 55% of the technical capacity at "Paraćin", "Pančevo" and "Gospođinci" exit points for a period not exceeding 20 years; 75% of the technical capacity at exit point "Horgoš" for a period not exceeding 18 years.

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conditions to be met by *Gastrans*, including the adoption of a compliance program, the appointment of an independent compliance officer and the designation of an *ad hoc* body to resolve complaints regarding capacity allocation in the new pipeline, the possession of all assets necessary to perform the transmission activity, to employ staff, use premises and operate separately and independent of related companies.¹²

Before AERS rendered the Exemption Decision to *Gastrans*, on 1 February 2019, the Secretariat issued Opinion ECS 1/19 on the AERS preliminary decision related to exemption, as envisaged by the Gas Directive.¹³ Since it does not fulfill the conditions for an exemption listed in Article 36(1) of the Gas Directive, the Secretariat expressed its view that the exemption cannot be granted as provided by AERS, unless it adopts a number of measures as listed and explained in the Opinion. In particular, the Secretariat concluded that the Project does not enhance competition on the Serbian market, and that the exemption granted by AERS is detrimental to competition.

In its operative part, the Preliminary Decision certifies *Gastrans* under the ITO model. The Preliminary Decision is based on the application by *Gastrans* and accompanying documentation, including, predominantly, a number of statements made by the management of *Gastrans* and its shareholders, *Srbijagas* and *Gazprom*. The Preliminary Decision also takes into account *Gastrans'* assets and resources, building permits and financing, as well as the contractual arrangements. A compliance programme, to which AERS gave its consent, and the appointment of a compliance officer are also part of the documentation submitted.

Based on AERS' assessment, the operative part of the Preliminary Decision requires *Gastrans* to submit within six months since beginning of operational work:

- *“certificate of occupancy or to register ownership rights over natural gas transmission system facilities and*
- *evidence confirming that the company operates and manages the constructed transmission system independently in line with item 4, paragraph 1-3 of the Decision of the Energy Agency of the Republic of Serbia on Exemption of New Natural Gas Interconnector”*

The second point refers to the Exemption Decision's requirement to operate the pipeline and be organized independently, to possess the necessary financial, material and technical means for transmission and the operation of the transmission system, and to have a sufficient number of employees who independently perform legal, economic, technical and other tasks, including IT.

Moreover, *Gastrans* is requested to report to AERS once per month on the actions taken in order to comply with these conditions. In case of non-compliance, the Preliminary Decision envisages that

“...the Energy Agency of the Republic of Serbia will initiate a new certification procedure in order to reassess the certification conditions and adopt a decision on the revocation of the certificate...”

¹² The Exemption Decision, items 3, 4, 5, 6 and 7 p. 2-5.

¹³ Secretariat Opinion 1/2019 of 1 February 2019 on the exemption of the *Gastrans* natural gas pipeline project from certain requirements under Directive 2009/73/EC by the Energy Agency of the Republic of Serbia.

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III. Assessment of the Preliminary Decision

1. Relevance of the Exemption Decision

Gastrans applied for certification of the TSO in line with Article 24(1) of the Exemption Decision which obliges the company prior to the commencement of the operational work, to obtain a certification from AERS. The certification shall be issued if the conditions set out by the Exemption Decision under items 4-7 are complied with, namely to permanently protect the confidentiality of commercially sensitive information of system users and apply measures to this end; operate the pipeline and be organized independently, to possess the necessary financial, material and technical means for transmission and the operation of the transmission system, and to have a sufficient number of employees who independently perform legal, economic, technical and other tasks, including IT; to adopt and implement a compliance program; to appoint a compliance officer and ensure that the compliance officer performs its duty separately and independently.

However, as has been pointed out by the Secretariat in Opinion ECS-1/19, the Project does not fulfill the conditions under Article 36 of the Gas Directive and should therefore not have been exempted from the unbundling regime enshrined in Article 9 of the Gas Directive.

In particular, the Secretariat recalls that the investment does not enhance competition, as required under Article 36(1)(a) of the Gas Directive, but that the exemption granted is detrimental to competition: Due to the monopolistic and/or dominant positions of the shareholders of the Project at different levels of the Serbian gas market, the Project is not expected to make new capacity effectively available to new market entrants and/or competitors, but will strengthen the market position of its owners, and further foreclose the markets. Furthermore, the exemption from third-party access and the exclusive allocation of the originally envisaged 88% or more of the capacity will further restrict competition, in particular because the new capacity is not available to new market entrants and/or competitors of the dominant undertakings but only to the already dominant market players themselves.

The Exemption decision did not require *Gastrans* to implement the proposed liquidity measures¹⁴ or any substitute to it. Also, unbundling of the system operator *Transportgas Srbija* from *Srbijagas* was not made a condition for the exemption. Without the safeguarding and liquidity measures stated in the Secretariat’s Opinion ECS-1/19, the Project will constitute an additional and persistent obstacle to market opening, transparency and the development of competition, which is currently almost non-existent and needs regulatory support. This is even more so as the authorities have failed to address serious violations of Energy Community law by or attributable to the shareholders of the Project such as lack of unbundling of *Srbijagas* and *Yugorosgaz Transport* or the refusal to grant third-party access on the only existing interconnector with Hungary.

¹⁴ Namely, the shareholders of *Gastrans* and their affiliates shall be obliged to offer each quarter a volume equivalent to 30% of the volume of their total natural gas sales in the corresponding quarter of the previous year in Serbia; delivery point should be Virtual Trading Point of Serbia; price shall not be higher than the price defined in the long-term contract of the entity; in absence of demand from third parties, the offered volumes shall remain in the ownership of the undertaking which offered it.

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As a consequence, the Project has not been lawfully exempted from Article 9 of the Gas Directive. It therefore must comply with the unbundling regime of the Third Energy Package.

Therefore, the Secretariat is of the opinion that the certification cannot be based on a *sui generis* model of unbundling, such as the one established by the conditions imposed in the Exemption Decision (items 4-7), but that *Gastrans* has to comply with Article 9 of the Gas Directive.

Since *Gastrans* applied for certification under the conditions imposed by the Exemption Decision, its application for certification should be rejected in the Secretariat's opinion.

2. Applicability of the ITO model

As has been pointed out above, the Third Energy Package as well as the Serbian Energy Law require unbundling of TSOs according to one of the three models: ownership unbundling, independent system operator or independent transmission operator. Since the Project has not been lawfully exempted from these provisions, *Gastrans* needs to comply with this unbundling regime.

In this respect, the Secretariat notes that according to Article 9(8) of the Gas Directive, the ITO model may only apply "*where on 6 October 2011, the transmission system belongs to a vertically integrated undertaking*". AERS certifies *Gastrans* under the ITO model in the operative part of the Preliminary Decision.

The Secretariat recalls that the European Commission clarified that "*New transmission systems, in particular systems which did not yet exist on [date], will have to follow the ownership unbundling regime.*"¹⁵ Since the Project concerns new infrastructure, the system was not operated at all on the cut-off date, and therefore, *Gastrans* is generally not eligible to be certified under the ITO model.

Therefore, the Secretariat is of the opinion that the certification cannot be based on the ITO model, but must be based on the assessment of the conditions of ownership unbundling as defined in Article 9 of the Gas Directive.

Although *Gastrans* explicitly applied for certification under the conditions imposed by the Exemption Decision and not under the ITO model, AERS certifies *Gastrans* under this model. However, since the company is not eligible to apply under the ITO model, the Secretariat is of the view that no such certification should be granted.

3. Conclusion

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

¹⁵ Commission Staff Working Paper, Interpretative Note on Directive 2009/72/EC concerning common rules for the internal market in electricity and Directive 2009/73/EC concerning common rules for the internal market in natural gas, The Unbundling Regime, dated 22 January 2010, p. 5.

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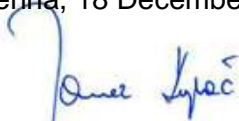
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The Secretariat's position on this particular notification is without prejudice to any position it may take vis-à-vis national regulatory authorities on any other notified draft measures concerning certification, or vis-à-vis national authorities and courts on the compatibility of any national implementing measure with Energy Community law.

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

Vienna, 18 December 2019

Handwritten signature of Janez Kopač in blue ink.

Janez Kopač
Director

Handwritten signature of Dirk Buschle in blue ink.

Dirk Buschle
Deputy Director/Legal Counsel