

Opinion 1/22

pursuant to Article 3(1) of Regulation (EC) No 714/2009 and Article 10(6) of Directive 2009/72/EC – Georgia – Certification of *GSE*

On 25 May 2022, the Georgian National Energy and Water Supply Regulatory Commission (hereinafter “GNERC”) notified the Energy Community Secretariat (hereinafter “the Secretariat”) of a preliminary decision (hereinafter “the Preliminary Decision”) on the certification of the electricity transmission system operator (hereinafter “TSO”) *JSC Georgian State Electrosystem* (hereinafter “*GSE*”) under the ownership unbundling model. The Preliminary Decision was adopted on 28 April 2022,¹ based on Articles 49 and 50 of the Energy Law,² as well as the Certification Rules adopted by GNERC.³

Pursuant to Article 10 of Directive 2009/72/EC⁴ (hereinafter “the Electricity Directive”) and Article 3 of Regulation (EC) No 714/2009⁵ (hereinafter “the Electricity Regulation”), the Secretariat is required to examine the notified Preliminary Decision and deliver its opinion to GNERC as to the compatibility of such a decision with Article 10(2) and Article 9 of the Electricity Directive (hereinafter “the Opinion”).

I. Background

1. The previous certification procedure

On 21 January 2021, *GSE* submitted an application for certification as TSO under the ownership unbundling model to GNERC. On 4 March 2021, GNERC adopted a preliminary decision.⁶ On 26 March 2021, the Secretariat issued an opinion on that preliminary decision (hereinafter “Opinion 1/21”), concluding that *GSE* was not unbundled in line with the ownership unbundling model as required by Article 9 of the Electricity Directive.⁷ Most notably, *GSE* was still directly and indirectly controlled by the same public body controlling also the public companies active in generation and/or supply of natural gas or electricity. On 1 April 2021, GNERC adopted a final decision on the certification of *GSE* (hereinafter “Final Decision of 1 April 2021”).⁸ In the Final Decision of 1 April 2021, GNERC instructed *GSE* to implement all measures in order to complete the unbundling and defined a detailed list of documents to be submitted to GNERC by 3 January 2022 in order to confirm the implementation of

¹ GNERC Decision No. 18/5, adopted on 28 April 2022.

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

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

⁴ Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, as incorporated and adapted by Decision 2011/02/MC- EnC of the Ministerial Council of the Energy Community of 6 October 2011.

⁵ Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003, as incorporated and adapted by Decision 2011/02/MC-EnC of the Ministerial Council of the Energy Community of 6 October 2011.

⁶ GNERC, Decision No. 9/10, adopted on 4 March 2021.

⁷ Secretariat’s Opinion 1/21 of 26 March 2021, *GSE*.

⁸ GNERC, Decision No.14/3, adopted on 1 April 2021.

these measures. As required by the Secretariat's Opinion 1/21, in the Final Decision of 1 April 2021, GNERC announced reopening of the certification procedure, including adoption of a preliminary decision to be submitted to the Secretariat for an opinion, after submission of the relevant documents by GSE.

In January 2022, GNERC informed the Secretariat that it has re-opened the certification procedure for GSE. Since GSE had not submitted the documents proving its unbundling by 3 January 2022, as required by the Final Decision of 1 April 2021, GNERC requested again submission of the necessary documents, including the proof that all the conditions set out in the Final Decision of 1 April 2021 were satisfied, by 31 January 2022.

On 21 February 2022, GSE re-submitted an application for certification to GNERC. On 28 April 2022, GNERC held a public hearing on the application and adopted the Preliminary Decision rejecting the certification of GSE. This new Preliminary Decision was submitted to the Secretariat and is subject to the present Opinion.

2. The applicant GSE

GSE is a joint-stock company established under Georgian law. It is active in electricity transmission on the territory of Georgia on the basis of a license issued by GNERC.⁹

GSE was created by reorganization of the *Georgian State Electrosystem LLC* in 2002 and was transformed into a joint-stock company in 2011. GSE is fully State-owned. The State's shares of GSE are held by the National Agency of State Property (hereinafter "State Property Agency"), an agency subordinated to the Ministry of Economy and Sustainable Development (hereinafter "the Ministry"). In 2020, the State Property Agency transferred the rights and obligations associated with shareholding to the Ministry.¹⁰ Under the transfer agreement, the Ministry can appoint and dismiss directors, approve reports and select an auditor; the consent of the owner (the State Property Agency) is only needed for decisions concerning the alienation of shares, the liquidation of the company, the disposal, pledging or transfer of assets, and withdrawal and contributions to the share capital.

On 4 January 2021, GSE concluded a lease agreement with *Sakrusenergo*, a company that holds another transmission license issued by GNERC.¹¹ The shares of *Sakrusenergo* are owned 50% by the State of Georgia, whereas the rights and obligations associated with the shareholding are exercised by the Ministry (transferred by the State Property Agency), and 50% by the *Federal Grid of the United Energy System JSC* registered in the Russian Federation.

⁹ License №008, series 12, GNERC Decision No. 20/1, adopted on 13 May 2021. In January 2021, GSE merged with the fully State-owned *Energotrans*, which previously operated as a separate TSO. Since then, GSE owns and operates also the transmission assets previously operated by *Energotrans*.

¹⁰ Agreement on Transfer of Management Rights of State-Owned Shares of JSC Electricity System Commercial Operator, JSC Georgian State Electrosystem and JSC United Energy System *Sakrusenergo* of 4 May 2020. Under the Law on State Property, the shares are considered state-owned assets and are administered by the State Property Agency, unless transferred to another body.

¹¹ License №001, series 12, GNERC Decision No. 8, adopted on 23 February 2000.

3. State activities in generation and/or supply of electricity or natural gas

In addition to *GSE* and *Sakrusenergo*, the State also fully owns the shares in other undertakings active in the energy sectors. In the electricity sector, those undertakings are: the generation company *Enguri HPP* (which in turn own the shares of *Vardnili HPP Cascade*), the wholesale trading and supply company *Electricity System Commercial Operator* (hereinafter “*ESCO*”), and the wholesale trading company *Karchal Energy* (registered in Turkey). In the gas sector, those undertakings are: the TSO *Georgian Gas Transportation Company* (hereinafter “*GGTC*”) and the wholesale trading company *Georgian Oil and Gas Corporation* (hereinafter “*GOGC*”). Moreover, the Ministry owns the shares of the *JSC Energy Development Fund*, which is active in renewable energy project development. The shares in these companies are formally held by the State Property Agency; the rights and obligations associated with shareholding in these companies are exercised by the Ministry.

II. Description of the notified Preliminary Decision

In December 2019, Georgia adopted an Energy Law transposing the Third Energy Package as incorporated in the Energy Community, and including provisions on unbundling and certification. It requires unbundling of TSOs according to one of the two models envisaged also by the Gas Directive: ownership unbundling or independent system operation.¹² Under Article 13(3) of the Energy Law, certification is a prerequisite for obtaining a license. *GSE* applied for certification under the unbundling model.

In the operative part of the Preliminary Decision, GNERC rejects the certification of *GSE* and requires *GSE* to take all measures necessary to comply with the requirements for unbundling, in particular the reallocation of the managing rights for the energy undertakings in order to separate the control over the TSO from the control over the electricity and gas generation and/or supply companies, by 1 July 2022. *GSE* is requested to send a list of documents to GNERC by 8 July 2022, as a proof of the completed unbundling. It is further envisaged that *GSE* is temporarily authorized to operate as a TSO until final decision of GNERC on compliance with the unbundling requirements. Finally, in case of non-compliance with the requirements of the Preliminary Decision, i.e. unbundling and submission of documents as evidence, *GSE* will be fined up to 10 percent of its annual turnover for 2021.

III. Assessment of the Preliminary Decision

The Secretariat recalls that the unbundling provisions were designed to separate, in vertically integrated undertakings,¹³ control over transmission system operation as a natural monopoly, on the one hand, and over production and supply activities as competitive activities, on the other hand. The purpose of unbundling is to eliminate actual and potential conflicts of interest between transmission and other activities performed by vertically integrated undertakings.¹⁴ In particular, the rules on unbundling thus aim to prevent vertically integrated undertakings from using their privileged position as operators of a

¹² Articles 44 to 46 of the Energy Law.

¹³ A VIU is defined in Article 2(20) of the Gas Directive as “a natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas”.

¹⁴ Secretariat Opinions 1/16 of 3 February 2016, *TAP AG*; 1/17 of 23 January 2017, *OST*.

transmission network by obstructing access of network users other than their affiliated companies to their network or other conduct affecting fair and undistorted competition, market integration or infrastructure investment.

Against this background, the ownership unbundling model enshrined in Article 9 of the Electricity Directive envisages that each undertaking owning a transmission system acts as TSO while the same person(s) are not entitled to (directly or indirectly) exercise control over a generation or supply undertaking and at the same time exercise control over a TSO and *vice versa*.

According to the Secretariat's well-established practice,¹⁵ the following aspects matter in particular when assessing the compliance of the Preliminary Decision with the ownership unbundling model enshrined in Article 9 of the Electricity Directive:

- 1) The undertaking to be certified needs to be the owner of the transmission system (Article 9(1)(a) of the Electricity Directive);
- 2) The undertaking to be certified needs to act, and be capable and viable to act as TSO (Article 9(1)(a) of the Electricity Directive);
- 3) Control over and exercising rights in the undertaking to be certified need to be separated from control over and exercising rights in undertakings performing any of the functions of production or supply of electricity or natural gas (Article 9(1)(b),(c),(d),(2),(3),(6),(7) and (12) of the Electricity Directive).

1. Ownership of the transmission system

Article 9(1)(a) of the Electricity Directive requires that "*each undertaking which owns a transmission system acts as a transmission system operator*". This means, in principle, that the undertaking applying for certification is the owner of the transmission assets, i.e. the transmission system.

The European Commission and the Secretariat have accepted only in exceptional cases that a TSO's right to use, manage and dispose of the transmission system through arrangements such as lease or concession agreements may be considered equivalent to ownership.¹⁶ In these cases, it was required that the TSO as lessee or concessionaire: (1) has the transmission system assets feature on its balance sheets and can use them as a guarantee (collateral) in acquiring financing on the capital market; (2) is responsible for exercising all of the TSO's tasks, which include the planning, construction, operation and maintenance of the entire infrastructure and the financing thereof; and (3) upon the expiry of the lease or concession, is compensated by the lessor with an amount equivalent to the corresponding value of the lease or concession assets.

GSE owns the assets of the transmission system it manages and operates. In addition to the transmission

¹⁵ Secretariat Opinions 1/16 of 3 February 2016, *TAP AG*; 1/17 of 23 January 2017, *OST*; 3/17 of 23 January 2017, *EMS*; 2/17 of 22 April 2017, *Yugorosgaz Transport*; 1/18 of 27 February 2018, *CGES*; 2/19 of 1 February 2019, *KOSTT*; 3/19 of 17 June 2019, *MEPSO*; 4/19 of 17 December 2019, *GTSO*.

¹⁶ Commission's Opinion on URE's draft certification decision for *PSE S.A.* of 9 April 2014, C(2014) 2471; Commission's Opinion on certification of *REN Rede Electrica Nacional S.A.* and *REN Gasodutos S.A.*, C(2014) 3255; Commission's Opinion on certification of *Transelectrica D.A.*, C(2015) 7053; Secretariat's Opinion 1/20 of 5 February 2020, *Ukrenerg*.

assets it owns, *GSE* operates the assets owned by *Sakrusenergo* on the basis of a lease agreement.

Following the Secretariat's Opinion 1/21, in its Final Decision of 1 April 2021, GNERC assessed the compliance of the lease agreement between *Sakrusenergo* and *GSE* with the requirements for ownership unbundling and concluded that *GSE* is entitled to exercise the powers specified in the lease agreement over the transferred assets during the whole period of authorization as a TSO and the corresponding value of the transferred assets will be compensated annually. GNERC therefore concluded that *GSE* exercises rights equivalent to those of an owner for the transmission assets it operates under the lease agreement with *Sakrusenergo*.

In the Preliminary Decision, GNERC confirmed that no amendments were made to the lease agreement following its Final Decision of 1 April 2021 and that the parties to the lease agreement duly comply with the rights and obligations enshrined in the agreement.

GSE owns the network it operates; however, it also operates assets owned by *Sakrusenergo* on the basis of a lease agreement. On the basis of the lease agreement and the Charter of *Sakrusenergo*, the latter assets can be effectively used as a guarantee for acquiring financing on the capital market (irrespective of whether they feature on *GSE*'s balance sheets). Furthermore, under the current license, *GSE* remains responsible for exercising all core tasks of a TSO. Finally, the lease agreement provides for remuneration to *GSE* calculated on the basis of principles set out in the Electricity Dispatching, Transmission, Distribution and Consumption Tariff Calculation Methodology¹⁷ which require that the value of the assets shall be compensated annually. It follows that the requirements for considering the rights of a lessee or concessionaire to be equivalent to those of an owner of a transmission system are fulfilled.

The Secretariat therefore agrees with GNERC's assessment and conclusion that *GSE* complies with the requirement under Article 9(1)(a) of the Electricity Directive to be the owner of the transmission system.

2. Capability and viability to act as TSO

Article 9(1)(a) of the Electricity Directive requires that the undertaking applying for certification "*acts as a transmission system operator*". The notion of TSO is defined in Article 2 No 4 of the Electricity Directive as "*a natural or legal person responsible for operating, ensuring the maintenance of, and, if necessary, developing the transmission system in a given area and, where applicable, its interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transport of electricity*". It follows from this definition that the core tasks of a TSO are the operation, maintenance and development of a transmission system.¹⁸ A regulatory authority's assessment in this respect needs to establish in particular whether an undertaking applying for certification is, by law and in fact, performing each of these core tasks, and whether it disposes of the necessary (human, technical, financial) resources for doing so.¹⁹

¹⁷ GNERC Resolution No. 14, adopted on 30 July 2014.

¹⁸ Secretariat Opinion 1/16 of 3 February 2016, *TAP AG*.

¹⁹ Commission's Opinion on certification of *VÜN C(2012) 2244 final* of 29.3.2012.

In its Final Decision of 1 April 2021, GNERC analyzed in detail the compliance of *GSE* with this requirement and concluded that *GSE* disposes of the necessary (human, technical, financial) resources to act as a TSO in the operation of its own assets and the assets owned by *Sakrusenergo* and that outsourcing some of the core TSO tasks to it is an efficient decision.

In the Preliminary Decision, GNERC does not report any changes regarding *GSE*'s activities.

As stated in the Secretariat's Opinion 2/21, there are no reasons to doubt that *GSE* satisfies these requirements with respect to the network it owns and operates. As regards the network of *Sakrusenergo*, the outsourcing of maintenance tasks to *Sakrusenergo* does not encroach upon *GSE*'s autonomy to perform the core tasks of a TSO because it can be considered an economically reasonable decision and *GSE* has the necessary resources to oversee, control and provide instructions to *Sakrusenergo* regarding these tasks. Furthermore, on the basis of the lease agreement and the Charter of *Sakrusenergo*, *GSE* autonomously decides about investment plans.

The Secretariat therefore agrees with GNERC's assessment and conclusions that *GSE* complies with the requirement under Article 9(1)(a) of the Electricity Directive to act and be capable and viable to act as TSO.

3. Separation of control

a. Separation of public bodies

The rules on unbundling apply equally to private and public entities. For the purpose of the rules on ownership unbundling, Article 9(6) of the Electricity Directive provides that two separate public bodies shall be deemed not to be the same person(s) within the meaning of Article 9(1) of the Electricity Directive, and may therefore exercise control over a TSO, on the one hand, and over undertakings performing any of the functions of generation or supply, on the other hand. The notion of control is further defined by the Merger Regulation²⁰ and includes the rights enumerated in Article 9(2) of the Electricity Directive, including the power to exercise voting rights, the holding of majority share and the power to appoint members of the TSO's corporate bodies and those legally representing the TSO. The objective of these provisions is to ensure an effective separation of control between the two public bodies in question capable of potential and actual conflicts of interest within the State structures controlling different energy activities.²¹

As described in the Preliminary Decision, control over *GSE* as well as the other undertakings active in generation and/or supply of electricity or natural gas listed above is exercised by the Ministry by way of majority shareholding. The Ministerial Order of 2 December 2020 provided for different departments within the Ministry to exercise the rights and obligations associated with shareholding in the TSO, on the one hand, and in the other undertakings active in generation and/or supply of electricity or natural gas, on the other hand.²² However, the Order expired on 31 December 2021. No measures have been

²⁰ Council Regulation (EC) No 139/2004 of 20 January 2004 on the, Official Journal L 24, 29.01.2004, p. 1-22.

²¹ Secretariat Opinion 1/17 of 23 January 2017, OST.

²² Minister's Order N1-1/521 on "Establishing a Different Rule for Assigning and Reallocation of the Functions among the Divisions of the Ministry of Economy and Sustainable Development of Georgia", 02.12.2020. Under this Order, the department of energy policy and investments exercised the Ministry's shareholding rights in *GSE*, *Sakrusenergo*, *GGTC*

adopted for ensuring that two truly separate public bodies exercise control over the TSO, on the one hand, and over the electricity or gas generation and/or supply undertakings, on the other hand. The Ministry remains the public body exercising full and unfettered control over the TSO as well as over the undertakings active in electricity or gas generation and/or supply.

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

The Secretariat agrees that separation of control within the State in line with Article 9(6) read in conjunction with Article 9(1)(b) and (c) of the Electricity Directive has not taken place even in its most basic requirement: the designation of two public bodies. The formal separation of competences between public bodies constitutes a *sine qua non* for unbundling of a state-owned TSO.²³ In similar cases, the Secretariat has held that a TSO cannot be certified as compliant with the Electricity Directive's provisions on ownership unbundling.²⁴ Without any separation of control over *GSE* and the other companies active in generation and/or supply of electricity or gas, one of the main objectives of the Electricity Directive's unbundling provisions, the elimination of an interest of the public body controlling the TSO in discriminating in favour of generation and supply companies controlled by it, is likely to be frustrated.

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

b. Avoidance of conflict of interests

Article 9(1)(d) of the Electricity Directive provides that the same person is not entitled to be a member of the supervisory board, the administrative board, or bodies legally representing the undertaking, of both an undertaking performing any of the functions of generation or supply and a TSO.

In its Preliminary Decision, GNERC explained that during the period 17 May 2021 to 18 February 2022, a member of the Supervisory Board of *GSE*, Ms. Leontina Galdava, was also a representative of the Partnership Fund in the Supervisory Board of *TPP Gardabani* and the gas wholesale trading company *GOGC* and is currently a in the position of director of several hydropower plant projects under construction, in particular *LLC Mtkvari HPP*. GNERC requested *GSE* to eliminate this conflict of interest by 1 July 2022 and to submit documents proving the fulfilment of this condition to GNERC.

Article 9(1)(a) of the Electricity Directive indeed prohibits the same person from being a member of the board of both a generation or supply company on the one hand and a TSO on the other hand in order to avoid any conflicts of interest for board members. Ms. Leontina Galdava is no longer a board member of *TPP Gardabani* and *GOGC*, but still a member of the supervisory board of both a TSO and a company

and the Energy Development Fund of Georgia, whereas the department of energy reforms and international relations exercises the Ministry's shareholding rights in *ESCO*, *GOGC* and *Enguri HPP* (which in turn owns the shares of *Vardnili HPP*).

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

²⁴ Secretariat Opinions 3/17 of 15 June 2017, *EMS*; 6/19 of 11 October 2019, *Moldelectrica*; 1/20 of 5 February 2020, *Ukrenerg*o.

(soon to be) active in generation.

The Secretariat therefore agrees with GNERC's assessment and conclusions that *GSE* does not comply with the requirement of avoidance of conflict of interests under Article 9(1)(d) of the Electricity Directive and GNERC's condition to be included in the Final Decision.

IV. Conclusions

Based on the information displayed in the Preliminary Decision, the Secretariat concludes that *GSE* does not comply with the unbundling provisions enshrined in Article 9 of the Electricity Directive. Most notably, *GSE* is still directly and indirectly controlled by the same public body controlling also the public companies active in generation and/or supply of natural gas or electricity.

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

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

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

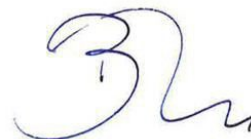
The Secretariat will publish this Opinion on its website. The Secretariat does not consider the information contained therein to be confidential. GNERC is invited to inform the Secretariat within five working days following receipt of this Opinion whether and why it considers that this document contains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

Vienna, 24 June 2022



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