

Energy Community Secretariat

Opinion 1/2015

on the prolongation of the exemption of the Trans Adriatic Pipeline interconnector from certain requirements under Directive 2009/73/EC by the Energy Regulatory Authority of Albania (ERE)

1. Background

1. Trans Adriatic Pipeline AG ("TAP AG") is a company seeking to develop, construct and operate the Trans Adriatic Pipeline ("the Pipeline"). The Pipeline aims at transporting gas by the Shah Deniz consortium produced mainly from the Phase II development of the Shah Deniz fields ("SD II") in the territory of the Republic of Azerbaijan. It is part of a larger set of interdependent projects both upstream and downstream of the Pipeline, collectively often referred to as the Southern Gas Corridor.

2. Procedure

2. By its Opinion of 14 May 2013¹, the Energy Community Secretariat (hereinafter, "the Secretariat") gave consent subject to several amendments and conditions to an exemption for TAP AG pursuant to Article 36 of Directive 2009/73/EC from certain of the requirements on third party access, tariff regulation and ownership unbundling as laid down in Articles 9, 32, 41(6), (8) and (10) of Directive 2009/73/EC ("Opinion 1/2013").
3. Subsequently, the Albanian Regulatory Authority for Energy (hereinafter, "ERE") adjusted its Exemption Decisions², endorsing the so-called Final Joint Opinion³. It was collectively elaborated by ERE together with the Greek and Italian regulatory authorities and amended to the extent required by the Secretariat's Opinion 1/2013 as well as the European Commission's Decision (2013) 2949 final, so that TAP AG was granted an exemption from certain of the requirements laid down in Articles 9, 32, 41(6), (8) and (10) of Directive 2009/73/EC.
4. Chapter 4.10 of the Final Joint Opinion contains provisions making the exemption granted to TAP AG conditional on the start of the construction of the Pipeline by a certain date and on the infrastructure becoming operational by a certain date, the so-called Commercial Operation Date which is the date on which the Pipeline will be completed and able to receive, transport and deliver natural gas. This conditionality is consequently reflected in the Exemptions Decision.
5. On 27 June 2014 ERE received a request by TAP AG to postpone the date by which the Commercial Operation Date had to take place until 31 December 2022 and the date by which construction had to start until 1 January 2018, in order for the exemption to retain its effect. On 17 December 2014, TAP AG modified its original request in that it now asked for a postponement of the date by which the Commercial Operation Date would take place until 31 December 2020. No modification was made to the request to postpone the date by which the construction has to start ("TAP AG's Request").
6. On 30 December 2014, ERE notified to the Secretariat in accordance with Article 36(9) of Directive 2009/73/EC its Decision No 135 of 24 December 2014 on TAP AG's Request. On 27 February 2015,

¹ Opinion 1/2013, available at www.energy-community.org.

² ERE Decision No 27 of 1.3.2013 amended by Decision No 64 of 13.6.2013

³ Joint Opinion version 6 June 2013.

the period within which the Secretariat adopts its Opinion was prolonged until 20 March 2015 upon consent between ERE and the Secretariat (Article 36(9), last sentence of Directive 2009/73/EC).

3. Assessment

3.1. Relevant legal provisions

7. The fifth paragraph of Article 36(9) of Directive 2009/73/EC provides that the Secretariat's opinion shall lose its effect two years from its adoption in the event that construction of the Pipeline has not yet started, and five years from its adoption in the event that the infrastructure has not become operational, unless the Secretariat considers that any further delay is due to major obstacles beyond control of the person to whom the exemption has been granted.
8. Section 4.10 of the Final Joint Opinion, to which the Secretariat did not object, states that for the Commercial Date of Operation, the Pipeline shall be put into operation no later than 1 January 2019 and that the Joint Opinion shall lose its effect three years from its adoption in the event that construction of the Pipeline has not yet started, and six years from its adoption in the event that the infrastructure has not become operational, unless it is established that any further delay is due to major obstacles beyond control of the person to whom the exemption has been granted.
9. The fifth paragraph of Article 36(9) of Directive 2009/73/EC provides for the possibility to prolong the validity of the Secretariat's approval of a granted exemption if the Secretariat considers that any delay in the start of the construction and/or in the infrastructure becoming operational is due to major obstacles beyond the control of the person to whom the exemption has been granted.
10. Therefore, the validity of the Secretariat's Opinion on an exemption can be prolonged provided that the Secretariat considers, first, that any delay is due to major obstacles and, second, that those obstacles are beyond control of the person to whom the exemption has been granted.

3.2. TAP AG's request

11. By means of the notified decision on TAP AG's request, ERE proposes to modify Section 4.10 of the Final Joint Opinion as follows:
"In line with the provisions of Article 36(9) of Directive 2009/73/EC, the present Opinion and the Commission's approval shall lose its effect in the event that construction of TAP has not yet started on 1 January 2018 and in the event that the infrastructure has not become operational on 31 December 2020, unless the Commission decides that any further delay is due to major obstacles beyond control of the person whom the exemption has been granted".
12. The Opinion 1/2013 was adopted on 14 May 2013. Therefore, the Secretariat's approval of the exemption would lose its effect if the construction of the Pipeline has not started by 14 May 2015. The ERE Proposed Modifications envisage a postponement, until 1 January 2018, of the date by which the construction of the Pipeline would have to have started in order for the exemption to retain its effect.
13. In addition, taking into account the five-year timeframe laid down in Article 36(9) of Directive 2009/73/EC, the Secretariat's consent to the exemption would also lose its effect if the operation of the Pipeline would not have started by 14 May 2018. The ERE Proposed Modifications envisage a postponement, until 31 December 2020, of the date by which operation of the Pipeline would have to have started in order for the exemption to retain its effect.

3.3. Grounds put forward by TAP AG

3.3.1 *The postponement of the date related to the Commercial Operation Date*

14. Gas originating from Azerbaijan is expected to be the first gas made available to the European markets through the opening of the Southern Gas Corridor. The Southern Gas Corridor is constituted by a chain of interdependent projects both upstream and downstream of the Pipeline. More in particular, the Southern Gas Corridor involves the development of the SD II production field and a series of pipelines such as the expansion of the South Caucasus Pipeline from Azerbaijan across Georgia, TANAP in Turkey and the connection via the Pipeline through Albania and to the SNAM gas system in Italy. Thus, the Commercial Operation Date of the Pipeline is inherently linked to the timing of the first gas deliveries by the Shah Deniz Consortium to the Union.
15. In order to align the planned Commercial Operation Date of the Pipeline with the availability of SD II gas volumes to the Union, TAP AG and the Shah Deniz Consortium agreed on a contractual mechanism, the so called "Funnelling Mechanism", by which, progressively, TAP AG is notified by the Shah Deniz Consortium more narrow time frames within which the Commercial Operation Date has to take place. Only the Shah Deniz Consortium controls the upstream progress of the project. The Funnelling Mechanism was finalised after the Opinion 1/2013 was issued.
16. On the basis of the Funnelling Mechanism, TAP AG was initially notified by the Shah Deniz Consortium on 17 December 2013 that the Commercial Operation Date would take place within a 36 months window period starting on 1 January 2020 and ending on 31 December 2022. On 16 December 2014, TAP AG was notified by the Shah Deniz Consortium of a more narrow time window for the Commercial Operation Date, namely from 1 January 2020 to 31 December 2020.
17. TAP AG underlines that the flexibility provided by the Funnelling Mechanism is well constrained. No contractual mechanism allowing for an extension of the planned COD beyond 2020 or for anticipation to an earlier date than 1 January 2020 exists.
18. TAP AG stresses that the economics of the Pipeline project would be significantly affected and would pose major risks for TAP AG's shareholders, shippers and the Shah Deniz Consortium alike if the exemption granted in 2013 would lose its effect prior to the Commercial Operation Date. According to TAP AG, legal uncertainty would exist regarding the legal validity of the capacity booking, the tariff methodology for the Pipeline and, consequently, TAP AGs revenue streams and the bankability of the Pipeline project. Such legal uncertainty would also pose problems to the administrative procedures related to securing in a timely manner capacity downstream of the Pipeline in the Italian SNAM network.

3.3.2 *The postponement of the date related to the start of construction*

19. In its submissions, TAP AG also argues that the Pipeline requires a construction period of at least five years and that postponing the date by which construction should be started to 1 January 2018 would cater for the possibility to align the construction schedule with the latest date for the expected commencement of operations. This would also align the ultimate date for the start of construction with the certification deadline set out in Section 4.5.2 of the Final Joint Opinion.

3.4. Assessment by ERE of TAP's request

20. ERE considers that TAP AG's request is well grounded because:

- (a) At the point in time where the Exemption Decisions were issued, TAP AG was not yet informed of the commencement date of the gas deliveries to the Energy Community since at that time the

Shah Deniz Consortium had not yet taken its Final Investment Decision. Only after the Final Investment Decision was taken, TAP AG was notified that the starting date of the first gas delivery could not occur earlier than 1 January 2020, contrary to previous estimates for a Commercial Operation Date and on which the Opinion 1/2013 and the Exemption Decisions were based;

- (b) The Commercial Operation Date is dependent on the time-table and developments of the upstream infrastructure. The developments in the upstream value chain of the project are beyond TAP AG's control. Consequently, any delay in the progress of the upstream infrastructure can be considered as a major obstacle to the timely starting date of the gas deliveries to Europe through the infrastructure concerned which is outside TAP AG's remit;
 - (c) The planned Commercial Operation Date is specified through the Funnelling Mechanism agreed between TAP AG and the Shah Deniz Consortium. The Funnelling Mechanism establishes the starting date of gas delivery to Europe, thereby mitigating the financial risks to which the overall project's development could be subjected in case the exemption was to lose its effect prior to the entry into operation of the pipeline for the reasons explained by TAP AG;
 - (d) There is no margin of further postponement of the entry into operation of the Pipeline due to the binding contractual commitments that according to TAP AG have already been taken by both TAP AG and the Shah Deniz Consortium with buyers and shippers. The risk of another delay in the planned Commercial Operation Date beyond 2020 for reasons related to the development of the project can thus be reasonably ruled out;
 - (e) As regards the latest date by which construction of the Pipeline should be commenced, ERE agrees with TAP AG.
21. ERE therefore takes the view that the conditions of Article 36(9) of Directive 2009/73/EC are met in the present case, as the delay in the commencement of the exploration of the SD II gas field as well as in the entry into operation of the Pipeline, respectively, is due to obstacles beyond the control of the project developer TAP AG, to whom the exemption has been granted.
22. Accordingly, ERE takes the view that the Final Joint Opinion should be revised in order to accommodate the TAP AG's Request.

3.5. Assessment by the Secretariat

3.5.1 Applicable law

23. ERE's Decision is based on Article 36 of Directive 2009/73/EC. Albania has not yet transposed this Directive into its national law, even though the deadline expired on 1 January 2015.⁴ Consequently, there is no proper legal basis for an exemption decision in Albanian law.⁵ Yet, the Secretariat, in Opinion 1/2013, decided to base its own assessment of the exemption of the TAP interconnector on Directive 2009/73/EC on account of general principles of Energy Community law.⁶ Directive 2009/73/EC also is the basis of the present Opinion.
24. That said, the Secretariat recalls that the transposition and implementation of 2009/73/EC by Albania is imperative. The continued failure to do so will not only entail infringement action against Albania. It will also jeopardize the certification of TAP as a transmission system operator which needs to be made in accordance with national rules properly transposing Article 10 of Directive 2009/73/EC and Article 3 of Regulation (EC) 715/2009, as incorporated and adapted by Decision 2011/02/MC-EnC of the Ministerial Council.

3.5.2 Importance of a date which can be foreseen with a reasonable degree of certainty

⁴ Article 3 of Decision 2011/02/MC-EnC of the Ministerial Council of 6 October 2011.

⁵ Article 40 of the Law on Gas in Albania transposes Article 22 of Directive 2003/55/EC.

⁶ Opinion 1/2013, at paragraphs 16 – 22.

25. The Pipeline is a commercial initiative by TAP AG and its shareholders, not incorporated or imposed by any national development plan of any of the countries through which the Pipeline runs. Shareholders and lenders invest in a project of this scale only after they have been assured that the potential risks have been covered to a maximum degree and that future revenues have a high degree of predictability. Granting an exemption, such as the one granted to TAP AG, shields private investors from certain of the risks associated with such large scale projects thereby rendering major infrastructure projects feasible, which would not be the case without the exemption.
26. At the same time, the Secretariat stresses that the general objectives of Directive 2009/73/EC require that an exemption granted under Article 36 of the Directive has a clear end date and that this date is not later than strictly necessary.
27. In particular, the advantages a granted exemption provides may constitute a disincentive to the development of infrastructure providing alternatives to the exempted one. Maintaining the validity of an exemption without the infrastructure being constructed may thus impede the development of alternative infrastructures. Consequently, exemptions should be provided for limited periods of time and, in particular, not last beyond what is strictly necessary. It follows from this that the precise date by which the construction of the infrastructure starts and the date by which the infrastructure becomes operational must be foreseeable with a reasonable degree of certainty.
28. The Secretariat takes the view that this condition is fulfilled now that the Shah Deniz Consortium has notified a more narrow time period in which the Commercial Operation Date will take place and that it is reasonably certain that no further postponements will take place in view of the, according to TAP AG, binding contractual commitments that were already taken by both TAP AG and the Shah Deniz Consortium with buyers and shippers. In this regard the Secretariat has taken note of the submission by TAP AG that the date for the Commercial Operation Date is well constrained within agreed deadlines, namely between 1 January 2020 and 31 December 2020, which can neither be anticipated nor extended further.

3.5.3 *As regards the postponement of the date by which COD takes place*

(a) "Delay is due to major obstacles"

29. The Secretariat considers that a delay in the upstream availability of gas to be transported through the Pipeline constitutes a major obstacle for the construction and the Commercial Operation Date of that Pipeline. This is particularly the case in view of the fact that:
 - (a) the gas originating from SD II is expected to be the first gas that will be available for delivery to the Union through the Southern Gas Corridor and the Pipeline;
 - (b) the business rationale of the Pipeline is the transportation of SD II gas to the European markets;
 - (c) a Commercial Operation Date for the Pipeline set at a time before SD II gas arrives would effectively mean that Pipeline lies idle. This is not commercially feasible for the Pipeline project and shippers that booked capacity in the Pipeline as transportation tariffs would have to reflect the costs incurred for idle capacity.
30. Consequently, the availability of SD II gas is critical to the economics of the development and operation of the Pipeline and the risks associated with the project. A change in the date of this availability hence constitutes a major obstacle within the meaning of the fifth paragraph of Article 36(9) of Directive 2009/73/EC.

(b) "Delay is beyond control of the person to whom the exemption has been granted"

31. The Secretariat agrees with ERE's assessment that the Commercial Operation Date is dependent on the time-table and developments of the upstream infrastructure and that such developments in the

upstream value chain, which are the basis for the business case of the Southern Gas Corridor project, are beyond TAP AG's control.

32. The Secretariat recognises that the start of construction of TAP as well as the start of its commercial operation are subject to events that are beyond the control of TAP AG. In particular, the start of the operation of TAP is inter-linked with the date the first natural gas will be supplied by the SD II project. Moreover, the development of the Southern Gas Corridor, including the SD II gas field and the associated infrastructure, is a highly complex project, involving many interested parties and factors changing over time, including the interested parties.
33. The Secretariat notes that the ownership structure of TAP AG, since the adoption of the Opinion1/2013, has changed and certain entities that are shareholders of the SD II Consortium are now also shareholders of the TAP AG. However, in view of the complexity of the overall project of developing the Southern Corridor, the Secretariat takes the view that the date on which gas from the SD II production will flow is beyond the control of TAP AG and/or its current main shareholders, regardless of the precise control structure of TAP AG and SD II Consortium.
34. The fact that TAP AG has agreed to the Funnelling Mechanism does not imply that it has control over the availability of gas from the Shah Deniz Consortium. This mechanism rather underlines the importance of the date by which SD II gas becomes available for the Commercial Operation Date of the Pipeline.
35. Consequently, the Secretariat takes the view that the change in the date by which the Commercial Operation Date has to take place is a delay beyond the control of the person to whom the exemption was granted, in this case TAP AG, within the meaning of the fifth paragraph of Article 36(9) of Directive 2009/73/EC.

3.5.4 *As to the postponement the latest date by which construction of TAP must have commenced*

36. The latest date by which the Pipeline becomes operational following the ERE Proposed Modifications is 31 December 2020. The construction of the Pipeline will take at least five years according to TAP AG's own submission⁷. Consequently, the construction of the Pipeline will have to start on 1 January 2016 at the latest in order for the Commercial Operation Date to happen by 31 December 2020.
37. As was already mentioned in recital 12 the Opinion 1/2013 loses its validity if construction has not started by 14 May 2015. The validity of the Commission's Decision relevant for the other two regulatory authorities implementing the Joint Opinion expires if construction has not started by 16 May 2016. The Secretariat considers it reasonable for the sake of legal certainty to align the two dates. It notes, however, that starting construction on this date would already be too late to finalize a five year construction project prior to the latest date foreseen for the Commercial Operation Date.
38. In this context it needs to be mentioned that TAP AG's original request, made on 27 June 2014, requested a postponement of the Commercial Operation Date until 31 December 2022 whereas its modified request of 17 December 2014, taking into account the further precision of SD II gas availability via the funnelling mechanism, requested a postponement of the Commercial Operation Date only until 31 December 2020. The request to modify the latest date by which construction would have to have commenced for the exemption to remain effective therefore lost its meaning when TAP AG modified its request for the postponement of the Commercial Operation Date.

⁷ In TAP AG's application for the initial exemption in 2011, construction was still deemed to take a maximum 2,5 years (Joint Opinion section 1.1.6). In its later submissions, TAP AG anticipated construction to take a between 3 and 4 years. Now TAP AG expects that construction will take 5 years. In view of the progressively longer period that TAP AG expects construction to take, extending the date by which the Commercial Operation Date takes place whilst leaving the date of first construction unaltered is consistent with previous assessments.

39. As a consequence, the ERE Proposed Modifications cannot be accepted as they were drafted as no justification has been provided to postpone the date for the start of constructions in view of the results of the funnelling mechanism. Therefore the ERE Proposed Modifications should be amended.

4. The Secretariat's Opinion

40. The Secretariat takes the view that sufficient grounds exist to postpone the latest date by which the Commercial Operation Date has to take place until 31 December 2020 in order for the Secretariat's approval of the exemption to retain its effect.

Secretariat Opinion 1/2013 of 14 May 2013 is amended by the following:

In line with Article 36(9) of Directive 2009/73/EC, the Secretariat's approval shall lose its effect in the event that construction of the Trans Adriatic Pipeline has not yet started by 16 May 2016 and in the event that the infrastructure has not become operational by 31 December 2020, unless the Secretariat is of the Opinion that any further delay is due to major obstacles beyond control of the person to whom the exemption has been granted.

Chapter 4 of ERE Decision 135 of 24 December 2014 shall be amended accordingly.

Vienna, 17 March 2015

For the Secretariat



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