

Opinion 1/16

pursuant to Article 3(1) of Regulation (EC) No 715/2009 and Article 10(6) of Directive 2009/73/EC – Albania – Certification of TAP AG

On 2 December 2015, the Energy Community Secretariat (hereinafter “the Secretariat”) received a notification from the Energy Regulatory Authority of the Republic of Albania (“ERE”) of a preliminary decision on the certification of the *Trans Adriatic Pipeline AG* (“TAP AG”) as a transmission system operator for natural gas (hereinafter “the Preliminary Decision”). The Preliminary Decision was adopted on 31 October 2015 based on Articles 13, 37 and 38 of the Law on Natural Gas¹ as well as Article 11 of ERE’s Regulation on the Certification of Transmission System Operators.² The Preliminary Decision has been prepared jointly with the national regulatory authorities of Italy and Greece which have issued similar preliminary decisions on the certification of TAP AG as a transmission system operator in their respective jurisdictions.³

Pursuant to Article 10 of Directive 2009/73/EC⁴ (hereinafter “the Gas Directive”) and Article 3 of Regulation (EC) No 715/2009⁵ (hereinafter “the Gas Regulation”) the Secretariat is required to examine the notified Preliminary Decision and deliver its Opinion to ERE as to the compatibility of such a decision with Article 10(2) and Article 9 of the Gas Directive.

On 26 January 2016, the Secretariat received an Opinion on the Preliminary Decision by the Energy Community Regulatory Board (hereinafter “the Regulatory Board”), as requested in line with Article 3(1) of the Gas Regulation.

I. Description of the notified Preliminary Decision

The Trans Adriatic Pipeline (hereinafter “TAP”) is a pipeline project aimed to transport the gas produced from the gas fields of Azerbaijan to European gas markets via Greece, Albania and Italy. TAP is being developed by TAP AG, a single purpose company, incorporated under the laws of

¹ Law of the Republic of Albania No 102/2015 on the Natural Gas Sector of 15 October 2015. By adopting the Natural Gas Law, Albania created the legal basis for the present certification procedure..

² Adopted by ERE on 5 August 2015 as amended on 31 October 2015.

³ In the form of a so-called Joint Draft Decision of the Energy Regulators on the Certification of TAP AG. The preliminary decisions of the national regulatory authorities of Greece and Italy are being jointly reviewed by the European Commission in a similar procedure, in close collaboration with the Secretariat.

⁴ 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.

⁵ 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

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Switzerland, with no other interest than the development, construction, ownership and operation, including the marketing and maintenance of TAP.

TAP AG's current shareholders are *BP Gas Marketing Ltd* (20%), *AzTAP AG* (former *SOCAR Gas Pipelines GmbH*) (20%), *Snam S.p.A.* (20%), *Fluxys Europe BV* (19%), *Enagás Internacional S.L.U.* (16%) and *Axpo AG* (5%). They are either vertically integrated energy undertakings, with interests in supply or production of electricity and gas, or certified gas transmission system operators. Even though some of the shareholders are from third countries, ERE reckons that they do not enjoy either sole or joint control over TAP AG within the meaning of the EU Merger Regulation.⁶

On 14 May 2013, the Secretariat – followed by the European Commission – approved subject to conditions an exemption for TAP AG pursuant to Article 36 of the Gas Directive from certain requirements of the Third Energy Package on third party access, tariff regulation and ownership unbundling for a period of 25 years.⁷ Taking into account the Secretariat's and the European Commission's comments on TAP AG's exemption, ERE together with the national regulatory authorities of Greece and Italy adopted in June 2013 the so-called Final Joint Opinion on TAP AG's request for exemption (hereinafter "the Exemption Decision").⁸

The exemption was initially valid until 1 January 2019 by which date TAP was supposed to commence operations. The Secretariat and the European Commission subsequently approved a prolongation for the start of commercial operations until 31 December 2020, but not for the start of construction which has to begin by 16 May 2016 for the exemption to remain valid under the Exemption Decision.⁹

Section 4.5 of the Exemption Decision exempts TAP AG from the provisions on ownership unbundling as set out in Article 9(1) of the Gas Directive:

"An exemption from the provisions of Article 9(1) of the Gas Directive is granted to TAP AG for a period of 25 years starting from the Commercial Operation Date and subject to the following conditions:

1. TAP AG, prior to allocating capacity as a result of the first Booking Phase has to implement functional unbundling. To this end, TAP AG shall establish and submit to the Authorities for their approval, a Compliance Programme, which sets out measures taken to ensure that discriminatory

⁶ Article 2(36) of the Gas Directive read in conjunction with Article 3(2) of the Merger Regulation (EC) No 139/2004. As a consequence of this finding, Article 11 of the Gas Directive is not applicable in the present procedure.

⁷ Secretariat Opinion 1/2013 of 14 May 2013 on the exemption of the „TAP“ interconnector from certain requirements under Directive 2009/73/EC by the Energy Regulatory Authority of Albania (ERE); European Commission Decision of 16 May 2013, (2013) 2949 final.

⁸ ERE Decision No 64 of 13 June 2013, amending Decision No 27 of 1 March 2013.

⁹ Secretariat Opinion 1/2015 of 17 March 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); European Commission Decision of 17 March 2015, C(2015) 1852 final.

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conduct is excluded and that, no commercially sensitive information is communicated to its shareholders. The Compliance Programme should be submitted to the Authorities not later than 6 months after the adoption of the Commission Decision. The Compliance Officer should be appointed not later than 1 month from the approval of the Compliance Programme by the Authorities. This Compliance Programme shall lay down at least the following:

(i) Measures to prevent discriminatory conduct in relation to the participants in the first Booking Phase of the market test, who are not shareholders in TAP AG.

(ii) The duties and the rights of the employees of TAP AG in the fulfilment of the purposes of the Compliance Programme.

(iii) The person or body responsible for monitoring the Compliance Programme and submitting to the Authorities an Annual Compliance Report, setting out the measures taken.

(iv) The principles of the tariff methodology and the congestion management rules that were to be applied to the marketing of capacity by TAP AG.

2. TAP AG should be required to be fully certified before the start of the construction of the pipeline, and not later than 1 January 2018. To this end, TAP AG will apply for certification in accordance with Article 10 or 11 of the Gas Directive, as the case may be, with the view to safeguard the degree of independence of the top and executive management of TAP AG from its shareholders. Therefore, TAP AG will need to be certified in each Member State, which territory it crosses. Regulatory Authorities of [Albania], Greece and Italy will need to assess in their certification decisions the compliance of TAP AG with the unbundling rules prescribed in the Exemption Decision. To this end, the certification application will be based on an independent transmission operator model. TAP should comply with all conditions set out in Chapter IV of the Gas Directive apart from Article 22 of the Gas Directive. These conditions should include, among others as specified in Chapter IV of the Gas Directive, the following provisions:

(i) The top and executive management of TAP AG will not participate in any company structures of the shareholders of TAP AG responsible for the day- to-day production and supply of gas;

(ii) Evidence that the professional interests of persons responsible for the management of TAP AG are taken into account in a manner that ensures that they are capable of acting independently;

(iii) All the financial supervision rights allowed under legal and functional unbundling shall be charged to a Supervisory Body. The Supervisory Body shall be in charge of taking decisions that may have a significant impact on the value of the assets of the shareholders within TAP AG. This includes the decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of TAP AG and the amount of dividends distributed to shareholders. However, the Supervisory Body cannot interfere with the day-to-day activities of TAP AG and the operation of TAP pipeline;

(iv) Evidence that TAP AG has the necessary resources, including human, technical, physical and financial to have effective decision-making rights;

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(v) *Evidence that TAP AG will have a Compliance Programme in place, which is adequately monitored by a compliance officer employed by TAP AG.*

3. *TAP AG is not compelled to comply with Article 22 of the Gas Directive, since the scope of the provisions of Article 22 of the Gas Directive are sufficiently addressed by the in-depth assessment of the Authorities and by the conditions and time limits which are imposed by the FJO."*

In accordance with the Exemption Decision, TAP AG has applied for certification according to the independent transmission operator ("ITO") model on 1 July 2015, i.e. in due time to be certified prior to the start of construction.

ERE and the other regulatory authorities have analysed whether and to what extent TAP AG complies with the unbundling rules of the ITO model following the conditions set out in Section 4.5 of the Exemption Decision. They have come to the preliminary conclusion that TAP AG complies with these requirements.

The Preliminary Decision was adopted having regard to:

- a) The requirements set out in Chapter IV of the Gas Directive that are already fulfilled by TAP AG during construction.
- b) The commitments undertaken by TAP AG to fulfill by the commercial operation date ("COD") all the remaining requirements set out in Chapter IV of the Gas Directive, apart from Article 22, laid down in a Road Map, according to which TAP AG shall:

- maintain, during the construction phase and until COD, the current functional unbundling regime monitored by the Regulatory Compliance Officer;
- twelve months before COD, provide the involved national regulatory authorities with full concrete evidence to prove TAP AG's readiness to comply with the Road Map not later than COD;
- during the construction phase and beyond, submit to the involved national regulatory authorities any technical operation and maintenance agreement signed with adjacent transmission system operators;
- submit to the involved national regulatory authorities for approval any service agreements with the shareholders not later than twelve months before COD;
- ensure that all seconded personnel from shareholders return to their respective companies not later than COD;
- twelve months before COD, inform the involved national regulatory authorities about the existence of any possible extraordinary circumstances that might justify the extension of the provision of specific services by its shareholders;
- amend corporate statutes so as to comply with the independence requirements as per Article 18(4) of the Gas Directive;
- provide the involved national regulatory authorities with all the necessary information on the definitive financial arrangements made for the construction of the pipeline and of the financial arrangements made, before COD, to ensure the

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financial independence of TAP AG as set out in Article 17 and Article 18 of the Gas Directive;

- and the further obligation upon TAP AG to: a) review the compliance programme pursuant to the Preliminary Decision; b) notify the involved national regulatory authorities of any change in its ownership structure that would result in a person acquiring control of TAP AG in order to evaluate the re-opening of the certification procedure; c) notify the involved national regulatory authorities of any change in the Shareholders Agreement which may affect the conditions.

In order to allow ERE and the other two regulatory authorities to monitor TAP AG's compliance with the commitments by COD, the Preliminary Decision stipulates that the Compliance Officer shall be in charge of: a) supervising the implementation of the commitments provided by TAP AG, b) submitting to the authorities an annual report setting out the measures taken by TAP AG in order to implement the commitments according to the time schedule indicated in the Road Map; c) notifying to the authorities any delay in the implementation of the commitments and any breach of the latter.

II. Comments

1. General

As was already observed by the Regulatory Board, the Secretariat notes that the Preliminary Decision - to the extent ERE is concerned - repeatedly makes wrong reference to legal provisions applicable under the EU instead of the Energy Community *acquis communautaire*. Similarly, the Preliminary Decision ignores the competences of the Secretariat and the Regulatory Board to issue opinions in the present procedure, and instead refers to the European Commission only, a body not competent in the framework of certifications issued by ERE. The Secretariat thus invites ERE to amend and correct the Preliminary Decision in this respect in line with the recommendations made by the Regulatory Board.

2. Relevance of the ITO model

Unlike most other cases, TAP AG is to be unbundled not on the basis of generally applicable legislation but on the basis of a regulatory decision, namely ERE's Exemption Decision. While exempting TAP from the provisions on ownership unbundling as set out in Article 9(1) of the Gas Directive, this decision obligated TAP AG to "*comply with all conditions set out in Chapter IV of the Gas Directive apart from Article 22 of the Gas Directive*". As a matter of principle, the suitability of the choice of unbundling model is to be evaluated in the context of the procedure under Article 36 of the Gas Directive and may, to the extent compliance with Energy Community law is ensured, not be called into question in the course of a certification procedure.

In the present case, the choice of the ITO model was suggested by the European Commission ("*... in order to ensure that the unbundling is effective, the Commission deems it appropriate to impose*

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on TAP that it complies with all conditions set out in Chapter IV of the Gas Directive...”).¹⁰ The Commission also suggested the present wording of the second paragraph of Section 4.5 of the Exemption Decision.¹¹ The Secretariat did not make a similar request.¹² Despite the fact that, unlike the national regulatory authorities of Greece and Italy, ERE is not bound by decisions of the European Commission, the regulatory authority of Albania autonomously decided to follow it and adopted the same text. The Secretariat sees no ground for challenging this choice in the context of the present procedure.

The second paragraph of Section 4.5 of the Exemption Decision explicitly and deliberately refers to Chapter IV of the Gas Directive. The Secretariat thus needs to assess whether ERE’s Preliminary Decision ensures compliance with Articles 17 *et seq.* of the Gas Directive, with the exemption of Article 22. For this purpose, these provisions are to be interpreted and applied in accordance with the general rules of interpretation under Energy Community law which require considering not only the wording of their terms but also the context and the objectives pursued by them.¹³

3. Application of the ITO provisions to TAP AG – General considerations

The Secretariat notes that the Preliminary Decision does not systematically subsume TAP AG’s situation under the individual provisions of Articles 17 *et seq.* of the Gas Directive. With the exemption of few requirements imposed under the ITO model and explicitly addressed by TAP AG, ERE generally refers to the particularities of TAP AG distinguishing it from other transmission system operators in its application for certification under the ITO provisions. In its application, TAP AG points out that TAP has not been built and that TAP AG is not carrying out most of the tasks of a transmission system operator at the time of certification, and that TAP AG does not belong to a vertically integrated undertaking in the meaning of Article 2(20) of the Gas Directive.

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. In particular, their rationale is the “*effective separation of networks from activities of production and supply*” which requires “*the removal of the incentive for vertically integrated undertakings to discriminate against competitors*” and should be “*effective in removing any conflict of interests between producers, suppliers and transmission system operators*”.¹⁴ Hence, the unbundling provisions were designed to separate, in vertically integrated undertakings, control over transmission system operation as a natural monopoly and production and supply activities as competitive activities, as well as to eliminate a potential source of discrimination related to other energy-related activities such as production and supply.

¹⁰ European Commission Decision of 16 May 2013, (2013) 2949 final, at paragraph 232, with the notable exemption of Article 22 of the Gas Directive.

¹¹ Article 6 of European Commission Decision of 16 May 2013, (2013) 2949 final.

¹² Secretariat Opinion 1/2013 of 14 May 2013, at paragraph 73.

¹³ See for instance judgment of the Court of Justice of the European Union in Case C-395/14 *Vodafone*, EU:C:2016:9, at paragraph 41.

¹⁴ Recitals 6, 8 and 9 of Directive 2009/73/EC.

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In the Secretariat's view, an interpretation of Articles 17 *et seq.* needs to take this rationale into account and cannot be made schematically. In the context of the present procedure, this in particular raises the questions, firstly, to what extent TAP AG actually functions as a transmission system operator at the time of certification and, secondly, if the company's relations with its shareholders gives rise to a potential conflict of interest between natural gas transmission and other activities performed by vertically integrated undertakings.

a. The notion of transmission system operator

The unbundling regime of the Gas Directive, to which the Exemption Decision refers, applies to transmission system operators. This is evident also from individual rules comprising the ITO model such as Article 17(1) of the Gas Directive.¹⁵ Whether or not an undertaking is considered a transmission system operator is not determined by the certification which is intended to confirm compliance with the unbundling requirements and constitutes a precondition for its licensing ("approval and designation", cf. Article 10(2) of the Gas Directive).¹⁶

From a formal point of view, the Secretariat notes that TAP AG has not been licensed as a transmission system operator in Albania.

Yet Article 2 No 4 of the Gas Directive follows a functional rather than a formal approach in determining that "*transmission system operator*" means a natural or legal person who carries out the function of transmission and is 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 gas". It follows from this definition that the key elements for an undertaking to be considered a transmission system operator – and thus under an obligation to fulfill the unbundling requirements before being designated and approved (licensed) – are the operation, the maintenance and the development of a transmission network.

Operation, maintenance and development are activities normally associated with an existing transmission network. This is not the case with TAP. TAP AG's main day-to-day activities currently relate to preparing the construction of such transmission infrastructure which is to start by 16 May 2016. In accordance with the timing approved by the Exemption Decision, it may be assumed that commercial operation and consequently maintenance and further development of the network will not start until sometime in 2020. In most respects, TAP AG is currently functioning as a project development company with a perspective of becoming the transmission system operator for TAP in the future.

At the same time, the Secretariat notes that TAP AG has already conducted a so-called market test and performed a binding booking phase between March and November 2014. As a

¹⁵ "... carrying out the activity of gas transmission ...", "... necessary for the activity of gas transmission ..." etc.

¹⁶ In general, approval and designation of a transmission system operator in the Energy Community Contracting Parties takes place through a licensing procedure. In Albania, a transmission system operator is to be certified before being licensed, Article 37 of the Natural Gas Law.

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consequence, a first allocation of transmission capacity on TAP has already taken place and certain of TAP AG's shareholders have contracted for capacity with TAP.

While capacity allocation and related activities¹⁷ indeed constitute a central element of commercial operation of a pipeline, the transmission services themselves can naturally not be provided before the pipeline is built and made operational. In the Secretariat's view, regard must also be had to Article 36(6) of the Gas Directive. That provision requires infrastructure promoters to test potential user interest in contracting network capacity and obliges regulatory authorities to "*take into account the results*" of such a market test before granting an exemption.¹⁸ Moreover, the Exemption Decision envisages allocation of initial capacity to shareholders as well as the obligation to perform a market test for expansion capacity and on a regular basis following COD.¹⁹ Given that detailed regulatory framework governing capacity allocation and related activities to be undertaken by TAP AG, the latter's entrepreneurial initiative and discretion in operating the (future) pipeline was and is limited to a considerable extent by the conditions set in the Exemption Decision.

That said, the Secretariat considers that whether or not TAP AG fully corresponds to the Gas Directive's definition of a transmission system operator before its construction needs not to be decided for the purpose of the present procedure. The Exemption Decision requires unbundling of TAP AG based on Chapter IV of the Gas Directive (apart from Article 22) already before COD, precisely to cover TAP AG's commercial operations of the kind which transmission system operators perform, and hence to eliminate risks of potential or actual conflicts of interest already before COD. ERE should thus assess both in general and in detail whether and in which respect TAP AG's activities lead to a risk of conflict of interest, the avoidance of which is the very purpose of the unbundling provisions.

b. Existence of a conflict of interest

The risk of a conflict of interest between transmission system operation and other activities such as production and/or supply of gas and electricity is normally associated with transmission being part of a vertically integrated undertaking. Article 2 No 20 of the Gas Directive defines 'vertically integrated undertaking' 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*".

¹⁷ Such as the management of information gathered in the market test, the management of shipping contracts and the execution of further market tests.

¹⁸ Namely could high market interest weaken the case for the infrastructure being exempted from regulated tariffs or make a case for larger scaled infrastructure.

¹⁹ Section 4.1 of the Exemption Decision. The Market Test was to be performed in two steps, namely (1) an expression of interest phase performed between 15 June and 15 August 2012 targeting the identification of market interest in capacities going beyond the initial capacities of 10 bcm for TAP shareholders; and (2) a booking phase that was performed in 2014.

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The Secretariat notes that the Preliminary Decision does not assess in detail whether and to what extent one or more shareholders of TAP AG exercise (single or joint) control over the company.²⁰ The Secretariat agrees with ERE that this was not necessary in the present procedure. The Exemption Decision, the source of law requiring certification of TAP AG, ascribes the potential conflict of interest not to the exercise of control as Article 2 No 20 of the Gas Directive but deems the ownership in TAP AG by its shareholders sufficient for establishing the risk of a potential conflict of interest. Some of these shareholders are indeed vertically integrated undertakings with interests in supply or production of gas and/or electricity. The Exemption Decision in Section 4.5 clearly links the requirement of certification under Article 10 of the Gas Directive to the objective of “safeguard[ing] the degree of independence ... of TAP AG from its shareholders”, without referring to the notion of control.

However, that does not mean that Articles 17 *et seq* of the Gas Directive are to be applied schematically to TAP.

Firstly, and as was already mentioned, these provisions are based on the assumption that the entity to be unbundled and certified operates a transmission system which, in the case of TAP AG, is currently considerably limited. Only to the extent the activities performed by TAP AG during the construction phase relate already to the operation of the future pipeline, and in particular the allocation of transmission capacity, conflicts of interest may in principle materialize, e.g. in the form of favoring shareholders over other actual or potential shippers.

In this context, the Secretariat attaches importance to the tailored regulatory regime established by the Exemption Decision and applicable already before COD (including the TAP Tariff Code, the TAP Network Code, the TAP Regulatory Compliance Programme and the Market Test Guidelines) as instruments mitigating the risk of conflicts of interest.

Secondly, a conflict of interest, the *telos* of the unbundling provisions, relates to a risk of discrimination which is deemed not acceptable under Energy Community law. In that respect, the Exemption Decision as accorded with the Secretariat and the European Commission matters, as it determines the degree of risk the European legal order is willing to tolerate based on an assessment of its impact on competition and security of supply, and balancing it against the project’s merits and requirements in the procedure established by Article 36 of the Gas Directive. Where, as in the case of TAP, an exemption from the obligation to admit third parties’ access is lawfully granted for a period of 25 years, the respective discrimination is accepted, in principle, under Energy Community law for the exempted capacity.²¹

In the Secretariat’s reading, by requiring TAP AG to unbundle and be certified under the ITO rules, the Exemption Decision did not call into question that principle assessment. Rather, the Exemption Decision aimed at counterbalancing the discretion granted to a transmission system operator by way of an exemption with a governance regime suitable to keep detrimental effects on the relevant

²⁰ The concept of control is defined by Article 2 No 36 of the Gas Directive which refers to the Merger Regulation.

²¹ It is to be noted that the exemption does not affect the construction of the so-called expansion capacity and the manner in which it is operated. In that respect, the Gas Directive’s rules on the access of competitors to infrastructure (third party access) fully apply.

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markets at a minimum. The European Commission's (second) exemption concerning the Gazelle pipeline project,²² to which the Commission's decision requesting TAP AG to comply with the ITO model explicitly refers,²³ imposed the ITO model as a "*less restrictive measure than unconditional exemption from ownership unbundling*", meant to enhance transparency and to ensure "*a level playing field between gas suppliers to non exempted capacity*".²⁴ The Secretariat observes that the ITO rules in Articles 17 *et seq.* of the Gas Directive, introducing a complex system of checks and balances, numerous incompatibilities and strong regulatory oversight while avoiding divestiture, indeed lend themselves to that purpose. At the same time, it is to be noted that the *Gazelle II* decision attached considerable importance to the fact that the imposition of the ITO rules would not lead to "*endangering the commercial viability of the project*", a concern relevant also for the TAP project.

The Secretariat further notes that pursuant to Section 4.5 of the Exemption Decision the exemption from the Gas Directive's unbundling provisions is granted starting from COD, which makes it seem consequential to apply the imposed counter-balancing measures as of that date as well. By contrast, the second point in Section 4.5 of the Exemption Decision primarily imposes a procedural condition for the period before COD, namely certification, which is being complied with in the present procedure.

Hence the purpose of requiring TAP AG to unbundle under the ITO rules was not to eliminate all and any conflicts of interest between transmission and the shareholders' production and supply activities but only to the extent the Exemption Decision so requires. The Secretariat agrees with ERE that compliance with the ITO requirements shall be read and interpreted not only in the context of the unbundling provisions' purpose to avoid conflicts of interest but also against the background of the Exemption Decision. This needs to be taken into account in assessing compliance with the individual provisions of Chapter IV of the Gas Directive, both before and after COD.

c. Conclusions

The above considerations related to the concept of transmission system operation and the potential for conflict of interest bear on the applicability of the ITO rules *ratione temporis* and *ratione materiae*.

In this respect, the Secretariat reiterates that the scope of TAP AG's commercial operations is currently too limited to be considered fully-fledged transmission system operation. They mainly relate to the allocation of transmission capacity and associated activities. In carrying out these activities, the prevention of discrimination against third parties is to a large extent addressed by the tailored safeguard regime in place as well as other mechanisms such as general competition law enforcement. The Secretariat was informed that a compliance officer was indeed appointed and compliance reports are regularly submitted to the regulatory authorities involved.

²² Commission Decision C(2011) 8777 of 1 December 2011.

²³ At paragraph 232.

²⁴ Commission Decision C(2011), at paragraphs 55 *et seq.*

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As regards TAP AG's required compliance with the ITO rules during the construction phase, the Secretariat considers that the ITO model as imposed by the Exemption Decision is not meant to ensure that the construction of the TAP pipeline is carried out independently of TAP AG's shareholders but that the operation of that pipeline later does not lead to potential or actual conflicts of interest. Consequently, a temporary non-implementation of the full ITO requirements during the construction phase can be justified where a conflict of interest in relation to the commercial and technical operations carried out by TAP can be excluded or neutralised by the specific regulatory measures in force.

Admittedly, interpreting the requirement to implement the ITO regime during the construction phase in this way creates a tailor-made governance which seems appropriate and tolerable during a transitional phase, namely for a company mainly engaged in constructing a pipeline. It must, however, be recalled that the exemption granted to TAP was explicitly conditioned on compliance with the ITO requirements as set out in Chapter IV of the Gas Directive (with the exception of Article 22). The Secretariat considers it important that as of COD, the tailor-made transitional regime is being replaced by the application of the standard ITO model. Once TAP AG is operational, and fulfils all elements constituting a transmission system operator, the potential of conflict of interest may be expected to significantly increase to an extent sufficient to trigger the full applicability of the ITO rules as envisaged by the Exemption Decision.

The Secretariat does not exclude that the full application of the ITO rules by TAP AG as of COD again is subject to an assessment in the light of the Exemption Decision and following a rule of reason. The outcome depends, to a large extent, on whether and which conflicts of interest will persist or emerge by COD. Given that TAP AG's future corporate, financial and human resources governance cannot be predicted at this point in time, and that external factors of relevance for the assessment may also change until then, such compliance assessment at COD is largely prognostic in nature and difficult to carry out now. In this context, the Secretariat also recalls that Albania currently does not have a gas market, the structure of which is yet to emerge. The Secretariat thus deems it important that ERE performs a compliance assessment by COD so as to make sure that once operational, TAP AG's governance corresponds to the ITO provisions, as requested by the Exemption Decision and interpreted in the light of their objective.

In this respect, the Preliminary Decision currently acknowledges that "*TAP AG will have to prove full compliance with all the remaining ITO requirements before it starts operations as a TSO*".²⁵ The Preliminary Decision seeks to ensure compliance with that requirement through the list of commitments made by TAP AG (the "Road Map"). Failure of TAP AG to comply with the commitments shall trigger the reopening of the certification procedure and may trigger the imposition of penalties under the national legislation of the regulatory authorities involved. However, the Preliminary Decision does not rule out that these commitments are being waived, modified or substituted or that TAP AG is being granted an extension of the deadlines by the authorities involved.

While the Secretariat acknowledges the importance of the safeguards included in the Preliminary Decision to ensure TAP AG's compliance with the ITO model upon COD, it cannot be excluded

²⁵ Section 4.3.6. of the Preliminary Decision.

that the Exemption Decision's imposition of the standard ITO model based on compliance with all relevant provisions of the Gas Directive (except its Article 22) is being replaced by another tailor-made unbundling regime based on the Road Map. Moreover, despite the Preliminary Decision requiring a reasoned request by TAP AG for any extension of deadline and the existence of "exceptional circumstances" in case of a waiver, modification or substitution, the criteria for such potential amendments to the list of commitments as well as their consequences are not entirely clear. Finally, an involvement of the European institutions in making such amendments is missing and the decision-making procedure between the three regulatory authorities involved is also not defined. For these reasons, the Secretariat is of the opinion that ERE's final certification decision should include a clear commitment to carry out a new certification procedure under Article 10 of the Gas Directive²⁶ immediately ahead of COD, and a corresponding obligation on TAP AG to ensure full ITO unbundling on time. Such commitment would not replace the Road Map committed to by TAP AG and compliance with it, but complement it. As a new certification would not depend on a breach of commitments by the company but on the significant change of circumstances the start of its operation entails per se, it would also increase legal certainty for all stakeholders involved.

Against this background, the Secretariat unconditionally supports certification of TAP AG in line with ERE's Preliminary Decision at this point in time, subject only to the remarks under point 4. below and the request to ERE, in its final certification decision,

to demand TAP AG to notify ERE of all circumstances of relevance for its full compliance with the requirements of Chapter IV of Directive 2009/73/EC, except for Article 22, at the latest three months before COD, and to undertake to conduct a certification procedure under Article 10 of the Gas Directive and Article 3 of the Gas Regulation immediately upon such notification.

4. Individual aspects of applying the ITO model to TAP AG before COD

a. Rendering of services to TAP AG

Article 17(1) of the Gas Directive bans the rendering of services to the transmission system operator by any other part of the vertically integrated undertaking or, in the context of the present certification, the shareholders.

ERE considers that TAP AG's shareholders should be allowed to continue providing engineering and supervision services to TAP AG which are strictly necessary for the completion of the pipeline, given that the application of all the requirements of Article 17 of the Gas Directive is not needed until COD. ERE also considers that any obligation to put an end to the current service agreement with the shareholders during construction might risk undermining the objective of the exemption that is to allow the investment into a new interconnector. Furthermore, it seems to ERE that those

²⁶ The effect of the change in TAP AG's activities from construction to operation, i.e. before and after COD, may be considered paramount to the type of transactions which, under Article 10(3) and (4a) of the Gas Directive, trigger a reopening of the certification procedure by default.

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technical services have no bearing on TAP AG's limited commercial operation in the construction phase (i.e. market test for the booking of capacity) and as a consequence any risk of conflict can be ruled out.

The Secretariat reiterates that the compliance with the ITO model as imposed by and considered in the context of the Exemption Decision aims to ensure that the technical and commercial operation of the pipeline, and not its construction, is carried out independently of TAP AG's shareholders. In view of this objective, the Secretariat shares ERE's position that Article 17(1)(c) of the Gas Directive should not be applied in the present case so as to limit the ability of shareholders to provide engineering and supervision services for the purpose of the construction of the pipeline.

In case certain construction related services are continued to be provided by the TAP shareholders after the start of the pipeline's operation, ERE should verify that these activities do not interfere with the independent (technical and commercial) operation of the pipeline in compliance with the ITO model.

To the extent that TAP AG envisages the conclusion of service agreements with its shareholders for some of the technical operation and maintenance activities during the operations phase, or the outsourcing of services to adjacent transmission system operators, the Secretariat invites ERE to assess this issue in detail during the certification procedure upon COD.

b. Financial autonomy of TAP AG

As regards its financial autonomy from the shareholders, TAP AG claims that it cannot fully comply, at this stage, with all the ITO requirements on financial autonomy provided for by the Gas Directive, given the nature of the financial arrangements in place for the project and their intended transition. TAP AG argues that an immediate implementation of the provisions on unbundling might endanger the completion of the transmission network and the bankability of the whole project.

In the Preliminary Decision, ERE considers that the application of Articles 17(1)(d), 18(1)(b), 18(6) and 18(7) of the Gas Directive is not possible until the network is operational and generates revenue. ERE assumes that compliance can be deferred until COD, on the grounds that shareholder involvement in TAP financing will not lead to conflicts of interests.

The Secretariat recalls that Article 17(1)(d) of the Gas Directive requires that appropriate financial resources for investment projects be made available to the transmission system operator by the vertically integrated undertaking, that Article 18(1)(b) of the Gas Directive provides that the transmission system operator must have the power to raise money on the capital market in particular through borrowing and capital increase and that Articles 18(6) and (7) of the Gas Directive demand that commercial and financial relations between the vertically integrated undertaking and the transmission system operator comply with market conditions and are approved by the national regulatory authority.

Of these provisions, only Article 17(1)(d) of the Gas Directive addresses arrangements for financing construction activities, namely the "*future investment projects and/or ... the replacement of existing assets*" and can be considered applicable, at least by analogy, to TAP AG already before COD. By contrast, Article 18(1)(b) of the Gas Directive pursues the objective of guaranteeing the independence of the transmission system operator in financial terms from the

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production and supply interests of the vertically integrated undertaking, i.e. TAP AG's shareholders in the context of the present case. Articles 18(6) and (7) of the Gas Directive aim to implement the arm's length principle in financial transactions and thus also relate to avoiding or mitigating conflicts of interests between transmission activities on the one hand, and production and supply activities on the other hand. Given the absence of such conflict of interest before COD, the Secretariat agrees with ERE's assessment and invites the regulatory authority to assess TAP AG's full compliance with these provisions in the certification procedure upon COD.

With regard to compliance with Article 17(1)(d) of the Gas Directive, the Secretariat understands that TAP AG is currently largely financed by its shareholders. The construction of TAP will be financed through a combination of equity and project finance to be further specified in the near future. As TAP AG explains lenders under project financing demand that TAP AG's shareholders assume full responsibility for completion risk. The Secretariat accepts that covering this risk corresponds to the shareholders' obligations under Article 17(1)(d) of the Gas Directive. According to TAP AG's shareholder's agreement, shareholders are also obliged to provide financing for an economically viable expansion of the capacity, and thus to comply with TAP AG's obligation to build expansion capacity under the Exemption Decision.²⁷ The Secretariat has thus no reason to call into question ERE's assessment that sufficient assurances exist that shareholders take the required decisions, including financial ones, to realise TAP AG's investments in the initial and expansion capacity.

c. Independence of TAP AG's staff and management

Articles 19(3), 19(4), 19(5) and 19(7) of the Gas Directive prescribe certain requirements with regard to persons responsible for the management of the transmission system operators, the members of its administrative bodies and its employees with regard to their relations with the vertically integrated undertaking, including *ex ante* and *ex post* cooling off periods.

It is evident from the Preliminary Decision that TAP AG currently does not comply with these provisions, as its management is essentially seconded from TAP AG's shareholders.

TAP AG seeks the non-application of the Gas Directive's provisions until COD. In its view, hiring and retaining personnel originating from its shareholders with experience pertinent for the management of complex construction projects is essential for the construction of TAP.

ERE considers that the application of the said rules only as of COD is appropriate in view of the limited commercial activities carried out by TAP AG as well as of the compliance programme approved by ERE and the other regulatory authorities involved. The Secretariat understands that the compliance programme imposes obligations upon TAP AG's employees and personnel seconded to TAP AG not to disclose commercially sensitive information (including but not limited to information in relation to the marketing of TAP's capacity) until at least two years post contract termination, and foresees the imposition of sanctions in case such obligations are breached.

The main objective of the cooling-off periods is to further limit indirect influence from the vertically integrated undertaking (*in casu* TAP AG's shareholders) on the decision-making by the

²⁷ Section 4.1.8 of the Exemption Decision.

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transmission system operator and to ring-fence the flows of commercially sensitive information between these entities, once again with the purpose of avoiding conflicts of interest. The Secretariat does not deem such conflict of interest present during the time the decision-making of TAP AG relates mostly to the construction of the pipeline and not to the day-to-day management of an existing gas transportation network. Furthermore, TAP AG's compliance programme seems to provide sufficient safeguards to the extent – namely with respect to the marketing and allocation of transmission capacity – it can be deemed as engaging in commercial activities already before COD. It agrees thus with ERE that until COD, compliance with Articles 19(3), 19(4), 19(5) and 19(7) of the Gas Directive is not required for TAP management and staff that are solely engaged in the management or execution of construction-related activities.

That said, ERE should verify to what extent Articles 19(3), 19(4), 19(5) and 19(7) of the Gas Directive need to apply to TAP AG's staff and management involved in commercial operations already before COD in order not to jeopardize their full independence afterwards. Based on what was said above, ERE should then make sure in the certification procedure upon COD that the independence rules under Articles 19(3), 19(4), 19(5) and 19(7) of the Gas Directive are complied with. Moreover, the Secretariat invites ERE to insist on TAP AG maintaining effective compliance rules until COD, the proposed due date for the new certification procedure.

d. Supervisory Body

Article 20 of the Gas Directive requires the transmission system operator to have a supervisory body, the competences of which, however, “*shall exclude those that are related to the day to day activities of the transmission system operator and management of the network [...].*”

In the Preliminary Decision, ERE takes the view that since TAP AG is currently not performing the activities of transmission, the setting up of the Supervisory Body is not required to ensure managerial autonomy of TAP AG from its shareholders in relation to the commercial activities in which the applicant will engage during pipeline construction.

Given that during the construction phase TAP AG cannot yet be considered a transmission system operator with the “*day to day activities*” Article 20 of the Gas Directive has in mind, and that the conflict of interest addressed by the Gas Directive in general and its Article 20 indeed relates to activities and the management of an existing network, the Secretariat agrees with ERE that the insisting on the introduction of a supervisory body before COD would exceed what is required to protect against risks of undue shareholder influence on the operations carried out by TAP AG. Full compliance with this Article should be assessed in the course of the certification procedure upon COD.

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5. Conclusion

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

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. ERE 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, 3 February 2016

A handwritten signature in blue ink, appearing to read "Janez Kopač".

Janez Kopač
Director

A handwritten signature in blue ink, appearing to read "Dirk Buschle".

Dirk Buschle
Deputy Director/Legal Counsel