

**TO THE MINISTERIAL COUNCIL OF THE ENERGY COMMUNITY  
represented by the Presidency and the Vice-Presidency of the Energy Community**

**REASONED REQUEST**

in Case ECS-9/13

Submitted pursuant to Article 90 of the Treaty establishing the Energy Community and Article 28 of Procedural Act No 2008/1/MC-EnC of the Ministerial Council of the Energy Community of 27 June 2008 on the Rules of Procedure for Dispute Settlement under the Treaty, the

**SECRETARIAT OF THE ENERGY COMMUNITY**

against

**THE REPUBLIC OF SERBIA**

seeking a Decision from the Ministerial Council that Serbia,

1. by failing to implement the requirement of legal unbundling of its transmission system operator *JP "Srbijagas"* from other activities not relating to transmission, fails to comply with Article 9(1) of Directive 2003/55/EC;
2. by failing to ensure the independence of its transmission system operator *JP "Srbijagas"* in terms of its organisation and decision-making from other activities not relating to transmission, fails to comply with Articles 9(1) and 9(2) of Directive 2003/55/EC; and
3. by failing to ensure the independence of its transmission system operator "*Yugorosgaz Transport*" d.o.o. in terms of its organisation and decision-making from other activities not relating to transmission, fails to comply with Articles 9(1) and 9(2) of Directive 2003/55/EC.

The Secretariat of the Energy Community has the honour of submitting the following Reasoned Request to the Ministerial Council.

**I. Relevant Facts**

- (1) As a Contracting Party to the Treaty establishing the Energy Community ("the Treaty"), Serbia is under an obligation to implement the *acquis communautaire* on energy as listed in Article 11 of the Treaty. This currently includes Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (OJ L 176, 15.7.2003)<sup>1</sup>.

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<sup>1</sup> With effect of 6 October 2011, Article 11 and Annex I of the Treaty have been amended by the Ministerial Council Decision 2011/02/MC-EnC so as to replace the Directive and Regulations constituting the so-called Second Energy Package (including Directive 2003/55/EC) by the Directives and Regulations constituting the so-called Third Energy Package. As the latter are only

- (2) Article 9(1) of Directive 2003/55/EC expressly requires that the transmission system operator, in case where it is a part of a vertically integrated undertaking, shall be independent at least in terms of its legal form (legal unbundling) as well as organisation and decision-making (functional unbundling) from other activities not relating to transmission. Further on, Article 9(2) of Directive 2003/55/EC stipulates the minimum criteria for the implementation of functional unbundling. These provisions are mandatory and have to be transposed and practically implemented in each domestic jurisdiction of the Contracting Parties.
- (3) Analysis performed by the Secretariat of the Energy Community (“the Secretariat”) and the results of the preliminary procedure undertaken in the present case, as explained herein below, lead to the conclusion that neither legal nor functional unbundling of transmission system operators for natural gas in Serbia has been implemented, which thus fails to comply with the relevant Energy Community Law.

#### 1. *Srbijagas and Yugorosgaz Transport*

- (4) The Serbian natural gas incumbent *Srbijagas* was established by a Governmental Decision of 2005<sup>2</sup> (Annex 5) in accordance with the Law on Public Utilities<sup>3</sup>. The Government of the Republic of Serbia (“the Government”) represents the State as the sole owner in the company’s structures. The Management Board and the General Manager of *Srbijagas* are appointed by the Government upon proposal by the Ministry of Energy, Development and Environment Protection of the Republic of Serbia (“the Ministry”).
- (5) *Srbijagas* holds licenses – issued by the national regulatory authority, the Energy Agency of the Republic of Serbia (“AERS”) – for, and is active in the business of natural gas transmission and transmission system operation<sup>4</sup>, distribution and supply<sup>5</sup>. The company owns and operates 95% of the gas transmission network in Serbia. *Srbijagas* also holds 49% of the shares in the underground gas storage *Banatski Dvor*.
- (6) *Srbijagas* is also a key player in wholesale and retail gas supply in the country. With respect to the wholesale market, the Government in July 2013 selected *Srbijagas* as a so-called supplier of public suppliers until 31 December 2014. Under Article 140(7) of the Energy Law of 2011<sup>6</sup> (Annex 4), this function is envisaged “*until a competitive natural gas market is established in the Republic of Serbia*”. As a supplier of public suppliers, *Srbijagas* procures natural gas under long-term contracts from the Russian company *Gazprom*, which is a sole supplier of natural gas to the Serbian market, through the company “*Yugorosgaz*” a.d. (see below). *Srbijagas* supplies all (currently 33) public retail suppliers active in the country. Given that all retail suppliers are at the same time public suppliers, this essentially covers the entire market<sup>7</sup>. *Srbijagas* offers a uniform wholesale price for which (public) suppliers are entitled to purchase

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to be transposed by the Contracting Parties of the Energy Community by 1 January 2015 (see Article 3 of Decision 2011/02/MC-EnC), the implementation of provisions of the Second Energy Package, including Directive 2003/55/EC, is still obligatory for the Contracting Parties.

<sup>2</sup> Decision of the Government of the Republic of Serbia on the Establishment of a Public Enterprise for Transport, Storage, Distribution and Trade of Natural Gas (Official Gazette RS, No 60/05, 51/06, 71/09, 22/10, 16/11, 35/11 and 13/12)

<sup>3</sup> Law on Public Utilities of the Republic of Serbia (Official Gazette RS, No 119/12)

<sup>4</sup> *Srbijagas* holds a licence for natural gas transmission and transmission system operation No 0146/13-ЛГ-ТСУ, as issued by AERS on 31 October 2006 by the Decision No 311.01-42/2006-Л-I for a period of 10 years.

<sup>5</sup> *Srbijagas* holds a license for supply of natural gas No 002/06-ЛГ-24, as issued by AERS on 18 August 2006 by the Decision No 311.01-43/2006-Л-1, and a license for public supply of natural gas No 0216/13-ЛГ-JCH, as issued by AERS on 28 December 2012 by the Decision No 311.01-99/2012-Л-I.

<sup>6</sup> Law on Energy of the Republic of Serbia (Official Gazette RS, No 57/2011)

<sup>7</sup> The *Russian-Serbian Trading Corporation a.d.* supplies big gas consumers in Serbia without being supplied by *Srbijagas*.

the desired quantities of gas<sup>8</sup>. Public suppliers, nevertheless, can opt for purchasing gas from other suppliers on the market. In practical terms, the market share of *Srbijagas* on the wholesale market is somewhere close to 90%.

- (7) In the retail supply of natural gas, *Srbijagas* is also the predominant market player, accounting for 69% of total natural gas sales in 2012<sup>9</sup>. The company was also designated as a supplier of last resort pursuant to Article 146 of the Energy Law. Until 1 January 2016 at the latest, customers supplied under market conditions will be entitled to the last resort supply in cases such as bankruptcy of their supplier. Last resort supply may last for a maximum of 60 days.
- (8) *Srbijagas* also holds 25% of the shares in *Yugorosgaz*, a company established in 1996. Other shareholders of *Yugorosgaz* are *Gazprom* (50%) and *Central ME Energy and Gas Vienna* (25%). *Yugorosgaz* owns and operates the remaining 5% of the Serbian gas transmission system, holds licenses and is active in the business of natural gas distribution and supply.
- (9) In December 2012, *Yugorosgaz Transport* was established as a subsidiary company of *Yugorosgaz*. According to Article 16 of its Statutes (Annex 8), the activity of the company is described as pipeline transport. The company obtained a license for transmission of natural gas and transmission system operation on 28 August 2013<sup>10</sup>. Subsequently, on 6 September 2013, AERS revoked the licence for transmission and transmission system operation from *Yugorosgaz* upon its request<sup>11</sup>.
- (10) According to the information obtained from AERS, the regulator believes that *Yugorosgaz Transport* employs appropriate staff and disposes of financial resources and the equipment needed to perform transmission activities. The company signed a contract with its mother company *Yugorosgaz* on leasing the pipelines, measuring stations etc., as *Yugorosgaz Transport* does not own the transmission system.

## 2. Energy Law of Serbia

- (11) Article 15 of the Energy Law of 2011 requires legal, management and functional unbundling between supply/production and system operation. Article 16 of the Law prohibits cross-subsidies among the energy subjects within a vertical integrated utility. Article 17 of the Law obliges transmission system operators as part of a vertically integrated energy companies to adopt a compliance programme, which shall set out measures to be taken to ensure discriminatory behaviour is excluded and which shall be approved by AERS.
- (12) Article 201 of the Energy Law sets the deadline for vertically integrated undertakings to unbundle their network operation activities by 1 October 2012. However, the Government has not taken any steps to implement and enforce these requirements of the Law. In particular, *Srbijagas* is still performing all its above-mentioned activities, including the operation of its transmission system, under the same legal structure and with one overall organisational structure, whereas *Yugorosgaz* has been unbundled legally *pro forma*, but has remained bundled in functional terms, as explained in detail herein below.

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<sup>8</sup> This wholesale price, formed upon proposal by *Srbijagas* in the tender procedure for the position of “supplier of public suppliers”, is a starting point for the calculation of public retail supply prices for suppliers supplied by *Srbijagas* and reflects *Gazprom's* import price.

<sup>9</sup> 2012 Energy Agency Report, Energy Agency of the Republic of Serbia (April 2013), p. 51.

<sup>10</sup> Licence No 0219/13-ПГ-ТСУ, as issued by AERS on 28 August 2013 by the Decision No. 311.01-50/2013-П-I.

<sup>11</sup> Decision No 311.01-46/2012-П-I of 6 September 2013.

## II. Relevant Energy Community Law

- (13) Energy Community Law is defined in Article 1 of the Rules of Procedure for Dispute Settlement under the Treaty (“Dispute Settlement Procedures”)<sup>12</sup> as “*a Treaty obligation or [...] a Decision addressed to [a Party]*”. A violation of Energy Community Law occurs if “[a] Party fails to comply with its obligations under the Treaty if any of these measures (actions or omissions) are incompatible with a provision or a principle of Energy Community Law” (Article 2(1) of the Dispute Settlement Procedures).
- (14) In the following, a selection of provisions of Energy Community Law relevant for the present case is compiled. This compilation is for convenience only and does not imply that no other provisions may be of relevance for legal assessment hereto.
- (15) Article 6 of the Treaty reads:
- “The Parties shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty. The Parties shall facilitate the achievement of the Energy Community’s tasks. The Parties shall abstain from any measure which could jeopardise the attainment of the objectives of the Treaty.”*
- (16) Annex I to the Treaty, entitled “Timetable for the Implementation of the EC Directives No 2003/54 and 2003/55, and the EC Regulation No 1228/2003 of 26 June 2003”, reads:
- “1. Subject to paragraph 2 below and Article 24 of this Treaty, each Contracting Party shall implement within twelve months of the entry into force of this Treaty: (i) the European Community Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity; (ii) the European Community Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas; (iii) the European Community Regulation 1228/2003/EC of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.*
- 2. Each Contracting Party must ensure that the eligible customers within the meaning of the European Community Directives 2003/54/EC and 2003/55/EC are: (i) from 1 January 2008, all non-household customers; and (ii) from 1 January 2015, all customers.”*
- (17) Article 9 of Directive 2003/55/EC, entitled “Unbundling of transmission system operators”, reads:
- “1. Where the transmission system operator is part of a vertically integrated undertaking, it shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to transmission. These rules shall not create an obligation to separate the ownership of assets of the transmission system from the vertically integrated undertaking.*
- 2. In order to ensure the independence of the transmission system operator referred to in paragraph 1, the following minimum criteria shall apply:*
- a) those persons responsible for the management of the transmission system operator may not participate in company structures of the integrated natural gas undertaking responsible, directly or indirectly, for the day-to-day operation of the production, distribution and supply of natural gas;*

<sup>12</sup> Procedural Act No 2008/01/MC-EnC of the Ministerial Council of the Energy Community of 27 June 2008.

*b) appropriate measures must be taken to ensure that the professional interests of persons responsible for the management of the transmission system operator are taken into account in a manner that ensures that they are capable of acting independently;*

*c) the transmission system operator shall have effective decision-making rights, independent from the integrated gas undertaking, with respect to assets necessary to operate, maintain or develop the network. This should not prevent the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect of return on assets regulated indirectly in accordance with Article 25(2) in a subsidiary are protected. In particular, this shall enable the parent company to approve the annual financial plan, or any equivalent instrument, of the transmission system operator and to set global limits on the levels of indebtedness of its subsidiary. It shall not permit the parent company to give instructions regarding day-to-day operations, nor with respect to individual decisions concerning the construction or upgrading of transmission lines, that do not exceed the terms of the approved financial plan, or any equivalent instrument;*

*d) the transmission system operator shall establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored. The programme shall set out the specific obligations of employees to meet this objective. An annual report, setting out the measures taken, shall be submitted by the person or body responsible for monitoring the compliance programme to the regulatory authority referred to in Article 25(1) and shall be published.”*

### III. Preliminary Procedure

- (18) According to Article 90 of the Treaty, the Secretariat may bring a failure by a Party to comply with the Energy Community Law to the attention of the Ministerial Council. Pursuant to Article 10 of the Dispute Settlement Procedures, the Secretariat shall carry out a preliminary procedure before submitting a Reasoned Request to the Ministerial Council.
- (19) The Secretariat, during missions<sup>13</sup> to Serbia and in its reports, has repeatedly pointed to the country's non-compliance with Energy Community Law related to the lack of unbundling of transmission system operators, which was deemed to be a main obstacle to the proper development of a competitive gas market in Serbia, affecting the development of a wider regional gas market, and the necessary investment in gas infrastructure. In line with its monitoring role under Article 67 of the Treaty, the Secretariat also assessed compliance of the existing legislation governing the gas sector in Serbia, with the *acquis communautaire* under Title II of the Treaty. In these reports, the Secretariat emphasized that Serbia has so far failed to implement both its national Energy Law and the relevant Energy Community Law, as both transmission system operators, *Srbijagas* and *Yugorosgaz* remained bundled.
- (20) In its Implementation Report of 1 September 2013, the Secretariat concluded that “[t]he priority tasks for Serbia, remaining to be done since 2007, should be full unbundling of the transmission system operators *Srbijagas* and *Yugorosgaz*”.

<sup>13</sup> Missions related to the gas sector took place on 1 February 2008, 30 September – 2 October 2008, 17 February 2009, 2-3 November 2009, 24-25 February 2010, 24-25 February 2011, 18 May 2011. At a meeting with the Minister for Energy of Serbia, which took place in Vienna on 17 December 2012, the Secretariat's concerns were presented in detail. Following up on the meeting, the Secretariat on 20 December 2012 sent a letter to the Minister in which the lack of compliance was reiterated.

- (21) Following up on the assessment referred to hereinabove, and in the absence of any progress made by the both natural gas undertakings, transmission system operators *Srbijagas* and *Yugorosgaz*, the Secretariat sent an Opening Letter under Article 12 of the Dispute Settlement Procedures to Serbia on 25 October 2013 (Annex 1). In the Opening Letter, the Secretariat preliminarily concluded that by failing to adopt, within the prescribed time limit, the necessary measures to ensure legal and functional unbundling of transmission system operators for natural gas, the Serbia is in breach of Articles 9(1) and 9(2) of Directive 2003/55/EC, and has failed to fulfil its obligations under the Treaty.
- (22) The Opening Letter set a deadline of two months for a reply by the Government. The deadline expired on 25 December 2013 without a reply having been received. By an e-mail dated 16 January 2014, a representative of the Ministry requested for an extension of the deadline for submission of a response to the Opening Letter. In accordance with Article 9(3) of the Dispute Settlement Procedures, the time-limit for the reply to the Opening Letter was subsequently extended to 5 February 2014. A reply dated 20 February 2014 has been submitted by the Ministry (Annex 2).
- (23) In its reply to the Opening Letter, the Ministry confirmed the factual information regarding the transmission system operators – *Srbijagas* and *Yugorosgaz Transport* – as described by the Secretariat. The Ministry further explained that (i) a project financed by funds of the EU Instrument for Pre-Accession Assistance (IPA) was carried out which made recommendations with regard to the unbundling of *Srbijagas* towards implementation of the Third Energy Package, (ii) the Ministry prepared a proposal for the restructuring of *Srbijagas*<sup>14</sup> to be approved by the Government, (iii) taking into account the complexity of the unbundling operations in *Srbijagas* from the financial, technical and legal point of view, and at the same time taking into account the country's energy security, consultations with all relevant institutions of the State are taking place in order to come up with an optimal solution for the unbundling of *Srbijagas*, and (iv) in compliance with the requirements of the Third Energy Package, all measures will be undertaken in the future in order to harmonise the work of *Yugorosgaz* with the provisions of the Energy Law.
- (24) The *status quo* of current vertical integration of *Srbijagas* was expressly confirmed by the consultant<sup>15</sup> in the abovementioned EU IPA project and the need for important transformations in order to ensure the compliance with unbundling requirements was emphasised. Furthermore, while providing its proposed schemes illustrating the steps to be taken for unbundling of transmission activities, the consultant indicated legal and functional unbundling as the very first phase of reforming *Srbijagas* in case of any unbundling scenario to be further on processed under the Third Energy Package.
- (25) Apart from explanations in its reply to the Opening Letter and the expressed intention to meet the unbundling requirements at some unspecified time in the future, the Ministry did not provide any concrete information about the action plan and/or deadlines for the practical implementation of the unbundling of transmission system operators in line with Directive 2003/55/EC. The Secretariat recalls in this regard that the future implementation of the Third Energy Package does not exempt the Contracting Parties from meeting the obligations for timely implementation of the Second Energy Package, including Directive 2003/55/EC.
- (26) The reply to the Opening Letter, as well as failure to proceed with practical implementation of any scenarios for unbundling of transmission activities, *inter alia* illustrated by outcomes of the

<sup>14</sup> <http://www.merz.gov.rs/lat/dokumenti/polazne-osnove-za-restruktuiranje-jp-srbijagas-novi-sad> (connected on 16-04-2014)

<sup>15</sup> Report of the consultant is at the possession of the European Commission and may be provided upon request.

abovementioned EU IPA project, essentially concludes with the perspective that even legal and/or functional unbundling of the two transmission system operators in question could only be expected after the transposition of the Third Energy Package. It thus openly disregards the obligations and deadlines set under the Second Energy Package. Therefore, given the importance of unbundling as a tool for achieving the objectives of the Energy Community in the gas sector, and given the long period within which Serbia has failed to comply with the one of the most basic provisions of the *acquis communautaire* and given that no concrete steps have been taken after the Opening Letter of the Secretariat has been submitted, the Secretariat decided to issue a Reasoned Opinion under Article 13 of the Dispute Settlement Procedures. The Reasoned Opinion was sent on 24 February 2014 (Annex 3).

- (27) In accordance with Article 13(2) of the Dispute Settlement Procedures, Serbia was given a two months, *i.e.* by 24 April 2014, to rectify the breaches of the Energy Community Law identified in the Reasoned Opinion, or at least to make clear and unequivocal commitments in that respect, and to notify the Secretariat of all steps undertaken. In communication with representatives of the Ministry, it was indicated that Serbia would not submit a reply to the Reasoned Opinion within the deadline.
- (28) Considering that the Secretariat has thus not been informed of any steps undertaken by competent institutions of Serbia to unbundle both transmission system operators for natural gas currently active in the country – *Srbijagas* and *Yugorosgaz Transport* – and taking into account the extensive delay in implementation of the respective requirements deriving from Directive 2003/55/EC, the Secretariat, in accordance with Article 28 of the Dispute Settlement Procedures, decided to submit this Reasoned Request seeking for a Decision from the Ministerial Council on the failure by Serbia to implement mandatory requirements of the Energy Community Law.

#### IV. Legal Assessment

##### 1. Introduction

- (29) The subject-matter of the present case consists of non-compliance of Serbia with the Energy Community *acquis communautaire* related to unbundling of transmission system operators for natural gas, as already identified in the Opening Letter and Reasoned Opinion.
- (30) Unbundling is a key requirement for ensuring efficient and non-discriminatory network access, and thus constitutes a precondition for the opening of the market.
- (31) In this regard, Recital 10 of the Preamble of Directive 2003/55/EC emphasises the necessity to ensure that transmission systems are operated through legally separate entities where vertically integrated undertakings exist, that transmission system operators have effective decision-making rights with respect to assets necessary to maintain, operate and develop networks, and that non-discriminatory decision-making process should be ensured through organisational measures regarding the independence of the decision-makers responsible.
- (32) To achieve these objectives, Article 9 of Directive 2003/55/EC imposes very concrete unbundling requirements on vertically integrated undertakings, which include legal and functional unbundling of the transmission system operators from other activities carried out within vertically integrated energy undertakings. According to the definition in Article 2(20) of Directive 2003/55/EC, *Srbijagas* and *Yugorosgaz* qualify as vertically integrated undertakings.

(33) By the present case, the Secretariat does not challenge the transposition by Serbia of Article 9 of Directive 2003/55/EC through its Energy Law of 2011. Based on the information before it, however, the Secretariat concludes that the two transmission system operators for natural gas active in the country have not been unbundled as required by Article 9 of Directive 2003/55/EC as transposed through Articles 15 *et seq.* of the Energy Law. As a result, Serbia fails to implement Energy Community Law in this respect.

## 2. Lack of unbundling

### 1) Lack of legal unbundling

- (34) Article 9(1) of Directive 2003/55/EC requires the transmission system operator, where it is a part of a vertically integrated undertaking, to be independent in terms of its legal form from other activities not related to transmission (legal unbundling).
- (35) As the European Commission explains in an Interpretative Note of 2004<sup>16</sup>, legal unbundling is to be understood to the effect that the transmission system is operated by a separate “network” company.
- (36) According to the information reported by AERS<sup>17</sup>, *Srbijagas* holds licenses, *inter alia*, for and performs the activities of (i) transmission of natural gas and transmission system operation and (ii) supply of natural gas which includes sale of natural gas in the open market, sales to the public suppliers, as well as public supply and supply of last resort. All these activities in the natural gas sector of Serbia are performed by *Srbijagas* without being legally unbundled within the meaning of Article 9(1) of Directive 2003/55/EC.
- (37) *Srbijagas* has never legally separated the transmission activity from other activities, notably from the supply of natural gas, by establishing a separate network company as it is required under Article 9(1) of Directive 2003/55/EC. As can be seen from the organisational structure of *Srbijagas* (Annex 7) all natural gas activities are performed within the same vertically integrated undertaking in the form of internal functional departments, including those for transmission, distribution and supply/trade of natural gas. *Srbijagas* has never legally separated the transmission activity from its other activities. The lack of legal unbundling of the transmission activity within *Srbijagas* was also confirmed by AERS<sup>18</sup> and the Ministry in its reply to the Opening Letter (Annex 2).
- (38) As a response to rising debts of *Srbijagas*, the Ministry published on its website in the first quarter of 2013 the “*Platform for restructuring Public Enterprise (JP) Srbijagas*”, to which the Ministry refers in its reply. The document mentions unbundling of *Srbijagas* into several companies, namely trading, transmission and storage, and distribution. All of these companies would remain in full State-ownership. The document also envisages a roadmap for unbundling of *Srbijagas*: financial and business consolidation of *Srbijagas* by 31 October 2013, unbundling of gas transmission and storage from *Srbijagas* in a new entity “*Transgas*” by 31 December 2013, while supply and distribution is seen to continue under the name of *Srbijagas*. This document, however, has never been approved by the Government of the Republic of Serbia. It remains at the level of an internal discussion paper. None of the steps envisaged there have ever actually been undertaken.

<sup>16</sup> Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas – the Unbundling Regime – 16.1.2004, p. 5.

<sup>17</sup> 2012 Energy Agency Report, *Idem*, p. 51.

<sup>18</sup> *Ibidem*, p. 52 (Table 4-1).

- (39) *Srbijagas* published on its website a document of the same name “*Platform for restructuring of Public Enterprise (JP) Srbijagas*” in October 2013<sup>19</sup>. The plan also elaborates in general manner reasons for restructuring and potential options for unbundling, including a holding structure. Unlike the above-referred plan issued by the Ministry, it does not envisage any deadlines. Moreover, those two restructuring plans prepared by the Ministry and *Srbijagas* are not compatible.
- (40) Consequently, *Srbijagas* remains legally bundled at the time of submitting this Reasoned Request, *i.e.* transmission of natural gas is performed within the same company directly engaged in the gas supply activities.
- (41) As it is stipulated in Article 2(2) of the Dispute Settlement Procedures, failure by the Contracting Party to comply with Energy Community Law may consist of any measure by the public authorities of the Contracting Party, including public undertakings, to which the measure is attributable. Consequently, failed implementation of the unbundling requirements by transmission system operators must be considered as a failure of the Contracting Party itself.
- (42) The Secretariat thus concludes that Serbia has failed to implement Article 9(1) of Directive 2003/55/EC with respect to its vertically integrated natural gas undertaking *Srbijagas*.

## 2) *Lack of functional unbundling*

- (43) Besides legal unbundling, Article 9(1) of Directive 2003/55/EC also requires that when forming a part of a vertically integrated company, the transmission system operator must be independent in terms of its organisation and decision-making from other activities not relating to transmission (functional unbundling).
- (44) Furthermore, Article 9(2) of Directive 2003/55/EC sets the criteria to be fulfilled in order to ensure functional unbundling of transmission system operators, *i.e.* independence of persons responsible for the management of the transmission system operator (indents (a) and (b)), effective decision-making rights with regards to assets (indent (c)) and establishment of the compliance programme and its observance (indent (d)).
- (45) Even in those cases where legal unbundling has been implemented (as in the case of *Yugorosgaz Transport*), the type of company as well as its management and decision-making rights have to comply with the requirements of functional unbundling, and eliminate the possibility for instructions by the network company owners regarding its day-to-day business. Where necessary, the organisational and management structure of the network company has to be modified through a specific contractual arrangement in its statute in order to give the management of the company sufficient independence from the parent company<sup>20</sup>. As will be explained in the following, the Secretariat respectfully submits that in both vertically integrated structures of *Srbijagas* and *Yugorosgaz*, all activities related to transmission, distribution and supply of natural gas are performed within one unified organisational and management structure. Both companies conduct their business activities as fully integrated undertakings, thus failing to comply with the requirements for functional unbundling under Articles 9(1) and 9(2) of Directive 2003/55/EC.

<sup>19</sup> [http://www.srbijagas.com/upload/documents/Vesti/Elementi%20projekta%20restrukturiranja%20JP%20Srbijagas\\_20131031-Final.pdf](http://www.srbijagas.com/upload/documents/Vesti/Elementi%20projekta%20restrukturiranja%20JP%20Srbijagas_20131031-Final.pdf) (connected on 16-04-2014)

<sup>20</sup> Note of DG Energy & Transport, *Idem*, p. 6.

a) *Lack of management separation*

- (46) Article 9(1)(a) of Directive 2003/55/EC requires that *“those persons responsible for the management of the transmission system operator may not participate in company structures of the integrated natural gas undertaking responsible, directly or indirectly, for the day-to-day operation of the production, distribution and supply of natural gas”*.
- (47) Furthermore, Article 9(1)(b) of Directive 2003/55/EC demands that *“appropriate measures must be taken to ensure that the professional interests of persons responsible for the management of the transmission system operator are taken into account in a manner that ensures that they are capable of acting independently”*.
- (48) In practical terms, an implementation of the provisions of Directive 2003/55/EC on management separation would require the following<sup>21</sup>:
- a) The management staff of the network business may not work at the same time for the supply/production company of the vertically integrated company. This applies to both the top executive management and the operational (middle) management.
  - b) Appropriate measures must be taken to ensure the independence of the persons responsible for the network management:
    - i. the salary of the network management must not be based on the holding/supply company’s performance and be established on the basis of pre-fixed elements related to the performance of the network company;
    - ii. the reasons justifying a replacement of a Member of the Board of Directors of the network company at the initiative of the parent company must be clearly spelt out in the statutes of the company;
    - iii. transfer of management staff from the network business to other activities of the vertically integrated undertaking and *vice versa* should be made subject to certain conditions, including that such transfer shall not be predetermined from the outset;
    - iv. shareholding interests of the network company and/or its management staff in the supply business of the vertically integrated undertaking shall be limited so as to ensure independence of the network company’s management staff and prevent any conflict of interest;
    - v. common services shared between the network activities and other businesses of the vertically integrated undertaken may be permitted provided that certain conditions are fulfilled to reduce competition concerns and exclude conflict of interest.
- (49) As the Secretariat will further elaborate in the following, with regard to each transmission system operators for natural gas in Serbia, in both *Srbijagas* and *Yugorosgaz* all activities related to transmission, distribution and supply are performed within one unified organisational and management structure. Both companies conduct their business activities as fully integrated undertakings.

<sup>21</sup> Note of DG Energy & Transport, *Idem*, p. 8-9.

i) *Srbijagas*

- (50) For *Srbijagas*, the Governmental Decision of 2005 establishes a centralised management structure of the entire company (transmission, distribution and supply) consisting of the Supervisory Board, the Management Board and the General Manager.
- (51) The Articles of Association of *Srbijagas*, adopted by the Management Board on 28 September 2005 (Annex 6), provide that the company's activities will be organised through six functional departments, including the "Technical affairs functional department", which *inter alia* deals with transmission system operations, and the "Commercial affairs functional department", which *inter alia* performs supply and trading activities. Thus, transmission and supply activities are performed within subdivisions subordinated to the centralised management structure. The other departments are in charge of financial settlements, HR/administration/legal, system development and investments respectively.
- (52) The company's own organisational scheme attached (Annex 7) illustrates that the management structure of *Srbijagas* is centralised with the responsibility of a single set of managerial bodies to which all other management staff is accountable. It also shows the interdependency of functions performed by separate functional departments.
- (53) First of all, the "Technical affairs functional department" is managed by the Executive Director for Technical Affairs, who is fully accountable to the General Manager and the Deputy General Manager. Moreover, the Executive Director for Technical Affairs participates in the so called "directorate" consisting of the top management of the company and executive directors managing all six functional departments. The "directorate" has no formal status in the organisational structure of *Srbijagas*, however, in practice it deals with all main commercial and operational issues of the company to be further on processed for formal decision-making at the level of the General Manager or the Management Board. This includes all issues related to the network activities and supply businesses.
- (54) Secondly, daily organisational matters, such as system development and investments, which according to Article 8 of Directive 2003/55/EC are inseparable from the network activities, were excluded from the competence of the "Technical affairs functional department" and are performed by other functional departments which do commonly serve the transmission, distribution and supply activities of the company, and relevant decisions on such matters are taken either by the General Manager or the Management Board.
- (55) Moreover, the organisational structure of *Srbijagas* clearly indicates that such services as HR, finance and IT are provided by horizontal functional departments or divisions for the entire company and all its departments. This suggests that separation of common services provided to the network activities and supply businesses is not implemented.
- (56) Considering the above, the Executive Director for Technical Affairs cannot be expected to perform his work independently from other activities of *Srbijagas*. On the contrary, the centralised organisational structure of the company and the split of certain network-related functions between separate horizontal departments do clearly indicate the interdependence of all activities of *Srbijagas*, and their management at the centralised level.
- (57) Furthermore, an analysis of the financial report of *Srbijagas* for 2012<sup>22</sup> does not allow the conclusion that the salary of the Executive Director for Technical Affairs, or any other

<sup>22</sup> [http://www.srbijagas.com/upload/documents/Finansijski\\_izvestaji/2012/NAPOMENE%202012..pdf](http://www.srbijagas.com/upload/documents/Finansijski_izvestaji/2012/NAPOMENE%202012..pdf) (connected on 16-04-2014)

remuneration conditions thereof, would be separated in any justifiable and transparent manner from the general policies of the company.

- (58) It has to be also noted, that neither the Article of Association nor other internal documents of *Srbijagas* accessible to the Secretariat would indicate the existence of any specific conditions for replacement or transfer of the Executive Director for Technical Affairs, so as to ensure his independence from the top level management of the company. Moreover, no particular measures have been taken to avoid a conflict of interest between the Executive Director for Technical Affairs and other activities of *Srbijagas*.
- (59) It follows from the above that the transmission activities of *Srbijagas* are only separated *pro forma*, and not even for all activities relevant for the transmission of natural gas, on the level of departments below the company's General Manager. The company's governance structure not only gives full authority, but even expressly requires all three bodies in charge of managing the vertically integrated undertaking to involve themselves in the management of the day-to-day operations in both transmission and supply activities, as prohibited by Article 9(2)(a) of Directive 2003/55/EC.
- (60) Furthermore, no measures have been taken which would ensure that the head of the functional department in charge of transmission system operation, *i.e.* the Executive Director for Technical Affairs, is capable of acting independently in compliance with Article 9(2)(b) of Directive 2003/55/EC.
- (61) The Secretariat thus concludes that Serbia has failed to implement Articles 9(1), 9(2)(a) and 9(2)(b) of Directive 2003/55/EC with respect to the functional unbundling of transmission activities performed by *Srbijagas*.

ii) *Yugorosgaz Transport*

- (62) As regards *Yugorosgaz Transport*<sup>23</sup>, it follows from the facts displayed above that the mother company *Yugorosgaz* is its sole shareholder. It is represented in the governance structures of *Yugorosgaz Transport* through the so-called Assembly which consists of one single member, the representative of *Yugorosgaz*.
- (63) Besides the Assembly, the other body within the governance structure of *Yugorosgaz Transport* is the General Manager. Despite not being a member of the management structure of *Yugorosgaz*, the General Manager is appointed and dismissed by the Assembly (Article 54 of the company's Statutes, Annex 8) and controlled by it (Articles 27 and 40 of the Statutes). The Statutes do not limit the discretion of the Assembly on either account. On the contrary, they explicitly stipulate that the General Manager can be dismissed by the Assembly without reasons (Article 54(2)).
- (64) The General Manager manages the daily operation of the company. The Statutes only mention transport of gas through pipelines (Article 16), but do not further specify any of the tasks to be performed by a transmission system operator under Article 8 of Directive 2003/55/EC.
- (65) According to Article 64 of the Statutes, the General Manager's tasks in managing the company include preparing the business strategy, executing the Assembly's decisions, adopting acts which the Assembly does not, as well as the preparation of the company's accounts and

<sup>23</sup> Decision of *Yugorosgaz a.d.* No 0-53 as of 11 December 2012 on Foundation of *Yugorosgaz-Transport Ltd Nis*.

financial reports<sup>24</sup>. In taking decisions with financial relevance, his authority is limited to commitments not exceeding € 10.000 (Article 55 of the Statutes). Commitments above this threshold require the written consent of the Assembly.

- (66) According to Article 59 of the Statutes, the General Manager may become a shareholder of the company, however only upon approval by the Assembly. The General Manager must inform the Assembly on potential conflicts of interest when the company is to conclude any contract with third parties (Article 62). The Statutes contain nothing, however, related to potential conflicts of interest between the transmission and the supply activities carried out by *Yugorosgaz Transport* and its mother company.
- (67) According to Article 40 of the Statutes, the Assembly monitors the General Manager's work and adopts his reports, including the company's financial reports. It also decides on increase/decrease of the capital of the company, profit distribution, and appoints an auditor.
- (68) These examples illustrate how *Yugorosgaz Transport's* Statutes delineate the competences between the vertically integrated mother company *Yugorosgaz* (through the Assembly) and the General Manager, representing the transmission system operation activities. In the Secretariat's assessment, the Statutes establish a governance structure that may be common under general company law but do not envisage any provisions/measures specifically aimed at management separation as required by the Energy Law. Given the silence in the Statutes on the purpose of the company, one may even doubt whether *Yugorosgaz Transport* actually fulfils all relevant tasks of a transmission system operator as assigned under Directive 2003/55/EC. As this, however, seems to be accepted by the regulatory authority, the Secretariat currently does not challenge compliance in that respect.
- (69) In any event, the review of the Statutes' provisions confirms that the delineation of competences establishes unlimited control and influence of *Yugorosgaz* over its subsidiary's activities, not only through the discretionary appointment and dismissal of the General Manager without reasons, but also in not being prevented from influencing his management of the day-to-day transmission operation.
- (70) Moreover, *Yugorosgaz Transport's* capital as established by the Statutes is by far not enough to enable the company to perform independently and effectively the tasks assigned to a transmission system operator by the Directive 2003/55/EC. The capital of *Yugorosgaz Transport*, as provided in Article 19 of the Statutes, which consists of monetary contributions of approximately EUR 1,300 and non-monetary (property) contributions equal to approximately EUR 3,500 as well as the limitations of the General Manager's power to take commitments on behalf of the company to € 10,000 (Article 55 of the Statutes) do not allow for the company to take independent decisions of any significance.
- (71) Taking all this into account, the Secretariat concludes that the *pro forma* legal unbundling of *Yugorosgaz Transport* from the vertically integrated undertaking *Yugorosgaz* does not address let alone solve the problem that all main decisions with regard to the activities of *Yugorosgaz Transport* are taken by the Assembly, which in practice means unilateral decisions of a single shareholder – *Yugorosgaz*. The Secretariat submits that such situation is not in compliance with Article 9(2)(a) of Directive 2003/55/EC.
- (72) Furthermore, the Secretariat – despite the specific request made in the Reasoned Opinion – has not been informed by Serbia of any appropriate measures taken to ensure that the professional interests of the General Manager of *Yugorosgaz Transport* are taken into account

<sup>24</sup> See also Article 65 of the Statutes.

in a manner that ensures that they are capable of acting independently, as required by Article 9(2)(b) of Directive 2003/55/EC.

- (73) The Secretariat thus concludes that Serbia has failed to implement Articles 9(1), 9(2)(a) and 9(2)(b) of Directive 2003/55/EC with respect to the functional unbundling of transmission activities performed by *Yugorosgaz Transport*.

b) *Lack of effective decision making rights*

- (74) Article 9(1)(c) of Directive 2003/55/EC requires that “*the transmission system operator shall have effective decision-making rights, independent from the integrated gas undertaking, with respect to assets necessary to operate, maintain or develop the network. [...] It shall not permit the parent company to give instructions regarding day-to-day operations, nor with respect to individual decisions concerning the construction or upgrading of transmission lines, that do not exceed the terms of the approved financial plan, or any equivalent instrument*”.
- (75) In the reading of the European Commission, this requirement means that all commercial and operational decisions related to the operation, maintenance and development of the network must be made within the network business, without involvement of the related supply business or holding company of the integrated company. The network company must also have enough human and physical resources at its disposal to carry out its functions independently from other parts of the integrated company. It must also have sufficient financial means available to fulfil its tasks to maintain and develop the network<sup>25</sup>.
- (76) In the following, the Secretariat will reason that the transmission activities both in *Srbijagas* and in *Yugorosgaz Transport* are not independent in terms of effective decision-making rights from other activities performed within the vertically integrated structures.

i) *Srbijagas*

- (77) According to Articles 20-23 of the Articles of Association of *Srbijagas*, the sole organ adopting the business and development plans of the company is the Management Board, and not the “Technical affairs functional department” formally in charge of transmission. Thus the sole responsibility for the management and development of the assets of the company, including those necessary for the operation of the network, is with the Management Board of the vertically integrated undertaking. The development plans it adopts are binding on the General Manager and, subsequently, on the Executive Director for Technical Affairs *inter alia* in terms of constructing and upgrading of transmission lines, thus running counter to the last sentence Article 9(2)(c) of Directive 2003/55/EC.
- (78) Furthermore, as was already explained above<sup>26</sup>, the internal organisational structure of *Srbijagas* simply eliminates any possibility of the Executive Director for Technical Affairs to exercise effective decision making rights, as all system development, investment and financing are dealt by separate functional departments.
- (79) In other words, the manager responsible for the transmission activities – the Executive Director for Technical Affairs – has no effective and independent competence to deal with all commercial and operational decisions related to the operation, maintenance and development of the network, as all relevant matters in this regard are managed by different internal

<sup>25</sup> Note of DG Energy & Transport, *Idem*, p. 11.

<sup>26</sup> See paragraphs 50-56 above.

functional departments and respective decisions are being taken either by the Management Board or the General Manager in accordance with the general business policy of the company, including related to supply and trading.

- (80) Moreover, the “Technical affairs functional department” does also not have its own financial means, as all matters related to system developments and their financing are managed by respective competent functional departments, and decisions, including financial ones, are taken either by the General Manager or the Management Board.
- (81) It follows that the Executive Director for Technical Affairs of *Srbijagas* has no effective and independent decision-making rights in any network-related issues, but is rather limited to performing day-to-day technical and operational activities.
- (82) The Secretariat thus concludes that Serbia has failed to implement Article 9(2)(c) of Directive 2003/55/EC with respect to the functional unbundling of transmission activities performed by *Srbijagas*.

ii) *Yugorosgaz Transport*

- (83) The Statutes of *Yugorosgaz Transport* do not envisage anything in particular on investments into or maintenance of the network. The financial report mentioned in the statutes does not refer to investments specifically but only to the development of the company in general. In this situation, the Secretariat assumed in the Reasoned Opinion that the Assembly, and through it *Yugorosgaz*, takes the decisions referred to by Article 9(2)(c), with the General Manager only executing such decisions. Considering that the mother company continues to own the network, the lack of an explicit mandate of the transmission company to independently take decisions regarding the development of and investments in the network indicates that these tasks remain with the owner, *i.e.* *Yugorosgaz*, directly.
- (84) The Serbian Government was explicitly invited in the Opening Letter as well as in the Reasoned Opinion to provide factual information suitable to sustain the opposite conclusion, namely that *Yugorosgaz Transport* has effective and independent decision-making rights respect to assets necessary to operate, maintain or develop the network. No such information has been provided in the course of the preliminary procedure.
- (85) The Secretariat thus concludes that Serbia has failed to implement Article 9(2)(c) of Directive 2003/55/EC with respect to the functional unbundling of transmission activities performed by *Yugorosgaz Transport*.

c) *No compliance programmes established*

- (86) Article 9(1)(d) of Directive 2003/55/EC requires that “*the transmission system operator shall establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored. The programme shall set out the specific obligations of employees to meet this objective. An annual report, setting out the measures taken, shall be submitted by the person or body responsible for monitoring the compliance programme to the regulatory authority referred to in Article 25(1) and shall be published*”.

- (87) The purpose of a compliance programme is to provide a formal framework for ensuring that the network business as a whole, as well as individual employees and members of the management, comply with the principle of non-discrimination<sup>27</sup>.
- (88) Neither *Srbijagas* nor *Yugorosgaz Transport* have so far established the compliance programme, designated the body or person responsible for monitoring of the non-discriminatory conduct of transmission activities, or otherwise report how the principle of non-discrimination is implemented. No information to the contrary was provided to the Secretariat during the preliminary procedure.
- (89) The Secretariat thus concludes that Serbia has failed to implement Article 9(2)(d) of Directive 2003/55/EC with respect to the requirement for establishment of compliance programmes both for *Srbijagas* and *Yugorosgaz Transport*.

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<sup>27</sup> Note of DG Energy & Transport, *Idem*, p. 12-13.

## ON THESE GROUNDS

The Secretariat of the Energy Community respectfully requests that the Ministerial Council of the Energy Community declare in accordance with Article 91(1)(a) of the Treaty establishing the Energy Community that:

1. by failing to implement the requirement of legal unbundling of its transmission system operator *JP "Srbijagas"* from other activities not relating to transmission, fails to comply with Article 9(1) of Directive 2003/55/EC;
2. by failing to ensure the independence of its transmission system operator *JP "Srbijagas"* in terms of its organisation and decision-making from other activities not relating to transmission, fails to comply with Articles 9(1) and 9(2) of Directive 2003/55/EC; and
3. by failing to ensure the independence of its transmission system operator "*Yugorosgaz Transport*" d.o.o. in terms of its organisation and decision-making from other activities not relating to transmission, fails to comply with Articles 9(1) and 9(2) of Directive 2003/55/EC.

On behalf of the Secretariat of the Energy Community

Vienna, 22 April 2014

Janez Kopač  
Director

Dirk Buschle  
Deputy Director / Legal Counsel

## List of Annexes

- ANNEX 1 Opening Letter in Case ECS-9/13, dated 25 October 2013
- ANNEX 2 Response to the Opening Letter in Case ECS-9/13 of the Ministry of Energy, Development and Environmental Protection of the Republic of Serbia, dated 20 February 2014
- ANNEX 3 Reasoned Opinion in Case ECS-9/13, dated 24 February 2014
- ANNEX 4 Law on Energy of the Republic of Serbia, as adopted in July 2011
- ANNEX 5 Decision of the Government of the Republic of Serbia on the Establishment of a Public Enterprise for Transport, Storage, Distribution and Trade of Natural Gas, as adopted in July 2005 and further amended (in Serbian\*)
- ANNEX 6 Articles of Association of *JP "Srbijagas"*, dated 28 September 2005 (in Serbian\*)
- ANNEX 7 Organisational structure of *JP "Srbijagas"* (in Serbian\*)
- ANNEX 8 Founding act and Statutes of "*Yugorosgaz Transport*" d.o.o., as adopted in December 2012 (in Serbian\*)

\* The Secretariat may provide translations from Serbian to English, where requested