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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

Subject:	COMMISSION STAFF WORKING DOCUMENT Assessing the amendments to Directive 2009/73/EC setting out rules for gas pipelines connecting the European Union with third countries <i>Accompanying the document</i> Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2009/73/EC concerning common rules for the internal market in natural gas
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Delegations will find attached document SWD(2017) 368 final.

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COMMISSION STAFF WORKING DOCUMENT

Assessing the amendments to Directive 2009/73/EC setting out rules for gas pipelines connecting the European Union with third countries

Accompanying the document

**Proposal for a Directive of the European Parliament and of the Council
amending Directive 2009/73/EC concerning common rules for the internal market in
natural gas**

{ COM(2017) 660 final }

INTRODUCTION

The regulatory framework for the operation of gas pipelines within the Union is set out in the Third Energy Package.¹

Directive 2009/73/EC² (hereinafter "the Gas Directive") establishes common rules for the transmission, distribution, supply and storage of natural gas.

By Commission Proposal (xxx(2017)), it is intended to amend the Gas Directive in order to specify the scope of its application so that it expressly includes gas pipelines connecting Member States with third countries.

In the Gas Directive, transmission lines "which cross or span a border between Member States for the sole purpose of connecting the national transmission systems of those Member States"³ are defined as 'interconnectors'. Pipelines connecting Member States with third countries currently do not fall under this definition. For this and other reasons, such pipelines do not explicitly fall into the scope of the Third Energy Package. The present proposal specifies the exact scope of application of the Gas Directive. It sets out that within the borders of Union jurisdiction, pipelines to and from third countries are to be regarded as "interconnectors" and thus fall within the scope of the Gas Directive, clearly establishing that such pipelines are subject to the rules set out therein. The proposal also clarifies procedural provisions on pipelines to and from third countries. Finally, the proposal provides for the possibility for Member States to derogate, for a limited period and where appropriate subject to conditions, existing pipelines to and from third countries from the application of the main provisions of the Gas Directive.

The present staff working document accompanies Commission Proposal (xxx(2017)). It sets out the motivation and objectives for the proposed amendment and assesses the expected impact as regards existing and future gas pipelines to and from third countries.

The proposal follows up on President Juncker's announcement in his Letter of Intent accompanying the State of the Union 2017⁴ that the Commission will propose common rules for gas pipelines entering the European internal gas market as an initiative to be completed by end 2018.

BACKGROUND

Regulation of gas transmission systems

The regulatory framework for the operation of gas transmission systems in the Union is set out in the Third Energy Package, notably in the Gas Directive, in Regulation (EC) No

¹ The so-called Third Energy Package consists of Regulation (EC) No 713/2009, Regulation (EC) No 714/2009, Regulation (EC) No 715/2009, Directive 2009/72/EC and Directive 2009/73/EC.

² 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, OJ L 211, 14.8.2009, p. 94–136.

³ Cf. Article 2(17) Gas Directive.

⁴ State of the Union 2017, Letter of Intent to President Antonio Tajani and to Prime Minister Jüri Ratas, Priority 3: A resilient Energy Union with a forward-looking climate change policy.

715/2009 (hereinafter 'the Gas Regulation') and in the Commission Regulations setting out Network Codes for gas⁵ (hereinafter 'the Network Codes').

The objective of these rules is the creation of an internal market in natural gas, so as to achieve efficiency gains, competitive prices, and higher standards of service, and to contribute to security of supply and sustainability.⁶ Due to the cost of installation and their technical specificities, it is not viable to construct and maintain multiple parallel gas transmission systems. Therefore, gas transmission systems are regarded as natural monopolies. Among the core principles of this regulatory framework are thus the obligation to implement a system of third party access to transmission systems,⁷ the separation of gas production and supply activities from activities of gas transmission via the unbundling of transmission system operators,⁸ and the obligation on national regulatory authorities to set or approve non-discriminatory and cost-reflective tariffs for the use of transmission systems.⁹

The application of these core principles seeks to ensure that undertakings that compete on the market for the supply of natural gas can access transmission systems across the Union under non-discriminatory conditions in order to deliver their products.

Whereas the possibility to grant partial exemptions from the above-mentioned principles exists for new infrastructure, it is subject to specific conditions¹⁰, notably that the investments enhance competition and security of gas supply in the Union.

Substantive scope of the Gas Directive

The rules set out in the Gas Directive and the Gas Regulation apply to "transmission systems" and to "transmission system operators". Certain provisions, notably the possibility to grant partial exemptions from the requirements of the Gas Directive,¹¹ apply specifically to 'interconnectors'.

It follows from the definition of the term 'interconnector' that the transmission systems and transmission lines connecting Member States are subject to the regulatory requirements set in the Gas Directive. Conversely, transmission lines connecting Member States with third countries do not fall under the definition of 'interconnector' in the Gas Directive. As a result, such infrastructure projects are not eligible for exemptions granted to major new infrastructure pursuant to Article 36 Gas Directive.

Moreover, the rules set out in the Gas Directive governing the key aspects of third-party access, unbundling and tariff regulation do not expressly provide for their application to gas pipelines connecting a Member State with a third country. While several provisions provide for close cross-border cooperation between national regulatory authorities of Member States in applying the Directive, no such cooperation is provided for as regards third country authorities. By comparison, the provisions on the certification of transmission system

⁵ See <http://ec.europa.eu/energy/node/54> for further information.

⁶ Cf. Recital 1 Gas Directive.

⁷ Cf. Article 32 Gas Directive.

⁸ Cf. Article 9 Gas Directive.

⁹ Cf. Article 13 Gas Regulation.

¹⁰ Cf. Article 36 Gas Directive.

¹¹ Cf. Article 36 Gas Directive.

operators¹² envisage specific requirements for the participation of persons from third countries. In the absence of such specific rules, the applicability of third party access, unbundling and tariff regulation requirements to pipelines to and from third countries could not be ascertained and it has been concluded that the Union legislator, when adopting the Gas Directive, has not expressly foreseen its application to pipelines crossing an external border of the Union.

NEED FOR LEGISLATIVE ACTION

As outlined above, the Gas Directive does not expressly regulate the operation of gas pipelines connecting Member States with third countries. In the absence of applicable regulatory rules at Union level, the operation of such infrastructure could be regulated at the national level in the law of the respective Member States. For infrastructure entering the Union from a third country and thereafter crossing several Member States, this could result in the application of different rules to one and the same pipeline within the Union and thus to regulatory conflicts, legal uncertainty and distortion of competition within the Union internal energy market. Furthermore, there would be no guarantee that the respective national framework is compatible with Union rules applicable to infrastructure directly downstream of the infrastructure in question, or that the national framework prevents negative market impacts in other Member States. Absent national rules, such pipeline could *de facto* be operated exclusively in accordance with the law of the third country to which it connects.

Furthermore, the lack of Union-wide rules in the area may be detrimental for the achievement of the Union's energy policy objectives set out in Article 194 TFEU. The Union imports most of its natural gas consumption via pipelines from third countries¹³, and gas has to be often transported over several national borders before reaching the place where it is actually consumed. The applicable legal framework under which these gas imports are carried out, including the rules applicable to the operation of the respective pipelines, can therefore significantly affect the functioning of gas markets within the Union and the security of gas supply of European citizens.

A transparent and effective legal framework for infrastructure to and from third countries is of high importance for the well-functioning of the internal energy market (Article 194 (1) (a) TFEU) and security of supply (Article 194 (1) (b) TFEU):

The introduction of third party access requirements for domestic pipeline infrastructure was motivated by the experience acquired in the deregulation of Union gas markets and the findings that in the absence of non-discriminatory access to transmission infrastructure, competition on commodity markets would be seriously hampered to the detriment of customers.¹⁴ Without an effective third-party access regime, individual suppliers could gain unduly privileged access to the Union market and downstream infrastructure.

Investments in large pipelines usually require considerable investments in connected infrastructure in the EU. For this infrastructure, potentially a significant share of the costs will

¹² Cf. Article 11 Gas Directive.

¹³ The EU's gas demand in 2016 was 465 bcm of which 70.4% has been covered by imports. 87% of the imported volumes were transported via pipelines, while 13% came from LNG (cf. Quarterly Report on European Gas Markets, Vol. 10, <http://ec.europa.eu/energy/en/data-analysis/market-analysis>).

¹⁴ [Cf. DG COMP sector inquiry of 2005.](#)

ultimately be borne – via regulated transmission tariffs – by EU gas customers. Certain pipelines can, because of their importance for market integration and security of supply, also benefit from direct public funding, for instance via the Connecting Europe Facility.¹⁵ Applying the principles of regulated third party access, unbundling and transparency to interconnectors to and from third countries is fundamental to ensure that competition is effective, security of supply is ensured and stranded assets and inefficient investments are avoided to the best possible extent.

A lack of transparency in the operation of pipelines to and from third countries can be a risk factor from a security of supply perspective. Therefore, it is important to ensure that information on the operation and maintenance of important infrastructure are made available to the market, and can be used by relevant national and EU authorities, including relevant competent authorities in the meaning of the Gas SoS Regulation 994/2010.¹⁶

THE PROPOSED AMENDMENTS

The proposed amendments can be categorised as follows:

Specification of the scope

By amending the definition of 'interconnector' as well as certain provisions related to pipelines to and from third countries as described below, the legislator's intention to apply the substantive rules set out in the Gas Directive and in related acts also to pipelines connecting third countries to the European Union is expressed.

Adjustment of unbundling rules

The use of unbundling models other than ownership unbundling was made conditional on the vertical integration of transmission infrastructure at a specific date, i.e. 3 September 2009. In order to ensure that pipelines to and from third countries are not treated less favourably than domestic infrastructure, a new reference date is set for the application of Article 9(8) and (9) of the Gas Directive. This will allow the use of alternative unbundling models in cases where pipelines to and from third countries belonged to vertically integrated undertakings at the date of adoption of this proposal.

Consultation requirements

In order to facilitate the operation of infrastructure to and from third countries, the regulatory authorities of the Member States in question should endeavour to consult with the relevant authorities of third countries aiming at, as regards this infrastructure, consistent application of the provisions of this Directive up to the border of EU jurisdiction. In particular, such consultation should be carried out before deciding on an application for an exemption for new infrastructure pursuant to Article 36 Gas Directive.

¹⁵ <https://ec.europa.eu/inea/en/connecting-europe-facility/cef-energy>.

¹⁶ Regulation (EU) No 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC, OJ L 295, 12.11.2010, p. 1. The Commission proposal COM(2016)0052, on which an interinstitutional agreement was found on 16 May 2017, intends to repeal this Regulation.

Possibility to derogate from certain rules in the Gas Directive

The new Article 49(9) envisages that a Member State may grant a derogation for existing gas pipelines to and from third countries from the provisions of Articles 9, 10, 11 and 32 and Article 41(6), (8) and (10) of the Gas Directive. This possibility should ensure that there is sufficient flexibility to avoid any adverse effects of the proposed application of EU market rules to such infrastructure. Thereby, due account is also taken of the lack of specific rules in this area since the adoption of the Gas Directive in 2009. By providing for time-limited derogations which may be made subject to conditions, Member States are enabled to progressively adapt the regulatory framework on these pipelines, moving it closer to full application of the principles where appropriate.

NO NECESSITY FOR A SEPARATE IMPACT ASSESSMENT

The present initiative does not require a detailed impact assessment. First and foremost, it aims at achieving a legal situation which reflects the common practice of applying core principles of the regulatory framework set out in the Gas Directive in relation to third countries, notably via intergovernmental agreements. Furthermore, the proposed amendments to the Gas Directive are limited both in terms of substance and quantity and do not introduce rules for pipelines to and from third countries which differ substantially from the rules applicable to pipelines within the EU's territory. Finally, there is an established practice of applying core principles of the regulatory framework set out in the Gas Directive (in particular third party access, unbundling, tariff regulation and transparency requirements) in relation to third countries. This is particularly evidenced by the fact that these principles are incorporated in international agreements between Member States and third countries as well as between the Union and third countries and have been consistently applied to onshore pipelines to and from third countries. In these instances, the present proposal provides additional transparency and legal certainty but results in limited changes to the applicable legal standard.

SCOPE AND LEGAL IMPACT OF THE AMENDMENT

The proposed amendments expressly establish that the Gas Directive as well as the Gas Regulation apply to gas pipelines connecting third countries with the EU.

This has in particular the following legal consequences

- The concerned pipelines have to offer non-discriminatory third party access. This means that all interested parties must get equal opportunities to access capacity, pursuant to Article 32 of the Gas Directive as well as Articles 14 and 16 of the Gas Regulation.
- Network tariffs need to be set in a non-discriminatory way and subject to the approval by the competent national regulatory authority (or authorities, in case the infrastructure crosses several Member States), pursuant to Article 41 (1) of the Gas Directive and Article 13 of the Gas Regulation.
- The transmission system operator of the pipeline has to undergo unbundling pursuant to Article 9 of the Gas Directive. According to Article 9(8) Gas Directive, where on 3

September 2009 a transmission system belonged to a vertically integrated undertaking, unbundling can occur on the basis of one of the alternative unbundling models under the Gas Directive (ITO or ISO). As the proposed application of the unbundling rules to existing pipelines to and from third countries may require a restructuring of ownership, the amendments envisage the possibility to apply these alternative unbundling models where such pipelines belong to a vertically integrated undertaking at the date of adoption of the present proposal. Otherwise, full ownership unbundling applies.

- Transparency requirements under the Gas Directive and the Gas Regulation (notably Article 18 thereof) become applicable.
- New pipelines to and from third countries could request exemptions from unbundling, third party access and/or tariff regulation pursuant to Article 36 of the Gas Directive. As existing infrastructure cannot meet the "risk" criterion of Article 36, existing infrastructure could not request an exemption (but could be subject to derogation, see below).
- Where the existing regulatory framework of the pipeline, in particular on the basis of third country legislation, substantially differs from the respective EU rules, a so-called "conflict of laws" can occur. Resolving contradicting requirements and ensuring legal certainty could be achieved by concluding an intergovernmental agreement establishing a specific regulatory framework for the operation of such pipeline.
- Network codes, to a large extent, do not apply to pipelines to and from third countries. This is due to specific provisions clarifying their scope. By way of example, Article 2 (1) of the Network Code on capacity allocation mechanisms (Commission Regulation (EU) 2017/459) expressly states that entry and exit points to third countries are only subject to its requirements where this has been decided by the relevant national regulatory authority. The non-application of this Network Code automatically results in non-application of major parts of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas (see Article 2 (1) thereof) although certain provisions (notably Chapters I, II and IV) of this Commission Regulation do apply. The proposed amendments will therefore only have a limited impact on the applicability of network codes.
- The application of the aforementioned rules to existing pipelines to and from third countries may in some cases be considered unsuitable or difficult to implement in practice, including in cases where the operation of such infrastructure is governed by existing international agreements with third countries. Therefore, the proposal envisages the possibility for Member States to grant derogations from the application of Articles 9, 10, 11 and 32 and Article 41(6), (8) and (10) of the Gas Directive for existing gas pipelines to and from third countries. Such derogations shall - as is existing practice for exemption decisions - be limited in time and may be subject to conditions. In order to ensure a coherent legal framework for pipelines passing through more than one Member State, the decision to grant a derogation shall be taken by the Member State in the jurisdiction of which the first interconnection point is located.

ECONOMIC IMPACT

The Third Energy package was targeted, *inter alia*, at resolving:

- market concentration and market power;
- vertical foreclosure (in particular the inadequate unbundling of network and supply);
- lack of market integration (including lack of regulatory oversight for cross-border issues);
- lack of transparency; inefficient price formation mechanisms; lack of competition on downstream markets for gas.

Most of the problems identified by the legislator are linked to the existence of vertically integrated companies, which not only control essential facilities (such as gas transport networks) but also enjoy significant market power in the wholesale and sometimes retail markets. Taking into account that the European Union showed an import dependency for natural gas of 70.4% in 2016 with a rising tendency due to declining domestic production, not applying the Third Energy Package to gas pipelines connecting third countries with the European Union would result in depriving the internal energy market of the full potential of economic and security of supply benefits resulting from the application of the market rules set out in the Third Energy Package.

Without unbundling, regulated third party access and tariff regulation, the owner of a gas pipeline connecting third countries with the European Union can effectively control access to the internal energy market (or parts thereof) and thereby has an impact on the level of downstream competition and security of supply in this market area. Restrictions to market entry and market integration would persist, should the regulatory status quo continue.

Applying the Third Energy Package rules to gas pipelines connecting third countries with the European Union may positively impact on the access to upstream supply projects leading to an increase of competition not only in the downstream, but also in the upstream market. The proposal does however not impact on the freedom of choice how to organise the upstream market in a third country. Nevertheless, assuming that there are several suppliers active in the upstream market, applying third party access rules on interconnectors with third countries would increase available sources, thereby leading to both, a diversification of sources in terms of supply companies, as well as to a higher level of competition. Due to the economies of scale and scope, providing access to third parties should reduce the cost of transporting gas from different production sources located in the same geographical area. Overall this should lead to efficiency gains, while the analysis on the impact of ownership unbundling on credit ratings and thereby also on the financing costs for new interconnectors did not show a negative impact¹⁷.

Efficiency improvements in the gas sector lead to lower energy prices, which in turn impact on the rest of the economy. Generally it is assumed that the quantitative analysis of economic

¹⁷ Comparing the credit ratings of vertically integrated companies to energy companies *without* network assets, no significant or systematic differences were observed in the Impact Assessment for the Third Energy package.

impacts as conducted for the Third Energy Package would show similar positive impacts on prices and GDP for the current proposal.

IMPACT ON THE REALISATION OF PLANNED PIPELINES

The amendments, by expressly establishing the application of the Gas Directive and Gas Regulation to pipelines to and from third countries, would ensure that such infrastructure projects could be realised and operated applying the relevant provisions of the Gas Directive and Gas Regulation (including, where no more specific provisions are included, the related legal acts like network codes and guidelines). Many pipeline projects inside the EU, and several pipeline projects connected to third countries, were realised in full respect of those requirements.

Where the application of these rules to existing pipelines to and from third countries would prove unsuitable or impossible in practice, Member States could decide to grant a derogation from the application of key requirements set out in Articles 9, 10, 11 and 32 and Article 41(6), (8) and (10) of the Gas Directive. The possibility ensures that there is sufficient flexibility to avoid any adverse effects of the present extension of the applicability of Union market rules to such infrastructure.

Furthermore, where the risk of new pipeline projects would be such that full application of the Gas Directive would prevent the investment, the project promoter could request an exemption under Article 36 of the Gas Directive. Were both the national authorities and the Commission find an exemption request to be justified, a project-specific regulatory framework could be granted.

CONTRADICTING LEGAL FRAMEWORKS

The proposed explicit application of the rules of the Gas Directive as well as of the Gas Regulation to a pipeline to and from third countries can result in conflicts between different legal regimes.

Where a contradicting framework results from the national law of a Member State, it has to be adapted accordingly.

The question is more complex where the conflicting framework is based on third country legislation and/or intergovernmental agreements, as will often be the case. In this context, it has to be borne in mind that a pipeline from a third country may cross different territories and is therefore, in its different parts, subject to different jurisdictions – that of the third country and at least that of the Member State(s).

This may result in the application of two conflicting regulatory regimes – that of the Union and that of the third country – to a single pipeline and thus in a "conflict of laws". Such "conflicts of laws" do not as such prevent the application of Union law.

In order to provide for a single and coherent framework, the conclusion of an intergovernmental agreement with the third country is a possible solution. Such an agreement could either specifically cover a given project, or generally agree on the framework for all projects between the contracting parties.

An agreement between the Union and the third country would, depending on its content, prevail over the Gas Directive as well as the Gas Regulation.

If the international agreement is concluded between a Member State and the third country and if this agreement is incompatible with the Gas Directive and/or Gas Regulation, the Member States concerned must thus take all appropriate steps to eliminate the incompatibilities between Union law and the agreement in question (Articles 351 (2) TFEU and 4 (3) TEU).¹⁸ This means that the Member State must renegotiate or terminate the agreement where appropriate. For the termination or renegotiation of international agreements the rules under public international law apply. Termination or renegotiation are, first of all, possible if and to the extent that the termination or amendment is expressly foreseen in the agreement. In some specific cases, Member States may also have recourse to the termination and adaptation grounds set out in the Vienna Convention of the Law of the Treaties.

Where the application of these rules to existing pipelines to and from third countries would be unsuitable due to the existence of bilateral intergovernmental agreements, Member States could decide to grant a derogation from the application of key requirements set out in Articles 9, 10, 11 and 32 and Article 41(6), (8) and (10) of the Gas Directive.

¹⁸ As an exception, Article 351 (1) TFEU allows Member States to fulfil their obligations arising from international agreement with third countries. However, this applies only to international agreement that were signed before the respective MS joined the Union. Furthermore, Article 351 (2) TFEU requires Member States to take all appropriate steps to eliminate incompatibilities between international agreements and the Treaties.