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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Directive on common rules for the internal markets in renewable and natural gases and in hydrogen and Regulation on the internal markets for renewable and natural gases and for hydrogen (recast) - Policy debate

In view of the TTE (Energy) Council on 25 October 2022, delegations will find in Annex the discussion note on the Directive on common rules for the internal markets in renewable and natural gases and in hydrogen and the Regulation on the internal markets for renewable and natural gases and for hydrogen (recast).

Discussion Note on the Regulation and Directive on Gas and Hydrogen Market

On 15 December 2021, the Commission submitted proposals for the Directive on common rules for the internal markets in renewable and natural gases and in hydrogen and the Regulation on the internal markets for renewable and natural gases and for hydrogen (Gas Package) as a part of new EU framework to decarbonize gas markets, promote hydrogen and reduce methane emissions.

Under the FR Presidency, the proposals together with the Impact Assessment were presented, followed by the first exchange of views by the Member States. In July 2022, the Czech Presidency started negotiations on the proposals in the Energy Working Party. Based on the first outcomes of those discussions, Presidency submitted the first revision of both the Regulation and Directive on 9 September 2022 to allow for further in-depth discussion in the Energy Working Party in the following weeks.

On the basis of the progress achieved to date, and in order to set a direction for further work, the Presidency now proposes 3 discussion topics, each with several options for the Ministers to consider:

1. The time frame of development of hydrogen markets with focus on vertical unbundling of Hydrogen Network Operators (HNOs)

The Commission proposal envisages a more flexible regulatory framework for hydrogen during the market ramp-up phase but, by 1 January 2031, more detailed rules should apply that facilitate market integration and cross-border trade. Some Member States considered that the fixed date of 2030 for this regulatory transition does not provide sufficient flexibility and time for hydrogen market to develop and mature sufficiently. The lack of a harmonized end-date of the transition period on an EU level however entails the risk of divergent regulatory systems across borders that could hamper the development of an efficient internal market.

The proposed rules for vertical unbundling of HNOs *(Article 62 of the Directive)* make the ownership unbundling model available. The independent system operator ('ISO') model is proposed to be available for hydrogen networks, which belonged to vertically integrated undertakings at the entry into force of the Gas Package. A more contested element is the expiry of the Independent Transmission Operator ('ITO') unbundling model by 2031 as some Member States worry that this could hamper the development of hydrogen networks, and thus markets, because the gas TSOs with ITO unbundling model would not be incentivized to invest into repurposing of their infrastructure.

The proposed transition period for hydrogen markets by the end of 2030 appears in several articles throughout the Gas Package. The Regulation proposes that no tariffs for access to hydrogen networks at interconnection points between Member States are charged from 1 January 2031 *(Article 6 of the Regulation)* which should be substituted by the creation of a compensation mechanism for financing cross-border infrastructure among the relevant HNOs *(Article 53 of the Directive)*. By the end of 2030 under the proposed Directive Member States shall ensure the implementation of regulated third party access to hydrogen networks *(Article 31 of the Directive)* and HNOs can benefit from derogations for existing hydrogen networks and geographically confined networks *(Articles 47 and 48 of the Directive).*

In this respect, the Ministers are invited to reflect on the following options:

a) *To implement a review mechanism for the 2031 regulatory transition date at Union level, where the Commission would review, based on pre-established criteria (e.g. market functioning, competition, effects divergence of rule on cross-border trade), the market conditions in [2028] and, where appropriate, would adopt a decision to postpone the transition at Union level.*

b) *To postpone the transition phase for hydrogen market design elements until year [X].*

c) *To preserve the Independent Transmission Operator ('ITO') unbundling model after 2030 for the existing gas TSOs with the ITO unbundling model.*

2. <u>Tariff discounts for renewable and low-carbon gases in the natural gas system and cross-border tariffs in hydrogen networks</u>

I. <u>Cross-border tariffs in dedicated hydrogen networks</u>

The Commission proposed a design for a future hydrogen market without cross-border tariffs as of 1 January 2031 *(Article 6 of the Regulation)*. As already the case for the electricity markets, this would create a level playing field for hydrogen production and avoid so-called ‘pancaking’ of tariffs, which is important to prevent an increase of costs for final consumers. Implementing a system of zero-level cross-border tariffs and appropriate cost sharing mechanisms may be more feasible in an early stage of hydrogen infrastructure deployment than in a mature market where considerable investments into infrastructure have been made. In order to ensure the development of (cross-border) hydrogen infrastructure in the absence of cross-border tariffs, a financial compensation mechanism among hydrogen network operators is proposed *(Article 53 of the Directive).* Some Member States prefer keeping the existing tariff mechanism also for hydrogen, whilst others would like to postpone the implementation of zero-level cross-border tariffs for hydrogen networks.

Subsequently, the Ministers are invited to reflect on the following options:

a) *To implement a review mechanism for the year 2031 at Union level, where the Commission would review, based on pre-established criteria (e.g. market functioning, competition, effects divergence of rule on cross-border trade), the market conditions in [2028] and, where appropriate, would adopt a decision to postpone the the obligation for zero-level cross-border tariffs for hydrogen networks.*

b) *To postpone the obligation for zero-level cross-border tariffs for hydrogen networks until year [X]*.

c) *To replace obligation of zero-level cross-border tariffs as of 1 January 2031 by a joint decision on cross-border tariffs by the national regulatory authorities, with a final ACER decision in case of disagreement.*

II. Tariff discounts for renewable and low-carbon gases in the natural gas system

The Commission proposal contains various tariff discounts whose main objective is to encourage the uptake and cross-border trade of renewable and low-carbon gases *(Article 16 of the Regulation*[1]*)*. Some Member States argued that renewable gases should be prioritized. Others expressed worries that the tariff discounts are not a suitable tool how to increase uptake of these gases and about the loss of revenues for the regulated gas TSOs and, thus, potential increase of price of fossil gas for final customers.

In this regard, the Ministers are invited to reflect on the following options:

a) *To differentiate between renewable and low-carbon gases discounts, i.e. different level of discounts for renewable and low-carbon gases.*

b) *Not to implement tariff discounts at all interconnection points, including entry points from and exit points to third countries, while Member States shall implement discounts at entry points from renewable and low carbon production facilities and at entry points from and exit points to storage facilities.*

c) *Not to implement mandatory discounts for renewable and low-carbon gases, i.e. full tariff to be paid to transport renewable and low-carbon gases.*

[1] Under Article 16 of the Regulation, 75% tariff discount is to be implemented at entry points from production facilities of renewable and low-carbon gases and 75% discount from transmission tariffs to and from gas storages in the natural gas system. 100% tariff discount is to be implemented at all interconnection points for renewable and low-carbon gases in the natural gas system.

3. Blending

The Regulation obliges the TSOs to accept blending of hydrogen up to 5% at interconnection points between EU MSs from 1 October 2025 *(Article 20 of the Regulation)*. In case differences in blending practices lead to cross-border flows restrictions, the process of cross-border coordination on gas quality *(Article 19 of the Regulation)* applies. Some Member States do not wish to blend hydrogen in their domestic natural gas networks and would prefer the transport and use ofpure hydrogen. Others would prefer to postpone the date of the implementation and decrease the maximum blending level to avoid high costs and limit possible risks.

Therefore, the Ministers are invited to reflect on the following options:

a) To change the maximum blending level at interconnection points to [X] %.

b) To postpone the implementation of the maximum blending level at interconnection points to 1 October [X].

c) Not to set a harmonized maximum blending level, i.e. leaving adjacent Member States and TSOs to agree bilaterally on maximum blending levels at interconnection points.