Annex 01/41st PHLG/04-03-2016

Energy Community Secretariat
Proposed Treaty Changes
For the Ministerial Council in October 2016

I. Introduction

Following the submission of the report by the High Level Reflection Group chaired by Jerzy Buzek, public consultation and further analytical work carried out by the Secretariat and the European Commission, the Ministerial Council in October 2015 embarked on a process of reforming the Energy Community. The main objective of this reform is to adapt the Energy Community to the new challenges faced by European and international energy policy, and to ensure that the Community can deliver successfully on its promise to reform the Parties' energy sectors in line with European law. At the meeting in 2015, the Ministerial Council adopted procedural rules related to its own procedures, the better involvement of the civil society, improved dispute settlement and the introduction of Parliamentary Plenum meetings. At the same time, the Ministerial Council adopted a General Policy Guideline whereby it committed to discussing further reform proposals during 2016 and 2017.

The experience made during 2015 clearly shows that reforming the Energy Community through secondary legislation reached its limits and that a few key upgrades need to be introduced through Treaty changes. The following list contains the Secretariat's proposals with some explanatory notes. It needs to be emphasized that amending the Treaty is common in the Energy Community's legal practice and has happened regularly over the last years. In its proposal, the Secretariat made sure that the proposed changes remains within the confinements of Article 100 of the Treaty (i.e. concerning only Titles I to IV) and thus do not trigger ratification by the Parties. Upon consultation with the European Commission, the Secretariat also made sure that the Treaty changes do not lead to the creation of new institutions but, where necessary, only to giving existing bodies a basis in the Treaty.

II. Proposed amendments based on Article 100 EnC

1. Revision of Article 13

Wording

> "**The Parties recognize the importance of the Kyoto Protocol and the Paris Agreement. The Energy Community shall implement them in line with the European Union's policy and legislation**."

Explanation

Following the Paris Agreement concluded at the COP21 in December 2015, international climate policy for the period after 2020 has been defined. Unlike under the Kyoto Protocol, the Contracting Parties participate on the same level as the European Union and its Member States. In the run-up to the COP21 as well as in bilateral agreements with the European Union, the Contracting Parties committed to follow the Union's policy related to climate change, and submitted individual INDCs to the UNFCCC Secretariat.

In the context of the Energy Community, however, there is at the moment a considerable gap between the aquis related to climate change applicable in the European Union and the commitments made by the Contracting Parties. This poses risks to homogeneity in the pan-European energy sectors (production, supply, consumption), the greatest contributors to climate change. The actual Article 13 of the Treaty never gained practical relevance. While the Secretariat does not propose to incorporate new substantial pieces of acquis at this point (with the possible exception of the so-called MMR Regulation currently under discussion in the Environmental Task Force), it suggests to close the gap on the level of the Treaty and provide a basis for further

alignment in the future. This is of particular importance at a moment when the European Union starts to reflect about its post-2020 climate change acquis.

2. New paragraph in Article 18

Wording

> **"(3) The Secretariat shall keep under constant review all systems of aid existing in the Contracting Parties. Contracting Parties shall notify any plans to grant new aid to the Secretariat and take into account the Secretariat's opinion before granting such aid. The Permanent High Level Group shall adopt procedural rules implementing this paragraph**."

Explanation

The High Level Reflection Group's report, the Analytical Paper as well as all other assessments concur in the view that application of the acquis related to competition and State aid in the energy sectors is non-functional in the Energy Community. It is equally clear that the energy markets in the Contracting Parties are seriously distorted due to extensive subsidization schemes. The main problem with State aid law enforcement in the Energy Community is the lack of a central authority monitoring the granting of State aid which, under the institutional framework of the Treaty, can only be the Secretariat.

The Secretariat's proposal to remedy this situation is conservative in the sense that it does not suggest to grant the Secretariat executive enforcement powers. Instead, the Secretariat proposes a procedure which is already applied in the context of the Third Package in order to increase transparency and help improving the implementation of the acquis. Instead of giving the Secretariat decision-making powers, an obligation to notify planned State aid by the local authorities and to take into account an assessment of the Secretariat similar to the procedures for exemptions or certifications is considered useful. With the exception of decision-making, the proposed solution is based on the EU model and would close the legal gap inside the Energy Community. In this respect, it is also to be noted that the Secretariat in line with the Ministerial Council's budget decision just reinforced its legal unit by a qualified State aid expert.

3. A new Article after current Article 41

Wording

> "**1. To the extent affecting Network Energy within the Energy Community, restrictions on the movement of capital, [on the establishment and on the provision of services] shall be prohibited between the Parties.**
>
> **2. The provisions of this Article and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health. [The provisions of this Article shall not affect Parties' regimes applicable to the free movement of persons nor those applicable to social security systems]**."

Explanation

This proposal comes back to the Secretariat's proposal during 2015 to complement the free movement of goods in the Treaty by the other fundamental freedoms under the EU Treaty. The High Level Reflection Group's Report and the Analytical Paper provide ample explanation of the problems the lack of those freedoms create, as well as a justification for such a proposal. These reasons are still valid. Fundamental freedoms support market participants from all Parties and thus boost further pan-European market integration. The Secretariat's proposal takes into account concerns expressed inside the European Union by 1) proposing to focus on the free movement of capital in a first step (no impact on the movement of persons) and 2) by introducing safeguards in paragraph 2 to the extent the inclusion of provision of services and/or establishment is considered feasible.

4. A new Chapter V in Title IV: "Single Market and Reciprocity"

Wording

"**Article xx**

1. Where the Agency for the Cooperation of Energy Regulators is competent to take decisions or issue recommendations in cross-border situations inside the European Union, it shall exert the same competences also with regard to borders between the European Union and Contracting Parties.

2. In procedures carried out to exercise the competences under paragraph 1, the regulatory authorities of the Contracting Parties involved shall be granted the same rights and powers within the Agency for the Cooperation of Energy Regulators as a regulatory authority of a European Union Member State."

Explanation

1. Reciprocity in general

The regime applicable to energy flows, infrastructure and cross-border cooperation on the interface between EU Member States and Contracting Parties has long been an issue of concern and may be considered the biggest obstacles to pan-European energy market integration. The reason for the regulatory gap on these borders is that, on the one hand, adaptations made under Title II of the Treaty (Article 24) only extends the acquis communautaire to Contracting Parties' part of the interface and not the Member States' and that, on the other hand, the Treaty requires non-discriminatory treatment in terms of rights and obligations also on this interface. The alternative option, extending acquis to the Energy Community under Titles III or IV of the Treaty, turned out to be barred on account of the European Union's Decision 500/2006. Past attempts to tackle this problem through an Interpretation under Article 94 of the Treaty also proved to be ineffective because the European Commission considers such Interpretations non-binding on the European Union and only issued a recommendation to EU Member States to ensure equal treatment on the interface with Contracting Parties. Non-binding recommendations, however, are at odds with an Energy Community based on the rule of law.

Finding a solution for this problem is of utmost importance and urgency for both existing and future acquis (such as network codes). Based on past experience, the Secretariat considers the introduction of a general reciprocity clause in the Treaty as necessary for ensuring legal certainty and non-discrimination. While refraining from making a proposal at this point in time, the Secretariat considers that either a general reciprocity clause or the so-called "switch-on clause" recently proposed by the European Commission for the new Regulation on Security of Gas Supply should become a general principle under the Treaty. Taking into account the evolution of the debate inside the European Union on that latter clause, the Secretariat will come up with a proposal to the Permanent High Level Group in June 2016.

2. The regulatory gap

The regulatory gap on the interface between Contracting Parties and the European Union also needs to be addressed with regard to the competences of the supranational institutions involved. This requires further Treaty changes. While the Secretariat is aware of the ongoing discussions related to Regulation 713/2009 inside the European Union, possible amendments to EU legislation cannot affect Contracting Parties and/or the role of the Energy Community Regulatory Board.

The proposed Article assigns the ultimate competence for the interface between Contracting Parties and the European Union to the Agency for the Cooperation of Energy Regulators (ACER) as it believes that a single pan-European energy market requires also a single supervisory authority, and that ACER is best placed for that role. The Energy Community Regulatory Board will retain its competences for all situations involving the borders between two (or more) Contracting Parties.

In order to ensure full involvement of the involved Contracting Parties' regulatory authorities in ACER's decision-making procedure and the legitimacy of its decisions also in the Contracting Parties' jurisdiction, the proposed paragraph 2 is necessary.

5. In Article 63, the word "**Two**" is deleted.

Explanation

The limitation to two Fora (gas and electricity) does not correspond to the reality any longer.

6. A new paragraph 4 in Article 76

Wording

> "**A Decision incorporating a Regulation adopted by the European Union shall have general application. It shall be binding in its entirety and directly applicable in all Parties it addresses**."

Explanation

The existing Treaty contains a major difference in terms of the effect of acquis communautaire between the European Union on the one hand and the legal orders of the Contracting Parties on the other, namely the lack of direct effect of Regulations in the latter. This deficiency creates major problems in the implementation of acquis. As longs as Regulations did not yet play a central role in European energy legislation and, where they existed, were of rather general and limited scope, the lack of direct effect could still be tolerated. With Third Package, however, Regulations became a major tool of European energy legislation, for instance in the area of security of supply and most importantly, network codes. Given their dense and detailed content, any transposition by Contracting Parties in their national legal order risks destroying their systematic consistency and thus endangers the goals they pursue. Transposition also entails major delays.

The Secretariat believes that giving direct effect to Regulations also in the Energy Community is the only way to make network codes equally effective for Contracting Parties and ensure homogeneity in the pan-European market. It notes that the proposed Treaty change will not pose problems for the legal order of Contracting Parties which generally follow a monist approach to international law already.

7. A new paragraph 3 in Article 91

Wording

> "**When taking decisions under this Article, the Ministerial Council shall take into account the opinion of a committee consisting of independent lawyers. To the extent the Ministerial Council decides to deviate from that committee's opinion, it shall set out the reasons for doing so in writing**."

Explanation

One of the big achievements of the reform process so far as the amendments to the Procedural Act on Dispute Settlement which strengthened, in terms of composition and procedure, the Advisory Committee established by the original Procedural Act in 2008. That body is the only element of enforcement under the Energy Community Treaty which comes close to an independent, neutral and expert-based resolution of dispute settlement cases. However, any attempts made last year to give this body also a greater role in the decision-making failed due to the wording of existing Article 91 which was interpreted rather restrictively. As a result, the enforcement of Energy Community acquis was not enhanced in the way requested by many stakeholders, including EU institutions.

Unlike in previous discussions, the Secretariat does not propose the establishment of a Court of Justice. Instead of proposing further futile amendments to the Procedural Act on Dispute Settlement, it rather proposes to include one slight improvement to the decision-making procedure in the Treaty. The proposal follows a pattern which has been used in similar contexts in the Energy Community (notably the Third Package adaptation): to not deprive the ultimate decision-maker (the Ministerial Council) of its role, even though structurally biased and non-expert, but to require it to motivate any decision dissenting from the opinion expressed by independent experts.

Alternatively, this modification could be also included in amendments to the Procedural Act on Dispute Settlement, as envisaged by Article 47 of that Procedural Act.

8. A new Article before current Article 92

Wording

"**1. Contracting Parties shall be required to take the necessary measures to comply with the decision of the Ministerial Council.**

2. If the Secretariat considers that the Contracting Party concerned has not taken the necessary measures to comply with the decision of the Ministerial Council, it may bring the case before the Ministerial Council after giving that Contracting Party the opportunity to submit its observations. It shall specify the amount of the lump sum or penalty payment to be paid by the Contracting Party concerned which it considers appropriate in the circumstances.

The calculation of the penalty payment shall take account of the seriousness of the infringement, having regard to the importance of the rules breached and the impact of the infringement on general and particular interests, its duration and the Contracting Party's ability to pay, with a view to ensuring that the penalty itself has a deterrent effect.

If the Ministerial Council finds that the Contracting Party concerned has not complied with its decision it may impose a lump sum or penalty payment on it. The Ministerial Council shall decide in accordance with Article 91(1).

3. When the Secretariat brings a case before the Ministerial Council on the grounds that the Contracting Party concerned has failed to fulfil its obligation to notify transposition of Measures, it may, when it deems appropriate, specify the amount of the lump sum or penalty payment to be paid by the Contracting Party concerned which it considers appropriate in the circumstances.

If the Ministerial Council finds that there is an infringement it may impose a lump sum or penalty payment on the Contracting Party concerned not exceeding the amount specified by the Secretariat. The payment obligation shall take effect on the date set by the Ministerial Council in its decision."

Explanation

The High Level Reflection Group as well as the European Commission's analytical paper concluded that the current political approach to sanctions does not satisfy the standards of an Energy Community based on the rule of law. The sanction regime lies at the heart of the weakness of the Energy Community's enforcement system. This conclusion has been confirmed by recent experience: A Contracting Party which does not rectify a breach declared by the Ministerial Council cannot be held accountable other through a highly politicized procedure of symbolic nature rather than being effective and deterrent, and depending on unanimity. The lack of a routine similar to Article 260 TFEU negatively affects implementation by Contracting Parties, it paralyzes Ministerial Council meetings by blending the legal with the political and it creates unequal enforcement standards privileging Contracting Parties over EU Member States. For these reasons, the Ministerial Council, in its General Policy Guidelines of 2015 as well as in the amended Procedural Act on Dispute Settlement, requested proposals for an improved sanction regime.

The Secretariat considers that Article 260 TFEU should indeed be the yardstick for enforcement measures also for Contracting Parties and proposes to incorporate this clause in the Treaty for any "normal" non-compliances identified by the Ministerial Council. For all "qualified" (i,e, serious and persistent) breaches by a Parties to the Treaty, Article 92 could be kept in its existing form. It is to be expected that a functioning regime for "normal" cases will make resorting to Article 92 a rare exemption rather than the default procedure it is now in the absence of any alternatives.

The calculation of penalties under Article 260 TFEU, the model for the Secretariat's proposal, is based on transparent mathematical formulas consisting of objectively defined elements, it could be easily transposed also to the Energy Community. As the sanction regime in the EU takes into account the capacity to pay of the state concerned, the relative low GDP in Contracting Parties would become a relevant factor in the formula. The revenues from penalties paid by individual

Contracting Parties could be used e.g. for decreasing all Parties' budget contributions accordingly. It could also feed special funds for dedicated purposes, such as environmental, energy efficiency, infrastructure investments etc.