

OPINION 01/2017 OF THE ENERGY COMMUNITY REGULATORY BOARD
on the preliminary decision No. 311.012/2016-C-I issued by the regulatory authority of the
Republic of Serbia on certification of *Yugorosgaz-Transport, LLC Niš*

THE ENERGY COMMUNITY REGULATORY BOARD

Having regard to the Treaty establishing the Energy Community and in particular Articles 5 and 11 thereof;

Acting in accordance with Article 60 of the Energy Community Treaty and the procedures laid down in Procedural Act no 01.1/2015/ECRB-EnC¹;

CONSIDERING THAT:

1. Procedure

- (1) On 12 August 2016, *Yugorosgaz-Transport, LLC, Niš* (hereinafter '*Yugorosgaz-Transport*') submitted to the national energy regulatory of Serbia (hereinafter 'AERS' or 'the regulator') an application for certification as independent system operator (ISO) in accordance with Articles 240 and 241 of the Energy Law² (hereinafter 'the application').³
- (2) On 12 December 2016 AERS adopted a preliminary decision on the certification of *Yugorosgaz-Transport* as independent system operator (hereinafter 'Preliminary Decision').⁴ The Preliminary Decision is based on Article 39(1) and 49(3) in connection with Articles 240 and 241 of the Energy Law, as well as Article 24 of the Rulebook on Energy Licence and Certification.⁵
- (3) According to Article 3(1) of Regulation (EC) 715/2009 (hereinafter '*Gas Regulation*') in conjunction with Articles 9 to 11 of Directive 73/2009/EC (hereinafter '*Gas Directive*')⁶ the Energy Community Regulatory Board (ECRB) is required to issue an Opinion on the preliminary decisions of Contracting Parties' national regulatory authorities on certification of national transmission system operators upon consultation by the Energy Community Secretariat ('Secretariat').
- (4) On 22 December 2016 AERS notified the Secretariat its Preliminary Decision.
- (5) On 10 January December 2017 the Secretariat forwarded the Preliminary Decision to the ECRB President with the request for providing an ECRB Opinion pursuant to Article 3(1) Gas Regulation.

¹ PA/2015.01/ECRB-EnC on the procedures for issuing an opinion of the Energy Community Regulatory Board on the decision of a national regulatory authority for certification of a gas or electricity transmission operator.

² Official Gazette No. 145/14.

³ Following the Decision No 0-20 of 12 May 2016 of Yugorosgaz.

⁴ AERS Decision, No. 311.012/2016-C-I, adopted on 12.12.2016.

⁵ Official Gazette No 87/15.

⁶ Throughout the entire document reference to the Gas Directive and Gas Regulation shall mean the versions of the Energy Community *acquis communautaire* as applicable in the Energy Community pursuant to Ministerial Council Decision 2011/02/EnC-MC.

- (6) The ECRB President on 12 January 2017 initiated ECRB consultation pursuant to Procedural Act no 01.1/2015/ECRB-EnC.
- (7) ECRB examined the Preliminary Decision in accordance with the procedures laid down in said Procedural Act by written procedure. The present Opinion received the positive majority required by Procedural Act no 01.1/2015/ECRB-EnC⁷.
- (8) Final issuance of the present Opinion follows a hearing held at the premises of the Secretariat on 10 March 2017 at which all relevant stakeholders participated and ECRB was represented by its President⁸.

2. The Preliminary Certification Decision

2.1. The applicant

- (9) *Yugorosgaz-Transport* was established on 11 December 2012⁹ and registered as a limited liability company on 15 October 2015 for the performance of pipeline transmission.¹⁰
- (10) *Yugorosgaz-Transport* is a fully-owned subsidiary of *Yugorosgaz JSC Belgrade* (hereinafter 'Yugorosgaz'), which in turn is owned by *Gazprom* (50%), *Srbijagas* (25%) and *Central ME Energy and Gas Vienna* (25%).
- (11) *Yugorosgaz-Transport* holds a license for gas transmission and gas transmission system operation.¹¹ *Yugorosgaz*, as owner of the gas transmission system, entered into an agreement on the lease of the transmission system with *Yugorosgaz-Transport* in February 2014¹².

2.2. Content

- (12) In December 2014, the Republic of Serbia adopted a new Energy Law ('the Energy Law') that transposes the Third Energy Package, including the provisions on certification and all three models for unbundling of transmission system operators (TSO)¹³.
- (13) The Energy Law conditions validity of the license held by *Yugorosgaz-Transport* for gas transmission and gas transmission system operation with certification of the company. In turn, *Yugorosgaz-Transport* is supposed to lose its license in case the company's certification in line with the Serbian and Energy Community law is not positively confirmed by decision of AERS.
- (14) Article 226 in conjunction with Article 416(2) of the Energy Law foresees that if a TSO was part of a vertically integrated company on 6 October 2011, it may be organised as ISO or independent transmission operator.
- (15) Having in mind that *Yugorosgaz-Transport* was founded only in December 2012, the Preliminary Decision concludes that the transmission system activity was part of a vertically integrated

⁷ One ECRB member expressed a dissenting opinion.

⁸ At said hearing ECRB received agreement of the Secretariat on an extended deadline for final issuance of the present ECRB Opinion with a view to reflect the information gained at the hearing.

⁹ Decision on the establishment of the limited liability company "Yugorosgaz-Transport", LLC, Niš, No. 0-53 of 11 December 2012.

¹⁰ Cf Preliminary Certification Decision. According to the founding decision, *Yugorosgaz-Transport* apart from this main activity is also entitled to perform all activities that do not require prior approval of a state body .

¹¹ Decision No. 311.01-50/2013-L-1 of AERS dated 28 August 2013.

¹² Registered with Yugorosgaz on 5 February 2015 (No U-12) and with Yugorosgaz-Transport on 6 February 2014 (No UG-3).

¹³ Article 223 et seq of the Energy Law.

company on 6 October 2011 and, thus, considered application for certification as ISO compliant with the Energy Law.

- (16) AERS accepted the application based on a notification of *Yugorosgaz-Transport* of 20 September 2016¹⁴ that there are no circumstances that would allow a person or persons from a third country/ies to take over control over the TSO or transmission system.
- (17) In the Preliminary Decision, AERS issued a certification. The regulator, however, did not consider compliance of *Yugorosgaz-Transport* with the unbundling requirements of the Third Energy Package given and, thus, made its decision conditional to actions to be taken by *Yugorosgaz-Transport* within twelve months from the adoption of the final decision on certification, namely to:
- *take all necessary actions with authorized bodies of the Republic of Serbia in order to harmonise the Law on Ratification of the Agreement between the Federal Government of the Federal Republic of Yugoslavia and the Government of the Russian Federation on Cooperation on Construction of Gas Pipeline on the Territory of the Federal Republic of Yugoslavia (“Official Gazette of FYR – International Treaties”, No. 4/96), the Law on Ratification of the Treaty establishing the Energy Community between the European Community and the Republic of Albania, Republic of Bulgaria, Bosnia and Herzegovina, Republic of Croatia, Former Yugoslav Republic of Macedonia, Republic of Montenegro, Romania, Republic of Serbia and the United Nations Interim Mission in Kosovo in line with the United Nations Security Council Resolution (“Official Gazette of RS”, No. 62/06) and the Energy Law (“Official Gazette of RS”, No. 145/14) so as to harmonise its organization and operations in a manner providing compliance with conditions concerning the independence of the system operator in line with the model of independent system operator;*
 - *submit a ten-year transmission system development plan adopted in line with the Energy Law (which was approved by the Energy Agency), programme for non-discriminatory behavior adopted in line with the Energy Law (which was approved by the Energy Agency) and a legal document signed together with the transmission system owner providing guarantees for the financing of transmission system development.”*

3. Assessment

3.1. Eligibility for certification as independent system operator

- (18) ECRB agrees with the argumentation of the Preliminary Decision that *Yugorosgaz-Transport* was part of a vertically integrated company¹⁵ on 6 October 2011 and, thus, qualifies for certification as ISO.

3.2. Compliance with the independent system operator requirements

- (19) According to Article 14(2) of the Gas Directive, an ISO can only be certified if:

- The candidate operator has demonstrated that it complies with the requirements of Article 9(1)(b), (c), and (d) of the Gas Directive;

¹⁴ Act no I-90.

¹⁵ According to Article 2(20) of the Gas Directive.

- The candidate operator has demonstrated that it has at its disposal the required financial, technical, physical and human resources to carry out its tasks under Article 13 of the Gas Directive;
 - The candidate operator has undertaken to comply with a ten-year network development plan monitored by the regulatory authority;
 - The transmission system owner has demonstrated its ability to comply with its obligations under Article 14(5) of the Gas Directive;
 - The candidate operator has demonstrated its ability to comply with its obligations under the Gas Regulation.
- (20) Article 15 of the Gas Directive requires legal and functional unbundling of the transmission system owner
- (21) It follows from Article 14(4) of the Gas Directive that an ISO should be considered as a TSO and, thus, has to comply with all the obligations applicable to TSOs under the Gas Directive and Regulation.

Performance of TSO tasks / ten year network development plan

- (22) ECRB has no reason to doubt that *Yugorosgaz-Transport* performs transmission system activities. The company holds a license for gas transmission and gas transmission system operation. The Preliminary Decision also provides evidence that the company provides third part access to its system at regulated tariffs as required by Article 14(4) Gas Directive, operates and maintains the system, is developing a ten year transmission system development plan that is to be adopted¹⁶ by AERS and that the company is committed to follow.

Financial, technical, physical and human resources

- (23) According to Article 14(2)(a) of the Gas Directive it has to be demonstrated that the ISO is equipped with the financial, technical, physical and human resources to carry out its tasks. Based on the documentation provided to AERS¹⁷, ECRB has no reason to question the assumption of the Preliminary Decision that financial, technical and physical resources are available to *Yugorosgaz-Transport*. The Preliminary Decision, however, runs short in providing clear evidence for the availability of sufficient human resources. The mere reference to the appointment of a managing director¹⁸ and two expert staff fails to prove the company's capability to independently perform its activities. **ECRB invites AERS to elaborate on this aspect in its final certification decision.**

¹⁶ According to the information provided at the hearing held on 10 March 2017 the approval of ten year transmission system development plan is close to be finalised.

¹⁷ Statement of the managing director of *Yugorosgaz-Transport* confirming that *Yugorosgaz-Transport* has employees and available technical material means for the performance of the activities of an ISO in line with Article 227 of the Energy Law; statement of the managing director of *Yugorosgaz-Transport* that *Yugorosgaz-Transport* has available financial and material means for the performance of natural gas transmission; statement of the general manager of *Yugorosgaz* confirming that *Yugorosgaz* will enable financing investments in the ten-year network development plan in line with decision No 24 of January 2016 of the shareholder assembly of *Yugorosgaz*.

¹⁸ Decision No 0-54 of 11 December 2012 and statement No I-87 of 1 December 2015 of the acting manager confirming that *Yugorosgaz-Transport* is represented independently by its managing director.

Requirements of Article 9(1)(b), (c), and (d) / legal and functional unbundling of the owner of the transmission system

- (24) ECRB agrees with the conclusion of the Preliminary Decision that the owner of the transmission system, *Yugorosgaz*, is not legally and functionally independent from any from other activities not related to transmission of gas as required by Article 14(2)(a) of Gas Directive in conjunction with Articles 9(1)(b), (c) and (d). Namely, *Yugorosgaz*, among others, holds a license for and is active in gas distribution, supply and wholesale trade
- (25) However, the Preliminary Decision only reflects on independence of the management body but runs short in assessing direct control of *Yugorosgaz* and indirect control of *Gazprom* in *Yugorosgaz-Transport* via their respective shareholding. Namely, *Yugorosgaz* holds 100% of the shares of *Yugorosgaz-Transport* and therefore exercises direct control over the TSO. The fact that *Yugorosgaz* performs the functions of supply and directly exercises control over *Yugorosgaz-Transport* via holding 100% of shares is non-compliant with the independence requirement of Article 9(1)(b) of the Gas Directive. Further to this, *Gazprom* holds a 50% share in *Yugorosgaz*. *Gazprom* performs the activities of exploration, production, transportation, storage, processing and sales of gas. The fact that *Gazprom* performs the functions of production and supply and indirectly – via its majority shareholding in *Yugorosgaz* – exercises control over *Yugorosgaz-Transport*, is non-compliant with Article 9(1)(b) of the Gas Directive. **ECRB invites AERS to elaborate on these aspects in its final certification decision.**

3.3. Conditions imposed on the applicant

- (26) Despite concluding that the independence criteria applicable to an ISO according to the Energy Community and Serbian law are not met, AERS certifies *Yugorosgaz-Transport* as ISO subject to the conditions outlined in the Preliminary Decision (cf paragraph (17)), in essence requiring complete re-organisation of *Yugorosgaz-Transport and Yugorosgaz*.
- (27) ECRB agrees with AERS that company re-organisation is indeed needed to meet the independence criteria applicable to an ISO according to the Energy Community and Serbian law in praxis.
- (28) ECRB also agrees with AERS that the related re-organisation is unlikely to be completed in a period shorter than twelve months and, thus, considers the granted timeframe reasonable.
- (29) ECRB however has doubts about the adequacy of the imposed conditions:
- First, ECRB not having provided any additional information on alternative solutions can only follow AERS' conclusion that meeting the relevant independence criteria will require harmonisation of the Law on Ratification of the Agreement between the Federal Government of the Federal Republic of Yugoslavia and the Government of the Russian Federation on Cooperation on Construction of Gas

- Pipeline on the Territory of the Federal Republic of Yugoslavia, the Law on Ratification of the Treaty establishing the Energy Community and the Energy Law.¹⁹
- ECRB also agrees with the conclusion of the Preliminary Decision concludes that such measure „does not depend solely on the applicant but it also includes the engagement of state bodies”.
 - Based on this ECRB, however, fails to see the suitability of the imposed condition for reaching the targeted result. First, the condition is vague, lacks concrete steps to be taken and, in particular, actions that have to be performed by the applicant. Beyond that, it is questionable that ensuring compliance with this condition can at all be influenced by the applicant²⁰.
- (30) ECRB also has doubts about the effectiveness of the consequences in case *Yugorosgaz-Transport* should fail to comply with the imposed condition within the twelve months deadline. According to the Preliminary Decision the only consequence would be a re-evaluation of the application leading to a new certification procedure. In practice this would mean that *Yugorosgaz-Transport* is certified for a year without meeting the requirements for independence necessary for compliance with the provisions of the ISO-model. At the hearing of 10 March 2017 AERS confirmed that lack of compliance of *Yugorosgaz-Transport* with the conditions of the Preliminary Decision will lead to withdrawal of the company's license for gas transmission and gas transmission system operation. ECRB fails to see such consequence clearly outlined in the Preliminary Decision and, thus, **invites AERS to further elaborate on this aspect in its final decision.**
- (31) ECRB stresses that the concept of conditional approval of certifications should target the imposition of improvements in context with a, in principle, positive assessment of the applicant's compliance with the relevant unbundling requirements. Contrary to this, the Preliminary Decision explicitly outlines lack of compliance of *Yugorosgaz-Transport* with the independence requirements of the Energy Community and Serbian law and, nevertheless, issues a certification under a condition that can be hardly complied with by the applicant (alone). ECRB is of the opinion that independence of the applicant in line with the relevant unbundling requirements of the Energy Community law must be a pre-condition for certification.²¹ It follows that a **certification should not be issued for *Yugorosgaz-Transport* as long as this requirement is not fulfilled. In any case the certification decision should clearly identify the concrete actions expected from the applicant.**²²
- (32) In this context ECRB acknowledges the link made in Article 239 of the Energy law between successful certification and licensing of a TSO. ECRB understands this link as intention of the legislator to promote the applicant's compliance with the unbundling requirements of the Serbian and Energy Community law which has not been proven in the case of *Yugorosgaz-Transport*. Translating the link between licensing and certification into a duty of the regulator to deliver a

¹⁹Neither the Preliminary Decision nor the hearing held on 10 March 2017 at the premises of the Secretariat carve out specific concerns as regards inconsistency of the Law on Ratification of the Agreement between the Federal Government of the Federal Republic of Yugoslavia and the Government of the Russian Federation on Cooperation on Construction of Gas Pipeline on the Territory of the Federal Republic of Yugoslavia with the unbundling requirements of the Serbian and Energy Community law. At the hearing alternative options have been suggested but have not substantiated in concrete terms.

²⁰ Different from that, conditions imposed in comparable certification Opinions only entail measures that can be reasonably expected to be met by the relevant company and building on confirmation of the applicant's compliance with the central unbundling requirements (see e.g. Commission, Opinion on certification of *HOPS* C(2015)9559).

²¹ See as well: ECRB, Opinion 1/16 on certification of *OST*; Secretariat, Opinion 1/16 on certification of *TAP AG* and Opinion 1/17 on certification of *OST*; Commission (e.g. and specifically on certification of *ISOs*), Opinion on certification of: *TAG GmbH*, C(2013) 649, 04.02.2013; *Transelectrica S.A.*, C(2013) 6891; *Transgaz*, C(2013) 8485; *BOG GmbH* C(2013) 963.

²² ECRB considers its related position confirmed by result of the hearing of 10 March 2017.

positive certification decision must be considered contradictory to the scope of the very legal provision.

3.4. Certification in relation to third countries

- (33) ECRB reminds that a comprehensive security test is a central pillar in context with certification in relation to third countries according to Article 11 of the Gas Directive²³ and applicable to the specific case, given the 50% of shares held by *Gazprom* in the transmission system owner *Yugorosgaz*.
- (34) ECRB notes the reference made in the Preliminary Decision to the opinion issued by the Ministry in charge²⁴ of energy concluding that certification of *Yugorosgaz-Transport* as ISO will not affect security of supply of the Republic of Serbia or of the region²⁵. ECRB has not been provided with this opinion and, thus, is not able to judge whether it indeed covers an as comprehensive test as required by Article 11 of the Gas Directive and specifically also the potential affects deriving from the position of the 100% owner of *Yugorosgaz-Transport* and the transmission grid, *Yugorosgaz*, as dominant supplier on the Serbian market; the impact of *Gazprom* indirectly controlling *Yugorosgaz-Transport* and holding 50% of shares in *Yugorosgaz*; as well the impact of future network developments and specifically the gas interconnector between Serbia and Bulgaria that is supposed to connect to the transmissions system owned by *Yugorosgaz*.
- (35) **ECRB invites AERS to elaborate on the above aspects more in detail in its final certification decision.**

HAS ISSUED THE FOLLOWING OPINION

1. AERS is invited to take the utmost account of the above views of ECRB when taking its final decision regarding the certification of *Yugorosgaz-Transport*.
2. This Opinion is provided to the Energy Community Secretariat according to Article 3(1) of Regulation (EC) 715/2009 in conjunction with Articles 9 to 11 of Directive 73/2009/EC for reflection in the Secretariat's Opinion on the preliminary decision of the regulatory authority of the Republic of Serbia on certification of *Yugorosgaz-Transport, LLC Niš*.
3. This Opinion will be published on the Energy Community website and submitted to the Energy Community Secretariat in line with Article 5 of Procedural Act 01.1/2015/ECRB-EnC. ECRB does not consider the information contained herein confidential. According to Article 4 paragraph (2) of Procedural Act 01.1/2015/ECRB-EnC, AERS is invited to inform the ECRB President within five (5) days following receipt whether it considers that, in accordance with rules on applicable rules on

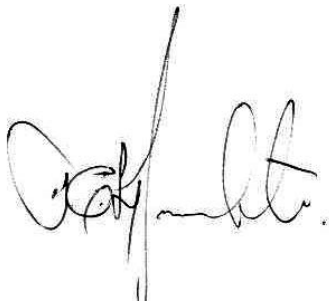
²³ See also Commission's Opinion on certification of *Gaz-Sytem*, C(2015) 2008.

²⁴ Upon consultation by AERS in line with the requirements of the Energy Law.

²⁵ Legal act No. 312-01-01319/2016-05 of 12 October 12 2016.

business confidentiality, this document contains confidential information which it wishes to have deleted prior to its publication, including reasons for such a request.

For the Energy Community Regulatory Board

A handwritten signature in black ink, appearing to read "Branislav Prelević".

Branislav Prelević
ECRB President

14 March 2016