

Annex II of the Memorandum of Understanding of the Central and South-Eastern European Gas Connectivity (CESEC) High Level Group

Action Plan

This Action Plan addresses the specific steps that are essential to be taken by Governments, National Regulatory Authorities, Project Promoters and Transmission System Operators (TSOs) in order to fulfil the objectives set out in the CESEC High Level Group (HLG) Memorandum of Understanding.

A. Selection of a limited number of key projects benefitting the CESEC region

In the context of the work of the CESEC High Level Group, the 21 projects listed in the Appendix have been assessed and – to varying degrees – are considered to provide benefit to the region, particularly in terms of contributing to security of supply and facilitating price alignment between markets and, with it, establishing competitive wholesale prices and affordable prices for final consumers.

As set out in the Memorandum of Understanding, it is crucial that, among all the projects, a limited number of key projects – deemed to bring the overall largest benefit specifically to the CESEC region – are identified. On the basis of the analysis commissioned by the European Commission, performed by the Regional Centre for Energy Policy Research (REKK), and approved by the CESEC High Level Group, the following set of interconnection and LNG terminal infrastructure has shown to contribute particularly to increasing welfare in the CESEC region, in the shortest possible term, by taking into account different combinations of future supply scenarios:

CESEC priority projects:

0. **Trans-Adriatic Pipeline (TAP):** key diversification infrastructure carrying Azeri and potentially in the future Central Asian gas; considered as "decided" on the basis of existing transport and supply contracts;
1. **Interconnector Greece-Bulgaria (IGB):** key route (together with the interconnection point Sidirokastro-Kulata) to carry gas, e.g. from TAP and Greek LNG, to the north;
2. **Interconnector Bulgaria-Serbia:** crucial diversification and security of supply link for Serbia. This route is significantly more advanced than the planned Croatia-Serbia interconnection;
3. **Phased Bulgarian system reinforcement:** in order to ensure that gas can flow in and out of Bulgaria across its existing and planned interconnectors with Greece, Serbia and Romania some specific system reinforcement is necessary;
4. **Phased Romanian system reinforcement:** system reinforcement is necessary to ensure that existing and planned bidirectional interconnectors with Bulgaria, Hungary, Republic of Moldova and Ukraine are integrated into the regional market, including the corresponding and necessary reinforcement of the transmission system in these countries;

5. **LNG terminal in Croatia (with phasing potential):** taking advantage of the worldwide LNG market can provide diversification and security of supply to Croatia and the broader CESEC region;
6. **LNG evacuation system towards Hungary:** gas from the LNG terminal in Croatia needs to be brought to market, including beyond Croatia. Modelling showed LNG flows to go most likely towards Hungary and Ukraine and the project enabling flows to Hungary is the most mature.

CESEC conditional priority projects:

7. **Connection of off-shore Romanian gas to the Romanian grid and further enhancement of the Romanian system:** evacuation route for prospective Romanian gas is contingent on the willingness of the production consortium to book transport capacities to deliver the new gas to market;
8. **Interconnection Croatia-Serbia:** in the event that there is no satisfactory progress on the Bulgaria-Serbia interconnection project and to the extent that it is likely to be or is terminated, it is crucial to put in place a second interconnection to Serbia (in this case carrying principally LNG from Croatia);
9. **New Greek LNG terminal:** the on-going expansion of the existing Revythoussa LNG terminal notwithstanding, a new LNG terminal in northern Greece may also be necessary in case there is (location-specific) market demand.

With these projects – complemented with the market integration initiatives set out below – three supply sources can be ensured for the countries of the CESEC region.

In the case of interdependent projects, the objective should be to complete the respective parts according to their individual schedules and independent of the status of other related projects.

B. Identification and addressing of project-specific challenges

Notwithstanding the project promoters' ultimate responsibility for their specific projects, it is crucial that this set of infrastructure is designed and executed in a way that allows it implemented as the first priority. This means implementation in the most efficient and timely manner, and that any issues relative to implementation are identified and addressed.

Importantly, this Action Plan cannot serve to substitute the legal process set up for the identification of Projects of Common Interest (PCIs) or of the Projects of Energy Community Interest (PECI) or the legal provisions related to financing under the Connecting Europe Facility or any other Union funding instrument, including those related to Energy Community Contracting Parties. The Action Plan and the connected monitoring process are however – as set out – aiming at ensuring that all challenges the projects are facing are identified and successively addressed.

Project-specific challenges and difficulties may be grouped along the following lines:

1. Organizational (e.g. project design, cooperation between promoters);
2. Legal, regulatory, environmental (e.g. permit granting processes);

3. Commercial (e.g. booking commitments, construction costs, cross-border cost allocation);
4. Financing (e.g. own sources, bank loans, financing gap);
5. Interdependencies between projects.

This Action Plan therefore foresees as mandatory – for the above-mentioned CESEC priority and conditional priority projects – and as recommended – for all the other projects listed in the Appendix – the following process:

1. submission of the project implementation plan by 31 July 2015;
2. establishment of *Project Implementation Groups* for **priority projects** consisting of the project promoters, Member States and/or Energy Community Contracting Parties, National Regulatory Authorities and the European Commission. These groups should have their kick-off meeting by 15 October 2015 and should serve the purpose of overseeing the progress of and, if necessary, guiding the project in overcoming its specific challenges, and reporting on it to the CESEC High Level Group;
3. screening by the relevant Project Implementation Group of the implementation plan for possible project-specific challenges (set out above) to ensure timely and efficient implementation and drafting of project-specific action lists to overcome those challenges by 31 December 2015;
4. possible update of the implementation plan on the basis of the recommendations of the screening process by the Project Implementation Group by 31 January 2016;
5. on-going monitoring of the implementation process via the Project Implementation Groups and in the broader frame of the NSI East and Southern Gas Corridor Regional Groups structure established under the TEN-E Guidelines.

C. The financing aspects, including the role of the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD)

One but clearly not the only challenge to infrastructure projects in the CESEC region, including for the Energy Community Contracting Parties, is project financing. International Financial Institutions such as the European Investment Bank and the European Bank for Reconstruction and Development are interested and should be seen as playing a crucial role in overcoming those challenges by considering offering – tailored – financial instruments to the respective projects. This should be for all projects preceded by a third-party financial screening by external experts commissioned by the European Commission on the basis of transparent procedures.

This Action Plan therefore foresees in this context as mandatory – for the above-mentioned priority and conditional priority projects – and as recommended for all the other projects – listed in the Appendix – the following process:

1. third-party financial screening to be carried out by 31 December 2016. This financial due diligence of the project would allow provide the basis for negotiations with IFIs and could thereafter identify the remaining financing gap in the project;

2. unless there is no up-front agreement between all parties for cross-border cost allocation (CBCA), a multi-project CBCA should be prepared for the priority projects allowing for simultaneous investment request and financing proposal¹, if necessary, six months after the completion of the financial screening – with possibility for later submission by less mature projects – with the assistance of a third-party (external experts commissioned by the European Commission and/or the Agency for the Cooperation of Energy Regulators (ACER)). The provisions of Regulation (EU) No 347/2013 apply.

In order to ensure that the use of financial instruments is most effective, it is crucial that regulatory environments fully comply with EU legislation and are conducive to enabling their full use. Therefore this Action Plan also foresees that the concerned CESEC Member States and Energy Community Contracting Parties, in cooperation with National Regulatory Authorities, review their respective regulatory frameworks to enable such full use of financial instruments by 31 December 2015 and report back to the High Level Group, as appropriate.

D. Addressing the market integration challenges

As set out in the Memorandum of Understanding, the CESEC region faces market integration challenges beyond those of missing key diversification and interconnection infrastructure.

With a view to overcoming those challenges, all applicable EU legislation in the gas sector is to be fully and effectively implemented to achieve in particular the following objectives:

1. Ensuring transparent and non-discriminatory third-party access (including respective congestion management, capacity allocation, balancing and tariffication rules) in forward and reverse flow direction to all regional infrastructure according to EU law;
2. Ensuring that neither explicit or implicit national measures or contractual obligations contrary to EU legislation prevent the uninhibited flow of gas between Member States and between Member States and Energy Community Contracting Parties irrespective whether the gas is domestically produced or imported;
3. Ensuring markets are not distorted by rules or regulatory measures favouring incumbents or discouraging entry.

1. On access rules

Several positive initiatives have the potential to change the way gas markets in the region function:

- The interconnection agreement between the TSOs of Slovakia (Eustream) and Ukraine (Ukrtransgaz) in 2014, concerning Budince, and between the TSOs of Hungary (FGSZ) and Ukraine in June 2015 leads to stronger integration of Ukraine – an Energy Community Contracting Party – to the EU internal gas market;

¹ CEF or WBIF/NIF, as appropriate

- On-going discussions between Ministries, National Regulatory Authorities and TSOs in Bulgaria and Greece with the stated intention to sign an interconnection agreement by 10 July 2015, has the objective of enabling reverse flows from Greece to Bulgaria.

Work on these interconnection agreements should serve as the basis for further agreements where – as yet – no such contracts are in place:

- Slovakia-Ukraine on Veľké Kapušany;
- Bulgaria-Romania and Romania-Ukraine relating to the interconnections along the Trans-Balkan pipeline network as well as the interconnections between those countries' systems.

It is understood in the context of the signed and planned interconnection agreements of Ukraine with Hungary, Slovakia and Romania that the full implementation therefore is contingent on the cooperation of Gazprom which is the current network user of the Ukrainian system and the Ukrainian TSO which has matching obligations with the three EU TSOs. Therefore, in the context of implementing the above-mentioned interconnection agreement, the European Commission and the Energy Community Secretariat will support Ukrtransgaz in its efforts. A specific approach to that end should be developed by the involved parties by 30 September 2015.

Furthermore all Member States are to implement provisions of the Capacity Allocations Mechanisms Network Code² by 1 November 2015 as stipulated therein. As regards the implementation of the Guidelines on Congestion Management Procedures³, that was due by 1 October 2013, it is crucial that – in addition to full implementation of all provisions – preparatory action is taken at interconnection points classified by ACER's recent Congestion Report of 29 May 2015⁴ as contractually congested and being possible candidates for the application of the so-called firm day-ahead use-it-or-lose-it rule – as a mandatory congestion management rule – by 1 July 2016.

The EU Member States bordering the Contracting Parties of the Energy Community are encouraged to apply the above Network Codes also on the interconnection points with Contracting Parties as soon as the Contracting Parties apply the Network Codes on their borders.

As regards tariffs the REKK study has demonstrated that high cross-border tariffs as well as so-called tariff pancaking⁵ can have the effect of preventing new sources from reaching markets further inland. Developing a solution to this situation is of high importance to the success of the objectives set out in the CESEC HLG Memorandum of Understanding. Therefore, National Regulatory Authorities from the CESEC region, in cooperation with

² Commission Regulation (EU) 984/2013

³ Commission Decision 2012/490/EU amending Annex I of Regulation (EC) No 715/2009

⁴ See acer.europa.eu

⁵ Tariff pancaking happens when gas flows across multiple – generally small – zones are charged with successive tariffs for each respective zone crossed. Such pancaking can often result in flows from new sources – having to cross several zones – priced out of certain markets due to tariffs.

ACER and the European Commission, are invited to identify the best way to effectively address this important concern and report back to the High Level Group, as appropriate.

2. On free flow of gas

Though it is clear that market opening and integration have overall beneficial effects, it is very important to assess the particular effects of new infrastructure or market opening on the respective Member States (and/or Energy Community Contracting Parties) because at national level those effects may under certain circumstances be adverse as regards for instance consumer welfare. The system of cross-border cost allocation introduced by the TEN-E Regulation 347/2013 is intended specifically to provide a solution to this concern. A decision on cross-border cost allocation is necessary when an assessment of market demand or of the expected effects on the tariffs have indicated that costs cannot be expected to be recovered by the tariffs paid by the infrastructure users. This assessment should take into account the impact on end-user prices and the vulnerabilities of the consumers in Member States where the projects are developed as well as the other – notably producer – welfare effects which may arise.

In this context, in addition to work on the contractual elements of enabling flows in the form of interconnection agreements, it is necessary to assess the conditions for the use of existing interconnection capacities in both physical directions, with particular emphasis on increasing firm capacities, as well as backhaul. In case such full reversibility is not yet achieved a dialogue should be launched between the relevant parties – facilitated by the European Commission – having regard to the respective provisions of the Security of Gas Supply Regulation (EU) No 994/2010 or any action taken pursuant to those rules. It is crucial to come to an agreement on such matters of physical reverse flows, including the preparation of a specific action plan by 31 December 2015.

3. On competition and the role of the State in markets

Furthermore, while it is every Member State's and Energy Community Contracting Party's prerogative what commercial role it chooses to play via its undertakings in the gas sector – in line with EU law – no national rules shall discriminate against market players from other Member States. Furthermore it is understood that a broader regional market necessitates market entry into markets where to date little competitive pressure exists. To that end national incumbents, as any other market player, may contribute to the regional competitive dynamics.

National Regulatory Authorities, with the support of ACER and the European Commission, are invited to specifically and objectively screen any national rules, including but not limited to licencing rules, and provide recommendations on those that are deemed to hamper market entry and market integration in the context of the work of the NSI East and Southern Gas Corridor Regional Groups. This should be undertaken by 31 December 2015.

4. Additional clause

The measures and actions foreseen in this Action Plan apply without prejudice to third-party access and tariff exemptions already approved or requests under evaluation.

Appendix: Projects considered in the CESEC HLG context