The EU Law Framework for Constructing New Gas Infrastructure in South East Europe

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Abstract—**The next few year will see a significant rise in the number of new gas infrastructure projects being constructed in South East Europe. This paper aims to provide a guide to both investors and governments in the region to the key provisions of EU law which will govern the construction and operations of such projects.**

Index Terms—**Energy Community, Energy Infrastructure, Energy law, EULNG Terminal, Pipelines, and SEE.**

I. Introduction

The next few years will see a significant rise in the number of new gas infrastructure projects being constructed in South East Europe ("SEE") in order to integrate the region into EU's natural gas market. This paper will highlight the key provisions of EU *acquis* relevant to the construction and operation of such projects. In particular, it will discuss in turn the key provisions of (i) the recently adopted TEN Regulation [1], (ii) the Gas Directive [2], EIA Directive [3] and the Habitats Directive [4]. The provisions of the Water Framework Directive [5], the IPPC Directive [6] and numerous other EU directives will not be discussed in this paper since they form the applicable law as concerns gas infrastructure projects only in the countries of the SEE that are members of the EU.

II. Gas Infrastructure projects in See

The integration of the gas markets of the SEE into the EU market is an important priority of EU's energy policy. For the purposes of this paper the region of South East Europe includes the following countries: Slovenia, Croatia, Bosnia and Hercegovina, Serbia, Kosovo, Macedonia, Greece, Albania, Romania, Bulgaria and Hungary. All the countries in SEE are either members of the European Union or members of the Energy Community.

The Treaty establishing the Energy Community was signed on 25 October 2005. The aim of the Treaty was to establish an integrated market in natural gas and electricity and create a single regulatory space for the trade in gas and electricity encompassing the European Communities on the one hand and Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Montenegro, Macedonia, Romania, Serbia and United Nations Mission in Kosovo on behalf of Kosova.

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Pursuant to the Treaty non-EU members of the Energy Community have undertaken to implement core EU energy *acquis communautaire* into their national law. The initial package of EU energy legislation which such states are required to implement in the areas of electricity, gas, environment, competition, renewables, energy efficiency, oil and statistics is enumerated in the Treaty. Different deadlines were set for the transposition and implementation of EU law in respect of each of the above-mentioned areas.

Although non-EU states are not required to implement amendments to EU *acquis* as the same evolves in EU, it is important to note that by the Ministerial Decision of 6 October 2011 the Energy Community agreed to implement inter alia the Gas Directive by 1 January 2015, to effectively unbundle their gas transmission system operators ("TSOs") from the generation and supply of gas by 1 June 2016 and to introduce the procedure for certification of TSOs owned by states not members of the Energy Community by 1 January 2017.

At the time of writing this paper a number of gas infrastructure projects in the region look like they will be included amongst EU's Projects of Common Interest ("PCI") in Annex 1 to the TEN Regulation. These include the Nabucco West Pipeline, the Trans-Adriatic Pipeline, the South Stream Pipeline, the Inter-connectors between Bulgaria and Greece, the ITGI Pipeline, and the LNG Terminal on Krk.

III. EU Law as applicable to Gas Infrastructure projects in See

This paper aims to provide a guide to both investors and governments in the region to the key provisions of EU law as will be applicable to such projects.

A. The Key Provisions of the TEN Regulation

The TEN Regulation entered into force on 15 May 2013. It forms part of EU's strategy to put energy infrastructures at the forefront of its initiative for a more competitive and resource EU. The Regulation identifies the following four strategic trans-European corridors as essential for the achievement of the Union's energy and climate policy objectives: (i) North-South Gas Interconnection in Western Europe, (ii) North-South Gas Interconnection in Central and SEE; (iii) Southern Gas Corridor; and (iv) the Baltic Energy Market Interconnection Plan in Gas. At the time of writing this paper the initial list of PCI are being finalised in respect of each of the four corridors. For the purposes of the SEE

region the second and the third corridor are of interest. The list is expected to be finalised by September of this year. Thereafter, projects will be able to eligible to become PCIs every two years.

Gas infrastructure projects proclaimed as PCI are to enjoy certain advantages as compared to other projects. In particular, they are *inter alia* to be subject to a one-stop-shop permitting procedure, the permitting procedure is to last no more than three and half years and they are eligible for Euro 5.1 billion worth of EU funding.

According to Article 4(1) the following are the general criteria for a project to be regarded as a PCI: (i) it is necessary for the implementation of gas corridors; (ii) its potential overall benefits outweigh its costs, including in the longer term; and (iii) it involves at least two EU Member States by directly crossing the border of two or more Member States, or is located on the territory of one EU Member State and has a significant cross-border impact, or crosses the border of at least one Member State and a European Economic Area country.

In addition, the specific criteria must be met by gas PCIs. Pursuant to Article 4(2)(b) to be listed as a gas PCI a project must contribute significantly to at least one of: (i) market integration, interoperability and system flexibility, (ii) security of supply; (iii) competition and (iv) sustainability.

The following additional criteria are required to be given due consideration when drawing up list of PCIs: (i) urgency of project to meet Union energy policy targets; (ii) the number of EU Member States affected by the project; and (iii) the contribution of each project to territorial cohesion and its complementarity with other projects.

As noted in the preceding section, a number of large gas infrastructure projects located in SEE are likely to be included in the initial list of PCIs including projects such as Trans-Adriatic Pipeline and the inter-connector between Serbia and Bulgaria which partly traverse the territory of a non–EU Member State.

It should be noted that the provisions of the TEN Regulation are automatically part of the law of EU Member States. However, projects listed as PCI will not be able to invoke the provisions of the TEN Regulation in the SEE countries which are not members of the EU since the TEN Regulation is not part of the EU acquis members of the Energy Community are required to transpose into domestic law. This issue must be carefully considered by an investor when planning its projects in SEE.

B. The Key Provisions of the Gas Directive

The Gas Directive forms part of EU's Third Energy Package ("TEP") [7]. TEP consists of three regulations and two directives. Only the key provisions of the Gas Directive will be examined in this paper, even though the Gas Regulation [8] and the ACER Regulation [9] contain important provisions which will affect the construction and operation of gas infrastructure projects in SEE.

The countries of the SEE which are members of the EU were required to transpose the Gas Directive into national law by March 2011. As discussed in Section II, other countries in the SEE as participants in the Energy Community are required to transpose the provisions of the Gas Directive into their national law by 1 January 2015. Given the long term nature of gas infrastructure projects any projects intended to be constructed going forward will be required to comply with the provisions of the Gas Directive as transposed in the national law of the SEE state in which it will be located.

1. Effective Unbundling

Article 9 requires states in the SEE to choose between three options for the effective unbundling of gas transmission networks for the generation and supply of natural gas. The states of the SEE which are members of the EU were required to effectively unbundle their gas transmission networks by 3 March 2012. The countries of the SEE which are members of the Energy Community have to do so by 1 June 2016.

The first option requires ownership unbundling. Pursuant to this option the same person must not directly or indirectly exercise control over a TSO or transmission system and directly or indirectly exercise control or any rights over an undertaking supplying or producing gas and vice versa. The second option requires the appointment of an independent system operator (known as "ISO"). This option permits a vertically integrated undertaking ("VIU") to maintain ownership over a gas network provided a separate legal entity conducts all the duties of the system operator. The third option requires the appointment of an independent Transmission Operator (known as "ITO"). Pursuant to this option a TSO can remain part of a VIU provided certain requirements concerning independence as set out in Articles 18 to 21 of the Gas Directive are complied with.

It is important to note that the ISO and ITO options are only available for VIUs that existed in the EU as of 3 September 2009 or in relation to Energy Community countries as of 6 October 2011. This means that all future gas pipelines built in the SEE will have to be ownership unbundled unless they are granted an exemption under Article 36 of the Gas Directive. In other words a supplier or producer of gas will only be able to a have direct or indirect shareholding in a network operator or system and vice versa if (i) it does not have a majority shareholding; (ii) it does not have directly or indirectly any voting rights; (iii) it does not directly or indirectly appoint members of supervisory board; and (iv) it does not directly or indirectly have any form of control over network operator or network system unless it obtains an exemption.

2. Exemption for Major New Gas Infrastructure

Pursuant to Article 36 of the Gas Directive major new gas infrastructure which has not been completed in the EU by

August 2003 (it is not clear what date applies in respect of countries of the Energy Community) can seek an exemption under Article 36 of Gas Directive from (i) ownership unbundling; (ii) third party access; (iii) access to storage; (iv) access to upstream pipeline networks; and (v) approval of tariffs by the national regulatory authority and from the requirement that tariffs must be non-discriminatory and proportionate.

The Gas Directive does not define the term "major new gas infrastructure. Instead Article 36(1) simply lists interconnectors, LNG and storage facilities as examples thereof. It is not clear whether this enumeration is meant to be exhaustive or not. What is clear is that a pipeline, an LNG Terminal and gas storage facility provided it is major and was not operational by August 2003 will be eligible to seek an exemption. It should further be noted that Article 36(2) further makes clear that "significant increases of capacity in existing infrastructure and to modifications of such infrastructure which enable the development of new sources of gas supply" will also be eligible to seek an exemption.

Pursuant to Article 2(17) an interconnector is defined as a "transmission system line which crosses or spans a border between [EU/Energy Community] Member States for the sole purpose of connecting the national transmission systems of those Member States". It should be noted that the definition seems to require that the pipeline seeking exemption (i) actually spans either two EU Member States or two non-EU Energy Community countries and (ii) that it is being constructed for the sole purposes of connecting these transmission systems. It would seem that neither the European Commission nor the Energy Community Secretariat have given much importance to these requirements when granting the exemptions to Nabucco West and Trans-Adriatic Pipeline.

For exemption to be granted the following criteria must be met: (i) the investment must enhance competition in gas supply and enhance security of supply; (ii) the level of risk must be such that investment would not take place unless exemption granted; (iii) Infrastructure must be owned by company which is at least legally unbundled from the system operator in whose system it will be built in; (iv) charges must be levied on users of infrastructure; and (v) the exemption must not be detrimental to competition or effective functioning of internal market.

Provided a gas infrastructure meets all of the above requirements it will be granted an exemption for a definite period of time and conditions are imposed regarding capacity allocation, congestion management and etc. Investors should carefully consider whether their gas infrastructure projects can be granted an exemption as this will undoubtedly have an impact on the bankability, rate of return and ultimately the viability of the project.

3. *Designation and Certification of TSOs*

As of 3 March 2013 in SEE countries that are members of the EU and as of 1 January 2017 in other SEE countries, an undertaking that owns a gas transmission network must be designated and approved as a TSO by national regulatory authority in the SEE country in which it intends to operate the network.

If not under the control of non-EU company/state then the key requirement, as per Article 10 of the Gas Directive, it must meet in order to be certified is effective unbundling discussed in Section 1 above.

The procedure for the certification of a TSO which is controlled by non-EU State or company is different. According to Article 11 of the Gas Directive such a TSO will be refused certification unless it has not been demonstrated that (i) it complies with ownership unbundling requirements; and (ii) its certification will not put at risk the security of energy supply of the relevant SEE country and the EU/ Energy Community taking into account.

Control is defined in Article 2 of the Gas Directive as "any rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by (i) ownership or the right to use all or part of the assets of an undertaking; and (ii) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking".

In order to determine that the certification of third country TSO would not put at risk the security of supply the following will be considered: (i) the rights and obligations of the EU/Energy Community arising under international law, including any agreements which address the issue of security of energy supply; (ii) the rights and obligations of the relevant SEE country with third countries, in so far as they are in compliance with EU law/ Energy Community Treaty; and (iii) other specific facts and circumstances of the case and third state concerned.

The tasks which a TSO is required to undertake are set out in *inter alia* Articles 13 and 32 and include (i) operating, maintaining and developing under economic conditions a secure, reliable and efficient transmission to secure an open market; (ii) refrain from discriminating between system users; (iii) provide system users with information they need for efficient access to system; and (iv) provide third party access to system users based on published tariffs.

As discussed in Section 2 above a TSO can be exempt from performing certain of the above-mentioned tasks pursuant to Article 36 provided it meets the necessary requirements.

4. *Designation of Storage and LNG System Operators*

Pursuant to Article 12 an owner of a storage or LNG facility (including an LNG Terminal) must be designated as a storage or LNG system operator.

The storage and LNG system operator tasks are the same as those of the TSO.

C. The Key Provisions of the EIA Directive

This Section will examine only the key provisions of the EIA Directive [3]. As noted at the beginning of this paper, a detailed examination of EU environmental *acquis* as may be relevant to the construction and operation of large gas infrastructure projects is beyond the scope of this paper. Accordingly, an investor in such projects in the SEE ought to undertake detailed review of such rules.

It should be noted that SEE countries that are not members of the EU have been required to transpose an earlier version of the EIA Directive to that which applies in the EU. Accordingly, investors wishing to construct and operate gas infrastructure projects in the SEE region should keep in mind that the provisions of EU law governing their projects are not the same throughout the region.

Pursuant to the terms of the EIA Directive any project which is likely to have significant effects on the environment must obtain development consent and undertake an environmental impact assessment ("EIA").

LNG Terminals being "trading ports or piers for loading or unloading… which can take vessels of over 1350 tonnes" and "pipeline[s] with a diameter of more than 800mm and a length of more than 40km … for the transport of gas" are deemed as likely to have a significant effect on the environment. Accordingly, an EIA must be undertaken for such projects and development consent must be obtained. Pipelines of smaller diameter may be required to undertake an EIA if certain conditions as set out in the Directive are met.

The following are the key requirements of the EIA Directive which may impact on gas infrastructure projects. First, Article 5 sets out in detail the information which the investor will as a minimum be required to provide to the national regulatory authority in which the project will be constructed. Second, Article 6 sets out in detail the information which must be provided to the affected public in respect of such project as part of the consultation process. Third, Article 7 requires the national regulatory authority to inform and consult with other EU Member States/Energy Community country in respect of the EIA process if it is likely that the project will have a significant effect on such other EU Member States/Energy Community country. Fourth, Article 8 requires the national regulatory authority to ensure that the result of public consultations and consultations with any other EU Member States/Energy Community country are taken into consideration when granting the development consent.

D. The Key Provisions of the Habitats Directive

This Section discusses the key provisions of the Habitats Directive as may be relevant to any future gas infrastructure project likely to be constructed and operated in the SEE.

It is very likely that such projects will be located near or will run through a site which is considered an eligible site under the Habitats Directive, be it a Natura 2000 site or other site.

According to Articles 6(3) and 6(4) of the Habitats Directive in such circumstances both the investor and the SEE state must take steps to determine (i) whether the gas infrastructure project is likely to have a significant effect on such sites and (ii) that the project will not adversely affect the integrity of the site concerned.

Article 6(4) sets out circumstances in which a project will be allowed to go ahead even if it has adverse effects on the integrity of the site. Arguably another advantage for a gas infrastructure project which is listed as a PCI under TEN Regulation is that it can more easily invoke the exception set out in Article 6(4) of the Habitats Directive. This possibility should be carefully considered in respect of such projects together with environmental experts since strong public opposition is likely to be encountered.

IV. CONCLUSION

This paper briefly outlined the provisions of some of the key EU energy and environmental *acquis* which will need to be considered by investors and governments alike when planning, approving, constructing and operating gas infrastructure projects in the SEE going forward. Since a detailed examination of all the provisions of EU law which may need to be considered in respect of a specific project is beyond the scope of this paper, this paper should be only used as a starting point for any such analysis.

V. REFERENCES

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VI. Biography

Ana Stanič is an English Solicitor Advocate and Honorary Lecturer at the Centre of Mining and Natural Resources at the University of Dundee. She is the founder of E&A Law Limited, an innovative law firm which combines energy specialism with expertise in EU law, international law and arbitration to provide advice to energy companies, states and financial institutions on the transactional, regulatory and dispute resolution aspects of the energy sector.

Ana has advised on concession agreements to construct large energy infrastructure, privatisations of energy companies, cross-border mergers and acquisitions, and host government agreements to construct pipelines. She has acted as counsel in gas price review arbitrations, investment treaty and commercial arbitrations. She has also appeared before the European Court of Justice. She has a LLM from Cambridge University, UK and a LLB and B. Commerce (Finance and Banking) from the University of New South Wales, Australia. Ana is recommended as a leading lawyer in Energy and Energy Disputes in the UK by Legal 500 and Chambers and Partners.

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