

TO THE MINISTERIAL COUNCIL OF THE ENERGY COMMUNITY
represented by the Presidency and the Vice-Presidency of the Energy Community

In Case ECS-1/12, the Secretariat of the Energy Community against Ukraine, the

ADVISORY COMMITTEE,

composed of

Rajko Pirnat, Helmut Schmitt von Sydow, and Wolfgang Urbantschitsch

pursuant to Article 90 of the Treaty establishing the Energy Community and Article 32 of Procedural Act No 2008/1/MC-EnC of the Ministerial Council of the Energy Community of 27 June 2008 on the Rules of Procedure for Dispute Settlement under the Treaty,

acting unanimously,

gives the following

OPINION

I. Procedure

By e-mail dated 30 May 2017 the Energy Community Presidency asked the Advisory Committee to give an Opinion on the Reasoned Request submitted by the Secretariat in Case ECS-1/12 against Ukraine. The members of the Advisory Committee received a copy of all relevant documents of the case (including the replies of Ukraine) from the Energy Community Secretariat. Pursuant to Article 46 (2) of the Dispute Settlement Rules cases initiated before 16 October 2015 shall be dealt with in accordance with the Dispute Settlement Rules applicable before the amendment adopted on that date. This case against Ukraine was opened already on 26 February 2013 and is thus to be dealt with according to the original Dispute Settlement Rules as adopted on 27 June 2008.

In its Reasoned Request the Secretariat seeks a Decision from the Ministerial Council declaring that Ukraine failed to fulfil its obligations arising from Energy Community law. The Secretariat argues that Ukraine fails to fulfil certain obligations of the Energy Community Treaty as well as several provisions of EU legislation taken over by the Energy Community related to the allocation of cross-border capacity.

Ukraine did not submit a reply to the Reasoned Request within the deadline ending 19 July 2017.

II. Preliminary Remarks

According to Article 32 (1) of the Procedural Act No 2008/01/MC-EnC of the Ministerial Council of the Energy Community on the Rules of Procedure for Dispute Settlement under the Energy Community Treaty, the Advisory Committee gives its Opinion on the Reasoned Request, taking into account the reply by the party concerned. As in the present case Ukraine did not reply either to the Reasoned Opinion or to the Reasoned Request, the

Advisory Committee takes into account the response of the Contracting Party to the Opening Letter of the Secretariat, insofar as it is still relevant for the present case.

The Advisory Committee, exercising its duty to give an Opinion on the Reasoned Request does not duplicate the procedure and therefore does not collect evidence itself. The Advisory Committee gives its Opinion on the basis of undisputed facts. Where the facts were not sufficiently determined by the Secretariat, including the Reasoned Opinion, the Advisory Committee is not in a position to give its decisive legal opinion on these allegations; instead, such cases of incomplete determination of facts are pointed out in the Opinion of the Advisory Committee.

On the basis of these principles the Advisory Committee assessed the Reasoned Request and the relevant documents, discussed the legal topics which were brought up and came to the following conclusions.

III. Provisions allegedly violated by the Contracting Party concerned

Article 7 of the Treaty reads:

Any discrimination within the scope of this Treaty shall be prohibited.

Article 41 of the Treaty reads:

- 1. Customs duties and quantitative restrictions on the import and export of Network Energy and all measures having equivalent effect, shall be prohibited between the Parties. This prohibition shall also apply to customs duties of a fiscal nature.*
- 2. Paragraph 1 shall not preclude quantitative restrictions or measures having equivalent effect, justified on grounds of public policy or public security; the protection of health and life of humans, animals or plants, or the protection of industrial and commercial property. Such restrictions or measures shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between the Parties.*

Article 3 (1) of Directive 2009/72/EC (as amended by 2011/02/MC-EnC) reads:

Contracting Parties shall ensure, on the basis of their institutional organisation and with due regard to the principle of subsidiarity, that, without prejudice to paragraph 2, electricity undertakings are operated in accordance with the principles of this Directive with a view to achieving a competitive, secure and environmentally sustainable market in electricity, and shall not discriminate between those undertakings as regards either rights or obligations.

Article 12 (f) of Directive 2009/72/EC (as amended by 2011/02/MC-EnC) reads:

Each transmission system operator shall be responsible for:

(a) – (e) [...]

(f) ensuring non-discrimination as between system users or classes of system users, particularly in favour of its related undertakings; [...]

Article 32 of Directive 2009/72/EC (as amended by 2011/02/MC-EnC) reads:

- 1. Contracting Parties shall ensure the implementation of a system of third party access to the transmission and distribution systems based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system*

users. Contracting Parties shall ensure that those tariffs, or the methodologies underlying their calculation, are approved prior to their entry into force in accordance with Article 37 and that those tariffs, and the methodologies - where only methodologies are approved - are published prior to their entry into force.

2. The transmission or distribution system operator may refuse access where it lacks the necessary capacity. Duly substantiated reasons must be given for such refusal, in particular having regard to Article 3, and based on objective and technically and economically justified criteria. The regulatory authorities where Contracting Parties have so provided or Contracting Parties shall ensure that those criteria are consistently applied and that the system user who has been refused access can make use of a dispute settlement procedure. The regulatory authorities shall also ensure, where appropriate and when refusal of access takes place, that the transmission or distribution system operator provides relevant information on measures that would be necessary to reinforce the network. The party requesting such information may be charged a reasonable fee reflecting the cost of providing such information.

Article 16 (1) of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

Network congestion problems shall be addressed with non-discriminatory market-based solutions which give efficient economic signals to the market participants and transmission system operators involved. Network congestion problems shall preferentially be solved with non-transaction based methods, i.e. methods that do not involve a selection between the contracts of individual market participants.

Article 1.1 of Annex I of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

Transmission system operators (TSOs) shall endeavour to accept all commercial transactions, including those involving cross-border-trade.

Article 1.6 of Annex I of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

No transaction-based distinction shall be applied in congestion management. A particular request for transmission service shall be denied only when the following cumulative conditions are fulfilled:

*(a) the incremental physical power flows resulting from the acceptance of that request imply that secure operation of the power system may no longer be guaranteed, and
(b) the monetary value of the request in the congestion-management procedure is lower than all other requests intended to be accepted for the same service and conditions.*

Article 2.1 of Annex I of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

Congestion-management methods shall be market-based in order to facilitate efficient cross-border trade. For that purpose, capacity shall be allocated only by means of explicit (capacity) or implicit (capacity and energy) auctions. Both methods may coexist on the same interconnection. For intra-day trade continuous trading may be used.

Article 2.5 of Annex I of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

The access rights for long and medium-term allocations shall be firm transmission capacity rights. They shall be subject to the use-it-or-lose-it or use-it-or-sell-it principles at the time of nomination.

Article 2.10 of Annex I of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

In principle, all potential market participants shall be permitted to participate in the allocation process without restriction. To avoid creating or aggravating problems related to the potential use of dominant position of any market player, the relevant regulatory and/or competition authorities, where appropriate, may impose restrictions in general or on an individual company on account of market dominance.

Article 2.13 of Annex I of Regulation (EC) 714/2009 (as amended by 2011/02/MC-EnC) reads:

The financial consequences of failure to honour obligations associated with the allocation of capacity shall be attributed to those who are responsible for such a failure. Where market participants fail to use the capacity that they have committed to use, or, in the case of explicitly auctioned capacity, fail to trade on a secondary basis or give the capacity back in due time, they shall lose the rights to such capacity and pay a cost-reflective charge. Any cost-reflective charges for the non-use of capacity shall be justified and proportionate. Likewise, if a TSO does not fulfil its obligation, it shall be liable to compensate the market participant for the loss of capacity rights. No consequential losses shall be taken into account for that purpose. The key concepts and methods for the determination of liabilities that accrue upon failure to honour obligations shall be set out in advance in respect of the financial consequences, and shall be subject to review by the relevant national regulatory authority or authorities.

IV. Legal Assessment

The Reasoned Request of the Secretariat alleges that Ukraine's current regime for allocation of cross-border capacity for electricity fails to fulfil obligations under Energy Community law, in particular Articles 7 and 41 of the Energy Community Treaty ('the Treaty'), Articles 3 (1), 12 (f) and 32 of Directive 2009/72/EC, Article 16(1) of Regulation (EC) 714/2009 as well as Articles 1.1, 1.6, 2.1, 2.5, 2.10 and 2.13 of the Congestion Management Guidelines as incorporated and adapted by Decision 2011/02/MC-EnC.

In 2011 the Second EU Energy Package was replaced in the Energy Community framework by its successor at EU level, the Third EU Energy Package, with an implementation deadline until 1 January 2015 (Decision 2011/02/MC-EnC). However, there is settled case-law of the European Court of Justice (ECJ) that '*the existence of a failure to fulfil obligations must be assessed in the light of the European Union legislation in force at the close of the period prescribed by the Commission for the Member State concerned to comply with its reasoned opinion*' (Case C-52/08 Commission v Portugal, para 41). According to Article 94 of the Treaty, '[t]he institutions shall interpret any term or other concept used in this Treaty that is derived from European Community law in conformity with the case law of the Court of Justice or the Court of First Instance of the European Communities'. The Advisory Committee acts on request of the Ministerial Council and is bound by Energy Community law pursuant to Article 5 (3) of its Rules of Procedure. Hence, despite the Advisory Committee not being explicitly named in Article 94 of the Treaty, it is bound by the interpretation of EU terms and concepts if adopted by Energy Community law. This interpretation is also confirmed by Article 32 (2) of the Dispute Settlement Rules as amended on 16 October 2015 where Article 94 of the Treaty is named as being of particular importance for the work of the Advisory Committee. However, the Dispute Settlement Rules as amended on 16 October 2015 do not apply to this case and can only serve as interpretation guidelines. In the present case, the close of the period prescribed by the Secretariat for Ukraine to comply with the Reasoned Opinion was 14 May 2017. It is clear that the legal acts comprising the Third EU Energy Package repealed the Second EU Energy Package from 1 January 2015, in other words more than two years before the expiry of the period prescribed in the Reasoned Opinion. The

legal obligations to be looked at are thus those originating from the relevant legal acts included in the Third EU Energy Package.

As the alleged points of non-compliance raised by the Secretariat are manifold, this opinion will – in the interest of improved readability – follow the structure of the Secretariat's Reasoned Request. It has to be noted up front that all the allegations remained undisputed throughout the entire dispute settlement procedure.

The Secretariat stated a number of legal provisions allegedly violated by the Ukrainian wholesale electricity market system. As there are so many specific legal provisions violated by certain aspects of this system, it is not necessary to resort to the most general provision of Article 7 of the Energy Community Treaty. Article 7 of the Treaty is only a subsidiary remedy if there were no more specific Treaty provisions available. This subsidiarity – explicitly spelled out in Article 18 TFEU – also applies to Article 7 of the Treaty considering the principle of *lex specialis derogat legi generali* and its extremely wide scope of application.

a. Different treatment of electricity imports and exports

In the current set-up of Ukraine's national electricity market imports are treated differently from exports. While there undoubtedly are certain differences between the two types of electricity flows, the legal framework of the Energy Community requires that certain aspects of imports and exports are treated equally. This is especially true for the allocation of cross-border capacity on interconnectors and non-discrimination of network users. Considering the arguments presented by the Secretariat and in the absence of a reply from Ukraine, it seems unquestionable that the necessity of an approval of the Ministry of potential imports of electricity, is incompatible with Energy Community Law, especially with Section 2.1 of the Congestion Management Guidelines. It discriminates between groups of system users, thereby violating Articles 3 (1), 12 (7) and 32 of Directive 2009/72/EC as well as Article 16 (1) of Regulation (EC) 714/2009. Furthermore, it establishes a system of measures having equivalent effect to quantitative restrictions; thereby violating one of the fundamental cornerstones of the extended EU internal electricity market, namely Article 41 of the Treaty.

b. Limited access to interconnectors

Similar to the allegations made under point a. above, the limitation of participants in cross-border allocation procedures in Ukraine violates some fundamental rules of the regional electricity market to be achieved by the Energy Community. In particular the Auction Rules 2017 contain some serious limitations to access to the transmission networks. They stipulate that participation in cross-border capacity allocation procedure is only possible for suppliers holding a supply license (Article 30 Electricity Market Law as amended in conjunction with Articles 1.2 and 2.2 Auction Rules 2017), which again has to be considered as contrary to Article 41 of the Treaty and Articles 12 (f) and 32 of Directive 2009/72/EC as well as Section 2.10. of the Congestion Management Guidelines.

The requirement to purchase electricity for export from the state-owned wholesale supplier and wholesale market administrator Energorynok constitutes another breach of Energy Community law by restricting the possibility to participate in the congestion management mechanism based on the underlying commodity contract; a breach of Article 41 of the Treaty together with an infringement of Articles 32 Directive 2009/72/EC, Article 16 (1) of Regulation (EC) 714/2009 and Sections 1.1, 1.6 and 2.10 of the Congestion Management Guidelines.

The Auction Rules 2017 include provisions stipulating several reasons for a participant to be excluded. They include inactiveness at the auctions for one year, indebtedness with Energorynok or non-participation in the wholesale electricity market. All those reasons, however, are not in line with Energy Community law, as basically the only reasons for limiting access are technical or competition concerns. In addition a successful participant in a yearly auction might lose its remaining capacity for the entire year if it used the obtained capacity less than 70% during one month; it still has to pay for the entire yearly capacity, though

(Point 12.9 Auction Rules 2017). All this again violates a number of provisions of Energy Community law, namely Article 32 of Directive 2009/72/EC as well as Sections 1.6, 2.5 and 2.13 of the Congestion Management Guidelines.

c. The effect of the security on trade in electricity

The auction rules provide that electricity suppliers interested in participation in auctions for allocation of cross-border capacity have to pay a fee and a bank guarantee before submitting an application for participation (Point 6.1 Auction Rules 2017 - Annex 14 to the Reasoned Request). The whole system of the auction rules suggests that it is more a collateral than a fee. The amount of this collateral accounts for at least 100 minimal wages as defined in a – not otherwise specified – piece of Ukrainian legislation (Point 6.2 Auction Rules 2017). Furthermore, this amount is retained by the auction office as a fine in case the winning participant does not pay for the capacity obtained in the auction (Point 6.6 Auction Rules 2017) in addition to losing the respective capacity (Point 17.2 Auction Rules).

While there is no doubt that a collateral is a suitable means to avoid consequence of default of a contractual partner, the amount of such collateral has to be proportionate to the financial risk the other contractual partner takes, in this case the auction office. In contrast to an entirely private enterprise operating outside any regulatory framework, the auction office as a system operator in the Ukrainian electricity market has to avoid discrimination of network users and has to abide by the requirements defined by the Third EU Energy Package. These measures have a highly restrictive effect on trade as both the amount of the fee and the punishment for not using the capacity obtained discriminate against market entrants with typically a lower budget than established companies from the region. Thus, they violate Article 41 of the Treaty, but also Sections 2.5 of the Congestion Management Guidelines.

V. Conclusions

The Advisory Committee considers that Ukraine failed to comply with Article 41 of the Treaty, Articles 3 (1), 12 (f) and 32 of Directive 2009/72/EC, Article 16 (1) of Regulation (EC) 714/2009 as well as Articles 1.1, 1.6, 2.1, 2.5, 2.10 and 2.13 of the Congestion Management Guidelines as incorporated and adapted by Decision 2011/02/MC-EnC.

Done in Vienna on 25 September 2017

On behalf of the Advisory Committee



Wolfgang Urbantschitsch, Chairman