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From a Reactive to a Proactive EU Regulatory Framework for Long-term Gas Import Contracts

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Highlights

- In the context of the current revamping of Regulation 994/2010 on the security of gas supply (hereafter the "Gas SoS Regulation"), this short paper from the Florence School of Regulation investigates ways to strengthen the EU regulatory framework for long-term import contracts (hereafter "LTCs") with non-EU gas suppliers. The focus is exclusively on commercial contracts.
- While LTCs do not constitute an impediment to competition or security of supply "*per se*" – they may actually enrich the energy mix and source diversification of certain EU Member States, contributing to their stability and security - it is undeniable that in some cases the dominance of a foreign supplier strongly impacts market competition and limits a Member State's economic and political choices. The impact of LTCs on security of gas supply and competition is therefore markedly different in hub-based Western markets and isolated Eastern markets. The issue raised by LTCs is both real and localised. The problem-solving potential of an effective implementation of the third energy and infrastructure packages cannot be emphasised enough, but transitory measures appear necessary.
- In essence, the existing EU regulatory framework on LTCs (mainly EU competition law, REMIT and Article 13(6)(b) of the Gas SoS Regulation) follows a 'reactive' approach, as it principally aims to respond to a budding gas supply crisis or a market abuse that has already occurred. Both the EU competition law and REMIT work *ex post*. They are not underpinned by a security of supply rationale and are unable to address the concerns of the most vulnerable Member States as regards the security of their gas supply. The Gas SoS transparency mechanism is a forward-looking instrument, but it only reaches its full effect in the so-called alert and emergency stages. It is also fundamentally limited by severe design flaws and enforcement issues.
- In this context, we advocate (i) an enhancement of the transparency framework anticipated by Art 13(6)(b) of the Gas SoS Regulation, both in its national and European dimensions; and (ii) the creation of a notification mechanism allowing for control by national regulators *ex ante*, i.e. before LTCs are signed.
- The notification mechanism, conditioned by a market share threshold, should be as simple as possible to limit regulatory costs and red tape. The assessment should be largely limited to (i) the most harmful infringements of competition law, which could be defined within dedicated soft law guidelines; and (ii) potential breaches of the Gas SoS Regulation, so as to limit the likelihood of regulatory errors. To make sure that regional and EU interests are well accounted for, and potential national regulatory capture is offset, an obligation modelled on Art 36(8) and (9) of the Gas Directive to request a binding opinion from the Commission should be introduced. In the longer term, ACER should be given a more central role.

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1. Introduction

The issue of long-term import contracts (henceforth "LTCs") with non-EU gas suppliers has been at the forefront of the EU energy policy debate for a considerable period of time. Back in 2003, the second liberalisation Directive had already acknowledged their necessity to ensure security of gas supply in the EU, as long as they were compatible with the objectives of the Directive and with the rules of the Treaty. At that time, LTCs were largely perceived as a competition problem, even though the preparatory documents leading to the Directive already provided evidence that EU institutions were divided on the impact of these contracts on security of gas supply. In a series of cases against Gazprom and Sonatrach in the early 2000s, DG Comp only partly tackled the problem through EU competition law, by focusing on unlawful territorial restrictions and profit sharing mechanisms. In 2007, the DG Comp sector inquiry emphasised the potential anticompetitive effects of LTCs, particularly regarding access to upstream supply markets, market liquidity and customer foreclosure. The ongoing competition probe against Gazprom for the alleged abuse of dominance on Central and Eastern European gas supply markets shows that competition issues remain a serious source of concern to this day.

The successive Ukraine-Russia transit crises also provided concrete evidence that an unwarranted level of dependency on a single supplier may endanger security of gas supply in some of the most vulnerable EU Member States. Dependency, which is not problematic "*per se*", might involve issues related to supply and transit. In this context, LTCs are always caught between law and politics. Externally, impinging on LTCs quickly heightens geopolitical tensions, in particular with Russia. Internally, Member States have always been reluctant to see the EU intervene in their external relations with non-EU gas suppliers. Some progress has been made with the Council Decision of October 2012, which established an information exchange mechanism for intergovernmental agreements (henceforth "IGAs") between Member States and third countries in the field of energy. However, a lot remains to be done in this area, as demonstrated by the public consultation launched by the Commission in July 2015.

The issue of the suitability of the existing EU regulatory framework for LTCs resurfaced recently in the Commission staff working document of 16 October 2014 (SWD(2014) 325 final) on the implementation of the Regulation 994/2010 on security of gas supply (hereafter the "Gas SoS Regulation"). In this paper, the Commission argued that the lack of transparency of these contracts was a source of concern for vulnerable Member States without supply diversification and gas hubs, and called for a strengthened transparency framework. The issue was raised again in the European Council conclusions of 19 and 20 March 2015 . The European Council recalled that both IGAs and commercial contracts should be plainly in line with EU law, in particular with the security of supply legislation, though safeguards for business confidentiality should be ensured.

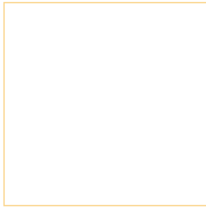
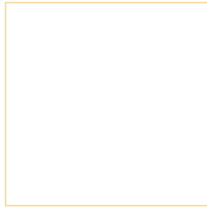
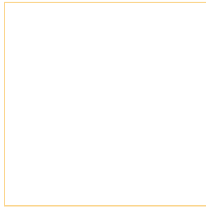
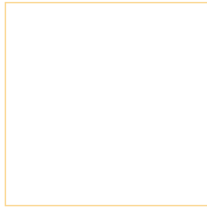
In such context, this short analysis investigates the possible ways of strengthening the existing EU regulatory framework for LTCs with non-EU gas suppliers. We focus exclusively on commercial contracts, as opposed to IGAs. Undoubtedly, a well-functioning internal energy market, where transparency and well defined rules are implemented, "*would finally enable a proper degree of cross-border coordination, which is required for a market response to a gas supply disruption*".[4] Our proposals should in no way be seen as contradicting or replacing full implementation of the third energy (including network codes) and infrastructure packages.

2. LTCs and the Internal Market: Impact on SoS and Competition – Understanding the Issue

Despite the emergence of a competitive and integrated internal gas market in some parts of the EU, LTCs are far from becoming a residual instrument in the gas business. Indeed, "[…] *new long-term contracts are still being signed, although their duration (typically around 10-15 years) is lower than the average duration of legacy contracts (20-25 years)*"[5]. In addition, the trend towards shorter contracts only concerns the new contracts, whereas there are no signs of downward modifications to the contract duration in the process of renegotiation affecting existing LTCs. Save for a few cases, expired LTCs have all been renewed.[6]

LTCs are based on complex long-term arrangements negotiated on a bilateral basis, sometimes at the inter-state level. Such contracts fall outside the scope of organised markets, and hence make it difficult for regulators to draw a clear picture of the overall gas trade. Firstly, the general framework of a LTC regularly lacks information or displays it in a non-typical way: unsurprisingly, in the new REMIT Regulation, LTCs belong to the category of "non-standardised contracts". Secondly, the underlying deal may envisage different prices for the different time periods of delivery within the overall delivery time-range, based on pre-agreed indices, the nature of which tends to be complex and highly contract-specific. Therefore, it is often not possible to identify precise quantities or prices at the time of execution/delivery. Thirdly, the quantities to be delivered generally have a high degree of optionality: contrary to "standard contracts" where clear and precise rules tend to guarantee certainty of delivery, the amount of gas eventually delivered may

4. CEER Concept Paper on Security of Gas Supply, July 2015.
5. "Long-term Gas Contracts in Europe", CIEP 2014.
6. See findings of the Commission in its staff working document of 16 October 2014, (SWD(2014) 325 final, 18-19.

be uncertain and subject to the discretion of one of the two contracting parties.

In order to have a complete and accurate overview of the European gas market, one cannot disregard the impact of LTCs on cross-border flows and the availability of capacity at the different points of delivery. This is true not only for monitoring security of supply, but also for efficient competition and for the effective identification of potential market abuses[7]. As ACER rightly pointed out; "*Reporting of records of transactions in non-standardised contracts is crucial to have a complete picture of the trading activities of market participants. Market abuse practices like ramping or cross-market manipulation could not or only hardly be detected without information on non-standardised contracts". For instance, a market participant being a seller in a long-term contract with price components depending on developments of spot market prices could influence the spot market prices by buying at artificial high prices to benefit from these higher prices as a seller in the long-term contract(s). If no information were available on the long-term contracts, the activity on the spot markets alone would not necessarily be sufficient to identify suspicious instances. Only with the knowledge about the long-term contracts the picture is complete.*[8]"

On the competition side, the impact of LTCs mainly depends on the development of spot and forward markets as well as horizontal and vertical market concentration. Pricing schemes which create excessive pricing or price discrimination and contract clauses such as duration, exclusivity, termination rights, rebates, destination and use restrictions (creating market partitioning) must be looked at carefully. Of course, LTCs help to hedge price and quantity risks, mitigate counterparty credibility risks and facilitate bank financing (and thus investment). However, if they do not allow for efficient renegotiation/adaptation, LTCs may yield efficiency losses for individual contracting parties. In different ways, LTCs may have negative effects on market opening. Customer foreclosure is created, in particular, by the exclusivity, tacit renewal and penalty clauses, and by rebate mechanisms. The resulting illiquidity of spot markets does not create transparency on the evolution of supply and demand, and on the costs of incumbents, which may hinder entry. LTCs might also result in stabilising market shares, thereby creating tacit collusion. The impact on competition is therefore very different in hub-based Western markets with a diversified portfolio of suppliers and liquid markets as well as sufficient infrastructure, and in certain Eastern Member States without supply diversification and gas hubs, where the national gas market is not yet "mature" or fully developed.

On the security of supply side, the potential problem comes from the lack of diversification. As there is an option to resell contracted gas on the European market and the portfolio of gas suppliers is changing, with a lesser share of LTCs, it is increasingly difficult to assess the impact of LTCs on security of supply in many parts of the Western hub-based gas markets. However, in several vulnerable Member States, long-term contracts remain an important element for security of supply. At the wholesale level, gas imports in these Member states are typically subject to long-term contracts between the national incumbent and a single external supplier. While the long term character of a contract *per se* does not necessarily raise concerns – and/or can even be supportive in terms of security of supply – diversification is a source of concern. The situation is even more problematic in countries where the energy mix does not include sufficient generation from renewable sources, or the existing infrastructure does not allow for reverse flows or other alternatives to the traditional East-West routes of gas pipelines. In some of these countries, the reliability and stability of gas flows is mostly guaranteed by long-term contracts with the external supplier.

In a nutshell, the impact of LTCs on security of gas supply and competition is markedly different in hub-based Western markets and isolated Eastern markets once these LTCs are signed.

3. The Shortcomings of the Existing EU Regulatory Framework: the Limits of a 'Reactive' Approach

The existing EU regulatory framework for LTCs with non-EU gas suppliers pursues two objectives: responding to an emergency supply crisis and tackling market abuse. It operates through three complementary but partly overlapping instruments: an *ex ante* transparency mechanism structured by the Gas SoS Regulation, an *ex post* EU competition enforcement by the Commission and a sort of hybrid *ex post* mechanism combining transparency and enforcement by national regulators through REMIT.[9]

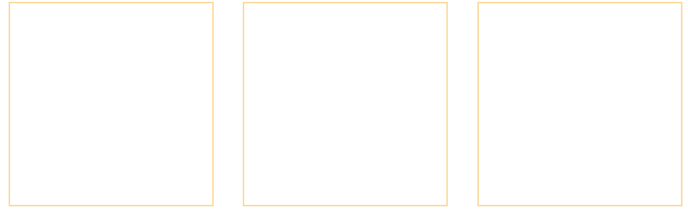
3.1 The limits of the Gas SoS Regulation transparency mechanism

Under Art 13(6)(b) of the Gas SoS Regulation, gas companies must notify the 'competent authority' (hence not necessarily the national regulator) of those contracts with suppliers from third countries, which have a duration of more than one year.

7. Additionally, the availability of certain gas capacities linked to LTCs, at present, could only be detected through a specific legal instrument. This is the case, for example of the so-called "hanging capacities" which were originally linked to LTCs and terminated at a second stage.

8. ACER Recommendations on REMIT Records of Transactions, 23 October 2012.

9. The *ex ante* / *ex post* dichotomy refers here to the period either before, or after, a particular contract is signed or a particular trade takes place.



However, the contracts themselves do not have to be reported. The transparency requirements only concern certain characteristics: contract duration, forecast of total annual volume and average volume per month, delivery points and forecasted daily maximum volume in case of alert or emergency.[10]

The national emergency plans covered by Art (10)(1)(k) of the Gas SoS Regulation must detail the reporting obligations imposed on natural gas undertakings at alert and emergency levels. National emergency plans also establish a list of predefined actions to make gas available in the event of an emergency, including commercial agreements between the parties involved in such actions and the compensation mechanisms for natural gas undertakings where appropriate, taking due account of the confidentiality of sensitive data. Such actions may involve cross-border agreements between Member States and/or natural gas companies, under Art (10)(1)(i) of the Regulation.

The Commission has drafted a template that the competent authorities must complete. The competent authorities must then notify the Commission of these data under an aggregate form. On a regular basis, information must be updated. Of course, the Commission and the competent authority have a duty to ensure confidentiality. According to the Commission's staff working document of 16 October 2014, only 10 Member States had provided information using the template and five (mostly Eastern and Baltic) Member States provided non-aggregated data.

It follows from the above that the Gas SoS Regulation transparency mechanism suffers from severe shortcomings and implementation flows:

1. **"in case of alert or emergency only":** some key information is either not communicated to the competent authority or is communicated at a very late stage (expected daily max. volumes).
2. **the 'competent authority' problem:** the competent authority (e.g., a ministry) does not necessarily have the same sanction powers as those ensured by the third liberalisation package for regulators. They might not have either the same level of understanding or even information on market functioning.
3. **the 'data aggregation' problem:** the Commission is largely kept in the dark due to data aggregation. This might have an impact on the Commission's assessment of national preventive and emergency plans and its ability to declare emergency situations at the EU and regional levels, even though the Commission can declare the existence of such a situation only when two competent authorities have requested it. In addition, the Regulation does not specify a timeframe for information updates.
4. **the 'lack of teeth' problem:** the mechanism does not specify clear sanction powers or to which entity such powers should be allocated when relevant data is not provided by gas companies.
5. **the 'one size fits all' problem:** the mechanism does not introduce differentiation in terms of transparency requirements according to the market situation (e.g. hub-based Western markets and isolated Eastern markets), creating both unnecessary regulatory costs and red tape.
6. **the 'Europeanisation' problem:** the mechanism does not allow for an information exchange mechanism across neighbouring Member States, whereas, as per Art 9 of the Gas SoS Regulation, competent authorities should do their national risk assessment with regards to real (projected) flows, including cross-border flows. The same problem occurs when competent authorities decide to build regional preventive plans (Art 4(3)).

3.2 The limits of EU competition enforcement

Up until now, EU competition law has been the main regulatory device used to address the negative effects of LTCs with non-EU gas suppliers. The ongoing battle between the Commission and Gazprom shows that this instrument can be used, even in a highly politicised context. It nonetheless suffers from serious shortcomings.

First, it is yet to be proven that competition enforcers can suitably integrate into the analysis all of the foreseeable issues pertinent to security of gas supply. Indeed, the concept of abuse under Art 102 TFEU might not cover, for instance, breaches of relevant provisions of the Gas SoS Regulation or the third energy package. In addition, the enforcement of EU competition law might not coincide with individual preferences of Member States as regards their security of gas supply.

10. Art 10(3) of the Gas SoS Regulation foresees 3 steps:
"(a) early warning level (early warning): when there is concrete, serious and reliable information that an event may occur which is likely to result in the significant deterioration of the supply situation and is likely to lead to the alert or the emergency level being triggered; the early warning level may be activated by an early warning mechanism;
(b) alert level (alert): when a supply disruption or exceptionally high gas demand occurs which results in the significant deterioration of the supply situation, but the market is still able to manage that disruption or demand without the need to resort to non-market measures;
(c) emergency level (emergency): in the event of exceptionally high gas demand, a significant supply disruption or other significant deterioration of the supply situation, and in the event that all relevant market measures have been implemented, but the supply of gas is insufficient to meet the remaining gas demand, so that non-market measures have to be additionally introduced with a view, in particular, to safeguarding the supplies of gas to protected customers according to Article 8."

Second, competition enforcement tends to be slow. It can take years to reach a decision and possibly a court judgment. In addition, compliance with decisions and judgments cannot be taken for granted in this context.

Third, damages cannot always be quantified with accuracy, or at all, in the context of subsequent damage suits. Redress and compensation through the private enforcement of competition law is therefore not reliable, in particular for household customers.

3.3 The limits of the REMIT mechanism

According to Art 7(1) of REMIT, ACER shall collect the data for assessing and monitoring wholesale energy markets as provided for in Art 8 of REMIT.

The Commission's implementing acts set the deadline for eligible market participants to start reporting on wholesale energy contracts (over-the-counter standard and non-standard supply contracts, transportation contracts) and on the reportable fundamental data from Transmission, LNG and Storage System Operators. Non-OMP contracts, i.e. contracts that are not traded via brokers or through exchange platforms, must therefore be reported only as of 7 April 2016. LTCs with non-EU gas suppliers fall into this category. Reporting takes place in case of execution, modification or the early termination of a transaction.[11]

Often, LTCs (with optionality) have daily executions: this means that the commodity purchased under a LTC is delivered daily at an entry point and then re-traded (either bilaterally or via exchange). The long-term (framework) contract will then be reported as a non-standard contract (describing optionality and complex pricing formulas). Individual daily executions will also be reported, but as standard contracts because they will have an outright price and volume.

The limits of this way of reporting *ex post* are obvious: while LTCs (framework) are reported in general terms and as non-standard contracts, the information (volumes, prices, etc.) on the daily deliveries or deals which are subsequent to the same framework contract are reported as standard contracts. This means that the two categories of data cannot be matched, or considered as belonging to the same agreement. As such, information collected under REMIT only provides a partial overview of the underlying agreement of a transaction.

Additionally, information collected under REMIT is only visible by ACER: market parties communicate the data of their wholesale transactions through a so-called RRM (Registered Reporting Mechanism) which interfaces with ACER directly. This implies that at no stage are national regulators or the EU Commission involved in this process.

3.4 From a Reactive to a Proactive Approach

In essence, the EU regulatory framework for LTCs with non-EU gas suppliers follows a 'reactive' approach, in the sense that it is not pre-emptive, but principally aims to respond once a gas supply crisis or a market abuse has already occurred or is in the making. We can see that regulatory powers concerning security of supply are still (unsurprisingly) largely in the hands of national governments. In some countries, this reflects the national division of constitutional responsibilities on security of supply.

EU competition law and REMIT work *ex post* and mainly, in the end, on hoped-for deterrence effects. They are not underpinned by a security of supply rationale and are thus unable to address the concerns of the most vulnerable Member States on this matter. It would be accurate to say that the Gas SoS transparency mechanism is a forward-looking instrument. However, it only reaches its real effect in the so-called alert and emergency stages. Furthermore, it is fundamentally limited by severe design and enforcement flaws.[12] This necessitates turning to a more 'proactive' approach.

In our view, a more proactive EU regulatory framework for LTCs with non-EU gas suppliers should:

- ensure *effective* transparency, i.e. that information on gas flows and available capacity at the various entry/exit points of the network is available in order to allow for the most accurate picture of all relevant gas flows.[13]
- make sure that both the security of supply and competition concerns are taken into account concurrently;
- fine-tune the role of the different players (national regulators, competent authorities, the Commission, ACER);
- refine the interaction of the available regulatory instruments;
- ensure that the EU and regional interests are well accounted for;
- guarantee proportionality: regulatory costs and red tape should be kept to a minimum to account for the fact that hub-based Western markets and isolated Eastern markets are in different situations.

11. According to the ACER Manual of Procedures on transaction and fundamental data reporting of 18 June 2015, non-standard supply contracts need to be reported following the requirements of Table 2 of the Annex of the implementing acts: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:JOL_2014_363_R_0009&from=EN

12. It must be mentioned that other mechanisms such as the early warning mechanism with Russia or information sharing within the Energy Community must also be taken into account.

13. This shall include measures urging TSOs and SSOs to implement the relevant Third Package provisions concerning information transparency and to make related data available on the ENTSO-G transparency platform.

In this context, we advocate:

a) an enhancement of the transparency framework and

b) the introduction of a notification mechanism allowing for the control of LTCs *ex ante*, i.e. before they are signed.

Ex ante control mechanisms are often characterised by worryingly high regulatory costs and red tape. As a result, the notification mechanism should be as simple as possible[14].

4. Towards a Strengthened Transparency Framework: The Low Cost – High Reward Route

A strengthened transparency framework is all the more important if an *ex ante* control mechanism does not exist. Both solutions should not be seen as substitutes but as complementary actions. Indeed, once LTCs are signed, supply crises and market abuses can always occur.

Amending the REMIT reporting regime is not the right course of action in this context, even if it provides useful (repeat) information on the market conditions (in particular, standard forward contracts) in a specific trading zone. The reasons for this statement lie both in the qualitative and quantitative nature of reporting under REMIT. First of all, REMIT provisions impose reporting of all wholesale transactions' data of a certain company on a daily basis, while the type of information we would like to obtain is very specific and relates to data which might be useful in case of supply disruptions. Also, the massive amount of data reported under the current regulation provides such an exhaustive and complete set of information, which becomes difficult to filter in light of a certain purpose.

We think that the Gas SoS Regulation transparency mechanism is thus the best candidate for improvement.

We propose to proceed according to the following guiding principles:

- Data reporting to the Commission should be improved, in particular through data disaggregation, even though it can be presumed that vulnerable Member States might be more likely to voluntarily provide data in such a format. A binding reporting to the Commission on the daily maximum volumes at each delivery point, at least as soon as we enter the emergency stages, is important.

- The EU Commission should be able to jointly analyse REMIT data and data reported under the Gas SoS Regulation transparency mechanism. Provisions concerning (binding) cooperation between the national regulator and the competent authority should be introduced.

- A binding timeframe for reporting by gas companies to the competent authority should be defined.

- EU legislation should require Member States to make sure that appropriate sanction measures are put in place (and thus powers suitably allocated) when relevant data is not provided.

- The one-year period should not be amended. Contracts shorter than one-year cover a fairly marginal part of demand in Eastern markets, and Western markets are liquid enough so that such contracts are not crucial.

- Respecting business secrets and confidentiality issues is paramount. In this context, publishing even aggregated contract data gathered through the different reporting mechanisms is not a priority, even though it can provide a useful benchmark for the ongoing contract negotiations.

5. Ex Ante Control Mechanism: Do Not Use a Hatchet to Remove a Fly

We envisaged three possible routes for the implementation of an ex ante mechanism:

5.1 The Competition Law Route

A first solution (the *competition law* route) would consist of strengthening the EU competition enforcement framework by introducing an *ex ante* element in terms of assessment. Following the rationale of the former Regulation 17, pre-notification of LTCs to the Commission for an *ex ante* compliance check with EU competition rules could be introduced. However, such a mechanism would not address most concerns depicted in section 3.2 and the pre-notification may impose too high of an administrative burden on the Commission (DG Comp). These problems could partially be alleviated through strengthened internal cooperation between DG Comp and DG Energy.

The Commission could also enact soft law guidelines on acceptable contract forms in order to provide guidance to operators. However, the non-binding character of such guidelines would largely undermine their concrete outcomes. In addition, guidelines on the application of Article 101(3) TFEU already exist.

An alternative option could consist of introducing a safe harbour in the context of a block exemption regulation, i.e. to define criteria *ex ante* in a part of the EU legislation, the fulfilment of which would result in automatic compliance with the competition rules without the need for companies to notify contracts

14. For instance, the notification mechanism could be transitory, as long as an effective implementation of the third energy and infrastructure packages has not taken place. A review clause, for instance after 5 years, could be introduced.

beforehand. This approach would have merit, as it would provide legal certainty to operators and limit the administrative burden on the Commission. It would, however, lack flexibility as no assessment of concrete situations would be carried out, as in the case of soft law guidelines. In addition, it remains difficult (but certainly not impossible) to define criteria that would be relevant for the whole Union due to the diversity of real-world EU gas market settings.

5.2 The National Regulators Route

A second and more promising solution (the *national regulators* route) would be to introduce, at the national level, a simple notification mechanism of the LTCs themselves, such as the one foreseen for merchant transmission investments.[15] Thanks to their continuous interaction with market participants, national regulators have a unique understanding of their national gas market and of its equilibrium. A good advantage of the "national regulators route" would indeed be to place national regulators at the centre of the game. It is worth recalling that in its first reading of the second gas Directive, the European Parliament had already recommended that regulatory authorities be entrusted with the ability to call LTCs into question. Member States could provide that their regulatory authority would submit its opinion on the notification to the competent authority, for the purposes of the formal decision. Informal discussions between the national regulator and gas companies in the contract negotiation phase could take place if difficulties are anticipated. As national regulators would only be responsible for their own markets, regulatory costs would be manageable. In addition, a provision stating that, without a formal decision by the national regulator after a certain period of time (e.g. 1 month), a positive decision would be deemed to be adopted, could be introduced. This would allow national regulators to focus administrative resources on the potentially most harmful LTCs. The national regulator could be given the option to extend the assessment period up to e.g. 3 months.

The two main challenges with the national regulators route are (i) to avoid an unnecessary burden on firms and (ii) make sure that regional and EU interests are taken into account.

(i) Given the differences between hub-based Western markets and isolated Eastern markets, the problem of red tape should be taken seriously. A way to solve the issue would be to define *ex ante* contracts, which have to be notified. It should be done at EU level. A simple criterion, which would encompass both the security of supply and competition issues, would be to define a market share threshold. Indeed, security of supply and most competition issues emerge when too high a part of the demand is serviced by a single contract or supplier. This criterion has the advantage of being easy to administer.

(ii) In order to make sure that both regional/EU interests are well accounted for and potential regulatory capture at national level is mitigated, an obligation modelled on Art 36(8) and (9) of the Gas Directive to request a binding opinion from ACER or the Commission should be introduced. ACER or the Commission could then require the national regulator to amend or withdraw its decision. To accelerate the procedure, LTCs received by national regulators could be sent immediately to ACER and the Commission. ACER or the Commission would have 1 month to adopt a binding opinion, with the possibility for extension, after the national regulator has adopted its preliminary decision. If the Commission is vested with that role, cooperation between DG Comp and DG Energy should be ensured.

5.3 The Euratom route

A third solution (the *Euratom* route) is to give a more central role to the Commission or ACER.

The first option along this line of thought would consider the introduction of a common purchasing mechanism (CPM) where ACER or the Commission would have an exclusive right to negotiate or conclude supply contracts.[16] Lighter and voluntary versions of such mechanisms are currently being discussed for emergency situations, following the usual 'reactive' approach described above. The idea of structuring a common purchasing scheme (aimed at regaining leverage on foreign gas suppliers) has been discussed for a long time but has lost momentum recently with the development of more competitive and integrated markets in Western Europe. This trend is clear from the recent communication of the Commission on the Energy Union.

On the positive side, wider EU/regional interests would be better taken into account and issues concerning both security of supply and competition could be tackled together. On the negative side, it would create worryingly high regulatory costs as well as a host of fairly complicated EU and WTO law issues.

Even more problematic, it would dramatically increase red tape for gas companies. Downstream competition would still need to be organised, probably through auctions. Overall, this first

15. Art 36 of the third gas Directive organises a mechanism where national regulators can grant derogations from certain provisions of the Directive, in particular third-party access, to private investors in gas infrastructure, provided that certain criteria are met. In particular, such profit-motivated investment should strengthen both competition and the security of gas supply.

16. To introduce flexibility, the Gas SoS Regulation could include an opt-in mechanism in this regard where only willing Member States would participate in the scheme.

Options		Costs		Benefits		
		Regulatory	Red tape	Ability to tackle both SoS and competition issues	EU/Regional interests	Tailor decisions
The *competition law* route	*Ex ante* notification	--	-	-	++	++
	Soft law guidelines	+++	++	--	-	---
	Block exemption regulation	+++	++	--	-	---
The *Euratom* route	'CPM'	-----	----	++	+++	++
	Ex ante Notification	--	-	++	+++	++
The *national regulators* route	*Ex ante* Notification + EU binding opinion	---	-	++	+++	+++

option, though interesting in theory, appears to overkill the problem at hand.

A second option would be to implement a notification scheme inspired by the revision in 1960 and 1975 of the Regulation on the Euratom Supply Agency (ESA), where ESA is not involved in commercial negotiations, but still assess contracts, after notification and within 10 days, against the principles of the common supply policy.[17] In essence, this second option is similar to the *national regulator* route discussed above, except for the fact that the national step is no longer included.

5.4 Conclusions

A qualitative assessment of the different routes is provided in the table above.

The *competition law* route is not able to solve the problem on its own. However, enactment of soft law guidelines could be used to complement a notification mechanism. Indeed, the different routes can be seen as complementary rather than as substitutes. The Euratom (option 1 – CPM) route should not be introduced in view of the costs incurred. Contrary to this, a simple notification mechanism should be introduced if it is well devised.

We favour the *national regulators* route over the *Euratom* (option 2) route, at least in the short to medium term. Indeed, national regulators are best placed to simultaneously assess both security of gas supply and competition[18] issues in their own markets, as it is something they are accustomed to, and not just when they assess notification of merchant infrastructure projects.

Regulators are also used to cooperating with each other in different fora. Having a binding opinion from an EU body would allow for regional and European interests to be sufficiently taken into account, as well as addressing risks of national regulatory capture. We also believe that it would be more feasible from a political point of view. As long as the Commission is at the centre of the EU architecture on gas security of supply and ACER is short on internal resources, the EU opinion should be a competence of the Commission. In the longer term, we believe that ACER, being the recipient of REMIT data, should be given a more central role.

Last but not least, we think that the assessment conducted by the national regulators and the Commission should be structured in such a way as to limit the likelihood of regulatory errors. As we have seen in section 2 above, LTCs have ambiguous effects on competition and security of supply, making it all the more difficult to assess their potential effects. We believe that the competition assessment should follow dedicated soft law guidelines enacted in this regard by the Commission and focus on the potentially most harmful infringements, such as territorial restrictions. The security of supply assessment should be limited to potential breaches or impediments to the effective implementation of the revised Gas SoS Regulation. The latter could therefore be amended with such assessment in mind.

17. ESA is also party to the contract. We note that Euratom has an exclusive competence as regards EU supply policy in this field.
18. It is worth mentioning that they have often been involved in competition proceedings.

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