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COMMISSION OPINION

of 25.7.2018

**pursuant to Article 3(1) of Regulation (EC) No 715/2009 and Article 10(6) of
Directive 2009/73/EC – Latvia – Certification of JSC Conexus Baltic Grid**

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I. PROCEDURE

On 30 May 2018, the Commission received a notification from the Latvian national regulatory authority for energy, Public Utilities Commission (hereafter, "PUC"), in accordance with Article 10(6) of Directive 2009/73/EC¹ (hereafter, "Gas Directive"), on a draft decision concerning the certification of "JSC Conexus Baltic Grid" (hereafter, "Conexus") as a transmission system operator ("TSO") for gas.

Pursuant to Article 3(1) of Regulation (EC) No 715/2009² (hereafter, the "Gas Regulation") the Commission is required to examine the notified draft decision and deliver an opinion to the relevant national regulatory authority as to its compatibility with Article 10(2) and Article 9 of the Gas Directive.

II. DESCRIPTION OF THE NOTIFIED DECISION

Conexus operates the Latvian gas transmission system and the underground gas storage Inčukalns. The company was set up in December 2016, when the vertically integrated gas undertaking JSC "Latvijas Gāze" was reorganised into two separate structural units.

Conexus is currently owned by JSC Augstsprieguma tīkls³ (hereafter "AST") (34.36%), JSC Gazprom (hereafter "Gazprom") (34.10%), Marguerite Gas I S.a r.l., a specialised investment fund indirectly controlled by Marguerite Fund (hereafter "Marguerite") (29.06%) and other shareholders (2.48%).

Conexus has applied for certification in accordance with the ownership unbundling model.

In its draft decision, PUC has examined whether Conexus fulfils the requirements of ownership unbundling pursuant to Article 9 Gas Directive. Further to this assessment, PUC has decided to certify Conexus subject to the following conditions:

- to ensure that beginning from 1 April 2019 the person which controls the energy supply company engaged in natural gas trade has no opportunity to directly or indirectly control JSC "Conexus Baltic Grid" and ensure that on 1 April 2019 JSC "Conexus Baltic Grid" fully complies with the independence requirements of the combined natural gas transmission and storage system operator laid down in Article 111(3)(1) and (2) of the Energy Law;

¹ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, OJ L 211/94 of 14.8.2009.

² Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, OJ L 211/36 of 14.8.2009.

³ JSC "Augstsprieguma tīkls" is the operator of the electricity transmission system in Latvia and is owned to 100% by the Latvian State.

- to ensure that beginning from 1 April 2019, the direct or indirect operation of JSC “Conexus Baltic Grid” by financial institutions and companies established for a special purpose does not create any conflict of interests between JSC “Conexus Baltic Grid” and the energy supply company engaged in natural gas or electricity production or trade and ensure that on 1 April 2009 JSC “Conexus Baltic Grid” fully complies with the independence requirements of the combined natural gas transmission and storage system operator laid down in Article 111(3)(1), (2) and (3) of the Energy Law;
- to obligate JSC “Conexus Baltic Grid” from the day this decision is adopted to inform the Regulator every two months about the process of implementation of the conditions included in paragraph one of the resolute part of this decision and the activities planned in the future by submitting a written report and the substantiating documents thereof.

III. COMMENTS

On the basis of the information contained in the draft certification decision, as notified on 30 May 2018, the Commission has the following comments.

1. Preliminary remarks

Article 9(1)(b)(i) of the Gas Directive prohibits the same person or persons to directly or indirectly exercise control over an undertaking performing any of the functions of production or supply, and directly or indirectly exercising control or exercising any right over a TSO or over a transmission system. Article 9(1)(b)(ii) of the Gas Directive prohibits the same person or persons from directly or indirectly exercising control over a TSO or over a transmission system, and directly or indirectly exercise control or exercise any right over an undertaking performing any of the functions of production or supply.

Article 9(1)(c) Gas Directive prohibits the same person or persons to appoint members of the supervisory board, the administrative board, or bodies legally representing the undertaking, of a TSO or a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of production or supply.

Article 9(1)(d) Gas Directive prohibits the same person from simultaneously being board member of a TSO and of an undertaking performing any of the functions of production or supply.

The above provisions are transposed into Latvian law by Article 111 of the Latvian Energy Law.

The Commission takes note of the fact that Article 111(5) of the Latvian Energy Law provides for a special derogation from the ownership unbundling requirements for "financial institutions and companies established for a special purpose", provided that i) they are supervised by "a competent financial and capital market surveillance institution of the Republic of Latvia, another European Union member state, a member state of the European Economic Area or a member state of the Organisation for Economic Co-operation and Development" and ii) their activities do not create any conflict of interests.

The Commission notes that such derogation is not expressly envisaged in the Gas Directive and that the provision in question must be interpreted in a manner that is compatible with the applicable Union legislation. In particular, the analysis of a potential conflict of interest should be carried out in accordance with the Commission Staff Working Document of 8 May

2013 on the Commission's practice in assessing the presence of conflict of interest including in case of financial investors ("Staff Working Dokument").⁴

According to Article 9.4 of Conexus' Articles of Association, shareholders which fall under the prohibition "to simultaneously exercise direct or indirect control in both the Company and joint stock company "Latvijas Gāze", or any other undertaking performing any of the functions of production or supply of natural gas" shall not attend the shareholders' meeting and shall not exercise any other shareholder's rights, including voting rights, save for the right to receive dividends and liquidation quota.

As a preliminary remark, the Commission notes that the draft decision does not contain an analysis of the extent to which the respective shareholders of Conexus may have *control* (e.g. joint control) over Conexus or over Latvijas Gāze (or any other undertakings active in the production or supply of gas, or the generation or supply of electricity). Such an analysis is required to determine whether the ownership unbundling requirements are applicable to a given shareholder in Conexus. The Commission therefore considers it necessary that PUC carries out and includes this analysis in its final decision.

2. Assessment of the respective compliance of Conexus' shareholders

a) AST

As regards the shareholding of AST, the draft decision concludes that it is compatible with the requirements of ownership unbundling. The Commission agrees with this assessment, noting that AST was certified as a transmission system operator under the ownership unbundling model by decision⁵ of PUC dated 30 January 2013.

b) Gazprom

In the draft decision, it is noted that Gazprom holds 34.10% of the shares in Conexus. PUC further notes that this participation would be incompatible with the ownership unbundling requirements as a result of Gazprom's participation of 34% in Latvijas Gāze and the fact that Gazprom "supplied at least 80% of the volume of the Latvian natural gas market in 2017 and the first quarter of 2018".

The Commission understands that, as a result of this incompatibility, Conexus and Gazprom considered Article 9.4 of Conexus' Articles of Association to be applicable to Gazprom, meaning that Gazprom would not be able to exercise shareholders' rights other than the right to receive dividends. In line with this interpretation, it is understood that Gazprom has not appointed any members of the Council of Conexus.

The Commission notes that according to Article 9 (1) Gas Directive, undertakings that have controlling interests in the production or supply of gas, or the generation or supply of electricity can retain participations in transmission system operators if such participations do not amount to "any rights" in the meaning of Article 9(2) Gas Directive, i.e. passive non-majority participations without voting rights or rights to appoint board members.

Whereas the limitations imposed by Article 9.4 of Conexus' Articles of Association would mean that Gazprom's non-majority share in Conexus would remain below the threshold of "any rights", the Commission takes note of PUC's view that such limitations are not legally

⁴ SWD(2013) 177 final.

⁵ Cf. also the Commission's opinion on the draft certification decision of 3 December 2012 (C(2012)9108 final).

valid due to the incompatibility with Latvian commercial law (notably Article 227 thereof⁶) and would thus only amount to a voluntary commitment by Gazprom. A non-binding commitment of a shareholder not to exercise voting rights or the right to appoint board members is not sufficient to fulfil the requirements of structural separation set out in Article 9 Gas Directive.

In view of the above, the Commission agrees with the conclusion of PUC that, absent sufficient clarity that conflicts of interest as described in Article 9 of the Gas Directive are excluded by binding legal rules, Gazprom's participation in Conexus cannot be considered compatible with the requirements of Article 9 Gas Directive.

c) Marguerite

Marguerite holds a participation of 29.06% in Conexus and a participation of 28.97% in Latvijas Gāze. The Commission is of the view that the draft decision does not contain a structured analysis as to the compatibility of Marguerite's participation in Conexus with the requirements of ownership unbundling.

As noted above, the Commission considers that PUC should analyse in its final decision whether Marguerite exercises at least joint control over Conexus or Latvijas Gāze, in order to establish whether the requirements of Article 9(1)(b)(i) and (ii) Gas Directive are infringed.

However, the Commission also notes that, according to the Articles of Association of Conexus and Latvijas Gāze, Marguerite is entitled to appoint members to the Council of both companies, which is incompatible with the requirements of Article 9(1)(c) Gas Directive (no appointment of board members).

In the draft decision, PUC considers the special derogation for financial investors pursuant to Article 111(5) of the Latvian Energy Law to be inapplicable to Marguerite. According to PUC the derogation cannot apply since Marguerite is not only shareholder in Conexus, the Latvian transmission grid, but also in the Latvian gas supply company Latvijas Gāze.

The Commission agrees with this assessment and considers it to be in line with the above-mentioned Commission Staff Working Document of 8 May 2013. Latvijas Gāze used to be the vertically integrated national incumbent gas company with monopoly rights for the supply of natural gas, and today still holds large market share in Latvia. Marguerite's shareholdings therefore concern two companies which are active in the same country, with manifold links between the activities of both companies. As PUC notes, Marguerite has a financial interest in maximising the profits of Latvijas Gāze. In the present case, it can therefore not be excluded that Marguerite may have an incentive and may have the ability as a shareholder of Conexus to use its influence to the benefit of Latvijas Gāze and to the detriment of other network users, for instance through its influence resulting from the right to appoint board members⁷.

The Commission notes that the question whether Article 9.4 of Conexus' *Articles of Association* (limitation of shareholder rights) may be applicable to Marguerite's participation can be left open in this case, given the doubts as to its validity under Latvian commercial law identified by PUC (see above, section III(2)(b)).

⁶ "Section 227. Categories of Stock

(1) Different rights may be fixed in stock in respect to: 1) receiving dividends; 2) receiving a liquidation quota; 3) voting rights at a meeting of stockholders.

(2) Stock in which an equal amount of rights are fixed is stock of one category. If the company has several categories of stock, each category of stock shall be given a different designation."

⁷ See for examples where a conflict of interest could be excluded absent an incentive or the ability to exercise influence to the own benefit (e.g. in case of ownership of companies operating in two remote and unconnected regions) the Commission's Staff Working Document, notably pages 5-9.

In view of the above, the Commission agrees with the conclusion of PUC that Marguerite's participation in Conexus is not compatible with the requirements of Article 9 Gas Directive.

IV. CONCLUSION

Pursuant to Article 3(2) Gas Regulation, PUC shall take utmost account of the above comments of the Commission when taking its final decision regarding the certification of Conexus, and when it does so, shall communicate this decision to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take vis-a-vis national regulatory authorities on any other notified draft measures concerning certification or vis-a-vis national authorities responsible for the transposition of EU legislation as regards the compatibility of any national implementing measure with EU law.

The Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. PUC is invited to inform the Commission within five working days following receipt whether it considers that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which it wishes to have deleted prior to such publication. Reasons should be given for any such request.

Done at Brussels, 25.7.2018

*For the Commission
Miguel ARIAS CAÑETE
Member of the Commission*