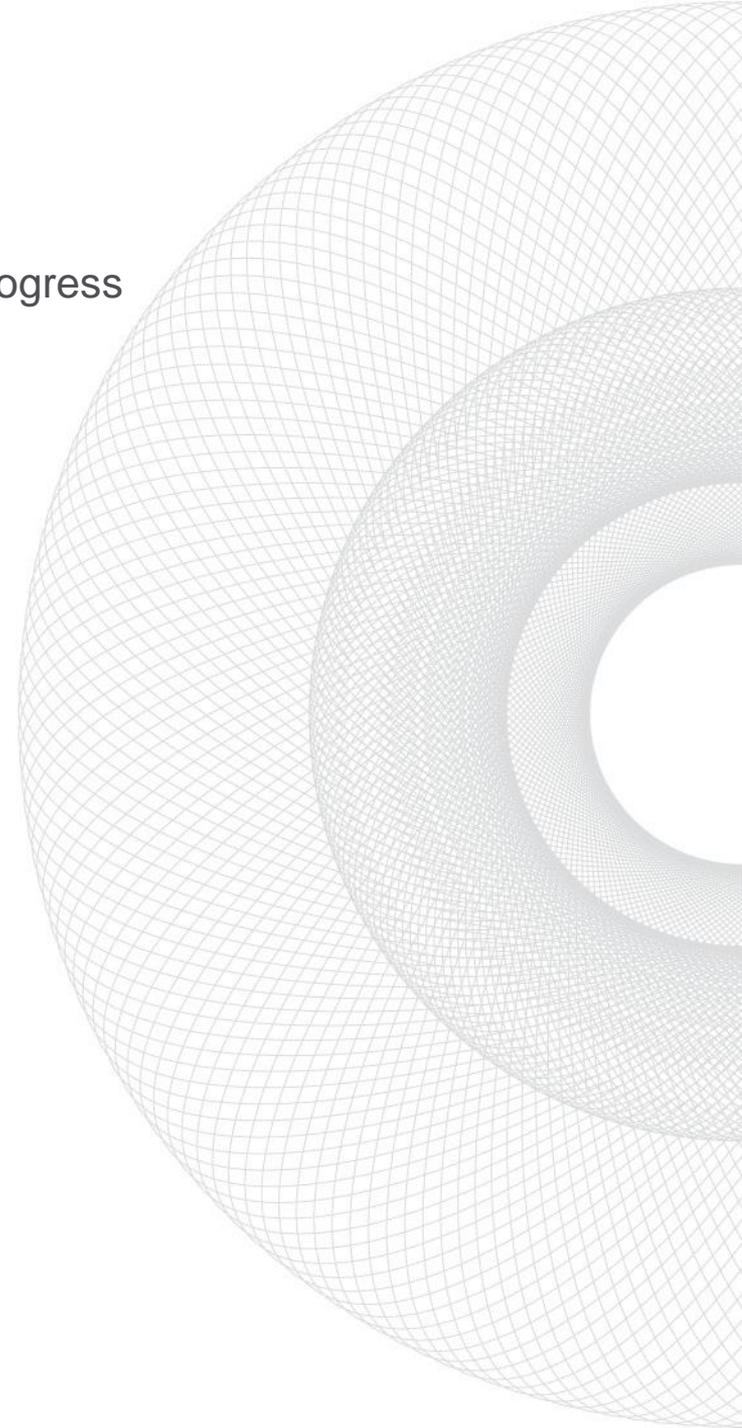


Energy Law Update

Communication from the European Commission on the progress towards completing the internal energy market

KINSTELLAR

October 2014



Preface



Communication from the European Commission on the progress towards completing the internal energy market

Kinstellar's Energy Law Update provides a timely overview of recent developments in energy policy and energy market regulation in Central, Eastern and Southern Europe, Turkey and Central Asia.

In addition to regulatory updates, reports on market and legislative developments, our Energy Law Update also presents our experts' views gained from their deep knowledge of the energy markets in Emerging Europe and Central Asia. As such, it has an element of subjectivity – which we hope will make it interesting for our readers.

If you have any questions or comments regarding this newsletter, please do not hesitate to contact us.

This newsletter provides concise information on certain topics. Its content is not necessarily exhaustive and should not be considered as legal advice. If you have any questions in relation to the content of this newsletter, please feel free to contact us and we will be more than happy to assist you.

The European Commission (the “**Commission**”) issued a report package on 13 October 2014 regarding progress on the development of the internal energy market, consisting of the following documents:

- Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the progress towards completing the Internal Energy Market (the “Progress Communication”);
- Commission Staff Working Documents on various subjects, including in particular: Investment Projects in Energy Infrastructure, Enforcement of the Third Internal Energy Market Package and Report on the ITO Model; and
- An interim report on subsidies and costs of energy in the European Union (“**EU**”).

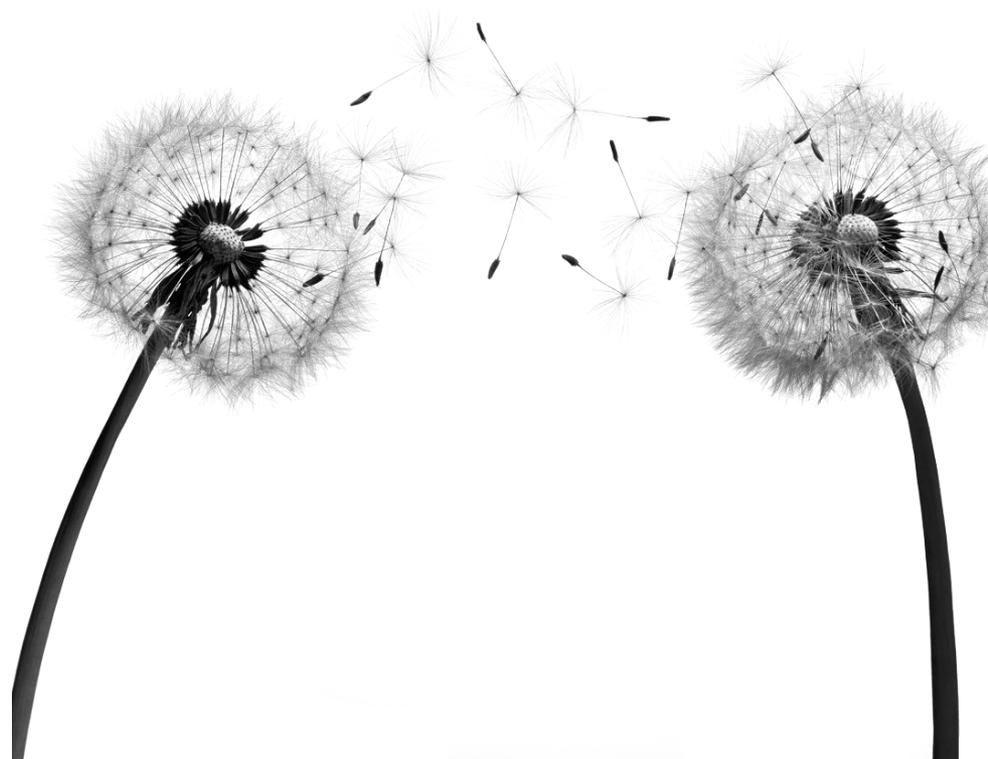
In this issue of the Kinstellar Energy Law Update we briefly highlight some of the progress report package statements we believe are of importance from a legal point of view to energy market stakeholders operating in Europe.

Context of the Progress Report Package

The original target date of end of 2014 to realise the EU internal energy market comes from the European Council's Conclusions of 4 February 2011. This date has since been repeated in other non-legislative acts. However, the Commission had already stated in its November 2012 Communication that the completion of the internal energy market by 2014 may no longer be realistic.

In the Progress Communication, the Commission expressly acknowledges that the internal energy market will not be completed by the end of this year. Nevertheless, the Commission makes it clear that completion of the internal energy market is necessary for the European economy and customers. Therefore, in addition to mentioning progress that has been made in the last few years, the Commission provides its view on further steps needed for the timely completion of the cross-border energy market.

The timing of the Progress Communication is noteworthy: the European Council will hold its decisive meeting on 23/24 October 2014, at which time it is expected to form its final position on the new EU climate and energy policy framework for the 2020 – 2030 period.



Approach for development

According to the Commission's approach as explained in the Progress Communication, integration and functioning of the internal energy market will have to be achieved by taking further steps in two main areas: the "hardware", being the energy network infrastructure, and the "software", being the EU-wide energy market rules

Hardware: Energy infrastructure

Although significant progress has been made in this area throughout Europe, the heading used by the Commission in the Progress Communication – "Additional infrastructure needs to be built urgently" – describes well its view in this respect. In both the natural gas and electricity sectors, the main purpose of building new infrastructure must be the linking of isolated areas to mainstream European energy infrastructure.

In the gas sector, specific focus must be put on the diversification of natural gas supply in Central and Southern Europe. One continuing challenge in the electricity sector is the smartening of the grids, in particular at the distribution level. The most significant challenges hindering infrastructure development remain access to finance and a stable and predictable regulatory framework, which can be achieved primarily by common EU-wide network codes. In addition, existing infrastructure, in particular LNG terminals and natural gas storage facilities, must be used more efficiently.

Software: EU-wide energy market rules

The adoption of EU-wide network codes remains a focal point for harmonising the legal framework at the European level, the next priority area being tariffs composition. In addition, clear data management processes are needed to ensure customers' privacy, security and non-discriminatory access to metering data.

The regulatory framework needs to accommodate all other aspects of the way in which electricity will be produced, transmitted and consumed in the future. Once harmonization work is done, attention will have to be redirected to proper implementation.



Hardware – Gaps between demand and supply

The Commission has carried out a cross-sector analysis in order to identify gaps between investment needs and planned investments in energy infrastructure in four core sectors: electricity, natural gas, oil and biofuels.

According to the Commission's findings, most investments are carried out in the electricity sector and improvements will be necessary to build further cross-border infrastructure.

The focus of gas infrastructure development should be on connecting isolated areas to promote security of supply and diversification, as well as preparing gas infrastructure for power generation as a means of complementing renewables.

Due to decreasing demand in refined products and overcapacities, no significant investment should be expected in the coming future in the oil sector.

Investments in biofuel production infrastructure are foreseen until 2025 to comply with the 10% increase in bioethanol and biodiesel use in the transport sector provided for in the Renewable Energy Directive.



Software

Status of Implementation of Third Energy Package

Although the deadline to implement the Third Energy Package setting out the legal framework for the creation of the internal energy market was 3 March 2011, most Member States only implemented it after the Commission had initiated infringement procedures.

Though some of these procedures are still pending, the Commission will focus on reviewing the proper implementation of the Third Energy Package by Member States, in particular the provisions relating to:

- Unbundling;
- Independence, powers and duties of national regulatory authorities; and
- Consumer protection.

Unbundling developments

According to the Commission, the ITO model generally seems to be an adequate instrument to achieve its goal, i.e. separating operation of infrastructure from generation and supply activities. Nevertheless, learning from previous experience in the application of the ITO rules across Europe may result in further refinements in certain areas:

- changes in independence requirements of supervisory body members so that not only a minority of members are subject to them;
- improving the effectiveness of compliance programmes by specifying their scope in more detail;
- developing a common guidance and establishing a network of compliance officers for a better and more unified application of the law;
- harmonising timeframes for network development plans at national and European levels.

The Commission will continue monitoring the application of the ITO rules and their compliance with EU competition rules.

Public intervention – Capacity mechanisms

As provided for in previous guidelines of the Commission, national measures will be compatible with the internal energy market only in exceptional circumstances. With respect to capacity mechanisms, national measures may be justified as compatible with the internal energy market if:

- they are not limited to national borders, i.e. capacity mechanisms are available to other Member States; and
- demand side solutions are taken into account to the same extent as generation solutions.

The Commission is carrying out studies on the development of a European generation and system adequacy assessment, which will provide adequacy standards for the effective functioning of the internal energy market.





Thank you and contact us

If you have any questions or comments regarding Kinstellar's Energy Law Update, please do not hesitate to contact us. We are at your disposal if you and/or your clients would like to discuss any element of our Energy Law Update.

Dr. Kristóf Ferenczi

Partner, Firm-wide Head of Energy

T: + 36 1 428 4471

E: kristof.ferenczi@kinstellar.com

Dr. Zsolt Csanádi

Managing Associate

T: +36 1 428 4413

E: zsolt.csanadi@kinstellar.com

We would be pleased to provide you with further information about any of our offices, lawyers, practice areas or expertise. All contact information is available on: www.kinstellar.com

KINSTELLAR