EUROPEAN
COMMISSION

Brussels, 16.2.2016
COM(2016) 54 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

on the application of the Decision 994/2012/EU establishing an information exchange mechanism on intergovernmental agreements between Member States and third countries in the field of energy

1. Introduction

Article 8 of Decision 994/2012/EU (the IGA Decision)[1] includes an obligation on the Commission to submit to the European Parliament, the Council and the European Economic and Social Committee a report on the application of this Decision. The current report serves to fulfil this obligation and it is based on the results of the evaluation report annexed to the Impact Assessment on the revision of the IGA Decision. This revision is foreseen by the European Energy Security Strategy of May 2014[2] and by the Energy Union Strategy of February 2015[3], which highlight the need for full compliance with EU law of national agreements with third countries in the field of energy. In the same spirit, the European Council in its conclusions of 19 March 2015 also called for "full compliance with EU law of all agreements related to the buying of gas from external suppliers, notably by reinforcing transparency of such agreements and compatibility with EU energy security provisions".

Negotiations with energy suppliers in third countries frequently require political and legal support in the form of the conclusion of intergovernmental agreements (IGAs). IGAs are usually negotiated bilaterally and are often the basis for more detailed commercial contracts. Compliance with some provisions of EU internal energy market legislation and competition law is not always in the commercial interest of third country energy suppliers. Therefore, Member States can come under pressure to include regulatory concessions in their IGAs with third countries. Such concessions can threaten the smooth operation and proper functioning of the EU internal energy market.

To address this challenge as well as to ensure consistency in the energy relations with key third countries, on 4 February 2011 the European Council invited Member States to inform the Commission, from 1 January 2012 onwards, of all their new and existing bilateral energy agreements with third countries.[4] The adoption of Decision 994/2012/EU of 25 October 2012 (the IGA Decision) addressed this request by setting up a mechanism for this exchange of information.

The IGA Decision defines IGAs as "legally binding agreements between one or more MS and one or more third countries having an impact on the operation or the functioning of the internal energy market or on the security of supply in the Union". In this respect, only IGAs concerning matters within the purview of the Euratom Treaty are excluded.[5]

This report on the application of the IGA Decision, in compliance with Article 8 of the Decision, assesses in particular:

- The extent to which the IGA Decision promotes compliance of IGAs with EU law and promotes a high level of coordination between Member States with regard to IGAs;
- The impact the IGA Decision has on Member States' negotiations with third countries;
- The extent to which the scope of the IGA Decision and the procedures it lays down are appropriate.

[1] Decision No 994/2012/EU of the European Parliament and of the Council of 25 October 2012 establishing an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy, OJ L 299, 27.10.2012, p. 13–17.
[2] COM(2014) 330 final
[3] COM(2015) 80 final
[4] This conclusion was confirmed by the Energy Council of 28th February 2011: "Improved and timely exchange of information between the Commission and Member States including Member States information to Commission on their new and existing bilateral energy agreements with third countries".
[5] For these IGAs, Article 103 of Euratom provides for a specific ex-ante procedure.

The current report covers the application of the IGA Decision since its entry into force on 17 November 2012 and its impact on IGAs notified both before and after that date. This report follows the criteria enshrined in the Better Regulation Guidelines, namely: effectiveness, efficiency, coherence, relevance and EU added value. It also assesses whether the current framework set up by the IGA Decision could be simplified.

2. Assessment

Since the adoption of the IGA Decision, 124 IGAs have been notified by Member States to the Commission. As far as it is possible to assess, Member States have complied with their notification obligations. However, there are non-legally-binding agreements[6], either according to the definition set out in Article 2 of the IGA Decision or in the sense of public international law, for which there is no notification obligation under the current IGA Decision. Nevertheless such agreements can go into great detail as regards the legal and technical specificities of the issue at stake (e.g. on energy infrastructure projects).

Among the 124 notified IGAs:

- Around 60% covered general energy cooperation (mainly bilateral energy cooperation between EU Member States and a wide range of third countries, including e.g. Cuba, Vietnam, Singapore, Korea, India or China). None of these IGAs raised concerns and none have therefore been followed up by the Commission;
- Around 40% concerned either agreements on the supply, import or transit of energy products (oil, gas or electricity) or the setting of rules for the exploitation of gas or oil fields; bilateral or multilateral agreements for the development of energy-related infrastructure, with the great majority being oil and gas pipelines.

After analysing the notified IGAs in the last category, the Commission expressed doubts on the compatibility with EU law for 17 of them. The EU law in question mainly concerned either Third Energy Package provisions (e.g.: unbundling, third party access and tariff setting, including the independence of the national regulator) or EU competition law (prohibition of market segmentation by means of destination clauses).

Therefore, around one third of the notified IGAs related to energy supplies or energy infrastructure has been judged of concern. Letters were sent in 2013 to the 9 Member States concerned by their IGAs, inviting them to amend or terminate the IGAs in question in order to resolve the identified incompatibilities.

2.1 Effectiveness

To date, no Member State has managed to terminate or renegotiate the non-compliant IGAs.[7] This is notably due to the complex legal situation that arises once IGAs are signed with a third country. Specifically, once a Member State has concluded an IGA which is binding under public international law and which does not contain a termination or suspension clause, it is - in legal terms - almost impossible for the Member State concerned to terminate the IGA within a short period of time and before the end of the initial duration of the IGA without the

[6] Such as memoranda of understanding, letters of intent, or political declarations.

[7] It should be noted that in some cases the IGA ceased to apply because the initial duration of the IGA has expired in the meanwhile or because a specific condition set out in the IGA was not fulfilled in time.

agreement of the third country. The same applies as regards the renegotiation of an IGA, for which the consent of the third country is required. This in turn considerably limits the enforcement powers of the Commission, even if an infringement process was to be launched.

As regards IGAs signed after the entry into force of the IGA Decision, only one IGA has been notified to the Commission. It is therefore not possible at this stage to draw any general conclusions as to the effectiveness of the IGA decision in ensuring the compatibility with EU law of IGAs adopted after 2012.

Since the adoption of the IGA Decision, the Commission has not been notified of any IGA negotiations by Member States. However, it is clear that Member States have had contacts with third countries about infrastructure and related commodity supply. In this regard, the Commission is not in a position to assess the extent to which Member States and third countries have entered into political commitments (e.g. in the form of memoranda of understanding, exchanges of notes or letters of intent).

On the basis of the above, the provisions of the current IGA Decision have not resulted in the transformation of concluded non-compliant IGAs into compliant ones. This is notably due to the ex-post nature of the compatibility check set out by the IGA Decision. The provisions of the current IGA Decision have not directly impacted Member States' negotiations with third countries, either. Therefore, the IGA Decision in its present form is not considered effective.

2.2 Efficiency

It is impossible to assess empirically or even to model the costs imposed by the current IGA Decision. However, the *ex-post* nature of the compatibility check of IGAs with EU law entails a number of qualitative considerations.

For compliant IGAs and IGAs concerning general bilateral energy cooperation that engage no aspect of EU law, the IGA Decision does not entail direct costs for Member States, apart from the administrative costs linked to the notification of IGAs under the current information exchange mechanism. These administrative costs are very limited, as IGAs can be uploaded electronically and there are no translation requirements for the Member States.

On the other hand, additional direct and indirect costs result from an IGA being assessed *ex-post* as incompatible with EU law. These costs include direct costs relevant to public authorities, such as administrative costs (i) for the Commission related to internal decision making and communicating with the Member State(s) concerned, and (ii) for both Member State(s) and the Commission in the event of follow-up action by the Commission such as structured dialogue with the Member States or infringement procedures. Furthermore, Member States can bear litigation costs in the case of IGAs with no termination clauses, as the third country can request compensation in front of an international arbitration court for the non-application of the given IGA.

In addition, indirect costs relevant to national authorities and to undertakings involved in infrastructure projects can arise. These are related to the cancellation, suspension or delay of infrastructure projects for which the legal framework is *ex-post* assessed as being incompatible, once the physical infrastructure has already been partly developed and/or costs have been incurred.

With regard to the benefits provided by the current system to date, these could be expected to stem from an increased level of IGA compliance with EU law, resulting from an expectation on the part of those entering into it or it later being subject to *ex-post* assessment. The economic benefits of compliant IGAs are related to:

- Increased legal certainty, which favors investment. This is particularly true for infrastructure-related IGAs that are intended to provide legal and regulatory certainty for projects involving high levels of investment. This increased legal certainty is particularly important where several bilateral IGAs cover one transit agreement/infrastructure project;
- A well-functioning internal energy market, without segmentation at a national level and with increased competition;
- Increased transparency as regards the security of supply situation in all Member States, which in turn can avoid redundant investments and/or infrastructure gaps;
- Increased cooperation between Member States and between Member States and the Commission, which can help the EU to deliver a single, consistent message to third countries and therefore enhance the EU's bargaining power in energy negotiations.

In conclusion, the IGA Decision can be considered reasonably efficient. Overall, the costs associated with the current IGA Decision are justified by the relative benefits it provides as it safeguards the functioning and integrity of the internal energy market and contributes to security of supply. However, the IGA Decision could be more efficient if the compatibility check it establishes were done ex-ante. This would considerably enhance legal certainty and avoid costs for both Member States and the Commission.

2.3 Coherence

The IGA Decision is coherent with a number of measures adopted at EU level to improve the functioning of the EU energy market and to increase the EU's energy security. It was developed in 2012 and complements the Security of Gas Supply Regulation adopted in 2010[8]. Moreover, the review of the current IGA Decision is part of the Energy Union deliverables. One of the five mutually reinforcing dimensions of the Energy Union - energy security, solidarity and trust – also underlines the importance of the objectives pursued by IGA Decision.

Overall, the IGA Decision is fully coherent with other initiatives under the Energy Union Framework Strategy that have similar objectives.

2.4 Relevance

Significant **infrastructure projects** continue to rely on public support in the form of IGAs that will need to be agreed or renewed in the coming years.

In the case of gas supplies, the share of piped gas in total imports from third countries reached 90% in 2014. The majority of the gas pipelines connecting the EU to its trading partners were commissioned between the late 1970s and the late 1990s. With regard to oil, 90% of EU crude

[8] Gas Security of Supply Regulation (EU) 994/2010, OJ L 295, 12.11.2010, p.1

oil imports are sea-borne and only 10% arrive via pipeline infrastructure[9], for which project developers might require an IGA. With regard to electricity, the share of EU net imports in gross electricity generation is less than 1% for the EU28[10]. Nonetheless, as in the case of crude oil, some isolated electricity systems in the EU (notably in the Baltic Member States) rely heavily on electricity imported via cables from third countries[11]. As with gas and oil, the relevant connecting infrastructure was constructed several decades ago. In summary, either a large share of a commodity at EU level (in the case of gas) or a critical share of a commodity for specific EU Member States (in the case of oil and electricity) is imported into the EU from third countries via physical interconnections.

The construction of infrastructure projects is based on complex contractual agreements between the project promoters, which are often underpinned by one or several agreements between the producing, transiting and receiving countries. Due to the long time span of many IGAs, their renewal and notification is subject to a cyclical effect. Therefore, the fact that the Commission has only been notified one IGA since 2012 does not imply that it will not be notified of new IGAs in future. In addition, it is not the number of notified IGAs that matters but the importance of the projects they underpin, and their compliance with EU law. With respect to the renewal of IGAs for older infrastructure, the initial construction-related risks may also by this point have been mitigated, meaning that it may be all the more important now to carry out an assessment of the IGA's compliance with EU law.

EU import dependency is expected to remain stable or increase over the next two decades[12] (for fuels, technology and other materials). Although only a limited number of new energy corridors are expected to be developed in the coming years, the potential new infrastructure involved in each of them could have an impact on the entire European energy market. It is therefore essential that IGAs related to such infrastructure be compatible with EU law and with the EU's diversification policy. Moreover, for new infrastructure projects, the number of issues typically referred to in IGAs is increasing. As energy routes increase in length, the number, legal hierarchy and complexity of IGAs also increases[13]. For fuels, liability is a major issue that can only be dealt with by governments and nearly all network connections are subject to bilateral or multilateral IGAs. In the context of this growing complexity, IGAs remain relevant, particularly as regards any potential new energy project development carried out in the context of the EU's energy diversification policy.

With regard to **IGAs related to the purchase of energy commodities**, the way in which those commodities are imported into the EU internal market has changed over the last decade. For gas in particular, the preferred means of price setting has shifted from long term oil indexed contracts to a market based mechanism, i.e. hub pricing. However, the general shift towards gas market-based pricing mechanisms conceals the disparities that exist between individual EU Member States. Whereas the situation in Member States in Central and Northwestern Europe mirrors the general trend, other regions of the EU – such as Baltics and Southeast Europe - have not yet experienced the switch to hub-based pricing.

9 A number of the refineries in the Baltics and Central Europe rely to various degrees on the Druzhba pipeline connecting those regions with production fields in the Russian Federation.
10 Source: annual data from ESTAT
11 For instance, Croatia, Lithuania and Latvia import more than 20% of their electricity.
12 https://ec.europa.eu/energy/sites/ener/files/documents/trends_to_2050_update_2013.pdf , p.49. For more information, see Impact Assessment on the Revision of the IGA Decision p. 43.
13 For instance, a network connection from Baku to the EU under the aegis of the Southern Corridor initiative involves up to 20 different agreements, more than half of them being IGAs and "Host Government Agreements" (i.e. agreements between governments and companies).

On the basis of the above, the Commission's assessment is that IGAs will continue to play a key role in the EU's energy sector. The IGA Decision is thus still relevant but needs to be adapted to the changing nature of energy supplies and routes.

2.5 EU added value

In terms of energy security, the situation of Member States is very diverse. Europe's least vulnerable areas are those where supplies are available from a substantial number of different sources/routes and where there is a functioning and liquid wholesale market. The most vulnerable areas often suffer from a lack of infrastructure, needed both to enjoy a diverse supply base and to develop a functioning market. While liquid markets are found only in a limited number of countries, the demand of those countries covers some 80% of total EU gas needs.

This differentiated situation means that different EU Member States have different levels of bargaining power vis-à-vis third countries, and different levels of exposure to external pressure. The progressive integration of energy infrastructure and markets and the resulting common reliance on external suppliers imply that fundamental political decisions on energy taken by one Member State should be discussed with neighbouring countries. The same holds true for the external dimension of EU energy policy. The IGA Decision plays a crucial role in linking the external dimension of energy policy (as it relates to agreements with third countries) and the internal dimension (since provisions in IGAs that are not compliant with EU law have a negative impact on the functioning of the internal energy market).

Therefore, there is a clear EU-added value to the IGA Decision, as it reinforces cooperation and transparency at EU level and contributes to the functioning of the internal energy market and to security of supply.

2.6 Simplification

The current IGA Decision establishes a relatively simple information exchange mechanism. The main administrative burden for Member States relates to the notification process. IGAs can be uploaded electronically and there are no translations requirements for Member States. A clarification, rather than a simplification, could be envisaged. Article 3 of the current IGA Decision sets the deadline for submission of existing IGAs on 17 February 2013. As this does not apply anymore, it could be clarified that the deadline of nine months to carry out the *ex-post* assessment applies to all new IGAs concluded after the entry into force of the IGA Decision.

There is limited potential for simplification in the current IGA Decision. However a clarification could be introduced concerning the submission deadline for IGAs concluded after the entry into force of the IGA Decision.

3. Conclusions

This report is based on the experience gained by the Commission since the entry into force of the IGA Decision in 2012 and on the in-depth analysis of the 124 IGAs notified in this context. It fulfills the Commission's obligation to assess the IGA Decision as set out in Article 8 of that Decision.

The IGA Decision in its present form is not considered effective. The current provisions (and in particular the *ex-post* nature of the compatibility check) have not resulted in the transformation of non-compliant IGAs into compliant ones and have not directly impacted Member States' negotiations with third countries. In particular, no draft IGA has been submitted on a voluntary basis for an ex-ante check.

As regards **efficiency** and in particular the aspects of cost and cost/benefit, the IGA Decision is considered reasonably efficient. In particular, the costs associated with the current IGA Decision are justified by the benefits it provides as it safeguards the functioning of the internal energy market and contributes to security of supply. However, the IGA Decision could be more efficient if the compatibility check it establishes were done *ex-ante*. This would considerably enhance legal certainty and avoid significant costs.

The IGA Decision is **fully coherent** with other EU initiatives and legislative acts.

On **relevance**, IGAs will keep playing a key role in the EU's energy sector. The IGA Decision is therefore relevant but needs to adapt to the changing nature of energy supplies and routes.

There is a clear **EU-added value** to the IGA Decision, as it reinforces cooperation and transparency at EU level and contributes to security of supply and the functioning of the internal energy market.

Finally, as regards **simplification**, a clarification could be introduced concerning the submission deadline for IGAs concluded after the entry into force of the IGA Decision.

Overall, this report concludes that the procedures laid down by the current IGA Decision are not fully appropriate, with the main procedural issue in this regard being the *ex-post* nature of the compatibility check.