Energy Regulators' Joint Opinion on TAP AG's request for a prolongation of the validity period of the exemption decision

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1 Introduction

On 27 June 2014 the Italian, Greek and Albanian National Regulatory Authorities (namely, AEEGSI, RAE, ERE and collectively, "the Authorities") received a request by TAP AG for the prolongation of the validity period of the exemption decision granted by the Authorities and the Italian Ministry for the Economic Development in June 2013[1].

By means of the aforementioned decision (and its annex, the "Final Joint Opinion", hereinafter "FJO"), TAP AG was granted an exemption from certain provisions of Directive 2009/73/EC ("gas directive") regarding third party access ("TPA"), regulated tariffs and ownership unbundling for 25 years . Pursuant to

[1]The Authorities, with three separate acts (AEEG Deliberation 249/2013/R/GAS of the 6$^{\text{th}}$ of June 2013, RAE Decision n. 269/2013 of 12$^{\text{th}}$ June 2013 ERE Decision n. 64/13.06.2013) approved a common document, the Final Joint Opinion, and the relevant authorities granted the requested exemptions subject to a number of conditions listed in Part 4 of the document.

Section 4.10.2 of the FJO, the exemption decision shall lose its effect 3 years from its adoption in the event that construction of TAP has not yet started, and 6 years from its adoption in the event that the infrastructure has not become operational, (that is in 2019). However, according to the information provided by TAP AG to the Authorities, the pipeline is not expected to enter into operation before 1st January 2020.

Notwithstanding the above, Article 36(9) of Gas Directive 2009/73 equally allows for a prolongation of the validity of an exemption decision in case a delay in the construction and/or entry into operation of an infrastructure is due to major obstacles beyond the control of the person to whom the exemption has been granted (that is, in the present case TAP AG).

In light of the above, the Authorities have therefore assessed whether the prolongation request can be satisfied.

2 Background

As recognized by the FJO, the TAP project is aimed at facilitating the transportation of gas produced mainly from the Phase II development of the Shah Deniz (SD) fields in the territory of the Republic of Azerbaijan. Azeri gas as outlined above is expected to be the first gas made available to the European markets through the opening of the so called Southern Corridor (SGC). The SGC will be realised through a chain of interdependent projects both upstream and downstream of TAP pipeline. In more detail, the realisation of the SGC involves the development of the SDII production field and a series of pipelines such as the expansion of the South Caucasus Pipeline from Azerbaijan across Georgia, TANAP in Turkey and the connection of TAP pipeline to the SNAM gas system in Italy. Thus, the Commercial Operation Date (COD) of the TAP pipeline is inherently linked to the timing of the first SD II gas deliveries to Europe.

In order to align the planned COD of TAP with the availability of SD gas volumes to Europe, TAP AG and the SD Consortium (SDC) have agreed on a contractual mechanism the so called "Funnelling Mechanism" which ensures a gradual alignment between the progress in the TAP project and the development of the rest of the SGC value chain upstream. Such upstream developments are, to a great extent outside the control of TAP AG. Indeed, according to the aforementioned mechanism TAP's planned COD is determined by SDC through a series of pre-defined time windows narrowed down as the planned COD approaches.

However, the Funneling Mechanism was not in place at the time the FJO was issued. As argued by TAP AG, prior to the notification of the first window of the Funnelling Mechanism by the SDC, the planned COD could only be based on the best estimates available. Hence, the Funneling Mechanism between TAP and SDC was finalised in July 2013, following the selection of the TAP pipeline as the route to transport Azeri gas to Europe. Subsequently, the said mechanism was included in the TAP Tariff Code[2] approved by the Authorities in November of 2013[3].

After taking its Final Investment Decision on the SD II project (on 17 December 2013), the SDC notified to TAP AG, in accordance with the Funnelling Mechanism, that the first 36 month window during which the Planned COD would occur is intended to start on 1st January 2020 and end on 31st December 2022.

Based on the above circumstances, on 27 June 2014 TAP AG formally applied for a prolongation of the validity period of the exemption decision granted by the Authorities and the Italian Ministry for the Economic Development until the 31st January 2022.

Subsequently however, on 16th December 2014, TAP AG was notified by the SDC that the second 12 month window period during which the planned COD would occur is intended to start on 1st January 2020 and end on 31st December 2020. TAP AG had promptly communicated this development to the Authorities thereby modifying its original request in accordance to the latest possible date on which the planned COD can take place (i.e. 31st December 2020).

3 The Assessment

3.1 TAP AG's arguments

In its application, TAP AG argues that the delayed entry into operation of the pipeline is not caused by events within its control since the former is strictly interlinked to the upstream development of the project. The arguments provided by TAP AG to justify the request for a prolongation of the validity period of the

[2]Pursuant to clause 1.5 of the TAP Tariffs Code "*The Planned COD assumed for the initial cost estimates is 1st January 2019. The Planned COD for the purposes of tariff calculation for the Initial Capacity may change due to developments outside the scope of the TAP Transportation System, and will be defined according to the following: a) The Planned COD will be updated by 31 December 2013 and a window of 36 months will be defined by the same date, within which the final Commercial Operation Date is scheduled to occur. b) The Planned COD will be updated and the corresponding window will be narrowed to 12 months five years before the then expected Planned COD and then further narrowed to a three month window nine months before the start of the 12 month window, with changes to the Planned COD promptly notified to Shippers c) The Planned COD will be finally defined for the purposes of tariff calculation six months in advance of the three month window and promptly notified to Shippers.*"

[3]The Authorities, with three separate acts (AEEG Deliberation 495/2013/R/GAS of the 7th of November 2013, RAE Decision n. 531/2013 of 6th November 2013 ERE Decision n. 127 of 7th November 2013) approved the Tariff Code of TAP AG as foreseen by paragraphs 4.2,4.3 and 4.4 of the FJO under specific terms and conditions, set in common by the Authorities and included as an Annex in all three decisions.

exemption decision are the following.

1. First, the Funnelling Mechanism which underpins the time schedule of the infrastructure developments from the Shah Deniz gas field to the exit of the TAP pipeline in Italy was finalised *after* the exemption decision was granted. Although this mechanism was designed with the view to prevent unnecessary costs for both TAP AG and the SDC which might result from a time mismatch between the upstream and downstream development of the overall infrastructure, only the SDC controls the upstream progress of the project. Hence, only the SDC can define the timing of the narrowing windows within which the planned COD of the pipeline can eventually take place.

   In this respect, TAP AG equally underlines that although the Funnelling Mechanism provides the necessary time flexibility for the development of complex projects like the one at stake, this flexibility is well constrained within agreed deadlines, which cannot be extended further. According to the requesting party's submissions, there is no contractual mechanism in place allowing neither for an extension of the planned COD beyond 2020 nor for an anticipation to a date earlier than 1st January 2020. Furthermore, this timeline is confirmed by the latest announcement of the SDC, which nominated the second window period, safeguarding as a result that the planned COD will not take place after 31 December 2020. Moreover, it results from the information received that both SDC and TAP AG are already bound by contractual commitments to deliver gas to network users by a set deadline defined in the Gas Transportation Agreements (GTAs) Indeed, the starting date of these GTAs is also defined through the Funnelling Mechanism and is currently expected to be January 1st 2020 at the earliest.

2. Second, the requesting party points out that the current situation in which the exemption decision would lose its effect prior to the planned COD, would be detrimental to the economics of the TAP project, posing major risks for TAP AG's shareholders, shippers and the SDC alike, due to the following reasons.

   - The investment in the TAP project is underpinned by GTAs for the usage of the initial capacity of 10 bcm/year that is exempted from TPA, therefore, any mismatch between the duration of those agreements and the exemption period would create significant uncertainty to shippers regarding the capacity availability for a 25-year period.
   - The said misalignment would also rise doubts on the legal validity of the TAP tariff methodology, already approved by the Authorities, throughout the lifetime of the GTAs. In turn, this would prevent TAP AG's

shareholders and third party lenders from forecasting the target revenue of the infrastructure and thereby also implicitly the project return, with the consequence of endangering the bankability of the project at a crucial stage of its development.

3. Finally with specific reference to Italy, TAP AG submits that the incorporation of the Funnelling mechanism in the exemption decision is essential for securing capacity in the SNAM Rete Gas (SRG) system for a 25-year period, so as to allow for the timely delivery of SD II gas to the Italian market. Thus, shippers wishing to participate in the Open Season procedure in order to obtain capacity in the SRG system, would require valid import authorisations granted by the Italian Ministry for Economic Development. The SRG Open Season procedure can take up to 13 months and the upgrade of capacity in the SRG system 5 years. According to the requesting party, it is therefore critical for all parties along the SD II value chain, that shippers can start this process in a timely manner in order to be able to complete this process in the run-up to TAP's planned COD. Incorporating the Funnelling mechanism in the exemption decision would therefore allow shippers to obtain the required import authorisations and thereby contribute to the mitigation of the potential commercial risk entailed by the lack of downstream available capacity in the Italian transmission system by the date that gas deliveries to Italy should commence

3.2 The Authorities assessment

Based on the above arguments, the Authorities consider that TAP AG's request for a prolongation of the validity period of the exemption decision is well grounded for the following reasons.

1. At the time when the FJO was adopted, TAP AG was not aware of the commencement date of the gas deliveries to Europe since back then the SDC had not yet taken the Final Investment decision in the project concerned. Subsequently, when such decision was finally taken, TAP AG was notified that the starting date of the first gas delivery could not occur earlier than the 1st of January 2020, contrary to previous estimates for a COD within 2019. Further, as it results from the requesting party's submissions, the planned COD is dependent on the time-table and developments of the upstream infrastructure. Such developments in the upstream value chain of the project are out of TAP AG's control. Consequently any delay in the progress of the upstream infrastructure can be considered as a major obstacle to the timely starting date of the gas deliveries to Europe through the infrastructure concerned which is outside TAP AG's remit.

2. The planned COD is specified through the Funnelling Mechanism agreed between TAP and SDC. The Funnelling Mechanism establishes the starting date of gas delivery to Europe thereby mitigating the financial risks to which the overall project's development could be subject.in case the exemption decision were to lose its effect prior to the entry into operation of the pipeline for the reasons above explained by TAP AG.

3. It results from the information received that, based on the Funnelling Mechanism, there is no margin of further postponement of the entry into operation of the TAP pipeline due to the alleged binding contractual commitments already taken by both TAP AG and SDC with buyers and shippers. As a consequence, the risk of another delay in the planned COD beyond 2020 for reasons related to the development of the project can be reasonably ruled out.

It follows from the foregoing that the conditions of article 36(9) of directive 2009/73/EC are met in the present case, as the delay in the commencement of the exploration of the Shah Deniz II gas field as well as in the entry into operation of the TAP pipeline respectively is due to obstacles beyond the control of the project developer TAP AG, to whom the exemption has been granted. Accordingly, the Final Joint Opinion should be revised so as to accommodate TAP AG request.

4 Conclusion

Based on the above arguments, the Authorities jointly propose to amend Section 4.10 of the Final Joint Opinion as follows:

> "In line with the provisions of Article 36(9) of Directive 2009/73/EC, the present Opinion and the Commission's approval shall lose its effect in the event that construction of TAP has not yet started on 1 January 2018 and in the event that the infrastructure has not become operational on 31 December 2020, unless the Commission decides that any further delay is due to major obstacles beyond control of the person to whom the exemption has been granted".