

THIRD ENERGY PACKAGE AND ITS IMPACT ON THE ENERGY SECTOR OF THE REPUBLIC OF MOLDOVA

Author:

Ruslan Surugiu, president of the Center for Energy Efficiency and Renewable Resources

Disclaimer: this document was translated in English language from Romanian language. In case of inconsistencies, the Romanian version will serve as the correct one.

Chisinau, 2012

This study is published as part of the "EU-Moldova Relationship - Monitoring the Progress of the Eastern Partnership" Project, implemented by the Independent Think-Tank EXPERT-GRUP and the Association for Participatory Democracy ADEPT, with the financial support of Soros Foundation-Moldova.

Note: the statements and opinions expressed herein are those of the authors alone and do not necessarily reflect the views of the funding organization.

CONTENTS:

1. Introduction.....	4
2. What Does the Third Energy Package mean?.....	5
Reasons for Approving the Third Energy Package	5
Changing the Rules of the Game	5
Implementation Conditions.....	6
Impacts of the New Rules	6
Are There Alternative Options Included in the Third Energy Package?.....	6
Advantages for Individual and Industrial Consumers	7
Impact on the Security of Electricity and Gas Supply	8
3. EU Member States and Implementation of the Third Energy Package	9
The Lithuanian Case.....	9
Electricity Sector	9
Gas Sector	10
The UK Case	11
4. Analysis of Benefits and Risks for the Republic of Moldova Associated to the Implementation of the Third Energy Package.....	12
Benefits.....	12
Disadvantages.....	13
Energy Sector Development Scenarios.....	13
Scenario A	14
Scenario B	15
Scenario C	16
Scenario D.....	17
5. Conclusions and Recommendations.....	18
References	20

1. INTRODUCTION

The energy sector in the EU Member States has developed remarkably during the recent years. Besides achieving a higher turnover, it was also restructured and modernized with the primary goal to establish market conditions in this sector, which is currently dominated by a strong natural monopoly.

That is why, the European Commission embarked upon a wide-ranging process of legal framework development with the view to create proper conditions for the development of the energy market, particularly in the sector of electricity and natural gas. As a result of these efforts a number of legal acts were passed, including the ones developed in 2003 and known as the Second Energy Package, and then the ones developed in 2009 and known as the Third Energy Package.

Whenever new legal acts are approved, the European Commission introduces new operating rules for this sector with the view to achieve the new objectives, such as security of electricity and gas supply, investment attraction in the transmission networks, compliance with the consumer right to choose the electricity or gas supplier, promotion of energy efficiency in production, supply and consumption, etc.

Having become member of the Energy Community in 2009, the Republic of Moldova assumed the commitment to transpose the European Union legislation in order to align the standards and operating conditions of the electricity and gas sector to the ones of the EU Member States. Thus, during the meeting of the Energy Community Council of Ministers, which took place in Chisinau in October, 2011, the Government of the Republic of Moldova signed the agreement on the transposition of the Directives and Regulations that form the Third Energy Package. In line with the agreement, this transposition shall be accomplished until 2015.

In this study we will try to find an answer to the following key questions: What is covered by the new rules? What impact can they have on the development of the Moldovan energy sector? What development scenarios can be drafted?

2. WHAT DOES THE THIRD ENERGY PACKAGE MEAN?

The energy sector of the EU Member States has developed constantly by introducing market principles. The relationship between consumers and suppliers, on the one hand, and the competition among various energy producers, on the other hand, witnessed a particular enhancement.

Once the so-called Second Energy Package was implemented, the European Commission made a number of new proposals for the legal framework with the view to accelerate the establishment of internal market conditions in the electricity and gas sector, including:

- a) Regulation establishing an EU Agency for the Cooperation of Energy Regulators;
- b) Directive 2009/72/EC (electricity), which contains amendments and addenda to the Directive 2003/54;
- c) Directive 2009/73/EC (gas), which provides amendments and addenda to the Directive 2003/55;
- d) Regulation (EC) No 714/2009, which provides amendments and addenda to the existing Regulation on Electricity No 1228/03;
- e) Regulation (EC) No 715/2009, which provides amendments and addenda to the existing Regulation on Gas No 1775/05.

Once the European Parliament and Council approved them in 2009, these documents formed the Third Energy Package.

REASONS FOR APPROVING THE THIRD ENERGY PACKAGE

After the approval in 2007 of the law allowing European consumers to enjoy all the rights related to the liberalization of the electricity and gas markets - mainly the right to choose the energy supplier - it turned out that this cannot be achieved on all internal markets of the EU.

That is why new rules were developed to solve the structural deficiencies both on the electricity and gas markets. The rules envisaged by the Second Energy Package on the separation between the transmission and distribution activities, on the one hand, and energy supply and production activities, on the other hand, fail to ensure a proper operation of the markets. The reason is that a large number of network operators can create discriminatory situations for the new suppliers or producers favoring the already existing ones. Therefore, the new companies that want to enter the electricity or gas market and have no other choice but to use the existing networks encounter difficulties, as network operators favor other companies.

CHANGING THE RULES OF THE GAME

To improve the market conditions, particularly the access of new electricity and gas producers and suppliers, the European Commission, based on the lessons learned from the implementation of the Second Energy Package, proposed to separate the transmission activities from the production and supply activities, thus ensuring access to transmission services for any company that intends to enter the internal electricity or gas market with production or supply activities.

In other words, the energy transmission networks - in this case the high-voltage transmission lines for electricity and high-pressure pipelines for gas - should operate like highways, which allow any traveler (in case of the energy sector - any electricity

or gas supplier) to have access to this highway in order to get to any point of destination.

This was also justified economically, as it is too expensive for a supplier to build a new transmission network in addition to the existing one, and the transmission network is regarded as a natural monopoly that should follow the rules regulating such activities.

The separation should occur not only in terms of operational and legal issues, but also in terms of company ownership. In such a case, a company that owns an electricity or gas transmission network will not be able to own any production or supply companies.

IMPLEMENTATION CONDITIONS

The package also contains two clauses stipulating that different compliance options can be accepted and approved by EU Member and Non-Member States. These clauses are:

- *the reciprocity clause;*
- *the "level playing field" clause.*

The reciprocity clause envisages that the EU Non-Member States must comply with the separation provisions before the companies from the respective countries are issued certificates of operation on the common market. Besides, these companies may be refused certification if their activity can endanger the supply of electricity or gas within the EU.

The "level playing field" clause enables Member States to take measures that would ensure an appropriate level of competition on the internal market of the respective state. For instance, an EU Member State that opted for a total separation of assets can refuse a producer or supplier from another Member State to have direct or indirect control over the transmission system operator.

IMPACTS OF THE NEW RULES

This separation will prevent the companies that are both producers and transporters of electricity or gas from using their privileged positions on the market and blocking the access of other competitors to the electricity or gas transmission networks. This will unavoidably eliminate conflicts of interests, will attract investment in networks and will prevent any discriminatory behaviors against market players.

If a network operator is member of a group of electricity or gas producers or suppliers, it is normal that it would try to protect the group interests and its decisions will take into account the commercial advantages of the sister companies. In such circumstances, there are almost no reasons to build a network that would allow new producers to enter the market. On the other hand, if the transmission system belongs to a totally independent company, its entire activity will aim at obtaining the highest profit possible. Obviously this is possible only if as many companies as possible have access to the network and that is why the transmission network operator will be interested to enlarge its system and build as many interconnections (with other transmission networks) as possible.

ARE THERE ALTERNATIVE OPTIONS INCLUDED IN THE THIRD ENERGY PACKAGE?

The Third Energy Package provides two alternatives for ownership unbundling:

- Independent System Operator (ISO)

- Independent Transmission Operator (ITO)

The ISO option means that the supplier may own transmission networks, but it has to cease to an independent company the activities related to network operation, maintenance, and investments. This option can be considered if the companies don't want to give up on their ownership of the transmission networks.

The ITO option, which was introduced in the draft Third Energy Package in 2008 by such countries as Austria, Bulgaria, France, Germany, Greece, Luxembourg etc., allows the Independent Transmission Operator (ITO) to be a component part of an integrated enterprise, provided that it acts according to the following rules:

- Autonomy (decision-making and financial autonomy; the necessary technical and human resources for its work; etc.);
- Independence guaranteed by a series of authorizations related to the operation of the transmission network;
- The investment-related decision should be taken by the company, without any interferences from another company;
- The decisions on investment plans can be taken jointly by the parent-company and the regulator;
- The transmission company must be a legally separated joint-stock company, with a different brand name from the parent-company.

Besides, the regulator should have the right and the possibility to monitor the tasks and duties both of the ISO and the network owner to make sure that the network is operated properly and any client has free access to it.

This option is also called *legal unbundling*.

ADVANTAGES FOR INDIVIDUAL AND INDUSTRIAL CONSUMERS

On any competitive market the rules of the game have always offered a number of advantages to consumers. The first one would be the freedom to choose products and services depending on the interests and possibilities of every particular consumer ("green" energy, more customized service package, etc.). In its turn, this leads to new offers on the market, innovations, specialized services and, in many cases, lower prices.

The establishment of an efficient pricing mechanism is an encouraging signal for investments in infrastructure. It increases the supply safety and diminishes the risk of disconnection or low quality services. This is the second advantage.

Another advantage is the higher energy efficiency at the stage of generation, supply, transmission, and distribution and, surely, lower greenhouse gases emission in the atmosphere.

The Third Energy Package tackles the consumers' problems, which were raised before, and introduces new rules with the view to streamline the implementation of free market rules, including the consumers' right to demand replacement of the electricity or gas supplier by submitting an application, which shall be satisfied within three weeks at most. The vulnerable consumers, such as retirees or people with disabilities, will have the right to access the services of electricity or gas supply.

Another requirement of the Third Energy Package relates to the introduction of **Smart Meters**, which can process and store a much larger amount of information and send it to a remote device. The main advantages of these meters are the possibility to benefit of energy price variations on the market and consumers'

motivation to increase their energy efficiency. The package envisages that 80% of population will have smart meters by 2020.

IMPACT ON THE SECURITY OF ELECTRICITY AND GAS SUPPLY

The situation generated by the disputes between the Russian Federation and Ukraine in January 2009 affected negatively the supply of gas, especially to the Central and Eastern Europe. This situation was also determined by the lack of an integrated and liberalized market, which obviously proved that isolated markets with a single source of electricity or gas are very vulnerable to the supply shortages, compared to the integrated markets with several sources of supply.

If introduced, the competitive rules for suppliers will diversify the sources (new sources will appear or develop) and transmission networks.

That is why the Third Energy Package envisages separation between transmission activities and supply or distribution activities, which will later attract new investments in networks and will facilitate the access of more suppliers to the market.

The Third Energy Package also provides for the establishment of new cooperation structures for network operators both of electricity and gas, the so-called European Network of Transmission System Operators (ENTSO). ENTSO together with the Agency for the Cooperation of Energy Regulators will develop detailed rules of access to networks. These rules will be applied in the EU to ensure a free flow of electricity and gas, so that the transmission systems could cope with crisis situations, like the 2009 one, and to make it possible to supply electricity and gas in the market segments where they are needed the most.

As well, transparent operation of the electricity and gas sectors is a basic requirement, which envisages daily publication of the information about the reserves of gas from the reservoirs and terminals of liquefied natural gas. This information can be used by market suppliers to find out where and how big the gas reserves are and where the demand for gas is located. The governments and regulators will be also able to use this information in order to analyze the market evolution and its capacity to respond to various situations (for instance supply shortages).

In their turn, the operators of electricity and gas transmission networks will be liable to cooperate and ensure proper operation of transmission networks, not exposing them to the risk of supply shortages or other emergencies. The ENTSO members must cooperate and coordinate the operation of networks by exchanging operational information and must develop common security and emergency standards and procedures. As well, every 2 years the ENTSO members will develop investment plans for a 10-year period, which will bring the planning standards from the national level to the European level and will determine what investments are needed to secure the supply at the European level.

3. EU MEMBER STATES AND IMPLEMENTATION OF THE THIRD ENERGY PACKAGE

EU Member States had to implement the Third Energy Package by March 3, 2011, exception made to the unbundling requirements, which should have been effective by March 3, 2012.

The Agency for the Cooperation of Energy Regulators, created by the Third Energy Package, was expected to be fully operational as of March 3, 2011.

As revealed by the position of the European Commission, as of June 2011 none of the EU Member States reported full transposition of the Third Energy Package Directives into the national legal framework. Only 4 countries stated their partial transposition and other few countries developed draft laws and submitted them to the Parliament for approval. In other countries, the Parliament mandated the Government to take all the needed measures for transposition, but the respective measures haven't been developed yet by the given Governments.

The situation on the implementation of the Third Energy Package by the EU member states is qualified by the European Commission as disappointing and with some infringements of the provisions of the Second Energy Package.¹

Taking into account the ardent discussions during the development of the Third Development Package, particularly the positions of Germany and France related to the promotion of an alternative to ownership unbundling and adopting ISO and ITO options, we could hardly say what would be the decision of each EU Member State, but we can predict that such countries as Romania, Finland, Spain, etc. will opt for a clear ownership unbundling, while Germany and France would choose the other options.

In his presentation of September 2011 about the situation of the energy sector in the EU Member States and particularly about the development of their internal energy markets, the EU Energy Commissioner Günther OETTINGER mentioned regretfully that the European Commission would have to take measures in relation to the infringements made by the governments of the EU Member States that failed to comply with the requirements of the Third Energy Package, i.e. failed to meet the deadlines for the transposition of the Directives of this legal package into the national legislation.²

Thus, out of the 27 member states, procedures will be initiated against 17 countries in relation to the electricity sector and against 18 countries - in relation to the gas sector.

THE LITHUANIAN CASE

The Lithuanian case is described in this study due to the similarities between the energy sectors, availability of energy sources (especially gas) and interconnections with other energy systems.

ELECTRICITY SECTOR

On May 4, 2010 the Lithuanian Government passed the new Electricity Law, which envisages transposition of the Third energy Package into the national legislation.

¹ European Commission, 2009-2010 Report on progress in creating the internal gas and electricity market.

² Günther OETTINGER EU Commissioner for Energy The completion of the EU internal energy market "Getting to 2014" DG ENERGY INTERNAL MARKET CONFERENCE Brussels, 29 September 2011.

Besides, the Government approved a plan to restructure the Lithuanian energy companies, according to which 4 groups of enterprises will be formed: transmission, generation, distribution, and service. At the same time, the Government will have control over all groups of companies. New reforms of the energy sector are foreseen later in order to align to the Third Energy Package.

As of July 2011, 68 licenses were issued for electricity supply, of which 32 were issued during 2010. Since 2010, the consumers with a capacity over 400 kWh purchased electricity from independent suppliers at contract prices.

In 2010 the market liberalization reached the level of 35%, compared to 12% in 2009. According to the Electricity Market Liberalization Plan, during 2011 and 2012 the consumers with a capacity over 100 kWh and over 30 kWh will have to choose independent suppliers. By 2014 only households will buy electricity at a regulated price. Thus, market liberalization will reach the level of 70%.

GAS SECTOR

During the past years no significant progresses have been registered on the gas market, which is highly concentrated - the gas is imported from a single source, OAO Gazprom, which distributes gas quotas to two suppliers. Until 2010 there were 13 suppliers, but the biggest share of gas belonged to two companies: Lietuvos Dujos AB and Dujotekana UAB, both controlled by OAO Gazprom. Though there are possibilities to buy gas from other countries, OAO Gazprom hinders the independent suppliers from doing this by not allowing them to use the networks that are under its control. Thus, Lietuvos Dujos AB holds a license of gas transmission and owns the transmission networks all over the country.

The situation in the distribution sector is similar to the one in the transmission sector, where Lietuvos Dujos AB holds 99% of the gas market, while the other 6 distribution companies cover only 1% of the respective market.

This is the only Lithuanian company that provides services to over 100,000 consumers. The company is integrated vertically and has unbundled internally its activities by keeping separate accounting records and financial plans, but the company's activities have not been separated legally.³

On December 7, 2010 the Ministry of Energy presented the draft Law amending the Gas Law and the draft Law on the Implementation of the Gas Law in Lithuania. Once approved by Government on June 30, 2011, the Law amending the Gas Law was passed by the Parliament. The law stipulates separation between gas transmission activities and gas extraction and supply activities, and is aligned to the provisions of the Third Energy Package.

This Law envisages the implementation of the first model from Directive 2009/73/EC on the separation between transmission activities and extraction and supply activities. The first model relates to the ownership unbundling of the transmission systems operators. The Law stipulates that in the Republic of Lithuania the gas transmission will be separated from gas extraction and supply by unbundling the ownership over the transmission system and/or transmission system operator from the ownership of the operators in the gas extraction and supply sector.

The purpose of this provision, inter alia, is to make sure that the Transmission System Operator acts independently from the commercial interests of the operators from other sub-sectors and aims at ensuring an efficient and safe operation of the transmission network and safe gas supply.

³ According to the Third Energy Package, the unbundling requirements are not compulsory for the countries that serve less than 100,000 consumers

To facilitate the transformation of this sector, the Lithuanian Government works on diversifying the sources of gas and plans to build a liquefied gas terminal in Klaipeda port (the construction works will start in 2014; it will have a capacity of 2-3 billion m³ per year) and intends to build a pipeline interconnected with the Polish transmission system. This project will be implemented by the Polish transmission system Gaz-System SA and the Lithuanian company Lietuvos Dujos AB.

THE UK CASE

The UK Government, having analyzed the provisions of the Third Energy Package in respect of the issues related to the unbundling of the electricity and gas transmission, formulated the following conclusions:⁴

- it will be possible to apply the ownership unbundling options, ISO model and the derogations according to Article 9 both to the electricity and gas sectors;⁵
- the ITO model will be applicable to gas interconnections, because, from the Government's point of view, this would give the needed flexibility and will help the regulator from UK and other EU Member States to agree on regulatory arrangements;
- the Government will allow transmission operators to have small scale generation capacities for the cases when there is a need to supply energy to some consumers, unless this discriminates other market players;
- the generation, production, and supply activities that are operated outside the EU economic area will be not taken into account;
- the legislation shall prohibit those who have control over the TSO to perform licensed generation, supply and production activities and vice versa.
- gas transporters shall not have the right to produce gas.

⁴ <http://www.decc.gov.uk/assets/decc/Consultations/eu-third-package/1163-eu-third-package-gov-response.pdf>

⁵ If on September 3, 2009 the transmission system belongs to a vertically integrated company and there exist arrangements that guarantee a much more effective independence of the transmission system operator, if compared with the stipulations of Chapter IV from the Directive, a Member State may decide not to apply para. 1 (ownership unbundling starting with March 3, 2012)

4. ANALYSIS OF BENEFITS AND RISKS FOR THE REPUBLIC OF MOLDOVA ASSOCIATED WITH THE IMPLEMENTATION OF THE THIRD ENERGY PACKAGE

As a Contracting Party to the Energy Community, the Republic of Moldova assumed the commitment to transpose the EU legislation in the energy sector. Thus, during the meeting of the Energy Community Ministerial Council on October 6, 2011 which took place in the Republic of Moldova, the Moldovan Government signed the Decision no D/2011/O2/MC-EnG, which provides that the Republic of Moldova shall implement the provisions of the Third Energy Package starting with 2015.

Particularly, this relates to the adjustment of the national legislation by transposing the following European acts:

- Directive 2009/72/EC (electricity);
- Directive 2009/73/EC (natural gas);
- Regulation (EC) No 714/2009;
- Regulation (EC) No 715/2009;
- The amendment of Articles 11 and 59a of the Treaty Establishing the Energy Community.

BENEFITS

The electricity and gas markets can be characterized as rigid, where the main issue relates to the lack of supply options. Thus, 100% of the gas consumed in the Republic of Moldova is imported from the Russian Federation; without any other import option. In case of electricity, 75% of the total electricity consumption is imported.

In both cases, the Republic of Moldova cannot import them from Romania, since it depends on the supply of gas and electricity from a single source. Certainly, this situation affects the supply security.⁶

The introduction of the requirements and rules of the Third Energy Package will set the needed conditions on the electricity and gas markets, **first**, for the enhancement of supply security by encouraging new producers and suppliers to enter the market.

Second, it offers the possibility to join the regional energy market of the South-Eastern Europe, with a further perspective to enter the EU market, which means opening the country for investments in electricity production.

Third, it is a possibility to eliminate legally the monopolies from all market segments, particularly the gas sector, where SA Moldova-Gaz owns 100% of the gas supply and over 80% of the distribution market, being a vertically integrated company, consisting of 1 transmission company and 13 distribution companies.

Last, but not the least - the introduction of smart meters will streamline the electricity consumption, offering consumers the possibility to save by choosing to consume energy during periods with lower prices. This measure will also help avoid

⁶ In case of electricity, the existing interconnection lines and the fact that the Moldovan electricity system operated simultaneously with the Ukrainian one will not allow to export and/or import electricity on the basis of the "island" principle

overloads in rush hours and overstraining of electricity networks, streamlining thus the operation of transmission and distribution networks.

As for the *indirect benefits*, besides bringing closer Moldova to the European Union, by accepting the Third Energy Package the Republic of Moldova will be able to access various European funds for the development of the energy sector. An indicative precedent in this respect is the 50% EU co-funding of the project for the interconnection of the Lithuanian and Polish electricity transmission networks.

Thus, the Republic of Moldova could benefit of multiple funding options to improve its energy security, including the possibility to establish interconnection networks to West. The energy security of Moldova could be strengthened by the appearance of new energy producers or modernization of the existing ones, as well as by enhancement of the demand side, where consumption can be streamlined significantly since the consumption per 1\$ of the GDP is three times higher in Moldovan than the European average.

Another indicative example is the case of Romania, where the EU funds are used extensively to solve the problems of the dwelling sector, for instance. Thus, 50% of the cost of heating energy efficiency projects in blocks of flats are co-funded from EU funds, which makes the consumption reduction program much faster and more attractive for final users.

Besides, the terms of the Third Energy Package offers the Moldovan Government another leverage during the negotiation with OAO Gazprom on the new gas supply contract.

OAO Gazprom has already expressed its reticence regarding the enforcement of the new conditions in the gas sector on the domestic market of the Republic of Moldova, where SA Moldovagaz - 50% of its capital belonging to OAO Gazprom - holds a total monopoly on supply and transmission and over 80% of distribution.

DISADVANTAGES

If new producers appear on the market, even of small scale, it will be necessary to invest in the transmission and distribution network in order to balance them, which surely will involve certain costs. The impact on costs is almost impossible to assess right now, because the technical rules for the connection of such producers are not developed yet and there aren't any real cases of small scale production and supply.⁷

The same story goes for the introduction of smart meters according to the Directives of the Third Energy Package.

In the gas sector, the biggest disadvantage now is the difficulty related to the negotiation of the new contract with OAO Gazprom on gas supply, the uncertainty related to the expiry of the previous contract on December 31, 2012 and the lack of a new signed contract.

According to Prime-Minister Vlad Filat, the negotiations between OAO Gazprom, on the one hand, and SA Moldovagaz and Government of the Republic of Moldova, on the other hand, reached a deadlock after the Republic of Moldova signed in October 2011 the obligation to implement the Third Energy Package, so that the previous contract was extended for three months.

ENERGY SECTOR DEVELOPMENT SCENARIOS

The Government of the Republic of Moldova, by signing the Decision of the Energy Community Ministerial Council and committing itself to implement the provisions of the Directives of the Third Energy package, in fact assumed the plenary

⁷ It refers mainly to the renewable energy generation, such as wind and sun energy.

responsibility for the future of the energy sector and, why not, of the national economy at all.

The decisions made now will have a medium and long term impact, determining the development strategy of the energy sector for the future and, indirectly, the development of the country on the basis of European principles.

On the background of the current situation we will describe the possible scenarios of situation development, depending on the decisions made by the Government of the Republic of Moldova on the transposition of the EU Directives in the energy area.

SCENARIO A

Moldova implements the 1st option on the separation of transmission from generation, supply and storage - ownership unbundling.

We cannot see any significant changes in the electricity area, because there isn't any vertically integrated dominant company and the generation, transmission and distribution are represented by separate companies, both legally and operationally, and there's both public capital (generation, transmission and distribution), and private capital (distribution). Major changes can occur only if new energy producers appear, but such developments cannot be expected in the short run.

However, in the medium and long run new electricity producers might appear in the renewable energy area, particularly wind energy.

Surely, from the perspective of supply security and energy security, this option will bring only benefits. But from the perspective of the costs associated with the generation and procurement of this energy on the domestic market, it is way too early to express an opinion, because a more complex analysis is needed, which would compare the impact on the supply security with the volume of investments needed to balance the transmission and distribution systems and the need to adjust the electricity fee for final users.

As for the gas sector, this option would mean radical changes, particularly diminishing the role of SA Moldovagaz (and implicitly of OAO Gazprom), forcing this company to accept the requirements according to which room should be provided for other potential players. Another option means that SA Moldovagaz and its major shareholder OAO Gazprom will have to decide what activity is priority - gas supply or transmission.

Both activities have strategic interest for OAO Gazprom. Hence, the control over the supply (currently there is only one supply source) provides the possibility to influence the situation in the gas and energy sectors and the economy as a whole (until new suppliers appear, who could become a real competitor). As for gas transmission, OAO Gazprom expressed publicly its wish to control all transmission networks from the former soviet republics, through which the gas is transited to the EU countries. The export to these markets is the main source of revenue for OAO Gazprom; according to the financial statement of this company for 2010, 60% of the company's revenue was generated by the exports to the EU countries and Turkey.⁸

If the Moldovan Government choses this option, OAO Gazprom will have to make a difficult choice among the aforementioned variants. In this case it is not excluded that in order to convince the Republic of Moldova to adopt other options from Third Energy Package, OAO Gazprom will have to make acceptable counter-offers, beneficial for the Republic of Moldova.

To summarize, the advantages of this option are the following:

⁸ <http://www.gazprom.ru/marketing/>

- demonopolization of the gas sector;
- proper conditions for the attraction of investments in the transmission and distribution sector due to the appearance of new market players;
- elimination of intra-sector interests between the transmission and distribution company;
- reducing the dependency of the energy sector on the gas supplier - OAO Gazprom.

Nevertheless, the advantages have to be compared with the disadvantages implied by Scenario A, specifically:

- tense relations with OAO Gazprom (at least during the negotiations of the new Gas Supply Contract) and possible a much more intransigent position of OAO Gazprom regarding the historical debts of SA Moldovagaz for the supplied gas;
- the need to find a solution for the SA Moldovagaz's ownership of the transmission system (if SA Moldovagaz chooses the supply option).

SCENARIO B

The Independent System Operator (ISO) option is accepted.

Like in the case of ownership unbundling, no significant changes are expected in the electricity sector. However, in the gas sector the situation can change - SA Moldovagaz can maintain its ownership over the transmission networks, but another company will deal with their operation and management (most likely, a state-owned company), which will have the responsibility to ensure all the needed technical, operational, and commercial conditions for the free access to network for any gas supplier.

The advantages of this scenario is the fact that the fears of SA Moldovagaz and its major shareholder OAO Gazprom related to the loss of ownership on the territory of the Republic of Moldova and the need to compensate them will be not possible to be used as arguments in the discussions between the Moldovan Government and OAO Gazprom (such as the negotiation of the new Gas Supply Contract for the Republic of Moldova). As well, another major advantage is the fact that the Republic of Moldova can regain control over the gas transmission activity, a strategic branch for any country.⁹

As for disadvantages, we could mention a few main aspects, such as:

- the lack of a clear foundation needed for the development of the transmission network, because ISO will not be interested directly in the development of the network, because it does not own it;
- the situation of the distribution system can be repeated, where the networks were built on public or private money and are owned by the local or central public authorities or various owners' associations and are managed by SA Moldovagaz; the future of these networks hasn't been decided yet.

⁹ Control over the operation of gas transmission system is regarded as strategic (like in the case of electricity). The Republic of Moldova lost this control when SA Moldovagaz was established.

Box 1. Debts of SA Moldovagaz for the gas supplied by OAO Gazprom

The establishment and existence of SA Moldovagaz as the national operator on the gas market is "assisted" by the generation of some huge debts for gas consumption, the largest of them belonging to the left bank of the Nistru river.

Thus, if in 1998 (the year when SA Moldovagaz was created) the total debt of the Republic of Moldova for gas amounted to USD 500 million, then in December 2011 the amount of the SA Moldovagaz debt towards OAO Gazprom amounted to USD 3,150 million, of which USD 350 million represent the debt of the right bank of the Nistru river, while USD 2,800 million - the debt of the left bank of the Nistru river.¹

The generation and existence of these debts raises many questions, which tried to be answered during the years of SA Moldovagaz existence, including by various parliamentary committees. Thus, the committee chaired by V. Ciobanu in early 2000s carried out investigations, based on which a Parliament Decision was passed, stipulating that the reorganization of the gas sector performed in 1998-1999 and the situation generated in the sector after the reorganization can be described as "an area of "massive misappropriation and fraud, which caused huge damage to the Government and consumers, undermined the energetic security of the country". And the situation with the gas supply to the Republic of Moldova, collection of payments from consumers and the settlement with the suppliers was regarded as "dramatic and cloudy".¹

The parliamentary committee established in 2010, with the participation of the MP Simion Furdui, who chaired the Administration Board of SA Moldovagaz in 2002-2003, aimed at clarifying the reasons and ways how the debts of SA Moldovagaz had been formed during its existence, but its efforts failed to achieve any tangible result,

The situation gets even more complicated when the debts of the right bank, but particularly the debts of the left bank of the Nistru river are used by the Russian party to blackmail Moldova for political and sometimes even economic purposes. The latter refers to the negotiation of contracts on gas supply to the Republic of Moldova.

SCENARIO C***Independent Transmission Operator (ITO) Option***

According to this option, changes are needed only in the gas sector.

The advantages of this option include the following:

- the current owner (in our case, SA Moldovagaz) keeps ownership of the transmission networks, the transmission company being vertically integrated with the parent-company;
- no institutional or legal changes are needed, keeping the company that operates currently (SRL Moldovatransgaz.);
- OAO Gazprom will not have any claims any more towards the Government of the Republic of Moldova during the negotiation of the new Gas Supply Contract and the ownership will remain with the current owners;
- the presence of the same company as owner and manager of the transmission networks and its commercial interests will motivate the owner to extend the transmission network with the condition to provide access to other suppliers as well.

The main disadvantage of this option is that it is not clear how real independence will be ensured for the decisions made by the parent-company on investment and trade plans related to the transmission company and how they will ensure that the respective decisions will not be affected by the commercial interests of the other sister-companies.

The countries, where the supply, transmission and even distribution companies are of national interest, which have a direct interest to ensure high gas supply security, are supporting this idea. But Moldova's case is fundamentally different, due to the existence of only one supplier - SA Moldovagaz, which represents indirectly the interests of a company outside the Republic of Moldova - OAO Gazprom.

SCENARIO D

Obtaining derogations from the provisions of the Directives.

Article 49 of the European Directive provides for situations similar to the Moldovan one, whose gas system is not interconnected with any of EU Member States and has a dominant supplier (who covers over 75% of the respective market). In such cases, derogation can be made from the provisions of Articles 4, 9, 37 and/or 38.¹⁰

The EU Member States included on the list of countries that can derogate from Article 9 (separation of transmission from supply, generation, and storage) are Cyprus, Malta and Luxembourg.

The Republic of Moldova can also use this right if the advantages of this option exceed its disadvantages. We can mention the following most important advantages:

- No need to introduce new rules on the gas market;
- No need to reorganize the companies from the gas system;
- OAO Gazprom will not be able to use any claim in the negotiations with the Republic of Moldova (the new Gas Supply Contract, the issue of historical debts, etc.).

However, these advantages must be carefully compared with the disadvantages that are more than obvious, specifically:

- maintaining the gas market status-quo (monopoly both at transmission and distribution);
- maintenance of the country's dependency on the interests of a foreign economic operator (OAO Gazprom);
- persistence of the risk to use OAO Gazprom as an instrument for the promotion of geo-political interests of the Russian Federation;
- lack of room for maneuver for the Republic of Moldova during the negotiation with OAO Gazprom;
- maintenance of the current development level of the gas market.

¹⁰ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0094:0136:EN:PDF>

5. CONCLUSIONS AND RECOMMENDATIONS

The European Union is developing continuously its electricity and gas markets and pursues several goals simultaneously. The approval of the Third Energy Package in 2009 supplements the provisions of the Directives from the Second Energy Package of 2003, adjusting the market rules with the view to achieve the following outcomes:

- enhance the security of electricity and gas supply;
- extend the scope of the electricity and gas supply services;
- offer new rights and possibilities to consumers;
- encourage new investments in the electricity and gas sectors;
- enhance the energy efficiency both at the stage of generation and transmission and at the stage of consumption;
- decrease the greenhouse gas emissions, etc.

The Republic of Moldova, as a signatory party to the Treaty Establishing the Energy Community, stated during the meeting of the Energy Community Ministerial Council of October 6, 2011 its availability and commitment to transpose the Directives of the Third Energy Package.

The implementation of the market rules developed in the EU will create suitable conditions for further integration of the Republic of Moldova in the regional energy markets, thus benefiting of the possibilities provided by this integration. At the same, this will bring the Republic of Moldova closer to the EU standards and, respectively, will add value to the European integration process.

As no significant changes are needed to align the electricity sector to the requirements of the Directives of the Third Energy Package, our recommendations will refer to the gas sector, for which we expect both problems and opportunities during the implementation of this legislative package.

It is known that currently the Moldovan Government is negotiating with OAO Gazprom the new Gas Supply Contract and that OAO Gazprom has a negative position regarding the implementation of the Third Energy Package in the Republic of Moldova.

Taking into account the advantages and disadvantages of the three options provided by the Third Energy Package on the separation between gas transmission activities and gas supply and generation activities, the current situation on the natural gas market in the Republic of Moldova and the nature of the relationship between the Republic of Moldova and OAO Gazprom, we recommend the following:¹¹

- a. In case of gas sector, we recommend to implement the first option in order to be able to benefit of all advantages of real ownership unbundling and, respectively, of the interests of companies from the sector, thus ensuring appropriate conditions for a fair competition on the market.
- b. Depending on the offers received from OAO Gazprom regarding the medium and long term options for gas supply to the Republic of Moldova and on the country's investment plans aimed at ensuring gas supply security, the second option could be adopted - Independent System Operator.

¹¹ Problems related to the historical debt for gas of about USD 3 billion and legal problems related to the ownership of OAO Gazprom in the Republic of Moldova

The derogations from the requirements on separation between transmission activities and supply and generation activities will raise a negative attitude from the EU structure and will consolidate the position of OAO Gazprom via means of SA Moldovagaz, the priorities of the Republic of Moldova being left to the discretion of an economic operator from the Russian Federation. This is the main reason why we do not recommend this option.

REFERENCES

1. http://ec.europa.eu/energy/gas_electricity/legislation/legislation_en.htm
2. <http://www.gazprom.ru/>
3. <http://www.moldovagaz.md/>
4. Does the impact assessment on the “Third Package” provide the correct economic forecast for the liberalization of the EU energy market?, Jacopo Torriti, European University Institute
5. ,Liberalising the EU energy market’, EurActiv, 2009
6. ,Implementation of the Third Package of EU Energy Legislation in Northern Ireland, Regulatory Impact Assessment’, Minister of Enterprise, Trade and Investment, UK, 21 March, 2011
7. Annual Report on Electricity and Gaz Market of the Republic of Lithuania to the European Commission, National Control Commission for Pricing and Energy, Lithuania, 2010
8. CEER Annual Report, 2011
9. Implementation of the EU Third Internal Energy Package, Government Response, Department for Energy and Climate Change, January 2010