

The Fourth Gas Package: New Unbundling Rules for Hydrogen

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On March 28, 2023, the Council announced its position (“**general approach**”) on the Hydrogen and decarbonised gas market package (“**Fourth Gas Package**”) proposed by the European Commission in December 2021. The Council’s declaration marks a step towards the adoption of the Fourth Gas Package.¹

Trilogue negotiations have now begun. The proposed legislation must be formally adopted by both the European Parliament and the Council in order to enter into force.

The Fourth Gas Package will address dedicated hydrogen networks and unbundling rules that may influence the transition to a hydrogen-based gas economy.

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¹ The Fourth Gas Package, proposed by the Commission on December 15, 2021, includes a proposal for a regulation and a directive establishing common internal market rules for renewable and natural gases and hydrogen. It is meant to foster decarbonisation, create the conditions for a more cost-effective transition, and achieve the EU’s goal of climate neutrality by 2050.

To achieve these goals, the Package builds upon the principles of the existing Directive 2009/73/EC (“**Gas Directive**”) and Regulation No 715/2009 (“**Gas Regulation**”) and extends their scope to cover hydrogen networks.

The proposal to recast Regulation No 715/2009 (“**Proposed Regulation**”) establishes rules for the organisation of the gas and hydrogen markets, for hydrogen blends, and for cross-border coordination on hydrogen quality. The Proposed Regulation also elaborates on principles and rules concerning: (i) tariffs for network access and discounts; (ii) separation of regulated asset bases, third party access services, principles of capacity-allocation mechanisms, and congestion-management procedure; (iii) the European network of transmission system operators for gas, regulatory authorities, and regional cooperation.

The proposal to recast existing Directive 2009/73/EC (“**Proposed Directive**”) contains several provisions applicable to dedicated hydrogen networks, including the unbundling of hydrogen network operators, and rules on the certification of natural gas and hydrogen system operators. The proposal also addresses other topics, including: (i) consumer protection; (ii) third-party access to infrastructure and integrated network planning; (iii) rules for gas transmission, storage, and distribution system operators, including unbundling obligations; (iv) rules on independent regulatory authorities.



1. Vertical unbundling

Vertical unbundling refers to the separation of activities potentially open to competition (i.e., energy production and supply) from those where competition is naturally or legally stifled (i.e., the operation of transmission or distribution networks), at different stages of the value chain.

1.1. The Gas Directive

Unbundling rules in the current regulatory framework aimed to remove conflicts of interest between the management of gas transmission networks and the production and sale of gas that could be injected into the grid. These rules addressed competition concerns² about the vertical integration of transmission networks, with dominant incumbents controlling large shares of upstream natural gas imports, domestic production, and supply. By foreclosing access to transmission infrastructures, dominant incumbents can strategically avoid investment (to users' detriment).

Under the Gas Directive, a gas company cannot operate a transmission or distribution network *and* generate or sell energy at the same time. This would prevent fair competition in the market and could lead to higher prices for consumers. The Gas Directive establishes different unbundling rules for gas transmission system operators (TSOs) and gas distribution system operators (DSOs). TSOs must apply ownership unbundling (OU), follow the Independent System Operator

(ISO),³ or Independent Transmission Operator (ITO)⁴ models, depending on each Member State's decision. The OU model is the most stringent form of unbundling; it prevents whomever directly or indirectly exercises control (or holds a majority shareholding or any voting or appointment right) over a gas TSO from also exercising control (or holding a majority shareholding or any voting or appointment right) in a company active in the production or supply, and vice versa.⁵

Under the Gas Directive, vertical unbundling rules already apply to companies carrying out gas transport and hydrogen production and supply. Gas Directive provisions for natural gas apply to LNG, biogas, gas from biomass and "*other types of gas in so far as such gases can technically and safely be injected into, and transported through, the natural gas system*" (Article 1 of the Gas Directive). Since hydrogen can be blended with natural gas and injected into the gas transmission network, it also falls within the scope of the Gas Directive.

The Commission itself confirmed this conclusion in the Evaluation Report accompanying the Fourth Gas Package. It noted that "the Third Gas Package applies to all gases that can be safely injected into the gas network, which include hydrogen blended safely into the natural gas system."⁶ Similarly, ACER stated that "*hydrogen production can be considered to be subject to [the Third Gas Package] since a certain amount of*

² Identified by the European Commission in its 2007 sector enquiry.

³ The ISO model requires a complete separation between the ownership of the transmission infrastructure (which continues to be owned by the vertically integrated undertaking) and the management of this infrastructure, carried out by a subsidised entity, the ISO, which is in ownership unbundling from the vertically integrated undertaking. The ISO acts as TSO and is subject to all the obligations imposed on transmission system operators under the Gas Directive.

⁴ Under the ITO model, TSO tasks are performed by a company (ITO) belonging to the vertically integrated undertaking. However, the ITO company must not control, be controlled by, hold participations, or be participated in by other companies belonging to a vertically integrated

undertaking that is active in the production or supply of natural gas. In other words, within the vertically integrated undertaking, the ITO and the company active in the production or supply of natural gas are owned by a common parent company but cannot have a (direct or indirect) parent-subsidiary relationship or hold cross-shareholdings. The ITO must comply with strict functional unbundling requirements (as well as accounting and reporting obligations).

⁵ Unbundling requirements are less strict for DSOs requiring legal, functional or accounting unbundling (See Article 26 of the Gas Directive).

⁶ Commission Staff Working Document, Evaluation Report, SWD (2021) 457 final, December 15, 2021, page 41.

hydrogen can be safely blended into the gas infrastructure".⁷

Accordingly, gas TSOs under the OU regime are prohibited from engaging in hydrogen production and supply activities. The Commission confirmed this in its opinion on the certification of gas TSOs partially and potentially involved in hydrogen activities.

The Enagás case serves as an example of this principle. Enagás Transporte S.A.U. ("**Enagás**") – the Spanish gas transmission system operator, certified in accordance with the OU model – initiated a recertification procedure before the Spanish regulatory authority (*Comisión Nacional de los Mercados y la Competencia, CNMC*) after acquiring a 44% stake in Power to Green Hydrogen Mallorca, a company that intended to develop a hydrogen production project.⁸ In the course of the procedure, Enagás enacted various structural and governance changes, including the waiver of voting and appointment rights in Power to Green Hydrogen Mallorca. The CNMC and the Commission's final opinion on the certification⁹ concluded that Enagás' participation fulfilled the unbundling obligations concerning: minority shareholding, purely financial rights, and the absence of voting or appointing rights.

In contrast, gas TSOs adopting the ITO or ISO regime remain part of a vertically integrated undertaking that may produce and supply hydrogen through one of their affiliated companies.

The Gas Directive is silent as to the unbundling regime of hydrogen network operators. The Commission's Evaluation Report accompanying the Fourth Gas Package states that the Third Gas Package "*does not apply to dedicated hydrogen infrastructure.*"¹⁰ ACER also confirmed that "*pure hydrogen transport is not subject to the Gas Directive.*"¹¹

1.2. The Fourth Gas Package

Almost 15 years after the enactment of the Gas Directive, hydrogen has become an increasingly important energy source. As a result, the Fourth Gas Package aims to extend unbundling rules to hydrogen network operators.

Pursuant to Article 62 of the Proposed Directive, Member States must ensure that hydrogen network operators are unbundled similarly to natural gas TSOs. Hydrogen networks must be operated separately from energy production and supply.

Under the proposed framework, hydrogen network operators cannot have:

- (i) the power to exercise voting rights;
- (ii) the power to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking; or
- (iii) the holding of a majority share

in an undertaking performing any of the functions of production or supply of hydrogen. More broadly speaking, they cannot exercise direct or indirect control over such an undertaking. At the same time, hydrogen producers or suppliers may not exercise the above-listed rights over a hydrogen network operator. Pursuant to Article 65 of the Proposed Directive, hydrogen network operators, like gas TSOs, must be certified by the national regulatory authority.

In other words, the Proposed Directive identifies the OU model as the default rule for hydrogen network operators.

Notwithstanding the preference for the OU model, Article 62(4) of the Proposed Directive (in the Commission's initial version) stated that the ITO model would also be allowed until the cut-off date of December 31, 2030. Up to this date,

⁷ ACER, *When and How to Regulate Hydrogen Networks?*, February 9, 2021.

⁸ Hydrogen produced was intended solely for the consumption of the island of Mallorca, with the possibility of being fed into the gas grid at a later stage.

⁹ Commission opinion C(2022) 6623 final, issued on September 13, 2022. See also Commission opinion C(2023) 914 final, issued on February 3, 2023.

¹⁰ See footnote 4.

¹¹ See footnote 5.

Member States could designate integrated network operators for hydrogen to be unbundled according to the rules for gas ITOs.

The Council later amended this provision and clarified that the ITO model may be used without a cut-off date in cases where a “*hydrogen network belongs to a certified gas transmission system operator or where a hydrogen network belongs to a vertically integrated undertaking*” at the entry into force of the Proposed Directive.

2. Horizontal unbundling

2.1. *The Gas Directive*

As noted, the transport of hydrogen on a *dedicated* network falls outside the scope of the Gas Directive and is not subject to specific unbundling rules.

2.2. *The Fourth Gas Package*

The Gas Directive and the Fourth Gas Package do not prevent gas TSOs from carrying out hydrogen transport activities on dedicated networks, and vice versa. Instead, gas TSOs seeking to operate hydrogen transport in a dedicated hydrogen network must comply with a more relaxed unbundling regime.

In particular, under the Proposed Directive:

- (i) hydrogen network operators, when part of a group active in the transmission or distribution of natural gas or electricity, should be independent at least in terms of their legal form (Article 63, legal unbundling);
- (ii) gas system operators who also operate hydrogen systems should keep separate accounts between the infrastructures to ensure transparency (Article 64 and 69, accounting unbundling).

3. Conclusion

The proposed Fourth Gas Package intends to regulate the hydrogen sector from the start and continue to do so in the long term—despite the fact that it is currently in its initial phases.

Under the proposed regulatory framework, hydrogen network operators who wish to be active in energy

production and supply are subject to vertical unbundling rules. However, the competition concerns that led to the adoption of the vertical unbundling rules in the Gas Directive appear to be inapplicable to the hydrogen sector: (i) hydrogen is an emerging market that requires substantial investment to develop, (ii) there are no dominant players, and (iii) hydrogen producers and suppliers will be newcomers and, at least at the beginning, will face strong competition by gas produced through traditional sources.

The Fourth Gas Package must strike a balance between the need to ensure investment in hydrogen by various energy players and the need to address potential distortions in the EU gas and hydrogen transport markets caused by vertical integration.

The EU regulatory environment should be keen to facilitate investment by gas infrastructure groups, who are well positioned to support the development of the hydrogen market. Furthermore, as the Gas Directive notes, unbundling rules “*should not create an overly onerous regulatory regime*” but only pursue their proper goal of “*removing any conflict of interests between producers, suppliers and transmission system operators*” (Recital 9).

Pursuant to the Gas Directive, a gas TSO under the OU regime is not allowed to produce and supply hydrogen. However, gas TSOs adopting the ITO or ISO regime remain part of a vertically integrated undertaking that may engage in hydrogen production and supply activities through one of their affiliated companies. One may argue that the development of hydrogen production and supply could be slowed in Member States where gas TSOs have adopted the OU model.

One of the latest drafts of the Proposed Directive seems to allow any certified gas TSO (including those under the OU regime) to adopt the ITO regime for the hydrogen network operator, thus allowing the remaining part of the group to produce and supply hydrogen.

This would be a welcome solution. Indeed, preventing gas TSOs from taking initiatives in the field of hydrogen production due to the OU regime would likely result in unfair discrimination against vertically integrated undertakings which—under the Gas

Directive—had adopted less stringent unbundling regimes (the ITO or ISO models) for their transport activities. According to settled EU Court case law, the right to equal treatment and non-discrimination, enshrined in Articles 20 and 21 of the Charter of Fundamental Rights of the European Union, requires that comparable situations not be treated differently and that different situations not be treated alike. In this case, it is highly doubtful that an objective justification can be found to allow a gas TSO certified under the ITO or the ISO model to produce hydrogen while denying the same possibility to gas TSO under the OU model (certified gas TSOs are in a comparable situation, as they all provide similar, if not identical, services). This discrimination is further exacerbated by the fact that, once the OU model has been adopted under the Gas Directive, gas TSOs can no longer apply for the other unbundling regimes, even if they were part of a vertically integrated undertaking when the Gas Directive entered into force.

The Proposed Directive does not dispel all doubts. Additional clarification is desirable regarding the different unbundling models (namely, OU and ITO) and how they will survive within groups of undertakings that carry out both the transport of gas and hydrogen as well as the production and supply of hydrogen.

Further clarification would also be very welcome with a view to explaining whether conflicts of interest may be considered limited or remote in specific circumstances. This is particularly the case if the blending of hydrogen into the gas network will be limited for technical and safety reasons.

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