

Track Changes

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BULGARIAN ENERGY LAW AMENDMENTS INTRODUCE DOMESTIC NATURAL GAS EXCHANGE

In the last few years, Bulgaria has made steady steps towards liberalization of its natural gas market and its integration into the EU common market. Linked to the development of the gas hub Balkan, Bulgaria is steadily investing in natural gas infrastructure projects, aiming for diversification of the gas supply while increasing the security of supply. Such efforts include the Bulgaria-Greece, Bulgaria-Serbia and Bulgaria-Turkey interconnectors, expansion of the Chiren natural gas storage facility, and an increase of the technical capacity of the existing interconnector between Bulgaria and Greece. The new infrastructure will facilitate the delivery of natural gas supply under the agreement between SOCAR and Bulgargaz, with first deliveries planned for 2020. Also in 2018, Bulgartransgaz EAD (TSO) made the decision to participate with a 20% stake in the new LNG terminal at Alexandroupolis, Greece.

The regulatory framework has also undergone significant changes. A new entry-exit model in accordance with Regulation (EC) 312/2014, establishing a Network Code on Gas Balancing of Transmission Networks was implemented. The Natural Gas Market and Balancing Rules were also amended to introduce a virtual trading point and in 2019 the first virtual transactions with LNG took place on the Bulgarian market.

Following this, on 8 October 2019, the Bulgarian Parliament adopted significant amendments to the Bulgarian Energy Act ("Amending Act")¹ for the operation of a natural gas exchange in Bulgaria.

The Amending Act aims to ensure the completion of the liberalization and to enhance liquidity of the Bulgarian natural gas market. The new natural gas exchange is envisaged to become operational from the beginning of 2020. For that purposes, draft trading platform rules have been submitted for approval by the national regulatory authority – the Energy and Water Regulatory Commission (EWRC).

Below we outline the main changes introduced by the Amending Act.

¹ Published in State Gazette issue 79 of 8 October 2019.

Introducing an organized Natural Gas Exchange

Historically, natural gas transactions in Bulgaria were concluded by way of bilateral written agreements. The Amending Act introduces the establishment of a gas exchange (Gas Exchange) and requires certain participants on the natural gas market to conclude their sale-purchase transactions at the Gas Exchange at freely negotiated prices. An exception is provided for licensed end-suppliers of natural gas and the district heating companies that are licensed to perform thermal power generation and transmission - they can continue buying natural gas at regulated prices from the incumbent supplier – Bulgargaz EAD. Similarly, households will continue to buy natural gas at regulated prices.

Until 1 January 2025, the Gas Exchange will cover several segments for products with a delivery term of less than or equal to 1-year, including short-term standardized products. After that date, all transactions, except for the short-term trading products, may also be traded outside the Gas Exchange.

An operator is to be designated to organize the platform of the Gas Exchange. This operator will be a company which is 100%-owned by the TSO Bulgartransgaz - Balkan Gas Hub Balkan EAD, licensed by the EWRC to operate the Gas Exchange.

Timeline

The Amending Act sets a short timeline for the introduction of the relevant framework and obligations to the market participants:

- Large industrial gas consumers are required to buy natural gas only at freely-negotiated prices starting from the enactment of the Amending Act - **8 October 2019**;
- The EWRC should approve the trading platform for the Gas Exchange by **1 December 2019**;
- Secondary legislation related to the functioning of the Gas Exchange (particularly the Ordinance for regulation of natural gas prices² and the Licensing Ordinance³) should be updated and approved by the EWRC by **8 December 2019**;
- The Rules for the operation of the Gas Exchange should be proposed by the gas exchange operator and approved by the EWRC by **8 January 2020**.

Measures set to increase gas market liquidity

Given the current status of liberalization of the Bulgarian natural gas market, where more than 90% of the gas is supplied by Bulgargaz and the percentage of transactions performed by other traders is still very low, the Amending Act introduces several

² Ordinance No. 2 for regulation of natural gas prices, published in State Gazette No. 33/2013, as amended from time to time.

³ Ordinance No. 3 for licensing of energy activities, published in State Gazette No. 33/2013, as amended from time to time.

measures to ensure a smooth transition to a functional natural gas market with sufficient liquidity and participants:

- market players such as the large industrial natural gas customers are required to participate in the Gas Exchange;
- new market participants are introduced – a liquidity provider and a market maker;
- a gas release program (GRP) for the incumbent supplier is to be implemented.

All transactions with short-term standardized products (which are transactions with products in day ahead and intra-day segments on the Gas Exchange) and with products of up to 1 year should be carried out by the market participants through the Gas Exchange. In addition, natural gas production companies are obligated to offer at least 15% of their produced gas in Bulgaria at the Gas Exchange (starting from 1 January 2020).

Strengthening the regulator's monitoring and supervision authorities

The Bill also extends the EWRC's authority to ensure the transition from a regulated to a liberalized natural gas market. The EWRC is to perform monitoring and market supervision of the Gas Exchange operations. The specific mechanisms for implementation of these additional powers are expected to be outlined in the secondary legislation currently under preparation.

Although discussed during the consultation process of the Amendment Act, no licensing obligations for the traders or additional administrative burden on market stakeholders have been introduced. This is a positive sign for the current and potential gas market participants, as Bulgaria remains one of the several European gas markets which does not foresee licensing requirements for performing trading activities on the wholesale gas market.

Comments

The new amendments to the Bulgarian Energy Act are a significant step toward future full liberalization of the Bulgarian natural gas market. It is expected that the current hybrid model of a regulated and free-negotiated prices market will continue for a certain period. However, with the Amending Act, the regulated market segment has been limited only to end-suppliers, district heating utilities and households. From now on, liberalized segment will include not only traders, production companies, transmission, storage and LNG operators, but all industrial consumers, directly connected to the gas transmission network as well.

The introduced law amendments come after the European Commission imposed a fine on Bulgargaz, Bulgartransgaz and their mother company BEH of €77 million for blocking competitors' access to key gas infrastructure in Bulgaria. Particularly, the incumbent supplier Bulgargaz has been sanctioned for monopolizing the capacity on the only import pipeline which brings Russian gas through Romania to Bulgaria, which resulted in an elimination of potential competitors. It is notable, however, that the introduction of

the GRP was not preceded by a market test or transitory/test period to allow the operators to properly assess whether the gas release remedy would be suitable to remove the identified competition concerns.

Implications for the current natural gas supply contracts and tariffs

The Bill does not provide an obligation for the industrial consumers to terminate their natural gas supply contracts and conclude new gas supply contracts on a level-playing field, i.e. to buy gas at freely-negotiated prices. The industrial consumers can participate at the gas release auctions in the first stage. However, considering the current lack of alternative gas sources, Bulgargaz may in all likelihood remain their prevailing supplier, but in the capacity of a gas trader or liquidity provider and under market prices.

End-suppliers and district heating utilities will continue buying natural gas from Bulgargaz at regulated prices. They will also have the choice to purchase natural gas from traders at freely-negotiated prices and will be allowed to participate in the GRP auctions organized by Bulgargaz.

Further actions

As a next step, changes in the secondary legislation are expected. In following client alerts, we will provide an overview of the draft Gas Release Program Implementation Agreement and Trading Platform Rules for the operation of the Gas Exchange, as proposed by the Gas Exchange operator, as well as the main changes proposed in the secondary gas legislation further developing the legislation of the liberalized natural gas market in Bulgaria.

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