

ANDRIS PIEBALGS

MEMBER OF THE EUROPEAN COMMISSION

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Your Excellency,

On 23 February 2007 the government of Italy submitted¹ a decision to exempt the Poseidon pipeline from the requirements relating to third party access contained in Articles 18, 20 and 25(2-4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC², pursuant to the provisions of Article 22 of that Directive relating to major new infrastructure projects.

The Poseidon project has been developed at the initiative of the Italian gas company Edison and the Greek gas company DEPA. The capacity of the interconnector has been determined by the developers taking into consideration their demand, some technical constraints and the assumed availability of natural gas for export from Greece. Therefore, the developers have decided to build a pipeline with a nominal capacity of 8 bcm/year.

It is noted for the record that, after the receipt of the formal notification, a notice was placed on the DG Energy and Transport website inviting observations from market participants. By letter dated 1 May 2007, the services of the Commission received comments from the Swiss Federal Office of Energy SFOE and by letters dated 2 May 2007, from EGL Elektrizität-Gesellschaft Laufenburg AG and from TAP Trans Adriatic Pipeline AG.

These third parties expressed strong concerns about the project and indicated that suppliers other than the shareholders of Poseidon (Edison, DEPA) have an interest in using the pipeline.

The services of the Commission, by letter dated 30 March 2007 have requested additional information to the Italian and Greek authorities, which have been answered by letter dated 24 April 2007. Finally the Italian and Greek authorities called a meeting with the services of the Commission, which was held on 18 April 2007. A second meeting was held on 10 May 2007.

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¹ The notification included an inter-governmental agreement on the specific issue. This fulfils the requirement for a consultation stated in Article 22(3)e of the Directive. Conversely, since the primary exemption decision was taken within the framework of the (Italian) Decree of 11 April 2006 (OJ n° 109 of 12 May 2006), the developers will lose any right if the exemption will be revoked pursuant to the provisions of Article 6 of the above mentioned Decree. [see Third party observations (i) and (vi)]

² OJ L 176, 15/07/2003, p. 57.

Summary of submissions

The submissions of the Italian and Greek authorities point out that:

- The Poseidon pipeline will be in competition with other import routes into Italy and not be in a position to abuse any dominant position,
- The project will increase the level of competition in the Italian and EU gas markets allowing DEPA and Edison to compete with the incumbent supplier and consequently reducing the latter's market power.
- The project will increase the level of gas supply security, allowing import of diversified sources of gas through a new route
- The project will favour the creation of an Italian gas hub, increasing the liquidity of the market and the number of players.
- The level of risk of the project is such that without an exemption for 100% of the initial nominal capacity and for 25 years the investment would not be realised
- The Poseidon Pipeline company, to be established by Edison and Depa before the commencement of construction activities, will be a separated legal entity from the TSOs in Italy (Snam Rete Gas) and Greece (Desfa, 100% owned by Depa).
- Charges for the transportation will be paid exclusively by the effective users of the Poseidon Pipeline and no additional charges will be levied upon other system users.
- The third party access exemption will not have any detrimental effect to competition because neither Edison nor Depa will achieve a dominant position on the Italian market. On the contrary, the exemption will allow Edison to effectively compete with the Italian gas market incumbent and Depa to enter into the Italian market.
- The third party access exemption will not have any detrimental effect neither to the effective functioning of the internal gas market, nor to the efficient functioning of the regulated system, as the related extension and improvement of Italian and Greece transport systems will be made within the relevant regulatory frameworks of the two countries.

The abovementioned authorities have therefore considered the application, as compliant with the relevant EU legislation for requesting an exemption from third party access, as well as with its national applications.

In addition, in order to enhance the pro-competitive effects of the project the regulatory authorities have imposed the following additional conditions:

- Backhaul Flow TPA access: The non-physical reverse flow capacity (from Italy to Greece) of the interconnector Poseidon pipeline shall be subject to regulated TPA regime under terms and conditions to be defined by the relevant energy regulators, according national and EU legislation.
- Capacity upgrade: Poseidon Pipeline Company shall perform within one year from the operation date an open procedure, to be approved by the relevant national authorities, to allocate to third parties incremental transportation capacity up to 0.8 BCM/Year.

- Contribution to Market Liquidity: Gas shippers through the Poseidon Pipeline exempted capacity shall commit to offer annually 10% the relative imported volumes to the Italian PSV (the existing Virtual Exchange Point within the national grid, established by Italian Energy Regulator and becoming the Italian trading hub) under transparent and non discriminatory conditions.
- Cap to exempt capacity: No Gas shipper through the Poseidon Pipeline will be authorized to contract more than 80% of the exempted transportation capacity.

Third party observations

The third party observations received by the Commission on the 1st and 2nd of May 2007 expressed a general concern about granting an exemption for the IGI Poseidon pipeline on the basis of Article 22 of Directive 2003/55/EC. More particularly, the third parties raise the following arguments:

- i. Various agreements require DEPA to refrain from entering into negotiations or commitments for the development of any other gas interconnector project. As a result, it is impossible for any other interested party to explore alternatives to the IGI project.
- ii. The Italian and Greek authorities have not taken account of the overall transportation interest in shipping gas from Greece to Italy by failing to impose on the developers an open procedure to test market demand. This leads to a reservation of this strategic supply corridor for the exclusive use of two incumbent gas suppliers.
- iii. The exemption decision has been notified only by one of the national governments concerned, that is the Italian government. One national decision is however insufficient to properly assess the competitive effect of the exemption in each of the Member States.
- iv. At the time of the exemption decision on 31 January 2007, Greece had not implemented Directive 2003/55/EC in full – in particular by failing to adopt the necessary secondary legislation to implement the Gas Directive and by delaying the requisite unbundling of DEPA which was effected only on 1 May 2007.
- v. It can be doubted that the project contributes to the security and diversity of supply as no upstream gas supply agreements are presently in place.
- vi. While the Italian exemption decision of 31 January 2007 elapses after two years from the date of issue if the construction will not have started, it is not clear whether a similar requirement will be imposed under Greek law.

Commission Evaluation

The project corresponds to a major new infrastructure in the sense of Article 22 of Directive 2003/55/EC.

The decision to exempt the project is required to fulfil the criteria set out in Article 22 of Directive 2003/55/EC as follows:

- (a) the investment must enhance competition in gas supply and enhance security of supply;
- (b) the level of risk attached to the investment is such that the investment would not take place unless an exemption was granted;
- (c) the infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built;
- (d) charges are levied on users of that infrastructure;
- (e) the exemption is not detrimental to competition or the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.

Of these five criteria, the exemption decision as drafted by the Italian and Greek regulatory authority fulfils criteria (c) and (d), that is to say that the company owning the project will be a legally separate company and that the use of the infrastructure will be subject to specific charges.

Regarding criterion (a), it is considered that the project has the potential to enhance competition in the Italian gas market. In fact it must be considered that to date all gas import infrastructure are under the direct or indirect control of the dominant supplier, which enjoys a de facto monopoly in gas import, even if not a legal one. In this context the addition of a new gas infrastructure which will be outside of the control of the dominant supplier would represent a substantial increase of competition.

As far as security of supply is concerned, it is clear that the new infrastructure would improve security of supply by opening up a new supply route. On the other hand, since no purchase contract has been made available to the Commission, it is not possible to know whether the infrastructure would also bring an additional improvement in security of supply by allowing access to new producer countries, which do not currently supply Italy, although this is the stated intention of the parties. In the latter case the positive effect of security of supply, both at national and EU level will be substantially stronger.

In relation to criterion (b), the level of risk attached to a project applying for an exemption must be of such a nature that the project developer needs to secure (long term) contracts to underpin the investment. The Italian and Greek authorities endorse the developers' claim that investment involves a level of risk such as it will not be financially viable without an exemption of 100% of the capacity for 25 years.

From the economic and financial point of view the project under consideration has been assessed as a stand alone infrastructure, since the subsea structure is the only part that has been granted an exemption from third party access rules. It is considered that all the onshore pipelines, both in Italy and in Greece will be subject to full third party access according to the general provisions of the gas Directive 2003/55/EC. Nevertheless the

availability of gas on the Greek end of the pipeline is subject to supplementary risks not related to the Poseidon infrastructure itself, but also to the need to ensure transit of gas on a long route, encompassing different countries thus adding a political risk. Indeed the developers claim that long term take-or-pay and ship-or-pay agreements will be necessary to allow producers and transportation system operators to underpin new investments in production and transportation infrastructures, and this in turn makes necessary for them to be able to secure such a long derogation. Finally the gas to be transported by the Poseidon pipeline will be burdened with the costs for transportation from the country of origin to Stavrolimenas and will have to compete with that imported by other infrastructures, both existing and planned ones.

The Commission has examined carefully the financial analysis produced by the developers, which has been assessed and endorsed by the two national governments and by the two independent regulatory authorities. The Commission notes however that the developers' claim on the need of derogation is particularly justified with reference to gas originating from "non-traditional" suppliers, because of the higher risk involved this is not necessarily the case for "traditional" origin.

Taking all the above mentioned circumstances into consideration the information submitted leaves some open questions on whether the risk level involved in the project can be considered sufficiently high in all scenarios to justify the derogation and therefore criterion (b) can be considered as having been entirely fulfilled.

In view of criterion (e), the Greek and Italian authorities consider that the project will not have a detrimental effect on the functioning of the internal gas market or the efficient functioning of the regulated system to which the infrastructure is connected. In connection to this, the Commission understands that the operation of the Poseidon pipeline will be subject to use-it-or-lose-it provisions, pursuant to the national legislation currently in force. In addition the same legislation provides for revocation of the exemption granted if the developers deviate substantially from the project or from the timetable submitted.

In fact the only mitigating measures that have been taken are above described additional conditions and the requirement to implement a system of UIOLI, according to the national legislation currently in force.

Moreover the Commission considers that – in the absence of an adequate open season or any other form of testing of market demand – the mitigation measures undertaken by the project developers are not sufficient to ensure that the criterion "e" is met. The requirement imposed by the Greek and Italian authorities to offer an additional capacity to the market of 0.8 bcm/year would constitute a limited amount of transportation capacity compared to the potential additional capacity that could be made available. In the project description, it is explained that the pipeline could be upgraded up to a capacity of 10 bcm/year (i.e. a 25% increase) if two additional compression stations are built.

Therefore the 0.8 bcm/year required increase in capacity seems unnecessary limited, as any test of market demand could point out that there is demand for higher pipeline capacity. In fact 0,8 bcm/year is fixed by the two national authorities due to limitations in the capacity of the Greek system, limits which can be overcome without unreasonable efforts. However, any capacity contracted for the interconnector would also need to ensure the availability of capacity in the Greek system. Finally there is no reason to delay

the open procedure until the infrastructure will be operational. These two circumstances may raise concerns on a possible detrimental effect on competition, which is not sufficiently justified by technical or financial reasons.

With reference to third party observation (i) the Italian and Greek authorities denied such circumstance, supplying the Commission with copy of the mentioned inter-governmental agreement; indeed such a limitation would not be in either the interest of Italy as a destination country or of Greece as a transit country; in addition DEFSA, the Greek transmission system operator has been legally unbundled from DEPA, and will respect all the EU rules. As far as third party observation (iv) is concerned it is considered that Greece has adopted part of the necessary secondary legislation and that the remaining part is in the process of being adopted. Indeed the Greek authorities claimed that the legislative framework currently in preparation will be in full compliance with all the provisions of Directive 2003/55/EC and of Regulation 1775/2005, thus creating favourable conditions for the gas undertakings willing to operate in the Country. Therefore – as long as DEPA has not previously entered into any valid agreement which would prevent it from taking the necessary measures to grant transit on its network or to undertake the necessary network improvements to enable other gas interconnector projects - there is no reason to believe that the infrastructure under consideration can have a detrimental effect on the possibility to develop other gas infrastructures.

Article 22(3)(b)(ii) and 22(3)(c) of the Directive requires national regulatory authorities to give consideration to the need to impose conditions regarding non-discriminatory access to the interconnector, and allows the regulatory authorities to decide upon the rules and mechanisms for management and allocation of capacity, insofar as this does not prevent the implementation of long term contracts. The Commission considers that, in order to mitigate the consequences of reduced regulatory involvement in capacity allocation, the Greek and Italian regulatory authorities should have applied these provisions, in order to ensure the most effective application of the "open season" approach reasonably possible, and it is therefore considered by the Commission that the exemption, as currently formulated does only partially fulfil criterion (e) of Article 22 of Directive 2003/55.

Conclusion

In conclusion, the Commission, having examined the arguments outlined in the exemption decision adopted by the Italian and Greek regulatory authorities and notified to the Commission on 23 February 2007, and the subsequent correspondence, considers that the positive effects on competition and security of supply seems not fully proportional to the extent of the exemption granted.

The Commission considers that the additional conditions imposed on the developers should therefore be strengthened as described hereafter:

- Capacity upgrade: Poseidon Pipeline Company shall within one year from the date of the exemption decision test market interest, by performing an open season procedure, to be approved by the relevant national authorities, thus making available to third parties incremental transportation capacity to meet the effective demand. The minimum capacity to be made available in this procedure shall not be less than 0.8 bcm/year, the final amount to be approved by the regulatory authorities in question, making full use where possible of all the technical capacity reasonably available.

- Duration of derogation: Given the potential different levels of risk associated with the project depending upon where the gas in question originates from "non-traditional" sources of gas supply to the Italian and Greek markets (i.e. those which make up less than 20% of the present natural gas consumption) compared to "traditional" sources, the Italian and Greek regulatory authorities should explicitly determine whether and to what extent different derogation periods should be granted depending on the actual origin of the gas that is eventually contracted with respect to the pipeline, and amend the decision accordingly.
- Respect of timetable; The national authorities shall apply strictly the provisions of article 6(1) of the Italian decree of 11 April 2006, by cancelling the exemption granted if the developers fail to put in operation the infrastructure by the year 2012, as stated in the documents attached to their application.
- Gas transport through Greece; The Greek national authorities shall approve without delay the currently pending secondary legislation on gas, ensuring effective access to undertaking willing to transport gas through the country. Furthermore, the Greek national authorities shall confirm that DEPA has no currently valid agreement which would prevent it from taking the necessary measures to grant transit on its network or to undertake the necessary network improvements to enable other gas interconnector projects.

Therefore by virtue of the third subparagraph of Article 22(4) of Directive 2003/55 the Commission hereby requests Italy and Greece to amend the exemption decision accordingly within four weeks upon receipt of the present letter and to inform the Commission of this action.

For the Commission

Andris Piebalgs

Member of the Commission