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Brussels, 22. 10. 2008  
CAB D(2008) 1094

C(2008) 6254

**Subject: Exemption decision on the Austrian section of the Nabucco pipeline**

Dear Sir,

I am writing with reference to the decision adopted by Energie-Control Kommission modifying its decision to exempt from certain parts of the Gas Directive 2003/55 the Austrian section of the Nabucco pipeline which was notified to the Commission and received on 22 July 2008.

The Commission has now completed its analysis of the decision and supporting material. The conclusion of this analysis is that the Commission requests a modification of the decision adopted by Energie-Control Kommission. The details are set out in the Annex to this letter.

Yours sincerely,

For the Commission,

Andris Piebalgs

Annex

Energie-Control GmbH  
Herr Walter Boltz  
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## ANNEX

### Procedure

1. On 24 October 2007, the Austrian energy regulator Energie-Control Kommission (hereinafter: "E-Control") adopted a decision (*Bescheid*) to exempt the Austrian section of the Nabucco gas pipeline project for 25 years from regulated third party access and from the tariff regulation as defined in Articles 18, 25(2), (3) and (4) of Directive 2003/55/EC (hereinafter: "the Gas Directive"), transposed as §17(1) and §31(e), (g) and (h) in the Austrian Gas Act (*Gaswirtschaftsgesetz*). The exemption decision was notified to the Commission on 8 November 2007.
2. On 8 February 2008, the Commission took a decision to request E-Control to amend the exemption decision by including additional conditions to ensure that the exempted project would comply with all conditions of Article 22 of the Gas Directive (hereinafter: "the Commission's amendment decision"). On 9 April 2008, E-Control amended its exemption decision in accordance with the Commission's request.
3. On 28 May 2008, Nabucco Gas Pipeline International GmbH (hereinafter "Nabucco International") submitted a request to E-Control to amend the exemption decision. Nabucco International requested to extend the validity of the exemption decision until the end of 2017 and to limit the obligation to extend capacity according to demand only to the construction steps as mentioned in its original exemption application.
4. On 16 July 2008, E-Control modified its exemption decision (hereinafter "the modified exemption decision") extending the final validity of the exemption decision until the end of 2016 and accepting Nabucco International's request with respect to the future capacity extension. The exemption decision was registered as received by the Commission on 22 July 2008.
5. On 31 July 2008, the Commission published a notice on the notification of E-Control's modified exemption decision inviting third parties to comment within two weeks. The Commission has not received any comments.
6. On 22 August 2008, the Commission requested additional information from E-Control. On 10 September 2008, E-Control replied to the Commission's request for information. On 15 September 2008, the Commission met with Nabucco International and with the regulatory authorities of all Member States involved in the Nabucco project in order to discuss the state of play of the Nabucco project and to coordinate the next steps in the exemption procedure. Considering the one month extension where additional information is sought, the final date for the Commission to request an amendment or withdrawal of the exemption decision is 22 October 2008.

### Description of the modified exemption decision of 16 July 2008

7. The present decision reviews the modifications which E-Control introduced in its modified exemption decision of 16 July 2008. The general review of the exemption of the Austrian section of the Nabucco pipeline project was already carried out by the Commission in its amendment decision of 8 February 2008. The modified exemption decision of 16 July 2008 changes two elements of the exemption, firstly,

the extension of the validity of the decision and, secondly, Nabucco International's obligation to build additional capacity according to demand.

*Extension of the validity of the exemption decision*

8. In its first exemption decision of 24 October 2007, E-Control required that the Austrian section of the Nabucco gas pipeline be put into operation not later than five years after this decision would have become legally effective. Otherwise, the exemption decision would be void.
9. In its amendment decision of 8 February 2008, the Commission considered that Nabucco International would have legal certainty about the full exemption of the Nabucco pipeline according to Article 22 only once the regulatory authorities of all four Member States concerned have granted exemptions for the pipeline sections in their respective jurisdictions and once the Commission has reviewed these decisions. The 5-year validity of the Austrian exemption decision before the start of operations was therefore in practice shortened by later exemption dates in the other Member States.
10. To preserve the 5-year validity of the Austrian exemption decision before the start of operations, the Commission considered it therefore necessary to link its validity to the date when the last exemption decision in any of the Member States concerned would become effective, i.e. to the date of the Commission's approval of the respective decision. However, in order to avoid that possible delays in the administrative procedures in one of the other Member States concerned would extend the validity of the Austrian exemption decision excessively, the Commission requested that the pipeline would have to be operational by the end of 2014 for the exemption decision to take effect.
11. In its application of 28 May 2008, Nabucco International requested to extend the validity of the exemption decision until the end of 2017. Nabucco International brought forward a number of arguments to justify its request. In particular, Nabucco International gave the following reasons:
  - The start of operations of the Nabucco pipeline relies heavily on the start of the exploitation of the Shah Deniz II gas field in Azerbaijan. Alternative sources of gas are unlikely to be available before 2013 when the Nabucco pipeline is in principle scheduled to become operational. Since the beginning of 2008, the promoters of Shah Deniz II have however announced that exploitation is delayed by one more year and is likely to start only by the end of 2013.
  - The conclusion of the Intergovernmental Agreement between the countries along the pipeline route was scheduled for late 2007. However, the agreement is still not signed and may in fact not be signed before the end of 2008. The Intergovernmental Agreement is of great importance in particular to create the necessary legal certainty in Turkey (the only country along the pipeline route outside the EU). This agreement is a necessary condition, for example, to establish the national Nabucco company in Turkey, to fix the tax regime for the national Nabucco companies and to ensure that the Turkish section of the pipeline benefits from an exemption similar to the exemption according to Article 22 of the Gas Directive.

- The present crisis of the financial markets involving several large banks located in the EU makes it more difficult to obtain the necessary long-term financing for the Nabucco project. In particular, the banks ask for more securities and for greater legal certainty such as for example the conclusion of the above mentioned Intergovernmental Agreement.

Nabucco International has put forward additional reasons to justify a longer validity of the exemption decision such as possible delays in the national administrative procedures to obtain environmental permits and a shortage in the steel supply market possibly delaying the delivery of the pipes to construct the pipeline.

12. In its modified exemption decision of 22 July 2008, E-Control in principle accepted Nabucco International's arguments to extend the validity of the exemption decision. It however considered that an extension until the end of 2017 would be excessive. It therefore decided to limit the validity of the decision until the end of 2016.
13. Notably, the main criterion to limit of the validity of the decision remained unchanged, i.e. the Austrian section of the Nabucco natural gas pipeline has to be put into operation no later than five years after the last exemption decision in any of the Member States concerned has become effective, i.e. after the Commission's approval of the respective decision.

*Obligation to extend the capacity according to demand*

14. In its original application for exemption, Nabucco International presented different planning scenarios for the construction of the Nabucco pipeline.<sup>1</sup> According to the scenario entitled Variant B, the pipeline will be built according to the following stages: The first construction stage of a capacity of 8 billion cubic meters (bcm) will begin in 2009 and will be put into operation by 2012. The following construction stages will lead to an increase in pipeline capacity to a total of 15.7 bcm/year (starting operation by 2014), 25.5 bcm/year (starting operation by 2017) and 31 bcm/year in the final stage (starting operation by 2020).
15. In its exemption decision of 9 April 2008, E-Control stated that Nabucco International is obliged to take into account all binding capacity bookings resulting from the open season procedure up to a total capacity of 25.5 bcm/year by moving forward the respective construction steps.<sup>2</sup> In its application of 28 May 2008, Nabucco International requested to clarify that it would move forward the construction of additional capacity only if the binding capacity requests corresponded to the entire volume necessary to fill the next construction step. Nabucco International argued that the pipeline extension would require the installation of additional compressor stations entailing that the capacity could not be extended marginally, but only in discrete steps. According to Nabucco

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<sup>1</sup> Commission's amendment decision, paragraph 11.

<sup>2</sup> Excerpt of condition 8 of E-Control's modified exemption decision of 9 April 2008: "Bei Überbuchung im Rahmen der Open Season Verfahren bis zu einer maximal verfügbaren technischen Gesamtkapazität von 25,5 Mrd. m<sup>3</sup>/a verpflichtet sich Nabucco International durch Vorziehen der Ausbauschritte alle Kapazitätsbuchungen gemäß den verbindlichen Kapazitätsanmeldungen zu berücksichtigen."

International, only the four capacity steps outlined above constitute technically and economically viable construction steps.

16. In its modified exemption decision of 16 July 2008, E-Control accepted Nabucco International's argument without further discussion.

### **Assessment of the modified exemption decision in the light of Article 22 of the Gas Directive**

17. Exemptions for major new infrastructures according to Article 22 constitute an exception to the general rules on regulated third party access in the Gas Directive. When granting or modifying an exemption, the regulatory authority therefore needs to accurately justify its exemption decision and to limit its scope and duration to what is strictly necessary.

#### *Extension of the validity of the exemption decision*

18. The Nabucco pipeline project is a unique project in that it stretches over more than 3 000 km crossing five different countries and has the potential to open up several new sources of gas for the EU. Moreover, the resource regions have recently been characterised by a high degree of political instability, notably Georgia which is a transit country for the gas coming from Azerbaijan. The Nabucco pipeline project thus bears technical, economic and political risks which exceed the risks of most other major infrastructure projects in the EU energy sector.
19. Nabucco International's request for a longer validity of the exemption decision should be considered, under Article 22 of the Gas Directive, in the light of facts which have changed since the original exemption decision was granted and which would justify a revision of the assessment underlying the provision on the validity of that decision.
20. Nabucco International has pointed out a number of events which indicate that the situation concerning its pipeline project has changed significantly since the beginning of 2008. In particular, the delay in the start of the exploitation of the Shah Deniz II gas field, the delay in the conclusion of the Intergovernmental Agreement and the considerable worsening of the present financial crisis which has started to affect Europe must be considered to adversely affect the time schedule for the Nabucco pipeline.
21. Another factor, which was known neither at the time of Nabucco International's request to modify the exemption decision on 28 May 2008 nor at the time of the adoption of E-Control's modified exemption decision on 22 July 2008, concerns the military conflict which broke out in Georgia in August 2008 and which highlighted the political instability in the region from which the gas for the Nabucco pipeline is planned to be sourced. Like the factors noted in paragraph 20, this conflict is likely to adversely affect the time schedule for the Nabucco pipeline because banks are likely to impose tighter financial credit requirements and because shippers are likely to show greater caution before committing to purchasing gas in the Caspian region and transporting it to the EU.
22. The Commission therefore considers that E-Control's decision to extend the validity of the exemption decision until the end of 2016 is justified. The Commission however notes that E-Control's modification of the relevant provision

in the exemption decision is unlikely to achieve the envisaged objective because the main condition limiting the validity of the exemption decision, i.e. five years after the Commission's approval of the last exemption decision in any of the Member States, has remained unchanged. If the last national exemption decision becomes effective, for example, in the course of 2009, E-Control's modification will not have any effect on the actual validity of the exemption decision because it would lose its validity already in the course of 2014.

23. Both E-Control and the Commission agree that the factual circumstances underlying the exemption for the Nabucco pipeline have changed significantly since early 2008 and justify an extension of the decision validity by two more years. The Commission therefore considers it necessary to also modify the main condition limiting the validity of the decision to effectively achieve such an extension. It therefore requests E-Control to amend the modified exemption decision in such a way that the Austrian section of the Nabucco natural gas pipeline has to be put into operation no later than *seven* years after the last exemption decision in any of the Member States concerned has become effective, i.e. after the Commission's approval of the respective decision. In any event, it shall be put into operation no later than on 31 December 2016.

*Obligation to extend the capacity according to demand*

24. With respect to Nabucco International's obligation to extend the pipeline capacity according to demand, the Commission notes that this obligation is relevant to assess whether condition (a) of Article 22(1) of the Gas Directive is fulfilled, namely that the investment must enhance competition in gas supply and enhance security of supply. As explained in the following, in the absence of such an obligation, smaller market players may not be able to obtain transport capacity because their requests are more likely to fall in between the large envisaged construction steps. This risks harming competition. Moreover, the investment may not enhance security of supply because there is a risk that such large construction steps favour the bundling of supply to serve few large downstream markets while other relatively small downstream markets may not be served.
25. With respect to the project planning as outlined in paragraph 14, the Commission would, first of all, like to point out that during the first exemption procedure, Nabucco International presented its planning only as indicative both in terms of timing and construction stages.
26. In fact, the above planning could necessarily be only indicative since neither the precise origin nor the destination of the gas volumes were known at the time of the application and are still not known. In the application, it was, for example, left open whether the Nabucco pipeline would connect to the Georgian/Turkish border or to the Turkish/Iranian border or both.<sup>3</sup> Moreover, the precise entry/exit points will be determined only at a later date when the results of the capacity allocation procedure are known.<sup>4</sup> As stated previously, market players will be able to bid for

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<sup>3</sup> Application, paragraph 17.

<sup>4</sup> For more detail on the capacity allocation procedure see paragraph 15 of the Commission's amendment decision. The location of entry/exit points and the volume of gas entered/exited at these points have an influence on the flow conditions in a pipeline. Flow conditions, in turn influence the choice of technical enhancement measures.

capacity for each exit/entry point.<sup>5</sup> Upon request, Nabucco International has to add other entry or exit points if those are technically and economically reasonable. This flexibility in installing entry and exit points along the pipeline shows that the pipeline design still can be, and in fact still needs to be, adjusted to different gas transport volumes in different parts of the pipeline.

27. Moreover, the additional capacity steps e.g. from 8 to 15.7 bcm/year (corresponding to 7.7 bcm/year) and from 15.7 to 25.5 bcm/year (corresponding to 9.8 bcm/year) represent very large gas volumes which are close to or even exceed the entire annual gas consumption of Austria (8.5 bcm/year in 2006).<sup>6</sup> The experience of other pipelines suggests that much smaller enhancement steps than those indicated by Nabucco International may be technically and economically feasible.
28. As in the case of other pipeline projects, the capacity of the Nabucco pipeline could be increased not only by very large amounts by laying a new pipe along the entire pipeline system. Instead, compressor stations varying in size could be added at different sections of the pipeline to increase the pressure and thus the transport flows of gas in smaller incremental steps.<sup>7</sup> The Commission also notes that in other European pipelines, the capacity at the final exit point was increased even though only individual stretches of the pipeline system situated at a considerable distance from the final exit point were looped by adding a further pipeline.
29. The Commission, for those reasons, considers that the four above mentioned capacity steps do not constitute the only technically and economically viable construction phases. There appears to be significantly more technical and economic flexibility to adapt the transport capacity of the Nabucco pipeline according to binding capacity bookings.
30. More flexibility to adapt the capacity according to market demand is crucial to ensure that the Nabucco pipeline increases competition and security of supply in all relevant markets. With respect to competition, there is a risk that the restriction to the indicative construction steps favours large capacity requests by large market players over the requests by smaller market players and may thus have a significant impact on the development of competition on the Austrian natural gas markets. Entry by one or more competitors to the companies which are dominant on the Austrian natural gas markets could turn out to be very significantly delayed or made impossible, if these competitors decided to enter with a volume below an additional capacity step as defined by Nabucco International (although such enhancement could still be technically feasible and commercially viable for Nabucco International).
31. Moreover, there is a risk that smaller markets along the Nabucco pipeline may not be served and that the Nabucco pipeline may thus not enhance the security of supply in the markets concerned. This may occur because large construction steps

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<sup>5</sup> Commission's amendment decision, paragraph 19.

<sup>6</sup> Source: E-Control.

<sup>7</sup> E.g. the latest capacity increase step on the Trans-Austrian-Gas (TAG) pipeline has led, through the addition of compressor power, to a capacity increase of about 3 bcm from the Austrian-Slovak border to the Austrian-Italian border as of 1 October 2008.

are likely to favour the bundling of supply to serve only few large downstream markets. In addition, the restriction to large construction steps risks to unnecessarily delay the enhancement of security of supply. It is only once there are binding capacity requests for an entire additional construction step that the pipeline would be expanded while at the same time there may, for several years, be sufficient binding capacity requests to carry out an intermediate, technically and economically viable pipeline expansion with beneficial effects on security of supply.

32. Based on these considerations, the Commission considers that Nabucco International's obligation to extend the capacity according to binding capacity requests should not be limited to the four construction steps of 8, 15.7, 25.5 and 31 bcm/year.
33. The Commission accepts that the minimum capacity bookings to launch the Nabucco project amounts to 8 bcm/year. Due to the magnitude of the initial investment, such a minimum critical size is necessary to spread the costs of the initial investment over a sufficiently high transport volume in order to ensure an economically viable transportation tariff. It also accepts that it is not necessary to oblige Nabucco International to review the technical and economic feasibility for all binding requests intermediate<sup>8</sup> to the above four construction steps.
34. That obligation should apply only if binding requests are made which amount to a volume of 1.0 bcm/year. A volume of 1.0 bcm/year corresponds to a share of the Austrian gas market of approximately 10% in the coming years.<sup>9</sup> In past merger cases, the Commission has found that such a volume share has an appreciable effect on competition in the market.<sup>10</sup> Moreover, given the above mentioned measures to marginally increase transport volume in a pipeline, a capacity increase of 1.0 bcm/year appears to be *prima facie* technically and economically feasible.
35. Thus, for aggregate capacity requests intermediate to the above four construction steps which amount to at least 1.0 bcm/year, Nabucco International should be subject to the obligation to extend the capacity of the pipeline according to binding capacity requests, unless it can demonstrate to the national regulator that a specific capacity expansion is not economically or technically viable. This is without prejudice to the application of condition II(b) of the Commission's amendment decision which reads as follows: "*In the event of overbooking, capacity allocation shall take place in a transparent and non-discriminatory procedure, for example*

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<sup>8</sup> Intermediate refers to capacity volumes in between the four construction steps as described by Nabucco International.

<sup>9</sup> This figure is based on the total Austrian gas consumption of 8.5 bcm/year in 2006 (see paragraph 27) and the estimation that gas consumption will increase by about 20% over the next years, see E-Control: Der österreichische Gasmarkt.

<sup>10</sup> In Case No COMP/M.3868-DONG/Elsam/Energi E2 of 14 March 2006, para 712, for example, the Commission accepted, as a commitment, a gas release programme by DONG whose volumes corresponded to approximately 10% of total Danish consumption. In Case No COMP/M.3696 E.ON/MOL of 21 December 2005, para. 802 and 741, the gas quantities released by the parties accounted for up to 14% of the total Hungarian demand and the E.ON alone undertook to implement a gas release programme of 1.0 bcm/year in Hungary, a market which is somewhat larger than the Austrian market.



*on a pro rata basis, which shall ensure that each bidder is allocated a minimum amount of capacity."*

36. The changes requested are the least restrictive conditions that can be envisaged in order to ensure that the exemption meets the conditions set out in Article 22 of the Gas Directive and do not go beyond what is necessary to that effect.

### **Conclusion**

37. Based on the foregoing analysis, the Commission considers that the modified exemption decision needs to be amended to fully comply with Article 22 of the Gas Directive. In order to ensure, firstly, that the validity of the modified exemption decision is extended to reflect the change in the factual circumstances and, secondly, that the project enhances competition and security of supply, the Austrian regulator is requested to amend the modified exemption decision to include following conditions:

- I. The Austrian section of the Nabucco natural gas pipeline has to be put into operation no later than *seven* years after the last exemption decision in any of the Member States concerned has become effective, i.e. after the Commission's approval of the respective decision. In any event, it shall be put into operation no later than on 31 December 2016.
- II. Nabucco International is obliged to build additional capacity also for binding capacity requests which are intermediate to the constructions steps as described in its application of 23 February 2007 in the versions of 7 August 2007 and 12 September 2007 of pre-act (*Vorakt*) K NIS G 01/07 to the extent that such an expansion is technically possible and economically viable and that the binding capacity requests amount to at least 1.0 bcm/year. If Nabucco International considers that in spite of the presence of such binding capacity requests a pipeline expansion is not technically possible or economically viable, it is obliged to notify and justify this situation to E-Control.

38. Therefore by virtue of Article 22(4) of the Gas Directive, the Commission hereby requests the E-Control to amend the modified exemption decision accordingly within four weeks upon receipt of the present letter and to inform the Commission of that action.