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MEMBER OF THE EUROPEAN COMMISSION

ENGLISH TRANSLATION

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Brussels, 8 February 2008
CAB D(2008)142

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 granting exemption from certain parts of the Gas Directive 2003/55 for the Austrian section of the Nabucco pipeline notified as received by the Commission on 8 November 2007.

The Commission has now completed its analysis of the decision and supporting material. The conclusion of this analysis is that the Commission requests the modification of the exemption decision. The details are set out in the Annex to this letter.

Yours sincerely,

For the Commission,

(signed)

Andris Piebalgs

Annex

Energie-Control GmbH
Herr Walter Boltz
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ANNEX

Procedural

1. On 24 October 2007, the Austrian energy regulator Energie-Control Kommission (hereinafter: "E-Control") adopted a decision to exempt the Austrian section of the Nabucco gas pipeline project (hereinafter "the exemption decision") for 25 years from regulated third party access as defined in Articles 18 and from the tariff regulation in 25(2), (3) and (4) of Directive 2003/55/EC, 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. The exemption decision imposed the following conditions:[1]

   (1) "Twenty years after starting operation of the first construction stage the tariff method submitted by the applicant for approval shall be reviewed by the E-Control or the regulatory authority that is competent at the time.

   (2) If after twenty years from putting into operation its first construction stage, the tariffs of the Austrian section of the Nabucco natural gas pipeline deviate by more than ten percent upwards or downwards in comparison with the average tariffs on comparable transport systems within the territory of the European Union, the applicant or its legal successor, upon request by the Energy Control Commission, shall be obliged to revise the tariff method approved and/or introduce a new tariff method. Prior to its entry into force the revised and/or new tariff method shall be subject to approval by the Energy Control Commission or the regulatory authority in charge at the time. Any tariff changes resulting from a revision and/or an introduction of a new tariff method shall affect contracts only if they are concluded after the revised or new tariff method was approved and became legally effective.

   (3) After every Open-Season procedure carried out by the applicant it shall without delay submit to the regulatory authority a final list of all companies who have applied for capacities and/or for whom the capacity of the Nabucco natural gas pipeline has been reserved.

   (4) The Austrian section of the Nabucco natural gas pipeline shall be put into operation not later than five years after this decision has become legally effective.

   (5) The exemption from the legal obligation to grant network access to third parties (§ 17 Para. 1 GWG, § 31e Para. 1 GWG) shall be limited to a maximum of 50% of the respective maximum total technical annual capacity available, but not more than 15 billion m^3 per year, if the final capacity is 31 billion m^3 per year.

   (6) The inclusion of the following provision in the Articles of Association of Nabucco Gas Pipeline International GmbH shall be proved by presenting this contract prior to starting operations of the first construction stage: "The

[1] Decision, p. 1

General Manager/General Managers acts/act independently in all current system operation issues and takes/take independent decisions on the construction or restructuring of pipelines within the framework of the approved financing plan or any other relevant document that complies with the respective rules and regulations for the natural gas business (in particular the Austrian Natural Gas Act, the European natural gas directives and the rules relating to natural gas). Therefore, any authorisation to issue instructions to the General Manager(s) is thus restricted."

3. On 11 November 2007, the Commission published a notice on the notification of E-Control's exemption decision inviting third parties to comment within two weeks. The Commission has not received any comments.

4. On 6 December 2007, E-Control informed the Commission that the applicant Nabucco Gas Pipeline International GmbH (hereinafter "Nabucco International") had submitted a request to modify the exemption decision. Nabucco International requested to modify the fourth condition of the exemption decision and to extend the validity of the exemption before the start of operations to ten years.

5. On 14 December 2007, the Commission requested additional information from E-Control. In the same letter, the Commission informed E-Control that E-Control would need to assess and approve Nabucco International's request for the extension of the exemption period before the Commission could consider this issue. Subsequently, E-Control informed the Commission that, at this point in time, it does not intend to modify the exemption decision.

6. On 9 January 2008, E-Control replied to the Commission's request for information. 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 8 February 2008.

Description of the project

7. Nabucco International is planning to build a gas pipeline from Turkey to Austria (hereinafter: "the Nabucco pipeline"). There is currently no pipeline connection from Turkey via Romania, Bulgaria and Hungary to Austria. An important objective of the Nabucco pipeline is to connect the EU better to the extensive sources of natural gas in the Caspian Sea and the Middle East. Today, gas from the Caspian region and Central Asia to the EU must be transported via Russia and the Ukraine or shipped as liquefied natural gas. Apart from the Nabucco pipeline, there are also plans for a pipeline from Turkey via Greece to Italy. The Nabucco project is included in the TEN-E programme and a feasibility study for the Nabucco pipeline has been performed under an EU project grant.

8. Nabucco International is a joint venture at equal parts of the gas transmission system operators of the five countries Turkey, Bulgaria, Romania, Hungary and Austria in whose territory the pipeline will be built: BOTAŞ Petroleum Pipeline Corporation, Bulgargaz-Holding EAD, MOL Hungarian Oil and Gas Company, TRANSGAZ S.A. and OMV Gas International GmbH (OGI).

I. BOTAŞ Petroleum Pipeline Corporation is the most important Turkish transportation company which is active in the field of crude oil and natural gas transportation through pipelines and in trade operations.

II. Bulgargaz-Holding EAD is a corporation owned by the Republic of Bulgaria. It fully owns the subsidiaries Bulgargaz EAD (public natural gas supplier) and Bulgartransgaz EAD (natural gas pipeline, transit and storage).

III. TRANSGAZ S.A. is the national company for natural gas transmission in Romania. It is fully owned by the Romanian State.

IV. MOL Hungarian Oil and Gas Company (MOL Plc.) is an integrated oil and natural gas group registered in Hungary. The natural gas transmission company MOL Natural Gas Transmission Plc. is fully owned by MOL Plc.

V. OMV Gas International GmbH (OGI) is a 100% subsidiary of the holding OMV AG, an integrated oil and natural gas group. 50.9% of the shares of OMV AG are owned privately, 31.5% are held by ÖIAG (Österreichische Industrieholding AG) and 17.6% by IPIC (International Petroleum Investment Company). Other subsidiaries of [OGI][*] are the sales and marketing branch Econgas GmbH owned to 50% by [OGI] and the transmission and storage subsidiary OMV Gas GmbH (OGG) fully owned by OGI.

9. Nabucco International is the owner and financing company of the five national Nabucco companies, which will be responsible for the operation and maintenance of the Nabucco pipeline. These companies are established in their respective countries. The pipeline sections located in the territories of the Nabucco countries will be owned by the respective national Nabucco companies. In Austria, the national Nabucco company is Nabucco Gas Pipeline Austria GmbH.

10. To finance their investments, the individual national Nabucco companies are provided with funds by Nabucco International e.g. through advance payments and/or transmission credits. Based on transport agreements, the national Nabucco companies allocate transport rights and transport capacity to Nabucco International against payment or they lease transport capacity to Nabucco International.

11. The Nabucco pipeline is planned to be built in 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).

12. The Austrian part of the Nabucco pipeline crosses the Danube near Hainburg and ends at Baumgarten gauging station. The total length of the Austrian pipeline section is approximately 46 km.

13. According to the application, gas for the Nabucco pipeline is expected to come mainly from Azerbaijan (up to 10-14 bcm/year), Iran (up to 10-20 bcm/year), Iraq

[*] Clarifications relative to the orginal decision text appear in square brackets […].

and Egypt (in total approx. 8-10 bcm/year). Natural gas originating from sources along the Nabucco pipeline may come e.g. from Romania and Bulgaria. To date, Nabucco International has not yet concluded any agreements with gas shippers. The Nabucco pipeline may also be used to transport gas originating from other regions, notably from Russia.

14. The total capacity of the Nabucco pipeline system is marketed by Nabucco International through a "one-stop-shop-mechanism", i.e. all shippers have one and the same contractual partner along the entire length of the pipeline. According to E-Control, this also implies that uniform tariffs, General Terms and Conditions and standard contracts must be used in all Nabucco countries.[2]

15. The expansion of the pipeline and the allocation of transport contracts will be determined in a capacity allocation procedure with the following characteristics. Each allocation procedure will be carried out in two steps. In a first step (hereinafter "the shareholder allocation procedure"), only the shareholders of Nabucco International, their affiliated companies and state enterprises acting as public suppliers can apply for half of the respective annual capacity. In any event, the capacity reserved for the shareholders in the first step of the allocation procedure is limited to a maximum of 15 bcm/year. In the second step (hereinafter "general open season"), all market participants, including the shareholders, their affiliated companies and state enterprises acting as public suppliers, can apply for the remaining 50% of the capacity.

16. Prior to the start of each construction stage, Nabucco International will carry out this type of allocation procedure to identify capacity requirements. If the requirements exceed the planned capacity of 8 bcm (in the first construction stage) Nabucco International is obliged to carry out the next construction step (up to maximum of 25.5 bcm). If the requirements exceed 25.5 bcm Nabucco International is obliged to expand the pipeline up to 31 bcm only if this is technically, economically and financially feasible.[3] In principle, it is possible that the entire capacity up to 31 bcm is allocated already during the first allocation procedure before the start of operation. Expansion beyond 31 bcm shall be investigated by Nabucco International and if economically, technically and financially feasible undertaken in order to fulfil all requests for long-term capacity (long-term means a term of more than 15 years).[4]

17. If the capacity bids in the shareholder allocation procedure exceed the reserved capacity of 50% per year (maximum of 15 bcm), their bids will be reduced and allocated *pro rata*.[5] The exemption from third party access is thus limited to half of the capacity and, in any event, to a maximum of 15 bcm. If the pipeline is expanded beyond 31 bcm, general rules on regulated third party access apply.

18. In the general open season, Nabucco International will reserve up to 10% of the capacity for short-term contracts. In case the short-term capacity is not booked, it will be converted to long-term capacity and offered in a second round of the general

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[2] Additional information provided by E-Control on 9 January, p.12 and 14.
[3] Annex 8a, p.3.
[4] Additional information provided by E-Control on 9 January, p.7, Annex 3 in section 7 on page 16.
[5] Annex 8b, p.2.

open season.[6] Conversely, if in the general open season the long-term capacity is not fully booked, it can be converted into short-term capacity and also offered in a second round of the general open season.[7] It is therefore not determined how much capacity that will be allocated to short-term and to long-term contracts until the capacity allocation procedures have taken place.

19. According to E-Control, market players will be able to bid on capacity for each exit/entry point.[8] Upon request, Nabucco International has to add other entry or exit points if those are technically and economically reasonable.[9]

20. A shipper can renominate an exit point and take delivery at other exit points upstream if it is technically feasible.[10] There are also, if operational possible and for an additional tariff, possibilities to transport gas in reverse flow direction (backhaul flows).[11]

21. Shippers are entitled to resell or lease their unused capacity. Nabucco International will establish a so-called "notice-board" for the secondary market which must be used by all network users offering capacity.

22. If a shipper does not use contractually booked capacity, Nabucco International will make available this capacity to the market according to a use-it-or-lose-it (UIOLI) principle. This capacity will be made available as interruptible capacity on a short-term day-ahead basis.[12] A capacity holder not using its capacity has to pay the full transport fee for the contractually booked capacity. In case the original capacity holder decides to use its capacity, shippers who bought the interruptible capacity will lose the capacity.[13]

23. E-Control has pointed out that several rules are in place to avoid the hoarding of capacity and to increase liquidity in the market:[14]

- In the general open season, 10% of the capacity is offered on short-term basis;
- Nabucco International will offer a Bulletin Board for the secondary market;
- Nabucco International will offer unused capacity on interruptible bases in case of congestion (UIOLI);
- Shippers have an incentive to resell or sublet unused capacity because they have to pay for it in any case (ship-or-pay principle);

[6] Additional information provided by E-Control on 9 January, p. 8, Annex 8b, p.3.
[7] Annex 8b, p. 4.
[8] Additional information provided by E-Control on 9 January, p. 16.
[9] Additional information provided by E-Control on 9 January, p. 15ff. and Application, Annex 3 section 8.
[10] Application, Annex 6, p.2.
[11] Application, Annex 3, p. 24.
[12] Application, p.22, Annex 3, p.14 and Annex 9, p. 8.
[13] Decision, p.13f.
[14] Additional information provided by E-Control on 9 January, p. 10, Annex 8b, Annex 3 and Annex 9, p.8-9.

24. All shippers will pay a distance related tariff to Nabucco International calculated by the tariff method described in the application. By adopting the exemption decision E-Control has approved this tariff methodology.[15]

25. E-Control notes that the exemption duration of 25 years is motivated by the assessment of Nabucco International's financial model.[16] Moreover, it is noted that Nabucco International will design fair, non-discriminatory and transparent balancing rules which will be approved by the regulatory authorities before they enter into force.

Assessment of the exemption criteria of Article 22

26. Exemptions for major new infrastructures according to Article 22 constitute an exception to the general rules on regulated third party access in Directive 55/2003/EC. When granting 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.

27. In relation to the specific criteria set out in the Article 22(1)(a)-(e), the Commission has made the following considerations.

Major new gas infrastructures i.e. interconnectors between member states, LNG and storage facilities, may, upon request, be exempted from certain provisions in the directive 2003/55/EC.

28. The Nabucco pipeline is an interconnector stretching over five countries with four of them being EU Member States. Taking into account that the pipeline is still at planning stage and considering the magnitude of the project the Nabucco pipeline is indeed considered a major new infrastructure. The pipeline may therefore be exempted under Article 22 if the further criteria of Article 22(1) are met.

29. Nabucco International will 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. Since the pipeline project has to be considered in its entirety, for example, with respect to its financing and the decision on its overall capacity, some essential planning steps can only be completed once there is certainty about the regulatory regime in all Member States concerned. The 5-year validity of the Austrian exemption decision before the start of operations is therefore in practice shortened by later exemption dates in the other Member States.

30. To preserve the 5-year validity of the Austrian exemption decision before the start of operations, the Commission considers it therefore necessary to link its validity to the date when the last exemption decision in any of the Member States concerned becomes 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 may extend the validity of the Austrian exemption decision excessively while the market situation on which the

[15] Annex 3, p.5ff and 29ff and additional information provided by E-Control on the 9 January, p.14-15.
[16] Annex 10 and Additional information provided by E-Control on 9 January, p. 18.

assessment is based may in the meantime have changed significantly and while other market players may be discouraged from initiating other pipeline projects, the Commission considers it necessary to limit the validity of the Austrian exemption decision, in any event, to 31 December 2014, i.e. the Austrian section of the Nabucco pipeline shall be put into operation no later than by that date.

(a) (1) The investment must enhance competition in gas supply.

31. To analyse the competitive effect of the exemption, the relevant upstream and downstream gas markets, and in particular the question whether the investment leads to the creation or strengthening of dominant market positions, need to be considered. As a general rule, an exemption is not granted to a new piece of infrastructure that is likely to have a significant amount of its capacity allocated to dominant player in one of the markets affected.[17] The Commission notes that E-Control has in its assessment relied *inter alia* on the gas market report of the Austria Competition Authority.[18] This report notes that the Austrian gas sector can be divided into six markets which, in some cases, can be divided into more narrow product markets. The report also notes that the following product markets have the geographic scope of Austria's largest market area being the Control Area East (Regelzone Ost)[19] and are each dominated by one company: [20]

- the [market for wholesale trade/ supply to large distributors] dominated by OMV Gas GmbH,[*]
- the gas storage market dominated by OMV Gas GmbH,
- the balancing gas market dominated by Econgas GmbH,[*]
- the market for supply to local distributors dominated by Econgas GmbH,
- the retail market for large customers with a consumption above 500 000 m³ dominated by Econgas GmbH, and
- the market for supply to power stations dominated by Econgas GmbH.

32. In the exemption decision, it is further stated that Gazprom is the dominant *supplier* to the Austrian wholesale market because about 60% of the gas in Austria originate from Russia where Gazprom has an export monopoly.[21]

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[17] See DG TREN note on Exemptions from certain provisions of the third party access regime, p.4-5.

[18] See Bundeswettbewerbsbehörde (2005): Allgemeine Untersuchung der österreichischen Gaswirtschaft, September 2005, BGBl I, Nr 62/2002. [Moreover, see Bundeswettbewerbsbehörde (2006): Allgemeine Untersuchung der österreichischen Gaswirtschaft, Endbericht, November 2006.]

[19] The Control Area East is the by far largest Austrian gas area. There are smaller geographic market definitions at retail level where local suppliers are dominant. In the following, such smaller market definitions will however not be further considered.

[20] See Bundeswettbewerbsbehörde (2005), in particular Table 7, p. 79, Decision, p. 15 ff, Annex 12 and Additional information provided by E-Control on 9 January, p.1-5.

[*] [It should be noted that the situation in the wholesale market (more specifically, in the market for wholesale trade/ supply to large distributors) is reassessed in a later report of Bundeswettbewerbsbehörde, see Bundeswettbewerbsbehörde (2006), p. 32-34]

[*] [It should be noted that also in the Additional information provided by E-Control on 9 January, Econgas is considered a dominant company in this market.]

33. The Commission thus notes that several of the markets which will be provided with gas from the Nabucco pipeline are today dominated by a single market player being the vertically integrated OMV including its subsidiary Econgas and that the dominant upstream supplier for gas imported into Austria is Gazprom. There is thus a risk that additional gas from the Nabucco pipeline may strengthen one or more dominant positions.

34. The Commission also notes that on 25 January 2008, OMV and Gazprom signed a cooperation agreement. The two companies agreed on a contractual framework to expand their cooperation: Gazprom will take a 50% interest in the Central European Gas Hub (trading hub) and OMV and Gazprom will carry out joint storage projects in Austria and neighbouring countries. This agreement is based on the Memorandum of Understanding which the companies signed in May 2007.[22] It can thus be assumed that Gazprom and OMV intend to align certain interests concerning the wholesale market and the storage market, on which both of them are already present. This, in combination with other links between OMV and Gazprom,[23] could result in a situation in which Gazprom and OMV have the power to adopt a common market policy[24] and are jointly dominant on such markets.

35. The Commission notes furthermore that, at this stage, it is not clear how much gas will be transported through the Nabucco pipeline to Austria or which market players will hold capacity. This will become clear only after the capacity allocation procedures have taken place. The Commission therefore considers it necessary to pay particular attention to the worst-case scenarios as developed in the exemption decision, i.e. a dominant market player becoming the capacity holder of all or of a large part of the gas from the Nabucco pipeline exiting in Austria. In such a worst-case scenario, Nabucco could not be considered to enhance competition.

36. Based on the allocation rules described above, OMV and Econgas have the right to participate in both capacity allocation procedures, Gazprom only in the general open season for third parties. It should also be noted that the 50% capacity split for each capacity allocation procedure refers to the *total* annual transport capacity of the pipeline and does not mean that this split will necessarily be reflected at each exit point of the pipeline. As a result, it cannot be excluded that all or a large part of the capacity exiting in Austria could be booked by a dominant undertaking. This result could in fact occur solely on the basis of the shareholder allocation procedure. The reason is that it is not certain that 50% of the annual Austrian exit capacity will still

[21] Decision, p. 19 and Additional information provided by E-Control on 9 January, p.1.
[22] See OMV press release of 25 January 2008.
[23] Such a link is GWH Gas und Warenhandelsgesellschaft m.b.H, [which was founded as] a joint venture between OMV (25.1 %), Gazexport and Centrex Europe Energy & Gas ("Centrex") two Gazprom affiliates which hold 24.9 % and 50% respectively. GWH is active in trading and the market of supplies to Austrian local distributors, on which latter market OMV, though its subsidiary Econgas, is dominant. The direct entry of GWH and Centrex into that market was the result of successful negotiations between Gazprom and OMV with regard to extending Gazprom's supply of gas to OMV from 2012 to 2027 (cf. Gazprom's press release of 29 September 2006, http://www.gazprom.ru/eng/news/2006/09/21184.shtml). Other press reports reported that the Gazprom subsidiaries would supply 20% of that market, stating the customers as the local distributors of Salzburg, Styria and Carinthia (http://www.finanznachrichten.de/nachrichten-2006-09/artikel-7065313.asp). [In the meantime, it has emerged that OGI has withdrawn from GWH and has transferred its partipatition to Centrex.]
[24] Case T-2285/97, Irish Sugar v Commission, (ECR 1999 II- 02969) cf. paras 46f.

be available to third parties in the general open season. Conversely, in case less than 50% of the capacity to Austria is booked by Nabucco shareholders, it cannot be excluded that even more than 50% of capacity into Austria are booked by a dominant third party.

37. Moreover, there are insufficiently clear rules on how the capacity in the general open season will be allocated in the case of overbooking. At the same time, the exemption decision exempts Nabucco from the application of paragraph 31(g)(1) of the Austrian Gas Act which gives the regulator certain powers regarding the approval, rejection or amendment of the general conditions for cross-border gas flows.[25] It therefore cannot be guaranteed that even in the case of the general open season, third party bids will be adequately considered and it could occur that for a certain construction stage, for example, larger capacity bids are preferred. To sum up, the present rules for capacity allocation do not prevent a possible worst-case scenario in which a dominant market player may book above 50% and even up to 100% of the annual Austrian exit capacity even if there is interest from non-dominant third parties and shareholders in booking Austrian exit capacity which risks not being adequately taken into account for the next step of capacity expansion. OMV's cooperation agreement with Gazprom,[*] which is also OMV's main gas supplier in Austria, may in fact provide an incentive for OMV to use its influence among the Nabucco shareholders to prefer a bid by Gazprom to bids by other third parties.

38. Furthermore, the Commission considers that this worst-case scenario is not moderated by the above mentioned anti-hoarding principles and other measures increasing market liquidity.[26] These measures are not suitable to provide new entrants or existing competitors with firm long-term capacity necessary to outweigh the risk of a strengthening of dominant position. Moreover, there is no guarantee that these measures will actually have a pro-competitive effect if, for example, the capacity holders use their capacity on a permanent basis, or if the positive effects of releasing unused capacity for third parties are felt in other sections of the pipeline than in Austria.

39. Since the above mentioned anti-hoarding principles cannot be considered sufficient to enhance competition, the Commission considers that additional conditions are needed to prevent the worst-case scenario and to ensure that the Nabucco pipeline will, in any event, enhance competition in gas supply. Such additional conditions have to ensure that a dominant market player cannot book a share of capacity in the Nabucco pipeline exiting in Austria which would reinforce its position and that some of the additional gas supply through the Nabucco pipeline is accessible to competitors.

40. For the above reasons, the Commission takes the view that the exemption with the conditions that have been proposed by E-Control does not fulfil the first criterion.

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[25] GWG, BGBl. I Nr. 121/2000 as amended by BGBl I Nr. 1006/2006. [Following the adoption of the present Commission decision, E-Control has maintained that the exemption concerns only parts of paragraph 31(g)(1) and in particular not the *ex ante* approval of the general terms and conditions for transport by the regulatory authority.]

[*] [The two companies co-operate or plan to co-operate more closely in various fields. What is known is the announced participation of Gazprom in CEGH and the common development of storage capacity.]

[26] See paragraph 23.

(a) (2) The investment must enhance security of supply.

41. If an investment provides a new route to the relevant market and connects new upstream sources of gas to the market it will typically increase the security of supply of that market. Security of supply is also enhanced if in the relevant market, the present or forecast demand/supply balance is tight.

42. Several observations substantiate that the Nabucco pipeline will enhance security of supply. Firstly, the Nabucco pipeline adds a major new gas route from the East to the EU. Notably, this route will be in the territory of countries with a comparatively high degree of political stability.

43. Secondly, the Nabucco pipeline will provide a better connection between the countries involved which are currently not very well interconnected. Better interconnection will increase the security of the supply in particular if one of the countries is affected by a supply crisis. It can also contribute to the more efficient use of other gas infrastructure such as storage sites or LNG terminals.

44. Thirdly, the Nabucco pipeline has the potential and declared purpose to connect the EU to new sources of gas supply in particular from the Caspian region.

45. Fourthly, the Nabucco pipeline will increase the import capacity into Austria and thus help to cover increasing gas demand in Austria and in Central Europe as a whole.

46. The gas demand in the EU was 528 bcm in 2003. Demand is expected to rise to 655 bcm by 2010, to 815 bcm by 2020 and to 1036 bcm by 2030.[27] Due to lack of internal gas resources within the EU, import will be of increasing significance to the EU as a whole. In 2006, imports to the EU-25 from suppliers outside EU-25 amounted to 237.8 bcm. The main external gas suppliers to the EU are Russia (32.4%), Algeria (12.7%), Egypt (1.8%) and Libya (1.8%).[28] E-Control notes that it is not clear if existing suppliers will be able to meet the EU's increasing demand in the future. Competition for gas sources will also come from increasing demand in other world regions, for example from China.

47. At present, Austria is not well connected to any LNG terminals. The majority of the national gas production is operated by OMV (1.2 bcm) and RAG (0.8 bcm) and almost the entire import portfolio is handled by OMV. While the current infrastructure capacity is sufficient to meet current annual and peak demand, the existing alternative sources may not be sufficient to meet demand in the case of delivery constraints on major pipelines in Russia or in transit countries. By 2010-2012 the daily peak demand is expected to exceed the infrastructures' technical limits. It therefore seems necessary that Austria increases its import capacity and Nabucco can contribute to this objective.

48. On the basis of the foregoing considerations, the Nabucco pipeline is considered to enhance the security of gas supply for the Austria and EU as a whole.

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[27] Annex 12, p. 12.
[28] BP Statistical Review of World Energy 2007, p. 30.

(b) The level of risk attached to the investment is such that the investment would not take place unless an exemption was granted.

49. Nabucco International has listed the potential risks of the project in their Risk Analysis (Annex 11 to the application). The risk is broken down into the following categories: cost overruns, construction delays until completion, upstream gas supply, gas transport/throughput quantities, gas off-take in the downstream area, pipeline operation, economic risks, political risks, environmental and social risks as well as risks in connection with the regulatory regimes.

50. The exemption decision notes that shareholders and lenders invest in a project of this scale only after they have been assured that the potential risks have been covered to a maximum degree and that future revenues have a high degree of predictability. The underlying reason is that the investment must be regarded largely as sunk costs. Returns can only be made predictable if the prices and terms in the initial contracts, which are fixed in accordance with the approved method, remain unchanged.

51. The exemption decision also finds that the Nabucco project involves a number of other risk factors such as the capacity utilisation risk which has to be borne by the operator and which is highly sensitive to the future cash flow. Furthermore, the Nabucco pipeline crosses five countries and would be thus subject to five different regulatory regimes which vary and which may change further over time. Another important risk element is the political stability in the gas production countries.

52. In view of the financial scale of the project, the potential regulatory risks in the absence of an exemption and the long-term commitment necessary to obtain upstream supply, the Commission considers that the risk criterion is fulfilled.

(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.

53. The section of the Nabucco pipeline that is built in Austrian territory will be owned by Nabucco Gas Pipeline Austria GmbH, which has a legal personality under Austrian law. It is owned by Nabucco International. Nabucco Gas Pipeline Austria GmbH is separate - at least as far as the legal form of organisation is concerned - from the system operators in whose networks the infrastructure is established. The Commission thus considers that this criterion is fulfilled.

(d) Charges are levied on users of that infrastructure.

54. Nabucco International will charge a system user fee. According to the exemption decision, Nabucco International will apply, without discrimination, one and the same tariff method enclosed in the application to all transport customers, including the Nabucco Partners and their affiliated companies.[29] The Commission thus considers that this criterion is fulfilled.

[29] Decision, p. 13.

(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.***

55. The Nabucco pipeline will improve the functioning of the internal gas market by increasing its liquidity due to the additional gas imports and some short-term capacity. Moreover, the pipeline is complementary to other infrastructure projects such as LNG terminals in the Mediterranean. It will thus contribute to a more comprehensive gas network and wider and more developed gas market in South Eastern Europe.

56. The Nabucco pipeline will not compromise the functioning of the regulated system because the exemption has precisely the effect of shielding the regulatory regimes of the Member States concerned, some of which are relatively small in size, from the costs of the Nabucco project.

57. The Commission therefore considers that this criterion is fulfilled.

Considerations to remedy the identified competition concerns

58. As explained above, the Commission considers that the exemption decision as it stands now does not guarantee that the investment enhances competition in gas supply because certain worst-case scenarios cannot be excluded. At the same time, the Commission considers that such worst-case scenarios can be excluded by introducing additional conditions in the exemption decision.

59. To prevent the outlined worst-case scenarios, it is necessary to limit the share of annual capacity which a dominant undertaking can book at the total of all Austrian exit points of the Nabucco pipeline to a maximum of 50% (hereinafter "the capacity cap"). Such a capacity cap leaves competitors at least half of the Austrian exit capacity of the Nabucco pipeline and thus to promote competition in the downstream markets. The capacity cap would thus fulfil the requirement that exemptions can generally not apply where an existing dominant position is created or reinforced or where the granting of an exemption reduces the scope for diluting existing dominant positions.[30] On the other hand, the capacity cap should not put the shareholders of Nabucco International, even if they are dominant, in a less favourable position than third parties with respect to the share of capacity they can book. Since third parties are in principle able to obtain half of the total transport capacity of the pipeline, dominant shareholders should also be allowed to book the same share of capacity exiting in Austria.

60. The Commission notes that the rules presented by Nabucco International do not clarify what would happen in the general open season in the event of overbooking. This creates the risk that a dominant *third party* may obtain up to 50% of the Austrian exit capacity at the expense of non-dominant companies also interested in capacity. To exclude this risk and to ensure that each capacity bidder is allocated a minimum amount of capacity the Commission considers it necessary to introduce a rule that the capacity allocation takes place in a transparent and non-discriminatory way, for example on a pro rata basis.

[30] See DG TREN note on Exemptions from certain provisions of the third party access regime, p.1.

61. The Commission acknowledges that the above described capacity cap may prevent a capacity expansion if, for example, third parties are not able to contract sufficient gas volumes with upstream suppliers and are thus not interested in booking pipeline capacity. As a result, the generally positive impact of a pipeline expansion on market liquidity could then not materialise. Moreover, it cannot be excluded that due to the capacity cap a part of the pipeline remains idle once the pipeline is built. The Commission therefore considers it necessary to derogate from the capacity cap if there is insufficient interest from other parties than a dominant undertaking to book capacity. In this case, the dominant undertaking can be allowed to acquire additional exit capacity in excess of the capacity cap. The undertaking should however be required to offer the additional gas volume to the market in an open, transparent and non-discriminatory procedure subject to the approval of the regulatory authority.

62. There may be a discrepancy between the share of capacity booked and the volume of gas actually imported through the Nabucco pipeline due to varying demand and supply conditions. It is therefore in the interest of the undertaking concerned to link the gas volume to be offered to the market to its share of booked capacity and not to its volume share which depends also on the activity of the other shippers. It is therefore proposed to calculate the volume as follows: the percentage points of booked annual capacity in excess of 50% (e.g. 5% in the case of 55%) shall be divided by the total share of annual capacity booked by the undertaking concerned (e.g. 55%). The resulting value (e.g. 9.09%) shall be multiplied with the total amount of gas which the undertaking imports through the Nabucco pipeline into Austria in a given year.

63. Moreover, if an undertaking dominant in Austria or in a neighbouring country should in the future become a shareholder or affiliated to a shareholder and thus be able to participate also in the shareholder allocation procedure, this could potentially have a negative effect on competition. It is therefore important that the competent regulatory authority is informed by Nabucco International and, on advice of the competition authority competent for the territory concerned, should impose a capacity cap on the dominant undertaking to ensure that the Nabucco pipeline still enhances competition. With this approach, potential future shareholders are treated in an equal manner to existing shareholders.

64. In order to avoid the parallel examination of the competitive effect of changes in the shareholding of Nabucco International at national and European level, the priority of Community law should be respected. Hence, where a change in shareholding is notifiable under the EC Merger Regulation,[31] no notification to E-Control is requested.

65. 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 Directive 2003/55/EC and do not go beyond what is necessary to that effect.

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[31] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, Official Journal L 24, 29/01/2004, p. 1

Conclusions

Based on the foregoing analysis, the Commission considers that the decision to exempt the Austrian part of the Nabucco pipeline project from regulated third party access needs to be amended to fully comply with Article 22 of the Gas Directive 2003/55/EC. In order to ensure, firstly, that the 5-year validity of the Austrian exemption decision is in practice not shortened by later exemption dates in other Member States and, secondly, that the project enhances competition, the Austrian regulator is requested to amend its exemption decision to include the following conditions:

I. The Austrian section of the Nabucco natural gas pipeline shall 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. In any event, it shall be put into operation no later than on 31 December 2014.

II. (a) An undertaking which holds a dominant position in one or more of the relevant upstream or downstream gas markets comprising the Austrian Control Area East (Regelzone Ost) shall not be allowed to book more than 50% of the total capacity at the exit points in the Austrian section of the Nabucco pipeline. For the calculation of the capacity cap, undertakings belonging to the same group (such as OMV and Econgas) shall be considered together.[32]

(b) In the event of overbooking, capacity allocation shall take place in a transparent and non-discriminatory procedure, for example on a *pro rata* basis, which shall ensure that each bidder is allocated a minimum amount of capacity.

(c) Where due to the lack of interest by other parties, the capacity cap prevents the expansion of the pipeline or causes existing capacity to remain idle, a derogation from the capacity cap shall apply on condition that the party concerned shall offer the volume of gas relating to the capacity it holds in excess of the 50% cap to the market in an open, transparent and non-discriminatory procedure which is subject to the approval of the regulatory authority. The gas volume to be offered to the market shall be calculated as follows: the percentage points of booked annual capacity in excess of 50% (e.g. 5% in the case of 55%) shall be divided by the total share of annual capacity booked by the undertaking concerned (e.g. 55%). The resulting value (e.g. 9.09%) shall be multiplied with the total amount of gas which the undertaking imports through the Nabucco pipeline into Austria in a given year.

III. If the shareholders of Nabucco International change compared to the situation as described in the application, or if any of the existing shareholders is acquired by another undertaking, Nabucco International shall notify such change to E-Control. E-Control in collaboration with the competent regulatory and competition authorities shall then evaluate the competitive effects of this change. Where the change implies the strengthening of a dominant position in Austria or in a neighbouring country, E-Control shall impose a capacity cap to counter the negative effect on competition. Where a change in shareholding is

[32] For the purpose of this decision undertakings belonging to the same group are defined as all undertakings controlled, directly or indirectly, by the same undertakings or persons.

notifiable under the EC Merger Regulation, it shall not be notified to E-Control.

66. Therefore by virtue of Article 22(4) of the Gas Directive 55/2003/EC, the Commission hereby requests the E-Control to amend its exemption decision accordingly within four weeks upon receipt of the present letter and to inform the Commission of this action.