EUROPEAN COMMISSION

Brussels,
C(2009)

Subject: Exemption decision on the Romanian section of the Nabucco pipeline

Dear Sir,

I am writing with reference to the decision adopted by the Romanian Energy Regulatory Authority granting exemption from certain parts of the Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC for the Romanian section of the Nabucco pipeline.

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
Andris Piebalgs
Member of the Commission

Annex

President Petru Lificiu
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ANNEX

1. PROCEDURE

1. On 24 June 2008, the Romanian Energy Regulatory Authority (hereinafter: "ANRE"), adopted a decision to exempt the Romanian section of the Nabucco gas pipeline project (hereinafter "exemption decision") for 25 years from regulated third party access as defined in Article 18 and from the tariff regulation in Article 25(2), (3) and (4) of Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (hereinafter "the Gas Directive"). The exemption decision was submitted to the Commission on 9 July 2008.

2. Article 1 of the exemption decision imposed the following conditions:[1]

"a) The period of enforcement of the exemption is of 25 years from the date when the first section of the Nabucco gas pipeline becomes operational, according to the description of the related project, as mentioned in the annex which is an integral part of this decision.

b) After 20 years from when the first section of the Nabucco section becomes operational, the rating methodology submitted by Nabucco Gas Pipeline International GmbH to be approved by the National Energy Regulatory Authority or by that administrative authority to which this competence was transferred will be re-examined. The competent authority may request Nabucco Gas Pipeline International GmbH or its rightful successor to modify the rating methodology for the last 5 years. The rates of use for the Romanian section of the Nabucco gas pipeline, calculated according to the modified methodology, will be applied to the contracts concluded after the entry into force of these modifications.

c) If Nabucco Gas Pipeline International GmbH decides to implement the project, it has the obligation to develop at least one public capacity contracting tender (the open season procedure), before the beginning of the construction works for the Nabucco gas pipeline, within 5 years since the granting of the exemption in the Member States of the European Union crossed by the Nabucco gas pipeline, being approved by the European Commission or by 31 December 2014.

d) Nabucco Gas Pipeline International GmbH or its rightful successor must notify the National Energy Regulatory Authority or the administrative authority to which this competence was transferred about any modification of the shareholding structure of the company, in relation to the situation described in the exemption request and about any statutory modification operation of the shareholding companies. The National Energy Regulatory Authority or the administrative authority to whom this competence was transferred together with all the other factors involved will analyse the effects on market competition of the notified modifications, if the

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[1] Exemption decision, Decision No. 1228 adopted on 24 June 2008, published in Romania's Official Journal, Part I, No. 488/01 July 2008, pp. 11 et. seq.

modification leads to the strengthening of a dominant position of the Nabucco Gas Pipeline International GmbH in Romania or the neighbouring countries, the National Energy Regulatory Authority or the administrative authority to whom this competence was transferred will proceed to the limitation of the already reserved capacity or of the capacity to be reserved on the Nabucco gas pipeline so that it can counteract the negative effects on competition. If the modification of the shareholding is notified to the competition authorities of the European Union, according to the community regulations, it is not necessary to inform the competent national energy authority.

e) If the use rates of the Nabucco gas pipeline on the Romanian territory differ with more than 10% from the average rates of similar transport systems from the territory of the European Union, Nabucco Gas Pipeline International GmbH or its rightful successor must modify the rating methodology approved or draw up a new methodology, the modified rating methodology or the newly drawn-up methodology being subject to the approval of the National Energy Regulatory Authority or to the authority to whom this competence was transferred, before its entry into force. The use rates for the Romanian section of the Nabucco gas pipeline, calculated according to the modified methodology or to the new methodology, will apply to the contracts concluded after the date of entry into force of these methodologies.

f) Nabucco Gas Pipeline International GmbH will submit the rating methodology and any modification or revision thereof for approval to the National Energy Regulatory Authority or to the authority to which this competence was transferred, before its entry into force.

g) If it is found that following the public capacity contracting tender (the open season procedure) the firm requests for capacity reservations exceed the maximum available capacity of 25.5 billion cubic meters/year, Nabucco Gas Pipeline International GmbH must extend the capacity of the gas pipeline to cover the requests, provided this extension is technically possible and economically feasible."

3. Articles 2 and 3 of the exemption decision provides for the following:

"Article 2

(1) The exemption mentioned at Article 1 is limited at maximum 50% of the total technically available yearly capacity, but no more than 15 billion cubic meters/year.

(2) The rating methodology approved by the National Energy Regulatory Authority is equally and non-discriminatingly applied to all users of the Nabucco gas pipeline.

Article 3

The validity of this decision ceases if the Romanian section is commissioned within 5 years from the granting of the exemption in the member states of the

European Union which are crossed by the Nabucco gas pipeline and of the approval of the European Commission or at the latest on 31 December 2014."

4. On 18 July 2008, the Commission informed ANRE that the submission of 24 June 2008 did not contain all the relevant information required under Article 22(4) of the Gas Directive and asked ANRE to provide all the relevant information as set out in Article 22(4) of the Gas Directive, *inter alia* seeking for submission of a copy of the application for the exemption decision and of the description of the tariff mechanism.

5. On 8 September 2008, the applicant Nabucco Gas Pipeline International GmbH (hereinafter "Nabucco International") submitted a request to ANRE to modify the exemption decision of 24 June 2008. Nabucco International requested to extend the validity of the exemption decision from five to seven years, but at the latest until the end of 2017. The justification for a longer validity of the exemption decision is *inter alia* based on the following:

   - The start of operations of the Nabucco pipeline relies heavily on the start of the exploration of the Shah Deniz II gas field in Azerbaijan. Alternative sources of gas are unlikely to be available before 2013 when Nabucco is in principle scheduled to become operational. Since the beginning of 2008, the promoters of Shah Deniz II have announced that exploitation is delayed by one more year and is likely to start only by end 2013.

   - At the time of the first application the conclusion of the Intergovernmental Agreement with the countries along the pipeline route was scheduled for late 2007. However, the agreement has not been signed yet. 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 the conclusion of the above mentioned Intergovernmental Agreement.

6. On 11 November 2008, ANRE submitted to the Commission a market study on the impact of the Nabucco project on the Romanian natural gas market.

7. On 18 December 2008, the Commission repeated its request from 18 July 2008 asking for additional information. The Commission pointed out that the conditions for a complete notification of the exemption decision as laid down in Article 22(4) had still not been fulfilled due to the lack of the requested information, in particular the notification of Nabucco International. By letter of 8 January 2009, ANRE informed the Commission about legal difficulties to disclose the requested application to the Commission for confidentiality reasons. ANRE also stated that the tariff methodology presented in Nabucco

International's application should be approved by the Romanian competent authority before entering into force.

8. On 21 January 2009, ANRE modified its exemption decision of 24 June 2008, extending the validity of the exemption decision until the end of 2016 (hereinafter "modified exemption decision").

9. The modified exemption decision amended Article 1 b) and c) of the exemption decision as follows:

"b) After 20 years from the commencement of the operations of the first sections of Nabucco gas pipeline, the tariff methodology, submitted for approval by Nabucco Gas Pipeline International GmbH to the Romanian Energy Regulatory Authority or to other administrative authority to which this jurisdiction was transferred, shall be reassessed. If the tariff for the use of Nabucco gas pipeline on the territory of Romania varies by more than 10% from the average tariffs of similar transmission system found on the territory of the European Union, Nabucco Gas Pipeline International GmbH or its lawful successor shall amend the approved tariff methodology or shall draft a new methodology. The tariff methodology amended or the newly drafted one shall be submitted for approval to the Romanian Energy Regulatory Authority or to the administrative authority to which this jurisdiction was transferred, before its coming into force. The tariffs used for the Romanian section of Nabucco gas pipeline, calculated according to the methodology amended or according to the new one, shall apply to the contracts concluded after the effective date of these methodologies.

c) If Nabucco Gas Pipeline International GmbH decides to implement the project, it shall carry out at least one public call for tenders for contracting the capacities (open season procedure). Nabucco Gas Pipeline International GmbH undertakes to send to the Romanian Energy Regulatory Authority or to that administrative authority to which this jurisdiction was transferred, as soon as possible, after the termination of the first public call for tenders for contracting the capacities, a final list of the companies that took part in the open season procedure and a list of those companies that concluded contracts of capacity reservation in Nabucco pipeline."

The conditions under Article 1 e) and f) of the exemption decision were deleted.

10. The modified exemption decision amended Article 2 (1) of the exemption decision as follows:

"(1) The exemption provided in Article 1 is applied for maximum half of the annual capacity technically available, but no more that 15 bcm/year."

11. The modified exemption decision amended Article 3 of the exemption decision as follows:

"Article 3 - This decision ceases to be valid if the Romanian section was not commissioned within 7 years since the exemption applied in the European Union Member States crossed by Nabucco gas pipeline was granted and since the approval of the European Commission was obtained or on 31 December 2016, the latest".

12. In its modified exemption, ANRE thereby in principle accepted Nabucco International's arguments to extend the validity of the exemption decision. It decided however to limit the validity of the decision until the end of 2016.

13. The notification of the modified exemption decision was registered as received by the Commission on 6 February 2009. On 12 February 2009, the Commission published a notice on the notification of ANRE's modified exemption decision inviting third parties to comment within two weeks. The Commission has not received any comments.

14. On 19 February 2009, the Commission requested ANRE to notify the entire application of Nabucco International, which forms part of the modified exemption decision, and additional information supporting the modified exemption decision. On 24 April 2009, ANRE replied to the Commission's request for information, providing the requested information, including the complete application of Nabucco International. Considering that the decision was notified in its entirety only on 24 April 2009, the final date for the Commission to request an amendment or withdrawal of the exemption decision is – in line with Article 22 of the Gas Directive – 24 June 2009.

2. DESCRIPTION OF THE PROJECT

15. 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 Bulgaria, Romania 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 program[2] and a feasibility study for the Nabucco pipeline has been performed under an EU project grant.

16. Nabucco International is a joint venture of the gas transmission system operators of the five countries Turkey, Bulgaria, Romania, Hungary and Austria in the territory of which the pipeline will be built, BOTAŞ Petroleum Pipeline Corporation, Bulgargaz-Holding EAD, TRANSGAZ S.A., MOL Hungarian Oil and Gas Company and OMV Gas International GmbH (OGI), and of the German energy company RWE AG. All six companies hold an equal share in Nabucco International, i.e. a share of 16.67% each.

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

[2] Decision No 1364/2006/EC of the European Parliament and of the Council of 6 September 2006 laying down guidelines for trans-European energy networks and repealing Decision 96/391/EC and Decision No 1229/2003/EC.

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 the OMV AG are the sales and marketing branch Econgas GmbH owned to 50% by OMV AG and OGG, the transmission and storage subsidiary.

VI. RWE AG, a publicly listed multi-utility company headquartered in Germany, is active in the generation and transmission as well as the sale and trading of electricity and gas.

17. 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 or will be established in their respective countries and are or will be legally separate from Nabucco International. The pipeline sections located in the territories of the Nabucco countries will be owned by the respective national Nabucco companies.

18. To finance their investments, the 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.

19. The Nabucco pipeline is planned to be built in stages. Based on the application of Nabucco International, 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).

20. 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 and Egypt (approx. 8-10 bcm/year). Natural gas originating from sources along the Nabucco pipeline may come e.g. from Romania and Bulgaria. The

Nabucco pipeline may also be used to transport gas originating from other regions, notably from Russia.

21. 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. This also implies that, according to the application of Nabucco International, uniform tariffs, General Terms and Conditions and standard contracts must be used in all Nabucco countries.

22. According to the application, 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, the shareholders' affiliated companies and state owned companies acting as public suppliers in the transit countries of the Nabucco pipeline can apply for a maximum of 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 of Nabucco International, the shareholders' affiliated companies and state owned companies acting as public suppliers in the transit countries of the Nabucco pipeline, can apply for the remaining 50% of the capacity.

23. Prior to the start of construction of the Nabucco pipeline and any subsequent expansion stage, Nabucco International will carry out this type of allocation procedure to identify capacity requirements. If the requirements of the first allocation procedure exceed the planned capacity of 8 bcm Nabucco International is obliged to carry out the next expansion step (up to a 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[4].[5]

24. If the capacity bids in the shareholder allocation procedure exceed the reserved capacity of 50% per year (maximum of 15 bcm/year), the bids will be reduced and allocated *pro rata*.[6] The exemption from third party access is thus limited to half of the capacity and, in any event, to a maximum of 15 bcm/year. If the pipeline is expanded beyond 31 bcm/year, general rules on regulated third party access apply.

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3 Application, Annex 8b, p. 3.

4 Application, Annex 3, section 7, page 16 f.

5 Long-term means a term of more than 15 years, Application, Annex 3, p. 17.

6 Application, Annex 8b, p. 2.

25. 10% of the maximum transportation capacity being available in the General Open Season shall be reserved for short-term transportation capacity.[7] 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 Open Season.[8] 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.[9] It is therefore not determined how much capacity will be allocated to short-term and to long-term contracts until the capacity allocation procedures have taken place.

26. Upon request, Nabucco International has to add entry or exit points on the Nabucco pipeline section in Romania other than the one(s) foreseen in the application, provided the addition of other entry or exit points is technically and economically reasonable.[10] A shipper can re-nominate an exit point and take delivery at other exit points upstream if it is technically feasible.[11] There are also, if operationally possible and for an additional tariff, possibilities to transport gas in reverse flow direction (backhaul flows).[12]

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

28. If a shipper does not use contractually booked capacity, Nabucco International will make available this capacity to the market (use-it-or-lose-it principle). This capacity will be made available as interruptible capacity on a short-term day-ahead basis.[13] 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 his capacity, shippers who bought the interruptible capacity will lose the capacity.[14]

29. Thus, several rules are in place to avoid the hoarding of capacity and to increase liquidity in the market:

- In the General Open Season, 10% of the capacity is offered on a short-term basis;

- Nabucco International will offer a "notice-board" for the secondary market;

- Nabucco International will offer unused capacity on interruptible basis in case of congestion;

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7 Short term transportation capacity is defined as having a maximum duration of one year, Application, Annex 8b, page 3.
8 Application, Annex 8b, p. 3.
9 Application, Annex 8b, p. 4.
10 Application, Annex 3, section 8.
11 Application, Annex 6, p. 2.
12 Application, Annex 3, p. 24.
13 Application, p. 22, Annex 3, p. 14, and Annex 9, p. 8.
14 Application, Annex 3, p. 14.

- Shippers have an incentive to resell or sublet unused capacity because they have to pay for it in any case (ship-or-pay principle).

30. All shippers will pay a distance related tariff to Nabucco International calculated on the basis of the tariff method described in the application. The details of the tariff will be established by Nabucco International after the closure of the open season when all the necessary data are known (e.g. long term contracted capacity, number of entry and exit points) and approved by ANRE before entering into force.[15]

3. ASSESSMENT OF THE EXEMPTION CRITERIA OF ARTICLE 22

31. Exemptions for major new infrastructures according to Article 22 of the Gas Directive constitute an exception to the general rules on regulated third party access in the Gas Directive. 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.

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

3.1. Major new gas infrastructures, i.e. interconnectors between Member States, LNG and storage facilities, may, upon request, be exempted from certain provisions of the Gas Directive.

33. The Romanian section of the Nabucco pipeline constitutes an interconnector as defined by Article 2(17) of the Gas Directive. In fact, the pipeline is a transmission line which crosses the borders between EU Member States, i.e. between Romania and Bulgaria as well as between Romania and Hungary, respectively, and its sole purpose is to connect the national transmission systems of these Member States. Taking into account that the pipeline involves high cost and considering the magnitude of the project as well as the size of the markets concerned, the Nabucco pipeline is indeed considered a major new infrastructure. The pipeline may therefore be exempted under Article 22 of the Gas Directive if the other criteria of Article 22(1) are met.

34. The Commission considers that the extension of the exemption's validity from five to seven years is justified. The Nabucco pipeline project bears technical, economic and political risks which by far exceed the risks of most other major infrastructure projects in the EU energy sector. The situation concerning the Nabucco pipeline has changed significantly since the beginning of 2008. In particular, the delay in the start of the exploration of the Shah Deniz II gas field, the delay in the conclusion of the Intergovernmental Agreement and the considerable worsening of the state of the financial markets must be considered to adversely affect the time schedule for the Nabucco pipeline.

35. Consequently, the Commission agrees with ANRE that the original five year validity of the exemption decision did not give Nabucco International sufficient

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15 Letter from ANRE to the Commission of 8 January 2009.

time to put the Nabucco pipeline into operation after the last exemption decision, and that, for the above reasons, the seven year validity is justified.

36. The Commission notes, however, that the modified exemption decision does not clearly specify the applicability of which of the Member States' exemption decisions shall be deemed to start the seven year period. In order to increase legal certainty for the Nabucco pipeline as a whole it is necessary to link the beginning of the seven year period to the date on which the last exemption decision in any of the Member States concerned has become effective, i.e. after the adoption of an exemption decision which complies with amendments proposed by the Commission in the context of a procedure under Article 22 of the Gas Directive.

37. Furthermore, the Commission agrees with ANRE that it is necessary to limit the validity of the Romanian exemption decision in absolute terms in order to avoid that possible delays in the administrative procedures in one of the other Member States concerned extend the validity of the Romanian exemption decision excessively while the market situation on which the assessment is based may in the meantime have changed significantly and while other market players may be discouraged from initiating other pipeline projects. Taking into account the above mentioned circumstances and the seven year validity of the (modified) exemption decision, the Commission considers that ANRE's decision that the Romanian section of the Nabucco pipeline shall be put into operation no later than by 31 December 2016 is justified and limited to what is strictly necessary.

3.1.1. The investment must enhance competition in gas supply.

38. 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 lead to the creation or strengthening of one or more dominant positions in one of the markets affected.

39. The following relevant product markets were identified in the market study[16] (hereafter "the Market Study") on which ANRE has based its exemption decision:

- the upstream wholesale market,
- the downstream wholesale market and
- the retail market (for eligible and captive customers).

40. The upstream wholesale market consists of domestic production and import of natural gas. Gas consumption in 2007 amounted to 16.4 bcm/year, out of which 71% came from domestic production and 29% from import.[17] Two companies,

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[16] "Market study regarding the impact of the Nabucco project on the Romanian natural gas market", submitted by ANRE on 11 November 2008.

[17] See Market Study, p. 2.

Romgaz and Petrom account for almost all the domestic production.[18] The sole import source is the Russian Federation. Because of the existing legal export monopoly in Russia it can be assumed that all imports ultimately originate from Gazprom.

41. On the downstream wholesale market there are 77 suppliers. By far the largest market participants are Romgaz (44%) and Petrom (33%).[19]

42. On the retail market the four biggest undertakings (Distrigaz Sud, E.ON Gas Romania, Romgaz and Petrom) together have a 78% market share, with Distrigaz Sud being the largest with 24%.[20]

43. The forecast for 2015 shows a modest decrease in domestic production and a constant growth in consumption resulting in a strong increase of imports (from 29% to 45%).[21] Currently the national transmission system is not connected to the network of neighbouring countries and Romania has no LNG terminals. Therefore, the only available import source is Russia and thereby Gazprom. The planned interconnector to Hungary (Arad-Szeged) is expected to be operational in 2010 and to be used for imports to Romania. This interconnector would however not change the competitive situation on the upstream wholesale market since the ultimate gas supplier will almost certainly be Gazprom.[22]

44. The Commission notes that the Romanian natural gas market has evolved strongly in the last years. The changes are reflected in the fluctuating market shares of most participants. In this situation there is a high degree of uncertainty about the future development of the market structure. The envisaged Romanian exit volume of 2 to 5 bcm/year from Nabucco can potentially be a crucial element in enhancing competition. However, under a worst-case scenario the same volume could also contribute to the strengthening of market power and eventually a loss of consumer welfare.

45. In general, in a market with only a few participants, a homogenous product and very high entry barrier there is a substantial risk for reduced competition through tacit collusion. In Romania primary gas is almost entirely (99%) controlled by three undertakings, Gazprom, Romgaz and Petrom. In addition, the lack of pipelines to other sources of gas than Russia means that no new entrants are expected to compete in the upstream wholesale market.

46. At this stage, there are only indications for how much gas will be transported through the Nabucco pipeline to Romania and it is not yet known 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 possible worst-case scenarios. This is all the more important since two of the biggest undertaking in the gas market, Romgaz and Petrom, will be able to benefit from the shareholder allocation procedure and thus have preferential access to capacity on Nabucco.

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18 Their respective market shares in 2007 were 51% and 47%.

19 Market share in 2007 (Petrom and Petrom Gas volumes are summed up). See Market Study, Annex 2.

20 See Market Study, Annex 3.

21 See Market Study, p. 3.

22 In Hungary the predominant source (at least 90%) of the imported natural gas is directly or indirectly Gazprom.

47. The Commission identifies the following worst-case scenarios under which the Nabucco pipeline would not enhance competition in the Romanian gas markets.

- *Single-firm dominance:* Any of the relevant gas markets[23] develops in such a way that it becomes dominated by a single undertaking. Although currently no undertaking can be considered as dominant on any of the relevant markets, the small number of market players with high market shares makes the emergence of such a situation possible.

- *Collective dominance:* Competition could also be severely restricted when a small number of undertakings jointly/collectively dominate a market.[24] Such situation might arise when undertakings have no or only limited incentives to increase their market share, a common incentive to keep prices high and a feasible strategy to do so.

48. It should be noted that the allocation rules foresee that the 50% capacity split for each capacity allocation procedure applies to the *total* annual transport capacity of the pipeline. This does not mean that the split will necessarily be reflected at each section of the pipeline. As a result, it cannot be excluded that all or a large part of the capacity exiting in Romania could be booked by one shareholder. Conversely, in case less than 50% of the capacity to Romania is booked by Nabucco shareholders, it cannot be excluded that even more than 50% of capacity into Romania is booked by a single third party.

49. Moreover, there are insufficiently clear rules on how the capacity in the general open season will be allocated in the case of overbooking. To sum up, the present rules for capacity allocation do not prevent a possible worst-case scenario in which a single dominant market player may book above 50% (even up to 100%) of the annual Romanian exit capacity even if there is interest from non-dominant undertakings in booking Romanian exit capacity. In case of collective dominance the dominant undertakings might be equally able to book a very large part of the exit capacity and thereby foreclose the Nabucco pipeline for new entrants.

50. The Commission considers that these worst-case scenarios are not moderated by the above mentioned anti-hoarding and liquidity increasing measures.[25] These measures are overall beneficial to competition but 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(s). Moreover, there is no guarantee that all these measures will actually have a pro-competitive effect since in case all capacity is used by the capacity holders, no unused capacity can be released.

51. 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 scenarios and to ensure that the

[23] See paragraph 39.

[24] See case Airtours/Commission, T-342/99 and case Gencor/Commission, T-102/96.

[25] See paragraph 29.

Nabucco pipeline will, in any event, enhance competition in gas supply. Such additional conditions have to ensure that a single dominant or several jointly dominant market players cannot book a share of Romanian exit capacity which would reinforce its/their position(s) and that some of the additional gas supply through the Nabucco pipeline is accessible to competitors.

52. For the above reasons, the Commission takes the view that the exemption with the conditions that have been proposed by ANRE does not fulfil the first criterion of Article 22(1) of the Gas Directive.

3.1.2. The investment must enhance security of supply.

53. 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.[26] Due to the lack of 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%).[27] Competition for gas sources will also come from increasing demand in other world regions, for example from China.

54. 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 relatively high degree of political stability.

55. The Nabucco pipeline will provide a better connection between countries which are currently not well interconnected. This will increase security of 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.

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

57. The Nabucco pipeline will increase the import capacity into Romania and thus help to cover increasing gas demand in Romania and in Central Europe as a whole. According to ANRE, gas consumption in Romania will increase in the future. ANRE expects demand to rise from 16.7 bcm in 2008 to 19.1 bcm in 2015, whereas domestic production is expected to decline from 11.3 bcm in 2008 to 10.6 bcm in 2015. As a consequence, imports over the same period of time are expected to rise from 5.4 bcm in 2008 to 8.5 bcm in 2015.[28]

58. At present, Romania's national transmission system has no interconnection with the gas transmission systems of the neighbouring Member States. Three transit pipelines in Romania transport Russian natural gas to Bulgaria across Romania and Ukraine. For 2010, an interconnection between Romania and Hungary is planned on the direction Arad – Szeged, which will serve as an import pipeline

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[26] Application, Annex 12, p. 12.
[27] BP Statistical Review of World Energy 2007, p. 30.
[28] Market Study, p. 3.

for gas from Hungary to Romania.[29] Currently, 100% of Romanian import capacities are connected to Russia. The Commission notes that ANRE estimates imports through the Nabucco pipeline into Romania to amount to 2 to 5 bcm/year.[30] Considering the expected decrease of domestic production, the Nabucco Project will contribute to reducing the dependency of Romania upon one single source of gas imports, thereby increasing Romanian security of supply.[31]

59. On the basis of the foregoing considerations, the Commission considers that the Nabucco pipeline enhances the security of gas supply for Romania and the EU as a whole.

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

60. Nabucco International has listed the potential risks of the project in their Risk Analysis.[32] The risks are 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.

61. 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 which is usually guaranteed by the expected future revenues. 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.[33] As also pointed out by ANRE[34], another important risk element in addition to the risks mentioned above is the political stability in the gas production countries.

62. In view of the financial scale of the project, the regulatory risks in the absence of an exemption and the long-term commitment necessary to obtain upstream supply, the Commission considers that the level of risk is such that the investment would not take place unless an exemption was granted.

3.1.4. 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.

63. The section of the Nabucco pipeline that is built in Romanian territory will be owned by the Romanian national Nabucco company. This company 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.

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[29] Additional information provided by ANRE on 24 April 2009.
[30] Exemption decision, p. 8.
[31] Application, p. 34.
[32] Annex 11 to the application.
[33] Application, pp. 36 et sequitur.
[34] Modified exemption decision, pp. 4 and 5.

3.1.5. Charges are levied on users of that infrastructure.

64. According to the application, tariffs will be the single source of revenues used to cover all maintenance and operation costs of the pipeline.[35] 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 shareholders of Nabucco International, the shareholders' affiliated companies and state owned companies acting as public suppliers in the transit countries of the Nabucco pipeline.[36] The Commission thus considers that this criterion is fulfilled.

3.1.6. 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.*

65. 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.

66. The Nabucco pipeline will not compromise the efficient functioning of the regulated system in particular because the exemption does not require the disproportionate expansion or reinforcement of the existing regulated infrastructure. Therefore, the exemption does not negatively influence the costs of operating the regulated system.

67. The exemption has no detrimental effect to competition since it does not foreclose the realisation of possible alternative projects with greater competition enhancing effect to be built in the foreseeable future without the need of an exemption under Article 22 of the Gas Directive.

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

3.2. Considerations to remedy the identified competition concerns

69. 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.

3.2.1. Limitation of the share of annual capacity which can be booked by one or more dominant undertaking(s)

70. To prevent the outlined worst-case scenario of single-firm dominance, it is necessary to limit the share of the annual capacity which a single dominant undertaking can book at the total of all Romanian exit points of the Nabucco

[35] Application, pp. 40 and 41.
[36] Exemption decision, p. 7.

pipeline to a maximum of 50% (hereinafter "the single dominance capacity cap"). Such a capacity cap leaves competitors at least half of the Romanian exit capacity of the Nabucco pipeline and thus promotes competition in the relevant markets.

71. To prevent that a position of collective dominance is created or reinforced on the upstream wholesale market, it is necessary to limit the share of the annual capacity which collectively dominant undertakings can book at the total of all Romanian exit points of the Nabucco pipeline (hereinafter "the collective dominance capacity cap"). Such a capacity cap should ensure that in case of collective dominance, competitors are left with a sufficient amount of Romanian exit capacity on the Nabucco pipeline. The collective dominance capacity cap should be set at a level which enables competitors to effectively challenge the group of collectively dominant undertakings.

72. Together, the single and the collective dominance capacity cap ensure the fulfilment of 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.

73. The Commission acknowledges that the above described capacity caps may prevent a capacity expansion if, for example, non-dominant 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 caps a part of the pipeline remains idle once the pipeline is built. The Commission therefore considers it necessary to derogate from the capacity caps if there is insufficient interest from other parties than dominant undertakings to book capacity. In this case, dominant undertakings can be allowed to acquire additional exit capacity in excess of the capacity cap. The undertakings 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.

74. 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(s) concerned to link the gas volume to be offered to the market to the share of booked capacity and not to the 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 the capacity cap (e.g. 5% in the case of a capacity booking of 55% and an applicable cap of 50%) 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 Romania in a given year. These volumes shall be adjusted annually based on the import volumes of the previous year. In the first period an expected capacity utilisation rate to be agreed between the undertaking(s) subject to the capacity cap and the Romanian regulator shall be assumed whereby the ex post difference between the expected and the actual volumes shall be added or subtracted from the volumes to be released in the following year.

3.2.2. Obligation to extend the capacity according to demand

75. With respect to the project planning as outlined above, the Commission would like to point out that Nabucco International presented its planning only as indicative both in terms of timing and construction stages.

76. In fact, the above planning could necessarily only be 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. The precise entry/exit points will be determined only at a later date when the results of the capacity allocation procedure are known. This flexibility in installing entry and exit points along the pipeline shows that the pipeline design can be, and in fact needs to be, adjusted to different gas transport volumes in different parts of the pipeline.

77. Moreover, the additional capacity steps e.g. from 8 to 15.7 bcm/year and from 15.7 to 25.5 bcm/year, as well as from 25.5 to 31 bcm/year, represent very significant gas volumes amounting to a large part of the Romanian gas consumption. The experience of other pipelines suggests that much smaller enhancement steps than those indicated by Nabucco International may be technically and economically feasible.

78. 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. 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.

79. The Commission, for those reasons, considers that the four above mentioned capacity steps[37] 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. It can also be assumed that such flexibility to expand the transport capacity exists throughout the range between the minimum and the maximum technical capacity.

80. 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 negatively impact the development of competition on the Romanian natural gas markets. Entry by new competitors 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

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[37] See paragraphs 19 and 77.

such enhancement could still be technically feasible and commercially viable for Nabucco International).

81. The restriction to large construction steps risks unnecessarily delaying the enhancement of competition and 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 competition and security of supply.

82. 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. The Commission acknowledges that the exemption decision imposes a further obligation on Nabucco International to extend the capacity of the pipeline according to binding requests. However, the obligation does not fully remedy the concerns described since it applies only after the available capacity exceeds 25.5 bcm/year.[38]

83. 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[39] to the above four construction steps.

84. That obligation should apply only if binding requests are made which amount to an additional aggregated transport capacity on the Nabucco pipeline of 1.0 bcm/year. A volume of 1.0 bcm/year corresponds to an expected share of the Romanian gas market of approximately 5% in 2015[40] and can therefore, if the additional volume is partly or fully booked for Romanian exit points have an appreciable impact on competition. 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.

85. 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 concerned that a specific capacity expansion is not economically or technically viable. This is without prejudice to the obligation of Nabucco International to allocate all capacity in a transparent and non-discriminatory procedure and to inform the competent regulatory authority accordingly.

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[38] See paragraph 2, letter g).

[39] Intermediate refers to capacity volumes in between the four construction steps as described by Nabucco International.

[40] See Market Study, p. 3.

3.2.3. Proportionality

86. 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.

4. CONCLUSIONS

87. Based on the foregoing analysis, the Commission considers that the decision to exempt the Romanian part of the Nabucco pipeline project from regulated third party access, including tariff regulation, needs to be amended to fully comply with Article 22 of the Gas Directive. In order to ensure, firstly, that the 25-year-period of the Romanian exemption decision is effective and, secondly, that the project enhances competition and the security of supply, the Romanian regulator is requested to amend its exemption decision to include the following conditions:

I. The beginning of the seven year period starts on the date on which the last exemption decision in any of the Member States concerned has become effective, i.e. after the European Commission's approval of the respective decision.

II. The share of annual capacity booked by one or more dominant undertaking(s) shall be limited according to the following principles:

(a) An undertaking which holds a dominant position on its own in one or more of the relevant gas markets shall not be allowed to book more than 50% of the total capacity at the exit points in the Romanian section of the Nabucco pipeline. For the calculation of the single dominance capacity cap undertakings belonging to the same group shall be considered together.[41]

(b) In the event of collective dominance on the upstream wholesale market the competent national authority should have the right to limit the capacity share of any of the collectively dominant undertakings. The competent national authority should set a capacity cap in such a way that non-dominant undertakings are enabled to compete effectively with the jointly dominant undertakings.

(c) Nabucco International shall inform ANRE in good time of the result of the open season procedures. ANRE should then, within a reasonable and specified period of time express its preliminary or final opposition to the submitted capacity allocation if one or more undertakings holding a dominant position exceed(s) the single dominance or the collective dominance capacity cap.

(d) Where due to the lack of interest by other parties, the capacity caps in II. a and II. b prevent the expansion of the pipeline or causes existing

[41] 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.

capacity to remain idle, a derogation from the capacity caps shall apply on condition that the undertaking(s) concerned shall offer the volume of gas relating to the capacity it/they hold(s) in excess of the 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 the capacity cap (e.g. 5% in the case of a capacity booking of 55% and a cap of 50%) 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 Romania in a given year, whereby an initial estimation of that value and adjustment in the following periods shall be made.

(e) 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.

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 holding capacity on the Nabucco pipeline or if two holders of capacity rights on the Nabucco pipeline merge, Nabucco International shall notify such change to ANRE. Based on this information, the competent authority shall make sure that the capacity cap defined above to counter the negative effect on competition is complied with.

IV. Nabucco International is obliged to build additional capacity also for binding capacity requests to a Romanian exit point which are intermediate to the constructions steps as described in its application of 23 February 2007 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 ANRE.

88. Therefore by virtue of Article 22(4) of the Gas Directive, the Commission hereby requests ANRE to amend its exemption decision accordingly within four weeks upon receipt of the present letter and to inform the Commission of this action.