EN

Case No COMP/M.3696 E.ON/MOL

Only the English text is authentic.

REGULATION (EC) No 139/2004
MERGER PROCEDURE

Article 8 (2)
Date: 21/12/2005

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21/XII/2005

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PUBLIC VERSION

COMMISSION DECISION

of 21/XII/2005

declaring a concentration to be compatible with the common market and the EEA Agreement

(Case No COMP/M.3696 – E.ON/MOL)

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(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Agreement on the European Economic Area, and in particular Article 57 thereof,

Having regard to Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings[1], and in particular Article 8(2) thereof,

Having regard to the Commission's decision of 7 July 2005 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

After consulting the Advisory Committee on Concentrations[2],

Having regard to the final report of the Hearing Officer in this case [3],

WHEREAS:

1 OJ L 24, 29.1.2004, p. 1

2 OJ C ...,...200. , p....

3 OJ C ...,...200. , p....

(1) On 2 June 2005, the Commission received a notification pursuant to Article 4 of Regulation (EC) No 139/2004 ("the Merger Regulation") of a proposed concentration by which the undertaking E.ON Ruhrgas International AG ("ERI") acquires, within the meaning of Article 3(1)(b) of the Merger Regulation, control of the whole of the undertakings MOL Földgázellátó Rt. ("MOL WMT", Hungary) and MOL Földgáztároló Rt. ("MOL Storage", Hungary), currently solely controlled by MOL Hungarian Oil and Gas Rt. ("MOL", Hungary), by way of purchase of shares. ERI will also acquire MOL's shareholdings in Panrusgáz Magyar-Orosz Gázipari Rt. ("Panrusgáz", Hungary), a joint venture company between OAO Gazprom ("Gazprom", Russia) and MOL.

(2) After examination of the notification, the Commission has concluded that the notified operation falls within the scope of the Merger Regulation and raises concerns as to its compatibility with the common market.

I. THE PARTIES

A. E.ON

(3) ERI is a solely-controlled subsidiary of E.ON Ruhrgas AG, which is in turn an indirect subsidiary of E.ON AG (Germany). The three companies are members of the E.ON group of companies which is a privately owned energy company with a focus on the supply of electricity and gas. The acquiring party will be henceforth referred to as "E.ON".

B. MOL

(4) MOL is an integrated oil and gas group which is primarily active in Hungary on the markets for natural gas, oils, fuels and chemicals. It is a public company listed on the Budapest stock exchange. The Hungarian state still owns 12% of share capital, plus a golden share.

II. THE OPERATION AND THE CONCENTRATION

A. Operation

(5) The companies which are being acquired are the following solely-controlled subsidiaries of MOL:

– MOL WMT (an acronym for Wholesale, Marketing and Trading) is a public utility wholesaler and gas trader which supplies natural gas to regional gas distributors, industrial customers and large power plants in Hungary;

– MOL Storage operates five natural gas storage facilities located in Hungary and is only active in providing storage services.

(6) E.ON will acquire an interest of 75 % minus 1 share in both MOL WMT and MOL Storage. The agreements provide for a 5-year put option under which MOL can sell its remaining 25 % plus 1 share interests in MOL WMT and MOL Storage to E.ON.

(7) E.ON is also acquiring MOL's 50% shareholding in Panrusgáz. Panrusgáz is a joint venture between OOO Gazexport ("Gazexport"), a subsidiary of Gazprom and MOL. 50 % of the shares in Panrusgáz are currently held by MOL, whereas 40 % of the shares are held by Gazexport and 10 % by Interprocom (a company having close ties with Gazprom).

(8) MOL Földgázszállító Rt. ("MOL Transmission"), another solely-controlled subsidiary of MOL, is not acquired by E.ON through the present transaction. MOL is instead granted a put option under which MOL can require E.ON to purchase a 25 % plus 1 share or a 75 % minus 1 share interest in MOL Transmission during the next two years.

(9) Finally, MOL retains control over its gas exploration and production business (the MOL upstream gas Exploration and Production division ("MOL E&P")). However, as part of the transaction, MOL and MOL WMT have entered into a new long-term gas supply agreement for the gas produced by MOL E&P (the "Supply Agreement").

B. Acquisition of MOL's shareholding in Panrusgáz

(10) The parties claim that the only business of Panrusgáz is to purchase gas from Gazexport for onward sale to MOL WMT. Therefore, Panrusgáz is only active for its shareholders and has no business relationships with third parties. It is thus submitted that Panrusgáz is technically not a party to the concentration because it does not constitute a full-function joint venture. Based on the information available, the Commission is inclined to regard Panrusgáz as a non full-function joint venture and its acquisition is therefore not part of the concentration assessed in the present case.

(11) In any event, the acquisition of MOL's stake in Panrusgáz will have to be taken into account in the competitive assessment of the transaction in view of the crucial importance of access to gas resources from abroad and in particular from Russia.

C. Put option relating to MOL Transmission

(12) The proposed transaction does not result in a change of control of MOL Transmission and this company is therefore not part of the concentration assessed in this case.

(13) In any event, the put option foreseen by the agreements will be considered in the competitive assessment of the transaction in view of the crucial importance of access to the gas transmission network.

(14) Finally, the Commission notes that the change in control that may result from the exercise of the put option would at any rate constitute a concentration for merger

control purposes and would thus be closely scrutinised by the competent competition authorities (either the Commission or national competition authorities).

D. Concentration

(15) In view of the structure of the transaction, the acquisition of sole control over MOL WMT and MOL Storage by E.ON constitutes the concentration assessed in this case.

III. COMMUNITY DIMENSION

(16) The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 000 million[4]. Each of the undertakings concerned has an aggregate Community-wide turnover in excess of EUR 250 million, but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

IV. PROCEDURE

(17) On 7 July 2005, the Commission initiated proceedings in accordance with Article 6(1)(c) of the Merger Regulation.

(18) On 2 August 2005, the procedure was suspended for eight days pursuant to Article 10(4) of the Merger Regulation owing to the fact that E.ON did not respond in a comprehensive and timely manner to a decision requiring information pursuant to 11(3) of the Merger Regulation.

(19) A Statement of Objections ("SO") was sent to E.ON on 19 September 2005. As agreed between E.ON and MOL, a version of the SO without E.ON's business secrets was transmitted to MOL by E.ON's legal representatives. In the following days, access to the Commission's file was granted. E.ON and MOL were given the opportunity to comment on the Commission's preliminary findings as set out in the SO by 3 October 2005. This deadline was subsequently extended to 6 October 2005 at E.ON's request. E.ON's reply was received on 5 October 2005. MOL's comments were received on 6 October 2005.

(20) The parties did not request to develop their arguments in a formal oral hearing.

(21) On 21 October 2005, the request of Energie Baden-Württemberg AG to be admitted as an interested third party was granted by the Hearing Officer. The same day, the Commission sent them a non-confidential summary of the SO.

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4 Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25).

(22) On 20 October 2005, E.ON offered commitments which were amended on 11 November, 15 November and 8 December 2005 respectively. Further to the market testing of the proposed undertakings, E.ON substantially improved its draft commitments, in particular as regards the duration of the gas release program and the price mechanism of the gas release auctions.

(23) In agreement with and following an express request by E.ON, to which MOL agreed, the Commission issued a decision on 10 November 2005 pursuant to Article 10(3) second paragraph of the Merger Regulation in order to extend the procedure by 11 working days.

(24) The Advisory Committee on Concentrations discussed the draft decision on 6 December 2005.

V. RELEVANT MARKETS

(25) The transaction affects the gas and electricity sectors. Natural gas and electricity activities can be delineated in several distinct product markets. The following analysis will deal first with the definition of the relevant natural gas markets and secondly with the definition of the relevant electricity markets.

(26) According to previous Commission decisions, the definition of the relevant product market(s) must take into account the existing and foreseen degree of opening thereof[5]. Accordingly, each chapter will contain a description of the regulatory framework including the state of the opening of the gas and electricity markets in Hungary and their expected evolution.

(27) It should be noted at the outset that, in their reply to the SO, the parties did not contest any of the relevant product market definitions.

A. Relevant gas markets

(i) The natural gas sector in Hungary

a. Gas demand

(28) Natural gas is the largest source of energy in Hungary. Gas currently satisfies 48% of Hungary's primary energy consumption, which is the highest share in the Community[6]. Approximately 80% of the population consumes natural gas, and natural gas accounts for 25% of the electricity produced in Hungary. In 2004, the total Hungarian gas market represented 14.0 billion cubic meter ("bcm"), including 5.6 bcm for industrial and commercial customers, 3.2 bcm for power plants and 5.2 bcm for residential customers. Gas demand is expected to grow from 14 bcm in

5 *See*, inter alia, Commission decision of 9 December 2004 in Case COMP/M.3440 – EDP/ENI/GDP.

6 By comparison, natural gas accounts for 40% of the Netherlands' primary energy consumption and 39% of the UK's primary energy consumption. Contrary to Hungary, the Netherlands – as well as the UK until last year – is a net exporter of gas.

2004 to [15-20]* bcm in 2020 (about [0-2 %]* compounded annual growth rate), due to the increase in Hungarian gross domestic product and the increase in gas-fired electricity generation.

Projections for Hungarian gas demand:[7]

In bcm	Residential	Industrial	Power plants	TOTAL
2005	[5-7]*	[6-8]*	[3-5]*	[14-20]*
2010	[5-7]*	[6-8]*	[3-5]*	[14-20]*
2015	[5-7]*	[6-8]*	[3-5]*	[14-20]*
2020	[5-7]*	[6-8]*	[3-5]*	[14-20]*

[…]*

b. Gas sources

(29) Natural gas is either imported from foreign sources or bought from Hungarian gas producers for it to be delivered to customers on the Hungarian market.

Domestic production

(30) Hungarian gas production is not negligible and amounted to approximately 3 bcm in 2004, accounting for about 20% of national gas consumption. The entire national production is handled by the MOL E&P. It should be added that besides MOL E&P there is another small independent gas producer in Hungary, El Paso, who also sells its entire production to MOL WMT (around 0.2% of Hungarian national gas consumption)[8].

(31) There are different qualities of gas in Hungary. Most of the gas produced by MOL E&P is high-calorific gas[9] ([2-4]* bcm in 2004). MOL E&P produces small quantities of low-calorific gas[10] ([0-1]* bcm in 2004), and a gas of a lesser quality

* Parts of this text have been edited to ensure that confidential information is not disclosed; those parts are enclosed in square brackets and marked with an asterisk.

7 Parties' submission dated 29 August 2005.

8 The US company POGO is also active in gas exploration in Hungary but does not yet produce natural gas. POGO's Hungarian subsidiary POGO Hungary Kft. was acquired in June 2005 by the US company Toreador Resources Co. and will change its name to Toreador.

9 High-calorific gas is gas with higher combustion properties according to the Hungarian Standard 1648 MSZ 2/H.

10 Low-calorific gas is gas with lower combustion properties according to the Hungarian Standard 1648 MSZ 2/S. This gas has different parameters from the low-calorific gas in other countries (CO_2 rather than nitrogen prevails as a non-combustible component due to special geological reasons).

called "inert gas"[11] ([0-1]* bcm in 2004). The Hungarian gas production (for both high-calorific and low-calorific gas[12]) is declining.

Imports

(32) Although there is a domestic natural gas production in Hungary, imports are key to satisfy the domestic natural gas demand, and Hungary is a net gas importer. In 2004, approximately 80% of natural gas consumed in Hungary was imported. The share of imports is expected to increase as Hungary's natural gas production decreases.

(33) Hungarian gas imports are traditionally and predominantly Russian gas. There are only two cross-border pipelines ("entry points") through which gas is imported into Hungary: the Hungarian/Ukrainian entry point Beregovo (Brotherhood pipeline, capacity of 15.01 bcm/year or 43.1 million m³/day) and the Hungarian/Austrian entry point (Hungary-Austria Gasleitung ("HAG pipeline") at Baumgarten, capacity of 4.5 bcm/year or 12.3 million m³/day). In addition, there is an exit point at the Hungarian/Serbian border through which Serbia and Bosnia-Herzegovina import Russian gas that transits through Hungary.

(34) Capacities available at these entry points are essentially booked and used by MOL WMT to import gas under its long-term supply contracts. Capacities booked by MOL WMT for the gas year 2004/2005 were [10-12]* bcm/year and [25-35]* million m³/day (out of 15.01 bcm/year and 41.3 million m³/ day) at Beregovo and [1-4]* bcm/year and [6-10]* million m³/day (out of 4.5 bcm/year and 12.3 million m³/day) at the HAG entry point[13]. In addition, a transit capacity of [3-5]* bcm/year and [10-13]* million m³/day are booked at the Beregovo entry point by the Serbian company Nis and the Bosnian Herzogovinan company BHGas for transit. As a result, free capacity on the Hungarian entry point is very limited for other market players[14].

(35) Two additional gas pipelines are envisaged to link Hungary with Romania […]*. The pipeline between Romania and Hungary has been contemplated for several years by MOL and Transgaz (Romania). Transgaz has already completed the Romanian section of the pipeline but the construction of the Hungarian section […]*. The pipeline would link Algyő and Csanádpalota (100 km transmission line, 45 km of which in Hungary) and would have an initial capacity of [1-3]* million

11 Inert gas is gas whose combustion properties are lower than for the MSZ 1648 2/S standard. Inert gas contains more carbon-dioxide and more nitrogen.

12 Low-calorific gas fields will be empty within […]*.

13 MOL WMT has booked [2-4]* bcm on the HAG pipeline with OMV, the Austrian gas incumbent, on a ship-or-pay basis until […]*.

14 Although actual imports amounted to approximately [10-13]* bcm in 2004 (excluding transit), total annual booked capacities reached approximately [15-20]* bcm in 2004. This suggests that there is contractual congestion at the entry points (capacity booked but not fully used).

m³/day (approximately [0-2]* bcm/year). MOL's internal documents[15] indicate […]*.

(36) In addition, Nabucco is a project for a new pipeline going from Turkey to Austria, crossing Bulgaria, Romania, and Hungary to bring Caspian and Middle East gas (from Azerbaijan, Iran, Syria, Egypt and Iraq, and even Kazakhstan and Turkmenistan) to European markets. The feasibility studies have already been performed and the project is currently at its planning stage. The operation phase is expected to start in 2011 and its yearly capacity will be either 25 bcm (base case scenario) or 31 bcm (high case scenario). According to parties involved in the project, it is expected that around [10-20]* bcm will be available at the Baumgarten hub for further transmission and distribution in Europe.

(37) Prior to the market opening, the MOL group had a monopsonistic position on all gas procurement activities, with exclusive rights to purchase Hungarian gas and to import gas into Hungary. In order to secure its gas supply, MOL WMT has entered into long-term supply agreements (up to […]* years) with […]* to import gas through the Hungarian Western and Eastern entry points.

(38) The long-term gas supply agreements of MOL include Take or Pay ("TOP") obligations. TOP obligations in gas supply contracts require the purchaser of the gas to pay in any event for a certain percentage (generally [70-90%]*) of the contracted quantities of gas, even if it does not take the whole contracted quantities. It means that the purchaser is obliged to pay the full price even if it has no opportunity to use or resell the gas. TOP losses typically occur if – due to market liberalization – certain customers switch, the consumption of which has been calculated by the given gas supplier when sourcing its gas to be resold. In such a case, the supplier does not need the whole amount of contracted gas, but it is obliged under the TOP obligation of its agreement to pay the TOP level. In the Hungarian gas system, TOP losses can be suffered by the Regional Distribution Companies ("RDCs") and by MOL WMT if eligible customers currently supplied by them switch to an alternative supplier. […]*

(39) As far as MOL WMT's Russian gas imports are concerned, Gazexport, the sole exporter of Russian gas, sells the relevant gas quantities to Panrusgáz, which in turn sells the same quantities onwards to MOL WMT. Imported natural gas flows thus directly through Panrusgáz to MOL WMT, on the basis of two "mirror contracts" concluded between Gazexport/Panrusgáz and Panrusgáz/MOL WMT. According to the agreements, natural gas is supplied to MOL WMT through the Brotherhood pipeline at Beregovo on the Ukrainian border and, to a lesser extent, through the HAG pipeline at Baumgarten on the Austrian border.

(40) MOL WMT also buys gas from other sources, notably […]* through the HAG entry point. Under pressure from the Hungarian government with the aim to improve the country's security of supply, MOL diversified its gas purchase portfolio ten years ago. It signed in 1995 and 1997 additional gas supply contracts (two contracts with duration of [10-20]* years with […]* and one […]* contract with[…]*) and established a new route connecting the country to the West European transmission

[15] Proposal to MOL Executive Board Meeting […]*, 9/12/2002,[…]*.

system[16]. The gas volumes supplied by […]* to MOL WMT are sourced from […]* overall gas purchase portfolio. This means that the gas sold by those companies to MOL WMT comes from all of […]* gas suppliers[17] and cannot be linked to a specific supply contract of those companies.

(41) Finally, MOL WMT had concluded gas supply contracts in 1998 with O&G Minerals Ltd. and Eurobridge which are suppliers of non-Russian gas. These contracts have now been terminated, and replaced by a 2004 contract (for an annual quantity of [0-2]* bcm) with Bothli-Trade, a Swiss company, affiliated with Eural Trans Gas. Eural Trans Gas was a Hungarian-registered company which was the sole distributor of Turkmen gas *"with Gazprom and NAK Ukrainie support"*[18].

c. Gas infrastructure

Transmission and distribution of gas

(42) The Hungarian high-pressure natural gas transmission pipeline network is owned by MOL Transmission, which transports both domestic and imported natural gas to the RDCs, natural gas-fired power stations and certain other large industrial users that are directly connected to the transmission network.

(43) The low- and medium-pressure distribution pipeline networks are extensive in Hungary, where 91% of the settlements are already connected to a natural gas network. The distribution networks are owned by the RDCs. There are six main RDCs in Hungary, each covering a different region of the country, and seven smaller ones[19]. The six main RDCs are TIGÁZ Rt. ("TIGÁZ"), FŐGÁZ Rt. ("FŐGÁZ"), DÉGÁZ Rt. ("DÉGÁZ"), ÉGÁZ Rt. ("ÉGÁZ"), KÖGÁZ Rt. ("KÖGÁZ") and DDGÁZ Rt. ("DDGÁZ"). In 2004, approximately 76% of the total natural gas sales volumes of MOL WMT were accounted for by sales to the RDCs.

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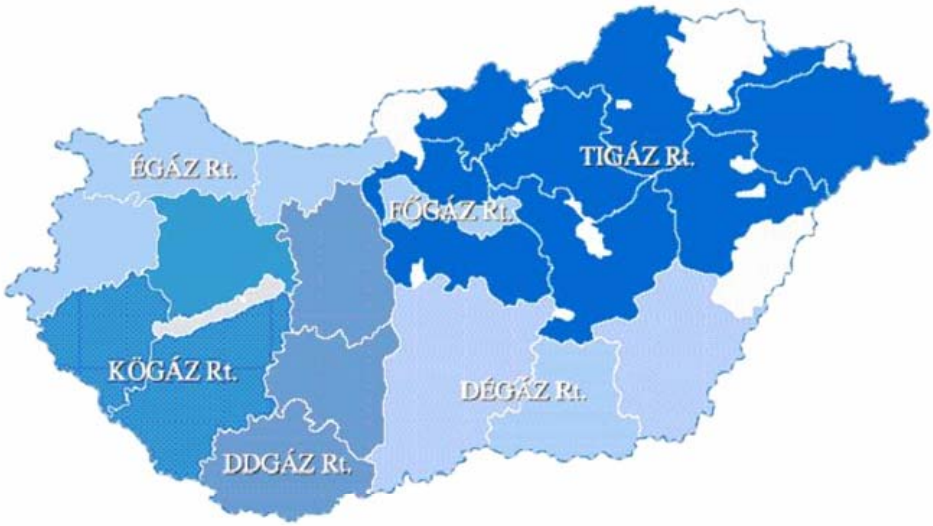
16 See minutes of the meeting with HEO on 26 July 2005.

17 See response of E.ON of 10 May 2005 to Question 39 on the draft Form CO: "*E.ON Ruhrgas, parent of ERI, has a gas supply portfolio including different sources. E.ON Ruhrgas sells gas to its customers based on this diversified portfolio. It is not possible to break down the origin of the gas for the sales per country as E.ON Ruhrgas serves each customer out of the whole diversified portfolio.*"; response of GDF to question 33 of the request for information of 19 July 2005.

18 Minutes of the Executive Board of MOL of 6 April 2004.

19 DBGÁZ Kft., TIGÁZ 2 Kft., OERG Kft., DUNAFERR ESZ. Kft. 1, DUNAFERR ESZ. Kft. 2, Csepel ESZ Kft., and Magyar Gázszolgáltató Kft. These RDCs are not further dealt with in the competitive assessment section of this decision, as they have marginal sales.



(44) It should be noted that there are separate transport and distribution networks (owned by MOL Transmission and the RDCs respectively) for the 2/H and 2/S gas, as these different qualities of gas cannot be mixed. The low-calorific gas is distributed via separate regional systems coming from the gas fields of MOL E&P to mostly domestic customers. The low-calorific gas only represents 5% of total Hungarian gas production, or 1% of total Hungarian gas consumption. The regions currently supplied with 2/S gas […]*.

(45) The inert gas produced by MOL E&P is transported via a direct pipeline and sold to […]*. Inert gas represents [0-10%]* of total Hungarian gas production, or [0-5%]* of total Hungarian gas consumption.

(46) Historically, the RDCs were also owned by MOL but were sold to private investors in a large privatisation process in 1995. E.ON has sole control of two RDCs (KÖGÁZ and DDGÁZ) and a participation in a third one (FŐGÁZ), which is controlled by the municipality of Budapest. Three large international energy groups own majority or minority stakes in the other RDCs: GDF (sole control of DÉGÁZ and ÉGÁZ), RWE (minority stakes in TIGÁZ, FŐGÁZ and DDGÁZ) and ENI/Italgas (sole control of TIGÁZ).

Ownership of the gas RDCs:

KÖGÁZ	**71.2% E.ON** 13.3% Julius Bar Holding AG 11.6% Swisspartners AG 3.9% Others
DDGÁZ	**50.01%E.ON** 49.9% RWE 0.1% Others
FŐGÁZ	**50% +2 Municipality** 32.7% RWE 16.4% E.ON 0.9% Others
DÉGÁZ	**99.8% GDF** 0.2% Others
ÉGÁZ	**99.4% GDF** 0.6% Others
TIGÁZ	**50% +1 ENI-Italgas** 44.2% RWE 7.9% Others

Storage of gas

(47) MOL Storage owns and operates the five existing underground gas storage facilities in Hungary. All the underground storage facilities in Hungary are depleted gas fields. Storage allows in particular covering the variation between gas procurement, which is relatively constant throughout the year, and gas needs which vary greatly according to seasons. For technical geological reasons, the storage facilities in Hungary can only be used to cover seasonal variations of demand, but not for peak shaving[20]. There is also a contract with the gas transmission system operator ("TSO") to use the storage for system balancing purposes. The flexibility of the storage sites is not high, but it is sufficient to handle the balancing demand in Hungary along with line pack.

(48) The five storage facilities have a total storage capacity of 3.38 bcm (with a withdrawal capacity of 44.5 million m³/day). There are two large storage sites (Hajdúszoboszló in the east with [1-2]* bcm, and Zsana in the south with [1-2]* bcm, undergoing capacity extension). The three other storage sites are much smaller ([250-400]* million, [150-250]* million and [100-200]* million m³). In addition, MOL E&P has more than 50 depleted gas fields. Almost every depleted gas field is convertible into an underground gas storage facility and the convertibility has been concretely examined for […]*.

[20] It is not possible to use storage sites in Hungary for peak shaving for geological reasons, as these are sandstone depleted gas fields. Sandstone is too fragile and technically not suitable for rapid injection and withdrawal of gas into and from the storage facilities.

(ii) Regulatory framework

a. Current regulatory framework

(49) The Hungarian natural gas sector is at the initial stage of the liberalisation process. The first European directive liberalizing the gas market was implemented in Hungary, with the entry into force on 1 January 2004 of the Hungarian Gas Act (Act 42 of 2003 – "HGA")[21]. This law was further implemented by Government Decree No. 111/2003 on the execution of certain provisions of the HGA ("Executive Decree") and Government Decree No. 112/2003 (as amended by Government Decree No. 219/2003) ("Eligibility Decree"). A law amending the HGA (Act 63) was adopted on 28 June 2005 to implement Directive 2003/55/EC of the European Parliament and the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC[22] in Hungary, and it entered into force on 1 August 2005. Further implementing decrees are being adopted.

Regulatory bodies

(50) The Hungarian Energy Office ("HEO") is the energy regulator in Hungary. The HEO is the general supervisory body for the gas market. It issues the various licences for gas and electricity activities, supervises the operation of the market players, approves their terms of business, examines customer complaints, undertakes price reviews and sanctions non-compliance.

(51) The Hungarian Mining Office ("HMO") is the special supervisory body dealing with the construction and operation of transportation pipelines and underground storage facilities. Licensing concerning the construction of these facilities also falls within the powers of the HMO.

(52) The Ministry of Economy and Transport ("MET") issues decrees on the more technical and specific fields (such as operational safety, general technical conditions etc.) and also sets official prices (tariffs) on the basis of a proposal by the HEO.

(53) The Network Code (or Grid and Commercial Code) contains the detailed technical rules concerning the operation of the gas system, such as the definition and allocation of free capacities, the rules of nomination, the minimum content of trade, metering and accountancy agreements. The Network Code is prepared by a Network Code Committee and approved by the HEO. The Network Code Committee comprises representatives of the licensees (system operator, public utility

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21 In addition to the Hungarian laws and decrees implementing the Gas Directives, other relevant legislation in the gas sector includes the Community Regulation on the conditions for access to the gas transmission networks (OJ L 289, 3.11.2005, p. 1), which will enter into force on 1 July 2006. This regulation ensures that the voluntary Guidelines for Good TPA Practice for Transmission System Operators adopted at the Madrid Forum will be implemented in all the Member States. Last, Guidelines for Good TPA Practice for Storage System Operators ("GGPSSO") were adopted by the European Regulators Group for Electricity and Gas ("ERGEG") on 23 March 2005, but compliance with these guidelines is voluntary and not mandatory at this stage (http://europa.eu.int/comm/energy/ gas/madrid/jwg/ggpsso_23.3.2005.pdf).

22 OJ L 176, 15.7.2003, p. 57.

wholesaler, storage system operator, distribution system operators, public utility suppliers, gas traders, cross-border traders) and of the registered eligible customers[23].

Eligibility

(54) Since 1 July 2004, all non-residential customers have become eligible customers free to choose their supplier under Hungarian law[24]. Residential customers will become eligible on 1 July 2007.

Coexistence of regulated and liberalized segments

(55) The Hungarian gas sector is characterized by a hybrid model, with the coexistence of a regulated segment of the market (or "public utility market"), resulting from the old gas regime in Hungary, and a liberalized segment of the market (or "open segment of the market"). Eligible customers have the right but not the obligation to exercise their eligibility and switch suppliers to enter the open segment of the market. They have the choice between remaining supplied within a public utility contract by their historic gas supplier (their RDC or the public utility wholesaler, MOL WMT if the customer was supplied directly by MOL WMT) or terminating their public utility contract and purchasing their gas requirements from a trader or a producer or importing natural gas themselves[25].

(56) The procedure of switching is described under the Eligibility Decree (Articles 3-7/B) and has been somewhat changed by the recent amendment to the HGA. An eligible customer can terminate its public utility contract at any time by a written notice addressed to its previous public utility supplier. The notice terminates the public utility contract with effect on the first day of the fourth month following the notice of termination (the parties may agree on a different date). According to the parties, switching does not entail any significant costs or time investment on the part of the eligible customer. Customers that have switched to the open segment of the market are allowed to switch back to the regulated segment.

(57) Customers that have actually switched supplier accounted for 5-6% of the total Hungarian gas consumption at the end of 2004 ([5-15%]* of the gas consumption of eligible customers)[26]. According to MOL, this share will increase to [5-15%]* in October 2005 ([5-15%]* of the eligible customer market) as more eligible customers have terminated their public utility contract with effect from October 2005.

(58) The old gas regime (under the old Hungarian gas act), now the regulated regime, consists of a vertical chain of exclusive supply/purchase relationships. The public utility wholesaler, MOL WMT, sells natural gas to the RDCs. The public utility

23 See slide 41 of the Presentation "Natural Gas Market II" of the HEO, 26 July 2005.

24 Article 36 of the HGA and Article 1(1) of the Eligibility Decree.

25 Article 36(2) of the HGA.

26 MOL presentation of 27 July 2005.

wholesaler is under an obligation, by law, to cover the full natural gas demand for public utility purposes of the RDCs, whereas the RDCs are under an obligation to source their natural gas needs for their public utility customers exclusively from the public utility wholesaler. To fulfil this obligation, the RDCs and MOL WMT have entered into long-term framework supply contracts, with duration from […]* years.[27] Detailed supply conditions and quantities are set in yearly contracts. The RDCs, the public utility suppliers, have in turn the exclusive right and obligation to supply the customers situated in their territory. MOL WMT also supplies directly certain large customers connected to the transmission network[28]. The prices for the supply of natural gas and other services at the different levels of the vertical gas supply chain[29] are also heavily regulated[30].

(59) In contrast with the public utility contracts, the relationship between the eligible customers that switched suppliers and their various possible commercial partners (traders, importers, etc.) is largely subject to the principle of contractual freedom.

Legal unbundling of the transmission network and storage facilities

(60) Until end 2003, MOL owned and operated the entire high-pressure transmission network and all the underground storage facilities in Hungary. Since January 2004, the transportation network and the storage facilities have been legally unbundled from MOL WMT in two separate wholly-owned subsidiaries of MOL, MOL Storage and MOL Transmission respectively.

Distribution networks

(61) The local medium and low-pressure distribution networks through which natural gas is distributed to the final customers (except those that are directly connected to the transmission network) are owned and operated by the RDCs. However, RDCs are not confined to mere distribution, since they also sell gas to eligible and non-eligible customers, as public utility suppliers and, in theory, as traders in the case of eligible customers having switched suppliers. Under the HGA, an RDC is entitled to have three licenses: distribution, public supply, and trading (on the open segment of the market). At this stage, there is thus no unbundling other than accounting unbundling between the different activities of the RDCs (distribution, supply as public utility supplier and supply as trader). In practice, however, most RDCs have set up a

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27 The contracts with […]* and […]* expire at [2005-2020]*

28 The public utility wholesaler is only entitled to supply for public utility purposes natural gas to a restricted number of customers which are listed in the licence of the public utility wholesaler.

29 These services are the following: transmission, distribution, public utility storage, gas supply between the public utility wholesaler and the public utility suppliers (i.e., sales by MOL WMT to the RDCs), gas supply between the public utility suppliers, or in some cases the public utility wholesaler, and the public utility customers (i.e., sales by the RDCs or in some cases MOL WMT to residential customers and to non-residential eligible customers which have not switched suppliers).

30 Pursuant to Article 48(2) HGA, the official price shall provide coverage for the costs of the assets that were part of a justified investment and the costs of efficient operation, and also the profit necessary for permanent operation. This is the so-called cost-plus principle.

separate company to be active as trader on the open segment of the market[31], and none of the RDCs or their trading subsidiaries has any customers on the open segment of the market at this stage.

(62) Under Directive 2003/55/EC, by July 2007 at the latest, the RDCs will have to split their activities into separate legal entities, one in charge of operation of the distribution network and the other one in charge of supply to end customers.

Licenses

(63) It is one of the fundamental principles of the HGA that, for reasons of public interest, the performance of the gas related activities is subject to the *ex-ante* control of the HEO. The *ex-ante* control is performed by way of licensing. Under Articles 7 and 9 of the HGA, the following activities are subject to licensing: transmission (operation of the high-pressure transmission network), storage (operation of the five storage facilities located in Hungary), distribution (operation of the local distribution pipelines), trade, public utility wholesale, public utility supply (RDCs), establishment and operation of the organised gas market (gas exchange), system operation, and access to cross-border natural gas pipelines.

(64) MOL Transmission is the transmission licensee and the system operation licensee, and MOL Storage is the storage licensee. MOL WMT holds a public utility wholesale license (for its supply of gas in the regulated segment of the market), a trading license (for its supply of gas in the open segment of the market), and two cross-border licenses (one as a gas trader, and one as a public utility supplier). The RDCs hold distribution licenses and public utility supply licenses (for their supply in the regulated segment of the market). The RDCs (or in some cases a separate subsidiary of the RDC) also hold trading licenses (for their supplies in the open segment of the market).

(65) Thirteen entities currently have a natural gas trading licence in Hungary[32]. Seventeen entities currently hold a cross-border license (which is necessary to transmit natural gas through the cross-border transmission pipelines) in Hungary. These are the same entities as those holding a trading license, plus El Paso Kft., MOL Transmission, NITROGÉNMŰVEK Rt. (a customer of gas), and POGO Kft.

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31 Édenergia Kereskedelmi Kft., the separate joint trading subsidiary of the two RDCs of Gaz de France, ÉGÁZ and DÉGÁZ; Fővárosi Gázkereskedelmi Kft., the separate trading subsidiary of FŐGÁZ Rt. (RWE, E.ON and the Municipality of Budapest); and E.ON EK, the trading subsidiary of the E.ON group in Hungary (separate from E.ON's two gas RDCs, DDGÁZ and KÖGÁZ). TIGÁZ (Italgaz/ENI and RWE), however, holds a gas trading license itself.

32 MOL WMT, PANRUSGÁZ Magyar Orosz Gázipari Rt., Első Magyar Földgáz- és Energiakereskedő és Szolgáltató Kft. ("EMFESZ"), E.ON Energiakereskedő Kft. ("E.ON EK"), BC Energiakereskedő Kft., CENTREX Rt., DBGÁZ Kft., DUNAFERR Központi Beszerzési Kft., EURO-BRIDGE Kereskedelmi és Szolgáltató Kft., Édenergia Kereskedelmi Kft. (a subsidiary of Gaz de France's two RDCs, ÉGÁZ and DÉGÁZ), ENERGY CAPITAL Energiakereskedő Kft., Fővárosi Gázkereskedelmi Kft. (a subsidiary of FŐGÁZ Rt.), and TIGÁZ Rt. (a subsidiary of Italgas/ENI).

Access to the gas networks and to storage

(66) Under the HGA, the system operator (to the extent it is necessary to ensure the stability of the system), the public utility wholesaler, the public utility suppliers, the traders, the gas producers (to the extent of their production) and the eligible customers (to the extent of their own consumption) have a right of Third Party Access ("TPA") to the free capacities in the transmission[33], distribution[34] and storage[35] systems. Access must be granted on a non-discriminatory basis to all operators[36].

(67) It is a fundamental principle pursuant to Article 30(6) of the HGA that free capacity may only be booked on the basis of a confirmed customer demand. The HGA thus expressly envisages a system whereby capacity reservation is directly linked to actual gas demand. As a consequence, capacity without underlying customer demand cannot be subject of trade on its own right. This, for the time being, excludes any secondary trading of capacity rights.

(68) The HGA provides for a priority order in the allocation of capacities for transmission, distribution and storage of gas. Pursuant to the HGA, first the system operator for the balancing of the network, then the suppliers of residential customers and so-called "communal customers" specified in separate regulations (e.g., customers which are active in the public field of military, healthcare, education) enjoy priority over all the other infrastructure users. The exact rules regarding the customers enjoying priority are set out in the Executive Decree and Decree No. 81/2003 of the MET.

(69) As regards the allocation of cross-border, transmission, distribution and storage capacities, the Hungarian gas regulation differentiates between (i) already allocated capacity, and (ii) free capacity, for which a new capacity booking may be requested.

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33 Article 30(1) HGA specifically obliges the transmission licensee to provide access to the free capacity of the system in its usage in return for a fee to (i) the public utility wholesaler, (ii) the traders, (iii) the eligible customers to the extent of their own usage, (iv) the natural gas producers to the extent of their gas production, and (v) the system operator to the extent that is necessary to ensure the stability of the system.

34 Pursuant to Article 30(4), the distributor licensee shall provide access to the network in its usage in return for consideration to the (i) RDCs, (ii) the traders, (iii) the eligible customer to the extent of its own usage, and (iv) the natural gas producer to the extent of the gas produced by itself.

35 Under Article 30(2) and (3) the storage licensee is obliged to provide access to the free capacity of the system in its usage in return for consideration to the system operator to the extent that is necessary to ensure the stability of the system. If, having fulfilled the needs of the system operator, the storage licensee still has free capacity, it is obliged to provide access on open, transparent and non-discriminatory commercial conditions in return for consideration to (i) the public utility wholesaler, (ii) the eligible customers to the extent of their own usage; and (iii) traders.

36 Article 30(5) of the HGA stipulates that the conditions for access may not include any unjustified discrimination, may not give ground for any abuse, may not include any unjustified restriction and may not endanger the safety and quality of supplies. According to Article 31 of the HGA, access to transmission and distribution networks or to storage may be refused if (i) the free capacity for the satisfaction of demand is missing, (ii) the access would impede the supply of gas to priority customers, (iii) there is a serious malfunction or crisis in the co-operative gas system or (iv) the quality of the gas to be put into the system does not comply with the minimum qualitative requirements set out in the Network Code.

In accordance with Article 1(30) of the Executive Decree, the capacity which is covered by an agreement for the supply of gas (contracted or allocated capacity) is already allocated capacity, the rest is free capacity. Existing capacity demands (already allocated capacity) have priority over new demands. If the demand for free capacities exceeds the amount of free capacities actually available, the free capacities are allocated through an auction[37]. There are special and detailed capacity booking rules for eligible customers exiting the public utility market (see below in recitals 73 to 79).

(70) The amount of free capacities is defined on a monthly basis. MOL Transmission, the transmission licensee, is required to publish on its website the available capacities for each entry and exit point of the transmission system[38].

(71) Competitors of MOL WMT and the RDCs (on the open segment of the market) have a right of TPA to the transmission and distribution networks, which are natural monopolies, at regulated tariffs[39]. The access to storage capacities is only regulated in respect of MOL WMT as a public utility wholesaler[40] (*i.e.*, as regards the supply of households and eligible customers which have not switched to the open segment of the market). The fees for access to storage in the open segment of the market are negotiated, *i.e.* set by individual agreement between the user of the storage (including MOL WMT as a trader) and the storage licensee.

(72) Capacities at the two cross-border entry points (Beregovo at the Ukrainian/Hungarian border and Baumgarten at the Austrian/Hungarian border) and for storage are booked (contracted) for a gas year[41]. Since the beginning of 2005, the amended grid code allows capacity reservation agreements for a longer duration. According to the parties, there are currently […]*. It is also possible to book capacity for shorter (monthly) periods but the fees in this case are much higher.

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37 Point 5.1.3.1 (g) of the Network Code.

38 Article 5.1.3.2 (a) of the Network Code. The capacities to be published are the maximum daily (in m³/day) and hourly (in m³/hour) technical capacities; the hourly and daily capacities already booked by system users; and the available capacities. They must be published 12 months in advance, in monthly breakdowns, and updated every month. The method used by the transmission licensee to determine free capacities must be approved by the HEO and is also published on the website. *See* slides 37 and 38 of the presentation of HEO "Hungarian Gas Market II", 26 July 2005; response of E.ON to Question 4 of the request for information of 29 June 2005.

39 On the open segment of the market, the system operation fee, the transmission fee and the distribution fee are normally paid by the gas trader to the system operation, transmission, and distribution licensees, and then passed on to the eligible customer by the trader.

40 It should be noted that RDCs are not entitled to book for and obtain free capacities in the Hungarian storage system for their public utility supply (but they can book storage capacities to supply customers on the open segment of the market).

41 The gas year runs from 1 July to 30 June for transport; and from 1 April to 31 March for storage.

Customer-driven capacities along the gas supply chain

(73) As indicated, there are special and detailed rules for capacity booking for eligible customers exiting the public utility market. The capacities used by these eligible customers in the public utility market are considered to be already allocated capacities, to which the customers remain entitled even after switching to the open segment of the market. Pursuant to Article 36(7) of the HGA and Article 3(4) of the Eligibility Decree[42], when an eligible customer leaves the public utility sector, it is entitled to "take along" all the cross-border, transmission, distribution and storage capacities that it was using as a public utility customer[43]. In other words, the capacities follow the customer, as long as the underlying demand of the customer subsists.

(74) The purpose of this provision is to ensure that eligible customers are entitled to adequate background capacities from the system even after switching. The "already allocated capacities" only serve as a base demand for the capacities for eligible customers. They can vary in accordance with the actual demand of a customer (for example a customer may not want to have storage capacities, but rather to book more import capacities, or the customer's gas consumption may increase at a later stage). These variations are treated as a demand for new capacities.

(75) Essentially this system, the parties argue, can be described as a "customer-driven system", that is to say that capacities (at all levels of the supply chain) automatically follow the customers switching supplier. This principle is also encapsulated, according to the parties, under Article 30(6) of the HGA and Article 32(11)-(12) of the Executive Decree which prescribes that cross-border, transmission, distribution and storage capacities may be booked, and later on held, by any licensee (or eligible customer) only on the basis of "confirmed customer demand" (or to the extent of its own demand). Article 32 (13) of the Executive Decree defines the term "confirmed customer demand" as the demand already covered by an agreement or a pre-contract (in the case of an eligible customer, it is defined on the basis of the business plan of the given customer).

(76) The very detailed technical and administrative rules of the "customer-driven system" are contained in the Network Code (Chapter 5.1. of the Network Code). Of special relevance is the methodology for calculating for a given customer the already allocated capacity at the entry points of the transmission system (namely the storage

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42 Article 3 (4) of Eligibility Decree provides as follows: "The registered eligible customer is entitled to the transmission, storage, distribution and cross-border capacity to the extent that is reserved in the public utility contract even after the termination of the public utility contract. The rules for the determination of this capacity are contained in the Network Code. This capacity is not deemed to be a demand for a new capacity reservation." See also point 5.1.2 of the Network Code.

43 The public utility wholesale licensee (MOL WMT public utility arm) and the public utility supply licensees (the RDCs) are under an obligation under Article 32 of the Executive Decree to reduce the level of booked transmission, distribution and storage capacities with the decrease of demand as a result of eligible customers switching to gas trader licensees. This is furthermore mirrored in Article 3(5) of the Eligibility Decree which provides that the public utility wholesale licensee and the public utility supply licensees are entitled to amend, without any negative consequences, such as contractual penalties, their capacity reservation agreements with the transmission, storage and distribution licensees, if and provided that the reason for such amendment is the switching of supplier by eligible customers and thus certain capacities becoming free.

and cross-border capacities)[44]. It is important to note that the basis for this calculation is the off-take (exit) capacity booked for the customer in the previous gas year, which is higher than the entry capacity booked by the public utility wholesaler for the customer as the public utility wholesaler could benefit from synchronicity, but an individual customer cannot[45]. This means that the eligible customer switching to the open segment of the market is allocated import capacity equal to its off-take capacity at the exit point.

(77) As regards cross-border capacity more specifically, Point 5.1.2 c) ii of the Network Code provides that this capacity shall be allocated as a maximum of 80% on the Beregovo entry point (East) and a minimum of 20% on the Baumgarten entry point (West). According to the parties, this 80-20 rule is designed to divide import capacities among the entry points reasonably, but respondents in the market investigation have stressed that this rule is difficult to satisfy for new entrants and constitutes a barrier to entry.

(78) The already allocated capacity is capacity to which the customer is entitled, and which can serve as a base demand. This does not mean that the new supplier has the obligation to use the capacity to which it is entitled and which is calculated in accordance with the above-described formula. However, any other capacity request is treated as a demand for new capacity. Thus, if the cross-border capacity according to the allocation 80% Beregovo and 20% HAG does not correspond to the capacity needed where the new supplier has access to gas, the new supplier will have to request additional cross-border capacity. This request will be treated as a demand for new capacity, which has a lower priority level. This may not be so much a problem at the HAG entry point where there is some free capacity, but it is a problem at Beregovo where there is congestion.

(79) The "capacity follows the customer" principle only applies to the allocation of the capacities used by existing customers switching to the open segment of the market, but not to the allocation of free capacities to new customers (for example, a new industrial plant consuming natural gas). As pointed out by the HEO, this is a problem for new customers without previous gas consumption[46].

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44 Point 5.1.2 of the Network Code.

45 The synchronicity factor results from the fact that peak capacity demands at the exit points arise at different times for different customers. This means that the peak capacity at the entry point that a supplier with a large portfolio of customers must book (aggregated peak capacity of all the customers) is less than the sum of the peak capacities at booked at the exit points. For example, a synchronicity factor of 0.97 could be calculated for the 2005-2006 gas year. *See* slides 22-32 of the presentation of the HEO "Hungarian Natural Gas Market II" on 26 July 2005.

46 See slide 32 of presentation "Hungarian Natural Gas Market II" of the HEO on 26 July 2005.

b. Evolution of the regulatory framework

(80) It is not clear at this stage how the Hungarian hybrid model will evolve in the future. The HEO is expected to publish a proposal for a new model for the gas market in the fall of 2005. A new model for the electricity market was recently published for public consultation on the website of the HEO (See Electricity section below in recitals 181 to 207).

(81) All Hungarian market players generally expect that in July 2007, when all residential customers become eligible, the current system of public utility supply (and thus the hybrid model) will disappear and be replaced with a Universal Service Provider ("USP") concept for residential customers and some small non-residential customers which have not concluded a supply contract with a specific supplier. Such USPs would be appointed through an open competitive tender by the HEO and would have the competence to supply the relevant customers throughout Hungary at a regulated price. All other customers would be forced to enter the open segment of the market. This market model would be very similar to the HEO's recommendation for the new electricity market model.

(82) As a result, the public utility wholesaler function of MOL WMT and the public utility supply function of the RDCs would disappear. MOL WMT and the RDCs would operate purely as holders of trading licenses on the open segment of the market. The RDCs may also operate as USPs (if issued a USP operational license as a result of a successful tender). The obligation of RDCs to purchase gas exclusively from MOL WMT would also end.

(83) The Commission notes that, in their reply to the SO, the parties did not challenge the description made in the SO of the future evolution of the regulatory framework for the Hungarian gas sector and its timetable. The expert report submitted by the parties notably confirms that *"The Hungarian government has disclosed its intention to remove the price cap in the natural gas sector"*.

c. The resolution of the HEO

(84) Under Article 52 of the HGA, the HEO must approve the acquisition of a controlling shareholding in any licensed undertaking and the exercise of the associated rights. The HEO may refuse the approval or may impose conditions if the transaction would endanger the security of the natural gas supply, the performance of the licensed activities as well as the regulations applicable to the prices and quality of service in transmission, storage, distribution, system operation or public utility supply activities. The HEO may also refuse to approve the transaction if, as a result of the transaction, the licensee is not able to satisfy the requirements for licensing set out in the HGA.

(85) On 27 June 2005, the HEO adopted a resolution approving the acquisition of certain gas businesses of MOL by E.ON, subject to eight conditions. It is only once E.ON has fulfilled these conditions (or submitted an irrevocable guarantee in respect of their fulfilment) and the HEO has adopted a second resolution approving such completion, that ERI will be allowed to exercise its shareholder's rights.

(86) These conditions can be substantively summarized as follows:

- Condition 1: The HEO required the legal and organizational unbundling of the public utility wholesale and the natural gas trade activities of MOL WMT by 31 May 2006;

- Condition 2: E.ON is required to submit an implementation plan to the HEO regarding certain organizational changes to be undertaken at MOL WMT and MOL Storage. The HEO in particular emphasized the independence of the management of the respective companies and of certain joint services to the companies (data processing, controlling, etc.);

- Condition 3: E.ON is required to make the public utility wholesaler submit for approval and execute a programme to ensure the securing of natural gas resources and on the safety of supply in Hungary for a mid-term period. The HEO also outlined the main elements of such a programme (sufficient amounts, rules for auction, etc.);

- Condition 4: E.ON is required to ensure that the public utility wholesaler does not expand the scope of its customers directly supplied via the transmission network (excluding communal customers);

- Condition 5: E.ON and MOL Storage are required to implement a gas storage development scheme for 2005-2009, to be approved by the HEO. The HEO also required E.ON to declare by 31 May 2006 whether it undertakes the development obligations to be set out in the forthcoming development directive issued by the HEO. In case E.ON undertakes these development obligations, it will have to ensure that MOL Storage amends and submits the development plan accordingly;

- Condition 6: E.ON is required to ensure that MOL Storage will apply regulated access for all system users, i.e. also in the open segment of the market, until real competitive market situation between natural gas storages takes place, and to comply with the GGPSSO. E.ON is required further to ensure that MOL Storage amends and submits its general business terms accordingly by 31 May 2006;

- Condition 7: E.ON is required to ensure that MOL Storage revises and confirms its qualification granted by the Hungarian Mining Office, unless E.ON can ensure that the acquisition does not affect such qualifications (whereby a declaration has to be made in this regard);

- Condition 8: E.ON is required to initiate the amendment of the HEO's decision in case the decision to be issued by the Commission regarding E.ON's notification of the planned acquisition would affect the HEO's decision within 30 days after the receipt of the Commission's decision. In case the Commission's procedure is not closed by 31 March 2006 with a final and binding decision, or if the prolongation of the competition procedure significantly hinders or makes impossible the fulfilment of the obligation by E.ON, the latter may request the HEO to amend the 31 May 2006 deadline set for the fulfilment of the conditions contained in the decision.

(iii) Relevant product markets

(87) In the Form CO, the parties have taken the view that the following activities are relevant to the proposed concentration, and constitute distinct product markets:
- Procurement (import and domestic production) of natural gas for onward wholesale and sale into the Hungarian market;
- Wholesale of natural gas to the RDCs on the regulated segment of the market;
- Sale of natural gas to eligible customers, distinguishing between (i) large power plants over 50 MW and (ii) industrial/commercial customers including smaller power plants;
- Sale of natural gas to residential (non-eligible) customers;
- Storage of natural gas; and
- Transmission of natural gas.

(88) The Commission has in the past identified the following activities as distinct product markets in the natural gas sector:
- Exploration and production;
- Transmission (via the high-pressure pipeline grid);
- Distribution (via low-pressure pipeline grids);
- Storage; and
- Trading and supply.

(89) As regards gas supply activities, following the opening of competition of the European gas markets, the Commission has also drawn distinctions between eligible and non-eligible customers, and between customers according to their annual gas consumption and their type of activity (*e.g.*, power plants).

(90) On the basis of the past practice and the investigation in this case, the Commission considers that the following product markets are relevant for the assessment of the present transaction:

- Gas infrastructure operations[47], including the transmission of gas, the distribution of gas and the storage of gas;

- Supply of gas, including (i) the supply of gas to traders; (ii) the supply of gas to the RDCs; (iii) the supply of gas to large power plants; (iv) the supply of gas to large industrial customers; (v) the supply of gas to small industrial and commercial customers; and (vi) the supply of gas to residential customers[48].

(91) This delineation of the relevant product markets in the gas sector only differs from the market delineation proposed by the parties as regard the combination of gas

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47 There are distinct infrastructures for the supply of the low-calorific gas (2/H gas) and inert gas, produced solely in Hungary, which may lead to the definition of separate product markets. However, these two qualities of gas only represent [0-5%]* and [0-5%]* of total Hungarian consumption, respectively. The Commission has therefore not further developed its analysis in this respect.

48 The supply of gas to traders, RDCs and large customers is often referred to as "wholesale" supply, while the supply of gas to small customers is referred to as "retail" supply.

procurement and wholesale and the distinction between the market for gas supply to small industrial and commercial customers and the market for gas supply to large industrial customers. The parties did not contest the definition of the relevant product markets in the gas sector in their reply to the SO.

(92) The market investigation has confirmed that the supply of gas to eligible customers should be further segmented in various product markets according to categories of customers due to distinct consumption profiles and supply conditions. The market investigation has shown that different categories of customers have different consumption patterns (quantities and consumption profile) and different flexibility needs. They are also characterized by different marketing approach from gas suppliers. MOL WMT itself distinguishes in its commercial and marketing organisation the following categories of customers: (i) RDCs; (ii) industrial customers; and (iii) power plants.

(93) By contrast, the Commission investigation has indicated that the following three criteria are not relevant for market definition in this case:

(94) First, the market investigation has confirmed the parties' view that, despite the current hybrid model, there should be no distinction between the regulated and open segments of the market. Eligible customers can easily switch back and forth between the free and the regulated segments of the market. Switching does not entail any significant costs or time for eligible customers and the recent amendments to the HGA have even made switching easier[49]. Hence, the distinction between gas customers that have switched to another gas supplier and customers that remain in the public utility segment is not relevant for the definition of the relevant product markets.

(95) Secondly, it does not appear relevant to distinguish customers depending on whether they are connected to the transmission network or to a distribution network. This makes a difference on the regulated segment of the market, as customers connected to the transmission network are directly supplied by MOL WMT, while those connected to the distribution networks can only be supplied by their local RDC. However, on the open segment of the market, traders (including MOL WMT as trader) compete to gain customers connected both to the transmission and distribution networks (and the transport and distribution fees are anyway pass-through fees for a gas supplier). While customers connected to the transmission network tend to be large or very large customers, there are also large customers connected to the distribution networks[50].

(96) Thirdly, the market investigation has shown that prices may not be an appropriate factor to identify the distinct categories of customers, as only few customers have switched to a supplier on the open segment of the market in Hungary up to now.

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[49] Pursuant to the amended Article 36 of the HGA, eligible customers can now terminate their public utility contract at any time with effect on the first day of the fourth month following, and can request their RDC or the Public Utility Wholesaler to switch back to the regulated market at any time with effect on 1 July of the following year. The parties may agree on different dates.

[50] Minutes of the meeting of 26 July 2005 with the HEO: *"Customers connected to the transmission are not that different from those connected to the distribution networks. This is more a question of location than size and industry. Some of the companies were built historically close to the transmission network."*

Gas prices paid by different categories of eligible customers are thus still set in accordance with the categories set out in the price decrees, namely: (i) residential customers; (ii) customers with a consumption below 20 m³/hour; (iii) customers with a consumption of 20-100 m³/hour; (iv) customers with a consumption of 100-500 m³/hour; and (v) customers with a consumption exceeding 500 m³/hour.

a. Infrastructure

Transmission of gas

(97) Consistently with previous Commission's decisions[51], the parties have identified the transport of natural gas through high-pressure network of natural gas as a relevant product market. This approach has not been contested by the market investigation. Therefore, the Commission concludes that gas transmission constitutes a relevant product market for the purpose of this case. The transmission of gas constitutes a natural monopoly.

Distribution of gas

(98) In previous decisions, the Commission has identified the distribution of natural gas through low- and medium-pressure networks as a relevant product market. The parties have not identified gas distribution as a relevant product market in their submission. However, the Commission takes the view that gas distribution constitutes a relevant product market for the purpose of this case[52]. The distribution of gas constitutes a natural monopoly.

Storage of gas

(99) In previous decisions, the storage of natural gas has been consistently defined by the Commission as a distinct product market[53]. The parties have also identified this activity as a relevant product market. This approach has not been contested by the market investigation. Therefore, the Commission concludes that gas storage constitutes a relevant product market for the purpose of this case.

b. Supply of gas

(100) The procurement of natural gas for wholesale and sale into the Hungarian market which the parties have defined as a separate market is in reality the upstream activity of a gas wholesaler/importer which purchases gas from domestic or foreign producers or traders for onward sale to end users or traders[54]. Procurement is therefore a pre-requisite to be active on the wholesale/retail supply of gas. This has been confirmed by the views of market players. The parties did not contest this approach in their reply to the SO.

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51 *See*, inter alia, Commission decision of 8 October 2004 in Case COMP/M.3410 – Total/Gaz de France.

52 In Hungary, gas distribution networks are owned and operated by the RDCs.

53 *See*, inter alia, Commission decision of 8 October 2004 in Case COMP/M.3410 – Total/Gaz de France.

54 *See*, notably, the response of MVM to question 8 of the request for information of 3 June 2005.

Supply of gas to traders

(101) In previous cases, the Commission has identified the supply of gas to traders as a separate product market. The market investigation has confirmed that there exists a separate product market for the supply of gas in Hungary, on which importers/producers sell gas to traders, and traders sell each other gas, for onwards supply on the open segment of the market. However, the market investigation has also indicated that, under the current regulatory framework, this market only exists marginally in Hungary, in light of the fact that (i) the open segment of the market has not developed much yet and there is little liquidity on the open segment of the market; and (ii) gas RDCs still have an obligation to purchase their gas requirements for public utility purposes exclusively from MOL WMT.

(102) The Commission concludes that the supply of gas to traders constitutes a relevant product market for the purpose of this case.

Supply of gas to RDCs

(103) Under the current regulatory framework, the public utility wholesaler (MOL WMT) has the exclusive right and also the obligation to supply the RDCs for their natural gas needs for public utility purposes (i.e., sales to non-eligible residential customers and eligible customers that have not switched to alternative suppliers) according to their demand. The RDCs have, in turn, an exclusive purchase obligation vis-à-vis the public utility wholesaler in respect of their natural gas demand for public utility purposes (no such exclusive purchase obligation exists in respect of the RDCs for their gas demand for the supply by them of eligible customers). Prices of the public utility wholesaler's to RDCs are regulated.

(104) Thus, the supply of gas to RDCs constitutes a relevant product market for the purpose of this case. This market is not open to competition.

(105) However, the gas regulatory framework is expected to change at the latest in July 2007. RDCs will be required to legally separate their supply activities and their distribution activities by July 2007 pursuant to Directive 2003/55/EC. RDCs will remain active in the supply of gas to end users as gas traders, through their trading subsidiaries already established as separate legal entities. RDCs could also be appointed as Universal Service Providers (for the supply of residential and some other small customers at regulated prices). It is expected that USPs will be free to choose their gas supplier.

(106) Thus, under these assumptions, the market for the supply of gas to RDCs would cease to exist as a separate market from the market for the supply of gas to traders at the latest in July 2007.

Supply of gas to large power plants

(107) The market investigation has shown that large power plants constitute a specific category of gas customers, and that the supply of gas to large power plants is a distinct product market.

(108) Two types of gas-fired power plants may be distinguished. Conventional gas-fired power plants only produce electricity, and emit the heat created as a by-product of

electricity generation into the environment through cooling towers, as flue gas, or by other means. Cogeneration plants (or "combined heat and power" (CHP) plants) simultaneously produce electricity and heat. Cogeneration plants capture the excess heat for domestic or industrial heating purposes, either very close to the plant, or distributed through steam pipes to heat local housing ("district heating"). A cogeneration plant cannot produce heat without electricity and vice versa.

(109) "Combined cycle gas turbine" ("CCGT") plants can function as a conventional power plant (in which case the heat is only re-used to improve the efficiency of the power generation process) or as a cogeneration plant (in which case, the heat is used partly to improve efficiency of the power generation process and partly for domestic and industrial heating purposes as a cogeneration plant).

(110) The consumption size and consumption profile of conventional and cogeneration power plants are similar. The main difference is that it is the demand for heat that is driving the generation of electricity in cogeneration plants, i.e. cogeneration plants are driven by the consumption of heat by the network, while electricity demand determines the operation of conventional power plants.

(111) The market investigation has clearly indicated that large power generators constitute a customer category with unique demand requirements in terms of gas quantities and consumption patterns. In particular, according to Magyar Villamos Művek Rt. ("MVM"), the electricity public utility wholesaler in Hungary:

MVM: "The gas consumption of power plants is much more significant than the consumption of any other eligible customer. They have a different consumption profile too. Cogeneration plants (heat/electricity production) have important peaks in winter and low consumption in the summer. The conventional power plants involved in the system balancing have also various consumption features within the same day." [55]

(112) Large power plants are the largest consumers of natural gas in terms of quantities. For example, the Dunamenti plant of Electrabel consumes [1-1.5] bcm of gas annually, which alone represents [10-15%] of the total Hungarian gas market. In addition, fluctuations of their demand are very high and reflect the variations in the power plants' level of activity.

(113) The market investigation has shown that since the opening of the Hungarian gas market to competition none of the large power plants has been able to find alternative suppliers to MOL WMT or their local RDC on the open segment of the market. This is due to the fact that their gas consumption is so large that it is not possible at this stage to purchase such large quantities of gas on the Hungarian free gas market (under the current regulatory framework, it is also not possible for large power plants to switch to the open segment of the market for only part of their needs). This is even more so for the power plants which provide balancing energy (the Electrabel Dunamenti, ATEL and AES power plants) and for cogeneration plants whose consumption is even more variable and cannot be predicted.

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55 Response of MVM to Question 11 of the request for information of 3 June 2005 (free translation).

(114) Suppliers of large power plants must be in a position to ensure the security of supply for a long term (power plants' gas supply contracts are […]*) and they need a critical size to be able to bear the huge variations in consumption of these power plants. EMFESZ notes that it is very difficult to supply power plants as they are regulated by the Hungarian electricity dispatcher. Their gas consumption is very variable: it may go from 100,000 m³ one hour to 20,000 m³ the next hour, and then 50,000 m³[56].

(115) The parties have proposed to distinguish between large and small power plants on the basis of a 50 MW threshold for installed electricity production capacity. While the market investigation has suggested that this criterion (which is based on the different licensing requirements for large and small power plants[57]) may be artificial, it has not provided indications that alternative criteria (such as the actual gas consumption of the power plants) may be more appropriate to distinguish large and small power plants. Therefore, the Commission takes the view that the supply of gas to large power plants with an installed electricity production capacity above 50 MW is a relevant product market for the purpose of this case.

Supply of gas to large industrial customers

(116) The market investigation has revealed that it is relevant to distinguish between small and large industrial customers, due to distinct consumption profiles and commercial relationships. In particular, the category of large customers is specifically targeted by new entrants[58]. In view of the current stage of development of the Hungarian gas market (with very few customers that have actually switched suppliers), the most appropriate consumption threshold to delineate large and small industrial customer is not clear-cut. However, market players have suggested that large customers are those with an hourly consumption exceeding 500 m³/hour (which corresponds to an annual consumption of close to 2 million m³). According to these respondents, customer with hourly consumption above 500 m³/hour have a more "sophisticated" relationship with their gas supplier, which implies for instance a different daily nominations regime and different flexibility clauses. Such large customers are usually attended by key account managers.

(117) In any case, small power plants (conventional plants and cogeneration plants) as well as other heat producers (using gas-fired boilers) should belong to the category of large industrial customers. Most industrial customers using gas in their industrial process are also considered as large customers in view of the importance of their gas purchases.

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56 Minutes of the meeting with EMFESZ of 28 July 2005.

57 Article 51 of the Hungarian Electricity Act required a license to establish and operate power plants with a capacity exceeding 50 MW, although but this difference will partially disappear following the recent amendments of the HEA which will also apply a similar licensing requirement to plants over 0.5 MW.

58 […]*; a third party active in gas has also indicated that "*We are targeting mainly large industrials and power plants because they are the most prepared clients for the free gas market (capability of nomination, daily consumption management, etc.) and they are the most demanding customers who request from their GDC free market offers as well. Large clients are specific customers with specific interests and demand; it is not possible to standardize their offers.*"

(118) The Commission concludes that the supply of industrial gas customers with an hourly consumption over 500 m³/hour constitutes a separate relevant product market for the purpose of this case. While the consumption threshold of 500 m³/hour is most appropriate on the basis of the information available to the Commission, it may be subject to changes with the further opening of the gas supply markets.

(119) In their reply to the SO, the parties did not contest the existence of a specific relevant product market for the supply of gas to large industrial customers.

Supply of gas to small industrial and commercial customers

(120) In view of the above market definition for large industrial customers, the supply of gas to industrial and commercial customers with an hourly consumption below 500 m³/hour constitutes a separate relevant product markets for the purpose of this case.

(121) From a supplier's perspective, there are a number of specificities in supplying these customers. The large number of locations and customers requires customer portfolio management tools. Suppliers develop standardized general offers for these customers as well as special offers such as dual offers for electricity and gas. Brand image plays a more important role for small industrial and commercial customers and they are generally less inclined to switch suppliers[59].

Supply of gas to residential customers

(122) In previous decisions, the Commission has defined a separate product market for the supply of gas to residential customers. Under the current regulatory framework in Hungary, residential customers are not yet eligible and can only purchase gas from their local RDCs at regulated prices. Therefore, the supply of gas to residential customers constitutes a relevant product market for the purpose of this case. This market is not yet open to competition.

(123) When residential customers become eligible, in July 2007, it is unclear at this stage whether they will be part of the same product market as small industrial and commercial customers or whether they will be part of a distinct relevant product market.

(124) In any case, for the purpose of this case, the question of whether gas supply to residential customers will constitute a distinct product market in 2007 or whether residential customers will belong to the same product market as other small industrial and commercial customers can be left open.

(iv) Relevant geographic markets

(125) The parties submit that all affected markets are national in scope, with the exception of the market for the supply of gas to residential customers which is sub-national (i.e., a specific region in Hungary) in scope. The market investigation carried out by the Commission has broadly confirmed this approach. The market investigation has

[59] See notably EDF response to questions of the Commission of 11 August 2005.

nevertheless shown that the market for the supply of gas to residential customers will also be national when residential customers become eligible in July 2007.

a. Gas infrastructure

Transmission of gas

(126) The Hungarian gas transmission network is owned and operated by MOL Transmission at the national level. Therefore, the market for gas transmission is national in scope.

Distribution of gas

(127) The Hungarian gas distribution networks are owned and operated by the RDCs. Therefore, the gas distribution market is sub-national in scope and each of the distribution grid regions constitutes a relevant geographic market.

Storage of gas

(128) The parties submit that the market for gas storage is national in scope due to the existing regulatory framework and the organisation of the storage facilities at the national level. Although some respondents to the market investigation have highlighted that storage services for gas wholesale or retail activities in Hungary could technically be provided by storage operators located in neighbouring countries, the market investigation has also shown that the limited availability of cross-border pipelines[60] anyway makes the use of foreign gas storage facilities difficult for Hungarian operators under current market conditions[61].

(129) This is confirmed by the fact that market players currently active in gas supply only use exceptionally gas storage facilities in foreign countries. In 2003, MOL WMT used only [450-700]* million m³ of gas storage in Ukraine (Bogorodscany), compared to [2-5]* bcm in Hungary. EMFESZ does not use gas storage facilities outside of Hungary.

(130) The Commission therefore concludes that the geographic scope of the gas storage market is indeed national in scope. The Commission notes that the geographic scope of the gas storage market may become broader than national with the further liberalisation of the European gas markets.

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60 As already indicated, capacities booked by MOL WMT for the gas year 2004/2005 were [10-12]* bcm/year and [25-35]* million m³/day (out of 15.01 bcm/year and 41.3 million m³/ day) at Beregovo and [1-4]* bcm/year and [6-10]*million m³/day out of 4.5 bcm/year and 12.3 million m³/day at the HAG entry point. In addition, a transit capacity of [3-6]* bcm/y and [10-13]* million m³/day are booked at the Beregovo entry point by the Serbian company Nis and the Bosnian Herzogovinan company BHGas for transit.

61 Market players using gas storage in foreign countries would have to import more gas in peak period, which might prove difficult in view of the limited available capacity at entry points in Hungary.

b. Supply of gas

Supply of gas to traders

(131) The parties submit that this market is national in scope. According to the parties, companies active on the market for the supply of gas purchase gas from foreign or domestic gas producers (or their intermediaries) for onward sale in Hungary. Thus, the relevant geographic market is defined by the destination of the product, which is the Hungarian gas markets[62].

(132) During the market investigation, some respondents have stressed that gas is procured by MOL WMT and EMFESZ from international companies (such as Gazprom, E.ON, GDF, etc.) and is commonly traded at the European level, including Russia. Therefore, the supply side (procurement) of the wholesale supply of gas is clearly international in scope. This activity is however carried out for Hungarian market players which source gas for onward sale in Hungary and pursuant to the regulatory framework set in the HGA. Competition is therefore taking place at the Hungarian level, as gas imported into Hungary is not re-exported[63] and is solely intended to meet Hungarian demand.

E.ON[64]: "It is important to note that there are no exports from Hungary to third countries (…). The natural gas that enters Hungary serves import purposes."

(133) The market investigation has clearly confirmed the parties' views. Accordingly, the Commission agrees with the parties that the geographic scope of the market of gas supply to traders is national.

Supply of gas to RDCs

(134) Under Hungarian law, RDCs have to procure gas for public utility purposes from the public utility wholesaler, MOL WMT. The market for gas supply to the RDCs for public utility purposes is therefore national in scope.

Supply of gas to large power plants/large industrial customers/small industrial and commercial customers

(135) The parties' view is that the market for the supply of natural gas to eligible customers is national because (i) there are no restrictions as to the territories where an eligible customer may purchase its gas needs from when switching from its RDC, and for customers remaining with their respective RDCs, conditions of competition are regulated and similar across Hungary; (ii) there is a regulated access to the entire network in Hungary, which customers and traders may access from any exit point all around Hungary; and (iii) traders are in fact active in approaching customers located all around Hungary, regardless of the location of the customers and gas transport in Hungary is governed by a "stamp tariff system" (i.e., the cost of transport is always

62 Form CO, p. 110

63 Except gas transit.

64 Form CO, p. 96.

the same independently of the distance of the transport and the location of the customer).

(136) This approach is consistent with the Commission's previous decisions[65], which generally considered the various markets for the supply of gas as national in scope. The market investigation has also confirmed that under the current regulatory framework competition takes place at a national level for eligible customers. The regulation is national, in particular as regards TPA to the transmission and distribution networks and to storage facilities. Traders do not privilege any specific geographic area within Hungary. As regards access to the transmission network in particular, Hungary constitutes a single balancing zone and under the new entry/exit fee system (introduced in July 2005 to replace the stamp tariff system), the tariff is the same for all points in Hungary. A third party active in the gas sector has stated:

"The applicable regulation allows eligible customers that have decided to exit the regulated market to choose their supplier, and the latter can conduct its business in the whole country. Moreover, conditions of access to the transmission network are the same all over the country and prices are established at the national level. The supply of gas to eligible customers is therefore a nationwide business."

"Due to the different transformation levels of the liberalisation directives into national laws different national regulatory frameworks do exist. These different regulatory frameworks have an impact on access to transport/distribution networks, to storage facilities and of course lead to different price levels in different European States."

(137) After 2007, neither the parties nor the market investigation have provided any indication that the markets for supply of gas to eligible customers would become broader.

(138) In conclusion, the different markets for the supply of gas to the three categories of eligible customers mentioned above (large power plants; large industrial customers; and small industrial and commercial customers) are national in scope.

Supply of gas to residential customers

(139) Under Hungarian law, residential customers are obliged to procure gas from their local RDC and are not entitled to switch to traders on the open segment of the market. Therefore, the geographic scope of the market for the supply of gas to residential customers is sub-national in scope and each of the distribution grid regions constitutes a relevant geographic market.

(140) After 2007, residential customers will be able to switch suppliers. The market for the supply of gas to residential customers will therefore acquire a national dimension for the same reasons as the other markets for the supply of gas to end users. The market investigation has largely confirmed this[66].

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65 Case COMP/M.3440 ENI/EDP/GDP.

66 *"As soon as residential customers will become eligible, this regional approach will end, as the customer will be able to decide which supplier / trader he/she should sign up"*, Pannonpower's reply to the Commission's first phase questionnaire.

Conclusion on relevant markets in the gas sector:

(141) The Commission has assessed the impact of the proposed transaction on the following gas markets:

– Gas infrastructure operations:

(i) Transmission of gas in Hungary,

(ii) Distribution of gas in the Hungarian RDCs' areas,

(iii) Storage of gas in Hungary,

– Supply of gas:

(i) Supply of gas to RDCs in Hungary,

(ii) Supply of gas to traders in Hungary,

(iii) Supply of gas to large power plants in Hungary,

(iv) Supply of gas to large industrial customers in Hungary,

(v) Supply of gas to small industrial and commercial customers in Hungary,

(vi) Supply of gas to residential customers in the Hungarian RDCs' areas.

B. Relevant electricity markets

(i) The electricity sector in Hungary

a. Electricity demand

(142) Hungarian electricity consumption increased from 38.6 TWh in 2000 to 41.2 TWh in 2004, a 1.6% compounded annual growth rate. In 2004, the largest end users sectors were manufacturing (30%), residential (27%) and transports (5%). According to the parties[67], electricity consumption in Hungary is expected to increase by [0-5%]* annually in the coming years. Electricity sold in Hungary is either produced by domestic power generators or procured from imports.

b. Electricity transmission and distribution

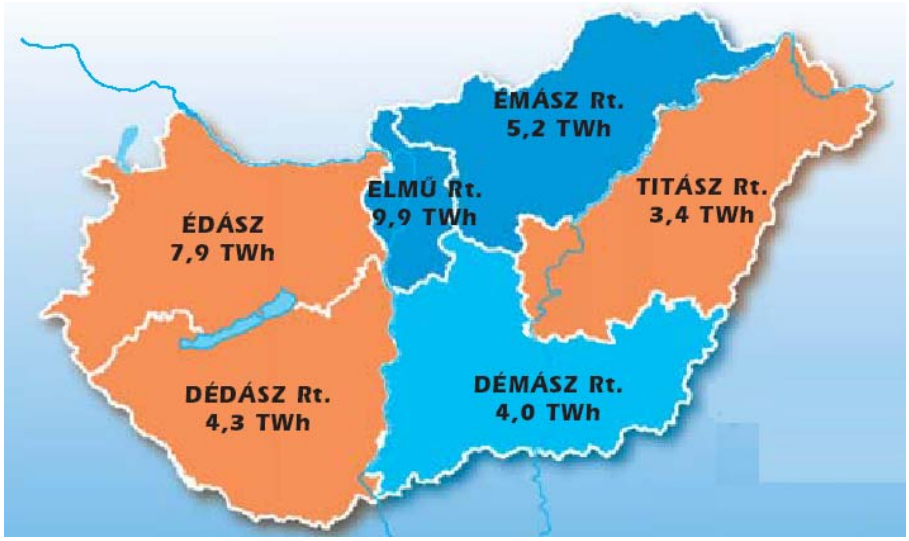
(143) MVM owns and operates the Hungarian high-voltage electricity grid. The low-voltage grids are owned and operated by the RDCs. There are six electricity RDCs in Hungary (TITÁSZ, ÉDÁSZ, DÉDÁSZ, ÉMÁSZ, ELMŰ, DÉMÁSZ). E.ON has sole control of three of these six RDCs: TITÁSZ, ÉDÁSZ and DÉDÁSZ. Out of the three remaining RDCs, ÉMÁSZ and ELMŰ are controlled by RWE and DÉMÁSZ by Electricité de France ("EDF"). ELMŰ is the largest electricity RDC in Hungary as it covers the Budapest area.

Ownership of the electricity RDCs:

ÉDÁSZ	**100% E.ON**
DÉDÁSZ	**100% E.ON**
TITÁSZ	**100% E.ON**
DÉMÁSZ	**61% EDF** 20.6% Institutional investors 18.4% Others
ÉMÁSZ	**54.3% RWE** 26.8% EnBW 18.9% Others
ELMŰ	**55.3% RWE** 27.3% EnBW 10.5% Municipality 6.9% Others

(144) The graph below shows the electricity RDCs' respective territories and sales in 2002:

67 Form CO, Page 192



c. Electricity generation

Current electricity generation capacities in Hungary

(145) Total generation capacity in Hungary was approximately 8,000 MW in 2004, to be compared with the country's peak load of 6,350 MW. The Hungarian electricity generation is split between nuclear energy (1,800 MW installed capacity) and lignite, gas and coal power plants (5,700 MW installed capacity)[68]. Renewable energies and hydro power are negligible. This generation mix differs slightly from neighbouring countries, where nuclear energy (Slovakia) or hydro power (Austria, Serbia, Romania) play a more significant role.

(146) In 2003, 18 power plants had a generation capacity exceeding 50 MW, compared to 13 in 1997, while there are around 150 smaller power plants, compared to 50 in 1997. Almost 40% of electricity consumed in Hungary is generated by the Paks nuclear power plant, the remaining 60% is mainly generated by power plants burning coal and hydrocarbons and by imports.

(147) The Hungarian power plants may be ranked according to their variable costs ("merit order curve"). The first power plant is the nuclear plant (with variable costs below [0-10]* EUR / MWh), followed by the lignite power plant (around [15-30]* EUR / MWh). The most expensive power plants are the gas-fired power plants[69] (from [15-40]* EUR / MWh to [15-40]* EUR / MWh) and the coal power plants (above […] EUR / MWh). The following chart, drawn from the Form CO, shows the merit order curve of Hungarian power plants in 2003:

68 Further details on the structure of electricity generation in Hungary are provided in Section V.(ii).a.

69 It should be noted in the chart above that gas/oil power plants are using gas as primary fuel.

[…]*

(148) Electricity generation capacities available for the open segment of the market are much lower than total installed capacities due to the existence of long-term Power Purchase Agreements ("PPAs"). According to the HEO, the capacity available for the open segment amounted to around [3,000-4,000] MW in 2005.

(149) Capacities contracted by MVM under the long-term PPAs in excess of its needs as public utility wholesaler and auctioned by MVM may be added to this figure. At the last auction for the period between 1 July 2005 and 31 December 2005, MVM sold 85 MW of base load capacity, 190 MW of off-peak capacity and 54 MW of peak capacity to electricity traders.

Need for additional generation capacity

(150) The Commission's market investigation has revealed that the Hungarian generation capacity will need to be renewed and expanded to a large extent in the next few years. Starting in 2007, the peak load will no longer be covered by installed capacity and imports, showing the need for investment in electricity generation as of 2007. According to MAVIR Rt. ("MAVIR"), the electricity system operator, the electricity market could even experience a deficit of production capacity around 2010 due to the lack of sufficient new generation capacity planned and the long time needed for new power plant projects.

(151) The HEO and MAVIR estimate that new generation capacity of approximately 5,000 MW has to be built until 2020 in Hungary to replace old power plants[70] (3,500 MW) and to satisfy the increase in demand. This figure accounts for roughly 60% of the total production capacity currently installed in Hungary. Accordingly the Hungarian electricity generation capacity should increase from 8,000 MW to approximately 10,500 MW. This estimate is also consistent with expectations from large market players which have estimated that half of the generation capacity in Hungary (approximately 4,000 MW) will need to be replaced in the next 5 to 7 years.

d. Electricity exports/imports in Hungary

(152) In view of the limited domestic generation capacities available for the open segment of the market, imports have developed rapidly to supply the open segment. MAVIR is responsible for granting non-discriminatory access to cross-border capacities.

(153) Hungary has a relatively high interconnection capacity with neighbouring countries, with 6 interconnectors. Import capacity amounts to approximately 3,000 MW, representing 38% of installed generation capacity in Hungary (by way of comparison with the most integrated regional electricity market in Europe, Nordpool, these figures are 18% for Norway, 29% for Sweden, 50% for Denmark, and 14% for

70 A number of old coal-fired power plants have already been decommissioned in Hungary and most of the remaining ones are expected to close down for environmental reasons.

Finland)[71]. The cross-border power lines enable transmissions from and to Ukraine, Slovakia, Austria, Croatia, Serbia and Romania.

(154) Some of these interconnections are not actually used for imports as there are either no or no cheaper electricity sources from some of Hungary's neighbouring countries. For example Serbia is a net importer following the destruction of the country's infrastructures in the war, and only one power plant in Ukraine is allowed to export electricity for technical reasons related to the stability of the Ukrainian electricity system. By contrast, all the import capacity for cheaper electricity (namely the Slovak interconnector) is fully used and congested.

(155) New interconnection lines with Croatia, Slovakia and Romania are planned by MVM in 2007. However, they are not expected to lead to a significant increase in electricity imports into Hungary due to the reduction of Hungary's electricity generation capacity surpluses.

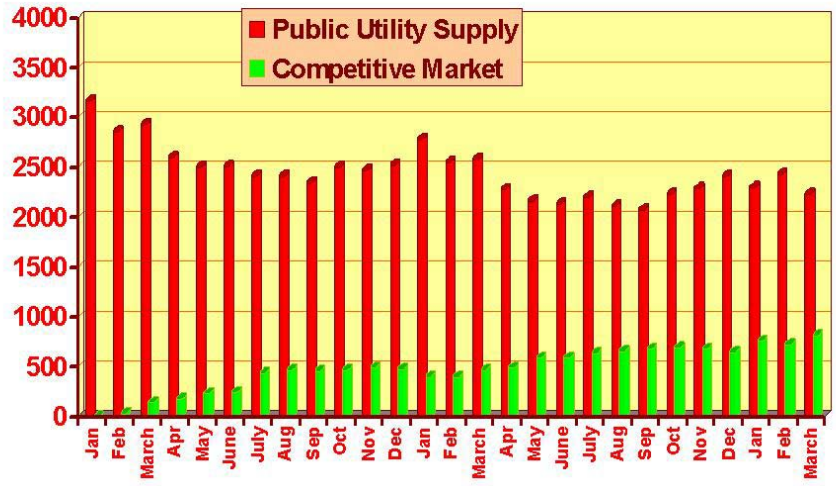
e. Development of the liberalised electricity markets in Hungary

(156) The proportion of customers (in volume) purchasing electricity on the open segment of the market increased steadily from 2003 to 2005: approximately 3% on February 2003, 7% on February 2004 and 27% on February 2005. In June 2005, 1,129 eligible customers (1,530 consumption sites) had switched to the open segment, accounting for 10.5 TWh of annual consumption. Accordingly, the open segment represented 31.8% of the total electricity market.

(157) According to statistics from the HEO, electricity end users on the open segment are mainly base load or "profile customers", for which the electricity consumption schedule is easily determined based on past statistics. These customers are active in various industry sectors (energy, chemicals, steel, food industry, retail, etc.). The market investigation has shown that most electricity market players consider the open segment of the electricity market in Hungary as competitive, while replies from electricity customers are mixed.

71 European Commission: "Annual Report on the Implementation of the Gas and Electricity Internal Market", 5 January 2005.

Development of the electricity free market from 2003 to March 2005:



Source: MAVIR Presentation, May 2005

(ii) Regulatory framework

a. Current regulatory framework

(158) The liberalisation process started earlier in the electricity sector than in the gas sector, with the old electricity act in 1994 (Act 48 of 1994), the privatisation of the regional distributions companies ("RDCs") in 1995, and the entry into force on 1 January 2003 of the Hungarian Electricity Act (Act 110 of 2001 – "HEA") adopted to implement Directive 92/96/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity [72]. Further measures were adopted to implement Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC [73] into Hungarian law. A law amending the HEA (Act 79 of 2005) was adopted on 6 July 2005 and entered into force on 1 September 2005, and a proposal for a new organization of the Hungarian electricity market was published by the HEO on June 2005 ("New Electricity Model") [74].

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72 , OJ L 27, 30.1.1997, p. 20.

73 , OJ L 176, 15.7.2003, p. 37.

74 Proposal for the Modification of the System of Market Relations of the Hungarian Electricity Market in order to Enhance the Efficiency of the Competition to Attract Consumers and to Achieve the Required Full Compliance with Relevant Community Directives, June 2005, http://www.eh.gov.hu/gcpdocs/200506/ honlapprateljes2005jnius27_angol.pdf.

Coexistence of regulated and open segments

(159) As the gas market, the Hungarian electricity market is also characterized by a hybrid model, including a regulated segment and an open segment of the market. Before the liberalisation of the electricity market in Hungary, cross-border electricity trading and transmission fell by law within the exclusive monopoly of MVM, a wholly-owned state company. Six regional suppliers had a monopoly to provide electricity services to customers in their respective regions.

(160) On 1 July 2004, all non-residential customers became eligible customers[75]. Residential customers will become eligible on 1 July 2007. As in the gas sector, eligible customers have the right, but not the obligation to switch suppliers, and may thus stay with their respective regional supplier in the context of a public utility contract. There are however more customers that have switched to the open segment of the market in the electricity sector than in the gas sector.

(161) Recent amendments of the HEA have made switching between public utility supply and open segment easier. For example, electricity customers can switch in 30 days if the contract does not specify it differently and can switch back to public utility supply in 60 days.

(162) The same chain of supply/purchase obligations exist in the public utility electricity sector as in the gas sector. Similarly, the relationships within the framework of public utility contracts remain, for reasons of public interest, heavily regulated both in terms of the applicable prices as well as other conditions of the contracts that are to be concluded among the various market players. By contrast, contractual freedom principally prevails in respect of the commercial relationship of eligible customers, having switched their supplier, and their commercial partners (traders, importers etc.).

Tariffs

(163) Electricity prices applicable in the public utility segment are regulated. Under Article 95 HEA, the prices of the following electricity products/services are regulated: (i) the transmission and distribution of electricity, (ii) the grid control by the system operator, (iii) the electricity sold by the public utility wholesaler to the public utility suppliers (the RDCs); and (iv) the electricity sold to public utility customers.

(164) Article 96 HEA states that the detailed rules pertaining to the tariff regime shall be drawn up by the HEO based on the least cost principle. The framework of the price regulations and the prices shall be determined by the MET. The HEO also has the

75 Article 3 of Government Decree No. 181/2002 on the eligibility of electricity customers.

obligation to review the price levels and the prices at the request of any interested party and shall make public the results of such review.

Market operators

(165) As in the gas sector, all electricity-related activities are subject to the *ex-ante* control of the HEO, through licensing, namely: (i) construction and operation of power plant with an output over 0.5 MW; (ii) transmission; (iii) distribution; (iv) grid operation (or system operation); (v) trading; (vi) public utility wholesale; (vii) public utility supply; (viii) operation of a power exchange; and (ix) cross-border transmission of electricity.

- *Generators*

(166) There are currently 19 licensed electricity generators in Hungary. According to the recent amendments of the HEA, power generators having a capacity between 0.5 MW and 50 MW are now also required to obtain a license, which can be requested under a simplified procedure.

(167) The generators are obliged by law to offer their production capacity contracted for public utility purposes to the public utility wholesaler (MVM)[76]. As result, the licensed generators and MVM have entered into PPAs, under which mutual selling and purchasing obligations were established on a long-term basis. The PPAs specify, inter alia, the annual capacity payment for generation capacity booked by MVM, the energy payments and the penalties for non-availability. PPAs are typically concluded for a period of twenty years.

(168) Under a PPA, the share of the generator concerned in MVM's total demand for the public utility segment is estimated and fixed in advance for the duration of the contract. The generator is obliged to reserve that production capacity and to supply the corresponding amount of electricity when requested. MVM, in turn, is obliged to remunerate the entire booked capacity, even if it is not used. MVM has therefore an economic interest to use all the capacities booked. The purchase prices for electricity are pre-fixed in the PPAs and are based on each generator's cost structure (fixed and marginal costs). The PPAs are scheduled to terminate between 2010 and 2015.

(169) As a result, the large majority of Hungarian power plants have long term PPAs with MVM, which cover a substantial part of Hungarian electricity needs. In 2003, capacities covered by the PPAs amounted to 4,800 MW out of 8,000 MW of installed capacity in Hungary, in comparison with a peak load of 6,300 MW and a base load of 3,500 MW.

- *The public utility wholesaler*

(170) The single-buyer public utility wholesaler MVM is obliged to supply electricity to the public utility suppliers (the RDCs) for public utility purposes (i.e. the electricity they need to supply their respective public utility customers). Article 65 HEA grants MVM an exclusive right to receive the "contracted electricity" of power plants under

76 Article 17 of the HEA.

the long-term PPAs[77] concluded with the licensed power generators. PPAs may also be concluded between MVM and licensed importers[78].

(171) The price of electricity sold by power generators was an official maximum price set by the MET until 1 January 2004 but is now freely negotiated between market players. The long-term PPAs contain complex price formulas for the calculation of prices. By contrast, the maximum price of the electricity sold by MVM to the RDCs continues to be regulated by the MET upon a proposal of the HEO.

(172) Where the generation of electricity is requested but is subsequently not used by MVM in due time, the generator is allowed to sell that electricity freely or to assign it to MAVIR, the system operator[79]. In practice, however, MVM has an economic interest in exploiting and reselling (domestically or by export) all booked capacities.

(173) Small power plants without a long-term PPA with MVM, as well as other power plants with a long-term PPA with MVM beyond the quantities contracted under those, are free to sell their electricity output to any party, such as a trader or directly to eligible customers. There are, however, only limited capacities, beyond those booked under long-term PPAs, for such free sales.

- Public utility suppliers (RDCs)

(174) The RDCs are, within the geographic territory specified in their licence, exclusively entitled and obliged to sell electricity to the public utility customers at a price determined by law. As in the case of gas RDCs, the electricity RDCs are the distribution grid licensees, but their activity is not confined to the mere distribution of electricity as they also sell electricity to eligible and non-eligible customers as public utility suppliers and in some cases as traders (in the case of eligible customers having switched to the open segment of the market).

- The system operator

(175) The system operator, MAVIR, is responsible for the management and operational safety of the Hungarian power grid, as well as the functioning of the electricity market.

- The transmission and distribution network operators

(176) The transmission network is owned and operated by MVM, and the distribution grids are owned and operated by the RDCs. These market players are obliged to provide Third Party Access ("TPA") to the networks without discrimination, at regulated tariffs.

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77 The PPAs are typically concluded for a period of 20 years, although shorter durations for certain plants are possible.

78 Article 3 (23) of the HEA.

79 Article 18 of the HEA and Government decision No 1070/2005 of 8 July 2005.

- *Traders*

(177) The licensed electricity traders are entitled to purchase electricity from the generators, other traders, the public utility wholesaler (if the latter has surplus electricity) and from abroad, and they are entitled to sell electricity to eligible customers, other traders and the public utility wholesaler. There are currently 23 licensed electricity traders in Hungary[80].

Imports of electricity

(178) There are no legal restrictions on the volumes that electricity traders may import[81]. The other licensees are limited as to the volumes of cross-border transmissions permitted (e.g. an eligible customer may only import electricity to the extent of its own consumption pursuant to Article 46(3) HEA[82]).

(179) The allocation of cross-border capacities is performed and administered by the grid operator, MAVIR. Existing capacity demands (already allocated capacity) have priority over new demands. The amount of free capacity is defined on a regular basis for each cross-border power line. If the demand for free capacities exceeds the amount of available free capacity, the free capacities are allocated through an auction. Auctions are held on a yearly and monthly basis. Currently, cross-border capacity auctions are essentially used to allocate capacities at the Slovak interconnector, where demand is the most important due to lower electricity prices.

Co-generation power plants

(180) Article 3 (19) HEA defines "co-generated electricity" as electricity produced with heat in the same generating installation[83]. The operation of co-generation power plants is regulated by the HEA and its Executive Decree. According to the newly enacted Article 19 HEA, the use of renewable sources and waste power generation, as well as the use of co-generated electricity shall be endorsed by the state. The MET Decree 56/2002 of the Regulation on Taking-Over and Definition of Prices for Electric Energy Coming under the Feed-in Obligation provides detailed rules on the

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80 AES Borsodi Energetikai Kft., APT Hungária Kft. , Árpád Energia Kft., Atel Energia Tanácsadó Kft., D-Energia Kereskedelmi Kft., DUNAFERR Központi Beszerző Kft. , EFT Budapest Rt., Electrabel Magyarország Kft. , Elektra Energia Kft., ENERGY CAPITAL Kft., ENKER-TEAM Kft., Entrade Hungary Kft., E.ON Energiakereskedő Kft., Észak-Budai Energiakereskedő Kft. , ETC Hungary Kft., JAS Budapest Kereskedelmi és Szolgáltató Rt., Magyar Áramszolgáltató Kft. , Mátrai Erőmű Rt. , MVM Partner Rt., PANNONTRADING Kft. , PCC Energie Kft. , Sempra Energy Europe Kft. and System Consulting Rt.

81 Article 42(1) of HEA.

82 Article 44(1) as regards the public utility wholesaler.

83 The additional conditions providing that co-generated electricity shall be produced with heat using identical fuels and by an energy conversion process with an efficiency of no less than 65% have been deleted by the latest amendment of the HEA.

mandatory take-over of electricity produced through co-generation as well as the definition of take-over prices. Subject to certain conditions, the public utility wholesaler is obliged to take over the co-generated electricity from power plants connected to the grid and receive subsidies from the system operator for these purchases.

b. Evolution of the regulatory framework

The New Electricity Model

(181) The market investigation has focused on the evolution of the Hungarian electricity sector regulatory framework. The most relevant document in this matter is the New Electricity Model prepared by the HEO at the request of the MET. The proposal recently released by the HEO presents the objectives set by the MET and describes a recommended new market model. The Commission has discussed the content of this proposal and the likelihood of the adoption of its main elements with the HEO and the MET.

(182) The objective of the Hungarian government is to bring the New Electricity Model into force at the complete liberalization of the Hungarian electricity markets.

(183) In the absence of additional information about the future electricity model in Hungary, the Commission takes the view that it can base its forward looking competitive assessment of the proposed transaction on the current regulatory framework until July 2007 and on the recommended new market model as described in the New Electricity Model thereafter[84].

(184) The objectives of the New Electricity Model, as set by the Hungarian government, are threefold. The first objective is to bring the Hungarian legal provisions into full compliance with Directive 2003/54/EC. The second aim is to increase competition on the electricity market to the benefit of end user customers, while preserving regulated prices for household customers. Finally, the third objective is to ensure high security of supply and to promote energy saving and environmental protection. Contrary to the current hybrid model, the New Electricity Model is a free market model with retail supply at a regulated price in a limited scope specified by law.

- Significant Market Power trader and Universal Service Provider

(185) Under the recommended new model, the current system of public utility should be terminated and the public utility wholesale and the public utility service providers' functions should cease to exist. MVM and the RDCs would be able to continue their activities on the open segment of the markets respectively as a Significant Market Power Trader (SMP trader) and as Universal Service Providers (USP). As most significant change concerning the relation between market players, the obligation of RDCs to purchase electricity from MVM would disappear. USP should be allowed to procure electricity from any market player, at a competitive price.

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[84] The recommended new market model as described in the New Electricity Model will most likely be implemented in July 2007.

(186) In order to correct the structural disparities and to support the emergence of competition, the HEO plans to introduce a special regulatory regime applicable to dominant market players. Under this regime, the HEO would have the power to impose additional obligations (e.g. mandatory capacity auctions, price control, supply obligations) in order to prevent abuse of dominant position from any SMP trader at the wholesale or the retail level.

- End users

(187) Under the New Electricity Model, regulated prices for industrial and commercial customers would terminate.

(188) Household customers would be granted the possibility to purchase electricity on the free market after 1 July 2007 but regulated prices should be maintained for those customers as a public utility service. Household customers would not be able to switch back to the regulated price service once they have switched to the open segment of the market.

- Power generators and electricity markets

(189) The obligatory capacity purchase currently present in the HEA should cease to exist and large power generators would not be obliged to reserve the most significant part of their capacity and electricity production to MVM anymore, unless they are required to do so under an existing long-term PPA with MVM.

(190) MVM would be entitled to sell on the open segment of the market the capacity and electricity purchased on the open segment of the market or through the long-term PPAs. Power generators would be entitled to sell on the open segment of the market capacity and electricity in excess of the quantities contracted in the long term PPAs and the capacity and electricity contracted in the long-term PPAs but not taken over by MVM.

(191) The recommended model foresees the establishment of two markets for the sale of electricity and capacity. An organized market should be established by a state owned Market Operator (a subsidiary of MAVIR) for hourly day-ahead trading. A "market" for bilateral transaction should also be available and will consists in (i) a set of Over The Counter transactions ("OTC market") between of power generators (to the extent of their free capacity) and traders and (ii) the sale of generation capacity released on mandatory auctions by MVM.

The evolution of the PPAs and of the electricity markets

(192) The functioning of the recommended new model will depend on the outcome of the long-term PPA renegotiations.

- The renegotiations of the PPAs

(193) In 2002, in the context of Hungary's entry in the European Union, the Hungarian government issued a decree[85] on the determination and management of stranded

[85] Government Decree 183/2002.

costs, which entitled MVM to recover stranded costs and introduced at the same time imposed an obligation for MVM to renegotiate the PPAs before 31 January 2003. In accordance with those provisions, a round of renegotiations of the PPAs between MVM and the 10 power generators concerned took place in February 2004. This round of renegotiations failed as none of the parties involved appeared to have any interest in changing the existing PPAs. It is not likely that the government will impose a new round of renegotiations in the short term.

(194) However, in parallel to the elaboration of the new electricity model, the HEO and the MET[86] are discussing with the Commission the validity of the system of long term PPAs and the possible volume of stranded costs (threshold price-mechanism). The aim is to ensure that the new regulatory framework is compatible with European competition law. Under the New Electricity Model, the government also intends to create the appropriate incentives for MVM and power generators to renegotiate the PPAs.

(195) It should be noted that the Commission has opened in November 2004 a State Aid investigation on long-term PPA in Hungary[87]. The opening of this procedure is likely to give all interested players an additional interest in a successful renegotiation of the PPAs.

(196) If the PPAs are substantially modified before entry into force of the New Electricity Model in 2007 and if the process results in the release of important generation capacities and electricity quantities[88], power generators will be able to supply traders (open segment of the market and USP) and eligible customers either directly through bilateral contracts (OTC market) or indirectly through the newly created organized market (power exchange).

- *Supply of electricity to end users*

(197) In terms of access to and supply of electricity to end users in Hungary and depending on the outcome of the long-term PPAs renegotiations, the New Electricity Model may bring the following changes.

(198) First, approximately one third of the total demand originates from residential customers in Hungary. Although the electricity market will be fully opened in 2007, it is expected that most household customers will continue purchasing from the USPs.

(199) Secondly, commercial and industrial users, which account for two thirds of total Hungarian demand, will potentially be supplied through four distinct supply channels: (i) OTC market, (ii) Organized market, (iii) Imports and (iv) MVM

86 Minutes of call with Mr. Hatvani, Deputy Secretary of State, MET, on 23 August 2005.

87 See Commission press release IP/05/1407 of 10 November 2005.

88 The renegotiation of the PPA could result in the transformation of the current physical capacity and energy delivery agreements into financial payments obligations, whereby MVM will only act as a clearing house.

auctions. Large electricity end users may be supplied directly through those ways while small and medium electricity end users will be supplied indirectly through traders.

(200) Large industrial users and traders may purchase through bilateral contracts, on the OTC market, from (i) current large power generators (provided the long term PPAs have been renegotiated or only for the quantities in excess of the long term PPAs), (ii) from smaller power generators (not subject to long term PPAs), (iii) from newly built power plants (not subject to long term PPAs) and (iv) from traders.

(201) Certain quantities of electricity will be traded through the Organized Market (traders and large industrial customers). Based on the discussions with the HEO, in the long term, this proportion can be roughly estimated to one third of the electricity finally sold to commercial and industrial users.

(202) Large industrial users and traders will continue importing electricity. Cross-border capacities will remain allocated among bidders through auctions. They will also be able to purchase power capacity through auctions imposed on MVM. The extent of these mandatory auctions is still unclear.

(203) If the PPAs are not substantially modified before 2007 and the introduction of the new model, power generators will continue reserving the majority of their capacities and delivering the majority of their electricity production to MVM, which will then in turn most likely sell the majority of these quantities to the USP[89] or through mandatory auctions (monthly and / or yearly). In this case, even under the new electricity model, current power generators will not be able to contract directly with traders or end users and this will impede the emergence of a competitive and efficient OTC market. Large power generators will remain bound to MVM and traders will have to rely on imports or electricity not sold through PPAs, as in the current situation.

(204) The negative impact of the PPAs on competition could be partially compensated by mandatory capacity auctions imposed on MVM either on the organized market or on the OTC market, which could be part of the additional obligations imposable on SMP traders on the wholesale market.

(205) In order to base its competitive assessment on the most reasonable assumptions as regards the future electricity markets developments in Hungary, the Commission also consulted the most important market players on their expectations about the evolution of the electricity regulatory framework in July 2007. Although most of those players referred to a certain degree of uncertainty, they generally confirmed that the essential elements of the HEO recommended market model would most likely be adopted.

(206) The market investigation has also pointed to a degree of uncertainty as regards the renegotiation of the long term PPAs. Although the PPAs are being scrutinised by the Commission under State aid rules to ensure they do not create any distortion of competition in the electricity sector, both MVM and power generators do not have

89 In case of insufficient liquidity on the market, the SMP traders may be required by the HEO to supply the USPs so that they are able to perform their functions.

an interest in renegotiating the PPAs. The PPAs grant power generators relatively high electricity purchase prices and stable and reasonable profitability. Their termination would imply more competition between power plants and greater uncertainty with respect to electricity sales prices. It would decrease the size and the role of the public utility segment and would put an end to MVM's strong position as public utility wholesaler.

(207) The Commission notes that the evolution of the electricity regulatory framework and its timing have not been contested by the parties in their Reply to the SO.

(iii) Relevant product markets

(208) In view of the current regulatory framework in market conditions in Hungary, the parties distinguish the following relevant product markets for the supply of electricity to (i) residential or household customers, (ii) small industrial and commercial customers and (iii) medium and large industrial and commercial customers. The parties also identify the generation of electricity as a relevant product market in itself, separate from the market for electricity wholesale. The parties further submit that only the generation of electricity is an affected market for the assessment of the proposed operation[90].

(209) The Commission has in the past[91] distinguished separate product markets for the generation and wholesale supply of electricity (i.e., production of electricity in power plants and physical import of electricity through inter-connectors and its sale on the wholesale market to traders, distribution companies or large industrial end-users), transmission of electricity (via high-voltage grid); distribution of electricity (via low-voltage grids), retail supply of electricity (to small commercial and industrial users and residential customers) and balancing services.

(210) On the basis of the past practice and the investigation in this case, the Commission considers that the following product markets are relevant for the assessment of the present transaction:

- Electricity infrastructure operations, including the transmission of electricity, the distribution of electricity
- Provision of balancing power;
- Generation and wholesale supply of electricity to traders, to MVM and to the RDCs;
- Retail supply of electricity to medium and large commercial and industrial customers, small and medium commercial and industrial customers and to residential customers.

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90 Form CO, Page 113.

91 Case COMP/M. 2947 Verbund/Energie Allianz, COMP/M. 3268 Sydkraft/Graninge, COMP/M.3440 ENI / EDP / GDP.

(211) This delineation of the relevant product markets in the electricity sector only differs from the market delineation proposed by the parties as regards the combination of electricity generation and wholesale activities in one single relevant product market. However, this difference (and the precise delineation) has no impact on the outcome of the assessment of this case. It should be noted that the parties did not contest the definition of the relevant product markets in the electricity sector in their Reply to the SO.

a. Infrastructure

Transmission of electricity

(212) The operation and management of the high voltage grid ("Transmission of electricity"), has been consistently identified by the Commission as a relevant product market and as a natural monopoly.

(213) In Hungary, the transmission grid is owned an operated by MAVIR, the transmission grid operator, which is a subsidiary of MVM. Access to the transmission grid is granted to third parties at a regulated tariff. Transmission lines may have a 750 kV, 400 kV or 220 kV voltage.

(214) Although this product market is not an affected product market under the meaning of the Merger Regulation, the analysis of the access to available capacity on this grid and to cross-border inter-connectors is relevant for the assessment of the proposed transaction.

Distribution of electricity

(215) The operation and management of the lower voltage grid(s) ("Distribution of electricity") has also been identified by the Commission as a relevant product market and as a natural monopoly.

(216) In Hungary, the distribution grids are owned and managed by the RDCs, which are the distribution grid operators. Access to the distribution grid is granted to third parties at regulated tariffs. Main distribution lines have a 120 kV voltage and secondary distribution line a voltage raging from 35 kV to 220 V.

(217) Although there are six regional distribution grids in Hungary, these grids cover different parts of the country and do not overlap. Each of these grids therefore constitutes a separate product market as, for any given customer, distribution through one distribution grid is not substitutable with distribution through another grid.

(218) Although these product markets are not affected product markets under the meaning of the Merger Regulation, the analysis of the access to available capacity on these grids is relevant for the assessment of the proposed transaction.

b. Balancing power

(219) In previous decisions, the Commission has distinguished a market for balancing power, in view of the lack of substitutability with other electricity supply at the wholesale level[92].

(220) In most electricity markets, the system operator is responsible for maintaining the tension in the grid within a very narrow bandwidth. If there is over-consumption, the tension in the grid would drop and this could cause at some point network stability problems. A problem also arises if there is under-consumption as then the tension in the grid rises above an acceptable tolerance level and the system operator must make sure that either some generation capacity is switched off or that some consumption is added. In Hungary, the system operator (MAVIR) operates the balance energy system and purchases energy in order to supply balance energy for the balance units. The system operator also purchases electricity in order to adjust the losses of the transmission grid as well as to provide network-related services.

(221) The electricity used for system balancing is only produced by gas power plants as nuclear and lignite power plants do not offer the appropriate technical requirements (load charging, speed) and is purchased by the system operator at the national level. In addition, a large part of the electricity is purchased from MVM due to the existence of long term PPAs.

(222) The Commission's investigation confirmed that the provision of balancing power constitutes a relevant product market for the purposes of this decision.

c. Generation/Wholesale supply of electricity

(223) The Commission has in previous decisions considered the generation and wholesale supply of electricity as a separate product market[93]. This encompasses the production of electricity at power stations as well as electricity physically imported through inter-connectors by traders[94].The parties distinguish the markets for the generation of electricity and the market for the wholesale of electricity[95]. However, they do not provide any reasons why the two product markets should be separate.

(224) The Commission's market investigation confirmed that the generation of electricity and wholesale of electricity in Hungary belong to the same relevant product market. The supply side of this product market is constituted by power generators, wholesale traders and electricity imports and the demand side is constituted by the various

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92 The wholesale services that come closer to balancing power services are so called "intra-day" trading opportunities at which the companies in actual under- or over-supply can trade their surpluses or purchase their extra needs. However, if there is no continuous intra-day trading, with immediate delivery, this trading system is in itself insufficient to match supply and demand at any time.

93 See Case COMP / M.3268-Sykdraft/Graninge.

94 Electricity may also be imported by large industrial customers directly. The activity of large industrial customers on the Hungarian market is however currently very limited.

95 Form CO Page 113 and 114.

categories of electricity resellers, MVM, the RDCs and electricity traders. The market investigation has also indicated that these various categories of customers belong to distinct relevant product market due to the distinct regulatory framework.

(225) The relevant product markets have to be seen against the background of the evolution of electricity regulatory framework in Hungary. For this purpose, a distinction has to be drawn between the current electricity sector structure and the structure that should soon be in place after the implementation of the New Electricity Model and the amendment of the long-term PPAs.

(226) In their reply to the SO, the parties did not contest the Commission's conclusion that electricity generation and wholesale belong to the same relevant product markets.

Wholesale supply of electricity to traders

(227) Under the current regulatory framework, traders that are present on the liberalised segment of the electricity wholesale market are entitled to purchase electricity from the power generators, from other traders, from the public utility wholesaler and from abroad, and they are entitled to sell electricity to the eligible customers, to other traders and to the public utility wholesaler. Electricity traders currently active in Hungary are generally subsidiaries set up by the RDCs to be present on the open segment of the market (referred to as "trading subsidiaries of the RDCs") or subsidiaries of recently established European trading groups[96]. At the moment, the majority of electricity traders only supply electricity to other traders or to large industrial customers.

(228) In view of the regulatory framework applicable to electricity traders, the wholesale supply of electricity to traders constitutes a relevant product market open to competition.

(229) Under the new regulatory framework, the scope of the open segment of the electricity wholesale market will expand significantly as RDCs will also act essentially as traders. Depending on the reduction of the scope of the long term PPAs and on mandatory auctions imposed on MVM, additional generation capacity will also be released to be traded on the open segment of the wholesale market.

Wholesale supply of electricity to MVM

(230) The current regulatory framework is based on a hybrid system (regulated and open segments of the market). On the one hand, a large part of the Hungarian wholesale market is organised according to a "single-buyer" scheme. In this regulated segment of the market, power generators offer the amount of electricity generated which has been contracted for public utility purposes to the public utility wholesaler, MVM. On the other hand, the open segment of the wholesale market is based on a competitive market. The volumes produced by power plants, not covered by a public utility contract, the electricity contracted by MVM for public utility purposes and imports are purchased by traders on the open segment of the wholesale market.

96 MVM also owns the MVM Partner electricity trader.

(231) In view of the existence of a public utility market segment and of the long term PPAs, the wholesale of electricity to MVM by large Hungarian power generators constitute a relevant product market not open to competition.

(232) Under the new regulatory framework, the public utility wholesale segment will most certainly cease to exist in the regulatory framework. The Commission therefore considers that the wholesale supply of electricity to MVM will therefore progressively become part of the same product market as the wholesale supply of electricity to other traders, depending on the reduction in the scope of the long-term PPAs.

Wholesale supply of electricity to RDCs

(233) Under the current regulatory framework[97], the public utility wholesaler has an obligation to supply the RDCs at an official price to the extent of the performance of the public utility contracts concluded between the RDCs and the public utility wholesaler. MVM and the RDCs are under an obligation to conclude an agreement for the allocation and receipt of the electricity required for the supply of public utility customers. These long-term PPAs between MVM and the RDCs provide that no discrimination shall be made by MVM among the RDCs. The RDCs are not allowed to purchase electricity for public utility purposes from other sources.

(234) In view of this regulatory framework currently applicable to RDCs, the wholesale supply of electricity to RDCs constitutes a relevant product market not open to competition.

(235) Under the new regulatory framework, the RDCs will not longer act as public utility suppliers but as Universal Service Providers (USP) and will be able to procure electricity from any electricity wholesaler. They will however obtain additional rights (privileged access to electricity sold by MVM) and obligations (public service of household customers). The Commission therefore considers that, after the introduction of the new regulatory framework, the wholesale supply of electricity to RDCs will most likely become part of the same product market as the wholesale supply of electricity to other traders.

d. Retail supply of electricity to end users

(236) In its past decisions, the Commission defined the relevant product markets for the retail supply of electricity to end users based on categories of customers. The Commission has identified these customers groups on the basis of the relevant regulatory framework applicable to them and their consumption profile.

(237) The parties submit that, for the purpose of the assessment of the present operation, the retail supply of electricity should be considered as a market distinct from the market for the wholesale supply of electricity. In accordance with the Commission past practice, the parties further distinguish three categories of end users (medium and large industrial and commercial customers (MLCs), small industrial and

97 Article 43 of the HEA

commercial customers (SCs) and residential customers). In addition, the parties take the view that all eligible customers - not only those who have actually switched to the open segment of the market - belong to those group of end users.

(238) Although a number of market respondents to the market investigation stated that end users in the regulated system and the non-regulated system should be distinguished as they have distinct supply conditions, the Commission supports the view of the parties that those end users belong to the same relevant product market. All eligible customers choose freely to be in the regulated or in the open segment of the market according to the price and conditions in each segment. Switching does not entail high costs for the customers. Hence, it has been confirmed that, not only customers switched to the open segment of the market, but also that customers switched back to the regulated segment of the market. Therefore, the Commission takes the view that the distinction between eligible customers that have switched to the open segment of the market and those that have stayed in the regulated segment of the market is not relevant for the purposes of the definition of the relevant product markets.

(239) The market investigation has confirmed that the three groups of end users identified by the parties are the most relevant for the definition of product markets due to their consumption profile and the applicable regulatory framework. MLCs and SCs have distinct consumption profiles and residential customers constitute a separate relevant product market as they are currently not eligible.

Retail supply of electricity to large commercial and industrial customers and retail supply of electricity to small commercial and industrial customers

(240) All non-residential customers (commercial and industrial customers) are entitled to switch supplier and purchase their electricity needs either on the regulated segment of the market from their local RDC or from an electricity trader on the open segment of the market. These end users are also entitled to change traders and to switch back to the regulated segment of the market. According to the parties, although the legal status of MLCs and SCs is similar, those two end user categories differ by their consumption profiles and the commercial relationship with their electricity suppliers.

(241) The parties define MLCs as end users having an average annual electricity consumption of more than 0.5 GWh whereas SCs are defined as non residential customers having an average annual consumption of less than 0.5 GWh. The parties submit that the group of customers described as MLCs includes all customers that receive electricity at high and medium voltage[98] and chain customers whereas the SCs purchase lesser amounts of electricity and are supplied at low voltage (0.4 kV).

(242) With respect to consumption profiles, the parties submit that MLCs' consumption profile is in general more stable than SCs consumption profile over the year and over the day. SCs have in general a fluctuating demand within the day, with a lower consumption in the evening and the night.

[98] 10-120 kV for TITÁSZ customers for instance – Source: Parties replies to the Request for Information dated 18/07/05 (Question 15). The parties underline that large industrial companies are often supplied on middle voltage (10-20-35 kW), such as […]*.

(243) MLCs and SCs also differ in their approach of electricity procurement. MLCs usually have professional staff and resources available to effectively negotiate and compare the various offers presented by the traders/RDCs. They usually open tenders for electricity procurement and seek offers from various market players. As a consequence, they usually receive individual offers tailored to their needs from their electricity suppliers. They are usually dealt with by so-called key-account managers by their commercial partners. On the contrary, SCs have limited resources to compare terms and conditions and are characterised by a mass marketing approach from electricity suppliers. As a result of these distinct procurement patterns, as of August 2005, more MLCs have switched supplier (on the open segment of the market) than SCs.

(244) E.ON's internal presentations[99] […]*. According to those documents, […]*.

(245) Hence, the market investigation has confirmed the market definition proposed by the parties and, under the current regulatory framework, the retail supply of electricity to MLCs and SCs constitute two distinct relevant product markets for the purposes of the present decision. Although these product markets do not constitute an affected product market under the meaning of the Merger Regulation, the analysis of their competitive dynamics and of the evolution of E.ON's market position are relevant for the assessment of the impact of the proposed operation.

(246) Under the new regulatory framework, the public utility segment is expected to be terminated for MLCs and SCs, which will have an impact on the competitive conditions on the retail supply of electricity to MLCs and SCs. As residential customers will become eligible, they may also become part of the SCs market (see below).

Retail supply of electricity to residential customers

(247) In the current regulatory framework, residential customers are currently not eligible to switch supplier and purchase their electricity needs from their local RDC in a regulated environment.

(248) In view of this regulatory framework currently applicable to residential customers, the retail supply of electricity to residential customers constitutes a relevant product market not open to competition.

(249) As regards the regulatory framework after the market opening, the market investigation has not provided clear-cut indications on whether residential customers and SCs will belong to the same relevant product market.

(250) However, the question of whether residential customers and SCs will belong to the same relevant product market after the opening of the residential customers market segment can be left open for the purposes of this case as the competitive assessment is the same under each alternative.

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99 E.ON's reply to the Commission's request for information of July 18, 2005. Binder Supplement I, Reply to Question 122. « E.ON Energie, Capital Market Day », Munich, September 6, 2004.

(iv) Relevant geographic markets

(251) The parties submit that the relevant product markets in the electricity sector are national or sub-national[100] in scope, essentially due to the regulatory framework in Hungary. This approach was confirmed by the market investigation.

(252) Although some respondents to the market investigation argue that the electricity wholesale market could have a broader geographic dimension, the majority of market players highlighted the specificities of the Hungarian market and supported the views of the parties. In view of those comments and of the significant imports to Hungary, the Commission carefully assessed the relevance of a geographic market wider than Hungary for electricity wholesale but came finally to the conclusion that, under the current regulatory framework, the most appropriate geographic scope of this relevant product market was national.

a. Infrastructure

Transmission of electricity

(253) The Hungarian electricity transmission grid is owned and operated by MAVIR at the national level. Therefore, the electricity transmission market is national in scope.

Distribution of electricity

(254) The six Hungarian electricity distribution grids are owned and operated by the six RDCs. Therefore, the electricity distribution market is sub- national in scope and each of the distribution grid regions constitutes a distinct relevant geographic market.

b. Balancing power

(255) Electricity used for system balancing cannot be imported as it needs to be produced in the country and controlled by the national Hungarian TSO in accordance with the UCTE regulation. In addition, import nominations/schedules are done for the next day and it is not possible to re-nominate them during the day. Therefore, the geographic scope of the market for balancing power is national.

c. Generation / Wholesale supply of electricity

Wholesale supply of electricity to traders

(256) The parties submit that the relevant product market is national in scope due to the Hungarian regulatory framework. They claim that, according to the relevant provisions of the HEA, in order to obtain a Hungarian license for electricity trading

[100] The Parties take the view that the market for the supply of electricity to residential customers has a sub-national scope; all other markets have a national scope.

it is necessary that a company is established in Hungary. It is therefore not legally possible for an electricity trader based outside of Hungary to sell electricity in Hungary without establishing a subsidiary in Hungary beforehand. The parties also underline that it cannot be excluded that with the ongoing liberalisation electricity wholesale markets will in the future be wider than national markets.

(257) In the market investigation, a few market respondents claimed that the geographic dimension of electricity wholesale market in the current regulatory framework was broader than national due to the significant role played by imports.

(258) Due to its central position in Eastern Europe, Hungary is highly interconnected with its neighbouring countries, notably Austria, Slovakia, Ukraine, Romania, Serbia and Croatia. In 2003, Hungary imported 11.4 TWh an exported 4.5 TWh, resulting in 6.9 TWh of net imports. According to MVM, the potential technical import capacity is even larger as connectors with Southern countries are not used for imports (Serbia, Romania). As a result, 18.1%[101] of the electricity used in Hungary in 2003 was imported. This share of import is relatively high in comparison to other European countries: Italy (15.9%), Austria (11%), Belgium (7.3%) and Portugal (6.5%). In 2005, the net import balance is expected to reach 8 TWh based on MAVIR estimates[102].

(259) Although electricity imports appear to represent a significant share of the national consumption (and have a predominant role in the open segment of the market), the competitive conditions for the wholesale supply of electricity differ significantly in Hungary and its neighbouring countries.

(260) First, Hungary has a significant role as a transit country and exported quantities amounted to around 40% of imported quantities in 2003. Electricity is essentially imported from the North (Slovakia and Ukraine) and exported to the South (Croatia and Serbia). The only country with which electricity flows take place in both directions is Austria. The real size of electricity transit through Hungary is difficult to estimate since there is no differentiation between export and import and transit under the CBT regime and cross-border capacities are attributed irrespectively of the ultimate use.

(261) This means that gross import figures and the interconnection capacities are not entirely relevant for the assessment of the geographic scope of the market. Net Import figures reflect more the competitive constraints exerted by imports and imports capacity with Southern countries should not be taken into account. Similarly, the fact that the vast majority of electricity sold on the Hungarian open segment of the wholesale market comes from import is essentially related to the very low domestic production capacity available on the open segment of the market due to the existence of the long-term PPAs.

(262) Secondly, the electricity interconnectors with Austria and Slovakia are almost all the time congested according to the HEO, so that no additional imports are currently

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[101] UCTE Statistical Yearbook, 2003.

[102] MAVIR's presentation: « Information on the Hungarian Power System and on the Hungarian Power System Operator Company », May 2005.

possible without any additional interconnection capacity. The HEO further underlines that domestic congestion and the cross-border allocation methodology limit the import capacities.

(263) As a result, the influence of imports on the electricity wholesale prices in Hungary is limited, as reflected in the differing price levels between Hungary and its neighbouring countries. Although electricity wholesale prices levels are difficult to estimate as most electricity wholesale markets in Hungary's neighbouring countries (except Austria) are not yet liquid and transparent, the market investigation showed that Hungarian electricity wholesale prices are lower than prices in Austria, Germany and Croatia but higher than in Slovakia, Romanian, Ukraine and Serbia. As an example, according to the parties[103], electricity wholesale prices in Romania, Slovakia and Serbia are currently respectively [0-5]* EUR/ MWh, [0-5]* EUR/MWh and [0-5]* EUR/MWh lower than in Hungary.

(264) The market investigation has also indicated[104] that limited interconnection capacity with countries in the North of Hungary – where electricity production costs are lower – entails that interconnection capacity allocated through auctions is expensive. As a result, electricity prices between Hungary and its Northern neighbouring countries do not converge as auction prices offset the electricity prices differences.

(265) Thirdly, as presented by the parties, the Hungarian regulatory framework explicitly specify that electricity traders should set up a Hungarian trading company and obtain a Hungarian trading license to be active on the Hungarian market[105]. A cross-border trading license is required to import electricity. These requirements clearly restrict the possibilities for any foreign company to pursue electricity trading and wholesale activities on the Hungarian market.

(266) Fourthly, the Hungarian regulatory framework and market opening rules still remain substantially different from those of neighbouring countries. A market operator has underlined that the legal framework concerning power plants primary fuel (state aid for local coal and nuclear) differ between countries as well as environmental and other regulations affecting power generation. As a result the power generation mix of Hungary and its neighbouring country differ much, which has an impact on the electricity wholesale market homogeneity.

(267) It cannot be excluded that, in the future, depending on future developments such as changes in the regulatory framework, additional interconnection capacity and potential price convergence, the market for the wholesale supply of electricity to traders in Hungary will acquire a broader geographic dimension.

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103 E.ON's submission dated 2 September 2005.

104 *"The congestion is due to the higher demand than supply. The TSOs are holding auctions for the cross-border transit capacity on each congested border connection. The result of these auctions is to be paid to the TSOs and practically the TSOs are gaining the price differences between the markets."*

105 Article 34 of the Executive Decree to the HEA.

Wholesale supply of electricity to MVM

(268) Under the current Hungarian law, MVM has to procure electricity for public utility purposes in the framework of long term PPAs with the largest Hungarian power plants. The geographic scope of the market for wholesale supply of electricity to MVM for public utility purposes is therefore national in scope.

(269) Under the new regulatory framework, MVM will have the ability to source electricity on the open segment of the market for the wholesale market depending on the reduction in the scope of the long-term PPAs. The market for wholesale supply of electricity to MVM will therefore remain national for the same reasons as the market for wholesale supply of electricity to traders.

Wholesale supply of electricity to RDCs

(270) Under the current Hungarian law, the RDCs have to procure electricity for public utility purposes in the framework of supply agreements with MVM. The geographic scope of the market for wholesale supply of electricity to the RDCs for public utility purposes is therefore national in scope.

(271) Under the new regulatory framework, the USPs will have the ability to source electricity on the open segment of the wholesale market. The market for wholesale supply of electricity to RDCs will therefore become part of the market for the wholesale supply of electricity to traders.

d. Retail supply of electricity to end users

Retail supply of electricity to MLCs and SCs

(272) In previous decisions[106], the Commission highlighted that a local presence is required for all electricity retail activities, whether to small or large customers, as brand recognition, marketing, customer service, metering and billing were essential.

(273) In their submission, the parties consider the supply of electricity to all eligible Hungarian customers as national in scope due to the homogeneous competitive conditions throughout the country. Eligible customers may procure electricity from their RDCs, active at a sub-national level, or from electricity traders which are active nationwide.

(274) The market investigation has confirmed that under the current regulatory framework competition takes place at a national level for eligible customers. First, electricity traders may target specific customers (essentially large industrial users or other traders) but do not privilege any specific geographic area within Hungary. Secondly, electricity import and export figures clearly indicate that very few eligible customers import electricity directly, although they are entitled to do so. According to the

106 Case COMP/M.3440 ENI / EDP / GDP.

HEO[107], Hungarian eligible customers imported [500-1,000] GWh of electricity in 2003 and [0-500] GWh in 2004, which account respectively for [0-5%] and [0-5%] of the net Hungarian imports in those years.

(275) The geographic scope of the market for retail supply of electricity to MLCs and SCs is therefore national in scope.

(276) As regards the new regulatory framework, neither the parties nor the market investigation did provide any indication that this geographic dimension of retail supply of electricity would become broader.

Retail supply of electricity to residential customers

(277) Under Hungarian law, residential customers are obliged to procure electricity from their local RDCs and are not entitled to switch traders on the open segment of the market. Therefore, the geographic scope of the market for retail supply of electricity to residential customers is sub-national in scope and each of the distribution grid regions constitutes a distinct relevant geographic market.

(278) Under the new regulatory framework, residential customers will be able to switch suppliers. The market for retail supply of electricity to residential customers will therefore acquire a national dimension for the same reasons as the other electricity retail markets.

(279) To conclude, the Commission has assessed the impact of proposed transaction in the electricity sector based on the following market definitions:

– Electricity infrastructure operations:

(i) Transmission of electricity in Hungary,

(ii) Distribution of electricity in the Hungarian RDCs' areas,

(iii)Provision of balancing power in Hungary,

– Generation/Wholesale supply of electricity:

(i) Wholesale supply of electricity to traders in Hungary,

(ii) Wholesale supply of electricity to MVM in Hungary,

(iii)Wholesale supply of electricity to RDCs in Hungary,

– Retail supply of electricity to end users:

(i) Retail supply of electricity to medium and large commercial and industrial customers in Hungary,

[107] HEO's presentation: "Hungarian Electricity Market", 26 July 2005.

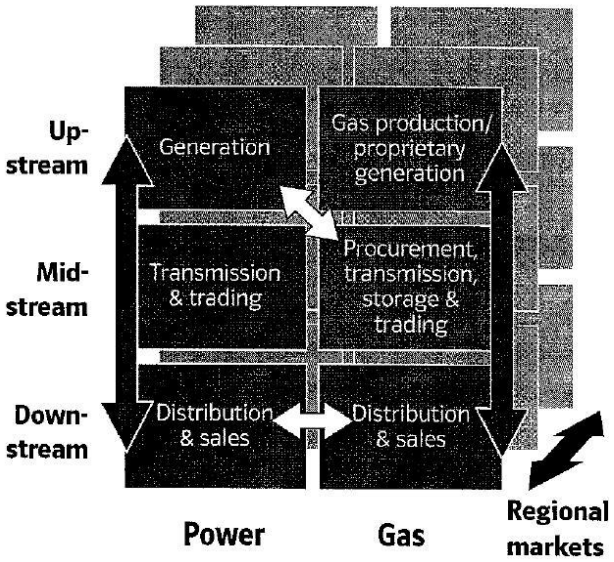
(ii) Retail supply of electricity to small commercial and industrial customers in Hungary,

(iii) Retail supply of electricity to residential customers in the Hungarian RDCs' areas.

VI. COMPETITIVE ASSESSMENT

(280) Respondents to the Commission's market investigation have expressed concerns at all levels of the gas and electricity supply chains, from the upstream level of gas procurement to the downstream level of electricity production and supply. They underline that direct access to gas is essential for gas and electricity retail activities as well as for the production of electricity in Hungary. In view of these concerns, the Commission has carried out a detailed assessment of the impact of the proposed transaction on the gas and electricity markets defined in recitals 141 and 279, with the exception of five markets which are not affected by this transaction (the market for the distribution of gas in the Hungarian RDCs' areas, the market for the transmission of electricity in Hungary, the market for the distribution of electricity in the Hungarian RDCs' areas, the market for the provision of balancing power in Hungary, and the market for the wholesale supply of electricity to MVM in Hungary).

Gas and electricity supply chain (simplified flow chart):



Source: E.ON's reply to the Commission request for information dated 18 July 2005 – Binder Supplement I

(281) Prior to the transaction, MOL already has an almost exclusive control over the Hungarian gas infrastructures and supply contracts. The group also owns all the Hungarian gas storage facilities and has a quasi-monopoly on the gas wholesale markets. The essential change brought by the proposed transaction is that E.ON, unlike MOL, has strong market positions in the retail supply of gas through its majority and minority ownership in three gas RDCs, in the generation of electricity, and in the retail supply of electricity through its majority ownership in three electricity RDCs and its trading subsidiary E.ON EK.

(282) Therefore, the proposed merger will create a fully vertically integrated entity along the gas and electricity supply chains. The Commission has established on the basis

of its investigation and its economic assessment that such integration will directly result in the new entity having the ability and the incentive to significantly impede competition on the downstream gas and electricity markets by raising rivals' costs or by foreclosing their access to gas resources.

(283) The Commission's competitive assessment of the transaction has been achieved both under the current regulatory framework and under the future regulatory framework. For the reasons developed below, competition concerns will arise in the gas and electricity sectors immediately after the transaction, already under the current regulatory framework. The concerns will be even greater when the regulatory framework will be modified, as expected by all market operators, in order to complete the liberalisation of the Hungarian gas and electricity sectors.

A. MOL WMT holds a dominant position in the wholesale supply of gas in Hungary

(284) Prior to the liberalization of the Hungarian gas sector, MOL was the legal monopolist for the wholesale supply of gas in Hungary. On the regulated segment of the market which still coexists with the liberalized market in the Hungarian hybrid model, MOL WMT retains its former monopoly rights. On the open segment of the gas markets, MOL WMT is currently dominant on all the markets for the wholesale supply of gas in Hungary (gas traders and large power plants) and its dominant position is not likely to be threatened in the short to medium term by new entry for the following reasons.

(285) In order to compete on the gas wholesale markets in Hungary, it is necessary to have: (i) access to a competitive source of gas in sufficient quantities[108]; (ii) non-discriminatory access to the transmission network, in particular cross-border entry points (and to the distribution network, for customers connected to a distribution network); and (iii) access to storage (to respond mainly to seasonal variations in the gas consumption of customers). It is also necessary to obtain the relevant licenses from the HEO, although the investigation has not revealed any particular difficulties in this respect.

(286) The market investigation has revealed the existence of significant barriers to entry on the Hungarian gas market. The main problem faced by new entrants in Hungary, including international energy operators, is the difficulty to access to competitive sources of gas, and the lack of liquidity[109] on the Hungarian gas wholesale markets. In addition, MOL WMT derives significant advantages from its incumbency position, notably in terms of balancing on the transmission network and storage costs (synchronicity).

(287) There are basically two main possibilities to obtain natural gas for Hungary: domestic production and imports of gas. In 2004, gas imports accounted for around 80% of Hungary's total gas consumption and this share is expected to increase as

[108] See notably the response of EMFESZ to Questions to Question 23 d) and 25 d) of the request for information of 19 July 2005.

[109] Lack of market players and offers on the gas "secondary market" (sale of gas between gas traders).

domestic gas production gradually declines and gas consumption increases. Prior to the transaction, MOL WMT already controls almost all gas sources available for Hungary. Following the transaction, the new entity will continue to have an almost exclusive control over all competitive gas sources for the Hungarian gas market.

(i) MOL WMT controls domestic gas resources

(288) Access to Hungarian domestic gas production is relevant for the assessment of the transaction as it constitutes one of the potential gas sources for new entrants and as it is currently a competitive gas source. The following section will demonstrate that the new entity will have control over these gas resources for at least three years and that the quantities of gas available for third parties in the subsequent years will in all cases be limited.

(289) Hungarian gas is competitive compared to imported gas[110]:

	2004	
MOL E&P	Gas total production cost	[25-35]* HUF/m³[111]
	MOL WMT average purchase price	[25-35]* HUF/m³[112]
Imports	MOL WMT average purchase price through the Beregovo pipeline	[25-35]* HUF/m³
	MOL WMT average purchase price through the Baumgarten pipeline	[25-35]* HUF/m³
	MOL WMT average purchase price	[25-35]* HUF/m³

Hungarian domestic gas production

(290) The Hungarian domestic gas production is not negligible and amounted to approximately 3 bcm in 2004, accounting for about 20% of the total national gas consumption. This domestic production is however declining and is expected to decrease from around [1-4]* bcm in 2005 to [1-4]* in 2015. MOL E&P accounts for the vast majority of the Hungarian domestic production. Two US companies, El Paso and POGO (now Toreador), have acquired exploration blocks to carry out gas exploration activities. At the moment, however, only El Paso produces marginal quantities of gas (35 million m^3 in 2004) sold to MOL.

The Supply Agreement

(291) As already indicated, MOL E&P is not being acquired by E.ON under the proposed transaction. Therefore the domestic gas resources belonging to MOL E&P will not be controlled by E.ON. However, MOL WMT and MOL E&P have signed, as part of the transaction, a long term supply agreement ([…]*) that entered into force on 1

110 See the Parties' submission dated 5 July 2005.

111 MOL submission dated 8 September.

112 In their reply to the SO, the parties claim that the lower average price of domestic gas is due to its lower calorific value. According to the parties, domestic gas and imported gas have the same price if calorific values are taken into account.

July 2005 (the "Supply Agreement"). The subject matter of the Supply Agreement is the delivery of domestic natural gas volumes produced by MOL E&P to MOL WMT.

(292) The volumes of gas to be delivered by MOL E&P to MOL WMT under the Supply Agreement (Contracted Volumes) are set by reference to MOL E&P's gas production forecasts. MOL's current gas production forecasts are set out in Annex 7 of the Supply Agreement. MOL E&P has the obligation before 10 March every year to update its production forecasts for the remaining duration of the Supply Agreement.

(293) The Supply Agreement foresees […]* to be contractually delivered for the […]* which correspond to MOL E&P gas production forecasts and are binding for those three years.

(294) For the subsequent gas years, the Supply Agreement requires MOL E&P to provide by the 31st March preceding (e.g., by 31 March […]*) the contracted volumes which MOL E&P has the obligation to supply and MOL WMT the obligation to purchase. The Supply Agreement contains minimum delivery quantities of [0.5-2]* bcm for the gas year […]* and [0.5-2]* bcm for the gas year […]* and maximum quantities of [1-3]* bcm from the gas year […]* to […]*. The Supply Agreement foresees a flexible system on the basis of which the actual yearly contracted volumes to be set by MOL E&P may deviate from its revised gas production forecasts, but by no more than 30%. In addition, the Supply Agreement states that MOL E&P has the obligation to make "*reasonable efforts*" in order to be able to set the gas production forecasts and the gas contracted quantities "*as close to each other as possible*".

(295) The Supply Agreement provides for a price formula, which takes into account a number of factors and is essentially linked to the […]* of natural gas in Hungary.

Availability of domestic gas for third parties

(296) On the basis of the terms and conditions set by the Supply Agreement and of the Commission's interpretation of the provisions relating to "Contracted Volume" in the Supply Agreement (including the […]* envisaged therein)[113], the Commission has calculated the amounts that are likely to be delivered to MOL WMT in the gas years covered by the Supply Agreement. The results of these calculations are illustrated in the table below:

[113] Response of E.ON of 6 July 2005 to Questions 5 and 6 of the Commission's request for information of 29 June 2005.

Quantities in million m³	MOL E&P Production Forecast		MOL WMT Contracted quantities	
	Total (1)	From existing fields (2)	Normal (3)	Min (4)
2005/2006	[1500-3000]*	[1000-2500]*	[1500-3000]*	[1000-2500]*
2006/2007	[1500-3000]*	[1000-2500]*	[1500-3000]*	[1000-2500]*
2007/2008	[1500-3000]*	[1000-2500]*	[1500-3000]*	[1000-2500]*
2008/2009	[1500-3000]*	[1000-2500]*		[1000-2500]*
2009/2010	[1500-3000]*	[1000-2500]*		[1000-2500]*
2010/2011	[1500-3000]*			[1000-2500]*
2011/2012	[1500-3000]*			[1000-2500]*
2012/2013	[1500-3000]*			[500-1500]*
2013/2014	[500-1000]*			[500-1500]*
2014/2015	[500-1000]*			[500-1500]*

(297) Figures in column 1 reflect MOL E&P total production forecasts as indicated in Annex 7 of the Supply Agreement, including both expected production from existing fields and expected production from new fields, not yet exploited by MOL E&P.

(298) Figures in column 2 reflect MOL E&P expected production of existing fields, already currently exploited. The Commission considers that these figures could represent a worst case scenario in case of difficult or unsuccessful exploitation of MOL E&P new gas fields.

(299) Figures in columns 3 and 4 indicate the volumes of gas to be delivered by MOL E&P to MOL WMT under the Supply Agreement and on the basis of three scenarios (Normal and Min) taking into account the […]* foreseen by the Supply Agreement[114].

(300) Based on MOL's current production forecasts, the Commission has estimated the resulting gas volumes which may be available on the market for third parties in the three different scenarios:

[114] The Agreement contains […]* for duration of the contract. Delivered quantities should also remain in a range of […]* around MOL E&P production forecast after the gas year […]*.

Gas year	Quantities of MOL E&P production available for third parties (in million m^3)		
	Normal (1)-(3)	**Worst case**	**Best case (1)-(4)**
2005/2006	[0-500]*	[0-500]*	[0-500]*
2006/2007	[0-500]*	[0-500]*	[0-500]*
2007/2008	[0-500]*	[0-500]*	[0-500]*
2008/2009		[0-500]*	[500-1000]*
2009/2010		[0-500]*	[500-1000]*
2010/2011		[0-500]*	[500-1000]*
2011/2012		[0-500]*	[500-1000]*
2012/2013		[0-500]*	[500-1000]*
2013/2014		[0-500]*	[500-1000]*
2014/2015		[0-500]*	[0-500]*

(301) The chart below (established by the Commission on the basis the Supply Agreement) gives a visual illustration of the very limited availability (if any) of domestic gas to third parties, even in the best case scenario:

Mol E&P's production available to third parties
(in million m³)

[…]*

Source: E.ON's reply to the Commission's request for information of 18 July 2005, Annex 21

Gas years […]* *to* […]*

(302) The Commission has focused its assessment on the impact of the Supply Agreement on the […]*, with the goal of assessing whether domestic gas produced by MOL E&P will be available on the market for third parties or not. As regards the subsequent years, the parties themselves acknowledge that […]* it is difficult to predict which quantities of gas will actually be produced by MOL E&P, as it depends on its exploration activities, and which quantities will actually be delivered to MOL WMT on the basis of the Supply Agreement.

(303) As shown clearly by the figures and the chart above, only marginal volumes of gas will be available on the market for […]* and only in the best case scenario. These gas quantities, ranging between [200-600]* million m³, only represent [0-5%]* of the total expected Hungarian consumption needs.

(304) The parties claim (also in their reply to the SO) that MOL WMT has no "*exclusivity rights*" over MOL E&P gas production, as no outright exclusivity clause is foreseen in the Supply Agreement. MOL E&P could theoretically sell gas produced from new fields and in excess of its production forecasts to third parties.

(305) The Commission acknowledges that the Supply Agreement does not expressly provide MOL WMT with exclusivity purchasing rights over all of MOL E&P's domestic gas production. The Commission however considers that the most relevant figures to assess MOL E&P gas production quantities are MOL E&P's own current production forecasts. It should be pointed out that these figures already include expected production from new gas fields.

(306) As the Supply Agreement explicitly indicates that the contracted gas quantities are MOL E&P's production forecasts […]*, the Commission concludes that no domestic gas (at most minimal quantities due to […]*) will be available for third parties during this period.

(307) At any rate, most crucially, in their reply to the SO, the parties do not contest the Commission's finding that as a result of the Supply Agreement practically no quantities of domestic gas would be available for third parties on the market during the first three years. The parties state that "*already […]* the agreement in fact allows MOL E&P significant discretion in deciding the amount of gas to be supplied to ERI/WMT*" while acknowledging that "*the forecast for […]*) is binding*". Implicitly, they do not contest the Commission's finding that, as a result of the Supply Agreement, access to domestic gas will in practice be foreclosed to the new entity's gas and electricity competitors for at least […]*.

Gas years […]* *to* […]*

(308) As regards the subsequent gas years, gas quantities potentially available to third parties increase to a maximum of [500-1300]* million m³ in […]* in the best case, due to more flexible contracted volumes in the Supply Agreement. Although the Commission agrees with the parties that the quantities of domestic gas available to third parties after the […]* period cannot be precisely evaluated, it should be noted that the Supply Agreement will in any case not allow third parties to have access to more than [25-35%]* of MOL E&P's gas production until 2014/2015 (slightly higher share taking into account the […]*).

(309) The parties state, in their reply to the SO, that the figures elaborated by the Commission constitute a "*misrepresentation of the underlying agreement*" and that the Commission has made a "*significant factual error of assessment in its reading of the long-term supply agreement between MOL E&P and MOL MWT*"[115]. The parties however do not contest explicitly any of the figures presented in the tables in recitals 296 and 300. The Commission also underlines that this presentation is not only not misleading but even favourable to the parties as it only shows the figures for the "best case" scenario.

(310) In their reply to the SO, the parties state that "*after the gas years […]* and certainly after […]*, a very significant if not all of the domestic production of MOL E&P will be available to be sold to third parties*" and that these quantities "*will continue to represent almost [15-25%]* of Hungarian gas consumption from 2008 to 2010"*[116].

[115] Parties' reply to the SO, II.4, page 17.

[116] Parties' reply to the SO, II.4, page 17.

(311) The Commission underlines that the [15-25%]* figure mentioned by the parties assumes that the entire domestic production would be available to be sold to third parties after the first three years of the contract, which seems at odds with the conclusion of a ten-year supply agreement between MOL E&P and MOL WMT. The Commission recognizes that MOL E&P's production forecasts beyond the gas years […]* is not binding. This gives MOL E&P some flexibility in its gas production activities, but not as regards the quantities that it is obliged to supply MOL WMT under the Supply Agreement which are based on MOL's production forecasts. The Commission notes that MOL E&P may not deviate by more than […]* from the production forecasts in setting the contracted quantities, and even has an obligation to make *reasonable efforts* to set the contracted quantities as close as possible to the gas production forecasts. In view of the figures presented above in recitals 296 and 300 (based on MOL E&P's current production forecasts and not contested by the parties), the Commission therefore estimates that the quantities will represent at most [5-15%]* of total expected Hungarian consumption needs. The quantities are in any case largely hypothetical and decline with the national gas production.

(312) The parties also argue that "*the proposed transaction can only improve the potential for access to domestic gas production… [as it] creates the possibility of access by others, since the contracts with MOL exploration and production business falls short of either full ownership or exclusivity*"[117].

(313) The Commission acknowledges that the transaction, by which E.ON acquires MOL's gas wholesaling, marketing and trading business (MOL WMT) while MOL retains its gas production business (MOL E&P division), leads to an "ownership unbundling" of domestic gas resources by separating the supply and production activities of MOL. While prior to the transaction, MOL had no incentive to sell gas to any other third party that would have competed with its affiliate MOL WMT, MOL may as a result of the transaction have an incentive to also sell gas to unaffiliated parties.

(314) However, in the Commission's view, this positive unbundling is strongly mitigated and offset by the ten-year supply agreement for domestic gas concluded, as part of the transaction, between MOL E&P and MOL WMT. To the extent of the volumes and duration of the Supply Agreement, MOL has already tied its "new freedom" to sell its domestic gas to whomever it pleases after the transaction. As demonstrated above, this agreement reserves most of MOL's future gas production for MOL WMT.

(315) In addition, as MOL retains a 25%+1 shareholding in MOL WMT, the transaction does not remove all structural links between MOL E&P's domestic gas production and MOL WMT, contrary to what the parties claim. As a result of this structural link, MOL would still have the incentive to favour MOL WMT over third party traders in the sale of its domestic gas production[118]. MOL would naturally favour a

[117] Parties' reply to the SO, Annex I, p. 11.

[118] To avoid any potential confusion, the Commission does not state that MOL E&P's incentive to favour MOL WMT results from the proposed transaction. The Commission simply takes the view that the 25% minority shareholding that MOL will retain in MOL WMT will maintain MOL E&P's incentive to favour MOL WMT post transaction.

company in which it holds shares over any other company in view of its financial interest arising from the possibility to receive dividends and to obtain capital gains on the increase in value of its shareholding resulting from MOL WMT's greater profitability (even if no dividends were distributed). The […]* foreseen in the Supply Agreement may therefore lend themselves to being interpreted and resorted to so as to reduce the availability of gas to third parties.

(316) The parties' argument that the Supply Agreement is necessary for MOL WMT to achieve […]*, notably for its […]*, does not appear convincing.

(317) As a matter of fact, if gas suppliers other than MOL WMT were ever to purchase gas from MOL E&P, it would be by definition to serve customers in the liberalised sector. In view of the current "infancy" state of the liberalised sector in Hungary, these customers will have, in all likelihood, just exited the regulated segment of the market and signed a supply agreement with a gas trader. The amounts of gas previously needed by MOL WMT (or by any of the RDCs, which are, for the regulated segment of the market, exclusively supplied by WMT) to supply these customers will no longer be needed. Hence, MOL WMT will not need to retain gas resources to serve customers which are no longer in its portfolio.

Conclusion on access to domestic gas resources

(318) The Commission believes that, even in the absence of a formal contractual exclusivity clause in the Supply Agreement (agreement between MOL and MOL WMT regarding MOL E&P domestic production), most (if not all) gas produced in Hungary by MOL E&P will be "captive" of MOL WMT, at the very least for the […]* of validity of the Supply Agreement and most likely also for the remainder of the contract[119].

(319) The Commission's market investigation has confirmed that the Supply Agreement will de facto provide the new entity with an exclusive control over the access to Hungarian domestic gas production and will prevent access to this resource by third parties during at least three years.

(ii) MOL WMT controls competitive import sources

(320) As indicated, there are only two entry points through which gas is imported into Hungary: Beregovo at the Ukrainian border and the HAG at the Austrian border.

[119] To avoid any potential confusion, the Commission does not state that third parties' access to domestic production will be reduced as a result of the proposed transaction. The Commission however concludes from the new Supply Agreement concluded between MOL E&P and MOL WMT (as part of the transaction) that the new entity will have an almost exclusive access to domestic gas production during […]* (as MOL WMT before the transaction). This strongly offsets any pro-competitive effect that the (partial) unbundling realised by the proposed transaction between MOL E&P and MOL WMT may have had.

a. Competitive gas import sources in Hungary

(321) With the exception of marginal quantities of Turkmen gas, all gas imported into Hungary is of Russian origin (i.e. Gazprom)[120]. The market investigation has established that the only competitive source of gas in Hungary is coming from Russia, either Russian gas sourced from Gazprom or gas sourced from another country in the Commonwealth of Independent States ("CIS")[121], but which needs to be transported through Russia and Ukraine (via transit pipelines under the control of Gazprom).

(322) Hungary is not geographically close to and/or connected through existing pipelines to other sources of gas in Europe, such as Norwegian gas, Dutch gas, Algerian gas or Middle East and Caspian gas. There is also no LNG (Liquefied Natural Gas) terminal close to Hungary. The HEO estimates that, due to the distance between Hungary and the gas sources and based on the current conditions of supply, the access to competitive alternative sources of gas is limited for Hungary. Due to the direction of gas flows and transportation costs, North African gas by pipeline or delivered as LNG to a North Adriatic port (e.g. Omisalj) is in any case more expensive than Russian gas. Due to North Sea gas flows directions, the only possible solution to source gas from this region is swapping, but the resulting gas price only matches the Russian import price in the best case scenario.

(323) Alternative gas sources are not expected to be available in Hungary before 2011 with the completion of the Nabucco pipeline, through which gas from the Middle East (Egypt, Iraq, Iran) and the Caspian area could be imported. The other envisaged pipeline projects between Hungary and Slovakia and between Hungary and Romania, if ever constructed, would not bring additional sources of gas into Hungary as Slovakia is also supplied by Russian gas and as Romania initially only intends to import gas from Hungary due the decrease in its national production.

(324) In their reply to the SO, the parties do not dispute that the only competitive sources of gas in Hungary are currently Russian and/or CIS gas.

b. MOL WMT's gas sourcing portfolio

(325) As indicated, prior to the market opening, MOL had a monopsonistic position on all gas procurement activities, with exclusive rights to purchase Hungarian gas and to import gas into Hungary. In order to secure its gas supply, MOL WMT has entered into long-term supply agreements with […]* to import gas through the Hungarian Western and Eastern entry points.

Overview of MOL WMT's existing long-term gas import contracts

[120] Gazprom ultimately controls, directly or indirectly, also the access to Turkmen gas, as indicated by both EMFESZ and Centrex, the two trading companies importing (or planning to import) Turkmen gas into Hungary.

[121] In particular gas from Turkmenistan.

[…]*[122]

(326) As can be seen from the above table, MOL WMT has […]* import contracts with […]*, which account for the vast majority of its gas imports. MOL WMT purchases approximately [5-20]* bcm from Gazprom/Gazexport through Panrusgáz, its joint venture with Gazprom/Gazexport, which is delivered at the Beregovo (81.4%) and HAG (18.6%) entry points.

(327) MOL WMT also purchase [0-2]* bcm of gas annually from EMFESZ, a Hungarian company affiliated with Eural Trans Gas. MOL initially concluded the contract with Bohlti Trade, a Swiss Company also affiliated to Eural Trans Gas to ensure Hungary's winter gas supply, at a price that is *"lower than the main market (dominant) PRG [Panrusgáz] price"*[123]. Eural Trans Gas is a Hungarian-registered company which is the sole distributor of Turkmen gas *"with Gazprom and NAK Ukrainie support"*[124]. Bothli-Trade subsequently assigned its two gas supply contracts with MOL WMT to EMFESZ Kft.[125].

(328) Finally, MOL WMT purchases [0-2]* bcm/year from E.ON and [0-2]* bcm/year from […]* at the HAG entry point. This gas is approximately […]* more expensive than the gas purchased from Gazprom/Gazexport via Panrusgáz or from EMFESZ. It is supplied from […]* on the basis of their overall gas purchase portfolio, although physically it is Russian gas. This gas is clearly not competitive with the direct Russian gas supply from Gazprom/Gazexport.

(329) In particular, gas imported through the Western entry point is less competitive due to the cost of transit through Slovakia and Austria, which is estimated at 4.0 HUF/m³ (or approximately [10-20%]* of MOL WMT's average gas purchasing price[126]). A third party active in gas has stated that "*In theory, the minimum price difference for gas between Beregovo and Mosonmagyaróvár corresponds to the transport costs through Slovakia to Baumgarten, plus the transport costs through the HAG system, it can be estimated at around 1,3 - 1,6 €/MWh according to the conditions of delivery. In reality, this difference can be much higher as the prices at Baumgarten and at Beregovo are not linked. Indeed, the specialized press mentioned prices above 21 €/MWh at Baumgarten during the last Econgas' auctions, and prices below 15 €/MWh at the Ukrainian border.*"

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[122] The contract started […]*; the normal annual quantity is [0-3]** bcm.

[123] […]* ; and minutes of the meeting with EMFESZ on 28 July 2005, p. 2: *"Since 1 January 2005, EMFESZ is selling 1.2 bcm to MOL WMT. EMFESZ believes that it is selling to MOL WMT for its gas needs as a trader licensee (and not as a public utility wholesaler licensee). MOL WMT buys from EMFESZ the additional quantities it needs in winter, and buys a stable quantity throughout the year under its contract with Gazprom."*

[124] […]*.

[125] […]*.

[126] Assuming a wholesale gas price of [25-35]* HUF / m^3.

(330) The parties indicated that the cost of transit of gas through the SPP network in Slovakia amounted to [0-2]* EUR/MWh under the presumption of 10 million m³/day, in addition to which customers have to contribute fuel gas in kind amounting to [0-5%]* of transported volumes[127]. Assuming a cost of gas of approximately [28-32]* HUF/m³, the total cost of transportation through the SPP network is [2-4]* HUF/m³. Tariffs on the HAG pipeline were provided by OMV, owner of the pipeline, and amount to approximately [0-1]* HUF/m³ under the assumption of a 3 year capacity booking for 1 bcm/year.

(331) As mentioned above in recital 40, the gas supply contracts with E.ON and GDF were entered into by MOL in order to diversify its gas sourcing portfolio, thereby increasing the country's security of supply, under the pressure of the Hungarian government.

(332) It follows that anyone wishing to compete with MOL WMT on the market for the wholesale supply of gas in Hungary must have access to Russian gas (or gas from CIS countries transiting through Russia); and must preferably source a significant part of its gas portfolio through the Eastern entry point (the more competitive entry point)[128]. The market investigation has clearly indicated that, until there are no alternative independent sources of gas (such as the Nabucco pipeline in 2011-2012[129]), all gas sources will be controlled by Gazprom and no competition will be able to develop on the Hungarian wholesale gas markets.

c. Difficult access to Russian gas

(333) The market investigation has shown that it is currently difficult for new entrants to get access to Russian gas in parallel to MOL WMT's existing contracts. It appears that there would be no incentive on the part of Gazprom to sell "more" gas for exports to Hungary, other than the gas necessary to meet the 2% yearly demand increase, to cover the "supply gap" between the future increase in the Hungarian demand and the demand already covered by the existing long-term import contracts of MOL WMT.

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[127] Submission of the parties dated 14 October 2005.

[128] Response of Euro-Bridge to the request for information of 3 June 2005 ("*According to our experience, seeing the situation in the Hungarian gas industry and in particular with regard to E.ON's planned steps, we have doubts if there will ever be a real competitive market and competitive conditions in Hungary, as:*
- *The gas supply is practically dependent upon one gas source (the Russian Gazprom) coming through the Eastern cross-border pipelines. The Western pipeline has small capacity and only has a strategic role in case there is turmoil in the Eastern side. The gas coming from West (Russian as well) has a significantly higher price level, the Hungarian consumers could not afford purchasing exclusively this gas;*
- *The country's gas supply is practically in MOL's hands, the gas distribution companies buy gas from MOL, as there is no other more economic way. It is very obvious, that new market player cannot enter the market without the approval (interests) of MOL and Gazprom (an example of this is RoszUkrEnergo or EMFESZ)*").

[129] Although according to the HEO, due to the 3,000 kilometres pipeline planned, gas from the Middle East is not likely to be cheaper than the Russian gas.

(334) Gazprom already supplies through Panrusgáz, its joint venture with MOL, gas quantities covering most of the needs of Hungary. The Commission believes that it is not possible to purchase gas from Gazprom to compete with MOL WMT: first, Gazprom has no incentive to sell gas to another gas trader at a cheaper price that would compete with the quantities it sells to MOL WMT through Panrusgáz and the quantities sold would simply displace the quantities it already sells for the Hungarian market[130]; secondly, the only incentive would be if Gazprom could sell gas at a higher price. However, the gas Gazprom would sell at a more expensive price would not be competitive in Hungary unless the entrant was able to operate at a lower cost than MOL WMT, in spite of the latter's incumbency advantages, or if the price was not substantially higher.

(335) In other words, it appears that Gazprom has no incentive to supply additional competitive gas to E.ON or any other operator(s) to the extent that it only risks displacing/out-pricing its current sales.

(336) If anything, MOL WMT's privileged access to Russian gas (due to Gazprom's current lack of incentives to support independent entry of competitors of MOL WMT) will be strengthened due to the privileged relationship and strategic partnership between Gazprom and E.ON. In view of the fact that access to competitive gas (namely Russian gas or CIS gas transiting through Russia) is the main barrier faced by new entrants, the Commission believes that the new entity will be no less, or even more, dominant after the transaction, compared to MOL WMT prior to the transaction.

(337) It is indeed even less likely that Gazprom would support the massive entry of a competitor of MOL WMT after the transaction in light of the close links and strategic partnership of Gazprom and E.ON. In particular, E.ON has a 6.5% ownership in Gazprom[131] and has a representative at Gazprom's Board of Directors. The two groups have entered into various large scale and long-term supply agreements and intend to further expand their cooperation in various areas, as stated in […]*. There also appears to be an agreement signed between Gazprom and E.ON to coordinate moves related to privatization of gas industry facilities, transit gas pipelines in Slovakia, Czech Republic and Hungary[132].

(338) In addition, the Hungarian press recently referred to plans of Gazprom to become a shareholder in MOL WMT or in other E.ON downstream subsidiaries[133]. This is […]*[134]. E.ON has […]*[135].

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130 A third party active in gas has stated that "*Supply in Hungary is dominated by Panrusgáz which buys from Gazprom. We do not think that a merger would change the situation as on the one hand long term supply contracts exist and on the other hand Gazexport has a stake in Panrusgáz. We do not think that Gazexport will create its own competition by supplying gas to new companies at lower prices.*"

131 E.ON has a 3.5% direct shareholding in Gazprom and a 3 % indirect shareholding through the Gerosgaz JV, an OOO Gazexport and Ruhrgas AG JV, created in 1999.

132 *See* Gazprom's website http://www.gazprom.ru/eng/articles/article8925.shtml, as of July 6, 2005.

133 *See*, *e.g.* Agence France Presse of 1 April 2005 *Gazprom intéressé par 11,8% de MOL*.

(339) It is fair to say that E.ON (which will take over MOL WMT's position as Gazprom's partner in Hungary after the implementation of the transaction) is a more significant and valuable partner of Gazprom than MOL was prior to the transaction for several reasons. E.ON purchases greater volumes of gas from Gazprom in Europe and, given its extensive presence in European markets, is a more privileged partner than MOL to help Gazprom achieving its strategy to enter downstream European gas markets. Furthermore, as regards gas transportation, Germany, due its central position in Europe, is an essential transit country to reach significant gas markets, in particular France and the UK[136]. Finally, E.ON (along with Wingas) will be a partner of Gazprom for the construction of major new pipeline between Russia and Western European markets (Baltic pipeline).

(340) In conclusion, no competitor of MOL WMT can enter the Hungarian gas market without the approval and support of Gazprom and E.ON/MOL and at most only for limited quantities corresponding to the future "supply gap" in Hungary. The table and charts below illustrate this "supply gap" and evidence the limited possibility for additional gas imports into Hungary:

Data in million m³	**Total Hungarian gas demand**	**Hungarian domestic production**	**Total import quantities forecasted by E.ON/MOL under long-term contracts**	**"Supply gap"**
2005	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2006	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2007	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2008	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2009	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2010	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2011	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2012	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2013	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2014	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*
2015	[13000-20000]*	[1000-3000]*	[11000-13000]*	[0-4000]*

Source: E.ON's reply to the Commission's request for information of 18 July 2005, Annex 21

134 Niederschrift über die Sitzung des Vorstands der E.ON Ruhrgas International AG am 9. August 2004, per Telefonkonferenz, Vorlage für den Vorstand, p. 7, Annex 8 of Form CO.

135 Response of E.ON of 10 May 2005 to question 19 on draft Form CO.

136 See, e.g., article "Russian' energetic enigma" in The Economist of 6 October 2005: "*Last month, Mr Putin and Gerhard Schröder, Germany's chancellor, presided over the launch of Gazprom's latest mega-project: a €4 billion ($5 billion) pipeline that will run under the Baltic Sea to Germany, Gazprom's biggest foreign customer, and thence, eventually, to Britain. Mr Putin again extolled the scheme's importance at the EU-Russia summit this week. Almost half of the European Union's gas imports come from Russia. European demand is expected to double between 2000 and 2030. Gazprom and the Russian government say that the Baltic pipeline is a useful way to diversify supply routes to a growing market.*"

Hungarian gas supply

[…]*

Source: E.ON's reply to the Commission's request for information of 18 July 2005, Annex 21

(341) The difficulty/marginality of "independent" entry is evidenced by the entry of EMFESZ, the only entrant so far, and the planned entry of CENTREX, while other more established Western European market players also outlined the difficulty to enter the Hungarian gas market.

EMFESZ

(342) EMFESZ is the only new entrant on the Hungarian gas markets as of July 2005. The company purchases gas from Turkmenistan and has gained half of the customers that have switched to the open segment of the market. The gas supplier of EMFESZ is RosUkrEnergo (also referred to as RosUkrGazprom[137]), a Swiss-registered company owned 50% by Gazprombank and 50% by Raiffeissen Investment AG, an Austrian investment company[138].

(343) The market investigation has suggested that EMFESZ' entry has been facilitated by Gazprom and MOL WMT. It depends on MOL for its access to customers and infrastructures (in particular it depends on a gas swap with MOL WMT to meet the 80/20 rule)[139]. The main customers of EMFESZ are MOL WMT ([0-2]* bcm/year, see Bothli-Trade contracts in the table in recital 325) and Nitrogenművek, an industrial customer that is allegedly managed by former MOL executives ([0-2]* bcm/year) [140]. According to some market respondents, the other customers targeted and quantities supplied by EMFESZ are not so significant[141]. EMFESZ itself planned to supply 0.3 bcm of gas in Hungary in the first year of its entry and up to 1 bcm in the long term[142]. The company currently supplies approximately 0.5 bcm to

[137] *See* the article in the issue of 23 August 2005 of *European Gas Markets* (published by Heren Energy) "*RosUkrEnergo's activities scrutinised*".

[138] It is however unclear whether EMFESZ can become a long-term player on the Hungarian gas market as its supplier RosUkrEnergo is being investigated in the Ukraine. *See, e.g.*, front page article in the Financial Times of 27 July 2005 "*Probe into criminal link to Gazprom company*"; article in the European Gas Markets (published by Heren Energy) of 23 August 2005 "*RosUkrEnergo's activities scrutinised*". As a result, some multinational customers indicated that they would not purchase gas from EMFESZ due to concerns as to its reliability and bad reputation

[139] Response of EMFESZ to Question 42 of the request for information of 3 June 2005; minutes of meeting with EMFESZ on 28 July 2005.

[140] To avoid any potential confusion, the Commission does not state that MOL has an ownership interest or voting rights in EMFESZ or in Nitrogenművek.

[141] Response of Euro-Bridge to the request for information of 3 June 2005; minutes of the teleconference with Centrex on 9 August 2005.

[142] Response of EMFESZ to Question 13 k) of the Commission's request for information of 19 July 2005.

other customers. EMFESZ's dependency upon/cooperation with MOL is confirmed by […]* [143].

CENTREX

(344) Centrex Hungary is a start up company, wholly-owned by Centrex Europe Energy and Gas AG, an Austrian group founded in April 2004. The Hungarian subsidiary was created in September 2004 to start activities on the Hungarian energy markets. CENTREX does not yet have any trading activities or customers but has already planned its entry on the Hungarian gas markets and to reach sales of approximately 0.5 bcm the first year of its entry and 2 bcm in the long-term[144].

(345) CENTREX has privileged access to competitive gas sources through its cooperation with Gazprom. In particular, CENTREX executives claim to have close personal relationships with Gazprom executives[145]. In Hungary, the company intends to import gas produced by the Centrex group through gas consortiums with Gazprom (in that case it depends on Gazprom to transport its gas to the European markets of Centrex) and gas procured from Gazprom. The company is currently negotiating its gas supply agreements with Gazprom.

Western European market players

(346) The other European importers/wholesalers which already purchase gas from Gazprom at delivery points close to Hungary (such as GDF, OMV and ENI/Italgas in Baumgarten) do not appear to be potential competitors of MOL WMT[146]. The main reason is that gas available at Baumgarten is not competitive in Hungary. To compete with MOL WMT, these operators would need a more competitive portfolio of gas, with a significant proportion sourced at the Eastern entry point, but Gazprom would most likely not allow these companies to enter the Hungarian gas market (with additional gas sourced at the Eastern border) at the detriment of Panrusgáz and MOL WMT, as explained above in recitals 333 to 340.

(347) This is confirmed by MOL WMT's internal documents that […]* the risk of new entries in Hungary and […]* [147]. E.ON/MOL WMT essentially focuses on the access to gas of the new entrants on the Hungarian gas market when assessing their respective position and strengths, as evidenced by the table below[148]:

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143 Minutes of the Executive Board of MOL of 6 April 2004.

144 Minutes of the conference call with CENTREX of 9 August 2005 and response of CENTREX to Question 13 k) of the Commission's request for information of 19 July 2005.

145 Minutes of the conference call with CENTREX of 9 August 2005.

146 *See*, *e.g.*, the response of FŐGÁZ to question 30 d) of the request for information of 19 July 2005 as regards E.ON's position as potential competitor of MOL WMT: "*Die EMFESZ Kft., CENTREX Rt. und eventuell andere Markteilnehmer mit günstigen östlichen Bezugsquellen hätten bessere Chancen als die E.ON in einer Grosshändlerrolle gehabt.*"

147 Report to the Supervisory Board of MOL of 2 June 2003, Budapest, "Gas Business Situation", slide 6.

148 Response of E.ON to Question 87 of the request for information of 18 July 2005 and Annex 87.

[…]*

(348) Finally, even assuming that other operators could have access to sufficient quantities of gas at the Eastern entry point, the market investigation has clearly shown that MOL WMT controls and saturates the Eastern entry point[149]. There are currently no available free capacities at the Beregovo entry point[150]. As shown above in recital 34, almost all capacities are booked by MOL WMT, as well as by the Serbian company Nis and the Bosnian Herzogovinan company BHGas for transit.

(349) Accordingly, the Commission believes that access to gas from Russia/CIS countries at Hungary's Eastern entry point is essential to compete on the Hungarian gas markets. These gas sources and/or their transport to Hungary is controlled by Gazprom, which supplies gas to MOL WMT, its partner in the country. As evidenced by the parties' internal document, access to competitive gas from Russia / CIS countries therefore constitutes a strong barrier to entry on the Hungarian gas markets.

d. The parties' reply to the SO as regards access to competitive gas imports

Gazprom incentives

(350) In their reply to the SO[151], the parties go a long way to try to *"demystify"* the *"special relationship"* between E.ON and Gazprom, as described by the Commission. The parties' argument is two-fold.

(351) Firstly, it is argued that the Commission is mistaken in considering that the 6,4% shareholding and E.ON's having one representative in Gazprom's supervisory board do imply that the relationship between the two companies is "special". To do so, the parties describe other allegedly "special" relationships that Gazprom would have with other Western companies.

(352) However, what clearly emerges from the parties' line of argument is that none of the other Western companies has a shareholding in Gazprom and/or one representative

149 *See*, *e.g.*, the response of GDF to Question 29 g) of the request for information of 19 July 2005.

150 Minutes of the meeting of 26 July 2005 with the HEO. According to the HEO, the Beregovo entry point is contractually congested (and physically congested in winter), as capacity is booked but not fully used. This contractual congestion is caused by transit. Transit flows to Serbia have seasonal variations because there is no storage capacity in Serbia, so that the transit capacity booked is not fully used during summer. The HEO wanted to force MOL Transmission to use the capacities booked for transit but not used for transit during the summer on the basis of use-it-or-lose-it principle but MOL Transmission brought the demonstration that under their long-term transit contract with the Serbian operator (the capacity is booked on a ship or pay firm basis and the Serbian operator paid for the cost of network development), MOL Transmission cannot use unused capacity for Hungarian transport needs.

151 Parties' reply to the SO, II.3.1, pages 11-13 and annex 1, pages 12-13.

in its supervisory board. These two elements, by themselves, suffice to qualify the E.ON/Gazprom relationship as "privileged" as compared to other allegedly "special" relationships.

(353) Moreover, the parties have not even attempted to dismiss (and not even commented upon) the information contained in paragraph 341 of the SO as regards the possibility that E.ON and Gazprom may agree on Gazprom's acquiring a […]*.

(354) To the Commission's understanding, all this provides sufficient ground for considering the E.ON/Gazprom relationship as "privileged", in spite of the parties' arguments and attempts to dismiss such claims.

(355) Secondly, and most importantly, still with the objective to *"demystify"* the E.ON/Gazprom relationship, the parties argue at length that, regardless of the nature of the relationship between the two companies and also in the absence of the transaction, Gazprom would have no financial incentives to *"undermine the price in existing contracts"*. The parties even quote, as confirmation of their analysis, the Commission's statement that *"it is not possible to purchase gas from Gazprom to compete with MOL WMT: first, Gazprom has no incentive to sell gas to another gas trader at a cheaper price that would compete with the quantities it sells to MOL WMT through Panrusgáz and the quantities sold would simply displace the quantities it already sells for the Hungarian market"* [152].

(356) The parties' argument is simple: *"if matters are so bleak, they cannot get any worse"*. Hence, it is argued that at any rate the *"special relationship cannot make matters worse"*.

(357) The Commission believes that by developing this line of argument the parties have in fact blatantly supported the Commission's assessment of MOL and E.ON relationship with Gazprom and the strategy and incentives of Gazprom for the supply of gas to Hungary.

(358) As a matter of fact, even assuming (for the sake of the argument) that the E.ON/Gazprom relationship is not "privileged", what really matters here is that the essential change brought by the proposed transaction is the creation of a fully vertically integrated entity along the gas and electricity supply chains.

(359) While MOL WMT, even prior to the transaction, had the ability to exploit its dominant position in gas, it lacked any incentives to do so. In the pre-transaction scenario, Gazprom's "financial incentives" not to sell gas to competitors of MOL WMT at lower prices than in existing contracts (as described by both the Commission and the parties) would not give rise to the risk of foreclosure. In the post-transaction scenario, the combination of Gazprom's "financial incentives", which would remain unchanged, and E.ON's incentives, which would change, as compared to MOL's, would directly result in the new entity having the ability and the incentive to significantly impede competition by foreclosing access to gas resources.

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[152] SO paragraph 338.

(360) In conclusion, the Commission first notes that the parties' reply to the SO confirms the assessment in the SO on access to competitive gas for import into Hungary and Gazprom's lack of incentives in supplying gas to other companies in competition with the new entity. Secondly, the Commission does not state that E.ON's privileged relationship with Gazprom will dramatically change the possibilities to import competitive gas in Hungary but simply that it will further limit Gazprom's – already low – readiness to supply others competitors.

Availability of competitive gas in Baumgarten for import into Hungary

(361) In their reply to the SO, the parties dispute the SO's conclusion that competitors of MOL WMT cannot enter the Hungarian wholesale gas market from Baumgarten. According to the parties, several large players in the European gas industry import gas via Baumgarten and could easily divert their imports to the Hungarian gas market. According to the parties, this will be made possible by the upcoming significant gas surpluses which these players will face and the upcoming removal of price regulation in the market to eligible customers in Hungary[153]. According to the parties, Baumgarten (as the marginal entry point) will attract additional imports if Hungarian demand cannot be satisfied through imports made at the Eastern border.

(362) The Commission first notes that the parties do not dispute that currently MOL WMT is more competitive due to its portfolio of existing long-term gas supply contracts[154], and arguably, that the new entity would immediately after the transaction have the ability to discriminate its downstream competitors. In addition, the parties do not dispute that the price of gas available in Baumgarten is higher than MOL WMT's gas prices under its portfolio of existing supply agreements.

(363) The parties however take the view that, at a later stage, imports made through Baumgarten will become competitive. There appear to be three pre-requisites for the competitive scenario presented by the parties in their reply to the SO to unfold: (i) there must be significant gas surpluses that could be diverted to Baumgarten; (ii) there must be significant entry capacity available at Baumgarten; and (iii) there must be price and regulatory changes in Hungary.

(364) The competitive scenario presented by the parties appears speculative and indirect at best and does not address convincingly any of three pre-requisites mentioned above in recital 363.

i) Gas surpluses that could be diverted to Baumgarten

(365) The Commission has not found any compelling evidence as regards the existence or the development of significant gas surpluses that would corroborate the scenario presented by the parties' expert.

153 Reply to the SO, II.1.1, page 6.

154 MOL WMT's current gas sourcing portfolio is comprised at 90% of Russian and Turkmen gas at advantageous prices, which is for 81.4% imported through the Eastern entry point.

(366) First, it is worth recalling that this scenario is in contradiction with MOL WMT's own internal documents quoted at paragraph 349 of the SO, that […]*[155]. The parties do not even try to explain this contradiction.

(367) Secondly, as mentioned above in recitals 355 and 357, the parties do not dispute the argument developed in the SO that Gazprom has no financial incentives to supply at Baumgarten additional volumes of gas for the Hungarian market. This is because by doing so Gazprom would be undermining Baumgarten prices under existing contracts and supporting independent entries in competition with Panrusgáz/MOL WMT. The expert report provided by the parties even develops further the reasons why Gazprom has no financial incentives to sell gas to competitors at lower prices than in existing contracts and undermine Baumgarten prices:

> "*Assume that Gazprom signs a contract with MOL WMT at a high price, and then starts selling gas to a second importer at a low price because the relationship with MOL was not sufficiently special. The new importer could profitably reduce the gas price in Hungary. However, Gazprom would suffer as a result, as its low-priced sales to the second importer would displace the volumes that Gazprom previously sold to MOL. Gazprom would also risk facing demands by MOL to renegotiate the price. The standard European gas contract contains "price re-opener" provisions that protect buyers. The reduced price to the second importer would permit it to sell gas at a discount in Hungary. The discounts would prompt MOL WMT to complain that the market price in Hungary was falling, that the decrease lay beyond MOL's control, and that the gas price charged by Gazprom should fall to the level necessary to restore MOL's profitability. If Gazprom disagreed, MOL could have a neutral arbitrator evaluate the claim. (…)*
>
> *[T]he discussion above suffices to establish Gazprom's incentives. If Gazprom starts selling gas at €1/MWh less than the price under existing contracts, then Gazprom will face two consequences. First, Gazprom will lose €1/MWh on every sale by the new importer who displaces the sale of high-priced gas by existing importers. Second, Gazprom will face the prospect of claims by the existing importers, to reduce the Baumgarten price by €1/MWh. Gazprom therefore opens up the prospect of selling gas to everyone in the market at €1/MWh less than previously. Gazprom's incentives are simple: sell as much gas as possible without undermining the price in existing contracts.*"

(368) As Gazprom is not willing to supply additional gas in competition for the volumes of gas it already supplies via Panrusgáz for the Hungarian market, only operators which *already* have access to competitive (Russian) gas at or near Baumgarten could be in a position to divert this gas to Baumgarten for supply in Hungary. Indeed, other operators with gas delivered far from Baumgarten would incur significant costs of transport to Hungary, which would make such imports non-competitive (assuming that the necessary transit capacity would be available and not fully booked under long-term capacity reservation agreements).

(369) However, it appears that none of the operators having gas in Baumgarten has significant volumes of gas which it could divert to supply the Hungarian gas markets. In particular, earlier expectations of a gas bubble in Italy, on which the

[155] Report to the Supervisory Board of MOL of 2 June 2003, Budapest, "Gas Business Situation", slide 6.

parties rely to a great extent in their reply to the SO, no longer appear likely, on the basis of the latest information from the Italian energy regulator[156]. ENI has been able to renegotiate its gas supply agreement with Gazprom and to reduce the level of its take-or-pay obligations[157]. It appears that gas volumes available to other gas market players in Baumgarten are fully committed under existing long-term supply agreements with other traders/customers, so that these operators would need to source additional volumes from Gazprom to be able to enter the Hungarian gas market[158].

(370) Thirdly, the parties' arguments about surpluses of gas in Western Europe and their export to Hungary do not appear to rely on any solid evidence. The only figures provided to show the existence of gas surpluses are in another study[159] which the expert report refers to. The figures provided by the expert are either misinterpreted or irrelevant for the present case. For example, the report provides data on the capacities of LNG terminals in the South of France and discusses capacities of LNG terminals on the US Gulf Coast, which appear to the Commission of little relevance for the supply of gas in Hungary. In the same way, the graph presenting the balance between supply and demand in Italy (Figure 1, Page 8) clearly shows that TOP supplies are in line with the countries' projected demand, although the report uses it to show the (allegedly) excess of contracted gas over projected demand in Italy.

(371) The expert report provided by the parties states (without any concrete evidence) that there are (will be) gas surpluses in various Western European countries, in particular Spain, Italy and the UK. This would result in gas companies diverting these surpluses to other European countries, in particular France, and would in turn create gas surpluses in France. ENI/Italgas and GDF would then use these surpluses for export into Hungary (Pages 1 to 9 of the Expert Report). As mentioned, this competitive scenario appears at best indirect, and presupposes that all the circumstances on these other European markets be met. The Commission notes that none of these circumstances or their causal relationship is demonstrated by the parties. All the relevant factors that would have to be assessed to support the parties' far-reaching conclusions are not mentioned (let alone analysed) in the report: evolution of gas demand in several European countries and their determining factors, evolution of the competitive environment of the gas sector in several European countries, development of new gas transport infrastructures, etc.

(372) In addition, it appears speculative to assume that any excess volumes (assuming there will be gas surpluses) would be diverted specifically to Hungary and not to

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156 See e-mail of 24 October 2005 from the Italian regulator, Autorità Energia.

157 See, inter alia, Financial Times article of 21 October 2005 "*Gazprom and Eni axe 'outdated' gas deal after contract dispute*": "*Eni will be anxious in any new agreement to preserve significant financial concessions that it won from Gazprom concerning the remainder of the gas that it purchases. Gazprom offered to extend the contract on the gas by 10 years to 2027 with its existing price-setting mechanisms and change a crucial "take-or-pay" clause that could save Eni millions of euros if the gas price fluctuates.*"

158 [Confidential: Statements on gas quantities available in Baumgarten for a certain gas operator]

159 Frisch, Carpenter and Lapuerta: "The Advent of US Gas Demand Destruction and its Likely Consequences for the pricing of Future European Gas Supplies", March 2005

other gas markets with a higher price level. For example, according to E-Control, the Austrian Energy Regulator, the largest part of the gas quantities sold in Econgas' auctions in 2005 was exported to Italy. The Commission therefore concludes that it is currently economically more interesting to export gas available in Austria to Italy than to Hungary. Finally, although it discusses the current and future developments of European gas markets, the other study to which the expert report refers does not even mention the possibility that these surpluses could be exported to Hungary[160].

(373) In view of the above, it appears that the parties' allegations on potential gas surpluses that would be diverted to Hungary through Baumgarten are largely speculative. They are neither supported by any evidence brought forward by the parties nor by the information gathered by the Commission in the course of its extensive market investigation.

ii) Availability of entry capacity into Hungary

(374) In Hungary, the Western entry point has only a 4.5 bcm/year import capacity while the Eastern entry point has approximately an 11 bcm annual capacity for imports into Hungary (4 bcm are reserved for transit). Therefore, in any event, the bulk of the gas used in Hungary will still be imported by MOL WMT (and other new entrants to the extent of Gazprom's support) through the Eastern entry point in the medium term.

(375) In order to import gas from Baumgarten, potential new entrant would have, in addition to sourcing gas, (i) to book transport capacity on the HAG pipeline between Baumgarten and Hungary and (ii) to book cross-border transmission capacity at the Hungarian Western entry point. The market investigation showed that both of these capacities would be difficult to obtain due to the significant share of capacities already booked by MOL.

(376) With respect to the HAG pipeline, the Commission believes that new entrants may face difficulties in obtaining access to transport capacity. As an example, E-Control, the Austrian regulator reported to the Commission:

"At present system access is on the basis of negotiated contracts, and is not regulated. Because of this no information is available as to how long-term transport rights on the transit pipeline are assigned, i.e. who has access to which second-level

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[160] The above-mentioned study of Frisch, Carpenter and Lapuerta takes the view that the construction of planned LNG terminals will nevertheless proceed in the UK, and that, as surplus emerges, UK developers will try to re-export to continental markets through the Bacton-Zeebrugge Interconnector and the Bacton-Balgzand pipeline being constructed. The study also foresees the emergence of surplus in Italy, which Italy will try to avoid by reducing its imports and selling the excess gas via backhaul to countries located to its north and west, through which transit pipes serving Italy pass, namely Austria, Germany, France and Switzerland. The Spanish gas surplus could only be dealt with through onward sale of LNG cargoes (as Spain has limited pipeline capacity with France and therefore fewer opportunities to serve Northern European markets through the backhaul of pipeline gas). The Spanish oversupply (in the form of surplus LNG cargoes) could influence gas markets in North West Europe as well as Italy.

The disclaimer accompanying this study emphasizes that it only reflects a correct view of the current situation and future developments in US and European markets at the time of its drafting in late 2004 and early January 2005, that no representation or warranty is made as to the accuracy or completeness of the presentation and that no person is entitled to rely on its content.

wholesale markets (Germany, Italy, etc.). It is difficult for new entrants to obtain access to transit pipelines. No capacity is currently reserved for new customers on any of the cross-border pipelines."[161]

(377) The Commission has analysed existing capacity bookings on the HAG provided by the OMV, the operator of the pipeline. [Confidential: Data on capacity bookings on the HAG pipeline].

(378) The situation is similar for the cross-border capacity at Hungary's Western entry point. In this regard, the expert report fails to recognize that potential new entrants through the Western entry point would also face severe capacity constraints. The report indicates that *"[u]nder the capacity allocation rule, the full 4.5 bcm could become available to competitors"*. This statement is misleading as MOL WMT has already booked a significant part of the cross-border capacities ([2-5]* bcm out of 4.5 bcm/year, or [5-15]* million m³/day out of 12.3 million m³/day) for its import contracts[162]. This situation is not expected to change in the medium term as Already Allocated Capacity has priority under the cross-border capacity allocation rules. MOL WMT requires in any case a significant part of the Western entry point capacity to perform its obligations under its gas import contracts and their related TOP obligations.

(379) Finally, according to the parties, MOL WMT is also planning to conclude a [5-15]*-year cross-border capacity reservation agreement with MOL Transmission. Such long-term capacity bookings will have priority over new requests for capacity, and could prevent access by other market players to the necessary entry capacity on HAG.

(380) In view of the above, the Commission concludes that only limited transmission capacities are available on the HAG pipeline and at the Hungarian Western entry point. It would therefore be difficult (and even impossible for large quantities) for a new entrant to obtain sufficient transmission capacities to import gas from Baumgarten into Hungary and become active on the Hungarian gas markets.

iii) Price and regulatory changes in Hungary

(381) The expert report submitted by the parties introduces the concept of *"marginal entry point"* to explain that gas imported through the Baumgarten entry point would become competitive in Hungary when current price regulations are lifted. According to the expert report, Hungary has in any case to import gas from Baumgarten (as total demand is higher than the Eastern entry point capacity) and this gas will set gas prices in Hungary as the *"marginal gas"*. According to the parties[163], current gas regulated prices in Hungary lead to a significant price differential between price

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[161] E-control, Press-briefing on the investigation of the Austrian gas industry under the Competition Act 2002, Vienna, 27 September 2005, page 6, "Access to interconnector capacity into Austria".

[162] Paragraph 25 of the SO; see also response of E.ON to question 9 raised in the Commission's e-mail of 14 October 2005 which shows that MOL WMT has booked [5-15]* million m³/day at the HAG entry point for the gas year 2005/2006.

[163] Reply to the SO, Annex II, p. 2 (comment concerning paragraph 346 of the SO), and E.ON's submission of 21 October 2005, part III and Annex 12.

levels for gas available in Baumgarten and gas supplied within Hungary, which will disappear once regulated gas prices are terminated.

(382) While the Commission agrees that gas will continue to be imported into Hungary through the Western entry point, its is clear that competitors that would import gas only from the Western entry point would be at a competitive disadvantage compared to MOL WMT, which would have a lower average cost of gas over its portfolio (due to its imports of Russian/Turkmen gas at cheap prices, and principally through the Eastern entry point). The Commission also refers to its previous analysis of transmission cost through Slovakia and on the HAG pipeline for gas imported through the Western entry point. Therefore, the fact that Baumgarten will constitute a "marginal entry point" does not mean that competitors having only access to this gas resource can compete effectively with MOL WMT in Hungary given their higher sourcing cost.

(383) With respect to cross-border transmission tariffs, the parties claim that the current regulatory framework (equalised entry/exit tariff at the Western and Eastern entry points) penalizes imports of gas through the Western entry point as compared to imports through the Eastern entry point. According to the parties, this situation will change once a differentiated entry/exit tariff is introduced by the HEO. Such new entry/exit tariff would equalise gas prices (import prices plus entry/exit tariffs) at the Western and Eastern entry points. However, it would be difficult to equalise gas prices at the two entry points through differentiated tariffs given the significant price differential between import prices. In addition, there are currently no clear plans of the HEO to introduce differentiated entry/exit tariffs and this would in any event not take place before 2008[164].

(384) In view of the above, the Commission believes that the price differential between gas imported through Hungary's Western and Eastern entry point is essentially structural (cost of transmission through Slovakia and Austria) and it is not expected to be removed by upcoming changes in the regulatory framework in the medium term. As a consequence, even if Baumgarten were to act as "marginal entry point", MOL WMT will continue to benefit from a significantly lower cost of gas as compared to any potential competitor importing gas from Baumgarten.

Existence of independent importers in the Hungarian wholesale gas market

(385) In their reply to the SO[165] the parties argue that the Commission *"tries to belittle"* the *"significant entry"* of *"independent"* companies like EMFESZ and CENTREX.

(386) To do so, the parties on the one hand contest the Commission's argument that both companies are not truly "independent" from Gazprom and on the other hand claim that their market entry demonstrates that Gazprom has no intention to prevent *"at all cost independent market entry which reduces the margin earned by Panrusgáz"*.

164 E-mail of the HEO of 20 October 2005.

165 Parties' reply to the SO, II.3.2, pages 13-16

(387) However, the parties' argument as regards the entry of EMFESZ and CENTREX on the Hungarian market is not new to the Commission and has been factored in its assessment of the proposed transaction. As a matter of fact, the whole range of arguments and quotations put forward by the parties is rebutted by in paragraph 342 of the SO, where the Commission states that *"no competitor of MOL WMT can enter the Hungarian gas market without the approval and support of Gazprom and E.ON/MOL and at most only for limited quantities corresponding to the future "supply gap" in Hungary"* (emphasis added).As a matter of fact, the parties fail to acknowledge that the long term plans of expansion for both EMFESZ and CENTREX match very closely the figures as regards the "supply gap" highlighted by the Commission. If one adds the [0-3]* bcm, representing CENTREX' long-term sales plans[166], and the [0-3]* bcm of long-term forecast sales by EMFESZ[167], the result is approximately the long-term "supply gap" as elaborated by the parties.

(388) Moreover, as regards EMFESZ, the parties fail to acknowledge that [0-3]* bcm of EMFESZ current sales are destined to MOL, as indicated in paragraph 339 of the SO. It therefore appears groundless for the parties to emphasize that EMFESZ *"was able to independently import more than [0-3]* bcm*", that it has built up a *"significant position*" in less than 2 years and that this volumes represent *"20% of the Hungarian gas demand by industrial and commercial customers as well as power plants"*. The Commission also refers to the swap agreement between MOL and EMFESZ and the other elements (see above in recital 343) that call in question the "independent" character of EMFESZ's entry. As regards CENTREX, the Commission underline that the company is not active on the Hungarian gas market yet and that its 2-2.5 bcm long term sales plans should be taken for granted.

(389) To conclude, the Commission estimates that the parties' remarks on Gazprom incentives, the availability of competitive gas in Baumgarten and the existence of independent new entrants are insufficiently supported by evidence and do not reflect accurately the current and future competitive situation of the gas sector in Hungary. Based on the information provided by the market investigation and its assessment thereof, the Commission therefore concludes that MOL WMT controls competitive import sources in Hungary prior to the transaction.

(iii) MOL WMT enjoys further significant incumbency advantages

(390) In addition to a privileged access to competitive gas sources, MOL WMT enjoys significant incumbency advantages in terms of security of supply, cost of transmission and storage of gas.

(391) The market investigation has shown that to compete in Hungary, it is necessary to have access to gas and transmission capacity at both entry points, which only MOL WMT, the incumbent, has. This is necessary to ensure the security of supply of the clients. According to a third party active in gas, "*having only one point of importation is not enough to secure a satisfactory supply to clients in case of reduction or force majeure at [HAG], as it happened in 2004 for example*". "*The*

[166] See report of teleconference with Centrex of August 2005, page 2

[167] See response of EMFESZ to Question 13 k) of the Commission's request for information of 19 July 2005

consequence of Force Majeure (i.e. any unpredictable event that makes the gas flow impossible or reduced) at [HAG] for a newcomer who is not allowed to contract through Beregovo because of saturation are important: (i) financial, as the newcomer will not be able to supply the gas quantities for its clients through another delivery point, he could be under strong penalties with MOL Transmission; (ii) commercial image will be deteriorated in front of the clients who will lose confidence."[168]

(392) The expert report provided by the parties in their reply to the SO disputes the fact that simultaneous access to gas at both entry points is required for successful competition. According to the report, the Hungarian gas network code permits reliable participation in the market from just one entry point. In case of technical problem at the entry point, a gas supplier would not be penalised as "firm" transmission capacity implies that it is the TSO's responsibility to deliver the gas injected at the Western entry point for example. If the TSO fails to do so, the Hungarian network code waives any imbalance penalties and it puts all customers on an equal footing with respect to potential curtailments of consumption in the event of a network failure. A supplier with access to gas from different sources would have the same likelihood of interruption as a competitor operating exclusively from Baumgarten in case of a problem on the transmission network.

(393) The Commission agrees that the provisions of the Hungarian network code described in the expert report ensure that a supplier with access to only one entry point is not penalized in case of network failure. However, that supplier's liability is not protected in case of problems with access to gas upstream of the Hungarian transmission network, which would not be the responsibility of the Hungarian TSO. It thus remains important for reliability and safety of supply to have access to gas at more than one entry point in the country (Hungary has only two entry points for gas, most countries have several entry points for gas). It remains true that a supplier which is not able to ensure back-up gas from an alternative entry point would face high imbalance penalties and damage to its reputation. Therefore, a supplier having access to gas at the two entry points benefits from a strong competitive advantage in term of security of supply, one of the most important criteria customers consider to select their gas supplier.

(394) Similarly, due to its position as gas incumbent, MOL WMT is the only gas operator that has several gas supply contracts with delivery points at the Hungarian borders. This means that only MOL WMT can fully benefit from the advantages resulting from a diversified gas supply portfolio and optimize its sourcing in terms of prices and flexibility provisions notably.

(395) Furthermore, as a direct result of its large size in Hungary and its incumbency position, the new entity has a competitive advantage in terms of costs of transmission and storage of gas vis-à-vis new entrants on the Hungarian gas markets. This constitute an additional barrier to entry on these markets. For example, it appears that balancing rules are biased in favour of the incumbent in Hungary: a gas

[168] Response of OMV to Question 17 of the request for information of 19 July 2005: "*Due to the fact that E.ON/Ruhrgas will have gas and import capacity available at the Ukrainian and Austrian borders, it will be in the best position to use the 80-20 percent division of capacity stipulated in the grid and commercial code (cf. point 5.1.2.). This might at least put it in a favourable position to an outside competitor.*"

trader licensee that can provide the TSO daily gas options can avoid paying a nomination penalty for deviations of up to +/- 8% from daily nominations. At this stage, only MOL WMT can provide such flexibility, thanks to its huge source portfolio. Other gas traders, which cannot offer such daily flexibility, have only a tolerance of +/- 2% for deviations and thus have to pay high imbalance penalties for any deviation exceeding 2%[169].

(396) Similarly, MOL WMT benefits from a synchronicity effect for its transmission and storage capacity bookings due to its large portfolio of customers[170]. A supplier with a large and diversified customer base needs lower transmission and storage capacities per customer than a supplier with a limited number of customers as the overall variation in demand of a large number of customers is lower on average than the sum of the variation in demand of each individual customer[171]. According to the HEO "*for daily balancing, it is necessary to have flexibility of sources and to be able to take import sources as needed. MOL WMT has a larger flexibility due to its huge customer base and because it has all the imports. The other traders have to buy their flexibility from MOL WMT in order to serve the specific needs of their new customers. (…) The Public Utility Wholesaler is well equipped to offer flexibility schemes for the remaining players, but this is done in a way in the least possible advantageous way for the small players.*"[172]

Conclusion on the new entity's dominant position in the wholesale supply of gas in Hungary

(397) For the reasons set out above, already before the transaction, MOL WMT is dominant on the different Hungarian wholesale gas markets identified in the market definition section (the market for gas supply to RDCs, the market for gas supply to traders and the market for gas supply to large power plants). According to the Commission, MOL WMT's dominance does not result from the transaction. However, the Commission disagrees with the parties' view that *"the proposed transaction does not bring about any relevant change to this situation"*[173].

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[169] See also minutes of the meeting of 26 July 2005 with the HEO (comments on slide 17 of the presentation entitled "The Hungarian Natural Gas Market: Storage and miscellaneous questions"): "*Furthermore the penalty for imbalance imposed by the TSO (MOL Transmission) is high. Although the penalty is lessened if the player can offer another flexibility tool, this system works obviously against the small players who cannot offer flexibility schemes for the TSO.*"

[170] A third party active in gas has stated that "*Being able to gain market share means not only to have competitive prices for importation, but also to be able to import enough quantities of gas to benefit from scale effects, and also to lower transportation and balancing costs by access to multiple delivery points.*"

[171] This results directly from the fact that, in a large pool of customers, not every customer has its peak demand at the same point in time. The peak in demand of the aggregate demand of the pools (which is relevant for the transmission and storage capacity booking) is hence lower than the sum of the peak demands of each customer in the pool. More generally, the larger the number of customers in the pool, the lower is the relative fluctuation of the aggregate demand.

[172] Minutes of the meeting of 26 July 2005 with the HEO (comments on slide 17 of the presentation entitled "The Hungarian Natural Gas Market: Storage and miscellaneous questions").

[173] Reply to the SO, page 2.

B. Impact of the transaction on the gas markets

(398) The following recitals will focus on the effects of the proposed transaction on competition on the Hungarian gas markets.

(i) Supply of gas

(399) The new entity, like MOL WMT prior to the transaction, will enjoy a dominant position in the upstream markets for the supply of gas to RDCs and to traders. MOL WMT controls, through long-term procurement contracts and structural links the two existing competitive sources of gas, namely domestic production and imports from Gazprom. The essential change brought by the transaction is that E.ON, unlike MOL, is active in the retail supply of gas, through the two RDCs it controls and its participation in a third one.. Thus, the proposed merger will result in a vertically integrated company active across all stages of the gas supply chain and controlling access to gas volumes and part of the infrastructure.

(400) While, prior to the transaction, MOL WMT had the ability to act, to an appreciable extent, independently of its customers (i.e., RDCs and traders) in the wholesale supply of gas in Hungary, it lacked any economic incentives to act to their detriment as it was not present on the downstream gas retail markets and was not, therefore, competing with them. Conversely, E.ON had no presence in the upstream market and thus no power to act to the detriment of its downstream rivals. For the reasons stated below, the Commission considers that the vertical integration created by the transaction is likely to result in the new entity having the ability *and* the incentive to foreclose its actual and potential competitors on the downstream markets for the supply of gas so as to significantly impede competition thereon.

a. The new entity will have the ability and incentive to foreclose access to wholesale gas to its competitors (RDCs and traders) in gas retail on the market for the supply of gas to small industrial and commercial customers

(401) The Commission's analysis indicates that, as a result of and immediately after the transaction, the new entity will have the ability and incentive to foreclose access to gas to its current downstream competitors supplying retail gas to small industrial and commercial customers[174], thereby significantly impeding effective competition on these markets. Emerging entrants in the open segment of the market, including the trading arm of independent RDCs, would be obliged to rely on their strongest competitor to procure their wholesale gas, thus placing them at a competitive disadvantage. Further, the Commission is concerned that by deterring or delaying entry, the transaction will also prevent the effective opening of the market to competition despite its full liberalisation since 1 July 2004[175].

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[174] Owing to different competitive and regulatory circumstances input foreclosure to gas-fired power plants is analysed separately.

[175] Pursuant to Directive 2003/55/EC and to the implementing provisions under Hungarian law (Article 36 of the HGA and Article 1(1) of the Eligibility Decree), all non-residential customers have become eligible and, accordingly, are free to choose their supplier.

(402) Several market participants have pointed out the likelihood and the negative effects of such input foreclosure on effective competition and potential new entries. As stated by a third party active in the gas sector, as a result of the merger, "*E.ON would become monopoly wholesaler*" and "*through its vertical integration, would be able to control the upstream gas market and – thanks to its existing position on the retail gas market would be in a unique position to control the whole gas supply chain*".

Ability to foreclose access to wholesale gas thereby raising the costs of competitors in the market for the supply of gas to small industrial and commercial customers

(403) Input foreclosure here refers to the strategy of raising the costs of wholesale gas procurement to rival RDCs in the regulated segment and traders in the open segment of the market for the supply of gas to small industrial and commercial customers. Higher costs will reduce rivals' profit margins and tend to reduce their ability to compete effectively in this retail market with the new entity. As a result, the new entity's downstream rivals are likely to be marginalised and effective competition to be significantly impeded, allowing the new entity to gain increased market power and raise retail prices to the detriment of final small industrial and commercial customers.

(404) Following the merger, the merged entity will have the ability to foreclose access to gas and raise its rivals' costs in various ways. According to the Commission's market investigation post-merger the new entity will first have the ability to deny access to gas resources and infrastructures to its downstream competitors on the market for the supply of gas to small industrial and commercial customers. A third party active in the gas sector points out for example that "*E.ON will be the only gas retailer who will have access to the TOP import contracts of MOL WMT and the domestic production of MOL E&P, so they will be able to control the gas resources in Hungary"*.

(405) The dependence of gas traders affiliated with the RDCs on MOL WMT for their access to gas is evidenced by […]*[176]. This table (extracted from a table presented above in recital 347) shows that these traders have already asked for a bid of MOL WMT trader for their access to gas for the liberalised segment of the market (on the regulated segment of the market, MOL WMT Public Utility Wholesaler has for the time being the obligation to supply them):

[…]*

(406) In the open segment of the market, the new entity could directly increase the wholesale price of gas to traders and/or engage in non-price discrimination. Non-price discrimination includes a whole range of actions intended to increase the costs of wholesale gas procurement to rivals, such as intentional delays in supply and in processing orders, reductions in the quality of service, lack of flexibility, reduced

[176] […]*.

transparency, unwillingness to renegotiate, etc. Non-price discrimination provides ways to raise rivals' costs even in the regulated segment of the market, where prices are regulated.

(407) The Commission's investigation has indeed revealed that safety of supply, flexibility and service guarantees are of significant importance for a small industrial and commercial customer in choosing its gas supplier. In turn retailers must ensure that they can receive the corresponding quality of service and supply guarantees from their respective wholesaler. Nomination penalty risk is also important for gas retailers.

(408) A number of market players have outlined the risk of non-price discrimination and have indicated the broad range of parameters on which the new entity would have the ability to discriminate its competitors. A third party active in the gas sector stated for instance:

"Besides the prices set in the supply contracts other contractual conditions may provide room for discrimination (e.g. terms of payments, capacity booking, synchronicity of customers' capacity needs, etc)"[177].

(409) E.ON would thus have the ability post-merger to influence the above-mentioned parameters of competition and to limit the ability of targeted retailers to compete on the downstream market for the supply of gas to small industrial and commercial customers.

Incentive to foreclose access to wholesale gas thereby raising the costs of competitors in gas retail markets

(410) Prior to the transaction, MOL WMT has no economic motive to discriminate among downstream gas players (i.e. RDCs and traders) active on the market for gas supply to small industrial and commercial customers as it has no gas retail activities. However, as a result of its vertical integration into gas retailing, the new entity will have the incentive, post-merger, to engage in input foreclosure strategies on the downstream market for the supply of gas to small industrial and commercial customers where E.ON is present, so as to favour its downstream affiliates and marginalise its rivals.

(411) The table below summarizes the current market shares of the existing RDCs on the market for gas supply to small industrial and commercial customers. No trader is active on this market so far.

[177] Submission of […] dated […].

Suppliers	Supply of gas to small commercial and industrial customers in 2004	
	In million m³	In %
KÖGÁZ	[0-500]*	[10-15%]
DDGÁZ	[0-500]*	[5-10%]
Total E.ON	[0-500]*	**[15-20%]**
FŐGÁZ	[500-1000]	[20-30%]
ÉGÁZ	[0-500]	[0-10%]
DÉGÁZ	[0-500]	[10-20%]
TIGÁZ	[500-1000]	[30-40%]
MOL WMT	**0**	**0%**
Total Market	**[2000-3000]**	**100%**

(412) E.ON has sole control of two RDCs (KÖGÁZ and DDGÁZ), which together represented nearly [15-25%]* of the sales on the market for the supply of gas to small commercial and industrial customers (< 500 m³/h) in 2004. Such market presence already gives the new entity a strong incentive to raise its current competitors' costs.

(413) In addition, E.ON holds a 16.4% participation in FŐGÁZ, an RDC exclusively controlled by the municipality of Budapest, which represents more than 20% of the sales of gas on the market for the supply of gas to small commercial and industrial customers. If one also takes into account FŐGÁZ's sales, because of E.ON's financial interest therein, the merged entity's position on the retail market for gas supply to small commercial and industrial customers is even stronger (around [35-45%]*).

(414) It is likely that, by pursuing an input foreclosure strategy as a result of which competing RDCs and traders will be marginalised because of higher gas costs, the merged entity will enhance its market position and gain increased market power on the market for the supply of gas to small commercial and industrial customers.

(415) The market investigation has confirmed that the transaction would change MOL WMT's incentives in this way. In that respect, EDF has stated that: "*We believe that MOL/E.ON, in a quasi-monopoly sourcing situation, could easily provide a wide and tailor-made range of products (blocks, peak, off peak…) favourable to their own downstream subsidiaries, for instance especially during peak hours*"[178].

(416) The new entity's incentives to foreclose are all the more likely in view of the specificities of the Hungarian gas retail market for the supply of gas to small industrial and commercial customers. As described above in recitals 55 to 59, the Hungarian gas sector is characterized by a hybrid model, with the coexistence of a regulated segment of the market and a liberalized market (or "open segment of the market"). Eligible customers have the right but not the obligation to switch suppliers to enter the open segment of the market. Customers who have switched to the open segment of the market are allowed to switch back to the regulated segment of the market (albeit this takes one year instead of 4 months).

[178] Response of EDF of 10 August 2005 to Question 27 of the request for information of 19 July 2005.

(417) Customers that choose to stay under the regulated regime are supplied by their local RDC at regulated prices. In turn the RDC has an exclusive right and obligation to purchase gas from MOL WMT also at regulated prices. MOL WMT is the sole public utility wholesaler licensee. It has the obligation, by law, to cover the full natural gas demand for public utility purposes of the RDCs. To fulfil this obligation, the gas RDCs and MOL WMT have entered into long-term framework supply contracts, with duration from […]* years. In contrast with the public utility contracts, the relationship between the eligible customers who switched suppliers and traders is largely subject to the principle of contractual freedom.

(418) According to the parties, switching does not entail any significant costs or time investment on the side of the eligible customer. A customer that switches to the open segment of the market remains entitled to the cross-border, transmission, distribution and storage capacities allocated to him under the regulated regime. Therefore retail competition for eligible customers is based largely on price. This in turn implies that access to wholesale gas at competitive prices is the only way to attract customers from the regulated segment and increase market share. The integration with MOL WMT will give E.ON's downstream affiliates such competitive advantage over all other emerging and potential rivals on the market for the supply of gas to small industrial and commercial customers.

(419) The Commission's analysis indicates that E.ON/MOL WMT's incentives to raise the costs of rivals on the market for the supply of gas to small industrial and commercial customers and its optimal foreclosure strategy is likely to evolve with the regulatory environment. One can distinguish two stages:

i) Immediately after the transaction: as long as both retail prices to small industrial and commercial customers and wholesale gas prices are regulated, the new entity will have an incentive to raise the costs to rivals RDCs through non-price discrimination. Simultaneously, it is likely to increase the price of wholesale gas to independent traders to capture customers that switch to the open segment of the market.

ii) In July 2007: regulated prices are expected to be suppressed. At that point all eligible customers will have to switch to the open segment of the market. It is then likely that the new entity will have an incentive to foreclose all its downstream rivals on the market for the supply of gas to small industrial and commercial customers either by increasing the cost of gas or by reducing the quality of supply, whatever is optimal.

Current regulatory framework

(420) Immediately after the transaction, the new entity will be in a position to increase the wholesale price to rival traders in the open segment of the market for the supply of supply to small industrial and commercial customers. This would tend to reduce their demand for wholesale gas but also it would reduce their ability to supply gas at competitive prices in the open segment of the market, thus losing market share to E.ON's trading affiliates. Given that the retail margin is high due to limited and

incipient competition, the lost profits upstream from reduced sales would likely be more than offset by increase profits in the open segment of the market[179].

(421) In contrast, under the current framework, the merged entity cannot raise the costs of rival gas RDCs by unilaterally increasing the wholesale price, at least in the short-run[180]. However, as the sole wholesale public utility supplier, MOL WMT has the ability to influence the profitability of RDCs. At the same time it increases wholesale gas prices to rival traders on the free segment of the market for the supply of gas to small industrial and commercial customers, the merged entity will have an incentive to raise the costs of rival gas RDCs by deteriorating the quality or flexibility of wholesale supply. It is also likely to deliberately reallocate costs associated with the supply to traders in the open segment of the market to the public utility segment[181]. In either case this would negatively affect the overall cost structure of RDCs, discouraging their expansion and limiting their ability to refinance their operations. This reduction in profitability would also affect the ability and incentive of rival RDCs to create and support trading arms to compete in the open segment of the market. As a result, competition would be significantly impeded to the detriment of consumer choice and the success of the ongoing liberalisation process.

(422) Furthermore, a strategy of raising rivals' costs through non-price discrimination can be reflected in higher regulated prices.

(423) Pursuant to Article 48(2) of the HGA the regulated price is based on the so-called cost-plus principle. The regulated purchase price that has to be paid to the public wholesaler contains both the gas fee and the fee for using the facilities (transport network and storage). The regulated price also includes the costs of the justified investments, as well as the profit necessary for long-term operation. The principle is that maximum prices shall be set so as to cover the costs of an efficient entrepreneur and the necessary profits for operation. Within the four-year revision cycle there are two built-in price correction elements: a regular price correction, proposed by the HEO with respect to annual changes e.g. in the import prices of natural gas, and an extraordinary price correction proposed in case events on the natural gas market make it obviously necessary.

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[179] E.ON's strong presence in the downstream market for the supply of gas to small industrial and commercial customers through its control of DDGÁZ and KÖGÁZ and participation in FŐGÁZ would raise no concerns if these markets were intensely competitive. This is because the merged entity could appropriate all monopoly rents through its choice of the input price. Hence, in these circumstances it would not matter whether the upstream monopolist participates downstream. However, in the present case this retail market is oligopolistic and in the process of liberalisation. As a result, in a free market, the downstream equilibrium price will likely exceed marginal cost.

[180] But note that in the regulated segment the merger will not lead to the elimination of the double margin, even if that is possible in practice. Double marginalization occurs when downstream firms mark up over their marginal cost, which because of market power upstream exceeds the marginal cost of the upstream producer. Hence there is a mark-up on a mark-up or double marginalization.

[181] According to economic analysis it is likely the merged entity will have an incentive to raise its rivals' costs all the way up to the point that revenues at regulated prices fail to cover costs thus forcing the rival RDC to push for an increase in the retail price, sell the company to the merged entity, or give up its own customers and focus on protecting its distribution profits.

(424) Pursuant to Article 49 (3) of the HGA the HEO is obliged to undertake a price revision procedure on the basis of the request of any interested party, and shall publish the result thereof. The merged entity and independent RDCs have the right for such a price revision. Thus, if increased gas procurement costs lead to reduced margins, RDCs may choose to request a revision of the retail gas prices in order to maintain their profit margins[182]. Unfortunately, higher regulated retail prices would also have negative consequences on the liberalisation process since they would induce end-customers to switch to the open segment of the market, most likely to E.ON's trading arm given that its rival traders would pay a higher price for wholesale gas to MOL WMT and would not be competitive at the retail level. Not only would RDCs lose customers but may be unable to meet their TOP obligations (due to lower sales than expected), which would entail an additional cost.

Future regulatory framework

(425) With respect to the medium term (after 2007), if customers were obliged to switch to the open segment of the market, this would only further strengthen the new entity's ability and incentive to foreclose access to wholesale gas. First, the new entity could increase prices in a fully open market unconstrained by the regulated price. Second, it could raise rivals' costs by increasing the wholesale gas price, which is likely to result in higher revenues than a reduction in the quality of supply – for an equivalent revenue loss from reduced demand for wholesale gas.

(426) All market participants consulted by the Commission expect the hybrid model to disappear shortly after July 2007, when all residential customers will become eligible. Small industrial and commercial customers that have not yet switched to the open segment of the market will be forced to do so. According to current HEO plans, a USP appointed through an open competitive tender shall supply the small industrial and commercial customers[183] that have not concluded a supply contract with a specific supplier.

(427) The market investigation has also revealed that most market players active in gas retail consider that the anti-competitive effects of input foreclosure are likely to be more immediate in such case. In particular, they have expressed the concern that *"post-transaction, E.ON's complete vertical integration on the gas supply chain will discourage new entries at the gas retail level, as it is likely to make it significantly harder for new operators to have access to competitive supplies and possibly storage service"*. Respondents also point to the mutually reinforcing effect of controlling access to wholesale gas and storage of gas, by arguing that, as a result of the merger *"E.ON would become de facto the exclusive supplier of its competitors in the Hungarian retail market. In addition through the control of storages, it could make significantly harder for third parties to supply fluctuating retail demand*", and that "*there is significant space for E.ON as supplier (or storage service provider) to*

[182] It is unlikely the regulator can monitor and oblige WMT to increase its efficiency with respect to supply to RDCs.

[183] The proposal for a new electricity market model foresees this for small industrial customers with fewer than 50 employees (see minutes of the meeting of 26 July 2005 with the HEO). It could be expected that the future proposal for a new gas market model will use the same reference.

apply to its competitors terms and conditions de facto different from those utilised by E.ON itself for its downstream activities in the Hungarian market".

Factors relevant for raising rivals' costs strategies

(428) In addition, several empirical factors relevant to determine the magnitude of the incentives to raise rivals' costs are present in this case.

(429) First, there is little differentiation in the retail supply of gas. Despite small differences in calorific content, natural gas can be regarded as largely homogenous. When the downstream products are viewed by consumers as very similar, then the vertically integrated firm can readily supplant the sales its rivals lose due to discrimination with its own sales, thereby mitigating the effects of lost input sales.

(430) Second, given contractual completeness, non-price discrimination may not only increase the costs of downstream rivals on the market for the supply of gas to small industrial and commercial customers but also reduce the costs of MOL WMT. By depressing quality and flexibility of supply and reducing customer service, MOL WMT avoids additional costs. When it is inexpensive for the upstream firm to non-price discriminate vis-à-vis its rivals then, other things equal, the upstream firm will have greater incentive to pursue non-price discrimination. Thus the merged entity benefits not only from the increased market share in the retail market for gas supply to small industrial and commercial customers but also from increased margins in the supply of wholesale gas to rival RDCs and traders.

(431) Third, when the marginal cost of downstream gas supply is increasing, then it becomes progressively more costly for the integrated firm to replace its rivals' sales with its own. Hence the integrated firm may find it profitable to engage in some non-price discrimination, but not to raise its rivals' costs so high that they exit the market. An extreme form of this occurs when the integrated firm has a capacity constraint on its downstream production. In contrast, in this case, it appears that there exist economies of scale in the retail supply of gas to small industrial and commercial customers. This is due to fixed costs in developing a sales network able to induce consumers under the regulated segment to switch to the open segment of the market. Furthermore the integrated firm faces no capacity constraint in its ability to procure gas from upstream sources to supply.

(432) Fourth, the incentive to raise rivals' costs also depends on the existence of a positive margin (price above cost) in the downstream market. If there is a high margin downstream the merged entity benefits from expanding market share at the expense of its foreclosed rivals. Profit margins are in general positively related to the intensity of competition. If competition is weak, margins are likely to be high. In this case, competition in the retail gas markets is limited. In part, this is because the open segment of the market is still incipient and RDCs have a strong incumbency position in their respective regions. It follows that, other things being equal, the new entity would have an incentive to raise its rivals' costs so as to obtain the profit margin from acquiring its rivals' customers on the market for the supply of gas to small industrial and commercial customers[184].

[184] The relative efficiency of downstream producers can also affect the incentive to raise rivals' costs. When the integrated firm has lower downstream production costs than its rivals, then the profit it can generate by

(433) It should be recognised that such discriminatory conduct is unlikely to be detected or penalised by the regulator. First, neither supply contracts nor the relevant regulation cover all scenarios and contingencies that may arise. As a result, MOL WMT enjoys certain discretion to worsen conditions of supply in ways that are difficult to verify by third parties. E.ON would enjoy the same discretion following the merger. Second, market players would not be likely to submit complaints to the regulator or competition authority in view of the dependence from the new entity for their gas supply. The likelihood of such input foreclosure strategy against downstream competitors would thus be increased, in the absence of sufficiently strong "regulatory" deterrence.

The parties' reply to the SO

(434) In their reply to the SO, the parties generally argue that the Commission's competition concerns do not go beyond the expression of "doubts" and, therefore, fail to meet the relevant standard of proof[185].

(435) However, the Commission's competition concerns identified in its SO and in the present decision rely, as required by the case-law[186], on a prospective analysis of the events which, in its view, "*are the most likely*" to occur in the future, should the merger as notified take place. Contrary to the parties' assertion, the Commission's competition concerns set out in it SO are not based on mere speculations, but on a close examination of all the relevant evidence available as well as on a thorough economic analysis thereof, showing that the development envisaged is particularly "*plausible*"[187] and thus, likely to occur post-merger. In particular, the Commission examined whether, in view of both the ability and the likely incentives of the merged entity, the merger would be likely to result in an input foreclosure strategy and, thereby, significantly impede effective competition on the downstream gas markets in the foreseeable future. Consequently, the Commission did not limit itself to consider possible strategies, but also considered whether such outcome would be more likely than not to take place.

(436) As to the competition concerns identified by the Commission, the parties, in their reply to the SO, do not specifically dispute that effective competition would indeed be significantly impeded on the market for the supply of gas to small industrial and commercial customers, should an input foreclosure strategy take place as a result of the merger. Nor do they dispute the timing envisaged by the Commission as regards the likely effects of the merger on the market. However, they argue that, in any event, input foreclosure of downstream gas competitors would not be likely to occur post-merger.

(437) In the parties' opinion, the new entity would not have the *ability* and the *incentive* to discriminate its downstream rivals because significant gas surpluses could be

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selling retail gas downstream is greater than the profit (gross of input charges) its rivals can generate by selling that quantity of gas.

185 Reply to the SO, I.2, pages 4-5.

186 See Case 12/03 P, Commission / Tetra Laval, paragraphs 42-43.

187 See Case 12/03 P, Commission / Tetra Laval, paragraph 44.

diverted to the Baumgarten entry point for onward supply into Hungary, following the removal of price regulation[188].

(438) However, this argument ignores that the Commission's competition concern is essentially based on the fact that, should gas supplies be available in sufficient quantities at the Western entry point, such supplies would not be made, in any event, at competitive prices. In that regard, the parties do not dispute that a substantial price difference exists with the cost of gas imported by MOL WMT, which purchases most of its gas from Gazprom and other operators at the Eastern entry point, and that, as a consequence, foreclosed competitors would not be in a position to rely on competitive gas should their input costs increase post-merger.

(439) The parties also dispute the likelihood of foreclosure by E.ON of its downstream competitors, arguing that the Commission's analysis is too pessimistic as it ignores the high level and effectiveness of Hungarian energy regulation and the sophistication of other market participants.

(440) While the Commission does not dispute the existence of regulations, it should be pointed out that the regulation mostly concerns the activities of transmission and storage rather than gas supply (with the exception of the hybrid model until July 2007). In addition, as pointed out by the HEO itself, regulations may not consider and address all possible scenarios of discrimination:

"*There is an ongoing polishing of the existing rules in the Grid Code, which is modified every year to give more chance to the free market. There are no stable rules in the market.*"[189]

(441) The parties also submit that the Commission's analysis relies on a purely speculative analysis of which type of "*abusive behaviour*" the merged entity might adopt in the future, which fails to satisfy a test of "high probability"[190]. In that respect, the parties essentially argue that the merged entity would have no *incentive* to adopt an abusive behaviour because, in light of the relative simplicity of gas market contracts, such a conduct would be detected by competitors and by the regulator, and would be penalised accordingly following complaints[191]. In addition, according to the parties, the various discrimination scenarios have not been identified by market respondents and are not typical of E.ON's conduct (or of other energy companies)[192].

(442) The parties' suggestion that the Commission's competition concerns rely on a list of "abusive behaviour" is based on a wrong reading of the SO. Contrary to what is argued by the parties, the Commission did not take a position as to whether the various strategies likely to be adopted by the merged entity as a result of the merger

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188 Reply to the SO, II.1.1, page 6.

189 Minutes of the meeting with the HEO on 26 July 2005, p. 5 (comments on slide 25 of the Presentation entitled "Introduction of the Hungarian Natural Gas Market").

190 Reply to the SO, II.1.2 and II.1.3, pages 6-8.

191 Reply to the SO, II.1.3, II.1.4 and II.1.5, pages 9-10. and Annex 1 thereto

192 Reply to the SO, II.1.2 and II.1.3, pages 7-9.

would necessarily fall within the scope of Article 82 EC and would be penalised as such. As recently held by the Court of Justice, it is not necessary for the Commission, when assessing the likely effects of a merger, to determine whether a specific conduct likely to be adopted by the merged entity would constitute an infringement of Article 82 EC and would be sanctioned as such in the relevant national order. Indeed, an exhaustive and detailed examination of the rules of the various legal orders which might be applicable and of the enforcement policy practised in them would call for a high probability of the occurrence of the acts envisaged as capable of giving rise to objections on the ground that they are part of anti-competitive conduct.[193] However, it would run counter to the Regulation's purpose of prevention to require the Commission to examine, for each proposed merger, the extent to which the incentives to adopt anti-competitive conduct would be reduced, or even eliminated, as a result of the unlawfulness of the conduct in question, the likelihood of its detection, the action taken by the competent authorities, both at Community and national level, and the financial penalties which could ensue[194]. Moreover, as stated by the Court of Justice, "*at the stage of assessing a proposed merger, an assessment intended to establish whether an infringement of Article 82 EC is likely and to ascertain that it will be penalised in several legal orders would be too speculative and would not allow the Commission to base its assessment on all of the relevant facts with a view to establishing whether they support an economic scenario in which a development such as leveraging will occur*"[195]. In that context, the Court of First Instance recently concluded, citing paragraph 74 of the Court of Justice's judgment in *Tetra Laval*, that "*where the Commission, without undertaking a specific and detailed investigation into the matter, can identify the unlawful nature of the conduct in question, in the light of Article 82 EC or of other provisions of Community law which it is competent to enforce, it is its responsibility to make a finding to that effect and take account of it in its assessment of the likelihood that the merged entity will engage in such conduct".*[196]

(443) In the present case, it would be all the more difficult to consider *ab initio* that the various foreclosure strategies likely to be adopted post-merger would necessarily be considered by the national authorities as discriminatory practices within the meaning of Article 82 EC given that, contrary to what the parties claim, gas supply contracts with traders are generally complex and contain specific clauses adapted to the needs of each negotiating party.

(444) Even if such discriminatory practices were ultimately considered as an abuse of a dominant position, it is nonetheless highly likely that, in the future market context, the merged entity would have strong incentives to act in such a manner. Indeed, there is generally no transparency as regards the price formulae applicable in gas supply contracts since such information is crucial for the competitive operation of

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193 Case C-12/03 P, *Commission* v *Tetra Laval* [2005] ECR I-987, paragraph 76.

194 Case C-12/03 P, *Commission* v *Tetra Laval* [2005] ECR I-987, paragraph 75.

195 See Case 12/03 P, Commission / Tetra Laval, para.77.

196 Case T-210/01, *General Electric* v *Commission*, judgment of 14 December 2005, not yet recorded, paragraph 74.

traders. For these reasons, it is very unlikely that a rival trader would be in a position, at any given time, to effectively compare the terms of its contract with those applicable in E.ON's affiliates' contracts.

(445) This is also true as regards the energy regulator, since it may not detect such differences in due time. In that regard, the HEO itself acknowledged, with respect to possible discriminative practices in access to storage (which is even more regulated than the market for the supply of gas to RDCs and traders) that they are "*very hard to prove using administrative methods (as it is indicated from time to time, the market player which is at a disadvantage fears for its future position on the market, and will rather not submit a complaint at the regulatory or competition authority)*"[197].

(446) As regards gas supply contracts, although the HEO has indicated that it has the right to control and to force market players to act without discrimination[198], it has also indicated several times, concerning different issues, that it did not have good information on the commercial contracts concluded by operators, nor could it request access to this information:

"*The HEO is not familiar with the free market prices, as few players provide information to the HEO on the prices on the free market (and only average prices).*"[199]

"*In the Hungarian regulatory framework, confirmed customer demand is required to book capacity. Every year, every market player is required to show the demand of its customers for the next ten years (the demand relating to the 9 years after is based on their hopes, not on facts!). The problem is that it is not clear who is responsible for checking this, as the law does not say how it is checked. The HEO takes the view that this should be checked by the TSO, but the TSO claims that they have no tools to do so, because the agreements signed between third parties are confidential. (…) The HEO can check the licensees and their books, <u>but not the commercial contracts</u>.*"[200]

"*The HEO does not know which companies were offered such a long-term contract and which have signed a long-term contract and for which volumes of gas.*"[201]

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[197] Document received by the Commission from the HEO on 9 May 2005 entitled "Answers to the questions raised by GVH related to the share transfer transaction between E.ON and MOL", page 4, dated 11 April 2005.

[198] Minutes of the meeting of 26 July 2005 with the HEO, p. 10 (slide 16 of the Presentation entitled "Hungarian Natural Gas Market: Storage and miscellaneous questions").

[199] Minutes of the meeting of 26 July 2005 with the HEO, p. 6 (comments on slide 27 of the Presentation entitled "Introduction of the Hungarian Natural Gas Market").

[200] Minutes of the meeting of 26 July 2005 with the HEO, p. 7 (comments on slide 18 of the Presentation entitled "Hungarian Natural Gas Market: Transmission and Distribution").

[201] Minutes of the meeting of 26 July 2005 with the HEO, p. 10 (comments on slide 20 of the Presentation entitled "Hungarian Natural Gas Market: Storage and miscellaneous questions").

(447) As to the argument that the various ways in which input foreclosure strategies may take place have not been precisely identified by market respondents, it ignores the fact that, nevertheless, market players have clearly identified the risk of input foreclosure as a likely effect of the merger. Similarly, the argument that discriminatory practices are not typical of E.ON's conduct in other jurisdictions does not demonstrate that such outcome is unlikely in Hungary as it relies on the wrong assumption that comparable market conditions exist in other jurisdictions and/or that such practices could have been easily detected and penalised under Article 82 of the Treaty.

(448) Last, the parties argue that it is pure speculation for the Commission to consider that market players would not be likely to submit complaints in view of their dependence on the new entity for their gas supply other market participants. According to the parties, this did not prevent Hungarian energy companies from expressing their opinion freely on the merger in the course of the Commission's market investigation. The parties disregard the fact that many respondents requested a confidential treatment of their responses, precisely to avoid possible future retaliation by the new entity on which they depend for their operations in the Hungarian energy markets.

Conclusion

(449) On the basis of the evidence available and the analysis developed above, the Commission considers that, as a result of the merger, the new entity is likely to have the ability and the incentive to foreclose access to gas resources to its downstream competitors on the market for the supply of gas to small industrial and commercial customers, starting immediately after the transaction.

(450) In view of the new entity's dominant position on the upstream markets for the wholesale supply, and the storage, of gas in Hungary and because of its presence in the downstream gas market for the supply of gas to small industrial and commercial customers (owing to its controlled RDCs) the merged entity will have, already in the current regulatory scenario and at the current stage of market liberalisation, the ability and the incentive to foreclose access to gas to a) its competitors in the current free market, thereby reducing the scope for the development of a competitive free market; and b) its competitors in the regulated market by engaging in non-price discrimination with a view to raising their input costs. As a result, actual competitors are likely to be marginalised, thereby allowing the new entity to gain increased market power on the downstream gas market for the supply of gas to small industrial and commercial customers.

(451) Furthermore, this vertical effect of the transaction (i.e. input foreclosure) will, in all likelihood, discourage new entries in the market as potential entrants will not expect to be in a position to contract gas supplies with the new entity under terms and conditions similar to those applicable to E.ON's affiliates.

(452) Furthermore, the Commission considers that the above-described foreclosure strategy will be all the more effective and easier to implement in the framework of an increasingly liberalised market, whose next developments are expected to occur in the near future (as from 1 July 2007).

(453) For all these reasons, the Commission is of the view that, by allowing the merged entity to raise its rivals' costs and deter new entry on the retail market for the supply

of gas to small industrial and commercial customers, the merger as notified will significantly impede effective competition in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation.

b. The new entity will have the ability and incentive to foreclose its competitors in gas retail on the market for the supply of gas to residential customers

(454) Currently, the market positions of the various retailers (RDCs and traders) on the Hungarian market for the supply of gas to residential customers are as follows:

Suppliers	**Supply of gas to residential customers in 2004**	
	In million m³	In %
KÖGÁZ	[0-500]*	[5-10%]
DDGÁZ	[0-500]*	[5-10%]
Total E.ON	[0-500]*	**[15-20%]**
FŐGÁZ	[500-1000]	[20-30%]
ÉGÁZ	[0-500]	[0-10%]
DÉGÁZ	[500-1000]	[10-20%]
TIGÁZ	[1000-2000]	[30-40%]
MOL WMT	**0**	**0%**
Total Market	**[4000-5000]**	**100%**

(455) As for the supply of gas to small industrial and commercial customers, the fundamental change brought about by the transaction is that E.ON, unlike MOL, is active on the market for the supply of gas to residential customers through its solely controlled affiliates, KÖGÁZ and DDGÁZ, and through FŐGÁZ, in which it holds a minority shareholding. Thus, whereas prior to the transaction MOL WMT had no incentives to act to the detriment of its customers as it was not competing with them downstream, the merger is likely to result in the new entity now having the ability *and* the incentive to foreclose competitors on the downstream market for the supply of gas to residential customers, so as to significantly impede competition thereon.

(456) In that regard, the analysis developed in section a) above (recitals 401 to 453) with regard to the likely effects of the merger on the market for the supply of gas to small industrial and commercial customers applies to the effects of the merger on the market for the supply of gas to residential customers. However, with respect to the timing of such effects, the Commission considers that a distinction should be drawn due to the different regulatory situations of both markets.

(457) Indeed, by contrast with the market for the supply of gas to small industrial and commercial customers, the market for the supply of gas to residential customers is not yet open to competition as, pursuant to Directive 2003/55/EC, residential customers will only become eligible as of July 2007. For the time being, residential customers are supplied within a public utility contract by their local RDC, which in turn is supplied by the public utility wholesaler, MOL WMT.

(458) When the market is open to competition, i.e. at the latest in July 2007, Hungarian players expect that the current system of public utility supply will be replaced with a Universal Service Provider ("USP") concept for residential customers which have not concluded a supply contract with a specific supplier. Such USP shall be a gas trader licensee appointed through a competitive tender and shall be entrusted with the supply of residential customers throughout Hungary at regulated prices.

(459) Although the parties have not raised any specific argument with respect to the impact of the regulatory situation on the competitive assessment[202], the Commission has carefully considered whether the absence of competition on the market for residential customers on the expected date of the decision could, by itself, dispel the concern that the merger will significantly impede effective competition within the meaning of Article 2(3) of the Merger Regulation.

(460) It follows from the case-law that, where markets are due to be open to competition in the future by virtue of Community legislation, the Commission must not limit itself to assessing only the future effects of the concentration as from the date of their opening to competition, but should also take into account the immediate effects of the concentration on these markets[203]. Indeed, according to the Court of First Instance, although the Commission "*may, where appropriate, take into account the effects of a concentration in the near future…or indeed base its prohibition decision of a concentration on such future effects…that does not allow it to refrain from analysing the immediate effects of such a transaction if they exist and from taking them into account in its overall assessment of the transaction"*[204]. On the other hand, it would run counter to the "*Regulation's purpose of prevention*"[205] and to the prospective analysis of the kind necessary in merger control[206] to focus exclusively on such immediate effects (if they exist) as it would lead the Commission to ignore that a merger may have the effect of pre-empting the introduction of effective competition - and thus significantly impede it - in markets not yet liberalized, contrary to the intention of the Community legislature.

(461) In the present case, since residential customers will become eligible in July 2007, i.e. only 18 months after the adoption of the present decision, the Commission considers that the main anticompetitive effects resulting from the merger will occur as from that date. Indeed, in view of the new entity's dominant position on the upstream markets for the wholesale supply, and the storage, of gas in Hungary and because of its presence in the downstream market for the supply of gas to residential customers (owing to its controlled RDCs), the merged entity will have – for the same

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202 It is not argued, in particular, that the Commission is not entitled to assess the effects of the merger on that market, due to be opened to competition shortly.

203 Case T-87/05, *EDP – Energias de Portugal / Commission*, [2005] ECR II-0000 para. 123.

204 Case T-87/05, *EDP – Energias de Portugal / Commission*, [2005] ECR II-0000 para. 124.

205 Case 12/03 P, P *Commission* v *Tetra Laval* [2005] ECR I-0000, para. 75.

206 According to the Court of Justice, such a prospective analysis entails "*a prediction of events which are more or less likely to occur in future if a decision prohibiting the planned concentration or laying down the conditions for it is not adopted*" (Case 12/03 P, P *Commission* v *Tetra Laval* [2005] ECR I-0000, paragraph 42).

reasons as for the market for the supply of gas to small industrial and commercial customers - the ability and the incentive to foreclose access to gas to its actual and potential competitors in the market for the supply of gas to residential customers, thereby a) reducing the scope for the development of a competitive free segment of the market for the supply of gas to residential customers (where residential customers would conclude a gas supply contract with the supplier of their choice); and/or b) its actual and potential competitors in the regulated segment of the market for the supply of gas to residential customers (USPs) which are in competition with E.ON's affiliates to be appointed as USPs in a competitive tender while having to source their gas from the new entity (at prices and conditions freely negotiated). As a result of this likely behaviour, actual competitors are likely to be marginalised, thereby allowing the new entity to gain increased market power on the downstream gas market for the supply of gas to residential customers when they become eligible in July 2007.

(462) Furthermore, the Commission considers that, in addition to these future anticompetitive effects, the merger is also likely to produce immediate effects. First, given that the merger is likely to immediately and significantly impede effective competition on the neighbouring and closely related market for the supply of gas to small industrial and commercial customers, existing rival retailers will be weakened. Since those retailers are the same as those likely to compete for residential customers when they become eligible, the merger will therefore produce an immediate spill-over effect. Secondly, the likely vertical effects of the transaction (i.e. input foreclosure) is likely to already discourage potential new entrants to prepare their entry on the market for the supply of gas to residential customers as they will not expect to be in a position to contract gas supplies with the new entity under terms and conditions similar to those applicable to E.ON's affiliates. In particular, it is worth recalling that gas supply contracts for the gas sourcing of the suppliers are often concluded well in advance and that market entry has to be planned well before the actual opening of the market. From that perspective, the merger will thus also produce immediate effects by further deterring possible entries on the market.

(463) Finally, it should be noted that the Commission's competitive assessment would be the same, should the markets for gas supply to residential customers and for gas supply to small industrial and commercial customers become one same market immediately after July 2007. The only change in July 2007 in that case would then be the size of the market of gas supply to small customers (residential and non-residential), which would increase from 2-3 bcm to 6-8 bcm (when residential customers are added).

Conclusion

(464) On the basis of the evidence available and the analysis developed above, the Commission considers that, as a result of the merger, the new entity will have the ability and the incentive to foreclose access to gas resources to its downstream competitors on the market for the supply of gas to residential customers.

(465) In their reply to the SO, the parties raise the same arguments with regard to both the market for the supply of gas to small industrial and commercial customers and the market for the supply of gas to residential customers, without putting forward considerations specific to the latter market. Consequently, it is sufficient to refer, in

that respect, to the Commission's analysis already set out in the previous section relating to the market for the supply of gas to small industrial and commercial customers.

(466) For all these reasons, the Commission is of the view that, by allowing the merged entity to raise its rivals' costs and deter new entry on the retail market for the supply of gas to residential customers, the merger as notified will significantly impede effective competition in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation.

c. The new entity will acquire a dominant position in the supply of gas to large industrial customers

(467) On the market for the supply of gas to large industrial customers, MOL WMT directly supplies natural gas to approximately [10-20]* industrial customers connected to the high pressure pipeline and, therefore, competes - to some extent - with the RDCs which also supply some large industrial customers through the distribution network. The customers supplied by MOL WMT (both as public utility wholesaler on the regulated segment of the market and as a trader on the open segment of the market) accounted for approximately [0-2]* bcm in 2004, that is [30-40%] of the market. The table below summarizes the market shares of the various suppliers of large industrial customers (both on the regulated segment of the market through RDCs and MOL WMT public utility wholesaler and on the open segment of the market through MOL WMT and the only new entrant so far, EMFESZ).

Suppliers	**Supply of gas to large industrial customers in 2004**	
	In million m³	In %
KÖGÁZ	[0-500]*	[5-10%]
DDGÁZ	[0-500]*	[5-10%]
Total E.ON	[0-500]*	**[10-15%]**
MOL WMT	**[500-1000]***	**[30-35%]**
FŐGÁZ	[0-500]	[10-20%]
ÉGÁZ	[0-500]	[10-20%]
DÉGÁZ	[0-500]	[0-10%]
TIGÁZ	[500-1000]	[10-20%]
EMFESZ	[0-500]	[0-10%]
New entity	**[1000-2000]***	**[45-50%]**
Total Market	**[3000-4000]**	**100%**

(468) It should be underlined that, up to now, MOL WMT and RDCs have only been indirect competitors on that market. On the regulated segment of the market, MOL WMT can only supply customers directly connected to the transmission network that are listed in its license as public utility wholesaler, whereas customers connected to the distribution network can only purchase gas from their local RDCs. In addition, despite being both supplying large industrial customers, MOL WMT and RDCs are in a vertical relationship as RDCs are obliged to source their gas from MOL WMT on the regulated segment of the market.

(469) Up to now, few customers have been able to obtain better offers on the open segment of the market from traders such as EMFESZ because regulated prices have so far remained quite low.

(470) As of July 2007, the hybrid model and regulated prices will disappear for large industrial customers. It is likely that, absent the merger, MOL WMT would have been able, in its position of gas trader licensee, to gain more customers connected to a distribution network by proposing to supply them directly. Therefore, the Commission acknowledges that, irrespective of the merger, MOL WMT would already have the ability and the incentive to increase its position on the market for gas supply to large industrial customers.

(471) Nevertheless, the change brought about by the merger results from the addition of E.ON's significant customer portfolio of its controlled RDCs (KÖGÁZ, DDGÁZ) and, arguably, of FŐGÁZ, about which it has privileged information. This overlap will grant an additional competitive advantage to the merged entity by enabling it, as opposed to its current competitor EMFESZ and to potential entrants, to immediately gain access to a significant customer base.

(472) In addition, the Commission believes that, for the same reasons as in section a) above (recitals 401 to 453), the new entity will have the ability and incentive to foreclose access to its competitors downstream in the market for the supply of gas to large industrial customers in Hungary. Moreover, such foreclosure strategy would likely be reinforced as MOL Transmission would have an incentive to discriminate vis-à-vis MOL WMT's rivals for the supply of gas to large industrial customers, with a view to increase MOL WMT's profits.

(473) In their reply to the SO[207], the parties argue that the Commission has not sufficiently developed its reasoning as regards the creation of a dominant position in this market and *"has not engaged into an analysis of the countervailing competitive forces emanating from the other five significant"* competitors.

(474) It appears that four out of the *"other five significant competitors"* referred to by the parties are RDCs not connected to E.ON. However, as explained in the SO, on the market for the supply of gas to large industrial customers, MOL WMT competes with RDCs, whilst, at the same time, the latter are obliged to source their gas from MOL WMT for their supply activities on the regulated segment of the market, and do not have any alternatives to sourcing from MOL WMT on the liberalised segment of the market. The parties have not even attempted to explain how RDCs would be in a position to exert a "significant" competitive constraint on the new entity while, at the same time, sourcing their gas from the latter, and have limited their rebuttal to alleging that the Commission has not developed its analysis in full. Consequently, in addition to the significant horizontal effects brought about by the merger, the new entity will have the ability and the incentive to foreclose these competitors on the market for gas supply to large industrial customers in the same manner as in other retail gas markets. Hence, the foreclosure scenario described in detail in the previous sections applies, mutatis mutandis, to this market as well.

(475) As to the parties' argument that the Commission has not made up its mind on whether the competition concerns on this market would be of horizontal or vertical nature, it is worth recalling, as indicated in the SO, that the concerns arising on this market are due mainly to the horizontal effects of the merger, which result not only from the overlap leading to a combined market share indicative of dominance ([40-

[207] Page 11

50%]* market share resulting from the combination of the market shares of MOL WMT and of E.ON's RDCs KÖGÁZ and DDGÁZ), but also from the addition of the significant customer portfolio of E.ON's RDCs, and arguably, of FÖGÁZ, about which the new entity will have privileged information.

(476) For these reasons, the Commission is of the view that the merger will significantly impede effective competition in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation, through the creation of a dominant position on the market for gas supply to large industrial customers.

(ii) Storage of gas

(477) Any gas supplier needs to have access to storage facilities to be active on the gas retail markets, essentially in order to manage the seasonal fluctuations in the demand of its customers. Depending on the type and the number of customers, a gas supplier has to deal with daily, weekly and seasonal fluctuations so that access to efficient storage facilities at good economic conditions is an absolutely necessary condition for any supplier.

(478) It is interesting to note that suppliers with a very large and diversified customer base may need to reserve lower storage capacities as the overall variation of demand of their customers is lower due to synchronicity (when using storage for balancing) than suppliers with a limited number of customers with a fluctuating demand. This provides large gas suppliers and other gas suppliers whose customers have a stable demand with a competitive advantage over smaller competitors.

a. MOL Storage holds a dominant position in the storage of gas in Hungary

(479) MOL Storage is the only company owning gas storage facilities in Hungary and therefore the only one able to offer gas storage services.

(480) MOL Storage will be acquired by E.ON as part of the transaction. The Share Purchase Agreement also foresees that MOL will retain a 25%+1 shareholding in MOL Storage. A structural link between MOL and MOL Storage will thus be maintained. An additional commercial link arises from the Supply Agreement concluded between MOL (MOL E&P) and MOL WMT for the sale of domestic gas.

(481) All Hungarian gas storage capacities are currently fully booked, essentially by MOL WMT as public utility supplier ([2-4]* bcm or [40-50]* million m³/day, accounting for [90-100%]* of storage capacities). The rest of the storage capacity is booked by EMFESZ for [0-1]* bcm and by MOL WMT as trader (MOL's trading licensee on the open segment of the market) for [0-1]* bcm.

(482) It is worth noting that, similarly as for the access to the transmission network, as the public utility wholesaler and supplier, MOL WMT has privileged access to storage facilities (for residential and "communal" customers), as specified in Article 30(2) of the HGA. Like any other operator, MOL WMT is entitled to book capacity only on the basis of confirmed customer demand.

(483) The remaining capacity can be allocated to operators on the open segment of the market (i.e. serving customers in the open segment of the market). Pursuant to the

HGA, access to storage in the open segment of the market is negotiated and not regulated (i.e. tariffs are not set by the regulator but through commercial negotiations with the storage operator). It is however foreseen that the system will change and become fully regulated for all operators (regardless of the status of their customers), pursuant to the conditions attached to the HEO resolution approving the E.ON/MOL transaction.

(484) As mentioned on 27 June 2005, the HEO adopted a resolution approving the E.ON/MOL transaction, subject to legally binding conditions.

(485) Some of these conditions are related to Storage, most notably Condition 5 (Implementation of a gas storage development scheme for 2005-2009 approved by the HEO); and Condition 6 (MOL Storage commit to apply a regulated access for all system users, i.e. also in the open segment of the market, until real competitive market situation between natural gas storages takes place, and to comply with the GGPSSO).

b. The new entity will have the ability and incentive to discriminate against its competitors in granting access to storage

Discriminatory behaviour in granting access to storage

(486) The Commission believes that, as the result of the merger, E.ON will have the ability and the incentive to adopt discriminatory behaviour with respect to access to storage with a view to reinforce the gas input foreclosure strategy as described above to the detriment of E.ON's competitors downstream.

(487) In their reply to the SO the parties argue that, as regards storage, *"MOL currently has the same power and incentive to discriminate"* and claim that *"the change in ownership in MOL Storage will not result in the emergence of a new discriminatory element or increase the chance or willingness for such discrimination"*[208].

(488) The Commission disagrees with the parties' argument that the incentive to discriminate will remain unchanged further to the transaction. As a matter of fact, the vertical integration of E.ON downstream (notably through its majority and minority participation in three gas RDCs) represents the fundamental difference vis-à-vis the situation pre-transaction, as MOL is not active in the downstream gas markets, and will create the incentive for the new entity to exploit its dominant position in storage to reinforce its strategy of foreclosure of competing operators in the gas downstream markets, by raising (directly or indirectly) the cost of storage services for those competitors.

(489) While the incentive to discriminate would change with the transaction, the ability to discriminate would not in spite of the conditions attached to the HEO resolution. The parties have stressed in particular the importance of condition 6 of the resolution, by emphasising that MOL Storage will be forced to apply the regulated segment of the market conditions also to all operators in the open segment of the market, thereby eliminating the possibility of discriminating against E.ON's competitors with the aim of raising rivals' costs.

[208] Reply to the SO, p. 18.

(490) However, the Commission understands that MOL Storage will have to submit a proposal for the new *"fully"* regulated regime by 31 May 2006. The HEO would then review and possibly approve MOL Storage's proposal. This approval process may take some time, as the HEO may request certain amendments to the proposal.

(491) This means that the fully regulated regime may enter into force well into the second semester 2006 if not later. Whilst the Commission acknowledges that the coming into force of a fully regulated storage regime may at least alleviate concerns regarding the discriminatory behaviour on the part of MOL Storage against E.ON' competitors, and that therefore the full and timely implementation of the conditions attached to the resolution of the HEO may reduce the ability to discriminate, it has to be stressed that during the period running up to the final approval by the HEO of the new fully regulated regime, MOL Storage would still have margin for manoeuvre for applying discriminatory pricing terms and conditions. In a scenario of growing liberalised market (as also stressed by the parties), the scope and the incentive for potential discrimination should be taken into account, as such discriminatory behaviour could be particularly harmful at the beginning of the liberalisation process.

(492) The parties argue in their reply to the SO that the Commission has not duly taken into account that *"under the approval decision of the HEO, the present transaction can only be consummated if E.ON/ERI submitted an irrevocable guarantee in respect of the fulfilment of the conditions"*.

(493) The Commission however stresses that the new entity's obligation is, in this respect, limited to elaborating *"the conditions of regulated storage access in its General Terms of Business"* by 31 May 2006 and applying for the HEO's approval. It is only following the HEO's approval – which may take some time – that *"MOL Storage obeys the amended provisions thereof in the c[o]urse of applying regulated storage access"*.

(494) Moreover, the parties also argue that the Commission *"should not be worried about the interim period of the first half year of 2006"* as *"this represents the second half of the current gas year for which all agreements relevant to storage access have already been concluded and those agreement cannot be changed post closing"*.

(495) The Commission considers that this argument fails to acknowledge the possibility that other third parties may need access to storage services during the second half of 2006, for which new contracts would have to be negotiated during the first half of 2006. The storage injection season does not correspond to the gas year, as it runs from 1 April until 30 September, and the withdrawal season starts from mid-October after a few weeks of maintenance. Furthermore, the parties may also engage in non-price discriminatory behaviour even in the framework of existing contracts, as further explained below. Finally, the parties put forward their argument as regards the first semester of 2006, while not contesting the Commission's assessment that "the fully regulated regime may enter into force well into the second semester 2006 if not later."

(496) Moreover, since the regulated prices are established by the HEO on the basis of inputs, estimates and information provided by the operator of the storage facilities, E.ON may have the ability and the incentive to cross-subsidise its activities in the gas downstream open segment of the markets through its near-monopolistic

activities (in gas storage) by providing information according to which the HEO would set regulated prices above real costs.

(497) The parties argue in their reply to the SO (Annex 2, page 3) that the HEO is currently reviewing the *"storage costs"* with the objective of *"calculating the new regulated storage tariffs, which will be in effect from 1 January 2006 for four years"*. This review should be finalised before the expected completion of the transaction. The parties conclude, on this basis, that *"E.ON can have no effect on the newly accepted cost regime for the period 2006-2009"*.

(498) However, the parties fail to mention that price reviews are possible, at the request of the storage operator. The HEO foresees a specific procedure for such reviews, to be concluded with HEO resolutions. In this light, the argument of the parties appears to be moot.

(499) Secondly, MOL WMT may still exploit its priority position for the allocation of storage capacity by over-nominating its capacity needs of storage. This appears to be a concrete possibility, in spite of the requirement that capacity only be booked on the basis of confirmed consumption/customer demand. As a matter of fact a third party indicated that the system's *"technical capacity"* is 20-30% higher than *"regulatory capacity"*[209], meaning that most if not all operators tend to book more capacity than actually needed. This has the effect of congesting the system and the objective/effect of raising barriers to entry for new suppliers.

(500) By overbooking its priority storage capacity, MOL WMT would increase the system's congestion. As a result, the "lower priority" capacity would become scarcer, thus raising, in the period up to the full implementation of the HEO resolution, the non-regulated price of storage services and creating an additional barrier to entry on the open segment of the market.

(501) The parties have argued[210] that it would not be *"in the interest of the owner of MOL WMT to overbook storage capacities as this would be costly"*. However, the Commission considers that the cost of overbooking incurred by MOL WMT may well be (more than) compensated by the extra revenues accruing to MOL Storage due to the higher price of storage services, now become scarcer due to their reduced availability, and by the revenues accruing to MOL WMT through preventing and/or raising barriers to the entry of competitors.

(502) Thirdly, as already indicated, the HGA provides for Third Party Access to storage, whose principles are the same as for the booking of transmission capacities. Once a new supplier has acquired an eligible customer, the Already Allocated Capacity required to supply this customer should be automatically transferred to the new supplier.

(503) However, the customer-based capacity allocation regime may leave some margin for discriminatory behaviour. As a matter of fact, MOL Storage may engage in a whole

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[209] Minutes of meeting with EMFESZ of 28 July 2005: "Better control of compliance with the rules should be secured, e.g. regarding the customer-based capacity allocation regime".

[210] Reply to the SO, annex 2, pp. 3-4.

range of actions intended to increase the costs to E.ON's downstream competitors, such as designing storage services that are more suited to the needs of an incumbent than those of new entrants (as regards injection and withdrawal rates and volumes of gas stored), delays in allocation of storage capacity, reductions in the quality of service, mistakes in processing orders, lack of flexibility and so on, thereby significantly increasing the operational costs of competitors of the merged entity in the downstream markets.

(504) Finally, even in the scenario of fully regulated prices for storage services, MOL Storage may have the ability and the incentive to discriminate against E.ON competitors by means of more onerous/less flexible contractual terms as compared to those negotiated with intra-group companies (e.g. the trading branch of MOL WMT active on the open segment of the market).

(505) Moreover, it may be argued, as an aggravating factor, that any discriminatory behaviour may also prove difficult to detect considering that market players would not be likely to submit complaints to the regulator or competition authority in view of the monopolistic position of E.ON in the market for storage. In addition, as MOL WMT will remain by far the biggest client of MOL Storage, E.ON may argue that contractual terms and conditions would differ for "objective" reasons. The likelihood of the anticompetitive behaviour aimed at reinforcing the gas foreclosing strategy vis-à-vis downstream competitors would thus be increased, in the absence of sufficiently strong "regulatory" deterrence.

(506) In their reply to the SO[211] the parties argue that *"there is no reason to believe that in the future, the customers of MOL Storage would be deterred from submitting complaints against the business conduct of MOL Storage".*

(507) Nonetheless, the Commission stresses that even the HEO, the body which is responsible for overseeing the fair, transparent and non discriminatory functioning of the gas sector in Hungary, has stated that *"[p]ossible discriminative rules applied regarding storage access is a behaviour that is very hard to prove using administrative methods. (…) The market player which is at a disadvantage fears for its future position on the market, and will rather not submit a complaint at the regulatory or competition authority"*[212]. In this light, the argument of the parties appears to be moot.

The development of storage capacity and the possibility of increased competition

(508) Finally, E.ON will be able to control the development of new storage capacities in Hungary. This is due to the combination of two elements: a) the call option foreseen in paragraph 10.10 of the Share Purchase Agreement for MOL Storage to purchase depleted fields from MOL E&P; and b) the 25%+1 shareholding to be retained by MOL into MOL Storage.

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211 Page 18

212 Reply of the HEO to the Hungarian Competition Authority's questions regarding the E.ON/MOL transaction, 11 April 2005, page 4.

(509) There are around 50 empty underground reservoirs in Hungary, owned by MOL E&P, which have the potential to be converted into storage facilities. The parties have stated that […]* of these 50 depleted fields can be converted into storage facilities within a 3 to 10 years period. The capacity of these potential storage facilities is between 100 million m^3 and 3 bcm each.

(510) Out of these ten "best" depleted fields, three may be converted within a period of 2 years for a total capacity of 350 million m^3 [213]. Another two may be converted within 3-4 years for a total capacity of 850 million m^3.

(511) Paragraph […]* of the Storage Shareholder Agreement ("SSA") between MOL and E.ON grants the […]*. The call option has a validity of […]* years. Schedule 7 attached to the SSA foresees that […]*.

(512) As mentioned, the call option grants MOL Storage the right to purchase depleted fields for a total capacity of up to 1 bcm. As a result, by exercising the call option E.ON will be in a position to prevent new entry into the storage market for a number of years, as the most readily available fields (i.e. convertible in a period of [0-5]* years) amount to a capacity of only [1-2]* bcm, thus leaving no scope for entry for at least [0-5]* years and only marginal scope, if any, for [2-5]* years.

(513) Furthermore, in view of the minority shareholding of MOL into MOL Storage and the commercial relationship between MOL (MOL E&P) and the new entity as regards the sale of domestic gas, MOL will have an economic interest to discourage potential new entrants into the storage market by refusing to sell depleted fields or by applying unfavourable terms and conditions as compared to those applied to MOL Storage. MOL's financial interest arises from the possibility to receive dividends from MOL Storage's profits corresponding to its shareholding and to obtain capital gain on the increase in value of its shareholding resulting from the company's greater profitability (even if no dividends are distributed). Such discrimination strategy is not expected to induce a decrease in MOL E&P's revenues deriving from the sale of depleted gas fields (as it would favour MOL Storage to the detriment of its potential competitors) and would strengthen MOL Storage's gas storage services input foreclosure strategy mentioned above.

(514) In addition, due to the structural links between MOL and MOL Storage, MOL Transmission will have the incentive to favour the development of MOL Storage's new storage facilities as compared to its competitors, in terms of connection to its gas transmission network. In their reply to the SO[214], the parties argue that *"the transaction reduces the incentive of MOL E&P to sell sites exclusively to MOL Storage, because the transaction weakens the relationship between MOL E&P and MOL Storage".*

(515) While the Commission acknowledges that the ownership unbundling of gas supply activities (MOL WMT) on the one hand, and gas production activities (MOL E&P), future storage sites (MOL E&P) and transmission activities (MOL Transmission) on

[213] See the MOL Plc document "Opportunities for UGS capacity expansion", submitted by the parties in reply to question 71 in the Commission's request for information.

[214] Annex 1 page 26.

the other hand brings, in principle, positive effects, the Commission nonetheless is of the opinion that that the cross-shareholdings, the existence of the put option for MOL Transmission, the Supply Agreement with MOL E&P and the call option for MOL Storage to purchase depleted fields from MOL E&P impair the "effectiveness" of the unbundling of those activities and, by maintaining a structural link between MOL and the new entity, significantly limit the scope of the positive effects described by the parties.

(516) At any rate, even in the absence of this structural link, the Commission stresses that the parties have, as a matter of fact, negotiated a call option which grants MOL Storage a right of "first choice" on the best fields to be developed into storage facilities and which will, in all likelihood, act as a barrier to entry into the gas storage market for the foreseeable future.

(517) To conclude, the Commission believes that, following the transaction, the new entity will have the ability and the incentive to discriminate against its competitors in the downstream gas markets for their access to storage capacity. MOL Storage already had the ability to exploit its dominance on the market for the storage of gas in Hungary prior to the transaction, but the transaction strengthens its incentives to do so by creating a fully vertically-integrated undertaking along the gas supply chain.

(518) Moreover, owing to the call option foreseen in the SSA, E.ON will have the ability and the incentive to make new entry into the storage market impossible, at least in the short-medium term.

(519) Finally, owing to the structural link between MOL and MOL Storage, MOL will have the ability and the incentive to contribute to raising barriers to entry into the storage market.

(520) For these reasons, the Commission is of the view that the merger will significantly impede effective competition in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation, as the new entity is likely to discriminate against its competitors in the downstream gas markets for their access to storage capacity and is likely to make new entry into the storage market impossible.

(iii) Transmission of gas

(521) MOL Transmission owns and manages the gas high pressure grid in Hungary including the two entry points for imports. MOL Transmission also acts as system operator, in charge of the continuous and transparent operation and balance of the integrated natural gas system.

(522) MOL Transmission is not part of the proposed transaction. However, as already mentioned, the parties have concluded an agreement whereby MOL is granted a "put option" under which MOL may sell to E.ON either a 25 % plus 1 share or a 75 % minus 1 share interest in MOL Transmission during the next two years. E.ON has stressed that it has no influence to request MOL to exercise this put option.

a. Nabucco pipeline

(523) Respondents to the Commission's investigation have argued that the mere existence of this put option may provide E.ON with a strong influence over MOL Transmission, which means that the market for the transmission of gas may also be affected by the merger, even prior to the exercise of the put option.

(524) In particular, respondents to the market investigation have expressed the concern that the new entity may be able to influence MOL Transmission's strategy post-merger and to have an impact on the transit options to other European countries. Market participants have reported to the Commission that E.ON already had de facto a decisive influence on new pipeline projects going through Hungary.

(525) Serious concerns have been raised in relation to the Nabucco project dealing with a new pipeline going from Turkey to Austria, crossing Bulgaria, Romania, and Hungary to bring Caspian and Middle Eastern gas to European markets. The pipeline's operation phase is expected to start in 2011/2012 and its yearly capacity will be either [25-30] bcm (base case scenario) or [30-35] bcm (high case scenario). Around [10-20] bcm are expected to be available at the Baumgarten Austrian hub for further transmission and distribution in Europe. The project has received the support of the European Union (TEN Programme) and plays a key role in diversifying the European Union's gas sourcing.

(526) Two respondents to the market investigation directly involved in the project have claimed that the project had already been delayed by the proposed transaction. According to these third parties, while all other partners were about to sign the JV agreement in March 2005, MOL Transmission indicated that it would first need to obtain the approval of E.ON Ruhrgas.

(527) More importantly, these companies have also raised the concern that MOL Transmission could be unwilling or unable to contribute to the development of the project over the duration of the put option. Any such development could have an impact not only on the availability of alternative sources of gas for new entrants in Hungary but also on the security of supply and sourcing policy of Hungary and the rest of the European Union.

(528) E.ON's incentives would be two-fold. First, according to these third parties, the Nabucco pipeline, which offers a chance to bring significant quantities of non-Russian gas to Europe, could interfere with Gazprom's commercial strategy in Europe. In the opinion of the parties involved in Nabucco, this gas could even be competitive on the Polish, Czech, Ukrainian and Belarusian markets, which are currently essentially supplied by Gazprom. In view of the strategic relationship between Gazprom and E.ON, Gazprom may therefore influence E.ON's position in order to delay or impede the success of the project. Secondly, E.ON would also have an incentive not to favour new pipelines entering Hungary to prevent new competitors from entering the Hungarian gas markets.

(529) The Commission has carefully assessed the concerns raised by these third parties but could however not come to the conclusion that the proposed transaction was likely to impede or delay significantly the construction of the Nabucco pipeline.

(530) The Commission first notes the company involved in the Nabucco joint venture is no longer MOL Transmission but its parent company MOL (MOL Rt.)[215]. The joint venture agreement was signed by the five Nabucco partners in July 2005. E.ON is thus not in a position to have a decisive influence on the project development and MOL is likely to continue to support the construction pipeline if the further economic analysis and the project financing confirm that it will be profitable for its joint owners.

(531) Moreover, the Commission's investigation did not provide indications that E.ON had strong incentives to oppose the new pipeline project. While the strategic relationship with Gazprom may have a bearing on E.ON's position[216], E.ON is also certainly interested in diversifying its gas sourcing portfolio in Europe and the Nabucco project could bring E.ON significant advantages in this respect.

(532) For these reasons, the Commission has concluded that the proposed transaction is not likely to impede or significantly delay the Nabucco pipeline project, as the result of which competition could be significantly impeded in a substantial part of the common market.

b. Transmission of gas in Hungary

(533) With respect to the impact of the proposed transaction on gas transmission within Hungary, respondents to the market investigation have argued that MOL Transmission will be in a position to favour E.ON in the allocation of cross-border or national capacities, although such behaviour would be subject to monitoring by the HEO. Moreover, it has been argued by some respondents that the existence of the put option may lead MOL Transmission to "freeze" the development of its network (e.g. new entry capacity) during the period up to the deadline for the put option, while waiting to decide whether the option will be exercised or not.

(534) As MOL Transmission is not part of the notified transaction, the full effect of the contemplated put option, which would further strengthen the vertical integration of E.ON, is not assessed in this document. However, the Commission acknowledges that the mere existence of the put option is likely to have an impact on the functioning of the markets and the management of the gas infrastructure in Hungary.

(535) Furthermore, as already indicated, according to the Share Purchase Agreement signed by the parties, MOL (which will continue to control MOL Transmission) will retain a 25%+1 shareholding in MOL WMT, which will be controlled by E.ON, thereby creating a structural link between MOL and the merged entity. An additional commercial link arises from the Supply Agreement concluded between MOL (MOL E&P) and MOL WMT for the sale of domestic gas. This commercial relationship between MOL and MOL WMT is likely to reinforce the structural link.

(536) The 25%+1 minority shareholding that MOL would retain in MOL WMT and the above-mentioned commercial relationship give MOL Transmission an incentive to discriminate against E.ON's downstream competitors when granting access to the

215 Parties' reply to the Commission request for information dated 19 July 2005 – Question 101.

216 In particular in light of E.ON's participation in the Baltic pipeline project led by Gazprom.

transmission network. MOL's financial interest arises from the possibility to receive dividends from MOL WMT's profits corresponding to its shareholding and to obtain capital gain on the increase in value of its shareholding resulting from the integrated new entity and MOL WMT's greater profitability (even if no dividends are distributed) owing to MOL Transmission granting it a favourable treatment. As for the gas input foreclosure, such non-price discrimination strategy is not expected to induce a decrease in MOL Transmission's revenues (as it would favour MOL WMT to the detriment of its competitors) and would strengthen MOL WMT's gas input foreclosure mentioned above.

(537) As a matter of fact the vertical integration of E.ON downstream (notably through its majority and minority participation in three gas RDCs) represents the fundamental difference vis-à-vis the situation pre-transaction, as MOL is/was not active in the downstream gas market. The incentive therefore exists to reinforce the gas input foreclosure strategy to the detriment of E.ON's competitors downstream through discriminatory behaviour in granting access to the transmission network.

(538) Whilst it has to be stressed and acknowledged that the operation of the transmission grid is highly regulated by the HEO, MOL Transmission is still likely to have the ability and incentive to favour MOL WMT for the access to the transmission network.

(539) Moreover, as already mentioned, the Network Code contains the detailed technical rules for the operation of the gas system. The Network Code is drafted by the Network Code Committee.

(540) It has to be highlighted that E.ON may, post transaction, directly or indirectly control the majority of the 9 members of the Committee, who are either representatives of or elected by the various licensees active in the gas sector[217]. Since changes to the Network Code are decided by simple majority, E.ON is therefore likely be in a position to influence the way in which the Network Code may be re-drafted/updated in the future with the objective/effects of discriminating against E.ON's competitors in the allocation of capacity along the grid and to favour MOL WMT over new entrants.

(541) Furthermore, as described, capacities along the transmission (and storage) chain are crucially divided into Already Allocated Capacity (AAC) and Free Capacity (FC) in accordance with Article 1(30) of the Executive Decree.

(542) Generally, MOL WMT will be in a position to exploit its priority position for the allocation of transmission capacity by over-nominating its capacity needs, in spite of the requirement that capacity only be booked on the basis of confirmed consumption/customer demand. As a matter of fact a third party indicated that the system's *"technical capacity"* is 20-30% higher than *"regulatory capacity"*[218], meaning that most if not all operators tend to book more capacity than actually needed. This has the effect of congesting the system and the objective/effect of raising barriers to entry for new suppliers.

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[217] See Chapter 3.1 of the Network Code.

[218] See minutes of meeting with EMFESZ of 28 July 2005.

(543) By overbooking its priority transmission capacity, MOL WMT would increase the system's congestion. As a result, the "lower priority" capacity would become scarcer, thus raising additional barrier to entry on the open segment of the market.

(544) Moreover, Free Capacities ("FC") are measured by the TSO (i.e. MOL Transmission) according to a methodology which has to be approved by the HEO. Capacities are allocated by the TSO to market players within a maximum of three months subsequent to their application.

(545) In case of "overbooking" of FC, the procedure for allocation foresees an "auction", pursuant to point 5.1.3.1(g) of the Network Code. The Network Code however does not specify how these auctions should take place and within which timeframe. The parties have argued that this auction process *"usually takes two weeks to complete"*.

(546) Arguably, in the presence of the MOL Transmission's incentive to discriminate in favour of the new entity, this auction processes could be managed in a non-transparent, discriminatory manner, or with undue delay, to the detriment of third parties. In the expectation that the liberalised market may grow after 2007, instances of discriminatory behaviour are still likely to occur in the allocation of FC to market operators. This discriminatory behaviour would be particularly harmful during the initial phase of liberalisation.

(547) In their reply to the SO, the parties underline that the transaction will bring about the ownership unbundling between gas wholesale and gas transmission. Although the ownership unbundling of gas wholesale and transmission activities brings in principle positive effects, the Commission notes that the cross-shareholdings, the existence of the put option for MOL Transmission and the Supply Agreement with MOL E&P do not achieve a full unbundling of those activities and significantly limit the scope of the positive effects described by the parties.

(548) In their reply to the SO, the parties contest that the *"timing and degree of [the transmission network] development"* may be negatively impacted by the transaction. On the contrary, the parties claim that it *"depends totally on consumer demand and the approval of the Hungarian regulator"*[219]. While this assertion may be verified in normal business conditions, the Commission estimates that the uncertainties about MOL Transmission's ownership are likely to negatively impact the company's ability to carry out and plan long term projects.

(549) To conclude, the Commission believes that MOL Transmission is likely to have the ability and the incentive to discriminate against E.ON's competitors in granting access to the gas transmission network, owing to the structural link resulting from the 25%+1 minority shareholding of MOL into MOL WMT. MOL Transmission already had the ability to exploit its dominance on the gas transmission market in Hungary prior to the transaction. The structural link created by the transaction will strengthen its incentives to do so in view of the vertical integration of the new entity along the gas supply chain.

(550) Moreover, the Commission is also concerned that, pending the exercise of the put option, the development of the network (for instance additional entry point capacity)

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may be put on hold while waiting to see who the "final" owner of such projects would be.

(551) For these reasons, the Commission is of the view that the merger will significantly impede effective competition in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation, as the new entity is likely to discriminate against its competitors in the downstream gas markets for their access to transmission capacity.

C. Impact of the transaction on the electricity markets

(552) In addition to the concerns related to the gas sector presented in section B above, the Commission's market investigation has identified competition concerns on various electricity markets, as a result of the vertical integration of MOL WMT's activities in the upstream market of gas supply to large power plants with E.ON's activities in the downstream markets of electricity generation/wholesale and electricity retail.

(553) Prior to the transaction, MOL WMT is dominant on the market for the supply of gas to large power plants, whereas it is not active in the electricity markets. On the contrary, E.ON already has a strong position on the electricity retail markets in Hungary and is likely to become significantly active on the generation/wholesale electricity markets.

(554) The Commission's market investigation has revealed that, following the merger, the new entity will have the ability and the incentive to raise the costs of future and existing gas-fired power plants in Hungary. The Commission is also concerned that the new entity will have the ability and the incentive to supply competitive gas to future and existing gas-fired power plants under the condition that they sell their electricity production to E.ON's RDCs or trading subsidiary at favourable conditions ("tolling strategy").

(555) The economic interest to pursue these strategies will increase with the further liberalization of the electricity sector in Hungary and the increase in E.ON's share in electricity generation. These two likely strategies would also prevent existing and future rival electricity generators/ wholesalers from competing effectively in the markets for the wholesale supply of electricity to traders[220].

(556) The new entity's strategy in electricity generation / wholesale would lead to a restriction of new electricity generation capacities in Hungary and would therefore have an impact on electricity wholesale prices in the country. The "tolling agreements" strategy would restrict E.ON's electricity retail competitors' ability to get competitive supplies of electricity, thereby significantly impeding effective competition on electricity retail markets. In addition, the transaction will give E.ON the ability and incentive to prevent its electricity retail competitors from developing dual offers (electricity and gas) in Hungary. This would further increase E.ON's market power on the electricity retail markets in Hungary.

[220] In addition, third parties have indicated that, since 80% of heat production in Hungary is gas-fired, E.ON will have the same ability and incentive as regards heat production as for electricity. Therefore the transaction will lead to similar anticompetitive effect in the district heating sector.

(557) The Commission's assessment of the effects of the transaction on the electricity markets in Hungary has been carried out both under current market conditions and within the foreseeable future, taking account of the most likely scenario following the implementation of the New Electricity Model in Hungary.

(558) The position of E.ON and other market players in the electricity sector is first presented before setting out in detail the competition concerns resulting from the transaction at the electricity generation / wholesale and electricity retail level.

(i) Market players in the electricity sector in Hungary[221]

(559) Besides E.ON, MVM and several large European electricity groups are active in Hungary at the generation, the wholesale or the retail level. Smaller electricity trading companies have also developed more recently.

a. E.ON

(560) E.ON has made significant investment in the electricity sector in Hungary since 1995/96. The group is currently active at the generation level with a gas-fired power plant in Debrecen, and at the wholesale and retail supply level with ownership of three out of the six electricity RDCs and the electricity trading company E.ON EK. In addition, E.ON controls various companies involved in electricity retail supply in Hungary's neighbouring countries.

Electricity generation

(561) E.ON owns a medium size gas-fired power plant and several smaller generation facilities in Hungary which produce both electricity and heat (for district heating purposes). These facilities had a total production of [0-2]* TWh in 2004, accounting for [5-15]*% of Hungarian gas-fired electricity and [0-5]* % of Hungarian electricity generation. It should be noted that E.ON has plans to expand significantly its generation capacity.

(562) In 2004, E.ON's largest power plant (Debrecen) sold almost[222] its entire electricity production ([500-1,000]* GWh) on the regulated segment of the market, in the frame of a long-term PPA with TITÁSZ[223]. Most of E.ON's plants are also used for heat production. E.ON is the sole heat generator/supplier for the district heating of two large cities (Debrecen and Nyíregyháza). However, at the national level, E.ON's share in heat production amounts to [5-10]*%.

(563) The assessment of E.ON's position in electricity generation in Hungary should also take into account the importance of gas-fired power plants in the Hungarian electricity markets, as explained by most market players. For instance, a third party active in the electricity sector has highlighted that:

221 None of the companies controlled by MOL is active in the production or supply of electricity in Hungary. MOL only indirectly owns minority interests in TVK-Erőmű, a 50 MW gas-fired cogeneration plant.

222 DKCE sold in 2004 minor quantities of electricity to […]* on the free market ([0-500]* MWh).

223 TITÁSZ is wholly owned by E.ON.

"The fact that E.ON currently only owns 2.8% of electricity generation capacity may be misleading. First, as regards electricity produced from gas for system balancing, suppliers with even a small percentage have market power because it is not possible to live without this electricity."

(564) Finally, E.ON is also active in power generation in Austria, through its interests in Donau Kraftwerk Jochensten AG ("DKJ") and Österreischisch-Bayerischen Kraftwerk AG ("OBK"). DKJ and OBK have respectively power generation capacity of [0-200]* MW and [200-500]* MW and produced [500-1,000]* GWh and [1,000-2,000]* GWh in 2003.

Electricity wholesale

(565) E.ON EK started its activities as electricity trader in Hungary in March 2003. In 2003, E.ON EK traded [0-5]* TWh of electricity and this quantity increased to [0-5]* TWh in 2004. The company sells electricity exclusively to MLCs and not to electricity traders. E.ON EK is one of the three major Hungarian electricity traders, with the ATEL group and MVM.

(566) In 2004, the company sourced the large majority of its electricity from imports ([0-5]* GWh), essentially from the group's German electricity trading subsidiary ("EST") ([35-45]*% of E.ON EK's imports) and through the Slovak interconnection ([85-95]*% of E.ON EK's imports). Domestic sources ([0-2]* GWh) were MVM auctions ([0-500]* MWh) and Electrabel ([0-500]* MWh).

Electricity RDCs

(567) E.ON has sole control of three of the six RDCs: TITÁSZ, ÉDÁSZ and DÉDÁSZ. In 2004, those three RDCs supplied respectively [0-5]* TWh, [5-10]* TWh and [0-5]* TWh of electricity to residential customers, SCs and MLCs in their respective regions and in the public utility segment.

Electricity retail in neighbouring countries

(568) E.ON is also active on the electricity retail markets in Hungary's neighbouring countries. In Slovakia, the group has a 49% interest in Zapadoslovenska Energetika a.s. ("ZSE"), active in retail supply of electricity. In 2003, ZSE had total electricity sales of [5-10]* TWh, accounting for [30-40]*% of the overall Slovak market. In Romania, E.ON acquired recently 51% in Electrica Moldova S.A ("Moldova"), also active in the retail supply of electricity. In 2003, Moldova had total electricity sales of [0-5]* TWh, accounting for [0-10]*% of the overall Romanian market.

(569) E.ON acquired in 2003 the control of three Czech electricity regional distribution companies, ZCE, JCE and JME. Together, these three companies supplied [10-15]* TWh in 2003, accounting for [20-30]*% of the overall Czech electricity market. It is worth mentioning that ZCE's, JCE's and JME's in the Czech Republic, ZSE's in Slovakia and ÉDÁSZ's and DÉDÁSZ's geographic areas in Hungary have contiguous borders. Finally, E.ON also has a majority interest in the electricity distribution companies Varna and Gorna in Bulgaria, which together accounted for [15-25]*% of total Bulgarian electricity market in 2003 with sales of [0-5]* TWh.

(570) Although there is currently no relationship between E.ON's electricity retail assets in Eastern Europe, E.ON's presence in several of Hungary's neighbouring countries allows E.ON to import electricity into Hungary. In addition, E.ON may enjoy an additional competitive advantage in terms of brand recognition, reputation and ability to supply large chain customers with branches in several countries.

b. MVM

(571) MVM is the former monopoly electricity wholesaler and electricity transmission grid operator in Hungary. During the energy sector privatization in 1995/1996, Hungarian power plants and RDCs were sold to private investors while MVM remained a state owned company, owning the electricity transmission network and retaining the ownership of the Paks nuclear power plant and other power plants. Since the opening of the market to competition in 2003, MVM has maintained a leading role in electricity wholesale, as public utility wholesaler and as trader on the open segment of the market.

- *Generation*

(572) MVM owns the Paks nuclear power plant, the Hungarian largest power plant, and several medium-size gas-fired or coal-fired power plants. The Paks nuclear power plant produced [10-12.5] TWh in 2004, entirely sold in the public utility segment. The company owns a 25% stake in the gas-fired Dunamenti power plant, the second largest power producer in Hungary.

- *Electricity wholesale*

(573) As the licensee for public utility wholesale, MVM has long-term contractual relationships with the majority of large electricity generators on the one hand and the electricity RDCs on the other hand. In 2004, the company sold [25-27.5] TWh in the public utility segment, to be compared to a total electricity consumption of [37.5-40] TWh in Hungary. The company organises auctions every six months to sell its surplus power to traders.

- *Electricity retail*

(574) MVM fully owns MVM Partner Rt. ("MVM Partner"), active in the Hungarian free electricity market. In 2004, the company sold [2.5-5] TWh on the open segment of the market and was the second largest electricity trader.

c. MAVIR

(575) MAVIR is the current transmission system operator in Hungary. The company started its operations in January 2001 according to a "Base contract" with MVM. Initially, MAVIR was part of the MVM group, but after the adoption of the HEA in December 2001, MAVIR's ownership was transferred to the MET in December 2002. MAVIR obtained the licence for System Operation in January 2003.

(576) Following a recent government decree[224] of July 2005, the ownership of MAVIR has been transferred to MVM. The ownership of the Hungarian electricity transmission grid has been transferred from MVM (parent company) to MAVIR.

(577) Due to the long-term PPAs contracted by MVM, MAVIR procures the electricity needed for system balancing mainly from MVM.

d. International groups

RWE

(578) RWE is active at the generation level, with a majority stake in the Mátra lignite power plant[225], at the retail supply level (public utility segment), with majority stakes in two electricity RDCs (ELMŰ and ÉMÁSZ) and at the wholesale and retail level with the electricity trader MÁSZ, a 50/50% joint venture between ELMŰ and ÉMÁSZ. In 2004, ELMŰ, ÉMÁSZ and MÁSZ had respective electricity sales of [7.5-10] TWh, [2.5-5] TWh and [0-2.5] TWh.

EDF

(579) In Hungary, EDF is present through its subsidiaries BERT, active in cogeneration and the electricity RDC DÉMÁSZ. BERT owns three medium size CCGTs with a total generation capacity of [250-500] MW. BERT's electricity production amounted to [0-2.5] TWh in 2004 and was entirely sold in the public utility segment.

(580) DÉMÁSZ supplies electricity in the public utility segment and sold [2.5-5] TWh in 2004. The company has established an electricity trading subsidiary named D-Energia. The latter sold [0-250] GWh and [250-500] GWh on the liberalized market in 2003 and 2004 respectively.

Electrabel

(581) Electrabel-Suez is a French/Belgian group active on several European electricity and gas markets. The group owns the second largest electricity production facility in the country, Dunamenti Erőmű (gas-fired), with a total capacity of [1,500-1,750] MW[226]. In 2004, the power plant produced [2.5-5] TWh and […%] of this capacity was sold to MVM in the public utility segment. Electrabel-Suez is not active in electricity retail in Hungary.

ATEL

(582) The Swiss group ATEL owns the gas-fired Csepeli power plant. It has a [250-500] MW generation capacity and produced [0-2.5] TWh in 2004, which were entirely sold in the public utility segment. The Csepeli power plant is the most recent large power plant in Hungary and started its operations in November 2000.

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224 Government decision 1070/2005 of 8 July 2005

225 RWE holds a 50.9% stake in Mátra. Lignite is produced in Mátra-owned mines.

226 Additional generation units installed in the 60's (530 MW capacity) are currently being mothballed.

(583) The group is also active at the retail level through the two electricity traders ATEL Energia Kft. ("ATEL Energia") and Entrade Hungary Kereskedelmi Kft.[227] ("Entrade Hungary"), which respectively sold [0-2.5] TWh and [0-2.5] TWh on the open segment of the market in 2004. Combined, the two trading companies constitute the largest electricity trader in Hungary. The Csepeli plant does not have commercial relationship with ATEL Energia nor with Entrade Kft.

Others

(584) The other major market players in electricity generation are the AES group, which owns the AES Tisza gas-fired power plant and the Borsod coal power plant, and the group PannonPower Holding Rt. ("Pannon Power") which owns the Pannon Hőerőmű gas power plant in Pécs.

(585) Several electricity traders are active on the open electricity markets in Hungary, the largest being System Consulting[228], Sempra Energy Europe and Energy Financing Team Budapest. Elektra Energia and ETC Hungary started their activity more recently and the trading company Energy Capital is planning to enter in the short term.

(586) The table below provides an overview of the main market player' position in electricity generation[229] and retail supply level in Hungary.

	MVM	**E.ON**	**RWE**	**EDF**	**Electrabel**	**ATEL**	**Others**	**TOTAL**
Electricity generated in 2004 (GWh)	[10000-12500]	**[0-2500]***	[5000-7500]	[0-2500]	[2500-5000]	[0-2500]	[5000-7500]	**[30000-35000]**
2004 - %	[30-40%]	**[0-5%]**	[10-20%]	[0-10%]	[10-20%]	[0-10%]	[20-30%]	**100%**
Electricity sales to final users in 2004 (GWh)	[2500-5000]	**[12500-15000]***	[12500 - 15000]	[2500-5000]	0	[2500-5000]	[0-2500]	**[35000-40000]**
2004 - %	[0-10%]	**[40-45%]**	[30-40%]	[10-20%]	[0-10%]	[0-10%]	[0-10%]	**100%**

[227] ATEL acquired at the beginning of 2005 the company Entrade GmbH, the owner of Entrade Hungary.

[228] System Consulting is an independent company that imports electricity from Ukraine to Hungary for resale to traders in Hungary and for exports. System Consulting is only active at the wholesale level and does not sell electricity to any final customer.

[229] As explained above, electricity generation does not constitute a relevant product market for the assessment of this transaction but is part of the generation/wholesale product market. "Electricity sales to final users" include sales in all retail electricity markets.

(587) As reflected in the above table, E.ON is the main player in the Hungarian electricity retail markets, with a market share in excess of 40%, due to its strong position both in the public utility segment and as an electricity trader.

(ii) Electricity generation/wholesale

(588) MOL already has the ability to exploit its position of gatekeeper of gas resources in Hungary prior to the transaction. The fundamental change brought about by the transaction is that the new entity will now also have the incentive to do so owing to the creation of a fully vertically-integrated undertaking along the gas and electricity supply chain.

(589) The Commission believes that, as the result of the proposed transaction, E.ON will have the ability and the incentive to foreclose access to gas to its competitors in electricity generation due its dominant position in the wholesale supply of gas to power plants. E.ON will also have the ability and incentive to discriminate against gas-fired power plant that do not supply its subsidiaries active in electricity retail and to engage in "tolling agreements" with new gas-fired power plants.

(590) E.ON is likely to pursue these strategies in view of its strategic plans to significantly develop its electricity generation capacity and its economic interest in obtaining competitive electricity supplies. These strategies would result in a restriction of new electricity generation capacities by other / independent market players and would strengthen E.ON's market power and lead to an increase in electricity wholesale prices.

(591) In their reply to the SO, the parties claim that the proposed transaction will not bring about any change in MOL WMT's strategy vis-à-vis power plants and contest the new entity's economic interest in engaging in foreclosure strategies. The Expert Report submitted by the parties states[230] that this *"would be equally likely in the absence of the proposed transaction, because the existing power stations of E.ON/ERI do not provide any head-start in the long road to monopolizing the power market"*. On the contrary, the Commission believes that the proposed transaction brings about significant changes in MOL WMT's incentives in view of E.ON's strategic focus on building/acquiring additional generation capacity in Hungary and of its strong position in the electricity retail supply markets.

(592) The parties also insist on E.ON's currently limited generation capacities and argue that *"E.ON will remain a small player [in the market for electricity generation] without significant market power".*[231] However, post transaction, E.ON will be dominant upstream from electricity generation / wholesale (wholesale supply of gas to power pants) and will have a very strong position in the downstream markets (electricity retail). This position will confer E.ON with unrivalled advantages to further increase its market power along the electricity supply chain.

(593) The following recitals will first present the current structure of electricity generation in Hungary and its likely evolution. The new entity's ability to foreclose access to

230 Expert Report, Page 22/23.

231 Reply to the SO, Page 24.

gas to its competitors in electricity generation will then be assessed and E.ON's focus on developing new generation capacities will be presented. The new entity's incentives to engage in the strategies mentioned above in recital 589 both in the current and in the future regulatory framework will finally be analysed.

a. The structure of electricity generation in Hungary

(594) The following recitals will present the current structure of electricity generation in Hungary and its likely evolution, based on information on new power plants and power plants decommissioning gathered by the Commission in its in-depth market investigation. The importance of gas-fired power plants in the current regulatory framework as well as in new generation capacities will be underlined.

Current generation structure

(595) Total generation capacity in Hungary is approximately 8,000 MW in 2005, to be compared with the country's peak load of 6,350 MW (in 2004). The Hungarian electricity generation is split between nuclear energy (1,800 MW installed capacity) and lignite, gas and coal power plants (5,700 MW installed capacity). Almost 40% of electricity consumed in Hungary is generated by the Paks nuclear power plant, the remaining 60% is mainly generated by power plants burning hydrocarbons (lignite, gas and coal) and by imports.

(596) In 2005, 19 power plants had a generation capacity exceeding 50 MW:

Large power plants in Hungary[232]:

Name of power plant	**Owner**	**Fuel**	**Official production capacity in 2003 (MW)**	**Official production in 2003 (GWh)**	**Market investigation: current production capacity (MW)**	**Market investigation: production in 2004 (GWh)**
Paksi Atomerőmű	MVM	Nuclear	1,866	10,297	[…]	[…]
Dunamenti	Electrabel	Gas/oil	2,126	5,053	[…]	[…]
Tisza II	AES	Gas/oil	860	2,426	[…]	[…]
Mátra	RWE	Lignite	836	5,032	[…]	[…]
Csepeli GT	ATEL	Gas	389	1,860	[…]	[…]
Oroszlány	MVM	Coal	240	1,033	[…]	[…]
Tiszapalkonya	AES	Coal/Gas	200	477	[…]	[…]

[232] The differences between the official production capacity in 2003 and the current production capacity in the table are due to capacity extension / decommissioning in 2004 and 2005.

Pécs	PannonPower	Gas	190	514	[…]	[…]
Lőrinci	MVM	Oil	170	5	[…]	[…]
Borsodi	AES	Coal/Gas/ Wood	137	282	[…]	[…]
Kelenföld GT II	EDF	Gas	136	602	[…]	[…]
Sajószöged	MVM	Gas	120	3	[…]	[…]
Litér	MVM	Gas	120	1	[…]	[…]
Újpest	EDF	Gas	110	423	[…]	[…]
Bánhida	MVM	Coal	100	462	[…]	[…]
Debrecen	E.ON	Gas	95	731	95	627
Ajka	Transelectro	Coal	71	205	[…]	[…]
Kispest	EDF	Gas			[…]	[…]
EMA Power	EPIC Energy Hungary	Gas			[…]	[…]
Small power plants			280	4,084	[…]	[…]
TOTAL			**8,046**	**31,632**	**[…]**	**[…]**

PPAs

(597) The major part of the large power plants' capacity is booked under long-term PPA with MVM. The market investigation has established that the total capacity booked under those PPAs amounted to [4,000-5,000 MW] in 2005, compared to the total national generation capacity of approximately 8,000 MW. The table below indicates the existing long term PPAs with MVM and their end-date.

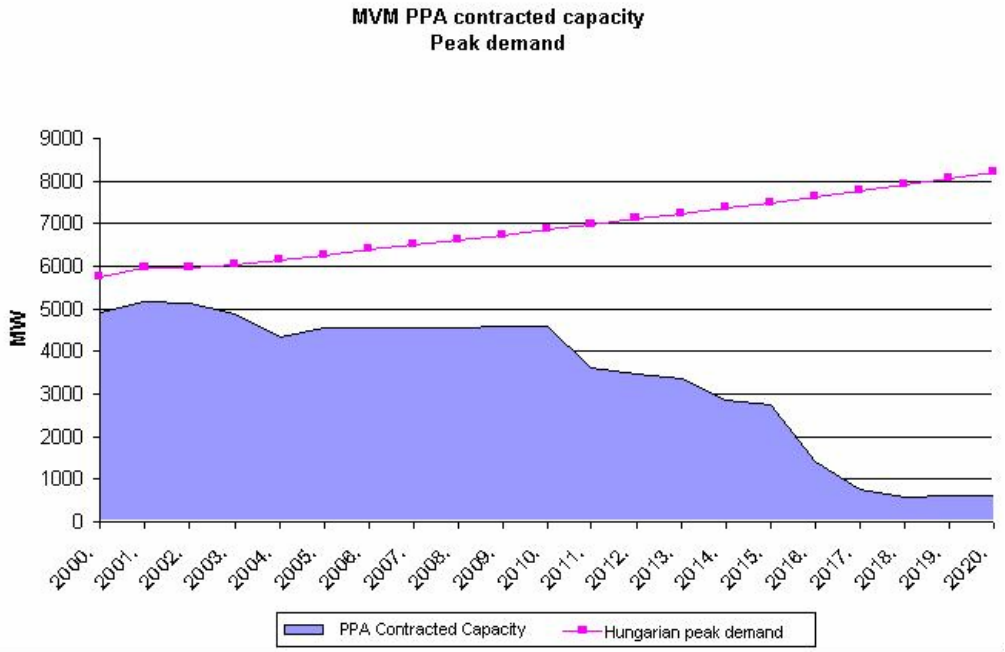
Existing long-term PPAs:[233]

Power plant	Owner	Fuel	Official production capacity in 2003 (MW)	Official production in 2003 (GWh)	PPA: Reserved capacity	PPA: End date
Paksi Atomerőmű	MVM	Nuclear	1,866	10,297	[…]	[…]
Dunamenti	Electrabel	Gas/oil	2,126	5,053	[…]	[…]
Tisza II	AES	Gas/oil	860	2,426	[…]	[…]
Mátra	RWE	Lignite	836	5,032	[…]	[…]
Csepeli GT	ATEL	Gas	389	1,860	[…]	[…]
Oroszlány	MVM	Coal	240	1,033	[…]	[…]
Tiszapalkonya	AES	Coal/Gas	200	477	[…]	[…]
Pécs	Pannon Power	Gas	190	514	[…]	[…]
Lőrinci	MVM	Oil	170	5	[…]	[…]
Borsodi	AES	Coal/Gas/ Wood	137	282	[…]	[…]
Kelenföld GT II	EDF	Gas	136	602	[…]	[…]
Sajószöged	MVM	Gas	120	3	[…]	[…]
Litér	MVM	Gas	120	1	[…]	[…]
Újpest	EDF	Gas	110	423	[…]	[…]
Bánhida	MVM	Coal	100	462	[…]	[…]
Debrecen	E.ON	Gas	95	731		
Ajka	Transelektro	Coal	71	205	[…]	[…]
Kispest	EDF	Gas			[…]	[…]
EMA Power	EPIC Energy Hungary	Gas			[…]	[…]
TOTAL			**8,046**	**31,632**	**[4,000-5,000]**	

233 Source: MVM, Submissions of 31 August 2005 and 6 October 2005.

(598) Competition on the market for the wholesale supply of electricity to traders is therefore limited to large power plants to the extent of their non-reserved capacity and smaller power plants. Generation capacities booked under those long-term PPAs are expected to decrease progressively as PPAs are renegotiated or come to expiry. In addition, new power plant are, in principle, not expected to enter into such long-term PPAs with MVM and will therefore play a significant role on the market for the wholesale supply of electricity to traders. The table below illustrates the progressive reduction in the scope of the PPAs.

Evolution of the capacity reserved under long term PPAs:



Source: HEO

New power plants projects

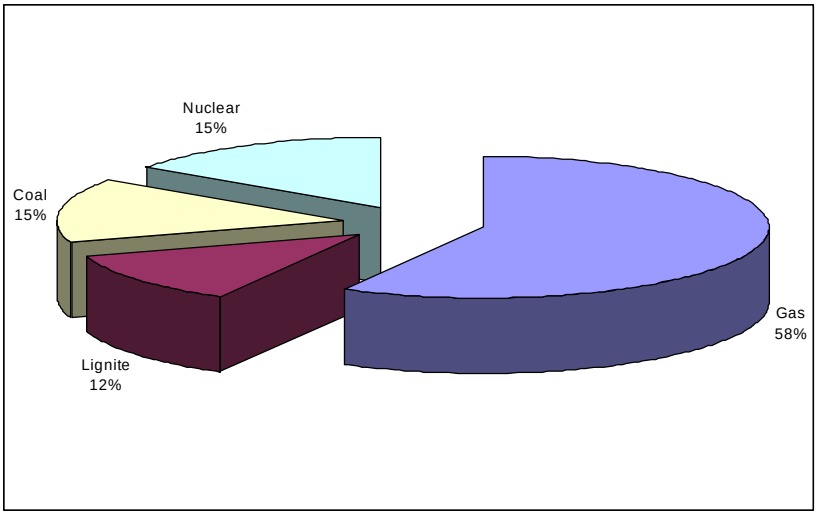
(599) As mentioned above in recitals 150 and 151, it is estimated that large electricity generation capacities will be needed in Hungary in the coming years. New generation capacity of approximately 5,000 MW has to be built until 2020 to replace old power plants[234] (3,500 MW) and to satisfy the increase in demand. This figure accounts for roughly 60% of the total production capacity currently installed in Hungary. Accordingly, the Hungarian electricity generation capacity should increase from 8,000 MW to approximately 10,500 MW.

(600) The market investigation has indicated that, as of December 2005, around [1,000-1,500] MW of new generation capacity is planned to be constructed by 2010, both in new power plants and in capacity replacement / expansion in existing power plants. All these projects relate to gas-fired power plants or units, which will play an

[234] The old coal-fired power plants are expected to be closed down for environmental reasons. Another possibility is to use new technologies, with lower impact on the environment and higher efficiency.

important role in the market for the supply of gas to traders, in particular in view of their ranking in the Hungarian electricity generation merit curve[235]. As regards the 2010-2015 period, the market investigation has shown that approximately 2,000 MW of additional generation capacity is envisaged although the degree of uncertainty is higher. The majority of projects are gas-fired, as evidenced by the following pie chart:

Breakdown of new capacity generation by type of fuel (new projects and capacity extensions until 2015):



(601) According to this investigation, the main projects to build new large power plants in Hungary will be carried out by E.ON. All other new power plant projects which are considered with a sufficient degree of certainty by other market players are of smaller size than those of E.ON.

(602) According to the HEO, power plant construction licenses have been granted for a total generation capacity of [0-500] MW until now. In addition, the HEO has received informal information about additional plans to build [1,000-1,500] MW generation capacity. Among those new power plant projects, [500-1,000]* MW are planned by E.ON. According to MAVIR[236], E.ON intends to build either a 500 MW coal-fired power plant or a 2 x 400 MW gas-fired power plant.

(603) E.ON has confirmed that it is considering […]* but noted that these […]* power plant projects are at an early planning stage and have not yet received all the required internal approvals. E.ON's internal documents submitted to the Commission[237] […]*. In addition, while MAVIR and another market player mentions a 2x400 MW power plant project in Gönyű, E.ON's internal documents […]*.

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[235] See section above on the Electricity sector in Hungary and the graph of the Hungarian electricity generation merit curve.

[236] MAVIR network planning realized in the spring of 2005. E.ON contributed to the realization of this analysis and requested MAVIR to take the two power plant projects into consideration.

[237] E.ON internal documents submitted in the Reply to the Commission's questionnaires dated 18/07/2005 (Question 122).

(604) As regards other market players, [Confidential: Overview of E.ON's competitors new power plants projects].

(605) [Confidential: Overview of E.ON's competitors new power plants projects]

(606) [Confidential: Overview of E.ON's competitors new power plants projects]

(607) The tables below summarize the new power plants or power plant capacity expansions planned by 2015, with a capacity above 50 MW. Only projects that were confirmed by the relevant companies have been reported.

New power plants projects (gas-fired):

Location	Company / Group	Fuel	Capacity (MW)	Schedule
[…]*	**E.ON**	**Gas**	**[250-500]*[238] - [500-1,000]*[239]**	**Planned – […]***
[…]	[…]	Gas	[0-250]	[…]
[…]	[…]	Gas	[0-250]	[…]
[…]	[…]	Gas	[0-250]	[…]

New power plants projects (other fuels):

Location	Company / Group	Fuel	Capacity (MW)	Schedule
[…]*	**E.ON**	**Coal**	**[250-500]***	**Planned – […]***
[…]	[…]	[…]	[250-500]	[…]

Capacity expansion (gas-fired):

Location	Company / Group	Fuel	Capacity (MW)	Schedule
[…]	[…]	Gas	[0-250]	[…]

238 According to E.ON internal documents submitted in reply to the Commission's questionnaire dated 18 July 2005 (Question 121).

239 According to various market players.

[…]	[…]	Gas	[250-500]	[…]

Capacity expansion (other fuels):

Location	Company / Group	Fuel	Capacity (MW)	Schedule
[…]	[…]	Nuclear	[0-250]	[…]

(608) E.ON is also currently refurbishing its power plant in Nyíregyháza with a 49 MW CCGT, which should be commissioned in […]*.

(609) As regard other market players, MVM currently conducts a programme to increase the Paksi nuclear power plant lifetime by 10-15 years and to increase the reactors efficiency (from 430 MW to 460 MW). Several old gas or coal power plants are also undergoing modernization and efficiency improvement programmes.

Limited potential for non gas-fired power plants

(610) The Expert Report submitted by the parties explains that the new entity's gas foreclosure strategies' would not be successful[240] as competitors may invest in non-gas fired power plants. Although the parties claim that competitors could develop non gas-fired power plants, they fail to indicate on which alternative fuel new power plants would rely and do not provide any analysis on the competitiveness of those alternative fuels.

(611) The Commission refers to the above market investigation on existing new power plants projects in Hungary and on the statements made by all the major market players in the electricity sector related to the predominance of gas as fuel for new power plants. The market investigation has clearly indicated that gas-fired power plants would represent the largest part of new generation capacities in Hungary. For example, the HEO considers that the proportion of gas-fired power plant in new generation capacity could reach 60%.

(612) As a matter of fact, this analysis is not disputed by the parties. In a presentation held by MOL gas division[241], the strong increase in new gas-fired electricity generation capacity is also cited as a key driver of the Hungarian gas demand:

MOL: "[...]."*

(613) The Commission and market players estimate that none of the alternative fuels (nuclear, lignite, coal, hydro, etc.) does offer the same advantages as gas for power generation.

[240] Expert Report, Page 4.

[241] "MOL Gas, Management presentation", March 2004. Annex 27 to Form CO.

(614) Nuclear power plants require a very large upfront investment compared to any other type of power plant and the process to expand or build a new nuclear reactor is subject to extremely long studies and involves political considerations. There is currently no indication that a new nuclear reactor could be built and become operational before 2015.

(615) There is only one lignite power plant in Hungary, the Mátra power plant, and it is closely linked to the exploitation of Hungary's only lignite mine. While lignite may be an efficient fuel for new power plants, […].

(616) Coal production is marginal in Hungary and is decreasing. Coal has to be imported with high transportation costs. In addition, old coal power plants have the highest variable generation cost in Hungary and require substantial investment to meet the stringent Community environmental standards. As evidenced by the market investigation, the large majority of power plants expected to be decommissioned by 2015 are old coal-fired power plants.

(617) While new coal power plants may have a higher efficiency, they still emit carbon dioxide and need expensive carbon dioxide emission permits. The only project to build a new coal-fired power plant is […]*.

(618) A strong increase in renewable (biomass, wind, solar, etc.) generation capacities in Hungary is projected due to the favourable feed-in tariffs set by the regulation. However, these new capacities are usually not competitive and subsidized by these high tariffs. They are not expected to account for a significant part of Hungary's generation capacity before 2015.

Power plants decommissioning

(619) The market investigation carried out by the Commission has identified projected power plants decommissioning and capacity reductions. According to the investigation, around [0-500] MW of generation capacity should be decommissioned by 2010. As regards the 2010-2015 period, approximately 1,500 MW of additional generation capacity should be decommissioned. The vast majority of power plants that are expected to close or to reduce their capacity are coal-fired; some of the oldest gas-fired units are also expected to be shut down and/or replaced.

Power plant decommissioning:

Location	**Company / Group**	**Fuel**	**Capacity (MW)**	**Schedule**
[…]	[…]	Gas	[0-250]	[…]
[…]	[…]	Gas	[500-750]	[…]
[…]	[…]	Gas	[0-250]	[…]
[…]	[…]	Coal	[0-250]	[…]
[…]	[…]	Coal	[0-250]	[…]
[…]	[…]	Coal	[0-250]	[…]

[…]	[…]	Coal	[0-250]	[…]
[…]	[…]	Coal	[0-250]	[…]
[…]	[…]	Coal	[0-250]	[…]
[…]	[…]	Coal	[0-250]	[…]

Importance of gas-fired power plants

(620) Gas-fired power plants account for 40% of the total generation capacity installed in Hungary but represent only 25% of the total electricity produced in Hungary[242]. The large gas-fired power plants are supplied either by MOL WMT directly through the gas transmission network or by the RDCs through their gas distribution network. The total gas consumption of gas-fired power plants amounted to approximately [3-3.5] bcm in 2004.

Name of power plant	**Owner**	**Official capacity in 2003 (MW)**	**Gas supplier**	**Gas consumption in 2004 (million m^3)**
Dunamenti	Electrabel	2,126	MOL WMT	[1,000-1,500]
Tisza II	AES	860	MOL WMT	[0-500][243]
Csepeli GT	ATEL	389	MOL WMT	[0-500]
Kispest	EDF	116	FŐGÁZ	[500-1,000]
Újpest	EDF	110	FŐGÁZ	
Kelenföld GT II	EDF	136	FŐGÁZ	
Sajószöged	MVM	120	TIGÁZ	[0-500]
Litér	MVM	120	KÖGÁZ	[0-500]
Debrecen	**E.ON**	**95**	**TIGÁZ**	[0-500]*
Others				[500-1,000]
TOTAL		**4,072**		**[3,000-3,500]**

(621) According to the parties, a 500 MW gas-fired power plant (CCGT) with a 56% thermal efficiency factor has an annual electricity output of approximately 3.5 TWh and an annual gas consumption of approximately 600 million m^3**, based on a 80%**

[242] It is MVM that decides which power plants should produce electricity based on the marginal costs of production of the respective plants. Gas-fired power plants have a higher marginal cost of production than the nuclear and lignite plants and are therefore used to satisfy peak demand.

[243] Excluding [0-250]* million m3 of inert gas. (E.ON's reply dated 29 August 2005 to various request for information from the Commission).

load factor[244]**.** Accordingly, the gas consumption of new gas-fired power plants planned until 2010 could be in the range of [1-2] bcm, depending on their efficiency and their load factor.

(622) As indicated by the market investigation, gas-fired power plants play a critical role in the functioning of electricity markets as they usually provide balancing energy and set electricity wholesale prices due their ranking in the national merit order. This is also the case in Hungary.

(623) First, due to their technical characteristics and load profile, gas-fired power plants play an essential role in the provision of balancing electricity in Hungary (mainly the Electrabel, AES and ATEL power plants). This is because Hungary has practically no hydro-power capacity, all the system balancing must be provided either by gas-fired or coal-fired power plants.

(624) Second, gas power plants are at […]* of the merit order ranking in Hungary, after the nuclear and […]*. This means that they are used partially for base load and for peak load and supply the fluctuation of the total demand. In countries where an organized day-ahead market[245] (or a pool structure) exists, an essential consequence is that gas power plants determine the electricity prices as they balance supply and demand. Any change in the costs of gas-fired power plants, such as an increase in the price of gas, therefore has an impact on the price of all electricity sold on the organized market.

b. The structure of electricity imports in Hungary

Current electricity imports

(625) Imports are essentially made by electricity traders for transit or to supply medium and large customers in Hungary[246]. MVM, the public utility wholesaler, accounted for 35% of electricity imports in 2003, while E.ON was the second importer, ahead of other electricity traders, with [10-20]*% of imports. Under interconnection capacity allocation rules, it is not possible to know the country of origin of the electricity imported (only the cross-border entry point is known) nor whether market players import electricity for their own needs or for resale.

Evolution of electricity imports

(626) A recent and in depth study on the evolution of Hungarian electricity imports has been carried out by MAVIR in 2005[247]. According to this study, Hungarian electricity imports are expected to decline over the next ten years compared to the

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244 E.ON's submission dated 28 October 2005.

245 Such a market is expected to be introduced in 2007 in Hungary.

246 E.ON's reply to the Commission's request for information dated 18 July 2005. Electricity binder.

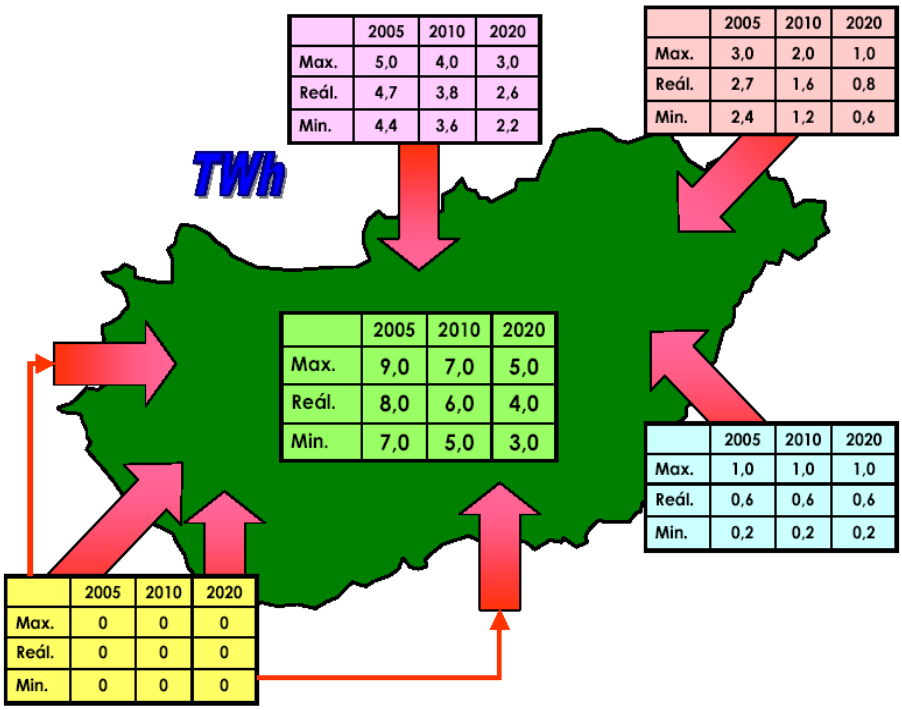
247 See: http://www.mavir.hu/domino/html/www/mavirwww.nsf/vAllPages/78D623653362C24FC1256FFF003D9E22/$FILE/korzeti_forraselemzes20050512.pdf

current level, while the total electricity demand will continue to increase in Hungary. The share of electricity imports in the total electricity demand would therefore decline while the share of domestic production would increase.

(627) The MAVIR study adopts a two-step approach; the countries which may export electricity to Hungary are first defined and then the evolution of electricity production is analyzed for each of these countries.

(628) As a result of this study, MAVIR estimates that the current surplus in electricity generation capacities in countries that may export to Hungary will gradually decrease until 2010. As a consequence, Hungary's net electricity import balance will certainly decrease from 1200-1300 MW today to around 700-800 MW (daily peak). The chart below clearly shows that even in the best case scenario, Hungarian net electricity imports will decrease in 2010 and 2020.

Net electricity import flows and forecasts in 2005, 2010 and 2020 by country of origin:



c. The new entity will have the ability to foreclose access to gas to its competitors' gas-fired power plants

(629) Prior to the merger, MOL WMT has a dominant position in the market for the supply of gas to large power plants. As a consequence, the Commission considers that post-merger, the new entity will have the ability to determine its competitors' power plants gas supply conditions (prices, rules for nomination, take-or-pay penalties, interruptibility, etc.) and to discriminate power generators in several ways.

(630) Pre-transaction, as demonstrated above in section A, MOL WMT is dominant on the market for the supply of gas to large power plants, with a market share of almost 70%. Furthermore, large power plants connected to a distribution network may only be supplied by the RDCs on the regulated segment of the market (as MOL WMT can

only supply customers directly connected to the transmission network on the regulated segment of the market). RDCs are in turn obliged to procure gas for their public utility needs from MOL WMT. No trader is active on this market, as reflected in the table below:

Suppliers	Supply of gas to power plants in 2004	
	In million m³	In %
KÖGÁZ	[0-500]*	[0-5%]
DDGÁZ	[0-500]*	[0-5%]
Total E.ON	**[0-500]***	**[0-5%]**
MOL WMT	**[2000-3000]***	**[65-70%]**
New entity	**[2000-3000]***	**[70-75%]**
FÖGÁZ	[500-1000]	[10-20%]
ÉGÁZ	[0-500]	[0-10%]
DÉGÁZ	[0-500]	[0-10%]
TIGÁZ	[0-500]	[10-20%]
EMFESZ	[0-500]	[0-10%]
Total Market	**[3000-4000]**	**100%**

(631) The market investigation has also confirmed the current and expected lack of alternative sources of supply for power plants. No other gas supplier (except the gas RDCs, which are dependent upon MOL WMT for their gas sourcing) is able to supply large power plants in view of their large consumption volume and of their requirements for high flexibility[248] and security of supply.

(632) The market investigation has shown that the new entity may discriminate against power plants: (i) by altering gas delivery conditions even without having to change the gas supply contracts, (ii) by increasing gas prices in July 2007 (iii) by altering gas delivery conditions in the context of a price renegotiation in 2007, (iv) by deteriorating gas supply conditions and prices at the expiry of the supply contracts and /or (v) by not offering more favourable gas supply conditions and prices on the open segment of the market.

(633) As a direct supplier of gas-fired power plants supplied through the gas transmission network, MOL WMT has long-term gas supply agreements with those power plants. These contracts are generally long-term contracts (20 year duration for instance) that were established at the power plant construction. Therefore, the new entity is not able to unilaterally change the conditions of the contracts immediately after the merger.

(634) As regards gas prices, at the moment, these supply contracts are public utility contracts subject to regulated prices, defined by governmental decrees. Therefore, the MOL WMT does not have the ability to increase prices under these contracts. However, as of July 1st 2007, it is expected that gas prices will be deregulated for all non residential customers. This means that the prices of public utility gas supply contracts will have to be renegotiated by the new entity and the power plants. Due to the lack of alternative supplier and the incipient stage of competition on the market for the supply of gas to power plants, the new entity will hence be able to increase gas supply prices to the power plants it will directly supply in 2007.

248 Because the operation of power plants depends on decisions by MVM, the single buyer, their gas consumption is extremely variable.

(635) This risk of price increases has been highlighted by the market investigation. In particular, a third party has stated that:

"Although we have a long-term gas supply agreement with MOL WMT, the price is not defined in this contract, instead it contains a reference to the public utility prices set out in the applicable regulation. In 2007, when the market has to be fully opened, large customers will probably be forced on to the free market, and they will have to have a serious negotiation on prices with their gas supplier (the reference to public utility prices in the long-term gas supply agreement will not be relevant any more once the market is totally liberalized)."

(636) Current prices paid by power plants for gas can also to some extent be renegotiated each year. As explained by a third party, gas prices do not always cover the entire gas quantities actually needed by power plants, leaving additional room for negotiation:

"Although the power plants have long-term contracts with MOL, their contracts only cover minimum quantities, and a new contract is signed each year to cover the needs of the coming year, in which the prices are renegotiated each time."

(637) As regards other supply conditions, no unilateral contractual changes are in principle possible before the contract expiry. However, following the merger, the new entity may have an influence over gas supply conditions in at least three ways.

(638) First, the new entity could alter the gas supply conditions of power plants it directly supplies <u>without any change in the contractual supply conditions</u>. As explained in the gas section, the gas supplier may alter the power plants gas supply conditions in various ways. The vast majority of market players confirm the new entity's ability to play with a broad range of supply conditions to discriminate power plants:

"E.ON can influence not only the pricing, but also the various conditions under which the plants take their gas in terms of minimum and maximum off take, balancing, nomination, cost of scheduling nominations (which is very important for "balancing" power plants)"

"E.ON/MOL can discriminate against its competitors not only through prices, but also by interrupting more competing power plants (even though the contracts with E.ON power plants and with competing power plants would formally provide for the same amount of firm and interruptible supplies), thereby forcing them to resort to alternative fuels and raising their costs. This behaviour cannot be regulated."

"There are many possibilities for E.ON to discriminate between customers, not only as regards prices, but also as regards other important supply conditions such as gas nominations, penalties for breaching nominations, take-or-pay limits, interruption of gas supply, etc."

"The gas supply to power plants can be influenced (legally and within the terms of the existing contracts) in such a way to support the energy market interests of E.ON and in a way that may damage the interests of non E.ON market players".

(639) As a concrete example (brought to the Commission's attention by a power generator during the market investigation), in a scenario in which the new entity is contractually allowed to interrupt the gas supply to gas-fired power plants, the new

entity will have the possibility to arbitrarily decide to which power plant to interrupt supply, thereby increasing its cost of operation.

(640) In their reply to the SO, the parties argue that "*possible interruptions of supply by MOL WMT to its customers would be contained and possibly penalized by the transmission operator*".[249] As evidenced by the market investigation, the Commission underlines that MOL WMT has the ability to foreclose gas-fired power plants in the various ways presented above in recitals 630 to 637, in particular as regards the interruptible gas supply to power plants.

(641) It is worth noting that such behaviour (alteration of gas supply conditions) would not be costly for the new entity as it would not result in lower gas sales. As it would not be reflected in a contractual increase in gas prices, it would simply result in higher generation costs for these power generators and therefore lower margins as their electricity sales prices are fixed in the PPAs.

(642) Second, the new entity could renegotiate part or all of the supply conditions in 2007 at the same time as the gas prices are renegotiated with power plants. The rules for setting the yearly, monthly and daily gas consumptions, their adjustment and the penalties for deviating for the fixed amounts also play an important role in a power plant's gas supply contract and are relatively complex. The new entity would thus have the possibility to influence various parameters to reduce the competitiveness of its competitors' gas-fired power plants: minimum and maximum yearly and monthly tolerance rate, maximum percentage of the yearly gas amount than can be nominated for one month, dates for providing gas nominations, penalties in case of over / under usage, rules for billing and payments, planning of maintenance operations, quantities of interruptible and uninterruptible gas, etc. The new entity could for instance impose higher penalties in case of non respect of the power plants' daily gas nominations for instance or lower tolerance ranges for daily nominations

(643) Finally, another way to discriminate power plants would be to offer more favourable gas supply contracts on the open segment of the market to certain gas-fired power plants. As large power plants are already eligible customers (although none of them has switched so far), they may change supplier and revert to the new entity as gas trader on the open segment of the market. Again, due to the absence of competition on the open segment of the gas market, power plants would not be able to switch to another market player on the open segment of the market.

(644) The new entity's ability to discriminate against the remaining power plants it does not supply directly with gas is more limited before 2007. While E.ON will not be in a position to modify the gas supply conditions to those power plants, it will still have the ability to discriminate amongst them by not offering them more favourable gas supply conditions and prices on the open segment of the market. As an example, E.ON may wish to offer more (or less) advantageous gas supply conditions to certain gas-fired power plants depending on their commercial relationships (or lack thereof) with E.ON electricity retail subsidiaries[250].

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[249] Reply to the SO, Page 9.

[250] E.ON's incentives to engage in such input foreclosure / discrimination is discussed in sections d) and e) below.

d. E.ON plans to expand significantly its electricity generation capacities in Hungary

(645) The essential change brought about by the transaction is that, contrary to MOL, E.ON has a strong presence in electricity retail in Hungary and has therefore a strategic interest in developing new electricity generation capacities.

(646) The Commission's investigation has established that E.ON's strategy is to expand its electricity generation capacity with a view to balance its strong existing position in electricity retail. This point is essential as it constitutes the essential change brought about by the proposed transaction in the electricity sector and it modifies MOL WMT's set of incentives vis-à-vis existing and future gas-fired power plants.

(647) As explained in recitals 150-151 and 599, due to the growth of domestic consumption and the closure of old power plants, a substantial part of the Hungarian electricity generation capacity will need to be renewed in the coming years. This large nation-wide need for additional generation capacity offers market players the opportunity to significantly increase their generation capacity in Hungary.

(648) E.ON is strongly focused on the electricity markets at the European level and in particular in Central Europe.

E.ON[251]: "[…]."*

E.ON[252]: "[…]".*

(649) In Hungary, E.ON's currently generation capacity is limited but the company is the leading player at the wholesale and retail level. According to the market investigation, E.ON's current limited generation capacity in Hungary will develop significantly in the next years. Internal documents from E.ON […]*[253].

E.ON[254]: "[…]".*

(650) The Commission's market investigation, based on data provided by MAVIR, the HEO and all major market players, has shown that E.ON was the only group planning to build large new power plants in Hungary in the next 5 years.

(651) Based on the information available to the Commission, although E.ON's projects are at an early stage, the likelihood that the power plants will actually be built is very high. E.ON has already purchased two sites to build the new power plants ([…]*) and the projects have been extensively discussed within the group. Although new

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[251] E.ON's reply to the Commission request for information dated 18 July 2005 – Binder Supplement I – Various presentations.

[252] E.ON's reply to the Commission request for information dated 18 July 2005 – Binder Supplement I – Various presentations.

[253] E.ON's reply to the Commission's request for information dated 18 July 2005. Binder Supplement I. Presentation « E.ON Energie – Capital Market Day – Munich, September 6, 2004 ».

[254] E.ON's reply to the Commission' request for information date 18 July 2005. Binder Electricity, Reply to Question 122, Document: « Greenfield power generation assets for the Hungarian market ».

power plant projects require a long time before commissioning, this will lead to an increase in E.ON's share of total and gas-fired power generation around […]*:

On the […] project, E.ON[255]: "[…]*".*

(652) New power plants will play a decisive role on the Hungarian electricity markets as they are not obliged to sell the bulk of their electricity production to MVM under long-term PPAs. This means that the share E.ON will acquire in electricity generation capacity available for the wholesale supply of electricity to traders will be much more important than its share of the total national generation capacity.

(653) Finally, due to its presence in neighbouring countries at the retail level, E.ON could seek to import competitive electricity into Hungary. Moreover, in view of its financial strength and its focus on Eastern European energy markets, E.ON is likely to further expand this position. Although the Commission acknowledges the apparent current lack of relationship between E.ON's owned companies in Eastern Europe, E.ON's position as a large vertically integrated company in the energy sector in several of Hungary's neighbouring countries provide the group with additional strengths in Hungary.

(654) To conclude, through its new power plants and its role in electricity imports, E.ON will acquire a critical role on the open segment of the wholesale electricity market in Hungary, as it will own new and competitive gas-fired power plant available for the wholesale supply of electricity to traders (as opposed to other generators with capacity booked under the PPAs) and will be in a position to play a major role in electricity imports through its presence in neighbouring countries. In view of the combination of these strengths, even before the proposed transaction, E.ON is set to become a major player in the market for the wholesale supply of electricity to traders in Hungary.

e. The new entity will have the incentive to foreclose its competitors in electricity generation/wholesale

(655) According to the Commission's assessment, the new entity is likely to engage in two types of foreclosure strategies to strengthen its position both in electricity generation / wholesale and retail supply in Hungary. The new entity has a substantial economic interest in carrying these foreclosure strategies against new or existing gas-fired power plants immediately after the transaction, either alternatively or simultaneously.

(656) As regards new power plants, the new entity is likely to increase the total cost of gas to its competitors' new gas-fired power plants immediately after the transaction, with the aim to deter these rivals from building new gas-fired power plants and to favour its own new power plants projects[256]. This strategy would be attractive for E.ON's in view of its strong interest in expanding significantly its power generation capacity in Hungary.

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255 E.ON's reply to the Commission request for information dated 18 July 2005. Binder Electricity, Reply to Question 122.

256 E.ON's focus and plans in new electricity generation capacities in Hungary is discussed in section d) above.

(657) The new entity may also immediately after the transaction discriminate against new gas-fired power plants that do not supply its downstream electricity retail affiliates. This strategy would be economically rationale as it would provide the new entity a certain degree of control over the market for the wholesale supply of electricity to traders and additional competitive advantage on all electricity retail markets. The new entity's ability and incentive to carry out this strategy would increase with the progressive reduction of the scope of the PPAs.

(658) The merger is therefore likely to limit the development of new electricity generation capacities in Hungary and to significantly impede effective competition on the market for the wholesale supply of electricity to traders. As explained below, the Commission stresses that this effect will materialize immediately after the transaction and will increase over time.

(659) The following recitals will present the new entity's incentives to carry out these foreclosure strategies and discuss the likelihood and potential combination thereof in the current regulatory framework.

Foreclosure of access to gas

(660) The new entity could first increase / threaten to increase the total cost of gas supply to its competitors' new gas-fired power plants through the various ways presented above in section c). The objective of such input foreclosure strategy would be to deter new gas-fired power plants projects from E.ON's competitors in Hungary.

(661) In to favour its own plans to build new gas-fired power plants, E.ON would offer worse conditions of gas supply to its competitors planning to build new gas-fired power plants than to its own power plants. Considering the risk to be foreclosed for their gas supply, E.ON's competitors with plans to invest in new gas-fired power plants (accounting for the large majority of new power generation capacities), would most likely to abandon / delay their projects. This strategy would lead to a reduction / slow down of new generation capacity projects compared to the situation where E.ON's competitors would have also invested in new power plants and it would therefore strengthen E.ON's position as the major investor in new generation capacity in Hungary.

(662) The new entity would not even need to actually carry out this strategy since the mere possibility that it will do so post-merger is sufficient to create a strong deterrence effect for E.ON's competitors.

(663) In order to plan large investments, private companies evaluate the return / risk ratio and require a certain level of return on investment with limited risks. These requirements are all the more stringent (and difficult to evaluate) than the return on investment is planned to be achieved over a long period, as it is the case for power plants projects. The simple fact that E.ON will be at the same time the unique significant gas supplier and a major player on the electricity markets hence suffice to deteriorate the return / risk ratio (by increasing the risk level of the project) and as a consequence to limit non-E.ON investments in new power plants.

(664) The cost of gas supply accounts for approximately 60-70% of gas-fired power plants operating costs and has therefore a major impact on their profitability. E.ON's

internal documents related to the heat and power plant in Nyíregyháza[257] confirm that […]*. E.ON estimates that the power plant modernization project has an Internal Return Rate ("IRR") of [5-10]*%, which would decrease by [0-5]*% as a result of a hypothetical [5-15]*% increase in the price of gas. The sensitivity of a gas-fired power plant's IRR on gas prices is obviously higher if the power plant does not produce heat.

(665) E.ON's competitors planning to invest in new gas-fired power plants also evaluate the IRR of their projects, which may be largely influenced by E.ON's gas supply policy. In view of these elements, the return / risk ratio of new gas-fired power plants projects is likely to fall below the threshold required by new electricity producers to invest in new generation capacity.

(666) All potentially affected competitors have expressed their serious concerns about the transaction. Some of them also compete with E.ON at the electricity retail supply level. The following are examples of concerns expressed by third parties:

"E.ON having privileged access to gas and capacities, it will obtain a competitive advantage over the other power generation companies. The merger may thus lead to discrimination of competitors on the Hungarian power market and may ultimately cause serious investment problems. (…) We strongly fear that the Parties will gain a considerable competitive advantage over our personal investment plans in electricity generation".

"We are uncertain what gas prices E.ON will offer to its competitors and this is a potential risk for new power plants projects. As a consequence, the transaction creates significant uncertainties for non-E.ON market players and deters new gas-fired power plant projects."

"As we don't see any new interconnection project on the medium term, locally, there will be no investments in power plants because no private investor will take the risk to be downstream under E.ON gas monopoly which, in the same time, is its electricity competitor. In the medium run, it will increase electricity price."

(667) Based on its knowledge of the energy sector and its contacts with market players in the electricity sector, the HEO's assessment confirms these concerns[258]:

"It is possible that in the case of E.ON dominating the natural gas sector supply side, power plant investors under different ownership will abandon their plans to build natural gas fuelled power plants (…). If electricity generation investors withdraw from creating new capacity - as they have already indicated in advance - E.ON may appear as a dominant power plant investor"

(668) The HEO also reported to the Commission that *"Several investors are hesitating to build new gas-fired power plants."*[259]

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257 E.ON's reply to the Commission's request for information of 18 July 2005. Binder Supplement 2, Reply to Question 121. "Errichtung eins GuD-Heizwerk in Nyíregyháza (Ungarn)", 16 June 2005.

258 "Answers to the questions raised by the GVH related to the Share Transfer Transaction between E.ON and MOL" - HEO

(669) The deterring effect on new gas-fired power generation would have a significant impact on the development of new generation capacity in Hungary. It should be recalled that, according to the Commission's market investigation, approximately [1,000-1,500] MW of gas-fired generation capacity is expected to be added / renewed until 2010 by several market players, accounting for the very large majority of new power plants projects in Hungary. Based on the concerns expressed by several market participants and its own assessment, the Commission estimates that the proposed transaction significantly puts at risk those projects. Furthermore, as discussed above[260], alternative fuels are less competitive than gas for new power plants to be built in Hungary and electricity producers would thus not be in a position to build non gas-fired power plants to counter the new entity's strategy to foreclose access to gas.

(670) In their reply to the SO and the accompanying Expert Report, the parties however claim that the new entity has no incentive to impede the development of new gas-fired power plant and, on the contrary, has rather an interest in supporting their development to increase its gas sales[261].

(671) The Commission acknowledges that the new entity, as a supplier of gas, has an obvious interest in increasing its gas sales over the long term. Deterring investments in new electricity generation capacities will therefore have a cost for the new entity if its results in less new gas-fired power plants in Hungary. The Commission however estimates that the new entity is likely to incur this cost in view of the substantial additional profit that this strategy would bring to the new entity in the electricity wholesale and retail markets, where it would strongly strengthen the new entity's market position. The new entity would also in any case revise and increase its own new power generation plans in order to partly replace the new power generation projects abandoned by its rivals.

(672) Finally, the foreclosure strategy may be combined with a "tolling strategy", whereby the new entity would only partially limit the development of new generation capacity by its competitors but would supply gas under competitive conditions only to the power plants that supply its electricity retail subsidiaries. This approach would effectively limit the new entity's "lost gas sales" to future gas-fired power plants. It would also enable the new entity to increase its share in new power generation projects, to limit its competitors' gas-fired power plants market power and to ensure competitive electricity supply to the new entity's electricity retail subsidiaries.

Tolling agreements

(673) During the market investigation, several market players expressed the concern that E.ON could provide competitive gas supply conditions only to the power plants that would sell electricity to E.ON's USPs and electricity traders ("friend" power plants):

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259 Minutes of meeting with HEO on 26 July 2005.

260 See section a) on the Limited potential for non gas-fired power plants.

261 Reply to the SO, Page 23

Enpol2000[262]: "The transaction will have an effect on the electricity markets even if E.ON has a small presence in generation since E.ON may connect its gas supply contracts with its electricity purchase contracts"

Other third parties have expressed similar concerns, as reflected in the following statements: *"One of the main threats of the merger is that E.ON will award advantageous gas contracts to its own power plants or to the power plants that are not related to a company with supply activities."*

"Although E.ON does not have large electricity generation capacities itself, it could grant more favourable natural gas supply conditions to the power plants that supply E.ON and its subsidiaries with electricity and discriminate against the power plants supplying other traders than E.ON."

"Following the merger, E.ON will have the opportunity to favour itself as trader on the electricity wholesale market and its RDCs on the electricity retail market. Secondly, E.ON/MOL may sell gas at better conditions to power generators on the conditions that they supply its RDCs at better prices (and thus would gain an advantage over its competitors)."

(674) The Commission takes the view that the new entity will have an economic interest, (and is therefore likely to) adopt this discriminatory behaviour immediately after the transaction. This strategy could be implemented for new gas-fired plants in various ways: (i) tacit understanding between the new entity and the power generators, (ii) explicit link between gas supply and electricity purchase contracts and (iii) "tolling agreement", where the conversion of gas into power is simply "outsourced" by the new entity.

(675) The objectives of such gas foreclosure strategy vis-à-vis new power plants would be twofold: (i) to gain a significant control over the development of new generation capacity and (ii) to secure competitive electricity supply for the new entity's electricity retail subsidiaries. The new entity would also seek to prevent the cost of lost gas sales to new gas-fired power plants as the reduction in total new generation capacity addition would be more limited than in the previous foreclosure scenario. Such strategy would in addition provide E.ON with more flexibility as regards the level of its own investment in new generation capacity and the investment risk will be shared to some extent with other electricity producers. E.ON could therefore decide which amount of new generation capacity it wants to build in Hungary and establish tolling arrangements for the additional increase in generation capacity.

(676) The new entity will have the choice of various contractual arrangements to achieve this objective. The first solution would consist in maintaining the link between the gas supply and the electricity purchase conditions tacit and absent from the two supply contracts (which constitute anyway business secrets). In a second solution, the two supply contracts could be linked and the electricity supply contract could mention the price of gas set in the gas supply contract or other supply conditions thereof. Finally, in a third solution, the new entity could also present it as the outsourcing of the electricity generation process in its integrated activities along the

[262] Energiapolitika 2000's reply dated 28 July 2005 on the Commission's second phase questionnaire. Energiapolitika 2000 is a group of independent energy experts in Hungary.

gas and supply chain. The competitor's power plant would be supplied with gas and would sell electricity under conditions defined by the new entity against a fee based on the reserved capacity or the quantity produced. Given the wide array of potential contractual arrangements, the Commission estimates that the new entity would be in a position to select the most advantageous way and in particular the procedure the less likely to give rise to complaints or legal concerns.

(677) The parties contest the new entity's ability to carry out these two foreclosure strategies. They first argue that competitors planning to build new gas-fired power plants would revert to alternative gas suppliers should they be confronted to such foreclosure strategies from the new entity. The Expert Report submitted by the parties also argues that Gazprom could sell gas directly to E.ON's competitors in power generation[263].

(678) The Commission refers to its assessment of the new entity's control over all gas resources available in Hungary and on its current dominant position on the market for the supply of gas to power plants, which clearly contradicts the parties' arguments. All major market players in electricity generation reported to the Commission their inability to find alternative gas suppliers to MOL WMT. It should be recalled that, as of December 2005, the only suppliers of gas to power plants are MOL WMT (market share in excess of 65%) and the gas RDCs, sourcing gas from the latter and that neither EMFESZ nor CENTREX (nor other traders) supply power plants in Hungary.

(679) With respect to Gazprom, the Commission notes that Gazprom has never engaged in the direct supply of gas to power plants (nor in any other gas supply activities), in competition with its gas wholesale customers. Although Gazprom has already publicly stated its interest in being active in the Hungarian gas supply markets, it is not expected to enter the market on its own but through acquisition of stakes in existing businesses or assets.

(680) The parties also claim that the manipulation of gas supplies would be easily identified by the regulator[264] and that the new entity would therefore be deterred from carrying out this strategy. The Commission disagrees with the parties on this point as gas supply contracts with power plants constitute business secrets and are not available to third parties or to the HEO. Therefore, the Commission believes that it is actually very difficult for power generators to detect whether they are foreclosed for their gas supply or to complain to the HEO with a sufficient degree of confidence (see comments in the gas section). In view of the specificity of power plants' gas supply needs, it would anyway be difficult to establish that differences in gas supply prices between two power plants result directly from a discriminatory behaviour rather than from differing gas supply conditions. In addition, neither Directive 2003/55/EC nor the HGA explicitly prohibit discrimination in gas supply[265].

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[263] Expert Report, Page 4.

[264] Expert Report, Page 21/22

[265] Such discrimination could be prohibited by the provision of the European Community Treaty on abuse of dominant position (Article 82).

Existing power plants

(681) The Commission that the new entity may also carry out the above-described foreclosure strategies against existing gas-fired power plants immediately after the transaction, with a view to marginalize existing gas-fired power plants and eventually induce some power producers to exit the market.

(682) The new entity may seek to marginalize existing gas-fired power plants to ultimately acquire the assets of exiting players. E.ON's interest in acquiring existing gas-fired power plant has been confirmed by the market investigation. For instance, a third party has stated that E.ON has started negotiations to acquire privately owned existing power plants:

"In addition, E.ON may be able to overtake easily one of the private electricity generators (according to this third party there would be currently negotiations with Dunamenti, AES and ATEL; EDF is also currently negotiating the sale of its Budapest plant)."

(683) […]* discussed in E.ON's internal documents. In the presentation "New Energy for Central Europe"[266], *"[…]*"* are discussed, in particular "*[…]**".

(684) To conclude, the Commission considers that, post-merger, the new entity has strong incentives to increase the total cost of gas supply to its competitors' new and existing gas-fired power plants or to supply competitive gas to those power plants only under the condition that they supply E.ON's electricity retail subsidiaries with competitive electricity supplies. These strategies would result immediately after the transaction in deterring new entries in electricity generation and restricting competitors' gas-fired power plant's ability to obtain competitive gas supply.

(685) For these reasons, the Commission considers that the merger will increase the new entity's market power and will already significantly impede effective competition on the market for the wholesale supply of electricity to traders under the current market conditions.

f. The new entity's incentives to foreclose its competitors in electricity generation/wholesale will increase with the further liberalization of the electricity sector and the increase in E.ON's generation capacity

(686) The Commission believes that the new entity's incentives to foreclose its competitors' gas-fired power plants and to implement a "tolling strategy" will increase in the future regulatory framework due to the conjunction of three factors: (i) the increase in E.ON's generation capacity, (ii) the progress in the liberalization of the gas and electricity sectors and the (iii) progressive reduction in the scope of the long term PPAs in Hungary. These three factors imply that the total cost of the gas supply will become even more crucial for gas-fired power plants to compete on the market for the wholesale supply of electricity to traders.

[266] E.ON's reply to the Commission's request for information dated 18 July 2005. Binder Supplement I – Presentation « E.ON Energie – Capital Market Day – Munich, September 6, 2004 ».

(687) The increase in E.ON's generation capacity has already been discussed above in section d). It is expected to start in […]*, except if E.ON speeds up its existing power plant projects or acquires existing power plants before that date.

(688) The greater E.ON's share in gas-fired generation capacity in Hungary is, the greater are the group's incentives to foreclose its competitors' gas-fired power plants. An increase in the share of gas-fired generation capacity both increases the benefits resulting for higher electricity sales and decreases the cost of lost gas sales for the new entity.

(689) The new step in the gas and electricity market liberalization in Hungary in July 2007 will also create additional opportunities and strengthen the new entity's ability and incentives to engage in foreclosure behaviours.

(690) The end of regulated gas prices for power plants will allow the new entity to increase contractual gas prices to its competitors' gas-fired power plants (and possibly to deteriorate gas-fired power plants' gas supply conditions). At the same time, the end of electricity regulated prices for non residential end-users and the eligibility of residential customers should increase competition among electricity traders on all electricity markets and their interest in procuring electricity at the lowest price.

(691) The potential renegotiation or even termination of the PPAs has also been discussed previously in this document. While the scope and the timing of these changes is still unclear, it may be assumed for the purpose of this assessment – as this is a very likely development - that their duration and the booked capacities may be progressively reduced. In any case, the proportion of generation capacity available for the wholesale supply of electricity to traders will necessarily increase as newly built power plants' capacities are generally not bound by long term PPAs.

(692) In this regulatory framework, gas-fired power plants will compete on the market for the supply of electricity to traders and the total cost of the gas supply will be a crucial competitive factor. The market investigation has also indicated that competition is largely price-driven for electricity wholesale and that gas-fired power plants have similar technologies in Hungary, and thus similar cost structure.

(693) Finally, the scope of the PPAs for the non gas-fired power plants, in particular the nuclear power plant, is less likely to be reduced , resulting in increased competition between gas-fired power plants on the market for the wholesale supply of electricity to traders. As indicated by the HEO, one of the essential objectives set by the Hungarian government for the New Electricity Model is to preserve the security of supply and the affordability of electricity supply for residential customers. In this respect, the government may decide to preserve cheap electricity generation resources for MVM for resale to USP and residential customers.

(694) Moreover, in this future regulatory framework, a significant part of electricity wholesale will be achieved through bilateral transaction ("OTC") between power plants (to the extent of their capacity available on the open segment of the market) and electricity traders. The news entity may therefore not only favour itself as an electricity trader but also replicate this mechanism with its competitors' gas-fired power plants and implement in a larger scale the "tolling strategy" described above. This concern has been expressed by several market players in the electricity sector:

"Such discrimination would be more accentuated once the "single buyer" framework ends after 2007 and once E.ON has built additional power generation capacities."

"As soon as this system ("single buyer" scheme) disappears (according to the last draft of the Hungarian Electricity Act issued by the Hungarian regulator in June 2005), E.ON will be in a favourable position to provide cheap gas either to its own power plants (existing + […] project) or to contract with existing power plants with low gas price in order to buy cheap electricity for its own needs to supply their electricity RDCs."*

(695) This strategy would benefit E.ON to the detriment of its competitors in two ways as it would strengthen its position both at the power generation level and at the retail supply level. First, gas-fired power plants that would not benefit from advantageous gas supply conditions ("non friend" power plants) would become less competitive on the market for the wholesale supply of electricity to traders. These power plants would become marginalized thereby inducing them to eventually exit the power generation activity.

(696) Secondly, USPs and electricity traders that would not have the ability to source electricity from gas-fired power plants supplied by the new entity under competitive conditions would have a significant competitive disadvantage vis-à-vis E.ON's electricity retail subsidiaries and would have to rely on other less competitive gas-fired power plants and other electricity sources[267].

(697) To conclude, the Commission considers that E.ON's ability and incentives to engage in the above-described foreclosure strategies will increase in the future liberalized regulatory framework. The significant impediment to competition on the market for the wholesale supply of electricity to traders will therefore become more severe in the long term, when the immediate "dampening effect" of the transaction on new generation capacities will materialize.

[267] This strategy will not imply significant costs for E.ON as the electricity production lost by "non-friend" power plants being captured by E.ON's or "friends'" power plants.

(iii) Electricity retail

(698) The impediment to the development of new power generation in Hungary and the impediment to competition on the market for the wholesale supply of electricity to traders would lead to price increases in electricity wholesale and retail and would limit E.ON's rivals ability to procure competitive electricity.

(699) In addition, the Commission estimates that the proposed transaction will provide the new entity with the ability and incentive to prevent its competitors from developing dual offers[268], which are expected to play a significant role in electricity retail markets. This would further contribute to increase E.ON's market power and would significantly impede effective competition on all electricity retail markets.

(700) The following recitals will first present the structure of electricity retail in Hungary. The impact of the various foreclosure strategies at the level of electricity generation / wholesale on competition in the electricity retail markets and the new entity's ability and incentives to prevent its electricity retail competitors from developing dual offers will be analysed. The Commission's assessment has been carried out both in the current and in the future regulatory framework.

a. Market structure

(701) Both RDCs (public utility segment) and traders (open segment) are active in the markets for the retail supply of electricity. As regards the various categories of customers, MLCs are supplied both by RDCs and traders; SCs are supplied essentially through RDCs and residential customers are only supplied through RDCs.

(702) E.ON is active in the retail supply of electricity both in the public utility segment, through its three RDCs and in the open segment, through E.ON EK.

RDCs

(703) The table below provides the sales of RDCs in each of the relevant product market for the retail supply of electricity[269]. While the figures reflect market shares for residential customers and SCs, sales of traders to MLCs are not taken into account and RDCs' actual market share are thus lower than those indicated in the table. It should be noted that E.ON's actual market share for the supply of electricity to MLCs should be approximately the same as the one estimated in the table below, in view of E.ON's strong position as electricity trader.

[268] Dual offers combine the retail supply of gas and electricity in one « package » with clear advantages for customers such as « one stop shop » service (e.g. single billing).

[269]

Suppliers	Supply of electricity to residential customers in 2004		Supply of electricity to small commercial and industrial customers in 2004		Supply of electricity to medium and large commercial and industrial customers in 2004	
	In GWh	In %	In GWh	In %	In GWh	In %
ÉDÁSZ	[1000-2000]*	[15-20%]	[1000-2000]*	[15-20%]	[2000-3000]*	[20-25%]
DÉDÁSZ	[1000-2000]*	[10-15%]	[0-1000]*	[10-15%]	[0-1000]*	[5-10%]
TITÁSZ	[1000-2000]*	[10-15%]	[1000-2000]*	[15-20%]	[0-1000]*	[5-10%]
Total E.ON	**[4000-5000]***	**[45-50%]**	**[3000-4000]***	**[50-55%]**	**[3000-4000]***	**[30-40%]**
ÉMÁSZ	[1000-2000]	[10-20%]	[0-1000]	[10-20%]	[1000-2000]	[10-20%]
ELMŰ	[3000-4000]	[20-30%]	[1000-2000]	[20-30%]	[3000-4000]	[30-40%]
DÉMÁSZ	[1000-2000]	[10-20%]	[0-1000]	[0-10%]	[1000-2000]	[10-20%]
Total Market	**[10000-12500]**	**100%**	**[5000-7500]**	**100%**	**[7500-10000]**	**100%**

Electricity traders

(704) Electricity customers that have switched to the open segment of the market are supplied by electricity traders. The main electricity traders active on the Hungarian market in 2003 and 2004 were:

Name	Group	2003 (GWh)	2004 (GWh)	% (2004)
Entrade	ATEL	[0-1000]	[1000-2000]	[10-20%]
ATEL Energia	ATEL	[0-1000]	[1000-2000]	[10-20%]
Total ATEL	ATEL	[1000-2000]	[3000-4000]	[20-30%]
MVM Partner	MVM	[1,000-2,000]	[2000-3000]	[20-30%]
E.ON EK	**E.ON**	**[1000-2000]***	**[2000-3000]***	**[20-30%]**
MÁSZ	RWE	[0-1000]	[1000-2000]	[0-10%]
System Consulting		[0-1000]	[0-1000]	[0-10%]
Sempra Energy Europe	Sempra Trading	[0-500]	[0-500]	[0-10%]
D-Energia	EDF	[0-500]	[0-500]	[0-10%]
Energy Financing Team	Energy Financing Team	[0-500]	[0-500]	[0-10%]
Others		[0-500]	[0-500]	[0-10%]
TOTAL		**[5000-10000]**	**[10000-15000]**	**100%**

(705) Electricity sales figures in the table above include both sales to traders and sales to final customers[270]. Total sales thus represent the total volume of electricity supplied by traders in Hungary and do not correspond to the total consumption of electricity end users that have switched to the open segment of the market.

(706) Based on the above, E.ON is clearly the leading player in the retail supply of electricity in Hungary and is the only group with strong positions both in the regulated and the open segments of those markets.

b. The new entity's strategies in electricity generation and wholesale would significantly impede effective competition in all the markets for the retail supply of electricity

(707) The deterring effect on new generation capacities and the impediment to competition brought about by the transaction on the market for the wholesale supply of electricity to traders would directly affect competition on all electricity retail markets. The proposed transaction would thus lead to higher prices on all electricity retail markets.

(708) In addition, the new entity's "tolling strategy" as regards competitors' gas-fired power plants would directly restrict E.ON's competitors' ability to compete effectively and increase E.ON's market power on all electricity retail markets.

(709) The Commission's projections on generation capacities available for the wholesale supply of electricity to traders indicate that E.ON could account for a substantial share of these capacities in 2010-2015. It should be stressed that these projections do not take into account the impact of the foreclosure strategies described above, which would deter new entries and favour E.ON's new power plants projects.

(710) The Commission estimates that the electricity generation capacities available on open segment of the wholesale market in 2010-2015 will reach approximately [4,000-5,000] MW. Gas-fired power plants will account for around [60-75%] of these capacities and E.ON for around 25%. The new entity's foreclosure strategies would therefore have an impact on at least 60% of total generation capacities available in Hungary for the wholesale supply of electricity to traders.

(711) In the reply to the SO, the parties argue that such strategies would be unsuccessful as *"electricity wholesalers and retailers have abundant alternative in buying electricity"*[271]. They further identify the following four electricity sources: (i) nuclear power, (ii) coal-fired power plants, (iii) other gas-fired power plants and (iv) imports *("for which sufficient interconnection capacity is available"*). The Expert Report also mentions[272] the *"ability of electricity retail competitors to obtain electricity supplies from non gas-fired power sources at competitive rates"*.

(712) The Commission acknowledges the existence of alternative electricity sources in Hungary, in particular those listed by the parties. However, each of these sources is

[270] There is no breakdown of electricity traders' sales according to the various categories of customers.

[271] Reply to the SO, Page 24.

[272] Expert Report, Page 26.

subject to major limitations, be it in terms of price-competitiveness, availability or flexibility. Procurement from non-gas-fired power plant may prove difficult as a large share of the cheapest power plants' capacity (nuclear and lignite) may not be available on the free market while coal power plants have much higher generation costs. This would be all the more difficult for peak-load electricity which in any event, cannot be procured from the nuclear and the lignite power plants.

(713) The scope of the PPA is not expected be reduced for the nuclear power plant (and potentially the lignite power plant) and the electricity produced by this power plant is therefore not expected to be available on the open segment for the market. As indicated by the HEO, one of the essential objectives set by the Hungarian government for the New Electricity Model is to preserve the security of supply and the affordability of electricity supply for residential customers. In this respect, the government may decide to preserve cheap electricity generation resources for MVM for resale to USPs and residential customers. Other market players confirmed this view:

"The nuclear power plant will be operated as a national company at a regulated cost for the benefit of residential customers in Hungary."

(714) According to the market investigation, the nuclear power plant's electricity production may be reserved for the USPs, which will take over the public service functions of the RDCs. The USP could purchase this competitive electricity to the extent of the quantities they supply to small customers at low regulated tariffs. In 2004, the quantity of electricity produced by the Paksi nuclear power plant ([10-12.5] TWh) was approximately the same as the quantity of electricity consumed by Hungarian households ([10-12.5] TWh).

(715) In addition, the nuclear power plant and the lignite power plant ([2,500-3,000] MW capacity together) are essentially used for base-load electricity in Hungary, while gas-fired power plants are both used for base-load and peak demand due to their ranking in the national merit order[273]. Electricity retailers are therefore not able to revert to those power plants to match the fluctuations of demand or to satisfy a peak in demand.

(716) The Commission notes that the Expert Report submitted by the parties also excludes the nuclear power plants to calculate the non gas-fired power capacity in Hungary as[274] *"it sells directly onto the public utility market"*.

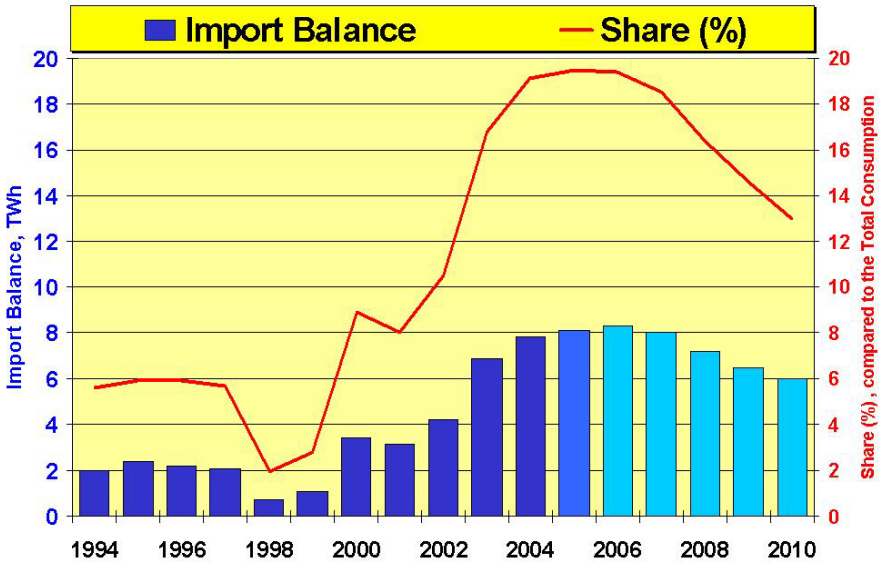
(717) As regards electricity imports, the market investigation has clearly shown that interconnectors with countries where electricity is competitive are already congested, which strongly limits the possibilities to increase electricity imports into Hungary. In addition, according to MAVIR projections, net Hungarian electricity imports are expected to decrease in the next five years due to lower availability of electricity generation capacities in neighbouring countries. Through its extensive

[273] See section V.B.(i).e on Electricity generation in Hungary for a graphic representation of the Hungarian power plants' merit curve.

[274] Expert Report, Page 26

presence in Hungary's neighbouring countries in electricity retail, in particular in Slovakia, E.ON would anyway play a significant role in electricity imports.

Expected evolution of Hungarian electricity net imports:



Source: MAVIR presentation, May 2005

(718) To conclude, the Commission considers that E.ON will have the ability and incentive to restrict its competitors' ability to obtain competitive electricity supplies and to distort competition on all electricity retail markets. For those reasons, the Commission considers that the merger would increase E.ON's market power on all the electricity retail supply markets in Hungary and would significantly in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation.

c. The new entity will have the ability and incentive to foreclose access to gas to its electricity retail competitors

(719) The Commission's market investigation has also revealed that access to gas resources is also crucial for electricity retail activities as dual offers are expected to play an important role in electricity retail markets. Following the transaction, the new entity will be in a position to foreclose access to gas to its electricity retail competitors with the objective to prevent them from developing dual offers[275]. The new entity will have an economic interest in denying access to competitive gas to its competitors in order to retain its current gas and electricity customers and to acquire new customers.

275 *"Dual offers are a good opportunity, but at present there are no accessible gas resources fro electricity traders to get into the gas trading business."*

"Although [we] could also team up with gas resellers (RDCs for instance), [we] could certainly not obtain gas in very competitive conditions. This gas would anyway be sourced from E.ON"

(720) In their reply to the SO, the parties state that "*whether dual offers will become important in the Hungarian gas market is a matter of pure speculation*" and allege that "*third parties have not expressed any more clear views than to say that dual offers might be possible in the future*"[276]. These statements do not reflect the result of the market investigation and the assessment carried out by the Commission.

(721) First, most of the respondents to the market investigation in the present case (both electricity and gas suppliers and customers) reported to the Commission that dual offers will play a significant role on the Hungarian energy retail markets. Although some large industrial customers concurred with this statement in their reply to the Commission, most market players indicated that this type of offer would be more attractive for residential customers and small industrial and commercial customers (together "small customers"). These small customers do not devote a large part of their budget to gas and electricity and do not make much effort to compare the offers from various suppliers (in countries where they may do so). From their view point, having only one bill (this also valid for IT services providers for instance or banks and insurance, etc.) is quite convenient and "makes life easier".

(722) The following are statements by third parties as regards the future importance of dual offers:

"The main advantages of a dual offer, from the client's perspective, are its simplicity (one bill, one call centre, etc.), the benefits of a customized commercial approach, the access to a unique qualified interlocutor and through him to advices and energy services and the impression of saving money"

"The electricity-gas (multi-utility) offers may become widespread after the full market opening (while the efficiency gains in the supply of the residential customers may become possible)."

"Dual offers could be very competitive at the retail market, especially if the service provider caters for energy efficiency, optimization, scheduling issues as well."

(723) Dual offers also represent significant advantages for gas and electricity suppliers. For incumbent operators, dual offers are a tool to limit customer switching by offering new services meeting customers' expectations and enhancing customers' commercial relationship. Dual offers also enable suppliers to enter into new energy markets and to benefit from economies of scale (purchasing, infrastructures, commercial network, etc.).

(724) Second, some respondents to the market investigation have pointed out examples of dual offers in other European countries, which have proved to be relatively successful. Dual offers have already been developed in the United Kingdom, in Spain and in Germany by energy suppliers and are currently advertised in France[277].

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[276] Reply to the SO, Page 25.

[277] See:

http://ecx.gazdefrance.fr/ecx/redirect.jsp?repertoire=/Espace_Entreprises/Offre_Elec/offre_elec_professionnels&caller_a_webc_url=temp_EEN/accueil_professionnel.htm

http://www.edfpro.fr/61033i/Accueilfr/EDFPro/Offres/GammeProenergies/EssentielProenergies.html

As an example, Centrica in the United Kingdom, a historical gas operator, entered the electricity market by introducing dual offers for all customers segments and has gained a significant share of the United Kingdom electricity retail market.

(725) The various acquisitions involving companies active both at the gas and electricity retail level show that there is a convergence of the gas and electricity retail markets in Europe. This trend is even […]* strategy by […]*:

E.ON[278]: "[…]"*

(726) Third, according to a survey conducted by a market player among its residential customers in Hungary, [50-100%] of the clients would be interested in dual fuel offers and they would expect such offers from their local energy supplier. The Commission notes that this result indicate without any doubt that dual offers are likely to play an important (if not essential) role, in Hungary's gas and electricity retail markets.

(727) In view of its dominance on the markets for the supply of gas to RDCs and to traders and the interest of small customers in dual offers, the Commission believes that the merged entity will have the ability and the incentive to foreclose access to gas resources for its downstream competitors in the markets for the retail supply of electricity to SCs and residential customers, thereby increasing its market power on these markets. As a result, effective competition would be significantly impeded in a substantial part of the common market within the meaning of Article 2 of the Merger Regulation.

(728) Although the parties have not raised any specific argument with respect to the impact of the regulatory situation on the competitive assessment[279], the Commission has carefully considered whether the fact that residential customers will only become eligible in July 2007, and thus the market for the supply of electricity to residential customers is not open on the date of the decision, could, by itself, dispel the concern that the merger will significantly impede effective competition within the meaning of Article 2(3) of the Merger Regulation. For the same reasons as those developed as regards the market for the supply of gas to residential customers, the Commission has concluded that the transaction is likely to have immediate effects on the market for the retail supply of electricity to residential customers by restricting the ability of potential suppliers to compete with the new entity on neighbouring markets and thus further discouraging potential entries.

Conclusion on the impact of the proposed transaction in the electricity sector

(729) In view of the merged entity's near monopoly in the access to competitive gas resources and its strategic focus on building new power generation capacities, the merged entity will have, already in the current regulatory scenario and at the current stage of market liberalisation, the ability and the incentive to foreclose access to gas to its competitors' new gas-fired power plants and /or to discriminate in its supply to

278 E.ON's reply to the Commission's request for information dated 18 July 2005. Binder Supplement I. Presentation « E.ON Energie – Capital Market Day – Munich September 6, 2004 ».

279 It is not argued, in particular, that the Commission is not entitled to assess the effects of the merger on that market, due to be opened to competition shortly.

competitors' new gas-fired power plants, thereby deterring competition from any of its rivals as regards the foreseen replacement and expansion of generation capacity in Hungary.

(730) E.ON's strategy would lead to a slower and less competitive development of new generation capacity in Hungary starting immediately after the transaction (compared to a situation where several market players would have built new power plants) and ultimately lead to higher electricity wholesale prices. It would thus impede effective competition on the market for the wholesale supply of electricity to traders.

(731) In the future liberalized regulatory framework characterized by a larger share of power generation capacities available on the open segment of the market (new power plants and potential renegotiation of the existing PPAs) and by E.ON's larger share in power generation (resulting from E.ON's current capacity extension projects and the foreclosure strategy described above), the above described foreclosure strategies will be all the more effective and therefore damaging. They would reduce E.ON's competitors' gas-fired power plants' ability to compete and limit the scope for the development of a competitive open segment of the electricity wholesale market.

(732) This would have a direct impact on competition in the all the markets for the retail supply of electricity, due to the restriction in new generation capacity and higher wholesale prices. As a result of the strategy to link the gas supply and electricity purchase of gas-fired power plants, the new entity would reduce its electricity retail competitors' ability to source competitive electricity and would increase its already strong market power in electricity retail, thereby significantly impeding competition on all electricity retail markets.

(733) Finally, immediately after the transaction, E.ON will have the ability and incentive to prevent any other company active in electricity retail from developing dual offers (gas and electricity) by foreclosing access to gas resources to those competitors willing to pursue this marketing strategy, thereby significantly impeding competition on the markets for the supply of electricity to SCs and residential customers.

VII. ASSESSMENT OF THE REMEDIES PROPOSED BY THE PARTIES

(734) In order to remove the competition concerns described above in section VI on the gas and electricity markets, on 20 October 2005 E.ON submitted a package of commitments. On 15 November 2005, following the market test, E.ON submitted revised commitments. E.ON submitted final commitments on 8 December 2005. The commitments are set out in the Annex. The recitals below describe the main features of the commitments, as submitted by the parties and modified/improved following the results and the suggestions of the market test.

A. Description of the remedies

(i) Ownership unbundling

(735) Under the agreements concluded between MOL and E.ON, MOL would remain a minority shareholder in MOL WMT and MOL Storage (25% + 1 share in each) and enjoy a 5-year put option under which it can require E.ON to purchase these minority interests.

(736) Pursuant to the undertakings, MOL will divest its remaining shareholdings of 25% + 1 share in MOL Storage and MOL WMT within six months following the transaction. The buyer of the shares will be subject to the Commission's approval. In addition, MOL will not acquire direct or indirect minority stakes in MOL WMT and MOL Storage for a period of 10 years as long as E.ON is a majority shareholder of those companies.

(737) The objective of the ownership unbundling remedy is to alleviate the competition concerns raised by the Commission as regards MOL's incentives (in particular through its subsidiary MOL Transmission and its branch MOL E&P) to favour MOL WMT (for access to the transmission network) and MOL Storage (for access to future storage sites).

(ii) Put option related to MOL Transmission

(738) Under the agreements concluded between MOL and E.ON, MOL would be granted a 2-year put option under which it can require E.ON to purchase a 25% + 1 share or a 75% - 1 share interest in MOL Transmission.

(739) Pursuant to the undertakings, MOL will not exercise the put option for the 25% + 1 share interest in MOL Transmission. In addition, MOL will not sell to E.ON or any of its affiliates, for a period of 10 years as long as E.ON is a majority shareholder of MOL WMT and MOL Storage, a share interest in MOL Transmission that would not result in the acquisition of sole control over MOL Transmission by E.ON or of joint control over MOL Transmission by E.ON and MOL.

(740) The objective of the undertaking related to the put option for MOL Transmission is to ensure that any acquisition of a share interest in MOL Transmission by E.ON will be subject to merger control review by the relevant competition authority.

(iii) Gas Release Programme

(741) E.ON undertakes to implement a gas release programme in Hungary by way of business-to-business internet auctions. The programme will start in 2006 and have a duration of 8 years. Auctions will be held in 2006, 2007, 2008, 2009, 2010, 2011, 2012 and 2013. The necessity of continuing the programme for the last three years can be reassessed upon request by the parties at the end of 2010. 1 billion m³ of gas will be released at each annual auction. The annual quantities to be released will be divided in 5 lots of 100 million m³, 5 lots of 50 million m³ and 10 lots of 25 million m³ each. E.ON's affiliates will be excluded from participating, directly or indirectly, in the auctions.

(742) The successful bidders will enter into gas supply contracts with E.ON under the following terms and conditions. The contracted gas will be equally split over two years and delivered at the two Hungarian entry points (80% at the Eastern entry point and 20% at the Western entry point). The gas supply contracts will provide for the same flexibility as MOL WMT's upstream gas supply contracts, namely an annual flexibility of 85% to the effect that the purchaser will have to purchase and pay only 85% of the annually contracted gas quantity ("TOP obligation"). In addition, the daily and quarterly flexibility shall not be lower than the weighted average daily and quarterly flexibility of all purchase contracts of MOL WMT. In any event, the daily flexibility shall be at least 50% of the daily contracted quantity.

(743) The auctions will be carried out by an international IT service provider, and the auction procedure will be handled so as to ensure that MOL WMT does not gain knowledge of the intermediary bids placed by participants to the auction.

(744) The starting price for each annual auction will be 95% of the weighted average cost of gas of MOL WMT ("WACOG"). The calculation of the WACOG will be verified by the HEO. Quantities that are not sold in a given auction shall be reoffered with one third of the quantities each in the following three auctions, but no auction for unsold quantities will take place after 2014.

(745) The Hungarian Energy Office (HEO) and a Monitoring Trustee will supervise the auctions and the implementation of the gas release programme. In particular, the HEO will comment on and review E.ON's proposal for the technical implementation of the auction and the details of the supply contracts with the successful bidders, before it is submitted to the Commission for its approval.

(746) In addition, E.ON undertakes to grant the existing direct customers of MOL WMT and E.ON (KÖGÁZ and DDGÁZ) who participate in the auction or who purchase gas from a trader/wholesaler participating in the auction the right to reduce their obligation to purchase natural gas from MOL WMT and E.ON by the amount of gas that they will purchase directly or indirectly from the gas release programme. E.ON also undertakes to grant to those purchasers access to storage at regulated prices and conditions (See Storage undertaking).

(747) E.ON undertakes to modify and/or improve the implementing regime on the basis of the experience gained from the yearly auctions with a view to improving the effectiveness of the gas release programme.

(748) The objective of the gas release programme is to ensure sufficient competitive alternatives for access to gas on the Hungarian gas and electricity markets (independently of the parties and at competitive conditions) so as to prevent the new entity from foreclosing the access to gas resources for its downstream competitors in the gas and electricity markets.

(iv) Contract release

(749) ERI undertakes to assign to a third party (the "Third Party") half of the contract between MOL WMT and MOL E&P for the supply of domestic gas ("Supply Contract") within 6 months. Once the contract assignment becomes effective, the Third Party will take over all the rights and obligations of MOL WMT under the Supply Agreement for the part assigned to it. The assignment will become effective at the beginning of the gas year 2007 (July 2007) and will be valid for the whole duration of the Supply Contract, until 2016.

(750) According to the parties, the part of the Supply Contract to be assigned represents approximately 7.6-10 bcm of gas in total, with the volumes to be released in the first year amounting to 1.2 bcm.

(751) ERI will procure MOL to approve the partial transfer of the Supply Agreement. In addition, MOL will grant equal treatment to MOL WMT and the Third Party as regards the Supply Contract flexibility provisions.

(752) The assignment to the Third Party of half of the contract will be subject to the HEO's and the Commission's approval. The Third Party must not be the purchaser of MOL's minority interests in MOL WMT and MOL Storage.

(753) In case E.ON (and subsequently the Divestiture Trustee) does not succeed in finding a Third Party for the partial assignment of the Supply Contract for the start of the gas year 2007 (or for a subsequent year), the gas quantities that would have been released in that given gas year will be added to the gas release programme for that year. In this case, E.ON (and the Divestiture Trustee) shall seek again to find a third party interested in the partial contract transfer until 50% of the Supply Contract has been effectively assigned.

(754) As for the gas release programme, the objective of the contract release programme is to ensure sufficient availability of gas on the Hungarian gas and electricity markets (independently of the parties and at competitive conditions) so as to prevent the new entity from foreclosing the access to gas resources for its competitors in the gas and electricity markets.

(v) Access to storage

(755) E.ON undertakes to grant access to storage capacities at regulated price and conditions to end users and wholesalers that purchase gas directly through the gas release programme or the contract release. In particular, E.ON undertakes to offer access to

sufficient storage capacities for those end users and wholesalers even if they purchase gas for the first time or develop an increased demand for storage when buying gas quantities through the gas release programme or the contract release.

(756) E.ON undertakes to report any issue related to storage capacity constraints to the HEO. In any event, in accordance with the HEO resolution, E.ON is under an obligation to implement a storage development plan.

(757) The objective of the access to storage capacities at regulated price and conditions is to ensure that successful bidders in the gas release programme and the Third Party assignee of the contract release will be able to structure the purchased gas quantities according to their own or their customers' needs.

B. Assessment of the concentration as modified by the remedies

(758) In the framework of the market test on the proposed undertakings, the Commission contacted approximately 100 third parties, including gas and electricity operators (both Hungarian and international companies) and participants in other gas release programmes (notably in Germany). Moreover, the Commission contacted a number of national energy regulators in Member States with a view to benefiting from their expertise and knowledge of similar programmes.

(759) Many respondents put forward concrete and substantial suggestions for amendments to the package proposed by the parties with a view to improving the overall package and making the commitments more effective. The most substantial suggestions related to the gas release programme and in particular to its overall duration, to the volumes of gas to be auctioned, to the minimum price of the auctions and to the flexibility rules as to the delivery of gas to the successful bidders.

(760) The final package of undertakings, submitted on 8 December 2005 and described in Section A above, incorporates the bulk of the suggestions and comments made by third parties in the context of the market test. The undertakings in their final form, substantially improved compared to the parties' initial offer, thus meet the concerns expressed by third parties as regards the need to ensure sufficient liquidity of gas on the Hungarian wholesale gas market at price and conditions which will allow third parties to compete effectively with the new entity on the downstream Hungarian gas and electricity markets.

(761) As described, the undertakings proposed by the parties aim essentially at (i) strengthening the positive unbundling of MOL E&P (gas production) and MOL Transmission (gas transmission) on the one hand and MOL WMT (gas wholesale) and MOL Storage (gas storage) on the other hand and at (ii) releasing volumes of gas on the Hungarian wholesale markets through a gas release and a contract release.

(i) Unbundling

(762) The Commission has found that the 25% + 1 minority shareholdings which MOL would retain in MOL WMT and MOL Storage and the existence of the "put option" for the shareholdings of MOL Transmission to E.ON (even though the sale of MOL Transmission is not part of the present transaction), would create structural links between ERI and MOL which would provide the ability and the incentive for MOL

to discriminate against the parties' competitors for access to domestic gas, gas transmission services and new gas storage facilities.

(763) The Commission is of the opinion that the divestment by MOL of its 25% + 1 interest in MOL Storage and MOL WMT within 6 months after the transaction remedies the concerns stemming from the structural links between MOL and E.ON. The market test has, to a very large extent, welcomed the severing of the structural link between the parties.

(764) In particular, the sale of MOL's minority share in MOL Storage and MOL WMT would eliminate the incentive for MOL E&P to engage in discriminatory behaviour vis-à-vis potential future gas storage operators as regards the sale of depleted gas fields and the incentive of MOL Transmission to engage in discriminatory behaviour vis-à-vis traders and rival RDCs with a view to increase MOL WMT profits[280].

(765) Moreover, the Commission is also of the opinion that the fact that MOL will not exercise the put option vis-à-vis E.ON for the 25% of MOL Transmission (and not to sell E.ON a shareholding that would not result in the acquisition of joint control over MOL Transmission by E.ON and MOL or of sole control by E.ON) can contribute to alleviate the concerns that may stem from E.ON's becoming further integrated also in the gas transmission market. What is essential for the assessment is that the exercise of the put option by MOL for the 75% stake (or the sale of another shareholding) would result in a change of control of MOL Transmission and would be subject to the review and require the approval of the competent competition authorities (the Commission or the Hungarian Competition Authority).

(766) By contrast, the exercise of the 25 % put option would not bring about a change in control of MOL Transmission, hence it would not be subject to any approval procedure, in spite of its creating a structural link between E.ON and MOL Transmission. The remedy at stake seeks precisely to avoid this situation, and, should the put option be exercised, will provide the competent competition authorities[281] with the opportunity to review the new transaction in the framework of the market situations prevailing at the time of the exercise of the put option.

(767) A large number of respondents to the market test, while highlighting their concerns as regards the possibility that the new entity may also acquire control of the transmission network, have confirmed that the commitment at stake contributes to alleviate the concerns that may arise from such transaction, should the put option be exercised.

(ii) Gas release programme and contract release

a. European experience on gas release programmes

(768) To be in a position to assess properly whether the gas release and the contract release commitments submitted by the parties are suitable to remove the competition concerns identified during the procedure, the Commission has carried out an

[280] See section on the Impact of the transaction on the gas sector.

[281] The Commission or the Hungarian Competition Authority.

additional investigation focusing on existing similar programmes in various European countries.

(769) The main results of this investigation are set out here below.

General features

(770) Gas release programmes and contract release programmes aim at making gas available to wholesalers and end users at the wholesale level. In this type of programmes, the gas incumbent company undertakes to offer certain quantities of gas for sale to its competitors/customers. The undertakings proposed by the parties in the present case comprise both a gas release and a contract release.

(771) In a gas release programme, the gas incumbent offers for sale certain quantities of gas from its overall gas sourcing portfolio. Purchasers enter into supply contracts with the gas incumbent for these quantities. In a contract release programme, the gas incumbent transfers (assigns) part of its gas supply contracts with gas producers. Purchasers enter into a supply contract directly with the gas producers (without the intermediary of the incumbent) and the transferred gas supply contract(s) of the incumbent is terminated, or the gas quantities in the transferred supply contracts are reduced accordingly. Both types of programmes are designed to improve the liquidity of gas markets and enable competing traders and customers to acquire gas for their own use or for resale. The essential difference between contract and gas release is that the incumbent's supply portfolio remains the same in a volume release programme, while it is partly transferred to competitors/customers in a contract release programme.

(772) The sale of the gas or the transfer of the gas supply contract may be achieved in two ways: (i) auctions, or (ii) bilateral contracts. The gas quantities may be sold through public auctions where companies with the highest bid are selected. In case of bilateral negotiations, the incumbent negotiates with interested companies and gas sales/contract transfers are concluded based on mutual agreement. The undertakings proposed by the parties in the present case comprise both a gas release through auctions and a contract release though bilateral negotiations.

Specific features

(773) Gas release programmes have been and are being implemented in several European countries; experience is more limited for contract release programmes. Gas release programmes are either part of a broader action plan required under national law and/or designed by the national energy regulators to open the gas wholesale markets to competition (UK, Spain, Italy) or are implemented as undertakings in merger or antitrust procedures (France, Germany, Austria).

(774) In order to assess whether the remedies proposed by the parties are suitable to remove the competition concerns identified, the Commission has contacted the energy regulators in each of the countries where a gas release programme has been implemented with a view to understanding whether the programme has actually fulfilled its objectives and to establishing which elements are crucial for a gas release programme to be effective. The recitals below describe the most important features for successful gas release programmes according to the Commission’s assessment and based on the experience of the energy regulators.

(775) The Commission has also drawn useful guidance and suggestions from the paper "Implementation of Gas Release Programmes for European Gas Market Development" published by the European Federation of Energy Traders"[282] (EFET) to which the parties have widely referred.

Volumes

(776) The quantities of gas to be released depend on the objectives of the gas release programme and of the regulatory framework. More specifically, in a merger case, the volumes should be sufficient to remove the competition concerns and thus depend on the number and the size of markets in which competition concerns arise. The released volumes need to be sufficient to exclude that the incumbent supplier can foresee that all or most of the released volumes will be acquired by certain customer categories. Only if the volumes released are sufficient to allow eligible customers in all affected markets to benefit from the programme (as direct purchasers or indirectly as customers of traders buying gas through the gas release programme) can a gas release programme offset the incumbent's ability and incentives to engage in anticompetitive behaviour and thus remove the negative impact on competition.

(777) A gas release programme should in addition foresee that gas quantities that were offered for sale but did not find a buyer a given year should be added to the quantities to be released the following years.

Duration of the programme

(778) A gas release programme generally aims at increasing the liquidity on gas wholesale markets and facilitating new entries. In the context of a merger case, a gas release programme may seek to reduce or eliminate the merging parties' ability and incentives to engage in behaviour that would significantly impede effective competition. To achieve these objectives, the gas release programme should remain in place for a sufficiently long time as to ensure that the market structure and the competitive conditions have changed significantly, and that the level of competition achieved through the programme is sustainable.

Price and costs

(779) The price at which gas is available through the gas release programme should enable wholesalers to compete with the supplier of gas under the gas release on the gas wholesale and retail markets. The auction mechanism is a convenient way to allocate efficiently the gas quantities to be released. As the final price results from competitive bids, it is the price that bidders are willing to pay for the gas made available under the programme, given prevailing market conditions.

EFET: "The release programme will only be successful if the price of the gas or capacity made available to new entrants is low enough for the competition to compete. As a guide, the price must not be higher than the average price paid by the incumbent (including contractual discounts), nor must it be higher than the average netback from the incumbent's eligible customers. If a release programme is also

[282] http://www.efet.org

used as a remedy to balance the incumbents' market power, the price must not be higher than that offered in the wholesale market, even if this implies a financial loss to the incumbent."

(780) The WACOG is recognised in the EFET paper as one of the benchmarks for the definition of price mechanisms in auctions for gas release programmes.

(781) As regards additional costs, all costs incurred by participants to the auctions and by successful bidders should be clearly defined. As a principle, the additional costs should be avoided unless there are specific reasons.

Gas supply duration and lot size

(782) The duration of the gas supply contract and the size of the lots in a gas release programme should be designed so as to meet the needs of the various categories of bidders in the relevant markets.

Flexibility

(783) The daily, quarterly and yearly flexibility provisions for the gas supplied through the gas release programme are essential. Wholesalers and industrial customers should have the ability to structure the gas quantities they purchase according to their own or their customers' consumption profiles. Depending on the conditions of access to storage, the requirements for the flexibility of the gas supplied through a gas release programme differ.

(784) The annual flexibility (swing and TOP levels) should reflect the incumbent's average annual flexibility. As quarterly flexibility needs may be provided by the storage of gas, the flexibility provided by the seller in the gas release programme depends on access to storage.

EFET: "The swing and take-or-pay levels of the release gas programme should reflect the overall portfolio of the incumbent. If only flat gas is available, and access to storage or other flexibility tools is still difficult or at punitive prices, then competition in supply will not arise from the release programme."

(785) Finally as regards daily flexibility, it is clear that wholesalers, especially small ones, and end users have higher flexibility requirements that large importers (such as the seller generally). Therefore, it is clear that a base-load gas supply or even a daily flexibility similar to the seller's gas portfolio's average daily flexibility may be insufficient.

German Ministry: "In our decision, only a base load supply was foreseen. Such a product has no flexibility and is not attractive for potential purchasers. Ruhrgas has voluntarily offered a certain degree of flexibility (…). For potential purchasers minimum gas deliveries in summer are an issue."

(786) Experiences in European countries, particularly in Germany, show that the attractiveness of a gas release programme for small wholesalers and industrial customers strongly depends on the flexibility provisions of the gas supply.

Gas delivery points

(787) The gas should be delivered at a delivery point from which wholesalers can easily transport and store the gas. A gas hub or cross-border entry points are therefore generally appropriate delivery points. A certain degree of flexibility for the choice of the delivery point (as is often the case for the seller) increases the attractiveness of the programme.

(788) The delivery point location is in particular relevant when gas transmission network are split among various owners, when the level of free capacity is low in the transmission or storage system and when entry-exit tariffs (and not post stamp tariffs) are applicable. Availability of gas at more than one delivery point reduces the risk that the transmission regime constrains competition in any market area and ensures that purchasers face the same physical and operational risks as the seller.

EFET: "Gas should be made available at more than one entry point, in principle using the same entry points as where the incumbent brings in most of its gas. This reduces the possibility that the transportation regime constrains competition in any specific area or market segment. It also ensures that new entrants face the same physical and operational risks as the incumbent by sharing the same entry points. In deciding delivery locations, consideration must also be given to the ease and cost to participants of onward transportation and/or trading."

(789) In a merger case, the delivery point of a gas release programme should be selected so as to enable wholesalers and end users to source gas from the gas release programme for resale or for their own use in the geographical market where competition concerns have been identified.

Security of supply

(790) The gas supply conditions should include standard provisions on security of supply issues (maintenance, force majeure, off-spec, interruptibility, etc.) following the common practices in the relevant markets. The rights and obligations of the purchasers and the seller should be balanced.

Auction design and guarantees

(791) The "ascending clock auction" has been used in several countries and is apparently an appropriate procedure to allocate the gas quantities. The organization of the auction should also ensure that the seller does not gain information on its competitors.

(792) The amount of the deposits and guarantees should not be disproportionate and should not constitute a disincentive for potential bidders. Payment terms should reflect standard market practices and in particular those of the seller's upstream supply contracts.

EFET: "Credit terms must not unduly restrict participation of new entrants, especially smaller companies".

Access to transmission

(793) Access to sufficient gas transmission capacities is necessary to ensure that wholesalers and end users purchasing gas through the gas release programme can transport gas to the place where the programme is intended to solve competition concerns. Thus, access to transmission capacities is essential and a gas release programme is not expected to be successful if little free capacity is available in the gas transmission network. If transmission capacity is booked by the company that organizes the gas release programme, it should be released to the transmission system operator to the extent of the gas quantities released.

EFET: "For gas release to be effective there needs to be properly implemented, regulated third party access downstream of the delivery point".

(794) Responses from market operators indicate that difficulties to obtain sufficient capacity to transport the acquired gas were one of the main issues explaining the lack of success of the first auctions in the German gas release programme of E.ON/Ruhrgas.

Access to storage

(795) If the flexibility conditions foreseen in the gas release programme are not sufficient to meet the flexibility needs of wholesalers and end user, access to sufficient gas storage capacities is necessary to ensure that wholesalers and end users purchasing gas through the gas release programme can structure the acquired gas according to their own or their customers' needs. Thus, access to storage capacities is essential and a gas release programme is not expected to be successful if marginal free capacity is available in the gas storage system. If storage capacity is booked by the company that organizes the gas release programme, it should be released to the storage system operator to the extent of the gas quantities released.

Access to customers

(796) A gas release programme has little chance to be successful if the majority of customers are bound to their gas suppliers under long-term supply contracts. In these conditions, a gas release programme is not expected to introduce much competition on the gas markets as customers are not able to switch suppliers. Therefore, it is essential that customers purchasing gas in the gas release programme or indirectly from a trader purchasing gas in the gas release programme have the opportunity to terminate their existing gas supply contracts or to reduce their obligation to purchase gas.

Monitoring and review provision

(797) Experience has shown that it was important for an effective gas release programme to be able to review the conditions of implementation to address the difficulties encountered with the practical implementation of the programme. Given the high complexity and the specificities of the various market conditions, it is essential to provide for a close monitoring by the competent national authorities and for sufficient flexibility to modify the auction and gas supply rules so as to take duly into account the needs of third parties.

(798) While gas release programmes imposed by energy regulators may be easily reviewed and improved on an on-going basis, this is more difficult for gas release programme

constituting undertakings in merger cases. Therefore the degree of freedom of the parties to set the terms and conditions of the programme should be restricted to ensure the effectiveness of the remedy and most practical/technical rules for the implementation of the programme should not be part of the undertakings attached to a decision, but rather defined at a later stage under the supervision of the relevant competition authority.

b. Assessment of the gas release programme and on the contract release proposed by the parties

(799) The Commission has concluded that the gas release programme and the contract release as offered by the parties, incorporating the amendments and improvements proposed by third party respondents to the market test, are sufficient to remove all the competition concerns identified by the Commission as resulting from the transaction. In particular, the Commission considers that the combination of the gas release programme and the contract release will ensure that gas end users and wholesalers will have the ability to source their gas needs under competitive and non-discriminatory conditions and, for at least a significant part, independently from the merged entity.

Volumes

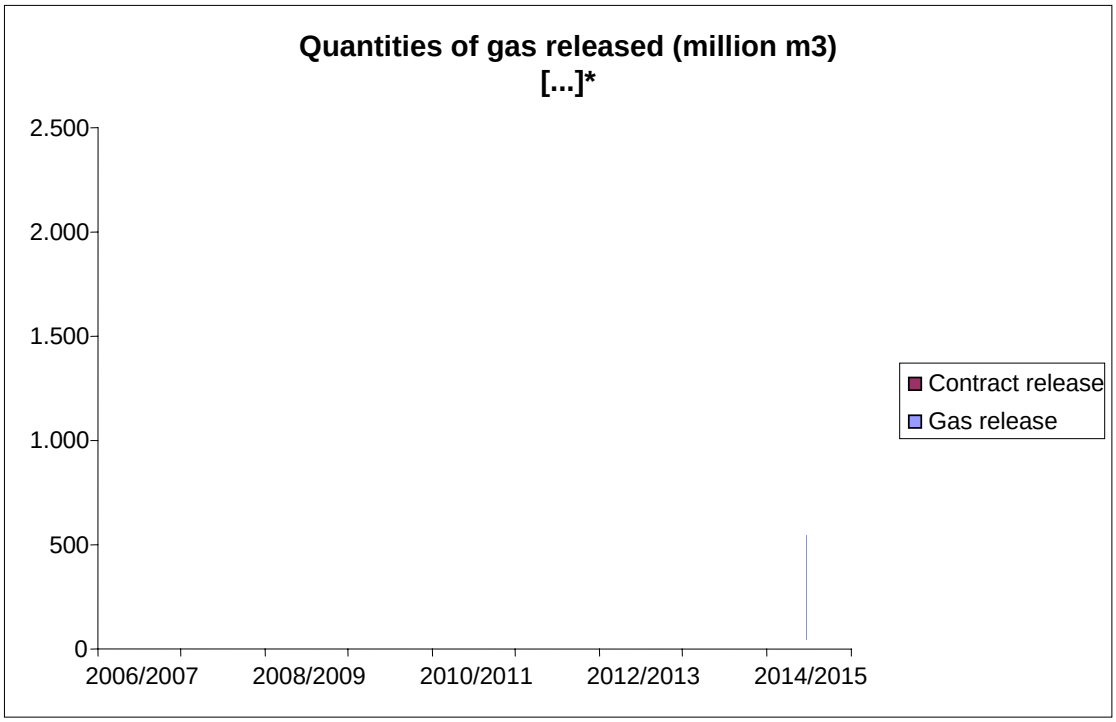
(800) In particular, the Commission considers that the volumes offered in the gas release programme (in conjunction with the volumes made available by the contract release for MOL E&P's production) are suitable to create sufficient liquidity of gas on the gas and electricity markets so as to ensure that effective competition can develop and remain sustainable. The total quantities of gas to be released through both remedies are significant in comparison to other existing gas release programmes.

(801) Based on MOL E&P current production forecasts (as included in Annex to the Supply Agreement), the Commission has estimated the quantities of gas that the parties undertake to release on a yearly basis until the gas year 2014/2015.

Quantities of gas released under the proposed commitments:

Gas Year	**Quantities of gas released (in millions m^3)**		
	Gas release	**Contract release**	**TOTAL**
2006/2007	500	[700-1300]*	[0-1000]*
2007/2008	1000	[700-1300]*	[2000-2500]*
2008/2009	1000	[700-1300]*	[2000-2500]*
2009/2010	1000	[700-1300]*	[2000-2500]*
2010/2011	1000	[500-1000]*	[1500-2000]*
2011/2012	1000	[500-1000]*	[1500-2000]*
2012/2013	1000	[500-1000]*	[1500-

			2000]*
2013/2014	1000	[0-500]*	[1000-1500]*
2014/2015	500	[0-500]*	[500-1000]*
TOTAL	**8,000**	**[5000-10000]***	**[13000-18000]***



(802) The table and chart in recital 799 above show that, at least until 2013/2014, substantial quantities of gas (around 2 bcm) will be released and the programmes will last until 2014/2015 (expiry of MOL WMT upstream procurement contracts and of MOL E&P's supply contract). The quantities released by the parties account for up to 14% of the total Hungarian demand and represent 21% of total third parties' gas sales (i.e., excluding sales of E.ON's RDCs and of MOL WMT). This means that third parties will have the ability to purchase a significant share of their gas from the gas release and/or the contract release.

(in million m^3)	**Quantities of gas released**	**Hungarian gas consumption**	**%**
2006/2007	[0-1000]*	[15000-20000]*	[0-10]*%
2007/2008	[2000-2500]*	[15000-20000]*	[10-20]*%
2008/2009	[2000-2500]*	[15000-20000]*	[10-20]*%
2009/2010	[2000-2500]*	[15000-20000]*	[10-20]*%
2010/2011	[1500-2000]*	[15000-20000]*	[10-20]*%
2011/2012	[1500-2000]*	[15000-20000]*	[10-20]*%
2012/2013	[1500-2000]*	[15000-20000]*	[5-15]*%
2013/2014	[1500-2000]*	[15000-20000]*	[5-15]*%
2014/2015	[0-1000]*	[15000-20000]*	[0-10]*%
TOTAL	**[10000-20000]***	**[140000-150000]***	**[5-15]*%**

(803) The commitments do not foresee any restriction on the quality of participants to the gas release programme and the gas released may thus be purchased by commercial and industrial customers and power generators to meet their own needs or by gas traders. It is therefore not possible to estimate which quantities of gas released will be used in each of the relevant market where the Commission has identified competition concerns.

(804) However, the total quantities of gas released over the gas years 2007/2008 to 2013/2014 represent approximately 60% of the size of the market for the supply of gas to power plants and 55% of the size of the market for the supply of gas to large industrial customers. The Commission therefore estimates that the released gas quantities will significantly increase liquidity and hence limit the likelihood of anticompetitive behaviour by the new entity.

(805) The total quantities of gas to be released through both remedies are significant in terms of international benchmark. In this regard, the volumes of gas to be released are significantly higher (in percentage value) than in the similar programmes implemented in other European countries. For example, the gas release programme organized by Econgas in Austria amounts to 2.9% of the total Austrian gas market, the programme by E.ON Ruhrgas in Germany corresponds to 2.5% and ENI's programme in Italy represents 3.1% of total demand.

Gas release programme

(806) The Commission believes that the gas release programme offered by the parties is designed, as regards its main features (volumes, duration, price mechanism) and in its more technical features (size of lots, duration of contracts, flexibility rules) largely in line with the criteria described in recitals 766 to 796 above, which are widely considered to be most relevant for the successful implementation of gas release programmes. The gas release programme was improved to take into account comments and suggestions made by respondents in the market test. The detailed rules for the effective implementation of the auction and the gas supply contracts will be elaborated by the parties under the scrutiny of the HEO, and submitted to the Commission for its approval.

(807) The duration of the gas release programme will ensure that sufficient liquidity will be available for a sufficiently long time as to ensure that the market structure and competitive conditions have changed. It has to be highlighted that all of the parties' current supply agreements, including those with Gazprom / Panrusgáz, will have terminated by 2015. The new entity's gas supply contracts with Gazprom and the privileged access to gas resources (which confer to new entity the ability to foreclose access to gas to its downstream competitors and to significantly impede effective competition on the gas supply markets) will be open for competition at this date.

(808) While the market investigation has revealed that Gazprom had no incentive to supply other traders competing with MOL WMT as long as it supplied the latter with gas quantities covering the bulk of the Hungarian gas consumption, at the expiry of the contract with MOL WMT, Gapzrom will obviously have an economic interest in selecting its "Hungarian partner(s)" based on a competitive process. Large international market players already present in Hungary through ownership in the gas RDCs (ENI, RWE and GDF) will indeed have an interest in bidding for this

(these) new gas supply agreements with Gazprom and the Commission believes that the new entity and the largest gas traders active in Hungary will be in the same position to negotiate such supply agreement(s) in 2015.

(809) Furthermore, the price mechanism foreseen for the programme will ensure that successful bidders will obtain gas at the same competitive conditions as the parties, and possibly cheaper, owing to the fact that the starting bidding price foresees a 5% discount off the WACOG. The Commission considers this pricing mechanism as enshrined in the remedies is attractive for third parties and will provide good incentives to participate actively in the programme's auctions. The remedy package also foresees that potential financial losses resulting from the price mechanism will be incurred by the parties for a considerable amount.

(810) As regards the implementation of the gas release programme, it is important to ensure that all participants are admitted at transparent and non-discriminatory terms and that the sale is made at competitive conditions.

(811) To this end, various parameters of the gas release programme have been modified by the parties following the market test in order to cater for the needs of potential buyers. For example, the size of the lots has been adjusted to meet the specificities of the Hungarian markets: three lots sizes are now offered to better meet the needs of the various categories of market players. The period between the auction and the delivery period has been extended by two months to give more time to successful bidders to find new customers if they intend to resell the gas they have acquired.

(812) Access to customers is also granted under the proposed remedies as the parties undertake to amend the existing contracts of their existing customers intending to purchase gas from the gas release programme, either directly or through a wholesaler.

(813) The Commission believes that the Hungarian regulatory framework (in particular "capacity-follows-the-customer" principle) should ensure that sufficient transmission and distribution capacities are made available to the successful bidders to transport the acquired gas within Hungary.

Contract release

(814) The Commission believes that the assignee of the contract release will constitute a sizeable and sustainable competitive force in the Hungarian gas markets. The assignee will purchase significant quantities of gas from MOL E&P starting in July 2007 (expected date of the further liberalization of the Hungarian gas markets) until 2013/2014, independently from the new entity. It will also have to ability to combine the contract release with the purchase of gas quantities through the gas release programme until 2013/2014. The assignee of the contract release will therefore have sufficient long term gas resources to develop its position on the Hungarian gas markets and introduce liquidity on these markets.

(815) The fact that the terms and conditions of the contract will be similar for the new entity and the assignee ensures that the latter will have the ability to compete with the new entity. In particular, MOL will grant equal treatment to WMT and the third party in exercising its put options concerning production quantities.

(816) Access to customers is also granted under the proposed remedies as the parties undertake to entitle to amend the existing contracts of their existing customers from the Third Party assignee of the contract release.

(817) The Hungarian regulatory framework (in particular "capacity-follows-the-customer" principle) should ensure that sufficient transmission and distribution capacities are made available to the Third Party assignee to transport the acquired gas within Hungary.

Storage

(818) Additionally, the commitments of the parties to grant access to storage for the successful bidders of the gas release programme and the assignee of the contract release at regulated prices are sufficient to grant an effective and non-discriminatory access to the storage capacities for the relevant gas quantities. The Commission believes that this commitment will enable traders and customers to structure the acquired gas according to their own or their customers' needs.

Monitoring

(819) Finally, the effective monitoring by the HEO, with the assistance of the Commission's Trustee, will help the Commission ensure that the parties will fully comply with their commitments for their full duration.

C. Conditions and obligations

(820) Under the first sentence of the second subparagraph of Article 8(2) of the Merger Regulation, the Commission may attach to its decision conditions and obligations intended to ensure that the undertakings concerned comply with the commitments they have entered into vis-à-vis the Commission with a view to rendering the concentration compatible with the common market.

(821) Where a condition is not fulfilled, the Commission decision declaring the merger to be compatible with the common market no longer stands. Where the undertakings concerned commit a breach of an obligation, the Commission may revoke the clearance decision in accordance with Article 8(5)(b) of the Merger Regulation. The undertakings concerned may also be subject to fines and periodic penalty payments under Articles 14(2)(d) and 15(2)(c) of the Merger Regulation.

(822) In accordance with the basic distinction described above, this Decision should be subject to compliance with the conditions set out in Section B, subsection I and II of the Annex.

(823) In accordance with the basic distinction described above, this Decision should be subject to compliance with the obligations set out in Section B, subsection III, IV and V and in Section C of the Annex.

VIII. CONCLUSION

(824) It is concluded that the commitments submitted by the notifying party are sufficient to address the competition concerns raised by this concentration. Accordingly, subject to compliance with the commitments submitted by the notifying party, the notified operation should be declared compatible with the common market and the functioning of the EEA Agreement.

HAS ADOPTED THIS DECISION:

Article 1

The notified operation whereby E.ON Ruhrgas AG acquires sole control of MOL Földgázellátó Rt. and MOL Földgáztároló Rt. within the meaning of Article 3(1)(b) of the Regulation (EC) No 139/2004 is hereby declared compatible with the common market and the functioning of the EEA Agreement.

Article 2

Article 1 is subject to compliance with the conditions set out in Section B, subsection I of the Annex.

Article 3

Article 1 is subject to compliance with the obligations set out in Section B, subsection III, IV and V of the Annex.

Article 4

This decision is addressed to:

E.ON Ruhrgas International AG
E.ON Ruhrgas AG
Huttropstrasse 60
D - 45138 Essen
Germany

Done at Brussels, 21/XII/2005

For the Commission
(signed)
Neelie KROES
Member of the Commission

DATE: 8.12.2005 (REVISION OF THE COMMITMENTS 15. NOVEMBER 2005)

By e-mail and by fax: 00 32 2 296 4301

European Commission
DG Competition
Rue Joseph II 70 Jozef-II straat
B-1000 Brussels

Case M.3696 E.ON/MOL

COMMITMENTS TO THE EUROPEAN COMMISSION

submitted by E.ON Ruhrgas International AG

Pursuant to Article 8(2) of Council Regulation (EC) No. 139/2004 (the "Merger Regulation"), E.ON Ruhrgas International AG ("ERI") hereby provides the following Commitments (the "Commitments") in order to enable the European Commission (the "Commission") to declare the acquisition of control of ERI over MOL Földgázellátó Rt. ("WMT") and MOL Földgáztároló Rt. ("MOL Storage") compatible with the common market by its decision pursuant to Article 8(2) of the Merger Regulation (the "Decision"). The Commitments shall take effect upon the date of adoption of the Decision.

This text shall be interpreted in the light of the Decision to the extent that the Commitments are attached as conditions and obligations, in the general framework of Community law, in particular in the light of the Merger Regulation, and by reference to the Commission Notice on remedies and under Commission Regulation (EC) No 802/2004.

Section A. Definitions

Affiliated Undertakings: Undertakings controlled by the Parties and/or by the ultimate parents of the Parties, whereby the notion of control shall be interpreted pursuant to Article 3 Merger Regulation and in the light of the Commission Notice on the concept of concentration under Council Regulation (EEC) No 4046/89.

Date of Closing: The day on which ERI will have taken over sole control of WMT and MOL Storage.

Divestment Business: The businesses as defined in section B. I.

Divestiture Trustee: One or more natural or legal person(s), independent from the parties, who is (are) approved by the Commission and appointed by ERI or MOL and who has (have) received from ERI or MOL the exclusive trustee mandate to sell the Divestment Business (in case of MOL) or the transferred business according to section IV (in case of ERI).

Effective Date: The day of adoption of the Decision.

ERI: Throughout this document the term ERI shall also apply to WMT and MOL Storage in the sense that after the Date of Closing ERI will cause WMT and MOL Storage to comply with their obligations as identified in this document.

First Divestiture Period: The period of six months from the Date of Closing.

HEO: The Hungarian Energy Office.

MOL: MOL Hungarian Oil and Gas Company Rt., including its gas exploration and production division (MOL E&P)

MOL Transmission: MOL Földgázszállitó Rt.

Monitoring Trustee: One or more natural or legal person(s), independent from the Parties, who is approved by the Commission and appointed by ERI and MOL (as procured by ERI), and who has the duty to monitor ERI`s and MOL`s compliance (as procured by ERI) with the conditions and obligations attached to the Decision.

Trustee(s): The Monitoring Trustee and the Divestiture Trustee.

Trustee Divestiture Period: Period of three months from the end of the First Divestiture Period.

Section B. The proposed remedies

(i) I. Ownership Unbundling

1. Under the agreements concluded between MOL and ERI, MOL remains a shareholder of WMT and MOL Storage and it enjoys put-option rights under which MOL can require ERI to purchase the remaining 25 % plus one share interests which MOL will have in WMT and MOL Storage following the date of closing of the transaction. The put-options have a term of 5 years.

2. ERI undertakes to procure MOL to dispose of its remaining 25 % plus one share interest in WMT and MOL Storage (the "Divestment Business") within six months following the Date of Closing. The disposal and acquisition of the Divestment Business will be subject to the approval of the HEO.

3. The disposal of the Divestment Business to a third party is subject to the Commission's approval. The Commission shall grant its prior approval if the disposal to the third party does not, in the light of the information available to the Commission, create competition concerns in the Hungarian energy markets or does not give rise to a risk that the implementation of the Commitments will be delayed. ERI is not a third party within the meaning of this subsection.

4. Should MOL, in spite of its best efforts, encounter difficulties arising from regulatory or other government-induced proceedings, such as a possible clearance procedure before the HEO, in the disposal of the Divestment Business, ERI shall immediately inform the Commission and then rely on the review-clause mechanism set out under section D. of this document below.

5. A Monitoring Trustee will supervise the divestiture of the Divestment Business in WMT and MOL Storage. ERI shall procure MOL to submit written reports in English on potential transferees of the Divestment Business and developments in the negotiations with such potential transferees to the Commission and the Monitoring Trustee no later than ten days after the end of every month following the Date of Closing.

   ERI shall procure MOL to inform the Commission and the Monitoring Trustee on the preparation of the data room documentation and the due diligence procedure and shall submit a copy of an information memorandum, if any, to the Commission and the Monitoring Trustee before sending the memorandum out to potential transferee.

6. If MOL has not entered into a final agreement with a third party or exercised its put-option vis-à-vis ERI at the end of the First Divestiture Period, ERI shall procure MOL to grant the Divestiture Trustee an exclusive mandate to sell the Divestment Business to a purchaser at no minimum price within the Trustee Divestiture Period. ERI shall be deemed to have complied with this Commitment if, by the end of the

Trustee Divestiture Period, MOL has entered into a final binding agreement on the disposal, if the Commission approves the transferee and the terms in accordance with subsection I.3 and if the closing of the disposal of the Divestment Business takes place within a period not exceeding three months after the approval of the transferee and the terms of disposal by the Commission.

7. The final binding agreement shall be conditional on the Commission's prior approval. When MOL has reached an agreement with a transferee, ERI shall procure MOL to submit fully documented and reasoned proposal, including a copy of the final agreement, to the Commission and the Monitoring Trustee. ERI must be able to demonstrate to the Commission that the transferee meets the requirements according to subsection I.3 and that the Divestment Business is being sold in a manner consistent with the Commitments. For the approval, the Commission shall verify that the transferee fulfils the transferee's requirements according to subsection I.3 and then the Divestment Business is being disposed of in a manner consistent with the Commitments.

8. In order to maintain the structural effect of the Commitments, ERI shall procure MOL, for a period of 10 years after the Effective Date, not to acquire direct or indirect minority stakes in WMT or MOL Storage as long as ERI is a majority shareholder, unless the Commission has previously found that the structure of the market has changed to such an extent that the absence of influence of MOL over WMT or MOL Storage is no longer necessary to render the proposed concentration compatible with the common market.

II. Put Option Mol Transmission

Under the Transmission Put Option Agreement concluded between MOL and ERI, MOL is granted a put option under which MOL can require ERI to purchase a 25 % plus one share or a 75 % minus one share interest in MOL Transmission. ERI hereby undertakes to the Commission that it shall procure MOL not to exercise the put option for the sale of 25 % plus one share interest in MOL Transmission. Also, ERI shall procure MOL, within the time period defined in section I.8., not to sell to ERI or any of its Affiliated Undertakings a share interest in MOL Transmission which would not result in the acquisition of sole control over MOL Transmission by ERI or of joint control over MOL Transmission by ERI and MOL. The terms "sole and joint control" are to be interpreted in compliance with the Merger Regulation.

III. Gas Release Programme

1. ERI undertakes to organize and implement a gas release programme to become effective on the Hungarian market. Under the gas release programme, ERI will offer for sale (release) natural gas on a non-discriminatory and transparent basis under the following terms and conditions:

1.1. The amount of gas to be auctioned each year will be 1 billion m³. The amount of 1 billion m³ will be auctioned in the years 2006, 2007, 2008, 2009, 2010, 2011, 2012 and 2013 respectively. However, by the end of 2010, ERI will have the possibility to apply for a termination of the gas release programme at the end of the initial five-year period if it can demonstrate to the Commission, on the basis of data available from the HEO and other public and reliable sources, that the market conditions have significantly changed.

The first auction and its envisaged date of commencement for the gas year 2006/2007 (July 1st) will be announced to the Hungarian market and be published on the websites of ERI and WMT no later than one month after the Date of Closing. The subsequent first auction will take place in the first week of May. In the next years, the auctions will take place in the first week of March. The above-mentioned gas volumes refer to gas suitable for public utility services according to the prevailing Hungarian national standard or in case there will be no public utility service always to the prevailing Hungarian national standard.

1.2. The sale will be organized by way of a business-to-business internet auction. Participants will be invited at an appropriate point of time before the beginning of the gas year to place their bids remotely via the internet. In 2006, the bidders will be invited in April; in the next years, they will be invited in February. Each auction shall comprise 5 tranches of 100 million m^3, 5 tranches of 50 million m³ and 10 tranches of 25 million m³ each with a duration of two years to be delivered to the successful bidders according to the flexibility provisions foreseen in paragraph 1.7. below. The quantity of the tranches will be equally split over two years. It will be possible to bid for more than one tranche at the discretion of the participant.

The execution of the auctions will be carried out by an international IT-service provider. The auction procedure shall be handled so as to ensure that WMT will not gain knowledge of the intermediary bids placed by participants to the auction. Only the number of lots awarded to each successful bidder and the final auction price shall be communicated to WMT. The auction process shall be documented including the intermediary bids and name of the bidders. The documentation shall be made available to WMT after the auction has been terminated in order to enable WMT and/or ERI to discuss with the Monitoring Trustee and the HEO any comments or

representations which may have been made by companies which have participated in the gas release programme

ERI shall submit, within two months after the Effective Date, a proposal for the technical implementation of the auctions and the details of the supply contracts for gas delivered to successful bidders to the HEO for its comments and review. At the same time the proposal will also be submitted to the Commission. The review by the HEO shall be concluded within one month after the submission of the proposal by ERI. Further to the review by the HEO, the proposal of ERI shall be subject to the approval of the Commission.

The procedure of the auction (e.g. auction mechanism, bidding stages) should be designed so as to ensure a transparent and non-discriminatory allocation of the offered gas quantities in a competitive way. ERI undertakes to fully abide by the procedure for the technical implementation of the auctions as approved by the Commission and as possibly modified according to paragraph 2.2. hereunder.

The terms and conditions of the supply contracts for gas delivered to successful bidders to the auctions (e.g. nomination procedure, payment periods, price indexation etc) and in particular as regards the security of supply and penalties (e.g. situation of maintenance, force majeure, off-spec gas, interruptibility, etc.) should be in line with standard practices of the Hungarian gas markets.

1.3. Each auction process will start at a minimum price as defined in subsection 1.4. below and shall be based on the weighted average cost of gas (WACOG) of WMT. The WACOG shall be calculated as the weighted average cost of gas under all gas purchase contracts of WMT and shall closely reflect WMT's actual net cost of procurement of gas (both domestic and imported) at the time of each auction. The respective calculations are subject to a verification procedure carried out by the Monitoring Trustee who will report to the Commission pursuant to Section C II 2. (d) (2) of the Commitments. The general methodology of the WACOG calculation shall be submitted to the Commission two months after the Effective Date for its prior review and timely approval.

1.4. WMT will carry out the auction at a discounted minimum price which will be 95% of WACOG provided that the aggregate loss WMT may incur as a result of the final auction price being set below WACOG does not exceed EUR 26 million. The loss in a given auction is the negative difference between the final auction price minus the respective WACOG multiplied with the volumes of gas sold under this auction. After each auction, WMT will communicate any such loss WMT has incurred as the case may be to the Monitoring Trustee who is entitled to verify this information if required.

1.5. Quantities that are not sold in the auction shall be carried forward to the following years. Unsold quantities of a specific year's gas release programme shall be reoffered with one third of the quantities each in the following three auctions. Such final auctions for unsold quantities will not take place after 2014.

1.6. Potential bidders must register for the auction process and will be admitted to the auction process upon payment of a deposit (per tranche they intend to bid for) for the participation. The amount of the deposit shall be in line with standard practices of the European gas market and shall be established in consultation with the HEO. This deposit can also be made by providing a bank guarantee. This deposit will be returned to the bidders after the end of the auction. Successful bidders will have to place an additional deposit as guarantee for the payment of the purchase price. The amount of such payment guarantee will be fixed in consultation with the HEO depending on the amount the successful bidder will have to pay for gas volumes acquired in the auction.

1.7. The sales contract will provide for an annual minimum offtake obligation of 85 % to the effect that the purchaser will only have to purchase and pay 85 % of the annually contracted quantity. The daily minimum offtake obligation for successful bidders shall not exceed the weighted average daily minimum offtake obligation of all purchase contracts of WMT (currently being 50%). The quarterly minimum offtake obligation shall be 85 % of the quarterly contracted quantities. In case the respective daily and quarterly minimum offtake obligations of the import contracts change, the weighted average daily and the quarterly minimum offtake obligations shall be adapted accordingly. WMT shall submit its calculations of the weighted average daily and of the quarterly minimum offtake obligations (including the methodology used for these calculations) to the HEO for its review (see subsection 2.2. below) and shall publish the results on WMT's webpage.

1.8. In the auction process, each tranche will be offered for 80% gas delivery at the Hungarian side of the Eastern entry point into Hungary and 20% at the Hungarian side of the Western entry point into Hungary.

The successful bidders shall bear the (regulated) cross-border transmission fees for the acquired gas and, for the volumes to be offered at the Hungarian side of the Western entry point into Hungary also the transportation fee on the HAG pipeline from Baumgarten to the Hungarian border. These fees shall be separately identified and added by WMT to the price of the gas sold under the gas release program.

In case the Hungarian grid code is changed and the 80%/20% ratio is amended, WMT undertakes to correspondingly change its Commitments under this subsection.

1.9. Transport capacity booked by WMT with MOL Transmission shall be returned to MOL Transmission by WMT in the amount and to the extent that gas is sold to the successful bidders. ERI shall procure MOL Transmission in turn, to ensure that the necessary transmission capacities are available for the successful bidders.

1.10. Existing direct customers of WMT or ERI which participate in the auction processes or which purchase gas from a trader/wholesaler, who participates in the auction processes, are entitled to ask WMT or ERI for an extraordinary contractual modification in order to reduce their obligation to purchase natural gas from WMT or ERI by the amount of gas they will have purchased as a result of the gas release programme. The other terms and conditions of the gas supply contracts between these direct customers and WMT or ERI shall not be modified. The total amount of reductions must not be higher than the quantities sold in the auction processes.

1.11. ERI and all of its Affiliated Undertakings are excluded from placing bids in the auction processes, be it directly or indirectly through an agent. Furthermore, ERI and all of its Affiliated Undertakings shall be excluded from purchasing gas from the successful bidders, be it directly or indirectly through an agent.

2. A Monitoring Trustee and the HEO will supervise the auction processes under the gas release programme.

2.1. Within a period of two months after the conclusion of each annual auction process up until the year 2010, ERI or WMT will inform the Monitoring Trustee and the HEO about the implementation of the yearly gas release programme and will make the respective tender and bidding documents, correspondence and contracts available to the Monitoring Trustee and the HEO for onward reporting to the Commission.

2.2. ERI undertakes to modify and/or improve the implementing regime established for the implementation of the gas release programme on the basis of the experience gained from the yearly auctions with a view to solve issues raised by participants to the previous auctions and to improve the effectiveness of the program in achieving greater liquidity on the Hungarian wholesale gas markets. The Monitoring Trustee and the HEO shall therefore receive and hear comments or representations from companies which have participated or which intend to participate in the gas release auctions. The Monitoring Trustee will evaluate such comments or representations and afford WMT the opportunity to reply to the comments or representation and to adduce factual evidence to the extent necessary. Should the findings of the Monitoring Trustee in his opinion give reasons for concern as to the implementation of the remedy, the Monitoring Trustee will prepare a written report to the Commission which will also be provided to WMT and to the company which had initially made the comments or representations, provided however, that business

secrets of WMT must not be revealed to this company and that business secrets of this company must not be revealed to WMT. The proposal for the amendment and/or improvement of the implementing regime established for the implementation of the gas release programme will be submitted to the HEO for its comments and review. At the same time the proposal will also be submitted to the Commission. The review by the HEO shall be concluded within one month after the submission of the proposal by ERI. Further to the review by the HEO, the proposal of ERI shall be subject to the approval of the Commission.

IV. Contract release

1. In addition to its gas release programme, ERI undertakes to to partially transfer and assign WMT's rights and obligations in and to its gas supply agreement with MOL (MOL E&P) to a third party gas trader in Hungary in respect of a 50 % portion of the gas volumes, including also the proportional volumes to be sold at the option of MOL contracted to be delivered and received under the terms of the said agreement. (**Note:** In view of the domestic production forecast indication as of today, this 50 % represent app. 7.6 – 10 billion m^3, whereas the amount to be released in the first year will correspond to app. 1.18 billion m^3.) The above-mentioned gas volumes refer to gas suitable for public utility services according to the prevailing Hungarian national standard or in case there will be no public utility service always to the prevailing Hungarian national standard.

1.1. This transfer shall become effective at the beginning of the gas year 2007 (July 1st) and shall remain in force through to the end of said gas supply agreement (June 30th 2015).

1.2. Under the terms of the transfer agreement, the third party gas dealer shall assume all of the rights and obligations of WMT under the supply agreement in respect of said 50 % portion of the gas volumes contracted under said agreement, and ERI shall procure MOL to agree to fulfil its delivery obligations stipulated under the supply agreement towards such third party in respect of said 50 % portion of the gas volumes. ERI shall procure MOL, in exercising its put options concerning production quantities, to grant equal treatment to WMT and the third party, respectively, according to the percentages of their contracted volumes and to acknowledge and agree that, in respect of this 50 % portion of gas volumes, MOL has established a direct contractual relationship with the third party whereby each of them shall be liable to the other for the rights and obligations assumed, without any recourse to ERI or WMT.

1.3. ERI shall procure MOL to approve the partial transfer of the supply agreement.

1.4. Within the First Divestiture Period, ERI undertakes to use its best efforts to transfer said portion of the gas supply agreement to a third party gas trader acceptable to MOL and to the Commission. The third party must be (a) independent of and unconnected to ERI and (b) have the financial resources, proven expertise and incentive to maintain and develop the transferred business as a viable and active competitive force in competition with ERI and other competitors. Moreover, this third party must not be identical to a possible purchaser of the Divestment Business.

The final transfer agreement shall be conditional on the Commission's prior approval. When WMT has reached an agreement with a purchaser, it shall submit a fully documented and reasoned proposal, including a copy of the final agreement, to the Commission and the Monitoring Trustee. ERI must be able to demonstrate to the Commission that the purchaser meets the above mentioned purchaser requirements and that the transferred business is being sold in a manner consistent with the Commitments. For the approval, the Commission shall verify that the purchaser fulfils said requirements and that the transferred business is being sold in a manner consistent with the Commitments.

In case that ERI has not entered into such an agreement within the six months period, ERI shall grant the Divestiture Trustee an exclusive mandate to transfer the portion of the supply agreement according to the terms and conditions of that agreement within the Trustee Divestiture Period, even without any additional consideration paid by the third party to WMT.

Should the Divestiture Trustee not be able to enter into such an agreement with a third party, it shall submit a report to the Commission which sets out and explains why ERI and the Divestiture Trustee have been unsuccessful in transferring said portion of the supply agreement. The annual volume of gas for that given gas year and, as the case may be, subsequent years, shall then be added to the gas release programme of that year in accordance with section III. For the following gas year, ERI shall then again seek to identify a third party gas trader in accordance with sections 1.1. to 1.4. above. In such a case the First Divestiture Period shall start on May 1st of the respective next year before the next gas year (e.g. for the gas year 2008 in June 2007). The same applies accordingly to the Trustee Divestiture Period which shall start on November 1st. The rights and obligations of the Divestiture Trustee apply accordingly for these subsequent years. The same is true for WMT's obligation to add the respective gas to the gas release programme of the following year. As a result, the gas release programme could continue to run for a longer term as described under section III, i.e. until the end of the gas supply agreement between WMT and MOL.

Existing direct customers of WMT or ERI which participate in the auction processes or which purchase gas from a trader/wholesaler, who participates in the auction processes, are entitled to ask WMT or ERI for an extraordinary contractual modification in order to reduce their obligation to purchase natural gas from WMT or ERI by the amount of gas they will have purchased as a result of the gas release programme. The other terms and conditions of the gas supply contracts between these direct customers and WMT or ERI shall not be modified. The total amount of reductions must not be higher than the quantities assigned to the third party trader in the contract release.

2. The Monitoring Trustee and the HEO shall be empowered to supervise that MOL is fully cooperative in bringing about the Contract Release and does not refuse to accept the transfer of the 50 % portion of the gas supply agreement to a suitable third party, which is eligible under this section IV and which is prepared to agree to the transfer of the agreement. The Monitoring Trustee and the HEO will have the power to review all relevant documents and correspondence. Should they see reasons for concern, they will immediately report these concerns to the Commission and give their opinion as to whether MOL has shown good cause for its behaviour. MOL and ERI will be provided with an opportunity to be heard.

3. Neither ERI nor any of its Affiliated Undertakings shall directly or through an agent purchase gas from the third party gas trader in Hungary.

V. Storage Capacity

1. ERI undertakes to make available storage capacities in Hungary under the terms and conditions as described in the following:

   ERI undertakes to transfer under the applicable regulated prices and conditions, as approved by the HEO, storage capacities required by successful bidders which purchase gas quantities in the gas release programme as described under section III. and/or gas quantities in the MOL E&P contract release as described under section IV above in order to structure the acquired gas quantities for their own or their customers' needs.

   In this respect, the current regulatory conditions provide that existing customers that switch from the regulated to the open market take their storage capacity into the open market. This will also apply to such customers being supplied with volumes from the gas release programme and/or the MOL E&P contract release. For customers and/or wholesalers that purchase gas for the first time, or develop an increased storage demand when buying gas quantities from the gas release programme and/or the MOL E&P contract release, ERI undertakes to offer them

sufficient access to storage capacities to structure the acquired gas quantities for their own or their customers' needs. Access to storage capacity shall be granted under the applicable regulated prices and conditions.

2. A Monitoring Trustee and the HEO will supervise that MOL Storage makes available storage capacities in Hungary under the terms and conditions defined in subsection 1. They will have the power to review all relevant documents and correspondence. Should the Monitoring Trustee or the HEO see reasons for concern, they will immediately report these concerns to the Commission and give their opinion as to whether MOL Storage has shown good cause for its behaviour. MOL Storage will be provided with an opportunity to be heard.

   In case MOL Storage is unable to give access to the storage capacities requested by the successful bidders to the gas release programme and the third party trader of the contract release due to contractual or technical constraints in storage capacities, MOL Storage shall submit within 15 days from the date of the unfulfilled demand for access to storage, to the Monitoring Trustee and the HEO a report explaining the constraints in storage capacities. Furthermore, MOL Storage will comply with the decision of the HEO under which it is obliged to complete the development of gas storage capacity provided in the respective plan of MOL Storage covering the years 2005 until 2009 by the end of such period.

Section C. Trustees

I. <u>Appointment Procedure</u>

1. ERI shall procure MOL to appoint a Monitoring Trustee in relation to the Divestment Business to carry out the functions specified in the Commitments for a Monitoring Trustee.

   ERI shall appoint a Monitoring Trustee concerning the gas release programme, the contract release and the storage capacity to carry out the functions specified in the Commitments for a Monitoring Trustee. ERI may appoint only one person as a Monitoring Trustee for the above mentioned tasks.

2. If MOL has not entered into a binding agreement regarding the disposal of the Divestment Business one month before the end of the First Divestiture Period or if the Commission has rejected a transferee proposed by MOL at that time or thereafter, ERI shall procure MOL to appoint a Divestiture Trustee to carry out the functions specified in the Commitments for the Divestiture Trustee.

If ERI has not entered into a transfer agreement one month before the end of the First Divestiture Period or if the Commission has rejected a purchaser proposed by ERI at that time or thereafter, ERI shall appoint a Divestiture Trustee to carry out the functions specified in the Commitments for the Divestiture Trustee. The appointment of the Divestiture Trustees shall take effect upon the commencement of the Trustee Divestiture Period.

3. The Trustees shall be independent of MOL and ERI, possess the necessary qualifications to carry out their mandate, for example as an investment bank or consultant or auditor, and shall neither have nor become exposed to a conflict of interest. The Trustees shall be remunerated in a way that does not impede the independent and effective fulfilment of its mandate.

4. No later than one month after the Effective Date, ERI shall submit (and shall procure MOL to submit) a list of one or more persons whom MOL or ERI propose to appoint as the Monitoring Trustee to the Commission for approval. No later than one month before the end of the First Divestiture Period, ERI (in case of the Contract Release Programme) shall submit and shall procure MOL (in case of the Divestment Business) to submit a list of one or more persons whom MOL and ERI, respectively, propose to appoint as Divestiture Trustee to the Commission for approval. The proposal shall contain sufficient information for the Commission to verify that the proposed Trustee fulfils the requirements set out above and shall include:

a) the full terms of the proposed mandate, which shall include all provisions necessary to enable the Trustee to fulfil its duties under these Commitments;

b) the outline of a work plan which describes how the Trustee intends to carry out its assigned tasks;

c) an indication whether the proposed Trustee is to act as both Monitoring Trustee and Divestiture Trustee or whether different Trustees are proposed for the two functions.

5. The Commission shall have the discretion to approve or reject the proposed Trustee(s) and to approve the proposed mandate subject to any modification it deems necessary for the Trustee to fulfil its obligations. If only one name is approved, ERI, shall appoint and procure MOL to appoint, the individual or institution concerned as Trustee, in accordance with the mandate approved by the Commission. If more than one name is approved, MOL or ERI, respectively, shall be free to choose the Trustee to be appointed from among the names approved. The Trustee shall be appointed within one week of the Commission's approval, in accordance with the mandate approved by the Commission.

6. If all the proposed Trustees are rejected, ERI, shall submit and, as the case may be, procure MOL to submit the names of at least two more individuals or institutions

within one week of being informed of the rejection, in accordance with the requirements and the procedure set out above.

7. If all further proposed Trustees are rejected by the Commission, the Commission shall nominate a Trustee, whom ERI shall appoint and shall procure MOL to appoint, in accordance with a Trustee mandate approved by the Commission.

II. Functions of the Trustees

1. Each Trustee shall assume its specified duties in order to ensure compliance with the Commitments. The Commission may, on its own initiative or at the request of the Trustees, MOL or ERI give any orders or instructions to the Trustee(s) in order to ensure compliance with the conditions and obligations attached to the Decision.

   MOL and ERI will only have the power to request such orders and will only be involved in the monitoring procedure according to the following procedural steps as far as their particular obligations under the Commitments are concerned, i.e. MOL in respect of the divestiture of its minority stakes in WMT and MOL Storage and ERI in respect of the gas release programme, contract release and storage capacity.

2. The Monitoring Trustees shall:

a) propose in their first report to the Commission a detailed work plan describing how they intend to monitor compliance with the obligations and conditions attached to the Decision.

b) assume the other functions assigned to the Monitoring Trustee under the conditions and obligations attached to the Decision;

c) propose to MOL or ERI such measures as the Monitoring Trustees consider necessary to ensure MOL's or ERI's compliance with the conditions and obligations attached to the Decision;

d) provide to the Commission, sending MOL or ERI a non-confidential copy at the same time, a written report

(1) in case of the disposal of the Divestment Business within 15 days after the expiry date according to section B. I. 2.;

(2) in case of the gas release programme for each auction by the end of July;

(3) and in case of the contract release for each transfer agreement, as the case may be one month after the expiry date of the First Divestiture Period and the Trustee Divestiture Period, respectively.

In addition to these reports, the Monitoring Trustees shall promptly report in writing to the Commission, sending MOL or ERI a non-confidential copy at the same time, if it

concludes on reasonable grounds that MOL or ERI is failing to comply with these Commitments.

3. As far as MOL is concerned, the Divestiture Trustee shall within the Trustee Divestiture Period sell at no minimum price the Divestment Business to a transferee, provided that the Commission has approved both the transferee and the final binding agreement in accordance with the procedure laid down in section B. I. 1.3. The Divestiture Trustee shall include in the agreement such terms and conditions as it considers appropriate for an expedience sale in the Trustee Divestiture Period. In particular, the Divestiture Trustee may include in the agreement such customary representations and warranties and indemnities as are reasonably required to effect the disposal. The Divestiture Trustee shall protect the legitimate financial interests of MOL, subject to the parties' unconditional obligations to divest at no minimum price in the Trustee Divestiture Period.

4. As far as ERI is concerned, the function of the Divestiture Trustee is defined in section IV. 1.4.

5. In the Trustee Divestiture Period (or otherwise at the Commission's request), the Divestiture Trustee shall provide the Commission with a comprehensive monthly report written in English on the progress of the divestiture process. Such reports shall be submitted within 15 days after the end of every month with a simultaneous copy for the Monitoring Trustee and a non-confidential copy to the Parties.

III. Duties and obligations of the Parties

1. ERI shall provide and shall cause its advisors and MOL's advisors to provide the Trustees with all such cooperation, assistance and information as the Trustees may reasonably require to perform their tasks. The Trustees shall have full and complete access to any of ERI's or MOL's or the Divestment Business' books, records, documents, Management or other personnel, facilities, sites and technical information necessary for fulfilling their duties under the Commitments, and MOL and ERI shall provide the Trustees upon request with copies of any document. MOL or ERI shall make available to the Trustees one or more offices on their premises and shall be available for meetings in order to provide the Trustee with all information necessary for the performance of their tasks.

2. ERI shall cause MOL's advisors to provide the Monitoring Trustee, on request, with the information submitted to potential transferees, in particular give the Monitoring Trustee access to the data room documentation and all other information granted to potential transferees in the due diligence procedure. MOL shall inform the

Monitoring Trustee on possible transferees, submit a list of potential transferees, and keep the Monitoring Trustee informed of all developments in the divestiture process.

3. MOL and ERI, respectively, shall grant or procure Affiliated Undertakings to grant comprehensive powers of attorney, duly executed, to the Divestiture Trustee to effect the disposal/transfer, the Closing and all actions and declarations which the Divestiture Trustee considers necessary or appropriate to achieve the disposal/transfer and the Closing, including the appointment of advisors to assist with the disposal/transfer process. Upon request of the Divestiture Trustee, MOL and ERI shall cause the documents required for effecting the disposal/transfer and the Closing to be duly executed.

4. MOL and ERI shall indemnify the Trustees and their employees and agents (each an "Indemnified Party") and hold each Indemnified Party harmless against, and hereby agrees that an Indemnified Party shall have no liability to MOL or ERI for any liabilities arising out of the performance of the Trustees' duties under the Commitments, except to the extent that such liabilities result from the willful default, recklessness, gross negligence of bad faith of the Trustees, their employees, agents or advisors.

5. At the expense of MOL or ERI, the Trustees may appoint advisors (in particular for corporate finance or legal advice), subject to MOL´s or ERI´s approval (this approval may not to be unreasonably withheld or delayed) if the Trustees consider the appointment of such advisors necessary or appropriate for the performance of their duties and obligations under the mandate, provided that any fees and other expenses incurred by the Trustees are reasonable. Should MOL or ERI refuse to approve the advisors proposed by the Trustees, the Commission may approve the appointment of such advisors instead, after having heard MOL or ERI. Only the Trustee shall be entitled to issue instructions to the advisors. Subsection 4. shall apply mutatis mutandis.

IV. Replacement, discharge and reappointment of the Trustees

1. If a Trustee ceases to perform its functions under the Commitments or for any other good cause, including the exposure of the Trustee to a conflict of interest:

   (a) the Commission may, after hearing the Trustee, require MOL or ERI to replace the Trustee; or

   (b) MOL or ERI, with the prior approval of the Commission, may replace the Trustee.

2. If a Trustee is removed, the Trustee may be required to continue in its function until a new Trustee is in place to whom the Trustee has effected a full hand over of all relevant information. The new Trustee shall be appointed in accordance with the procedure referred to in section I.

3. Beside the removal, the Trustee shall cease to act as Trustee only after the Commission has discharged it from its duties after all the Commitments with which the Trustee has been entrusted have been implemented. However, the Commission may at any time require the reappointment of the Trustee if it subsequently appears that the relevant remedies might not have been fully and properly implemented.

Section D. Mediation

1. In the event that a third party, notably but not exclusively a bidder in an auction under the gas release program, has reasons to believe that ERI is failing to comply with the requirements of the Commitments, the Monitoring Trustee may be instructed by the Commission to act as mediator to attempt to settle the dispute amicably. The Monitoring Trustee shall be allowed to appoint further professionals to assist him in the mediation process. The appointment of such professionals must be acceptable to ERI and the third party.

2. The procedure of the Mediation process under the Monitoring Trustee stewardship shall be proposed by the Monitoring Trustee and agreed to by ERI and the third party. The Monitoring Trustee shall also set forward a proposal as to who bears the costs of the mediation procedure which shall take into account general mediation standards. The procedure shall correspond to the European Code of Conduct for Mediators as developed by the European Commission and launched on 2 July 2004 in as far as appropriately applicable under the stewardship of the Monitoring Trustee. The procedure shall comprise a first phase of exchange of written observations between the parties. It is envisaged that the deadlines to reply to the observations shall be set by the Monitoring Trustee in a timely manner in order to accelerate the mediation process.

3. Following the exchange of written observations the Monitoring Trustee shall arrange for negotiations between ERI and the third party under his stewardship with a view to reaching an amicable solution of the dispute. Should such negotiations not produce an amicable solution, the Monitoring Trustee is then empowered to recommend a solution which shall become binding upon ERI and the third party unless ERI and / or the third party have lodged its / their opposition to this recommendation within one month from receiving a fully reasoned version of the recommended solution in the English language. In the latter case the Monitoring Trustee shall prepare a report for the Commission on the outcome of the Mediation

process. A copy of this report shall also be provided to the HEO and to ERI and the third party. Nothing in the mediation procedure shall affect the powers of the Commission to take decisions in relation to the Commitments in accordance with its powers under the Merger Regulation and the EC Treaty.

Section E. The Review Clause

The Commission may, where appropriate, in response to a request from ERI showing good cause and accompanied by a report from the Monitoring Trustee:

(i) Grant an extension of the time periods foreseen in the Commitments, or

(ii) Waive, modify or substitute, in exceptional circumstances, one or more of the undertakings in these Commitments.

Where ERI seeks an extension of a time period, it shall submit a request to the Commission no later than one month before the expiry of that period, showing good cause. Only in exceptional circumstances shall ERI be entitled to request an extension within the last month of any period. An appropriate extension of the time periods foreseen in this document for the implementation of the gas release programme shall be granted in case the Date of Closing will be after 28 February 2006.

Section F. ERI's full responsibility regarding conditions and obligations involving MOL

ERI shall be fully responsible for procuring MOL to act so as to ensure ERI's full and effective compliance with and implementation of these Commitments.

Duly authorized for and on behalf of ERI

Berlin/Düsseldorf, 8 December 2005

for ERI

……

Dr. Gerhard Wiedemann

……

Dr. Thomas Lübbig

EUROPEAN COMMISSION
Competition DG

Policy and Strategic Support

OPINION

of the ADVISORY COMMITTEE on CONCENTRATIONS
given at its 135th meeting on 6 December 2005
concerning a draft decision relating to
Case COMP/M.3696 – E.ON/MOL

1. The Advisory Committee agrees with the Commission that the notified operation constitutes a concentration within the meaning of Article 1(3) and 3(1)(b) of the Merger Regulation and that it has a Community dimension as defined by the Merger Regulation.

2. The Advisory Committee agrees with the Commission that for the purpose of assessing the present operation, the **relevant product markets** are
   in the gas sector:
   a) Transmission of gas
   b) Distribution of gas
   c) Storage of gas
   d) Supply of gas to traders
   e) Supply of gas to Regional Distribution Companies ("RDCs")
   f) Supply of gas to large power plants
   g) Supply of gas to large industrial customers (with an hourly consumption exceeding 500 m^3/hour)
   h) Supply of gas to small commercial and industrial customers (with an hourly consumption below 500 m^3/hour)
   i) Supply of gas to residential customers

   in the electricity sector:
   j) Transmission of electricity
   k) Distribution of electricity
   l) Provision of balancing power
   m) Wholesale supply of electricity to traders
   n) Wholesale supply of electricity to the public utility wholesaler
   o) Wholesale supply of electricity to RDCs
   p) Retail supply of electricity to medium and large commercial and industrial customers
   q) Retail supply of electricity to small commercial and industrial customers
   r) Retail supply of electricity to residential customers

3. The Advisory Committee agrees with the Commission that for the purpose of assessing the present operation, the **relevant geographic markets** are **national** for the following markets
   in the gas sector:
   a) Transmission of gas
   b) Storage of gas

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c) Supply of gas to traders
d) Supply of gas to RDCs
e) Supply of gas to large power plants
f) Supply of gas to large industrial customers (with an hourly consumption exceeding 500 m^3/hour)
g) Supply of gas to small commercial and industrial customers (with an hourly consumption below 500 m^3/hour)
h) Supply of gas to residential customers (after July 2007 when residential customers become eligible)

in the electricity sector:

i) Transmission of electricity
j) Provision of balancing power
k) Wholesale supply of electricity to traders
l) Wholesale supply of electricity to the public utility wholesaler
m) Wholesale supply of electricity to RDCs
n) Retail supply of electricity to medium and large commercial and industrial customers
o) Retail supply of electricity to small commercial and industrial customers
p) Retail supply of electricity to residential customers (after July 2007 when residential customers become eligible)

4. The Advisory Committee agrees with the Commission that for the purpose of assessing the present operation, the **relevant geographic markets** are at present **sub-national** for the following markets

in the gas sector:

a) Distribution of gas
b) Supply of gas to residential customers until July 2007

in the electricity sector:

c) Distribution of electricity
d) Retail supply of electricity to residential customers until July 2007

5. The Advisory Committee agrees with the Commission that the proposed transaction will create a fully vertically integrated entity along the gas and electricity supply chains by combining MOL's almost exclusive control over gas resources and storage and E.ON's strong market positions in the retail supply of gas through its ownership of regional distribution companies in both gas and electricity, and E.ON's activities in electricity generation/wholesale.

6. The Advisory Committee agrees with the Commission that therefore after the transaction, the new entity will have both the ability and incentive to foreclose access to gas for its competitors in the downstream gas and electricity markets.

7. The Advisory Committee agrees with the Commission that the merged entity has **a dominant position** in the following markets in the gas sector:

a) Supply of gas to traders in Hungary
b) Supply of gas to RDCs in Hungary
c) Supply of gas to large power plants in Hungary
d) Storage of gas in Hungary

8. The Advisory Committee agrees with the Commission that the proposed concentration is likely to result in a **significant impediment to effective competition** in the common market or in a substantial part of it and the EEA for the following markets

   in the gas sector:

   a) Supply of gas to large industrial customers in Hungary through the creation of the dominant position
   b) Supply of gas to small commercial and industrial customers in Hungary
   c) Supply of gas to residential customers in Hungary (in each of the RDCs' areas separately before July 2007)

   in the electricity sector:

   d) Wholesale supply of electricity to traders in Hungary
   e) Retail supply of electricity to medium and large commercial and industrial customers in Hungary
   f) Retail supply of electricity to small commercial and industrial customers in Hungary
   g) Retail supply of electricity to residential customers in Hungary (in each of the RDCs' areas separately before July 2007)

9. The Advisory Committee agrees with the Commission that the maintenance of cross-shareholdings between MOL and the new entity will allow the new entity to reinforce its foreclosure strategy through its position in the gas storage market and MOL's position in the transmission market.

10. The Advisory Committee agrees with the Commission that the **undertakings** are sufficient to remove the significant impediment to competition in the following markets

    in the gas sector:

    a) Supply of gas to large industrial customers in Hungary
    b) Supply of gas to small commercial and industrial customers in Hungary
    c) Supply of gas to residential customers in the Hungarian RDCs' areas (in Hungary after 2007)
    d) Storage of gas in Hungary

    in the electricity sector:

    e) Wholesale supply of electricity to traders in Hungary
    f) Retail supply of electricity to medium and large commercial and industrial customers in Hungary
    g) Retail supply of electricity to small commercial and industrial customers in Hungary
    h) Retail supply of electricity to residential customers in the Hungarian RDCs' areas (in Hungary after July 2007)

11. The Advisory Committee agrees with the Commission that, subject to full compliance with the undertakings offered by the parties, and considered all undertakings together, the proposed concentration does not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, within the meaning of Article 2(2) of the Merger Regulation and that the proposed concentration is therefore to be declared compatible with Article 2(2) and 8(2) of the Merger Regulation and Article 57 of the EEA Agreement.

12. The Advisory Committee asks the Commission to take into account all the other points raised during the discussion.

BELGIË/BELGIQUE	**ČESKÁ REPUBLIKA**	**DANMARK**	**DEUTSCHLAND**	**EESTI**
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---	---	I. KUDZINSKIENE	---	I. NAGYHAZI
MALTA	**NEDERLAND**	**ÖSTERREICH**	**POLSKA**	**PORTUGAL**
---	Mr VAN GEMERT	A. LUKASCHEK	---	S. MOURA
SLOVENIJA	**SLOVENSKO**	**SUOMI-FINLAND**	**SVERIGE**	**UNITED KINGDOM**
---	---	J. BOÊLIUS	C. BERGER	T. KRAJEWSKA

EUROPEAN COMMISSION

The Hearing Officer

FINAL REPORT OF THE HEARING OFFICER IN CASE COMP/ M.3696 – E.ON/MOL

(pursuant to Articles 15 and 16 of Commission Decision (2001/462/EC, ECSC) of 23 May 2001 on the terms of reference of Hearing Officers in certain competition proceedings – OJ L162, 19.06.2001, p.21)

On 2 June 2005, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 of 20 January 2004 ("the Merger Regulation") whereby the German group E.ON intends to acquire sole control over the gas wholesale, marketing and trading activities as well as gas storage activities of MOL Hungarian Oil and Gas Company Rt. ("MOL", Hungary). Furthermore, E.ON intends to acquire MOL's 50% shareholding in Panrusgáz, a joint venture between MOL and Gazexport (a subsidiary of Gazprom).

At the end of the first phase of the investigation, the Commission concluded that the concentration raised serious doubts as to its compatibility with the common market and with the EEA Agreement. In particular, the transaction was found to have significant impact on the gas and electricity sector in Hungary, given that MOL has an almost exclusive control over the procurement of gas (imports and domestic production) and therefore enjoys a gatekeeper position for access to gas resources and to the gas infrastructures in Hungary.

On 7 July 2005, the Commission therefore initiated proceedings in accordance with Article 6(1)(c) of the Merger Regulation.

On 20 July and 2 August 2005, E.ON was provided with access to the "key documents" in the Commission file in accordance with chapter 7.2. of the "Best Practices on the conduct of EC merger control proceedings".

On 2 August 2005, the procedure was suspended for eight days pursuant to Article 10(4) of the Merger Regulation owing to the fact that E.ON did not respond in a comprehensive and timely manner to a decision requiring information pursuant to 11(3) of the Merger Regulation.

A statement of objections was sent to E.ON on 19 September 2005. As agreed between E.ON and MOL, a version of the SO without E.ON's business secrets was transmitted to MOL by E.ON's legal representatives. In the following days, access to the Commission's file was granted. E.ON and MOL were given the opportunity to comment on the Commission's preliminary findings as set out in the statement of objections by 3 October 2005. This deadline was subsequently extended to 6 October 2005 at the parties' request. E.ON's reply was received on 5 October 2005.

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The parties did not request to develop their arguments in a formal oral hearing.

On 21 October 2005, I granted the request of Energie Baden-Württemberg AG to be admitted as an interested third party. The same day, the Commission sent them a non-confidential summary of the statement of objections.

On 20 October 2005, E.ON offered commitments which were amended on 11 November and on 16 November 2005 respectively. Further to the market testing of the proposed undertakings, E.ON substantially improved their draft commitments, in particular as regards the duration of the gas release program and the price mechanism of the gas release auctions.

I have not been asked to verify the objectivity of the enquiry.

In agreement with and following an express request by the parties, the Commission issued a decision on 10 November 2005 pursuant to article 10(3) second paragraph of the Merger Regulation in order to extend the procedure by 11 working days.

In the light of the commitments eventually proposed and having analysed the results of the market test, the draft decision concludes that the proposed concentration is compatible with the common market and with the EEA Agreement.

In the light of the above, I consider that the rights to be heard of all participants to the present proceeding have been respected.

Brussels, 7 December 2005

(signed)
Serge DURANDE