Brussels,
CAB D(2009)

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

Dear Sir,

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

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

Yours sincerely,

Andris Piebalgs

Annex

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ANNEX

1. PROCEDURE

1. On 11 February 2008, the Bulgarian energy regulator, the State Energy and Water Regulatory Commission (hereinafter: "SEWRC"), adopted a decision to exempt the Bulgarian section of the Nabucco gas pipeline project (hereinafter "exemption decision") for 25 years from regulated third party access as defined in Article 18 and from the tariff regulation in Article 25(2), (3) and (4) of Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (hereinafter "the Gas Directive"), transposed as Article 21(1)(6) and (9), Article 30(1)(7) and (8) and Article 172 in the Bulgarian Law of the Energy Sector. The exemption decision was submitted to the Commission on 7 March 2008.

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

"(1) The exemption from the legal obligation for granting access to the grid of third persons (Article 21, Para. 1, Item 6 and Item 9, Article 30, Para. 1, Item 7 and Item 8 and Art. 172 of the Energy Law) shall be limited to a maximum of 50% of the maximum available total technical annual capacity, but not more than 15 billion cubic meters per year in case of a final expansion of 31 billion cubic meters per year.

(2) Twenty years after the start of operation of the first stage of construction of the Nabucco gas pipeline the tariff model, representing an integral part of the reviewed application, shall be subject to revision by SEWRC or the competent authority at the time.

(3) In case that as a result of the review of the tariff model referred to in point 2 above it is established that the tariffs for the Bulgarian section of the Nabucco gas pipeline depart from the average tariffs of comparable transmission networks on the territory of the European Union by more than +/- 10%, Nabucco Gas Pipeline International GmbH or its universal successor shall submit for approval a modified tariff model. The new tariff model is applicable only to contracts signed after entry into force of the approval by SEWRC or the competent authority at the time concerned.

(4) After each open season procedure Nabucco Gas Pipeline International GmbH shall provide to SEWRC a list of the companies which have reserved capacities of the Nabucco gas pipeline.

(5) The Bulgarian section of the Nabucco gas pipeline shall be put into operation within a term of 5 (five) years from entry into force of the present decision.

(6) Nabucco Gas Pipeline International GmbH shall provide to SEWRC at least by the time of the start of operation of the first construction stage its

[1] Exemption decision, pp. 10f.

Articles of Association in which the following provision must be incorporated: 'The Manager/Managers shall act independently on all current issues related to the operation of the system and shall decide independently on the construction or restructuring of gas pipelines within the framework of the approved funding plan or another relevant document and in compliance with the applicable requirements and rules for trade in gas. For this reason, any empowerment of the Manager/Managers in this sense shall be restricted.'"

3. On 11 April 2008, the Commission informed SEWRC that the submission of 7 March 2008 did not contain all the relevant information required under Article 22(4) of the Gas Directive and asked SEWRC to provide all the relevant information as set out in Article 22(4) of the Gas Directive.

4. On 6 June 2008, the applicant Nabucco Gas Pipeline International GmbH (hereinafter "Nabucco International") submitted a request to SEWRC to modify the exemption decision of 11 February 2008. Nabucco International requested to extend the validity of the exemption decision from five to seven years, but at the latest until the end of 2017. In order to justify a longer validity of the decision Nabucco International gave in particular the following reasons:

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

- At the time of the first application the conclusion of the Intergovernmental Agreement with the countries along the pipeline route was scheduled for late 2007. However, the agreement has not been signed yet. The Intergovernmental Agreement is of great importance in particular to create the necessary legal certainty in Turkey (the only country along the pipeline route outside the EU). This agreement is a necessary condition, for example, to establish the national Nabucco company in Turkey, to fix the tax regime for the national Nabucco companies and to ensure that the Turkish section of the pipeline benefits from an exemption similar to the exemption according to Article 22 of the Gas Directive.

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

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

5. On 12 January 2009, SEWRC modified its exemption decision of 11 February 2008 extending the validity of the exemption decision until the end of 2016

(hereinafter "modified exemption decision") and, in line with the Commission's request for further information, elaborated further on the factual and legal grounds for the exemption. The fifth condition was modified as follows:

"(5) The Bulgarian section of the Nabucco gas pipeline has to be put into operation no later than seven years after the last exemption decision in any of the Member States concerned has become effective, i.e. after the European Commission's approval of the respective decision, but no later than on 31 December 2016."

6. In its modified exemption decision, SEWRC in principle accepted Nabucco International's arguments to extend the validity of the exemption decision. It however considered that an extension until the end of 2017 would be excessive. It therefore decided to limit the validity of the decision until the end of 2016.

7. The notification of the modified exemption decision was registered as received by the Commission on 19 January 2009. On 12 February 2009, the Commission published a notice on the notification of SEWRC's modified exemption decision inviting third parties to comment within two weeks. The Commission has not received any comments.

8. On 19 February 2009, the Commission requested SEWRC to notify the entire application of Nabucco International, which forms part of the modified exemption decision, and additional information supporting the modified exemption decision. SEWRC replied to the Commission's request for information on 24 February 2009 and on 9 and 19 March 2009, providing the requested information, including the complete application of Nabucco International. Considering that the decision was notified in its entirety only on 19 March 2009, the final date for the Commission to request an amendment or withdrawal of the exemption decision is – in line with Article 22 of the Gas Directive – 19 May 2009.

2. DESCRIPTION OF THE PROJECT

9. Nabucco International is planning to build a gas pipeline from Turkey to Austria (hereinafter: "the Nabucco pipeline"). There is currently no pipeline connection from Turkey via Bulgaria, Romania and Hungary to Austria. An important objective of the Nabucco pipeline is to connect the EU better to the extensive sources of natural gas in the Caspian Sea and the Middle East. Today, gas from the Caspian region and Central Asia to the EU must be transported via Russia and the Ukraine or shipped as liquefied natural gas. Apart from the Nabucco pipeline, there are also plans for a pipeline from Turkey via Greece to Italy. The Nabucco project is included in the TEN-E program[2] and a feasibility study for the Nabucco pipeline has been performed under an EU project grant.

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

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

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

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

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

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

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

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

11. Nabucco International is the owner and financing company of the five national Nabucco companies, which will be responsible for the operation and maintenance of the Nabucco pipeline. These companies are or will be established in their respective countries and are or will be legally separate from Nabucco International. The pipeline sections located in the territories of the Nabucco countries will be owned by the respective national Nabucco companies.

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

13. The Nabucco pipeline is planned to be built in stages. Based on the application of Nabucco International, the first construction stage of a capacity of 8 billion cubic meters (bcm) will begin in 2009 and will be put into operation by 2012. The following construction stages will lead to an increase in pipeline capacity to a total of 15.7 bcm/year (starting operation by 2014), 25.5 bcm/year (starting operation by 2017) and 31 bcm/year in the final stage (starting operation by 2020).

14. According to the application, gas for the Nabucco pipeline is expected to come mainly from Azerbaijan (up to 10-14 bcm/year), Iran (up to 10-20 bcm/year), Iraq and Egypt (approx. 8-10 bcm/year). Natural gas originating from sources along the Nabucco pipeline may come e.g. from Romania and Bulgaria. The Nabucco pipeline may also be used to transport gas originating from other regions, notably from Russia.

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

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

17. Prior to the start of construction of the Nabucco pipeline and any subsequent expansion stage, Nabucco International will carry out this type of allocation procedure to identify capacity requirements. If the requirements of the first allocation procedure exceed the planned capacity of 8 bcm Nabucco International is obliged to carry out the next expansion step (up to a maximum of 25.5 bcm). If the requirements exceed 25.5 bcm Nabucco International is obliged to expand the pipeline up to 31 bcm only if this is technically, economically and financially feasible.[3] In principle, it is possible that the entire capacity up to 31 bcm is allocated already during the first allocation procedure before the start of operation. Expansion beyond 31 bcm shall be investigated by

3 Application, Annex 8b, p. 3.

Nabucco International and if economically, technically and financially feasible undertaken in order to fulfil all requests for long-term capacity[4].[5]

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

19. 10% of the maximum transportation capacity being available in the General Open Season shall be reserved for short-term transportation capacity.[7] In case the short-term capacity is not booked, it will be converted to long-term capacity and offered in a second round of the General Open Season.[8] Conversely, if in the General Open Season the long-term capacity is not fully booked, it can be converted into short-term capacity and also offered in a second round of the General Open Season.[9] It is therefore not determined how much capacity will be allocated to short-term and to long-term contracts until the capacity allocation procedures have taken place.

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

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

22. If a shipper does not use contractually booked capacity, Nabucco International will make available this capacity to the market (use-it-or-lose-it [UIOLI] principle). This capacity will be made available as interruptible capacity on a short-term day-ahead basis.[13] A capacity holder not using its capacity has to pay the full transport fee for the contractually booked capacity. In case the original capacity holder decides to use his capacity, shippers who bought the interruptible capacity will lose the capacity.[14]

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

5 Application, Annex 3, section 7, p. 16 f.

6 Application, Annex 8b, p. 2.

7 Short term transportation capacity is defined as having a maximum duration of one year, Application, Annex 8b, page 3.

8 Application, Annex 8b, p. 3.

9 Application, Annex 8b, p. 4.

10 Application, Annex 3, section 8.

11 Application, Annex 6, p. 2.

12 Application, Annex 3, p. 24.

13 Application, p. 22, Annex 3, p. 14, and Annex 9, p. 8.

14 Application, Annex 3, p. 14.

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

- In the General Open Season, 10% of the capacity is offered on a short-term basis;
- Nabucco International will offer a notice-board for the secondary market;
- Nabucco International will offer unused capacity on interruptible basis in case of congestion;
- Shippers have an incentive to resell or sublet unused capacity because they have to pay for it in any case (ship-or-pay principle).

24. By adopting the exemption decision, SEWRC has approved a distance related tariff to be paid by all shippers to Nabucco International and calculated on the basis of the tariff method described in the application.[15] Subject to the conditions set out in paragraph 2, SEWRC also approved the access to the network rules, the establishment of TPA services, harmonised principles for capacity allocation and congestion management, the transparency requirements, balancing rules, imbalance charges and rules facilitating capacity trading as set out by Nabucco International in its application.[16]

3. ASSESSMENT OF THE EXEMPTION CRITERIA OF ARTICLE 22

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

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

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

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

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15 Additional information provided by SEWRC on 9 March 2009. Annex 3, pp. 5ff and 29ff.

16 Additional information provided by SEWRC on 9 March 2009.

28. The Commission considers that the modified exemption decision appropriately links the validity of the Bulgarian exemption decision to the date when the last exemption decision in any of the Member States concerned becomes effective, i.e. to the date of the Commission's approval of the respective decision.[17] Nabucco International will have legal certainty about the full exemption of the Nabucco pipeline according to Article 22 of the Gas Directive only once the regulatory authorities of all four Member States concerned have granted exemptions for the pipeline sections in their respective jurisdictions and once the Commission has reviewed these decisions.

29. Furthermore, the Commission considers that the extension of the exemption's validity from 5 to 7 years is justified. The Nabucco pipeline project bears technical, economic and political risks which by far exceed the risks of most other major infrastructure projects in the EU energy sector. The situation concerning the Nabucco pipeline has changed significantly since the beginning of 2008. In particular, the delay in the start of the exploration of the Shah Deniz II gas field, the delay in the conclusion of the Intergovernmental Agreement and the considerable worsening of the state of the financial markets must be considered to adversely affect the time schedule for the Nabucco pipeline.

30. Consequently, the Commission agrees with SEWRC that the original 5-year validity of the exemption decision did not give Nabucco International sufficient time to put the Nabucco pipeline into operation after the last exemption decision in any of the Member States concerned has become effective, and that, for the above reasons, the 7-year validity is justified.

31. The Commission also agrees with SEWRC that it is necessary to limit the validity of the Bulgarian exemption decision in absolute terms in order to avoid that possible delays in the administrative procedures in one of the other Member States concerned extend the validity of the Bulgarian exemption decision excessively while the market situation on which the assessment is based may in the meantime have changed significantly and while other market players may be discouraged from initiating other pipeline projects. Taking into account the above mentioned circumstances and the 7-year validity of the (modified) exemption decision, the Commission considers that SEWRC's decision that the Bulgarian section of the Nabucco pipeline shall be put into operation no later than by 31 December 2016 is justified and limited to what is strictly necessary.

32. The Bulgarian exemption decision provides, however, for an exemption of 25 years starting on the date on which the Bulgarian exemption decision becomes legally effective. In order to increase legal certainty for the Nabucco pipeline as a whole, it is necessary to link the beginning of the 25-year-period to the date when the first construction stage is put into operation rather than to the date of entry into effect of the Bulgarian exemption decision. The Commission considers it necessary that SEWRC specifies in its exemption decision that the 25-year-period will start on the date on which the first construction stage of the Nabucco pipeline is put into operation.

[17] See Modified Exemption Decision, p. 4.

3.1.1. The investment must enhance competition in gas supply.

33. To analyse the competitive effect of the exemption, the relevant upstream and downstream gas markets, and in particular the question whether the investment leads to the creation or strengthening of dominant market positions, need to be considered. As a general rule, an exemption is not granted to a new piece of infrastructure that is likely to have a significant amount of its capacity allocated to any dominant player in one of the markets affected.

34. The following relevant product markets are each dominated by one undertaking:

- the upstream wholesale market by Gazprom and its affiliates[18],
- the downstream wholesale market by Bulgargaz EAD,
- the market for supply to local distributors by Bulgargaz EAD and
- the retail market for industrial customers by Bulgargaz EAD.

35. The Commission notes that the Bulgarian natural gas market is characterised by a very high dependency on gas imports from a single source, namely Russia. Imports covered about 98% of the country's gas demand in 2004 and this share is not expected to change significantly in the foreseeable future.

36. All natural gas delivered from Russia to Bulgaria is contracted between Bulgargaz EAD and affiliates of Gazprom under long-term agreements which will expire in 2012.[19] Being the only company receiving gas from imports, Bulgargaz has virtually a monopoly on the wholesale market. Local distributors are exclusively supplied by Bulgargaz EAD as they have no alternative source available. The company also supplies the big industrial customers directly connected to the gas transmission system – this made up about 89% of total consumption in 2006.[20]

37. In its decision, SEWRC emphasises that the Bulgarian gas market is characterized by a lack of alternative supply sources. The existing gas network has only one entry point for imports which is fully booked by Bulgargaz EAD for imports from Russia.[21] Under the current situation potential new entrants are faced with serious barriers to compete in the gas supply market.

38. The Commission notes that, at this stage, it is not clear how much gas will be transported through the Nabucco pipeline to Bulgaria or which market players will hold capacity. This will become clear only after the capacity allocation

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[18] Currently Gazprom sells gas to Bulgaria through its following affiliates: Wintershall Erdgas Handelshaus Zug AG, Gazexport Ltd and Overgas Inc Ltd. It is noted that due to the degree of supplies for Bulgaria originating in or transiting through Russia, for which Gazprom has a legal export monopoly, it is not necessary for the purpose of the current assessment to establish the exact status of affiliation of suppliers not 100% owned by Gazprom. In the following, the term "affiliates" will, however, be used for these companies.

[19] See Exemption Decision, p. 7.

[20] See Exemption Decision, p. 6.

[21] See Exemption Decision, p. 6.

procedures have taken place. The Commission therefore considers it necessary to pay particular attention to the worst-case scenarios as developed in the exemption decision, i.e. a dominant market player becoming the capacity holder of all or of a large part of the gas from the Nabucco pipeline exiting in Bulgaria.[22] In such a worst-case scenario, the Nabucco pipeline could not be considered to enhance competition.

39. Based on the allocation rules described above[23], Bulgargaz EAD and its affiliated companies have the right to participate in both capacity allocation procedures, the shareholder allocation procedure and the General Open Season. It should also be noted that the 50% capacity split applying to the shareholder allocation procedure refers to the *total* annual transport capacity of the pipeline and does not mean that this split will necessarily be reflected at each section of the pipeline. As a result, it cannot be excluded that all or a large part of the capacity exiting in Bulgaria could be booked by a dominant shareholder of Nabucco International. In case less than 50% of the capacity to Bulgaria is booked by Nabucco shareholders, it cannot be excluded that even more than 50% of capacity into Bulgaria are booked by a dominant third party.

40. Moreover, there are insufficiently clear rules on how the capacity in the General Open Season will be allocated in the case of overbooking. To sum up, the present rules for capacity allocation do not prevent a possible worst-case scenario in which a dominant market player may book above 50% (even up to 100%) of the annual Bulgarian exit capacity even if there is interest from non-dominant undertakings in booking Bulgarian exit capacity.

41. Furthermore, the Commission considers that this worst-case scenario is not moderated by the above mentioned anti-hoarding and liquidity increasing measures.[24] These measures are overall beneficial to competition but not suitable to provide new entrants or existing competitors with firm long-term capacity necessary to outweigh the risk of a strengthening of dominant positions. Moreover, there is no guarantee that all these measures will actually have a pro-competitive effect in case all capacity is used by the capacity holders, no unused capacity can be released.

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

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

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[22] See Exemption Decision, p. 6.

[23] See paragraphs 16 et seq.

[24] See paragraph 23.

3.1.2. *The investment must enhance security of supply.*

44. The gas demand in the EU was 528 bcm in 2003. Demand is expected to rise to 655 bcm by 2010, to 815 bcm by 2020 and to 1036 bcm by 2030.[25] Due to the lack of gas resources within the EU, import will be of increasing significance to the EU as a whole. In 2006, imports to the EU-25 from suppliers outside EU-25 amounted to 237.8 bcm. The main external gas suppliers to the EU are Russia (32.4%), Algeria (12.7%), Egypt (1.8%) and Libya (1.8%).[26] Competition for gas sources will also come from increasing demand in other world regions, for example from China.

45. The Nabucco pipeline adds a major new gas route from the East to the EU. Notably, this route will be in the territory of countries with a relatively high degree of political stability.

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

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

48. The Nabucco pipeline will increase the import capacity into Bulgaria and thus help to cover increasing gas demand in Bulgaria and in Central Europe as a whole. According to SEWRC's decision, gas consumption in Bulgaria is expected to cease its current decline and increase moderately in the future. SEWRC expects demand for gas to reach 4.2 bcm by 2010 whereas natural gas derived from local production in 2008 had a market share of 3.46% only.[27]

49. At present, Bulgaria's gas transmission network has only one entry point for imports. All gas imports are from Russia. Currently, no gas interconnectors exist between Bulgaria and its neighbouring states. The transit pipelines owned by Bulgartransgaz EAD transport gas to Greece, the Former Yugoslavian Republic of Macedonia and Turkey.[28] The existing infrastructure does not permit to diversify supplies and there is currently no potential for the market entry of new upstream suppliers.[29] The Commission notes that SEWRC expects that the Nabucco pipeline will reduce the dependence on a single source and ensure that other companies will have the opportunity to enter the Bulgarian gas market. In the most favourable event, SEWRC expects that in 2015 about 20% of the Bulgarian gas demand will be satisfied by the Nabucco pipeline which will lead to an improvement of the supplies on the Bulgarian gas market. Even if the gas pipeline will be fully used for gas supplies from Russia, this would also mean an

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25 Application, Annex 12, p. 12.
26 BP Statistical Review of World Energy 2007, p. 30.
27 Additional information provided by SEWRC on 9 March 2009.
28 Additional information provided by SEWRC on 9 March 2009.
29 See Exemption Decision page 6 and paragraph 63 of the present Decision on Gazprom's export monopoly.

improvement of the security of gas supplies in technical terms, as there will be an additional route to the market.

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

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

51. Nabucco International has listed the potential risks of the project in their Risk Analysis.[30] The risks are broken down into the following categories: cost overruns, construction delays until completion, upstream gas supply, gas transport/throughput quantities, gas off-take in the downstream area, pipeline operation, economic risks, political risks, environmental and social risks as well as risks in connection with the regulatory regimes.

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

53. In its exemption decision, SEWRC also points out that the Nabucco project involves a number of other risk factors such as the capacity utilisation risk which has to be borne by the operator and which is highly sensitive to the future cash flow. Another important risk element is the political stability in the gas production countries.

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

3.1.4. The infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built.

55. The section of the Nabucco pipeline that is built in Bulgarian territory will be owned by the Bulgarian national Nabucco company, Nabucco Gas Pipeline Bulgaria EOOD. It is owned by Nabucco International. Nabucco Gas Pipeline Bulgaria EOOD is separate – at least as far as the legal form of organisation is concerned – from the system operators in whose networks the infrastructure is established. The Commission thus considers that this criterion is fulfilled.

[30] Annex 11 to the application.

3.1.5. *Charges are levied on users of that infrastructure.*

56. According to the application, tariffs will be the single source of revenues used to cover all maintenance and operation costs of the pipeline.[31] According to the exemption decision, Nabucco International will apply, without discrimination, one and the same tariff method enclosed in the application to all transport customers, including the shareholders of Nabucco International, the shareholders' affiliated companies and state owned companies acting as public suppliers in the transit countries of the Nabucco pipeline[32], i.e. all shippers will have to pay the same tariff for the same transportation service. The Commission thus considers that this criterion is fulfilled.

3.1.6. *The exemption is not detrimental to competition or the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.*

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

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

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

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

3.2. *Considerations to remedy the identified competition concerns*

3.2.1. *Limitation of the share of annual capacity which can be booked by a dominant undertaking to 50% at all exit points of the Bulgarian section*

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

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[31] Application, p. 41

[32] Exemption Decision, p. 8.

62. To prevent the outlined worst-case scenarios, it is necessary to limit the share of the annual capacity which a dominant undertaking can book at the exit points in the Bulgarian section of the Nabucco pipeline to a maximum of 50% (hereinafter "the capacity cap"). The capacity cap leaves competitors at least half of the Bulgarian exit capacity of the Nabucco pipeline and thus promotes competition in the downstream markets. The capacity cap would thus fulfil the requirement that exemptions can generally not apply where an existing dominant position is created or reinforced or where the granting of an exemption reduces the scope for diluting existing dominant positions.

63. The application of the capacity cap needs to take into account the specific supply relationship between a company active in the downstream supply markets and its upstream supplier. In the case of the Bulgarian gas market, the downstream supplier and the upstream supplier are both dominant and have a long established supply relationship. The likelihood of Gazprom and its affiliates to effectively compete with Bulgargaz EAD is significantly reduced, given that Gazprom and its affiliates are Bulgargaz EAD's almost exclusive suppliers and given that Russia, for which Gazprom holds an export monopoly, is currently Bulgaria's near exclusive source of supply (whether for gas produced in Russia or merely transiting through Russia). In that situation, an outcome in which Bulgargaz EAD would hold 50% of the Bulgarian exit capacity and Gazprom, or an affiliate of Gazprom, would hold the remaining 50%, or indeed any additional share going cumulatively with Bulgargaz EAD's share beyond 50%, would not be pro-competitive. It is therefore necessary that Gazprom's and Bulgargaz EAD's capacity shares are capped jointly, until such moment as Bulgaria sources less than 50% of its gas supply from or through Russia or until such moment as Gazprom loses its export monopoly for Russian gas or gas transiting through Russia.

64. The Commission notes that the rules presented by Nabucco International do not clarify what would happen in the General Open Season in the event of overbooking. This creates the risk that a single third party may obtain all of the Bulgarian exit capacity not booked by Bulgargaz EAD, even though there is interest of further third parties in obtaining capacity. This could lead to a non-competitive outcome in which a duopoly is established on the Bulgarian markets. To exclude this risk the Commission considers it necessary to introduce a rule that the capacity allocation takes place in a transparent and non-discriminatory way, for example on a pro rata basis, which must ensure that each capacity bidder is allocated a minimum amount of capacity.

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

and non-discriminatory procedure subject to the approval of the competent regulatory authority.

66. There may be a discrepancy between the share of capacity booked and the volume of gas actually imported through the Nabucco pipeline due to varying demand and supply conditions. It is therefore in the interest of the undertaking concerned to link the gas volume to be offered to the market to its share of booked capacity and not to its volume share which depends also on the activity of the other shippers. It is therefore proposed to calculate the volume as follows: the percentage points of booked annual capacity in excess of 50% (e.g. 5% in the case of 55%) shall be divided by the total share of annual capacity booked by the undertaking concerned (e.g. 55%). The resulting value (e.g. 9.09%) shall be multiplied with the total amount of gas which the undertaking imports through the Nabucco pipeline into Bulgaria in a given year. These volumes shall be adjusted annually based on the import volumes of the previous year. In the first period an expected capacity utilisation rate to be agreed between the undertaking subject to the capacity cap and the Bulgarian regulator shall be assumed whereby the ex post difference between the expected and the actual volumes shall be added or subtracted from the volumes to be released in the following year.

3.2.2. Obligation to extend the capacity according to demand

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

68. In fact, the above planning could necessarily only be indicative since neither the precise origin nor the destination of the gas volumes were known at the time of the application and are still not known. The precise entry/exit points will be determined only at a later date when the results of the capacity allocation procedure are known. This flexibility in installing entry and exit points along the pipeline shows that the pipeline design can be, and in fact needs to be, adjusted to different gas transport volumes in different parts of the pipeline.

69. Moreover, the additional capacity steps e.g. from 8 to 15.7 bcm/year and from 15.7 to 25.5 bcm/year represent very significant gas volumes which exceed the entire annual gas consumption of Bulgaria (projected by SEWRC to be at 4.2 bcm/year in 2010).[33] The experience of other pipelines suggests that much smaller enhancement steps than those indicated by Nabucco International may be technically and economically feasible.

70. As in the case of other pipeline projects, the capacity of the Nabucco pipeline could be increased not only by very large amounts by laying a new pipe along the entire pipeline system. Instead, compressor stations varying in size could be added at different sections of the pipeline to increase the pressure and thus the transport flows of gas in smaller incremental steps. The Commission also notes that in other European pipelines, the capacity at the final exit point was increased even though only individual stretches of the pipeline system situated

[33] Exemption decision, p. 6.

at a considerable distance from the final exit point were looped by adding a further pipeline.

71. The Commission, for those reasons, considers that the four above mentioned capacity steps do not constitute the only technically and economically viable construction phases. There appears to be significantly more technical and economic flexibility to adapt the transport capacity of the Nabucco pipeline according to binding capacity bookings.

72. More flexibility to adapt the capacity according to market demand is crucial to ensure that the Nabucco pipeline increases competition and security of supply in all relevant markets. With respect to competition, there is a risk that the restriction to the indicative construction steps favours large capacity requests by large market players over the requests by smaller market players and may thus have a significant impact on the development of competition on the Bulgarian natural gas markets. Entry by one or more competitors to the companies which are dominant on the Bulgarian natural gas markets could turn out to be very significantly delayed or made impossible, if these competitors decided to enter with a volume below an additional capacity step as defined by Nabucco International (although such enhancement could still be technically feasible and commercially viable for Nabucco International).

73. Moreover, there is a risk that smaller markets along the Nabucco pipeline may not be served and that the Nabucco pipeline may thus not enhance competition and security of supply in the markets concerned. This may occur because large construction steps are likely to favour the bundling of supply to serve only few large downstream markets. In addition, the restriction to large construction steps risks unnecessarily delaying the enhancement of competition and security of supply. It is only once there are binding capacity requests for an entire additional construction step that the pipeline would be expanded while at the same time there may, for several years, be sufficient binding capacity requests to carry out an intermediate, technically and economically viable pipeline expansion with beneficial effects on security of supply.

74. Based on these considerations, the Commission considers that Nabucco International's obligation to extend the capacity according to binding capacity requests should not be limited to the four construction steps of 8, 15.7, 25.5 and 31 bcm/year.

75. The Commission accepts that the minimum capacity bookings to launch the Nabucco project amounts to 8 bcm/year. Due to the magnitude of the initial investment, such a minimum critical size is necessary to spread the costs of the initial investment over a sufficiently high transport volume in order to ensure an economically viable transportation tariff. It also accepts that it is not necessary to oblige Nabucco International to review the technical and economic feasibility for all binding requests intermediate[34] to the above four construction steps.

76. That obligation should apply only if binding requests are made which amount to an additional aggregated transport capacity on the Nabucco pipeline of

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

1.0 bcm/year. A volume of 1.0 bcm/year corresponds to an expected share of the Bulgarian gas market of approximately 24% in 2010[35] and can therefore, if the additional volume is partly or fully booked for Bulgarian exit points have a significant impact on competition. Moreover, given the above mentioned measures to marginally increase transport volume in a pipeline, a capacity increase of 1.0 bcm/year appears to be *prima facie* technically and economically feasible.

77. Thus, for aggregate capacity requests intermediate to the above four construction steps which amount to at least 1.0 bcm/year, Nabucco International should be subject to the obligation to extend the capacity of the pipeline according to binding capacity requests, unless it can demonstrate to the national regulator concerned that a specific capacity expansion is not economically or technically viable. This is without prejudice to the obligation of Nabucco International to allocate all capacity in a transparent and non-discriminatory procedure and to inform the competent regulatory authority accordingly.

3.2.3. Change in shareholding

78. If an undertaking dominant in Bulgaria or in a natural gas market including Bulgaria which holds capacity on the Nabucco pipeline acquires a controlling stake in a Nabucco International shareholder or another Nabucco capacity holder, this could potentially have a negative effect on competition, in particular if this leads to aggregated capacity shareholdings above the capacity cap for dominant undertakings. It is therefore important that the competent regulatory authority is informed by Nabucco International about any such change in shareholding in Nabucco International or a shareholder of Nabucco International or among capacity rights holders of Nabucco International. Based on this information, and in order to safeguard that the Nabucco pipeline still enhances competition, the competent regulatory authority should ensure that the provisions in the exemption decision regarding the capacity cap on dominant undertakings are respected.

3.2.4. Proportionality

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

4. CONCLUSIONS

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

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[35] SEWRC is concerned if at least parts of these capacity requests concern existing capacity in Bulgaria.

is requested to amend its exemption decision to include the following conditions:

I. The 25-year-period of the exemption decision will start on the date on which the first construction stage of the Nabucco pipeline is put into operation.

II. (a) An undertaking which holds a dominant position in one or more of the relevant upstream or downstream gas markets shall not be allowed to book more than 50% of the total capacity at the exit points in the Bulgarian section of the Nabucco pipeline. For the calculation of the capacity cap undertakings belonging to the same group shall be considered together.[36] For the calculation of the capacity cap dominant upstream suppliers and dominant downstream suppliers shall be considered together. Nabucco International shall inform SEWRC of the result of the capacity allocation procedures.

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

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

III. If the shareholders of Nabucco International change compared to the situation as described in the application, or if any of the existing shareholders is acquired by another undertaking holding capacity on Nabucco or if two holders of capacity rights on Nabucco merge, Nabucco International shall notify such change to SEWRC.

IV. Nabucco International is obliged to build additional capacity also for binding capacity requests to a Bulgarian exit point which are intermediate to the construction steps as described in its application of 23 February 2007 to the extent that such an expansion is technically possible and

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

economically viable and that the binding capacity requests amount to at least 1.0 bcm/year. In this context, Nabucco International shall allocate capacity in a transparent and non-discriminatory way and inform the competent regulatory authority of the results of that procedure. If Nabucco International considers that in spite of the presence of such binding capacity requests a pipeline expansion is not technically possible or economically viable, it is obliged to notify and justify this situation to SEWRC.

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