

## Energy Community Secretariat

**Opinion 1/2019**

on the exemption of the *Gastrans* natural gas pipeline project from certain requirements under Directive 2009/73/EC by the Energy Agency of the Republic of Serbia

**1. Procedure**

1. On 1 October 2018, the Energy Community Secretariat (“the Secretariat”) was notified by the Energy Agency of the Republic of Serbia (“AERS”) of the latter’s Decision No 40/2018-D-03/46 of 1 October 2018 concerning an exemption granted to *Gastrans d.o.o. Novi Sad* (“*Gastrans*”) from the requirements of Articles 9(1), 32, 41(6), (8) and (10) of Directive 2009/73/EC<sup>1</sup> (“the Decision”).
2. Based on Article 288 of the Energy Law of the Republic of Serbia (“the Serbian Energy Law”),<sup>2</sup> which transposes Article 36 of Directive 2009/73/EC, the Decision exempts the *Gastrans* natural gas pipeline project (“the Project”), as described in Section 2 of this Opinion, from certain requirements under Directive 2009/73/EC regarding ownership unbundling of the natural gas transmission system operator, third-party access to the natural gas transmission system, and regulated setting of natural gas transmission tariffs. The scope of the exemption, its respective effects and compliance with Article 36 of Directive 2009/73/EC are the subject of this Opinion.
3. Pursuant to Article 36(9) of Directive 2009/73/EC, “*within a period of two months from the day following the receipt of a notification, the Secretariat may issue an opinion inviting the regulatory authority to amend or withdraw the decision to grant an exemption. That two-month period may be extended by an additional period of two months where further information is sought by the Secretariat. That additional period shall begin on the day following the receipt of the complete information*”. In a letter dated 20 November 2018, the Secretariat submitted to AERS a set of clarification questions concerning the Decision and the Project. By consequence, the deadline for submitting the Secretariat’s Opinion was extended by an additional period of two months. AERS’ response to the Secretariat’s questions was provided by letter dated 3 December 2018.
4. In the course of the procedure, several meetings were held between the Secretariat and AERS concerning the Decision. On several occasions, the Secretariat met representatives of *Gastrans* presenting the Project. Further, the Secretariat organised a public consultation between 24 October 2018 and 9 November 2018, inviting interested parties to provide their observations on the Decision. During the public consultation, comments from *ENGIE*, *Ukrtransgaz*, and the Embassy of the United States of America in Austria were received. Additional information received from AERS and *Gastrans* as well as observations provided by other interested parties were also considered by the Secretariat and, to the extent necessary, reflected in this Opinion.
5. According to the third subparagraph of Article 36(9) of Directive 2009/73/EC, “*the notifying bodies shall take the utmost account of a Secretariat opinion that recommends to amend or withdraw the exemption decision. Where the final decision diverges from the Secretariat’s opinion, the regulatory*

<sup>1</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13.07.2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC as adopted and adapted by Decision 2011/02/MC-EnC of the Ministerial Council of the Energy Community of 6.10.2011.

<sup>2</sup> Official Gazette No 145/2014.

authority concerned shall provide and publish, together with that decision, the reasoning underlying its decision. Diverting decisions shall be included in the agenda of the first meeting of the Ministerial Council following the date of the decision, for information and discussion”.

## 2. Description of the Project

6. According to the Decision, the Project consists of a future natural gas transmission pipeline which is planned to pass through the territory of Serbia in the approximate length of 400 km, and to connect the Serbian natural gas transmission system with those of Bulgaria and Hungary, including four metering stations and one compressor station to be built on the territory of Serbia. The projected technical capacity of the new pipeline is 13.88 bcm annually (“bcm/a”).
7. The new pipeline is supposed to enter the territory of Serbia at Zaječar, where it should connect to the Bulgarian gas transmission system operated by *Bulgartransgaz EAD* (“*Bulgartransgaz*”). Four exit points are envisaged, i.e. one exit point at Horgoš connecting the new pipeline with the Hungarian gas transmission system operated by *FGSZ Zrt.* (“*FGSZ*”), and three exit points – Paraćin, Pančevo and Gospođinci – connecting the pipeline with the existing Serbian gas transmission system, operated by *JP Srbijagas Novi Sad* (“*Srbijagas*”). The projected technical capacity of the exit points is 3.8 bcm/a for the exit points to the Serbian system, and 10.1 bcm/a at the exit point to the system in Hungary. According to the Decision, the technical parameters of the Project may still be adjusted, including the routing of the new pipeline as well as the locations of the entry/exit points.
8. The schedule presented by *Gastrans* foresees the completion of construction activities to enable the start of the pipeline’s commercial operation (“COD”) on 1 January 2020. The date for reaching its full transportation capacity is envisaged for [BUSINESS SECRET].
9. The promoter of the Project envisaged as a future operator of the new pipeline is *Gastrans*, the successor of *South Stream d.o.o. Novi Sad* which was originally founded on 30 April 2012 for the construction of the Serbian branch of the South Stream pipeline project. The original South Stream project was based on intergovernmental agreements between the Russian Federation and the countries through which the pipeline was supposed to pass. It was abandoned after the Secretariat and the European Commission had raised concerns regarding the compliance with the *acquis communautaire*.
10. The company was re-established on 26 January 2018, and the company’s name was changed to *Gastrans* as of 1 February 2018. *Gastrans* is fully owned by *South Stream Serbia AG*, which is registered in Switzerland and owned by *PJSC Gazprom Transgaz Krasnodar* (51%), a subsidiary of the Russian natural gas holding *PJSC Gazprom* (“*Gazprom*”), and *Srbijagas* (49%). *Gastrans* has two appointed directors: Mr. *Dušan Bajatović* (also the General Director of *Srbijagas*) and a representative of *Gazprom*, who remained in their respective positions following the re-establishment of the company in January 2018.
11. Both *Gazprom* and *Srbijagas*, the ultimate shareholders of *Gastrans*, are dominant players on the Russian and Serbian gas markets respectively and *Gazprom* being dominant on both markets. *Gazprom* possesses more than 72% of Russia’s proven natural gas reserves and accounts for 68% of the national natural gas output. The company’s corporate group dominates domestic transmission, distribution and supply, and it owns the Unified Gas Supply System (UGSS), which is an exclusive route for export of piped natural gas, *inter alia*, to Europe.<sup>3</sup> *Srbijagas*, a 100% state-owned Serbian natural gas incumbent, is engaged in gas transmission, distribution and supply activities and

<sup>3</sup> Energy and Natural Resources Global Guide: Oil and gas regulation in the Russian Federation, Practical Law by Thomson Reuters, 01.05.2018; <http://www.gazprom.com/about/>.

dominates the market both at wholesale and retail levels.<sup>4</sup> The position of *Gastrans*' ultimate shareholders on the relevant markets, and the impact of the Project on these markets is further considered in Section 4.2.1 of this Opinion.

12. The Project aims at transporting natural gas from Turkey (using capacities of the so-called TurkStream pipeline<sup>5</sup>) and Bulgaria, where a new pipeline is to be built. Downstream of the Serbian gas system, the gas transmitted through the pipeline is to be transported to Hungary. The Project was triggered by the interest of *Gazprom Export LLC* ("*Gazprom Export*"), another *Gazprom* subsidiary, to export natural gas from the Russian Federation.<sup>6</sup> *Gazprom* has a long-term interest in increased capacities for the transportation of natural gas via Bulgaria, Serbia and Hungary.
13. As part of a natural gas corridor from the Russian Federation to Central Europe, the Project essentially envisages the flow of natural gas from the Bulgarian to Serbian and further downstream to the Hungarian natural gas systems. In addition to the Project located in Serbia, the natural gas transmission system operators in the neighbouring countries – *Bulgartransgaz* and *FGSZ* – are expected to complement their respective existing natural gas transmission systems by new sections to which *Gastrans* could connect its pipeline upstream and downstream. However, neither of the two transmission system operators has requested or plans to request an exemption similar to the one requested by *Gastrans*.
14. On 2 February 2018, *Gastrans* submitted to AERS an initial request for an exemption ("the Initial Exemption Request"). Based on AERS's decision,<sup>7</sup> *Gastrans* proceeded with the market test for the use of the new infrastructure in the form of collecting non-binding bids from market participants. The market test for the Project was carried out by *Gastrans* in the period between 5 March 2018 and 30 April 2018.
15. By the deadline for registration set in *Gastrans*' public invitation, i.e. by 5 April 2018, six participants had registered for participation in the market test. Another four entities submitted information about their interest in capacity of the new pipeline after the deadline or without complete registration. The Secretariat analysed the bids based on an aggregated information provided by *Gastrans* in the addendum to the Initial Exemption Request ("the Amended Exemption Request") as submitted to AERS on 29 June 2018.<sup>8</sup> The Secretariat's findings are provided in Section 4.2.1(a)(i) of this Opinion.
16. In the Amended Exemption Request, and based on the results of the market test, *Gastrans* requested an exemption from the obligations under the Serbian Energy Law to unbundle the company as future transmission system operator of the new pipeline, to grant third-party access for 88% of the new pipeline's technical capacity,<sup>9</sup> and to apply regulated tariffs for the transmission of natural gas in the corresponding volumes. The exemption was requested for a period of 20 years from the pipeline's COD.<sup>10</sup>

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<sup>4</sup> Energy Community Secretariat, Annual Implementation Report 2017 (01.09.2018), p. 162-163.

<sup>5</sup> TurkStream is a natural gas pipeline project directly connecting, through its offshore segment under the Black Sea, the Russian and Turkish natural gas systems. The pipeline has two lines with a total capacity of 31.5 bcm annually. The offshore part of the pipeline being complete in November 2018, it is expected to become operational by the end of 2019. The TurkStream project is implemented by *South Stream Transport B.V.*, a subsidiary of *Gazprom*.

<sup>6</sup> [BUSINESS SECRET]

<sup>7</sup> AERS Decision No 40/2018-D-03/1 of 09.02.2018.

<sup>8</sup> Section 5.2 of the Amended Exemption Request.

<sup>9</sup> Instead of a full capacity (100%) exemption as requested by *Gastrans* in the Initial Exemption Request. Cf. Section 6.1 of the Amended Exemption Request.

<sup>10</sup> Instead of a period of 25 years as requested by *Gastrans* in the Initial Exemption Request.

### 3. The Decision

17. In its Decision, AERS decided to grant “to GASTRANS d.o.o. Novi Sad [...] an exemption in respect of the future gas interconnector, described in Item 2 of the disposition of this Act, from the application of third party access rules (general rules for capacity allocation and terms and conditions for natural gas transmission services), and regulated prices under Article 283 paragraph 1 of the Energy Law (hereinafter referred to as: “Law”) and the exemption from the implementation of ownership unbundling requirements under Article 224 of the Law, as further determined in Items 3-17 of the disposition of this Act.”
18. The Decision thus exempts the Project, and in particular the operation and use of the new pipeline within the territory of Serbia, for a period of 20 years from the new pipeline’s COD from: (i) the unbundling of the pipeline’s system operator; (ii) regulated third-party access to 88% of the pipeline’s capacity; and (iii) setting of regulated tariffs for the transmission of natural gas through the new pipeline. The exemption is subject to *Gastrans*’ compliance with conditions set by AERS as further assessed in this Opinion.
19. Firstly, the Decision exempts *Gastrans*, as the future transmission system operator in charge of the new pipeline, from the mandatory obligation to unbundle from any other activities and interests in the energy sector pursuant to Article 9 of Directive 2009/73/EC. This exemption means that *Gastrans* may remain under the control of one or more vertically integrated companies engaged in the production and/or supply of natural gas besides transmission. For this exemption to be effective, the Decision establishes a number of mandatory conditions to be met by *Gastrans*, including the adoption of a compliance program, the appointment of an independent compliance officer and the designation of an *ad hoc* body to solve complaints regarding capacity allocation in the new pipeline, possession of all assets necessary to perform the transmission activity, having an independent staff, separate premises, and operating independently from related companies. The Decision also specifies AERS’ monitoring rights concerning *Gastrans*’ independent conduct. By this exemption, the unbundling regime enshrined in Article 9 of Directive 2009/73/EC is replaced with a set of tailor-made requirements to be complied with by *Gastrans* during the entire exemption period.<sup>11</sup>
20. Secondly, the Decision exempts the new pipeline from unrestricted third-party access to its natural gas transmission capacities in accordance with Article 32 of Directive 2009/73/EC based on an objective and non-discriminatory capacity allocation procedure. In particular, *Gastrans* is allowed to allocate and contract up to 88% of the maximum technical capacity of the new pipeline exclusively for the benefit of its ultimate shareholders – *Gazprom* and *Srbijagas*. The remaining 12% of the maximum technical annual capacity of the new pipeline may be allocated and contracted to companies other than *Gazprom* and *Srbijagas* provided they had submitted non-binding bids in the market test.<sup>12</sup> In other words, this exemption makes available up to 88% of the new pipeline’s capacities for exclusive use by *Gazprom* and/or *Srbijagas*, whereas the rest of capacities can be made available only to those other companies which participated in the market test. Thus the entire capacity of the new pipeline is exempted from third-party access for 20 years. The Decision provides, however, that in case the long term capacity demand for *Gastrans* is smaller than the nominal technical capacity of the new pipeline, a residual 10% of its technical capacity is set aside for short term bookings.
21. Thirdly, the Decision exempts *Gastrans* from the obligation to apply regulated tariffs for the transmission of natural gas through the new pipeline and related services as required under Articles 41(6), (8) and (10) of Directive 2009/73/EC. Instead, *Gastrans* is required to set network tariffs under its approved methodology and in accordance with the conditions established in the Decision. Tariff-setting by *Gastrans* will be subject to AERS’ supervision.<sup>12</sup>

<sup>11</sup> The Decision, items 3, 4, 5, 6 and 7 and chapter 6.5, p. 57-63.

<sup>12</sup> The Decision, items 11 and 12 and chapter 6.5, p. 72-77.

22. The exemption is granted under the condition that *Gastrans* becomes the owner of the new pipeline, once it is constructed, and manages it as a transmission system operator. The Decision will lose its validity if *Gastrans* does not start constructing the new pipeline within two years from the date of the AERS' final act on exemption and/or does not commence the new pipeline's operation within five years from the date of AERS' final act on exemption.
23. It is envisaged in the Decision that *Gastrans*' compliance with all mandatory requirements set therein will be assessed through the certification procedure to be conducted under the terms and conditions stipulated in the Energy Law pursuant to Articles 10 and 11 of Directive 2009/73/EC.

#### 4. The Secretariat's assessment of the conditions for an exemption

24. In the following, the Secretariat, gives its Opinion on the compliance of the AERS Decision with the conditions for an exemption listed in Article 36(1) of Directive 2009/73/EC.

##### 4.1. Major new gas infrastructure, i.e. interconnectors, LNG and storage facilities (Article 36(1) Directive 2009/73/EC)

25. Article 36(1) of Directive 2009/73/EC limits the scope of projects which may benefit from an exemption from certain provisions of the Directive to major new gas infrastructure which, in the case of a pipeline project such as *Gastrans*, needs to qualify as an interconnector. By contrast, pipelines not qualifying as interconnectors are not eligible for an exemption.
26. Pursuant to Article 2(17) of Directive 2009/73/EC, an interconnector is defined as "*a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States*". When incorporating the Directive in the Energy Community, the Ministerial Council adapted that provision as follows: "*interconnector*" means *a transmission line which crosses or spans a border between Contracting Parties for the sole purpose of connecting the national transmission systems of those Contracting Parties*" (emphasis added). Article 2(25) of the Serbian Energy Law defines an interconnector as "... *a natural gas pipeline ... that crosses the borders between the states for the purpose of connecting their systems, as well as equipment that is used for connection of the energy systems*".

##### 4.1.1. The existence of an "interconnector"

27. As regards the qualification of the *Gastrans* project as an interconnector within the meaning of Article 36(1) of Directive 2009/73/EC, the Decision is based on the assumption that the pipeline to be built by *Gastrans* will connect to the Hungarian and Bulgarian national transmission systems following a "*border to border*" design, with exit and entry points "*to be situated on the Serbian-Hungarian border and the Serbian-Bulgarian border*".<sup>13</sup> For the purpose of connecting to *Gastrans*, both the Bulgarian and the Hungarian system operators are expected to build new gas pipelines. The upstream connection with Bulgaria is envisaged near Zaječar (Serbia) and the downstream interconnection at the border station with Hungary near Horgoš (Serbia).<sup>14</sup> According to the Amended Exemption Request, "[t]he exact location of the entry point at the Bulgarian-Serbian border and the exit point Horgoš at the Hungarian-Serbian border are still being confirmed. In both cases, the exact location will be agreed with the adjoining transmission system operators FGSZ and Bulgartransgaz, whereby in any case one of the connections will be on the territory of the Republic of Serbia and the another one on the territory of Bulgaria/Hungary."<sup>15</sup> In a response to the Secretariat's questions of 20

<sup>13</sup> Information provided by AERS by letter dated 16.03.2018.

<sup>14</sup> Initial Exemption Request p. 1, 10, 16; Amended Exemption Request, p. 12.

<sup>15</sup> Amended Exemption Request, p. 12.

November 2018, AERS essentially confirms that the exact location of the interconnection points is still unclear.

28. The uncertainty as to whether and where the Project will be interconnected with the Bulgarian and Hungarian transmission systems calls for a verification as to whether the *Gastrans* project constitutes an interconnector within the meaning of Article 36 of Directive 2009/73/EC.
29. At the outset, the Secretariat recalls that the notion of an interconnector must be interpreted strictly, as Article 36 of Directive 2009/73/EC is an exception to the general rules of the internal market, and the legislator of the Third Package did not intend to exempt purely domestic infrastructure.<sup>16</sup> The notion of an interconnector as defined by Article 2(17) of Directive 2009/73/EC ultimately requires a pipeline to cross a border.<sup>17</sup>
30. As requests for exemptions are typically made during the planning stage of a pipeline project, it is in principle appropriate to consider the design pursued by the project developer for the determination of the notion of an interconnector. The definition in Article 2(17) of Directive 2009/73/EC also refers to the “purpose” of a transmission pipeline.<sup>18</sup> In this respect, it is relevant [BUSINESS SECRET]. This may be considered the main purpose of the Project and its upstream and downstream extensions. As such, they are economically interdependent.
31. That said, Article 2(17) of Directive 2009/73/EC is based on a technical, not an economic notion of interdependence. The mere commercial interest of shareholders and shippers in transit of gas across borders does not suffice for the infrastructure to be qualified as an interconnector.
32. At the project stage, the Secretariat thus deems an objective likelihood for the future creation of physical interconnections necessary. Otherwise, an exemption under Article 36 of Directive 2009/73/EC could ultimately depend on wishful thinking of a project promoter. This is of particular importance in a case, as the one under scrutiny, where the national regulatory authorities of the neighbouring countries to which the infrastructure to be exempted is supposed to connect, have not received corresponding exemption requests.
33. Instead, the regulatory authorities of Hungary and Bulgaria, in their responses to a letter by AERS of 17 July 2018, expressed concern as regards an exemption granted to the Project in Serbia. The Hungarian Energy and Public Utility Regulatory Authority (“MEKH”)<sup>19</sup> raised concerns that an exemption granted to *Gastrans* would frustrate a harmonized incremental capacity procedure based on Commission Regulation (EU) 2017/459 (“the CAM Network Code”)<sup>20</sup> across all three jurisdictions. Similarly, the Energy and Water Regulatory Commission of Bulgaria (“EWRC”) called for a “*single regulatory regime*” based on the CAM Network Code and identified a risk that “*along the pipeline route in the Bulgaria-Serbia-Hungary corridor a different regulatory regime with regard to TPA will be applied*”. EWRC concluded that an exemption from third-party access rules as requested by *Gastrans* “*would have a negative effect on the development of trade, competition and market integration within the regional market*”.<sup>21</sup>
34. Beyond regulatory concerns in the jurisdictions up- and downstream of Serbia, by the time of issuing the Decision, also the transmissions system operators had not yet taken any final investment decision (“FID”) as to whether or not to build the infrastructure required for connecting with the Project with

<sup>16</sup> Cf Commission Decision C(2011)3424 of 20.05.2011 on the exemption of the Gazelle interconnector, paragraph 22.

<sup>17</sup> Cf Commission Decision C(2011)3424 of 20.05.2011 on the exemption of the Gazelle interconnector, paragraph 20; Commission Decision C(2015) 1852 of 17.03.2015 on the exemption of the Trans Adriatic Pipeline, paragraph 54.

<sup>18</sup> Cf Commission Decision C(2013) 6159 of 17.09.2013 on the exemption of the SK-HU interconnector, paragraph 54.

<sup>19</sup> Letter dated 26.07.2018.

<sup>20</sup> Regulation 2017/459 of 16.03.2017 establishing a network code on capacity allocation mechanisms in gas transmission systems; adopted for the Energy Community Contracting Parties by Decision 2018/06/PHLG-EnC.

<sup>21</sup> Letter dated 15.08.2018.

their respective systems. Moreover, Joint Development Agreements with the neighbouring transmission system operators have still not been concluded as envisaged by *Gastrans*.<sup>22</sup>

35. As regards a potential interconnection with *Bulgartransgaz* of Bulgaria, an “*expansion of the gas transmission network of Bulgartransgaz in the section from the Bulgarian-Turkish to the Bulgarian-Serbian border*” is listed as a key project in the company’s Ten-Year Network Development Plan (TYNDP) 2018-2027.<sup>23</sup> At the time of issuing the present Opinion, *Bulgartransgaz*, on the basis of the CAM Network Code, conducted an economic test for incremental capacity for a maximum of 20 years.<sup>24</sup> As a result of the final phase of the test, *Bulgartransgaz* announced on 31 January 2019 that binding offers had been submitted by three shippers for 100% of the offered 11.2 bcm/a long-term capacity. On 21 December 2018, *Bulgartransgaz* also initiated a tender for the equipment and construction works for a 474.7 km of new pipeline which follows the route previously envisaged for South Stream and runs from Provia to the Bulgarian-Serbian border,<sup>25</sup> where it is expected to cross the border south of the border control point Vrashka Chuka.<sup>26</sup> The Secretariat considers that the successful conclusion of the economic test and the procurement activities of *Bulgartransgaz* demonstrate a sufficiently concrete indication for a future interconnector with the Project.
36. As regards the interconnection with *FGSZ* of Hungary, project(s) for building new infrastructure and/or upgrading the existing elements of the Hungarian transmission system related to accommodating gas flows from the Project are in a more preliminary phase at the time of issuing the present Opinion. MEKH decided not to include the project connecting to *Gastrans* in the Hungarian TYNDP due to the uncertainty in the development of the upstream section of the project and indicated that it may be subject to further examinations.<sup>27</sup> Yet AERS bases its Decision on the presumption that the final exit point of the *Gastrans* pipeline will be within the existing metering station Kiskundorozsma,<sup>28</sup> on the territory of Hungary. Kiskundorozsma is also the interconnection point between the existing systems of *FGSZ* and *Srbijagas*.<sup>29</sup> There are currently still several options of linking the Hungarian transmission system to the Project that significantly differ in terms of entry and compressor capacity, new pipeline length, capital expenditure need etc. A decision between the three options and an FID can only be taken once a binding economic test as part of the incremental capacity process under the CAM Network Code has been carried out to identify the precise capacity demand.
37. The uncertainties related to the potential downstream interconnection aside, the Secretariat, based on the developments in Bulgaria, sees a sufficient degree of probability at this point in time for the Project to develop into an interconnector within the meaning of Article 36 of Directive 2009/73/EC.

#### 4.1.2. Interconnectors between Contracting Parties and Member States

38. The present case also raises the question of whether a pipeline crossing a border between a Contracting Party (Serbia) and one or more Member States of the European Union (Bulgaria and Hungary) qualifies as an interconnector.

<sup>22</sup> AERS, reply to the Secretariat’s questions.

<sup>23</sup> РЕШЕНИЕ № ДПРМ - 1 от 25.07.2018 г – [http://www.dker.bg/uploads/reshenia/2018/res\\_dpdm-1\\_18.pdf](http://www.dker.bg/uploads/reshenia/2018/res_dpdm-1_18.pdf).

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[https://bulgartransgaz.bg/en/news/bulgartransgaz\\_ead\\_announced\\_the\\_procedure\\_for\\_construction\\_of\\_a\\_stage\\_of\\_the\\_expansion\\_of\\_the\\_gas\\_t-437-c15.html](https://bulgartransgaz.bg/en/news/bulgartransgaz_ead_announced_the_procedure_for_construction_of_a_stage_of_the_expansion_of_the_gas_t-437-c15.html).

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[http://tenders.bulgartransgaz.bg/bg/competitions/izgrajdane\\_na\\_obekt\\_razshirenje\\_na\\_gazoprenosnata\\_infrastruktura\\_na\\_bulgartransgaz\\_ead\\_paralelno\\_n-424-c1-1.html](http://tenders.bulgartransgaz.bg/bg/competitions/izgrajdane_na_obekt_razshirenje_na_gazoprenosnata_infrastruktura_na_bulgartransgaz_ead_paralelno_n-424-c1-1.html).

<sup>26</sup> According to the Technical Specification included in the tender documents, “the point of crossing the Bulgarian-Serbian border is in the WGS84 system with the following coordinates: B= 43°50’25,9199”; L= 22°22’30,4357”.

<sup>27</sup> MEKH Resolution No 9050 /2018 - [http://www.mekh.hu/download/2/63/60000/9050\\_%202018.pdf](http://www.mekh.hu/download/2/63/60000/9050_%202018.pdf).

<sup>28</sup> Amended Exemption Request, p. 12.

<sup>29</sup> ENTSOG, Capacity Map 2018.

39. The definition of an “interconnector” in Article 2(17) of Directive 2009/73/EC, as applicable in the European Union, and as applicable in the Energy Community differs. The former applies only to interconnectors between EU Member States whereas the latter applies only to interconnectors between Energy Community Contracting Parties. Interconnections between a Contracting Party and EU Member States fall outside the scope of either definition.<sup>30</sup> At the time of issuing this Opinion, the resulting legal gap is subject to negotiations for amendments to the Treaty establishing the Energy Community. That gap cannot be closed by recurring to national legislation.
40. The fact that the Serbian Energy Law in its Article 2(25) transposes Article 36 of Directive 2009/73/EC in a neutral manner which refers to “States” rather than “EU Member States” or “Contracting Parties” is immaterial for the present assessment. The exclusive benchmark for the Secretariat’s assessment is Energy Community law, i.e. Article 36 of Directive 2009/73/EC, as adopted and adapted by the Ministerial Council. For the same reason, the fact that from an EU law perspective, the *Gastrans* project might be considered “spanning” two borders of EU Member States by crossing a non-EU Member State, Serbia,<sup>31</sup> is immaterial. Finally, whether or not the regulatory authorities of Bulgaria and Hungary have taken a decision to apply the CAM Network Code to interconnection points from and to Contracting Parties under Article 1(2) of the CAM Network Code is also of no relevance for the purpose of the present assessment.
41. It is on account of primary Energy Community law, and in particular Articles 7 (prohibition of discrimination) and 41 (free movement of energy) of the Treaty establishing the Energy Community (“the Treaty”), that the Secretariat ultimately supports the view that the Project is to be considered an interconnector within the meaning of Article 36 of Directive 2009/73/EC, as adopted and adapted by the Ministerial Council.
42. On 23 September 2014, the Ministerial Council adopted Interpretation No 2014/01/MC-EnC under Article 94 of the Treaty (“the Interpretation”). Article 1 of the Interpretation determines that “*in any legal act of the Energy Community incorporating European Union legislation, any reference to [...] c. existing or new gas and electricity infrastructure (including interconnections and interconnectors) crossing borders, zones, entry-exit or control areas between Parties and integrating the Contracting Party/Contracting Parties with the EU internal energy market, shall be treated in the same way and be subject to the same provisions as the respective [...] infrastructure between Contracting Parties under Energy Community law.*”
43. The recitals of Interpretation No 2014/01/MC-EnC recall that the Treaty requires equal treatment for any energy infrastructure located within the Energy Community, by “*stressing that the different treatment of interconnections, cross-border flows, transactions or network capacities, depending on whether the border to be crossed is situated between two Member States of the European Union, two Contracting Parties or an EU Member State and a Contracting Party, frustrates the very idea of a single regulatory space for Network Energy and leads to barriers of trade.*”
44. According to Item VIII.4. of the Rules of Procedure of the Ministerial Council, to which the recitals of Interpretation No 2014/01/MC-EnC refer, an Interpretation is binding on the Parties and the institutions under the Treaty.<sup>32</sup> The Interpretation thus requires the authorities of Serbia – a Party to the Energy Community – as well as the Secretariat – an institution of the Energy Community – to treat a gas pipeline crossing a border between Serbia and Bulgaria or Hungary – such as *Gastrans* – in the same manner as it would treat a gas pipeline connecting Serbia with another Contracting Party, e.g. with Bosnia and Herzegovina. As the latter constellation would be considered an interconnector within the meaning of Article 36 of Directive 2009/73/EC, treating the former not as an interconnector would

<sup>30</sup> Cf Secretariat Opinion 1/2013 on the exemption of the Trans Adriatic Pipeline interconnector, paragraph 25.

<sup>31</sup> The provision reads: “This Regulation shall apply to interconnection points. It may also apply to entry points from and exit points to third countries, subject to the decision of the relevant national regulatory authority.”

<sup>32</sup> Unless and until the EU judiciary rules otherwise, cf. Article 94 of the Treaty.



amount to discrimination and hence run counter to the Treaty establishing the Energy Community, as interpreted by the Ministerial Council.

45. While the principle of non-discrimination and its Interpretation by the Ministerial Council are crucial for the establishment of an interconnector within the meaning of Article 2(17) of Directive 2009/73/EC, the same principle requires the operators of infrastructure crossing the borders between Contracting Parties and EU Member States to ensure equal treatment on their respective segments. While the Secretariat does not call into question the legitimacy of requesting an exemption in one jurisdiction only, it also concurs with the regulatory authorities of Bulgaria and Hungary that an exemption granted for a part of a continuous pipeline supposed to connect Contracting Parties and Member States risks creating different conditions for access and capacity allocation on different segments of the pipeline. The Ministerial Council's Interpretation aims to avoid such a situation. Eligibility of the Project for an exemption and applying the same conditions for the non-exempted part of the Project as hypothetically applicable between two EU Member States or two Contracting Parties are in fact two sides of the same medal. Important basic elements for such harmonization are the Network Codes, including the CAM Network Code which, since 29 November 2018, is applicable in the Energy Community following the European Union.<sup>33</sup> The other Network Codes are either already applicable in the Energy Community,<sup>34</sup> or are expected to become applicable very soon.
46. On this basis, AERS is requested to ensure that the Network Codes, to the extent applicable in the Energy Community, apply to the non-exempted part of the Project's capacity on all interconnection points.

## Conclusion

47. The Project is a major infrastructure with a length of some 400 km and a total investment of over [BUSINESS SECRET] EUR. It will be capable of transporting 13.88 bcm/a gas towards Serbia. Its transport capacity, once built, will have made up around 72% of the overall gas import capacity of the country.
48. Based on the above, the Secretariat concludes that the Project may be regarded as an interconnector within the meaning of Article 36 of Directive 2009/73/EC. At the same time, the Interpretation on which this conclusion relies requires that the non-exempted part of the Project is fully subjected to the *acquis communautaire* applicable to the Project during the exemption period.

## 4.2. Investment must enhance competition in gas supply and enhance security of supply (Article 36(1)(a) Directive 2009/73/EC)

### 4.2.1. Effect on competition

49. Article 36 of Directive 2009/73/EC requires that (i) the investment enhances competition in gas supply and (ii) the exemption is not detrimental to competition. While these two requirements are not identical, they imply that the project must be pro-competitive and thus create benefits for consumers.<sup>35</sup> For the

<sup>33</sup> Regulation (EU) 2017/459 was adopted and adapted by Decision 2018/06/PHLG-EnC on 28.11.2018. According to Article 3 of the Decision, the scope of the Regulation determined in Article 2(1) of Regulation (EU) 2017/459 is limited to interconnection points between Contracting Parties. While this follows the same logic as the adaptation of Article 2(17) of Directive 2009/73/EC, Article 2(1) of Regulation (EU) 2017/459 further provides for the possibility of the Regulation to be applied "to entry points from and exit points to third countries, subject to the decision of the relevant national regulatory authority."

<sup>34</sup> Namely Regulation 703/2015 establishing a network code on interoperability and data exchange; amendment to Annex I of Regulation 715/2009 as amended by Commission Decision 2012/490 and 2015/71; and Regulation 2017/460 establishing a network code on harmonized transmission tariff structures for gas.

<sup>35</sup> Cf Commission Staff Working Paper on Article 22 of Directive 2003/55/EC concerning common rules for the internal market in natural gas and Article 7 of Regulation (EC) No 1228/2003 on conditions for access to the network of cross-border exchanges in electricity – "New Infrastructure Exemptions" ("Commission Staff Working Paper"), paragraph 30; Commission Decision on the exemption of the interconnector Greece-Bulgaria, C(2018)5058 of 25.07.2018.

analysis of this condition, the likely positive and negative effects of the project on competition need to be analysed and balanced.<sup>36</sup> Only if the positive effects of the investment outweigh the negative effects, an exemption under Article 36 of Directive 2009/73/EC can be granted.<sup>37</sup>

50. In its review of the structure of the natural gas market in Serbia, AERS notes a high level of concentration and concludes that the *“ultimate shareholders of GASTRANS d.o.o. and their affiliates hold a dominant position in all segments of the natural gas market in the Republic of Serbia”*. AERS examines the impact of the Project on *“the increase of market competitiveness”* in Serbia and the South East Europe region by predominantly referring to the arguments in *Gastrans’* Initial and Amended Exemption Requests, including a Market Study. On this basis, AERS concludes that the Project *“has the potential to enhance competition in the supply of natural gas in the Republic of Serbia and the SEE region”* and that it *“can transport natural gas from new sources”*.
51. In particular, AERS argues that enabling imports of natural gas into Serbia from two directions and increasing import capacities at the entry points, the Project will create the necessary conditions for competition for importing natural gas and have positive effects on the functioning of the natural gas market in Serbia. It argues that apart from Russian gas imported by *Gazprom* as the dominant supplier of natural gas to the countries of South East Europe, a *“potentially cost-effective source of natural gas in the Republic of Serbia, as well as in the region of South-East Europe, is natural gas from Romania”*, as well as from Azerbaijan. Furthermore, LNG from Greece and Turkey are listed as potential sources, and gas from Iraq, Iran and the Mediterranean Sea are identified as hypothetical alternative sources. Moreover, AERS maintains that the construction of an entry point into the Hungarian transmission system from Serbia will enable importing of natural gas from various sources which would have a positive effect on competition on the Hungarian natural gas market. It also assumes that gas could be transported from Hungary to the connected countries in Central Europe because the capacity of the new interconnector at the border between Serbia and Hungary would be greater than the demand for imports in Hungary. Finally, AERS argues that the Project, as part of a new transmission route for gas from Turkey through Bulgaria and Serbia to Hungary, will enable imports of natural gas from various sources. AERS concludes that the Project has the potential to enhance competition in the supply of natural gas in Serbia and the South-East Europe (*“SEE”*) region under the conditions referred to above.
52. At the outset, the Secretariat recalls that when assessing whether the Project is pro-competitive, the question whether the investment leads to the creation or strengthening of a dominant market position needs to be considered.<sup>38</sup> A dominant position is *“a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers”*.<sup>39</sup> The existence of a dominant position can only be assessed in connection with a definition of the relevant markets.<sup>40</sup>
53. The relevant market is established by the combination of the product and geographic markets. A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.<sup>41</sup> The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the

<sup>36</sup> Commission Staff Working Paper, paragraph 31.

<sup>37</sup> Cf Commission Decision C(2011)3424 of 20.05.2011 on the exemption of the Gazelle interconnector, paragraph 27.

<sup>38</sup> Commission Decision on the exemption of the interconnector Greece-Bulgaria, C(2018)5058 of 25.07.2018, paragraph 64.

<sup>39</sup> ECJ 27/76, *United Brands*, ECLI:EU:C:1978:22, paragraph 65; 85/76, *Hoffmann-La Roche*, ECLI:EU:C:1979:36, paragraph 38.

<sup>40</sup> Commission Staff Working Paper, paragraph 36.

<sup>41</sup> Commission Notice on the definition of relevant market for the purposes of Community competition law, [1997] C 372/5, paragraph 7.

conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.<sup>42</sup>

*a. Effect on competition in Serbia*

54. Natural gas is the third most used primary energy source in Serbia, after coal and oil. Gross domestic consumption in 2017 amounted to 2,66 bcm/a, which was 11.94% higher compared to 2016. The domestic production covered 18.4% of gas demand in 2017, while the rest was secured by imports from the Russian Federation under a long-term contract. There were no imports from other sources or other contracts.
55. The gas transmission system in Serbia currently has one entry point at the Hungarian border (Kiskundorozsma- Horgoš) with the annual technical capacity of (approx. 4.55 bcm/a) and one exit point on the border with Bosnia and Herzegovina (Zvornik). Both points are connected to the *Srbijagas* transmission system. In 2016, the utilisation rate of the entry firm capacity on the Serbian-Hungarian border amounted to an average of 42.6%, varying according to seasons. The natural gas transmission services are performed by two transmission system operators: *Srbijagas* which operates 95% of the gas transmission network and *Yugorosgaz-Transport* which operates the remaining 5% of the network in south-east Serbia. Neither operator complies with the unbundling requirements under the Third Energy Package.
- i. Development, production and upstream gas supply
56. The European Commission has defined a single product market for development, production and upstream supply of natural gas to large importers/wholesalers.<sup>43</sup> With respect to the geographic market, the market can be defined as national from a supply side perspective, due to limited interconnection infrastructure or lack of available cross-border capacity.<sup>44</sup>
57. The current Serbian development, production and upstream gas supply market is highly concentrated, with two players active on this market: *Gazprom Export* and *Naftna industrija Srbije JSC, Novi Sad* (“*NIS*”).
58. *Gazprom Export* exports gas via an intermediary, the vertically integrated company *Yugorosgaz*, under long-term contracts to *Srbijagas*, the dominant player downstream. The ultimate owners of *Yugorosgaz* are *Gazprom PJSC* (75%) and *Srbijagas* (25%). The long-term gas supply contract between *Yugorosgaz* and *Gazprom Export* runs until 2021. It covers 1.5 bcm/a until 2018, and 2 bcm/a starting from 2018.<sup>45</sup> The data taken from the 2017 Report of AERS show that the volumes actually supplied under the long-term contract may be even higher.
59. *NIS* is the only producer of natural gas in Serbia. The total annual production which was delivered to the transmission and distribution system in 2016 amounted to 399 mcm. Out of this total volume, 44% was sold to other suppliers and 56% was spent by *NIS* to cover its own demand.<sup>46</sup> *NIS* is majority owned by *Gazprom Neft*<sup>47</sup> (56.15%), while 29.87% are held by the Republic of Serbia, i.e. the sole

<sup>42</sup> Commission Notice on the definition of relevant market for the purposes of Community competition law, [1997] C 372/5, paragraph 8.

<sup>43</sup> COMP/M.6910 *Gazprom/Wintershall Target Companies*, of 3 December 2013, paragraph 83; COMP/M.6801 *Rosneft/TNK-BP*, of 08.03.2013; COMP/M.5585 *Centrica/Venture Production* of 21.08.2009; COMP/M.4545 *Statoil/Hydro* of 03.05.2007.

<sup>44</sup> COMP/M.6801 *Rosneft/TNK-BP* of 13.04.2013, paragraph 12; COMP.39.315 *ENI* of 29.09.2010, paragraph 28; COMP/M.4545 *Statoil/Hydro* of 12.06.2007, paragraphs 13-16; COMP/M.3696 *E.ON/ Mol* of 16.09.2006, paragraph 131; COMP/M.3440 *ENI/EDP/GDP* of 19.11.2005, paragraphs 25-28.

<sup>45</sup> <http://www.gazprom.com/press/news/2017/december/article388143/>  
<http://www.gazprom.com/press/news/2018/october/article461916/>

<sup>46</sup> AERS Annual Report 2016, p. 57.

<sup>47</sup> The largest shareholder of *Gazprom Neft PJSC* is *Gazprom PJSC* (95.68%); the remaining shares are in free float.

shareholder of *Srbijagas*.<sup>48</sup> For the purpose of assessing the structure of the market and competition within this market, the fact that *NIS* is effectively under the control of *Gazprom* as its majority shareholder needs to be taken into account.<sup>49</sup>

60. Based on the figures included in the 2017 Report of AERS,<sup>50</sup> the Secretariat agrees with AERS' finding that *Gazprom* has a dominant position on the Serbian development, production and upstream supply market. The market share of *Gazprom Export* amounts to approx. 80%, whereas the remaining approx. 20% are held by *NIS* which due to its shareholder structure is again controlled by *Gazprom*. It follows that companies under the control of *Gazprom* effectively enjoy a monopoly on the Serbian market for development, production and upstream gas supply.

|  | 2015<br>million m <sup>3</sup> | % of total    | 2016<br>million m <sup>3</sup> | % of total    | 2017<br>million m <sup>3</sup> | % of total    |
|--|--------------------------------|---------------|--------------------------------|---------------|--------------------------------|---------------|
| Total volume   | 2,172                          |               | 2,206                          |               | 2,560                          |               |
| Local production   | 432                            | <b>19.89%</b> | 399                            | <b>18.09%</b> | 377                            | <b>14.73%</b> |
| Import from Russian Federation<br>via long-term contract                                     | 1,733                          | <b>79.79%</b> | 1,807                          | <b>81.91%</b> | 2,183                          | <b>85.27%</b> |
| Import from other sources  | 7                              |               | -                              |               | -                              |               |
| <b>Total volume supplied by<br/>undertakings ultimately<br/>controlled by <i>Gazprom</i></b> | 2,165                          | <b>99.68%</b> | 2,206                          | <b>100%</b>   | 2,560                          | <b>100%</b>   |

61. While generally speaking, investment in infrastructure may provide an opportunity for market entrance of new market players or for a change in market shares of already active market players, this is almost certainly not to be the case on the Serbian market in view of the Project's shareholding structure controlled by *Gazprom* (51%) and *Srbijagas* (49%).
62. Firstly, since *Gazprom* enjoys a monopoly on the Serbian market for development, production and upstream gas supply, the Project creates the risk of foreclosure of access to the upstream market. *Gazprom* will be able to block delivery of gas to any downstream competitor and with *Gazprom* controlling 51% of *Gastrans* it will also have an incentive to deny competitors access to the pipeline. For this reason, the Secretariat does not share AERS' expectation that the Project may be used to ship gas from other sources than the Russian Federation. Apart from the theoretical availability of such alternative gas sources, these sources should also effectively be available to competitors of the monopoly for them to enter and compete on the Serbian market. Given the structure of the market monopolized by the exclusive exporter of Russian gas, there is no commercial interest in the Project being made available for other sources. The Secretariat further elaborates on that in the context of security of supply (below at point 4.2.2).
63. Secondly, since the second shareholder, *Srbijagas*, is dominant on the markets for downstream wholesale supply, retail supply, transmission and distribution, the Project also creates the risk of foreclosure of the downstream markets, as will be shown below under iii). As *Gastrans* is owned by undertakings with exorbitant market power on all levels of the Serbian gas market, the assumption

<sup>48</sup> <https://www.nis.eu/en/about-us/company-information>.

<sup>49</sup> Control means the possibility to exercise decisive influence on an undertaking, meaning the power to determine the strategic commercial decisions of the other undertaking. This power is typically achieved by owning a majority of the shares. See European Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (2008/C 95/01), paragraphs 18-34.

<sup>50</sup> Available at <https://www.aers.rs/Files/Izvestaji/Godisnji/Izvestaj%20Agencije%202017.pdf>.

that Project developed by these undertakings will enhance competition on the Serbian gas markets cannot be substantiated.

64. The Secretariat further notes that the majority of the annual gas supplies to Serbia are fixed on the long-term to *Gazprom*. Based on an Intergovernmental Agreement between Serbia and Russia, *Gazprom* and *Yugorosgaz* signed a long-term contract for natural gas supply to Serbia until the end of 2021 for an annual supply of 1.5 bcm/a until 2018 and 2 bcm/a from 2018-2021. The foreclosure of the upstream and downstream markets through the Project makes the prolongation of the long-term supply contract with *Gazprom* the most likely option. The prolongation of the long-term supply contract will in turn further reinforce the foreclosure of the market by stabilizing the supply market structure for another significant number of years. The effect of the Project and the long-term contract mutually reinforce each other, effectively perpetuating the market position of *Gazprom*, and of *Srbijagas*.
65. Hence, the Project is not expected to make new capacity effectively available to new market entrants and/or competitors but will strengthen the market position of its owners and further foreclose the markets.
66. The effect of the Project on competition is further and significantly exacerbated by the impact of the exemption. The Third Energy Package envisages third-party access as a crucial element for ensuring equal access to energy infrastructure and as the main instrument for opening the market to competition. However, the Decision exempts the Project from Article 32 of Directive 2009/73/EC, i.e. third-party access. According to the Decision, *Gastrans* has the right to allocate and contract up to 88% of the maximum technical annual capacity to *Gazprom* and *Srbijagas*, thereby exempting it from third-party access for a duration of 20 years.
67. Moreover, according to the Decision, the remaining 12% may be allocated and contracted to companies other than *Gazprom* and *Srbijagas* only if they submitted non-binding bids in the market test. Due to this caveat of participation in the non-binding market test, also for this 12%, there is no third-party access, but access is reserved to the companies having indicated interest earlier on. The Secretariat has analysed the submitted bids for the non-binding phase of the market test: [BUSINESS SECRET]
68. [BUSINESS SECRET] who submitted bids to transport gas to the Serbian market [BUSINESS SECRET].<sup>51</sup>
69. The European Commission has established a general rule under which “*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*”.<sup>52</sup> Where access to the infrastructure is restricted, this will restrict competition, in particular if the new capacity is not available to new market entrants and/or competitors of the dominant undertaking. If, on the contrary, the new capacity is only available to the already dominant market player, the Project will strengthen its market position and further foreclose the market. Therefore, the European Commission only accepted allocation to any dominant market player at a maximum of 50%<sup>53</sup> or even 40%.<sup>54</sup>
70. The data of the non-binding phase of the market test shows that not only 88% but even more capacity could be allocated to market players ultimately controlled by the dominant companies on the Serbian market. A significant part of the capacity will thus be allocated to dominant or monopolistic undertakings for a significant period of time, while the remaining capacity is also not open for any third party but only to the limited pool of market participants which have indicated interest in the non-binding

<sup>51</sup> [BUSINESS SECRET]

<sup>52</sup> Cf Commission Decision C (2009) 3037 of 24.04.2009 on the exemption of the Nabucco interconnector (BG), paragraph 31; Commission Decision D(2008) 142 of 08.02.2008 on the exemption of the Nabucco interconnector (AT), paragraph 55.

<sup>53</sup> Cf Commission Decision C (2009) 3037 of 24.04.2009 on the exemption of the Nabucco interconnector (BG).

<sup>54</sup> Cf Commission Decision on the exemption of the interconnector Greece-Bulgaria, C(2018)5058 of 25.07.2018.

market test. Therefore, the effect of such exemption is to eliminate any competitive constraints which could have hypothetically been created by a Project open to third-party access.

71. The Project, subject to the exemption granted by the Decision, does not open the market for new competitors but effectively forecloses the market to the advantage of the already dominant market player. The Project significantly impedes effective competition by helping the monopoly *Gazprom* to eliminate the possibility of rival firms to compete or enter the market, on account of its exclusive right to book up to 88% of the capacity on *Gastrans*. Potential market entrants are not, neither individually or in the aggregate, in a position to exercise any competitive pressure on *Gazprom* and constrain its behavior on the market.
72. Therefore, the Project as exempted from third party access does not only have likely anti-competitive effects, but effectively cancels out any potential pro-competitive effects that new infrastructure may have in principle. The Secretariat comes to the conclusion that the Project and the exemption conditions granted by AERS in the Decision do not enhance competition in the Serbian market for development, production and supply, but on the contrary, strengthen the market position of the dominant undertaking *Gazprom*.

#### ii. Storage

73. The market for the storage of natural gas constitutes a separate product market.<sup>55</sup> The geographic scope of the market for the storage of natural gas is either national or regional.<sup>56</sup>
74. In Serbia, there is only one storage, *Natural Gas Underground Storage Banatski Dvor, LLC* (“*Banatski Dvor*”), founded and owned by *Srbijagas* (49%) and *Gazprom Germania*<sup>57</sup> (51%). The currently available capacity amounts to 450 mcm while the designed withdrawal capacity amounts to 5 mcm/d. The bidirectional gas pipeline *Gospođinci – Banatski Dvor* connects the underground gas storage with the transmission system of *Srbijagas*.
75. According to the Decision, 88% of the capacity of the Project will be reserved for *Gazprom* and *Srbijagas*, i.e. the shareholders of *Banatski Dvor*. As a consequence, the Decision allocates a significant part of the capacity not only to the company dominant on the Serbian market for development, production and upstream supply of gas, but also to the same companies enjoying a monopoly on the Serbian gas storage market. The exemption granted by the Decision therefore leads to the companies, which will reinforce their quasi-exclusive access to the Serbian downstream market, to be in the position and to have an incentive to utilize the storage facility for their own interests on the highest possible level, thereby foreclosing competitors from the storage market.

#### iii. Downstream wholesale gas supply and retail supply

76. The European Commission has identified a distinct product market for the downstream wholesale supply of gas which encompasses sales by shippers or suppliers with an upstream gas supply contract (as well as those with domestic production),<sup>58</sup> to retailers and other wholesalers.<sup>59</sup> In terms of geography, the European Commission has generally considered downstream wholesale gas supply markets to be delineated along existing (regional) grid areas, by market area or at a national level.<sup>60</sup>

<sup>55</sup> COMP/M.5549 *EDF/Segebel* of 12.11.2009, paragraph 167-168; COMP/M.3696 *E.ON/MOL* of 21.12.2005, paragraph 99; COMP/M.3410 *Total/Gas de France* of 08.10.2004.

<sup>56</sup> COMP/M.3696 *E.ON/MOL* of 21.12.2005, paragraph 130.

<sup>57</sup> *Gazprom Germania* is fully owned by *Gazprom Export*, a 100%-subsidiary of *Gazprom*.

<sup>58</sup> COMP/M.7228 *Centrica/Bord Gais Energy* of 13.06.2014.

<sup>59</sup> COMP/M7936 *Petrol/Geoplin* of 10.03.2017, paragraph 17; COMP/M.6984 *EPH/Stredoslovenska Energetika*, of 20.11.2013.

<sup>60</sup> COMP/M7936 *Petrol/Geoplin* of 10.03.2017, paragraph 18; COMP/M.6984 *EPH/Stredoslovenska Energetika* of 20.11.2013; COMP/M. 5802 *RWE Energy/Mitgas* of 17.06.2010; COMP/M.5467 *RWE/Essent* of 23.06.2009; COMP/M.5220 *ENI/DISTRIGAZ* of 15.10.2008.

77. As rightly pointed out by AERS, *Srbijagas* is dominant on the Serbian market for downstream wholesale supply of gas. In particular, on this market, only two market players – *NIS* and *Srbijagas* – are active. In 2016, *Srbijagas* was also appointed as the public supplier and supplier of the last resort of final customers, putting it in a legal monopoly with regard to these customers. The market shares of *Srbijagas* in the last three years clearly indicate its dominant market position:<sup>61</sup> [BUSINESS SECRET].
78. Besides the downstream wholesale supply of gas market, the European Commission further distinguishes between: i) retail supply of gas to gas-powered electricity producers, ii) retail supply of gas to large industrial customers, iii) retail supply to small industrial and commercial customers and iv) retail supply to households.<sup>62</sup> It considers that the geographic scope of retail markets is general national in scope.<sup>63</sup>
79. Also in this regard, the Secretariat confirms AERS' finding that *Srbijagas* is dominant on the Serbian retail supply market, accounting for some 79% of total natural gas sales in 2016.<sup>64</sup> The remainder consists of other suppliers, such as the public supplier *DP Novi Sad* (3%) and *NIS* (2.5%), whereas all others have even lower market shares.
80. As has been explained above, the Project will not enable market entrance of new competitors and/or a change in market shares of already active market players, because *Gazprom* and *Srbijagas* as the shareholders of *Gastrans* have strong market positions on all levels of the Serbian gas markets and an incentive to foreclose the market to their own advantage. The Project also creates the risk of further foreclosure of the downstream markets. Being in a dominant position on the wholesale supply market, *Srbijagas* will be in the position to foreclose any potential competitor downstream.
81. Furthermore, since the Decision effectively reserves 88% or more of the capacity of the Project for *Gazprom* and *Srbijagas*, a significant amount of its capacity is allocated to undertakings dominant on different segments of the Serbian gas market. In particular with regard to *Srbijagas*, this will put *Srbijagas* as shareholder of the Project in the position to foreclose the downstream and retail supply markets for other (potential) market participants. The Decision would perpetuate the current lack of competition by effectively prescribing quasi-exclusive access to the Project for an already dominant undertaking.
82. With a 49%-share in *Gastrans*, *Srbijagas* also has an incentive to foreclose access to the infrastructure serving the downstream wholesale and retail markets. *Srbijagas* is not only dominant on the downstream wholesale and retail markets, but also directly controls 95% of the gas transmission system in Serbia, and *Yugorosgaz-Transport* (ultimately held by *Gazprom*) the remaining 5%. *Srbijagas* also controls 47.6% of the gas distribution system in the country. The company continues to perform transmission (and distribution) of natural gas in breach of the unbundling provisions of the Third Energy Package, and does not separate control over transmission and supply activities. Its lack

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<sup>61</sup> With regard to market shares, the European Court of Justice has found that very large market shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant market position, Case 85/76, *Hoffmann-La Roche*, ECLI:EU:C:1979:36, paragraph 39 *et seqq.* That is the situation where there is a market share of 50%, Case C-62/86, *AKZO*, ECLI:EU:C:1991:286, paragraph 60.

<sup>62</sup> COMP/M.8701 *Edison/GNVI* of 05.02.2018; COMP/M.8358 *Macquarie/National Grid/Gas Distribution Business of National Grid* of 16.03.2017, paragraph 18; COMP/M7936 *Petrol/Geoplin* of 10.03.2017, paragraph 25; COMP/M.7602 *Deutsche Telekom Group/Met Holding/JV* of 19.08.2015, paragraph 10; COMP/M.5740 *Gazprom/A2A/JV* of 16.06.2010.

<sup>63</sup> COMP/M.8358 *Macquarie/National Grid/Gas Distribution Business of National Grid* of 16.03.2017, paragraph 18; COMP/M7936 *Petrol/Geoplin* of 10.03.2017, paragraph 26; COMP/M.6068 *ENI/ACEGASAPS/JV* of 11.04.2011; COMP/M.5740 *Gazprom/A2A/JV* of 16.06.2010; COMP/M.3230 *Statoil/BP/Sonatrach/In Salah JV* of 19.12.2003.

<sup>64</sup> AERS Annual Report 2016, p. 77.

of unbundling in line with the Third Energy Package has already led to a Decision establishing a serious and persistent breach of Energy Community law by the Ministerial Council.<sup>65</sup>

83. Moreover, *Srbijagas* effectively prevents competitors to enter the Serbian market via the interconnection point Kiskundorozsma-Horgoš but uses the interconnection capacity exclusively for its own (and *Gazprom*'s) deliveries. The Secretariat has initiated an infringement procedure. An increase of capacity to Serbia on account of granting third-party access at the Kiskundorozsma-Horgoš interconnection point would not constitute a pro-competitive effect attributable to the Project, but would simply restore compliance with Energy Community law.
84. The Secretariat thus concludes that, by reserving 88% or more of the capacity for *Gazprom* and *Srbijagas*, the Project and the exemption granted to it effectively ensures foreclosure not only of the upstream market on which *Gazprom* holds a dominant position, but also of the downstream wholesale and retail markets on which *Srbijagas* is dominant and can leverage its dominance across markets. Therefore, the Secretariat comes to the conclusion that the Project and the exemption conditions granted by AERS do not increase competition in the Serbian markets, but on the contrary, significantly strengthen the dominance of the existing market players.

#### *b. Effect on competition in Hungary*

85. In 2017, the Hungarian natural gas demand amounted to approx. 9.5 bcm/a.<sup>66</sup> Domestic production met less than 20% of the total consumption and most (95%) of the remainder was effectively imported from the Russian Federation. The majority of imports – including the volumes transited to Serbia – amounted to 13.4 bcm in 2018 and entered Hungary from Ukraine through the interconnection point Beregovo.<sup>67</sup> Another important entry point is from Austria at Mosonmagyaróvár through which 6.8 bcm were imported in 2018. In addition, gas can be transported to Hungary from Slovakia, and it is expected to become possible to import gas from Romania and Croatia in the course of 2019.
86. The Hungarian market for development, production and upstream gas supply already shows a high-level of concentration. Between 1995 and 2015, a long-term gas supply contract with *Gazprom* was the cornerstone of gas supplies to Hungary providing at maximum 9.5 bcm/a of supplies.<sup>68</sup> Currently, the long-term contract continues to be extended on a short-term basis, most recently until the year 2020.<sup>69</sup> Under this contract, *Panrusgaz*,<sup>70</sup> the Hungarian counterparty imported 4.9 bcm in 2016 and 5.1 bcm<sup>71</sup> in 2017 to Hungary, the latter representing half of the total annual gas demand.
87. On the market for downstream wholesale supply, approx. 90 companies have a license to trade gas in Hungary. The state-owned *Hungarian Gas Trade Ltd*, who has an obligation to supply gas at regulated prices to universal service providers upon request, has a market share of over 60%. Due to the number of competitors on the market, there is a certain degree of competition. However, since around 20 traders source their gas from *Gazprom* (as is *Panrusgaz*), the market cannot be considered to be fully competitive.

<sup>65</sup> Cf Case ECS-9/13S, Reasoned Request, paragraph 48. In particular, the obligation to implement the requirement of legal unbundling of *Srbijagas* from other activities not related to transmission is not fulfilled. Furthermore, the obligation to ensure the independence of *Yugorosgaz-Transport* in terms of organization and decision-making from other activities not relating to transmission is not fulfilled. Moreover, the obligation to ensure the independence of the two TSOs in terms of its organization and decision-making from other activities not relating to transmission is not fulfilled.

<sup>66</sup> BP Statistical Review of World Energy 2018 - <https://www.bp.com/content/dam/bp/en/corporate/pdf/energy-economics/statistical-review/bp-stats-review-2018-full-report.pdf>

<sup>67</sup> These figures include also those quantities, which are sold from Hungary to Ukraine.

<sup>68</sup> Report on the activities of the Hungarian Energy and Public Utility Regulatory Authority in 2013, p. 59.

<sup>69</sup> <http://kremlin.ru/events/president/news/58586>

<sup>70</sup> Owned by *Gazprom Export*, *E.ON Ruhrgas International AG* and *Centrex Hungaria Zrt*.

<sup>71</sup> <http://www.panrusgaz.hu/en/ker.htm>



88. The Project foresees an exit capacity of 10 bcm/a reaching Hungary.<sup>72</sup> According to the demand assessment by ENTSOG in its latest TYNDP,<sup>73</sup> the forecasted Hungarian demand by 2030 is expected between 7.6 - 9 bcm/a; no market expansion is anticipated. This indicates that the planned exit capacity from the Project is capable to comfortably cover the entire Hungarian gas demand.
89. The Project, subject to the exemption granted by the Decision, in particular the allocation of 88% or even more of the capacity to undertakings which are ultimately controlled by *Gazprom* could lead to a scenario where both of the major entry points into Hungary (Beregovo<sup>74</sup> and Kiskundorozsma-Horgoš) are controlled by *Gazprom* which is already in a dominant position on the Hungarian market for the development, production and upstream wholesale gas supply (with a market share between 50% and 80%). The additional capacity foreseen by the Project to reach Hungary and the very limited allocation of capacity to third parties effectively would strengthen *Gazprom*'s position on the upstream market by increasing its market share and thereby enabling it to foreclose the downstream markets to any potential competitor. Whereas the competition on the downstream wholesale supply market is already limited due to the exclusively Russian supply of gas, the Decision would promulgate this market concentration and further limit competition.

*c. Effect on competition in Bosnia and Herzegovina*

90. Natural gas can currently enter Bosnia and Herzegovina only via one cross-border entry point from the domestic gas transmission system of Serbia. The capacity of this point is used by *BH-Gas d.o.o. Sarajevo* and *Gazprom Export*.
91. Since the Project does not provide for a connection to Bosnia and Herzegovina, nor for any capacity destined for this market, the Project does not directly impact competition on the Bosnian gas markets. The Project might have certain pro-competitive effects only if due to the Serbian capacity of the Project, new supply could reach the Bosnian market. However, such pro-competitive effects will not materialize in case significant parts of the capacity are, as envisaged by the Decision, allocated to the undertakings dominant on the Serbian and Bosnian gas markets.

*d. Effect on competition in Bulgaria*

92. The Bulgarian gas transmission network contains two co-existing systems i.e. the national gas transmission network and the gas transmission network for transit transmission. The latter is used for the transmission of Russian natural gas to Turkey, Greece and the former Yugoslav Republic of Macedonia and has a technical capacity of 17.8 bcm/a. The transit system is technically and commercially interconnected with the national gas transmission network, although only to a very limited extent. The capacity of entry into the national system is 0.3 bcm/a, whereas entry into the transit system is 0.6 bcm/a. The Project is planned to connect to a newly-built pipeline section on the territory of Bulgaria, which is expected to have only one connection to the domestic Bulgarian network.
93. The vast majority of Bulgaria's approx. 3.5 bcm/a gas demand is met via imports, which are procured dominantly by the state-owned *Bulgargaz*. A long-term supply contract, between *Bulgargaz* and *Gazprom Export* covers the supply of 2.9 bcm/a between 2013 and 2022,<sup>75</sup> which indicates that *Gazprom* is a dominant player on the market for the Bulgarian market for the development, production and upstream supply of gas.

<sup>72</sup> *Blueberries*, Market Study for the Project.

<sup>73</sup> <https://www.entsog.eu/tyndp#entsog-ten-year-network-development-plan-2020>

<sup>74</sup> Currently *Ukrtransgaz* is unable to carry out all the TSO functions vis-à-vis *FGSZ* at the Beregovo interconnection point in the direction Ukraine-Hungary. The reason for this barrier derives from the contractual provisions between *Naftogaz* and *Gazprom* [<http://www.naftogaz.com/www/3/nakweben.nsf/0/AE96AA9D16162AA9C2257E5B004AB86D?OpenDocument&Highlight=0,FGSZ>].

<sup>75</sup> <http://www.gazpromexport.ru/en/partners/bulgaria/>.

94. The main players on the Bulgarian gas market are grouped into a 100% state owned conglomerate, the *Bulgarian Energy Holding* (“*BEH*”). Both *Bulgargaz* and the transmission system operator *Bulgartransgaz* are part of *BEH*. As a result of an investigation opened in July 2013, the European Commission found that the “*BEH group holds dominant positions both in the gas infrastructure markets and in the gas supply markets in Bulgaria*”.<sup>76</sup> In 2017, 99.5% of the total downstream wholesale market was covered by *Bulgargaz* at regulated prices, while 0.5% was supplied by other traders at negotiated prices. This indeed indicates an extreme level of market concentration on the downstream wholesale market with *Bulgargaz* enjoying a quasi-monopoly.
95. As Bulgaria is in the upstream direction of the Project, the Secretariat does not consider that the Project and the exemption from third-party access for the flows in the default south-north flow direction have a direct impact on the Bulgarian gas markets. Only in case of reverse flow, gas may be traded freely from Central-Eastern Europe to Bulgaria. This would constitute an alternative gas supply, putting competitive pressure on the currently dominant upstream gas supplier *Gazprom*. Furthermore, such trade could also serve an opportunity for arbitrage between the CEE and SEE markets and thus facilitate market integration, enabling a potential Bulgarian gas hub to be integrated, liquid and mature.

### Conclusion

96. The Secretariat concludes that due to the dominant position of the shareholders of the Project on different levels of the Serbian gas market, the Project is not expected to make new capacity effectively available to new market entrants and/or competitors but will strengthen the market position of its owners, and further foreclose the markets. Furthermore, the exemption from third-party access and therefore exclusive allocation of 88% or more of the capacity will further restrict competition, in particular because the new capacity is not available to new market entrants and/or competitors of the dominant undertakings but only to the already dominant market players themselves. Therefore, the Secretariat comes to the conclusion that the Project and the exemption conditions granted by AERS in the Decision do not enhance competition either on the Serbian, or the Hungarian and Bulgarian markets, but on the contrary, strengthen the market position of the dominant undertaking *Gazprom* and *Srbijagas*.
97. The Secretariat therefore concludes that the Project does not enhance competition, but that the exemption granted by the Decision is detrimental to competition. Under these conditions, an exemption cannot be granted and would violate Article 36 of Directive 2009/73/EC.
98. Apart from the necessity to establish compliance with Energy Community law regarding the unbundling of *Srbijagas* and the capacity allocation at the interconnection point Kiskundorozsma-Horgoš, the Secretariat deems it indispensable to amend the conditions regarding exemption from third-party access by significantly lowering the percentage of capacity which is allocated exclusively to *Gazprom* and *Srbijagas* to a level that allows for competitors to enter and compete on the respective markets. The remaining capacity must be allocated in a competitive manner, in accordance with the *acquis communautaire*. Furthermore, in order to open the market for potential competitors of the dominant firms, the Secretariat insists on additional liquidity measures whereby the dominant companies must offer gas on the Serbian market in order to stimulate the emergence of at least some degree of competition on highly concentrated markets.

#### 4.2.2. Impact on security of supply

99. Article 36 of Directive 2009/73/EC requires that gas infrastructure must enhance security of supply as a precondition to be granted with an exemption. For this it needs to be assessed whether and to what

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<sup>76</sup> [http://europa.eu/rapid/press-release\\_IP-18-6846\\_en.htm](http://europa.eu/rapid/press-release_IP-18-6846_en.htm).

extent the Project enhances the security of supply in Serbia and the neighbouring markets in South East Europe.

100. In the Decision, AERS concludes that the Project “*increases the security of supply of natural gas in the Republic of Serbia and the SEE region*”.<sup>77</sup>
101. At the outset, the Secretariat notes that in general, an investment which provides a new route to the Serbian and other markets in South East Europe,<sup>78</sup> and connects new sources of upstream gas from new suppliers, will normally increase the security of supply of those markets. Yet, the impact of security of supply has to be assessed on a case-by-case basis.<sup>79</sup>
- a. New supply route to Serbia, Bosnia and Herzegovina, Hungary and Bulgaria*
102. In general, the Secretariat agrees that the Project constitutes a new supply route to Serbia, Hungary and indirectly to Bosnia and Herzegovina and enhances the security of supply of those markets.
103. Currently, all natural gas imports to Serbia (and Bosnia-Herzegovina) enter Serbia through the Kiskundorozsma-Horgoš interconnection point on the Hungarian-Serbian border. The maximum import daily capacity for both Serbia and Bosnia and Herzegovina at the Kiskundorozsma entry point is 540,000 m<sup>3</sup>/h or 13 mcm/d, out of which 11 mcm/d is booked for Serbia.<sup>80</sup> Serbia’s peak consumption of 17.274 mcm/d is covered from imports through that interconnection point, the underground gas storage site at Banatski Dvor (maximum withdrawal rate 5 mcm/d),<sup>81</sup> and the maximum domestic production of 1.2 mcm/d. The historical supply peak through Kiskundorozsma is at 11.3 mcm/d in the winter months for both Serbia and Bosnia and Herzegovina combined.<sup>82</sup>
104. Hence the current Serbian peak demand can be satisfied with the use of all available sources, but may reach a capacity limit should the demand further increase. The Project is expected to add a total entry capacity of 34.4 mcm/d (13.88 bcm/a) at the border between Bulgaria and Serbia, of which a capacity of more than 10 mcm/d<sup>83</sup> (3.8 bcm/a) can exit to the Serbian system. The Project is thus likely to increase the resilience of the Serbian system, in particular in situations where the entry capacity to Serbia from the Kiskundorozsma-Horgoš interconnection point reaches its limits.<sup>84</sup>
105. AERS also concludes that the Project will increase the N-1 standard for Serbia, which foresees that in the event of a disruption of the single largest gas infrastructure element the capacity of the remaining infrastructure is still able to satisfy peak gas demand<sup>85</sup>. The N-1 standard is deemed fulfilled if it is higher than 100%. The Project would increase Serbia’s N-1 standard from existing 38% to 114%.<sup>86</sup>
106. At the same time, the Secretariat recalls that *Srbijagas* has committed to, and the Government has supported, building other interconnectors with adjacent transmission system operators which are expected to become operational in the course of the next years. The most mature of these is the

<sup>77</sup> The Decision has reached its conclusion on enhancement of security of supply based on assessment of the four criteria as defined by the Commission Staff Working Paper.

<sup>78</sup> For the purpose of the security of supply assessment, the term “SEE market” includes Serbia, Bulgaria, Hungary and Bosnia and Herzegovina.

<sup>79</sup> Cf Commission Decision C(2015) 1852 of 17.03.2015 on the exemption of the Trans Adriatic Pipeline, paragraph 59; Commission Decision on the exemption of the interconnector Greece-Bulgaria, C(2018)5058 of 25.07.2018. paragraph 38; Secretariat Opinion 1/2013 on the exemption of the Trans Adriatic Pipeline interconnector, paragraph 43.

<sup>80</sup> AERS, Annual Report 2017.

<sup>81</sup> The Serbian storage facility Banatski Dvor has a capacity of 460 mcm working level with maximum injection and withdrawal rates which stand at 2.7 and 5 mcm/day.

<sup>82</sup> AERS, Annual Report 2017.

<sup>83</sup> Calculated by the Secretariat based on the annual capacity.

<sup>84</sup> Cf Commission Decision C(2015) 1852 of 17.03.2015 on the exemption of the Trans Adriatic Pipeline, paragraph 89.

<sup>85</sup> As defined by Article 5 of Regulation (EU) 2017/1938.

<sup>86</sup> AERS Decision p 36-37.

Bulgarian-Serbian interconnector (IBS). Once built, that interconnector would increase Serbia's N-1 standard to approx. 65%. Moreover, *Srbijagas* is in negotiations with *Transgaz* of Romania for an interconnector Arad-Mokrin. This interconnector would increase Serbia's N-1 standard to 50,5%. While the parallel development of these projects which *Srbijagas* has committed to construct in the coming years do not eliminate the impact of the Project on improving the infrastructure security standard in Serbia, they show that Serbia's security of supply in terms of route diversification is likely to improve anyhow.

107. As regards Bosnia and Herzegovina, the entry point at the existing Serbian transmission system in Zvornik has a capacity of 2 mcm/d.<sup>87</sup> The Project will not affect that capacity and thus does not affect the N-1 standard of Bosnia and Herzegovina.
108. As regards Hungary, the Decision argues that the Project will enhance the N-1 infrastructure standard from 124.5% to 151%. While the Secretariat generally agrees that this is the case, it is to be noted that the Project's impact on Hungary's N-1 standard is not of the same importance as in the case of Serbia, since the N-1 standard is already fulfilled by Hungary at present.
109. As regards Bulgaria, AERS claims that the Project will improve the N-1 infrastructure standard from 62.8% to 175.6%. The Secretariat disagrees with this conclusion. The Bulgarian N-1 standard will be increased by the Project only under the assumption that firm physical reverse flows from Serbia to Bulgaria are possible. Under the conditions imposed by AERS, however, the Project represents a plain exit point from Bulgaria because only transit towards Serbia and further to Hungary is envisaged. Physical reverse flow is mentioned only as noncommittal possibility without any requirements or concrete time period for implementation. [BUSINESS SECRET]<sup>88</sup> Without further specification it cannot be concluded that Bulgaria's N-1 standard will improve on account of the Project. In case physical reverse flow on the Project were ensured, it would indeed constitute another route of supply to Bulgaria and increase N-1 standard by adding a new entry point to the Bulgarian system.
110. The Secretariat concludes that the Project may be considered improving the N-1 standard in Serbia and Hungary, and thus contributes to route diversification, an element for security of supply within the meaning of Article 36 of Directive 2009/73/EC.
111. Besides, the Secretariat notes that natural gas is currently imported to the countries in Central and South East Europe on the basis of transit through Ukraine. The current transit contract between *Gazprom* and the gas incumbent of Ukraine expires by the end of 2019. Whether and to what extent it will be replaced by a new transit contract is currently subject to negotiations. The state of these negotiations entails a degree of uncertainty. In this situation, the Secretariat was made aware by the system operators and authorities of Serbia and Hungary of the increased importance of the Project for their security of supply. The Project's capacity of approximately 14 bcm/a will not allow for a full replacement of the Ukrainian route, which transported 93.5 bcm of Russian gas in 2017.<sup>89</sup> Yet it would enable the supply of natural gas to Serbia in case that the transit capacities through Ukraine are interrupted or diminished. Although Hungary is much better interconnected with its neighbours, the Project will enable another supply route at a capacity comparable to the current Hungarian market of around 10 bcm/a.

*b. New supply sources*

112. The Decision states that the new interconnector will also permit the flow of existing and new sources of natural gas from south to north.

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<sup>87</sup> <https://ots-test.srbijagas.com/frontend/ulizl.php>.

<sup>88</sup> Annex of the FEED contract for Gastrans.

<sup>89</sup> Cf. Commission Decision C (2016) 6950 of 28.10.2016 on the exemption of the OPAL interconnector, paragraph 50.

113. As regards the Project's impact on security of supply by opening new sources from new suppliers to Serbia, however, the Secretariat notes that apart from the theoretical availability of such sources, these must be realistically available to the Serbian market. In this respect, the Secretariat notes that the non-binding phase of the *Gastrans* market test indicated that [BUSINESS SECRET].
114. By contrast, the likelihood of bringing gas from new supply sources to Serbia and the SEE region through the other planned interconnectors (Bulgaria-Serbia and Romania-Serbia) is much higher.
115. The existence of long-term contracts between *Gazprom* and *Srbijagas* (via *Yugorosgaz*) covering the entire demand for imports in Serbia also underpins that only Russian gas would be transported on the Project to Serbia, which hence is not likely to result in source diversification. Rather, the Project could either turn into a partial substitute of the existing route of Russian gas to Europe via Ukraine, or serve as incremental capacity for bringing additional quantities of Russian gas to Europe.
116. In order to improve the security of supply beyond the mere N-1 infrastructure standard<sup>90</sup> the Secretariat requests to by default set aside short-term capacities to third parties in line with what was reasoned above from a perspective of effective competition. The current Decision provides that 12% of the Project's capacity is non-exempted, although even this portion of the pipeline is set aside for participants in the non-binding market test for long-term booking. This is, in the Secretariat's view, not enough to enable short-term flexibility for new sources which may come upstream later, through the interconnector Greece-Bulgaria for instance and its opening to Azeri and LNG supplies via Greece, or from new production sources in the Black Sea. The region has been historically supplied only with Russian gas, and the Project, which continues this trend, should offer at least a part of its capacities available to take advantage of this opportunity and realize its potential for security of supply even more. This would also enable flexibility to contract gas sources on a short term basis also in cases of emergency.

*c. Reverse flow and incremental capacity*

117. The Secretariat recalls that the Decision does not exempt the Project from any current or future pieces of the *acquis communautaire* related to security of gas supply.<sup>91</sup> The *acquis* at present consists of Directive 2004/67/EC in the Contracting Parties to the Energy Community, and of Regulation (EU) 2017/1938 of the European Parliament and of the Council<sup>92</sup> in the European Union. The incorporation into Energy Community law of Regulation (EU) 2017/1938 and its preceding Regulation (EU) 994/2010 has long been discussed in the Energy Community institutions, and is envisaged still for 2019. Once adopted, it will be applicable to the new interconnector and its operators. It follows from point 4.1.2 above and from the Interpretation referred to there, that for all aspects not subject to an exemption, AERS must ensure homogeneity and compliance with current and future pan-European standards.
118. According to Article 5(4) of Regulation (EU) 2017/1938, all cross-border interconnections must be physically bi-directional at all times. The Decision should ensure *Gastrans* enables permanent physical reverse flow capacities. [BUSINESS SECRET] The Secretariat requests AERS to ensure that the Decision requires *Gastrans* to enable adequate capacity of physical reverse flow from Hungary to Serbia (and further to Bulgaria) for emergency operations, in the same manner as any infrastructure project subject to Regulation (EU) 2017/1938 in the European Union would.

<sup>90</sup> The Staff Working Paper emphasis to a certain extent the flexibility of sources though linked somewhat to an emergency: "The more flexibility of supply an infrastructure project adds for bringing additional gas to a market in case of an emergency, the more it enhances security of supply".

<sup>91</sup> Cf Commission Decision on the exemption of the interconnector Greece-Bulgaria, C(2018)5058 of 25.07.2018. paragraph 39; Commission Decision C(2015) 1852 of 17.03.2015 on the exemption of the Trans Adriatic Pipeline, paragraph 60.

<sup>92</sup> Regulation (EU) 2017/1938 of the European Parliament and of the Council of 25 October 2017 concerning measures to safeguard the security of gas supply and repealing Regulation (EU) No 994/2010.

119. Moreover, the Decision currently includes only a general request<sup>93</sup> to *Gastrans* to examine the interest of the market for capacity expansion (including reverse flows) every six years. This is three times less than the typical frequency of market demand testing envisaged by Article 26 of the CAM Network Code. AERS does not give reasons for such unusual long intervals. The Secretariat requests AERS to amend its Decision by obliging *Gastrans* to identify the demand for incremental capacity through regular binding market tests which will be performed every second year, and consequently build incremental capacity, unless it shows that expansion is not economically viable. Expansion capacity (as well as any remaining unused initial capacity) must be made available to the market under the non-exempted regime.

### Conclusion

120. The Secretariat concurs with AERS that the Project will enhance security of supply of natural gas in Serbia and to the SEE region, albeit only by opening a new transportation route and not by providing access to new sources of gas.

121. Based on the above, the Secretariat requests AERS to ensure full compliance of the entire Project (regardless of the exemption) with Article 5 of Regulation (EU) 2017/1938. The Secretariat also requests AERS to apply Article 26 of the CAM Network Code for non-exempted capacities.

### **4.3. The level of risk attached to the investment must be such that the investment would not take place unless an exemption was granted (Article 36(1)(b) Directive 2009/73/EC)**

122. Article 36(1)(b) of Directive 2009/73/EC requires an analysis of whether the Project would not take place without granting the exemptions for ownership unbundling, third party access and application of regulated prices, in the scope and manner granted by the Decision.

123. At the outset, the Secretariat recalls that an exemption under Article 36 of Directive 2009/73/EC is a risk mitigation measure to be tailored to the specific risk profile of major new infrastructure projects. For this purpose, the risks incurred by the Project need to be identified. Any exemption granted must be proportionate compared to the risk it is expected to mitigate.

124. Based on the documents provided by the company and its own analysis, AERS concludes that the investment would not take place unless the exemption in the form provided by the Decision is granted. In the Decision, AERS accepts the following risks and their justification: (i) the size of the project; (ii) very limited possibilities for financing the project of that size by existing TSOs; (iii) the small number of shareholders; (iv) limited interest of third- party users of the system.

125. The Secretariat generally agrees that the investment in the Project, with an expected CAPEX of around [BUSINESS SECRET] EUR, is of a high magnitude. The Secretariat also notes that the equity-debt ratio for financing the Project is assumed to be [BUSINESS SECRET] %.

126. The Secretariat further notes that the cost-benefit analysis carried out in the feasibility report, which was submitted together with the exemption request, is based on one single scenario, namely on the assumption that 88% of the total capacity is utilized on Exits Paraćin, Pančevo and Gospođinci from 1 January 2020 and on the Exit Horgoš from [BUSINESS SECRET]. This scenario models only the

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<sup>93</sup> Cf Item 8 of the Decision: "GASTRANS d.o.o shall at least every six years, or may at its discretion, if GASTRANS d.o.o deems it necessary, at any time verify the interest of the market for investments in the New interconnector and, provided that such investment is economically justified, make the investment plan and submit such investment plan to the Agency for the approval pursuant to Article 250 of the Law".

“exemption granted” scenario when the shareholders of Gastrans reserve capacity in the extent allowed by the Decision.<sup>94</sup>

127. A state-of-the-art cost-benefit analysis for projects of such an investment size would have required a sensitivity analysis,<sup>95</sup> along with a scenario analysis as a basis for a proper risk assessment. This would have allowed defining the most pertinent risks for the Project’s financing.<sup>96</sup> Identifying the most sensitive variables would have been the precondition to come up with appropriate risk mitigation strategies.<sup>97</sup> Such an assessment is typically requested by financing institutions as well. This type of assessment is missing from the feasibility study and the cost-benefit analysis where a single assessment scenario is presented without any sensitivity analysis or alternative scenario analysis. Hence it is difficult to conclude whether the current level of exemption granted addresses the identified risks proportionately.
128. In the feasibility study, no analysis has been carried out to compare the financial feasibility of the project under the regulated and the exempted regime. The Secretariat however notes that the currently applicable regulated transmission tariff methodology in Serbia would result in high tariffs in the first years of operation, until higher utilization of the pipeline is reached, thus risking lower capacity bookings. The Secretariat recognizes the fact that the tariffication methodology as proposed by *Gastrans*, addresses this issue and avoids tariff oscillations. Nevertheless, there are regulatory measures, such as smoothing of revenues/tariffs over the years, to mitigate the risk of lower bookings due to higher tariffs in the first couple of years within the regulated regime. Consequently, such regulatory measures could lower the risk.
129. The Secretariat considers the following risks brought forward by *Gastrans* as relevant for the present assessment:
- (i) The size of the project (in terms of the value of investment above [BUSINESS SECRET] EUR, length, capacity) compared to the size of the natural gas market of Serbia;
  - (ii) the existing transmission system operator(s), or *Gastrans* as an unbundled entity, would not be able to attract equity and third party financing to construct infrastructure;
  - (iii) Existing transmission system operators are not in the position to construct the project due to insufficient human and logistical resources;
  - (iv) Small number of shareholders among which to spread the project risk;
  - (v) Investment incentives (i.e. direct state funds, tax break) cannot be obtained from the Republic of Serbia<sup>98</sup> for the project, and it cannot (partially) be financed by grant support from international financial institutions, including the European Union.
130. The Secretariat notes that Article 36(1)(b) of Directive 2009/73/EC addresses investment and financing risks, but not risks of a general nature such as delayed land rights and permits or regulatory and legal risks which cannot be not mitigated by an exemption. Project management risks attributable to interface risk with contractors and connecting to downstream and upstream systems should be mitigated with insurance policies, appropriate project design and planning, but not via exemptions.

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<sup>94</sup> Schedule 1 - GASTRANS d.o.o. Novi Sad Feasibility Study of Construction of the Energy Infrastructure, June 2018; pg.23. Main assumptions 3 and pg. 6. Executive bullet 3.

<sup>95</sup> Guide to Cost-Benefit Analysis of Investment Projects, 1.2 Definitions and scope of ‘major projects’ Assessment, Directorate-General for Regional and Urban policy, December 2014.

<sup>96</sup> In the sense of the “critical variables of the project [which] have the largest impact on the project’s financial and/or economic performance”, cf. Guide to Cost-Benefit Analysis of Investment Projects, 2.9 Risk Assessment, Directorate-General for Regional and Urban policy, December 2014.

<sup>97</sup> Commission Staff Working Paper, paragraph 45.

<sup>98</sup> Funds available according to Rules of Procedure on conditions and manner of attracting the direct investments (Official Gazette of the Republic of Serbia No 18/2018).

131. In general terms, the Secretariat does not support the argument that an investment needs to be protected from future changes in third party access regulation.<sup>99</sup> Activities of a commercial character are by nature susceptible to legislative development and possible changes of the legal framework. The competence of any legislature to develop and adjust primary and secondary legislation to economic, market and policy considerations would be unduly and unrealistically limited by requiring absolutely no changes in the legal framework for 20 years.<sup>100</sup>
132. Equally, the risk to find creditworthy shippers is addressed through the binding capacity allocation conditions/market testing conditions and via the binding contract, but not through an exemption.
133. The Secretariat notes that the potential cost overruns can be recovered through the regulated tariff regime, namely via the correction element<sup>101</sup> that recovers all efficiently incurred and justified cost overruns in the following tariff/regulatory period. Also AERS stated that the currently applicable methodology ensured covering of all justified costs and yields on investments. Thus, the Secretariat considers that this claimed risk is not relevant for the exemption.
134. Moreover, the size of the Serbian market as a demand risk is not the relevant benchmark for the risk assessment, as the Project's goal is not only to supply Serbia and Bosnia and Herzegovina, but to transit majority of gas volumes (approx. 72% of the planned technical capacity) to Hungary and its neighbouring countries.
135. As regards the Project's investment and financing risk, the Secretariat notes that the cost of debt assumed for the Project is at [BUSINESS SECRET] %.<sup>102</sup> This is low given that the project is realized in Serbia and the current risk-free rate of Serbia, is 4.2%,<sup>103</sup> even if it aims to supply markets beyond Serbia. The low cost of debt assumed is the reason for the Project's low weighted average capital cost (WACC).<sup>104</sup> The low WACC assumption, in turn, results in a relatively low internal rate of return (IRR) of [BUSINESS SECRET] %.<sup>105</sup>
136. The financing of such a significant project is inevitably a blend of financing instruments. Among others, these can feature: (i) sovereign grants, loans and guarantees, thus decreasing the financial exposure; (ii) International Financial Institutions (IFIs) project financing or state financing to be sub-lent to a special purpose vehicle/project company typically with very competitive conditions; (iii) Export Credit Agency (ECA) financing; (iv) commercial and syndicate loans from the financial market; (v) project bonds; (vi) corporate financing, shareholder (recourse, limited- or non-recourse or subordinated) loans; (vii) completion support/shareholder guarantee to decrease risk exposure of other financiers; (viii) and shareholder equity to limit financial gearing.
137. The assumed low cost of debt would be achievable through a significant share of project financing from IFIs, blended with sovereign guarantees, loans or decreased exposure via national or international grants. The Secretariat agrees with AERS that these options are not realistic to support finance of the Project in its current design. Rather, the Project will need to involve commercial bank/syndicate loans within the financing portfolio, due to the size of the financing needs.

<sup>99</sup> Commission Staff Working Paper, paragraph 17.

<sup>100</sup> Cf Secretariat Opinion 1/2013 on the exemption of the Trans Adriatic Pipeline interconnector, paragraph 65.

<sup>101</sup> Cf Methodology for Setting Natural Gas Transmission Use-of-System Charges (Official Gazette of the Republic of Serbia No. 93/2012).

<sup>102</sup> Schedule 1 - GASTRANS d.o.o. Novi Sad Feasibility Study of Construction of the Energy Infrastructure, June 2018, pg. 24: "cost of debt is 2.5% (information provided by the Company Management)".

<sup>103</sup> <https://www.ekapija.com/en/news/1872406/yield-on-15-year-government-bonds-remains-at-42> and <http://www.icbbg.rs/eng/berza/sno.php?ID=241>, also presented in the feasibility study submitted by Gastrans. The risk-free rate is based on the 15 years T bond issue of the Republic of Serbia of 06.09.2018 as retrieved on 14.01.2019.

<sup>104</sup> Where debt is assumed to be [BUSINESS SECRET] % in the capital structure and because the cost of equity ([BUSINESS SECRET] %) has been set at [BUSINESS SECRET] %.

<sup>105</sup> Schedule 1 - GASTRANS d.o.o. Novi Sad Feasibility Study of Construction of the Energy Infrastructure, June 2018, pg. 26.



138. A possible way to achieve such favorable financing conditions would be through significant corporate financing by the shareholders. Corporate financing may take the form of shareholder loans, special project bonds<sup>106</sup>, limited/non-recourse debt or completion support/shareholder guarantees. In all these cases, if the debt is owned/financing is provided by the ultimate shareholder, the risks are not attributable to the Project itself, but to the risk profile of the entire undertaking providing the corporate financing. Such a financing structure would indeed significantly decrease the investment and financial risks of the Project, and may enable achieving the envisaged cost of debt. Against this background, the Secretariat concludes that the alleged risk related to the limited number of shareholders in particular cannot substantiate the exemption, as the Project's ultimate majority shareholder is a diversified, integrated gas export company, namely *Gazprom*, with capital investments in progress in the value of approx. 15.7 billion EUR and financial investment in the value of approx. 38.5 billion EUR out of which approx. 2.1 billion EUR is long term loans provided to companies.<sup>107</sup> This means that the project is part of a diversified risk portfolio. Furthermore, the majority shareholder is in the position to provide favourable corporate and project financing to the shareholders of *Gastrans* or the project company directly via its financial affiliates, which further decreases the financial risk.
139. The Secretariat acknowledges that the exemption, and in particular certain aspects thereof, has a significant role for enabling the targeted low cost of debt, especially due to the necessary involvement of commercial/syndicate loans. Without the exemption on ownership unbundling, *Gazprom* could not be engaged as majority shareholder in the Project.
140. The Secretariat recalls its findings above that the Project, in its current design, will strengthen the shareholders in their monopolistic positions on the relevant markets. This lowers the risk of the investment and thus reduces the need for an exemption.<sup>108</sup> The exemptions from third-party access and regulated tariffs, as granted by AERS under the current conditions are not proportionate compared to the risks incurred.
141. Taking into consideration the results of the non-binding market test, it is also reasonable to assume that third-party bookings will materialize, which will increase the Net Present Value and the IRR, and decrease the payback period. In the absence of the sensitivity analysis in the feasibility study, the Secretariat cannot determine the magnitude of the improvement in the financial key performance indicators (KPIs) and thus reduction in financial risks, as a result of an extra unit of third party booking on any of the Entry or Exit points.

## Conclusion

142. Based on the above, the Secretariat acknowledges the need for long-term financial stability and predictability for financing a project involving high investment costs. In this respect, the Secretariat understands the project promoters' argument that this requires a certain share of the capacity exempted from the application of regulated prices and a certain amount of capacity reserved for use by the investors only.<sup>109</sup>
143. The Secretariat furthermore accepts the conclusion of AERS that the exemption from the obligation of ownership unbundling of *Gastrans* as the Project's transmission system operator is justified based on the investment risk attached to the Project in its current design. The exemption from ownership unbundling may be considered a proportionate measure to mitigate risks caused by the size of the project and the targeted costs of debt, which requires the shareholder's involvement in equity and debt financing.

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<sup>106</sup> In the special case when the parent company buys the bond.

<sup>107</sup> Gazprom PJSC Annual Report 2017 - Balance Sheet as at 31 December 2017.

<sup>108</sup> Commission Staff Working Document, paragraph 46.

<sup>109</sup> Cf Secretariat Opinion 1/2013 on the exemption of the Trans Adriatic Pipeline interconnector, paragraph 66.

144. On the other hand, the Secretariat considers the conclusions of AERS concerning the exemption from third-party access and the application of regulated prices under its current conditions of 88% of capacity exempted not proportionate in view of the risks incurred.
145. The low cost of debt targeted by the Project enables lower tariffs (everything else left unchanged). If these lower tariffs are not accessible through third party access to every shipper on all interconnection points, it further enhances the dominant position of the shareholders. For this reason, the exemption conditions of the Decision are not proportionate compared to the recognized risks.
146. In order to mitigate the risk of attracting finance, not all the currently exempted capacity on the Serbian and Hungarian Exit points and the Serbian Entry point would need to be exempted from third-party access and regulated prices, as the Project's financial viability, together with anticipated third party bookings, will not be jeopardized. The Secretariat recalls that an increase in the share of non-exempted capacities is also indispensable to make capacity accessible for potential new market entrants for the Serbian and regional gas markets.
147. The scenario used for the financial cost-benefit analysis can be considered as conservative for the investor, as no third party booking has been assumed. The Project has been evaluated as financially viable in this conservative scenario by the shareholders and AERS. However the Secretariat observes that any third party booking will further increase the financial viability of the project. Therefore, there is room for competition enhancement without jeopardizing the financial viability of the Project.

#### **4.4. 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 system that infrastructure will be built (Article 36(1)(c) Directive 2009/73/EC)**

148. Article 36(1)(c) of Directive 2009/73/EC requires for the major new gas infrastructure requested for exemption to *“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”*.
149. In this respect, the Decision confirms that the new pipeline will be constructed by *Gastrans*, which is not an operator of any other segment of the Serbian natural gas system. AERS further relies on the commitment of *Gastrans* to acquire ownership rights over the new pipeline once it is constructed, to manage and operate the pipeline, and to carry out the activity of the transmission of natural gas through the pipeline. The Decision is made subject to a condition that *Gastrans* becomes the owner of the new pipeline and manages it as a system operator in accordance with the Decision.
150. The Secretariat considers it sufficiently established that *Gastrans*, at least in terms of its legal form, is separate from the transmission system operators in charge of any other segment of the Serbian natural gas transmission system, namely *Srbijagas*<sup>110</sup> and *Yugorosgaz Transport*.<sup>111</sup> Moreover, the Secretariat has no reason to doubt the company's intention to acquire the ownership over the pipeline once it is constructed, and to be designated as a natural gas transmission system operator for carrying out the transmission of natural gas through the pipeline as confirmed by AERS.

#### **4.5. Charges must be levied on users of that infrastructure (Article 36(1)(d) Directive 2009/73/EC)**

151. Article 36(1)(d) of Directive 2009/73/EC requires that the charges for using the major new gas infrastructure requested for exemption *“must be levied on users of that infrastructure”*.

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<sup>110</sup> As explained above, *Srbijagas* continues to carry out the activities of the natural gas transmission system operator, covering 95% of the natural gas transmission network of the Republic of Serbia, pursuant to Article 421 of the Energy Law, which authorises such activity before certification of the newly designated transmission system operator.

<sup>111</sup> License No 0219/13-LG-TSU issued by AERS on 28.08.2013 for the period of 10 years.

152. According to the Decision, the tariffs for long-term contracted capacities on the Project will be imposed on all users of the exempted capacities. These tariffs will be calculated in line with the tariff methodology to be developed by *Gastrans* in accordance with the principles established by the Decision.
153. Having in mind that the Project's shareholders are vertically integrated undertakings active also in the supply of natural gas, it is of utmost importance that the transport charges are not excessive to deter third-party access (of non-shareholders)<sup>112</sup> and that there is no abuse of a dominant position of shareholders in the respective markets. Therefore the Secretariat deems it important that the tariff methodology determined by *Gastrans* is approved by AERS before entering into force and that AERS is empowered to regularly monitor whether *Gastrans* complies with the approved methodology i.e. whether the tariffs are calculated according to the approved methodology.<sup>113</sup>
154. Provided that the Decision is amended in the abovementioned manner, the Secretariat confirms that the criterion established by Article 36(1)(d) of Directive 2009/737/EC is fulfilled.

**4.6. The exemption must not be detrimental to competition or the effective functioning of the internal market in natural gas, or the efficient functioning of the regulated system to which the infrastructure is connected (Article 36(1)(e) Directive 2009/73/EC)**

**4.6.1. The exemption must not be detrimental to competition**

155. On the basis of its assessment under point 4.2.1 above, the Secretariat comes to the conclusion that the exemption is detrimental to competition.

**4.6.2. The exemption must not be detrimental to the effective functioning of the internal market**

156. The effective functioning of the internal market may be affected where an exemption impedes the overall optimization of the functioning of markets connected to the Project or creates barriers to free movement of gas, such as congestion.<sup>114</sup> The Decision excludes any such effects.
157. The Decision further assumes positive effects of the Project on the functioning of the internal market. From a technical point of view, AERS envisages that the Project's higher pressure level compared to the one of the existing gas transmission system of Serbia will avoid congestion. AERS also refers to the envisaged operation agreement between the Project and the Serbian transmission system.<sup>115</sup> Moreover, AERS assessment is based on the assumption that common technical interoperability standards will apply at interconnection points.<sup>116</sup>
158. There is no reason to assume that the Project will create barriers in terms of compatibility with technical and (inter-)operational standards with the gas systems of Serbia, Hungary and Bulgaria to which it aims to connect. Technical harmonisation is probably just a function of the project promoters' interest to physically reach the markets targeted by the Project.
159. However, Article 36(1)(e) of Directive 2009/73/EC refers to the effect of the exemption and not the technical parameters of the Project. In this respect, the Decision analyses only the positive impact of selected elements of the exemption, namely the availability of short-term capacities and the applicability of congestion management at the interconnection points to Serbia, Hungary and Bulgaria

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<sup>112</sup> Commission Staff Working Paper, paragraph 57.

<sup>113</sup> Also in the case of increase or decrease of tariffs according to the tariff methodology.

<sup>114</sup> Commission Staff Working Paper, paragraph 61.

<sup>115</sup> The Decision, page 56.

<sup>116</sup> I.e. the rules of Regulation 703/2015 establishing a network code on interoperability and data exchanges; the Regulation has been incorporated into the Energy Community *acquis communautaire* Decision 2018/02/PHLG-EnC of the Permanent High Level Group of 12.01.2018 with a deadline for implementation and transposition of 01.10. 2018.

which is supposed to avoid congestion.<sup>117</sup> Yet the impact of the exemption on the effective functioning of the internal market is not only a question of whether congestion can be minimized. The Decision does not elaborate on potential other negative impacts of an exemption to the creation of an integrated internal gas market and the free flow of gas across borders. In this respect, the Secretariat recalls that Article 2 of the Treaty establishing the Energy Community tasks the Parties to the Treaty to “*create a single regulatory space for trade in gas*” and “*to develop gas and electricity market competition on a broader scale*”.

160. In principle, a new interconnection between gas markets is able to develop positive effects on the development of competition, increase liquidity and facilitate the flow of gas between these markets, i.e. in the present case Hungary and Bulgaria.<sup>118</sup>
161. Under the exemption granted by the Decision, however, the potential of those effects to materialize is not likely. With a large part not being open to third parties, the strengthening of the dominant positions of the Project’s shareholders on the relevant capacity and commodity markets, the systematic elimination of incentives for enhancement of competition, the scope of the exemption rather undermines the effective functioning of the internal market and the free movement of gas and cross-border trade.<sup>119</sup>
162. The availability of short-term capacities and the application of congestion management procedures at the interconnection points between Serbia and Hungary, in itself, is not sufficiently able to lift these negative effects for Hungary.
163. With regards to Hungary, the Secretariat further notes the potential risk of the capacity market (and thus the commodity market) becoming further foreclosed. This concern is reflected in Decision 1858/2017 of MEKH. The exemption, in the manner and form granted by the Decision, is likely to have negative effects on the effective functioning of the Hungarian market. Additional conditions are necessary to ensure access to capacity by third parties.
164. Moreover, for the assessment of the impact of the exemption on the functioning of the internal market, also the likely effects on present or future infrastructure projects should be taken into account. This requires that repercussions that the exemption may have on other projects, whether regulated, exempted or submitted for exemption, need to be considered.<sup>120</sup> In particular, the exemption may have a detrimental effect on the economic viability of a similar infrastructure planned in parallel to the Project.<sup>121</sup>
165. In the view of the Secretariat it is relevant to analyse this aspect specifically with regard to the planned interconnector between Serbia and Bulgaria (IBS) as the most mature one affecting the markets of Serbia, Bulgaria and Hungary.<sup>122</sup> The interconnector will make available capacities for the transport of 1 to 1.8 bcm/a of gas from Bulgaria to Serbia and 0.15 bcm/a from Serbia to Bulgaria on the basis of unlimited third party access. According to the above, IBS is capable of positively affecting competition, increasing liquidity and facilitating the flow of gas between gas markets. As elaborated above, the Project and its exemption, on the other hand, entail market foreclosure and are detrimental

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<sup>117</sup> The Decision, page 56.

<sup>118</sup> Secretariat Opinion 1/2013 on the exemption of the Trans Adriatic Pipeline interconnector, paragraph 105; Commission Decision D(2008) 142 of 08.02.2008 on the exemption of the Nabucco interconnector, paragraph 55; Commission Decision on the exemption of the interconnector Greece-Bulgaria, C(2018)5058 of 25.07.2018. paragraph 151.

<sup>119</sup> Commission Decision of 9.12.2016 on the exemption for an electricity interconnector between Italy and France, paragraph 72.

<sup>120</sup> Commission Staff Working Paper, paragraphs 60 and 63.

<sup>121</sup> Cf. Commission Decision C(2011)3424 of 20.05.2011 on the exemption of the Gazelle interconnector, paragraph 63.

<sup>122</sup> The project forms part of the EU’s Projects of Common Interest and should allow for the transfer of between 1 and 1.8 billion cubic meters of natural gas annually from Bulgaria to Serbia and 0.15 billion cubic meters from Serbia to Bulgaria. On the Serbian side the project would connect to the existing Serbian gas transmission system. The European Commission contributes to the Serbian side of the project with a Pre-Accession grant of EUR 49.6 million. See: [https://ec.europa.eu/info/news/eu-investment-gas-interconnection-between-bulgaria-and-serbia-enhance-energy-security-region-2018-may-17\\_en](https://ec.europa.eu/info/news/eu-investment-gas-interconnection-between-bulgaria-and-serbia-enhance-energy-security-region-2018-may-17_en).

to competition. At the same time, its capacity is much larger than IBS'. Under these circumstances, there is a risk that IBS may not be realized on the account of the Project. Given this risk, the Project should allow at least a comparable level of freely accessible gas volumes for supply to the Serbian market and physical reverse flows to Bulgaria in the case of an emergency.

166. The Secretariat concludes that the exemption, as granted by the Decision, is detrimental to the effective functioning of the internal market, unless significantly modified.

#### **4.6.3. The exemption must not be detrimental to the effective functioning of the regulated system to which the infrastructure is connected**

167. This criterion requires an assessment of how the exemption influences the costs of operating the regulated system to which the Project will be connected. A negative impact on the effective functioning of the regulated system occurs if the Project, as exempted by AERS, would lead to substantially higher network tariffs in any of the connected regulated gas systems of Serbia, Bulgaria or Hungary. This could be the case if the realization of the Project require the expansion or reinforcement of the existing regulated infrastructure.<sup>123</sup>

168. The Decision concludes that the exemption will not have an impact on the tariffs of the regulated systems of Serbia, Hungary and Bulgaria and will thus not be detrimental to the effective functioning of the regulated systems. AERS argues that the high level of interest expressed in the non-binding phase of the Project's market test for long-term capacities at the entry point to Serbia from Bulgaria and further on at the interconnection point to Hungary suggests that the income to be gained from allocation of the new capacities in Bulgaria and Hungary for the benefit of *Gastrans* will out-weigh the related costs of system expansion in those countries.

169. In the view of the Secretariat, this assessment is reasonable for the case of Serbia. The Project will not increase the regulated asset base and thus the tariffs of the regulated gas transmission system in Serbia. Given that the Project will largely be exempted, the regulated system and Serbian customers are shielded from the risk to reimburse the costs of an underuse of the system via the regulated tariffs.<sup>124</sup>

170. The Secretariat also has no reason to challenge the assumption of a neutral impact of the exemption on the regulated system of Bulgaria.

171. However, the Secretariat has concerns as regards the impact of the Project, as exempted, on the regulated system of Hungary. Namely, the consultation documentation related to the TYNDP of the Hungarian gas transmission system operator *FGSZ*<sup>125</sup> suggests an impact of the Project on increasing the regulated transmission tariffs in Hungary. However, the precise dimension of such effect remains subject to the final decision on the technical approach for linking the Hungarian transmission system to the Project, which has still not been decided upon (as discussed at point 4.1.1 above).

172. Until *FGSZ* has taken a decision as to whether and how incremental capacity will be built, it is difficult to evaluate the impact of the Project on tariffs and the possible increase resulting from the Project's interconnection with Hungary. In this situation, the Secretariat cannot fully subscribe to the conclusions of the Decision with respect to the impact on the effective functioning of the regulated system to which the Project is connected.

<sup>123</sup> Cf. Commission Staff Working Paper, paragraph 62.

<sup>124</sup> Cf. Commission Staff Working Paper, paragraph 62; Secretariat Decision 1/2013 on the Trans Adriatic Pipeline interconnector; Commission Decision C(2011)3424 of 20.05.2011 on the exemption of the Gazelle interconnector, paragraph 66; Commission Decision D(2008) 142 of 08.02.2008 on the exemption of the Nabucco interconnector, paragraph 55.

<sup>125</sup> [https://fgsz.hu/file/documents/1/1158/tyndp\\_18122018\\_hu.pdf](https://fgsz.hu/file/documents/1/1158/tyndp_18122018_hu.pdf).

#### 4.7. Others (Article 36(6) Directive 2009/73/EC)

173. Article 36(6) of Directive 2009/73/EC also requires that the regulatory authority concerned decides upon the rules and mechanisms for management and allocation of capacity before an exemption is granted. The Secretariat deems that this requirement was fulfilled by AERS in its decision published on 12 February 2018.

### 5. The Secretariat's Opinion

174. It follows from the assessment of the criteria in Article 36(1) of Directive 2009/73/EC and their application to the Project by AERS, that the Decision fails to meet all the conditions required by that provision. The list of conditions in Article 36(1) of Directive 2009/73/EC is of a cumulative nature. If one condition is not fulfilled, the Project cannot be exempted. In this respect, the Secretariat recalls that in particular the detrimental impact of the Project, as exempted by the Decision, on competition in the relevant markets but also the level of risk is such that it does not justify an exemption under Article 36(1) of Directive 2009/73/EC.

175. The Secretariat finds it imperative that an exemption is not granted to the Project, unless the following safeguards and remedies are introduced in their entirety, and their implementation is ensured and monitored by AERS. AERS shall ensure that in the case of non-compliance with these safeguards and remedies the exemption shall lose its effect.

176. The Secretariat stresses that the required safeguards are applicable and shall be implemented in full regardless of any potential changes in the technical capacity by the Project.

177. Therefore, if AERS decides to uphold its decision to grant an exemption to the Project, the Secretariat requests that the following safeguards and remedies are included in AERS' final Decision.

*On the sales, bookings and allocation of capacities on the interconnection point Bulgaria-Serbia at Zaječar*

178. The exemption shall allow, for a period not exceeding 20 years from COD, *Gastrans* to sell and allocate a maximum of **70%** of the total technical annual capacity of the interconnection point on the Serbian/Bulgarian border to the companies *Gazprom Export* and *Srbijagas* ("exempted capacity"). In the case of over-booking of the exempted capacity, the bookings made by *Gazprom Export* and *Srbijagas* shall be reduced on a pro rata basis. In the case of under-booking of the exempted capacity, the remaining available capacity shall be considered as non-exempted long-term capacity and shall be sold and allocated according to the rules in the following paragraph.

179. A minimum of **20%** of *Gastrans*' total technical annual capacity of the interconnection point on the Serbian/Bulgarian border ("long-term non-exempted capacity") shall be sold and allocated to interested system users via auctions on an annual yearly basis organized on a capacity booking platform pursuant to Article 37 of the CAM Network Code. In order to facilitate a smooth implementation, the Secretariat suggests that the long-term non-exempted capacity products are offered on the same platform used in the neighbouring EU Member States i.e. Bulgaria and Hungary. The auctions for the long-term non-exempted capacity shall be performed in two phases: Phase 1 of the auction shall be open to all interested system users excluding the shareholders of *Gastrans* and any affiliates. The capacity offered in Phase 1 of the auction shall comprise of yearly products with a duration of not more than 20 years. The reserve price in Phase 1 of the auction shall be equal to the tariff applicable to the shareholders of *Gastrans* for using the exempted capacity. Phase 2 of the auction shall be open to all interested system users. The capacity offered shall comprise of yearly

products for no longer than the upcoming 3 years. The reserve price in Phase 2 of the auction shall be equal to the tariff applicable to the shareholders of *Gastrans* for using the exempted capacity.

180. A minimum of **10%** of *Gastrans*' total technical annual capacity of the interconnection point on the Serbian/Bulgarian border ("short-term non-exempted capacity") shall be sold and allocated via auctions organized on a capacity booking platform pursuant to Article 37 of the CAM Network Code. In order to facilitate a smooth implementation, the Secretariat suggests that the short-term non-exempted capacity products are offered on the same platform used in the neighbouring EU Member States i.e. in Bulgaria and Hungary. The auction shall be open to all interested system users. The capacity offered shall comprise of quarterly, monthly, daily and within-day products. The reserve price for all short-term products at the auction shall be calculated pursuant to Chapter III of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas ("TAR Network Code").

*On the sales, bookings and allocation of capacities on the Gastrans interconnection point Serbia-Hungary*

181. The exemption shall allow, for a period not exceeding 20 years from COD, *Gastrans* to sell and allocate a maximum of **75%** of the total technical annual capacity of the interconnection point on the Serbian/Hungarian border to *Gazprom Export* and *Srbijagas* ("exempted capacity"). In the case of over-booking of the exempted capacity, the bookings made by *Gazprom Export* and *Srbijagas* shall be reduced on a pro rata basis. In the case of under-booking of the exempted capacity, the remaining available capacity shall be considered as non-exempted long-term capacity and shall be sold and allocated according to the rules in the following paragraph.

182. A minimum of **15%** of *Gastrans*' total technical annual capacity of the interconnection point on the Serbian/Hungarian border ("long-term non-exempted capacity") shall be sold and allocated to interested system users via auctions on an annual yearly basis organized on a capacity booking platform pursuant to Article 37 of the CAM Network Code. In order to facilitate a smooth implementation, the Secretariat suggests that the long-term non-exempted capacity are offered on the same platform used in the neighbouring EU Member States i.e. Bulgaria and Hungary. The auctions for the long-term non-exempted capacity shall be performed in two phases: Phase 1 of the auction shall be open to all interested system users excluding the shareholders of *Gastrans* and any affiliates. The capacity offered in Phase 1 of the auction shall comprise of yearly products with a duration of not more than 20 years. The reserve price in Phase 1 of the auction shall be equal to the tariff applicable to the shareholders of *Gastrans* for using the exempted capacity. Phase 2 of the auction shall be open to all interested system users. The capacity offered shall comprise of yearly products for no longer than the upcoming 3 years. The reserve price in Phase 2 of the auction shall be equal to the tariff applicable to the shareholders of *Gastrans* for using the exempted capacity.

183. A minimum of **10%** of *Gastrans*' total technical annual capacity of the interconnection point on the Serbian/Hungarian border ("short-term non-exempted capacity") shall be sold and allocated via auctions organized on a capacity booking platform pursuant to Article 37 of the CAM Network Code. In order to facilitate a smooth implementation, the Secretariat suggests that the short-term non-exempted capacity are offered on the same platform used in the neighbouring EU Member States i.e. in Bulgaria and Hungary. The auction shall be open to all interested system users. The capacity offered shall comprise of quarterly, monthly, daily and within-day products. The reserve price for all short-term products at the auction shall be calculated pursuant to Chapter III of the TAR Network Code.

*On the sales, bookings and allocation of capacities on the exit points into the domestic gas transmission system of Serbia at Paraćin, Pančevo and Gospođinci*

184. The exemption shall allow, for a period not exceeding 20 years from COD, *Gastrans* to sell and allocate a maximum of **55%** of the total aggregated technical annual capacity of the three exit points to the system operated by *Srbijagas* to *Gazprom Export* and *Srbijagas* (“exempted capacity”). In the case of over-booking of the exempted capacity, the bookings made by *Gazprom Export* and *Srbijagas* shall be reduced on a pro rata basis. In the case of under-booking of the exempted capacity, the remaining available capacity shall be considered as non-exempted long-term capacity and shall be sold and allocated according to the rules in the following paragraph.
185. A minimum of **35%** of *Gastrans*’ total aggregated technical annual capacity of the three exit points to the system operated by *Srbijagas* (“long-term non-exempted capacity”) shall be sold and allocated to interested system users via auctions on an annual yearly basis organized on a capacity booking platform pursuant to Article 37(1) of the CAM Network Code. In order to facilitate a smooth implementation, the Secretariat suggests that the long-term non-exempted capacity are offered on the same platform used in the neighbouring EU Member States i.e. Bulgaria and Hungary. The auctions for the long-term non-exempted capacity shall be performed in two phases: Phase 1 of the auction shall be open to all interested system users excluding the shareholders of *Gastrans* and any affiliates. The capacity offered in Phase 1 of the auction shall comprise of yearly products with a duration of not more than 20 years. The reserve price in Phase 1 of the auction shall be equal to the tariff applicable to the shareholders of *Gastrans* for using the exempted capacity. Phase 2 of the auction shall be open to all interested system users. The capacity offered shall comprise of yearly products for no longer than the upcoming 3 years. The reserve price in Phase 2 of the auction shall be equal to the tariff applicable to the shareholders of *Gastrans* for using the exempted capacity.
186. A minimum of **10%** of *Gastrans*’ total aggregated technical annual capacity of the three exit points to the system operated by *Srbijagas* (“short-term non-exempted capacity”) shall be sold and allocated via auctions organized on a capacity booking platform pursuant to Article 37 of the CAM Network Code. In order to facilitate a smooth implementation, the Secretariat suggests that the short-term non-exempted capacity are offered on the same platform used in the neighbouring EU Member States i.e. in Bulgaria and Hungary. The auction shall be open to all interested system users. The capacity offered shall comprise of quarterly, monthly, daily and within-day products. The capacity offered shall comprise of quarterly, monthly, daily and within-day products. The reserve price for all short-term products at the auction shall be calculated pursuant to Chapter III of the TAR Network Code.

#### *Liquidity measure for the gas market in Serbia*

187. As from COD, the shareholders of *Gastrans* and their affiliates shall be obliged to offer each quarter a volume equivalent to 30% of the volume of their total natural gas sales in the corresponding quarter of the previous year in Serbia – regardless of the point of entry into the Serbian domestic transmission system – on an independent organized market place e.g. SEEPEX. The delivery point of the offered gas shall be the Virtual Trading Point (VTP) in Serbia. The offer price shall not be higher than the price defined in the long-term contract of the entity. In the absence of demand from third parties, the offered volumes shall remain in the ownership of the undertaking which offered it.
188. At the end of each quarter the shareholders of *Gastrans* shall submit a report to AERS about the volumes of natural gas sold by them and their affiliates in Serbia and the volumes of gas they offered on the organized market place.
189. AERS shall monitor the compliance of the shareholders’ obligation under the previous two paragraphs, and shall ensure that all interested parties have free and non-discriminatory access to the services and to the gas offered on the organized market place. AERS shall publish annual reports on the liquidity of the gas market in Serbia.



190. In case third parties not related to either shareholders of *Gastrans* and their affiliates reach a combined share in the volume of total annual natural gas sales in Serbia of 20% or more, the application of the Liquidity Measure may be suspended in the following year.
191. Not later than five years as from COD, AERS and the Secretariat shall review whether the liquidity measure has contributed to the enhancement of competition on the natural gas market in Serbia and, as the case may be, propose changes respecting the general scope of the exemption.

*Other measures related to the enhancement of competition and avoiding conflicts of interest*

192. Before COD, *Gastrans'* shareholder *Srbijagas* shall ensure that its subsidiary *Transportgas Srbija* is unbundled, and unconditionally certified by AERS, taking into account the Opinion of the Secretariat, as the transmission system operator of the gas transmission system currently operated by *Srbijagas*.
193. The tariff methodology determined by *Gastrans* shall be approved by AERS before entering into force. AERS shall regularly monitor whether *Gastrans* complies with the approved methodology i.e. whether the tariffs are calculated according to the approved methodology.

*For the enhancement of security of supply of natural gas in Serbia*

194. *Gastrans* shall ensure that physical reverse flows for emergency operations are enabled from Serbia to Bulgaria.

*Additional safeguards for the effective functioning of the internal market in natural gas and the efficient functioning of the regulated system to which the infrastructure is connected*

195. To the extent not conflicting the exemption, the Energy Community *acquis communautaire* shall apply in its entirety to the non-exempted part of the Project as from the date of expiry of the respective transposition deadlines.
196. AERS shall ensure that the capacities on interconnection points are offered as bundled products in line with Articles 19-21 of the CAM Network Code.
197. AERS shall ensure that congestion management rules (Use-It-Or-Lose-It or Use-It-Or-Sell-It) shall be fully applied on both the exempted and non-exempted capacities of *Gastrans*.— AERS shall ensure that *Gastrans* offers non-nominated day-ahead capacities firm (UIOLI) and provides the relevant rules immediately for the approval of AERS.
198. AERS shall ensure that interruptible capacity (i.e. backhaul) is made available on the *Gastrans* pipeline in the direction from Hungary to Serbia and from Serbia to Bulgaria at a close-to-zero tariff from the start of commercial operations. AERS shall ensure that all relevant elements of the Energy Community *acquis* enabling counter nominations and the provision of interruptible capacities in the reverse direction on the pipeline for all shippers are applied by *Gastrans*. AERS shall closely work with the national regulatory authorities of Bulgaria and Hungary to ensure that the relevant interruptible capacity matching the offer on the *Gastrans* pipeline can be booked and nominated in their jurisdictions and regulatory systems as well.
199. *Gastrans* shall identify the demand for incremental capacity in both forward and reverse directions on the pipeline through regular binding market tests which will be performed every second year, and consequently build incremental capacity, unless it shows that expansion is not economically viable. The newly built incremental capacity shall be offered and allocated via auctions of long-term and short-term capacity products on a capacity booking platform pursuant to Article 37 of the CAM Network Code. The auctions shall be open for all interested parties.

200. *Gastrans* shall ensure and AERS shall monitor that *Gastrans* operates independently from its shareholders. *Gastrans* shall preserve the confidentiality of commercially sensitive information and shall guarantee that no information related *inter alia* to the booking, nomination and allocation of capacities is disclosed in a discriminatory manner to the advantage of its shareholders and affiliates.

Vienna, 1 February 2019

A handwritten signature in blue ink, appearing to read "Janez Kopač".

Janez Kopač

Director

A handwritten signature in blue ink, appearing to read "Dirk Buschle".

Dirk Buschle

Deputy Director/Legal Counsel