

OMV Gas Position to the Consultation Paper REM SSE

Introductory remarks

OMV Gas welcomes the opportunity to comment on the proposed Discussion Paper for an Action Plan for the South-South Eastern European Natural Gas Market.

We find the Regional Gas Initiative which aims at achieving the Internal Market in Natural Gas by the step by step method quite reasonable, pragmatic and practical. We consider that the harmonisation of regulation in the four regional energy markets and thus striving for simplified procedures for gas flows in these regions is a further important step on the way to reaching the final goal. However, in order not to miss the target, a proper assessment of the status quo is necessary on the basis of which the appropriate areas for action can be prioritised.

The consultation paper describes the initial position for RGI in Europe in general and further more in the individual countries of the region in detail in a rather critical way, sometimes without taking into consideration a correct reflection of the given situation, in particular the supply characteristics and / or the historical background.

When comparing national markets in the SSE region we can see that they are in varying phases of the transposition of the Directive II and other European regulations. A lot has been done in implementing the appropriate measures in Austria and we believe that this will be proven when the intended monitoring in the region has been carried out.

We consider that the preliminary assessment concerning Austria does not reflect the latest development, mainly related to the implementation of the Energie-Versorgungssicherheitsgesetz 2006 (Energy Security of Supply Act).

It is correct, as stated on page 12 of the Consultation Paper, that in Austria up to now there has been a negotiated TPA to transit pipelines, but the replacement by a regulated one is already under way. A customer requesting transit capacity in the Austrian transit network will then have 2 possibilities for contracting this capacity:

the customer can request the needed capacity directly from the relevant TSO or holder of capacity rights (“Inhaber der Transportrechte”) or
the customer can use a special “one-stop shop” service provided by OMV Gas, if more than one network is concerned

When using the second possibility OMV Gas will provide all relevant information for the customer needed to contract transportation capacity via the requested routes. Therefore the customer has to enter into a service agreement with OMV Gas regulating all rights and obligations of the parties related to this special service. As far as the transportation contracts are concerned, each shipper has to enter into transportation contracts with the relevant TSO or holder of capacity rights even in the case of using the special “one stop shop” service offered by OMV Gas. We believe that this will again add to transparency and help shippers in booking capacity.

When using “Online Capacity Booking”, an online application of OMV Gas, or by screening the websites of other “holder of capacity rights,” all information concerning primary capacity data is available to all market participants in a user friendly and standardised manner. Furthermore, OMV Gas and other “holders of capacity rights” are promoting the secondary market in Austria by offering transportation capacity on an interruptible basis and by means of bulletin boards in order to enable a new supplier to enter the market.

What we must seriously challenge in the consultation paper is the first sentence in the first paragraph on Austria which may lead to misunderstandings. As is well known by E-Control, for the domestic market the customer itself holds the capacity, also the interconnector capacity. There is no need for an alternative supplier to gain additional access for existing customers. This statement should be clarified

Similar to the transit issues, we consider that the description of the position of storage and its impact on competition does not reflect the real situation in Austria either.

OMV Gas follows the rules as laid down by the Austrian Gas Act § 39 and takes every effort to facilitate the access to its storage system. In order to guarantee non-discrimination all concluded storage contracts have to be presented to the national regulation authority. Access to storage services is available to anybody on a negotiated basis. The percentage of storage cost of total current energy cost given is misleading and erroneous, even if you only compare the wholesale energy price with storage cost not including transportation cost and taxes within Austria. Not to mention that storage prices have remained relatively constant over the last years in stark contrast to the energy price increase.

When considering the Gas Regional Initiative in general and the REM SSE specially we should keep in mind that such an initiative can only be successful if it is taken within the whole European context and the active cooperation of the relevant players. The significant position of the largest natural gas supplier to this REM and the importance of transit flow through this region to the European Union require a certain form of involvement of Russian and Ukrainian gas companies in this initiative as well. Their representatives should be invited on an ad hoc basis to those meetings where issues directly related to these companies will be dealt with.

We appreciate that transmission system operators, storage system operators and hub operators can play an active role in GRI. ERGEG will report about the progress achieved in GRI to the Madrid Forum. We believe that for creating a more balanced structure of GRI a direct representation of these stakeholders in the Madrid Forum should be considered, in addition to the participation of GIE in the Madrid Forum. This could be achieved e.g. in the form of participation of a speaker for each REM in the Madrid Forum which we consider a very important platform for an accelerated creation of the single European market.

For some of the TSOs, confidentiality is an issue and might impact on the level of detail in which practical issues can be discussed. Therefore it should be observed at all times, and implementation group meetings should be restricted to implementation group members, which has not been the case in the July meeting. As stakeholders have other venues to state their position, this should not be an issue.

Notes on the Discussion points

Discussion point 1. Do you agree on such priorities? Are there any other issues to be included?

We consider that all four listed areas:

1. Monitoring
2. Practical case studies
3. Transparency requirements and
4. Interoperability issues

are important for helping the REM SSE to move more efficiently towards the development of a single natural gas market, although we feel that monitoring and the implementation of transparency requirements are activities that have to be done by the national authorities and are the subject of yearly benchmarks anyway. It is hard to see the potential to influence these issues from outside.

In addition, we believe that to ensure the success of the Regional Gas Initiative in our region it will be necessary to extend this list somewhat.

We suggest including the following priority areas:

5. Facilitating efficient investment into gas infrastructure

This can happen mainly by creating a conducive investment climate through investor friendly legislation that will make investments possible and economically feasible (it is obvious that the permanent pressure on the rate of return level has a counterproductive effect). In this context we strongly believe that the creation and maintenance of a stable and predictable regulatory framework that can be trusted by investors is of utmost importance. Our opinion has been confirmed by an internal survey of the current EU investment environment carried out recently by GIE which came to the conclusion that the regulatory regime is a significant impediment to investment and is discussed in detail in the GIE's response to the Commission's Green paper Work therefore has to be done not only with regard to TSOs' best practice, but also with regard to regulators' best practice.

A special challenge concerning non domestic infrastructure investment is the harmonization of the legal and regulatory framework in the region as a whole, not only in the EU countries forming part of the region. We believe that e.g. one stop shop for approval procedures in connection with pipeline construction and also with Art. 22 exemptions can be the logical first step in this direction and will substantially facilitate investment in new transit infrastructure.

6. Producing a vision/scenario how the SSE region will develop over the next 10 – 15 years

The GRI has being considered predominantly in the perspective of the next few years so far. We believe that GRI should be understood in a long term dimension as well, with

respect to the necessity of creating and maintaining a balance between short-term perspective and long-term impacts and also helping to understand and interpret bottlenecks and potential extension plans.

Therefore, a scenario should be produced within the frame of GRI as to how the demand-supply situation will develop in the mid- and long-term period in the SEE region. Based on it and on the envisaged import needs of the relevant countries supplied with adjacent pipelines a vision of the possible development of the pipeline system in the region should be created.

This will contribute to overcome the uncertainty and the lack of information caused by unbundling when infrastructure operators do not have direct and long-term market signals (commitments – shippers + regulators) needed for the strategic planning of new or additional transportation capacity.

7. Implementation of interconnection agreements and OBAs

In accordance with the priority number 4 we propose an early implementation of these agreements not only between the countries in the region but also with the countries with adjacent transit systems. More to this proposal please find in our comments on the Discussion Point 6.

8. Enhancing security of gas supply via diversification of source and routes (and storage facilities)

Based on the characteristics of REM SSE, diversification of sources and routes is a significant factor which can enhance supply security in this region. The temporary cut in supplies at the beginning of this year might be an impulse for more endeavours for such a diversification.

For the REM SSE and other countries in Western Europe the Nabucco project will enhance the security of supply significantly. Therefore it is desirable that the implementation of this project is fully supported in the frame of GRI in the SSE region.

One additional aspect of enhancing the supply security is that a certain redundancy in capacity should be accepted as essential and necessary for the short-term resilience needed in the transportation system. Even more, we consider that transmission system operators should be incentivised to build a certain excess capacity which will enhance the flexibility of the system and facilitate market liberalisation as well. The cost of these improvements will be compensated for by cheaper because more diversified energy supplies.

We suggest that the proposed priority areas 5 and 6 should be incorporated in the Action Plan for the region as well.

<p>Discussion point 2. Stakeholders are invited to comment on the implementation of the Regulation and to suggest in which areas and countries action may be necessary.</p>
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Apart from the fact that any regulation under European law does not require any implementation by way of national legislation (and at the same time itself should be sufficiently determined), OMV Gas as concerned TSO cannot comment on Regulation 1775/2005 in any other way than to state that it is in force since 1 July 2006 and that it complies with it.

Also, as a TSO (active exclusively in Austria) OMV Gas naturally sees no need to comment on the status of implementation of Regulation 1775/2005 – in Austria or any other country. The same is true of “other areas” in which action may be necessary. It will be the logical impulse of other stakeholders in the GRI, e.g. shippers to demand corrections and improvements where they see shortcomings in the implementation.

Discussion point 3. Stakeholders are invited to signal in which areas and countries the implementation of the 2nd Directive is inadequate.

OMV Gas thinks that the 2nd Directive has been sufficiently implemented in Austria, at the least since entry into force of the most recent amendment to the Austrian Gas Act (Energie-Versorgungssicherheitsgesetz 2006).

It seems fair to say that based on the tables and figures in the ERGEG presentation July 13, 2006 on the SSE market, Austria looks fairly advanced in comparison.

In particular, we do not see any need for more detailed unbundling rules. There are no further steps foreseen in this direction by the European legislation.

Discussion point 4. Stakeholders are invited to signal difficulties they may have encountered in the use of transportation routes in the SSE region, by considering the above check list.

We agree that measures have to be taken to promote hub trade in the SSE region. As far as liquidity of hubs is concerned it cannot be denied that a sufficient and well utilised infrastructure is an important building block towards this goal. However, we believe that there are some more important issues to deal with in order to raise liquidity on hubs such as upstream infrastructure on the one hand and diversification of supply sources on the other. In addition we would like to point out that not all of the five transit routes proposed for the case study are relevant for the liquidity in the SSE region. The routes suggested are more relevant for liquidity in Germany. If liquidity in the SEE region were relevant, existing and additional routes leading into this region would have to be focus of the investigation.

Nevertheless, with regard to TSOs` obligations in this context it seems to be a reasonable and practical approach to implement as a first step an investigation of different supply (transit) routes (from supply source via hubs to consumer markets), with respect to their potential for increasing liquidity on trading hubs.

In order to be able to reach a viable result within a reasonable time, on the one hand, and a maximum rate of usability of the issued questionnaires on the other hand, the TSO questions asked should be reduced to a manageable number. Therefore we recommend removing such questions which have no direct connection to the issue to be investigated. For example, it is not obvious what information could be gained concerning the liquidity of hubs by means of asking such questions as “Can the rate of returns of the pipelines concerned be defined or estimated?” or “Are they derived from negotiated or regulated settings? From our experience, most of the questions asked are completely irrelevant to hub traders. If there is no gas available, the easiest and simplest transportation contract will not help.

On the other hand, and which for us is the most striking point here, all trading issues in connection with hubs are – with one exception: regulated end user prices – completely left out of the picture, e.g. are there licensing requirements for traders? How many traders are active in the country? Are there Gas release programmes in place? If yes, is transportation capacity auctions as well? What are the supply sources? Are export licences required to export out of the region and from surrounding countries? How long does it actually take to issue licences? etc. We therefore suggest to replace the questions from “Which tariff methodology...” to “Can the rate...” with more relevant ones.

Discussion point 5.

Stakeholders are invited to signal availability of such services (*storage and hub*) and to suggest steps that may facilitate their introduction, by considering the above check list.

All storage services offered by OMV Gas such as Injection Rate, Withdrawal Rate and Working Gas Volume are available as separate services and are even offered on a daily basis. These so called “unbundled services” have become an important part of the product portfolio. Our gas storage services are offered without transportation from/to the storage location. For injection and withdrawal, customers need transportation through the national pipeline system between the transit system and the OMV Gas storage pool.

In the Austrian gas market two companies provide storage services: OMV Gas and RAG (Rohöl Aufsuchungs Aktiengesellschaft). For the Austrian market additional storage services are also available from the Slovak storage system operator “Pozagas” in a storage facility which is located close to the Austrian border.

Recently, OMV Gas has started to offer interruptible storage services in order to increase flexibility.

Additional flexibility services are offered by the Central European Gas Hub (CEGH) which was established in October 2005. CEGH offers services such as “Wheeling”, “No notice storage nomination” and “Title Transfer”.

On a more general note, we would like to mention that the absence of hub services should not be taken as an indicator of market failure or a sign of unwillingness by TSOs or storage operators. It might well be the case that due to market structure services are not asked for and offering them just would increase cost of basic service.

Discussion point 6. Are interoperability issues in the SSE region hindering competition in the SSE region?

As there is mostly Russian gas available in the region we cannot see big quality issues emerging. We cannot see enforcement of OBAs as an option for Austria, only a voluntary implementation, as the market based balancing model for the Austrian domestic market would possibly force the Austrian TSOs to purchase gas at prices they cannot influence. Also, the line to draw between steering difference and interruption of supply will be a very fine one that has to be tested by the adjacent TSOs.

In this context the meaning of the used term ‘competition friendly’ should be explained as it sits very uncomfortably with TSOs’ obligations not to discriminate.

OMV Gas intends to conclude Interconnection Agreements with operating and balancing regimes (IA) at all interconnection points with the neighbouring TSOs. At the interconnection points Überackern Penta West/ABG –Mozonmagyarovar HAG/MOL Interconnection Agreements are already in force and the agreements on the remaining points are under discussion. The common goal of the TSOs is to start up with such set of IA on 1 October or by the end of this year at latest.

Discussion point 7. Do you agree with this proposal (*capacity reservation one-stop-shop*)? Is any other solution to the congestion management preferable?

OMV Gas considers capacity reservation as an act of capacity selling. We think that guidelines should always assist in creating common provisions within one market. Therefore they should not be applied only to specific routes but to all routes in one region. Also with respect to supply security, the guidelines should address themselves to new or available transportation capacity only, splitting up existing long-term supply contracts from long-term transportation services, seems not to be a realistic option in this context

The role of TSOs is to make sufficient capacity available and to provide transparent and non-discriminatory access to this capacity, thereby facilitating competition and contributing to security of supply. To supply the market with sufficient gas in order to create a competitive and liquid market is a role that involves other market participants like commodity and upstream players. For the investment needed to ensure the availability of sufficient transportation capacity, long-term transportation contracts will remain crucial, so we see the proposed guidelines rather relevant for short- term flows and in connection with new capacity.

The one-stop-shop principle is currently under adoption in Austria involving different national TSOs. The one-stop-shop principle crossing national borders involves international TSOs as well. It seems reasonable to foresee a one-stop-shop provider acting as an agent for cross-border shippers. For rendering this service the one-stop-shop provider will charge a service fee to the shipper. In the consultation paper ERGEG does not say that such a service should be performed on a regulated basis, and we appreciate that. We think it is reasonable to prepare the ground for proposed one-stop shop with the authorities’ assistance, but the performance of the service should be left to market initiative.

As the interruptible services and capacity release concerns, we interpret “commercial congestion” as “contractual congestion.” We do not consider the “capacity release” as mandatory because a mandatory capacity release is interference in private law and in some countries’ legal framework may be unconstitutional. We understand the term as application of UIOLI. Therefore the issue will be regulated by the market e.g. via secondary capacity trading which is a sort of voluntary capacity release. This development is progressing well and, from our perspective, we see no need for additional regulatory intervention.

TSOs shall provide appropriate economic signals for the efficient and maximum use of the technical capacity. The provisions for interruptible services to be offered by TSOs will contribute to this goal.

We are of the opinion that transportation contracts signed with non-standard commencement dates or with a shorter duration than a standard annual transportation contract shall not result in arbitrarily higher or lower tariffs, but should reflect the market value of the service. If technically and economically feasible, capacity should be offered to the shippers as requested by them. Offering lots of capacity might in some cases be the second best solution.

<p>Discussion point 8. Do you agree with this proposal (<i>inter-TSO compensation scheme</i>)? Is any other solution to the tariff problem preferable?</p>

We agree that any possible inadequateness which might impede investment into gas infrastructure should be eliminated as far as possible. We believe that the legal framework currently in force is sufficient to achieve this goal. ERGEG should give examples of such inadequacies, because as a general rule the relationship between the shipper paying for transit services and the TSOs providing the service in return is a fairly straightforward one. In regulated entry – exit systems such as the Austrian one with its intransparent allocation system down to distribution networks and its complicated planning system this direct relation between shipper and TSO is unfortunately missing. To transpose these shortcomings also to the transit level seems not to be an attractive option.

We therefore think that a regional transportation tariff might not be an appropriate measure to eliminate such obstacles to the undertaking of investment; especially with regard to the fact that the specific situation, i.e. the relation transit to domestic consumption varies significantly from country to country. Therefore it is not possible to have a “one size fits all” approach. Furthermore, in cases where taking into account the specific conditions in a country where the cross-subsidization by applying entry-exit tariff systems is clearly identifiable and produces unacceptable distortions, the application of specific tariffs for transit is certainly more appropriate.

To ensure and attract investments into gas infrastructure an appropriate regime should be applied to secure that existing investments are protected and new investments are stimulated. Due to the size of the investments involved, the use of long-term contracts to secure the investments will remain an essential element of existing and future pipeline projects. Any attempt however well-intended to change this regime to short-term allocations and yearly fixing of prices will almost certainly have negative consequences for investment.

An inter-TSO compensation regime does not seem to be appropriate to be applied to different gas transportation infrastructures because of the physical transportation actually taking place in such systems (as opposed to systems in the electricity sector). The possible inadequateness

of the allocation of costs and risks would not be lowered by a regional inter-TSO compensation regime, but might be even worsened by the application of tariff structures which are not suitable to the specific conditions. Furthermore, as already stated above, would it relieve shippers of the need to commit themselves to certain routes and leave the obligation for the investment with the TSO and the general public. In the extreme, shippers could request a certain investment in a given year for transportation to a neighbouring country, and in the next year – as alternative supply routes open up – simply walk away. We do not think this can be in the public interest and we strongly believe that the clear relationship between shipper and TSO is advantageous compared to any inter-TSO compensation scheme which we strongly reject.

Discussion point 9. Do you agree with this proposal (*guidelines for new infrastructure*)? Is any other solution to the investment problem preferable?

As already mentioned in our comment on Discussion point 8, to ensure and attract investments into gas infrastructure an appropriate regime should be applied to secure that existing investments are protected and new investments are stimulated. We are of the opinion that granting an exemption pursuant to Art 22 of the Gas Directive might be a suitable instrument to enable and enhance such a process. Furthermore, due to the size of the investments involved, the use of long-term contracts to secure the investments will remain an essential element of existing and future infrastructure projects.

With regard to the exemption, we agree that having a co-ordination of regulatory decisions is useful for a timely and appropriate granting of an exemption. We are of the opinion that the composition of such regulatory co-operation shall be undertaken on a case by case basis, depending on the respective project/investment into gas infrastructure. Furthermore we believe that only the respective regulatory authorities who are involved in the exemption process (because the respective infrastructure investments are planned in their state territories), should participate in such regulatory co-ordination from the regulators' side. We consider that the number of parties which are involved in the granting of the exemption for the new infrastructure should be kept as small as necessary because a timely, appropriate and efficient granting of the exemption is an essential prerequisite for the investment decision and realization of investment projects.

We believe that one project needs to obtain the same level of exemption in different countries. The absolute basic requisite of the financial feasibility and financing through financial institutions for the large scale investments is having one single exemption in order to mitigate the risks (e.g. regulatory risk) for the investments.

Discussion point 10. Do you agree with this proposal (*guidelines for balancing*)? Is any other solution to the balancing preferable?

Generally, we are not sure here whether ERGEG's suggestion relates also to domestic markets or only to gas in transit.

From our point of view it is desirable to define the Common Guidelines for balancing, with broad involvement of the market participants to enable harmonised conditions and enhance

competition. Due to the fact that balancing is strongly determined and dependent on local and regional circumstances (e.g., storage facilities) the goal “identical terms throughout SSE-Europe” seems very theoretical. Nevertheless, if one system for all relevant countries were to be developed, it would be necessary to make a lot of compromises with the result that no country has its ideal system. Furthermore, competition in all these countries has evolved differently in the past few years.

For these reasons we suggest that the guidelines should concentrate on principles only, such as

Balancing responsibilities

Balancing period

Market based mechanisms

Balancing costs

Information and Transparency

Trading of imbalance positions

Commercial incentives for suppliers of balancing energy and for shippers.

Detailed rules for the operation of the daily business should be based on these principles but – as abovementioned – only each individual country dependent on its special situation can define them. In addition, non-discrimination and transparency should be considered.

An example, which includes all the aforesaid principles and which works well in practice for the domestic market, but might not work for transit, is the balancing regime for the Austrian domestic market. We therefore prefer detailed balancing rules on a country-by-country basis.

Discussion point 11. Do you agree with this proposal (*guidelines on transparency*)? Is any other solution to the transparency issue preferable?

While OMV Gas thinks that it conducts its business in a sufficiently transparent way and that users of its systems are provided with all the necessary information, it acknowledges that there may be deficiencies in this respect in other countries. Harmonization – be it by way of regulators’ guidelines to be introduced or by a code of conduct to be adopted by the industry – of the rules applicable in this respect should certainly be useful for network users although these rules shall not extend TSOs’ obligations under the Directive and the Regulation They should, in any case, not place any additional, excessive burden on the TSOs. Already now, under Austrian law, TSOs have to provide the regulator with a bulk of data the compilation of which is difficult and the use of which is not always evident.

Discussion point 12. Is any special intergovernmental agreement between SSE countries, ensuing enhanced cooperation on a regional basis feasible and useful? Which issues should it cover?

We consider that existing European legislation, regulations and other policy measures when applied effectively are fully sufficient for a consistent gas market regulation in the SSE region. Recently, the ECSEE- Treaty has been ratified which concerns the most countries of the REM SSE and for the moment we believe that no further special intergovernmental arrangements are needed.