



**CROATIAN ENERGY
REGULATORY AGENCY**
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SUBJECT: Coordinated decision on the allocation of investment costs regarding the Investment request for the gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I

Dear Sirs,

Based on the Investment request for the gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I submitted on 14 October 2016, pursuant to Article 12(3) of Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No. 714/2009 and (EC) No 715/2009 (hereinafter: Regulation (EU) No 347/2013), and taking into account ACER Recommendation No 5/2015, we are informing you on the outcomes of the consultations between national regulatory authorities concerned and on the coordinated decision on the allocation of investment costs, as follows.

The gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I (furthermore: gas pipeline), which relates to the project of common interest 6.5.2. Gas pipeline Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica, is one of the strategic energy projects of the Republic of Croatia and for the European Union. This project, consisting of three connected pipeline sections from Omišalj-Zlobin, Zlobin-Kozarac and Kozarac-Slobodnica, is the main evacuation pipeline for the gas from LNG Terminal on the island of Krk and for the gas imported by the future Ionian-Adriatic pipeline. With its geographical route and planned capacity, this gas pipeline is intended for the supply of natural gas to Croatia, Hungary and other countries of Central-East and South-Eastern Europe. Given that these countries are highly dependent on natural gas supply from Russia, a new gas supply route from the LNG Terminal on the island

of Krk in Croatia through this gas pipeline will represent one of the key alternatives of gas supply.

As stated in the project-specific cost benefit analysis, being part of the Investment request, both the financial and the economic profitability of the project were determined, based on the identified costs and benefits. The financial profitability of the project is of utmost importance for the project promoter whilst the economic profitability is important for the society in general. Financial profitability of the project was determined by the revenue and expenditures assessment. Revenue was assessed based on the expected level of gas pipeline utilization and the related average gas transmission tariffs, whilst costs have been assessed based on the analysis of the operative, administrative and other processes which will take place during the gas pipeline construction and operation. The preliminary level of the gas pipeline utilization was assessed based on market research, i.e. non-binding phase of Open Season procedure. Final level of the gas pipeline utilization will be known when project promoter conducts the binding capacity booking procedure.

Economic profitability of the project was determined by the cost-benefit analysis. Socio-economic benefits of the project related to competition, market integration, sustainability and security of gas supply, have been calculated and monetized by the ENTSOG. Therefore, the construction of the gas pipeline will contribute to achievement of European energy objectives and in particular to:

- enhanced competitiveness and further market integration by saved costs of gas supply,
- improved sustainability through saved costs of coal supply and CO₂ emissions, and
- increased security of gas supply through savings of avoided gas disruptions.

Pursuant to Article 12(5) of Regulation (EU) No 347/2013, Croatian Energy Regulatory Agency (hereinafter: HERA) provides detailed information as the basis on which costs were allocated among Croatia and Hungary.

1. An evaluation of the identified impacts, including concerning network tariffs

By detailed cost-benefit analysis being part of the Investment request, project revenues were calculated by project promoter on the basis of incremental gas flows and average gas transmission cost.

Incremental gas flows represent the sum of gas flows from LNG Terminal on the island of Krk with exit from Croatia to Hungary. At the same time, gas flows from LNG Terminal with exit in Croatia are treated as the substitute flow due to the fact, that in case of increased gas demand in Croatia and without project implementation, gas would be imported to Croatia through current interconnections with Slovenia at Rogatec and with Hungary at Dravaszerdahely, so those gas flows were excluded from the calculations.

Average gas transmission cost is calculated for each year as a minimum of current average gas transmission cost and new average gas transmission cost calculated for the situation when the project is implemented. In this approach the general assumption is made, that regulated revenues from the project will be recovered to the extent that will not increase the current average gas transmission cost. The current average gas transmission cost for Croatia is calculated as the ratio between current regulated revenue and current gas flows in the system, and amounts 2.44 EUR/MWh in 2016, with an average of 2.37 EUR/MWh in the period 2019-2038. The new gas transmission cost for Croatia is calculated as the ratio between total regulated revenues when the project is implemented and the total gas flows in the system including the incremental gas flows related to the project, resulting with an average of 2.74 EUR/MWh for the period 2019-2038. Therefore, following the above mentioned assumption that regulated revenues from the project will be recovered to the extent that will not increase

the current average gas transmission cost, the resulting average gas transmission cost with the project implemented will amount from 2.24 EUR/MWh in 2019 up to 2.37 EUR/MWh in 2038, with an average of 2.36 EUR/MWh in the same period.

HERA has evaluated aforementioned calculation and therefore notes that further increase of transmission tariff would not be reasonable, and therefore any financial gap for the project to be sustainable should be covered by the financial support from the Connecting Europe Facility. Furthermore, gas volumes used for the purpose of revenue calculation were based on the results of the non-binding phase of the Open Season procedure, whereas final results will be known when project promoter conducts the binding capacity booking procedure. Therefore, in the Investment request it has been stated that the development of Zlobin-Bosiljevo-Sisak-Kozarac pipeline section will be confirmed according to the results of binding capacity booking procedure, which HERA considers to be essential and a key condition for the implementation of the project.

2. An evaluation of the business plan referred to in paragraph 3(b)

Business plan as a part of the Investment request provides detailed description of the development process of the gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I. It also gives analysis of regional gas markets and their development regarding future gas demand and future development of the gas transmission pipelines. Furthermore, the business plan evaluates financial aspects for the project development, as addition to the CBA analysis. HERA considers the information and data contained in the business plan as being valid and justified.

3. Regional or Union-wide positive externalities, which the project would generate

In the CBA analysis it has been calculated that total social welfare of the project, which represents sum of effects calculated by ENTSOG, are approximately 1,252 million EUR, with the sharing among countries as follows: Hungary 52.8%, Croatia 46.5%, and Ukraine 0.7%. Therefore, following the ACER Recommendation No 5/2015, Croatia and Hungary are the only net beneficiary EU countries for which Cross-Border Cost Allocation has been submitted.

Furthermore, the project of gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I, as a part of the European North-South gas corridor, enhances competitiveness and further market integration by saved costs of gas supply, improves sustainability through saved costs of coal supply and CO₂ emissions, and increases security of gas supply through savings of avoided gas disruptions. The project also enables gas source diversification through direct access to the LNG Terminal on the island of Krk.

4. The result of the consultation of the project promoters concerned

Project promoter being Croatian transmission system operator Plinacro Ltd. conducted consultations with concerned Hungarian transmission system operator FGSZ Ltd., Croatian LNG Terminal operator LNG Croatia Ltd. and Innovation and Networks Executive Agency (INEA), in the process of preparing the Investment request, as reported in detail in the submitted Investment request.

Finally, after joint consultations HERA and Hungarian Energy and Public Utility Regulatory Authority (MEKH) adopted coordinated decision on Cross-border cost allocation, titled "*Statement about agreement on Cross-Border Cost Allocation for the gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I*", pursuant to Article 12(4) of Regulation (EU) 347/2013. In the coordinated decision, based on the results of the CBA analysis by which the resulting net benefits from the project for Croatia as the hosting country are higher than the

costs of the project, it has been mutually agreed among HERA and MEKH that there are no compensations required and that no costs concerning the gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I are to be allocated to Hungary based on this Investment Request.

However, in order to make the project sustainable, HERA considers the coverage of the determined financial gap by the financial support from the Connecting Europe Facility as the crucial step in the whole process, considering the project is commercially not viable and at the same time provides significant positive externalities in EU Member States as well as in countries in the region.

HERA also emphasizes that any increase of gas transmission tariff in Croatia due to the development of new significant infrastructure is not acceptable. Therefore, development of the gas pipeline section Omišalj-Zlobin as well as of the section Zlobin-Bosiljevo-Sisak-Kozarac will be confirmed and approved by HERA based on the results of binding capacity booking procedure, which HERA considers to be essential and a key condition for the implementation of the project.

Finally, providing that binding capacity booking procedure or the financial support from the Connecting Europe Facility make the project sustainable, HERA would include it in the regulatory asset base of the transmission system operator Plinacro Ltd.

With kind regards,


Tomislav Jureković
President of the Board of Commissioners
Croatian Energy Regulatory Agency

Attachment: Statement about agreement on Cross-Border Cost Allocation for the gas pipeline Omišalj-Zlobin-Bosiljevo-Sisak-Kozarac-Slobodnica – Phase I

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