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The EU Competition investigation of Gazprom's sales in central and eastern Europe:

a detailed analysis of the commitments and the way forward

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Executive Summary[1]

In 2011, the EU competition authorities initiated an investigation into Gazprom's supply and pricing of gas in central and eastern European member states on the grounds that the company might have: hindered the free flow of gas, prevented the diversification of gas supply, and imposed unfair prices on its customers by linking the price of gas to oil prices. In 2013, DG COMP issued a Statement of Objections with the conclusion that Gazprom was hindering competition in eight member states. At the end of 2016, a set of commitments was offered by Gazprom which, in March 2017 after further negotiations, satisfied DG COMP that it would address the problems which it had identified. The main commitments offered by Gazprom are that it will:

- cease to apply any clause restricting resale or territorial restrictions in existing or new contracts;
- enable interconnections – particularly between Bulgaria and neighbouring countries – to promote diversification of supplies;
- offer its existing buyers in Poland, Slovakia, and Hungary the right to request a change of delivery points for gas;
- give customers a contractual right to request changes to their gas prices when these diverge from competitive price benchmarks (defined as border and hub prices), increase the frequency and speed of price revisions, and introduce price revision clauses where they do not currently exist.

DG COMP then implemented a market test process inviting parties to comment on the commitments. By the end of May 2017, few detailed comments had been placed in the public domain. The Lithuanian and Bulgarian comments called for minor amendments but did not raise general objections to the settlement. By contrast, the Polish company PGNiG issued a 92 page document in which it deemed the commitments 'incapable of changing [the] situation and addressing any competition concerns raised in the Statement of Objections'. PGNiG also called for Gazprom to be fined and required to pay compensation to the countries in question.

The most likely scenario is that DG COMP will – with minor amendments – accept the Gazprom commitments and settle the case. It cannot be ruled out that the Polish authorities will refer the commitments to the European courts, but such action is unlikely to either derail the implementation of the commitments or to result in a fundamentally different outcome.

[1] This essay is a significant expansion of the authors' previous comment, Stern and Yafimava (2017).

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1. Introduction

On 27 September 2011 the Competition Directorate (DG COMP) of the European Commission (EC) carried out unannounced inspections ('dawn raids') at the premises of several companies active in the supply, transmission, and storage of gas in 10 EU member states, mainly in central and eastern Europe – both incumbents and upstream suppliers. This action was taken due to concerns that these companies:

(a) may have engaged in anticompetitive practices in breach of EU competition law – which prohibits abuse of dominant position (Art. 102 of the Treaty on the Functioning of the European Union, TFEU, see Annex 1) and restrictive business practices (Art. 101 of the TFEU),

or

(b) that these companies are in possession of information relating to such practices.[2]

In its inspections, DG COMP officials were accompanied by their counterparts from the relevant national competition authorities.

One year after the inspections, DG COMP announced, on 4 September 2012, that it was opening formal proceedings against Gazprom for possible abuse of a dominant position (Art. 102) in upstream gas supply markets in central and eastern European member states on three grounds:

- Gazprom may have divided gas markets by hindering the free flow of gas across member states;
- Gazprom may have prevented the diversification of supply of gas;
- Gazprom may have imposed unfair prices on its customers by linking the price of gas to oil prices.[3]

Predictably, the news was not well received in Moscow. Within days of the DG COMP announcement, the Russian president, Vladimir Putin, signed an Executive Order (N 1285, 11 September 2012), forbidding Russian strategic commercial entities – such as Gazprom (where the Russian state also has a majority ownership share) – to provide information on their activities 'upon request from the authorities of foreign countries, international organizations, unions (communities) of foreign countries and their authorities, including authorities responsible for regulation and (or) control'[4] other than under the prior consent of a relevant federal executive agency, authorized by the Russian government.[5] The order also prohibited the amendment of Gazprom's contracts with foreign counterparts, and other documents relating to commercial (pricing) issues, as well as divestments of Gazprom's shares in foreign companies, rights to conduct commercial activity, and assets located abroad.

The all-encompassing nature of the order, and the swiftness with which it was adopted, suggest that the Russian government wanted to be prepared for all – including worst-case – scenarios relating to the treatment (both politically and commercially) of Gazprom's case. In European circles, this order was generally – and wrongly – interpreted as a direct instruction to Gazprom not to cooperate with the

[2] EC (2011). Notably the press release has not named member states where the inspections were carried out.
[3] EC (2012).
[4] Thus including DG COMP.
[5] Executive Order, signed by the Russian president, on measures protecting the interests of the Russian Federation associated with international economic activity by Russian legal persons, N 1285, 11 September 2012. (However, the order did not apply to information which must be made publicly available under the Russian law and information that must be disclosed in relation to shareholdings).

DG COMP investigation. It is probably more correct to see it as a form of insurance, safeguarding the interests of the Russian state during the course of the investigation.

In addition to the DG COMP investigation being seen in Moscow as (at least, partly) politically motivated, it was also seen as being commercially motivated, with the (then) Director General of Gazprom Export, Alexander Medvedev, connecting it with the development of European gas prices, and asking if the investigation could 'be an attempt to use political methods to secure a reduction in Russian prices by artificial means?'[6]

This paper is structured in four sections. Following this introduction we repeat the main points of DG COMP's original Statement of Objections and Gazprom's reactions. Section 3 looks at the details of the commitments and is divided into sections on: market segmentation, infrastructure, and prices. Section 4 deals with the reactions of both DG COMP and third parties to the commitments, together with the way forward; and Section 5 presents our conclusions.

2. Statement of Objections

In October 2013, DG COMP made it known that it was preparing a 'Statement of Objections' against Gazprom, but gave no indication as to how widespread the charges, and what the proposed remedies, might be.[7] No action was taken in the course of 2014, presumably due to the EC being wary of being seen as acting politically during the Ukraine crisis. The delay could also be explained by the transfer of power from (the then) President of the EC, Jose Manuel Barroso, to the new President of the EC, Jean-Claude Juncker, and subsequent changes in the EC's Directorates, including DG COMP, where Margrethe Vestager took over as commissioner.

In April 2015, more than two and a half years after the investigation had started (and a further year after the initial 'dawn raids') DG COMP issued a Statement of Objections,[8] setting out its preliminary view that Gazprom was 'hindering competition in the gas supply markets in eight member states': Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovakia.[9]

Specifically, the Statement of Objections press release listed the following objections (charges), which are largely identical to those stated by DG COMP in September 2012, when it decided to open formal procedures against Gazprom:[10]

- Gazprom 'imposes *territorial restrictions*' preventing the export of gas in eight member states (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovakia) in order to prevent gas from flowing freely between and to these member states. These restrictions include:
    - export bans (provisions that explicitly prohibit the export of gas),
    - destination clauses (provisions that require the purchased gas to be used in a specific territory),
    - other measures (such as: requiring importing states to obtain Gazprom's agreement to export gas; Gazprom's actions in refusing, under certain circumstances, to change the location of delivery points);
- these territorial restrictions 'may result in higher gas prices and allow Gazprom to pursue an *unfair pricing policy'* in five member states (Bulgaria, Estonia, Latvia, Lithuania, and

[6] 'Role of pipeline gas in Europe to grow: LNG overestimated', *Interfax Russia and CIS Oil & Gas Weekly*, 30 May–5 June 2013, pp. 29–34.
[7] 'EU preparing to charge Gazprom in antitrust case', *Reuters*, 3 October 2013.
[8] EC (2015a). See also, EC (2015b). Only a press release and factsheet – but not the Statement of Objections itself – were published.
[9] Notably, DG COMP concerns were not confirmed in respect of companies operating in two other member states where DG COMP carried out its unannounced inspections in September 2011, as proceedings were started only in respect of gas sales in eight (rather than ten) member states.
[10] EC (2015a); EC (2015b).

Poland), charging prices that are 'significantly higher compared to Gazprom's costs or to benchmark prices. These unfair prices result partly from Gazprom's price formulae that index gas prices in supply contracts to a basket of oil product prices and have unduly favoured Gazprom over its customers';

- Gazprom 'may be leveraging its dominant market position by making gas supplies to Bulgaria and Poland conditional on *obtaining unrelated commitments concerning gas transport infrastructure*. For example, gas supplies were made dependent on investments in a pipeline project promoted by Gazprom [South Stream] or on accepting Gazprom reinforcing its control over a pipeline' [Yamal–Europe]'.[11]

DG COMP referred to these practices as abuse of dominance (prohibited under Art. 102) although the strength of its position varied on each of these objections, being strongest in respect of *territorial restrictions* (see Section 3.1) and, arguably, weakest in respect of unfair pricing policy (see Section 3.3).

On the same day as DG COMP issued the Statement of Objections, Gazprom issued a press release referring to these objections being 'unsubstantiated'.[12] The press release stated that the company 'strictly adheres to all the rules of international law and legislation in the countries' where it operates, and its operation in the EU market 'meets the standards that are used by other producers and exporters of gas', including 'applicable principles of gas pricing'. It further noted that the company has the status of a strategic state-controlled entity and 'expects the situation to be resolved in accordance with the agreement reached earlier between the Government of the Russian Federation and the European Commission on finding on the intergovernmental level of mutually acceptable solution on the issue of antitrust investigation'.[13] Notably, Gazprom's deputy CEO, Medvedev, called on the EC not to politicize the investigation, against the background of a deep crisis in the EU–Russia political relationship (initially over the Ukraine crisis and subsequently over the Syria crisis).[14]

At the start of the proceedings, the case was somewhat over hyped as 'the anti-trust clash of the decade', with the possibility of intransigent EC authorities and an equally intransigent Kremlin provoking a major crisis in EU–Russia energy and natural gas relations.[15] However, this scenario, while possible, was never very likely and failed to materialize, with the EC and Gazprom negotiating throughout 2015 and 2016 towards a settlement. The negotiations drew to a close in October 2016 when the Competition Commissioner, Vestager, signalled her willingness to reach a settlement. She stated that DG COMP was awaiting commitments from Gazprom 'to ensure the free flow of gas in central and eastern Europe at competitive prices', [16] and reflected common ground on the commitments.

It is worth noting that ever since the Statement of Objections, DG COMP maintained significant pressure using a dual track mechanism: a formal procedure where Gazprom would reply to the Statement of Objections with oral hearings at DG COMP, and a technical procedure where Gazprom would discuss the proposed commitments with DG COMP.[17] This approach was successful in finally securing commitments from Gazprom ('Gazprom's Commitments').

On 31 October 2016 (the end of the same week in which DG COMP and Gazprom came to a preliminary agreement on the draft commitments) the EC also adopted a decision allowing Gazprom a higher utilization of capacity in the OPAL pipeline (one of the onshore extensions of the Nord Stream pipeline), provided there was no interest on the part of third parties. The use of OPAL by Gazprom had hitherto been restricted to 50 per cent, under the initial EC exemption decision, adopted in

[11] EC (2015a). The pipelines were not referred to by name in the press release.
[12] Gazprom (2015).
[13] Ibid.
[14] 'Gazprom seeks EU deal with no admission of antitrust breach', *Bloomberg*, 29 September 2015.
[15] Riley (2012).
[16] 'EU waits for Gazprom settlement proposal', *EUobserver*, 26 October 2016.
[17] 'Vestager: we should thank the Luxleaks whistleblowers', *EurActive*, 11 January 2016.

2009.[18] Although not a constituent part of the DG COMP investigation *per se*, the 2016 OPAL decision included an assessment of its potential impact on competition in central and eastern Europe, and hence must have taken into account the impact of Gazprom's draft commitments.

3. Gazprom's proposal for commitments: actual offers and potential consequences

Gazprom formally submitted its proposal for commitments to DG COMP on 27 December 2016 to cover a period of eight years,[19] but pleaded not guilty on all counts of possible abuse of a dominant position and restrictive practices, and denied any wrongdoing.[20] The commitments addressed all DG COMP's main objections relating to territorial restrictions, refusals to change the location of delivery points, pricing, and infrastructure.

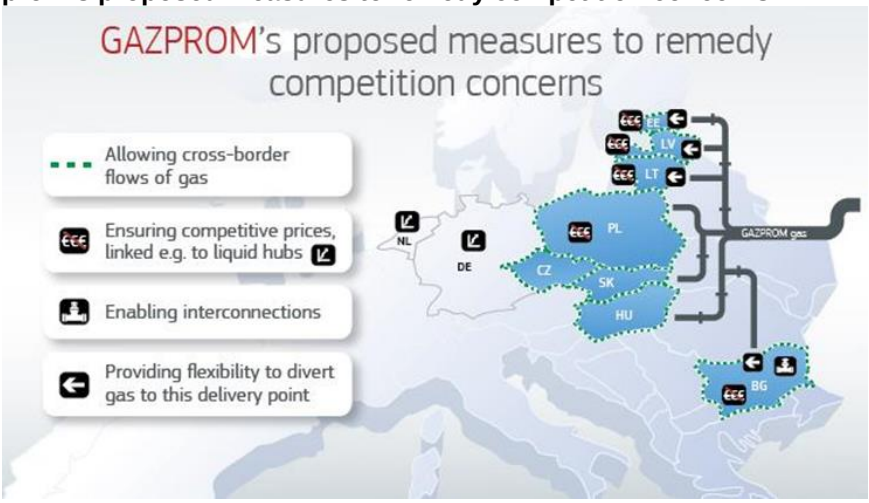
The proposal was submitted in line with Art. 9 of Regulation 1/2003, which regulates the implementation of the rules of competition (laid down in Art. 101 and 102 of the TFEU), and reads as follows:[21]

> Where the Commission intends to adopt a decision requiring that an infringement be brought to an end and *the undertakings concerned offer commitments to meet the concerns expressed to them by the Commission in its preliminary assessment*, the Commission may by decision make those commitments binding on the undertakings. Such a decision may be adopted for a specified period and shall conclude that there are no longer grounds for action by the Commission. (emphasis added)

While submitting the commitments, Gazprom's deputy CEO, Medvedev, who led the Gazprom negotiating team, stated that the proposal was 'the result of serious consideration' and demonstrated Gazprom's 'willingness to take into account in the established procedure the European side's concerns about gas market issues where it is warranted and possible'. He further noted that Gazprom was hopeful that both the EC and the market participants would 'positively respond' to the proposal, thus paving the way to 'make progress' in the case and 'reach its conclusion in the near future'.[22] The proposed commitments ('Gazprom's Commitments') are analysed below in detail (references are made to sections within that document).[23] DG COMP's pictorial representation of the commitments is presented at Figure 1.[24]

[18] For a detailed analysis of the decision see Yafimava (2017). The EC OPAL decision has been suspended as of January 2017 as a result of Poland's court action.
[19] This eight year period is counted from the effective date of the commitments, namely the date on which the commitments adopted by the EC were notified to Gazprom. Thus if the commitments were adopted and notified in mid-2017, the commitments would be in force until the mid-2020s.
[20] 'EC mulls Gazprom's proposals to end EU gas market antitrust case', *Platts*, 3 January 2017.
[21] Regulation (EC) 1/2003. For issues relating to the conduct of proceedings also see Regulation (EC) 773/2004.
[22] 'Gazprom presents proposals to EC to settle antitrust case', *Interfax Russia & CIS Oil and Gas Weekly*, 22–28 December 2016, pp. 8–9.
[23] Gazprom (2017a) – Gazprom's Commitments.
[24] EC (2015b).

Figure 1: Gazprom's proposed measures to remedy competition concerns



Source: DG COMP.

3.1 Concerns on market segmentation: enabling the free flow of gas in central and eastern Europe

Territorial restrictions

As noted above, DG COMP was concerned that Gazprom had imposed territorial restrictions[25] in its supply agreements with wholesale buyers and some industrial customers in eight member states (*Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Hungary,* and *Slovakia*) which prevented the free trade of gas within central and eastern Europe.

To address these concerns, Gazprom offered (Section II.1, para 5)[26] that it will <u>not</u>:

- apply any clause restricting resale or imposing territorial restrictions,
- introduce any new clause restricting resale, or new territorial restriction clause, in any existing or new contract on gas supply, including gas sold via auctions.

The mechanism and the timeline for giving effect to these commitments is as follows: within 10 weeks of the effective date of the commitments Gazprom would inform all its existing customers with gas supply contracts (excluding contracts relating to auctions) that any such clauses are deemed 'null and void' and that the contracts' provisions 'do not restrict the resale of gas' (Section II.1, para 6).[27] In so doing, Gazprom has committed to remove all *contractual* barriers to the free flow of gas in central and eastern European gas markets.

In respect of territorial restrictions, DG COMP can rely on its previous investigations carried out in the early 2000s in respect of Gazprom's long-term contracts with buyers in western Europe. When such clauses were found in those contracts, it was made abundantly clear that they were seen as hard core restrictions of competition, illegal under European competition law, and were therefore subsequently removed.[28]

[25] The proposal for commitments defines 'territorial restriction clause' as 'any binding contractual stipulation which limits the re-export or resale by a customer of all or parts of the annual contract quantity (ACQ) taken from Gazprom according to the contract on gas supply by directly (explicitly) or indirectly (having similar effect to a direct restriction) restricting or prohibiting the use of gas in other geographic areas than those for which the gas is supplied' (I.4).
[26] Gazprom's Commitments, p. 4.
[27] Ibid, p. 4.
[28] Talus (2011).

It is understood that Gazprom had ceased to apply territorial restrictions in all of its central and eastern European contracts prior to DG COMP issuing the Statement of Objections, with the last restrictions being removed from the Baltic contracts by October 2013.[29] Nonetheless, the existence of any such clauses is a very serious problem for Gazprom as they should have been removed in 2004 when the Baltic States joined the EU. It is understood that DG COMP found at least two such clauses (in the Lithuanian contracts), which gives the competition authority sufficient grounds for imposing fines on Gazprom for violation of EU competition law.[30] Given the painful removal of all destination clauses from western European gas contracts in the 2000s, Gazprom can hardly claim lack of knowledge of this aspect of competition law. The only possible mitigating factor could be that the competition authority of Lithuania, an EU member state since 2004 and whose complaint started the investigation, apparently made no attempt to request a removal of these restrictions despite their illegality under EU law. But it was the existence of at least one destination clause, and the resulting ability to impose a fine on the basis of this violation of competition law (against which there is no defence), which gave DG COMP substantial leverage in its negotiations with Gazprom, thus helping to secure the commitments.

In summary, Gazprom's commitments would ensure the removal of all direct and indirect contractual restrictions that prevent Gazprom's customers in central and eastern Europe from re-selling the gas they have bought across borders, or make it economically less attractive to do so. In line with Art. 9 of Regulation 1/2003, by accepting Gazprom's commitments not to apply, and not to introduce, territorial restriction clauses in its existing and new contracts, DG COMP would conclude that there are no longer grounds for further action.

Changes to the Bulgarian gas system

DG COMP was concerned that the monitoring and metering provisions in Gazprom's contracts with the Bulgarian buyer had resulted in isolation of the Bulgarian gas market from those of neighbouring member states. It is understood that these provisions were preventing the Bulgarian TSO, Bulgartransgaz (part of 100 per cent state-owned vertically integrated Bulgargaz Holding), from concluding interconnection agreements with adjacent member states in line with the EU network code on interoperability (applicable from 1 May 2016).[31] The network code requires an interconnection agreement to cover a number of issues aimed at the harmonization of technical, operational, and communication areas – consequently reducing barriers to the free flow of gas within the EU. These issues include: rules for flow control; measurement principles for gas quantities and quality; rules for the matching process; rules for the allocation of gas quantities; communication procedures in case of exceptional events; settlement of disputes arising from interconnection agreements; and an amendment process for the interconnection agreement (Art. 3).

Gazprom addressed DG COMP's concerns by offering commitments that would facilitate Bulgaria's interconnections, thus enabling better integration of central and eastern European member states' gas markets. Specifically, it offered to make changes to its supply contract (concluded in November 2012) and transportation contract (concluded in April 1998) 'to the extent necessary to remove obstacles for Bulgartransgaz' to conclude interconnection agreements at the interconnection points between Bulgaria and other EU member states, and to adjust the current 'allocation-as-measured' methodology to the 'allocation-as-nominated' methodology (Section II.1.1, para 7a).[32] Gazprom also offered to make changes to its gas supply contracts with Greece (in relation to gas transiting Bulgaria) that may have an impact on the realization of the two aforementioned objectives (Section II.1.1 para

[29] 'Gazprom allows Baltic customers to trade gas with third countries – paper', *Interfax Russia and CIS Oil and Gas Weekly*, 24–30 October 2013, p.52.

[30] Ibid states that Gazprom removed these clauses from two of its four contracts with Lithuanian companies. It is not known whether DG COMP found destination clauses in other contracts. PGNiG (2017) states that the destination clause was removed from the Yamal contract at the end of 2010. Section IV.1 para 27c, p. 13.

[31] Interoperability Network Code (Regulation (EU) 2015/703).

[32] Gazprom's Commitments, p. 4.

7b).[33] Lastly, Gazprom offered not to require all interconnection agreements to be concluded by TSOs simultaneously. These commitments would serve to put the Bulgarian TSO in control of the cross-border flows of gas and facilitate interconnection agreements between Bulgaria and its EU neighbours, in particular with Greece.

Gazprom's commitments in respect of its Bulgarian and Greek contracts are important in that they would enable the Bulgarian TSO to conclude interconnection agreements with TSOs from other EU member states. This in turn would pave the way for not only enabling TPA (third-party access) on the Bulgaria–Greece border at Sidirokastro (both physical and virtual reverse flows from Greece) where, historically, all capacity was booked by Gazprom, but also at the new (yet to be built) interconnection point at the Bulgaria–Greece border at Komotini (the IGB).[34]

Gazprom holds several legacy transport contracts under which it has capacity bookings both at intra-EU (Bulgaria–Greece, Bulgaria–Romania, Poland–Germany) and EU/non-EU interconnection points (Slovakia–Ukraine). Gazprom's commitments in respect of Bulgaria are in line with the EC's approach that legacy contracts should be amended and brought in line with the TEP (Third Energy Package) for gas – which includes inter alia the Third Gas Directive and the Gas Regulation 715[35] – particularly in respect of TPA and tariffs. It is worth noting that the negotiations between Gazprom and Bulgartransgaz to amend their legacy transport contract had been ongoing for more than a year before Gazprom made its commitment in response to the DG COMP investigation. However, the solution remained elusive as some bilateral commercial issues (such as nomination and allocation rules, methodology for fuel gas distribution) continued to be unresolved. This led to delays in signing a legally binding protocol, which Gazprom deemed necessary for conducting a test phase under the new system, which would in turn pave the way for amending the contract and signing corresponding interconnection agreements. Should the commitments be accepted, this issue would be finally resolved, enabling Bulgaria to access other (than Russian) sources of gas via existing (as well as newly built) infrastructure.[36]

Notably, commitments in respect of the Bulgarian gas system are subject to several conditions, which ensure that no liability is placed on Gazprom as a result of their implementation. These conditions are as follows:[37]

- Bulgartransgaz ensures that no expenses (including, but not limited to, fuel gas) related to third-party gas transport will be allocated to Gazprom,
- Bulgartransgaz is able to fulfil all contractual obligations towards Gazprom, as amended pursuant to commitments,
- Bulgartransgaz shall be responsible for ensuring that quality of gas transited across Bulgaria is in compliance with the quality requirements of downstream TSOs,
- necessary changes to the supply contracts applicable at the relevant interconnection points are implemented, including the waiver of Gazprom's liability with regard to gas quality.

The commitments state that Gazprom 'is given the opportunity to make its views known and to comment on proposals and draft agreements in the process of the development of interconnection agreements to facilitate that the interconnection agreements are designed in a manner that takes account of Gazprom's legacy contracts with due regard to commercial interests of Gazprom'.

[33] Ibid, p. 4

[34] Apart from some small capacity for Bulgarian domestic offtake.

[35] Third Gas Directive and Gas Regulation 715 were adopted in July 2009, and TEP became law in the EU in March 2011. In addition, four EU network codes on gas, which stipulate more detailed rules, were adopted during 2013-17 (CAM, Tariffs, Balancing, and Interoperability Network Codes).

[36] It is worth noting, however, that the contractual clauses were not the only factor preventing the conclusion of an interconnection agreement between Bulgaria and Greece, with both countries' legislation needing to be brought into compliance with the TEP and the EU network codes.

[37] Gazprom's Commitments, pp. 4-5.

Furthermore, should Gazprom demonstrate that 'its comments have been disregarded and that this leads to a situation in which essential elements of Gazprom's legacy contracts are affected' beyond what is offered by the commitments in respect of the Bulgarian gas system, 'and to an extent that causes the commercial basis for the contracts to be jeopardized', Gazprom would have a right to request the EC to review the commitments. (Section II.1.1, para 7v.)[38]

Overall, Gazprom's commitments in respect of the Bulgarian gas system offer a possibility for Bulgaria to bring its legacy contracts with Gazprom in line with the TEP and the EU network codes, and enable it to access alternative supplies via existing infrastructure. At the same time, the commitments preserve the commercial basis of Gazprom's contracts, while ensuring that no abuse of dominance takes place in the future.

Changes of delivery points

In its Statement of Objections, DG COMP stated that Gazprom's refusal to change the location of delivery points prevents gas from flowing freely between and to EU member states. To address this concern (and in addition to the commitments on territorial restrictions), Gazprom offered its existing buyers in Poland, Slovakia, and Hungary *a right to request a change from the original delivery points* – Kondratki (Poland–Belarus border), Veľké Kapušany (Slovakia–Ukraine border), Beregovo (Hungary–Ukraine border) – specified in their existing contracts with Gazprom, *to new delivery points* – entry point Negru Voda (Bulgaria–Romania border) or entry point Kotlovka (Lithuania–Belarus border) – to the extent that the latter two are located on the transmission routes used by Gazprom for supplies to Bulgaria and the Baltic States (Lithuania, Latvia, and Estonia) (Section II.1.2, para 9)[39] (see also Figure 1 above).

At present, Negru Voda is the delivery point for Gazprom's supplies to Bulgaria, and Kotlovka is the delivery point for Gazprom's supplies to all three Baltic States. The commitments state that if Gazprom stops using Negru Voda or Kotlovka for supplies to Bulgaria and the Baltics respectively, then 'another entry point at the border' of either Bulgaria or the Baltics, which 'Gazprom will use for supplies' to these countries, 'if any, should be considered as the new delivery point'.[40] Such changes could be requested for all, or for part, of the gas quantities supplied by Gazprom under the relevant contract. If such changes are requested and granted, Gazprom would be delivering its gas to its existing buyers in Poland, Slovakia, and Hungary as from Negru Voda and/or Kotlovka. Gazprom would be entitled to charge the existing customer the service fee for the change of the delivery point(s): the fee is in the range of €8.00–24.40 per mcm (adjusted for inflation) for different pairs of original/new delivery points.[41] However, the service fee must cover the actual costs incurred by Gazprom in respect of a change of delivery points, and the actual costs are to be used as the corresponding service fee if the latter is below the actual costs.

The mechanism and the timeline for giving effect to these commitments are the same as in respect of the commitments on territorial restrictions. Namely within 10 weeks from the effective date of the commitments, Gazprom would propose, in writing, to all its existing customers with gas supply contracts (those with a duration of more than two years with delivery at one of the three aforementioned delivery points) to introduce such changes and also to include them in prolongations of such contracts, or in new supply contracts with delivery at one of the three aforementioned delivery points with existing customers with a duration of more than two years. Gazprom 'may however reasonably refuse a substantiated request' if there is:

(a) 'lack of free firm transmission capacities', which are 'contracted by Gazprom *within or outside* the EU sufficient to fulfil the request of the existing customer (including the

[38] Ibid, p. 5.
[39] Ibid, p. 5.
[40] Ibid, p. 5. We believe that 'if any' refers to supplies thus suggesting a possibility that Gazprom might not supply gas to these countries in the future, but there is ambiguity in the language.
[41] From Kondratki to Kotlovka – 8 euros/mcm; from Beregovo to Negru Voda – 16 euros/mcm; from Veľké Kapušany to Kotlovka – 22.30 euros/mcm; from Veľké Kapušany to Negru Voda – 24.40 euros/mcm.

duration of supplies to new delivery point(s))', or 'due to *inability to book or use the necessary firm transmission capacity* required to bring shifted volumes of natural gas to the new delivery point(s)' (emphasis added); or

(b) 'lack of resources to ensure delivery of gas to the new delivery point(s)'.
(See Section II, 1.2, para 12[42])

Should Gazprom refuse to implement a requested change of the delivery points, it would be obliged to send both a written refusal to the existing customers who requested the change, as well as a reasoned and documented opinion to the monitoring trustee (to be established under Art. 5 of Gazprom's Commitments (Section II.5)[43]) justifying the refusal. The trustee is obliged either to accept the refusal or give a non-binding recommendation; Gazprom would have a right either to accept the recommendation or reject it. However, should Gazprom reject the trustee's recommendation, the EC will conduct an assessment of whether such rejection amounts to non-compliance with the commitments by Gazprom (Section II.1.2, para 13).[44]

It is important to understand the reason why the commitments offer a right to request a change in the delivery points for existing customers in Hungary, Poland, and Slovakia. According to DG COMP, the right to request a change in the delivery points will create opportunities for more gas flows to the Baltics and Bulgaria (which currently lack access to interconnections with their neighbouring EU countries). Should Hungary, Poland, and Slovakia request delivery of their contracted gas to entry points into the Baltic States and Bulgaria, this would enable them to 'seek new business opportunities' in these countries, 'even before the connecting gas infrastructure becomes available'.[45] (New infrastructure, such as the Lithuania–Poland interconnector (GIPL) and the Bulgaria–Greece interconnector (IGB), which would connect the Baltics and Bulgaria to the rest of Europe, is under development.) However, it is possible that Hungary, Poland, and Slovakia might have limited (or no) interest in such a change, as they might view the aforementioned new business opportunities in the Baltics and Bulgaria as being insufficiently advantageous to justify a change in delivery points, not least because of the relatively small size of these gas markets (~8 bcm in total in 2016).

In our view, establishing the right to request a delivery point(s) change as a part of commitments in an anti-trust case is a very important development, potentially having significant implications outside the current investigation. In particular, it suggests that *any future refusal by Gazprom to grant a request (made by any of its European buyers, not just those that are part of the current investigation) to change a delivery point could be considered anti-competitive*. This could be relevant, for example, in respect of Russian gas transit across Ukraine, as it would make it more difficult for Gazprom to refuse a potential request from EU buyers to move the delivery points to the Russia–Ukraine border. In turn, this would necessitate continuing transit across Ukraine, thus contributing towards the EU's political objective of preserving transit across Ukraine post-2019.[46]

3.2 Concerns on infrastructure

DG COMP has also been concerned about Gazprom leveraging its dominant position on the gas supply market to 'obtain advantages relating to access to or control of gas infrastructure'.[47] In particular, the Statement of Objections raised concerns in relation to two pieces of gas infrastructure: the South Stream project in Bulgaria and the Yamal–Europe pipeline in Poland. Gazprom offered commitments in response to DG COMP's concerns on South Stream, but not on Yamal–Europe. The legal/regulatory frameworks governing both pipelines and their differences (explaining why commitments were made in respect of South Stream but not in respect of Yamal–Europe) are analysed below.

[42] Gazprom's Commitments, p. 6.
[43] Ibid, p. 9.
[44] Ibid, p. 6.
[45] EC (2017a).
[46] For a detailed account of the
[47] Ibid.

South Stream pipeline

In 2006, Gazprom and Italy's ENI announced a joint venture to build the South Stream pipeline system across the Black Sea; in 2010 the project was joined by France's EdF and Germany's Wintershall. The pipeline system was to consist of four pipelines (each 930 km in length) to be laid from Anapa on the Russian Black Sea coast to Varna on the Bulgarian Black Sea coast.[48] The plan was to flow gas through the first pipeline in the fourth quarter of 2015, with full capacity of the first two lines to be reached by the end of 2017, and four lines by 2020. Once onshore in Bulgaria, the pipeline was envisaged to take the following routes:

- northern (Bulgaria–Serbia–Hungary, with two possible branches past Hungary – one to Austria and another to Italy and Slovenia),
- southern (Bulgaria–Greece–Italy).[49]

Gazprom decided to base the South Stream project solely on a set of intergovernmental agreements (IGAs) with the host countries of the territories the pipeline would cross, rather than by applying to individual EU member states' regulatory authorities for an exemption from the TEP (which ultimately would have to be approved by the EC). Gazprom's reluctance to apply for an exemption – despite being publicly encouraged by the EC to do so[50] – is understood to have been largely due to its negative experience with an exemption for the OPAL pipeline (Nord Stream's onshore extension).[51] During 2008–10, Russia signed IGAs with seven host countries – both EU (Bulgaria, Hungary, Slovenia, Croatia, Austria, Greece) and non-EU (Serbia[52]) members – for the onshore sections of South Stream. Under these IGAs the project was given regulatory treatment similar to what could have been expected under an exemption regime. However, the EC stated that the IGAs were not compliant with the TEP (specifically on TSO unbundling, tariffs, and TPA); while Russia maintained that the IGAs prevailed over the TEP. Notably, the EC had no authority to conduct *ex ante* mandatory assessment of the IGAs in respect of their compliance with the TEP, prior to being signed and ratified by a member state,[53] but could only do so *ex post*. (In 2017, new EU legislation entered in force which made it mandatory to provide an IGA to the EC for *ex ante* assessment.[54]) Having done *ex post* assessment, the EC concluded that the IGAs were not compatible with the TEP and called on member states to renegotiate or renounce these IGAs. It threatened to open infringement procedures against member states concerned otherwise. Unilateral renouncing of an IGA necessitates a payment of compensation to a counterparty, whereas renegotiation requires the counterparty's consent. Russia maintained its legal position that IGAs prevail over the TEP and refused to renegotiate. This effectively presented member states with a stark choice of either renouncing their IGAs, thus making themselves liable to penalties imposed by Russia, or retaining their IGAs intact, thus making themselves liable to penalties imposed by the EC.

Eventually, in 2014 the EC initiated an infringement procedure against Bulgaria (the EU member state where the South Stream pipeline would first come onshore) on the grounds of incompatibility of its IGA with the TEP, and irregularities in procurement procedures. On its part, Bulgaria halted construction of South Stream on its territory in June 2014 and failed to provide the necessary regulatory approvals, thus breaking its commitments under the IGA. Although no regulatory approval was needed for the offshore section, in the absence of regulatory approval from Bulgaria in respect of the onshore section, it was deemed too risky to proceed. In December 2014, Russian president,

[48] Gazprom (2007). Originally the project was planned to be two lines with a capacity of 31 bcm/year but, following the January 2009 Russia–Ukraine crisis, this was then expanded to four lines and 63 bcm/year.
[49] The routes of the two onshore pipelines were changing over time as the project encountered increasing regulatory challenges on the part of host countries and the EC.
[50] 'EC: Russia should apply for South Stream exemption', *Natural Gas Europe*, 7 December 2013.
[51] For a detailed account on the OPAL exemption see Yafimava (2017).
[52] Serbia is a party to the Energy Community Treaty (EnCT).
[53] Decision (EU) 994/2012.
[54] Decision (EU) 2017/684. Also see EC (2016).

Vladimir Putin, and Gazprom CEO, Alexei Miller, announced that the South Stream project had been cancelled due to unresolved regulatory issues with Bulgaria and the EC.[55]

EU energy acquis issues

The Russia–Bulgaria IGA[56] ('***The 2008 IGA***') was signed in January 2008 and entered into force in August 2008 – in other words, before the Third Gas Directive and the Gas Regulation 715 entered into force in 2009. In its current form, the IGA contains a number of provisions that are problematic in respect of compatibility with the TEP.

In respect of *TSO unbundling requirements*, the IGA stipulates that the Bulgarian section of South Stream would be owned and operated by a new Russia–Bulgaria joint venture (JV), in which Gazprom and Bulgargaz Holding would hold 50 per cent of shares each. Although the Third Gas Directive[57] allows avoidance of ownership unbundling where the transmission system belonged to a vertically integrated company on 3 September 2009 (the date of the Directive's entry into force) – as was (and still is) the case in Bulgaria – it requires that the transmission system be operated by a TSO, which is either a certified independent transmission operator (ITO) or an independent system operator (ISO). This appears sufficient to conclude that the IGA's provision on joint ownership and operatorship of the Bulgarian section of South Stream by the JV is not in compliance with the TEP. To be consistent with the TEP, the Bulgarian section would need to be operated either by the Bulgarian TSO, Bulgartransgaz (certified as an independent transmission operator (ITO) in June 2015), or by a new certified TSO.

In respect of *tariff requirements*, the IGA stated that a transportation tariff for the Bulgarian section of South Stream would be set by the JV, which would have an '*exclusive* competence' (emphasis added) over the tariff. It specified that the tariff must ensure that no losses are incurred (in other words, it should at least cover costs), generate a 'reasonable rate of return', and ensure a payback period of 15 years (Art. 8). Notably, the Third Gas Directive stipulates that 'The regulatory authorities shall be responsible for fixing or approving […] at least the [tariff] methodologies used to calculate or establish the terms and conditions for […] transmission […] tariffs' (Art. 41.6.a), and that member states must ensure that 'those tariffs, or the methodologies underlying their calculation are approved prior to their entry into force in accordance with Article 41 by a regulatory authority […] and that those tariffs – and the methodologies, where only methodologies are approved – are published prior to their entry into force' (Art. 32.1).

The Gas Regulation 715[58] stipulates the list of requirements with which the tariffs (or the methodologies used to calculate them) must comply, including reflection of 'the actual costs incurred' and inclusion of 'an appropriate return on investments' (Art. 13.1). It further required that tariffs shall be 'set separately for every entry point into or exit point out of the transmission system' (Art. 13.1). It is argued here that there is no automatic contradiction between the IGA and the TEP in respect of tariffs. This is because the TEP allows for a choice in respect of whether a regulator fixes or approves the methodologies or the tariffs themselves. By stipulating that tariffs are the 'exclusive competence' of the JV, the IGA does not preclude the possibility of the Bulgarian regulator being able to fix or approve their underlying methodology. Furthermore, the IGA's requirements on tariffs' cost-reflectivity and reasonable rate of return are consistent with the TEP's requirements. At the same time, the IGA's terms on tariffs are of a general nature compared to those contained in the TEP (and, subsequently, in the EU network code on tariffs[59]). Notably, the IGA does not specify any specific methodology in line with which the tariffs were to be calculated. As noted above, the Gas Regulation 715 requires that tariffs must be set 'separately for every entry point […] or exit point', thus effectively prescribing an

[55] Stern, Pirani, and Yafimava (2015). The project has been replaced by the Turkish Stream project, which is based on the Russia–Turkey IGA and is under construction.
[56] The 2008 IGA (Agreement between the government of the Russian Federation and the government of the Republic of Bulgaria on cooperation on the development of gas pipeline for transit across the territory of Bulgaria of 18 January 2008).
[57] The Third Gas Directive (Directive (EC) 2009/73).
[58] The Gas Regulation 715 (Regulation (EC) 715/2009).
[59] Tariffs Network Code (Regulation (EU) 2017/460).

entry–exit tariff regime, while leaving national regulators to approve cost allocation mechanisms and rate-setting methodology.

In respect of *third-party access (TPA) requirements*, the IGA stipulates that it is the JV that holds capacity rights in the Bulgarian section of the pipeline (Art. 9), and states that Gazprom guarantees full utilization by means of a long-term transportation contract that was to be concluded between the JV and Gazprom (or a company designated by Gazprom), and which would include, inter alia, a 'ship-or-pay' clause. Notably, the IGA states that capacity rights *can be assigned fully or partly to a third party*. The Third Gas Directive obliges member states to ensure the implementation of a system of TPA to the transmission networks (Art. 32) whereas the Gas Regulation 715 stipulates that TSOs must ensure inter alia 'that they offer services on a non-discriminatory basis to all network users' (Art. 14.1). The IGA's provision for Gazprom to book the entire capacity in the Bulgarian section does not *per se* constitute a violation of the TEP, as it is only if such an arrangement leads to contractual congestion that the Gas Regulation 715 mandates the application of congestion management procedures (CMP) to make capacity available to other users. Notably the IGA does not *exclude* the possibility of providing capacity rights in the Bulgarian section of the pipeline to a third party, albeit it does not state that such an offer is guaranteed in the event of contractual congestion. Thus it could be argued that the IGA is consistent with the TEP in that it envisages the *possibility* of third parties acquiring capacity rights (alongside Gazprom) but, unlike the TEP, it *does not guarantee* such rights in the event of contractual congestion. Notably, at the time when the IGA was concluded in 2008, the energy *acquis* contained no legally binding mechanism for the development and allocation of new pipeline capacity in the EU. These provisions were only established in the EU network code on capacity allocation mechanisms, adopted in March 2017.[60]

Overall, our brief analysis of the Bulgaria–Russia IGA's compatibility with the TEP suggests that on many issues both frameworks – although not entirely consistent with each other – nonetheless share a significant degree of similarity. This suggests that there certainly was scope for renegotiating the IGA to align it more closely with the TEP to the mutual satisfaction of both parties – Bulgaria and Russia – and also of the EC. Renegotiation of this IGA (and those of other South Stream host countries) would have provided the least confrontational – and least costly – solution. The IGA contains a clause allowing it to be amended, subject to the written consent of both parties (Art. 20.3).[61] The Russian government might have agreed to renegotiation had there been a reasonable expectation that this would lead to South Stream being given either a regulatory regime amounting to an exemption, or a regime based on an open season procedure (or to an alternative allocation rule which was then under development as part of the CAM Network Code). However, the EU–Russia political relationship worsened dramatically over the course of 2014 (due to the Ukraine security crisis and the Russian annexation of Crimea), and the EC's attitude towards South Stream turned distinctly negative given that it would further decrease Ukrainian transit and its leverage against Russia.

Due to its failure to provide regulatory approval, which in turn led to the cancellation, Bulgaria would be liable for damages. However, Gazprom's proposal for commitments confirms that the Bulgarian part of South Stream is terminated and states that neither Gazprom nor any of its subsidiaries will claim the $70 million stipulated in the Protocol between Gazprom and the 100 per cent state-owned Bulgarian Energy Holding (BEH) that was signed in August 2012,[62] or any other damages on the basis of the project's cancellation (Gazprom's Commitments, Section II.3).[63] This is a significant positive development for Bulgaria. It is worth noting that DG COMP has refrained from expressing a position on the validity of such claims (for damages), by stating that Gazprom's commitment is 'without prejudice'.[64] Some Bulgarian officials argued that the issue of damages for South Stream

[60] CAM Network Code (Regulation (EU) 2017/459).
[61] The 2008 IGA (Agreement between the government of the Russian Federation and the government of the Republic of Bulgaria on cooperation on the development of gas pipeline for transit across the territory of Bulgaria of 18 January 2008).
[62] Gazprom (2012). The text of the Protocol does not appear to be available in public domain.
[63] Gazprom's Commitments, p. 8.
[64] EC (2017a).

cancellation had already been settled in 2012, suggesting that Bulgaria would not have to pay damages in any event.[65] However, it's our understanding, given that Bulgaria has not fulfilled its obligations under the IGA in respect of South Stream, that it would have been extremely difficult (and most likely impossible) to avoid paying damages had Gazprom not expressly waived them.

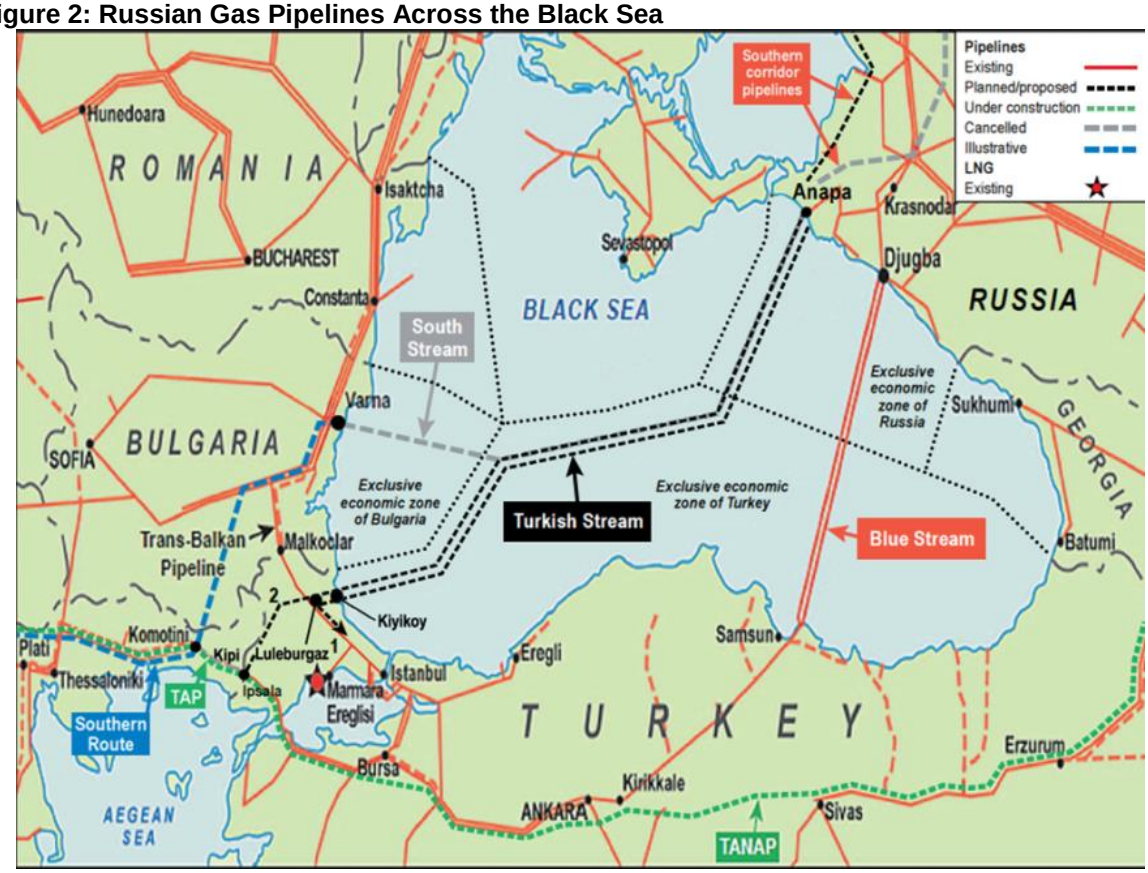
EU competition law issues

Although Gazprom made this commitment in response to DG COMP's concern that it 'made wholesale gas supplies conditional upon the participation'[66] of Bulgarian Energy Holding (BEH) in the South Stream project, it is not clear whether this concern is well grounded. The only provision on gas supply in the IGA is that the Russian party 'will provide *additional* supplies of natural gas' (emphasis added) from Russia to Bulgaria via the new gas pipeline system under market conditions (The 2008 IGA Art. 4). This clause appears to be a Gazprom guarantee to provide additional gas supplies to Bulgaria via South Stream on market terms, but it does not say that either existing (or additional) supplies would be withheld should South Stream not be built. Furthermore, it states that gas would be supplied on 'market terms' with no apparent connection to infrastructure issues. In our view, this clause alone is not sufficient to conclude that Gazprom made supplies conditional on Bulgarian participation in South Stream. However, other clauses in annexes or additional protocols between the Russian and Bulgarian governments, and/or between Gazprom and BEH (which are not in the public domain) may have made gas supplies conditional on participation in South Stream. In any event, Gazprom's commitment not to claim damages saves Bulgaria a significant amount of money and avoids a prolonged legal battle (with an uncertain outcome) that could have taken place had these damages not been paid.

It is worth noting that the Bulgaria–Russia IGA is not an agreement specifically about South Stream. The title of the IGA is given as an agreement on 'cooperation on the development of *gas pipeline for transit across the territory of Bulgaria*' (emphasis added), which suggests that it provides a general framework for *any* gas pipeline that would cross Bulgaria with the purpose of transit, not *necessarily* South Stream. Therefore, it could be argued that the IGA could potentially serve as a framework for construction of the second string of Turkish Stream, should there be a decision to connect it to Bulgaria with a view of further transit across Bulgaria to Greece (where it could connect to the TAP pipeline which is currently under construction), and further to Italy via either TAP or potentially the (yet to be agreed) ITGI/Poseidon pipeline (thus resurrecting the southern route of the South Stream pipeline); or across Bulgaria to Serbia, Hungary, and further to Austria (thus resurrecting the northern route of the South Stream pipeline) (Figure 2).[67] It is clear, however, that the IGA would need to be amended in such a way as to provide a regulatory framework for the Bulgarian (onshore) part of the pipeline that is compatible with the TEP.

[65] 'Bulgaria may seek more time to reply to Gazprom concessions', *The New York Times*, 24 April 2017.
[66] EC (2015b).
[67] Yafimava (2016). It is worth noting that in June 2017 Gazprom signed several agreements with Greece's DEPA and Italy's Edison (Gazprom (2017b)), Austria's OMV (Gazprom (2017c)), and Italy's SNAM (Gazprom (2017d)) concerning possible development of southern route(s) for Russian gas exports to Europe.

Figure 2: Russian Gas Pipelines Across the Black Sea



Source: OIES.

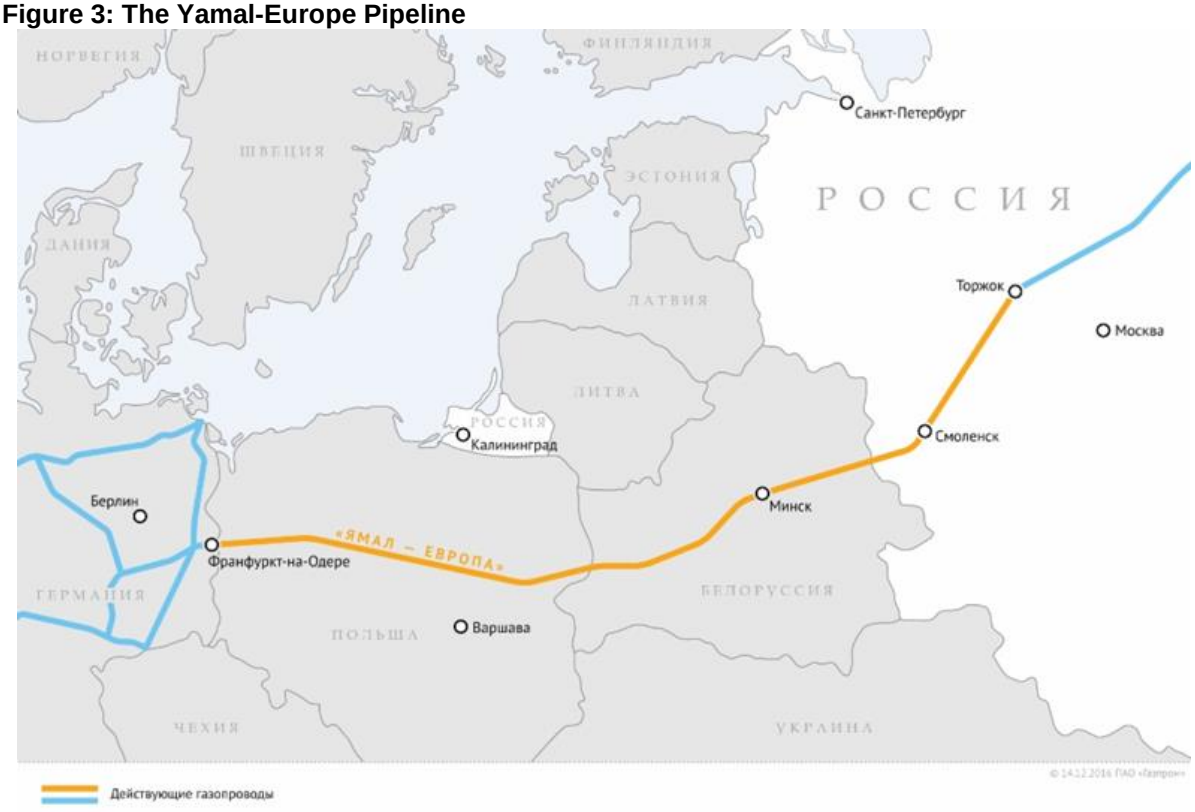
Yamal–Europe pipeline

Although DG COMP's preliminary view was that Gazprom had made gas supplies conditional upon maintaining Gazprom's control over investment decisions concerning the Yamal–Europe pipeline, it concluded that this was not a competition law issue and that therefore 'the situation cannot be changed' by means of an anti-trust procedure 'due to the impact of an intergovernmental agreement between Poland and Russia'.[68] Thus no commitments were offered by Gazprom in respect of the Yamal–Europe pipeline in response to DG COMP's concerns. DG COMP stated that it would be able to 'deal better with future international agreements' once the new EU legislative proposal on intergovernmental agreements is adopted (which happened in April 2017).[69] This decision stipulates a mandatory *ex ante* assessment of all IGAs by the EC before their signature and ratification.

The Yamal–Europe pipeline was first initiated in the early 1990s as the first transit-diversification pipeline, aimed at reducing dependence on Ukraine which was becoming increasingly problematic. Instead of carrying gas via Ukraine, the pipeline brings Russian gas across Belarus (running in parallel to the existing Northern Lights pipeline system) to Poland (at the entry point Kondratki at the Poland–Belarus border) and then to Germany (at the IP Mallnow at the Poland–Germany border) (Figure 3). In Germany, the pipeline connects to the GASCADE Gastransport system which (together with OPAL Gastransport and NEL Gastransport), is part of the WIGA Group, indirectly owned and jointly controlled by Wintershall and Gazprom.

[68] EC (2017a).
[69] Decision (EU) 2017/684.

Figure 3: The Yamal-Europe Pipeline



Source: Gazprom

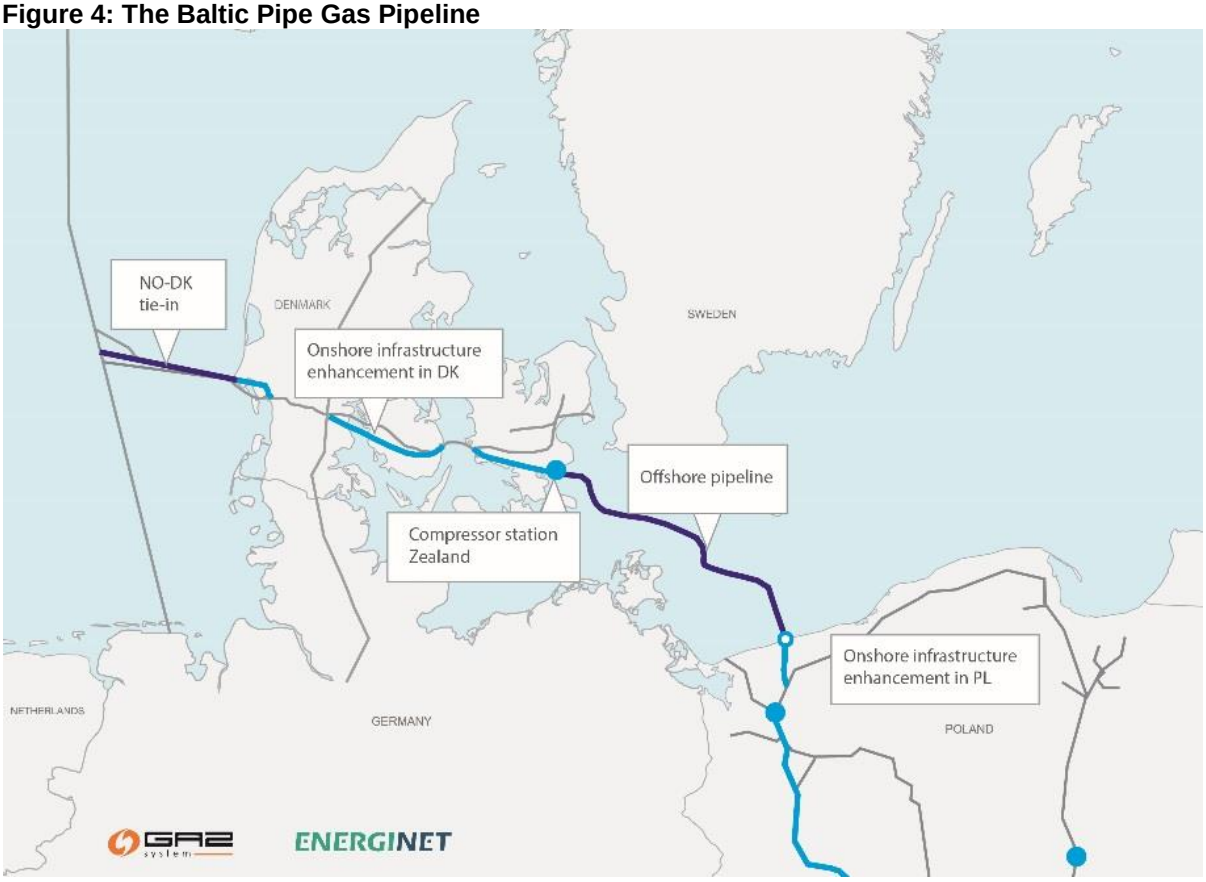
Pipeline construction started in 1994, but the pipeline only reached its planned capacity of 33 bcm in 2006. Originally two strings were envisaged, but only one was completed. There were many reasons for the project's delays and down-scaling. One was Gazprom's shortage of capital in the 1990s and the early 2000s.[70] Another was that during the 2000s, the Belarus–Poland transit corridor became problematic for Gazprom due to the commercial (also compounded by political) difficulties in its gas relationship with Belarus (such as the January 2004, January 2007, and June 2010 disputes[71]) and with Poland (for example, disagreements over EuroPolGaz ownership, see below). These difficulties made Gazprom question the logic of increasing transit via Belarus and Poland (which eventually led Gazprom to develop the Nord Stream pipeline, thus establishing a transit-free export route to Europe). Yet another reason was that it became clear that Poland would only need 12.7–13.7 bcm in the mid-2000s – a sharp decrease in projected gas demand compared to 1996 projections of 18–20 bcm. All of these factors eliminated the need for a second string of the Yamal pipeline to be built in the 2000s. However, Polish gas demand projections were revised upwards in the 2010s (19.5 bcm for 2025 and 21 bcm for 2030) so negotiations re-started on the second string of the Yamal pipeline, but these subsequently failed, largely due to significant opposition from the Polish government (which dismissed the then PGNiG CEO, Grazyna Piotrowska-Oliwa, and treasury minister, Mikolaj Budzanowski over the signing of a preliminary agreement on the second string of the pipeline in April 2013).[72]

In respect of PGNiG's long-term supply contract with Gazprom, in 2016 the Polish government stated that it did not plan to renew the contract after expiry at the end of 2022. It did 'not rule out' buying

[70] Stern (2005), p. 119.
[71] Yafimava (2009); Yafimava (2007); Yafimava (2010).
[72] 'PGNiG boss latest high-profile victim of Russia pipeline deal', *Financial Times*, 29 April 2013; 'Poland to Gazprom: what pipeline?', *Financial Times*, 5 April 2013.

Russian gas if the price is 'competitive enough ... but definitely not as part of a long term contract'.[73] Meanwhile PGNiG started to import LNG via the new Świnoujście terminal under a long-term contract with Qatar to import 1.5 bcma. Poland also intends to build a new import pipeline with a capacity of 10 bcma by 2022, which would run from Norway through Denmark and the Baltic Sea to Poland (Figure 4). No figures for the entire cost of the pipeline have been revealed, while cost estimates of the Baltic Pipe (an interconnector between Denmark and Poland) differ: €1.6–2.1 billion according to the Polish TSO, Gaz-System (of which Gaz-System is expected to cover €0.84–1.1 billion)[74] and €1.8–2.4 billion according to the Danish TSO, Energinet.[75] (The cost of the Norway–Denmark section would probably be at least as (and potentially more) expensive.) The Baltic Pipe open season procedure was launched on 6 June 2017 and shippers are expected to provide binding commitments by 25 July 2017.[76]

Figure 4: The Baltic Pipe Gas Pipeline



Source: Gaz-System.

[73] 'Poland aims to end long-term gas supplies from Russia after 2022', *Reuters*, 31 May 2016.
[74] 'Capex of planned Poland–Denmark gas link seen at up to 2.1 bn euros', *Reuters*, 6 June 2017.
[75] 'Poland, Denmark agree on Baltic Pipe Project', *Platts European Gas Daily*, 7 June 2017, p.7.
[76] Gaz-System (2017a).

The legal/regulatory framework underpinning the Yamal–Europe pipeline consists of:

- the Russia–Poland intergovernmental agreement (IGA), signed on 25 August 1993 ('***The 1993 IGA***'),[77] as amended by
  - The Additional Protocol, signed on 12 February 2003 ('***The 2003 Additional Protocol***')[78] as amended by,
    - The Protocol, signed on 29 October 2010 ('***The 2010 Protocol amending the 2003 Additional Protocol***'),[79]
  - The Protocol, signed on 29 October 2010 ('***The 2010 Protocol amending the 1993 IGA***');[80]
- the EU Trans-European Networks (TEN) programme, under which it was designated as a 'priority investment project' at the Energy Charter Treaty conference in Lisbon in December 1993.[81]

EU energy acquis issues and compatibility with the TEP

The 1993 IGA outlined the main provisions on the Polish section of the Yamal–Europe pipeline, including ownership and operatorship as well as transportation tariffs, but contained no provisions on third-party access. Just as was the case with the South Stream IGA, some provisions of the Yamal–Europe IGA are problematic in respect of their compatibility with the TEP. These are analysed below.

In respect of ownership and operatorship issues, the 1993 IGA stated that the Polish section of the Yamal–Europe pipeline was to be built and operated by a new joint venture, EuroPolGaz, which would be jointly owned by PGNiG (the Polish state-owned gas company) and Gazprom, each holding 50 per cent of shares (Art. 1 and 2).82 This provision suggests a conflict with the TEP as the Third Gas Directive requires the transmission system to be operated by a certified TSO. In 2010, the IGA was amended by a Protocol (The 2010 Protocol amending the 1993 IGA)83 with a new provision, stipulating that the functions of operatorship were to be carried out by Gaz-System, which was designated as the (only) national gas TSO by the Polish regulatory authority on 13 October 2010.84 In 2014 Gaz-System was certified under the ownership unbundling (OU) model by the Polish regulatory authority in respect of its own gas transmission network, and in 2015 under the ISO model in respect of the Polish section of Yamal–Europe.[85] Gaz-System was to operate the Polish section of Yamal–Europe on the basis of a new contract between itself and EuroPolGaz, signed on 25 October 2010 (Art. 3 of **The 2010 Protocol amending the 1993 IGA**). This amendment brought the IGA in line with the TEP in respect of TSO unbundling and certification requirements.[86]

The amendment also brought the ownership structure of EuroPolGaz in line with the IGA. It transpired that EuroPolGaz, rather than being 50–50 owned by PGNiG and Gazprom (as stipulated by the IGA), was owned 48 per cent by PGNiG, 48 per cent by Gazprom, and 4 per cent by a third company, Gaz Trading. In turn, Gaz Trading was owned 43 per cent by PGNiG, 16 per cent by Gazexport, 2.73 per cent by Wintershall, 2.27 per cent by Weglokoks, and 36 per cent by Bartimpex (a trading company

[77] The 1993 IGA (see Agreement between the government of the Russian Federation and the government of the Republic of Poland on the development of gas transmission pipelines system for transit of Russian gas across the territory of the Republic of Poland and on supplies of Russian gas to the Republic of Poland of 25 August 1993).
[78] The 2003 Additional Protocol (see Additional Protocol to 'The 1993 IGA').
[79] The 2010 Protocol amending the 2003 Additional Protocol (see Protocol amending 'The 2003 Additional Protocol').
[80] The 2010 Protocol amending the 1993 IGA (see Protocol amending the 'The 1993 Agreement').
[81] Stern (2005) p. 118.
[82] The 1993 IGA.
[83] The 2010 Protocol amending the 1993 IGA.
[84] Gaz-System (2017a).
[85] Gaz-System (2017b); Energy Regulatory Office (2014); Energy Regulatory Office (2015); EC (2014a); EC (2014b); EC (2014c); EC (2015c).
[86] The 2010 Protocol amending the 1993 IGA.

with close historical links to Gazprom).[87] It is not clear why this lack of compliance had persisted for seven years since the IGA had first been signed. Apart from being in violation of the IGA, this ownership structure led Polish politicians to claim that EuroPolGaz was 'majority Russian-owned – or at least Russian-influenced', and thus not under the control of the Polish government.[88] It is not clear whether this was the case, but it had certainly become a contentious issue in the Poland–Russia gas relationship. To rectify this, the amendment stipulated that:[89]

- by 1 December 2001, PGNiG and Gazprom start the process of implementation of their mutually agreed plan (aimed at ensuring that EuroPolGaz is 50 per cent owned by PGNiG and 50 per cent owned by Gazprom) and complete it as soon as possible once all the necessary procedures are accomplished, and
- by 1 March 2011, to enshrine the principle of *parity* management in the EuroPolGaz statute ensuring, in particular, that all relations with third parties are undertaken *jointly* by PGNiG and Gazprom (2010 Protocol amending the 1993 IGA, Art. 2.1). (emphasis added)

Although the 1993 IGA contained no provisions in respect of *transportation tariffs*, such provisions were incorporated into it by means of an Additional Protocol, signed on 12 February 2003.[90] The **2003 Additional Protocol** stipulates that a tariff for transportation (both for transit of Russian gas across Poland and for transportation to Polish consumers) by EuroPolGaz (a pipeline operator prior to operatorship being transferred to Gaz-System in 2010, see above) must provide for continuous operation and ensure that no losses are incurred (Art. 4). The tariff is calculated with a view of ensuring that EuroPolGaz covers its operating costs, carries out an investment programme agreed with its main shareholders, honours its loan commitments and taxes, and accumulates free cash in line with (but not in excess of) the business plan (Art. 4). An annex to the 2003 Additional Protocol set a progressively decreasing tariff for the 2002–19 period.[91]

In October 2010, a further Protocol was added to the IGA (**The 2010 Protocol amending the 2003 Additional Protocol**), replacing the 2003 tariff provisions.[92] This Protocol outlined the main principles for calculating the tariff during the post-2009 period: all of the Article 4 provisions in the 2003 Protocol (see above) were preserved with the addition of ensuring an annual net profit at the level of 21 million Polish Zloty (~ $ 7million[93]) (Art. 4). EuroPolGaz was to calculate tariffs in line with these principles and submit them to the Head of the national energy regulatory authority (or other competent regulatory authority) for approval. The Protocol is clear that EuroPolGaz is not allowed to set the tariff at a higher level than that approved by the regulatory authority. Importantly, as of January 2010, the 2010 Protocol abolished the specific tariff rates set by the 2003 Additional Protocol, and specified no new rates.

This suggests that the IGA (as amended in 2003 and 2010) is in line with the requirement of the Third Gas Directive for the national regulatory authority to approve (at least) methodologies or tariffs themselves; it is also line with the requirement of publishing the tariffs in advance. Furthermore, it is in line with the requirements of the Gas Regulation 715 on cost-reflectivity and reasonable rate of return. Prior to being amended in 2010, the IGA set specific tariffs for 2009–19 based on a point-to-point regime; this was not in line with the Gas Regulation 715, which prescribed the entry–exit regime. However, the amended (2010) IGA does not specify any regime and does not set any tariffs. This suggests that the IGA is not *necessarily* incompatible with the TEP in respect of tariffs, as EuroPolGaz would be able to set, and the Polish regulatory authority to approve, an entry–exit tariff. Although the IGA's provisions on tariffs are not specific in terms of methodology, this does not prevent

[87] Stern (2005), p. 119.
[88] Ibid.
[89] The 2010 Protocol amending the 1993 IGA.
[90] The 2003 Additional Protocol.
[91] The specific tariff rates can be found in Annex 2.
[92] The 2010 Protocol amending the 2003 Additional Protocol.
[93] The 2010 average rate of conversion of 1$ = 3 Polich Zloty is used, Polish Central Bank website.

EuroPolGaz and the Polish regulatory authority, respectively, from setting and approving an entry–exit tariff in line with the TEP and the EU network code on tariffs.[94]

The IGA (as amended in 2003) did not contain specific provisions in respect of *third-party access*, apart from stating that the tariff was set assuming full capacity utilization (while noting that 4 per cent of capacity is booked by Gaz Trading). However, in 2010 the IGA was amended, and Gaz-System, the Polish TSO, was made operator of the pipeline (in place of EuroPolGaz), thus suggesting that Gaz-System – a certified ISO – is obliged to provide non-discriminatory third-party access to the pipeline. This amendment has served to bring the IGA in line with the TEP requirements on TPA.

Our analysis of the IGA, as amended in October 2010, suggests that it is compatible with the EU energy *acquis*, as represented by the TEP, in respect of the latter's main requirements in respect of TSO certification and unbundling, transportation tariffs, and TPA.

Notably, since the IGA was signed in 1993 (well before the start of EU gas market liberalization, which started with the adoption of the First Gas Directive in 1998), the EU has made significant progress in liberalizing gas markets – the most recent wave of liberalization having taken place in 2009, when the TEP was adopted. It is worth noting that Russia, although continuously maintaining that IGAs prevail over the EU energy *acquis* (including the TEP), adopted a cooperative stance towards the Polish government and agreed to renegotiate the 1993 IGA to bring it in line with the changing energy *acquis*. The most recent round of renegotiations was held in October 2010, with EC participation. Several substantial amendments were made, and as our analysis above suggests, the amended IGA is compatible with the TEP, in respect of the latter's main requirements regarding TSO certification and unbundling, transportation tariffs, and TPA. This assessment was echoed by the (then) EU Energy commissioner, Gunter Oettinger, who said the EC 'managed to ensure that the intergovernmental agreement between Russia and Poland was brought in line with EU law'.[95]

EU competition acquis issues

DG COMP was concerned that Gazprom 'made gas supplies conditional upon maintaining Gazprom's control over investment decisions'[96] concerning the Polish section of the Yamal–Europe pipeline. We now analyse the IGA provisions on supplies, with a view to concluding whether they contain any conditionality in respect of Gazprom maintaining control over investment decisions and obtaining unrelated commitments concerning gas transport infrastructure.

The 1993 IGA envisaged an increase in Russian gas supplies to Poland via the Yamal–Europe pipeline of up to 14 bcma by 2010, in addition to gas supplies delivered via the existing (Northern Lights) pipeline (around 6 bcm in 1993), thus suggesting that by 2010 Russian gas exports to Poland would reach (at least) 20 bcm.[97] (Art. 3.3). However, actual Russian gas exports to Poland in 2010 were 11.8 bcm – only just over half of what had been envisaged in 1993. In February 2003, the IGA was amended by means of the **2003 Additional Protocol**, which stipulated the export volumes as follows: 6.6 bcm in 2003; 7.0 bcma in 2004–5; 7.1 bcma in 2006–7; 7.3 bcma in 2008–9; 8 bcma in 2010–14; and 9 bcma in 2015–22 (Art. 1).[98] The 1996 supply contract was renegotiated and amended to reduce volumes accordingly.[99] The Protocol stated that by the end of 2004, Poland and Russia would re-examine the case for construction of the second string of the Yamal–Europe pipeline (Art. 1), but made no connection between this issue and changes in supply volumes.

By the end of the 2000s, it became evident that Poland would need more gas than previously envisaged. Thus, in October 2010 the 2003 Additional Protocol was amended by another Protocol

[94] Tariffs Network Code (see Regulation (EU) 2017/460).
[95] Oettinger (2010).
[96] EC (2015b).
[97] Given that Russian gas exports to Poland in 1993 (when the IGA was signed) were ~6 bcm, this would suggest that by 2010 overall Russian exports to Poland would reach at least 20 bcm, see Stern (2005), p. 110.
[98] The 2003 Additional Protocol.
[99] Stern (2005), p. 120.

(**The 2010 Protocol amending the 2003 Additional Protocol**).[100] This increased the export volumes as follows: 9.7 bcm in 2010; 10.5 bcm in 2011; 11 bcma in 2012–22 (Art. 1) and, noting that the export volumes for the post-2022 period (in other words, after the contract expires) would be clarified separately, an agreement was reached to amend the supply contract accordingly. The Protocol also stated that Poland and Russia would aim for the swift conclusion of a contract between PGNiG and Gazprom for 2020–45, covering ~28 bcma (Art. 2.3).[101] Notably, the Protocol does not appear to contain provisions suggesting any connection between export volumes and the conclusion of such a contract, or in respect of any infrastructure-related issues. Furthermore, the Protocol stated that EuroPolGaz's investment programme would have to be agreed with its *main shareholders* (at the time, PGNiG and Gazprom), thus suggesting the inability of Gazprom to control investment decisions. In October 2010, another Protocol (**the 2010 Protocol amending the 1993 IGA**) was signed which stipulated that by 1 March 2011 Poland and Russia were to ensure that that the principle of *parity management* was enshrined in the EuroPolGaz statute, thus also suggesting that Gazprom would not be able to maintain control over investment decisions.

This assessment suggests that there is insufficient evidence (on the basis of the publicly available IGA and subsequent amending protocols) that Gazprom made its gas supplies to Poland conditional on control over investment decisions, or on obtaining unrelated commitments concerning gas infrastructure.

3.3 Concerns on prices: ensuring competitive gas prices in Central and Eastern Europe

In response to DG COMP's concern that Gazprom may have pursued an unfair pricing policy in *Bulgaria, Estonia, Latvia, Lithuania,* and *Poland*, Gazprom has committed to introduce *competitive benchmarks*, including western European border and hub prices, in price review clauses in contracts with customers in these member states. These commitments will give customers a contractual right to request changes to their gas prices when they diverge from competitive price benchmarks, thus ensuring competitive prices in these countries in the future. Gazprom has also committed to *increase the frequency and speed of price revisions* and will also introduce clauses reflecting the above elements into those contracts where price revision clauses do not currently exist.

Questions have been raised as to how the competition authorities could construe linking the price of gas to oil prices as 'unfair', given that this had been the principal way of pricing gas in Europe for several decades prior to 2008. Part of the answer appears to be that for countries which had a choice of suppliers and could hence choose which gas to purchase, oil price linkage was not unfair. But for countries that were entirely dependent on Russian gas, reinforced by an export monopoly which meant that these countries had no alternative to buying from Gazprom, a refusal to sell on terms other than oil linkage could be considered abuse of a dominant position.

However, the switch of the original language from 'fair' pricing in the Statement of Objections to 'competitive' pricing in Gazprom's commitments is an acknowledgement that 'fair' cannot be adequately defined in commercial terms (which was demonstrated in the 2016 Lithuanian arbitration judgement).[102] But 'competitive pricing' also has definitional problems in relation to these countries, a subject to which we return below.

[100] The 2010 Protocol amending the 2003 Additional Protocol.

[101] No such new transit contract has been concluded to date, whereas the existing transit contract expires at the end of 2019.

[102] 'Lithuania puts brave face on Gazprom judgement', *Interfax Gas Daily*, 27 June 2016, pp.1–2. Lithuania filed an appeal against the judgement which, at the time of writing, was under review by a Swedish court of appeal. However, arbitral decisions are generally considered to be not subject to appeal. 'Lithuania files appeal against Gazprom ruling', *Platts European Gas Daily*, 3 October 2016, p.2; 'Court mulls Gazprom defence in Lithuania case; *Platts European Gas Daily*, 22 June 2017, p.2.

Key Provisions

The key provisions in relation to pricing commitments are the amendment (or insertion) of price review clauses with language in the first paragraph similar to what is found more generally in European contracts (Gazprom's Commitments Para 19(i)):

'If at any time either Party shows that:

> economic circumstances in the European gas markets beyond the control of the Parties have changed significantly as compared to what the Parties have reasonably expected when entering into the Contract or — after the first Contract Price Revision – at the time of the latest Contract Price Revision **and/or**;
>
> the prevailing price level resulting from the Contract does not reflect the development of the European gas markets as reflected, inter alia, in the development of the average weighted import border prices in Germany, France and Italy and/or the development of the prices at the relevant generally accepted liquid hubs in Continental Europe.

then such Party may request a Contract Price Revision by notifying the other Party in writing, substantiating its reasons for such a Contract Price Revision taking into account the characteristics of the natural gas supplied under the Contract'.[103]

In relation to price adjustment, the commitments (Para 19(iii)) state:

> 'when reviewing the Contract Price provisions the Parties will take into account the price level in the European gas markets, including, inter alia on average weighted border prices in Germany, France and Italy and the price level at the relevant generally accepted liquid hubs in Continental Europe having due regard to all characteristics of the natural gas supplied under the Contract (such as but not limited to quantity, quality, continuity and flexibility)'.

Finally the arbitration part of the price review commitment (Para 19(iv)) states that:

> 'If no agreement is reached within 120 days from the date of notifying substantiated request for a Contract Price Revision, either Party shall have the right to refer the dispute to arbitration as provided for in the relevant Contract on Gas Supply'.

Defining competitive prices

References to the prevailing price level needing to reflect average weighted import border prices and/or the development of the prices at generally accepted liquid hubs in continental Europe mean that the Commission is no longer willing to allow the traditional definition of alternative fuels (principally oil products) as competition to gas to apply in these five countries. The methodologically weak part of the judgement is that these border and hub prices cannot, either *historically or currently*, be said to be applicable to energy and gas market conditions in the Baltic States and Bulgaria (and only since 2014, and only approximately, in Poland). The acceptance by Gazprom that it can no longer continue to charge oil-linked prices, and the designation of border prices and liquid hubs as alternatives which meet DG COMP's definition of 'competitive prices', is significant both in respect of the pricing of Russian gas and European gas pricing in general.

Given the long standing public position of both Gazprom and the Russian government in support of oil-linked gas pricing, and their general opposition to hub-based pricing, public acceptance of this regulatory commitment represents a watershed in Russian gas pricing policy. But the emphasis is on 'public' given that Gazprom has been forced to accept market pricing through a series of renegotiations and arbitrations in respect of its long-term contracts, and this has been an ongoing

[103] The frequency of the review is set at every two years, with an extraordinary price review every five years (Para 19(ii)).

process since at least 2012.[104] Hence references to public statements by Gazprom executives miss the point in relation to the actual commercial position of the company.[105]

Gazprom may have taken the pragmatic stance that it was preferable to come to an agreement with DG COMP rather than risk further legal action and/or fines. Another part of Gazprom's pragmatism may be that although in 2016 these weighted average prices did not represent a competitive price in either Bulgaria or the Baltic States, this situation will change over the next two to three years with the construction of interconnectors between Poland and the Baltic States, between Poland, and central Europe, and within and between south-eastern European (SEE) countries and the rest of Europe. By 2020, it is likely that only some of the very smallest SEE markets (which are not EU member states) will remain cut off from hub prices in north-western Europe.[106] Furthermore, as mentioned above (Section 3.2), the Polish government has expressed its intention to become independent of (at least long-term contract) Russian gas supplies by 2022.

In markets where competition and liquid hubs are not yet present, it remains difficult to agree a definition of competitive pricing. In this respect we agree with the reservations expressed in the Polish, but especially the Bulgarian, comments that the pricing commitments require further clarification.[107] For either a border or a hub price to be accepted in long-term gas contracts, at least two conditions must be satisfied:

1) these prices must be reported for a range of time periods (day, month, year) by reputable, independent price reporting services with a transparent methodology;

2) these prices must have a well-defined relationship with the relevant market to which they are being applied.

In terms of border prices in France and Italy, there is no generally accepted reporting of border prices; in Germany the BAFA price – previously a generally accepted marker for long-term gas contracts – has been superseded by German hub prices (NCG and Gaspool). We would therefore suggest that it will be difficult to use border prices as a relevant commitment metric and the focus should be on hub prices.[108]

It is not clear which hub or hubs should serve as the marker for competitive prices in the Baltic States and Bulgaria. The Polish case is less of a problem given the approximation of hub prices to those of north-western Europe post-2014 (see below). The obvious candidate would be the Dutch TTF, the most liquid euro-denominated hub price. But correlation between prices at TTF and the German hubs is near total, and the correlation between TTF and the Austrian VTP/CEGH hub has improved considerably since 2014 (although not to the same extent as the German hubs).[109] As far as Poland is concerned therefore, there should not be a problem agreeing that the German/Dutch hubs reflect an appropriate competitive price, due to increasing correlation with the Polish hub (VPGX) and exchange (POLPX), although in 2016 this was far from perfect (see below). For the Baltic States, some

[104] For details see Stern (2014a), Chapter 3, especially pp.58–66.

[105] An example of this can be found in the Polish objections to the commitments (para 97) although this also suffers from selective quotation from the source. PGNiG (2017).

[106] PGNiG (2017) (para 139) suggests that 'The [interconnection] projects are not going to be completed before 2020–2022. Over the next couple of years any trade between CEE Countries will actually be possible only via Gaspool, Central European Gas Hub or NetConnect Germany'. We believe many interconnections will be complete by 2020 and (as noted below) prices at these hubs should be very similar to other hubs in north-western Europe.

[107] Although we would dissent from the Polish position, the DG COMP proposal 'does not provide any protection against price exploitation', PGNiG (2017) Section VI.7. 'Bulgaria requests additional information on Gazprom's commitments. May ask for deadline extension to submit comments', BTA, 24 April 2017.

[108] PGNiG (2017) (para 282) comes to a similar conclusion.

[109] For correlations see Heather and Petrovic (2017), especially pp.17–20.

combination of German and Dutch hubs appears the most appropriate, while for Bulgaria, Germany's NCG/Gaspool and Austria's VTP hubs might be geographically more representative.[110]

A further potential criticism of the DG COMP commitments on pricing is that they provide a set of principles – but not a sufficiently specific commercial solution – for how gas contracts should be changed and interpreted. Specifically, they allow Gazprom too much latitude to interpret the language in the commitments. In relation to the phrases: '… the prevailing price level resulting from the Contract *does not reflect* the development of the European gas markets…' (Gazprom Commitments II.2 para 19i), '... when reviewing the contract price provisions the parties *will take into account* the price level in the European gas markets, *including, inter alia* the average weighted import border prices … and the price level at the relevant generally accepted liquid hubs in Continental Europe *having due regard to all characteristics of the natural gas supplied* under the Contract …' (II.2 para 19iii). It can be argued that such phrases do not amount to a requirement that Gazprom charge competitive pricing (at hubs) and could allow Gazprom to continue to overcharge for gas.[111]

While we see the possibility of such an outcome, we think it highly unlikely; we also believe that it would have been undesirable for DG COMP to have been more prescriptive. The role of competition authorities is to set principles, not to define price levels. In this connection, we agree with the PGNiG observation that, because of the room for interpretation of these principles, the commitments will not necessarily avoid the need for arbitration.[112] However, we disagree with the proposition that the scope of the European gas market and the criteria of general acceptance of liquid gas hubs is insufficiently clear and cannot be interpreted by either the parties or (should they fail) an arbitral tribunal.[113] We believe the principle of hub pricing stated in the commitments will provide a guide that would be difficult for any arbitral tribunal to ignore when setting (or resetting) prices.

Wider implications

These commitments are very important, not just for Gazprom but also for the pricing of gas in European long-term contracts generally, because they signal a definitive end to oil-linked/alternative fuel pricing. They should also mean that many arbitration proceedings will reach conclusions very similar to DG COMP's requirements (albeit with some uncertainty about the date from which border or hub prices should be adopted). Any party in a price negotiation or arbitration can now argue that DG COMP has ruled that, even if a country is not connected to a hub, 'competitive pricing' means border or hub prices in western Europe, and this is universally applicable.[114]

Compensation for alleged overcharging for gas

Finally, in this section we consider the Polish view that DG COMP should have imposed a fine on Gazprom for overcharging countries for gas and should be required to pay compensation to PGNiG (and other countries). DG COMP has conducted a five year investigation and therefore it is difficult to conclude that it has arrived at its findings in haste, or failed to consider all of the relevant issues. Furthermore, in arriving at these judgements, DG COMP will have had access to a wide range of

[110] We believe that the Polish suggestion (PGNiG (2017)) paras 275 and 284) to include a wider range of hubs and borders, including the UK border and NBP, is over complicated and not relevant for the countries in question, particularly as there is a possibility that, post-Brexit, NBP may become less connected with the continental European hubs, see Bros (2017).

[111] The term 'overcharge' can be misleading here given that Gazprom's post-2012 pricing arrangements with many European customers have involved rebates, such that if customers have been 'overcharged' in relation to hub prices they receive a rebate at the end of the price period. In this respect, the price data for countries in western Europe post-2012 in Table 1 may be misleading. For details see Stern (2014a), Chapter 3, especially pp.58–64.

[112] PGNiG (2017) para 121.

[113] PGNiG (2017) para 156.

[114] A different interpretation could be that DG COMP has applied this requirement only because of Gazprom's dominance in these markets. Following this logic, suppliers which are not dominant suppliers to a market could continue to argue that alternative fuels should remain a relevant pricing benchmark (although we believe with decreasing credibility and likelihood of success).

confidential commercial information, including historical prices and other contractual terms, which PGNiG has chosen not to reveal.[115]

We believe that DG COMP will have considered the following issues in arriving at its conclusions on Gazprom's behaviour in respect of pricing gas to these countries:

- The overall commercial context of the European gas market, in terms of pricing, competition, and supplier behaviour during the relevant period;[116]
- Prices paid by these countries for Russian gas in relation to prices paid by other Gazprom customers;
- Efforts that these countries had made during this period to access non-Russian gas;
- Efforts made by these countries to liberalize their gas markets and develop competitive market conditions;

We consider each of these issues briefly in the following paragraphs.

Prior to the 2010s, the continental European gas market was largely monopolized by national companies and gas was largely priced on the basis of alternative fuels (mainly oil products). This began to change in 2008 and it accelerated in respect of moving from oil-linked to hub-based pricing, facilitated by access to pipeline networks, through the 2010s.[117] It is therefore difficult to claim that Gazprom's commercial behaviour prior to 2010 was significantly different from that of other suppliers from whom central and eastern European countries could have purchased gas.

In other research, we have pointed out that central and eastern European countries have always believed that they have been overcharged by Russia for their gas, and have ascribed political motives to this overcharging.[118] We have suggested that in central and eastern Europe (as opposed to in former Soviet Union countries) gas pricing can be explained by commercial, rather than political, factors.

Table 1 shows public domain prices for Russian gas exports for the period 2010–14. The data certainly suggest that central and eastern European countries paid higher prices than western European countries, approximately 10 per cent above the average in the case of Poland. This can be partly accounted for by the lack of supply diversification in the nearly 25-year period since the end of the Cold War. The advantage of supply diversification was reflected in the price reduction which Lithuania received from Gazprom when it commissioned its LNG terminal in 2014.[119]

[115] Referred to throughout PGNiG (2017) as 'business secret'.
[116] But we do not know the exact period which DG COMP has considered to be relevant. Clearly this encompasses the period of the dawn raids to the present (namely 2011–16), but the Polish objections cite events from 2006 and it is unclear how far back DG COMP's judgement extends given, as mentioned above, the fact that competition and pricing conditions on continental European gas markets did not change significantly until after 2008.
[117] Stern and Rogers (2012), Chapter 4.
[118] Stern (2014b), Chapter 4, especially pp.91–7.
[119] For an account of Lithuanian gas pricing relationship with Russia see Pakalkaité (2016), pp.16–17.

Table 1: Russian Gas Export Prices to Selected European Countries 2010–14 (US$/mcm)

	2010	2011	2012	2013	2014
Germany	270	379	353	366	323
Italy	331	410	438	399	341
Denmark	0	480	394	382	341
Austria	305	387	394	402	329
France	306	399	398	404	338
Netherlands	308	366	346	400	362
Finland	273	358	373	367	354
Poland	331	420	433	429	379
Romania	325	390	424	387	394
Bulgaria	311	356	435	394	388
Slovenia	312	377	400	396	395
Hungary	350	383	416	418	338
Czech Republic	326	419	500	400	378
Slovakia	371	333	428	438	308
Serbia	341	432	405	386	382
Bosnia and Herzegovina	339	429	500	421	375
Turkey	326	381	416	382	366
Greece	359	414	475	469	400

Source: 'Gazprom to sharply increase gas supply to Europe via Ukraine on Friday', Interfax Russia and CIS Oil and Gas Weekly, 5–11 March 2015, pp. 4–7.

Indeed, the question of diversification of gas supplies away from Russia has been on the agenda of certain central and eastern European countries since the early 1990s, significantly prior to these countries becoming EU member states. The fact that so little diversification had been achieved prior to the 2010s – and, arguably, still in some countries – has not been due to a lack of attention or of suggested pipeline and LNG projects. Substantial studies were carried out by consultants under the auspices of the EC and national governments during the 1990s and 2000s, the vast majority of which were never progressed.[120] The principal reason for this lack of progress is that they would have required investment on a scale that neither the countries themselves, nor external investors, believed would be commercially viable.[121]

Another reason was that, on the basis of public domain information, the prices being negotiated and charged during this period by non-Russian pipeline and LNG suppliers did not suggest that gas would be made available at prices significantly lower than those being offered by Gazprom. This was partly confirmed by the price negotiated in the Polish long-term LNG import contract with Qatar which, in 2013, was estimated at 40–50 per cent higher than the Russian price.[122] Global LNG price levels suggest that, even if LNG import terminals had been operating in Poland and the Baltic States

[120] An example of 25 gas connection and storage projects which were proposed prior to 2001 can be found in Baltic Gas/BaltRel (2001).

[121] Many gas pipeline interconnectors and LNG regasification terminals in central and eastern Europe that have been completed and are under construction in the 2010s have been made possible by the contribution of EU funding under the PCI (projects of common interest) programme.

[122] The price has subsequently been renegotiated downwards and the volume of imports significantly increased. 'Poland's energy security strategy comes at high cost', *Reuters*, 9 September, 2013; 'Qatargas agrees to double LNG supplies to Poland – UPDATE2', *Reuters*, 14 March 2017.

between 2011 and the second half of 2014, they would have had difficulty in accessing gas at lower prices than those offered by Gazprom.[123]

As mentioned above, since 2008, competition and liberalization of gas markets have proceeded rapidly with the development of market hubs. However, in central and eastern Europe, liberalization of access to gas networks, and hence competition, has proceeded much more slowly.[124] Heather and Petrovic have been monitoring the development of European gas hubs and hub price correlations since 2010. Their 2017 study makes clear that in the Baltic States, traded gas prices are not quoted on any consistent basis and (according to the European Federation of Energy Traders) hubs in Romania, Bulgaria, and Greece are only at the planning stage.[125] Of the five countries in question, only Poland could be said to have an operating gas hub or exchange and:[126]

> '... the Polish [hub] VPGS just makes it as a poor hub with a score of 9½ which is echoed in the impressive increase in traded volumes carried out on the POLPX since 2014 … There has been very little OTC trading but the TGE exchange (POLPX) has been offering products at the Polish VPGS hub since 2013 both spot (WD and DA) and curve (Months, Quarters, Seasons and Years).'

On price correlation, the study concludes:[127]

> 'The trading hub in Poland (VPGS) is connected to GPL and to the Czech hub, but Polish day ahead prices are weakly correlated to the adjacent markets. In particular, notwithstanding the high premium for day ahead gas quoted on the Polish exchange with respect to adjacent markets and the presence of ample spare cross border capacity, gas did not flow from the lower-priced Czech/GPL markets to the higher priced Polish hub. This signals a non-physical barrier to gas trade into Poland, and suggests that the market in this country is not yet fully integrated and not fully liberalized. Polish gas price levels appear to be heavily dependent on local conditions, although an improvement compared to 2015 has occurred.'

Overall, many countries in this region have either never privatized and liberalized their gas sectors (Poland), or have renationalized and re-monopolized their industries in the 2010s (Lithuania), thus making it extremely difficult for them to benefit from competition.[128] This has led to their customers paying higher prices than would otherwise have been the case.

4. DG COMP's and third parties reactions to the commitments and the way forward

On 13 March 2017 DG COMP, having analysed the commitments and conducted additional negotiations with Gazprom throughout January and February 2017,[129] announced its satisfaction with Gazprom's commitments. According to Competition Commissioner, Vestager, the commitments 'will enable the free flow of gas in central and eastern Europe at *competitive* prices' (emphasis added), address competition concerns, 'provide a forward looking solution in line with EU rules', and 'help to better integrate gas markets in the region'. Subsequently, DG COMP invited all interested parties to comment on the commitments (during the so called 'market test' procedure) by 4 May 2017,[130] thus

[123] Stern (2016), especially pp. 468–73.
[124] On almost every competition metric, these countries have very modest achievements. ACER/CEER (2016).
[125] Heather and Petrovic (2017), pp. 13 and 15. For a comment on the lack of progress of a Lithuanian hub, based on the country's LNG terminal, see: 'Lithuania's gas hub plans move further away', *Interfax Gas Daily*, 2 June 2017, p.4.
[126] Ibid, p.13. Annual traded volumes on the Polish exchange in TWh have been 2013: spot 0.425, curve 1.968; 2014: spot 5.390, curve 105.076; 2015: spot 13.925, curve 92.634; 2016: spot 24.595, curve 89.974.
[127] Ibid, p.26.
[128] For details of the Lithuanian case see Pakalkaité (2016), pp.27–9.
[129] 'EU says needs more talks with Gazprom over competition dispute', *Reuters*, 31 January 2017.
[130] EC (2017b).

providing them with seven weeks for doing so.[131] While the majority of third parties submitted their comments by the aforementioned deadline, the Polish oil and gas company, PGNiG, applied for an extension on the grounds of needing more time for setting out its multiple concerns (the final document runs to over 90 pages) which were submitted on 19 May 2017, two weeks after the original deadline.[132] Notably, DG COMP asked for comments to be 'reasoned', to set out 'the relevant facts', and to 'suggest a possible solution' if a problem is identified with any part of the commitments.

There are two – mutually exclusive – avenues open to DG COMP in proceeding with the case once the market test has been completed. One is to reject the commitments and close the case with an infringement decision (prohibition) (Art. 7 of Regulation 1/2003). Another is to accept the commitments and close the case with a commitments decision (settlement) (Art. 9 of Regulation 1/2003). In line with Art. 7, where the EC finds that there is an infringement of EU antitrust rules it may by decision (but does not have to) require the undertakings concerned to bring such infringement to an end (an infringement decision). To do so, it may impose 'any behavioural or structural remedies' provided that they are 'proportionate' to the infringement committed and 'necessary' to bring it 'effectively to an end'. Regulation limits the imposition of structural remedies 'either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome'. Notably, the EC 'may by decision' – but does not have to – impose fines on undertakings where EU antitrust rules were infringed; the amount of the fine is fixed with regard to both the gravity and the duration of the infringement, but in any event must not exceed 10 per cent of the undertaking's total turnover in the preceding business year (Art.23.2). In line with Art. 9, when the EC *intends* to adopt an infringement decision – but has not done so yet – and the undertaking concerned *offers commitments* to meet the EC's concerns expressed in its preliminary assessment (namely, Statement of Objections), the EC 'may by decision' – but does not have to – accept these commitments and make them binding (a commitments decision). The commitments decision must conclude that 'there are no longer grounds for action' by the EC. Notably, the EC is not obliged to conclude in its commitment decision whether or not there has been or still is an infringement (Regulation 1/2003, preamble, section 13). Thus the Regulation is very clear that it is impossible to adopt an infringement decision and a commitments decision in respect of one and the same case.

In our view, there are several scenarios – some more, and others less, likely – of how the DG COMP investigation might be concluded following the evaluation of the market test results. Should DG COMP consider those results satisfactory, it can decide to accept the commitments in their original form and make them legally binding on Gazprom. Alternatively, should DG COMP consider the results of the market test being *not entirely satisfactory*, it might (and indeed did) decide to hold further talks with Gazprom to address any substantiated concerns made by third parties. Should this be the case, Gazprom might be willing to offer amendments to its original commitments to alleviate these concerns. Should DG COMP decide these amendments are satisfactory, it can accept the amended commitments. Notably, DG COMP would be under no obligation to conduct another market test in respect of the amended commitments but might decide to hold informal consultations with market players. Prior to adopting a final decision, DG COMP is obliged to consult an advisory committee composed of representatives of the competition authorities of the member states (Art. 14.1 and 14.2 of Regulation 1/2003) which delivers an opinion on DG COMP's preliminary decision. Although DG COMP is obliged to take the utmost account of that opinion (Art. 14.5 of Regulation 1/2003), neither the committee as a whole nor any of its members have a veto power over DG COMP's final decision.

The fact of Commissioner Vestager and Gazprom's Deputy CEO Medvedev having met on 29 May 2017[133] – only 10 days after third parties' comments had been received by DG COMP – 'to discuss

[131] Notably, DG COMP allowed for more than twice the time normally allocated for comments, presumably to avoid any potential accusations of insufficient time being allowed.

[132] Following the submission of its comments, PGNiG held a press conference where its CEO, Piotr Woźniak, outlined the content of PGNiG's submission; PGNiG subsequently published its submission on its website, the only third party from an EU member state to have done so.

[133] 'EU, Gazprom buy time to settle gas antitrust case', *EurActiv*, 29 May 2017.

the way forward in relation to the commitments'[134] and agreeing 'to hold further talks at technical level […] to assess the results of the market test', with Medvedev expressing hope that this 'should allow moving the procedure forward and concluding the settlement procedure in the near future', suggests that settlement is the most likely scenario. Furthermore, we believe that a scenario under which Gazprom would offer amendments to the commitments, before they are accepted by DG COMP, is more likely than a scenario under which DG COMP would accept the commitments in their original form. This is partly because some third parties' concerns are sufficiently well substantiated, and the commitments would benefit from being made more specific in some respects, and partly because it would be extremely difficult – although not impossible – for DG COMP to accept the commitments in their original form due to the very negative public position adopted by Poland. It is possible (but not likely) that Gazprom might not offer *any* amendments to the commitments, thus presenting DG COMP with a choice between either accepting the commitments in their original form or rejecting the commitments altogether (in other words, adopting an infringement decision).

Should DG COMP adopt an infringement decision and impose a fine, Gazprom would likely appeal, which would lead to a protracted legal battle, the outcome of which might not be decided before 2020. On the other hand, should DG COMP accept the commitments (either in their original or amended form) and adopt a commitments decision, a third party (such as the Polish government/PGNiG) could attempt to legally challenge the decision both at the general court and at the CJEU. Meanwhile, the commitments would continue to remain in force. Potentially, a third party could apply for interim measures for the commitments to be suspended for the duration of the case, but in order to do so it would have to demonstrate that continuing application of the commitments would cause it irreparable damage. In our view, this would be extremely difficult given that, on the contrary, the commitments serve to improve the competitive situation of all central and eastern European member states.

Overall, we believe that Gazprom offering amendments to the commitments, and DG COMP accepting the amended commitments, constitutes the most likely scenario. This scenario would strengthen the position of DG COMP, should it be legally challenged by any third party, enabling it to demonstrate that it did not ignore the third parties' concerns expressed during the market test, as the *substantiated* concerns would be addressed in the amended commitments. It would also allow Gazprom to settle the case and avoid a protracted legal battle and/or fines. Closing the case with a settlement would not be unusual, as many other anti-trust cases brought by DG COMP against European gas companies have been settled with commitments in the past 10 years (including Belgium's Distrigaz, France's GDF Suez, Germany's E.ON and RWE, and Italy's ENI).[135] Once a commitments decision is adopted, Gazprom would have to meet its commitments in full, including in respect of making corresponding contractual adjustments within the time frame specified. If Gazprom were to break its commitments at any time during which these are in force, DG COMP would be able to impose a fine on Gazprom without having to prove an infringement of EU antitrust rules.[136]

Although we believe that DG COMP is likely to accept Gazprom's commitments – either in their original form or as amended to take into account the results of the market test – thus closing the case with a settlement, the potential for confrontation remains. This potential could only be realized should third parties overwhelmingly express – and *substantiate* – their dissatisfaction with the commitments. Given that the majority of third parties' comments on the commitments are not available in the public domain, it is difficult to judge whether the results of the market test are satisfactory overall. However, it is our understanding that only Poland has publicly spoken against the settlement and called for a 'firm infringement decision with fine and effective remedies'[137] to be imposed on Gazprom.[138] Other central and eastern European countries appear to have adopted a more moderate view. Some of

[134] 'Gazprom and Brussels chart course to address antitrust settlement concerns', *Fast FT*, 30 May 2017.
[135] Talus (2011); 'EC mulls Gazprom's proposals to end EU gas market antitrust case', *Platts*, 3 January 2017.
[136] However, Gazprom could dispute a potential conclusion from DG COMP that the commitments had been broken, which would likely see the start of legal proceedings probably lasting several years.
[137] PGNiG (2017), section III(9), p. 10.
[138] 'Poland's PGNiG urges tough stance in EU antitrust case vs Gazprom', *Reuters*, 18 May 2017.

them, such as Bulgaria and Lithuania, have commented on the commitments to the media. Bulgaria expressed more positive, and Lithuania more negative, views, while both requested further clarifications and called for further commitments. More specifically, Bulgaria asked for more details on the exact future benchmark for gas prices (which is a fair point in respect of which the commitments could be clarified, see Section 3.3 above) and for guarantees of retaining its transit status in respect of Russian gas (which, by virtue of not being a competition law issue, could not possibly be addressed in the commitments).[139] Lithuania argued that as the commitments on prices only apply to contracts with a duration of more than four years, and as it no longer has such a long-term contract with Gazprom, there would be no guarantee that it would be able to benefit from these commitments and be offered a 'fair' price[140] (this concern is hardly valid given that the commitments state explicitly that those would apply to new contracts with a duration of more than four years and there is nothing to prevent Lithuania from concluding such a contract with Gazprom). Other countries, such as Latvia and Slovakia, have provided more general (and largely positive) comments to the media[141] whereas Hungary and the Czech Republic have abstained altogether from public comment.[142] The Energy Community Secretariat[143] also provided comments on the commitments, stating that it 'generally supports' them. The Secretariat's submission mostly refers to issues outside the scope of the Statement of Objections – for example, (a) a recommendation to 'extend' the commitments 'to restrictive clauses in contracts with suppliers in Energy Community Contracting Parties and to interconnection agreements at the interconnection points between Bulgaria and Energy Community Contracting Parties' (despite the fact that no such Contracting Parties are referred to in the Statement of Objections), and (b) a proposal that 'Gazprom commits to provide the necessary matching information to any Ukrainian TSO … to be able to effectively engage in management of cross-border gas flows including virtual reverse flows' (despite the fact that Ukraine is not – and could not have been – referred to in the Statement of Objections, not being an EU member state).[144]

Despite an evident diversity of views expressed by third parties – countries, companies, and an international organization – all of them have stopped short of arguing against the settlement. Thus this brief survey (based on public statements only) demonstrates that the results of the market test have not been considered wholly unsatisfactory by any party except Poland/PGNiG.

It is clear that DG COMP's apparent willingness to adopt a commitments decision – as opposed to an infringement decision with a fine – caused a significant degree of unhappiness in Poland, which has expressed an expectation that the investigation should result in Gazprom's 'punishment', in the form of multi-billion euro fine. Notably, prior to the announcement of the commitments, the Polish authorities threatened to sue the EC should the investigation be closed without a fine. Soon after the commitments were announced, Poland's Foreign Minister Witold Wąsikowski stated that Poland will use 'all legal means' to block the commitments.[145] The CEO of the Polish 100 per cent state-owned oil and gas company, PGNiG, Piotr Woźniak, referred to the commitments as being 'highly insufficient'

[139] 'Bulgaria may seek more time to reply to Gazprom concessions', *The New York Times*, 24 April 2017.

[140] 'Lithuania rejects Gazprom antitrust conditions', *Platts European Gas Daily*, 8 May 2017. It is worth noting that Lithuania is still using the notion of 'fair' price whereas DG COMP has switched to the notion of 'competitive' price, thus acknowledging that 'fair' cannot be adequately defined in commercial terms (see Section 3.3).

[141] 'EU's imminent Gazprom settlement opens up old wounds', *Euranet Plus News Agency*, 27 October 2016.

[142] It is worth noting that in April 2017 Gazprom signed framework agreements with the TSOs in Slovakia and the Czech Republic (Eustream and Net4Gas) for gas transportation until 2050 and 2040 respectively, which suggests that these two countries are unlikely to be negative about the commitments which, if adopted, would contribute towards further integration of central and eastern European markets, and continuing utilization of their respective gas networks, see 'Gazprom and Eustream sign deal on gas transport', *The Slovak Spectator*, 12 April 2017; 'Gazprom started early bookings' (in Russian), *Kommersant*, 12 April 2017.

[143] EnCT includes the following Contracting Parties: Albania, Bosnia & Herzegovina, Georgia, FYROM, Moldova, Montenegro, Serbia, Ukraine, and UNMIK. Following the accession of Bulgaria, Romania, and Croatia to the EU, their legal status changed from that of a Contracting Party to a Participant; at present 20 EU member states have a Participant status in the EnCT. See the Energy Community Secretariat website for more detail.

[144] 'Secretariat submits comments to the European Commission regarding Gazprom's proposed anti-trust commitments', Energy Community Secretariat, press release, 4 May 2017.

[145] 'Poland to use "all legal means" to block Gazprom's EU antitrust deal', *Reuters*, 15 March 2017.

and promised to propose 'minimum requirements to be imposed on Gazprom'. This promise was fulfilled in PGNiG's 92-page response to the market test, which called for an 'infringement decision with fine and effective remedies'. It is worth noting that many objections expressed in the document are outside the scope of the Statement of Objections.

Poland's attitude towards the EC's (provisional) acceptance of Gazprom's commitments echoes its attitude towards the 2016 EC OPAL exemption decision (which allowed Gazprom greater utilization of OPAL and, consequently, of Nord Stream), which has been contested by the Polish government and PGNiG at the CJEU (the case is still pending).[146] Both appear to be part of Poland's broader commercial strategy. This strategy aims at strengthening its position in the ongoing arbitration between PGNiG and Gazprom under existing supply contracts where price formation – one of the central issues addressed by the DG COMP inquiry – is reported to be one of the contentious issues. It is also aimed at strengthening its position against Gazprom in respect of the expiring (at the end of 2019) contract under which Russian gas is transited across Poland via the Yamal–Europe pipeline, with Poland willing to retain its transit role. It might also be aimed at strengthening its position against Gazprom in respect of the expiring (at the end of 2022) gas supply contract, as although Poland has said this would not be renewed, it did not rule out continuing to buy gas from Gazprom post-2022 (see Section 3.2 above).

It is worth noting that, in addition to expressing its dissatisfaction with the commitments at the national level towards the EC, Poland is also doing so at the EU level while attempting, in the process, to present it as a position uniformly shared by other central and eastern European countries. On 16 March 2017, the head of the European Parliament's Committee on Industry, Research, and Energy (ITRE), the veteran Polish politician Jerzy Buzek, sent a letter to DG COMP expressing disappointment about the commitments 'missing the provisions for compensation to the affected parties and a fine for the breach of the EU rules', and called for the introduction of 'all appropriate measures to ensure that Gazprom effectively compensates the affected parties for the losses they have incurred in the respective member states'.[147] Notably the letter does not refer to Poland specifically but to central and eastern European member states as a group. The letter was signed by several members of the European Parliament (MEPs), representing all its main parties. The same committee has previously sent a letter to the European Council calling for Nord Stream 2 to be stopped, and criticized the EC's OPAL exemption decision.[148] (There is a significant, albeit incomplete, overlap between the two letters' signatories.) However, while Poland has succeeded in persuading Lithuania and Latvia (and prior to that, Ukraine) to join its legal battle against the EC on the OPAL exemption decision at the CJEU,[149] it appears to have failed to build a similar coalition with central and eastern member states to express stronger criticism of Gazprom's commitments. As noted above, even Lithuania – a member state at the request of which DG COMP opened the investigation against Gazprom in 2012 – has stopped short of calling for an infringement decision.

5. Conclusions

Our main conclusion is that Gazprom's proposal for commitments has addressed *all* the concerns expressed by DG COMP in the Statement of Objections in respect of territorial restrictions, pricing, and infrastructure issues – both in form and in substance.

More specifically, the proposal envisages the following commitments:

[146] Yafimava (2017).
[147] European Parliament (2017a).
[148] European Parliament (2017b).
[149] 'Litwa i Łotwa przyłączyły się do polskiej skargi do TSUE ws. Opalu', *PAP*, 31 March 2017; Naftogaz (2017).

- price review clauses will be introduced and reinforced, providing the customers in five central and eastern European countries (Bulgaria, Estonia, Latvia, Lithuania, and Poland) with an explicit contractual right to trigger a price review when the prices they pay diverge from competitive price benchmarks, while also accepting the average weighted import border prices in Germany, France, and Italy and/or the prices at the liquid continental European hubs as a competitive alternative to oil-linked prices;
- territorial restrictions are no longer applied in existing, and will not be introduced in future, contracts;
- a right to request a change from existing to new delivery points will be introduced in contracts with customers in Poland, Hungary, and Slovakia;
- contractual measures will be taken to allow an increased integration of Bulgaria with adjacent markets, thus enabling diversification of supplies, while waiving damages in respect of South Stream cancellation.

Most importantly, the commitment for the prevailing contract price level to reflect prices at generally accepted liquid hubs in continental Europe means that if the proposal is accepted, buyers in those central and eastern European countries (in respect of which this commitment was offered) would be able to buy Russian gas at prices which otherwise would not have been offered to them until interconnections had been established with north-western European hubs (which might not have been the case prior to 2020). More generally, DG COMP's definition of competitive pricing appears to us to signal a definitive end to alternative fuel (oil-linked) pricing in continental European long-term gas contracts.

Acceptance and implementation of these commitments would serve as an insurance against any future abuse by Gazprom of its dominant position in central and eastern European member states. Should Gazprom break its commitments at any point in time when they are in force, DG COMP would be able to impose a fine of up to 10 per cent of its annual total turnover, without having to prove an infringement of EU antitrust rules.

It will be extremely difficult for third parties to substantiate negative comments to an extent that would lead DG COMP to reject the commitments and adopt an infringement decision. This is true in respect of two main objections expressed during the market test: *the lack of fines and the lack of compensation*. Although third parties could express their dissatisfaction that no fine is being imposed on Gazprom – especially in respect of territorial restrictions (against which there is no defence) – DG COMP possesses exclusive competence in deciding whether or not to apply a fine (Art. 23 of Regulation 1/2003). Notably, Competition Commissioner Vestager has stressed that DG COMP's guiding principle in deciding between a commitment decision (settlement) (namely accepting the commitments with no fines imposed) and a prohibition decision (infringement, in other words rejecting the commitments and imposing fines) has been based on its assessment of *which decision would ensure that Gazprom will change its behaviour in central and eastern European gas markets*, so that no abuse of dominance could possibly occur in the future, thus ultimately benefitting European consumers.[150] She stressed that imposing a fine for past (anti-competitive) behaviour would not necessarily result in Gazprom changing its behaviour and therefore would not bring a positive change to European consumers.[151] It would also involve a protracted legal battle (as Gazprom would certainly contest any such decision) with uncertain outcomes and would be unproductive for both sides. It appears that, in being minded to accept Gazprom's commitments, DG COMP believes that the commitment decision is the best way to make Gazprom change its behaviour in central and eastern European gas markets, thus fulfilling the main objective of DG COMP's investigation – which is to ensure that Gazprom cannot in future exploit its dominant position, and that gas flows freely across borders at competitive prices.

[150] Vestager press conference and Q&A, 13 March 2017.
[151] Ibid.

In respect of compensation, given that the Baltic States and Bulgaria have been unable to access gas from suppliers other than Gazprom, and that Poland was unable to access significant non-Russian supplies prior to 2014, there is no realistic benchmark against which the prices they were paying to Gazprom could be compared. This situation has changed since 2014 as LNG terminals have opened in Lithuania and Poland, and additional terminals and pipeline interconnections will enhance diversification away from Russian gas. Similar diversification will be available to Bulgaria by 2020 with imports of Azeri (and possibly Romanian) gas and interconnectors with other European countries.

Other comments made by third parties during the market test that are sufficiently well substantiated – such as, for example, that the pricing commitments would benefit from further clarification – might result in DG COMP holding further talks with Gazprom to see whether the latter might be willing to amend the commitments in this respect.

Our analysis leads us to believe that, having assessed the results of the market test, DG COMP will accept Gazprom's commitments – either in their original (less likely) or amended (more likely) form – thus closing the case with a settlement. Any DG COMP decision to accept the commitments could be legally challenged by a third party should it believe that its comments were ignored, but the commitments would likely continue to remain in force during that process and the outcome of any such legal challenge would likely be in favour of the EC. Should DG COMP decide to reject the commitments – either in their original or amended form – and adopt an infringement decision, Gazprom would be likely to appeal, thus leading to a protracted legal battle with uncertain outcomes for both sides.

Glossary

CJEU – Court of Justice of the EU

DG COMP – Directorate General for Competition

EC – European Commission

EU – European Union

IGA – Intergovernmental Agreement

IGB – Interconnector Greece–Bulgaria

IP – Interconnection Point

mcm – thousand cubic metres

PCI – project of common interest

PGNiG – Polskie Górnictwo Naftowe i Gazownictwo

TEN – Trans-European Network

TEC – Treaty Establishing the European Community

TEP – Third Energy Package

TFEU – Treaty on Functioning of the EU

TFEU – Treaty on the Functioning of the European Union

TSO – Transmission System Operator

Annex 1

Art. 102 TFEU (abuse of dominance)

(ex Art. 82 TEC)

Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between member states.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Annex 2

The 2003 Additional Protocol: tariff provisions

The 2003 Additional Protocol[152] stipulated that a transportation tariff (both for transit of Russian gas across Poland and for transportation to Polish consumers) charged by EuroPolGaz (a pipeline operator prior to operatorship being transferred to Gaz-System in 2010, see above) must be set at a level which ensures continuous operation such that no financial losses are incurred (Art. 4). The tariff is calculated with a view of ensuring that EuroPolGaz covers its operating costs, carries out an investment programme agreed with its main shareholders, honours its loan commitments and taxes, and accumulates free cash in line with (but not in excess of) its business plan (Art. 4).

The protocol sets a progressively decreasing tariff for the 2002–19 period, while stating that a corresponding Polish authority (i.e. the national regulator) will approve (and amend) a transportation tariff as follows:

- 1 September 2002–31 August 2003: the tariff set by the Polish regulatory authority in 14 August 2002, the US dollar equivalent of which is $2.74/mcm/100 km;
- 1 September 2003–31.12.2003: $2.74/mcm/100 km;
- 2004–2005: $2.5/mcm/100 km;
- 2006–2013: $1.55/mcm/100 km;
- 2014–2019: $1.00/mcm/100 km.

The tariff was set based on the assumption of 100 per cent utilization of pipeline capacity, as of September 2003, while noting that should the 4 per cent of capacity booked by Gas-Trading not be utilized, the tariff was to be amended by the aforementioned Polish authority.

[152] The 2003 Additional Protocol.

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