College of Europe
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Natolin

'Juggling Geopolitics and Competition Law'

an Analysis of the Role Geopolitics Plays in the Application of Competition Law in Upstream Gas Contracts

Aisling Murphy

DEPARTMENT OF
EUROPEAN INTERDISCIPLINARY STUDIES

Natolin Best Master Thesis 02 / 2014

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Aisling Murphy

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Abstract

Creating an internal gas market aims to lower prices for consumers, increase security of supply and ultimately enhance the competitiveness of the EU. Competition law plays an essential role in creating this market. This paper analyses the role geopolitics plays in the application of competition law in upstream gas contracts. Taking European companies' experiences as a normative example, it aims to study the experiences of Sonatrach, the Algerian gas exporting company and Gazprom, the Russian gas exporting company.

The findings of this paper suggest that there is evidence to substantiate the claim that geopolitics plays a role in the application of competition law in the upstream gas contracts. Sonatrach received preferential treatment both in terms of the procedural approach adopted by the Commission and the legal settlement accepted. Nevertheless, the current Gazprom investigation is an example of where the Commission may strictly apply competition law despite the presence of geopolitical concerns. This case highlights another dimension of the way in which geopolitics could affect the application of competition law in the sector. Some critics have claimed that this strict application was motivated by geopolitical claims. Further research is required into the issue when the case is resolved.

The Natolin Best Masters' Theses Series

Prof. Nanette Neuwahl
Director of studies
College of Europe (EIS programme, Natolin Campus)

The "Natolin Best Master's Thesis" series showcases the best Masters' Theses produced by the students of the Natolin campus of the College of Europe in any given year.

The College of Europe (CoE), founded in 1949 at the instigation and with the support of leading European figures, in particular, Salvador de Madariaga, Winston Churchill, Paul-Henri Spaak and Alcide de Gasperi, is the world's first university institute of postgraduate studies and training specialised in European affairs. The idea behind this particular institution was, to establish an institute where university graduates European countries could study and live together, and the objective was to enhance cross-border interaction and mutual understanding. The Natolin campus of the College of Europe in Natolin, Warsaw (Poland) was established in 1992 in response to the revolutions of 1989 and in anticipation of the 2004 and 2007 enlargements of the European Union. Ever since, the College of Europe operates as 'one College – two campuses'.

The European Interdisciplinary Studies (EIS) programme at the Natolin campus invites students to view the process of European integration beyond disciplinary boundaries. Students are awarded a 'Master of Arts in European Interdisciplinary Studies'. This programme takes into account the idea that European integration goes beyond the limits of one academic discipline and is designed to respond to the increasing need for experts who have a more comprehensive understanding of the European integration process and European affairs. The EIS programme is open to graduates in Economics, Law or Political Science, but also to graduates of History, Communication Studies, Languages, Philosophy, or Philology who are interested in pursuing a career in European institutions or European affairs in general. This academic programme and its professional dimension prepare graduates to enter the international, European and national public sectors as well as nongovernmental and private sectors. For some of them, it also serves as a stepping stone towards doctoral studies.

The European Single Market, governance and external relations are focal points of academic activity. Recognised for its academic excellence in European studies, the Natolin campus of the College of Europe has endeavoured to enhance its research activities, as well as to encourage those of its students who are predisposed to do so,

to contemplate a career in academia. The European Parliament *Bronislaw Geremek* European Civilisation Chair and the *European Neighbourhood* Policy Chair in particular, encourage research on European History and Civilisation, respectively, the Eastern and Southern Neighbourhood.

The EIS programme culminates in the writing of an important Master's Thesis. At the College of Europe every student must, in order to get his or her degree, produce a Thesis within the framework of one of the courses followed during the academic year. The research must be original and linked to European policies and affairs, on a topic chosen by the student or proposed by the Professor supervising the Thesis. Very often, a student chooses a subject which is of importance to his or her subsequent career plan. Masters' theses are written either in French or in English, the two official languages of the College of Europe, often not the native language of the students.

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Prof. Nanette Neuwahl
Directeur d'étude
Collège d'Europe (Programme EIS, campus Natolin)

La série « Meilleure thèse de Master du campus de Natolin" met en valeur les meilleures thèses de master rédigées par les étudiants du campus de Natolin du Collège d'Europe pour une année donnée.

Le Collège d'Europe (CoE), fondé en 1949 à l'instigation et avec le soutien de figures européennes de proue telles que Salvador de Madariaga, Winston Churchill, Paul-Henri Spaak et Alcide de Gasperi, est le premier institut universitaire d'études supérieures du monde spécialisé dans les affaires européennes. L'idée à l'origine de cette institution était de créer un institut dans lequel des diplômés universitaires issus de différents pays européens pourraient étudier et vivre ensemble afin de promouvoir la communication transfrontalière et la compréhension mutuelle. Le campus de Natolin du Collège d'Europe à Natolin, Varsovie (Pologne) a été fondé en 1992 à la suite des révolutions de 1989 et pour anticiper les différents élargissements de l'Union européenne prévus pour 2004 et 2007. Depuis lors, le Collège d'Europe fonctionne désormais selon la formule « un collège – deux campus ».

Le programme d'études européennes interdisciplinaires (EIS) du campus de Natolin invite les étudiants à analyser le processus de l'intégration européenne au-delà des frontières disciplinaires. Les étudiants obtiennent un "Master en études européennes interdisciplinaires ». Ce programme tient compte de l'idée que l'intégration européenne dépasse les limites d'une seule discipline académique et est conçu pour répondre aux besoins croissants d'experts qui conservent une compréhension globale du processus de l'intégration européenne et des affaires européennes. Le programme EIS est ouvert non seulement aux étudiant en économie, en droit ou en science politique, mais également aux diplômés en histoire, en communication, en langues, en philosophie ou en philologie désireux de poursuivre une carrière dans les institutions européennes ou les affaires européennes, en général. Ce programme académique et sa dimension professionnelle préparent les étudiants à intégrer les secteurs publics nationaux, européens et internationaux ainsi que les secteurs non-gouvernementaux et privés. Pour certains d'entre eux, ce programme constitue également une étape vers des études doctorales.

Le marché unique européen, la gouvernance et les relations extérieures sont des points majeurs de l'activité d'enseignement. Reconnu pour l'excellence de ses programmes en études européennes, le campus de Natolin du Collège d'Europe s'est engagé à améliorer ses activités de recherche, ainsi qu'à encourager ses étudiants les mieux prédisposés dans une carrière d'enseignement. La chaire de civilisation européenne du parlement européen *Bronislaw Geremek* et la chaire de politique de voisinage européen en particulier, encouragent la recherche sur l'histoire et la civilisation européenne, respectivement, et sur le voisinage avec l'Europe de l'est et du sud.

Le programme EIS se termine par la rédaction d'une importante thèse de Master. Au Collège d'Europe, chaque étudiant doit, pour obtenir son diplôme, produire une thèse dans le cadre de l'un des cours qu'il a suivi au cours de son année d'enseignement. La recherché doit être originale et liée aux politiques et aux affaires européennes, sur un sujet choisi par l'étudiant, ou sur proposition du professeur chargé de la thèse. Souvent, l'étudiant choisit un sujet qui est important pour le déroulement ultérieur de sa carrière. Les thèses de master sont écrites en français et ou en anglais, les deux langues officielles du Collège d'Europe, bien souvent une langue différente de la langue maternelle de l'étudiant.

Un comité scientifique sélectionne les meilleures thèses de master parmi les 100 dossiers produits sur le campus de Natolin chaque année. En les publiant, nous sommes fiers de disséminer dans toute la communauté enseignante européenne quelques-unes des recherches les plus intéressantes menées par nos étudiants.

Introduction

Establishing a competitive and liberalised gas market has been a principle objective[1] of the EU for over 20 years. Although the first directive[2] to achieve this aim was introduced in 1998, a common gas market still remains to be completed. Central to the aims of the Commission is establishing a competitive and open market while ensuring security of supply across Europe. The compatibility of long-term gas contracts in reconciling these two priorities has long been contested and recent case law has increasingly placed restrictions on the types of clauses that can be included in such contracts and their length.

Yet decisions regarding energy carry with them concerns about geopolitics. Large third party producers who are not under the direct influence of EU law and who are largely under state control are often party to these contracts. Algeria and Russia are the two largest exporters of gas to the EU, disregarding Norway which participates in the European Free Trade Area and is considered to have stable and secure relations with the EU. Gas imports from Algeria and Russia to the EU are negotiated with Sonatrach and Gazprom respectively, both of which are State controlled public entities. The issue of international energy governance is closely linked to domestic governance. Europe's energy governance is focused on ensuring a competitive market and differs from exporting countries who are concerned with ensuring security of demand. Within Russia for example, the concept of state capitalism and resource nationalism predominates and forms a crucial element of Russia's energy governance system.[3]

Long term gas contracts have become features in relations between European suppliers and third country suppliers of energy.[4] Decisions relating to the compatibility of these

1 Identified in the Lisbon Strategy and the Europe 2020 objectives as one of the goals of the EU to achieve

2 Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, Official Journal L 204 , 21/07/1998 P. 0001 – 0012

3 Andrei Belyi, 'Russia's position on the Energy Charter, Meeting Summary: Russia Eurasia Programme', Chatham House, 27 April 2012

4 Sanam S Haghighi, Energy Security, Hart Publishing, Oxford, 2007. P24

contracts with the principles of EU competition law can therefore have an impact on the relationship large state owned foreign companies and their government have with the EU. Hypothetically speaking, a decision which is perceived to be grossly unfair to the foreign gas producing company could result in a government deciding to curtail or stop gas imports to the EU. Energy security could therefore be jeopardised. Yet the application of competition law in this area seeks to do exactly the opposite – it furthers energy security by ensuring that the price of energy is not affected by external forces. Balancing external geopolitical forces with strict internal regulations can sometimes prove difficult. Risk management must take place not only during the evaluation of external policies but also in the implementation of internal measures.

This paper analyses the role geopolitics plays in the application of competition law by the Commission in upstream gas contracts. This will be achieved by studying the experiences of Gazprom and Sonatrach with DG Competition. It is clear that while the internal gas market should essentially be governed by the rules of the free market, geopolitical concerns can distort this principle. Security of supply is a priority for the Commission. It must attempt to achieve a balance between creating a single gas market via the operation of competition norms and maintaining healthy relations with their energy suppliers. Although the principle objectives of competition law are most often achieved, the path leading to the resolution of a case is often more complicated when a non-European company is involved. This paper suggests that geopolitics has an impact on the application of procedural rules and processes in competition law enforcement. While there is some evidence that the principles of competition law itself have been tempered by DG Competition in order to ensure security of supply, the evidence is not conclusive. Whether competitive rules are the most adequate solution for ensuring energy security will not be discussed in this paper.

DG Competition's decisions regarding European companies will be used as a normative example from which to compare the decisions involving Sonatrach and Gazprom. Of course geopolitics may also enter into the decision making process when European companies are concerned. However these geopolitical concerns are similar to those faced in any of the Commission's decisions not only relating to energy but also to other sectors. If a member state is unhappy with the Commission's behaviour it is unlikely that they will cut off energy supplies. In any case, most European companies are not net energy producers. The threat to security of supply is not nearly as serious as when non-member states are concerned. This fact justifies the use of decisions concerning European companies as a norm in this context.

It is interesting to analyse the case law in this area as it highlights different tensions existing in energy market regulation in Europe. Competition policy is an essential tool for creating and maintaining a competitive market. Equality before the law is a basic principle of justice and should therefore guide DG comp's actions and decisions as a semi-judicial organ. How can it justify treating international monopolies leniently while subjecting EU companies to the strict application of competition law? On the other hand, the EU is dependent on imports for over half of its energy consumption[5] and this figure is set to increase in the coming year [6]. The Commission must therefore ensure security of supply in both gas and other energy sectors. The EU's high dependency upon energy imports makes it vulnerable to the political decisions of producer states controlling energy companies. These risks also impact the global competitiveness of the EU – the high risk of energy supply to the EU from non- EU suppliers increases the cost of energy to end users within the EU. This in turn lowers the competitiveness of EU goods in the global market.[7]

This paper is divided into two sections, each containing three chapters. The first section (chapters 1 -3) aims to give an overview of the geopolitical concerns that the Commission might need to consider before applying competition law in situations involving non-European companies. The second section (chapters 4-6) provides a comparative analysis of the application of competition law in cases involving European companies, Sonatrach and Gazprom.

Section 1, Chapter 1 will present the European gas market. It will begin with an examination of the structural problems traditionally present in the market, the aim of the single gas market as well as the steps that have been taken to create it. The concept of security of supply will then be explored and attention will be focused in geopolitical risks. Finally the interplay between geopolitical risks and competition law will be presented.

Section1, Chapter 2 and 3 will detail EU -Russian energy politics and EU – Algerian energy politics respectively. The legal norms that structure these relationships will first

5 According to Eurostat more than half (54.1 %) of the EU-27's gross inland energy consumption in 2010 came from imported sources. (http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Energy_production_and_imports consulted on the 12/03/2014)

6 Andrea Renda, 'Globalisation, the New Geography of Power and the EU Policy Response', Transworld working paper 10, March 2013, p. 17

7 Andrey A. Konoplyanik, 'Russia and the Third EU Energy Package: regulatory changes for internal EU energy markets in gas and possible consequences for suppliers (including non-EU suppliers) and consumers', I.E.L.R 327, 2011, P 1

of all be examined. We will then proceed to analyse the political and commercial realities behind these structures.

Section 2, Chapter 4 presents European gas companies' experience with regards to competition law since the beginning of the new millennium. Two issues which were traditionally elements of long-term contracts will be examined – namely network foreclosure and destination clauses.

Section 2, Chapter 5 focuses on Sonatrach's negotiations with the Commission during 2000s in relation to the deletion of destination clauses from long-term contracts. The legal issues at play will be exposed as well as the procedural approach (or lack thereof) adopted by the Commission.

Section 2, Chapter 6 will finally focus on the current Gazprom investigation that deals with the presence of destination clauses, oil indexation in long term contracts and with issues of network foreclosure. We will examine whether the case was geopolitically motivated, as has been suggested by Russian officials. Furthermore, the response of the Russian Federation will briefly be described as an indication of how competition law can affect geopolitics.

The Conclusion will provide an overall evaluation of the role geopolitics plays in the application of competition in long-term upstream markets. Finally policy recommendations will be presented.

SECTION 1

Chapter 1: Security of Supply – Winds of Change

Natural gas is unique. Since the first deliveries of gas to Europe in the early sixties, gas has become an essential commodity in our everyday lives. It is a preferred energy source not only because of its environmentally friendly and efficient properties but also because of its versatile uses in industry and at home. Yet it is also distinct because it brings together a mixture of historical facts, changing political realities and commercial interests. The aim of this chapter is to provide an over-view of the structure of the European gas market, the changes it is undergoing and the security threats it is facing. These three issues are interlinked and a reform of the structure of the market will impact the threats faced. It is important to analyse the role of competition law in transforming the markets and the effect this transformation can have on security of supply.

1. Structure of the European Gas Market

With over 500 million consumers, the European market is the largest regional gas market in the world.[8] Yet the development of the market is a relatively new phenomenon. The idea of laying pipelines to deliver natural gas was perfected by the Soviet Union, which began transporting gas via pipeline before the Second World War. With the discovery of the Groningen gas field in the Netherlands in 1959, Europeans began to consider gas as a viable energy option and by the 1970s, long term contracts were concluded between both Gazprom and Sonatrach in order to develop pipelines to bring gas to Europe. The foundations of the European gas markets were thus laid and it is this legacy that structures gas markets in Europe today.[9]

1.1. European Annual Gas Consumption and Importation

Despite the fact that the EU is the largest gas market in the world, its production of natural gas is declining. It is forecast that gas production will continue to decline particularly as the Groningen field is expected to decline in production after 2020. This, coupled with a modest rise in shale gas production, means that the EU is dependent upon gas imports[10] as detailed in the chart[11] below.

Russia provides us with over one third of our gas needs, a fact which has lately become a strategic weakness as the drama in Ukraine unfolds. It is feared that Russia will retaliate to European sanctions by cutting both gas and oil supplies. Nevertheless the level of dependency varies from Member State to Member state. While the Baltic States are completely reliant upon Russia for all of their gas needs[12], countries such as Ireland, Denmark and the Spain import almost no Russian gas[13]. Similarly Norwegian gas accounts for over one third of gas imports. However Norway is part of the European Economic Area and is a secure and stable energy partner. Algeria, providing the EU

8 European Commission, 'Energy 2020, A strategy for Competitive, Sustainable and Secure Energy' Communication, 10 November 2010, p. 17

9 Robert Marbo & Ian Wybrew-Bond, 'Gas to Europe – the Strategies of Four Major Suppliers', Oxford University Press, Oxford, 1999, pp. 6 – 9

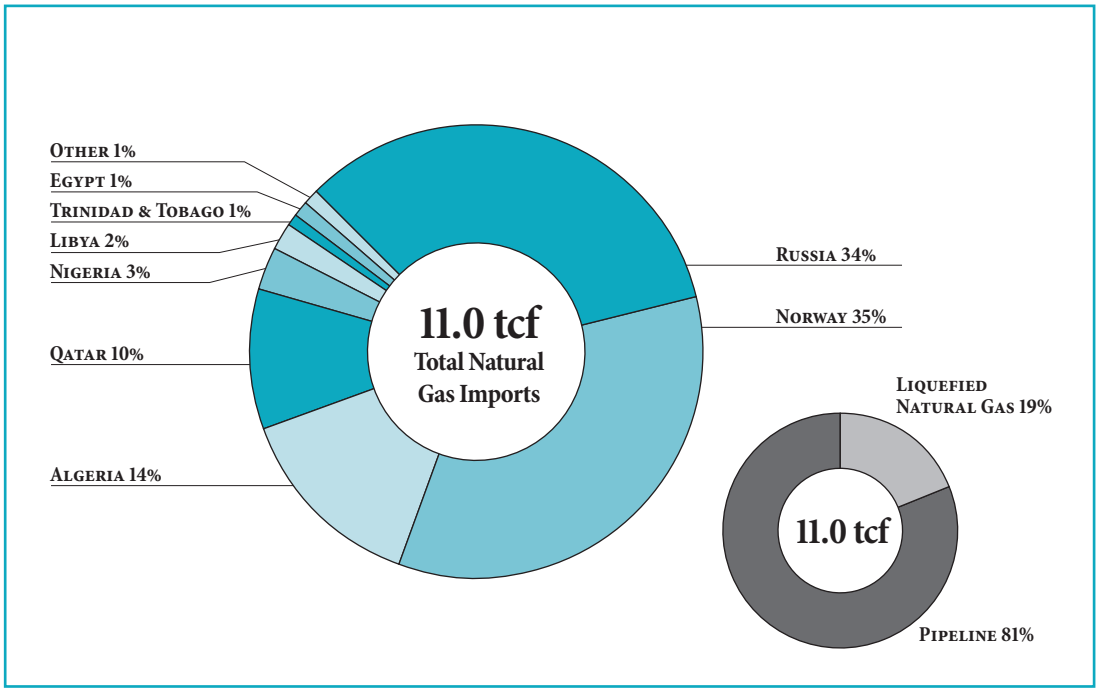
10 International Energy Association, 'World Energy Outlook – 2013', OECD/IEA, Paris, 2013 p. 110

11 Micheal Ratner et al., 'Europe's Energy Security: Options and Challenges to Natural Gas Supply Diversification' Congress Research Service Report, Washington DC, 20 August 2013 p. 6

12 Arno Behrens & Julian Wieczorkiewicz, 'Is Europe Vulnerable to Russian Gas Cuts?' Centre for European Policy Studies Commentary, Brussels, 12 March 2013 p. 2

13 Reuters News Service: http://blogs.reuters.com/globalinvesting/2014/03/17/who-shivers-if-russia-cuts-off-the- gas/ consulted on the 05/05/2014

with 14% of its gas needs, is also a big player. One important conclusion that can be drawn from this chart is that it is undeniable that the EU is dependent upon imports for its energy needs.



1.2. European Gas Prices in Perspective

In the first quarter of 2013, wholesale customers on the UK's National Balancing Point (NBP) were paying double the price customers of the Henry Hub in the USA while German customers were paying almost three times that amount.[14] Wholesale piped and LNG gas prices fluctuate throughout the EU and vary depending upon the country.[15] DG Energy's quarterly report noted similar trends in pricing for retail customers.[16]

Europeans pay more for gas than American consumers partly because gas markets remain regional in structure. In its 2013 World Energy Outlook, the International Energy Agency (IEA) noted that there is no global benchmark for gas prices as there is for oil.[17] Instead the global gas scene is composed of three regional markets – North America, Asia-Pacific and Europe. This can be explained by the fact that gas transportation and

14 European Commission, 'Quarterly Report of European Gas Markets', Market Observatory for Energy, DG Energy, Volume 6 issue, 2 Second quarter 2013 p. 16

15 Ibid. pp. 16 -24

16 Ibid. pp. 24 -35

17 International Energy Association, Op.Cit. p. 45

storage is more difficult than oil. While gas transportation is rigid and requires a physical link between the producer and the buyer, oil can easily be redirected from one destination to another. This explains why gas markets are regional while oil markets are global.[18]

Nevertheless, LNG gas is playing a role in diminishing the regional nature of these markets, notably in connecting the North American and Asia- Pacific markets. It is predicted that LNG exports from the US will place pressure on traditional oil-indexed prices however various market and institutional barriers continue to halt global gas market integration.[19]

1.3. Long-term Contracting in Traditional European Markets

The price of gas in European markets has traditionally been determined by clauses inserted into long- term supply contracts. Upstream contracts signed between the upstream producer and the EU supplier form the basis for gas investments. Large national champions dominated national or sub-national markets and were often granted the right, *de jure or de facto,* to sell, export, import and construct infrastructure in a given region.[20] These companies entered into long-term supply contracts with Gas exporters (Sonatrach and Gazprom) who had monopoly rights on exporting gas. These contracts are based on the 'Groningen model'[21] and usually include take or pay clauses in order to mitigate risk involved in such a long term, capital intensive investment. The buyer and seller are tied into a bilateral monopoly for a certain period (usually 15 -20 years). The seller carries the risk of ensuring a certain quantity of gas will be delivered while the buyer guarantees to pay for this gas regardless of whether they need it or not. The nature of these clauses reflects the particular nature of gas importation via pipelines. When a pipeline in built between Russia and the EU or Algeria and the EU, it is a large scale, upfront investment where returns are not guaranteed and will not be made in the short term. The take or pay clause therefore ensures that the seller will have a guaranteed income for the duration of the contract while the buyer is guaranteed a minimum volume of gas.

18 Ibid.

19 Ibid. p. 99

20 Christopher Jones & Al. 'EU Energy Law – Volume 1 The internal Energy Market, the Third Liberalisation Package' (3rd edition) Claeys & Casteels, Belguim, 2010 p. 1

21 Kim Talus, 'Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law', Kluwer Law International, The Netherlands, 2011, P 12

Take-or-pay contracts typically include net back pricing whereby the price of the gas is determined by calculating the current price of an alternative fuel minus the transportation costs from the delivery point to the market where the gas is consumed.[22] Destination clauses or territorial restrictions clauses have also traditionally featured in these contracts. The buyer of the gas is prohibited from reselling it in countries or geographical areas other than the one agreed. These clauses are included to prevent price arbitrage between EU consumers however they also allow sellers to charge different prices to different buyers.[23]

22 Ibid.

23 Ibid. pp.12 – 159

2. Reforming European Markets

The price differentials experienced in Europe highlight that flaws exist in the European gas market. Since its inception, the EU and its forerunner the EC, has been based on the ideas of a free market economy. According to neo-classical economic theory, perfect competition achieves allocative and productive efficiency and therefore increases consumer welfare.[24] Competitive markets drive down prices while increasing the quality of goods.

1.1. The Logic of Liberalisation

Delor's single market initiative launched in the Commission's White Paper of 14th June 1985 heralded not only the re-ignition of the European project but also the beginning of the end for gas monopolies. Unlike other proposals contained within the infamous document, the internal gas market (IGM) has taken a significant amount of time to put in place. The aim of the single market is two-fold: as well as lowering prices via competition, the policy aims to respond to the weaknesses that Europe is exposed to as an energy importing union. The IGM is an attempt to neutralise the geopolitical risks associated with natural gas. In order to combat the extremely political nature of the relationship since the 2006 Russia-Ukraine energy dispute, the most efficient remedy is to ensure the functioning of the single market. Other possible solutions to the problem such as diversifying energy supply by focusing on renewable and nuclear energy sources are impractical in the short- medium term while concluding treaties with Russia to regularise relations is currently off the table. The aim is to improve solidarity amongst Member States and collectively ensure supply security.[25] Put simply, by placing interconnectors between one Member State, for example Lithuania and other Member States, we can reduce Russia's dominance. If and when Russian gas is cut off, gas can be shipped from other Member States to Lithuania. An added advantage would be that large non-European exporters would find it difficult to negotiate their way into a dominant position by signing bilateral contracts with a number of European firms who would no longer be national champions but simply market actors.[26]

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24 Richard Whish & David Bailey, 'Competition Law', (7th edition), Oxford University Press, Oxford, 2012, p. 2

25 Pierre Noel, 'Beyond Dependence: How to Deal with Russian Gas' European Council on Foreign Relations, Policy Brief, November, 2008

26 Richard Youngs, 'Europe's External Energy Policy: Between Geopolitics and the Market' Centre for European Political Studies, working document No. 278, Brussels, November 2007, p. 1

The EU is ambitious in its plans to create an IGM and is determined that the project will be a pan- European one. The underlying aim is to increase security of supply by spreading European internal market rules east-wards and southwards.[27] This aim is reflected in the Energy Charter treaty and the Energy Community Treaty which both aim to export market rules to signatory countries. While the Energy charter treaty is open for signature by any state and contains market systems, the Community Treaty involves the transposal of the energy *acquis communautaire* into third country member states.[28]

1.2. The Third Energy Package

The project to build an IGM began in earnest in 1992 when the Commission formally proposed the first gas directive[29] and has only been accelerated in recent years.[30] There have been three energy packages in the gas sector[31] which have overcome the major obstacles to creating the IGM. As many gas importers benefited from a legal monopoly to import, it was first of all necessary to allow competition in this sector. However this was insufficient in the face of a market with no liquidity and vertically integrated monopolies with a large market share in particular regions. Problems such a third- party access and unbundling had to be tackled by the directives and an independent energy regulator had to be set up.

1.3. The Role of Competition law in creating and regulating the European Gas Market

Competition law has been instrumental in the creation of the IGM. Given the sensitive nature of energy markets, member states were initially unwilling to legislate for the

27 Ibid.

28 Peter Cameron, 'Competition in Energy Markets – Law and Regulation in the European Union', 2nd edition, Oxford University Press, Oxford 2007 p. 78-79

29 Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, OJ N C123 4/5/1994

30 Christopher Jones & Al. Op. Cit p. 1

31 1ST Package: Directive 98/30/EC Op. Cit. ; 2ND Package: Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003OJ L 176/57 15/7/2003 and Regulation 1775/2005 of the European Parliament and of the Council of 28 September 2005 L 289/1 3/11/2005; 3rd Package:
- Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 OJ L 9/112 14/8/2009,
- Regulation (EC) No. 713/2009 of the European Parliament and of the Council of 13 July 2009 OJ L 211/1 14.8.41 and
- Regulation (EC) No. 715/2009 of the European Parliament and of the Council of 13 July 2009 OJ L 211/36 14/08/2009.

creation of the IGM. The Commission therefore decided to act on the basis of the treaty articles in order to force member states to abolish the exclusive rights granted to their national energy companies. In a landmark case, the Commission took action against 8 different Member States concerning electricity and gas import monopolies arguing that the exclusive rights granted to these companies violated article 31 of the EC Treaty on the free movement of goods. The ECJ ruled that although the Commission had the right to take action against member states to prohibit exclusive monopoly rights, a high burden of proof must be met by the Commission in order to prove the existence of such a monopoly.[32] Jones notes that although 'these judgments are now of largely academic interest… they are of fundamental importance [as they] confirm that the Commission did have the power to abolish rights under certain circumstances [and] brought the MS to the negotiating table'.[33] These cases are also of interest for this paper as they highlight that competition law can sometimes be exploited by the Commission for political purposes.

32 CF: FR V Com, case C-202/88 [1991] ECR 1-1223; Com V FR, case C – 159/94 [1997] ECR 1-2925; Hofner – Macrotron, case C – 41/90 [1991] ECR I – 1979; ERT, case C-260/89 [1991] ECR 1 – 2951; Port of Genoa, Case C-179/90 [1991] 1- 5699

33 Christopher Jones & Al. Op. Cit p. 3

3. Defining Security of Supply in a Changing Context

In Section 1 the structural weaknesses of European gas markets were identified – namely high prices and import dependency. High prices stem from long-term contracts concluded with foreign gas importers. While the IGM, which will bring about lower prices by encouraging competition, aims to also reduce the risks associated with security of supply. It cannot, however, eliminate them. An economist might consider that energy security is not an issue as it is subject to market rules which provide a solution to any problems that might arise. However an interdisciplinary approach is required to understand the multifaceted nature of energy security.[34] We must first of all identify the conditions which indicate that energy security has been achieved and then discuss the risks that threaten the realisation of this situation. Finally we will discuss the implications of the IGM on energy security in 'Energy Europe'. Note that in this paper the terms security of supply and energy security will be used interchangeably.

3.1. Energy Security Objectives

Energy security objectives have been identified by the European Commission in various working papers. The European Commission acknowledged in its green paper that 'Security of supply does not seek to maximise energy self-sufficiency or to minimise dependence but aims to reduce the risks linked to such dependence.'[35] An analysis of the policy documents of the EU clarifies that the objective of energy security is not to become more self-sufficient but to mitigate the effects of being dependent upon energy imports.

What are the negative effects of energy dependency? When an importer can directly influence the price and availability of energy in Europe, the EU economy becomes vulnerable as the importer can effectively raise prices or cancel energy deliveries making energy a scarce resource. Energy is a basic factor of production for industry and its availability, and hence its price, is directly connected to the rate of economic growth. It is also used in private homes for basic tasks such as heating and cooking. The importance of energy in society requires that it should be sufficiently and continuously available at a reasonable price.[36] Therefore energy security is achieved when the price is affordable

34 Arianna Checchi, Christian Egenhofer & Arno Behrens, 'Long-Term Energy Security Risks for Europe: A Sector-Specific Approach', CEPS working documents, 29 January 2009, pp. 1 -2

35 European Commission, 'Towards a European Strategy for the Security of Energy Supply' (Green Paper) COM (2000)769 Final pp. 2 -3

36 Gonzalo Escribano & Javier Garcia-Verdugo, 'Energy Security, energy corridors and the geopolitical context : a conceptual approach' in 'Energy Security for the EU in the 21st Century – Markets,

and there is physical availability[37] as the possible negative effects of energy dependence has been neutralised.

This definition has however been criticised for using terms that are vague and unclear.[38] Words such as 'reasonable' and 'sufficient' can be subjectively interpreted. It is therefore necessary to clearly define the scope of the two constituent elements of energy security – physical availability and price. What constitutes a 'reasonable' and 'unreasonable' price is debatable but for the purposes of this paper it will mean that prices should not be driven upward by market imperfections that are not linked to shifts in supply and demand.[39] This is of course far from the truth but is one of the aims of the European single market. It should be noted that it is widely accepted that eliminating all price volatility does not constitute part of security of supply and will naturally occur in a market, particularly when there is fall in supply or an increase in demand.[40] Physical availability carries with it fewer ambiguities. It requires that the flow of energy be uninterrupted by the risks that will now be outlined.

3.2. Risks threatening Energy Security

Risks can be classified in many different ways: internal or external risk, the length of time the potential risk can happen within, or the very nature of the risk itself. Although this paper will focus on external risks of a geopolitical nature, it also helpful to understand the other risks that can threaten energy security. As will become obvious, these concerns often overlap and therefore a general understanding of these risks is necessary.

A. Geopolitical Risks

'A geopolitical risk to the security of supply… is when a change or breakdown in the international economic order or system or a part of that system takes place (exclusivity/ discrimination, autarky, political boycott, failed states, terrorism) that results or could result in absolute or relative scarcity in energy (oil and gas) flows.'[41] This definition

Geopolitics and Corridors' by Jose Maria Marin-Quemada, Javier Garcia-Verdugo & Gonzalo Escribano Routledge, Oxon, 2012 p. 27

37 Arianna Checchi, Christian Egenhofer & Arno Behrens, 'Background Paper on Long-Term Security Strategy for Europe', CEPS working paper 2009, pp. 1-2

38 Gonzalo Escribano & Javier Garcia-Verdugo, Op.cit. p. 27

39 Gonzalo Escribano & Javier Garcia-Verdugo, Op.cit. p. 27

40 See for example: Tomas Liege & Christian Egenhofer, 'Security of Energy Supply: A Question of Policy or the Markets?' CEPS Task Force Reports, November 2001 p. 4

41 Clingendael International Energy Programme, 'Study on Energy Supply, Security and Geopolitics:

provides an accurate and clear insight into the various sources of this risk which we will now investigate.

The removal of a country from the world economy, either by will or by force will disrupt energy flows. A clear example of such a scenario is the exclusion of non-state planned economies from access to oil and gas sources from Russia and the Caspian Sea before the fall of the Berlin Wall in 1989.[42]

Today many gas producers do not fully participate fully in the world economy which is a cause of concern. It is recommended that foreign policy and to a certain extent security policy should be orientated towards preventing the complete disintegration of these countries from the world system.[43]

Yet ensuring external policies take these factors into account may not be enough. Applying strictinternal rules (such as competition law) to state controlled companies at risk from disintegration may aggravate the situation and encourage the producer to move further away from the world economy.

However the wholesale removal of a country is not the only source of disruption of security of supply. Mere changes in the international economic order can affect the energy relations between countries. The cause of these changes can be either political, social or economic. Notably the decision by the EU to liberalise gas markets had economic consequences for state controlled companies outside the EU.

These sources of risk can manifest themselves in a variety of different ways. Some authors classify export restrictions and monopolistic practices by supplier countries as individual risks. However it is argued that often the cause of these risks are the same – political responses by supplier countries to a change in the international order or a change in policy by the country which brings about a subsequent change in the international order. Therefore such disaggregation of risk is unnecessary.[44] Checci et al. notes that energy industries in supplier countries do not usually operate in competitive markets and are often subject to significant government interference.[45] The imposition of export restrictions is often used by producer countries when there is a breakdown in the

Final report', The Hague, 2004, p. 37

42 Clingendael International Energy Programme, Op. Cit. p. 42

43 Clingendael International Energy Programme, Op. Cit. p. 42

44 Javier Garcia-Verdugo & Enrique San-Marin, 'Risk Theory applied to Energy Security', in 'Energy Security for the EU in the 21st Century – Markets, Geopolitics and Corridors' by Jose Maria Marin-Quemada, Javier Garcia-Verdugo & Gonzalo Escribano Routledge, Oxon, 2012 p. 123

45 Checci et al. Op. Cit. p. 5

international system. Therefore this paper will include export restrictions by exporting countries as geopolitical sources of risk. Similarly monopolistic behaviour can be used as a political tool by producer countries. Nevertheless, monopolistic behaviour can also be motivated purely by economic factors and it is therefore evident that it is not always easy to provide a theoretical classification of geopolitical risks.

B. Other Risks

Of course other factors can also threaten security of supply. Today it is widely accepted that environmental risks should be incorporated into energy security policies. Although environmental and energy security policies have different aims, they concern the same issues – the use of energy sources and our dependence on imported CO2 emitting fuels. We can also identify geological and economic risks factors. Nevertheless we will see that energy security risks are often intertwined and overlap.

i. Geological Risks

Currently 81.3% of the EU's energy sources come from non-renewable sources[46]. This reality poses two problems. The potential exhaustion of natural resources will cause a major shortage of energy. Nevertheless the amount of world reserves of oil, gas and solid fuels is unknown and there is much debate as to how long they will last. This threat on its own is not particularly looming or substantial as more renewables technology comes on stream and shale gas discoveries are made. Secondly and more importantly is the geographical situation of these sources of energy. It is estimated that over 90% of world hydrocarbon reserves are controlled by state-owned companies in the Middle East and Eurasia.[47] This geological fact does not sit well with the political situation in these countries and makes it difficult for European companies to access energy sources. There is an obvious overlap between a potential geological risk and a geopolitical one.

ii. Economic Risks

This includes the many different factors that can give rise to irregular price fluctuations of energy sources including market power abuse, speculative movements, actual or anticipated trade imbalances.[48] Increasing fuel prices can cause trade imbalances

46 European Commission, 'EU Energy in Figures – Statistical Pocketbook 2013' – figure in handbook relates to 2010

47 Arianna Checchi, Christian Egenhofer & Arno Behrens, Op. Cit. p. 5

48 Checci et al. op. Cit. p. 5

between producer and consumer economies which can in turn have negative effects on the consumer economy. Note that we see a potential geopolitical risk emerging as the trade balance can lead to severe adverse economic conditions and therefore a breakdown in the international order. Market regulation by the government can also be classified as an economic risk as it can affect the price of energy both in supplier and producer countries.[49]

3.3. Energy Europe and the impact Competition law can have on Security of Supply

It is clear from the above discussion that Europe faces security of supply challenges which it must try to overcome via policy. However this paper will examine the link between competition law enforcement and security of supply. At first glance the link between security of supply and competition law is not evident. Understanding the concept of 'Energy Europe' helps to clearly focus on the reality that internal decisions made by Europeans impacts energy producing countries in a number of ways.

The EU has a sovereign right to legislate in areas where Members States have given it the competence to do so and no other Country can interfere with this legislative process. It can also apply its internal norms, including competition law provisions, to companies operating within its territory. However in energy matters, EU legislation can have widespread effects not only within its borders but also in 'Energy Europe'. 'Energy Europe' encompasses a much broader geographical area than merely the EU or geographical Europe. The EU is a community of end-user markets and mainly energy importing states which are interdependently linked to non-EU energy producing countries by immobile infrastructure that runs through transit states. 'Energy Europe' therefore encompasses the EU, the rest of geographical Europe (from the Atlantic to the Urals), part of North Africa and part of Asia (Russia western Siberia and Central Asia).[50] While EU legislation is only binding on EU member states and the Energy Community countries, it will nevertheless have implications for the other members of this interdependent 'Energy Europe' by promoting or hindering sovereign energy investment in these countries. This must be taken into consideration by Europe when creating new norms or applying existing ones. Failure to do so could result in the deterioration in relations between these countries and the EU and a subsequent change in the international economic order, leading to the creation of a new security risk.

49 Arianna Checchi, Christian Egenhofer & Arno Behrens, Op. Cit. p. 5

50 Andrey A. Konoplyanik, 'Op.Cit. (2011) p. 1

However, the EU may have more ambitious plans for its IGM idea. As mentioned previously the single market idea does not merely incorporate the EU. The Commission has also attempted to export the *acquis communautaire* to third countries as witnessed in the Energy Community Treaty. Projects such as the Energy Charter treaty also reflect Europe's intention to base energy relations on the principles of a free market economy. This policy is in line with the EU's wider policy approach to ensure the rule of law prevails by creating reinforced legal frameworks.[51] Yet one fundamental obstacle stands in the way of this method – before the EU can apply rule based governance[52], there must first of all be agreement on what the rules are. This is a daunting task in the current climate where resource rich countries oscillate towards a resource nationalist approach.[53]

Although Europe has opted for a market based approach to gas markets, gas exporting countries rarely endorse this approach. The interface between the rules of the European free market and third countries' often political approach to energy can raise tensions and threaten to undermine security of supply. This suggests that the application of competition law will not be well received by countries who export gas to our markets and the ultimate response to its application could be a rupture in gas supplies.

51 Benita Ferrero-Waldner, 'Opening Adress – External Energy Conference' 20 November 2006

52 For further discussion see Richard Youngs, Op.Cit

53 Pami Aalto, 'The Emerging New Energy Agenda and Russia: Implications for Russia's Role as a Major Supplier to the European Union' , Acta Slavica Iaponica, Tomus 30, 12 June 2012, p.6

Chapter 2: EU – Russia Energy Politics

There is no doubt that Russia is a major energy power in Europe54 and beyond. It is very well endowed in terms of fossil fuel resources, possessing 23% of global natural gas reserves,55 yet a worrying tendency has emerged in the past number of years. As Russia regained its stature on the world stage at the turn of millennium it began to see energy as means to regaining its status as a super state. Nevertheless Europe is not a mere pawn on the Russian chess board. Recent tensions between the EU and Russia following the annexation of Crimea not only highlighted Europe's vulnerability in energy matters but also underlined the interdependent nature of the relationship between the two. The aim of this chapter is to give a detailed account of the energy relationship between the EU and Russia.

54 Ibid. p. 1

55 Government of the Russian Federation, "Energeticheskaia strategiia Rossii na period do 2030 goda, 'November 13, 2009, no. 1715-p. [http://minenergo.gov.ru/activity/energostrategy/]; Kari Liuhto, "Energy in Russia's Foreign Policy," Electronic Publications of Pan-European Institute 10 (2010), pp. 8–11.

1. Legal Framework of Energy Relations – a spineless agreement

There are many different dimensions to this framework however very few, if any, can be labelled as a success. Whether through the instruments of international law or through more political channels, the discussion has ultimately been a disaster. The relationship has been explored using at least six different components:

1994 Partnership and Cooperation Agreement (PCA)

This Agreement, which is the first of its kind between the two partners, provides a legal basis for trade and regulates political, economic and cultural relations. The treaty contains a number of provisions relevant to energy. Article 15 of the PCA expressly prohibits quantitative restrictions and excessive import taxes on imported goods. Article 65 PCA also requires that cooperation be carried out 'within the principles of the market economy and the European Energy Charter, against a background of the progressive integration of the energy markets in Europe'.[56] However the treaty, which entered into force on the 1st of December 1997, expired after 10 years and was not mutually continued by the parties, which had been provided for by the treaty if both parties consented. Instead the parties decided to initiate negotiations in order to conclude a new EU – Russia agreement. The project failed after negotiations were initially postponed because of the Russia/Georgia crisis and subsequently 12 rounds of negotiations lead to the creation of only one legal instrument, the 'Memorandum on an Early Warning Mechanism in the energy sector within the framework of the EU- Russia dialogue'.[57]

Energy Charter Treaty

This is the main instrument of international law promoting EU security of supply.[58] The treaty is a multi-lateral investment treaty specific to the energy sector. It provides for the application of many WTO norms, including free trade rules and MFN treatment, to be extended to energy products. It also provides a legal framework to promote and protect foreign investments. A protocol on freedom of transit has been adopted however it has proved to be a source of controversy.

56 Article 65(1) of the PCA

57 Umut Turksen & Jacek Wojcik, 'The European Union and Russia energy trade – thickening of legality and solidarity?' International Energy Law Review , 21, 2012 pp. 8-10

58 Kim Talus, Op. Cit. (2011) p. 23

Membership to the ECT is not geographically restricted and is open to all members who follow the application procedure. Although the Russian Federation acceded to the ECT in 1994, it never formally ratified it the Charter. Nevertheless article 45 of the ECT provides that signatories can provisionally apply the treaty before its ratification so long as the treaty was not inconsistent with national laws and regulations. The treaty was therefore applicable in Russia until 20 August 2009 when Russia notified the Depository of the Energy Charter Secretariat of their withdrawal from the ECT.[59] Taking into account the expiration of the PCA, Russia's withdrawal from the ECT can be seen as a step backwards. Energy relations between the two partners are now largely unregulated.

Russia's reasons for withdrawal are essentially threefold. First and foremost, the Russian Federation cannot reach agreement on the transit protocol and particularly the Regional Economic Integration clause which provides that the protocol is not applicable to transport across the EU. Secondly, Russia contests the 'right of first refusal' relating to the renewal of transit terms for existing users. Finally they have concerns relating to the access to pipelines and tariff setting procedures.[60] Several authors have noted that the treaty favours consumer countries which is why producer countries (including Norway and Algeria) have failed to adopt the treaty.[61] Despite this fact, there are many reasons why Russia should reconsider its position on the ECT. Its energy sector is in need of investment which will be difficult to attract if they are not part of the treaty. Gazprom, for example, needs to develop new fields in order to avoid a supply crisis[62] and it is estimated that it will cost approximately US$200 billion to develop.[63] Furthermore the recent Yugos decision[64]means that although Russia will not benefit from the ECT, it will be required to afford the protection prescribed by the treaty to investments made during its provisional application for a period of twenty years. In 2009, Russian President Dmitry Medvedev proposed a new energy convention however it has been judged to contradict the EU's interests.[65]

59 Umut Turksen & Jacek Wojcik, Op.Cit. pp. 8-10

60 Kim Talus, Op. Cit. p. 24

61 CF. Doran Doah & al. 'Russia and the Energy Charter Treaty: Common Interests or Irreconcilable Differences?', Oil, Gas & Energy Law Review, 2, 2007

62 Alan Riley, 'The Russian Gas Deficit: Consequences and Solutions' Centre for European Policy Studies, Policy Brief, Brussels,no. 116, October 2006 p. 1

63 Vladimir Milov, 'Russia and the West: The Energy Factor' CSIS, Washington DC, 2008 p. 10

64 Hulley Entreprises LTD (Cyprus) V Russian Federation PCA Case No. AA 226, UNCITRAL

65 Umut Turksen & Jacek Wojcik, Op.Cit. p. 11

Energy Community Treaty (Encom)

The aim of Encom is to create a legally binding framework for energy trade in South-Eastern Europe by transposing the energy *acquis communautaire* to non EU member states. Encom ensures European energy security however Russia is not a signatory to this treaty.[66] This fact reflects a general trend by the Russian Federation to reject EU norms as a means to regulate energy relations.

World Trade Organisation

Russia's accession to the WTO was long, arduous and is a testimony to the fact that 'nothing is agreed until gas is agreed'.[67] The EU had claimed that the extremely low tariffs Russian companies paid for energy tariffs amounted to an unfair subsidy.[68] However it became the 156th member of the WTO on August the 22nd, 2012. Their accession had wide ranging implications for the gas sector. Export restrictions are prohibited under article XI:1 of the General Agreement on Trade and Tariffs (GATT) of 1994 . While export duties are permitted under the GATT[69], they must be applied in a non-discriminatory way. Russia took an accession specific commitment 'not to increase export duties, or to reduce or to eliminate them, in accordance with the… schedule, except in accordance with GATT 1994'[70] Nevertheless, the maximum bound duty for gas exports is 30%.[71] Energy pricing came under scrutiny during the accession negotiations as it is regulated by the State. Gas prices and prices for sales to refineries of gas produced by Gazprom are established and regulated by the Federal Tariff Service.[72] These price controls are permitted under WTO practices however during accession negotiations Russia agreed to take the interests of exporting WTO members into account in accordance with article III:9 of the GATT when setting prices. On May the 28th, 2007, the Russian government resolved to introduce a new formula for calculating gas prices that ensured equal return on gas supplied to national and international markets.[73] Finally, Russian accession will

66 Umut Turksen & Jacek Wojcik, Op.Cit. p. 12

67 Chiara Cinquepalmi, 'Nothing is agreed until Gas is agreed" : The Role of the European Union in Russia's Accession to the WTO', College of Europe, Natolin Campus, 2004

68 Umut Turksen & Jacek Wojcik, Op.Cit. p. 13

69 CF: Appellate Body Report, China – Measures Related to the Exportation of Various Raw Materials WT/DS394/AB/R (December 15, 2008)

70 Part VI of the Schedule of Concessions and Commit on Goods

71 Youhai Baisburd & al., 'Russia's obligations in the Oil and Gas Sector', International Trade Law & Regulation, 53, 2013, p. 2

72 Youhai Baisburd & al. Op.Cit. p. 3

73 Resolution no. 333 On Improving State Regulation of Gas Prices

have implications for Gazprom as a state trading enterprise (STE). Due to their special privileges relating to gas export, Gazprom will have to act in conformity with the principles on non-discrimination and make business decisions based on commercial interests.[74] Although the WTO does not provide the same level of protection as the ECT, it does provide a minimum level of protection for the EU and has the benefit of an effective dispute settlement mechanism.

EU – Russia Dialogue

The EU – Russia Dialogue is an energy specific form of bilateral cooperation established after the EU- Russia Summit on October 30th, 2000. Given the importance of energy to both sides, it was recognised that the PCA was insufficient to regulate energy relations and therefore further dialogue was necessary. The success of this dialogue has however been limited. Despite 'friendly declarations and warm assurances on both sides'[75], there has been no concrete evidence of progress in the form of new legal norms. It has been suggested that that this lack of progress is linked to the differing priorities of both sides. While the EU wants to focus on EU energy security, Russia is more concerned about investment in infrastructure.[76]

It is clear that the legal structure of EU- Russian gas relations is disjointed. Russia's withdrawal from the ECT highlighted the unsurmountable differences between the two partners. While the WTO does not offer an adequate solution to the problem, it provides a basic level of protection which is absent at present in relations between the two countries. Turksen and Wojcik noted in 2012 that 'the current situation indicates that the EU is facing a monopolistic and quasi-statist energy supplier which is not willing to embed the energy trade in predictable legal framework'.[77] Yet making accusations that Russia is uncooperative and thus abandoning the aim of finding a legal framework for EU- Russian energy relations is not an answer to the problem. If the EU is committed to rules based governance based on the rule of law as discussed in chapter 1 then it must also work hard at establishing rules that will be accepted by all sides. Otherwise, initiatives such as the Encom risk giving the impression that Europe wants to impose rules that are only in their own interests, and isolating itself from its partners.

74 Working Party Report (2011) para. 88

75 Youhai Baisburd & al. Op. Cit. p. 12

76 Kim Talus, Op. Cit. p. 21

77 Youhai Baisburd & al. Op. Cit. p. 14

2. The Commercial and Political Realities of EU – Russia Relations

The legal framework of the EU – Russia relationship, or lack thereof, illustrates the underlying political difficulties they face. However from a purely economic point of view, the EU- Russia relationship is a fully functioning one where state – owned Gazprom interacts with European energy companies every day to deliver gas to the European market. Despite the fact that political and commercial tensions between the two neighbours are never far from sight, gas still flows from Russia to the EU on a daily basis.

2.1 Interdependence

As noted previously, Russia supplies the EU with over one third of its gas needs. This equates to 6% of the total energy supplies in the EU.[78] However dependence varies from Member State to Member State. The Baltic States, Poland and Bulgaria are highly, and in certain circumstances, completely, dependent upon Russian gas. We must put this dependence into context: the total consumption of Bulgaria, Sweden, Finland, Lithuania, Latvia and Estonia is 12.2 BCM which equates to approximately 16% of the German gas demand.[79] The fact that member states' dependency varies leads to a situation where member states' approaches are strongly divided.[80]This also suits Russia who often adopts a 'divide and conquer' approach to negotiations with the EU[81] and therefore prefers to negotiate on a bi-lateral basis with its favoured European partners such as Germany and France.

It is hard to deny however, that taking into account the current fuel mix of the EU, a gas cut from Russia would be devastating for Europe's economy. Nevertheless such a rupture in energy relations would also be detrimental to the Russian Federation. Revenue from oil and gas industries account for 30% of Russian GDP, while they make up approximately 60% of its export earnings.[82] Some 53% of Russian gas is exported to the EU valued at approximately 17 billion euro. [83] Gazprom and Russia therefore rely heavily on EU trade in order to balance their books. The company is facing financial difficulties and is it estimated that $200 billion of investments is needed in order to avoid

78 Ibid.

79 Arno Behrens & Julian Wieczorkiewicz, Op.Cit. p. 3

80 Vladimir Milov, Op.Cit. p. 15

81 F. Michael Maloof, 'Moscow 'stranglehold' targets Western Europe' in WND available at: http://www.wnd.com/2014/05/moscow-stranglehold-targets-western-europe/ consulted on 7, May, 2014

82 Youhai Baisburd & al., 'Russia's obligations in the Oil and Gas Sector', International Trae Law Review & Regulation, 53, 2013, p. 1

83 Arno Behrens & Julian Wieczorkiewicz, Op.Cit. p. 1

a gas crisis as its current gas fields face depletion.[84] It would be difficult for Gazprom to find a replacement market for its oil. As well as being Russia's most peaceful boarder, Europe is a well governed legal space where the legal situation is predictable. Gazprom can access a liberalised European market while benefiting from the protection of its export monopoly at home.[85]

Faced with this situation of interdependence, both partners are essentially tied to one another whether they like it or not. Despite this interdependent reality, there has been a struggle for power and control over the energy relationship by both partners. After the destruction of the Soviet Union in 1993, Russia was at its weakest and cooperated enthusiastically with Europe. This is reflected in the signature of the PCA agreement. By the turn of the century, Russia had regained economic stature and Putin's arrival to power signalled a new era in Russian politics. There are many connections between the government and the board of directors of Gazprom. Following Putin's election in 2000, Dmitry Medvedev (Prime Minister of Russia 2008 – 2012, supported by Putin) was appointed the Chairperson of Gazprom in 2002. There is much debate in academic literature as to the extent to which Gazprom has become a component of the geopolitical tools used by the Kremlin. Some scholars interpret Russia's behaviour as an attempt to become an 'energy superpower'[86] The extent to which oil and gas can be utilised to become a superpower is of course debatable[87] and some argue that Gazprom's primary motives are economic.[88]

The EU is not innocent in exacerbating Russia's aims to regain its status as a world superpower. It has failed to take into account Russia's size and political power in its policy creation. When the European Neighbourhood Policy (ENP) was launched in 2004, the EU included Russia in its proposal. Russia was the first country to reject the plan and later the EU had to back track and propose a 'strategic partnership between the two countries.[89] The ENP, which will be discussed further in the following chapter, aims at creating a stable and secure neighbourhood around the boarders of Europe. It includes countries in both the Southern and Eastern neighbourhood. Moves such as that could be considered as a 'faux-pas' on Europe's behalf as it underestimates both the size and power of the Russia.

84 Alan Riley, Op. Cit, P3

85 Pami Aalto, Op.Cit. pp. 1-20

86 CF: Andrew Monaghan, 'Russia's Energy Diplomacy: A political Idea Lacking a Strategy?', Southeast European and Black Sea Studies, 7, 2/06/2007

87 CF: Peter Rutland, 'Russia as an Energy Superpower', New Political Economy, 13, 12/06/2008

88 CF: Johnaton Stern, 'The Russian- Ukrainian Gas Crisis of January 2006', Oxford Institute of Energy Studies, 16 January 2006

89 Hakim Darbouche & Susi Dennison, 'A 'reset' with Algeria: The Russia to the EU's South', European Council on Foreign Relations, Policy Brief, London, December 2011, p. 1

2.2 Game-Changers and Geopolitical Turmoil

There are currently both economic and political situations which threaten to change the nature of the EU – Russia interdependency. In chapter one we defined geopolitical threats to security of supply as occurring when there is a breakdown in the international order or part thereof. The mal-functioning of the international order can stem from social, political or economic change within countries. It is clear from the above that there is a precarious balance in EU – Russia energy relations, we will now examine the situations that could lead to a disequilibrium.

Economic changes are on the horizon in the gas markets. As the impact of the shale gas revolution begins to hit Europe, LNG gas arriving on ships is challenging piped gas from Russia. This coupled with the economic crisis experienced across the world and particularly in Europe in past seven years, has reduced demand for energy. While Russian gas prices remained high, spot prices for LNG became increasingly attractive and many European importers violated the strict take-or-pay contracts, paid the due penalties and purchased cheaper LNG gas instead. Gazprom therefore re- negotiated contracts with some of its European partners.[90] These changes could lead to a shift in the balance of the energy partnership giving the EU an upper-hand. Such trends will also reduce security of supply threats as supply becomes more diversified.

Political changes also loom over Europe casting a dark shadow. The current events unfolding in Ukraine will directly affect Europe's supply security. These threats stem from the fact that Ukraine is a transit country and there are fears that if the situation deteriorates, it could threaten the physical supply of gas to Europe. This discussion is beyond the scope of this thesis, however the Ukrainian crisis is also leading to a breakdown in the International order. First and foremost it is a reminder that Russia is prepared to use energy as a political tool to achieve its goals. Russia continues to increase gas prices offered to Ukraine in order to heighten pressure on the administration.[91] Secondly. As Europe and the USA attempt to check Russia's bid to re-take control of the former- Soviet Union, sanctions have been put in place and more are threatened. The decision to ban Russia from the G8 summit[92] is a classic example of how the crisis is leading to a breakdown in the international boarder. It is feared that if the current

90 Pami Aalto, Op.Cit. p. 8

91 BBC News, 'Ukraine rejects Russia Gazprom gas price hike' available at: http://www.bbc.com/news/business-26902522 consulted on the 07/05/2014

92 Alison Smale & Miceal D. Shear, 'Russia Is Ousted From Group of 8 by U.S. and Allies', New York Times available at: http://www.nytimes.com/2014/03/25/world/europe/obama-russia-crimea.html?_r=0 consulted on 07/05/2014

situation continues without resolution, Russia will retaliate to European sanctions by cutting gas and oil supplies to Europe.

Regulatory changes within the EU also threaten to upset the equilibrium. The introduction of the third energy package has changed relations between the two partners. Article 11 of Directive 2009/73/EC, commonly referred to as *'lex gazprom'*, requires vertically integrated companies from third countries to obtain consent prior to investing and operating in the EU markets. The legal and economic implications of this clause have been questioned by many authors[93] and Russia will now challenge the measure using the WTO dispute mechanism.[94] Furthermore the EU seems to be now doubting whether the expansion of the IGM project can veritably ensure energy security. It is indeed naïve to consider that one initiative can provide the solution to the multi-faceted problem of European security of supply, as Javier Solana former High representative for Common Foreign and Security Policy in the EU stated in 2007.[95] Other European leaders have gone further. Lithuanian President Valdas Adamkus has reiterated that as Russia is overtly using energy as geopolitical tool, the EU must respond in kind and find a more all-encompassing solution than the IGM. [96]

2.3 The Straw that Breaks the Camel's Back?

There are clearly heightened tensions between Russia and the EU and this is in turn increasing the geopolitical energy threats faced by Europe. Any move in this tense situation could be seen as an aggression. While the European Commission appeared adamant to investigate Gazprom for abusing its dominant position in in 2012, it has now been reported that the Commission will now refrain from taking a decision regarding the case until the situation between the two powers becomes more stable.9797 If such claims made in the media are true, they indicate that geopolitics does play a role in taking decisions about competition law enforcement.

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93 CF: S.S Haghighi, Establishing an External Policy to Gaurentee Energy Security in Europe? A Legal Analysis', in M.RoggenKamp & U. Hammer, European Energy Law Report VI (Intensia 2009) pp. 155- 188

94 http://euobserver.com/news/123984 consulted on 06/05/2014

95 Richard Youngs, Op.Cit. p. 6

96 Commentaires de la France sur les propositions du Livre Vert, available at www.industrie.gouv.fr/energie P3

97 Gaspard Sebag, 'EU Said to Review Gazprom Complaint Amid Ukraine Crisis' available at http:1/www.bloom berg. com/news/2014-03-05/gazprom -complaint-said-to-be-reviewed-by-eu-amid-ukraine crisis.html consulted on the 06/05/2014

Chapter 3: EU Algeria Energy Politics

Is Algeria the new Russia of North Africa? In a recent European Council on Foreign Relations Policy Brief, it was noted that 'while Algeria is much smaller than Russia and does not have the same level of international influence, it sees itself as a regional power not just in the Maghreb, but also on the broader Arab world and Africa, and it expects to be treated as such by its partners.'98 These claims appear to be exaggerated and Algeria has been a cooperative partner with the EU on many fronts. The stability of the Mediterranean neighbourhood as a whole is very uneasy. Countries such as Libya, Syria and Egypt are a rife with turmoil with little hope of resolution in the short-term. In contrast, despite terrorist attacks in the 1990s and early part of the new millennium the political situation in Algeria appears to be quite stable.99 This chapter will provide a concise description of the legal and political structures of energy relations between the two partners.

98 Hakim Darbouche & Susi Dennison, Op.Cit p. 1

99 European Neighbourhood and Partnership Instrument, 'Algeria – Strategy Paper 2007 – 2013 National Indicative Programme2007 – 2010' p. 1

1. Legal Framework

EU – Algeria energy relations are mainly dealt with within the wider framework of the ENP and EURO-MED partnerships.[100]

- **European Neighbourhood Policy and Euro – Mediterranean Partnership agreement**

The European Neighbourhood Policy (ENP) was launched after the 2004 enlargement in a bid to create a circle of safe, secure and peaceful countries surrounding Europe to guarantee security on the EU's borders.[101] The ENP complements and supports the EU's Euro- Mediterranean Partnership Agreement (EURO-MED) signed in Barcelona in 1995[102]. While the EURO – MED provides a multilateral forum for the EU and the southern Mediterranean countries[103], the ENP is a more comprehensive policy for the region and provides for bilateral negotiations.

Algeria was initially supportive of the EURO-MED programme and signed an Association Agreement (AA) with the EU under the Barcelona process in 2002 which entered into force in 2005.[104] It provides for a free trade area between the two partners for twelve years. Currently negotiations are under way in order to draw up an action plan under the renewed ENP programme.[105] The ratification of the AA proved difficult for Algeria as the government had been counting on closer political ties to the EU.[106] Nevertheless it has been noted that the Algerian Government 'made considerable efforts to be able to ratify the AA'. It is likely that Algeria's enthusiasm is linked to the civil turmoil it was experiencing during 1990s. It saw the EURO-MED as an opportunity to gain support in its war against the insurgents.[107] However Algeria did not respond positively to the ENP in 2004 and was the second country, after Russia, to reject the policy.[108] This is illustrative of the overall misunderstanding that takes place in EU- Algerian relations.

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100 Sanam S Haghighi, Op.Cit. 2007 p. 358

101 Edzard Wesselink & Ron Boschma, 'Overview of the European Neighbourhood Policy: Its History, Structure and Implemented Policy Measures' SEARCH , January 2012, pp. 5-6

102 Barcelona declaration, [1995] OJ L/278

103 http://www.enpi-info.eu/medportal/content/340/About%20the%20EuroMed%20Partnership consulted on the 05/05/2014

104 European Neighbourhood and Partnership agreement, Op.Cit. p. 1

105 European Commission, 'ENP Package – Algeria', Memo 27, March 2014

106 European Neighbourhood and Partnership Instrument, Op.Cit p. 2

107 Hakim Darbouche & Susi Dennsion, Op.Cit. p. 5

108 Ibid.

While the EU attempts to deal with Algeria with the same policies and tools as its weaker neighbours, Algeria would prefer to cooperate on issues of mutual interest to the pair.

In terms of energy relations, the Barcelona declaration refers to 'the pivotal role of the energy sector and the importance of strengthening cooperation and intensifying dialogue in the field of energy policies'.[109] More specifically, article 61 of the AA focuses on cooperation in the field of energy and mining and stipulates that cooperation should be done with the aim of upgrading regulatory, legislative and institutional systems and technological systems. Partnerships between companies and promotion of private investment is also advocated in article 61. Haghighi notes that the Barcelona declaration is an 'example of a change in the Community policy from 'aid' as a purely demand driven policy [where governments of third countries decide their own projects and requests EU help] to 'cooperation and partnership' based on a mutuality of interest in which the energy sector could play an important role'.[110] This trend can be seen as a step in the right direction considering Algeria's demands to be recognised as an equal partner.

- **Energy Charter Treaty**

As previously noted, the ECT is the EU's most important tool for promoting security of supply. The ECT has not been ratified by Algeria. This does not place Algeria in an unusual situation as none of the EU's main gas suppliers, including Norway have ratified the treaty. It has been noted by academics that the treaty have only been adopted by consuming countries[111], which calls into question the methods of the EU. If it is intent upon 'cooperation and partnership' in the energy sector, it cannot unilaterally impose norms but must instead begin to search for a common solution amongst all energy partners, both consuming and producing.

- **WTO**

Algeria is not a member of the WTO and therefore the EU cannot envoke the GATT agreement rules or use the dispute resolution mechanism in the case of an energy related dispute between the

EU and Algeria. The EU should continue to strongly support Algeria in the negotiation process.

109 Barcelona Declaration, Op.Cit.

110 Sanam S Haghighi, Op.Cit. 2007 p. 362

111 Doran Doeh, Alexander Popov & Sophie Nappert, Op.Cit.

As can be seen from the discussion in the previous chapter regarding Russia, the WTO legal norms can be beneficial if other channels of negotiations to create a legal framework for energy relations are not fruitful.

- **Energy Community Treaty**

In line with the EU's aim to extend the IGM project beyond its boarders in order to ensure security of supply. The Commission's new Mediterranean aid programme for 2007- 2013 supported the expansion of the Encom to the southern Mediterranean.[112] Given the luke warm reception the treaty has received in Eastern Europe, there is little hope that it will be adopted by the basin.

- **Memorandum of Understanding on Strategic Energy Partnership**

Signed on the 7th of July, 2013 by the President of the European Commission and the Algerian Prime Minister, the memorandum was concluded within the context of bilateral negotiations under the ENP framework.[113] The aim of the document is to provide a tool for energy cooperation, according to Barrosso.[114] Algeria has also been invited to attend the Gas Coordination Group meeting in the Brussels this December.[115] The group brings together the members' states authorities competent for security of supply, the ACER and the Energy Community Secretariat among others.[116]

It must be acknowledged, however, that the memorandum of understanding substitutes the failed attempt at a Strategic Energy Partnership. One of the main reasons for this project failing was that the parties could not agree on the extent to which legal norms should be included. While the EU, keen as ever to promote the rule of law, favoured a norm based approach, this was not Algeria's intention. While the memorandum of understanding may not go far enough in codifying EU- Algeria relations, it should be recognised as a step in the right direction.

From the above it is clear that the ENP/EURO-MED framework provides the main legal framework for EU-Algerian energy relations. The EU has faced difficulties in producing a coherent policy towards North-Africa in general as can be seen from the array of tools

112 Richard Youngs, Op.Cit. p. 3

113 European Commission, Op.Cit. (March 2014)

114 http://news.xinhuanet.com/english/africa/2013-07/07/c_132520084.htm consulted on the 05/05/2014

115 http://www.africa-eu-partnership.org/newsroom/all-news/increased-energy-cooperation-between-eu-and- algeria-towards-euro-mediterranean consulted on 05/05/2014

116 http://ec.europa.eu/energy/gas_electricity/secure_supply/coordination_group_en.htm consulted on 05/05/2014

used over the past three decades – the Barcelona Process, EURO-MED, the ENP and finally the Mediterranean Union created in 2008. Yet they have never quite managed to provide a cohesive policy.[117] Obviously this lack of coherence also impacts on the structure of the EU's energy relations with Algeria. Furthermore, it can be questioned whether the ENP provides a solid basis for negotiations and cooperation in the energy sector. Its scope is very broad and it may therefore not dedicate enough attention to the energy sector. The creation of the Memorandum of Understanding is therefore to be welcomed as a step in the right direction.

117 Sarah Kilpelainen, 'Energy Relations between the European Union and North Africa? Commentary' Journal of Contempory European Research, Volum 9, Issue 2, 2013, p. 1

2. The Commercial and Political Realities of EU – Algerian Relations

The legal make-up of the EU- Algerian partnership highlights a common tension found between energy dependent and energy producing countries. While the EU would like to impose rules based on the ISG across Europe and North Africa, Algeria is less enthusiastic. This tension is similarly found in the EU-Russian relationship. However it is the commercial and political realities that distinguish the Algerian and Russian cases. In terms of interdependence, the balance is in favour of the EU. While political tensions do exist – particularly related to energy market issues – they cannot be compared to the Russian hotpot of boiling political tensions.

2.1. Asymmetric Interdependence

The term 'asymmetric' interdependence has been used to coin situations in which interdependence is lopsided and one party relies more on the other than vice versa[118]. This is true of the EU – Algerian relation. Although the EU is dependent upon Algerian gas supplies, Algeria is more dependent upon revenues from gas sales. Algeria is currently heavily dependent upon hydrocarbon exports for balancing its books. In 2012, 95% of export receipts came from the sector while it makes up an enormous 35% of GDP.[119] The majority of the country's gas exports are destined for Europe while oil exports are sent either to Europe or to north America.[120] Nevertheless, the Algerian State is the only northern African country who does not require aid from the EU although it benefitted from some 72 million euros in funds in the period 2011 -2013 under the ENP and EURO-MED.[121]

On the other hand, Algerian imports account for 14% of the EU's total gas consumption.[122] Sonatrach imports most of its gas to neighbouring Mediterranean countries such as Italy who imports 29% of its gas from Algeria. Pipelines transport gas to Italy and Spain while LNG is exported to France and Greece among others. Nevertheless this figure could be set to rise as Italy attempts to reduce its dependence on Russian gas in the

118 The term is used in by Hakim Darbouche & Susi Dennison's paper to describe EU –Russia relations

119 European Commission Memo, Op.Cit

120 http://www.eia.gov/countries/country-data.cfm?fips=ag consulted on 06/05/2013

121 Hakim Darbouche & Susi Dennison, Op.Cit. p. 5

122 Congress Research Service, 'Europe's Energy Security: Options and Challenges to Natural Gas Supply Diversification' p. 6 available at http://www.google.pl/url?sa=t&rct=j&q=&esrc=s&source=web&cd=6&ved=0CE0QFjAF&url=http%3A%2F%2Fwww.fas.org%2Fsgp%2Fcrs%2Frow%2FR42405.pdf&ei=2nlmU- T6HcbXPcqGgCA&usg=AFQjCNEMUZ3a4W8jT75sJDd6dnKR1uBPNw&sig2=YtrGTh5x8iD6C699RvSpeA&bvm=bv.65788261,d.ZWU&cad=rja

wake of Russia's current foreign policy goals.[123] Indeed many European countries will undoubtedly towards North Africa if Russia proves to be an unreliable supplier. This could lead in a shift it the current 'asymmetric' nature of the Algerian relationship towards a more mutually inter-dependant partnership.

Gas production in Algeria has declined since 2003 because of depletion of gas fields and despite the fact that gas resources currently require investment in order to increase or even sustain current levels of production, Algeria has gained a reputation as a secure supplier of gas to Europe.[124] Indeed, during an interview with the Algerian attaché for Energy in the Algerian Embassy in Brussels, the diplomat stressed that the Algerian State and Sonatrach did not merit comparison to Gazprom. Algeria has always delivered gas on time and with problem.

2.2. Mutual Partnership

It is evident that there is one significant issue preventing the EU- Algerian partnership from blooming – what Algeria describes as the EU's 'autistic' foreign policy attitude which fails to fully appreciate the interests and specificities of third countries. While the EU struggles to create a comprehensive policy response to the Maghreb, Algeria demands respect as an equal partner. EU policies under the ENP tend to focus on democracy promotion, economic liberalisation and security of supply.[125] Yet Algeria is less interested by democracy promotion and more interesting in cooperating as equal partners. As mentioned previously, it is not dependent upon aid from the EU and this therefore weakens the influence the EU can have in the region.[126]

Algeria wants to cooperate as an equal partner and it also wants to be bound by the same terms as the EU. Therefore, in the first part of the new millennium, the country perceived the EU as dictating norms that it itself did not observe. For example, the EU regularly criticises the fact that the Algeria is not open to foreign investment. The European Commission noted that FDI flows in Algeria would remain low until limitations on foreign ownership and profit repatriation were eliminated.[127] Yet in 2007, Sonatrach was

123 Domenico Conti, 'In Ukraine Crisis, Italy's Hunger For Russian Gas Weakens Western Coalition' available at: http://www.ibtimes.com/ukraine-crisis-italys-hunger-russian-gas-weakens-western-coalition-1559914 consulted on the 06/05/2013

124 Hakim Darbouche & Susi Dennison, Op.Cit. p. 4

125 Ilan Stein, 'EU Policy vis-a-vis Algeria : Challenges and Opportunities' available at :http://bcjournal.org/volume-11/eu-energy-policy-vis-a-vis-algeria.html

126 Hakim Darbouche Susi Dennison, Op.Cit.

127 European Commission,Op.Cit. memo

refused permission to take control of the petrol company Cespa.[128] Similarly the third country clause, inserted in article 11 of Directive 2009/73/EC requires Member States approval before a vertically integrated non-European company can invest and operate within the European market. This clause has provoked anger in both Algeria and Russia.

EU – Algeria relations do not merit a comparison to EU- Russian relations. Algeria is willing to cooperate once the EU acknowledges that both partners are equal. Nevertheless, the EU must pay attention to this situation as some of its policy actions lack sensitivity to the fact that Algeria resents the EU's big brother approach.

128 http://www.vitaminedz.com/durcissement-des-conditions-d-acces-aux-groupes-etrangers-l/Articles_15688_58177_16_1.html consulted on the 06/05/2014

SECTION 2

Chapter 4: Rupturing the Status Quo in European Gas Markets

Is it better to be a big fish in a small pond or a small fish in a big pond? EU energy companies may well be best placed to answer this question. Traditionally, European Energy Companies were champions of their territory, enjoying the advantages of providing a monopoly service to their consumers – they were effectively big fish in either small or medium sized markets. Yet the consecutive adoption of the energy packages in the past two decades, has heralded the end of their legacy in particular national markets. The European Commission has not been sensitive to the bruised egos of these companies, applying competition law strictly and methodically. This chapter will focus on two particular legal issues that have arisen in up-stream gas contracts: network foreclosure and destination clauses.

1. Network Foreclosure

Third party access and unbundling are essential features of a functioning internal gas market. The Commission's aim during the preparation of the third energy package was to enforce ownership unbundling.[129] Yet Member States' enthusiasm is still lagging behind that of the Commission's and the third energy package did not require Member States to transpose ownership unbundling into national law. Instead a half-way house approach was adopted through the use of control unbundling.

'While the Commission may have lost the battle on the regulatory front, it is winning the war through the use of general competition law'[130] and it has used article 102 TFEU to bring about legal unbundling within the gas sector.

The E.ON case is only one of many regarding network foreclosure. There are other examples of similar cases taken against European companies including ENI[131] and RWE[132]. The E.ON case was chosen as it is the most recent.

1.1. Facts and Procedures

E.ON is the leading supplier of gas to the German market and is a large European player. It operates distribution activities through E.ON Ruhrgas, a wholly owned subsidiary. E.ON Ruhrgas also wholly owns E.ON EGT, the operator of the gas transmission system in Germany. E.ON is accused of abusing its dominant position by booking all or almost all of the available flexible capacity within the gas transmission network and thereby foreclosing its competitors from the market.

The Commission launched formal proceedings on the 22 December 2009. Although E.ON did not accept the findings of the Commission, it proposed a commitment decision which was accepted by the Commission. The Commission is authorised to take a commitment decision under article 9 of regulation 1/2003. The decision substitutes a final decision, and requires a binding commitment by the undertaking under investigation.

129 Angus Johnston & Guy Block, 'EU Energy Law', Oxford University Press, Oxford, 2012 p. 37

130 Kim Talus, Op.Cit. p. 168

131 COMP/39.315

132 COMP/39.402

1.2. Violation of Article 102 TFEU – Abuse of a Dominant Position

Article 102 TFUE prohibits undertakings who have substantial market share or who are in a monopoly position from unilaterally behaving in a manner which restricts competition. Four criteria must be established in order for the prohibition to apply[133]:

- **A Dominant Position**

It is first of all necessary to identify the relevant market definition which is a preliminary tool for determining whether the company has a dominant position. In the present case the Commission identified the gas transport market as separate from the gas sales market. It also differentiates between firm and interruptible capacity markets and transmission of high calorific gas and low calorific gas. This is in line with its previous jurisprudence.[134] The geographic element of the market was considered to be the networks themselves. E.ON clearly holds a dominant position on the markets identified. It controls 100% of the marketing of entry and exit capacity to the grid and the transport of both high and low calorific gas to its networks.[135]

- The Dominant PoZsition must be **held within the internal market** or a substantial part of it.

The Commission estimated that a large part of the internal market was affected as E.ON is the largest operator in Germany and the gas transported amounts to the same quantity as that consumed in France.

- **An Abuse**

The 'essential facilities' doctrine, first laid down in the Sealink/B&I case, stipulates that: 'a dominant undertaking which both owns or controls and itself uses an essential facility i.e, a facility or infrastructure without access to which competitors cannot provide services to their customers, and which refuses its competitors access to that facility or grants access to competitors only on terms less favourable than those which its gives its own services, thereby placing the competitors at a competitive disadvantage, infringes article 102 TFEU.'[136] In the current case, the Commission identified E'ON's transmission

133 CF: Alison Jones Brenda Suffin, 'EU Competition Law – Text, Cases and Materials' 5th Edition, Oxford University Press, Oxford, 2014 p. 271 – note that the authors identify a fifth criteria – one or more undertaking. However in this case it is evident that E.ON is one undertaking.

134 CF: COMP/39.402

135 COMP /39.317, Paragraph 24

136 Sealink/B&I Holyhead: Interim Measures [1992] 5 CMLR 255, Paragraph 41

network as an essential facility[137] as it is a necessary input in order for gas suppliers to be able to deliver gas to their clients. The fact that E.ON booked almost all the capacity on its own network grid constitutes a refusal to supply under article 102 TFEU.

- **An Effect on Inter-State Trade**

It is sufficient that the measure directly, indirectly, actually or potentially influences the pattern of trade between Member States.[138]The Commission ruled that the behaviour was capable of affecting trade between Member States and therefore fulfilled this requirement.

An abuse of a dominant position has therefore been established and article 1.2 TFEU applied from the Commission's point of view. E.ON objections to the findings are unfortunately inaccessible as the affair was 'settled out of court' and a commitment decision was taken.

The final decision settled on by the parties involved substantial commitments on E.ON's part. It agreed to reduce its shares in reservations of high calorific gas to 50% by 2015 and to 64% for low calorific gas. The commitments also included divestiture of extra-high voltage network and approximately 5000 MW of generation capacity. In an earlier case involving RWE, it was agreed that the company would divest its gas transmission network in order to settle the anti-competitive complaints brought by the Commission.[139] The unbundling commitments offered by RWE in the gas sector (and E.ON in the electricity sector[140]) are the first ever structural remedies of their kind in EU antitrust history. Authors have questioned whether decisions such as these are in line with fundamental rights and the principles of proportionality.[141]

1.3. Analysis

Firstly, this case continues an interesting trend. Commitment decisions have been used frequently by the Commission in the energy sector as they allow for the quick settlement of the case while avoiding negative publicity for the company. Commitment decisions are very attractive from the point of view of both the Commission and the undertaking. The investigation is terminated quickly, allowing the Commission to resolve anti-competitive behaviour while circumventing the ordinary requirements of detailed legal

137 COMP /39.317, Paragraph 32

138 COMP /39.317, Paragraph 42

139 COMP/39.402

140 Comp/30.388 & Comp/39.389

141 CF: Kim Talus, Op.Cit. pp. 169 – 175

and economic analysis. Similarly, undertakings avoid long and protracted proceedings where the outcome is uncertain and may result in hefty fines, bad publicity and follow on, private actions.[142] Nevertheless, commitment decisions hinder the development of article 102 TFEU in the energy sector as the issue never goes before the courts[143] and there is an absence of a published decision outlining both the parties' defence and the Commission's decision.[144] It therefore undermines the clarity of law for those who are subject to it.

The effect of such commitment decisions can be substantial. In the present case, E.ON had to divest its property rights over the gas transmission network. Remedies in competition law can be divided into behavioral and structural remedies. Companies usually prefer behavioral remedies as they consider them to be less restrictive. Structural remedies, on the other hand, are often dubbed as disproportionate as they do not strike a balance between public interests and those of the private addressee.[145]The decisions have been seen as a awake up call that remedies will play an important role in shaping the market in the energy sector. Merger regulation by the European Commission will also prevent companies from overcoming their divestiture commitments.[146] Van Rosenberg notes that the principle of proportionality guarantees the neutrality of competition law vis-a-vis political aims. The principle dictates that the remedy adopted must be proportional to the anti-competitive situation. Therefore the Commission can only impose divestiture decisions when there has been a competition law violation and it cannot use such decisions as a vehicle to fulfil regulatory ambitions.

Nevertheless this argument is not totally convincing. While it is true that the Commission can only require network divestiture in cases where there is a proven breech of competition law, it is argued that in the current cases, behavioural remedies would have been sufficient in order to achieve the goals of the Commission. In other cases involving essential facilities[147], behavioural remedies have indeed been accepted and the energy sector can be singled out as the only discipline in which the Commission has enforced structural reforms for unbundling. Willis & Hughes have questioned whether

142 Alison Jones & Brenda Sufrin, Op. Cit. p. 983

143 Ibid. p. 273

144 Christopher Jones, Op.Cit. p. 336

145 Hubertus Van Rosenburg, 'Unbundling through the Back Door... the case of network divestiture as a remedy in the energy sector', European Competition Law Review, 2009 p. 2

146 Hubertus Van Rosenburg, Op.Cit. p. 18

147 CF: Sea Containers v. Stena Sealink – interim measure, OJ L 72/30, 1998 & Frankfurt Airport Case, OJ L 72/30, 1998

the competition concern has been exacerbated or the proportionality test is too relaxed in the energy sector cases examined above.[148]

Placing these in the political context lends towards the conclusion that the Commission has used competition law in order to achieve political goals. While the Commission advocated for ownership unbundling during the preparation of the third energy package, France and Germany were strongly opposed to such propositions.[149] A half-way house of control unbundling was eventually settled upon during the legislative process. Yet the Commission has used competition law to nevertheless achieve its goal of ownership unbundling. It would not be the first time that the Commission employed such tactics in the energy sector. We recall the cases in the mid-1990s alluded to in the first chapter[150]. The Commission used competition law in an attempt to bring about competition in the telecommunications and energy sectors. While the court agreed that they could in principle do this, they imposed a very high burden of proof. The cases ultimately failed but sufficiently frightened Member States who preferred the option of introducing sector specific legislation to allowing the Commission free rein with competition policy. This innovative use of competition law may be difficult to swallow for Member States. However, as we will see in chapter 6, it can cause even bigger problems when the cases relate to non-European companies.

148 Peter Willis & Paul Hughes, 'Structural Remedies in Article 82 Energy Cases' Competition Law Review, 4, 2008 p. 167

149 Hubertus Von Rosenberg, Op.Cit. p. 1

150 CF: FR V Com, case C-202/88 [1991] ECR 1-1223; Com V FR, case C – 159/94 [1997] ECR 1-2925; Hofner – Macrotron, case C – 41/90 [1991] ECR I – 1979; ERT, case C-260/89 [1991] ECR 1 – 2951; Port of Genoa, Case C-179/90 [1991] 1- 56 and discussion in chapter 1

2. Destination Clauses

The first step to creating an internal EU gas market is to remove the major barriers to cross-border gas competition. Yet destination clauses, traditionally inserted in long-term upstream gas supply contracts, restricts the territorial area in which gas can be resold by purchasers. Such clauses offer the importer the advantage of being able to charge different prices to Member States for the same gas sold at the same delivery point. An archaic reminder of traditional, vertically and horizontally segmented markets in Europe, these clauses limit the freedom of the buyer to resell the gas, reduce liquidity in the market and allow for differentiated price setting.[151] As the case-law in this area has evolved and the Commission has cracked down on these clauses, profit sharing mechanisms, which aim to indirectly restrict resale by the purchaser, have become more common place. Competition between gas from both different and the same supplier would result in a fall towards cost price and would therefore benefit importing countries, particularly those reliant on Russian and Algerian gas. It is therefore of strategic importance for the EU to remove such clauses from long-term gas contracts.[152]

The GDF/ENI and GDF/ENEL cases are the only cases to date where the Commission issued a formal decision. The saga is also unique as it only involves European players and therefore provides a classic illustration of the Commission's strategy to apply competition law in the gas sector without the complication of extra-EU geopolitics.

2.1. Facts and Procedure

The facts of the case are as following: ENEL, an Italian company, who prior to liberalisation benefited from an exclusive right to sell electricity in Italy, expanded its activities into gas distribution in Italy, Spain and Eastern Europe during the process of liberalisation. It concluded a take or pay contract with NLNG, a Nigerian LNG exporter, for gas to be delivered to a LNG terminal in Montalto di Catro. Subsequently the project to construct the terminal fell through, however, ENEL remained contractually obliged to 'take or pay' for the gas contracted with NLNG. The company therefore concluded a 'service contract' with GDF under the following conditions:

- ENEL would transfer ownership of the gas delivered by NLNG to EDF at the LNG terminal Montoir de Bretagne.

151 Kim Talus, Op. Cit. p. 159

152 Harold Nyssens & Iain Osborne, 'Profit-splitting mechanisms in a liberalised gas market: the Devil lies in the Detail', Competition Policy Newsletter, (1) Spring 2005 p. 1

- EDF would then transfer ownership of gas from other sources to ENEL using existing gas pipelines between France and Italy.

The contract contained a territorial restriction clause prohibiting ENEL from selling the gas it received from EDF outside of Italy. GDF concluded a similar contract with ENI which also included a territorial restriction clause.[153]

The Commission opened an enquiry into the presence of territorial restriction clauses in contracts concluded by EDF on the 28th of January 2003. It is fair to say that all three undertakings cooperated actively with the Commission during the period of inquiry. Indeed the Commission itself noted that the companies provided the Commission with an abundance of correspondence during the preparation of the document.[154] They responded positively to the request made by the Commission to use information provided during previous inquiries[155] and also responded promptly to any request for information sent by the Commission.[156] The undertakings informed the Commission of the deletion of all territorial restriction clauses from the contract on the 14,17 and 18th of November. [157] At the time the Commission had also been negotiating the exclusion of such clauses with other companies including Gazprom and Sonatrach. Talks had been underway since 2001 and it is therefore evident that the companies believed that cooperation with the Commission would lead to the resolution of the case before a formal investigation, by way of issuing a statement of objections, was given.

Nevertheless, an official statement of objections was issued on the 26th of February 2004 marking the opening of official proceedings. As will be discussed later, the decision to open formal proceeding is at odds with Commission practice in this area to date whereby the Commission has allowed parties to find a commercial solution to the competition raised.[158]

2.2. Violation of Article 101 TFEU – Anti- Competitive Agreements

Article 101 TFEU only applies to undertakings. It is settled case law that the 'concept of undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed'[159]. Therefore ENI, ENEL

153 COMP/38662 – GDF – décision GDF/ENI, Affaire COMP/38662 – GDF – GDF/ENEL

154 Ibid. Paragraph 31

155 Ibid. Paragraph 25

156 Ibid. Paragraph 26 – 30

157 Ibid. Paragraph 31

158 Christopher Jones, Op.Cit. p. 396

159 Case C-41/90, Hofner and Elser v. Macrotron GmbH [1991] ECR 1 -1979, Paragraph 21

and GDF fall within the definition of undertaking regardless of the fact that they are publicly or privately owned or that they carry out missions of public service. In order for Article 101 (1) TFEU to apply, it must first of all be established that[160]:

- There is **collusion or joint conduct**

In order to establish the existence of such collusion or joint conduct there must be concurrence of wills. 'It is sufficient that the undertakings in question should have expressed their joint intention to conduct themselves on the market in a specific way'.[161]In the present case, the existence of a clause within the contract illustrates the joint intention of the parties to conduct themselves in this manner. The fact that the clause was adopted on the initiative of one of the parties and serves their own interests does not affect the qualification of such a clause as collusion.[162]

- Collusion which **Appreciably restricts competition**

Collusion is not prohibited unless it has the object or effect of preventing, restricting or distorting competition. An agreement therefore restricts competition if its object or[163] effect is to do so. The category it falls into will nevertheless have substantial effects on the burden of proof to be carried by the claimant and defendant. Once an agreement's object is to restrict competition, article 101 is violated, unless it falls within one of the exceptions laid out in article 101(3). On the other hand, if the agreement does not have an anti-competitive object, the complainant must first of all prove that the agreement in question has an anti-competitive effect.

In the present case, the clause prohibits the two undertakings from selling outside of Italy and it therefore clearly violates the principles of the EU internal market.

- an appreciable **effect on trade between Member States**

This requirement is seen as a jurisdictional matter and is therefore interpreted broadly by the ECJ.[164] In the current context trade between Member States is obviously affected as the measure results in the compartmentalisation of the EU market.[165]

160 Alison Jones & Brenda Sufrin, Op.Cit. 2014 p. 124

161 Case T-41/96, Bayer AG V Commission [2000] ECR II-3383, Paragraph 67

162 COMP/38662, Paragraph 63

163 The alternative nature of the conditions has been widely accepted since the case 56/65, Société Technique Minière v. Mashinenbau Ulm GmbH [1966] ECR 235

164 Alison Jones & Brenda Sufrin, Op. Cit. p. 181

165 COMP/38662, Paragraph 135

The conditions of article 101(1) TFEU are therefore fulfilled. However, if the conditions of article 101(3) are satisfied then the agreement will benefit from an exemption from the application of article 101(1). The current agreement is considered a hard-core[166] restriction and does not fulfil the efficiency criteria laid down in article 101(3). Article 2 of regulation n 2790/1999 allows for two or more undertakings from different parts of the production or distribution chain (i.e a vertical situation) to conclude an agreement relating to the conditions under which the parties can buy, sell and resell products. Article 4 of the same regulation excludes vertical agreements which restrict the territory in which a buyer can sell the contractual products from the benefit of the exemption. Therefore the agreement does not benefit from the protection of article 101 (3) TFEU. The territorial restriction clauses inserted in the contracts violate are 101 TFEU.

Despite the Commission's findings, no sanctions were applied in the present case. The Commission cited the fact that 'the gas sector is subject to a process of liberalisation that involves a profound evolution in the commercial practices used by the actors present on the market , notably those linked to the commercialisation of natural gas by companies in Member States other than those where they are traditionally established'.[167]

2.3. Analysis of Commission's Approach

In the next chapter we will comparatively compare the approach of DG Competition when dealing with Sonatrach and Gazprom. However this decision highlights interesting trends.

Cameron makes an interesting comparison between the decisions in the automotive industry and the gas sector in order to highlight that the decisions taken by DG Competition in the gas markets are not strict.[168] Decisions were taken against many of the big players in the market including Volkswagen[169] and Opel[170] highlight that the Commission has acted leniently in the present case as no fine was imposed. Cameron points in particular to the DaimlerChrysler case where it instructed its distribution network not to sell cars outside of their respective territory. These and other behaviours were found to be in breach of article 81. The Commission imposed a fine of 10% of

166 Christopher Jones, Op. Cit, p. 269

167 COMP/38662, Paragraph 163

168 Peter Cameron, Op.Cit. 2007 p. 314

169 Volkswagen AG (CaseIV/35.733) Commission Decision 98/273/EC [1998] OJ L124/6

170 Opel Nederland BV/General Motors Mederland BV (Case COMP/36.65)

the company's global revenues – which amounted to 72 million euro.[171] Comparitively speaking, the Commission adopts a more lenient approach in this case as no fine is imposed. Yet a comparison such as this may be over simplified. The gas sector is undergoing a transformation from a monopolised to a liberalised market. When the agreement concluded between EDF, ENI and ENEL were concluded they were not illegal and only became so after the introduction of the sector specific legislation. Rather the Commission may be favouring the idea that parties should 'find a commercial solution for the competition problem identified'.[172]

This case was resolved shortly after the introduction of the second energy package. Since the introduction of the first energy package, the monopoly rights of gas companies across Europe have been withdrawn. These monopolies were either de jure or de facto[173] and they guaranteed energy companies a guaranteed market where there would be no other competitors. Such a liberalisation process comes as a shock to the system and it is unrealistic to expect that an IGM would manifest itself the morning after the introduction of the directive. Agreements such as those concluded by GDF in the present case are a testimony to the previous market structure in Europe and therefore must be removed from contracts. The Commission has therefore used competition law as a support for sector specific legislation in order to achieve liberalisation. This zealous application of competition law in the gas sector has led to a rupture in the status quo. Large national champions' reign in Member States is being undermined slowly but surely. It is perhaps this fact that prevented the Commission from imposing a fine in the current case.

Contrary to Cameron's analysis, the absence of a fine does not signify that the Commission have treated these Energy companies lightly. This case is the only example of where an official decision was taken with regards to destination clauses whereas cases involving Gazprom, Sonatrach, NLNG and Norwegian producers Statoil and Norsk Hydro were concluded via negotiations. The Commission stated that the purpose of the decision was to clarify the law, not only for the companies involved but also for other companies.[174] Many academics agree with this analysis.[175] This paper challenges this statement. In the

171 Commission press Release IP/01/1394, 'Commission Imposes Fine of Nearly 72 million on Daim;er-Chrysler for infringing the EC Competition ruels in the area of car distribution', 10 October 2001

172 Mario Monti, 'Applying EU Competition Law to the Newly Liberalised Energy Markets', World Forum on Energy Regulation, 6 October 2003

173 Christopher Jones, Op.Cit. p. 1

174 Commission press release, 'Commission confirms that territorial restriction clauses in the gas sector restrict competition', (IP/04/1310), 26 October 2004

175 Christopher Jones, Op.Cit. p. 271

next chapter, it will be shown that a formal decision was indeed taken for geopolitical reasons by analytically comparing the present case with the Sonatrach negotiations.

Obvious obstacles for accepting that the purpose of the decision was to clarify the law in this area for market actors will first of all be pointed out. First and foremost, if the Commission felt the need to clarify the law, surely it would have taken the opportunity to do so when the first deal to remove destination clauses from a contract with NLNG was taken in December 2002. It should also be noted that the decisions relating to the EDF/ENEL/ENI cases are only published in French and Italian. If it had been the aim of the Commission to clarify the law, surely it should have published the decisions in English, the main business language of the EU? Finally, the E.ON foreclosure case and similar decisions highlight the use of commitment decisions in the gas sector. As previously discussed, commitment decisions do not help to clarify the law, either for the company involved or for others. Ensuring clarity is clearly not one of the top priorities of DG Competition. Accepting the argument that the decision was made in the GDF/ENI/ENEL case to clarify the law leads to the conclusion that the Commission's behaviour is contradictory.

Chapter 5 : Patience is a Virtue the Commission was Blessed with – Depending on the Applicant – The Algerian Experience

Why rock the boat? Algeria – EU relations are relatively stable and Algeria has proved a secure energy exporter as outlined in chapter 3. We have also seen the Commission's ambitious application of competition law to European gas companies in order to create a single gas market. Yet issues of security of supply discussed in chapter 1 are never far from the Commission's mind and they have treaded carefully when dealing with Sonatrach. This chapter aims to illustrate that the legal issues in both the Sonatrach investigation and the EDF/ENI/E.ON cases were very similar if not identical. Nevertheless the Commission tempered the application of competition law and used a more lenient approach in the Sonatrach case.

It is difficult to discuss the Sonatrach 'case' as no formal proceedings were opened in this situation. The circumstances surrounding the negotiations are peculiar and merit detailed discussion. Destination clauses in upstream contracts pose the same threats to competition whether the contracting parties are both European or whether one of them is non-European. In order to achieve a fully functioning single market, it was therefore necessary to erase these clauses from all contracts including those signed by Gazprom and Sonatrach. In early 2000, the Commission began a long process of negotiations in order to achieve this. A settlement was eventually announced in 2007.

The facts of the case are as following. Destination clauses were periodically inserted into long-term gas supply contracts for both pipeline and LNG supplies concluded between European importers and Sonatrach. The contracts in question were much more straight forward than the 'transit' contracts concluded in the EDF/ENEL/ENI case. Gas purchased by European suppliers, for example ENI, could not be sold outside the territory of the member state – i.e ENI could only sell gas within Italy.

1. Procedural Anomalies

1.1 Timeline of Events

At the cusp of the new millennium, the Commission turned its attention to investigating destination clauses present in long-term gas contracts[176]. In December 2002, the first settlement between Nigerian NLNG and the Competition authorities was announced. They pledged to remove destination clauses or profit sharing mechanisms in any of their contracts with European customers and not include them in the future. In October 2003 an agreement had been reached between Gazprom and ENI to remove both destination clauses and profit sharing mechanisms. In 2005, the Commission issued a formal decision in the GDF/ENI/ENEL case, the only one of its kind. This was followed by a series of agreements between Gazprom and the Commission in 2005. In February, it was agreed that destination clauses would be removed from contracts concluded with Austrian company OMV and in June they were removed from contracts concluded with E.ON. The 2005 settlements with Gazprom did not make reference to profit sharing mechanisms and whether the parties agreed to prohibit them or not. Below is a timeline of events:

December 2002
Nigerian LNG agrees to remove destination clauses from European contracts[177]

June 2003
Gazprom agrees to remove destination clauses from contracts concluded with Italian company ENI[178]

October 2004
GDF/ENI – GDF/ENEL formal decision taken by the Commission stating destination clauses violate competition law[179]

176 Elonora Waktare, 'Territorial Restrictions and Profit Sharing Mechanisms in the Gas Sector: the Algerian Case', Competition Policy Newsletter, Number 3, 2007, p. 1

177 Commission press release, 'Commission Settles investigation into territorial Sales Restrictions with Nigerian Gas Company NLNG' (IP/02/1869), 12 December 2002

178 Commission press release, 'Commission reaches Breakthrough with Gazprom and ENI on Territorial Restriction Clauses ', (IP/03/1345), 6 October 2003

179 Comp/38.662

February 2005

Gazprom agrees to remove destination clauses from contracts with Austrian importer OMV[180]

October 2005

Gazprom agrees to remove destination clauses from contracts concluded with German company E.ON[181]

July 2007

Sonatrach concludes negotiations with Commission regarding destination clauses[182]

The above chart clearly indicates that the Sonatrach case took much longer to settle than any other case. We can also see that GDF/ENI/ENEL were the only companies against which a formal decision was announced. In the previous chapter we clearly highlighted that the purpose of the decision was not to clarify the law, as the Commission stated. Studying the timeline of events illustrates a potentially different explanation. By 2004, The Commission had already spent four years negotiating with the Sonatrach. Taking a decision against a European company allowed the Commission the opportunity to highlight to Algeria that this treatment was being afforded to all companies, regardless of their nationality. As we will now see, this case involved not only Sonatrach the company but also the Algerian government.

1.2 Competition Case or Intergovernmental Deal?

The press release issued by the Commission on the 11th of July 2007 is peculiar with regard to the language and structure used. A comparison between the announcement of the Gazprom settlement in 2003 and the Sonatrach settlement in 2007 illustrates interesting differences. The Gazprom announcement is clearly a standard settlement involving DG Competition, the key enforcer of competition of EU competition rules[183], and two companies – ENI and Gazprom.

> *"The European Commission's competition services have reached a settlement with the Italian oil and gas company ENI and the Russian gas producer Gazprom regarding a number of restrictive clauses in their existing contracts"*

180 Commission press release, 'Competition: secures improvements to Gas Supply Contracts between OMV and Gazprom', (IP/05/195), 17, February, 2005

181 Commission press release, 'Commission secures Changes to gas supply contracts between E.ON Ruhrgas and Gazprom', (IP/05/710), 10 June 2005

182 Commission press release, Op.Cit. (IP/07/1345), 6 October 2007

183 Alison Jones & Brenda Sufrin, Op. Cit. P 102

The Commission goes on to outline the outcome of the investigation – the removal of the clauses – and the benefits for European consumers. What is striking about the Sonatrach announcement is that the agreement is not concluded between the Competition authorities of the European Commission and Sonatrach but between EU Commissioner for Competition and the Algerian Minster for Energy and Mines.

> "*The EU Commissioner for Competition, Neelie Kroes, and the Algerian Minister for Energy and Mines, Dr. Chakib Khelil, have reached a common understanding on the clauses dealing with territorial restrictions and profit sharing mechanisms in gas supply agreements by the Algerian gas producer Sonatrach destined to satisfy the gas requirements of the European countries. Both sides welcome this outcome and regard it as a further step in deepening the strategic relations between Algeria and the EU*".

This is not an issue of competition law whereby an independent authority, the Commission, supervises the enforcement of EU competition law on its territory. The statement amounts to a political agreement between two political figures. This is a worrying trend. DG Competition is, to a certain extent, the court of first instance for competition cases. It should therefore adopt a neutral approach to the companies being investigated. Concluding intergovernmental agreements with a minister from the home country of the company clearly calls into question the nature of DG Competition's functions. Is it to apply the rules article 101 and 102 TFEU equitably and indiscriminately or is it to conclude political agreements with other heads of state regarding the behaviour of their national companies?

2. Legal Anomalies

The case turned around the presence of destination clauses and also profit sharing mechanisms (PSM). Central to the disagreement is the differing attitudes of Algeria and the EU. While Algeria agreed to remove the destination clauses, it wanted to replace them with PSM in order to ensure the contractual equilibrium negotiated at the time of the conclusion of the contract was maintained. On the other hand, the Commission saw both destination clauses and PSMs as methods of partitioning the EU internal market and thus stagnating the liberalisation process.

2.1 Legal Issues

Destination clauses

In the current case, all destination clauses were eventually deleted from contracts. As outlined in chapter 4, destination clauses violate article 101 TFEU. Legally speaking there is no difference between the commitment by Sonatrach to delete such causes and EDF/ENI/ENEL decision. Yet in one case seven years of negotiations were needed to arrive at this point and in the other case the Commission took a firm and swift approach. It should be noted that during negotiations these clauses continued to be enforced in contracts between Sonatrach and EU importers while decisions had already been taken prohibiting them from inter-EU contracts in the EDG/ENEL/ENI case.

Profit Sharing Mechanisms

It is obvious that the destination clauses inserted in contracts were anti-competitive. The presence of PSMs is more controversial. PSMs 'oblige the buyer to share a certain part of the profit with the supplier/producer if the gas is resold by the buyer to a customer outside the agreed territory or to a customer using the gas for another purpose other than agreed.'[184]

It is first of all important to note that there are different methods of transfer of ownership of LNG gas during delivery. The first is sales under DES (delivery ex-ship) – the title and risk remain with the seller until the gas is placed at the disposal of the purchaser at the port of destination. CIF (costs, insurance and freight) means while the seller pays for the costs, and freight necessary, the risk is transferred to the buyer when the goods pass the rail of the ship at the port of shipment. Nevertheless the seller must purchase insurance for the goods during shipment. FOB (free on board) means that the title and

184 Eleonora Waktare, Op.Cit. p. 1

risk are transferred to the purchaser when the goods pass the rail of the ship at the port of departure. [185] Sonatrach claimed that when goods were shipped under DES conditions, it should be entitled to profits from the sale of the gas as they maintain title until the gas has reached its port of destination, whether it be the port initially agreed upon or a new port where the buyer has decided to sell the gas.

We will analyse whether such clauses constitute a violation of article 101 TFEU.

- There is **collusion or joint conduct**

As previously outlined, a clause in a contract is sufficient to prove concurrence of wills.

- Collusion which **Appreciably restricts competition**

As stated in chapter 4, an agreement restricts competition only if its object or[186] effect is to do so. PSM may have the same object as a destination clause (i.e to restrict the territory in which a company can sell) based on the lack of clarity of the rules attached to the clause rendering it unworkable.[187] In this case the clause would have an anti-competitive object. Otherwise it would be necessary to prove that the clause had an anti-competitive effect.

The extent to which PSM have an anti-competition effect depends upon the conditions of the clause and the conditions of shipment. Many authors are of the opinion that the effect of the clause may or may not be competitive depending on whether it reduces the buyer's incentive to sell the gas for the best price available, even if this is outside the area designated. These clauses also place reporting duties on the buyer and may necessitate providing commercially sensitive information to the supplier.[188] It has agreed to only insert the PSMs in contracts concluded under DES conditions. In this circumstance it is argued by some scholars of the Commission that the once the title and risk of the gas has been transferred the purchaser should be entitled to deliver the gas where he likes – to prohibit this violates article 101 TFEU.[189] However in DES shipment agreements the title remains with the producer until the goods are unloaded from the ship. When a decision is taken to redirect the LNG fuel to another port, the producer is still the legal

185 Ibid.

186 The alternative nature of the conditions has been widely accepted since the case 56/65, Société Technique Minière v. Mashinenbau Ulm GmbH [1966] ECR 235

187 Christopher Jones, Op.Cit. p. 272

188 Eleonora Waktare, Op.Cit. p. 19

189 Eleonora Waktare, Op.Cit p. 3

owner of the gas and should therefore be entitled to benefit from a share the profits made from the sale.

This paper challenges this reasoning. The Commission's logic is hard to agree with for two main reasons. Firstly, although contractual law varies from jurisdiction to jurisdiction, the transfer of property is a usually formal requirement for a contract for the sale of goods to be completed. Regardless of whether the producer legally holds the title, it can nevertheless be argued that once the price has been paid the owner is legally entitled to possess the goods. Once the price has been settled and the goods identified, the contract is concluded. It is irrelevant whether or not the purchaser decides to have them delivered from one port or another or whether he subsequently sells them on.

Secondly, PSM can have an anti-competitive effect regardless of when the title of goods are transferred. Rules relating to the transfer of title and risk are devised in order to regulate situations in which the goods are damaged at the port or at sea. The Commission should not consider when the transfer of the title takes place in order to analyse the anti-competitive effect of the clause but should look at whether it reduces or eliminates the incentive for the purchaser to trade their goods in the single market. The logic of the Commission is based on legal formalities rather than substantial legal and economic analysis to decide whether the measure is anti-competitive. Scholars note that the formalistic approach taken by the Commission (allowing PSMs only in DES shipments of LNG) will not be maintained in future cases and stems from a necessity to find a workable compromise with Sonatrach and the Algerian Government.[190] This paper argues that this is a correct analysis.

- an appreciable **effect on trade between Member States**

This requirement is seen as a jurisdictional matter and is therefore interpreted broadly by the ECJ.[191] In the current context trade between Member States is obviously effected as the measure results in the compartmentalisation of the EU market.[192]

Based on the above analysis, this paper suggests that PSMs inserted into gas supply contracts have an anti-competitive effect regardless of whether the contract concerns pipeline or LNG gas. While it is clear that PSMs are anti-competitive in pipeline contracts,

190 Kim Talus, 'Long-term natural gas contracts and antitrust law in the European Union and the USA' Journal of World Energy Law and Business, 2011 p. 284

191 Alison Jones & Brenda Sufrin, Op. Cit. p. 181

192 COMP/38662, Paragraph 135

the Commission have seemingly found a 'legal' argument to justify the agreement concluded with Sonatrach to allow such clauses in LNG DES shipments.

2.2. Analysis – Why was Sonatrach treated favourably?

As highlighted above, PSM can have anti-competitive effects similar to destination clauses. Nevertheless, in the agreement concluded between Soantrach and DG Competition PSM were allowed in LNG shipments. On a comparative note, both NLNG and Gazprom accepted not to include these clauses in the agreements concluded in 2002 and 2003. As was seen in the GDF/ENI/ENEL case, the competition authorities took a strict approach to clauses that partition the market. This provides clear evidence that Sonatrach was treated more favourably than other companies in very similar situations.

It is difficult to pin-point the motives behind the difference in treatment for Algeria. It appears to receive more favourable treatment than both EU and Russian companies – but why? Placing the case in the context of EU- Algerian relations at the time may help to provide clarification. As noted in chapter 3, Algeria rejected the ENP in 2004 claiming that it was not based on the principles of partnership but was dictated by European Partners without prior consultation.[193] During an interview with the attaché for Energy at the Algerian Embassy in Brussels, it became clear that the Algerian government was slightly perplexed by the EU's behaviour during the 2000s. The EU has been delegated a sovereign right to legislate by Member States and it is free to introduce legislation on its territory. Yet the introduction of the energy packages and the stricter application of competition rules had an impact on exporters of gas to the EU. The decisions made were not taken in an informative manner. While Algeria did not expect to be invited to the negotiation table, it did expect to be informed of changes. 'You cannot change [the rules] from one day to another'[194] without notifying your partners. An analogy can be made with a business – it would not change its terms of business from one day to another without notifying (and probably negotiating with) its contractual partners.

It is clear that if the EU wishes to create a single market, it must not only inform and consult with our energy partners but it must also play by its own rules. Yet at the time of the negotiations, the EU was receiving negative press in Algeria regarding access to the European market for Algerian companies. For instance, Sonatrach's bid for 30% of

193 Lotfi Boumghar, 'The Algerian Position on the European Neighbourhood Policy, Mediterranean Yearbook 2013, p. 1

194 Interview with Attaché for Energy, Embassy of the Democratic Republic of Algeria to Brussels, 17.03.2014, Brussels

the capital in Spanish petrol company Cespa was rejected by the Spanish government in 2007.[195] In particular the decision to impose legal unbundling and to insert the third country clause in the third energy package was under discussion at the time. Algeria was under the impression that the EU was creating an energy market to suit themselves which did not take into consideration the business considerations of Sonatrach or other foreign companies. These tensions could explain why Algeria received particular treatment.

The price for healthy EU – Algerian relations is high – as long as PSM clauses remain entrenched in the contractual practice of Sonatrach, market segmentation will continue to pose a problem. As noted by Nyssens and Osborne, as long as entry costs to energy markets remain restrictively high, established players' ability to supply gas beyond their tradition market will be a vital catalyst for the development of competitive markets.[196]

195 http://www.algeria-watch.org/fr/article/eco/hydroc/sonatrach_indesirable.htm consulted on the 01/05/2014

196 Harold Nyssens & Iain Osborne, Op.Cit. p. 6

Chapter 6: DG Competition and the Gazprom Headache

Was the Gazprom investigation geopolitically motivated? On the 4th of September 2012, the Commission launched an investigation into Gazprom's behaviour in Central and Eastern Europe. Despite the fact that Gazprom had worked with the Commission during the previous decade to reach agreements on destination clauses in western Europe, the announcement sent shockwaves through the system, particularly in Russia where the attack was seen as geopolitically motivated.197 The question this chapter therefore seeks to answer is not whether geopolitics was a factor in delaying or avoiding the application of competition law but whether competition law was applied with the aim of achieving a geopolitical goal. It will first of all be highlighted that Gazprom is receiving treatment that appears in line with the treatment European companies have received in the past. Secondly the geopolitical consequences of such a competition law decision will be analysed.

197 Nicolo Sartori, 'The European Commission V.s Gazprom: An Issue of Fair Competition or a Foreign Policy Quarrel?' Instituto Affari Internazionali working Papers 13/03 January 2013 pp.1 -15

1. Legal Parity?

We will analyse the separate elements of the investigation in order to deduce whether or not the claims that the investigation into Gazprom is geopolitically motivated can be substantiated. We will then analyse all of the geopolitical issues raised by each element of the case together in order ot decipher whether the case was geopolitically motivated.

1.1 Facts and Procedure

The current Gazprom investigation formally began on the 4th of September 2012 following a series of raids on Gazprom's offices in Eastern and Central Europe[198]. There is a general assumption that the investigation was prompted by complaints made by the Lithuanian government and it has been established that it made at least one formal complaint to the Commission.[199] Lithuania is a 'gas island'[200] and therefore relies solely on Russia for its gas needs. This places it in a vulnerable position not only in terms of potential gas cut –offs but also in terms of exploitative pricing. This is worsened by the fact that Gazprom owns the 'Lietuvos dujos' gas transportation company responsible for transporting gas from Russia to Lithuania. The Lithuanian government claims this violates the third energy package's unbundling requirements.[201] The investigation also comes after the sector enquiry into gas and electricity markets in the EU carried out in 2005 where the Commission outlined the causes of high gas prices in Europe, namely oil indexation.[202]

The fact that Lithuania may or may not have instigated the review of Gazprom's practices does not necessarily mean that the case is geopolitically motivated in itself. Article 7(2) of Regulation 1/2003 stipulates that 'those entitled to lodge a complaint… are natural or legal persons who can show a legitimate interest and Member States'. Legally speaking, Lithuania was well within its rights to lodge the complaint. Nevertheless this fact is laden with political innuendo. During Soviet times, Lithuania was integrated into the

198 Commission, 'Antitrust: Commission Confirms Unannounced Inspections in the Natrual Gas Sector', Memo/11/641, Brussels, 27/09/2011

199 CF: Andrey Konoplyanik, 'European Commission Vs. Gazprom: How to Find a Balance (Between Demands for Immediate Competition from the First & Justified Long-Term Economic Considerations from the Latter)' , OGEL, August 2013 P 3, Alan Riley, Op.Cit P6

200 Alan Riley, Op.Cit P6

201 Andrey Konoplyanik, Op.Cit P3

202 European Commission, 'Sector Inquiry Pursuant to Article 17 of Regulation 1/2003 in the European Electricity and Gas Markets', Communication by Ms. Neelie Kroes in Agreement with Mr Piebalgs, Brussels June 2005.

Soviet Union. Today it is a well-known fact that relations between the countries are tense and cold.[203] Yet Lithuania remains dependent upon Russia for its energy needs and obviously the fact that Russia controls its transmission network prevents competition in the market.

The Commission announced that its concerns centred around two specific practices typically found in long-term contracts across Europe – destination clauses and oil indexation clauses. The Commission also voiced concerns over the potential violation of article 102 TFEU relating to third party access. The investigation looks at three particular breaches of competition law which will be dealt with separately. As no formal decision has been taken, the following chapter is based on the hypothetical legal analysis the Commission is likely to make.

1.2 Destination Clauses

Destination clauses were not only the Algerian bête noire. They are also traditional features in contracts between Gazprom and its European partners. At the turn of the new millennium, Gazprom proved a cooperative partner in the single market project, and was committed to remove destination clauses from contracts concluded with Austrian company OMV[204], Germany's R.ON Ruhrgas[205] and Italy's ENI[206]. The Commission has now turned its attention to gas markets in Eastern and Central Europe. The legal issues these clauses pose in competition law will not be dealt with here (see chapter 4 and 5), however we will briefly comment on why Gazprom has continued to use such clauses, conscious that they violate EU competition law. As noted previously, the evolution of the destination clause saga has taken a different direction regarding Russia. While it is true that no formal decision was taken against the Russian company (while formal decisions were taken against European companies), the resolution of the issue did not require years of negotiations. The question must be asked whether the swift resolution was because of the Commission's approach to Gazprom or Gazprom's willingness to find a solution. It is not inconceivable that the preferential treatment afforded to Sonatrach sent the wrong message to other non-European gas companies, who now expect to be facilitated with an endless deadline for coming up with a lenient compromise.

203 Matt Ford, 'Russia's Seizure of Crimea Is Making Former Soviet States Nervous', the Atlantic website available at: http://www.theatlantic.com/international/archive/2014/03/russias-seizure-of-crimea-is-making- former-soviet-states-nervous/284156/

204 Commission press release, Op.Cit. (IP/05/195), 17/02/2005

205 Commission Press release, 'Op.Cit. (IP/05/710), 10/06/2005

206 Commission press release, Op.Cit. (IP/03//1345) 6/10/2003

Studying the scope of the countries involved in this complaint is interesting – all countries either Warsaw Pact countries or former members of the Soviet Union. Could this explain why this investigation has hit a sensitive nerve with Gazprom? In previous settlements with the Commission, it has agreed to remove destination clauses from contracts involving Western European companies (Austria, Italy, Germany). This is the first time that an investigation has taken place regarding countries that were formally part of the Soviet empire. It is questionable whether this fact is significant. When questioned on this topic, the Russian attaché for energy denied any allegation of the kind.

Some authors believe however that if the case simply centred around destination clauses, a swift solution would have already have been found. [207] Given that cases involving destination clauses have been tackled by the Commission since the early 2000s, this part of the investigation does not lead to the conclusion that there are geopolitical motives. It is the latter two argument that are causing tensions to mount.

1.3 Oil indexation

First and foremost it is necessary to correctly identify the legal issue the Commission is investigating. The Commission stated in its press release that 'Gazprom may have imposed unfair prices on its customers by linking the price of gas to oil prices.'[208] The aim of the investigation is not, as certain articles incorrectly state, to determine the compatibility of take-or-pay obligations with competition rules per sae.[209] Rather, the Commission is investigating whether oil indexation violates article 102 TFEU. Nevertheless this is the first time that this issue has been investigated, fuelling arguments that the investigation was geopolitically motivated.

1.3.1 Violation of article 102 TFEU

As previously outlined in chapter 4, there are four conditions which must be met in order for the behaviour of a company to violate article 102 TFEU:

- **A Dominant Position**

207 Alan Riley, Op.Cit. P8

208 European Commission press release, 'Antitrust: The Commission Opens Proceedings against Gazprom', Brussels, 4.09/2012

209 CF: Nicolo Sartori, 'The European Commission Vs. Gasprom: an Issue of Fair Competition or a Foreign Policy Quarrel?' IAI working Paper 13 – 03/01/2013 identifies it as such at P7

In the absence of concrete facts about the investigation, it is difficult to define precisely either the product market or the geographic market concerned. The natural gas market can be divided two distinct categories, upstream and downstream activities[210] and the current case involves upstream activities of supply.[211] The scope of the wholesale supply market has, in itself been subject to further categorisation. The decisional practice of the Commission appears to indicate that the market can be defined as comprising of 'transactions between traders/resellers and not between a trader/supplier and an end customer'[212] such as large industrial customers.[213] With respect to the geographic scope of markets, the Commission has systematically taken the approach that the market is national, despite the process of liberalisation.[214]

The case concerns eight Member States[215] all of whom rely heavily, if not totally, on Russian gas. It is possible to say with a certain degree of accuracy that it is quite likely that Gazprom will occupy a dominant position in all of the above mentioned countries.

- The Dominant Position must **be held within the internal market** or a substantial part of it

As noted early this is mainly a jurisdictional issue. The Commission have never specified how much of the internal market must be concerned. However in the ABG Oil case, the Avocate General was content that the Dutch petrol market which consisted of approximately 4.6% of the overall Community market was substantial.[216] In the present case, the practice concerns several Members States and it is therefore evident that the dominant position is held within the market.

- **An Abuse**

The characterisation of oil indexation clauses as abusive is the most controversial element surrounding this case. There is no previous case law or decisional practice dealing with oil indexation clauses and the decision to investigate the abusive nature of such clauses came as a surprise to most commentators of competition law in the energy sector.[217]

210 Kim Talus, Op.Cit, p. 140

211 Commission, 'Antitrust: Commission Confirms Unannounced Inspections in the Natrual Gas Sector', Memo/11/641, Brussels, 27/09/2011

212 COMP/M.3868, Paragraph 71

213 For further illustration see: Christopher Jones, Op.Cit, Chapter 4

214 Christoper Jones, Op.Cit, Chapter 5

215 Andrey Konoplyanik, Op.Cit. p. 2

216 Case 77/77, Benzine en Petroleum Handelsmaatschappij BV v Commission [1978] ECR 1513, 1537

217 Kim Talus, Op. Cit (USA Comparision), p. 32

While there is no ECJ precedent, a German Federal Court ruling[218], which held that the clauses violated national civil law, provides an interesting indication of how the courts are likely to treat such provisions. It was judged that such clauses disproportionately place the buyer at a disadvantage in certain circumstances such as when the price of gas is strictly linked to the oil price and therefore allows the seller not only to compensate price increases but also to profit from them. [219]

Secondly, and importantly, it should be noted that article 102 TFEU prohibits undertakings from imposing certain conditions that would otherwise be legal if it were not for their dominant position. Article 102 TFEU specifically mentions 'directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions'[220]. The logic is to prevent dependant customers (and suppliers) from being exploited by the dominant undertaking. The principle was confirmed by the ECJ in the seminal United Brands case that *'charging a price which it is excessive because it has no reasonable relation to the economic value of the product supplied would be [considered] an abuse'*.[221]

The pertinent fact is that the price is determined by oil products which have no relevance to gas markets in the modern era. Does the fact that Gazprom uses this indexation constitute an abuse? Taking the cases discussed above into account, it is likely that the Commission will find the existence of an abuse on the part of Gazprom.

- **An Effect on Inter-State Trade**

High prices in one Member State will affect trade flows between this Member State and other member. Therefore there is an effect on inter-State Trade.

1.3.2 Analysis

It is therefore this paper's contention that oil-indexation clauses in gas contracts do violate article 102 TFEU when they are imposed by a dominant firm and when there is no connection between the indexation method used and the product. Nevertheless, there are signs that the Commission may be back tracking. During an interview conducted with 'G plus' the agency charged with Gazprom's legal communication, it was suggested that the Commission were now considering dropping allegations. It is unclear whether this is the reality of the situation.

218 Bundesgerichtshof, VII ZR 178/08 and VIII ZR 304/08

219 Kim Talus, OP.Cit (2011)

220 Article 102 (a) TFEU

221 Case 27/76 United Brands V Commission, [1978] ECR 207 p250

This will be the first time that such clauses are investigated and may contribute to the feeling that both Gazprom and Russia have that this case is geopolitically motivated. From a logical perspective, it makes sense to target the biggest offender first off in order to achieve the greatest market liberalisation. Once this is complete, smaller players can be attacked if they do not conform to the precedent. It should be noted that when the Commission investigated the destination clauses, they

investigated all companies concerned including both European (GDF, ENEL, ENI) and non-European (Nigerian company NLNG, Norwegian Statoil Sonatrach and Gazprom.) Nevertheless this does not appear to be the case in the current situation. Sonatrach, for example, traditionally uses oil indexation clauses in their long-term contracts.[222] Yet there is no evidence of on-going investigations concerning these clauses.

1.4 Network Foreclosure

Although the facts in the current case are, as of yet, unknown, it can still be deduced with relative certainty that the situation in this investigation and the E.ON foreclosure case detailed in chapter 4 are very similar. Let us examine the situation in Lithuania as an example. Gazprom controls the transmission network and is also the sole importer of gas. Note that this legal analysis is not exhaustive as the actual facts pertaining to the case are unknown.

1.4.1 Violation of article 102TFEU

We are aware of certain details such as the fact that Gazprom owns the 'Lietuvos dujos' gas transportation company responsible for transporting gas from Russia to Lithuania. We will now look at the conditions which must be fulfilled briefly.

- **A Dominant position** – As outlined above, Gazprom has a dominant position on the market.

- The Dominant Position is **be held within a substantial part of the internal market**

- **Abuse**

We recall the essential facilities doctrine outlined in chapter 4. The transmission network controlled by Gazprom is an essential facility. Failure to give other operators access to it constitutes a breach of competition law.

222 Robert Marbo & Ian Wybrew, 'Gas to Europe', Oxford University Press, Oxford, 1999, p. 137

- This measure also has the potential to **effect inter-State trade**

The case is almost identical to the E.ON case discussed in chapter four. The Commission will be likely to look for network divestiture from Gazprom in order to settle the case.

1.4.2 Analysis

In chapter four the debate centred on the Commission's use of commitment decisions in order to achieve the political aim of unbundling, which was a controversial issue between member states at the time. It appears that the Commission may be applying the same logic to this case. It is adamant to create fully functioning free markets, whether it be through the use of sector specific legislation or general competition law. Nevertheless, this political motive does not necessarily hold geopolitical connotations. The Commission has clearly decided to litigate many cases where third party access has

been denied to competitors including cases involving large European players such as E.ON, ENI and RWE. The fact that the Commission applies the same treatment to both European Companies and to Gazprom leads to the opposite conclusion, that geopolitics was not considered when deciding to investigate the case.

When defining security of supply, we referred to the necessity of having a continuous flow of reasonably priced gas. Lithuania has long complained of high gas prices because of the control Gazprom has on the market. If Gazprom were forced to divest its assets, it would allow for competitors to enter the market thus introducing price competition and ensuring that gas is available at a reasonable price. Competition law is therefore effectively being applied to ensure security of supply. Indeed this is one of the objectives of the IGM, to create an internal market whereby security of supply is guaranteed.

1.4. Conclusion – was the Gazprom investigation geopolitically motivated?

We will now consider all of the above arguments together in order to determine whether the case was geopolitically motivated. It is difficult to give a straight forward yes or no answer to this question for several reasons. Firstly, this case raises a multitude of issues that highlight the complexity of the Russia – EU energy partnership and their relationship as a whole. The claim that the case is based on a complaint made by Lithuania, or the fact that the countries concerned are all either former Warsaw Pact or Soviet Union members, do not, on their own, substantiate the argument that the case was geopolitically motivated. However taken together they indicate a certain reality that is undeniable.

The Commission's aim in launching the investigation was almost undoubtedly to continue to pioneer for the creation of the IGM. As noted previously, the Commission has applied the rules in a vigorous fashion to European companies in order to achieve this goal. It has not hesitated to use the provisions of article 102 TFEU in order to bring about ownership unbundling despite the fact that this had not been endorsed by Member States during the discussions for the completion of the third energy package. Yet it was noted that the aim of the IGM is more than just the text-book case of increasing consumer welfare by promoting competition. Europe also hopes to reduce its dependency on Russian gas via the IGM. It is therefore conceivable to argue that the case is geopolitically motivated. Nonetheless it requires a stretch of the imagination.

2. A Russian Reaction

On the 11th of September 2012, 7 days after the announcement by the Commission regarding the opening of the investigation into Gazprom, President Putin signed Decree no. 1285 'On measures for the protection of interests of the Russian Federation in the course of foreign economic activity, conducted by Russian legal entities'[223] into force. This decree provides that the protected strategic state entities must receive prior consent of federal executive bodies and the authorisation of the Government of the Russian Federation before providing information on activities, making amendments to agreements and disposing of shares in foreign organisations.[224] Gazprom is named as a strategic company for the purposes of the Decree. The timing is not coincidental and his decree will have significant impacts on the proceedings currently facing Gazprom and future competition investigations.

Firstly, the decree prevents companies from providing information to the Competition authorities. While the dawn raids have already been conducted in this case, this will have significant impacts on the future cases. Secondly, the act specifically states that Gazprom cannot dispose of shares in foreign investments. It is therefore extremely unlikely that we will see the conclusion of a commitments decision similar to those concluded in the E.ON case discussed in chapter 4. For Gazprom to conclude a settlement with the Commission related to network foreclosure, the Commission will likely only accept an offer which would see Gazprom divesting some of its shares in the network transmission company. Yet Gazprom cannot offer such a proposal without first consulting with the Russian Government. It has been confirmed that Russian officials are also attending meetings concerning the Gazprom case.

The Commission is caught between a rock and a hard place. Settling a commitments decision with Gazprom which doesn't require divestiture would be at odds with its decisional practice. A commitments decision which requires less than divestiture would obviously indicate that geopolitics has played a role in the application of competition law. Nevertheless if the Commission does not come to an agreement with Gazprom, it will be forced to take a decision which will probably be appealed. Given the nature of the present decree by Russia, it is possible that it would not conform with any decision made by Gazprom.

223 Official Site of the Russian President, available at: http://eng.news.kremlin.ru/acts/4401/print consulted on 08/05/2014

224 Andrey Konoplyanik, Opi.Cit. p. 7

It is fair to say that security of supply is jeopardised in the current climate. EU- Russian relations continue to deteriorate by the day mainly due to the unfolding events in Ukraine. In terms of Energy politics, the Commission is also facing a changing political relationship. On the 5th of May 2014 it was reported that the Russian Federation would challenge the third energy package before the WTO dispute settlement board.[225] There are also unconfirmed media reports that the Commission will withhold from issuing any further statements on the Gazprom case until the tensions between the two Neighbours dye down.

225 EU Oberser, available at: http://euobserver.com/news/123984 consulted the 09/ 05/2014

Conclusion

In 1999 the gas markets were described as following:

> *'The development of the European gas Industry is in some senses very much a fairy tale. It has all the ingredients of a great story with nation states battling for territory, the gas companies behaving like 'barons' who mark out their fiefdoms and, some would say, control the lives of their 'serfs' in the form of customers.'* [226]

Today, following over two decades of energy legislation in order to bring about the ISM, we could make the following statement: The development of European competition law in the gas sector is in some senses very much a fairy tale. It has all the ingredients of a great story with the European Commission playing the role of the main protagonist, which challenges large gas companies in Robin- hood style, to lower prices for innocent consumers. Commission beware! Some of these large gas companies have dragons in the form of large home states, to protect them.

This paper set out to analyse the role geopolitics plays in the application of competition law in long- term upstream gas contracts. A detailed outline of the case law applied to European companies was first of all given in order to serve as a normative example. Analysing the Sonatrach negotiations illustrates that geopolitics does play a role in the application of competition law. There was a substantial difference between the procedural approach adopted in the Sonatrach case and the GDF/ENI/ENEL cases. Similarly the legal solution differed in both cases. While market partitioning was prohibited in GDF/ENI/ENEL case, certain mechanisms allowing partitioning were accepted by the Commission in the Sonatrach negotiations.

Yet the answer to the question 'To what extent does geopolitics play a role in the application of competition law in the gas sector?' is complicated by the Gazprom investigation as it highlights another element to the question. Here it was argued by Russian critics that

226 Robert Marbo & Ian Wybrew, Op.Cit. p. 1

geopolitics was the reason why the Gazprom case was opened. There was therefore a suggestion that the law was applied more harshly to a non-European company than to a European company. The preliminary evidence presented in this paper suggests that there may be certain geopolitical links between the objective of the Commission and the decision to investigate the anti-competitive behaviour by Gazprom. Nonetheless the Commission equally uses competition law to achieve political goals within the EU as was seen in the E.ON network foreclosure case. Further research is required into this topic. At this stage of the investigation, it is not possible to say whether geopolitics influenced the application of competition law in the Gazprom case. While reports circulating about the Commission's decision to delay a judgment in this case until tensions between Russia and the EU subside would clearly substantiate the argument that geopolitics plays a role in competition law application, it is currently too early to confirm whether this is fact or fiction.

Nonetheless, the present investigation does highlight the consequences competition law application can have on geopolitics. The swift adoption of Decree no. 1285 by the Russian Federation confirms this statement. The development of the EU- Russia energy relationship since the investigation was launched has highlighted that there are geopolitical tensions between the two partners. In years to come, when the case has been closed and all the facts are available, the truth will be revealed.

The EU's goal is to create an IGM in order to reduce energy prices, ensure security of supply and ultimately increase the competitiveness of the European economy. Nonetheless, this objective will not be achieved if the root causes of the structural problems in the gas markets are not addressed. The practices used in long-term upstream contracting are causing these structural problems and DG competition is charged with the difficult task of stamping out such techniques. Yet this task is complicated further by the presence of geopolitical concerns which must be taken into account. This paper will now present practical policy recommendations for DG Competition:

- The Commission should avoid offering preferential treatment to certain companies. In particular, it should avoid press releases that give the impression that an intergovernmental agreement has been concluded instead of the resolution of a competition case. The treatment offered to Sonatrach may have created a legitimate expectation for other countries that the Commission would treat them with patience. Furthermore, it is contrary to the basic principles of justice to offer one offender more preferential treatment based on their nationality.

- The reaction of the Russian government to the Gazprom case highlights that applying competition law to non-European Gas companies does have

geopolitical consequences. While it is neither fair nor wise to treat these companies differently based on this fact, the Commission must come up with a solution to the problem.

- The EU must engage in dialogue with its Algerian and Russian partners, but on equal terms.
- The legal structures that frame EU energy relations with both Algeria and Russia must be strengthened. The Commission may have to relax its mantra of achieving an IGM and instead focus on finding common ground with our energy partners. Obviously European Security of Supply will not be the greatest concern of producing countries. Any agreement must reflect this.
- The IGM is a necessity to Ensure Europe's competitiveness. Nevertheless, the project will not on its own ensure security of supply. In fact it may do the opposite and reduce security of supply. The Gazprom case, for instance, was taken in a bid to further the creation of the ISM. Today, however, it is jeopardising security of supply by increasing tensions between Europe and Russia.
- Relations between Russia and Europe are tense and fractured at the moment. The EU should concentrate on maintaining positive relations with Algeria in order to promote security of supply.

It would be easy to conclude this paper with a moralistic lesson that the law should be applied equitably and indiscriminately. Nevertheless this would not be an adequate conclusion to this paper given the current geopolitical situation Europe find itself in. Geopolitical risks are by nature unpredictable and often uncontrollable. It is doubtful that anybody could have predicted Russia's reaction to the Gazprom case. DG Competition must tread carefully and juggle single market concerns with these geopolitical risks. The consequences of blindly applying competition law to all market actors, could have serious consequences. Nevertheless, it cannot continue to offer preferential treatment to large energy producing, state-owned companies to the detriment of European operators and consumers. Engaging with our energy partners and finding common solutions will undoubtedly help to relieve DG Competition of the current predicament it finds itself in.

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