

No fines for Gazprom's monopolistic practices in Central Europe?

Szymon Kardaś, Agata Łoskot-Strachota

On 13 March, after five years of antitrust proceedings against Gazprom, the EU's commissioner for competition Margrethe Vestager announced that the European Commission (EC) was ready to settle the case. The Russian gas company was accused of abusing its dominant position on the markets of Central and South-Eastern European (CEE) countries. Despite the ongoing market test examining the consequences of such a solution before a final decision by the EC, the conclusion of proceedings with a settlement is very likely. This would mean no formal recognition of Gazprom's infringement of competition rules. The Russian company would avoid also any fines, despite having been charged with abuse of its dominant position and tangible losses incurred by the participants on the Central European gas market.

The commitments submitted by Gazprom would enable the more rapid adaptation of its business practices in CEE to those already widely used by the company in Western Europe. This would above all remove the still existing contractual barriers which hinder the free flow of gas and make possible the price discrimination against CEE clients. In addition, Gazprom has committed itself to specific steps improving the situation of the most isolated markets in the region (Bulgaria and the Baltic states).

Gazprom's readiness to commit to changing its practices is largely related to the changes on the EU gas market and its regulation, as well as to the diversification and integration projects implemented in the region. Gazprom's commitments thus seem to fit into the company's strategy, modified in recent years, of defending its market share in Europe. It is likely that Gazprom would have implemented at least some of the changes anyway (as it has already started to do), no matter what the outcome of the antitrust proceedings would have been. Consequently, the amicable conclusion of the proceedings would mostly mean the amendment of Gazprom's 'old' practices, which had anyway been undergoing modifications in recent years. However, such a conclusion would not in any way relate to the new challenges connected to Gazprom's more aggressive market game in the EU, as well as its continuing dominance on the CEE European markets (and to the Nord Stream 2 project, among other factors).

The antitrust proceedings

After the antitrust investigation concluded in spring 2015, the European Commission accused the Russian group (within the framework of the so-called written statement of

objections) of abusing its dominant position and employing monopolistic practices in the CEE countries. In accordance with procedure, Gazprom gave a written response to the allegations as early as September 2015; it sent a preliminary list of the commitments it was prepared to undertake in connection with the allegations which the EC had brought against it. On 14 February 2017, after nearly a year and a half of negotiations, Gazprom sent the final version of its commitments. The EC accepted them on a preliminary basis, finding that they correctly addressed its objections, and would contribute to improving the competitiveness and liquidity of the gas markets in the CEE countries covered by the investigation. Thereupon the EC launched the market test phase of Gazprom's commitments; this consists of assessing the potential market effects of the possible implementation of the commitments made by the company which has been accused of monopolistic practices.

Within the framework of the market test, the comments from the interested parties are expected within the next seven weeks (i.e. by 4 May), including in particular the CEE market participants and governments. Reactions from CEE to the proposed commitments have so far been scarce; for the time being, the Polish PGNiG has been critical of them. After assessing the comments of the market participants, the Commission is to decide whether they constitute an adequate premise to reject Gazprom's commitments, and to release a prohibition decision finding a breach of EU competition rules involving a fine and the disclosure of the collected evidence. Such an option seems much less likely now, after the long negotiations and the acceptance of Gazprom's present proposal by the Commission itself, and the EC will probably release a so-called commitment decision, making Gazprom's commitments legally binding (it would be fined if it breached them) and formally prohibiting the company from using of some of the discriminatory practices it has so far employed against its customers in CEE.

Gazprom's commitments

Within the framework of the EC's statement of objections as sent in April 2015, Gazprom is alleged to have abused its dominant position in eight EU countries: Bulgaria, the Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland and Slovakia. Gazprom was then charged with infringing competition law by applying a strategy of separating gas markets, including by territorial restrictions in the contracts; unfair pricing (in the Baltic states, Poland and Bulgaria); and making gas deliveries conditional on commitments concerning transmission infrastructure (Poland and Bulgaria). The Russian company, which was seeking a compromise conclusion to the anti-monopoly proceedings, has committed to undertake corrective measures in all the areas identified by the EC.

These would rely first and foremost on Gazprom's commitment to remove, in existing and future contracts on gas supply to CEE customers, most of the existing clauses which put up barriers against the free flow of gas and price convergence. In particular, Gazprom has agreed:

- to opt out of the use of direct and indirect territorial restrictions (which prevent or impede the re-export or resale of gas), and
- to introduce the common, more frequent and faster procedure for gas price reviews inter alia by introducing the price benchmarks (linkage to the prices at Western hubs and border

points).

These changes would be largely analogous to the changes already implemented a few years ago (roughly from the mid-2000s) in contracts for the supply of Russian gas to Western European consumers. They would be particularly important for those countries, principally Bulgaria and the Baltic states, in which this type of modification of the Russian gas supply conditions did not occur at all, or at only a slow pace. In a number of other states in the region, including the V4 countries (according to the available information), the gradual elimination of territorial restrictions from the contracts, and adjusting prices to market conditions, had already begun some years ago. This was connected in some degree to the launch of the EC's antitrust proceedings, but was also due to increasing integration and liquidity on the regional markets, as well as lower oil prices in recent years, and as a consequence lower, oil-indexed contractual prices of Russian gas as well.

At the same time, Gazprom has committed itself to implement changes in its transit contract with Bulgaria, which would give more control to the national regulator over the transit of Russian gas within the country, as well as simplify integration with neighbouring countries (including Greece). Gazprom would also abandon any financial claims to Bulgaria related to the cancellation of the construction of the South Stream gas pipeline through the territory of the country (although this came about thanks to a decision by Gazprom itself). Finally, Gazprom is also supposed to allow customers in the region to change the gas delivery points – from those set down in contracts to the ones used by Gazprom in deliveries to Baltic states and Bulgaria, thus opening up the way to swap operations (Poland could in consequence supply gas to the Baltic states, and Slovakia and Hungary could do likewise for Bulgaria).

The consequences of Gazprom's commitments for the CEE region

An overall assessment of the importance of the commitments proposed by Gazprom is difficult; one reason for this is the fact that they relate to the details of contracts for gas supplies, which are subject to trade secrecy restrictions. The consequences of the obligations Gazprom has proposed will definitely vary for the different CEE states. The most tangible benefits could be felt by Bulgaria and the Baltic states (mainly Lithuania). In the case of other countries – such as the V4, which are less isolated on the European gas market – the commitments will contribute to the increasingly market-based business relationship with the Russian company. Undoubtedly, the commitments proposed by Gazprom would pave the way to a closer (albeit not necessarily total) link between the gas prices in the region with the prices on the Western European (mainly German) gas markets. At the same time, it is difficult to say unambiguously how much the change of Gazprom's behaviour derives from the antitrust action taken by the EC, and how much from the changes on the EU gas market, the diversification activities taking place in the region, and Gazprom's changing strategy in Europe's as a consequence of these factors. In the V4's case, the commitments Gazprom has made may result not so much in the decisive change of its business practices, as in the acceleration of (at least some of) the processes which would have happened anyway due to market changes (the increasing role of hubs and the Central European operators' access to them) or EU legislation (such as prohibiting territorial restrictions in contracts).

Consequently, Gazprom's commitments relate largely to past practices, which have actually been modified in recent years. To a small degree, these commitments are forward-looking, and prevent the consequences of emerging new challenges and risks related to Gazprom's continuing dominant position in certain countries & its more active efforts to defend its market share in Europe. This is visible in the example of the company's gas infrastructure-related commitments in the region, which relate to the currently stalled South Stream project, but do not in any way relate to the new planned gas pipelines which may significantly affect the conditions and security of gas supply in the region, i.e. the Nord Stream 2 project and its onshore leg EUGAL, or the Turkish Stream project (and its possible onshore legs in the EU).

As a result, it is a source of some controversy that Gazprom, by committing to a faster, but probably in many cases unavoidable, modification of its business practices, is avoiding being fined for the monopoly practices it had used for years. This may give rise to an objection by some Central European countries and companies which have incurred substantial losses due to the Russian company's practices in the past.

The consequences for Gazprom and Russia

Gazprom's commitments confirm that the Russian company, regardless of its rhetoric, has from the beginning sought a settlement of the antitrust proceedings with the EU. The European Commission's possible acceptance of those commitments will mean the lack of any formal recognition of Gazprom's infringement of the EU rules of competition. As a consequence, the Russian company will avoid both a financial penalty and the disclosure by the EC of the evidence it had been accumulating throughout the proceedings. On the one hand, therefore, the proposed commitments submitted by Gazprom are an expression of formal concessions to the EC, displaying the company's willingness to legally guarantee the changes to some of its previous practices in the CEE area. On the other hand, however, the actual scale of the commitments' severity for the Russian company is hard to assess, because of the lack of access to the content of the contracts. However, taking into account the public information about the changes introduced so far by Gazprom in its agreements with its Western European customers, it seems that the reported obligations – if they are approved – will probably not prove very troublesome for the Russian company.

Firstly, Gazprom has not been forced to take any action regarding the restructuring or sale of any of its assets. All the proposed commitments relate exclusively to modifying the contracts – for supply and transit – between the Russian company and its customers in CEE.

Secondly, most of the commitments made by Gazprom to consumers of its gas in the CEE countries (both the standardisation of the price review clauses, and the removal of clauses impeding the free flow of gas in the EU) had in previous years become an important part of the contractual practices in its relationship with its Western European partners. The changes in the contracts implemented during the last decade, and their dissemination now also among Gazprom's CEE customers, are part of the company's modified strategy in the EU, symptoms of which are its ever more frequent adjustment to the rules of EU law, the auctioning of Russian gas, the implementation of new infrastructure projects, and a more active effort to maintain or even increase its market share.

Thirdly, some of the new obligations seem largely superficial. One example is the commitment to allow customers in the region to request a change of delivery point for the Russian gas (see above). Any such operation would in practice take place on conditions favourable to Gazprom: the supply would mean increased supplies of Russian gas to the region; they would have to amount to at least 100 mcm of gas per year; and any change of delivery point would mean the need to pay additional fees to the Russian company. In addition, Gazprom would not bear liability for any problems with the transmission in the case of changes to the collection points, and reserves the right to refuse the request in the absence of available transmission power or the lack of gas.

The antitrust case and EU-Russia gas relationships

The likelihood of a conciliatory conclusion to the antitrust proceedings against Gazprom indicates that both Russia and the EC are interested in improving their bilateral relations.

For Gazprom and Russia, the European Union is a strategic market for gas, and will remain so for at least the next decade. With regard to the changing market conditions in the European Union and Russia, it is to be expected that Gazprom will continue to increase its flexibility and adapt its European strategy to conditions on the European gas market (for example, by modifying the clauses in its commercial contracts, and the increasing sales of gas through auctions). Consequently, it can be assumed that many of the points contained in the proposed antitrust commitments reflect a more general change in Gazprom's strategy in Europe, and they would have been implemented by Gazprom anyway – albeit to varying degrees in different EU countries, and at a slower pace. It is also certain that Gazprom will, imminently and with even more determination, push through its plans to build new pipelines to the EU – above all Nord Stream 2, but also Turkish Stream – in the hope that thanks to the improvement of bilateral relations with the EU (as proven by adopting a constructive position in the antitrust proceedings, among other), the European Commission will not block them. The company would thus also acquire other instruments to pursue its objectives on the European gas market (increasing market share, maximising profits).

The EC's inclination to find a compromise with Gazprom, despite serious objections to this kind of decision, also indicates the desire of Brussels (with the support of the biggest EU countries, including Germany) to improve and normalise the EU's gas relationship with Russia. This confirms the EC's decision at the end of 2016 to allow the Russian company greater use of the OPAL gas pipeline, as well as the ever-increasing favourability within the EU for the Nord Stream 2 project. At the same time, Gazprom's avoidance of penalties for the monopolistic practices in the CEE [countries](#) could undermine the confidence of at least some of the region's countries and companies in the EC. Due to the existing differences of interests within the EU regarding both the antitrust procedure and the Russian gas pipeline projects, we can expect a rise in intra-EU controversy (primarily between Central Europe, especially Poland, and Germany) on the desired shape of cooperation with Gazprom and the gas relationship with Russia, in the context of the continuation of the conflict in Ukraine and on the role of Russian gas on the European market.