

# BULLETIN

No. 84 (417) • September 13, 2012 • © PISM

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## European Commission's Antitrust Inquiry of Gazprom: Consequences for the Gas Market in Europe

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*The initiation of an antitrust proceeding against Gazprom proves that the European Commission is aiming to play an active role in the liberalisation of the gas market in the European Union and thus have an influence on the shape of external energy policy. It follows from the nervous reactions of Gazprom officials that the Russian monopoly is in a tough situation and is attempting, at any price, to retain the division of gas markets in Europe and benefit from insufficient diversification. The antitrust decision that may arise from the competition investigation may not only impose multi-billion euro fines on Gazprom but also limit its further expansion on the European market (the acquisition of foreign companies' assets) and hamper efforts to win over investors for capital intensive ventures (the development of pipelines or new gas fields). Changing the price formulas in long-term contracts for market-oriented ones sought by the EC may enhance the transformation of the gas sector, a process which is under way in Poland and other EU Member States.*

**The Actions of the European Commission.** On 4 September, the European Commission (EC) reported the opening of a formal proceeding against Gazprom for possible abuses of its dominant position on the EU internal gas market. The EC suspects Gazprom of anticompetitive practices, such as dividing gas markets by hindering the free flow of gas across Member States (re-export prohibition), preventing the diversification of the supply of gas, and imposing unfair prices on its customers by linking the price of gas to oil prices. The charges concern the activity of the Russian monopoly on markets in Central and East European states, where Gazprom supplies 60% to 100% of the gas consumed (although those countries were not directly mentioned by the EC). The initiation of the proceeding is a consequence of the EC's dawn raids in September 2011 of Gazprom-linked offices and its trade counterparts (i.e., the Polish company PGNiG). If Gazprom is found to have abused its dominant position, it may be fined up to 10% of its total turnover in the preceding business year. The EC is also empowered to order interim measures (in the course of the investigation) or to accept a commitment to cease breaches of EU competition law.

The EC has extensive experience in antitrust cases and has never lost an appeal. In 2004, the EC for the first time prohibited a merger on the energy market (in the case against EDP/ENI/GDP); the EC also has addressed decisions in antitrust cases regarding such things as long-term contracts (Distrigaz, 2007), the unbundling of commercial activities from network activities (RWE, 2009), access to cross-border capacities (ENI, 2010). Quite often, in the completed cases, the EC has accepted voluntary commitments. The most spectacular example of a financial penalty for the abuse of a dominant position was a €497 million fine imposed on Microsoft in March 2004.

**Russia's Interests.** Russia's reaction to the EC's investigation seems to be inconsistent and displaying nervousness. This is explained on one hand by the present decrease in Russian gas supplied to Europe, and on the other by Moscow's strong fear of the EU gas market's liberalisation. At the beginning, Russian officials stressed the commitment to full cooperation with the EC during the antitrust inquiry, but after a few days they changed their position. During the APEC summit in Vladivostok, Russian President Vladimir Putin criticized the EC's inquiry, calling it a result of the difficult situation in the eurozone and an attempt to solve the economic problems of the EU at Russia's cost. He also viewed the EU probe as shifting some of the financial burden of subsidising

Eastern European countries to Gazprom by cracking down on the gas company. In turn, Alexander Medvedev, the deputy board chairman of the Russian energy giant and the head of Gazprom's export arm, Gazprom Export, accused the EC of unfair proceedings, arguing that his company is a victim of strong restrictions included in the EU's third energy package, which forces the Russian giant to separate its transport and trading activities on the EU's territory. In response to the EU probe, Putin pushed through a law on 11 September blocking Gazprom from normal cooperation with EU anti-trust officials. His new decree established the obligation of a federal executive body to refuse permission to conduct cooperative activities if they would be capable of damaging the economic interests of the Russian Federation. At the same time, Putin suggested that Russia would divert gas exports to Asian markets.

Certainly, serious conflict with the EC is not in Gazprom's interests, as the company remains the largest gas supplier to the EU, but in recent years there has been a constant decrease in the export volume to Europe. Although Gazprom maintains one of the highest prices compared to other non-EU gas suppliers, its profits declined in the first quarter of 2012 by as much as one-quarter (\$11.1 billion). The Russian company is thus unable to meet its investment plans in the exploration of new gas deposits. These are crucial to sustaining the high level of Russia's gas production as old West Siberian fields decline. In August, Gazprom announced the suspension of the development of the Stockman deposit in the Barents Sea due to high costs (earlier, the Norwegian energy company Statoil-Hydro withdrew from this project). Gazprom has also been unsuccessful with expansion on European energy markets. In 2011, the company's negotiations with Germany's RWE on the construction and modernisation of a dozen gas power plants in Europe failed. At the same time, the German government rejected the offer to build the third and fourth lines of the Nord Stream pipeline and increase the supply of Russian gas to Germany. Despite the many declarations by Russian politicians, Moscow is unable to quickly redirect gas supplies from the European markets to the energy-intensive Asian markets. So far, negotiations with China on the construction of a pipeline and the conclusion of long-term gas supply contracts have not been completed. The outcome of these discussions, which have been conducted since 2006, seems to be difficult to predict because of the current alternative proposals. During the APEC summit, Russia signed a preliminary agreement with Japan for the construction of an LNG terminal in Vladivostok.

**Conclusions and Prospects.** Undoubtedly the EC's investigation of Gazprom will contribute to shaking the position of the Russian energy giant by limiting its bargaining position, thus reducing its profits. It may also result in changing Gazprom's strategy for the European market by possibly limiting mergers and acquisitions there. Moscow may see as a risk further actions by Brussels during contract renegotiations with European trade partners because an EC proceeding may act as an accelerator for companies still considering suing Gazprom before an international arbitration court for charging too high prices. It is worth mentioning that the dispute between the EC and Gazprom gives the latter a strong argument against price discounts for selected contracting parties (i.e., PGNiG) until the end of the case. However, an intensification of the conflict that makes Gazprom withhold gas supplies seems unlikely. This is mostly because of Gazprom's limited ability to export gas to other clients, as well as the improved ability of the EU states to cope with a gas crisis. After joining the WTO, Russia may, in revenge, put forward arguments often that the so called Gazprom clause in the third energy package (which allows companies from third countries to invest in transmission assets with the prior consent of a national regulator and a positive opinion of the EC) is inconsistent with WTO rules on investment security and the free flow of capital. Hence, it is possible that Gazprom will bring an action against the EU before the WTO.

The proceeding started by the EC may also be perceived as a comprehensive strategy for the energy market towards other third country parties. Although the EC is not directly mandated to act in the field of external EU energy policy, it is making a good use of its competition competences. The ability to influence long-term supply contracts may be seen as a long-expected breakthrough in forming an external dimension of EU energy policy. Likewise, the proposed cessation of linking gas prices to the prices of oil in long-term contracts and replacing them with market prices (hub prices) may enhance the gas sector's transformation in the EU, which, in the case of Poland, is currently being developed in the form of a so called gas release program based on an energy exchange mechanism.