

Policies on trade and competition have become a new field of international conflict and the European Commission (EC) has shown its willingness to use them as a weapon. Yesterday, the EC sent a Statement of Objections to Russian state-owned gas company Gazprom for its alleged abuse of market power in Central and Eastern European gas markets. It is the next step in an antitrust case that was first opened in August 2012. In an initial response, Gazprom states that the claims of the EC are unsubstantiated. Of course, in the current political climate it is difficult to see this as a regular antitrust case, but that is exactly how it should be assessed.

## The preliminary findings of the European Commission

The preliminary view of the EC is that Gazprom is breaking EU antitrust rules by “pursuing an overall strategy to partition Central and Eastern European gas markets with the aim of maintaining an unfair pricing policy in several of those member states.” The EC believes that Gazprom has pursued this strategy along three different lines:

**Gazprom might be hindering cross-border gas sales**, by imposing export ban clauses, destination clauses (stipulating that natural gas can only be consumed in a certain country, or



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sold to a limited number of customers within that country), or requiring wholesalers to obtain Gazprom’s approval for exports. According to the EC, Gazprom has included territorial restrictions in its supply agreements with eight EU member states: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovakia. Territorial restrictions on gas sales are anticompetitive, as for example ruled by the EC in 2009 when it fined France’s EDF and Germany’s E.ON for making agreements not to sell gas from the MEGAL pipeline in each other’s markets.

**Gazprom allegedly has an unfair pricing policy.** The EC is investigating whether the prices that wholesalers and industrial customers pay are unfair, and how Gazprom’s price formulae—which are based on oil price indexes—have contributed to the unfairness. The EC has preliminarily concluded that Gazprom has charged unfair prices in five EU member states, Bulgaria, Estonia, Latvia,

Lithuania, and Poland.

**Concerns on gas transport infrastructure.** According to the EC, Gazprom leveraged its market dominance in Bulgaria and Poland by making gas supplies conditional upon obtaining certain infrastructure commitments from wholesalers. In Bulgaria, for instance, this involved the South Stream pipeline, which Gazprom cancelled in December 2014.

## **Tough nuts to crack**

Though we do not have access to all the data that the EC has gathered in this antitrust case, a number of issues are worth contemplating.

First, that EU competition policy is being applied to a part of the EU gas market—Central and Eastern Europe—that is not developed properly. Neither do these nations have fully developed markets or trade, and lack competition. Admittedly, improvements have been made in recent years, but much work remains to be done. Contracts in these countries have predominantly been signed on a government-to-government basis. Obviously all those agreements are different (similarly, commercial agreements are all different). So it will be difficult to compare them in order to make a case that market power has been abused.

Second, does the lack of market development hinder gas from flowing freely throughout the EU, or is Gazprom to blame? The EC argues the latter, but that seems debatable. As the EC itself has described in recent communications, gas flows in this part of the continent are hindered by a lack of

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available infrastructure, and a structural lack of investments in interconnectors, reverse flows, and so on. In these circumstances, and noting that this is a core responsibility of the member states themselves, it will be challenging to make the case that Gazprom's behavior hindered the free flow of gas, considering that in many cases that flow was physically impossible. Still, the lack of market development under no circumstances gives a supplier the right to abuse its market power, and destination clauses are not allowed under EU law.

Third, what is fair pricing? As the EC indicates, several key components of Gazprom's pricing policy are not illegal. Oil indexation, for example, is a form of pricing that is used around the world, with the exception of North America and parts of the EU (the parts that have sufficient trade and liquidity). It is also normal that gas prices are different per country, as these are all separate negotiations, where volumes, transport distances, and changing market conditions play a role.

The EC states that it has estimated fairness based on several benchmarks. Yet fairness seems an arbitrary concept, and proving unfair pricing practices is a daunting task.

### **How will Gazprom respond?**

Formally, Gazprom has three months to respond to the complaints as put forward by the EC, and it can request an oral hearing to present its arguments. If the EC can make the case, it can fine Gazprom up to 10 percent of its annual revenues, potentially a multibillion-dollar fine.

Historically, antitrust cases in the EU have often been settled, and that may happen in this case. Yet it is worth considering the recent deterioration in the relations between the EU and Russia, starting long before the crisis in Ukraine. In June 2015, the EU member states will have to decide whether or not to extend the sanctions, with Greece and Hungary publicly saying that they do not want to, and others like Slovakia privately supporting that stance as well.

Surely the Russians feel antagonized by this antitrust case. From a Russian point of view, it has been a reliable supplier of natural gas to Europe, and it has been investing in different supply routes to circumvent Ukraine, which it sees as an unreliable transit state. Gazprom last week in Berlin stated that it will abide with existing EU law. Obviously, the mood in the EU is very different. There, Gazprom is viewed as a dominant supplier, and for many governments in Central and Eastern Europe it is evident that Gazprom is guilty of all charges. Whether the EC can build a case and actually make it stick, remains to be seen. But if it believes it can, it should. Regardless of the outcome, EU-Russian relations may not have yet hit