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THE EXTERNAL DIMENSION OF THE EU'S INTERNAL MARKET: EXPORTING THE ENERGY ACQUIS AND ITS IMPLICATIONS FOR GAZPROM

INTRODUCTION. *The article examines the extent to which the Union's internal market can be said to have been externalised, given the extraterritorial implications of the Union's internal energy market rules and regulations. In this respect, the article investigates the exercise and control of EU regulatory power beyond EU borders by examining the cross-border reach of the Union's regulatory power beyond its boundaries given its implications for Gazprom and Russia's interests on the European market.*

MATERIALS AND METHODS. *The article pursues a doctrinal approach to the research methodology which includes the internal dimension of the Union's energy policy and the extent to which the Union's internal market regulation has been externalised and imposed on its external energy relations with Russia – this includes a detailed analysis of: (i) the Third Energy Package (TEP)'s ownership unbundling rules; (ii) the Third Country Clause; and (iii) the Union's Competition law (given the recent decision of the EU Competition investigation of Gazprom's sales in Central and Eastern Europe).*

RESEARCH RESULTS. *A fundamental aspect of the EU's rule-based market approach, is the perception that a fully liberalised and competitive EU market can facilitate energy security by way of enhancing diversification of suppliers. As such, the TEPs' ownership unbundling; the Third Country Clause; and the EU's Competition law have become significant*

*mechanisms in the Union's toolbox of instruments to further its rule-based approach and market-based agenda for the purpose of ensuring European energy security. The article illustrates the Union's sectoral application of the *acquis* beyond its borders in its efforts to export its liberalization model and Europeanise its energy corridors in pursuit of European security of energy supply.*

DISCUSSION AND CONCLUSIONS. *The article reveals a fascinating dimension to the Union's role as a global actor by analysing the Union's normative agenda which it pursues through the export of its *acquis* and rule-based market approach which it imposes on third countries and its strategic energy partner, Russia. In undertaking this analysis, the article shows that the EU's efforts to reform Russia's energy markets through its liberalization movement and European model, suggest an external dimension to its internal market rules given the implications for Russia and Gazprom.*

KEYWORDS: *EU-Russia energy relations, Gazprom, EU energy policy, Internal Market, energy *acquis*, energy regulation, gas market liberalisation, TEP, ownership unbundling, third country clause, third party access rules, EU competition law*

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РАЗВИТИЕ ЕДИНОГО РЫНКА ЗА ПРЕДЕЛАМИ ЕС: РАСПРОСТРАНЕНИЕ ACQUIS В СФЕРЕ ЭНЕРГЕТИКИ И ЕГО ПОСЛЕДСТВИЯ ДЛЯ ПАО «ГАЗПРОМ»

ВВЕДЕНИЕ. В настоящей статье рассматриваются пределы развития единого рынка вне ЕС с учетом экстерриториального характера правил и положений, регулирующих единый рынок. В связи с этим в данной работе изучаются особенности использования регулятивных полномочий ЕС за его пределами и контроля над ними. Для этого анализируется присущая этим полномочиям трансграничность с учетом их влияния на интересы России и «Газпрома» на европейском рынке.

МАТЕРИАЛЫ И МЕТОДЫ. В статье используется научно-исследовательская методология при изучении развития энергетической политики в рамках ЕС и пределов применения норм, регулирующих единый рынок вне ЕС, а также влияющих на развитие отношений с Россией в сфере энергетики. Для этого детально анализируются правила Третьего энергетического пакета (ТЭП) о разделении права собственности, правило доступа третьих сторон, законодательство ЕС о защите конкуренции, в частности недавнее решение Европейской комиссии, касающееся конкуренции при осуществлении «Газпромом» продаж в Центральной и Восточной Европе.

РЕЗУЛЬТАТЫ ИССЛЕДОВАНИЯ. Представляется, что основой рынка ЕС выступают полная либерализация и конкуренция, повышающие уровень энергетической безопасности путем увеличения диверсификации энергетических поставщиков. Таким образом, разделение права собственности, оговорка о третьих государствах, законодательство ЕС о защите конкуренции стали важными механизмами ЕС для продвижения элементов рыночной экономики в целях обеспечения европейской энергетической безопасности. Статья отражает отраслевое применение *acquis* за пределами ЕС в целях либерализации и европеизации энергетических коридоров, в частности ради обеспечения безопасности поставок энергоресурсов в Европу.

ОБСУЖДЕНИЕ И ВЫВОДЫ. При анализе нормативной базы раскрывается значение ЕС как глобального актора, которое проявляется в распространении *acquis*, а также элементов рыночной экономики как на третьи государства, так и на своего стратегического партнера в сфере энергетики – Россию. Анализ, осуществленный в рамках настоящей статьи, показывает, что усилия ЕС по реформированию энергетического рынка России посредством

его либерализации и приведения в соответствие с европейской моделью предполагают применение за пределами ЕС правил единого рынка, которые влияют на политику российской стороны и «Газпрома».

КЛЮЧЕВЫЕ СЛОВА: отношения России и ЕС в сфере энергетики, ПАО «Газпром», энергетическая политика ЕС, единый энергетический рынок, *acquis* в сфере энергетики, регулирование в сфере энергетики, либерализация газового рынка, Третий энергетический пакет, разделе-

ние права собственности, оговорка о третьих государствах, правила доступа третьих сторон, законодательство ЕС о защите конкуренции

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1. Introduction

This article will assess the internal dimension of the EU's energy policy, which is predominantly focused on promoting a fully liberalised gas market and the extent to which it has been externalised with its implications for Gazprom further analysed. The article will briefly explore the ways in which the EU has endeavoured to implement this liberalisation model by briefly considering the directives and energy liberalisation packages initiated with a specific focus on the third liberalization package (in Section 2) which sets out the common legal framework in the energy sector. Section 3 will focus on the TEP's ownership unbundling rules (which require the separation of networks from production and supply activities of vertically integrated energy companies) and Section 4 will examine the Third Country Clause (which requires that undertakings from third countries which intend to acquire control over an electricity or gas network, need to comply with the same unbundling requirements as EU undertakings). For the purpose of this analysis, the article will also consider to what extent the Union's internal market can be said to have been externalised, given the extraterritorial implications of the Union's internal measures. In undertaking this analysis, the article will investigate the exercise and control of EU regulatory power beyond EU borders by examining the cross-border reach of the Union's regulatory power beyond its boundaries and its implications for Gazprom (Section 5). Russia's interests on the European market (Section 6) and the conflicting views of the unbundling regime (Section 7). Against this backdrop, Section 8 will assess the increasingly important role that Competition law plays in the EU's energy market and to what extent the Union's competition rules have become a significant mechanism

in its toolbox of instruments to further its rule-based approach and market-based agenda and the subsequent effects on Gazprom given the EU Competition investigation of Gazprom's sales in Central and Eastern Europe (Section 9). Finally, Section 10 will provide some concluding remarks reflecting on the Sections above whereby it will be shown that at the core of the EU's rule-based market approach, is the belief that a fully liberalised and competitive EU market can facilitate energy security by way of enhancing diversification of suppliers; boosting infrastructure investment; which will diminish the impact of any supply disruptions and in turn build energy solidarity at a Community level. In this respect the Union's efforts to fulfil its objectives in the energy sector by way of a market-based approach heavily embedded in regulation suggest that the Union has evolved into a global normative energy actor. The Union's sectoral application of the *acquis* beyond its borders in its endeavours to Europeanise its energy corridors and ensure energy security, alludes to an external dimension of the EU's internal market whereby the Union's market mechanisms and liberal market-based energy regulation are being imposed on third countries and its strategic energy partner.

2. The EU's Liberalization Model and the Internal Energy Market

The endeavours of the European Community (EC) and its predecessor the European Economic Community (EEC), to complete an "internal market" as embodied in the 1986 Single European Act (SEA), potentially represents the most ambitious undertaking of multilateral cooperation since the inception of the post-World War II international order [Garrett 1992:533]. The economic objective of the internal market entailed eliminating all import and

export duties existing between Member States. This included the removal of several non-tariff trade barriers which were construed as politically intractable, including border controls, procurement policies, preferential national standards and subsidies [Garrett 1992:533].

The European Common Market was established as the backbone of European integration in the EEC Treaty¹. The creation of a “common market” and thereby a single European economic area, is therefore a fundamental objective of the EEC Treaty which came into force on 1 January 1958 (also known as the “Treaty of Rome”). Article 2 of the Treaty of Rome articulates that objective as the Community’s task of (*inter alia*) establishing a common market and the progressive approximation of the economic policies of Member States so as to promote a harmonious development of economic activities; a continuous and balanced expansion; an increase in stability; an accelerated raising of the standard of living throughout the Community; and closer relations between the States belonging to it².

It is important to note that the terms of “common market”, “single market” and “internal market” are often used synonymously despite significant subtleties and nuances in meaning. The “common market” is a “stage in the multinational integration process, which aims to remove all barriers to intra-Community trade with a view to the merger of national markets into a single market giving rise to conditions as close as possible to a genuine internal market”³. Significantly, the Treaty of Lisbon does not refer to the “single market” or the “common market”. Instead, it replaces “common market” with “internal market” which according to Art. 26 of the TFEU comprises “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties”⁴.

Prior to Lisbon, energy remained an objective under the Treaties with no specific legal basis with Art. 95 of the Treaty Establishing the European Community (TEC) and Art. 308 TEC often used to as a source of reference. Article 95 TEC facilitated

measures which had the establishment and functioning of the internal market as an objective and Art. 308 TEC enabled additional legislative competence where action was deemed necessary to fulfil the Community’s objective. These articles subsequently lead to a broader discussion on “the future of Europe” which found its inception in the Laeken Declaration in 2001. With regard to the frequent recourse to these articles, the Laeken Declaration advocated striking a balance between enabling the EU to address new challenges and develop new policy areas on the one hand whilst addressing any questions of Union competence on the other. To address these issues, the Convention on the Future of Europe in 2002 suggested that energy receive its own specific legal basis to facilitate the Union pursuing policy in this field. However, whilst energy finds its legal basis in Art. 194 TFEU, not all EU measures in energy are confined to this specific Treaty provision, with internal market provisions most notably invoked in the past.

Express competence in the energy sphere was only conferred by Lisbon in December 2009, with all prior legal developments undertaken in the energy sphere without any explicit conferral of energy competence. These developments were predominantly facilitated by different legal bases where the Union drew competence that enabled the adoption of legal instruments, such as the internal market (Art. 114 TFEU), the environment (Art. 191 TFEU) and competition (Art. 101 TFEU onwards). However, while energy remains a shared competence it is important to note that the Union’s exclusive competence to establish the competition rules necessary for the functioning of the internal market pursuant to Art. 3(1)(b) TFEU inevitably means that this competence extends into the internal energy market. The Union has therefore obtained increased regulatory oversight in undertaking its competition scrutiny which has largely been shaped by the single market objective. By implication, the Commission has become a *de facto* regulator of regulators in its application of competition law to oversee national regulators when the latter are undertaking their duties. It

¹ Khodakovskyy Y. The Legal Framework of EU-Russia Energy Relations: Master’s thesis. Universiteit Gent. 2014. P. 28. URL: https://lib.ugent.be/fulltxt/RUG01/002/163/152/RUG01-002163152_2014_0001_AC.pdf (accessed date: 31.07.2018).

² Section 2.1 of the Treaty of Rome dated March 25, 1957. URL: https://ec.europa.eu/romania/sites/romania/files/tratatul_de_la_roma.pdf (accessed date: 31.07.2018).

³ As per the Court of Justice in case 15/81. See Judgment of the ECJ of 5 May 1982 *Gaston Schul Douane Expeditie BV v. Inspecteur der Invoerrechten*. URL: <http://curia.europa.eu/juris/showPdf.jsf?jsessionid=2CC4F2DA35F07C80A6ACAAEEE7EA2EB4?text=&docid=91250&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=8823912> (accessed date: 31.07.2018).

⁴ Article 26 of the Treaty on the Functioning of the European Union. URL: <https://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=CELEX:12012E/TXT&from=EN> (accessed date: 31.07.2018).

follows that competence by implication extends into the external aspects of energy policy.

With this in mind, it is important to note that the Union's energy policy has explicitly been placed "in the context of the establishment and functioning of the internal market" and "with regard to the need to preserve and improve the environment". Its objectives include: (i) to ensure the functioning of the energy market; (ii) to ensure security of energy supply in the Union; (iii) to promote energy efficiency, energy saving and the development of new and renewable forms of energy; and (iv) to promote the interconnection of energy networks. It is posited that Lisbon's creation of a separate energy title within which the Union's energy policy draws its legal basis, has bolstered the Union's self-perception and self-projection as an energy actor with the added value of a European energy policy. Whilst Member States were initially wary of the Europeanization of this strategic policy area falling within the ambit of the Union's growing competence in the energy realm, it facilitated increased external action on the part of the Union which surpassed the effectiveness of the activity undertaken at Member State level. As will be shown here further, one of the novelties introduced by Lisbon was greater coherence in EU external relations with the explicitly conferred shared competence in the energy domain setting the legal platform for the development of an external energy policy. In this respect it is important to note, as has been mentioned before, that whilst Art. 194 expressly confers competence in energy, there is no express external competence conferred on the Union. Here, the legislative packages adopted in the electricity and gas sectors are important as any external action will need to transpire from the internal rules adopted by the Union. Notwithstanding, Member states retain competence to decide their energy mix which the Union's internal action cannot interfere with.

3. The TEP and the Unbundling Regime

The TEP⁵ represents the third bundle of legislation that was adopted with the aim of creating an

integrated European energy market. With the EU's heavy energy dependence on imports and its energy demand expected to continue to rise; safe, secure, sustainable and affordable energy had become key to maintaining Europe's continuing prosperity. Ensuring a robust EU energy policy, has therefore become a priority and an important factor at the fore of the Union's package of energy laws and regulations that have been rolled out in an effort to create a truly pan-European energy market. For many years, the completion of the internal market for electricity and gas has been at the heart of the Union's objectives⁶ with the third bundle of legislation bolstering this impetus. Of the plethora of market liberalization measures that were introduced in the energy packages, two of the measures were specifically aimed at the anticompetitive behavior of the vertically integrated energy incumbents. These included the Third Party Access Regulation (TPA) and "Unbundling".

The key provisions of the TEP include: (i) the effective unbundling of energy generation and supply from transmission network ownership and operation; (ii) bolstering the powers and duties of national energy regulators; (iii) establishing an EU energy agency; and (iv) the introduction of separate certification procedures for transmission system operators (TSOs) controlled by non-EU legal entities [Stanic 2011:1]. The provisions are significant in their contribution towards creating an integrated energy market, however, this thesis will focus on the unbundling regime and ownership unbundling.

Besides the novelties noted above, the TEP is best known for its unbundling rules, albeit controversial. The unbundling rules aim to prevent companies that are involved in both the transmission of energy and production or supply of energy from using their position as a TSO to prevent competitors from using the transmission network [Stanic 2011:2]. The Commission found that the legal and functional unbundling of energy supply and production from transmission networks under the Second Energy Liberalization Package did not suffice for the purpose of ensuring a fully functional liberalized energy market⁷. Ownership unbundling was therefore included by the Commission as the fundamental foundation of the

⁵ The TEP is a legislative package for an internal gas and electricity market in the European Union. Its purpose is to further open up the gas and electricity markets in the European Union. The package was proposed by the European Commission in September 2007, and adopted by the European Parliament and the Council of the European Union in July 2009.

⁶ European Council. Conclusions on Energy European Council dated February 4, 2011. URL: https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/trans/119253.pdf (accessed date: 31.07.2018).

⁷ EU Commission. The Sector Inquiry pursuant to Article 17 of Regulation (EC) 1/2003 in to the European gas and electricity sectors dated January 10, 2007. URL: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52006DC0851> (accessed date: 31.07.2018).

TEP. Ownership unbundling entailed the separation of energy generation and supply from transmission network ownership and operation which was considered controversial amongst vertically integrated energy companies [Stanic 2011:2]. Significantly, the Commission's TEP⁸, which was adopted on 13 July 2009, introduced a choice of three unbundling options at the discretion of Member States. Although the options were presented as equal alternatives, they differ substantially in substance in terms of their implications for vertically integrated undertakings⁹.

The third option is the so called "ownership unbundling" which is the most controversial option on account of its implications for energy incumbents. Full ownership unbundling requires vertically integrated energy companies to dispose of their gas networks and electricity grids. Under the third model, supply and production companies are forbidden a majority share in a TSO or from exercising rights such as voting or board member appointment [Stanic 2011:2].

Article 9 of the Gas Directive prescribes ownership unbundling in the following manner:

1. Member States shall ensure that ... :

(a) each undertaking which owns a transmission system acts as a transmission system operator;

(b) the same person or persons are entitled neither:

(i) directly or indirectly to exercise control over an undertaking performing any of the functions of production or supply, and directly or indirectly to exercise control or exercise any right over a transmission system operator or over a transmission system; nor

(ii) directly or indirectly to exercise control over a transmission system operator or over a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of production or supply;

(c) the same person or persons are not entitled to appoint members of the supervisory board, the

administrative board or bodies legally representing the undertaking, of a transmission system operator or a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of production or supply; and

(d) the same person is not entitled to be a member of the supervisory board, the administrative board or bodies legally representing the undertaking, of both an undertaking performing any of the functions of production or supply and a transmission system operator or a transmission system.

2. The rights referred to in points (b) and (c) of paragraph 1 shall include, in particular:

(a) the power to exercise voting rights;

(b) the power to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking; or

(c) the holding of a majority share.

Simply put, the process requires vertically integrated companies to transfer ownership of the transmission system to a separate legal entity that also acts as the TSO [Van Hoorn 2009:52]. The rationale being that ownership unbundling would ensure complete independence of the transmission arm of the incumbent and thereby remove any potential anti-competitive conduct [Van Hoorn 2009:52]. Unbundling is a market liberalisation tool and refers to the process of separation of energy supply and generation from the operation of transmission networks. This is seen as an appropriate mechanism to remove the conflict of interest that may arise if a single company operates a transmission network and generates or sells energy at the same time. This would in turn facilitate free competition amongst energy suppliers which is why the third model is strongly advocated by the Commission. Nevertheless, it would appear that most Member States have opted not to prescribe to this model. Despite the Commission's initial proposals¹⁰, the new regime does not include mandatory ownership unbundling with a choice of the three alternative models available at Member State discretion.

⁸ The TEP consists of (i) a directive concerning the common rules for the internal market in electricity (2009/72/EC) (the Electricity Directive); (ii) a directive concerning the common rules for the internal market in gas (2009/73/EC) (the Gas Directive); (iii) a regulation on the conditions for access to the natural gas transmission networks ((EC) No. 715/2009); (iv) a regulation on the conditions for access to the network for cross-border exchange of electricity ((EC) No. 714/2009); and (v) a regulation establishing the Agency for the Cooperation of Energy Regulators ((EC) No. 713/2009).

⁹ A vertically integrated undertaking is defined in Art. 2(19) of the Gas Directive as a "natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas". A similar definition can be found in the Electricity Directive.

¹⁰ See Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity. URL: https://eur-lex.europa.eu/resource.html?uri=cellar:caeb5f68-61fd-4ea8-b3b5-00e692b1013c.0004.02/DOC_1&format=PDF

It goes without saying that unbundling is a fundamental tool in the Union's liberalization movement generally and the EU energy market specifically. With liberalization as its core objective, it is not surprising that the ownership unbundling model is often met with much resistance from third countries, given its impact on their interests in the European market. Through the three separate waves of liberalization and the regulation that was rolled out subsequent thereto, the current unbundling regime was adopted. As the EU embarked on its third wave of energy reforms, political observers cautioned that the Commission administer the gas sector with care to avoid raising any alarm bells with third country suppliers. In this respect it is important to note that Europe's main gas supplies come from Russia, Norway, Algeria, Nigeria, Libya, Qatar, Egypt, amongst others¹¹. However, the main concerns were that the TEP and its schemes would raise potential issues with Russia, Europe's largest gas supplier, whereby some Member States were totally dependent on Russian gas for their national consumption.

4. Ownership Unbundling and the Third Country Clause

As articulated above, ownership unbundling requires that vertically integrated energy incumbents forego their transmission activities. Notwithstanding, and contrary to what the name suggests, ownership of the transmission assets is still allowed, albeit only to a certain degree. Rather than abandon ownership, the ownership unbundling model merely requires that undertakings separate ownership so as to ensure full independence of the transmission chain and thereby eliminate any discrimination between competing suppliers.

The Commission has persistently pursued this separation in the context of the third legislative package to avoid any conflict of interest. This was considered necessary given that vertically integrated companies often engage in potentially anti-competitive conduct which can adversely affect EU market liberalization efforts [Van Hoorn, Ramsees 2014:450]. The Commission's rationale for its pursuit of liberalization is that it increases the efficiency of the en-

ergy sector and the competitiveness of the European economy as a whole. As such, the liberalization of energy markets in Europe was predominantly for the purpose of enabling consumers to freely select their gas suppliers based on competitive deals from a plethora of suppliers within a competitive marketplace [Cottier, Matteotti-Berkutova, Nartova 2010:1].

It follows that the TEP's separation requirement is applicable to any company active within the European market and is imposed by the relevant unbundling models under the Gas Directive¹². Significantly Art. 11 of the Gas Directive, the so-called "Third Country Clause", applies to third country operators on the continent which by implication places them under a specific regime. The Third Country Regime is largely an effort on the part of EU legislators to eliminate any threat posed to the Union's security of energy supply through the control of a transmission system or transmission system operator by third countries [Cottier, Matteotti-Berkutova, Nartova 2010:3]. Recital 22 of the Directive brings this concern to the fore which is elaborated as follows: "The security of energy supply is an essential element of public security and is therefore inherently connected to the efficient functioning of the internal market in gas and the integration of the isolated gas markets of Member States. Gas can reach the citizens of the Union only through the network. Functioning open gas markets and, in particular, the networks and other assets associated with gas supply are essential for public security, for the competitiveness of the economy and for the well-being of the citizens of the Union. Persons from third countries should therefore only be allowed to control a transmission system or a transmission system operator if they comply with the requirements of effective separation that apply inside the Community... The security of supply of energy to the Community requires, in particular, an assessment of the independence of network operation, the level of the Community's and individual Member States'" dependence on energy supply from third countries, and the treatment of both domestic and foreign trade and investment in energy in a particular third country. Security of supply should therefore be assessed in the light of the factual circumstances of each case as well as the rights and obligations aris-

(accessed date: 28.07.2018); Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC of the European Parliament and of the Council amending Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas. URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52008AP0347&from=EN> (accessed date: 28.07.2018).

¹¹ See Assessment Report of Directive 2004/67/EC on Security of Gas Supply. P. 63. URL: https://www.cep.eu/Analysen_KOM/KOM_2009_363_Sicherheit_der_Erdgasversorgung/SEC_2009-978.pdf (accessed date: 23.07.2018).

¹² In particular, Art. 9 (which relates to Ownership Unbundling); Art. 14 and 15 (which relates to ISO) and Art. 17 to 23 (which relates to ITO).

ing under international law, in particular the international agreements between the Community and the third country concerned¹³.

Therefore, the third energy liberalization package puts forward provisions which prevent transmission systems or transmission system operators from being controlled by companies of non-EU member states until they satisfy certain requirements. Article 11 establishes the certification requirements for a transmission system operator from third countries, which is largely aimed at regulating the open gas markets and ensuring security of supply [Cottier, Matteotti-Berkutova, Nartova 2010:4]. Article 11 thereby addresses any concerns that ownership unbundling would facilitate the acquisition of strategic Union energy transmission assets by foreign entities¹⁴. As a consequence, national regulators now have the right to refuse certification of a transmission system operator under the control of a company by a third country state if the said foreign entity fails to comply with the requirements of Art. 11.

Article 11 of the Gas Directive deals with certification in relation to third countries, which states as follows:

1. Where certification is requested by a transmission system owner or a transmission system operator which is controlled by a person or persons from a third country or third countries, the regulatory authority shall notify the Commission. The regulatory authority shall also notify to the Commission without delay any circumstances that would result in a person or persons from a third country or third countries acquiring control of a transmission system or a transmission system operator.

2. The transmission system operator shall notify to the regulatory authority any circumstances that would result in a person or persons from a third country or third countries acquiring control of the transmission system or the transmission system operator.

3. The regulatory authority shall adopt a draft decision on the certification of a transmission system operator within four months from the date of notification by the transmission system operator. It shall refuse the certification if it has not been demonstrated.

(a) that the entity concerned complies with the requirements of Art. 9; and

(b) to the regulatory authority or to another competent authority designated by the Member State that granting certification will not put at risk the security of energy supply of the Member State and the Community. In considering that question the regulatory authority or other competent authority so designated shall take into account:

(i) the rights and obligations of the Community with respect to that third country arising under international law, including any agreement concluded with one or more third countries to which the Community is a party and which addresses the issues of security of energy supply;

(ii) the rights and obligations of the Member State with respect to that third country arising under agreements concluded with it, insofar as they are in compliance with Community law; and

(iii) other specific facts and circumstances of the case and the third country concerned.

Article 11(3) forms the core segment of the Third Country Clause which sets out the conditions by which certification can be refused. By implication, it sets out the condition by which a third country undertaking needs to comply. Compliance with these conditions and the burden of proof thereof, is undertaken by the applicant in question¹⁵. The remainder of the Article addresses the certification procedure for which the national regulatory authority is responsible while the Commission acts as an advisory body [Johnston, Block 2012:61–62].

Article 11(3)(a) states that certification can be refused where the entity has not complied with Art. 9. This inadvertently extends the unbundling regime to third country undertakings which means that transmission system owners and operators from third countries are obliged to comply with the same unbundling requirements as EU undertakings. Here it is important to note that the provision is specifically addressed to third country undertakings and not their respective governments, which means that the unbundling obligation is restricted to the operations of the said undertakings within the European market. The Third Country Clause therefore does

¹³ See Recital 22 of the Gas Directive 2009/73/EC adopted July 13, 2009. URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32009L0073&from=EN> (accessed date: 30.07.2018).

¹⁴ Europa press release: Energising Europe: A real market with secure supply. September 19, 2007. URL: europa.eu/rapid/press-release_IP-07-1361_en.pdf (accessed date: 30.07.2018).

¹⁵ Commission staff working paper of 22 January 2010: Interpretative note on Directive 2009/72/EC concerning common rules for the internal market in electricity and Directive 2009/73/EC concerning common rules for the internal market in natural gas. The unbundling regime. P. 23. URL: https://ec.europa.eu/energy/sites/ener/files/documents/2010_01_21_the_unbundling_regime.pdf (accessed date: 30.07.2018).

not propose any reciprocity and as such, any reference to a “reciprocity clause” in relation to the Third Country Clause is erroneous given the adopted version which has deviated from that initially proposed [Cottier, Matteotti-Berkutova, Nartova 2010:5–6].

Article 11(3)(b) states certification can be refused where the Member State and/or Community’s security of energy supply is put at risk, for which additional criteria is provided to facilitate the regulatory authority in undertaking its assessment and reaching its decision. Whilst the criteria are not cumulative, the Commission alludes to a preference where there are agreements in place, either pursuant to international law under the first criterion or EU law under the second criterion¹⁶. The third criterion relates to circumstances where there is no agreement in place by which “other specific facts and circumstances” will apply on a case-by-case basis [Goldberg, Bjornbye 2012:19].

Significantly, as evidenced above, Art. 11 requires that undertakings from third countries which intend to acquire control over an electricity or gas network, need to comply with the same unbundling requirements as EU undertakings. Failure to do so will entail refusal of the necessary certification which will effect energy incumbents with an active presence within the European market. The TEP requires “effective unbundling” which means energy companies have a legal obligation to unbundle the ownership and operation of its gas pipelines on EU territory and allow third party access to its pipelines. It therefore comes as no surprise that the TEP is a highly contentious issue for such entities given the implications for their interests in the European market, which will be elaborated on further in the article specifically in relation to Russia and Gazprom, the entity allegedly targeted by the said TEP’s Third Country Clause.

5. The External Dimension of the Internal Market: The Third Country Clause and Gazprom

Significantly, Art. 11 requires that undertakings from third countries which intend to acquire control over an electricity or gas network, need to comply with the same unbundling requirements as EU undertakings. Failure to do so will entail refusal of the necessary certification which will have severe ramifications on energy incumbents, in particular Russia’s energy giant Gazprom, which has an active

presence within the European market [Van Elsuwege 2012:13]. The TEP requires “effective unbundling” which means Gazprom has a legal obligation to unbundle the ownership and operation of its gas pipelines on EU territory and allow third party access to its pipelines. It therefore comes as no surprise that the TEP is a highly contentious issue for Russia, given its implications for Russian interests in the European market. In particular, the Third Country Clause which is perceived by Russia as the Commission’s attempt to specifically target Gazprom, Russia’s largest vertically integrated state-owned energy incumbent. It follows that the TEP’s ownership unbundling and Third Country Clause has been famously dubbed the ‘Gazprom Clause’ after the entity allegedly targeted by the Commission’s unbundling rules as an attempt to curb its strategic purchasing of EU liberalized assets [Van Vooren, Wessel 2014:451].

Gazprom is a textbook example of a vertically integrated energy undertaking which is indisputably acknowledged as the largest in the world [Grigoryev 2007:132]. Gazprom is Russia’s largest oil and gas company. Although the company was initially Government owned, it was later converted into a joint-stock company in 1993. The Russian Government held 40% of the shares which was later increased to 51% in 2003. With the state as the majority owner, Gazprom operates much like a quasi-governmental agency given the significant control the Russian Government exercises [Juravlev 2011:5]. Russia’s natural gas production and distribution is run by Gazprom for which the revenues from the company are a substantial contribution to the Russian state budget [Yergin 2011:335]. By way of example, Gazprom is among Russia’s largest taxpayers with approximately RUB 2 trillion contributed to the budget in taxes and customs duties every year¹⁷. Gazprom’s core activities in the gas market include production, exploration, transportation, storage, processing and marketing. In addition thereto, the energy giant is a major operator of pipelines with its infrastructure deeply imbedded within the European market. The fact that Gazprom has a monopoly on the export of Russian gas to Europe to which it is bound by its pipeline network and the fact that it is the only entity that manages the transmission pipelines, serves to validate that Gazprom has established a significant presence within the European market [Grigoryev 2007:132].

¹⁶ Khodakovskyy Y. Op. cit. P. 38.

¹⁷ Kruglov A. Gazprom’s Financial and Economic Policy. – *Press Conference Gazprom’s Financial and Economic Policy*. June 29, 2016. URL: <http://www.gazprom.com/f/posts/87/380788/transcript-press-conference-2016-06-29-en.pdf> (accessed date: 18.07.2018).

Gazprom's monopoly and global ambitions to become a world leading energy company¹⁸ set the agenda and pace at which the Company undertook its activities in the energy sphere [Godzimirski 2009:178]. Gazprom's prominent position within the European market, raised some concerns within the Union, in particular the Commission, as it suggested a strategic relevance that energy resources hold where resource nationalism has an important part to play in developing Russia's energy industry [Bilgin 2011:120]. This appears to be inconsistent with the Union's outlook of energy which is driven by an economic-based view which is less focused on strategic relevance [Umbach 2010:1229–1240]. In this respect, Gazprom's monopoly plays a key role and is often perceived to be a lever of the state given its ties to the Russian Government and the directions it takes from President Putin [Pirani Stern, Yafimava 2009:31]. There therefore appear to be conflicting interests and objectives – the EU wants Russia to reform its energy markets and partake in the liberalisation movement, whereas Russia is reluctant to do so as this would ultimately end Gazprom's monopoly and thereby eliminate any leverage that the Russian Government would be able to use as a policy tool to pursue its political agenda [Aalto, Westphal 2008:13].

It is no secret that Gazprom is of significant economic and strategic political importance which has made full liberalisation of the Russian gas sector unlikely. The Union has therefore increasingly become wary of the incongruousness of the Union's liberalisation paradigm and Russia's resource nationalism [Bilgin 2011:121]. The Union is dependent on Russian energy imports and therefore endeavours to ensure security of supply, whereas Gazprom is dependent on exports for which it wants to ensure security of demand. In its efforts to improve its global presence, Gazprom has tried to move in the downstream sector in Europe [Stern 2006:17]. Gazprom's downstream diversification has entailed Gazprom moving into EU Member States to reap the benefits of the liberalisation and privatisation of the markets. This has resulted in opposition from EU Member States who have objected to Gazprom's increasing presence and power in the European energy market [Finon, Locatelli 2008:434–435]. In an effort to curb Gazprom's growing dominance within the European market, the Gazprom clause emerged which subjects

companies from third countries to the same unbundling rules as EU entities.

The Union had become increasingly cautious of Russia's manoeuvres in the energy sphere and the security of its energy supply ever since the gas crises in 2006 and 2009 when gas supplies were temporarily halted which strongly affected Western European consumers. Furthermore, the Union's caution has been further exacerbated by the fact that its efforts to institutionalise EU-Russia energy relations within a legally binding framework has been unsuccessful with Russia constantly refuting any form of binding agreements, the Energy Charter Treaty being a case in point. After several failed attempts to formalise any bilateral energy cooperation agreements with Russia, the Commission undertook efforts to instil strict rules for third countries operating within the European energy market whereby its energy relations could be regulated.

The Gazprom clause imposes a restriction on third country incumbents, namely that they cannot control transmission systems or transmission system operators unless (i) an agreement exists between the Union and the said third country within which the incumbent is based; and (ii) the incumbent can demonstrate that it is not influenced by a third country or an operator active in the production or supply of gas or electricity. The clause was included in the text of the Commission's third energy liberalization package as a response to concerns that ownership unbundling would inadvertently lead to the indiscriminate acquisition of EU energy assets by third countries. The rationale that was provided at the time by the then Commission President, Jose Manuel Barroso, was (inter alia) to protect the openness of the European market and the expected benefits that the unbundling regulation would bring by implementing strict conditions on the ownership of assets and making sure all non-EU companies play by the same rules¹⁹. Therefore, under the clause, any third country incumbents are required to unequivocally comply with the same unbundling rules as EU companies.

From an external perspective, the application of unbundling rules to non-EU energy companies active within the European market is politically sensitive. Particularly in the gas sector where many Member States are heavily dependent on Russian gas imports. The Commission's law-based approach

¹⁸ See Gazprom. Annual Report 2011. Moscow. 2012. 188 p. URL: <http://www.gazprom.com/f/posts/51/402390/annual-report-2011-eng.pdf> (accessed date: 18.07.2018).

¹⁹ European Commission, press release: Energising Europe: A Real Market with Secure Supply. September 19, 2007. URL: http://europa.eu/rapid/press-release_IP-07-1361_en.htm?locale=en (accessed date: 22.07.2018).

to energy policy which endeavours to implement market principles as the foundation for international energy trade therefore appears to be at odds with Russia's approach to energy policy which is largely driven by a divide-and-rule strategy. With this in mind, the fact that non-EU companies are required to ensure effective unbundling of transmission from supply and production activities means that the third legislative package has acquired an external dimension. By implication, third countries are required to unbundle and thereby comply with the same rules otherwise applicable to their European counterparts.

According to the Commission, the extension of the TEP's unbundling rules to non-EU entities, was intended to prevent any discrimination between non-EU and EU undertakings²⁰. More specifically, the Commission's restriction that non-EU individuals and third countries do not acquire control over an EU transmission system or operator unless permitted by an agreement between the EU and said third country, was aimed at guaranteeing that non-EU undertakings respect the same rules applicable to EU based companies. It is often the case that grid infrastructure will be controlled by a company in third country state and gas equally traded by a non-national operator. However, given European gas supplies largely depend on imports, particularly from Russia, the relationship between the Union and such third countries and the grids and gas supplies controlled by these non-EU states, is of crucial importance for the Union's energy security [Cottier, Matteotti-Berkutova, Nartova 2010:1].

6. The Gazprom Clause and Reciprocity

Reciprocity is a political instrument used to moderate market opening in strategic sectors of the economy. Reciprocity essentially makes the granting of particular rights contingent on the receipt of similar or comparable rights. It was first applied between EU member states, whereby one state granted access to its markets to another state provided that it equally

opened its own market. The reciprocity principle is one of the major instruments used in exporting the EU *acquis communautaire* [Belyi 2009:117]. The Community *acquis* is the body of common rights and obligations which bind all the Member States together within the Union including inter alia the legislation adopted in application of the treaties and the case law of the Court of Justice²¹; and measures relating to the common foreign and security policy. The principle of reciprocity therefore protects markets against states that have not liberalised their energy sectors to the same degree [Belyi 2009:117]. It was intended to protect European markets against "free riders" who had opted not to liberalise their markets to a similar extent [Cottier, Matteotti-Berkutova, Nartova 2010:6]. In that respect, reciprocity can be seen as is a political tool to facilitate market opening [Cottier, Oesch 2005:367]²².

The TEP's so-called "Gazprom Clause" is only one of the requirements imposed on third country service providers. Article 11 sets out two main criteria of certification which include: (i) unbundling of transmission systems and transmission system operators; and (ii) the security of supply risk assessment. Through Art. 11(a), the TEP appears to extend the principle of reciprocity to third countries which (as already mentioned) requires a foreign operator to comply with the same unbundling requirements as EU operators under Art. 9. However, as stipulated above, the provision is addressed to the foreign entity rather than its Government and as such, the undertaking that Member States establish a regime compatible with ownership unbundling, does not apply to non-EU states [Cottier, Matteotti-Berkutova, Nartova 2010:6]. The provision is therefore incongruous with the usual obligations of reciprocity that exist in other regulatory areas, such as the reciprocity requirements found among Member States in relation to access to electricity within the EU [Cottier, Matteotti-Berkutova, Nartova 2010:16]. Here the Union has refrained from formally imposing the full reciprocity unbundling requirements to third coun-

²⁰ European Commission: Inquiry pursuant to Article 17 of Regulation (EC) No. 1/2003 into the European gas and electricity sectors (Final Report). 2007. URL: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0851:FIN:EN:PDF> (accessed date: 22.07.2018). See also Lowe P., Pucinskaite I., Webster W., Lindberg P. Effective Unbundling of Energy Transmission Networks: Lessons from the Energy Sector Inquiry. 2007. URL: http://ec.europa.eu/competition/publications/cpn/2007_1_23.pdf (accessed date: 22.07.2018).

²¹ Europa – Summaries of EU Legislation. – *Glossary*. URL: http://europa.eu/legislation_summaries/glossary/community_acquis_en.htm (accessed date: 22.07.2018).

²² By way of example, foreign banks were allowed to operate subsidiaries to the extent only that domestic banks were able to obtain licenses in the partner country. In this respect, see the 1934 Swiss Banking Act which states that permission to operate a foreign bank is made dependent upon the grant of reciprocal rights, subject to international obligations to the contrary ("*...von der Gewährleistung des Gegenrechts durch die Staaten, in denen die Ausländer mit qualifizierten Beteiligungen ihren Wohnsitz oder Sitz haben, sofern keine anderslautenden internationalen Verpflichtungen entgegenstehen...*").

tries. Instead the conditions merely affect operations within the EU. As such, the regime is often mistakenly called a “reciprocity clause” as it simply requires that non-EU companies comply with domestic unbundling rules applicable to EU countries. Therefore, in order for a foreign entity to operate within the EU, it needs to discard its monopolistic composition and structurally separate its grid and trading operations [Cottier et al 2010:6]. While the unbundling of foreign controlled companies within the EU can be monitored on the basis of competition rules, it is unclear how such unbundling will be enforced or exercised independent of mutual cooperation in matters of competition control [Cottier, Matteotti-Berkutova, Nartova 2010:7].

The second certification requirement for non-EU entities entails entry into the European market without hindering security of supply of the Member State involved or the Union as a whole²³. There is a wide range of considerations that the Member State and Commission can take into account in undertaking their assessment to allow the non-EU entity within their territory. Inevitably the concerned Member State will provide certification once it has been ascertained that the third country company does not pose a threat to its security of supply or that of the Union.

In undertaking its assessment, rights and obligations under international agreements will be taken into account. This enables the EU to make certification conditional upon secure supplies and transit rights. It also provides the EU with leverage to secure energy supplies in exchange for operational right of grids within the EU. These open-ended conditions which the EU may impose on third country incumbents extend beyond the commitments of Member States, which has raised objections from major supply partners, in particular the Russian Federation.

7. The TEP and Russia's Interests in the European Market

Whilst the third country clause was initially proposed by the Commission as an incentive for Member States to implement the proposed unbundling regime, there were concerns that Gazprom would buy European networks on sale while the said European

undertakings were unbundling their activities [Eikland 2011:29]. Article 11(3)(a) of the Gas Directive remedies this concern as it requires that non-EU undertakings abide by the same unbundling rules [Van Hoorn 2009:58]. This would in turn ensure that Gazprom would not be able to discriminate against other energy suppliers by preventing access to its pipelines [Juraslev 2011:11–12]. In so doing, Art. 11(3)(a) would help irradicate potential anti-competitive behaviour by dismantling Gazprom as a vertically integrated company and thereby ensuring a level-playing field amongst all market participants [Haghighi 2009:178]. Therefore Art. 11(3)(a) curbs the possibility of Gazprom acquiring strategically important European assets which would give it a competitive advantage and threaten the Union's energy security [Borisocheva 2007:12]. The same security considerations were taken into account with the conditions under Art. 11(3)(b) which provide an additional layer of insurance in securing the Union security of energy in accordance with Recital 22 of the Gas Directive giving credence to this endeavour²⁴. Non-EU undertakings therefore have an obligation to prove that their operations within the European market would not jeopardise the Unions security of supply [Cottier, Matteotti-Berkutova, Nartova 2010:3–4]. The conditions imposed under Art. 11 thereby aim to ensure fundamental Union's interests, namely the enhancement of competition within its energy market and security of supply [Talus 2012:20].

The Commission has been strongly advocating that the TEP and its new unbundling regime will facilitate an open competitive energy market which will in turn facilitate new business opportunities for Russian companies [Goldberg, Bjornbye 2012:20]. Russia however does not agree for which it views the third country regime as untoward [Yastrzhembsky 2008:35]. Russia has subsequently expressed its dissatisfaction towards the unbundling requirements which it has proclaimed amounts to a “robbery” of Russian property²⁵. This would inevitably be the case in a situation where Russia was forced to sell its assets in its efforts to unbundle which would result in asset value losses. Notwithstanding, even where Gazprom would not need to unbundle its ownership and thereby retain its transmission assets, the TEP would still

²³ See Recital 22 of the Gas Directive 2009/73/EC adopted July 13, 2009. URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32009L0073&from=EN> (accessed date: 30.07.2018).

²⁴ See Recital 22 of the Gas Directive 2009/73/EC adopted July 13, 2009. URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32009L0073&from=EN> (accessed date: 30.07.2018).

²⁵ Bryanski G. Russia may contest EU Energy rules in WTO. – *Reuters*. November 16, 2011. URL: <https://www.reuters.com/article/russia-wto-energy/russia-may-contest-eu-energy-rules-in-wto-source-idUSL5E7MF3ZE20111116> (accessed date: 31.07.2018).

restrict Gazprom from managing the said assets. As such, Gazprom's investments in its pipelines would be devalued which would impact its activities in the European market²⁶. These concerns seem justified where a Member State opts to apply ownership unbundling or the ISO model to a transmission system operated by a Gazprom subsidiary. The same holds true where an ITO model has been applied and Gazprom is (irrespective thereof) prohibited from controlling its pipelines due to the additional security of supply condition under Art. 11 of the Gas Directive.

Apart from the direct financial losses incurred from the obligatory divestment and subsequent loss of control over its transmission network, there are additional implications for Gazprom which may pose a threat to its operations. In particular in relation to Gazprom's long-term supply contracts under which Gazprom supplies gas to its European consumers²⁷. Pursuant to the new unbundling regime and TPA rules, Gazprom would risk losing control over its pipelines and thereby the necessary capacity to deliver on its supply commitments [Juravlev 2011:18–19]. With a loss of control over its existing transmission network, Gazprom may not be in a position to ensure sufficient transportation capacity which could lead to supply disruptions and therefore financial and reputational damage [Yafimaya 2013:29–36]. Therefore, with the Commission's unbundling and TPA rules potentially hindering supply and the Union's energy security, Gazprom has argued that the probable repercussions outweigh any likely advantages of an increasingly competitive market [Juravlev 2011:21–22].

Russia has subsequently disputed any favourable investment opportunities that may result from the Union's regulation which appears to be discriminatory towards Russia²⁸. The Russian Government's stance is clear – that it needs to maintain control over its mass distribution system in order to ensure reliable and consistent deliveries to its largest energy

consumer base [Juravlev 2011:24]. This appears to be inconsistent with the Union's unbundling regime and its ultimate goal of alleviating Russia's stronghold in the European energy market²⁹. Russia has subsequently argued for exemptions from the unbundling regime and concessions for Gazprom as the EU's largest energy supplier, the grievances of which were not taken into account in the prevailing regulation. It would therefore appear that where the Commission seeks to detach itself from Russia's energy grip, the more Russia seeks to enhance its control in order to secure its interests. Whilst Member States are reluctant to apply the discriminatory third country regime on Gazprom subsidiaries, Gazprom inevitably tries to avoid application through legal proceedings or lobbying for exemptions³⁰.

8. The Unbundling Regime and Conflicting Views

Russia's WTO accession has opened a window of opportunity to the trigger of a WTO ruling on the TEP and compatibility of the Gazprom clause with the WTO [Van Der Loo 2013:22]. The condition under Art. 11(3) of the Gas Directive which requires non-EU entities to unbundle, appears to discriminate third country undertakings from European undertakings, and further, third country undertakings with an agreement in place with the Union. With discrimination prohibited under various international instruments, Gazprom has legal grounds to challenge the application of Art. 11 on its EU-based subsidiaries for which it can claim compensation or annulment [Willems, Sul, Benizri 2010:241].

Russia claims the TEP is a violation of Art. 34(1) PCA which states that parties "shall use their best endeavours to avoid taking any measures or actions which render the conditions for the establishment and operation of each other's companies more restrictive than the situation existing on the day preceding the date of signature of the agreement"³¹. The Com-

²⁶ Komlev S. Third Energy Package and Impact on Gazprom Activities in Europe. Speech at the EBC Working Committee "Energy". Essen. March 18, 2011. URL: http://www.gazpromexport.ru/files/komlev_speech_essen_18_03_1124.pdf (accessed date: 30.07.2018).

²⁷ Ibidem.

²⁸ Iskauskas C. Third Energy Package: dispute between Russia and the EU. – *Geopolitika*. March 23, 2011. URL: <http://www.geopolitika.lt/?artc=4561> (accessed date: 30.07.2018).

²⁹ Vinatier L. Gazprom and the Kremlin: Russia's Double Approach to Europe's Energy Markets? – *Thomas More Institute*. May 2013. URL: <http://institut-thomas-more.org/2013/05/28/gazprom-and-the-kremlin-russias-double-approach-to-europes-energy-markets/> (accessed date: 30.07.2018).

³⁰ Ibidem.

³¹ Government of the Russian Federation: Notes of Press Conference after the February 2011 EU-Russia Summit. URL: <http://archive.premier.gov.ru/eng/events/pressconferences/14257/print/> (accessed date: 30.07.2018).

mission, in turn, has warned Gazprom that it will fall privy to competition law within the EU pursuant to principles of market liberalisation [Van Elsuwege 2012:24]. Subsequently, EU-Russia energy relations have been further aggravated by the Commission's formal proceedings initiated in September 2012 as to whether Gazprom abused to its market position in Central and Eastern-European member states, in breach of Art. 102 TFEU. Russia, on the other hand, having threatened to use the WTO instruments as a means of protecting its interests³² submitted a request for consultation on 30 April 2014 regarding the TEP which it views as inconsistent with several obligations of the EU under the WTO³³.

9. EU Competition Law and the Energy Markets

Tackling the anti-competitive behaviour of vertically integrated energy undertakings and ensuring free access to the transportation infrastructure was at the fore of establishing competition in the European energy market. Whilst various proposals were made in order to achieve this objective, competition rules (Art. 85 and 86 of the EC Treaty (today's EU Competition Law under Art. 101 and Art. 102 TFEU)) initially had a lesser role to play in the EU energy market with the regulatory approach being pursued in the alternative through the consecutive liberalization packages adopted. Amongst the Union's market liberalization efforts implemented through the packages, the two measures, as mentioned above, which specifically targeted anticompetitive behaviour of energy incumbents was the unbundling regime and TPA rules. Therefore, despite competition law being pushed to the periphery during the early stages of the EU energy market, throughout the implementation of the liberalization directives, Competition law began to play an increasingly important role as the EU's

energy market grew and matured [Roggenkamp, Boisseleu 2005:3].

Today competition law appears to be a powerful tool in the Commission's Liberalisation artillery. EU competition law is found in Art. 101 TFEU, which prohibits agreements between undertakings, which may affect trade between Member States and distort competition in the internal market, and in Art. 102 TFEU, which prohibits the abuse of a dominant position by an undertaking within the internal market or in a substantial part of it. The EU Merger Regulation (EC) No. 139/2004 is also powerful tool. Under Art. 2(3) of the Merger Regulation³⁴, the Commission is entitled to declare a concentration that causes significant impediments to effective competition incompatible with the internal market, particularly if it concerns the strengthening of a dominant position in the market³⁵.

Where energy undertakings are reluctant to abide by the applicable unbundling rules, the Commission encourages them to do so by virtue of Competition law under Art. 102 TFEU [Talus 2013:67]. In many ways, the Commission can be said to be achieving more through resorting to general competition rules, than it did before through its regulatory measures [Talus 2013:83]. It follows that the Commission has been using Art. 102 TFEU to further its agenda and secure further commitments from undertakings that extend beyond the ambit of the unbundling requirements [Johnston, Block 2012:71]. In particular, the Commission has been approaching TSO's of vertically integrated energy undertakings that are operating under an ITO model, with evidence of its anti-competitive behaviour which it then uses as leverage for obtaining further commitments [Westerhof 2009:27]. In so doing, the undertakings are obliged to agree to ownership unbundling or alternatively fall privy to antitrust prosecution under

³² Bryanski G. Russia May Contest EU Energy Rules in WTO. – *Reuters*. November 16, 2011. URL: <https://www.reuters.com/article/russia-wto-energy/russia-may-contest-eu-energy-rules-in-wto-source-idUSL5E7MF3ZE20111116> (accessed date: 31.07.2018).

³³ WTO, European Union and its Member States. Certain Measures Relating to the Energy Sector. Request for consultations by the Russian Federation dated April 30, 2014. URL: [https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=\(%20wt/ds476/1%20or%20wt/ds476/1/*\)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%20wt/ds476/1%20or%20wt/ds476/1/*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#) (accessed date: 31.07.2018).

³⁴ See Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation). URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004R0139&from=en> (accessed date: 27.07.2018).

³⁵ A recent case concerns the proposed acquisition of the only Greek gas transmission system operator DESFA by SOCAR, the State Oil Company of Azerbaijan Republic which is pending approval by the European Commission on account of the Commission's concerns that the proposed merged entity "may have the ability and the incentive to hinder competitive upstream gas suppliers from accessing the Greek transmission system, in order to reduce competition on the upstream wholesale gas market in Greece" (see Commission Press Release: Commission opens in-depth investigation into proposed acquisition of Greek gas transmission system operator DESFA by SOCAR dated November 5, 2014. URL: http://europa.eu/rapid/press-release_IP-14-1442_en.htm (accessed date: 24.07.2018)).

Art. 102 TFEU [Willems, Sul, Benizri 2010:340]. Given the prospect of hefty financial fines and the likely reputational damage, undertakings have been willing to concede on the Commission's request [Willems, Sul, Benizri 2010:340]. This manoeuvre has been particularly successful amongst European undertakings that have agreed to unbundle and sell segments of their transmission activities despite the ITO model under which they were operating [Johnston, Block 2012:71]. The Commission's use of Competition law has therefore proved to be a persuasive instrument in ensuring compliance with the prevailing unbundling regime [Talus 2013:137].

10. Application of EU Competition Law on Gazprom: the EU Competition Investigation of Gazprom's Sales in Central and Eastern Europe

To discuss the realities of the application of the unbundling regime on Russia's Gazprom, without taking into the account the contribution EU competition law has made to the unbundling process, would be negligent. After all, the unbundling process is aimed restricting undertakings from discriminating against its competitors, which is strongly linked to the abuse of dominant position under Art. 102 TFEU. Today competition law appears to be a powerful tool in the Commission's Liberalisation artillery. Where energy undertaking are reluctant to abide by the applicable unbundling rules, the Commission encourages them to do so by virtue of Competition law under Art. 102 TFEU [Talus 2013:67]. These developments have also affected Gazprom. Where the transmission of gas to the EU by Gazprom was not previously affected by competition law, today the situation has completely changed [Talus 2013:241].

The full extent of the influence of competition on Gazprom is best illustrated in the Baltic energy market where the Commission was asked to investigate potential market abuse on account of the politically motivated price discrimination of Lithuania's gas³⁶. In September 2011, the Commission launched a series of raids on Gazprom offices in Central and

Eastern Europe to accumulate sufficient evidence on suspicions that Gazprom was abusing its dominant position in its upstream gas supply markets. The Commission alleged that some of Gazprom's business practices in Central and Eastern gas markets constituted an abuse of its dominant position in breach of Art. 102 TFEU. In particular, the Commission alleged that by imposing territorial restrictions in its supply contracts, Gazprom was effectively segregating Central and Eastern gas markets. The territorial restrictions included measures inhibiting the cross-border flow of gas such as export ban clauses and destination clauses which facilitated Gazprom to pursue a strategy of market partitioning, thereby enabling Gazprom to charge unfair prices in five eastern EU member states, namely Bulgaria, Estonia, Latvia, Lithuania, and Poland, by charging prices significantly higher compared to Gazprom's costs or to benchmark prices³⁷.

Formal proceedings were brought against Gazprom on 4 September 2012 for market abuse in Central and Eastern Europe contrary to Art. 102 TFEU [Riley 2012:1]. According to the Commission's preliminary findings, Gazprom may have been leveraging its dominant market position by making the supply of gas to Bulgaria and Poland dependent on obtaining unrelated commitments from wholesalers concerning gas transport infrastructure. By way of example, gas supplies were contingent on investments in pipeline projects promoted by Gazprom (i.e. the South Stream project in Bulgaria) or conceding on Gazprom's reinforced control over a pipeline (i.e. the Yamal-Europe pipeline in Poland). Such behaviour, if confirmed, would impede the cross-border sale of gas within the single market thus lowering the liquidity and efficiency of gas markets. Furthermore it would raise artificial barriers to trade between Member States and results in higher gas prices. The hefty fines imposed for antitrust violations, which may reach up to 10% of the dominant undertaking's total turnover in the preceding year³⁸, may explain Gazprom's willingness to offer commitments³⁹ so as to alleviate the Commission's con-

³⁶ See *OAO Gazprom v. Republic of Lithuania*. SCC, Final Award. Arbitration No. V (125/2011). Para. 155. URL: http://arbitrations.ru/files/articles/uploaded/Gazprom_v_Lithuania_Final_Award_SCC.pdf (accessed date: 22.07.2018).

³⁷ Commission Press Release: Commission sends statement of objections to Gazprom for alleged abuse of dominance on Central and Eastern European Gas Supply Markets dated April 24, 2015. URL: http://europa.eu/rapid/press-release_IP-15-4828_en.htm (accessed date: 29.07.2018).

³⁸ See Art. 23(2) of the Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003R0001&from=EN> (accessed date: 29.07.2018).

³⁹ *Ibid.* Art. 9.

⁴⁰ See Case AT.39816. Upstream gas supplies in Central and Eastern Europe dated May 24, 2018. URL: http://ec.europa.eu/competition/antitrust/cases/dec_docs/39816/39816_10148_3.pdf (accessed date: 29.07.2018).

cerns⁴⁰. Introduced into EU competition law by Art. 9 of Regulation 1/2003, commitment decisions allow the Commission to terminate the investigation without the finding of infringement and the subsequent imposition of a fine. The standard of proof is thus significantly low. The parties may propose remedies to remove the Commission's concerns embodied into legally binding commitment decisions. In essence, "commitment decisions are a bargain between the Commission and the undertaking concerned" [Von Rosenberg 2009:245]. By contrast, antitrust procedures under Art. 7 of the same regulation may lead to the establishment of an infringement and levy significant fines. Damages before national courts may also be triggered.

In particular, Gazprom's proposed measures to remedy competition concerns relate to the removal of restrictions to re-sell gas cross-border, to ensuring competitive gas prices in Central and Eastern European gas markets and removing demands in relation to gas infrastructure projects obtained through its dominant market position⁴¹. The Commission's market testing of Gazprom's concessions, if satisfactory, would mean it could adopt a decision making the commitments legally binding on Gazprom. In the event that Gazprom breaks such commitments, the Commission may then impose a fine up to 10% of the company's worldwide turnover, without having to prove an infringement of the EU antitrust rules⁴².

Although the proceedings only reached fruition in May 2018⁴³, on account of the market testing, they have no doubt nudged Gazprom towards ownership unbundling on the Lithuanian market, as well as other affected Eastern European states where Gazprom may fall privy to EU Competition rules. The fact that the Commission has secured the commitments from Gazprom that extend beyond the usual unbundling provisions, makes it clear that the Commission's use of Competition law has proved to be a persuasive instrument in obtaining Gazprom's compliance with the prevailing unbundling regime [Talus 2013:137].

11. Conclusion

Having discussed the different perspectives of the unbundling regime, it is clear that the EU and Russia's

objectives are manifestly inconsistent with the EU seeking more competition to secure its energy supply whilst Russia seeks to retain its dominant position within the European energy market. It goes without saying that Russia is not pleased by the Commission's unbundling rules for which it has raised several legal issues to contest its application. That said, the EU sees Gazprom's ever-increasing control over EU energy infrastructure as a source of concern for which its measures are justified. By imposing the requirements of the so-called Gazprom clause, the EU seeks to secure its energy supply which is threatened by Gazprom's control over its transmission network. This is in addition to other incidents which have driven the Union to err on the side of caution such as the gas crises and Russia's reluctance to formalise its bilateral energy relations with the Union in a legally binding framework [Van Der Bergh 2009:232].

Providing an elaborate account of the pros and cons of the unbundling regime and the third country clause falls beyond the ambit of this article. However it is important to note that in the absence of a legal framework, the unbundling regulation has not done much to stabilise EU-Russia relations. The TEP's unbundling regime seems to have become another simmering issue in a relationship already riddled with concerns [Talus 2013:84]. If anything, it has brought the differences between these strategic partners to the fore. This is not surprising given that unbundling hinges on control of the gas transmission network which is of strategic relevance to both the EU and Russia.

Whilst the EU's unbundling regulation is limited to its own territory and does not specifically address Gazprom, Gazprom's presence on the European energy market means that it falls within the scope of its application. Albeit surreptitiously, perhaps the application of EU energy regulation concerning ownership and management of Russian pipelines on EU soil, would have best been addressed within the realm of a bilateral or multilateral legal agreement, rather than unilaterally imposed obligations pursuant to EU directives. With that in mind, the fact that Russia has been reluctant to institutionalise EU-Russia relations within a legally binding framework or the multilateral global architecture, may well jus-

⁴¹ Press Release: Antitrust: Commission invites comments on Gazprom commitments concerning Central and European gas markets Brussels dated March 13, 2017. URL: http://europa.eu/rapid/press-release_IP-17-555_en.htm (accessed date: 29.07.2018).

⁴² Ibidem.

⁴³ Press Release: Antitrust: Commission imposes binding obligations on Gazprom to enable free flow of gas at competitive prices in Central and Eastern European gas markets Brussels dated May 24, 2018. URL: http://europa.eu/rapid/press-release_IP-18-3921_en.htm (accessed date: 29.07.2018).

tify the Union's manoeuvres in pursuing its agenda (although unilaterally) beyond the ambit of a bilateral agreement. The ever-prevailing delays in negotiating a new partnership agreement and Russia's withdrawal from the ECT, give credence to this assertion and to some degree allude to a somewhat strategic Union which has pursued its energy security agenda through its internal regulation which has been externalised, in the absence of international legal instruments that could regulate energy relations between these strategic partners.

The objectives of EU internal energy policy, quite simply put and as indicated earlier, entail three elements – competitiveness; security and the environment. More specifically, the three objectives relate to the EU's endeavours to provide secure and affordable energy to European consumers; curb the Union's vulnerability in its energy dependence on external suppliers; and combat climate change. What links these three dimensions is the fact that the Union seeks to fulfil these objectives by way of a market-based approach which is heavily embedded in regulation. As such, legal frameworks such as regulations; direc-

tives; and bilateral or multilateral agreements, which is quintessentially normative, provide a platform from which the Union can pursue its energy policy objectives. This law-based agenda therefore sets the stage for the Union's internal and external policy with the relevant dimensions serving as both instrument and objective. It follows that security, competitiveness and sustainability, each in turn, facilitate the fulfilment of the other. By way of example a well-functioning market increases energy security; whilst energy efficiency diminishes energy dependence and thereby increases energy security. Each objective therefore correlates with the other and serves as a means unto itself with the Union's laws and regulations as the preferred medium to attain these objectives [Van Vooren, Wessel 2014:444]. In this respect the Union's legal and market-based approach becomes a means for all other ends and in turn, an end in itself. The fact that the Union uses legal instruments as a mechanism to forward its market-based approach in the energy sector (both internally and externally), serves to validate the Union's role as a global normative energy actor.

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