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Joint Gas Purchasing

Options for reducing dependency on Russian gas

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- The particularly high level of dependency on Russian gas supplies in Eastern EU countries weakens their negotiating position. It allows Russia to impose higher prices on them than on the other EU countries („price discrimination").
- A mandatory gas purchasing in the EU would protect the Eastern EU countries from excessively high prices, but interfere with freedom of contract, restrict competition and reduce incentives for the investments needed to ensure the security of the gas supply.
- A voluntary purchasing community is appropriate. It complicates price discrimination by Russia, maintains competition and investment incentives.

CONTENT

1 Introduction

The economies of the EU Member States and the well-being of its citizens require a secure and affordable gas supply. The EU, however, only produces about one third of its gas consumption and is therefore dependent on gas imports from counties outside the EU. In the last few decades, Russia has become the European Union's main supplier. In 2013, 27% of the EU's entire demand was covered by the Russian state gas company Gazprom, which has a monopoly over Russian gas exports.[1]

Concerns have grown about the EU's high dependency on gas imports from Russia in view of the repeated conflicts between Russia and Ukraine. Ukraine is still the main transit country for gas supplies from Russia to the EU and it will not be possible to completely replace Russian gas with alternative sources any time soon. In the winters of 2006 and 2009, there was major disruption to gas supplies in the Eastern EU Member States. As a result, in 2010, the EU tightened its rules on the security of the gas supply – particularly with regard to gas supply standards and the protection of critical gas infrastructure.[2] In May 2014, in the wake of the Russian-Ukrainian gas dispute in the winter of 2014, the European Commission proposed additional measures to ensure a secure energy supply in the EU.[3] It called on the Member States to complete the internal energy market and protect critical infrastructures such as gas pipelines against the political influence of state-owned companies in non-EU countries. In addition, the Commission carried out a "stress test" to examine the resilience of the European gas network and recommended measures to increase the security of the gas supply in the EU.[4] Faced with an escalation of the Russian-Ukraine crisis and its possible impact on the EU gas supply system, Central and Eastern EU Member States ("CEE States") in particular have expressed major concerns about the high level of dependency on Russian gas and its negative influence on the security and affordability of their national gas supplies.

In April 2014, the then Prime Minister of Poland, Donald Tusk, proposed an "EU Energy Union". In order to improve the collective negotiating power of the gas importing companies in the CEE States, which are heavily dependent on Gazprom as the main gas supplier, he considered the creation of a mandatory system for the joint purchasing of gas in the EU.[5] His proposal envisages the development of an "Energy Union" along the lines of the Euratom Supply Agency ESA which has a right of option on nuclear materials from countries within and outside the EU.

By contrast, the European Commission has now announced, in its strategy Communication on the "Energy Union" of 25 February 2015, that it wants to examine "options for voluntary demand aggregation mechanisms for collective purchasing of gas during a crisis and where Member States are dependent on a single supplier", subject to the requirement that these are "fully compliant with WTO rules and EU competition rules".[6] The European Council also backed such an assessment in its Conclusions on the Energy Union of 19 March 2015.[7]

Against this backdrop, this cepInput aims to contribute to the current discussion of the advantages and disadvantages of a joint gas procurement system in the EU. Even though EU gas companies

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[1] European Commission, Communication COM(2014) 330 of 28 May 2014, European Energy Security Strategy, p. 2; see cepPolicyBrief No. 2014-38.
[2] Regulation (EU) No. 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply.
[3] European Commission, Communication COM(2014) 330 of 28 May 2014, European Energy Security Strategy.
[4] European Commission, Communication COM(2014) 654 of 16 October 2014 on the short term resilience of the European gas system. Measures in the event of disruption in the gas supply from the East in fall and winter 2014/2015; see cepPolicyBrief No. 2015-02.
[5] Donald Tusk (2014): A united Europe can end Russia's energy stranglehold, Financial Times, 21 April 2014.
[6] European Commission, Communication COM(2015) 80 of 25 February 2015, A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy, p. 6.
[7] European Council, Conclusions on Energy Union of 19 March 2015.

also acquire gas from other countries apart from Russia, this analysis focuses on Gazprom because Russian gas is the main source of gas in the EU and Gazprom is the most prominent example of disproportionate negotiating power on the European gas market.

Section 2 describes the latest developments and problems on the EU gas market, illustrates the dependence on Russian gas imports and shows how these affect the gas import contracts and wholesale gas prices in the EU and above all in the CEE States. Section 3 sets out possible solutions to the problems described in Section 2. Here we will look at both mandatory and voluntary systems of joint gas purchasing. Section 4 provides an economic impact assessment and legal evaluation of the solutions described in Section 3.

2 Gas Trading Relations between Russia and the EU

2.1 EU dependency on Russian gas

2.1.1 Status quo

After oil, gas is the second most important source of energy in Europe. In 2013, it covered 23% of final energy consumption in the EU. Gas is used primarily in private households (41%), industry (31%) and in electricity production (23%) but only to a small extent in the transport sector (0.4%).[8]

In 2013, approx. two thirds of gas consumption had to be imported into the EU. Since transport via pipelines is still cheaper than transporting liquefied natural gas (LNG) by ship, almost all imports of natural gas are concentrated (94%) in four countries located adjacent to the EU: Russia (41%), Norway (32%), Algeria (12%) and Libya (9%).[9]

Since the capacity of cross-border pipelines, with regard to gas flows both into and within the EU, is limited, the internal gas market is divided into several regional markets which are dependent to a varying extent on certain gas exporting countries. This applies in particular to CEE States of which the Baltic States, Finland, Slovakia and Bulgaria obtain their entire gas supply from just one company, Gazprom. The gas supply to Northern and Western European countries is much more diversified. Thus Germany obtains only 46%, Italy 33% and France 18% of their respective national gas consumption from Russia. These countries can cover their gas requirement by way of alternative imports from Norway, the Netherlands and North Africa as well as by way of domestic production.[10]

In the same way that Europe is dependent on Russian gas imports, Russia also relies on the revenue from the sale of gas to Europe. Gazprom exports approx. 112 billion cubic metres of natural gas to the EU. The EU is therefore the destination of more than 50% of all Russian gas exports.[11] The revenue from gas exports also contributes substantially to federal and regional budgets in Russia.[12] Within the EU, however, the import volumes of Russian gas vary considerably between the large Western European countries such as Germany, France and Italy and the smaller CEE States such as Bulgaria, Lithuania and Slovakia. Thus the annual gas imports from Russia to Germany and Italy

[8] Eurogas (2014): Statistical Report 2014, p. 2 et seq.
[9] Ibid., p. 6.
[10] Ibid.
[11] Holz, F.; Engerer, H.; Kemfert, C.; Richter, M.; von Hirschhausen, C. (2014): European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies, p. 7 and 59.
[12] Ibid., p. 9.

amount to 50 billion cubic metres and therefore exceed Russian gas exports to the eleven CEE States which together import only 40 billion cubic metres of gas from Russia.[13]

2.1.2 Future Developments

The EU's dependence on Russian gas is more likely to grow than to decrease in the future. Thus, on the one hand, forecasts indicate that demand for gas up to 2030 will increase. On the other hand, the current annual output from domestic sources will fall significantly by 2030 and it will not be possible to increase imports from Norway - the largest gas supplier after Russia. Although the EU has been trying for several years to increase the diversification of natural gas suppliers by investing in pipeline projects and ports for bringing in liquid gas ("LNG terminals"), these only have limited potential to replace Russian gas supplies:[14]

The planned "Southern Corridor" – a pipeline project which from 2019 will allow natural gas to be transported from the Caspian region, via Georgia and Turkey avoiding Russia and Ukraine – will, if successfully implemented, be limited to gas supplies from Azerbaijan. Geopolitical problems - such as political instability in Iraq, the economic isolation of Iran and the unresolved international status of the Caspian Sea, which makes it impossible to extend the pipeline to Turkmenistan - will prevent the import of significantly larger quantities of natural gas from this region for the foreseeable future.[15]

LNG offers more potential because it significantly reduces the need for geographical proximity between the country of origin and the consumer country. There is no need for costly investment in pipelines and no dependence on unstable transit countries. Above all, the shale gas boom in the USA has ignited a discussion about LNG as a cheap alternative to Russian pipeline gas and motivated some CEE States to build LNG terminals – like those which already exist in Northern and Western Europe. Thus, in 2014, an LNG terminal was completed in Lithuania; and in Poland one is due to be finished in 2015.[16]

However, LNG is only competitive if its world market price does not exceed that of Russian pipeline gas. However, the costs of transport by ship and the conversion processes which this would entail (liquefaction and regasification) are still high and much less competitive than gas imports via existing pipeline systems. In addition, the growing demand for LNG in Japan, China and other East-Asian countries is driving up the world market price of LNG. According to estimates, even in the optimum case scenario in which the USA exports a large amount of LNG and the demand in China turns out to be low, at least 100 to 120 billion cubic metres of Russian gas will still have to be imported into the EU. This value may double to 210 to 250 billion cubic metres, however, if US export volumes are low and demand in China higher.[17]

2.2 Anticompetitive Gas Supply Contracts

Increasingly in recent years, wholesale prices have been determined by the development of supply and demand in regional gas hubs. However, the majority of Russian gas deliveries today still take

[13] The calculation is based on Holz, F.; Engerer, H.; Kemfert, C.; Richter, M.; von Hirschhausen, C. (2014): European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies, p. 59.
[14] Dickel, R.; Hassanzadeh, E.; Henderson, J.; Honoré, A.; El-Katiri, L.; Pirani, S.; Howard, R.; Stern, J.; Yamifavy, K. (2014): Reducing European Dependence on Russian Gas: distinguishing natural gas security from geopolitics, Oxford Institute for Energy Studies, Chapter 2.
[15] Ibid., p. 40.
[16] Holz, F.; Engerer, H.; Kemfert, C.; Richter, M.; von Hirschhausen, C. (2014): European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies, p. 34.
[17] Dickel, R.; Hassanzadeh, E.; Henderson, J.; Honoré, A.; El-Katiri, L.; Pirani, S.; Howard, R.; Stern, J.; Yamifavy, K. (2014): Reducing European Dependence on Russian Gas: distinguishing natural gas security from geopolitics, Oxford Institute for Energy Studies, p. 32.

place on the basis of long-term supply contracts which are generally kept secret. These contain complex, non-transparent price models and exhibit many features which contradict the principle of free trade in the internal market.[18]

In 2012, the European Commission brought formal competition proceedings against Gazprom in order to find out whether the company was in violation of Article 102 Treaty on the Functioning of the European Union (TFEU) due to the misuse of its dominant market position on the wholesale gas market in some CEE States. The Commission investigated three alleged anti-competitive practices in central and Eastern Europe: (1) Gazprom may have obstructed the free flow of gas within the EU. (2) Gazprom may have prevented the diversification of the gas supply. (3) Gazprom may have imposed unreasonable prices on its customers by linking its gas prices to the oil price.[19]

(1) Free trade in gas in the EU internal market can be restricted by using territorial restrictions such as "destination clauses" which prevent gas from being re-sold to third parties. Thus the gas-exporting company is able to split the EU gas market into smaller national markets and demand varying prices for gas within the EU. This type of market segmentation may arise due to restrictions on capacity. This is the case where non-discriminatory access by third parties to essential gas infrastructure – such as pipelines or LNG terminals, as required under Regulation (EC) No. 715/2009 on conditions for access to natural gas transmission networks – is refused or where the capacity of the pipeline infrastructure is simply too small to allow free trade in gas in the EU. In this regard, it should be pointed out that, in the last few decades, Gazprom has managed to acquire large shares or even majority shareholdings in the largest gas infrastructures, particularly in Eastern Europe.[20]

(2) Long-term gas supply contracts (with terms of between ten and thirty-five years) with so-called "Take-or-Pay" clauses represent the main restriction on greater diversification of the gas supply in CEE States. A Take-or-Pay clause is an agreement on contractual penalties which the gas importer has to pay if it fails to take up a minimum volume of gas stipulated in the contract. Such clauses are aimed at ensuring that gas importers have constant yearly gas deliveries and that the gas exporter has reliable revenues. This makes sense where the exporting company has to cover high infrastructure costs for gas production and transport. However, the risk of a reduction in the demand for gas in the importing country – e.g. due to an economic crisis or warmer temperatures – is borne solely by the importing company. This is particularly problematic if the company concerned has only a few possibilities to diversify its gas imports due to a lack of alternative suppliers.[21]

(3) Finally, linking gas prices to the price of crude oil ("oil price link") is increasingly regarded as an unsatisfactory method of identifying a regional price for gas based on competition. Criticism has been fuelled by the fact that the "shale gas revolution" in the USA and the ensuing rise in LNG imports to Europe have had no significant impact on the price of crude oil or the gas prices which are linked thereto. Consequently, in 2013, wholesale natural gas prices based on oil-indexed gas contracts were much higher than the prices for gas traded on regional gas trading hubs such as the National Balancing Point (NBP) in the United Kingdom.[22]

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[18] Holz, F.; Engerer, H.; Kemfert, C.; Richter, M.; von Hirschhausen, C. (2014): European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies, p. 22 et seq.
[19] European Commission, press release of 4 September 2012, Antitrust: Commission opens proceedings against Gazprom.
[20] Holz, F.; Engerer, H.; Kemfert, C.; Richter, M.; von Hirschhausen, C. (2014): European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies, p. 30 et seq.
[21] Fischer, (2011): Auf dem Weg zur gemeinsamen Energiepolitik, p. 129 et seq.
[22] International Gas Union (2014): Wholesale Gas Prices Survey 2014. A Global Review of Price Formation Mechanisms 2005 to 2013, p. 20.

2.3 Price Discrimination with Russian Gas Imports to the EU

Whereas Gazprom has more or less maintained its anticompetitive approach to the gas importers in the CEE States, between 2005 and 2013, many Western European gas importers successfully managed to renegotiate their gas supply contracts and replace the oil price link with a more market-orientated pricing method ("gas-on-gas competition") which takes account of regional spot market prices. Today, the pricing of 53% of EU gas wholesale volumes is based on gas-on-gas competition. There are still enormous differences within the EU however: Whereas wholesale pricing by way of gas-on-gas competition dominates in North-Western Europe (80% of gas consumption in 2013) pricing in the South-Eastern European Member States is still determined by the oil price link or by state regulation.[23]

Whereas greater market integration and gas-on-gas competition in North-Western Europe has led to a harmonisation of the wholesale gas prices, gas importers in the CEE States are still paying a significant premium. Although natural gas supply contracts are kept secret, there are indications that the prices being paid for gas imports in CEE States are higher than those in North-Western European countries. According to a 2013 estimate, the unweighted average price for 1000 cubic metres of Russian gas in ten CEE States was $ 452.70 as compared with just $ 396.70 in five Western European countries (see Table 1). CEE States are therefore paying an average surcharge of about 14% for Russian gas. Another estimate puts the premium between 10% and 13%.[24]

[23] Ibid., p. 25 et seq.
[24] Genoese, F.; Dimitrova, A.; Egenhofer, C. (2014): Energy Union: Can Europe learn from Japan's joint gas purchasing? CEPS Commentary of 11 December 2014, p. 1.

Table 1: Estimated Import Prices for Russian Gas

Western Europe	Price ($/1,000 m³)
Austria	397
France	394
Germany	379
Italy	440
Netherlands	371
Unweighted average	**396.7**

CEE	Price ($/1,000 m³)
Bulgaria	501
Czech Republic	503
Estonia	442
Finland	385
Hungary	391
Latvia	416
Lithuania	500
Poland	528
Romania	432
Slovakia	429
Unweighted average	**452.7**

Source: Kates, G. and Luo, L. (2014): Russian Gas: How Much Is That? Radio Free Europe, 1 July 2014

The surcharge that CEE States have to pay for Russian gas is a result of their higher dependency which is due to a lack of own resources, insufficient cross-border pipelines to other Member States and unfavourable long-term gas contracts. In addition, gas companies in CEE States import relatively small volumes due to their smaller populations. Thus, Gazprom depends to a much greater extent on gas exports to large countries like Germany, Italy or France and is probably more willing to agree to more favourable supply terms for gas companies in these countries. In fact, the German energy companies RWE and E.ON as well as the Italian company Eni have been able to secure better contract terms with Gazprom in recent years. The largest French gas company GDF Suez SA will endeavour to do so in 2015.[25]

The variation in the price of Russian gas indicates that Gazprom is able to conduct price discrimination by exploiting the fact that CEE companies are unable to buy cheaper gas from Western European countries. This situation amounts to a near perfect price-discriminating monopoly. Even though Gazprom is not the only supplier of natural gas, it has enormous market power and is thus able to negotiate prices far above its production costs. As mentioned before, Gazprom's bargaining power is especially high *vis-à-vis* those companies for whom it would be extremely costly to replace Russian gas and who are only able to import small volumes of gas. By

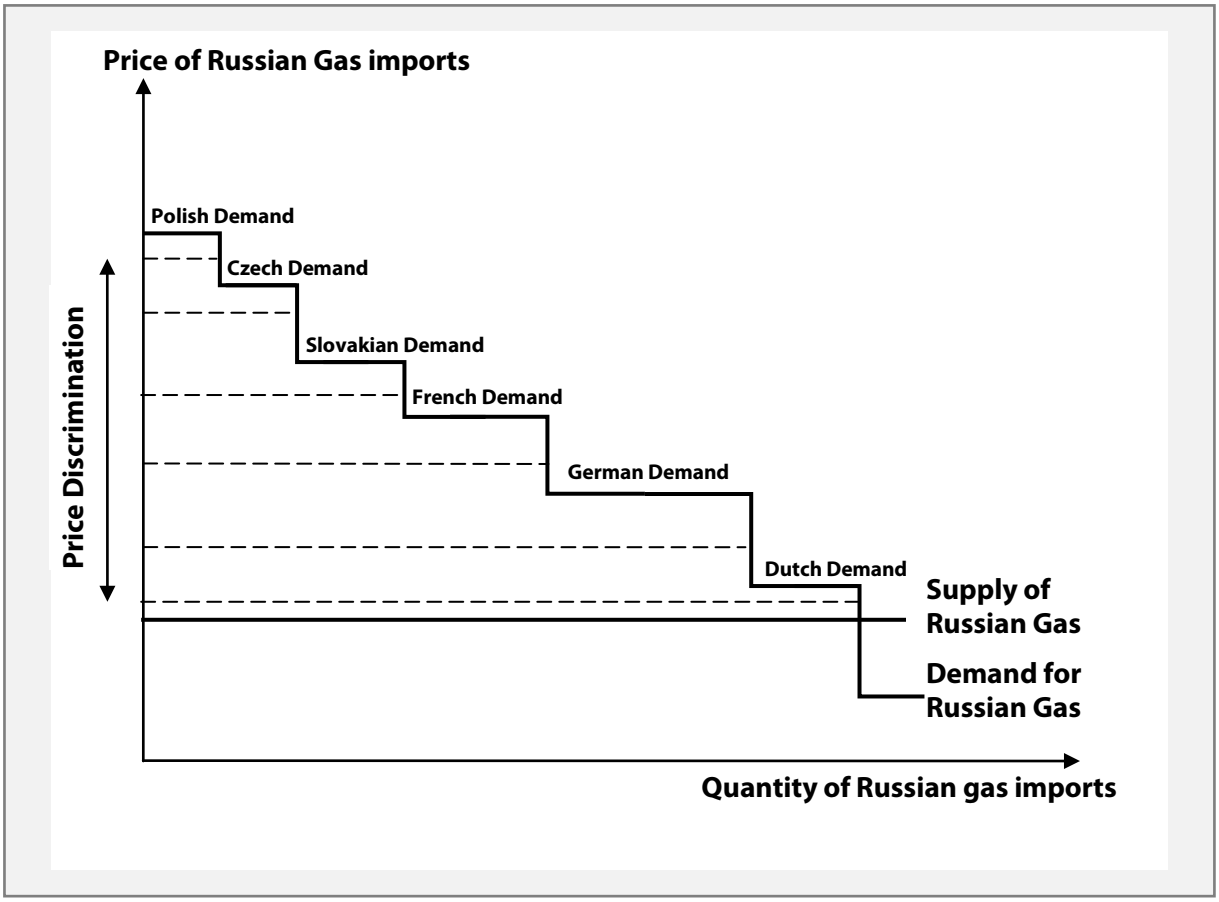
[25] European Commission (2014): Quarterly Report on European Gas Markets, Vol. 6 and 7, p. 25.

contrast, German, French and Italian companies have more bargaining power since they are able to diversify their gas imports.

Figure 1 shows an idealised gas supply function for Gazprom which equals its marginal costs of producing and delivering gas to Europe. For the sake of simplicity the marginal costs are assumed to be constant. The supply curve reflects the minimum price at which Gazprom is prepared to supply gas to the Member States. The EU demand for Russian natural gas is depicted by the staircase-shaped demand curve which aggregates the individual gas demand curves of each gas-purchasing company in the EU. These reflect what it would cost the purchasing company to replace Russian gas with gas from an alternative supplier or with alternative fuel and thus show the maximum price that the company will accept for Russian gas ("reservation price"). If the reservation price is below the minimum price charged by Gazprom, the company will not buy Russian gas.

The price that the individual gas importing company and Gazprom negotiate – indicated by the different dashed lines – will be somewhere between the individual reservation price of the importing company and the minimum price charged by Gazprom. The exact outcome – closer to the reservation price or closer to minimum price charged by Gazprom – will depend on the company's bargaining power. As already mentioned, a high level of bargaining power can be achieved if the company purchases comparatively large amounts of Russian gas or if it is easily able to replace Russian gas. Due to the different reservation prices and the different degrees of bargaining power, Gazprom can increase its profits by conducting price discrimination.

Figure 1: An Illustration of Price Discrimination in the EU Market for Russian Gas



Source: cep

3 The Idea of a Gas Purchasing Association

3.1 Background

Since the large majority of Russian gas exports to Europe still take place on the basis of long-term contracts lasting between ten and thirty-five years, under which as a result of Take-or-Pay clauses, importers have to order minimum volumes of gas, changes in gas purchasing by Member States can only take place gradually.[26] The further integration of the internal gas market requires a strict application of EU law – such as the ban on anti-competitive contractual provisions which restrict the flow of gas in the internal market (see Section 2.2) – and the construction of additional gas pipelines which are also able to transport gas from West to East against the main direction of flow ("reverse flow"). EU gas companies will then be able to buy and sell imported Russian gas via regional trading hubs in the EU which will result in a convergence of the gas prices in the EU like that which already exists in North-Western Europe. It will primarily be the CEE gas importers who will profit from this; they currently still have to pay high prices for Russian gas imports due to a lack of alternative supplies. Western European gas importers will gain additional revenue from reselling Russian gas to CEE States which will reduce the incentive for Gazprom to carry out price discrimination in the EU.

However, even a functioning internal gas market can do nothing about the fact that large quantities of gas will still have to be imported from Russia in the future as long as alternative sources of supply are unavailable or uneconomic (see Section 2.1.2). Thus, in the foreseeable future, there is a risk that Gazprom will exploit its dominant market position on the EU gas market, even without price discrimination, by imposing monopolistic gas prices. The price discriminating monopoly will then turn into a simple monopoly which nevertheless many individual importers will still have to deal with.

In the light of this, there have been calls for this monopoly of supply to be met with a demand cartel in the form of a "purchasing association" of European gas importers. In principle, it would be possible to have both mandatory joint gas purchasing ("MJGP") and voluntary joint gas purchasing ("VJGP").

3.2 Mandatory Joint Gas Purchasing (MJGP)

Mandatory purchasing associations mean that purchasing can only be carried out in consultation with a single, central office. An example in the energy sector is the Euratom Supply Agency (ESA) which has a right of option on ores, source materials and in particular fissile materials from countries within or outside the EU. A joint supply policy will ensure equal access to the supply sources and prevent preferential treatment being given to individual consumers.[27]

The ESA served as a model for a MJGP in the EU, put forward by Donald Tusk in April 2014 as the main component of a European "Energy Union", which would, in his view, be realised in three stages. First, the existing non-transparent and anti-competitive contractual clauses in bilateral gas supply contracts would be removed and then a model gas contract would be used for all new contracts. Finally, the European Commission would be actively involved in the contractual negotiations.[28] These proposals are, on a strict interpretation, equivalent to MJGP because, in Tusk's view, no gas import company would be able to negotiate more advantageous supply conditions

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[26] Dickel, R.; Hassanzadeh, E.; Henderson, J.; Honoré, A.; El-Katiri, L.; Pirani, S.; Howard, R.; Stern, J.; Yamifavy, K. (2014): Reducing European Dependence on Russian Gas: distinguishing natural gas security from geopolitics, Oxford Institute for Energy Studies, p. 4.

[27] Articles 52–57 Treaty establishing the European Atomic Energy Community (EURATOM).

[28] Donald Tusk (2014): A united Europe can end Russia's energy stranglehold, Financial Times, 21 April 2014.

than its competitors. This type of MJGP will increase the solidarity between the Member States and restrict Russia's market power.

In the European Energy Security Strategy[29] of May 2014, the European Commission spoke in favour of better coordination of national energy policies in general and welcomed the idea of an "Energy Union" as the expression of greater integration of national energy markets. The Communication, however, contains no explicit support for MJGP. In fact, in November 2014, Klaus-Dieter Borchardt, Director of the Internal Energy Market at Directorate General Energy, indicated that the European Commission will not be pursuing the idea of MJGP for the whole of the EU. Firstly, he said that MJGP did not have the support of larger Member States such as the UK and Germany. Secondly, it may be in breach of EU competition law and WTO regulations. Currently, therefore, the idea of "voluntary joint gas purchasing" (VJGP) is the subject of intense debate.[30]

3.2 Voluntary Joint Gas Purchasing (VJGP)

Companies may also set up an exclusive purchasing association with other companies on a voluntary basis or accede to one which already exists and is open to all companies. As with MJGP, VJGP can improve the negotiating position of the participating companies. Unlike MJGP, however, with VJGP companies can also decide not to join the purchasing association.

There are already many examples of exclusive, often bilateral gas purchasing associations. In October 2014, the two largest Japanese electricity producers – Tokyo Electric Power Co. (TEPCO) and Chubu Electric Power Co. – reached an interim agreement on setting up a joint venture which, in the future, will purchase an annual volume of 54 billion cubic metres of LNG.[31] A similar agreement was concluded in March 2010 between the Dutch gas network operator Gas Transportsystem and the German gas network operator Gasunie Deutschland, on the joint purchase of gas to operate their networks.[32]

The establishment of a voluntary purchasing association, which would be open to all companies, is also feasible for the EU. In this case, as with MJGP, natural gas is imported via a central office. In this regard, it is likely that those companies, who currently have to purchase gas at inflated prices due to their small delivery volumes and lack of import alternatives, would be particularly keen to join the purchasing association. In this case, natural gas importers from CEE States would have the opportunity to bundle their small import volumes into one aggregate import volume of approx. 40 billion cubic metres[33] thereby greatly improving their negotiating position with regard to the main supplier Gazprom.

[29] European Commission, Communication COM(2014) 330 of 28 May 2014, European Energy Security Strategy.
[30] Botzki, A. (2014): EU rules out obligatory gas-purchasing body. Strategic Framework for the Energy Union, Interfax natural gas daily, 13 November 2014, http://www.interfaxenergy.com/gasdaily/article/14173/eu-rules-out-obligatory-gas-purchasing-body (last accessed on 17 March 2015).
[31] Genoese, F.; Dimitrova, A.; Egenhofer, C. (2014): Energy Union: Can Europe learn from Japan's joint gas purchasing? CEPS Commentary of 11 December 2014.
[32] Gasunie (2010): Gasunie Deutschland and GTS launch joint tender for transmission gas, Press release of 16 March 2010.
[33] Calculation based on Holz, F.; Engerer, H.; Kemfert, C.; Richter, M.; von Hirschhausen, C. (2014): European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies, p. 59.

4 Economic Impact Assessment

4.1 Impact of Mandatory Joint Gas Purchasing

Mandatory joint purchasing (MJGP) via a central gas purchasing agency represents a "mandatory cartel" which restricts both the freedom of contract of importers of natural gas and competition in the internal gas market. In this regard, it must be borne in mind, however, that in many cases the mandatory cartel is up against only a small number of gas suppliers such as Gazprom and competition is already restricted due to the high degree of negotiating power of these gas exporters.

Whereas those countries that currently have a weak bargaining position will in particular support the establishment of such a cartel, companies that currently have a strong bargaining position will not, with MJGP, be able to gain a competitive advantage over their competitors. In fact, their competitive position would deteriorate and thus they have no interest in MJGP.

Since, in the case of MJGP, all importers have to buy Russian natural gas via the same agency, the ability of Gazprom to operate price discrimination in the EU would cease - irrespective of the level of integration in the internal gas market. This would result in a harmonisation of natural gas prices in the EU. The bundling of import volumes which results from joint gas purchasing will also significantly strengthen the bargaining power of the EU gas sector as a whole with respect to the gas exporters and consequently the average import prices for natural gas will tend to fall.

If the lower gas import price is passed on via the downstream sales markets to the end-customers in the respective Member States, private households and companies also stand to gain from it. The expected harmonisation of consumer gas prices also influences competition in the internal market in those sectors in which natural gas or electricity from gas power stations accounts for a large proportion of output. This may influence the choice of business location made by energy-intensive companies in the EU.

It is, above all, the CEE States who will profit from the reduction and harmonisation of gas import prices for imported natural gas within the EU. Since these states are currently very dependent on Russian gas, the price reduction will be particularly noticeable for them. In addition, the expected harmonisation of consumer gas prices will lead to an increase in the competitiveness of energy-intensive companies in the CEE States with respect to their competitors in the other EU countries.

On the other hand, MJGP may also have a negative impact on the other EU states. Although importers of natural gas in these countries also profit from falling gas prices (though the effect is not as marked as in the CEE States because large energy companies such as RWE, E.ON and Eni already pay cheap prices for Russian gas due to their strong negotiating position), the removal of price discrimination in the other EU states has a negative impact because it makes it uneconomic to resell natural gas, obtained from Russia, against the main direction of flow ("reverse flow") to the CEE States located to the east. As a result of the expected harmonisation of consumer gas prices, energy-intensive companies in these countries will also lose their existing competitive advantage over competitors in the CEE States. The overall effect depends on which of these contradictory effects prevails.

MJGP via a central gas purchasing agency may prevent Russia from restricting gas exports to CEE States for political reasons. As a result, however, the Member States have less incentive to increase the diversification of their energy supply which would allow them to reduce their dependence on individual energy sources, import countries and transport routes. Infrastructures which are crucial for the development of the internal natural gas market and security of EU supply, such as cross-border gas pipelines in particular, will not then be established to a sufficient degree.

4.2 Impact of Voluntary Joint Gas Purchasing

The opportunity to take part voluntarily in gas purchasing (VJGP) which is optional for all EU natural gas importers via a central gas purchasing agency will be taken up primarily by companies in the Member States which currently pay the highest prices due to their minimal and non-diversified supply volumes. These are, in particular, the CEE States. Here we will analyse the impact arising from VJGP in which only the natural gas importers from the CEE States participate.

Since participation in VJGP is voluntary, the freedom of contract of natural gas importers in the EU is not restricted. On the other hand, VJGP has a negative impact – similar to that of MJGP if to a lesser extent – on competition in the internal market. By bundling their purchasing power, the participating companies achieve a competitive price advantage over the non-participating competitors which they can pass on to the gas-consuming industry in the CEE States via the sales price.

In any case – irrespective of the integration in the internal gas market –, VJGP will result in the harmonisation of the prices for Russian natural gas in the EU by at least restricting the ability of Gazprom to operate price discrimination in the EU. By bundling their demand volumes, natural gas importers from CEE States can improve their negotiating position with regard to Gazprom and thereby reduce the price of Russian gas imports. By contrast with MJGP, however, the potential for improving the negotiating position is limited with VJGP because, firstly, CEE States only receive about a third of the Russian gas supplies to the EU[34], and secondly, all natural gas companies in the CEE States have a similar level of dependency on Russian natural gas exports so diversification of gas supply by way of VJGP is scarcely possible.

Gas importers in the other EU states which do not participate in VJGP may still choose between gas from Russia and gas from third countries. However, they are affected by the existence of VJGP to the extent that it becomes less lucrative for them to resell cheaply imported gas from third countries to CEE States due to the fall in wholesale prices for natural gas in these states resulting from the bundling of gas purchasing.

The bundling of demand may also reduce the risk of gas exports to individual CEE States being halted for political reasons. However, VJGP is in this regard a much less effective instrument than MJGP because, even with VJGP, diversification of the natural gas supply is only possible to a limited extent.

On this basis, incentives therefore still exist – to a lesser degree – for the CEE States to diversify the gas supply by way of investment in the energy infrastructure, thereby expediting the integration of the internal gas market The same applies to the other EU states because selling natural gas, which has been procured from other countries, to the CEE States is not without its attractions.

Table 2 sets out the positive and negative effects of a mandatory and a voluntary gas purchasing association. The effects of VJGP are comparable in terms of content to those of MJGP, but are less pronounced in the case of both the positive and negative effects.

[34] Calculation based on ebd.

Table 2: Positive and negative effects of MJGP and VJGP

	MJGP	VJGP
Competition and freedom of contract	– –	–
Preventing price discrimination	++	+
Economic impact on the CEE States	++	+
Economic impact on the other EU states	?	–
Protection of CEE States against gas supply boycotts	++	+
Impact on incentives for investment in infrastructure	– –	–

Source: cep

5 Legal Preconditions

The idea of joint gas purchasing – whether mandatory or voluntary – contradicts prima facie the concept of a competitively structured internal energy market. In particular, it is questionable whether such mechanisms would violate the cartel ban under European competition law. A final legal assessment would depend on the actual form which joint gas purchasing takes, so in that regard we will have to wait for the results of the assessment, announced by the European Commission in February 2015, on "options for voluntary demand aggregation mechanisms for collective purchasing of gas".[35] Nevertheless, the main framework conditions for such mechanisms are already indicated by European competition law with which these options – as the European Commission correctly emphasises – must be fully consistent.[36] The following key points are relevant in this regard:

Article 101 (1) TFEU prohibits, in principle, agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market. Agreements or decisions of this type are void under Article 101 (2) TFEU. Exceptions to this basic cartel ban are only permitted pursuant to Article 101 (3) TFEU under strict conditions.

According to the European Commission Guidelines on the applicability of Article 101 TFEU to horizontal cooperation agreements (hereinafter: "Commission Guidelines")[37], the scope of the cartel ban under Art. 101 (1) TFEU also covers agreements on the joint purchasing of products ("joint purchasing arrangements")[38] which would in principle include joint gas purchasing. The aim of joint purchasing arrangements to create buying power may be questionable from a competition

[35] European Commission, Communication COM(2015) 80 of 25 February 2015, A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy, p. 6.
[36] Ibid.
[37] European Commission, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements, in: Official Journal of the European Union C 11 of 14 January 2011, p. 1 et seq.
[38] Ibid., para. 194.

law perspective.[39] Thus joint purchasing arrangements may have an anticompetitive effect, firstly on the purchasing markets (in this case the gas supply countries outside the EU) and, secondly, on the downstream sales markets (in this case the gas markets in the EU):

- In general, the buying power of participants in a joint purchasing arrangement in the form of VJGP could be used to push competing purchasers out of the purchasing market.[40] Consequently it would be potentially anti-competitive if, as a result of the buying power arising from joint gas purchasing, gas purchasers from the EU who are not participating, were prevented from having access to Russian gas.

- Insofar as participants in a joint purchasing arrangement generally compete with one another on the downstream markets, as is the aim on the EU internal energy market , the incentive for them to compete on price may be significantly reduced.[41] Where jointly they have a significant degree of market power, the Commission Guidelines generally consider it to be unlikely that the lower purchase prices attained by way of the joint purchasing arrangement will be passed on to the consumer.

Such restrictions of competition within the meaning of Art. 101 (1) TFEU may be justified, however, in the exceptional case under Art. 101 (3) TFEU, if the consumer receives a "fair" share of the gains thereby obtained. For this, according to the Commission Guidelines, the gains attained must be passed on to the consumer to the extent that this offsets the anticompetitive impact of the joint purchasing arrangement. Consequently, the participants in a joint purchasing arrangement would have to pass on lower purchase prices obtained as a result of the increased buying power in the form of correspondingly lower sales prices to the consumer.[42] Under Art. 101 (3) (b) TFEU, the exception does not apply, however, if the joint purchasing arrangement would allow the participants to eliminate competition, both on the purchase markets and on the sales markets, in relation to a substantial part of the products.[43]

[39] Ibid., para. 200 et seq.
[40] Ibid., para. 203.
[41] Ibid., para. 201.
[42] Ibid., para. 219.
[43] Ibid., para. 220.

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