IN THE

EUROPEAN COMMISSION
DIRECTORATE GENERAL
FOR
COMPETITION

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BULGARIAN ENERGY EXPERTS' JOINT COMMENTS ON PROPOSED SETTLEMENT WITH PJSC GAZPROM AND GAZPROM EXPORT LLC IN CASE № AT 39816

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1. Pursuant to the European Commission's ("Commission") invitation of March 13, 2017 for comments on Proposal for Commitments under Article 9 of Regulation (EC) No 1/2003 ("Regulation 1/2003"), submitted by PJSC Gazprom and Gazprom Export LLC (collectively referred to as "Gazprom") in case № AT 39816, the energy experts of the Fair Pricing of Fuels Initiative C.A. ("FPFI"), Mr. Ilian Vassilev, Mr. Traicho Traikov, Mr. Vassil Chakarov, and Mr. Vassil Nachev, joined by three prominent Bulgarian independent experts, Mr. Krassen Stanchev, Mr. Julian Popov, and Mr. Martin Vladimirov ("Independent Experts"), respectfully submit these joint comments.

2. The commissioner in charge of competition policy, Ms. Margrethe Vestager, stated: "We believe that Gazprom's commitments will enable the free flow of gas in Central and Eastern Europe at competitive prices. They address our competition concerns and provide a forward looking solution in line with EU rules. In fact, they help to better integrate gas markets in the region." In the Commission's view the proposed commitments "will enable cross-border gas flows at competitive prices."[1] Specifically, to achieve these goals with regard to Bulgaria, the Commission proposes to accept Gazprom's proposals to:

- Grant rights to request price review if gas prices diverge from Western European price benchmarks, including prices at competitive gas hubs.
- Remove market segmentation clauses in gas supply contracts with Bulgarian customers to enable the export and import of gas to/from other EU gas markets. Gazprom's commitments would require the company to render destination clauses, as well as any other clauses that effectively restrict resale of gas, null and void.
- Amend relevant contractual provisions to facilitate cross-border flows of gas into Bulgaria by accepting requests for change of contractual delivery points, thereby enabling virtual swaps of gas from Hungary and Slovakia into Bulgaria.

[1] *See* http://europa.eu/rapid/press-release_IP-17-555_en.htm (last visited on 24.04.2017).

- Amend its contracts with Bulgargaz and Bulgartransgaz to remove any clauses that present obstacles for Bulgaria in concluding interconnection agreements with Romania and Greece.
- Waive its alleged claims arising out of the terminated "South Stream" project.

A. About The Fair Pricing Of Fuels Initiative and the Independent Experts

3. FPFI is an unincorporated Bulgarian association headed by pragmatic, free market oriented Bulgarian energy and government experts. FPFI was conceived to fight the excessive prices of fuels paid by Bulgarian consumers across the board. FPFI's contributing members to these joint comments are Mr. Ilian Vassilev, Managing Partner, Innovative Energy Solutions LLC, a prolific political risk analyst and commentator, and Ambassador of Bulgaria to Russia between 2000 and 2006, Mr. Vassil Chakarov, Managing Director, Universal Assets Management LLC, finance professional and emerging markets expert, Mr. Traicho Traikov, an energy expert with direct price negotiations experience with Gazprom, Minister of the Economy, Energy, and Tourism between 2009 and 2012, and Mr. Vassil Nachev, energy expert and drilling engineer. For these comments FPFI's experts are joined by independent experts Mr. Krassen Stanchev, Associate Professor in Economics at the "st. Clement Ohridsksy" University of Sofia, Mr. Julian Popov, EU energy policy expert, and Mr. Martin Vladimirov, Senior Analyst at the Center for the Study of the Democracy ("Independent Experts").

B. Gazprom's History of Colluding with the Bulgarian Government, The Reduction of Bulgargaz and Bulgartransgaz to Silent Extensions of Gazprom's de Facto Monopoly in Bulgaria, and The Lack of Government Interest to Achieve Real Market Liberalization

4. Gazprom has been the only supplier of natural gas for Bulgaria since 1976. The only local gas field, in Chiren, has been depleted and has been converted into a storage

depot. Until 1997 Gazprom supplied gas at a relatively low fixed price, as an in-kind payment for construction works performed in the Soviet Union days. 10 years prior to its term Gazprom forced the termination of this agreement. After 1997, Gazprom has been charging excessive prices, based on an arcane formula, thrust upon Bulgaria on the strength of Gazrpom's position as the only available supplier. At the time of the submission of these comments Bulgaria remains disconnected from the European spot market, and fully dependent on Russian pipeline gas. The emergence of a liquid internal gas market, along with a reliable price discovery mechanism is currently precluded.

5. Beyond the panoply of anticompetitive practices identified in the Statement of Objections ("SOB"), in order to fend off any form of competition and to preserve its monopoly position, Gazprom has consistently engaged in collusion with members of the Bulgarian executive and legislative branches.[2] This is important for two reasons: (1) the Commission must apply particularly searching scrutiny of the positions of the Bulgarian government, Bulgargaz EAD, and Bulgartransgaz EAD (wholly owned subsidiaries of the state-owned Bulgarian Energy Holding and exclusive partners of Gazprom in Bulgaria) that shall be submitted in these proceedings, and whether they seek to maximize Bulgaria's and the Bulgarian consumers' position, and (2) critically assess, against that backdrop, whether the substance and mechanics of the proposed commitments from Gazprom can realistically be expected to work effectively.

[2] *See*, *e.g.*, https://www.nytimes.com/2014/12/31/world/europe/how-putin-forged-a-pipeline-deal-that-derailed-.html?_r=2 (last visited on 24.04.2017); *see also* https://vz.ru/politics/2016/9/23/834372.html. The two most pressing examples are the amendment of the gas supply contract in 2005 on vastly unfavorable terms to Bulgaria and the government's full cooperation in the construction of South Stream Pipeline, including the obsequious amendment of Bulgaria's laws to circumvent European regulations in favor of Gazprom.

6. Bulgaria's current political establishment shows patent ineptitude with the realities on the Bulgarian gas market, and no apparent interest to pursue actual market liberalization. On April 24, 2017, Mr. Delyan Dobrev (designee in charge of the matter by GERB, the party which shall be leading the incoming coalition government), concurring with Mr. Nikolay Pavlov (Minister of Energy in the Caretaker Government), stated as a matter of official position:

> The caretaker government is moving in the right direction…. May 4 is not the deadline because the companies from the BEH group [Bulgargaz and Bulgartransgaz] have submitted follow up questions [with the Commission]…. [T]hese are not negotiations with Gazprom over prices. We are now discussing the clauses in the contracts, not new prices…. Bulgargaz is not monopolizing the market. After the second half of 2016 there are hundreds of transactions, carried out by different companies, which, although for minimal volumes, show that natural gas has been imported…. [A]s soon as the prices of gas on foreign markets become more lucrative than Bulgargaz', the state-owned company will not be able to compete with the traders. The natural gas market in Bulgaria is liberalized.[3]

7. Mr. Dobrev supported his statements with the test swap transactions that were made possible for a limited period of four months, when Gazprom waived enforcement of its monitoring, balancing, and quality control rights against the TSOs of Bulgaria, Romania and Greece. Beyond verifying the strictly technical ability to perform swaps, each of these transactions, as Mr. Dobrev admitted, was for marginal volumes and had no actual, objectively perceptible, pro-competitive effect. At the time Mr. Dobrev stated

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[3] *See*, *e.g.*, http://www.publics.bg/bg/news/15976/%D0%9D%D0%B8%D0%BA%D0%BE%D0%BB%D0%B0%D0%B9_%D0%9F%D0%B0%D0%B2%D0%BB%D0%BE%D0%B2_%D1%89%D0%B5_%D0%B8%D0%BD%D0%B8%D1%86%D0%B8%D0%B8%D1%80%D0%B0_%D0%B8%D0%B7%D1%81%D0%BB%D1%83%D1%88%D0%B2%D0%B0%D0%BD%D0%B5_%D0%B2_%D0%9D%D0%A1_%D0%B7%D0%B0_%D0%B1%D1%8A%D0%BB%D0%B3%D0%B0%D1%80%D1%81%D0%BA%D0%B0%D1%82%D0%B0_%D0%BF%D0%BE%D0%B7%D0%B8%D1%86%D0%B8%D1%8F_%D0%B7%D0%B0_%E2%80%9E%D0%93%D0%B0%D0%B7%D0%BF%D1%80%D0%BE%D0%BC%E2%80%9D_(%D0%94%D0%9E%D0%9F%D0%AA%D0%9B%D0%9D%D0%95%D0%9D%D0%90).html (last visited on 01.05.2017).

the government's position, Gazprom was no longer applying the exemptions. Currently, every swap requires active communication and *de facto* unilateral release by Gazprom to be finalized. The clauses Gazprom's exempted from enforcement for four months are contained in the transit agreements with the TSO and constitute Gazprom's main levers to exert unilateral control over any swap transaction planned on the territories of Bulgaria, Romania and Greece. As shall be explained further below, these and other clauses that allow undue interference by Gazprom have not been fully addressed in the proposed commitments, and constitute the true control switch Gazprom is trying to preserve while offering, largely, palliative commitments. Mr. Dobrev's further failed to discuss the existing technical impediments that need to be addressed by the TSOs, such as the lack of pressurizing pump installations at interconnectors with Romania and Greece, before swaps can actually become an effective market liberalization vehicle.

C. IT IS AGAINST BULGARIA'S INTERESTS THAT THE COMMISSION PROCEEDS TO A COMMITMENT DECISION UNDER ARTICLE 9 OF REGULATION 1/2003 IF THE COMMISSION IS PERSUADED THAT AN ARTICLE 7 DECISION, AND A FINE, CAN WITHSTAND JUDICIAL SCRUTINY

8. The proposed Commitment Decision concerns anticompetitive conduct that has been going on for at least the past 10 years. Preliminary analysis shows that the total amount of supra-competitive extractions from the Bulgarian consumer, for the period after 2010, is in the vicinity of EUR 0.4 billion, and for the period between 2005 and 2015, around EUR 1.5 billion. Proceeding to a Commitment Decision under Article 9 of Regulation 1/2003 will achieve forward looking corrective action only (as shall be explained more fully below much more will be needed, in terms of further commitments, to expect effective market liberalization). In light of the fact that it is unlikely for Bulgargaz, Bulgartransgaz or another party in Bulgaria to bring a private action under

Directive 2014/104/EU, a fine in a potential Article 7 decision, would be the only form of vindication, although admittedly vicarious, for the Bulgarian consumer.

9. Unless the Commission is persuaded that a prohibition decision, and a fine under Article 7 of Regulation 1/2003, is not likely to withstand judicial scrutiny, it should not let Gazrpom walk away free of penalty for its past behavior, and the proposed Commitment Decision under Article 9 should be abandoned.

10. In case the Commission decides to move forward with a Commitment Decision under Article 9, it should bear in mind that the proposed commitments are hardly sufficient to achieve the intended liberalization.

D. Comments on Specific Commitments

1. *Pricing*

11. The SOO found that Gazprom had engaged in unfair pricing policy in five EU member states, including Bulgaria. The existing supply contract between Gazprom and Bulgaria uses a formula containing an arbitrary "base rate" and adjustments depending on the spot gas-oil and fuel-oil prices. The formula has never been made public, and is subject to regular renegotiation (the next due in November, 2018) ordinarily out of sync with supply-demand dynamics or the prices of substitutes in the region.

12. The SOO found that the formula generates prices "significantly higher compared to Gazprom's costs or to benchmark prices," referring to border prices and traded hub prices for gas in Western Europe.

13. Gazprom's proposed commitment would address this issue through the introduction of price review clauses. The buyer would be allowed to seek price review every two years, and once every five years as a matter of extraordinary review. The

proposed language provides that any price reviews would reflect changes in economic circumstances and "take into account" price levels on the broader European market, with specific reference to weighted average border prices in Germany, France, and Italy, and prices at "generally accepted liquid hubs in Continental Europe."

14. The primary purpose of this commitment would be to establish a price correction mechanism that uses the cheapest options.

15. The Commission should expect that any component in the formula that is not pegged directly to a liquid market-based benchmark shall be abused by Gazprom to thwart the stated purpose. The proposed price reviews will not only yield similarly excessive prices, as before, but they will also spur non-transparent arbitration proceedings, which will allow Gazprom to reinforce, in the end, the perception of fairness of the prices, as they will parade as formal determinations of independent triers of fact.

16. Until actual, healthy, competition appears on the Bulgarian market, a more workable solution would be to resort to direct *non-discretionary* proxy market pricing. Under this solution the price would be *automatically revised* based on the indexation to the average border price in Germany, Italy and France. Indexation could be triggered when the formula-derived price deviates substantially from the benchmark (for example 5% over 3 months).

17. In addition to removing any non-market components, the formula should be amended to include a proportion of gas and oil spot prices (rather than gas-oil and fuel oil-based), and take into consideration the average spot price for the last six months on the most liquid gas hub in Continental Europe – TTF.

18. Spot-based pricing would provide the following benefits to Bulgaria:

(i) Drastically increase the transparency of the gas pricing in Bulgaria
(ii) Remove the monopoly price discrimination
(iii) Curb the arbitrage opportunities
(iv) Improve the competitive standing of the Bulgarian industrial gas users, as it will put their cost base on similar footing with Central European users
(v) Reduce the basis risk and improve the overall economic efficiency because key parameters in the oil-based formula are not substitutes for natural gas
(vi) Dismantle Gazprom's and the Russian government's key price-control lever
(vii) Preclude non-transparent price review proceedings.

19. The transition to spot-based pricing must be achieved within a compressed timeframe, until 2018-2020, at the latest. To the extent that transitional periods must necessarily remain subject to the operability of the oil-based formula, the Commission should insist that Gazprom, to modify the formula in the interim to rely on a liquid crude oil benchmark, rather than gas-oil and fuel-oil based.

2. *Territorial and Resale Restrictions*

20. The Commission found that Gazprom had imposed territorial restrictions (often referred to as "destination clauses"). Gazprom's commitments would require the company to render such clauses null and void. This includes destination clauses, as well as any other clauses that effectively restrict the resale of gas. Though this is a step in the right direction, this portion of the commitments will be only nominally effective until Gazprom's *de facto* unilateral control rights over imports and exports and connections between national and transit gas systems are not removed. This *de facto* control is exerted through the metering, quality certification, and balancing clauses, in the transit agreements with the TSOs. While such clauses are operable Gazprom can unilaterally

block reverse-flow and swap agreements between the TSOs of Romania, Bulgaria and Greece, claiming that the transactions violate the transit agreements with Gazrpom.

21. Furthermore, Gazprom's ability to arbitrarily deny certification under any of the clauses operates as a significant deterrent to the commitment of financing (or other long-term planning) by stakeholders interested in developing the gas infrastructure. This way, though Gazprom further undertakes to amend its contracts with Bulgargaz and Bulgartransgaz to remove any clauses that present obstacles to the conclusion of interconnection agreements with Romania and Greece, its ability to meddle operates as a major disincentive to investments from independent third parties for the finalization of the interconnector between Greece and Bulgaria, which is critical to allow Azerbaijani gas to flow to Bulgaria and the CEE (planned for approximately 2020 based on the gas sales agreement reached in 2013 between Azerbaijan and Bulgargaz for 1 Bcm/y of gas from the Shah Deniz Phase 2 project). Without this infrastructure in place the reverse-flow capacity, as it currently stands, is insufficient for an effective impact on the regional market – 1,5 billion from Bulgaria to Greece and only 0.5 billion in reverse.[4]

22. Furthermore, Gazprom makes a number of caveats in the commitments, which confer effective powers to influence the terms of the interconnection agreements. Gazprom reserves a right to be consulted on the terms of any interconnection agreements to ensure compliance with the legacy transit contracts with Bulgaria, Romania and Greece. This right is further enhanced with referral rights for review by the Commission of Gazprom's commitments in case the interconnection agreements would—in

[4] In 2016 Bulgartransgas signed an interconnection agreement with its Greek and Romanian counterparts, DESFA and Transgaz, to launch reverse-flow gas swap deliveries in test mode. The full implementation of direct and reverse-flows on the existing pipeline system would represent a significant step toward more fully integrating Bulgaria into a single EU gas market, in particular by allowing LNG imported via the Greek regasification terminal at Revithoussa to flow to Bulgaria, and be used in swaps.

Gazprom's view—jeopardize the commercial basis of Gazprom's legacy contracts. The two proposed rights are in effect a blank check to meddle in the negotiations between the TSOs and to control the content of the agreements. The Commission cannot accept these conditions, or should, at the very least, ask Gazprom to provide an adequate counterbalancing mechanism that would defend the interests of the TSOs and their ability to freely negotiate terms working toward the liberalisation of cross-border trading.

23. An additional proposed commitment in this section will have Gazprom accept requests to change contractual delivery points, to enable virtual swaps of gas from Hungary and Slovakia to Bulgaria. However, the terms and service fees for the swaps come with undue limitations as to geography and as to volume. As they are proposed those would most likely contribute to higher costs of the gas supplies to the already existing deliveries. First, swaps would be allowed only for four specific changes in destination points:

- From Poland to Lithuania
- From Slovakia to Lithuania
- From Hungary to Bulgaria
- From Slovakia to Bulgaria

24. It is not immediately clear why supplies cannot be shifted from Poland to Bulgaria or from Hungary to Lithuania, or why other EU off-takers of Russian gas would not have the same mandated rights to shift their delivery point to enter the Bulgarian or Baltic gas markets. Second, a further restriction goes to the specific terms of the requested changes in delivery points, which must be for volumes of no less than 100 MMcm within a one-

year period, and for no less than 12 months, which rules out any short-term swaps, based on dynamics related to seasonal pricing, and the time-lag in Gazprom's oil-linked contracts. The 12-month term requirement, in particular, will limit the potential uptake of swap rights by Gazprom's counterparties. Third, only Gazprom's counterparties—which are likely single entities in each of Poland, Hungary, and Slovakia—will be able to request changes in the delivery points. This means that the active pursuit of swaps to enter the Baltic or Bulgarian markets will be left in the discretion of companies with no track record as dynamic gas traders outside their national markets. A more effective solution would be to have any gas trader be able to approach Gazprom's counterparties in Poland, Hungary, and Slovakia to propose swaps based on a changed delivery point.

25. Fourth, Gazprom introduced multiple disclaimers to providing consent to the swap agreements based on informational asymmetry, an arrangement that has proven time and again susceptible to abuse. The ability of Gazprom to effectively veto a proposed swap agreement should therefore be subject to concrete requirements minimizing the possibility for arbitrary refusals. As one example, Gazprom reserves the right to refuse a swap for "lack of resources to ensure delivery of gas to the New Delivery Point," claiming that it might not be able to book or use the necessary firm transmission capacity. This is unconvincing. Gazprom, being a monopoly supplier for most of the countries in the region, is already using a large share of the firm transmission capacity in Central and Eastern Europe. With the plummeting of domestic gas demand in all of the CEE clients of Gazprom, a larger share of the existing transmission capacity is available for booking.

26. The Commission should carefully assess the service fees that Gazprom can charge for requested changes in the delivery point. The proposed commitments state that these service fees will be "based on the actual costs for Gazprom" to change the delivery point, relative to "transmission, balancing etc." subject to specifically defined caps. In practice, it is likely that the fees will always reach the caps because Gazprom will not reduce fees based on voluntarily disclosure of lower costs.

- To change the delivery point from the Polish-Belarusian border to the Lithuanian-Belarusian border: €8/Mcm
- To change the delivery point from the Hungarian-Ukrainian border to the Bulgarian-Romanian border: €16/Mcm
- To change the delivery point from the Slovakian-Ukrainian border to the Lithuanian-Belarusian border: €22.30/Mcm
- To change the delivery point from the Slovakian-Ukrainian border to the Bulgarian-Romanian border: €24.40/Mcm

27. Gazprom must provide a verifiable schedule of its current costs. It should be noted that service fees to shift the delivery point to the Romanian-Bulgarian border would justifiably include transit fees charged in Romania by Transgaz. In any event, it is likely that the fees will be high enough to create a nontrivial disincentive toward swaps. Swaps targeting Bulgaria will be commercially attractive only if Gazprom contract prices with Bulgargaz are at least $0.50–1.00/MMBtu higher than Gazprom contract prices in Slovakia and Hungary. This used to be the case in 2012-2015, but now the price is basically the same.

28. The existing supply agreements set a fixed point of delivery on the border between Romania and Bulgaria lumping together the price of gas and the transportation cost. It is significantly more efficient to distinguish the transportation costs, charged by third parties, from the price of gas. The Commission should require Gazprom to refrain from specifying a point of delivery outside of the territory of Russia. Bulgaria, as well as other

EU buyers, should be able to opt for delivery at any export point on the Russian border, *e.g.* on the Russian-Ukrainian border. The EU buyers would then be able to negotiate a joint transportation deal with the transit countries, such as Ukraine, Turkey and others. This would allow the EU to negotiate a transportation deal with Ukraine, removing another pressure point that Gazprom had been using in the past, and make the gas purchase terms vis–a–vis Gazprom uniform.

3. *Commitments Regarding Gas Transportation Infrastructure and Take-Or-Pay Clauses*

29. The Commission found in the SOO that Gazprom had made wholesale gas supplies conditional on the participation of Bulgargaz in the South Stream pipeline project (now supposedly terminated). Gazprom's relevant commitment states that it will not seek to enforce any damage claims against Bulgargaz in relation to this termination.

30. Russia and Gazprom are yet to publicly articulate on what legal basis they proceeded to the unilateral termination of the South Stream project. The questionable strength of the claims being waived notwithstanding, this waiver should have no bearing on Bulgaria's rights to pursue its own claims against Russia and Gazprom, arising out of the termination. The Commission should request that express language is included in the settlement agreement stipulating to the fact that the waiver is made without prejudice to Bulgaria's claims, counterclaims, rights or recourses against Russia and Gazprom.

31. Furthermore, the terms of gas supply to Bulgaria have been consistently used by Russia as leverage in the negotiation of Intergovernmental Agreements ("IGA"), like the one signed for South Stream.[5] To the extent that the Commission has now introduced a

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[5] The oil pipeline between Burgas (Bulgaria) and Alexandroupolis (Greece), Nuclear Power Plant "Belene," and the South Stream gas pipeline.

mandatory *ex-ante* compatibility check of Intergovernmental Agreements related to gas and oil, for the purposes of the Commitment Decision, the Commission should insist that contracts and IGA's already in place and operable, should specifically exclude any tying of gas pricing, reliability, quantity or quality of supply, with anything other than the buyer paying for the gas supplied. Gazprom should agree that all contracts or IGAs, still operable, to which it is a party, shall be revised to that effect.

32. Separately, Gazprom's proposed commitments do not address the existing take-or-pay clauses that are still operable in the contracts with Bulgargaz and Bulgartransgaz. The minimum volumes according to these clauses far exceed the current consumption in Bulgaria, which provides Gazprom with a claim, that the company unduly uses as leverage to suppress unwanted actions by Bulgargaz. Furthermore, Gazprom had long amortized its infrastructure—the reason why take-or-pay clauses are ordinarily included in long term supply agreements—and the clauses have become redundant. The Commission should expressly require Gazprom to declare take-or-pay provisions null and void and expressly waive any liabilities that may have been incurred during the operation of these clauses.

33. Lastly, Gazprom should expressly commit to follow EU regulations requiring no more than 50% of the network capacity to be reserved for one supplier. Any reserved, but unused capacity must be released for use by other suppliers. This would prevent the opportunity for any market participant to effectively block access to the infrastructure for competing supplies. This would be consistent with the principles applied to the OPAL gas pipeline in Germany. We propose a transition period of 2 to 3 years, during which Gazprom must ensure compliance. In Bulgaria Gazprom should allow Bulgargaz and

Bulgartransgaz to auction supply and transit contracts starting from 30 % minimum - for the quantities above ToP for the year 4 Q up to 50% in 2020 for the supply and transit contracts. Similar to OPAL, if no competitor interest exists for the released market share or capacity Gazprom should be able to supply and claim the available portions.

E. CONCLUSION

34. In response to the invitation, FPFI and the Independent Experts respectfully requests the Commission to consider the comments contained herein.

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Respectfully submitted,

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