The territorial restrictions case in the gas sector: a state of play

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1. Introduction

On 6 October 2003, the Commission services announced the closure of their investigation into the supply relationship between Russian gas producer Gazprom and Italian wholesaler ENI (1). Just as other cases recently settled (2), this case shows how the Commission's Competition Directorate General (‘DG COMP’) applies antitrust rules in the European gas sector. In this regard, it is impossible to overemphasise the complementary roles of the Gas Directive (3) which addresses, amongst other issues, state barriers to integrated energy markets, and of regulatory and antitrust enforcement which address behaviour by commercial companies having restrictive or abusive effects (4). This is because the regulatory and the competition approaches — implemented both at national and Community level — have the same objectives and reinforce each other. This article provides an overview of the achievements since DG COMP started its investigation into territorial restrictions in 2000. The investigated territorial restrictions prevent wholesalers from reselling the gas outside the countries where they are traditionally established, which is incompatible with European competition law and undermines the ongoing creation of a European gas market. Indeed, clauses of this sort keep national markets artificially separated and force the various importers to ‘stay at home,’ thereby denying them new sales opportunities liberalisation creates and disallowing consumers in other Member States the possibility to benefit from alternative suppliers.

Historically, the investigated clauses find their origin in the fact that European energy markets were divided up into horizontal — and vertical — segments, which hindered competition and integration. In the gas sector, producers did not sell gas directly to final customers (disregarding certain exceptions), while the wholesaling importers limited their sales activities to specific geographical areas (5), namely those in which they owned and operated pipelines. The investigations addressed here are intended to transform that traditional structure into a competitive one. The current investigations concern, at this stage, the Russian company Gazprom, Sonatrach of Algeria, NLNG of Nigeria and many of their European customers.

The territorial restriction cases should be seen in the context of a three-pronged approach of the Commission intended to achieve a structure favourable to competition in the electricity and gas markets, first by increasing supply competition, second by ensuring effective access to energy networks (which remain natural monopolies even after liberalisation), and third by guaranteeing free consumer choice by challenging consumer lock-in (6). The current territorial restrictions cases essentially focus on the creation of upstream gas-to-gas supply competition, but also address, where appropriate, related restrictions concerning the two other fields of action. Although they are sometimes entered into by competitors or potential competitors, the Commission has, in practice, dealt with all of these cases as vertical agreements (7). In this perspective, the pending territorial restric-

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(1) IP/03/1345, ‘Commission reaches breakthrough with Gazprom and ENI on territorial restriction clauses’.
(2) See list provided in MEMO/03/159.
tion cases complement the cases challenging joint commercialization by gas producers (1), together enhancing gas-to-gas competition in the upstream parts of the gas supply chain.

2. The NLNG case

On 12 December 2002, the Commission announced that it had settled its investigation into territorial sales restrictions with Nigerian gas company NLNG (2). NLNG is the second largest supplier of liquefied natural gas (LNG) in Europe with approximately 5 billion cubic meters of gas shipped every year to customers in Italy, Spain, France and Portugal. The investigation showed that only one of the many European contracts entered into by NLNG contained a territorial sales restriction, from which NLNG has agreed to release its customer.

In the discussions and subsequent settlement with the Commission, NLNG also undertook not to include a number of clauses, identified by the Commission as being restrictive, in its future gas supply agreements.

Most prominent amongst those are obviously the territorial restriction clauses.

Furthermore, NLNG confirmed that none of its existing gas supply contracts contain so-called profit splitting mechanisms affecting the EU markets and that it would not introduce such mechanisms in future contracts. Profit splitting mechanisms are clauses obliging the buyer to pass over to the producer a share of the profits made when re-selling the gas outside the territory agreed upon (normally a Member State) or when the gas is re-sold to a customer using the gas for a different purpose than that agreed upon. They hence have a similar object and/or effect as territorial sales restrictions (3) and are equally void in accordance with Article 81(2) of the EC Treaty.

NLNG finally undertook not to introduce use restrictions into its future gas supply contracts. Use restrictions are clauses preventing the buyer from using the gas for other purposes than those agreed upon. It is noteworthy that in the recent DUC/DONG case (4), a similar form of a use restriction was identified in the gas supply agreements between the DUC gas producers and Danish gas wholesaler DONG. The contracts provided that DONG had to report to the DUC partners the volumes sold to certain customer groups in order to benefit from special price formulas for these customers. From the point of view of the Commission services, these reporting obligations effectively amounted to a ‘use restriction’, as DONG is not free to sell the gas to whichever customer without losing the benefit of the specific price formula. Such use restrictions are hardcore restrictions to the extent they lead to market partitioning, which is incompatible with EC competition law and the creation of a common gas market.

In view of the above commitments, the Commission's investigation into NLNG’s European gas supply contracts was closed. The commitments confirm that non-EU producers can successfully market their gas in the Union without making use of these clauses. In other words, these producers can achieve sufficient revenues from the sale of gas in the EU when respecting competition rules. Indeed, in July 2002, Norwegian companies Statoil and Norsk Hydro had already accepted this when they undertook vis-à-vis the Commission not to introduce territorial restrictions and use restrictions in their gas supply contracts with European importers (5).

3. The Gazprom cases

On 6 October 2003, Commissioner Monti announced that DG COMP had reached a settlement with ENI and Gazprom regarding a number of restrictive clauses in their existing gas supply contracts. This achievement is particularly significant not the least because of the huge volumes of gas involved, as ENI is one of the biggest European customers of Gazprom with approximately 20 billion cubic meters of gas bought every year. ENI is the first of the European importers concerned to have reached an agreement with Gazprom, Europe's largest external gas supplier, as regards the deletion of territorial restriction clauses in existing gas supply contracts.

When announcing the settlement of this case, Commissioner Monti pointed to a number of its particularities: ‘this settlement was made possible

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(2) IP/02/1869 of 12 December 2002, ‘Commission settles investigation into territorial sales restrictions with Nigerian gas company NLNG’.
(3) See vertical guidelines, recital 49.
(4) See above footnote n° 1.
(5) See IP/02/1084.
because the Commission did not initiate formal procedures, as would have been the normal course of action, but allowed the companies concerned to find a commercial solution for the competition problem we identified. This goes to show that during the initial delicate transition phase from monopolised to liberalised energy markets, the focus should lie, in some occasions, on Commission’s interventions improving effectively the market structure, rather than on formal procedures imposing fines’ (1).

Principally, the tripartite settlement consists, first, of a chapter dealing with contractual issues (Gazprom and ENI have deleted a number of restrictive clauses in their contracts) and, secondly, of accompanying measures which ENI has offered to the Commission. The latter should, on the one hand, enhance liquidity in the relevant parts of the European gas market and, on the other, facilitate gas transport to Italy for all interested shippers. They also aim at ensuring that the improvements to the contracts have a real effect on the market.

The contractual chapter of the settlement essentially contains the following elements:

1) The parties have deleted the territorial sales restrictions imposed on ENI from all of their existing gas supply contracts. The amended contracts now provide for two delivery points for Russian gas, as opposed to one only in the past. Most prominently, ENI is free to take the gas to the destinations of its choice from these two delivery points.

2) The parties also committed to refrain from introducing the contested clauses in new gas supply agreements. Gazprom had already made this intention public in 2002. ENI committed — along the same lines as NLNG — not to accept such clauses or any provision with similar effects (e.g. use restrictions and profit splitting mechanisms) in all its future purchase agreements with any gas producer, be they for pipeline gas or gas in liquefied form (LNG).

3) The parties deleted a provision in the existing contracts that obliged Gazprom to obtain ENI’s consent when selling gas to other customers in Italy (consent clause). The companies had already implemented in practice the amendment now formalised, allowing Gazprom to start selling to ENI’s competitors in Italy.

The main features of the accompanying measures are the following:

1) ENI made a commitment to the Commission to offer significant gas volumes to customers located outside Italy over a period of five years. The primary beneficiaries are likely to be customers in Austria and Germany. It is noteworthy in this regard that ENI already has interests in the latter country, where it recently acquired together with Energie Baden Württemberg (EnBW), a controlling stake in regional gas wholesaler GVS, which is mainly active in Southern Germany (2). If ENI has not sold sufficient volumes during the first half of the commitment period, which started on 1 October 2003, it will however have to organise an auction offering certain gas volumes at Baumgarten, the border point between Austria and Slovakia, where Russian gas is delivered to a number of EC customers.

2) ENI also undertook to promote an increase of the capacity in its majority-controlled Trans Austria Gasleitung (TAG) pipeline, which runs through Austria from Baumgarten to the Italian border and is used to transport gas from Russia and elsewhere to the Italian market (3). The expansion has to be completed between 2008 and 2011 depending on certain developments in the Italian market.

3) ENI finally offered to promote an improved third party access regime (TPA regime) facilitating the use of the TAG as a transit pipeline. This commitment includes amongst others the introduction of one-month transport contracts, an effective congestion management system, the introduction of a secondary market and the regular publication on the Internet of the available capacity. The new TPA regime will be inspired by the Guidelines for Good Practice developed by the European Commission, European Regulators and European gas industry in the context of the so-called ‘Madrid Forum’ (4). The main beneficiaries of this commitment will be customers in Italy, who are interested in buying Russian gas for entering into competition with ENI or for their own needs.

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(1) SPEECH/03/447, mentioned above.
(2) See decision of the Commission of 17 December 2002 ENBW/ENI/GVS (M. 2822) and press release IP/02/1905.
(3) See also in this regard, the decision of the Italian competition authority in the Blugas case, available at www.agcm.it.
In view of these benefits for gas consumers, the Commission's investigation into territorial sales restrictions contained in the gas supply contracts between Gazprom and ENI has been closed. At the same time, DG COMP decided to close its probe into the gas supply relationship between Gazprom and Gasunie of the Netherlands after verifying that their contracts do not contain territorial sales restrictions and after Gasunie explicitly confirmed it was free to sell the gas delivered by Gazprom wherever it wishes. In this respect it is important to note that the gas is delivered to Gasunie at the German / Dutch border.

DG COMP continues, however, its investigation regarding other contracts involving Gazprom and the importers concerned, most prominently contracts with two companies in Germany and Austria.

DG COMP in this context clarified that it does not oppose long term upstream gas supply contracts which have no restrictive objects or effects (1). In this regard Commissioner Monti emphasised, more particularly, that the Gazprom-ENI case ‘had no impact on the producers' ability to sell their gas in the Union under long term contracts. To the contrary the settlement strengthens the legal certainty of these contracts’.

4. The Sonatrach cases

As mentioned before, the Commission is also looking into the gas supply contracts concluded by the Algerian gas company Sonatrach and its main European customers. The Algerian Energy Ministry and Sonatrach informed the Commission services in 2003 that Sonatrach will no longer introduce any provisions limiting cross border sales into its future gas supply contracts with European importers. DG COMP welcomed this constructive step because it opened up the possibility to deal also with the existing supply contracts containing restrictions by way of settlement.

Accordingly, Sonatrach undertook to discuss the modification of the existing contracts with its European customers concerned. DG COMP has called on all parties to intensify negotiations in good faith and to establish an ambitious timetable in order to reach an agreement soon. These negotiations are still ongoing.

5. Conclusion and state of play

The settlements reached in the NLNG and Gazprom-ENI cases contain important guidance as regards the application of EC competition law to upstream gas contracts. Together with the cases relating to the joint marketing by gas producers, these cases outline a number of important limitations applying to gas supply agreements.

Several chapters of the cases have not been finalised yet. Although the settlement achieved with Gazprom and ENI constitutes an important breakthrough, Gazprom still has to bring a number of contracts with other European importers in line with EU law. Sonatrach and the Commission have also managed to bring their respective positions closer to each other. Sonatrach should however, together with its Community counterparts, bring its existing contracts in line with EC antitrust law. Whatever the timing and the outcome of the still pending cases, the different settlements already achieved mark important milestones towards the enforcement of competition rules in the sector and the creation of a European gas market.

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(1) See also recital 25 of Gas Directive 2003/55/EC.