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The EU Regulatory State, Commission Leadership and External Energy Governance

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Introduction

In the 1990s the European Union extended its regulatory state model (Majone 1994; Lodge 2002; Moran 2002; Lodge 2008; Levi-Faur 2011) to the utilities sectors, and began to liberalize its gas market. As this process got underway, the EU began to pursue a parallel process: extending the reach of the single market beyond its borders. In fact, the EU sought to guarantee security of energy supplies primarily by extending its regulatory governance beyond its jurisdiction. These efforts included enlarging the EU (thereby expanding the direct reach of its regulatory apparatus), establishing the European Economic Area (EEA) (making key energy-supplier Norway comply with EU rules), and setting up policy agreements such as the Energy Charter Treaty with former Communist states – notably Russia (which currently supplies the EU with 30 per cent of its gas and 35 per cent of its oil) (Eurostat 2012).

However, after 2000, a series of geopolitical events began to generate severe challenges for the EU's liberal trade policy model in the gas sector. These include the rise of oil and gas prices, Russia's increasing assertiveness under Putin, and a broader set of changes in international energy markets related to the rise of new consumers with a more mercantilist outlook, such as China (Goldthau 2012). These problems were not unique to the energy sector (Langehove 2010; Telò 2011; Dieter and Higgott 2012), but they did involve energy-specific challenges linked to the secure supply of fossil fuels. Against this backdrop came calls for a more muscular and more realist external policy on the part of the EU in order to improve security of supply (Correlje and van der Linde 2006; Youngs 2009; Smith 2010). The present chapter explores the EU's

reaction to such challenges, investigating its role as a foreign policy actor in the gas sector.

The answer to this question very much lies in the EU's very nature as a regulatory state and the policy tools available to the Commission, the key executive body of the EU. As per its 'institutional DNA', the Commission draws more heavily on law and regulation than on redistribution of resources and direct intervention in industry (Majone 1994, 1996; Lodge 2008). At the same time, it has adopted a pragmatic approach to governance that leaves its member states with considerable room for manoeuvre (Stone 2011; Sabel and Zeitlin 2012; Andersen and Sitter 2013). But the use of these policy tools also represents a strategic choice when it comes to addressing the challenges related to energy security. Here the EU's approach is very much driven and shaped by the role of the Commission as the guardian and enforcer of the EU regulatory state. Indeed, the Commission emerges as a central actor in the EU's external energy governance, exerting leadership in shaping relations with key suppliers and their companies, and in addressing challenges related to transit countries and infrastructure.

The EU as an external energy actor

Compared to other major players in the international energy market, like the USA, Russia or China, the EU is a weak actor. The EU polity has been described as an intensifying network of relationships among the component member states – a 'network polity' (Kohler-Koch 1999). Since the second half of the 1990s the EU has undergone an extensive 'deepening and widening'. But increased EU integration has been combined with increased heterogeneity among and within the member states, making it necessary for the EU to find ways to accommodate diverse policy preferences. In terms of the autonomy, cohesion and capacity of EU institutions, the picture is therefore mixed. The 'stateness' of the EU relates primarily to its role as a regulator and maker of markets, with the Commission as the guardian and enforcer of the Single European Market (SEM) (Majone 1996, 2005). Outputs and outcomes vary considerably across sectors. In relation to the external regional and global environment, the EU is characterized by diversity of interests, parallel member-state authority and weak institutional capacity for unified action. The exception is trade policy, where considerable authority is vested in the Commission.

Internally, the EU has an energy market policy that makes the Commission a strong actor with strong policy tools at its disposal

(competition law), an actor able to elaborate a clear policy (energy market liberalization, but with a nod to other priorities) and achieve some of the intended effects (market opening). Externally, however, the EU does not constitute a firm system, in the sense of its ability to regulate behaviour – let alone behave like an actor on the international scene, in the sense of defining and pursuing a clear strategy. The Commission is a much weaker actor externally than internally. It does not have a strong mandate, as the EU is heterogeneous; member-state preferences diverge, and there are no clear policy goals or priorities.

Thus, the EU's institutional autonomy, capacity and cohesion – the basis for the Commission's status as an actor – in the energy sector differ radically from the situation of other state-like actors (domestically and internationally) and other international organizations (as international actors). In addition, three other factors that set the EU apart from other states and international organizations merit further attention.

First, the EU's policy tools are quite limited compared to the range of policy tools available to most states. Instruments for affecting the external energy environment reflect the full state policy toolkit – in Christopher Hood's (1983) terms, *nodality* (being at the centre of things, the ability to use information), *authority* (executive and legislative power), *treasure* (expenditure) and *organization* (including ownership). For example, many states regulate investment, prices and/or profits of utilities; they own (directly or indirectly) national oil and gas companies (NOCs), instruct companies to act in particular ways, use their status and expertise to aid even private companies in external negotiations with states or NOCs, and directly or indirectly spend considerable amounts of money on energy infrastructure projects and/or subsidies. Most of these tools are either unavailable to the EU, or available in only a very limited way. It is but a slight oversimplification to assert that the EU has only the tools of regulation – and these have been designed primarily for the single market (Majone 1994).

Second, both the EU and its member states lack the 'hard-power' tools of the USA (or Britain in the past), China or Russia (Hill 1993). In terms of international trade, the US Fifth Fleet keeps the Straits of Hormuz open and the oil flowing. In Russia, state ownership of Gazprom and Rosneft makes the borders between state and company policy unclear, and provides the Kremlin with the opportunity to make these firms part of statecraft. By contrast, the EU tries to secure transit in the regional gas sector primarily by establishing rule-based governance (see contributions in Kuzemko et al. 2012). The EU's aspirations are primarily regional; as for the governance and security of international oil and gas trade, it is

largely a free-rider on the USA. Moreover, instead of fostering 'European champions' in energy, the EU has sought to rely on anti-trust laws to prevent the dominance of individual companies and to promote competition in the energy sector.

Third, the EU does not have the power or policy tools of international organizations like the OPEC oil cartel. The EU's market-liberal approach to regulation means that it neither can nor will act as a consumer cartel. Nor does it have the International Energy Agency's (IEA) authority to coordinate oil stock releases in times of crisis – which is delegated to the IEA by its member states (Kohl 2010). However, the EU does work closely with the IEA, notably on emergency stocks and information: both are public goods, and thus fit the EU's liberal policy paradigm. As regards global trade, the EU has the advantage of operating with basically the same framework as the WTO: rule-based free trade is a central goal for both organizations.

While the globalized nature of the market for oil implies that EU imports are diversified and priced efficiently (based mainly on supply/demand fundamentals), the natural gas market has a strong regional dimension. The main energy security challenge for the EU lies in ensuring reliable supplies of natural gas at affordable prices (European Commission 2010), against the backdrop of heavy reliance on a handful of producer countries: Russia, Norway, Algeria, complemented with liquefied natural gas (LNG) from Qatar and other overseas suppliers (Eurostat 2012). The EU's eastward expansion further strengthened the importance of Russia as a major supplier, as many of the new member states are heavily dependent on Russian gas – notably, Poland (66 per cent), Bulgaria (98 per cent) and the Baltics (100 per cent).

EU member states have traditionally adopted a bilateral approach to the supply security challenge, concluding individual contracts with external suppliers, Russia in particular. As a consequence, and given differing preferences and diverging set-ups in domestic energy sectors, the member states have not agreed on a unified policy for security of gas supplies at the EU level – the much-deplored lack of a 'single voice in energy' (Oettinger 2011). The Commission comes somewhat closer to being a robust actor. However, with no mandate and relatively little power or capacity to address security of supply per se, it must rely on the policy tools at its disposal as the EU agency in charge of market integration. Within the parameters set by the overall EU approach to gas markets, this allows the Commission to develop a reasonably consistent policy towards external gas suppliers. This policy is based on the idea

that security of supply is an EU-level public good: it is necessary in order to make the internal market function properly. The pursuit of this goal should be therefore carried out with policy tools that are compatible with the single market. A potential 500 bcm gas import market coupled with a strong regulatory body translates into a 'market power Europe' (Damro 2012) to be reckoned with – and the Commission emerges as an important player in international gas affairs.

To be sure, the Commission's impact and reach depend on how attractive the single market is – as a market for gas exporters and for third-country firms that want to operate in it and as a regulatory model that the third countries may choose to adopt. Those factors seem to define the Commission's institutional capacity and its sector-related leadership.

The Commission's capacity in external energy governance

Energy policy has always been a question of high relevance to the European Communities, but for a long time it was considered an EU-level policy failure. Energy security and energy policy more broadly have traditionally been left to the member states (also today – note the Lisbon Treaty). The turning point came in the early 1990s, when the Commission proposed that the single market be extended to cover several utilities sectors, including electricity and gas. As a consequence, energy was gradually included in the SEM that was launched on 1 January 1993. This set in motion a familiar mechanism: the Commission gained executive powers, the community method was applied to energy, and this gave rise to the EU as a new potential external actor (Stern 2002; Andersen and Sitter 2009; Kuzemko 2014). By the turn of the millennium, a new pattern of mixed competence was in place: the Commission was responsible for the SEM, the states for energy mix and bilateral contracts.

So while the European Commission's power in the energy sector derives from the Treaties, it is directly related to the primary goal of the creation of the SEM: its mandate is to resolve problems concerning public goods. In the energy sector this involves regulation to overcome market failures stemming from uneven geographical distribution of resources, and the need for regulated and diversified pipeline infrastructure to buffer security-of-supply risks, including price volatility and physical disruption (Goldthau 2011). The Commission seeks to deal with these challenges in its capacity as the enforcer of the regulatory

state – which is limited in scope, but very powerful within the limits set by SEM rules, and particularly by competition law, the European Economic Community's first real supranational policy area.

Our central point here is that these competition policy and internal market rules also have significant effects beyond the borders of the single energy market established as one of the key elements of the SEM. Because of its sheer size, this market casts a long shadow, whether the Commission wants it or not. Producers wishing to sell their goods on the EU market must comply with single market rules such as product standards; they must follow transparency standards, and must not abuse a dominant market position. The moment these rules are applied to the fossil fuel sector, this has implications for external companies supplying the EU market – whether they are private firms like ExxonMobil or state-owned ones like Gazprom. Moreover, the Commission also has a second – though admittedly much weaker – set of tools, related to its efforts to export its own rules-based system for investment, transit and trade in gas to the near abroad. All in all, as a regulatory state actor the Commission has the capacity to exert external influence beyond its immediate jurisdiction through two main channels: making markets abroad and making them work at home (Goldthau and Sitter 2014).

Whereas the legal basis of the Commission's power is relatively clear within the single market, the longer reach of the EU regulatory state is ambiguous and depends on a wider set of factors, circumstances and policy tools. The starting point, however, remains the same: the Commission's external actions in the energy sector are based on the identity of the SEM as a liberalized market (in principle, if not always in fact) and on the Commission's role as the enforcer of the regulatory state. Consequently, all initiatives are justified with reference to improving the functioning of the liberalized SEM, resolving public goods problems, or mitigating the effect of externalities. Most of the policy tools deployed externally are those of the regulatory state – the policy toolkit of a liberal actor in a realist world (Goldthau and Sitter 2014).

With that in mind, we can identify ways in which the Commission can exert leadership in shaping the EU's external energy governance. We can expect that, for the Commission, challenges in upstream and midstream markets – external production and transit – will relate to securing transit, as regards robustness and diversity, and to helping to foster investment in non-EU upstream oil and gas producers. Put simply, for the Commission, the rationale is to enhance competition through additional external gas (and oil) supply and to make the single market work better. As regards the policy tools, they are – unsurprisingly – mostly regulatory in nature. In turn, the regulatory state argument gives rise to three sets of expectations.

In energy transit, the expected focus is on supporting gas pipeline projects, through access regulation but possibly also some financial support in order to account for the public goods nature of infrastructure. This also implies that, outside the realm of physical infrastructure, the Commission will abstain from playing a visible role – already indicated by the fact that it is primarily the USA that polices the world's sea lanes. Regarding transit, the Commission can be expected to promote the establishment of legally binding rules to ensure smooth energy trade between producer, transit and consumer countries.

With regard to oil and gas investment, we would expect the Commission to push for general rules that can level the playing field for foreign and domestic investors in reserves-holding countries in order to ensure sufficient capital flows into upstream projects. Finally, the Commission can be expected to push for the adoption of its own regulatory regime by third countries (or at least support for such measures), in order to create a larger space for rule-based energy regulation. The goal is to enhance available information for all market participants and lower the transaction costs for energy production, transit and trade.

Regarding the downstream market, the Commission can be expected to exert leadership in promoting competitive, open markets and consumer choice, and in making it difficult for companies to misuse their dominant position. The Commission should be interested in using single market regulation to get foreign energy companies operating in the EU to play according to SEM rules, thereby strengthening the functioning of the domestic market. The main tool for achieving this is competition law. In theory all these rules apply to external firms wishing to operate on the EU market. In practice, the question is how the Commission is able and willing to exercise its power, and in particular how it can apply competition law to firms from third countries. The next two sections turn to the empirical investigation of how, and to what extent, the Commission has been able to live up to its regulatory state identity, projecting rules beyond the EU's borders.

Midstream and upstream: extending the SEM rules beyond the EU

In the mid- and upstream sector, the Commission has been instrumental in pursuing two main EU approaches towards external energy governance. First, it has sought to export EU rules, notably through

establishing common frameworks with producer countries (Russia) and transit states (Ukraine, the Balkans). Second, it has complemented these efforts with measures aimed at lending direct support to crucial infrastructure or to negotiations on supply contract arrangements with third-country producers.

Regarding the first approach related to exporting the EU's policy regime, the EEA represents a successful extension of single market rules on energy to Norway (as well as Iceland and Liechtenstein). That said, it can be argued that this success came in spite of the implications for energy policy, rather than because of them. For Iceland and Lichtenstein, the internal energy market – the natural gas market in particular – was of little importance. Norway, on the other hand, is a major exporter of natural gas to the EU, together with Russia and Algeria, currently accounting for around 34 per cent of supplies to the EU (Eurogas 2012). The country had developed its offshore oil and gas sector before the EEA question came on the agenda in the mid-1980s, and had set up a system for export of natural gas where the state played a strong and privileged role. When Norway negotiated EU membership in the early 1990s, energy policy was a key issue for both sides. The ongoing work on the directives on licences for exploration and production and the organization of gas sales were of great importance for Norway. This was not only due to the interest in EU membership, but also because Norway was dependent on the EU market as an outlet for most of its gas export.

The link between the licensing directive and Norwegian membership negotiations led to a delicate situation. The directive could derail the entire membership negotiation with Norway if it was not concluded to both parties' satisfaction well in advance of the national referendum. This opened for flexibility both in relation to procedures and final decisions (but it was also important that few EU countries had much at stake here). As it turned out Norway did not join the EU, but the licence directive was incorporated through the EEA Agreement in any case. Norway was thus forced to make changes that did not apply to the two other major exporters of gas to the EU, Russia and Algeria. While Norway was subject to EU competition law, the two competitors were allowed to preserve their monopolist export organizations in their dealings with EU companies. To be sure, the EEA was not primarily driven by the Commission. Still, the Commission has played an important role in implementing EU rules abroad and in projecting them towards EEA member countries.

Another attempt to export EU rules – eastward this time – clearly failed: the Energy Charter Treaty (ECT) aimed at reforming the energy sector

in the former Soviet Union and at setting binding rules and standards for energy market exchange in Europe and Eurasia. The ECT represents the first comprehensive *agreement* common to the East and West after the end of the Cold War. Moreover, the parties to the Treaty are major energy producers like Russia and Norway, European consumer nations, and transit countries, notably Ukraine. Clearly based on the liberal paradigm, the ECT used General Agreement on Tariffs and Trade (GATT) norms to govern rules for investment, transit and trade in Eurasian energy affairs (Bamberger and Waelde 2007).

The idea behind the ECT was to exploit the natural complementarity between huge energy resources in the East and technology and capital in the West. In Eastern Europe, the former command economies had a bastion in the energy sector. In the West, the energy sector was still an area with considerable government regulation and intervention. What started as a bilateral initiative intended to strengthen regional cooperation gradually developed into a multilateral attempt to institutionalize an international energy market system. The first year of preparations was mainly an EU-internal process, but later some 50 countries became involved. This is a rare example of the EU operating as an international player. The Charter was negotiated in less than six months, in an atmosphere characterized by political optimism and the wish to exploit an historic opportunity. Many participants hoped that the actual treaty text and binding sector protocols could be completed quickly. Yet it took another three years before the ECT was signed – not only because the dramatic events in the former Soviet Union but also because the project's ambitions grew into a plan for an international market regime for energy. Russia signed the treaty but abstained from ratifying it (as did Norway, while the USA and Canada supported the establishment of the Treaty but retained observer status). This was partly because the ECT was negotiated at a moment of relative Russian weakness, and was seen as less and less attractive as Russia recovered and became more self-confident – which led to a return to more 'resource nationalist' policies and growing state domination in its energy sector.

A final example of EU regime export in the energy sector, the Energy Community of 2005, is of considerably less significance in terms of energy security than the ECT aims to be, but more of a success story as regards the EU's efforts to extend its own rules eastwards (Buschle 2011). This arrangement includes the EU, the West Balkans, Moldova and Ukraine, all of which agree to adopt the energy *acquis*. It is an entirely voluntary arrangement, which features no coercive power or enforcement, but clearly comes with the obligation of contracting parties to

liberalize their domestic energy sectors and transpose EU directives and regulations, including the 2009 Third Energy Package. Although part of the attraction for the members of the Energy Community lies in the prospects of full EU membership, as regards the energy sector the 'carrot' is not so much a question of realistic prospects of accession to the EU, as it is a matter of reducing transaction costs and establishing a common set of rules that can make trade with the EU easier. For these states, the EU regulatory system is attractive, both from a normative and practical point of view. The Commission plays a key role in this process, as it implements policies in the context of the Treaty and leads negotiations with accession or observer countries.

A second approach – focusing on pipelines and investment – has been developed partly as an alternative or supplement to the first, given the EU's limited success in exporting its rule-based energy regime. The Commission has explored a range of policy tools to improve energy security that are not simply a matter of extending single market rules beyond its own borders. These policy tools come with a harder edge, inasmuch as they involve finance, guarantees and coordination abroad, and the exercise of regulatory authority – often in the form of permitting exemptions from single market rules – at home.

Supporting pipeline projects is one of the main ways in which the Commission has sought to foster transit security and diversification of supply, in terms of both sources and routes. The policy tools applied here include both expenditure of treasure – in the form of financial support for pipelines – and executive authority – by allowing projects such as Nord Stream and Nabucco to be exempted from SEM rules on competition policy and pipeline access. Such projects have also benefited from direct support from the European Investment Bank. This has a regional – rather than global – impact, and is conceived in terms of improving infrastructure and competition (i.e. public goods) rather than securing access to foreign resources. Both stand in contrast to the global reach of state actors like the USA and China today, which can act globally and focus on securing access to oil and gas, or at least secure transit.

As a major consumer market, the EU exercises the economic power by its mere existence (Damro 2012). Recently, however, the EU has begun to use some of this power more actively to induce and encourage mid- and upstream energy investment with a view to diversification of supply and transit routes. The clearest example is the Caspian Development Corporation initiative, designed to provide Caspian producers (notably Turkmenistan) with 'security of demand' regarding gas sales to the EU (IHS CERA 2010). The focus is on aggregating EU purchases of gas, supporting new pipeline infrastructure (the Southern Corridor) and making long-term commitments to sales to the EU attractive to Caspian states. For the Commission, a central point is that in the overall context of limited competition in terms of external supply and transit routes, this kind of initiative should *increase* competition as far as the EU is concerned, even though it is technically a restrictive agreement. Further, the Commission has become actively engaged in negotiations concerning physical infrastructure. In 2011 the EU member states authorized the Commission to negotiate a treaty involving the EU, Azerbaijan and Turkmenistan to build a Trans-Caspian Pipeline (TCP) system. This obviously complements the Commission's authority and leadership in infrastructure regulation – an important aspect with regard to major pipelines bringing gas into Europe, including Nord Stream (now in operation), the Nabucco-successor Trans-Adriatic Pipeline (TAP) (under construction) and South Stream (now discarded).

Although it remains to be seen to what extent the Commission's complementary second approach will live up to its full promise, several smaller agreements have been signed in this context, including on upstream investment and gas (by a BP-led consortium in December 2013) sales and pipeline development (the Trans-Anatolian Pipeline [TANAP] through Turkey and the above-mentioned TAP to Greece and Italy). Particularly in the context of the Ukraine crisis, pipeline projects in the Southern Corridor have received renewed attention from the Commission (European Commission 2014). In the last few years the Commission has also assumed a more active role in supporting member states in their exercise of national policy tools, for example, in the shape of supporting bilateral gas negotiations (the Commission was present during Polish negotiations with Gazprom in 2010, to ensure that the agreement complied with SEM rules and lent its weight to the Polish side). Finally, several policy proposals emerging in the context of the Ukraine crisis again invoke the idea of a central EU gas purchasing mechanism, possibly coupled with a unified gas import price for the EU (Tusk 2014). In February 2015 the Commission tabled a proposal for an 'Energy Union', aimed at unifying the EU's scattered approach to energy policy and seeking to make it more robust, also vis-à-vis external actors like Russia. This includes the suggestion that member states may pool consumer interests when (re)negotiating gas contracts. To what extent the Commission will be able to implement its proposals pertaining to the Energy Union remains to be seen, as of this writing.

In short, the Commission has been able to draw on a range of policy tools derived from its role as enforcer of the EU regulatory state at

home to exert influence over gas markets in the near abroad, although less over global oil markets. This was a success with regard to enlargement and the EEA – but the results have been less impressive, the further from the single market the EU has sought to reach. That said, the Commission also has some (limited) harder policy tools at its disposal, and has recently shown greater interest in exploring these.

Downstream: the external dimension of the SEM

The SEM is arguably primarily an internal EU affair, but it exerts strong external effects by affecting how third-country firms operate, and how they bring gas to market. Because it regulates the EU downstream sector, the Commission emerges as an important external energy player, by default rather than by design. Several rounds of energy market liberalization required a number of sector-specific arrangements beyond merely breaking up monopolies and exposing the sector to the full force of SEM rules and competition policy, such as certification of pipeline operators, rules for third-party access (TPA) to pipelines, separation of the transmission and sales operations of firms, as well as provisions enabling member states to impose public service regulation on major operators (Andersen and Sitter 2009).

That said, SEM regulation has been not entirely consistent, and has been subject to interference from EU member states. As a result, the gas sector has been a policy regime riddled with exemptions (gradual market opening with minimum common targets on paper, but variable compliance in reality), multiple options (e.g. for regulating pipeline access and for unbundling) and strong member-state presence in the sector (national champions, subsidies, different patterns of energy production). On the other hand, the Commission won the battle at the level of paradigms: policymaking in the energy sector is now clearly dominated by the liberal market paradigm (Andersen and Sitter 2009, 2013). However, the recent Ukrainian crisis has again made member states and the EU aware of the geopolitical challenges caused by dependence on energy from external suppliers. Exemptions to the rules are sought, and sometimes granted, but arguments are cast in terms of efforts to make the SEM work, to provide public goods or mitigate negative externalities. The member states set the rules, but the Commission has established the norms and exercised considerable discretionary power through its enforcement role and as the EU's competition authority. It is first and foremost in this capacity – based on this 'regulatory state' identity – that the Commission applies its power to external actors on the internal EU market.

First, the most obvious external reach of the single market – in energy and more generally – concerns applicant states and prospective members. For example, Sweden, Norway and Denmark all reformed their national competition policy rules in the early 1990s, the first two with a view to joining the EU and the latter in order to adapt to the coming single market. In all three cases administrative simplification and the prospects of lower transaction costs for industry were the principal arguments for aligning national and EU systems. The single market has a strong effect on other aspirant and applicant states, as well as having legal and direct effect on the states that opted for the EEA. The key point here is that Norway is effectively a member of the EU as far as energy policy is concerned, albeit without voting rights. Neither Norway's joining the EEA nor the EU's Eastern enlargement was in any sense driven by energy policy, so this is not really about the external reach of the single market: but today the SEM includes Norway, Iceland and Liechtenstein through the EEA, and Switzerland through a series of bilateral agreements.

Second, and more controversially, SEM rules apply to all companies that choose to operate on the EU market, whether they do so directly, through subsidiaries established in the member states, or by partnerships. In legal terms, the rules under EU competition law are very clear: they prohibit agreements between companies that restrict competition (Art. 101), interdict the abuse of a dominant position (Art. 102), promote market opening to competition and dismantling national monopolies (Art. 106), and restrict state aid (Art. 107) (European Communities 2007). In addition, a set of regulations and case laws governs mergers and acquisitions, stipulating that companies must 'unbundle' (i.e. establish 'walls' between their transmission and sales operations), and establishing rules on TPA to pipelines.

But how does the Commission actually prioritize its enforcement of the single market with respect to non-EU firms? Here, considerable discretion remains in terms of the Commission's operationalization of rules, and its priorities (Wilks 2005). In recent years the Commission has shifted its focus to external suppliers of gas, particularly after Russia abandoned the Energy Charter Treaty. Most controversially, whereas the Commission had for years avoided having to deal with the dominance of Russia's Gazprom in several European gas markets (particularly in Central Europe), the company's operations have recently become the focal point of investigation. In September 2011 the Commission carried out a dawn raid on Gazprom's German, Czech, Polish, Bulgarian and Austrian subsidiaries and partners. In 2012, it launched an antitrust case against the company. At the time of writing that case is still

pending (in effect suspended because of the Ukrainian crisis), but it may prove to have important repercussions for Gazprom's business model and operations on the European energy market (Riley 2012).

Likewise, the Commission enjoys considerable discretion as regards timing and focus concerning practices specific to the gas market. Destination clauses have long been a core feature of European gas contracts, together with long-term take-or-pay contracts and pegging of gas price to the oil price (Energy Charter Secretariat 2007). The Commission's efforts to dismantle this practice have brought into question an important aspect of the business model of several non-EU firms (Talus 2012). Within the borders of the single market the Commission was the driving force between the break-up of Statoil, ENI and Gaz de France's use of destination clauses (clauses in a contract that restrict the buyer's option to sell the gas on to another company in the single market – a clear breach of the rules on free movement of goods). Externally, the Commission sought and achieved the removal of destination clauses in several cases, including deals involving Gazprom, Algeria's Sonatrach and Italy's ENEL (the latter in a case that involved the import of Nigerian LNG).

Finally, the EU has adopted some legislation specifically designed to address the asymmetries between a liberalized single market and the monopoly or near-monopoly status that NOCs and other national champions may enjoy in their home markets in non-EU states. Commonly known as the 'Gazprom Clause', because it resulted from extensive debate on whether and how to address that firms' market power and political resources, the Third Energy Package in 2009 included rules, like Article 11, specifically targeting third-county firms wishing to establish themselves on the EU market (Council of Ministers 2009). The rules stipulate that national regulators in EU member states may consider security-of-supply risks when certifying third-country firms' acquisition, ownership and operation of transmission networks. This effectively gave national regulators the option of rejecting Gazprom's involvement in national transmission operations.

Our overall finding is that as regards the downstream market, the Commission's priority is liberalization, and its authority and capacity is strong here. It exerts leadership thanks to its mandate and strategy: promoting competitive, open markets, with consumer choice and secure (diverse and robust) external supply. The Commission's key policy tool is the enforcement of the single markets rules, and competition law in particular. This creates spillover effects to external suppliers and their firms, which must comply with single market rules and perhaps also change their business and pricing models – an indirect means of external energy governance. Clearly, this model is conditional on the firm's

choice of operating within the EU. It has proven effective because the EU is highly attractive, as the world's largest predictable and reliable importer of 500 bcm of natural gas. With the failure of other initiatives to extend the EU policy regime beyond the borders of the SEM, such as the Energy Charter Treaty, and in the face of increasing resource nationalism and assertiveness from external suppliers of gas, the Commission has found it opportune to flex its regulatory muscles with respect to third-country energy companies wanting access to the EU market.

Conclusions: the Commission's leadership, the EU as an international energy actor

The Commission remains committed to extending the regulatory state model beyond the borders of the EU, despite the rapidly changing international political economy of energy. Importantly, this is a matter of strategy, rather than merely a reflection of the limited set of policy tools available to the Commission. Indeed, the central lesson from the energy sector is that what the EU *does* is inextricably linked to what the EU *is*. The core identity of the EU in terms of the energy sector – and this can be extended to economic, trade and industrial policy in general – is that the EU is a regulatory state. This means a shift in focus towards regulation (remedying market failure) at the expense of other core tasks of the state, such as redistribution or direct intervention and industrial policy. It involves reliance primarily on majoritarian institutions and independent agencies, and on policy tools such as rule-making and arm's-length governance, rather than direct state ownership and subsidies.

The EU regulatory state has a long reach but a restricted scope. Regulation is applied to address regional energy challenges rather than the global ones, and therefore is restricted to gas. It is more relevant to the near abroad than more distant countries, and more applicable to transit countries than suppliers. The longer the attempted reach (in terms of distance), the more specific the tools need to be – as shown with the Caspian Development Corporation initiative and its follow-up projects. Finally, the EU's power is often more effective with respect to companies than governments, because its reach depends on how receptive the targets are. The long arm of the regulatory state comes fully into play when the EU targets firms, operators and regulators – not the governments of producer states. This is where the Commission exerts most authority and leadership in the EU's external energy governance.

In doing so, the Commission is clearly far still from utilizing the full toolkit of 'regular' states. *Nodality* emerges in the context of the mandate to negotiate external trade agreements, *authority* in the limited context

of the SEM, *treasure* remains a function of the rather small EU budget and *organization* is outside the realm of the Commission's mandate. Yet, it can be argued that the Commission has used the available regulatory state tools creatively, to project its reach beyond EU borders and to get third parties to change course. This leadership on the part of the Commission may well lead to the emergence of a new actor in its own right: one that relies on the attractiveness of its domestic market, rather than its exclusiveness, in order to exert power beyond it. The call is now on IR scholars to give this issue a place in the study of international (energy) affairs.

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3

The Foreign Dimension of EU Energy Policy: The Case of the Southern Gas Corridor

Matteo Verda

The EU depends on energy imports for more than half of its primary energy consumption. This long-term trend has necessarily influenced the evolution of the EU's energy policy and its foreign dimension. During the past decade, the coupling of environmental and energy policies has created the conditions for a strong push towards a growing share of renewable sources in the energy mix, reducing the overall need for fossil fuels. At the same time, EU hydrocarbons production is decreasing, thus creating a growing demand for energy imports.

In this context, EU member states have been adopting various strategies to ensure their energy security, ranging from diversifying import routes to strengthening the relationship with historical suppliers. At EU level, only recently has energy policy gained a more consistent foreign dimension, shifting from a purely market-oriented approach to a more geopolitical approach. This change has become particularly evident in the case of the Southern Gas Corridor (SGC), which is intended to bring Central Asian and Middle Eastern natural gas to European markets. The current evolution of the projects along this corridor provides an example of the potentialities and the limits of the foreign dimension of the EU's energy policies.

New goals for climate and energy will represent a further push for renewable sources. However, imported fossil fuels are expected to remain the backbone of EU energy supply, so all national and EU energy policy will necessarily have to deal with this external energy challenge.

The EU energy mix and the dependence on imports

The EU energy mix is based on fossil fuels (IEA 2013a).[1] Oil, gas and coal account for three quarters of the EU's overall energy consumption,