

# Serbia: Bridging streams - recent developments in the implementation of the Serbian gas pipeline

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Much ink has been spilled in connection with the notorious South Stream project and its cancellation. As a brief reminder, the planned pipeline was to transport Russian natural gas under the Black Sea to Bulgaria, and then through Serbia, Hungary and Slovenia, further to Austria. The project was finally discontinued in 2014, in the midst of the Ukrainian crisis, due to non-compliance with European Union competition and energy legislation (Third Energy Package), especially the rules on ownership unbundling (preventing Gazprom from simultaneously supplying gas and owning a transmission network), as well as because of concerns about third party access to the pipeline (or lack thereof) and tariff structure.

Following the cancellation of the project, Russia turned its attention to the Turkish Stream, a new pipeline to Turkey. The first part of the pipeline, completed in 2018, is intended to supply the Turkish market, while the second part would bring gas to the border with Turkey and then route it through connected pipelines to Southeast and Central Europe, similar to the South Stream concept.

Important steps have recently been taken regarding further development of the gas pipeline, now known as the Gastrans gas pipeline: in late 2018, the Serbian energy regulator announced its intention to exclude the project from the EU's Third Energy Package, allowing the project to continue, despite the fact that it failed to meet the unbundling obligations (Gazprom was allowed to own pipeline infrastructure despite being active on the supply side), and regulate third party access and tariff regulation for gas transmission over a period of twenty years.

According to EU and Energy Community rules, Serbia is required to apply unbundling requirements for transmission system operators and certification procedures, as well as to provide non-discriminatory network access to transmission and distribution systems, storages and upstream pipelines as a principle. Certain projects may be exempt, but the gas pipeline operator should demonstrate, *inter alia*, that the investment enhances competition and security of supply and that the exemption is commensurate with the associate risk level. The Serbian energy regulator claimed that Gastrans, i.e. Gazprom and Srbijagas shareholders, had done just that in connection with the new gas pipeline project.

In February 2019, the Secretariat of the Energy Community issued an opinion regarding the planned exemption, which the Serbian regulator was required to take into account in its final decision, according to the Energy Community rules. Although the opinion confirmed that a project exemption would be possible, it insists that a number of prior safeguards are needed to ensure that the project will not lead to market closure in Serbia or beyond. The Secretariat noted that Serbia is a striking example of full dependence on Russian gas supply, with very limited connections with neighbouring countries (the only existing gas transmission

connection is upstream with Hungary). Shareholders of Gastrans (indirect), Gazprom and Srbijagas strongly dominate and even have a practical monopoly at various levels of the Serbian gas market, including development, production and upstream supply, natural gas storage and downstream gas supply and retail supply.

While a new route through Bulgaria would improve security of supply, the Secretariat considered that it would also consolidate and increase the dominance of Gazprom and Srbijagas, as the existing arrangement would actually close the market even more. Since Gazprom enjoys a monopoly in the Serbian market, it could block the supply of gas to any downstream competitor, and with 51% control in Gastrans, would also have an incentive to deny competitors access to the gas pipeline, meaning it would have no commercial interest - and no legal obligation - to make the gas pipeline available to other gas suppliers.

The European Commission has previously established a general rule that does not grant an exemption for a new piece of infrastructure that could have a significant amount of capacity allocated to a dominant player in relevant markets. Where access to infrastructure is restricted, competition will also be restricted, especially if new capacity is not available to new entrants and/or competitors to the dominant company. If, on the contrary, the new capacity is only available to the dominant market player, such a project will only strengthen the market position of the dominant owners and close the market even more.

The Secretariat concluded that Gastrans and the exemption conditions originally required by the Serbian regulator would not enhance competition in the markets of Serbia, Hungary or Bulgaria - but rather that the project would be detrimental to competition as it would strengthen the market position of dominant owners and close the market, considering that it would not effectively make the new facilities available to existing or potential competitors.

For this reason, the Secretariat insisted on additional exemption conditions: firstly, to bring Serbia into compliance with the outstanding obligations within the Energy Community (regarding the unbundling of Srbijagas and capacity allocation at the existing Hungarian border interconnection point, which is why the Energy Community has previously initiated legal action against Serbia for non-compliance) and then several specific measures regarding the project itself, the most important being the reduction of the exclusive gas pipeline capacity allocated to Gazprom and Srbijagas, with the aim of providing access to a significant capacity share to new entrants in a competitive way (through auctions) and introducing additional liquidity measures, forcing Gazprom and Srbijagas to offer certain gas amounts on the market, in order to encourage at least some degree of competition.

In March, the Energy Agency of the Republic of Serbia made its final decision confirming the exclusion of the project from the Third Energy Package. The Regulator stated that it had carefully considered the Secretariat's opinion and recommendations in its deliberations and implemented all the recommendations that it could implement within the current legal framework, to ensure that the project would not harm competition in the Serbian market. The reaction of the Energy Community was less enthusiastic, so key people of this organization publicly commented that "AERS rejected or fundamentally changed all conditions set by the Energy Community regarding third party access and price regulation ... The Turkish Stream pipeline is not covered by the Third Energy Package and we regret this.

This was an important opportunity, perhaps the only one, to ensure that a project of such magnitude and impact, not only on Serbia but also on neighbouring markets, complies with European rules.” According to the Energy Community, the project will threaten competition in Serbia and region, and the national regulator failed to align it with the EU’s energy and competition legal framework, including the recommendation it had to accept.

The future has never been easy to predict in this region, and especially with regard to projects of this magnitude; on the one hand, it seems that Gastrans is pleased to continue with the project, seeking binding offers for gas transit reservations by 2039. On the other hand, while Serbia is not yet an EU member, it is a candidate country seeking accession. This is not the first time that Serbia has violated its energy and competition rules regarding gas supply, accounting for previous proceedings concerning a persistent failure to unbundle Srbijagas and Banatski Dvor gas storage operations, a failure to regulate third party access to Hungary’s existing interconnection point and anti-competitive gas provisions in agreements with Russia (finally repealed in 2018), which complicates the relationship between Serbia and the Energy Community.

The Energy Community was already quite open in its assessment that the gap between the transposition of rules and their implementation in Serbia is getting bigger every year. Neither Hungary nor Bulgaria seem ready to deviate from the EU acquis on the Gastrans project; indeed, their national regulatory authorities appear to have expressed concern to the Serbian regulator during the exemption process, clearly stating that this could adversely affect the development of regional trade, competition and market integration.

This essentially makes Serbia the point where the Third Energy Package collapses when it comes to a politically and legally sensitive international project. One does not have to be a magician to see that this is a very unenviable position, especially when the country is strategically committed to joining the club. Although lucrative, Russian energy arrangements can prove to be a significant stumbling block to Serbia’s accession ambitions.