Building the Single EU Gas Market in Hungary, Lithuania and Romania: Domestic Interests and the Dynamics of Europeanisation

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Submitted to

Central European University

Doctoral School of Political Science, Public Policy and International Relations

In Partial Fulfillment of the Requirements for the Degree of Doctor of Philosophy

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Budapest, Hungary
April 2017

Word count: 88,787

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ABSTRACT

This thesis is about building EU single gas market in 2002-2010 Hungary, 2008-2016 Lithuania, 2008-2016 Romania and 2010-2016 Hungary. Their natural gas sectors represent four different outcomes of integration according to EU policies, which is defined as market liberalisation and cross-border interconnectivity combined. From 2002 to 2010 Hungary gradually liberalised its natural gas market according to the First (1998) and Second (2003) Natural Gas Directives and embarked on building cross-border interconnectors, but from 2010 retrenched in liberalisation of household consumers. After decades of persistent *status quo*, Lithuania changed its natural gas market in a matter of several years from 2009 in a dual reform: it implemented the ownership unbundling option envisaged in the Third Natural Gas Directive of 2009 and built an LNG terminal following the Security of Supply Regulation of 2010. In 2008-2016 Romania, however, the *status quo* continued almost through the most of the research period: EU internal market directives and cross-border interconnectivity projects were implemented late.

These cases explain why and how the EU agenda to create single natural gas market gives very heterogeneous outcomes across member states. The principal explanatory approach used in this thesis is the interplay between domestic interests and the policies of the European Commission and the EU, which merges the Europeanisation framework by Knill and Lehmkuhl (2002) with political/economics interests. The thesis claims that EU instruments related to the natural gas sector and the Commission impose structural limitations and freedoms, in other words, change opportunity structures, that affect the behaviour of the domestic actors. EU policies affect power distribution between political and sectorial domestic actors and shifts the gas sector towards reforms if the initial balance of power is in equilibrium. Pro-integration actors within the domestic structure proactively use changes in opportunity structures. However, in cases of dominance of particular interest on the domestic level that diverge from

EU policies, EU policies will have an effect only in as much as non-compliance would be costly to the anti-integration domestic actors.

To understand why these countries chose so different paths, this thesis uses a combination of congruence and process tracing methods. It uses two causal process tracing mechanisms, a mechanism of 'EU opportunism' in the cases characterised by balanced and a mechanism of 'EU leverage' in the cases characterised by dominant interest structures. Elite and expert interviews with 48 people were conducted and a procedure of right to access information from the Commission was used. The first mechanism was identified in Hungary from 2002 to 2010 and Lithuania from the 2008 general election to 2016. Within the identified mechanism, the domestic interplay of interest differed: in Hungary the push to deregulate and interconnect the gas sector strongly came from the sectorial actors, whereas in Lithuania from executive politicians. The second mechanism was found in 2008-2016 Romania and 2010-2016 Hungary. Within this mechanism, interplay of different interests resulted that household segment liberalisation and cross border interconnectivity stalled in Romania, but in Hungary the cross-border interconnectivity continued despite the retrenchment in the household segment liberalisation.

ACKNOWLEDGEMENTS

It is impossible to mention and thank everyone without whom I would not be where I am today. I express my gratitude to my supervisory panel Professors Nick Sitter, Andreas Goldthau[1] and Marie-Pierre Granger at Central European University (CEU), and also Robin Bellers from the CEU Academic Writing Centre (AWC) for accompanying me on my way to this PhD. I also thank Katja Yafimava, Howard Rogers and Jonathan Stern from the Oxford Institute for Energy Studies for creating opportunities for me to learn from the best and for providing valuable comments on my writing. Professors Ingo Rohlfing (the University of Cologne) and Derek Beach (University of Aarhus) helped me to understand the political science methods. I thank Barbara Breitschopf and Jakob Wachsmuth from Fraunhofer-Institut für System-und Innovationsforschung, Andrea Kirchknopf from CEU AWC and CEU Professor Erin Jenne for the invaluable support in the final stages. I would also very much like to thank my interview partners, many of whom I do not reveal to protect their confidentiality, and Nottingham Trent University Professor Robert Ackrill. I separately express my gratitude to the CEU Library personnel for adjusting to my research needs and Adriaan Bredekamp for language corrections.

I feel very grateful to my mom Rasa Pakalkienė and grandmother Birutė Neverauskaitė for their unconditional support. My partner Andreas Huber lived throughout the most difficult stages of my PhD together with me. I hope I will be able to return the endless support to him. I thank my dear friends that I met in Budapest, Aušra Gedminaitė, Igor Gavrič, Shota Gvaramadze, Evgenia Ivanova and Alena Ivanova for helping me with the studies and, not less important, for being true friends. I also thank Joshua Posaner, Olga Löblová, Živilė Stubrytė, Sabina Karmazinaitė, Hana Holla and Barbara Ochotnicka. The family of Minea in Bucharest nearly adopted me during my research in Romania, and I will never forget their warm hearts.

[1] Now at Royal Holloway University of London.

CONTENTS

ABBREVIATIONS

Energy sector

ANRE	Romanian Energy Regulatory Authority
BEMIP	Baltic Energy Market Interconnection Plan
CESEC	Central East South Europe Gas Connectivity High Level Group
CEER	Council of European Energy Regulators
DSO	Distribution system operator
ENKSZ	First National Public Utility company in Hungary
ENTSOG	European Network of Transmission System Operators for Gas
FGSZ	Hungarian gas transmission system operator Földgázszállító
HEPURA	Hungarian Energy and Public Utility Regulatory Authority (from 2013)
ISO	Independent System Operator
ITO	Independent Transmission Operator
HEO	Hungarian Energy Office
MFB	Hungarian Development Bank
MGT	Hungarian gas transmission system operator Magyar Gáz Tranzit
MNV	Hungarian National Asset Management
NCC	National Commission for Energy Control and Prices of Lithuania
NRA	National regulatory authority
OU	Ownership Unbundling
TSO	Transmission system operator

Political parties

ALDE	Romanian Alliance of Liberals and Democrats
LSDP	Social Democratic Party of Lithuania
MSZP	Hungarian Socialist Party
PNL	Romanian National Liberal Party
PC	Romanian Conservative Party

PSD	Romanian Social Democratic Party
TS-LKD	Lithuanian Homeland Union – Lithuanian Christian Democrats
UNPR	Romanian National Union for the Progress of Romania
USL	Romanian Social Liberal Union

Other

BoP	Balance of Payment
IMF	International Monetary Fund
SME	Small and medium enterprise
TFEU	Treaty of Functioning of the European Union

Abbreviations of interviewees

COMM	European Commission
DS	Downstream source
EX	Energy expert
GV	Government employee at political level
IND	Energy industry
LEGS	Legal expert
NRA	National regulatory authority
MP	Member of Parliament
PRES	Person from a President's administration
SE	Administrative official
UPS	Upstream source

INTRODUCTION

The idea to create a single European market where goods and services would flow with no borders is older than the current European Union (EU) itself.[2] Now, as almost three decades have passed, the vision of its creators of the single market is closer to reality, except for energy markets. Despite all the perceived benefits and substantial efforts from supranational EU institutions, the 'merger of the national markets in a single European electricity and gas market' (Glachant and Finon 2004, 135) is simply not taking place. Over the past half century, a gas pipeline net remained as was built with roots in Russia and branches in various EU member states (Högselius 2013). Many of those EU members at the ends of those pipeline branches are not sufficiently interconnected with each other by pipelines. Just as been in the 1980s (Estrada 1988), gas markets are divided according to national borders of different states. The fact that the EU natural gas markets are still fragmented can be seen even from the fact that in the antitrust or abuse of dominant position cases the Commission's Directorate-General for Competition (DG Competition) defines relevant markets for natural gas as coinciding with the national borders of the member states or even smaller (DG Competition 2015).

Natural gas markets also tend to be far less liberalised than other sectors. In 2015, eight years of full market opening prescribed by the Second and Third Natural Gas Directives, 13 EU countries still regulated gas household prices and 8 countries also regulated gas prices for industrial consumers (ACER 2016, 11). Moreover, often even in the cases where governments have undertaken a liberalisation process, [3] there is not much real competition in these markets, which would be expressed by a high number of suppliers and low market concentration. Even

[2] In 1986, the Single European Act was adopted with the aim of creating an internal market. The EU was founded under its current name in 1993 by the Treaty of Maastricht.

[3] In this dissertation the term 'liberalisation' mostly means liberalisation at the level of the downstream, namely, making consumers eligible to switch energy suppliers, allowing for third-party access to the natural gas transportation systems, ceasing regulating final natural gas prices. The natural gas business stems across three vertical levels: upstream (gas production, import), midstream (transit and transportation pipelines) and downstream (where it reaches end-users). All three Natural Gas Directives (1998, 2003 and 2009) had strong emphasis on liberalisation of the downstream part of the business). See more about the three-stage approach by the Commission: Andersen (2001).

the latest EU energy market monitoring results by ACER show that 'many markets remain highly concentrated, with the market share of the three largest suppliers on average in the EU exceeding […] 83% in gas markets' (ACER 2016, 9).

Both the slow path towards more cross-border connectivity and liberalisation, and varying paths of development by member states is puzzling. All EU member states are exposed to an identical legal framework at the EU level. Even those EU members that joined the EU later, in 2004-2013, had to adapt the EU legal order in the pre-accession period. EU legislation that foster the gas sector liberalisation and/or supply diversification accompanied by supranational enforcement of it by the Commission inevitably has an impact on natural gas markets at the national level. However, EU requirements are necessary but not sufficient for real changes to happen in the gas markets of EU member states. The domestic changes caused by the European policies, just as Schmidt (2005) explains, happen 'in the shadow of the Community law, however, they cannot simply be seen as top-down enforced adaptation' (Schmidt 2005, 157). What could be the cause of some countries transposing just minimal requirements of EU directives and regulations or even trying to halt the process of transposition, while others overstep minimal requirements within their natural gas markets? What could be the cause of reversals of reforms even in the countries that had earlier transposed Directives on time and correctly?

The aim of this dissertation is to answer the research question of why, despite similar exposure to the Directives, EU competition policy tools and other EU instruments establishing the single EU natural gas market, there exists an obvious divergence in market liberalisation and interconnectivity across EU member countries, and how this divergence develops. The thesis looks beyond mere transposition and implementation of EU Directives and concentrates on deeper structural changes in the natural gas markets of the selected EU member states. Via analysing the pathways that separate EU member states, Hungary, Lithuania and Romania took

in different periods, the thesis addresses a broader question why natural gas markets in the EU are fragmented rather than integrated. Examining this phenomenon helps to reveal the causes of delays of EU policy implementation in the member states and the reasons why mere transposition and implementation of EU regulations is not enough to induce sufficient structural changes in the markets. It also explains the politics and forces behind the national energy markets liberalisation agenda. This exploration sheds a light on reasons of divergence in natural gas sector developments among EU member states.

The peculiarities of the natural gas sector in EU member states place its research in between of economics and EU integration theories. This research also steps into theories of regulationism, which themselves stand in between of economics and political science. On one hand, the existence of natural monopolies in the sector, frequent application of competition policies and other features make liberalisation and integration of the EU natural gas sector an object of research in economics (economic policy, microeconomics, and subfields of microeconomics such as economics of regulation (Viscusi, Vernon, and Harrington 2000) and competition policy). The economics literature on natural gas markets, however, concentrates heavily on the pricing of this commodity which does not fully reflect the structural changes in the market. On the other hand, heavy dependence on policies in managing this sector, brings it to the attention of political scientists (more generally, in EU studies, regulatory state, public choice literature, and more specifically in policy studies, for example, energy policy, and policy diffusion).

In general, the political science literature views integration of the network industries, natural gas included, as a part of wider EU integration, even as one of the 'final topics of the EU agenda on the completion of the internal market' (Arentsen 2004, 70). What makes the network industries, such as natural gas sector, interesting for 'integration' researchers is the strong economic interests in these industries, which result in 'strong motives for voluntary non-

compliance with problematic provisions of the *acquis*' (Maniokas 2009, 9). Network industries, such as electricity, natural gas, telecommunications and railways and even airlines, have features of natural monopoly. By default, they were heavily regulated and/or owned by governments (Stratling 2001), and creating competition and single market required substantial deregulation. However, the natural monopoly segment (market failure) required re-regulation. Subsequently, the EU instigated network industry organisation is based on a peculiar model of the upstream production/generation part exposed to competition, transmission and distribution networks regulated, and supply again exposed to competition (Kaderják 2011, 2, 5, 10).

The restructuring of the network industries is a part of the larger EU integration process, and often appears after a 'push' from above in the 'two–level' EU arena (consisting of EU policy making in Brussels and the domestic level). Therefore, energy and telecommunications research is also an object of EU integration studies. There it can be researched as an example of integration that works or does not work. The more classical research from political science and energy policy in EU points of view either argues about the 'upper' one in the 'two–level' European arena, policy making in Brussels, or concentrates on the 'usual suspects' – the old and/or large EU member states. The literature, published after important pieces of EU legislation were adopted, is pre-occupied with transposition, implementation and compliance of policies in general (Falkner and Treib 2008), or liberalisation directives in particular (Andersen and Sitter 2007). This more recent literature on Europeanisation often takes the EU legislative decisions as given and in various degrees of detail analyses the process of liberalisation of natural gas markets (Buchan 2012), why they have not been integrated yet, why there is a lack of competition in the markets or why a variety of regulatory models still persist (Finon and Midttun 2005) and what impact Europeanisation processes have at the national level (Green Cowles, Caporaso, and Risse-Kappen 2001; Radaelli 2002; Windhoff-Héritier 2001). Even in those cases, often published after the EU enlargement of 2004-2007,

the object of analysis is often Western European countries (EU-15), such as the United Kingdom, France, the Mediterranean states, Germany, and the Netherlands (Windhoff-Héritier 2001; Hambach 2006; Andersen and Sitter 2007; Honoré 2013). Although there is some research in the natural gas markets of the new EU member states, which have joined the EU from 2004, it often tends to focus in the Visegrad countries only, for example, Slaba (2009), Nosko (2013) and Posaner (2016). Based on a simple academic articles search on EBSCOhost Online Research Databases made in the mid-2016, it appears that the case selection strategies to explore Europeanisation skew towards the large EU member states: search 'Europeanisation and Germany' provided 1,040 results, 'Europeanisation and France' – 704 results, but 'Europeanisation and Hungary' – just 218 results and 'Europeanisation and Latvia' – only 48 results. Even though the longer amount of time that a country has spent in the EU would be expected to increase the amount of articles on this topic, some large new EU member states have more research about Europeanisation than small 'older' ones: compare a search 'Europeanisation and Poland' (EU member since 2004) that returned with 361 results, and 'Europeanisation and Finland' (EU member since 1995) that returned with 127 results.

A part of Europeanisation scholars sees Europeanisation as a dynamic transformation process, where instead of being a 'single independent variable' push for reforms, 'Europeanisation 'serves as a kind of catalytic transmission of these pressures' (Schneider 2001, 61, 72). This is especially used in the research of sectors where Europeanisation entails substantive reforms, which in turn have often been those sectors where member states retained autonomy longer than in other – telecommunications, energy and so on. The dynamic approach towards Europeanisation is especially actor-centred: Knill and Lehmkuhl use a term terms *actor coalitions* and *interest constellations* (2002, 261); Schneider argues about *interest structures* (Schneider 2001, 74).

The thesis adapts a model advanced by Knill and Lehmkuhl (1999, 2002), in which

Europeanisation (EU legislations) change opportunity structures for domestic actors and may or may not induce change. As EU energy regulations, being uniform to all EU member states, cannot explain the differences in the paths the countries' gas sectors take, the model of Knill and Lehmkuhl is further extended as to what the causal conditions of differences may be. The main outcome in the dissertation is structural natural gas market changes that follow the EU requirements, referred to as 'gas market integration', which is a more encompassing term than just compliance with EU requirements. This term, adopted in the frame of Commission evaluations of EU energy sectors (2005), reflects structural changes in the gas sectors and encompasses more than just the term of compliance with EU requirements.

The main causal conditions for the Europeanisation mechanism to be in place, thus, are the configurations of *interest structures* on the domestic level. *Interest structures* consist of *actor coalitions* in favour or against EU induced reforms, factored by their power positions. The research focuses on the most relevant actors that influence gas sectors. On the political hemisphere/system in a country, such actors are analysed as political parties (and their channels of power, i.e. parliaments, governments and state ownership in energy companies) and presidents (which may not belong to a party). On the sectorial hemisphere/system, interests and power positions of such actors as gas upstream, midstream, downstream companies and large consumers, are analysed. Two kinds of special actors – the Commission and national regulatory authorities (NRAs) are also taken into account.

The two main hypotheses tested in the thesis come out of this conceptual framework. The causal model predicts that if a new EU internal market policy encounters balanced *interest structures* on the national level, it may push the domestic natural gas market towards closer convergence with EU policies (H1). There are actors both in favour and against liberalisation, and both sides have power. EU regulations in such a case redistribute the power among the ones in favour of reform vis-à-vis the ones preferring the *status quo.* H2 is that in the cases of

dominant *interest structures* (in which *actor coalitions* that have aims diverging from the EU aims in the sector would have more power) would prevent from Europeanisation mechanism fully developing. If there are not many actors favouring liberalisation and/or they do not have power, - then, as Knill and Lehmkuhl would expect, changes are unlikely. In a broad sense, this thesis is a 'theory testing' or 'hypothesis-testing' (Rohlfing 2012, Chapters 1-3) type.

The thesis analyses four non-chronological cases from the set of new EU member states, 2002-2010 Hungarian gas sector, 2008-2016 Lithuanian and Romanian gas sectors and 2010-2016 Hungarian gas sector. The selected cases do not represent exactly the same time periods because the main story in them revolves around coexistence of *interest structures* and certain more important EU instruments, for example, the Second (2003) or Third (2009) Natural Gas Directives, which required deeper adjustments on the domestic level. The selected cases are natural gas sectors in new EU member states, where natural gas is widely consumed by the domestic sector; thus, the population is sensitive to end-user natural gas prices and can exert pressure on politicians via (re)electing them or not.[4] Even though the thesis does not seek to abandon the experiences and lessons from Western Europe, the new EU member states' gas sectors started their path of development in the EU at more comparable positions than some Western European countries, as the natural gas sectors of the latter have more entrenched vertical integration and state regulation. On the contrary, Great Britain, for instance, has been a country where over long periods of time liberalisation policies were pushed through even before the EU adopted the First Energy Package of 1996-1998. Since the New EU member states' natural gas markets were significantly underdeveloped, there was a large 'misfit' between EU policies and national ones. This makes them more comparable and creates an opportunity to analyse the impact of Europeanisation on their markets.

Based on operationalisation of the model by Knill and Lehmkuhl, a combination of

[4] End-users are customers purchasing natural gas for their own use.

congruence and process tracing methods are used in analysing four case studies. The process tracing approach used in this thesis mostly follows subdivision within the process tracing methods advanced by Derek Beach and Rasmus Brun Pedersen. In order to increase research transparency in qualitative methods (ECPR 2015), the thesis explicitly predicts required evidence in mechanisms before going into empirics. For the same reasons, it also provides detailed expected evidence that would allow to confirm with enough confidence that one or another causal process tracing mechanism was indeed in place in the case studies. Two expected causal mechanisms are tested in the cases. One is the 'EU opportunism' mechanism, tested in the cases where *interest structures* were identified as balanced, and actors were expected to exploit changes in *opportunity structures*. The mechanism of 'EU leverage' is tested in the cases where dominant *interest structures* were identified, and any significant reforms in the gas sectors were expected to take place mainly when the Commission used leverage vis-à-vis domestic actors. The 'EU opportunism' mechanism is found in the 2002-2010 Hungarian and the 2008-2016 Lithuanian cases. The 'EU leverage' mechanism is expected in the 2010-2016 Hungarian and the 2008-2016 Romanian cases.

The first two cases, mostly related to events in Hungary from the 2002 general election to 2010 and in Lithuania from the 2008 general election to 2016, show that balanced *interest structures* used opportunities provided by then available EU instruments. The other two cases, 2010-2016 Hungary and 2008-2016 Romania (almost all its membership in the EU), show that dominant *interest structures* stalled household liberalisation and cross border interconnectivity in Romania and household liberalisation but not interconnectivity in Hungary. Having two case studies for each mechanism shows the possibilities to generalise these mechanisms to a broader set of cases.

In the course of the research, elite and expert interviews with 48 people were conducted and some of them updated. Some of the interviewees were very high level officials on national

and on the EU level, such as the 2008-2012 Prime Minister of Lithuania, Andrius Kubilius, and the former Commission's Director-General of DG for Energy, Philip Lowe. Using databases accessible in the CEU Library, such as Agence Europe, Enerdata, Eurostat, Lexis-Nexis and more, extensive media analysis and countries profiles were made. A procedure of right to access information was used in order to obtain documents related to the infringement cases in the analysed countries from the Commission.

The strength of the thesis lies in its interdisciplinary approach. Whereas different disciplines attempt to research it, rarely any provides comprehensive explanations. Following the interdisciplinary origin of the natural gas sector, this thesis borrows different aspects from a handful of theories and takes an actor-centric approach. The conceptual model of Europeanisation is used as a framework and is filled with interest approaches from political economy to create two process tracing mechanisms. The thesis bases the assumption that actors in question having bounded rationality, and predicts the actions of the actors based on their self-interest depending on losses and gains. From economics, the thesis borrows concepts of natural monopolies and knowledge of competition policies, including antitrust regulation. Against this backdrop, this thesis developed insights on both theoretical and empirical fronts and attempts to contribute to the Europeanisation and political economy.

The major theoretical contribution of this thesis is threefold, related to testing Europeanisation theories through case studies and to further refining political science methodology. First, this thesis sheds light on the process of different pathways that EU member states take in adjusting to EU requirements. In other words, in addition to the 'why' question (H1 an H2, because of different *interest structures*), by developing two causal process tracing mechanisms this thesis also provides a response to a 'how' question. It shows what mechanisms lead from the balanced or dominant *interest structures* to varying outcomes in the gas sector.

Second, the thesis develops a practical application of the theory by providing a system

and strategy of indication whether there is a balanced or dominant *interest structure*. The concept of *interest structures* allows synthesising all the possible political ideology differences among influential actors on the domestic level. Because of how this concept is operationalised, this thesis avoids the need to go into a debate on left and right parties in Central and Eastern Europe, where it is difficult to place parties on the left - right dimension. Admittedly, several recent PhD theses about the natural gas markets of the Visegrad countries attempted to base the analysis of the developments of gas sectors on ideological left-right explanations (Nosko 2013; Posaner 2016). However, even if ideological cleavages among parties in post-socialist countries can be found, they differ from the ones among political parties in the Western Europe (Sitter 2002). In post-socialist countries, including the ones analysed in the thesis, modern social democrat or socialist parties are successors of the Communist Party, which is not the case in the Western Europe. Therefore, an analytical value to the research by simply basing actions of national policy makers on their left-right ideology would be limited. The operationalisation of *interest structures* developed in this thesis allows expanding the theoretical framework to the old EU members (EU-15) as well, even though the political parties ideologically differ there from the ones in post-socialist countries.

The third contribution is the transferability of the qualitative set of indicators of *interest structures* developed in this thesis. They can be used not only in different countries, but also in other similar fields, where EU regulations initiate reforms. This would be fields that share characteristics with the natural gas sector, such as existence of natural monopolies and heavy regulation, and their indispensable nature for a large part of the population, for example, electricity or telecommunications.

The main empirical contribution of this thesis is also threefold. There are calls in EU compliance research to 'merge research on the law on the books and the law in action', which in turn requires a more 'more labour- intensive data collection' (Conant 2012, 15, 26), and this

dissertation responds to those calls with an in-depth empirical analysis. This dissertation shows the possibilities and limitations of EU instruments with regard to one sector, and the changing role of the Commission and actors in member states. Firstly, it leaves aside negotiations of the EU natural gas policies and concentrates on the European impact at the national level. Secondly, the thesis takes a close look at real structural changes in the natural gas markets of the selected EU member states and expands the inquiry beyond analysing just natural gas price convergence or mere transposition and implementation of the Natural Gas Directives. This dissertation also analyses different ways how not only the institutional, but also private actors may use opportunities that EU energy regulatory tools create, and how the Europeanisation of the gas sector work. Thus, the focus is not on the opportunities and limitations of EU energy policies on the member states as such, but on the separate actors within them. Sometimes it could be politicians who could ensure supply diversification that make gas price drop for their electorate and industries. Sometimes it is gas companies that become able to compete for liberalised consumers, and sometimes network companies that benefit from building interconnectors and collecting more income from transmission. Thirdly, by leaving the comfort zone of much researched Western Europe ('old' EU members) and analysing natural gas markets in the 'new' EU member states, the thesis sheds a light on processes in those countries.

The thesis consists of two major parts. The first part (CH 1 – CH 3) sets the theoretical and methodological approaches of the thesis and translates relevant EU instruments into the opportunities and limitations they provide for domestic actors. The second part (CH 4-CH 8) is an empirical analysis in four cases.

In the first part, after the introduction sets the puzzle, the CH 1 selects appropriate theoretical lenses to use for the inquiry. It points to uses and limitations of 'classical' EU integration theories and theories of policy diffusion in researching natural gas market. Then, after a review of political economy and Europeanisation theories, the chapter takes one

particular dynamic model of Europeanisation and applies it to the specific research of EU's natural gas sectors. In CH 2, European instruments that are applicable to domestic natural gas markets during the research period are analysed in terms of opportunities and limitations they provide to domestic actors. Informed by a thorough analysis, conclusion is made that the analysed set of EU instruments, seen as a whole, mostly change *opportunity structures* for domestic actors rather than prescribe very specific recipes to national policy makers and companies as to how to manage their natural gas sectors. In CH 3, a two-step research design is operationalised and two process-tracing causal mechanisms, 'EU opportunism' and 'EU leverage' are proposed and expected evidence is presented in each step of the mechanisms. In the same chapter, four cases from three countries are selected.

The second part goes on in testing the 'EU opportunism' and 'EU leverage' causal process tracing mechanisms. The cases are analysed in two groups by two mechanisms. Within these two groups, they are presented in a chronological manner. However, as case selection was non-chronological, each chapter could be standalone. CH 4 and CH 5 test the 'EU opportunism' mechanism in 2002-2010 Hungary and 2008-2016 Lithuania. The CH 6 and CH 7, respectively, analyse 2008-2016 Romanian and 2010-2016 Hungarian cases, where fingerprints of the 'EU leverage' process tracing mechanisms are found. In the beginning of the latter chapter, it is established that in mid-2010 due to fundamental political reconfigurations in Hungary, the previously found 'EU opportunism' mechanism broke down because of fundamental changes in the *interest structure*, which turned from balanced into a dominant anti-integration. The CH 8 compares all four cases, and shows that even though the expected mechanisms were found in all cases, they were expressed in different degrees.

1 THE DYNAMICS OF EUROPEANISATION

The aim of this chapter is to choose the most appropriate theoretical approach to explain the varying responses to EU natural gas policies. The empirical puzzle presented in the introductory chapter limits the range of suitable theories to those that deal with the international/external/exogenous influence on the domestic level and can explain both policy change and the persistence of the *status quo*. Theories that only analyse domestic political processes, such as party politics (and analysis of electoral cycles) fail to take into account external influences are not sufficiently comprehensive. On the contrary, theories that focus on international politics, for instance, macro theories taking states as units of analysis, tend to overlook the importance of domestic power structures. In other words, suitable theories will be able to embrace two-level (international/supranational and national/domestic) arenas and capture the interaction between national and international levels.

This chapter will hence discuss theories dealing with two-level decision making arenas, supranational and national. It starts with two branches of literature that are not specific to EU policy making, which are the theories of policy diffusion and of political economy. Subsequently, different approaches of EU integration are analysed, such as 'classical' theories of EU integration, followed by the more recent approach of Europeanisation and differentiated integration. Finally, a conceptual framework is developed to formulate hypotheses to be tested in the empirical investigation. I will suggest that pro-integration national actors perceive EU policies as new strategic opportunities to pursue their interests. Their proactive use of these opportunities results in convergence with EU policies if on the domestic level the power of pro-integration actors is balanced and not necessarily dominant. Where anti-integration actors dominate, pro-integration actors would not be able to overturn it.

1.1 Policy diffusion: the small role of the EU

The literature on policy diffusion, a branch of comparative politics, is concerned with the diffusion of policies between countries. Some authors consider emulation, lesson drawing or at least policy transfer to be synonymous terms to policy diffusion (Dolowitz and Marsh 1996, 344), and some separate the terms (Marsh and Sharman 2009; Bender, Keller, and Willing 2014). Here they are considered to be synonymous.

Diffusion 'describes a trend of successive or sequential adoption of a practice, policy or program' (Stone 2004, 3). Even though most often used for quantitative comparisons (Bennett 1991, 216), the more recent policy diffusion literature also includes small-N studies and qualitative approaches. In the diffusion literature, it is postulated that policy choices in one country affect those in another. Evidence for this is the increasing convergence of policies internationally. In general, policy diffusion or transfer is conceptualised as either a voluntarily or coercive process or the combination of both. Such terms as coercion, emulation /mimitism/mimicry, learning and competition are used to distinguish the different mechanisms of diffusion (Dolowitz and Marsh 1996; Stone 2004; Evans 2009; Meseguer and Gilardi 2009; Marsh and Sharman 2009; Graham, Shipan, and Volden 2012). Learning, emulation/ mimicry and competition are considered to be voluntary and communication based policy diffusion mechanisms. Coercion mechanisms are less categorised, but generally diffusion occurs 'when political units are forced to adopt certain policies by other actors, e.g. states or international or supranational organizations' (Bender, Keller, and Willing 2014, 14).

Overall, policy diffusion theories could be used to partially explain differential outcomes of market integration policies among the EU member states. The policy diffusion is a process-based approach interested in relationships and interactions between actors involved in diffusion processes. Therefore, this approach pays attention to the within-state level. According to Dolowitz and Marsh, the complexity of a policy, the persistence of status quo

rules, institutional and structural misfits with existing systems, the lack of skills and competences, as well as t of sufficient funds for new policies can present important barriers (1996, 353–54). Frequently, leader states pioneer the adoption of a policy that 'laggard' states subsequently follow (Stone 2004). Policy diffusion may be useful in analysing changes at the domestic level that are influenced by changes at the international level, be it global or EU variables. Deregulation and interconnectivity of natural gas markets would be interpreted as policies that diffuse from the centre (Brussels) to member states. In particular the coercion mechanism type (vertical policy diffusion) could be helpful.

However, as Meseguer and Gilardi criticize, research on policy diffusion tends to ignore the role of domestic politics for policy diffusion, for example the importance of ideology in a country or that politicians can learn not only from 'the economic results of policies but also from their electoral consequences' (2009, 533). Scholars tend to assume that mechanisms operate the same way across all cases. All governments are considered to be equally willing to learn although it is likely that in practice policies will converge as a result of a range of different mechanisms, or a combination of them (2009, 531–32). In addition, the policy diffusion theories do not have much to say about how policies change during the process of adoption in particular states (Orenstein 2003). Therefore, by identifying patterns of policy adoption, the approach neglects the political dynamics involved in the transfer (Stone 2004, 4).

Another criticism of the policy diffusion literature is that scholars often focus just on cases where instances of policy diffusion were observed, so they cannot explain why certain policies diffuse, and others not. Even though some authors acknowledge that policy transfers vary in visibility and 'factivity' (whether the transfer is clearly recognizable in legislation and whether the transfer is instrumental or just a symbolic act (Strebel and Widmer 2012)), in many cases a selection bias exists. Less explanations are provided why policies are *not* diffused (Meseguer and Gilardi 2009, 531). Policy diffusion literature is also criticized for not paying

enough attention to structural power explanations that influence, facilitate and constrain policy transfer (Dolowitz and Marsh 1996, 355). Moreover, by focusing on adoption, diffusion studies tend to ignore agenda-setting processes as well as implementation and evaluation stages of the policy cycle (Graham, Shipan, and Volden 2012, 17).

The EU as such is not very important in the policy diffusion literature (Wasserfallen 2016) , and when it is, the research often steps into the field of Europeanisation. The relatively small role of EU institutions may come from the fact that, as Bender, Keller, and Willing explain, 'in its narrow conceptualization policy diffusion is understood as a de-central mode of policy coordination characterized by the absence of a central governing instance (e.g. the state; supra-national institutions)' (2014, 13). This focus on a horizontal perspective, 'where subnational units, countries or even international organisations influence one another in decision making' is dominant in policy diffusion studies (Wasserfallen 2016, 3).

When EU policies are taken into account, policy diffusion research resembles Europeanisation research. For example, although in his analysis of the liberalisation of telecommunication sectors in Germany, France and Italy in the 1990s, Schneider maintained that sectoral reforms were an outcome of policy diffusion, his approach rather resembles Europeanisation studies (2001), which are discussed later in this chapter In his approach, the Commission and other European institutions acted as 'amplifiers' and 'transmitters' in this process (Schneider 2001, 73, 77). The terms of coercion, mimitism, and policy transfer are also directly used in the approaches of Europeanisation literature (Windhoff-Héritier 2001, 4; Radaelli 2002; Padgett 2003, 227–45), as well as acknowledging 'leaders' and 'laggards' in policy adaptation.

Thus, even though they provide some valuable insights into policies spreading to different countries, theories of policy diffusion are not sufficiently comprehensive for the aims of this dissertation. The undeniable influence of European Union policies on national energy

markets calls for a theoretical framework that works better with EU integration theories.

1.2 Political economy: winners and losers of reforms

A branch of literature in political economy which combines elements of economics and political science analyses the political economy of reforms. As it can be applied to both inaction and reforms, it is suitable to explain the heterogeneity of policy outcomes. However, this approach has some limitations as well. Advocates of this this perspective argue that, even when in economic terms a certain reform appears reasonable, political constraints may obstruct, delay or reverse reforms, especially if reforms *ex-ante* clearly define losers (breaking up monopolies) rather than emphasising societal benefits (macroeconomic stabilization) (Drazen 2000, chap. 10). In political economy, actors are rational and make decisions to maximise their utilities. However, as opposed to the purely demand- and supply-based theories in economics, political economy research assumes that states have their own agendas beyond interventions in case of a market failure. The importance given to states and politics is a departure from neoclassical economics and its assumptions of Pareto efficiency and perfectly informed actors. If 'economics is the study of the optimal use of scarce resources, political economy begins with the political nature of decision making and is concerned with how politics will affect economic choices in a society' (Drazen 2000, 5). Frohlich and Oppenheimer argue that political actors' preferences follow the chances of getting or holding political offices (1978). Thus, politicians have dual concerns, increasing the chance of staying in office and increasing the rewards from office, which frames their actions. When incumbent politicians, who started a reform, face possible losses in elections, they are likely to create 'political irreversibilities' for their successors to back their reform (Drazen 2000, 636).

Drazen argues that the key to explaining inaction or delay are conflicts of interests, and the 'easiest' explanation of non-adoption of a policy is that policies are chosen 'by a minority whose interests are different and who would be hurt by the change' (Drazen 2000, 411). Any

current institutional equilibrium is not necessarily considered as the best arrangement by all the actors, but, due to the occurring costs, changes are not made unless costs and benefits alter and it triggers re-negotiation (North 1990, 86). According to North and Thomas, 'some disequilibrium must occur in the system that adds weight to the profit side in the judgement of the decision-making individuals or groups, i.e. the perceived benefits must have risen, the costs fallen, or both' (North and Thomas 1970, 9). Whenever there are changes at the level of domestic political processes, there will be 'beneficiaries' as well as 'victims'. Based on Rogowski, in such a case the beneficiaries of change will try to push reforms and accelerate them, while victims of it will endeavour to retard or halt it. Those who enjoy a sudden increase in wealth and income will thereby be enabled to expand their political influence as well (Rogowski 1989, 4–5).

A large part of the political economy of reform literature focuses on macro-reforms of countries in transition ('first stage reforms'). Such research objects can be often found in articles written in 1990s or early 2000s, after the collapse of the Soviet Union. However, even quite recent articles analyse post-socialist reforms, for example Gehlbach and Malesky (2010) or Balcerowicz (2015). Nonetheless, reforms in the energy markets can be referred to as 'second stage reforms', which are 'more demanding because their impact is less immediate and visible while their costs tend to be borne by specific groups that have therefore more incentives to organize in order to resist the reforms' (Naim 1999). The final societal benefits of the liberalisation of energy markets may initially not be that obvious, while the losers of reforms are clearly identifiable from the very beginning. Attempts of price liberalisation and 'decontrol of artificially low prices' are especially 'unpopular and hence politically difficult' (Drazen 2000, 661). Although it is deemed to be beneficial to the population as a whole, price liberalisation 'implies extremely large gains for some, smaller gains for others, and losses in welfare for those who benefited most from artificially regulated prices' (Drazen 2000, 663–

64); in the utility sector the latter ones are usually household consumers, and they are the electorate. To sum up, while the future benefiters of economic reforms are unclear, the immediate 'losers', the electorate, are predictable.

Even the literature of political economy that considers international institutional actors, focuses more on the political economy of IMF actions than on the ones of the Commission.[5] Both institutions promote the liberalisation of energy markets, IMF across the globe, and the Commission in the EU. However, the questions of security of supply and cross-border diversification are only on the Commission's agenda. While there is plenty of research explaining the liberalisation (in energy or other fields) by political economy approaches, there is hardly any diversification explained by it. To overcome of the partial ignorance of EU integration, there have been attempts to combine EU integration research and political economy frameworks. For example, some articles published as research of EU integration and not political economy, presented empirical evidence that the transposition of EU regulations depends on the chances of staying in office. Some researchers found evidence that the likelihood of non-transposition of EU directives is higher when they coincide with national elections or/and economic hardship (Kaeding 2008, Thomas 2013). According to Sedelmeier (2009), the perceived costs of the implementation of the EU regulations may increase if EU requirements target private actors on whom the government depends on to stay in power.

The last weakness of political economy of reforms approaches is that even though it recognises the role of rational thinking politicians, institutional veto players, the timing of elections, and the costs of the reforms as constraints, it provides little explanations of why politicians opt for reforms. For example, in his chapter on economic reforms and transitions of former socialist countries, Drazen considers reforms to be the 'adoption of a superior policy' (Drazen 2000, 617). He also claims that 'goals such as liberalisation, privatisation, and

[5] A search of the term 'political economy' and 'IMF' in EBSCOhost Online Research Databases in early 2017 returned twice more results than the same term and 'European Commission'.

democratization are worthwhile in themselves' (2000, 620). In this way, preferences of 'benevolent' politicians towards reforming are taken as given, and research analyses what are the reasons for delays. Such an approach fails to explain why politicians that try to increase their chances of staying in office or increasing the rewards from it, yet are making reforms, which may be politically costly to them.

To summarise, a number of weaknesses in the political economy of reforms theory limits its capacity to explain the diverging implementation of EU legislation in domestic natural gas sectors. Firstly, they mainly concentrate on 'first stage reforms', which are 'decree-driven, hard-to-decide but simple-to-execute macroeconomic shocks' (Naim 1994, 35), such as macroeconomic stabilisation or currency reforms. Secondly, similar to the policy diffusion literature political economy studies often do not have an 'EU variable'. Thirdly, while they are suitable for explaining political preferences in delaying costly reforms, they fall short of explaining why office maximising politicians do start them nonetheless. Due to these weaknesses, the political economy literature cannot fully serve the aims of this dissertation, but interest-based approaches in the political economy can help to explain the interests behind the scenes and the logic of 'winners' and 'losers' of reforms within causal mechanisms. In addition, since the EU directives and other regulations usually have longer time horizons than election periods, the notion of 'political irreversibility' is also helpful to explain why reforms in natural gas markets may not be reversed after government changes.

1.3 Classical EU integration theories

The drive by supranational institutions to liberalise and integrate natural gas markets across the borders of sovereign states is very specific to the EU because of the EU variable in the natural gas markets on the European continent, such as EU directives, regulations and activities (enforcement of competition). The drive for introducing the market model in gas and the fact that it is the EU that emerges as a key factor in this context makes it imperative to look

at theories of EU integration.

The literature on EU integration has changed together with the changing and expanding the European Union. First, there was a search for a 'deeper and wider' Europe as a grand project and analysis of its enlargement and boundaries (Haynes and Pinnock 1998). Classical EU integration theories attempted to explain the developments of the EU and supranational policy making. Later theories started addressing the reasons why, even though the European Union existed and was enlarging, the convergence with EU policies happened at very differing pace and degree both across sectors and across countries. In this vein, early theories of European integration may attempt to explain *why* changes occur, whereas the later analyses *how* the changes occur. Thus, some of them have more weight on the rationale of the European integration, and others rather on the mechanisms.

There is a wide array of 'classical' or 'early' EU integration theories (see, for example, Schmitter's attempts to place more than 20 EU integration theories on a two-dimensional property space (2004)). Two of them, namely, liberal intergovernmentalism and (neo)functionalism, come close to explaining EU integration in two-level (domestic and EU) research arena.

In liberal intergovernmentalism the preferences are formed domestically, and then international bargaining takes place. As Moravcsik and Schimmelfennig explain, liberal intergovernmentalism centres on grand decisions – EU treaties and on the grand bargains between governments (which would be, for example, the Treaty of Rome, the Single European Act, and the Maastricht Treaty). Preferences are formed domestically, taking into account interests of domestic actors, and bargaining takes place at the EU level (Moravcsik 1993; Moravcsik and Schimmelfennig 2009). According to intergovernmentalists, the Commission institution either increases the efficiency of interstate bargaining and/or strengthens the autonomy of national governments compared to social groups within the domestic policy

(Moravcsik 1993, 507).

Regarding European market integration, liberal intergovernmentalism would predict an outcome of a grand bargain, an agreement would be reached at the 'lowest common denominator' and with minimal compromise (Stephanie 1999). It is possible to speculate that this could lead to two outcomes. It would be low integration if the member states develop their markets based on the 'lowest common denominator' agreement. Conversely, steep changes towards deeper integration and rise of competition in the natural gas markets could mean that member states' governments' preferences converge. In either case, it would predict similar developments in each natural gas market of the EU member states which are not the case in reality; therefore, traditional liberal intergovernmentalism theories provide little theoretical tools to explain differences in the European energy markets.

Neo-functionalism could come closer to explaining changes in natural gas markets by assigning rising autonomy to supranational institutions and by the direction of causality of changes from top-to-down. Neo-functionalism places major emphasis on the role of non-state actors in integration and predicts that supranational institutions may have their own interests that may diverge from its creators, the members States (Schmitter 2004, 3). Even so, and even ironically, the lack of integration of natural gas markets may be a big puzzle for neo-functionalism: the central prediction of neo-functionalism is that economic integration would be self-sustaining through the concept of spill-over. The whole idea of EU's single market provisions in the sector of natural gas is to target consumer welfare[6]. Therefore, neo-functionalism would predict that this economic advantage would drive integration of natural gas markets. Contrary to such predictions, the Single European Act has existed since 1986, but energy markets have not yet integrated.

[6] Targeting consumer welfare can be seen from the rhetoric of the EU institutions: the directives aim "to deliver choice for consumers of the EU, be they citizens or businesses, new business opportunities and more cross–border trade, so as to achieve efficiency gains, competitive prices, and higher standards of service, and to contribute to security of supply and sustainability' (European Parliament and Council of the EU 2009).

Despite very 'European' issue such as natural gas markets in the EU, early EU integration theories would fall short to explain differing outcomes in different countries. Already in 1996, Schmidt challenged 'sterile debates and dubious' applicability of 'classical' EU integration theories ('dichotomous debate between intergovernmentalism and supranationalism') for their inability to explain telecommunications and electricity (Schmidt 1996). By representing non-homogenous integration across the EU member states with regard to certain policy areas, instances of differentiation 'fall outside the scope of traditional integration theories' (Andersen and Sitter 2006, 320). The main focus of the dissertation is not the Single European Act or other 'grand bargains', but structural changes in the natural gas markets of the member states following the efforts of the supranational institutions to create an internal natural gas market. Moreover, the focus of the dissertation leaves aside all the EU integration theories that deal with the 'uploading' of the national preferences to the 'upper', supranational. Therefore, the EU integration theories that analyse upwards directed causality and the impact of member states on the EU-wide decisions are not relevant to this dissertation. Thus, the international/external/exogenous forces need to be seen as an explanatory factor for changes at the domestic level. The concept of Europeanisation, discussed next, is considered to be 'younger' and less developed than the 'classical' EU integration theories (Exadaktylos and Radaelli 2009; Radaelli 2002).

1.4 Europeanisation and differentiated integration

Moving away from literature on the reasons of EU integration, theories of Europeanisation and differentiated integration come closer to the aims of this dissertation as they focus on the outcomes of EU integration processes. Even though Europeanisation and differentiated integration literature sometimes stands as a separate branch, these research strands frequently appear together. Convergence or divergence of policies, as Radaelli notes, may be consequences produced by the process of Europeanisation (2002, 6). The same applies

to this thesis.

In a systemic literature review on Europeanisation and theories of EU integration, Exadaktylos and Radaelli (2009) discuss Europeanisation as a sub-field of European integration studies. However, the main difference between Europeanisation (or differentiated integration) approaches and 'classical' EU integration theories is the period of their research: EU integration theories frequently explain adoption of EU policies, and Europeanisation – developments afterwards. In this vein, Radaelli (2002) and Bulmer and Radaelli (2004) state that Europeanisation is about the effect of EU policies on national policies *after* their adoption at the supranational level. Thus, despite the fact that 'Europeanisation would not exist without European integration' (Radaelli 2002, 6), it is used to analyse the processes following EU rule setting (Caporaso 1996). The main interest of Europeanisation literature lies in whether and how the ongoing process of European integration has changed nation-states, their domestic institutions and their political cultures, as well as the impact of Europeanisation on both, formal structures and informal structures. Differentiated integration is conceived of as variations in the implementation of EU policies, such as directives. The compliance literature in particular deals with differences in national approaches. This research strand analyses the national transposition of EU directives across member states, assessing the compliance with EU laws, the non-respect of timeframes for transposing directives into domestic law, that is transposition deficits, and the lack of implementation after transposing directives.

There are other differences between Europeanisation literature and the 'classical' EU integration theories, such as the interest in mechanisms, while having less expectations that outcomes would converge across cases. A review by Exadaktylos and Radaelli reveals that the focus of Europeanisation studies is rather on mechanisms than on single independent variables. They also demonstrate that in Europeanisation theories effects-of-causes are preferred to causes-of-effects as in works on European integration (2009). Europeanisation studies usually

deal with top-down processes (Exadaktylos and Radaelli 2009, 510; Featherstone and Radaelli 2003). According to Caporaso (2008), this top-down perspective has two functions. First, it highlights the role of European politics and institutions as an independent variable/causal condition as it turns 'the causal arrows around and asks how European integration and everyday policy making affect domestic structures'. Second, it emphasises the processes in which domestic structures get adapted to European integration forces (Caporaso 2008, 27). The interest in processes in the Europeanisation literature tends to dominate, so that often concept definitions of Europeanisation seem to be cut from the same cloth as a concept of policy diffusion, the major difference being the emphasis on EU variables. For example, Featherstone and Radaelli (2003) define Europeanisation as 'processes of (a) construction, (b) diffusion, and (c) institutionalization of formal and informal rules, procedures, policy paradigms, styles, 'ways of doing things', and shared beliefs and norms which are first defined and consolidated in the making of EU public policy and politics and then incorporated into the logic of domestic discourse, identities, political structures, and public policies' (2003, 30).

In the top-down analysis of EU influence, the role of domestic executives and national governments is of utmost importance. According to Laffan, 'core executives' project 'domestic preferences in the EU arena and act as translators and editors of EU policies, norms and practices in the domestic arena' and therefore Laffran calls them 'key nodal points' (Laffan 2007, 129). 'Core executives' include the prime minister, the government, ministries and the administrative service (Laffan and O'Mahony 2007, 169). Their importance arises from several sources. National governments are more embedded into EU policy making and political networks than other national actors and they have political and administrative resources. Also, their constitutionally defined position endows them with legitimacy (Laffan 2007, 129). The more recent literature on Europeanisation concentrates on how the process of integration poses difficulties or provides opportunities for national actors (Mair 2008, 154). According to Mair,

by removing certain policy areas from the exclusive authority of the national political arena, Europeanisation exerts indirect influence on the way in which parties compete with one another (Mair 2008, 154).

Europeanisation research 'challenges expectations of a far reaching harmonization and convergence of policies and politics in EU member states' (Lehmkuhl 2006, 1). Some scholars have described the uneven outcomes of Europeanisation as 'messy' (Windhoff-Héritier 2001) and 'fuzzy' (Andersen and Sitter 2007, 2015). Radaelli distinguishes inertia, absorption, transformation or retrenchment as possible reactions to EU policies (Radaelli 2002). Similarly, Börzel discusses pace-setting (actively pushing policies at the European level, which reflect a member state's policy preference and allow to minimize implementation costs), foot-dragging (blocking or delaying costly policies in order to prevent them altogether or achieve at least some compensation for implementation costs) and fence-sitting (neither systematically pushing policies nor trying to block them at the European level but building tactical coalitions with both pace-setters and foot-draggers) (Börzel 2002). Falkner and Treib (2008) found that some countries (especially new EU member states) may transpose the directives timely but later fail to implement and comply. Thus, they suggest a fourth 'world of compliance', the 'World of Dead Letters', to complement the previously defined three worlds of compliance (Falkner and Treib 2008).

The possibilities to combine the analysis of top-down factors of influence with an analysis of domestic interest structures make Europeanisation theories appear particularly promising for the aims of this thesis. By and large, the EU impact on natural gas markets can be conceptualised as a two-step process. First, different waves of the Natural Gas Directives and developments of competition rules form institutional environments at EU level. These rule sets are then 'downloaded' to the national level where they have differing impacts. The energy sector is particularly interesting to research, because 'there are strong economic interests in this

industry and, accordingly, strong motives for voluntary non-compliance with problematic provisions of the acquis' (Maniokas 2009, 9), which may lead to divergences among member states. Furthermore, Europeanisation theory is also useful due to its focus on mechanisms, which may help to grasp the 'how' of EU impacts. Insights into the 'vagueness' of EU legal instruments whose 'degrees of freedom' leave room for interpretation to national actors are also useful for the analysis of gas markets. In addition, Europeanisation theories emphasize the importance of state actors in translating EU regulation on the national level. Even though some literature on differentiated/flexible integration touches upon enlargement questions, such as the 'two-speed Europe' (for example, Egeberg and Trondal 1999; Kolliker 2001; Majone 2008; Hobolt 2014) or the fiscal/banking union (Thygesen 1997; Sutter 2000; Dyson and Marcussen 2010; Schweiger 2014), the majority of research concentrates on single market questions, amongst them Eyre and Lodge (2000), Dougan (2000), Andersen and Sitter (2006), Knill, Tosun, and Bauer (2009), Buchan (2012), Andersen and Sitter (2015).

Within the Europeanisation research, I want to distinguish two major schools of thought, whose core explanations of differential outcomes diverge. The first conceptualises Europeanisation as a response to a more static, one-off EU policy, the second views Europeanisation as a more dynamic process. I suggest grouping researchers who focus on the mismatch between the requirements of EU policies and national policies in the first group. For example, Green Cowles, Caporaso, and Risse-Kappen at least implicitly treat the 'goodness of fit' as an explanatory factor related to mechanism of change. A large 'misfit' between proposed EU directives and existing national strategies is expected to induce more resistance to the Europeanisation process (2001, 61). Others look at interplay of ambiguous formulations, requirements varying from tight to loose and autonomy of local actors in the hierarchical relationship between the EU and the national level, which indicates more focus on the EU policy input and less on the policy receiving end (Andersen and Sitter 2007). As Windhoff-

Héritier claims, EU legislation at its initial phase is often loosely framed and leaves room for a differential solution at the member states' level (Windhoff-Héritier 2001, 2). In other words, authors who explain the differential results of Europeanisation draw attention to the 'degrees of freedom' of the Natural Gas Directives (Arentsen 2004, 75). Some authors distinguish between EU-level explanations, such as a directive's complexity (Haverland and Romeijn 2007; Kaeding 2008; Thomas 2013), the decision-making on the EU level (Haverland and Romeijn 2007; Kroll and Leuffen 2015), and the room for discretion allowed by the Directives. The causes of non-compliance are related to domestic decision-making structures, for instance, the overall efficiency/capability of a member state's or administrative structure to transpose directives (Haverland and Romeijn 2007; Maniokas 2009; OECD 1998), parliamentary involvement (Haverland and Romeijn 2007), or negotiation processes between bureaucratic/administrative and political transposition actors (Kaeding 2008; Steunenberg 2007).

For the purposes of longitudinal case studies such as this thesis, authors who see Europeanisation as a dynamic transformation process can provide a more valuable theoretical framework. Rather than regarding being Europeanisation a 'single independent variable' for reforms, they view it as serving 'as a kind of catalytic transmission of these pressures' (Schneider 2001, 61, 72). Prominent examples of this are works on policy fields where Europeanisation entails substantive reforms. No surprise that it was precisely these sectors where member states retained their autonomy the longest: telecommunications, energy, banking etc. (to name a few, Schneider in 2001 analysed reforms in telecommunications, Lütz in 2005 the finance sector in transition, and Lehmkuhl in 2006 transport sector).

Schneider conceives the Europeanisation (or, as he calls it, the policy diffusion) process as multilevel and dynamic, where inter- and supra-national organizations, such as the Commission, transmit policies. The process of member states adapting to those policies

depends on the national interest structure ('interest positions of the major political actors for or against institutional changes, weighted with their power resources'), the degree of institutional entrenchment and the number of 'veto players' in a particular policy subsystem. The interest structures may be reform-prone or status-quo prone (Schneider 2001, 74–75). Similarly, there is a number of studies on the impact of EU policies on domestic reforms that analyse how, by constraining the choices of reform opponents (Lütz 2005, 141) or by using EU-level policies to circumvent national veto points (Schmidt 2005), these policies strengthen the positions of reform advocates. *Opportunity structure* is defined as the sum of diverse structural limitations and structural freedoms that affect the behaviour of agents. According to Williams, when formal and informal rules change, they may 'open' or 'close' over time, 'narrow' (reduce the likelihood of success of reform movements) or wide (increase the probability of success) (Williams 2010, 443). The changes in *opportunity structures* are also described as convergence or coupling of *processes* (Kriesi 2007, 67). Lütz understands *opportunity structures* as EU policy context 'within which the advocates of reforms were able to constrain the choices of those preferring the *status quo*' (2005, 141). In his analysis of the influence of European and international liberalisation on the German finance sector, Schmidt (2005) finds that 'top-down' pressures to reform are part of the reasons for actual changes, while also national actors attempt to use the European context as an *opportunity structure* to push their interests. She argues that the system of multilevel governance (particularly EU competition policy) served as an *opportunity structure* 'for those reform advocates who lacked the institutional resources to realise their preferences in the domestic context' (2005, 193). Domestic reforms can go beyond EU requirements (2005, 170).

Admittedly, the concept of domestic political *opportunity structure* is in particular used in studies on social movements (see for example, De Fazio 2012, Hooghe 2005; Lee 2011; Poloni-Staudinger 2008; Stevenson and Greenberg 2000; Wahstrom and Peterson 2006;

Williams 2010). However, despite of its proliferation in the social movements research, the notion of opportunity structures was actually borrowed from the political process framework and is also found in the literature on the liberalisation of different sectors in the European Union, such as EU transport liberalisation (Knill and Lehmkuhl 2002).

Knill and Lehmkuhl (1999, 2002), who join other authors in their understanding of Europeanisation as transformative processes, propose three conceptual models of these processes. They have similar understanding to the role of domestic interests to Schneider (2001). While Schneider speaks of domestic *interest structures* (2001, 74), Knill and Lehmkuhl use the terms *actor coalitions* and *interest constellations* (2002, 261)**.** According to them, EU policies vary from those which are very prescriptive and have direct institutional impact to others which "only" aim to change domestic beliefs and expectations (Knill and Lehmkuhl 2002, 257–58). Europeanisation mechanisms confined to changing domestic opportunity structures stands somewhere in the middle of this range. This kind of two-tier mechanism of Europeanisation can be encountered in EU market-making policies , where 'policies basically exclude certain options from the range of national policy choices rather than positively prescribe distinctive institutional models to be introduced at the national level' (Knill and Lehmkuhl 2002, 258). In Knill and Lehmkuhl's view, Europeanisation processes have an impact on the domestic level when 'European legislation may affect domestic arrangements by *altering the domestic rules* of the game […] and hence the distribution of power and resources between domestic actors. Such changes in domestic opportunity structures in turn may imply that existing institutional equilibria are successfully challenged. New strategic options emerge and other strategies may no longer be feasible' (Knill and Lehmkuhl 2002, 258).

Knill's and Lehmkuhl's mechanism as illustrated in Figure 1 below works as follows. The first explanatory step identifies the equilibrium of *constellations* of domestic interests and whether changes are possible due to EU policies redistributing the power in balanced

constellations. This first step does not tell much about the direction of any domestic change but only about the likelihood of it. Knill and Lehmkuhl expect that EU regulations will not trigger EU-induced changes if pro-reform actors do not have enough resources and/or access to power at a decisive period. They write: when 'domestic opportunity structures and *interest constellations* are characterized by the clear dominance of one actor coalition', the 'potential domestic impact of Europe will be much lower', because 'in these cases new opportunities and constraints for domestic actors are less likely to alter the existing distribution of powers and resources between domestic actors' (Knill and Lehmkuhl 2002, 261). In case of balanced *interest constellations* at national level, EU policies are more likely to tip the scales in favour of one actor coalition, while the presence of one dominant *actor coalition* is likely to result in a rather low domestic impact of the EU, preserving the *status quo* (2002, 258).

The authors do not expect the fourth way – a dominant pro-reform *interest constellation* to exist - and do not explain the reasons behind this. It could be inferred that since EU single market policies aim to remove discrimination (Ortino 2004, 18), to ensure the free movement of goods and services (Scharpf 1997, 1), remove obstacles to market integration, limit monopoly power and market dominance (Majone 2005, chap. 7), it is unlikely that the majority of powerful actors would be in favour of such significant changes. The likelihood of dominant pro-reform *interest constellation* is even smaller in the energy sector, which is an area that is traditionally dominated by internal member state interests.

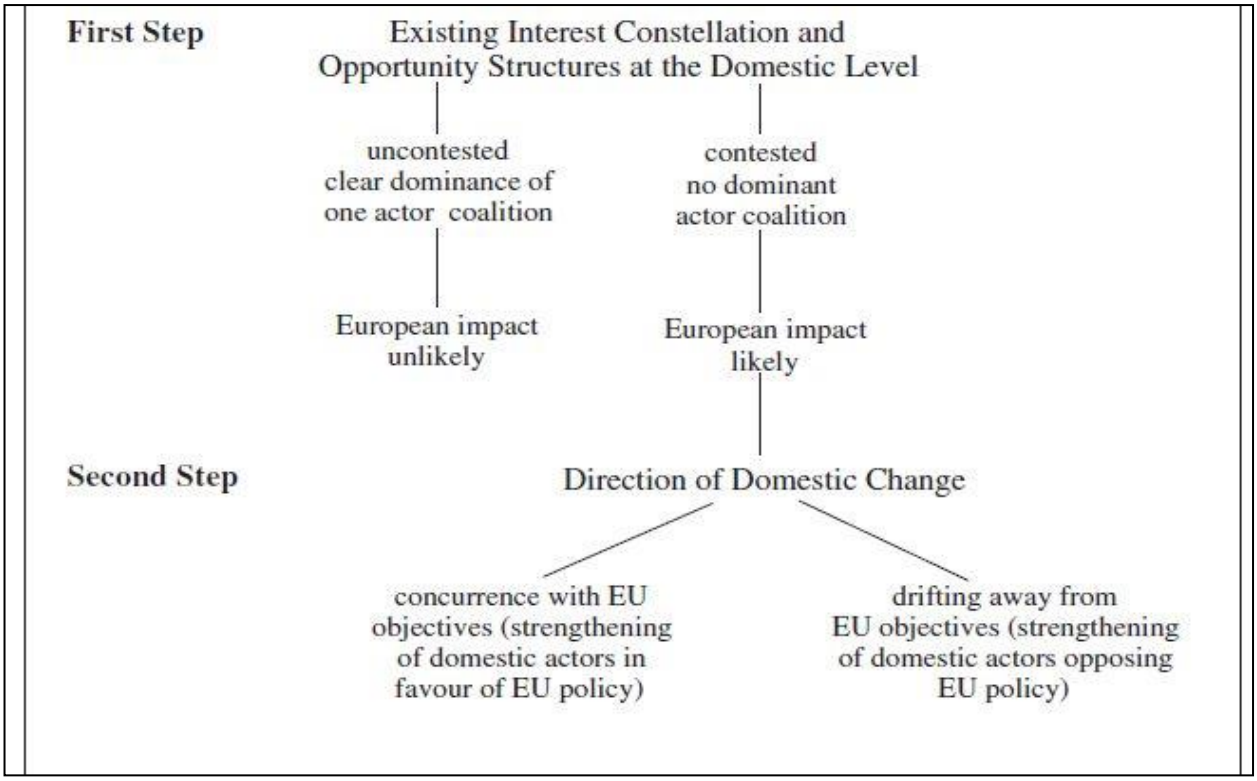

Figure 1 Europeanisation by changing domestic opportunity structures: Explaining varying domestic responses (Knill and Lehmkuhl 2002, 262)

The second explanatory step (which is important in the case of balanced *constellations*) consists in analysing the fit between domestic reforms and EU regulatory objectives. This helps to predict the direction of possible policy changes. Knill and Lehmkuhl expect that if no actor coalition is clearly dominant, policy changes will be implemented which are in favour of those actors who get strengthened by the European policies (2002, 261).

The last section of this chapter presents the conceptual framework for this thesis on which causal process tracing mechanisms in CH 3 are based. The conceptual model is an adaptation of the Europeanisation model by Knill and Lehmkuhl combined with political economy of reform.

1.5 Merging Europeanisation with political/economic interests

Knill's and Lehmkuhl's Europeanisation framework is used for an overall conceptual model, and insights from political economy of reform are used on a lower analytical level for causal process-tracing mechanisms.

I adapted the model of Knill and Lehmkuhl in the following three ways. First, I consider that only two out of free pathways of developments are possible, namely, that either dominant *interest structures* lead to no significant changes or *balanced interest structures* lead to changes. I do not consider the third pathway they propose where in balanced *interest structures* EU policies would strengthen the proponents of the *status quo*. Knill and Lehmkuhl found such situation in French transport policy, where, as they say, EU liberalisation led to a 'domestic counter-reaction which resulted in the already liberalized French regime being considerably reregulated' (2002, 261). They explain that hauliers' associations increasingly coordinated their activities and trade unions emerged as a new actor in calling for protection of the national industry and their workforce. Reference to the European threat, according to them, was a 'significant factor in contributing to a strengthening of the opposition to effect a shift in the balance in favour of reregulation' (2002, 271). I would consider this to be a special case, and reference to 'European threat' by *status quo* proponents is not exactly the direct case of EU policies strengthening opponents of the reform. Therefore, the pathway of EU policies strengthening opponents in the cases of balanced *interest structures* is not considered here and rather is an implicit counterfactual pathway in the cases where balanced *interest structures* were identified.

Second, I adapt the model to the fact that this dissertation reviews extended periods of time during which power and/or positions among different actors in a member state may change. The model of Knill and Lehmkuhl is better fitting for short periods of time, during which identified *interest structures* would not change. Therefore, this model does not only have balanced or dominant interest structures as starting points, but also allows for a power reshuffle between *actor coalitions* during the research period (the dashed line in Figure 2), which then would cause retrenchment from the developments under prior balanced *interest structure.* Taking all this into account, the initial general causal model of Europeanisation by Knill and

Lehmkuhl is adapted to analyse EU impacts on developments in different national gas sectors, presented in Figure 2 below. The third way of adaptation is methodological. Even though Knill and Lehmkuhl provide a useful analytical tool to evaluate the reasons of varying impact of EU in different EU member states, they do not provide ways to measure balance or dominance of *interest structures*. Nor do they show how exactly balance or dominance of interest structures leads to impacts of the EU on the domestic level. This thesis goes one step further than simply adapting and applying the aforementioned model to EU's gas market. It complements the theory with strategies of evaluating the balance or dominance of *interest structures*, presented in CH 3, which consist of the identification of the salient questions, and respective interest and power positions of actors.

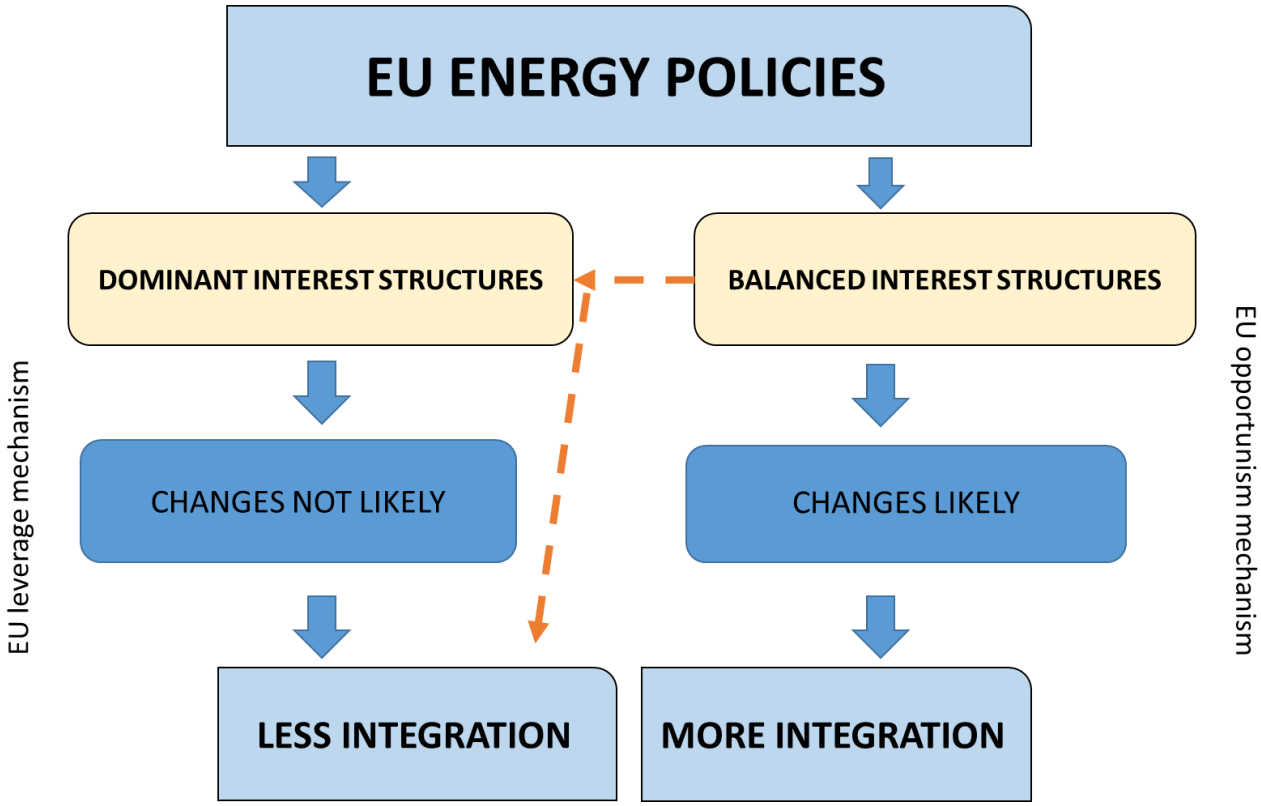

Figure 2 Possible domestic responses to changing EU-level opportunity structures adopted from Knill and Lehmkuhl

As seen in Figure 2, being uniform to all EU member states, EU gas sector policies cannot explain the differing paths the countries have taken. However, they are analysed in CH

2 as potential constraints and opportunities for domestic actors. Consequently, the main causal conditions triggering EU impact on the domestic level are *interest structures*. When there are actors both in favour and against gas market integration, and both sides have power, *interest structures* are **balanced.** In such cases, EU policies redistribute the power among the ones in favour of reforms, to the detriment of the advocates of the *status quo.* If *interest structures* are dominant – there are not many actors favouring liberalisation reforms and/or they do not have power - then changes are unlikely. This is because a **dominant** *interest structure* opposing EU policies would prevent the Europeanisation mechanism from developing fully. Significant changes of power positions, for example after elections, may result in the reversal of reforms even if these have already taken off.

The main observed **outcomes** in the dissertation are changes in gas sectors of EU member states resulting from EU requirements, referred to as 'gas market integration'. This term, adopted in the frame of Commission evaluations of EU energy sectors (2005), is more encompassing than just the term of compliance with EU requirements. The Commission assigned two indicators to assess 'integration between national markets': price convergence across the EU and cross-border trade. The analysis of EU instruments in CH 2 shows that in general these EU regulations strive for end-user liberalisation (as a precondition to price convergence) and security of supply (cross-border flow).

Subsequently, my first guiding hypothesis is: There will be changes in domestic natural gas sectors in line with EU legislation if domestic *interest structures* are balanced (the right side of Figure 2). Accordingly, the second hypothesis is: There will be little or no changes in line with EU legislation if domestic *interest structures* exist or arise which oppose core elements of EU policies (the left side of Figure 2). Moreover, if after elections or for other reasons balanced *interest structures* turn into dominant anti-integration structures, divergence from EU policies is expected (the third hypothesis).

I go on with adaptation of the model in adding methodological point of view in CH 3. The expected process tracing mechanisms in the case studies are more detailed narratives of the conceptual framework developed in this chapter. The underlying approach in the mechanisms comes from political economy of reform, such as heterogeneity of interests of political, sectorial and transnational actors, political decision making, election cycles, and, resulting (in)action in reforms. Before, the next chapter analyses relevant EU instruments regarding the opportunities and limitations they provide to domestic actors. It is shown that EU gas market legislation leaves certain 'degrees of freedom' (Arentsen 2004, 75) or, in the words of Kaeding, 'level of discretion' (Kaeding 2008, 121) for its transposition in terms of minimal requirements and presence of exceptions.

2 EU INSTRUMENTS AS OPPORTUNITY STRUCTURES IN GAS POLITICS

In adapting the selected Europeanisation conceptual framework to the gas sector that was selected in the previous chapter, I am interested in which political and market players EU gas sector liberalisation and diversification policies strengthen or weaken. This is because, as emphasized in CH 1, 'European legislation may affect domestic arrangements by altering the domestic rules of the game' (Knill and Lehmkuhl 2002, 258). EU member states are obliged to comply with the legally binding requirements in transposing directives or adapting to regulations or decisions. The latter two instruments are applied directly from the EU level to member states in their entirety, whereas directives must be incorporated into national legislation via parliaments and other relevant institutions transposing them. In this chapter, accordingly, first EU instruments applicable to domestic gas sectors of EU member states are reviewed.[7] Then the chapter analyses influence and the role in translating EU policies on the national level natural gas sectors by the main actors, such as political, sectorial and institutional EU players. The chapter finalises in specifying which particular actors were strengthened or constrained because of the EU polices in the natural gas sector. Concluding the chapter, I demonstrate how each of the EU instruments strengthens and constraint different public and private stakeholders at the domestic level and these effects combined change 'the rules of the game'. In certain situations, when enough actors prefer reforms in their domestic natural gas markets, they use these opportunities to overcome the resistance from the advocates of the *status quo*.

The majority of the EU policies analysed in this chapter can be summarised as focusing on the following aspects of natural gas markets: (1) market liberalisation/deregulation (downstream) and/or (2) diversification of routes and/or supply/exports/imports/security of

[7] By 'instruments' it is meant legal EU requirements, such as directives, regulations and rules coming from the EU treaties that are generally applicable to all EU member states and possibilities to involve the Commission and to receive funding that depend on activism of separate countries.

supply (upstream). Similar to this division, the Commission itself groups the EU's internal energy market legislation as either the 'Competitive Internal Market' or the 'Interconnected Internal Market' (European Commission 2016d). Making this distinction here is important because it simplifies the process of identification of the views of domestic actors and grouping them into *actor coalitions* that are for or against downstream liberalisation and/or diversification/security of supply in the case studies.

Table 1 Main EU policies affecting natural gas sectors of member states in the research period

Dimension	Legal instruments
Market liberalisation dimension	General EU competition policy and state aid rules that can be applied in the gas sector
	Sector specific First, Second and Third Natural Gas Directives (1998, 2003 and 2009), the most important piece of the EU internal natural gas market legislation)
	Gas Regulations 1775 of 2005 and 715 of 2009 that accompanied the Second and the Third Gas Directives and laid out more detailed rules
Cross-border diversification dimension	Security of Supply Directive of 2004 and Regulation of 2010
	Financing trans–European networks: the European Energy Programme for Recovery (EEPR) and Connecting Europe Facility (CEF)
Across dimensions	Commission's consultations, assistance and infringement procedures

Legal regulation of the natural gas sector of the EU's members is based on primary EU legislation, such as provisions of the Treaty of Functioning of the European Union (TFEU), and via secondary EU legislative measures. The provisions in the primary legislation are related to creating a single market for goods and services and ensuring competition (Council of the EU 2010). Secondary legislation includes various directives, regulations for ensuring security of supply, for creating trans–European networks and others. In Table 1 above is the list of the main EU policies that are deemed as significant in the research period, which includes both legally-binding (e.g. directives) and not legally-binding (i.e. the Commission consultations or funding energy projects) rules. They are discussed in this chapter.

2.1 Market liberalisation

The general EU *competition acquis* (mostly laid by the EU Treaties) and internal gas market directives and accompanying regulations (a part of the *energy acquis*) very much focus on the conditions for consumers as the final target. EU competition policy consists of supervision of state aid to businesses so that it does not distort competition (Art. 107 and 108 of TFEU), merger (Art. 119 TFEU) and antitrust regulation. The latter in turn analyses abuse of dominant position by a single company (Art. 102) or agreements between companies that restrict competition (Art. 101). Even though the directives discuss security of supply as well[8], they are mostly focused on liberalisation of the market by requiring eligibility of consumers to use gas suppliers of their choice, provision of third-party access to the system and separating interests of transmission system owners from other interests in more competitive segments. One of the main purposes of such provisions is creating competition of gas supplies for end-users.

The Commission has more freedom to maneuver in the field of competition framework than in the energy regulation. Establishing of the competition rules 'necessary for the functioning of the internal market' is an exclusive competence of the EU, and energy is a shared competence (Council of the EU 2010, Art. 3-4). Therefore, EU competition policy, coming directly from TFEU, gives more powers to the Commission to ensure compliance with the principles. If a merger or an acquisition of a company in any sector may significantly influence a market of more than one EU member state, the Commission DG Competition analyses the potential impact on competition in those markets. Then it either gives a green light to proceed with the merger or requires changes in the acquisition/merger contracts, so-called 'remedies' to counterbalance the possible anticompetitive impact. For example, this was applied

[8] Admittedly, possibilities to exempt new infrastructures that enhance competition and security of gas supply from certain provisions of the directives and clauses about regional solidarity were mostly a security of supply/diversification question. A security of supply question was also stricter certification requirements for TSOs controlled by persons from non-EU countries in the Third Natural Gas Directive, colloquially called 'the Gazprom clause' (Euractive 2007).

concerning Hungary when in 2005-2006 German E.ON acquired a part of business from MOL, and the Commission gave a green light to it only if certain conditions were fulfilled (European Commission 2005). In the antitrust realm, the Commission DG Competition observes whether dominant suppliers abuse their market position and whether there are any illicit cartels that may deprive consumers of a fair price of goods. Based on the Regulation 1/2003, the EU competition policy is enforced via a decentralised system, in which the Commission and national competition authorities of the EU member states form the European Competition Network, which deals with the infringements of the TFEU (Wils 2013). During the investigations, the Commission officials are accompanied by their counterparts from relevant national competition authorities.

Directives, decisions and regulations are secondary EU legislation, adopted in accordance with the primary legislation, TFEU. The secondary legislation regarding the energy sector is mainly based on such principles as free movement of goods (Articles 34–37 of TFEU) and free movement of services and capital and right of establishment (Articles 49–66 of TFEU). Regulations (and decisions) tend to command more detailed provisions while directives outline more general principles with more specific provisions to be developed at the national level (Ortino 2004, 18). Even though regulations have direct application at the national level (OECD 2010, 97), in reality they may be followed by changes in national regulations and legislation. Directive as a policy instrument 'provides member states with some leeway concerning form and method' (Haverland and Romeijn 2007, 758). Directives often leave considerable room for discretion in domestic transposition and implementation, and that may have consequences as 'significant as across–sector variation in the EU as a whole' (Andersen and Sitter 2006, 321).

The cornerstone framework of the single EU natural gas market is composed of three subsequent internal gas market directives, which established common EU rules for transmission, distribution, supply and storage of natural gas (European Parliament and Council

of the EU 2009, Art. 1). The first attempt to lay down sector-specific rules for the functioning of the EU gas market was Directive 98/30/EC Concerning Common Rules for the Internal Market in Natural Gas in 1998 that had to be implemented by mid-2000 (hereinafter, the First Natural Gas Directive) (European Parliament and Council of the EU 1998, 30). It was followed in 2003 by the Directive 2003/55/EC Concerning Common Rules for the Internal Market in Natural Gas that had to be transposed by 1 July, 2004 (hereinafter, the Second Natural Gas Directive) (European Parliament 2003).[9]

The Third Natural Gas Directive, one of the fundamental parts of the so-called Third Energy Package of 2009, was mainly built on the previous natural gas directives. The major differences between the Second and Third Natural Gas Directives were new or strengthened requirements with regard 'to the unbundling of networks, the independence and the powers of national regulators and the functioning of retail markets via enhanced consumer protection measures' (European Commission 2014d, 2). Member states had to transpose the Third Natural Gas Directive and apply the majority of its requirements by 3 March, 2011 (2009, Art. 54), except for unbundling of TSOs that had to be applied by 3 March, 2012 (2009, Art. 9). The two most difficult options to implement, one of four unbundling options, ownership unbundling (OU), and the implementation of the 'third party TSO certification' (Article 11), had to be in effect no later than March 2013 (European Commission 2010; European Parliament and Council of the EU 2009, Art. 54).

There are three ways how internal market directives seek to liberalise the gas sector, namely, opening the market (making consumers eligible), third-party access to system and separation of interests of gas infrastructure owners. Market opening goes hand in hand with deregulation of end-user prices, even if it is not the same. Conversely, the natural gas directives are in favour of regulating a part of the tariff that competitors of the vertically integrated

[9] For extensive analysis of the three generations of the EU internal gas market directives please see (Yafimava 2011, chap. 5)

companies pay for using their transmission, distribution and LNG systems, which are areas of natural monopoly[10]. It was deemed by the Commission that gas companies, which have business interests on more than one level of the gas sector, referred as vertically integrated operators of the network/infrastructure, could have had both incentives and means to discriminate possible competitors and to favour their own affiliates in third party network access and investment in infrastructure development. Thus, unbundling, which means separation of networks (pipelines) from production (upstream) and supply (downstream) interests was expected to be a remedy to the situation (European Commission DG Competition 2007).

Each directive left fewer 'degrees of freedom' to national implementing institutions as to how many consumers can have free choice, and the Third Natural Gas Directive required making all consumers, including households, eligible. The overall idea behind market opening is allowing consumers to choose energy suppliers instead of continuing to buy energy from the prescribed ones under regulated end-user prices. In other words, consumers have to become eligible to buy gas from the supplier of their choice. The First Natural Gas Directive began the process of transition towards deregulation, firstly allowing industrial customers the choice of supplier. This Directive required that at least gas-fired power generators and other very large gas consumers would become 'eligible'. The share of market opening was initially expected to constitute at least 20% of the total annual gas consumption of the national gas market, to increase 33% 20 years after the entry into force of this Directive, and in certain cases 43% of consumption 10 years after the entry into force of this Directive (European Parliament and Council of the EU 1998, Art. 18). However, a gradual market opening started by the First Natural Gas Directive 'tended to create serious imbalances' (Cameron 2005, 49), as some countries proceeded beyond the requirements, and others not. According to the Second Natural

[10] Natural monopoly exists "if the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more" (Posner 1999).

Gas Directive, from 1 July, 2004 non-household customers, and from 1 July, 2007, all customers had to be eligible to switch suppliers. In this way, it left some 'degrees of freedom' before 1 July, 2007. This 'freedom', however, could be used only upwards in terms of increasing the share of eligible consumers and fully open the market earlier than the final deadline set in the Directive. No 'degrees of freedom' were allowed after 1 July, 2007 unless a derogation was applied. The Third Natural Gas Directive also required member states to ensure that 'all customers connected to the gas network are entitled to have their gas provided by a supplier regardless of the member state in which the supplier is registered' (European Parliament and Council of the EU 2009, Art. 3).

Making consumers eligible does not mean that national authorities are obliged to push eligible consumers out to the unregulated market segment or to cease regulating all end-user prices altogether, but goes to that direction. The general view of the EU institutions is that end-user price regulation constitutes barriers to entering retail energy markets and has negative impact, especially if prices are set below costs (ACER 2015b, 113). It is noted that regulated end-user prices, if kept low by NRAs or politicians, demotivate eligible domestic consumers from leaving the regulator and entering the free market with potentially higher prices. It is important to note that despite increasingly strict requirements to allow consumers to choose suppliers, none of the three Natural Gas directives prescribed ending the end-user price regulation, especially for households. The Third Natural Gas Directive states that regulated transmission and distribution tariffs should be cost-reflective (in the recitals). It also requires that those access to system tariffs should allow the necessary investments in the networks and LNG facilities to ensure viability of those networks and facilities (Article 41 (6) a) (European Parliament and Council of the EU 2009). The directives in essence omitted the whole question of end-user price regulation, except for indirectly approaching this question in discussing the public service obligations. All three directives allow member states to impose on natural gas

companies, 'in the general economic interest, public-service obligations which may relate to security, including security of supply, regularity, quality and price of supplies, and to environmental protection' (European Parliament and Council of the EU 1998, Art. 30). Moreover, the Third Natural Gas Directive states in its recitals that 'the citizens of the Union and, where member states deem it to be appropriate, small enterprises, should be able to enjoy public service obligations, in particular with regard to security of supply and reasonable tariffs' (European Parliament and Council of the EU 2009, para. 47). This may be understood as a green light to regulate end-user prices and make them 'reasonable' and call it a 'public service obligation'.

Nonetheless, as interpreted by the European Court of Justice (ECJ) ruling in 2010, the prices for business consumers should not be regulated, and the regulated prices in general must be for a limited time only. The case was based on the Second Natural Gas Directive and the Italian authorities which in 2007 gave the power to the Regulatory Authority for Electricity Gas and Water to define 'reference prices' for the sale of gas for supplies of natural gas to domestic customers. The ECJ interpreted that even though the Second Natural Gas Directive did not preclude national legislation from defining the 'reference prices', such interventions could last for a period that is 'necessarily limited in time' and 'guarantees equal access for EU gas companies to the consumers'. Regulating 'reference price' was allowed for as long as such intervention 'pursues a general economic interest consisting in maintaining the price of the supply of natural gas to final consumers at a reasonable level' in finding a balance 'between the objective of liberalisation and that of the necessary protection of final consumers' (European Court of Justice 2010). Taking all this into account, the Commission has much fewer tools to force EU members to cease end-user price regulation for households than to ensure applications of other aspects of the directives.

In order to overcome the problem that even if customers become eligible, but there are

no other suppliers of gas in the market but the incumbent, an obligation to provide third-party access to transmission networks and/or distribution networks and/or LNG facilities (system) was established in the directives. If gas transportation pipelines belonged to vertically integrated companies, which also produced or sold gas, these companies may have had discriminatory motives towards competitors. Third-party access means that owners of pipelines are obliged to carry gas, which they do not own, for another gas supplier (a third party) and for a fee (Stern 1993). Requirements for third-party access, established in natural gas directives, left to member states to ensure that suppliers had a right to access transmission, distribution and LNG facilities and ship their gas across it to sell to the consumers eligible to change their suppliers. In ensuring third-party access, the EU directives increasingly tended to give competence for energy regulators to regulate tariffs of access instead of leaving them for negotiations between system owners and users. Already the First Natural Gas Directive required member states to ensure third-party access to transmission and/or distribution networks and/or LNG facilities (European Parliament and Council of the EU 1998, Chapter VI). The Second Natural Gas Directive explicitly required third-party access to storages as well (European Parliament 2003, Art. 18-20), and such requirements remained in the Third Natural Gas Directive. Whereas the First Natural Gas Directive of 1998 still allowed member states to choose either or both negotiated or regulated access to system (European Parliament and Council of the EU 1998, chap. VI), the subsequent generations of the directives demanded that at least third party access to the transmission and distribution system, and LNG facilities could only be based on published regulated tariffs (European Parliament 2003, Art. 18; European Parliament and Council of the EU 2009, Art. 32). This brings more competences to NRAs, but there are limitations in how they may use them. Tariffs should be set in line with certain principles outlined in the Directive and Regulation 715 of 2009 (and previously Second Natural Gas Directive and Regulation 1775). Furthermore, there are more specific requirements in the

Tariffs Network Code (European Commission 2017).

Generally, the Third Natural Gas Directive placed much more importance on the role of energy regulators than its predecessors. It sets exclusive competences to regulators in certain areas, in which, according to the Second Natural Gas Directive, another 'relevant body' could have had a final decision power. Based on the Third Natural Gas Directive, national regulatory authorities have exclusive competences to fixing or approving, in accordance with transparent criteria, transmission or distribution tariffs or their methodologies (European Parliament and Council of the EU 2009, Art. 41 (1) (a)). Regulators also had competences to fix or approve 'at least' the methodologies used to calculate or establish the terms and conditions for connection and access to national networks, including transmission and distribution tariffs, and terms, conditions and tariffs for access to LNG facilities, provision of balancing services and access to cross-border infrastructures, 'sufficiently in advance of their entry into force' (European Parliament and Council of the EU 2009, Art. 41 (6)).

In addition to previous directives, the Third Natural Gas Directive required member states to guarantee more independence of the regulatory authorities: NRAs had to be independent not only from economic, but also from state interests. The Directive required that decisions taken by regulatory authorities had to be fully reasoned and justified to allow for judicial review (European Parliament and Council of the EU 2009, Art. 41). NRAs had to be legally distinct and functionally independent from any other public or private entity, to ensure that its staff and the persons responsible for its management act independently from any market interest; and do not seek or take direct instructions from any Government or other public or private entity when carrying out the regulatory tasks. Member states also had to ensure that NRAs had separate annual budget allocations and implement them autonomously. The Third Natural Gas Directive, however, does not prescribe how national regulatory authorities should be financed – from the state budget or fees paid by market participants. It does require,

however, for NRAs to have separate annual budget allocations and autonomy to implement the budgets (European Parliament and Council of the EU 2009, Art. 39).

Board members or top managers of regulatory authorities had to be appointed for a fixed term of five up to seven years, renewable once (European Parliament 2003, Art. 39). The latter requirement meant that the terms of top-management of regulators would not coincide with parliamentary elections which are usually held every four years. It also is not precise how the management of the regulator should be assigned, what the role of parliaments, governments and presidents is in this, except for the recitals of the Directive that the autonomy of regulators should not preclude 'parliamentary supervision in accordance with the constitutional law of the member states' (European Parliament and Council of the EU 2009, para. 30). This ambiguity allows, if politicians of member states wish so, for the same institutional actor (e.g. just a Prime Minister) both to nominate and appoint the leadership of an NRA, which in certain cases may hinder independence of it.

Each subsequent directive also required stricter unbundling between interests of transmission system owners (natural monopoly) and their other businesses in production or supply (competitive business), if companies had interests in those several layers. The First Natural Gas Directive of 1998 imposed unbundling of accounts: integrated natural gas companies in their internal accounting had to keep separate accounts for their natural gas transmission, distribution and storage activities, and consolidated accounts for non-gas activities 'with a view to avoiding discrimination, cross-subsidisation and distortion of competition' (European Parliament and Council of the EU 1998, Art. 13). The Second Natural Gas Directive of 2003 added the requirement to unbundle the vertically integrated gas companies legally and functionally. Where the transmission system operator was part of a vertically integrated company, it had to be independent 'at least in terms of its legal form, organisation and decision making from other activities not relating to transmission' (European

Parliament 2003, Art. 9). In transposing the Third Natural Gas Directive, national policy makers could choose from four models of interest separation in production and/or supply each of which imposed much stricter requirements than the previous two directives. As the findings of the Energy Sector Inquiry completed in 2005-2007 by the Commission's DG Competition showed that a solution to ensure that network companies are not influenced by overlapping supply/generation interests as regards investment decisions was ownership unbundling (European Commission DG Competition 2007), one of the models was ownership unbundling (OU). Other three models were Independent System Operator (ISO), Independent Transmission Operator (ITO), and another model which would 'guarantee more effective independence of the transmission system operator' than the ITO (so called 'ITO plus') (2009, Article 9(9)). By providing four different alternatives of the unbundling regime, which were adopted 'to accommodate certain member states with powerful vertically integrated incumbents', 'the system has helped to avoid institutional paralysis at the EU level' (de Hauteclocque and Ahner 2012, 1).

The OU model prohibits the transmission system owner from having control over either gas production or supply (Art. 9). Under the OU model, if chosen, a member state must ensure that the legal entity cannot control production or supply and – simultaneously – 'exercise control or any right' over a transmission system or its operator. Conversely, control over a transmission system or its operator precludes the owner from 'directly or indirectly exercising control' or any right over a company that is active in production or supply, supply meaning sale and resale of natural gas.[11] The other possible models, ISO, ITO and 'ITO plus', still allow a vertically integrated gas company to maintain its ownership of networks, but interests have to be effectively separated by other means. Under the ISO model, a separate independent system operator maintains technical and commercial operation of the transmission system.

[11] Note this would include natural gas supplied from domestic production, pipeline imports or LNG.

Under the ITO model, a vertically integrated company continues to operate the transmission system but with extremely strict separation requirements. If a gas transmission system was a part of a vertically integrated company in September 2009, a member state had a right to decide not to apply the OU model but apply instead one of the remaining models, neither of which required divestment. However, if chosen, the OU model had to be in effect by March 2013 at the latest (European Commission 2010). A member state chooses an unbundling model at the legislative level while transposing the relevant provisions of the Third Natural Gas Directive into the national legislation. If a member state opts for full ownership unbundling on its territory, a gas company does not have the right to set up an ISO or an ITO (para. 18.).

Third Natural Gas Directive does not prescribe or preclude state or private ownership of the natural gas companies. It says that two separate public bodies should be able to control production and supply activities on the one hand, and transmission activities on the other [if those natural gas companies are owned by a state] (European Parliament and Council of the EU 2009, Art. 9). This means that ownership unbundling is deemed to be in place even if the companies are kept by the same owner, the state, as long as separate institutions control them. Some protection of private transmission system owners from states simply nationalising their assets comes from another related legal EU instrument, the Energy Charter Treaty (ECT). The EU itself and its member states are all parties to the ECT and are 'internationally responsible for the fulfilment of the obligations contained therein, in accordance with their respective competences' (Stibbe 2013). The ECT protects [private] investors from nationalisation, expropriation or subjection to 'a measure or measures having effect equivalent to nationalisation or expropriation' of the [energy] investment unless such actions are 'for public interests, not discriminatory, carried out under due process of law and accompanied by the payment of prompt, adequate and effective compensation' (Energy Charter Secretariat 2016, Art. 13).

Natural gas directives had possibilities for derogations and exemptions from certain requirements. Derogations are temporary until certain conditions changed (European Parliament and Council of the EU 2009, Art. 48-49), and exemptions are (European Parliament and Council of the EU 2009, Art. 28, 36, 50) more of a permanent nature. They are particularly interesting, because they allow member states and their gas companies having flexibility on complying with those requirements. The directives provided two kinds of derogations or exemptions if requirements to receive them were fulfilled – across the board derogations to a whole member state or exemptions for specific projects or areas. The former provided possibilities to derogate from the core provisions of the directives, but only for a small array of countries that fulfil the requirements.

Provisions of the Third Natural Gas Directive from which it is possible to derogate largely reflect provisions that appeared in the First and Second directives. If a country is qualified as an 'isolated market', it could apply for derogation from authorisation procedure requirements (Article 4), market opening and reciprocity (Article 37), the requirement to unbundle transmission system operators (Article 9) and a direct line to consumers (Article 38) requirements. Isolated markets were defined as natural gas markets of member states that were not directly connected to the interconnected system of any other member state and having only one main external supplier (a market share of more than 75%) (2009, Art. 49). A member state, qualifying as an 'emergent market' (if the first commercial supply of its first long-term natural gas supply contract was made not more than 10 years earlier), could receive the abovementioned derogations and some more, including, derogation from the requirement to unbundle distribution system operators (Article 26) and third-party access (Article 32) (2009, para. 31, Art. 49). An eligible country had to ask for derogation before the Directive was adopted; thus, the derogated countries would be listed in the Directive for an unlimited time, until it would no longer be considered as an isolated or emergent market.

In addition to derogations, with the adoption of the Second Natural Gas Directive possibilities for a regulatory authority to exempt new major investments into infrastructure (interconnectors, LNG facilities) from such certain provisions of the directives appeared. They remained in the Third Natural Gas Directive. Exemptions could be granted only if an investment enhanced competition in gas supply and security of supply and fulfilled other conditions (Art. 36 in the Third Natural Gas Directive). Such new major infrastructures can be exempted from the requirements to unbundle transmission systems, third-party access to the system, storage, and upstream pipeline networks. The Commission may request to amend or withdraw the exemption decision of a regulator.

The Third Energy Package, an integral part of which was the Third Natural Gas Directive, envisaged creating a new EU level institution, the Agency for the Cooperation of Energy Regulators (ACER). ACER – a formal cooperation structure of the EU energy regulators – was officially launched in March 2011 and is seated in Ljubljana, Slovenia, which has the status of being an EU Agency and has its own staff and resources (European Energy Regulator 2011). ACER has a right to decide on issues related to cross—border infrastructure (e.g. terms and conditions for access and operational security) that regularly fall within the competence of the natural regulators if these regulators have not been able to reach an agreement within a specified period or if these regulators issue a joint request to do so. If the previous conditions are fulfilled, the ACER can also provide exemptions from third—party access and other requirements to direct electricity interconnectors or investments in major new gas infrastructures. In a new infrastructure located in the territory of more than one member state is in a process of receiving an exemption issued by an NRA, the ACER can submit an advisory opinion. If all concerned NRAs are not able to reach an agreement in six month, ACER may decide about it (European Parliament and Council of the EU 2009, Art. 36).

To conclude, researchers, analysing the First and Second Directives, acknowledged that

even though the directives 'acted as the reference point in the process of legal change', 'the reach was rather limited and held degrees of freedom allowing the member states to make their choices in regulatory reform' (Arentsen 2004, 75). Even in the recitals of Third Natural Gas Directive, which leaves the least 'degrees of freedom', the Commission and the Council acknowledged that 'under this Directive different types of market organisation would exist in the internal market in natural gas' (European Parliament and Council of the EU 2009, para. 19). Observations about the degrees of freedom that domestic actors used are insightful in revealing whether they exploited new opportunities created by EU policies or fulfilled just minimal requirements (more about this is in CH 3).

2.2 Cross-border diversification

If the natural gas directives were aimed at establishing a functioning EU natural gas market and at the very end focused on the retail level, the EU legal instruments related to security of supply focused on infrastructure and related to safeguarding the gas flow even using 'exceptional measures', if the market forces could not deliver the required gas quantities (European Parliament and Council of the EU 2010, Art. 3). There were two most important binding EU legal instruments with regard to security of supply/diversification during the research period.

The first, Council Directive 2004/67/EC (hereinafter Security of Supply Directive of 2004) was only five pages long, and provided all the 'degrees of freedom' for the member states as to how to ensure the security of supply. Member states had to transpose it by 9 May 2006 (European Council 2004). This version established for the first time a legal framework at Community level to safeguard the security of gas supply and to contribute to the proper functioning of the internal gas market in the case of supply disruptions. However, it only set a minimum security of supply standard, which is to ensure supplies of household consumers, providing with a possibility to extend this standard to small and medium-sized enterprises and

other customers if a member state wished so. Second, member states had to ensure that gas supply for those customers was guaranteed in the event of a partial disruption of national gas supplies during a period to be determined by the member states taking into account national circumstances, extremely cold temperatures during a nationally determined peak period and periods of exceptionally high gas demand during the coldest weather periods statistically occurring every 20 years (European Council 2004, Art. 4). Third, the non-exhaustive list of the instruments that the member states could use was also very flexible. Some measures were rather long-term, such as liquid tradable gas markets, system flexibility, cross-border capacities, diversification of sources of gas supply, long term contracts, investments in infrastructure for gas import via regasification terminals and pipelines domestic production of gas. Others were more reactive and short term in cases of emergencies, such as working gas in storage capacity, withdrawal capacity in gas storage, provision of pipeline capacity enabling diversion of gas supplies to affected areas, development of interruptible demand, use of alternative back–up fuels in industrial and power generation plants, production flexibility (European Council 2004, Annex). None of them actually demanded the member states or their companies to invest.

In July 2009, after the Ukrainian gas crisis of January 2009 (Agence Europe 2009a, 2009b), the Commission proposed the updated Security of Supply Regulation. Subsequently, the previous directive was repelled by the European Parliament and the Council, which in October 2010 adopted the Regulation No 994/2010 Concerning Measures to Safeguard Security of Gas Supply (hereinafter Security of Supply Regulation of 2010). Note that the EU level regulation of gas security of supply changed their form from a directive, which the member states have to transpose, to a regulation, which is applied directly and in its entirety. In its form – that is a regulation and no longer a directive – the Security of Supply Regulation provided less ‘degrees of freedom’ to national policy makers, as it directly applied to the member states.

The Security of Supply Regulation of 2010 outlined security of gas supply as a 'shared responsibility' of natural gas companies, member states, mostly through 'Competent Authorities' assigned by them by 3 December 2011, and the Commission. NRAs could also be designated as 'Competent Authorities' to be responsible for ensuring the implementation of the measures set out in this Regulation, which would give to regulators even more power. The 'Competent Authorities' had to create Preventive Action Plans and Emergency Plans and consult about these plans with the other EU countries, especially the neighbours, and with the Commission (2010, Art. 3). The Commission could request to amend the plans. However, even though the structure of the Preventive Action Plans and the Emergency Plans was listed in Regulation's Article 5, the member states had many 'degrees of freedom' about the contents of those plans. 'Competent Authorities' by June 2012 also had to identify natural gas companies to take measures to ensure gas supply to protected customers of the member state in certain extreme weather conditions, very high demand or supply disruption. To fulfil this requirement, companies may need to invest; thus, 'Competent Authorities' have indirect power on investments of gas companies (European Parliament and Council of the EU 2010, Art. 8).

Besides these changes, there were two very important requirements in the Security of Supply Regulation of 2010. First, it obliged the EU member states by 3 December 2014 at the latest to ensure an infrastructure standard referred to as 'N – 1'. The standard required that in the event of a disruption of the single largest gas infrastructure, the capacity of the remaining infrastructure should be able to satisfy total gas demand 'during a day of exceptionally high gas demand occurring with a statistical probability of once in 20 years' (European Parliament and Council of the EU 2010, Art. 6). This requirement was easier to fulfil for countries that had already more interconnectors or LNG import terminals, because these pieces if import infrastructure would balance out the loss if the largest import pipeline failed. Another important requirement was for TSOs of the member states to enable permanent bi-directional capacity on

all cross-border interconnections between the member states at the latest by 3 December 2013. Before that, many of the cross-border interconnectors would transport gas only to one direction, from one member state to another.

The infrastructure standard 'N-1' provided many 'degrees of freedom' for the member states, whereas the TSOs were more limited in fulfilling the bi-directional flow requirement. Member states were asked to assess whether the investment in infrastructure needed to fulfil the 'N-1' obligations, but neither they nor their companies were directly obliged to invest into interconnectors or LNG facilities to increase interconnectivity. Moreover, the Regulation left 'degrees of freedom' for the 'Competent Authorities' of the member states to consider 'N-1' obligation fulfilled if they demonstrated that a supply disruption could be sufficiently compensated for by appropriate market-based demand-side measures (European Parliament and Council of the EU 2010, Art. 6). The requirement to ensure permanent bi-directional capacities on all cross-border interconnections at the latest by 3 December 2013 was less flexible and placed this responsibility on transmission system operators unless exemptions were granted.

Besides legal instruments to increase cross-border diversification, there are direct financial incentives from the EU level to encourage investments in the interconnectors that have appeared after the global financial crisis of 2008-2010. Whereas before the crisis the Commission would not intervene financially into the EU energy projects besides providing minor funding for feasibility studies and so on, after 2009 the Commission 'left the "liberal" paradigm' and 'became more mercantilist – or "realist" (Goldthau and Sitter 2014, 1468). Before the financial crisis, projects of European interest had priority for the granting of Community funding under the TEN–E budget. However, in order to avoid possible distortions to competition the budget allocated to the TEN–E (around EUR 20 million per year) was mainly intended for financing feasibility studies (Pakalkaitė 2012a, 32). As provided above,

there were also some non-financial incentives to invest into the major new gas infrastructure or a substantial expansion of the existing pipelines in the Third Natural Gas Directive and the earlier directives in form of exemptions. However, first, the European Energy Programme for Recovery (EEPR) was established in 2009, as the Commission claims, to address both Europe's economic crisis and European energy policy objectives. The total fund for energy projects was 3.98 billion Euro (European Commission 2016a). Another programme is Connecting Europe Facility (CEF), in place from 2014.

High-level regional energy groups are related to the EU funding of energy projects. The Baltic States belong to the Baltic Energy Market Interconnection Plan (BEMIP) High Level Group, established by the Commission in late 2008 and chaired by it. Participating countries of BEMIP High Level Group are Finland, Estonia, Latvia, Lithuania, Poland, Germany, Denmark, Sweden and, as an observer, Norway (European Commission 2009d; Tanasa 2015, 8). BEMIP projects have been part of the EERP. They can also be funded through the European Regional Development Fund, the EU's Cohesion Fund, and, as projects of common interest, through the Connecting Europe Facility (European Commission 2016i). In February 2015, the Commission established a similar group to BEMIP, the Central East South Europe Gas Connectivity High Level Group (CESEC) (European Commission 2015b).

Developers of gas interconnectors, LNG and other projects in an EU member state may choose not to apply for EU funding, but to finance them from state budgets and/or tariffs. This entails state aid to those projects, the legitimacy of which the EU regulates. Opponents of those projects may complain to the Commission about possibly illegal state aid, and the Commission must investigate such complaints.

2.3 Political, sectorial and EU-level actors and EU opportunities

Having discussed the main EU policies regarding the natural gas sector, it is now important to map the main actors that translate these policies on the national level and influence

it otherwise. There are many players active in natural gas sectors of EU member states; therefore, in this section they are grouped into actors active on the political hemisphere/system, sectorial hemisphere/system and special actors that belong to neither. After presenting each type of actor, this section summarises the above elaborations what opportunities which EU tools create for which actors. The most important groups of actors are presented in Figure 3. In the figure, a red arrow means that an actor has decisive power tools (can issue binding decisions), a blue - that it may influence in other ways (e.g. lobbying, but not necessary).

The political hemisphere (and the power balance there) is the most important in implementation of EU policies on the national level. Conant rightfully notes that 'legal compliance is a necessary precursor to practical compliance in any field of activity that actually requires regulation' (Conant 2012, 15). Transposition of natural gas directives into the national legislation usually required at least some changes in laws in parliaments. Domestic executives as 'key nodal points' act as 'translators and editors of EU policies, norms and practices in the domestic arena' (Laffan 2007, 129). On the political side, the main actors who influence natural gas markets are executive politicians (presidents and governments) and legislative politicians using regulatory tools.[12] Tools that political actors possess to influence developments in the natural gas markets depend on channels of power they have. Governments and parliaments are channels of actions by political parties, whereas representation of party interests by presidents is more limited. Politicians influence natural gas markets in several channels: via decisions that influence the markets directly and decisions that influence independence and powers of NRAs, which later influences the markets. Parliaments issue laws, and this is a longer process than preparing Government decisions, but the target of the laws is broader than the one of decisions. Governments and presidents can initiate legislation to be adopted by parliaments, and they also implement the laws. Governmental decrees or decisions are faster to issue and require less

[12] Even public ownership is often described as a form of regulation. For example, Genoud, Arentsen, and Finger (2004) call public ownership a "dominant and traditional form of regulation'.

consensus among all the political representatives than laws in parliaments. However, governments can manage the gas sector only within the frameworks predefined by more general laws. This role of state actors to adapt local regulations to EU regulations makes political actors the most important actors in 'Europeanisation' of domestic natural gas sectors.

Tools that require transposition or another kind of adaption, mostly directives, into national legislation necessarily involve state actors as channels or 'subjects' of transposition. This role creates opportunities for state actors to instigate changes in laws and to justify this by requirements to transpose directives. Whereas draft laws may usually be submitted both by governments and parliaments, each of those kinds of actors may use the 'requirement' to change domestic laws to implement their own agendas and, if necessary, to 'blame-shift' to Brussels. By initiating transposition, any of state actors have the 'power of the first draft'. In the cases of disagreement on how to interpret the transposing laws, presidents may veto them if national constitutions give such powers to them. Possibilities for exemptions and especially derogations created opportunities for those in favour of the status quo in the specific gas market.

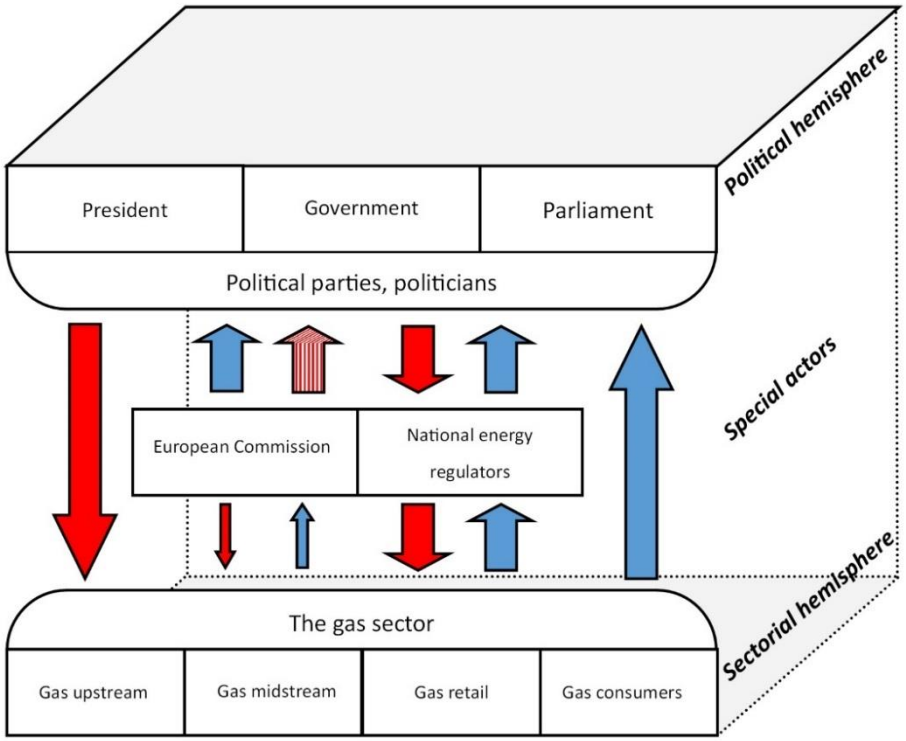

Figure 3 Actors that influence domestic gas sectors and implementation of EU policies in these sectors

In the sectorial hemisphere, main actors are incumbent monopolies in the gas sector that may have business interests on several levels of the market, real or potential competitors of theirs and large consumers. Natural gas sector activities occur on three levels referred to as upstream (extraction, production of natural gas), mid-stream (transportation of gas via pipelines, storage facilities, LNG terminals) and down-stream (deliveries to consumers). Gas companies that control several functions along the supply chain, for example in transmission, distribution, LNG or storage and production or supply of natural gas are called vertically integrated companies (European Parliament and Council of the EU 2009, para. 20). Sectorial players can resort to other channels of influencing those actors that can issue binding decisions, for example, lobbying.

Different aspects of the three natural gas directives target an array of actors or 'objects'

starting with the energy regulators and finishing with gas companies and consumers. The set of unbundling options in the Third Natural Gas Directive allows the governments and/or parliaments to initiate changes in ownership of TSOs and their regulatory environment otherwise. Yet, the Third Natural Gas Directive slightly constrains states' ownership of TSOs by imposing separation of the shares of TSOs and energy production/supply companies among state institutions. Unbundling requirements of vertically integrated companies very much affect vertically integrated natural gas companies (incumbent monopolies). They restrict possibilities to use discriminatory practises against competitors and cross-subsidisation in the cases where TSOs belong to vertically integrated companies. OU unbundling option may entail selling of the shares of TSOs. ISO unbundling option may result in a separate independent system operator maintaining technical and commercial operation of the transmission system and deciding on investments when the system remains owned by another owner. In an indirect way, unbundling requirements created opportunities for competitors of vertically integrated gas companies, because they can no longer cross-subsidise between different activities. They also created a bigger role for NRAs: they gained powers to impose fines on companies that did not comply with unbundling requirements.

Gradual consumer liberalisation in natural gas directives, reinforced by the ECJ decision of 2010, constrains possibilities of governments to regulate end-user prices for businesses. However, possibilities to impose public service obligations on companies allow them to keep regulating end-user prices for households. This and a lack of clear requirement to deregulate end-user prices for households enables those in favour of keeping the *status quo* of regulated prices to keep doing this. Requirements to open consumer markets affect incumbent natural gas companies by creating potential competition for them. Subsequently, it creates opportunities for competitors of incumbents. On the other hand, liberalisation may help incumbent natural gas companies to forego loss-making sales to customers if regulated end-

user prices were below their costs. Deregulation of prices enables eligible customers to buy gas from competitors. Large consumers can especially benefit from this because they have strong bargaining power. Interestingly, in certain situations large consumers may benefit from partial liberalisation if other consumers remain regulated. In such a situation, the unregulated consumers may use the regulated price as a 'reference price' in their negotiations. Thus, liberalised large consumers may in turn start favouring the *status quo.*

Third-party access to system affects owners of transmission, distribution systems and LNG facilities: they must make the system accessible to potential competitors. Access to system creates opportunities for eligible customers to buy gas from competing gas companies other than the owner and/or operator of the system. It subsequently creates opportunities for competitors of incumbent companies and new market entrants. Some new prospects also open for gas production companies, which could access both the liberalised consumers and the system and could start selling gas directly without intermediaries inside or outside the country.

The Commission and NRAs are special actors because they are partially active on the EU and partially on the domestic levels. They both can issue binding decisions (the Commission more to the direction of the political hemisphere, and less so to the gas sector hemisphere). The Commission has a dual role in the EU natural gas sector regulation. On one hand, it co-creates directives and regulations that later apply to all member states equally. On the other hand, it is also an actor, which selectively uses tools of 'enforcement' or 'management' of compliance with EU laws regardless of them being primary, such as TFEU provisions, or secondary (Conant 2012, 6). By using 'implementing powers' when member states do not comply (European Parliament and Council of the EU 1998, Art. 18), the Commission becomes a domestic actor as much as it is an EU actor. In enforcing compliance, the role and competences of the Commission depend on which sort of EU regulations – primary or secondary – are applicable. The secondary legislation, such as the natural gas directives and

security of supply regulations, assign to the Commission a less direct role in enforcing implementation of the rules, mainly through infringement procedures against the member states. The Commission may start an infringement procedure if a member state actively fails to fulfil EU requirements (active behaviour) or fails to act to fulfil them (inaction) (Ramírez-Cárdenas Díaz 2011). From the moment Commission refers a member state to the European Court of Justice, it risks to become very costly for the budget of this country, as the Commission proposes a daily penalty. In case of an affirmative judgement of the Court, the daily penalty is to be paid from the date of the judgment until the transposition is completed (European Commission 2013c).

Because of the primary application of the TFEU, rules on competition policy provide more powers to the Commission to intervene directly in ensuring compliance. In competition policies, the Commission targets authorities of the member states in state aid cases and state or privately owned natural gas companies in the merger and antitrust cases. Complaints with regard to competition issues can be submitted to services of the Commission; the Commission must react to all non-anonymous complaints. EU-wide rules for competition restrict cross-subsidisation, mergers that increase dominance, abuse of dominant position, and agreements between gas supply companies. In this way, they constrain gas supply companies with large market shares, and provide opportunities for their potential competitors to enter markets and/or expand their shares. Gas and capacity release programs enable competitors to buy more gas and access the systems.

Via infringement procedures to bring in compliance with the secondary EU legislation, the Commission targets state authorities of the member states. This may include any organ of the state, legislature, executive and judiciary, central, regional and local authorities and even private companies controlled by public authorities. Commission may participate in negotiations and bring leverage to governments vis-à-vis the other side. By participating in the

negotiations of member states with the external suppliers, the Commission may also seek to ensure 'real time compliance'; thus, not only provide leverage but also limit them.

The Commission is also a decisive actor concerning EU funding to a country and may use it to incentivise compliance with EU gas policies. The EU funds can be either general to stabilise a member state's economic situation (the instrument for EU members outside the euro area is balance of payment (BoP) assistance) or specific to energy projects. Companies, both state and privately-owned, can apply and receive EU funding for projects. By assigning funding to energy projects, the Commission influences the route and supply diversification of countries and may couple funding decisions with requiring a member state to comply with energy regulations. One more avenue for the Commission to influence the gas policies of the EU member states, related to funding of projects, are regional High Level Groups in energy, which are chaired by the Commission and tightly related to the EU funding for gas projects.

Whereas the First Natural Gas Directive did not have a single word about NRAs, the Second Natural Gas Directive made establishment of a regulator compulsory, and the Third Natural Gas Directive strengthened their powers and independence. Being 'new additions to the governance landscape of the EU' and functioning as 'agents' of integration' (Nicolaides 2004, 600), NRAs are special actors. Even though in some countries, including those analysed in the case studies, NRAs existed from before the Second Natural Gas Directive, this directive ensured existence of NRAs across the EU to implement the EU aims. At the same time, in most of the cases the decisions of NRAs apply only to the domestic realm, and in this way, they are domestic actors. Whereas taxes are 'the sole responsibility of member state governments', the regulatory regime, the level of competition in retail markets, and the possible harmonisation of network regulation methodologies 'are issues that national regulatory agencies can tackle to facilitate the creation of a truly functioning internal retail market' (ACER/CEER 2013, 139).

More generally, requirements related to NRAs mostly created opportunities for NRAs

gain power and independence, but there are some aspects to single out. First, admittedly, ceasing to regulate end-user prices (necessary for business consumers) reduces the domain of power of NRAs. However, in this way, by leaving the prices to be determined by demand and supply, they make regulators more immune to attempts of capture by politicians and industries.

Second, whereas expansion of powers of regulators to regulate infrastructure issues started from the Second Natural Gas Directive, this directive still allowed politicians have the ultimate power over setting transmission and distribution tariffs and the provision of balancing services if they wished so. The Second Natural Gas Directive gave the following powers of NRAs. Member states could delegate regulatory authorities to monitor the security of supply issues (Art. 5). NRAs had to monitor the effective unbundling of accounts, to ensure that there were no cross-subsidies between transmission, distribution, storage, LNG and supply activities (Art. 25). NRAs also gained power over setting transmission and distribution tariffs and the provision of balancing services. According to the directive, regulatory authorities had to be responsible for fixing or approving prior to their entry into force, 'at least the methodologies' used to calculate or establish the terms and conditions for connection and access to national networks, including transmission and distribution tariffs and the provision of balancing services.[13] Yet, a member state could decide that its regulator would only submit the tariffs or at least the methodologies for formal decision to the relevant body in the member state. This 'relevant body' then would have the power to either approve or reject a draft decision submitted by the regulatory authority (Art. 25). Besides mentioning that NRAs had to be 'wholly independent of the interests of the gas industry', the Directive left a wide room for manoeuvre how this independence should be implemented. The Directive did not even mention independence from political interests.

According to the Third Natural Gas Directive, NRAs may define methodologies for

[13] Tariffs must be in line with certain principles outlined in the directives and other EU legal instruments; thus, NRAs do not have a full freedom to set tariffs without adhering to these principles.

setting the state-regulated gas prices, set the prices and their ceilings themselves, and issue recommendations for compliance of the prices in the energy sector with the requirements on transparency. Regulators may also use tools unrelated to pricing, for example, define methodologies for conditions of connection or access to the natural gas transmission or distribution systems. The more complex are the natural gas sector of a separate member state and the bigger the number of companies in different segments, the bigger the scope is for the NRAs to regulate. In countries, which produce gas and/or have gas storages and or/LNG facilities, in addition to what regulators supervise in other countries that do not produce gas, the Third Natural Gas Directive requires NRAs to regulate at least access conditions to storages, facilitate 'access to the network for new production capacity', and terms, conditions and tariffs for access to LNG facilities (European Commission 2009d, Art. 40-41). Similarly, the more cross-border interconnectors a country has, the bigger is the scope for the national regulator to regulate, but there is also a role for ACER in respect of cross-border issues. NRAs regulate the supply of the natural gas balancing services and access to the cross-border natural gas interconnection links.

NRAs also have a special role regarding transmission system operators. They may exercise control over the efficient unbundling of the activities in the energy sector aimed at ensuring independence of the energy transmission and distribution operations from commercial interests in the energy activity and at avoiding cross-subsidies. To do so, NRAs designate natural gas transmission, distribution, storage, liquefied natural gas systems and the market operators, supervise and monitor the activity of those operators and issue licences for natural gas suppliers (NCC 2014).

The security of supply regulations enables domestic state actors to initiate projects for the 'security of supply' aims. NRAs may become 'Competent Authorities' in implementing the security of supply of a country. Ensuring the 'N – 1' standard and provision of bi-directional

flow across the borders may require new investments in infrastructure. Even though the Security of Supply Regulation of 2010 did not directly require investments in infrastructure, 'Competent Authorities' did gain some power in determining investments in transmission infrastructure. Moreover, by June 2012 'Competent Authorities' also had to identify natural gas companies to take measures to ensure gas supply to protected customers of a member state in certain extreme weather conditions, very high demand or supply disruption. To fulfil these requirements, companies may need to invest; thus, 'Competent Authorities' gain indirect power on investments of gas companies. New investments in infrastructure may bring more income from tariffs of system use to transmission system operators. Requirement for member states to ensure bi-directional flows provides opportunities for gas producers and traders to use interconnectors to sell gas to neighbouring countries.

This chapter reviewed EU policies relevant to domestic natural gas sectors of EU member states. Then it put these policies in the context of domestic actors that influence the natural gas sector and showed that mostly it created opportunities to political actors and sectorial players that sought liberalisation and posed limitations to incumbent monopolies. The new areas of regulation according to EU rules only (e.g. setting transmission tariffs, organisation of TSOs) and requirements to deregulate (e.g. end-user prices for non-households) also created possibilities for natural gas companies and NRAs to escape political capture. The following chapter presents the expected 'EU opportunism' and 'EU leverage' process-tracing mechanisms to explain how domestics actors may use these opportunities provided by EU policies. It also selects four cases for testing the mechanisms.

3 CONGRUENCE AND PROCESS TRACING METHODS AND CASE SELECTION

This chapter presents the research design and the research strategy of my dissertation. It complements the Europeanisation approach of Knill and Lehmkuhl and turns it into detailed process-tracing mechanisms. The chapter is structured as follows: first strategies to identify *interest structures* are presented, followed by two expected causal mechanisms based on an identified type of an *interest structure.* First, a mechanism of 'EU opportunism' is expected in cases where *balanced interest structures* were identified. Second, a mechanism of 'EU leverage' is expected when *dominant interest structures* were identified. Then to show the impact of different EU instruments and of domestic political changes, the chapter selects four non-chronological cases, the politics of gas markets in Hungary 2002-2010, Hungary 2010-2016, Lithuania 2008-2016 and Romania 2008-2016 based on the results of their parliamentary elections.

I apply a within-case comparison, which comprises a within-case and cross-case level analysis. The research design, which I present in the following, reflects the two-step conceptual framework developed in CH 1. The congruence method is used on the first step, and process-tracing on the second step. By going beyond mere 'inputs' and 'outcomes', both the congruence and the process tracing methods are alternatives to co-variation qualitative case studies (Blatter and Blume 2008). As Blatter and Blume (2008) explain, applying the congruence method, researchers analyse (mis-)matches between empirical findings and detailed expectations on central actors and structures. These expectations are deduced from core elements of theories. In applications of the process tracing method, scholars scrutinize the temporal unfolding of situations, actions and events, traces of motivations (or other lower level mechanisms), (complex) interactions between causal factors, and/or information about restricting/catalysing contexts/conditions, as well as detailed features of a particular outcome (Blatter and Blume 2008, 319).

3.1 Interests and power positions of actors

Even though the congruence method is often equated with the process tracing method, these two approaches do differ in one essential aspect. When applying the congruence method researchers do not need to identify causal mechanisms that possibly lead to the outcome. Instead, one needs to search whether there was consistency/congruence between a theory's predictions and case outcomes (George and Bennett 2005, chap. 9; Beach and Pedersen 2013, 11). Thus, the congruence and process tracing methods are on different analytical levels, and in this thesis the former method is used to analyse congruence of what the identified different kinds of *interest structures* mean in terms of the outcome, natural gas market integration.

For my understanding of *interest structures,* I follow Schneider's approach who argues that these are 'interest positions of the major political actors for or against institutional changes, weighted with their power resources' (2001, 74). Consequently, *interest structures* are conceptualised as *actor coalitions* with similar interests regarding key aspects in the domestic natural gas sectors, factored by their power resources. In my approach, I group actors who share certain interests and positions regarding key aspects of the domestic gas sectors into reform-prone (pro-integration) or *status quo*-prone (anti-integration) *actor coalitions*. Without going into detailed analysis of all the interests that may be surrounding gas sectors, I identify the actor positions only with regard to two main groups of issues, internal market (liberalisation, consumer choice) or security of supply (diversification, cross-border integration). These two main groups of issues come from the analysis of the body of the main EU instruments in relation to the gas sector in CH 2; therefore, reforms in natural gas sectors of EU member states would mainly follow these two directions. Grouping of actors into the *coalitions* is independent of whether these actors have, formally or informally, agreed on common agendas.

Following assumptions of bounded rationality[14], the motives behind different interests

[14] Bounded rationality is a concept which allows considering actors rational even if they change their action, because it does not assume that those actors have perfect information (Simon 1997).

of actors are explained by the expected losses and gains due to the implementation of EU policies. Diverging interests in domestic gas sectors may enhance divisions among political actors on whether to maintain the *status quo* or comply with EU regulations which may mean reforms. As unregulated, and at times rising end-user prices 'is a[n important] factor in prosperous times, and even more so in economically difficult times', it can limit Government's willingness 'to expose electorate' to them (Economist Intelligence Unit 2010, 12). Interests of politicians may influence interests of national energy regulators, because it is the legislators who define the ultimate limits of power and independence of regulators. The status of regulators is set in laws. Thus, politicians define the mandates for regulators, set their budget rules and appoint their leading administration. Consequently, actions of the national energy regulators depend on whether they are allowed to act in a particular sphere of the sector (whether they have competences/power), and whether they are independent of the industries they regulate (Kay and Vickers 1992) and/or from state bodies and politicians (Viscusi, Vernon, and Harrington 2000).

Different stages of gas market liberalisation incur costs and benefits to different actors. According to a comprehensive study on losers and winners of market liberalisation processes in Central and Eastern Europe by Economist Intelligence Unit, liberalisation processes most strongly influence gas producers, distributors and consumers, and the impact of liberalisation differs according to the stage of the reforms (2010). In the first stage of energy market liberalisation in Central and Eastern Europe, end-user energy prices had to rise from regulated, 'artificially low levels' to reflect the real costs of production and transmission. In this stage, producers of energy are the winners of the liberalisation process, and energy consumers are the immediate losers. In the second phase of liberalisation, the competition and increase in efficiency tend to drive prices down, and consumers start to benefit (Economist Intelligence Unit 2010, 17). Because of appearance of competition, however, natural gas companies may

engage in defensive or offensive strategies (Porter 1998). The Neoclassical theory on production implies that the (energy) companies are all seeking the same aim: to maximise profits. Energy companies employ strategies 'in search for a favourable competitive position in an industry' (Porter 1998, 1). Facing the introduction of competition into the markets, incumbent natural gas companies not only risk losing market shares but also losing power. According to Caporaso, 'large firms in concentrated industries have greater potential power […] the most striking thing about a competitive market is how little power the agents possess' (1992, 166). Based on their interests about reforms, gas sector actors may attempt to influence politicians who define the frameworks for the sector. Whereas business companies, both gas and consumers, may find a way to lobby their interests directly, household energy consumers, as another very large actor group, may express their interests by voting. If the legislative majorities want to remain in power, they may react to voters' pressure regarding gas market reforms.

Balanced *interest structures* are mainly composed by the following two elements: actors having diverging positions regarding either internal gas market or cross-border diversification (or both) and power to influence the developments in the gas sector. Dominant *interest structure* is, therefore, mainly composed by dominant interests among the actors that have power to influence the gas sector. Configurations of *interest structures* are identified using a strategy consisting of three steps. *Firstly,* salient questions are identified regarding a country's natural gas market stemming from two main categories of EU energy instruments. As shown in CH 2, these are (1) internal market/competition (positions on gas price, and private or state capital) and (2) security of supply (positions on diversification and on the dependence on Russia/Gazprom). In addition, if available and relevant, statements regarding the EU are evaluated. *Secondly,* a stakeholder mapping is performed, highlighting the most influential actors in a particular gas sector. Mostly, these include the main political actors with executive

and legislative powers, national energy regulators, the European Commission, other transnational actors, natural gas companies and large consumers of natural gas. The stakeholders are placed into reform-prone (pro-integration) coalitions and *status quo*-prone (anti-integration) coalitions based on their (identified or at least assumed) positions towards the aforementioned salient questions. Thirdly, simultaneously, *actor coalitions* are weighted by their power positions to evaluate the balance or dominance of *interest structures* by reform or *status quo* oriented interests. This step is one of the most difficult ones.

As shown in Figure 3 in the previous chapter, there is a wide net of actors with complex interrelationships that influence national natural gas sectors and, subsequently, the implementation of EU policies. However, as the implementation of EU policies mostly starts with legal changes (adjustments of national laws and other regulations); the balance of power in an *interest structure* will mostly depend on the balance of power in a political hemisphere. A balance of power in the sectorial hemisphere may facilitate or counterbalance interests on the political hemisphere. (In)dependence of a national energy regulator may strengthen one or another *interest structure.* A non-exhaustive list of possible channels of power exertions is presented in Table 2 on the next page. Political parties may exercise power via channels available to them in Parliament and Government. Presidents may follow party interests, but not necessarily. Therefore, the evaluation of a president's power is separated from the evaluation of the power of political parties. Household energy consumers are not listed as separate actors; instead, it is assumed that political actors take their interests and power to elect politicians into offices is into account.

Table 2 Measurement of power of actors that have interests towards domestic natural gas markets

<table>
<tr><th>Level</th><th colspan="2">Actors</th><th colspan="4">Mechanisms of power exertion</th></tr>
<tr><td rowspan="6">Political hemisphere</td><td colspan="2">Presidents</td><td rowspan="2">Presidential, semi-presidential, or parliamentary democracy with the features of semi-presidential or parliamentary democracies</td><td rowspan="2">If a country is a (semi) presidential democracy, periods of ‘unified government’ or ‘divided government’ in the research period</td><td rowspan="2">Role in nominating and appointing leaderships of national energy regulators</td><td rowspan="2">Representation of the state in European Council by a President or a Prime Minister</td></tr>
<tr><td colspan="2">Political parties</td></tr>
<tr><td colspan="4">Belonging to a parliamentary ruling coalition or opposition (opposition is still a power position compared to not being elected to parliaments)</td></tr>
<tr><td colspan="4">Existence of influential parliamentarian committees regarding the natural gas sector and members of which political parties head those committees</td></tr>
<tr><td colspan="4">Coalition or single-party governments</td></tr>
<tr><td colspan="4">State-ownership in energy companies</td></tr>
<tr><td rowspan="5">Level of ‘special actors’</td><td colspan="2" rowspan="3">The Commission</td><td colspan="4">Use of compliance instruments assigned by TFEU (infringement, state aid, competition policy investigations)</td></tr>
<tr><td colspan="4">Participation in domestic decision making (e.g. in national negotiations with energy suppliers)</td></tr>
<tr><td colspan="4">EU funding for projects of interests to specific EU member state</td></tr>
<tr><td colspan="2" rowspan="2">National energy regulators</td><td colspan="4">Scope of regulatory power in the natural gas sector</td></tr>
<tr><td colspan="4">Being a ‘competent authority’ according to the Security of Supply Regulation (2010)</td></tr>
<tr><td rowspan="5">Sectorial level</td><td rowspan="2">Upstream</td><td>Gas importers</td><td rowspan="4">Market power</td><td rowspan="4">Vertical integration (a company is active on more than one level);</td><td rowspan="4">Presence of long-term gas supply agreement/gas production of large quantities</td><td rowspan="4">Presence of an association that represents interests</td></tr>
<tr><td>Gas producers</td></tr>
<tr><td colspan="2">Owners of natural gas transmission systems</td></tr>
<tr><td colspan="2">Natural gas retailers</td></tr>
<tr><td colspan="2">Large natural gas consumers</td><td colspan="4">Dependence of an economic performance of a country on the performance of a consumer (expressed via a share of gas consumed)</td></tr>
</table>

As seen in Table 2, power of political actors is assessed mainly based on formal power distribution (concentrated or shared power), which stems from constitutional configurations in

the analysed countries (about patterns of dominance and balance of power see Lijphart (1999), especially chap. 6, 7, 10, 11). Power of presidents very much depends on whether a country is a parliamentary democracy, a semi-presidential or fully presidential democracy. While in some countries presidents may at least partially counterbalance the actions of legislative majorities, in countries where parliaments elect presidents, this may result in the dominance of one political interest. In (semi)presidential democracies power also depends on specific combinations of parliamentary majorities and presidents. Typologies of relationships between presidents and governments are often used in researching US policy making, which is a presidential democracy. Yet, it can also be useful in research of partisan policies in semi-presidential countries in Europe (Manolache 2013, 427). To put it simply, if a president represents the same political party that forms a government, their relationship can be described as 'unified government/executive' (Monroe 2010, 114). In contrast, a 'divided government' exists when 'the legislative is firmly controlled by a party or coalition that is in opposition to the presidential party' (Norkus 2013, 15). During the period of 'divided government', veto authority is important, especially the one of the president and of the majority party within the legislative chambers' (Monroe 2010, 113). In semi-presidential democracies, 'unified governments' may contribute to strengthening dominant *interest structure* and 'divided governments' may counterbalance the parliamentary majority and contribute to a more balanced *interest structure.*

Exerting parliamentary power is measured by coalition or single-party governments, belonging to a parliamentary opposition (still a power position compared to not being elected to parliaments), existence of influential parliamentarian committees regarding the natural gas sector and members of which political parties head those committees. If a Government is formed by a single party, it is expected to reinforce the dominance of likeminded political actors. Actions by parliaments and governments do not necessarily coincide on all the questions

in the cases where political party representation is more diverse and governments are formed based on parties that have thin majorities or even minorities in parliaments. Taken the above discussion into account, the power of the political parties is identified depending on whether they form governments or are in the opposition in parliaments. Marginal political parties are not taken into account, whereas parliament presence, even in opposition, provides power resources to political parties. If a Government is formed by a party coalition, it is expected to bring more balance and less dominance. A minority coalition 'provides most opportunity for the active role of presidents' (Norkus 2013, 18).

National energy regulators have very special power positions with regard to domestic natural gas sectors. On one hand, they are the ones directly defining the rules for the sector; on the other hand, they may lack many powers withheld from them by domestic political actors. Furthermore, it is decisive whether the regulator was assigned to be a competent authority for issues stipulated by the Security of Supply Regulation (2010), and whether it is endowed with the 'power of the first draft' in transposing and implementing the EU regulations. Finally, the independence of energy regulators is crucial, because their 'affiliations' may strengthen one or another *actor coalition*. Here again, the nomination and appointment rules for the heads of national energy regulation bodies is important. For example, if one political institution nominates and another appoints the leadership, more independence could be expected. If a regulator is captured by the state or by industry, it strengthens the interest positions of them.

In the gas sector hemisphere, the proxy of the companies' political power is their market power. This is because in highly regulated sectors businesses exert their market power against their regulators, which (and not demand by consumers) set the price for their products.[15] The bigger the market share of gas companies and the more vertically integrated across different market segments they are – the bigger the power. Producing gas and holding long-term gas

[15] Sang Gon Jeon even came up with a term 'political oligopoly' to describe this peculiar situation in Korean dairy market where Government sets raw-milk price (2008, 2).

supply agreements over large quantities also gives them power. In terms of interest configurations among the gas companies, their ownership is also considered: state-owned companies have less room for manoeuvre in their positioning towards the government policies, whereas privately owned companies may bring in more 'balance' to one or another direction, pro-reform or pro *status quo.* It is also important whether gas industry companies and/or their consumers organise themselves into associations. Associations may have stronger lobbying power and may approach members of parliaments and governments to defend their interests. Similar criteria apply to measuring the power of gas consumers: whether there are large gas consumers, accounting for significant parts of a country's gas consumption, and whether they organise themselves in associations.

Identified interests of main actors are summarised in tables in each empirical chapter. The *interest structures* of each case study are presented in CH 8 using Boston matrixes (Martin 2016). They are instrumental in visualising indicators in three dimensions (interests in two categories and evaluation of power). The next section theorises two detailed process-tracing causal mechanisms in the cases where balanced and respectively dominant *interest constellations* were identified. These causal mechanisms shall be called 'EU opportunism' and 'EU leverage', because in balanced *structures* I expect actors using EU opportunities to push reforms, and in dominant ones I expect reaction only if the Commission exerts significant pressure. I will come up with a proposition of what empirical findings are necessary to qualify a case to fit with an expected mechanism.

3.2 Process-tracing the effects of interest structures

The process tracing method is selected because it enables researchers to make strong within-case causal inferences about existence of causal mechanisms (Beach and Pedersen 2013), and selected Europeanisation approach focuses on mechanism of EU impact on the domestic level. In process tracing, separate parts of a causal mechanism 'have no independent

existence in relation to producing Y; instead, they are integral parts of a system that transmits causal forces to Y'. Thus, mechanisms are not theorised in terms of 'intervening steps' (Rohlfing 2012, chap. 6) or 'intervening variables' (George and Bennett 2005, chap. 10). Instead, a causal mechanism is a 'causal story' linking X with Y in more or less abstract terms (Beach and Pedersen 2016b, 6). The causal condition in this thesis is either balanced or dominant *interest structures* that catalyse a process. Some small power reshufflings may take place within the *interest structure.* However, if the changes are significant to largely change the *interest structure*, this would call for another causal process tracing mechanism coming in place. The initial causal condition, thus, does not vary, and should not be called a 'variable'. The expected causal mechanism is presented in terms of entities engaging in activities.

Evidence on all parts of the expected mechanisms needs to be found. As Beach and Pedersen (2013) explain, 'our inferences about the presence of the whole mechanism are only as strong as the weakest link in our empirical tests' (Beach and Pedersen 2013, 131). Therefore, propositions about the expected evidence are set for each part of a mechanism and not for a mechanism as a whole. If fingerprints are found, this allows claiming with enough confidence that indeed the expected part was in place. If all parts of the mechanism were confirmed in this way, then it is possible to claim that the whole mechanism was in place.

Beach and Pedersen group process-tracing evidence into four types, pattern, sequence, account and trace. Pattern evidence is 'predictions of statistical patterns in the evidence'; sequence evidence 'deals with the temporal and spatial chronology of events predicted by a hypothesized causal mechanism'. Trace evidence is evidence 'whose mere existence provides proof that a part of a hypothesized mechanism exists; account evidence 'deals with the content of empirical material, such as meeting minutes that detail what was discussed or an oral account of what took place in a meeting' (Beach and Pedersen 2013, chap. 6).

In order to strengthen each step of the causal mechanism, the expected evidence for

each part has to be assessed in terms of theoretical certainty and uniqueness. With regard to theoretical certainty, we must ask how certainly this evidence must be found to infer that the part of the mechanism was in place and if not found how strongly it disconfirms the presence of the part of the mechanism. Thus, the certainty criterion has the disconfirming power. In terms of theoretical uniqueness, we must ask how unique if found this evidence is, in other words what other plausible explanations of this empirical manifestation can be. Therefore, the uniqueness criterion has a confirming power of evidence (Beach 2016). Based on these two criteria, expected evidence is grouped into four kinds, which are shown in Figure 4 on the next page. The four groups of evidence are those that pass the 'smoking gun' tests (highly theoretically unique, but not very certain), 'hoop' tests (highly theoretically certain, i.e. they must be found, but not very unique), 'straw-in-the-wind' test (neither unique, nor certain) and 'doubly decisive' tests (both highly certain and unique) (Beach and Pedersen 2016a, chap. 6; Rohlfing 2013). Evidence that passes 'Doubly decisive' tests is very rare to find in real life, and evidence passing 'straw-in-the-wind' tests do only marginally confirm our confidence in a part of a mechanism. Thus, the causal process tracing mechanisms analysed in this thesis are mostly based on 'hoop' tests, and, if possible, 'smoking gun' tests.

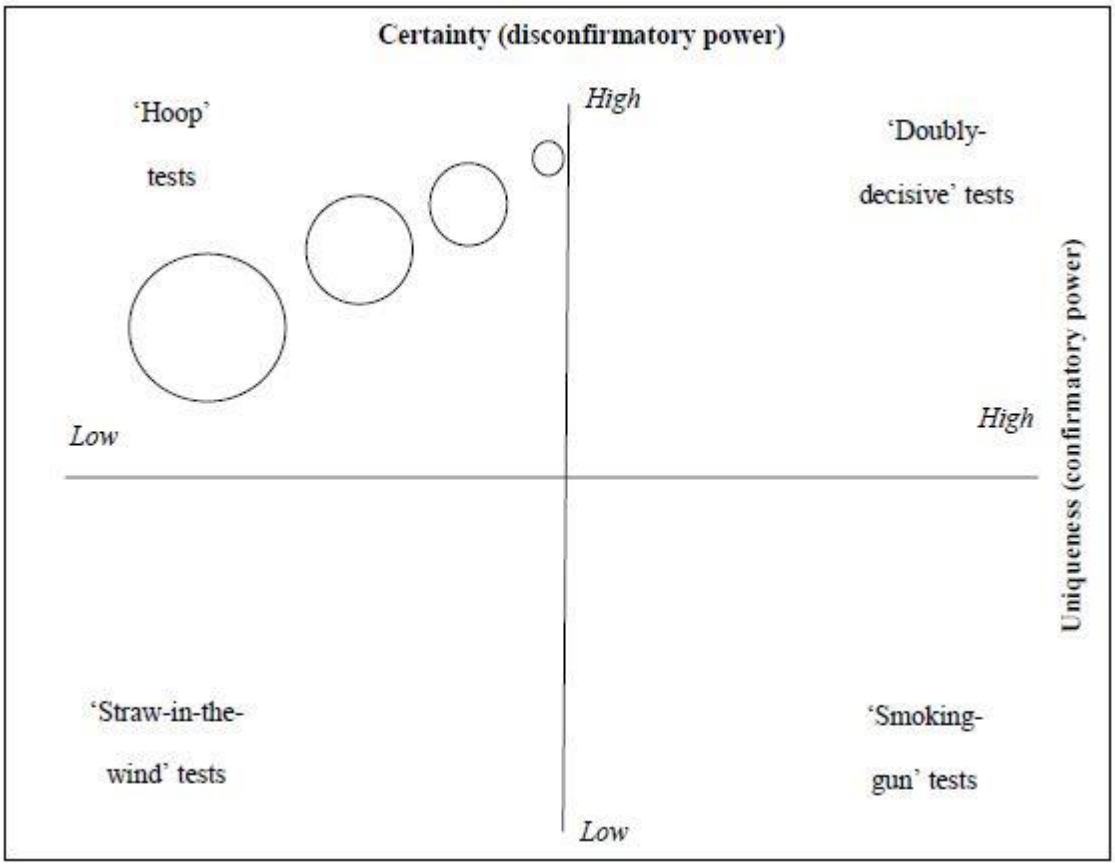

Figure 4 Types of tests of parts of a causal mechanism. Source: Beach and Pedersen 2013, 171, originally based on Van Evera, 1997

The proposed process tracing mechanisms conceptualise directives and other EU instruments as exogenous conditions that (re)frame the choices of domestic actors. Subsequently, the mechanisms correspond to the structural type, which Parson advices to use to 'rationalist' researchers (2007). In structural mechanisms, causes are 'exogenously given' and 'people's choices followed from given conditions in the environment' (Parsons 2007, 7). The general conceptual framework predicts specific actors' behaviour as being dependent on whether these see new opportunities in the EU legislation. The 'EU opportunism' mechanism following from this framework is expected when *interest structures* are characterised as balanced, while the 'EU leverage' mechanism is predicted for the cases where interest structures are deemed as dominant.

The first step in both 'EU opportunism' and 'EU leverage' process tracing mechanisms is assessing domestic *interest structures* as being either balanced or dominant (unbalanced). In addition to the strategies for identifying and mapping stakeholders and their power positions, indications of resistance, conflicts and opposition with regard to important aspects of the gas sector need to be identified. If there is no significant opposition to salient questions, this indicates that a certain *actor coalition* occupies dominant positions. Therefore, some questions in my interviews aimed to identify conflicts. For example, interviewees were asked to indicate the most salient topics in domestic natural gas markets and then to comment on (dis-)agreements regarding those questions. In a balanced *interest structure*, *status quo* prone actors are expected to be powerful enough to resist. In case of disagreements regarding certain aspects of the gas sector, *trace evidence* is expected, such as voting distributions in parliament (none of the sides should dominate absolutely) or the surfacing of conflicts to the media (public announcements). *Trace evidence* of the existence of conflicts among political and private actors can be: changes in natural gas price (rise or fall) that cannot be explained by market conditions (certainty and uniqueness low); documents showing commercial/investment arbitration; litigation taking place (not very certain, but very unique evidence). An *actor coalition* which fears to lose its power soon, may attempt to create irreversibility of rules in the gas sector. This would be visible from law(s) in question accepted. For instance, special safeguard measures can be embedded in laws, final investment decisions on natural gas infrastructure can be made that are difficult to reverse.

If there is evidence that certain *actor coalitions* both in their statements and actions expressed intentions against liberalisation and diversification, and that these *actor coalitions* held or gained enough power, this is evidence of a dominant *interest structure*. To indicate that a certain *actor coalition* is against liberalisation, trace evidence, such as public announcements and *account evidence* from interviews, is expected. Expected evidence should be highly

theoretically certain (if not found, this strongly disconfirms the claims) and highly unique (no alternative possible explanations). Other evidence is expected, such as draft laws, which use existing 'room for manoeuvre' to transpose minimal requirements of EU legal tools rather than exceeding them, and/or transpose the EU legal tools word-by-word instead of adjusting to the certain needs of actors. This may indicate that political actors do not proactively use opportunities provided by EU tools and rather reactively implement them as all EU member states are required. Such evidence is theoretically not very certain and neither is unique (it can explain that the transposition of minimum requirements was enough for certain aims).

3.3 'EU opportunism' mechanism

In the 'EU opportunism' mechanism Figure 5 I expect proactive actions of actors who have stakes in the gas markets of the member states. This proactivity does not necessary have to be related to their prospects to receive EU funding for infrastructure projects because the reason of proactivity is opportunities and constraints that domestic actors see. The mechanism and the predicted evidence are presented step-by-step below. The process starts from the causal condition (1), which is a balanced 'interest structure' with regard to available EU instruments. In the next step, the reform-prone *actor coalition* seizes these EU opportunities (2), and uses them for its interests. This strengthens its position (3). The reform-prone coalition shapes the sector in line with EU policies (4). The process results in growing liberalisation and interconnectivity of the respective gas market.

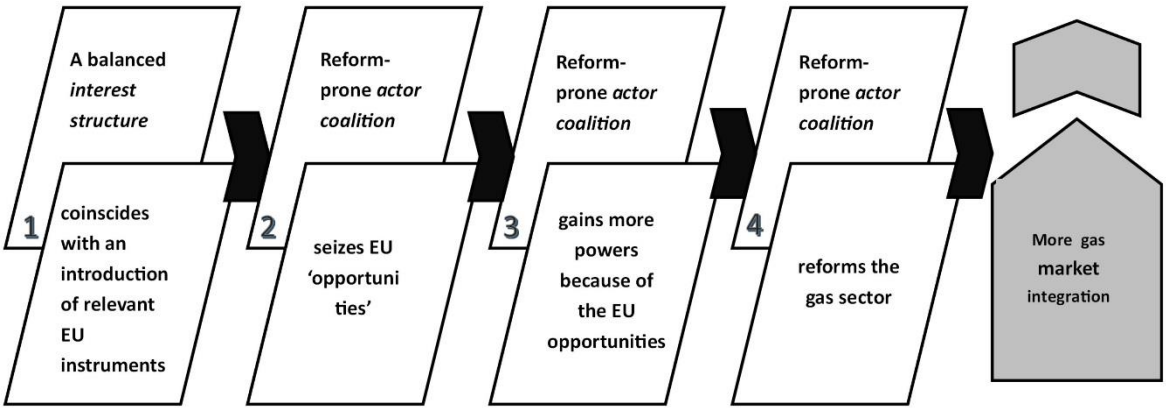

Figure 5 Expected causal mechanism in the cases of balanced *interest structures*

In the first step, evidence needs to be found for two co-existing elements. First, it needs to be shown that interest structures at a certain point of time were 'balanced'; second, available data should indicate that newly adopted or existing EU policies in the natural gas sector presented exploitable opportunities for national actors. The operationalisation of balanced or dominant *interest structures* was presented in the previous sections. EU instruments may become available following EU accession or the adoption of new legislation or practices in Brussels. While the order of appearance is not important, their timing of a balanced *interest structure* and EU instruments must overlap (*sequence evidence).*

In the second step, it is expected that a pro-integration *actor coalition* has realised opportunities in EU instruments and attempted to use them. As shown in the previous chapter, natural gas directives left 'degrees of freedom' to the EU member states in four main areas, consumer liberalisation, separation of interests in the system, national energy regulators and derogations/exemptions. First, by setting minimum requirements for market opening, the early generations of those directives allowed for member states to choose which consumers can buy gas for unregulated prices and at what moment. They also did not call for action to force eligible consumers to leave the regulated market. This question was left for national consideration. Even though the last directive, the Third Natural Gas Directive, left much less 'degrees of

freedom' in terms of liberalising consumers *de facto*, *de jure* countries could continue regulating the prices for eligible consumers who do not wish to switch to unregulated markets. Therefore, actions taken by a particular member state to fulfil those requirements may indicate either proactivity or reactivity of its authorities. Since defining customers as eligible does not automatically mean that they must leave the regulated prices area, it signals the decision makers' willingness to reach consumer liberalisation more rapidly when a member state is forcing eligible customers to leave the regulated prices. The proactivity of decision makers can also be inferred if a member state made all, including household consumers eligible to switch suppliers before the final deadline set in the Second Natural Gas Directive, 1 July, 2007. Second, regarding the separation of interests between system owners and production and/or supply, the early generations of the directives set only minimum requirements for account unbundling (1998) and legal unbundling (2003). Even though the Third Natural Gas Directive (2009) set much higher minimum requirements with regard to unbundling, it still gave policy makers in the member states a choice of four models of unbundling. If a member state did not opt for the ownership unbundling model, it would leave 'degrees of freedom' to a transmission system operator. Third, even though the directives (starting from 2003) required to establish national energy regulators and to ensure their independence, they did not prescribe exactly how this independence should be realised. Forth, all three generations of directives left many opportunities for exemptions and derogations. 'Across the board' derogations were available to a small number of EU member states that qualified as 'isolated' or 'emergent', but if a country was eligible, the derogations were wide, as an emergent or isolated member state could be exempted from 'most if not all of the *acquis communautaire* in energy, both on market design and on the regulatory framework' (de Hauteclocque and Ahner 2012, 2). If a country receives a derogation, it is applied 'across the board', but the country is free to choose to implement the relevant provisions regardless. If an exemption is provided for a project, the

project managers also can choose not to use it. The Security of Supply Regulation of 2010, and especially the Security of Supply Directive of 2004 left a wide room for manoeuvre for domestic actors to interpret them.

Indications of pro-integration *actor coalitions* using the EU opportunity structures can be identified by such *trace evidence* as politicians deciding not to use exemptions and derogations provided in the EU legal instruments (exemptions and derogations mostly help to maintain the *status quo*). Other trace evidence can be the adoption of laws that intend to transpose EU legal instruments that go beyond the minimal requirements (using the 'degrees of freedom' allowed for in these EU legal instruments upwards and not downwards). In the cases of transposition of the Second Natural Gas Directive, politicians may set household consumers as eligible before the deadline on 1st July 2007. Observations of legislators forcing the eligible consumers to leave the protected space of regulated prices can also be treated as evidence to support this part of the mechanism. Confirming evidence would also be the timely transposition of the EU legal instruments (no 'foot-dragging'). *Account evidence* is also expected. For example, this would be the case if interviewed actors who were identified as reform-prone use such justifications as 'directive as a tool', 'we used the Directive/Regulation' and similar.

Disconfirming evidence would be the beginning of an infringement procedure by the Commission in the research period due to delays in transposition or incorrect transposition started. Indirect evidence that disconfirms that EU regulations are used as opportunities is a word-by-word transposition of EU regulations to national legislation. Steps that prevent the market making, such as the increased regulation of gas prices, would be considered as strongly disconfirming evidence.

After establishing that domestic actors attempted to use EU opportunities, in the third step of the mechanism it is expected that they gained more power because of this. This is based

on Knill and Lehmkuhl expectations that the EU influence would change distribution of power and resources between domestic actors. It needs to be found that reform-prone *actor coalitions* achieved policy measures which they would be unlikely to implement without the support of relevant EU instruments. Following Lütz, evidence should be found that EU *opportunity structures* allowed advocates of reform to constrain the choices of those preferring the *status quo*' (2005, 141). This step is partially related to the next step – reforming the gas sector. Confirmation of this step is expected to be substantially based on *account evidence* (interviews) that would confirm that available EU tools strengthened or constrained an actor's position.

In the fourth step, significant changes in line with EU regulation must be observed in the direction of implementation of internal market rules and increased gas system diversification of a country. *Trace evidence* is expected which shows reforms in the sector, such as the adoption of laws, changes in the sector's structure, or changes in natural gas prices (rise or fall) which can be interpreted as an adjustment to new market conditions. Besides that, *account evidence* is expected from the interviews and market announcements by gas companies.

3.4 'EU leverage' mechanism

This mechanism predicts in dominant *interest structures* actors choose non-action, fulfilling only minimal requirements of EU policies, delaying transposition of EU regulations or transposing them incorrectly. One of the main differences to the 'EU opportunism' causal mechanism is reactive actions (to infringement procedures) instead of proactive use of changed *opportunity structures* when EU policies come into force. More proactive actions can only be expected when monetary possibilities provided by EU funds open. In such a case, the Commission may use this avenue to instigate more compliance with the EU natural gas market regulations on the domestic market, in other words, to 'condition' the support for the cross-border infrastructure projects with the internal gas sector management of a country.

The causal process (see Figure 6 below) starts with the dominant interest structure appearing (step 1, causal condition). The anti-integration *actor coalition* delays liberalisation and/or diversification processes and/or diverges from the EU goals if previously pro-integration *actor coalition* have implemented them (2). Subsequently, the Commission starts infringement procedures and other investigations. It might also condition EU funding for gas projects to compliance with EU internal market requirements (3). The anti-integration *actor coalition* reacts by partially complying with the regulations, especially in the cases where EU funding depends on cooperative behaviour (4).

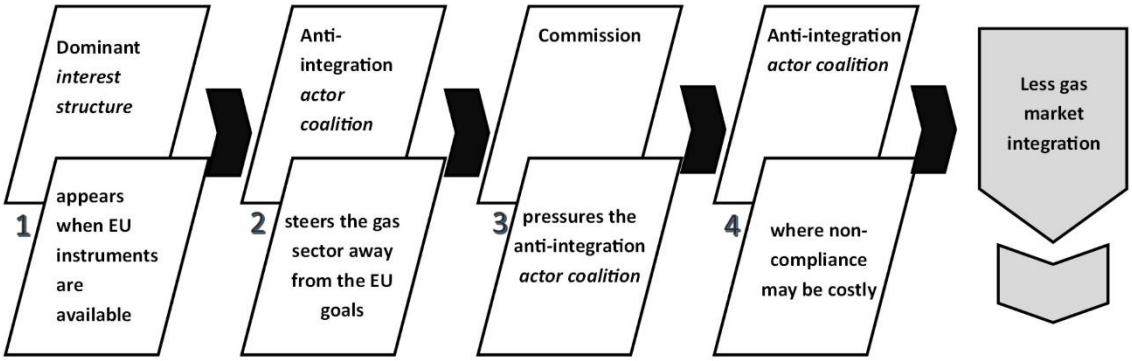

Figure 6 Expected causal mechanism in the cases of dominant *interest structures*

The following empirical manifestations are expected in the depicted steps of this causal mechanism: In the first step, evidence needs to be found that an *interest structure* was dominant and coincided with the appearance or previous existence of EU-level opportunities. The operationalisation of balanced or dominant *interest structures* was presented in the previous sections.

In the second step, the emergence (or existence) of dominant anti-integration *interest structures* in a country is expected to bring about policy development diverging from EU aims. The evidence for this part of the mechanism overlaps with evidence in the previous part. Late

and incorrect transpositions of EU requirements, as well as legal initiatives opposed to main principles of EU requirements are expected. Such *trace evidence* is rather theoretically certain and even more unique (there are few alternative explanations besides the anti-integration inclination of actors). Interviews with market participants are expected to provide account evidence.

In the third step, the Commission is expected to launch infringement procedures and/or customise EU funding to 'correct' the divergences from the EU aims. Unlike in the 'EU opportunism' mechanism, where actors in balanced *interest structures* closely cooperate with the European Commission, here the latter is expected to assume a more punitive role. Being the 'guardian of the Treaties' the Commission is expected to use the powers assigned to it in the Treaty to ensure compliance. It will put pressure on the anti-integration *actor coalition.* These instruments may be infringement and antitrust procedures and the EU funding, where the Commission may customise the conditions to receive it accordingly to the situation it seeks to 'correct' in the domestic gas sector. *Trace evidence* of these actions needs to be found. This kind of evidence is highly certain (must be found), but less unique (the Commission may start infringement proceedings even against 'cooperative' countries although less frequently).

In the fourth step, it is assumed that actors of the dominant anti-integration coalition may respond to EU pressures when the Commission's infringement procedures is about to reach the third stage, which is litigation at the European Court of Justice. According to an author Ramírez-Cárdenas Díaz, this happens, if a member state fails to adopt necessary measures within the time-limit set by the European Commission. Since the adoption of the Maastricht Treaty, the ECJ may impose economic sanctions in the form of lump sums or penalty payments to a member state. Yet, the formal start of the litigation phase puts an end to the possibilities of negotiation with the Commission on ceasing the infringement (Ramírez-Cárdenas Díaz 2011). Support that this step of the mechanism existed is mostly expected from

account evidence.

3.5 Selection of four non-chronological cases

This is based on the idea that the cases are a 'multidimensional empirical phenomenon' with 'substantive bounds' (the research area), 'spatial bounds' (the countries) and 'temporal bounds' (the observed period) (Rohlfing 2012, chap. 2). The substantive bounds have been pre-defined by the topic of the thesis, namely, the interplay between EU and domestic politics in the sector of natural gas. This part of the chapter therefore focuses on the spatial and temporal bounds to select four cases.

The spatial bounds are defined according to Mill's Method of Residue (one of Mill's methods, may also be referred to as Mill's Method of Difference[16]). The countries are ordered based on several structural characteristics: the importance of natural gas for the economy, and the household sector as well as the year of EU adhesion. Mill's Method of Residue would require the stepwise elimination of any possible cause other than a few core causes to possibly explain the outcome (selection of *most similar*, but not identical cases). However, the fact that a remaining 'cause' coexisted with the outcome does not prove that it indeed caused it. Therefore, while this Mill's method may be useful in case selection, it does not provide strong insights as a research method. In this thesis, the logic of Mill's Method of Residue is used to identify the potentially most interesting cases. First, Mill's logic is used to select the countries where gas sector developments are an important issue of public debate and may hence produce more interesting research results. Second, country's 'misfit' with EU policies is inferred based on the time of EU adhesion.

As shown in Table 3 below, the countries are firstly ordered by the importance of gas

[16] The 'true' Mill's Method of Difference requires comparing instances in which the phenomenon does occur with instances in other respects similar in which it does not (Mill 2012, chap. CHAPTER VIII: Of the Four Methods of Experimental Inquiry). It is hard to find in reality (non experiment, energy) countries that would be absolutely identical in all the features of size, political structure, energy consumption patterns, therefore, the more flexible Mill's Method of Residue is used.

for their economies, counted as the share of gas in the primary energy consumption. In such cases the issues of gas sector regulation were possibly more salient among industries and households, and subsequently, politicians. Secondly, the countries were ordered by the importance of gas in the household segments. It was measured as a sum of gas consumed in the residential sector and district heating plants as shares in gross inland gas consumption. The gas input in district heating plants was added to gas consumed in households for two reasons. First, even those households that do not consume much gas directly, they can be strongly affected by gas prices via the heating prices. Secondly, adding these numbers provides an opportunity to measure 'gas penetration' in the economy (Kaderjak 2015, 9–11), which otherwise would not be captured. I assume that politicians are more responsive to the electorate's perceived needs for gas price regulation if there is a large share of residential gas consumers. In calculating the shares, Enerdata and Eurostat databases were used. To balance out the possible fluctuations in shares during the economic crisis and the recovery, averages from 2010-2015 were calculated.

The year of EU adhesion in the last three EU expansions in 2004, 2007 and 2013, is used as a division line between 'old' and 'new' EU member states. Selecting 'new' member states allows controlling for the 'misfit' degree between the EU and national policies, which is assumed to be larger than in the 'old' EU members. Moreover, focusing on 'new' EU member states allows addressing an important gap in the Europeanisation literature, which is often concentrated on 'old' EU members. Table 3 highlights Hungary, Lithuania and Romania as the three most noteworthy countries to be researched.

Table 3 EU member states ordered first by the importance of gas for their economies, then for households

Country	Share of gas in total primary energy consumption	Share of gas consumed in households and district heating	'new' EU member
Netherlands	42.54%	24.34%	no
Italy	37.15%	29.55%	no
United Kingdom	35.88%	39.73%	no
Hungary	34.58%	39.76%	yes
Lithuania	33.06%	13.95%	yes
Ireland	30.18%	14.78%	no
Romania	30.06%	27.23%	yes
Latvia	28.12%	18.76%	yes
Croatia	27.02%	24.35%	yes
Belgium	26.01%	23.37%	no
Slovakia	25.75%	33.10%	yes
Luxembourg	23.97%	22.83%	no
Spain	22.26%	12.55%	no
Germany	22.22%	33.43%	no
Austria	22.02%	19.27%	no
Denmark	19.58%	27.82%	no
Portugal	18.22%	6.57%	no
Czech Rep.	16.27%	37.84%	yes
France	14.88%	32.67%	no
Poland	13.66%	26.69%	yes
Bulgaria	13.52%	10.40%	yes
Greece	12.76%	9.15%	no
Slovenia	10.21%	20.62%	yes
Estonia	8.76%	58.96%	yes
Finland	8.50%	13.45%	no
Sweden	2.06%	7.27%	no
Cyprus	no significant gas market	no significant gas market	yes
Malta	no significant gas market	no significant gas market	yes

The temporal bounds of the cases are defined based on coincidence with national elections and main EU legal instruments to be transposed to the national level. The temporal bounds of the cases are delineated as theoretical time, which allows for 'comparisons at points in time that are comparable in light of the theory at hand' (Rohlfing 2012, 129–30). Rohlfing considers such a comparison to be a better choice for cross-section comparison than one based on chronological time, which would cover the same period of time for all cases (2012, 129–31). National elections are expected to influence a balance in *interest structures*, especially if

incumbent ruling parties were replaced as a result. As CH 2 showed, many EU instruments influenced the natural gas sectors of EU member states, but the most dramatic changes were required by the last two internal market directives of 2003 and 2009 and the Security of Supply Regulation of 2010. For these reasons, in Figure 7 a timeline is presented, where the rose-coloured segments on the bottom side indicate time periods from the adoption of a certain EU instrument in 2003, 2009 and 2010 to the deadline set for national implementation. On the upper side, Hungary, Lithuania and Romania are placed according to the timing of parliament elections. In case of major changes in ruling coalitions, they are indicated in yellow. Otherwise, they are indicated in blue. In case of governmental change, I assume a bigger likelihood for reforms. Based on this timeline, cases are selected.

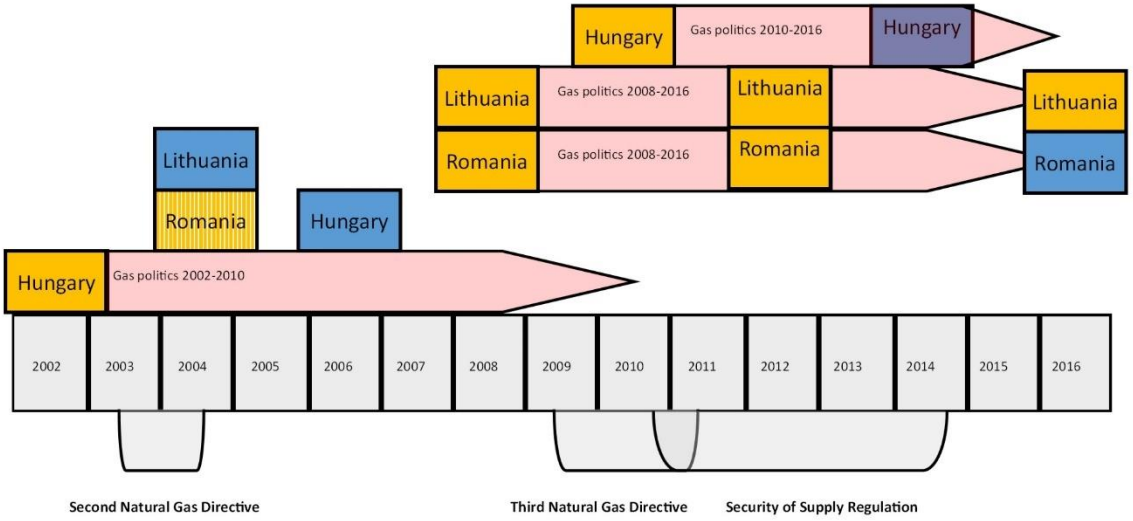

Figure 7 Defining temporal bounds to select cases

In order to have enough time for the political events to develop and the effects of EU instruments to show, the earliest possible time periods were selected for case studies. The first research period in Hungary starts in 2002, when after an election the Hungarian Socialist Party took over forming Government from the right-wing Fidesz. In Lithuania, it starts in 2008, when after an election Homeland Union – Lithuanian Christian Democrats (the Conservatives) took

over forming the coalition Government from the Lithuania Social Democratic Party that had formed several consecutive governments before. In Romania, it also starts in 2008,[17] when following the 2008 legislative election; the Democratic Liberal Party formed the coalition government. The fourth case starts in Hungary in 2010, when Fidesz won two-thirds of seats in Parliament, which was repeated in a 2014 election. Hungary is represented in two cases because of the fundamental changes in political power took place after the mid-2010 election. This warrants explorations into how those changes among the political actors were reflected regarding the Hungarian natural gas sector. This places a temporal end in mid-2010 in the first Hungarian case. The end points in the other three cases are mid-2016, the latest possible with regard to the thesis writing. In each of the four cases, firstly the congruence method is used for evaluating the state of *interest structures* at the domestic level (balanced or dominant). Then the process tracing method allows for an in depth within-case analysis of processes that have shaped developments in domestic natural gas sectors.

Key characteristics of selected case studies

Hungary, based in Eastern Europe, and Lithuania, situated in northern Europe (UN 2017), joined the EU in 2004. Even though Romania, based in Eastern Europe (UN 2017), joined the EU later than Hungary and Lithuania, in 2007, it had to the so-called *acquis communautaire* – the legal basis of the EU, nonetheless. These three countries share a socialist past: Lithuania used to be fully incorporated into the Soviet Union, and Hungary and Romania were Soviet satellite states. The population of Hungary in January 2016 was around 9.831 million, in Lithuania around 2.889 million and in Romania around 19.760 million people (Eurostat 2016c). Even though Lithuania and Hungary were only in the EU accession process when the Second Natural Gas Directive was adopted and could not participate in negotiations,

[17] Even though there were reconfigurations in Romania after its 2004 general election, the EU membership was four years ahead. Therefore, the European Commission did not have possibilities to launch infringement procedures before that period. Conversely, Hungary joined the EU in less than two years after the election of 2002, at approximately the same time when the Second Natural Gas Directive had to be implemented on the national level.

by mid-2004 they were EU member states and had to transpose the Directive on time. Romania, which joined the EU on January 1, 2007, underwent the pre-accession process, where it had to comply with the EU rules, including the ones regarding the internal market legislation (Trauner 2009, 9). Hungary, Lithuania and Romania, then members of the EU, could participate in negotiations in Brussels during the adoption of the Third Natural Gas Directive, which took place in 2007-2009.

Lithuania and Romania are semi-presidential democracies, and their populations directly elect presidents. In contrast, Hungary is a parliamentary democracy, where presidents are elected by Parliament. Hungary and Romania take part in CESEC and Lithuania in BEMIP High Level Groups.

The natural gas sectors of these three countries also share many similarities, such as tendencies to regulate end-user gas prices, coming from the socialist times, and gas import direction from the East, Russia combined with no or little supply routes diversification until late-2000s. Before 2015, all gas imports to Lithuania stemmed only from the Russian Gazprom via Belarus. Lithuania was also linked to Latvia by a gas interconnector - however Latvia was also supplied by Gazprom. Among current EU member states, Lithuania was the first to get the Soviet gas already back in 1961 (Heinrich 2014, 29; Dienes and Shabad 1979, 75), and also became the first EU country to implement ownership unbundling of its gas transmission system in which Gazprom had an ownership interest. Lithuania also built its LNG terminal at the Baltic seacoast in the end of 2014; from 2015 on, the Norwegian Statoil complemented the supply of gas. This occurred after five decades of prevailing *status quo* of a single dominant gas supplier (Russia), and two decades after the dissolution of the Soviet Union. In Hungary and Romania, the majority of gas imports used to be delivered via the pipelines that were extended in the 1970s from the Brotherhood system via Ukraine (Stern 1983, 373; HEO 2011, 40). In addition, in 1996 the Hungaria-Austria-Gasleitung (HAG pipeline) connected the Hungarian and

Austrian systems (European Commission 2005, 79; Gas Connect Austria 2016). During the second period researched in this thesis, Hungary finalised three more interconnectors, to neighbouring Slovakia, Romania and Croatia. However, by the end of the analysed period these were rarely used. The first interconnector to another EU member of Romania was to Hungary in 2010 (FGSZ 2016). Hungary and Romania also produce gas. Hungary covers on average around 25% and Romania around 75% of its gas consumption by own resources.

In the period from 2002 to 2010, when the Second and the Third Natural Gas Directives were adopted in Brussels, Hungary showed many attempts to establish competition in its gas market. It also actively implemented infrastructure projects that connected the Hungarian natural gas system with neighbouring countries. From 2010 on, however, the gas sector liberalisation process got reversed, with household prices first being frozen and then cut, which, together with other reasons, resulted in private gas companies leaving the gas sector. Romania delayed the transposition of the Third Natural Gas Directive even when facing possible sanctions from EU institutions. Despite strong external incentives, provided not only by the Commission, but also by the International Monetary Fund (IMF) and the World Bank (WB), the progress in this regard is sluggish.

3.6 Research data

I used primary and secondary sources for my analysis. Primary sources are interviews with stakeholders in the domestic natural gas sectors (elite and expert interviews). Altogether, interviews with 48 people were conducted and some of them were later updated with complementary information. Interviewees represented influential organisations or expertise in domestic natural gas sectors and held decisive positions being, for example, energy ministers, deputy ministers, members of parliament, high level managers of natural gas companies and

representatives from NRAs.[18] The interviewees were identified using the 'chain-referral' sampling technique. Thus, the initial set of potential respondents chosen mainly by desktop research, were asked to suggest further potential interviewees (Tansey 2007). Quotes from interviews in Lithuanian language were translated to English. All the other interviews were conducted in English. Most of the interviewees wished to remain anonymous and are indicated only by their role. The full list of the interviewees can be found in the annexes. Interviewees were coded by using abbreviations of their positions and the country they represent. For instance, SE means state employee (can be a Government official at non-political level), PRES stands for a person from a President's administration, GOV- a Government employee at political level, MP - a Member of Parliament (sometimes accompanied by an abbreviation of the political party the interviewee represented), NRA – a person from a national regulatory authority, COMM – a representative from the Commission, LEGS – a legal expert, EX – energy expert, IND - energy industry representative, UPS – an upstream segment and DS – a downstream segment.

Other primary sources were, amongst others, (draft) energy laws and regulations and market announcements by gas companies. When preliminary research for Lithuania indicated that many important developments happened in parliamentary committees, I obtained dossiers from the Committee on European Affairs (2007-2008) and the Committee of Economics (2007-2011) from the Lithuanian Parliament archives. I also executed a procedure to access information from EU institutions available to EU citizens to gain the correspondence between the Commission and Hungary, Lithuania and Romania during infringement procedures. Besides that, secondary sources were used, such as media accounts about events in the natural gas markets and energy statistics, such as Lexis-Nexis, Agence Europe, Enerdata, Eurostat and more.

[18] The interviewees included highest level officials on national and on the EU level, such as the 2008-2012 Prime Minister of Lithuania, Andrius Kubilius, and the former European Commission's Director-General of DG for Energy, Philip Lowe.

Possible biases and limitations of sources were diminished by data triangulation. Primary sources, such as legal documents, may be more reliable and valid, but this information is not sufficient to draw the full picture. Interviewees were stakeholders who pushed or were opposed to reforms. Media accounts may be misleading for varying reasons: certain media owners or journalists may be in favour or against a particular reform, may be not familiar with the topic in question and can be simply misguided. Biases were avoided by selecting stakeholders from both camps, pro-integration and anti-integration, and by carefully evaluating their motives. In addition, data triangulation was executed by using less interdependent sources on each other, such as interviewees compared to reports by the Commission etc. Media quotes were used only if no other data sources were available.

4 HUNGARY 2002-2010: TOWARDS THE 'TRACES OF GENUINE COMPETITION'

The unfolding of events in this chapter show that the general election of 2002 and Hungary's EU accession in 2004 changed *opportunity structures* for domestic actors in the gas sector. Unlike in Lithuania (next chapter), where the strive towards reforming the gas market according to the Third Natural Gas Directive and route diversification primarily came from the Government, in Hungary, the push towards both towards implementation of the Second Natural Gas Directive and diversification came strongly from the private energy sector. It was private actor MOL, national energy 'champion', who by 2003 started seeking to deregulate the gas prices, which, in turn, was met by the socialist government. In turn, even though the Government did not want to increase end-user prices, it considered that it should liberalise the sector because the EU required so (SE HUNG 1 2016). This company later also concentrated on an investment program to interconnect the Hungarian gas market with the neighbouring countries (Deák 2015; EX HUNG 1 2015). Even though in the beginning of the research period Hungary had to transpose only the First Natural Gas Directive of 1998, the requirements transposed already resembled the Second Natural Gas Directive at that time still discussed in Brussels. The subsequent 2006 general election did not cause major political power reshuffling, but after selling storage and wholesale businesses to the German energy holding company E.ON and remaining with the transmission company, MOL focussed on the cross-border interconnectivity of the Hungarian transmission system. The transposition of the Second Natural Gas Directive in 2008 changed the sector further.

This chapter is structured as follows. It identifies *actor coalitions* related to the gas sector and their relative power positions. After this, in the second part, the chapter exercises a process tracing method to follow the impact of Europeanisation and shows how the balanced *interest structures* led to changes towards increased liberalisation in the Hungarian gas sector. Three waves of transposition of EU internal natural gas market directives in 2003, 2008 and

2009 and the interests behind them are examined. The third part analyses Hungary's participation in cross-border interconnection projects.

4.1 The sector driven interest structure

In the 2002-2010 period in Hungary, there were two salient questions in public related to the gas market, (de)regulation of gas prices for end-users and gas supply diversification. The low end-user gas price issue extended to the research period from the first Viktor Orbán Government of 1998-2002 and it was a much more internally contested topic than the cross-border interconnectivity. A Hungarian energy industry source said in an interview:

> Especially since the 2000s, opposition and government, no matter who is in charge (of course, the roles were switching), but they have accused the ruling Government of raising the gas prices. […] In public debate, even the fuel prices for many, many years have been considered as the tools of the government, and the prices are interpreted openly by the politicians that, of course, this was just a political will that you decrease or raise the specific prices (IND HUNG 2 2016) .

During the transition from socialism, Gazprom started to increase import border prices for the former socialist countries. MOL was buying Gazprom via a complex arrangement. It shared a joint company with Gazprom (50/50), called Panrusgáz Magyar-Orosz Gázipari (hereinafter Panrusgáz), established in October 1994 (Panrusgáz 2014). Panrusgáz acted as an intermediary to import Russian gas to Hungary: it had two gas contract from 1996 until the end of 2015, one to buy gas from Gazexport and another to sell it to MOL (Orban 2008, 46). As the retail prices were regulated, MOL had to buy gas at higher prices than it could sell to retailers (IND HUNG 3 2016; UPS HUNG 2016). Because of discrepancies between the rising gas import price and regulated domestic end-user prices, the company had suffered losses and attempted to persuade the First Viktor Orbán Government of 1998-2002 to increase the regulated gas prices (Hungarian Radio 2000a). This topic soon turned into a battle between MOL and the Government, and in the second half of 2000 MOL took the Hungarian

Government to court (Duna TV 2000). This was the period when Viktor Orbán was first recorded using rhetoric that he heavily deployed later from 2010, discussed in CH 7, that 'neither multinationals nor domestically owned firms will be permitted to impose unbearable burdens on Hungarians' (Hungarian Radio 2000c). By 2001, Viktor Orbán was clear that the Government wanted to buy MOL's gas branch (Hungarian Radio 2000b, 2001), but Fidesz lost the general election of 2002.

Yet, the end-user price question became very prominent. In media articles from 2002, the election year, there are examples of how Viktor Orbán and Fidesz started to employ gas prices in electoral campaigning. He was quoted as saying that if the Hungarian Socialist Party (MSZP) were to form a Government 'it would be the big industrialists and finance capital that would form the government'. He also reportedly pointed out to the rising price of MOL's shares in the Stock Exchange during the election and related it to Socialist politicians planning to raise gas prices' (Hungarian Radio 2002b). In response, an MSZP member Ildiko Lendvai said famously in 2002, the year of the general election: 'I say it slowly so that everybody understands it. I say it slowly so that even Viktor Orbán understands it. There. Will. Be. No. Gas. Price. Hike'[19]. A current member of Parliament of the MSZP in an interview related the appearance of the gas prices in the 'high politics' realm to the conscious actions of Fidesz back in the 2000s:

> In a normal country, energy prices are not a political question. In Hungary, it was not a political question until 2002 either. Between 2000 and 2002, Viktor Orbán made a trap: they were holding back artificially the energy prices on a low level and under the purchase price. During the election campaign, they were accusing the socialists that they would raise the prices. Every expert knew that it was impossible to sell it under the purchase price for a long time. Yet socialists said in the campaign that there would be no increase in prices. They won the election and for the half a year they did not raise the prices. However, international prices were rising, and domestically they also had to rise. So

[19] In Hungarian: 'Lassan mondom, hogy mindenki megértse. Lassan mondom, hogy Orbán Viktor is megértse. Nem lesz gázáremelés': http://magyarnarancs.hu/aszerk/regi-nota-83228.

> Viktor Orbán is representing a liar politics, because conversely to the market processes, they made the gas price into a political question (MP MSZP HUNG 2016).

For the socialist governments the low end-user prices were important. The degree and manner of retail market deregulation shows that even though the socialist governments were inclined to liberalise the gas retail market, they were not keen to deregulate the whole sector. Household consumers remained under the price control mechanism, and the NRA (at that time the Hungarian Energy Office, HEO) - even if it could have been fully pro-liberalisation inclined – did not have the power to control the degree of liberalisation, neither the regulated prices until 2009. However, as one interviewee commented, 'for those governments it was important that the prices did not skyrocket, but they have never thought they could go as far as reducing prices by 20 percent' (EX HUNG 2 2016).

Interviews reveal that the cross-border interconnectivity was not contested that much, and by the end of the research period Hungary had embarked on several pipeline mega-projects, such as Nabucco and South Stream, and the construction of cross-border interconnections. Hungarian energy relations with Gazprom and Russia have been imbued with different sentiments than in the Lithuanian case in CH 5. Similar to Lithuania, the majority of gas is imported,[20] and it has predominantly been of Russian origin, even the gas that comes from Baumgarten, Austria (HEPURA 2014, 52). The official rhetoric was that Hungary needed diversification from the Russian supplies (Orban 2008, 151). Yet whoever formed the government, especially since the early 2000s, has had a moderate-to-positive political approach towards Russia and Gazprom. From the MSZP return to govern Hungary in 2002 and until their defeat by Fidesz in 2010, the prime ministers maintained constant contact with the highest level

[20] According to the annual reports of Hungarian Energy and Public Utility Regulatory Authority (former Hungarian Energy Office), the ratio of domestic production and import in aggregate supply has been around 20-80% for several years, with gradually decreasing domestic production: http://www.ceer.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National_Reporting_2014/NR_En/C14_NR_Hungary-EN.pdf

politicians in Russia, such as Vladimir Putin, sometimes acting as the Prime Minister and sometimes as the President of Russia (Hungarian Radio 2002a, 2002c, 2002d; Interfax news agency 2002; Interfax News Agency 2002; Interfax news agency 2003; Kossuth Radio 2005; RTR Russia TV 2005; NTV Mir 2006; Orban 2008, 114–15, 149). The relationship between Hungary and Russia became so warm that in February 2006 Russia's then President Vladimir Putin visited Hungary making 'the first visit to Hungary by a Russian leader in 14 years', after 'all this time [that] the two countries have pretended not to notice each other in political terms' (NTV Mir 2006). As Orban suggests, the socialist governments from 2002 'never developed a serious strategy for Hungary to diversify its energy supplies, and they were open towards Russian investments in the energy sector and elsewhere' (Orban 2008, 113). In the meanwhile, in opposition, Viktor Orbán carried out the negative communication towards Russia and Russian energy supplies. It stemmed from his first premiership in 1998-2002 (see more about Russian attempts of takeovers of the industry during the 1998-2002 Viktor Orbán Government and energy security being synonymous to a fight against it in Deák (2006, 47) and Orban (2008, 92–97)). In 2007 Viktor Orbán claimed that Hungary did not want to be 'the happiest barrack in Gazprom's camp' (MTI 2007).

The period of 2002-2004 marked a very fragile balance of power in the political system, and MSZP subsequently was seeking a friendly relationship with actors in the sectorial hemisphere. As a Former High-Level Executive for the State Energy and Oil & Gas Upstream explained in an interview, 'the socialistic Government of course, and Péter Medgyessy was interested to keep some businessmen on their side against Orbán' (UPS HUNG 2016). The relationship between the socialist governments in 2002-2010 were described as a 'a regulatory dialog, a tough love relationship' (Deák 2015). As one interviewee from a Hungarian gas industry said, in the period until 2010 there was 'rather healthy dialog between the industry players and the regulator, and not only the regulator, but even the policymakers, like the

responsible Ministry, were quite ready and open to at least to hear what we are saying and sometimes even take some parts of it' (IND HUNG 1 2016). Many occasions illustrated that the socialist governments of Hungary were 'on the same page' with MOL. For example, as shown later in this chapter, in 2003, the early steps towards liberalisation of the Hungarian gas market appear came from MOL. In 2007, a controversial law dubbed 'lex-MOL', which was seen as designed to protect MOL from being taken over by Austria's OMV *despite* the EU criticism (Szakacs and Peto 2007).

In 2002, the MSZP and the Alliance of Free Democrats secured a narrow, ten-seat parliamentary majority over a coalition of Fidesz and Hungarian Democratic Forum (MDF), while both the Independent Smallholders' Party (FKgP) and Hungarian Justice and Life Party (MIÉP) that together with Fidesz formed the 1998-2002 Government lost all their seats, which reduced from six to four the number of parties represented in the National Assembly. Although Viktor Orbán and Fidesz (as well as MIÉP) initially refused to acknowledge the election outcome (Álvarez-Rivera 2016), non-partisan Péter Medgyessy subsequently formed a Socialist-Liberal coalition cabinet. MSZP had less than 50% in Parliament (45.9%) and needed an Alliance of Free Democrats (SZDSZ, 5.2%) to form the Government (Gabriela Ilonszki and Kurtán 2005, 1035). Based on Köker, being a non-party Prime Minister, Péter Medgyessy 'struggled to control the MSZP' (2015, 237–38). This fragile balance collapsed in mid-2004, when 'for the first time since 1990 a cabinet change occurred for political reasons' (Gabriela Ilonszki and Kurtán 2005, 1033). Péter Medgyessy resigned and Ferenc Gyurcsány (MSZP) became the Prime Minister. However, before this collapse, the Hungarian Parliament in 2003 voted for the laws that transposed the First Natural Gas Directive of 1998.

The next Government after the 2006 general election was led by Ferenc Gyurcsány also (MSZP - 49.2% seats, SZDSZ – 5.3% seats) (Gabriella Ilonszki and Kurtán 2007, SZDSZ). However, in the election runoff Fidesz consolidated power and support, and by 2006 Hungary

faced a ‘bipolar political scene’ (Gabriella Ilonszki and Kurtán 2006, 1124). MSZP-SZDSZ Government went into trouble in September 2006, when secret post-election speech by Ferenc Gyurcsány was leaked to media, and resulted in mass protests in Hungary (Gabriella Ilonszki and Kurtán 2007, 971–72). Especially since then the left-leaning Government had strong political resistance until the end of the research period.

Between the country’s executive powers, the President’s role in the energy policy was weaker than in the Lithuanian or Romanian cases. This came from the constitutional configurations of Hungary. Hungary was a parliamentary Republic; Parliament elected a President for five years (Hungarian National Assembly 1989, Art. 29/A). Thus, it was the elected political parties and not a popular vote that defined define who the President would be. Admittedly, a President could veto laws, but in such cases Parliament could override the veto on general laws with a simple majority. Even though it is not precisely specified in the 1989 Hungarian Constitution in place until 2011, the wording suggests that Parliament could adopt the reconsidered law without the changes suggested by the President based on one-half of the votes of the Members of Parliament present (and not one-half of all the Members of the Parliament as in Lithuania) (Supreme Council of the Republic of Lithuania 1992, Art. 72; Hungarian National Assembly 1989, Art. 24-26).

In 2002, the newly elected Parliament did not re-elect the President and entered a period of ‘cohabitation’ with Ferenc Mádl, who had been in place since 2000. According to Köker, although Ferenc Mádl was not officially affiliated with any political party, he ‘was seen as the president of Fidesz’ (2015, 237–38). During the period of ‘cohabitation’, Ferenc Mádl vetoed several laws (Köker 2015, 238–42). In August 2005, Parliament elected ‘the candidate of the opposition’ (supported by Fidesz) László Sólyom to presidents, where he remained until the end of this research period, August 2010 (Köker 2015, 245). His presidency mostly coincided with the next MSZP-SZDSZ Government led by Ferenc Gyurcsány. Köker described the period

of Sólyom-Gyurcsány (2005-2008) ‘as cohabitational from the beginning, yet […] increasingly hostile over time’ (Köker 2015, 246). László Sólyom was ‘the most’ active Hungarian president during its cohabitation with Ferenc Gyurcsány, vetoing 32 laws (Köker 2015, 246). SZDSZ leaving the government formation in 2008 made the balance in the political hemisphere even more feeble. The last two governments in this research period, Ferenc Gyurcsány 2008-2009 (MSZP) and Gordon Bajnaj 2009-2010 (MSZP) were minority governments (Köker 2015, 246).

The HEO was a pro-liberalisation actor, which had some power. According to a former Hungarian state administration official, the HEO had the ‘power of the first draft’. He explained: ‘The regulator is deeply involved in the preparation of not only drafts of [legal] acts, but also executive decrees, governmental and ministerial decrees; the first draft is always coming from the regulator, and then the draft will be studied and changed in the ministry in charge of energy.' The regulator was ‘outsourced’ frequently in developing the legislation, because it had a large administration, more than 100 experts, as opposed to the staff of the Ministry of National Development (SE HUNG 1 2016).

The stance of the NRA (at that time Hungarian Energy Office, HEO) used to be ‘very keen to establish the liberalised energy market’ during the First Viktor Orbán Government 1998-2002 and later on (UPS HUNG 2016). Just a few months before the change and in the month of the general election, in April 2010, Zoltan Matos demonstrated his unwillingness to obey (then in power the socialist administration) politicians requests to keep the gas prices low and allowed the end-user prices to increase by 10 percent. In this incident, Zoltan Matos was quoted by media as saying that ‘everything was on the basis of the law' (Független Hírügynökség 2010), which shows that the head of HEO was able to resist political pressures to keep the end-user prices low for political reasons. Even an interview with an employee of the Hungarian NRA conduced in 2016 showed that at least a part of the staff of the regulator

was willing to accept instead of the Government the 'blame shift' in energy price questions. For example, an interviewee from the NRA said:

> We just said in the regulator that if I were the government, I'd let the decision to the regulator to let people hate the regulator, not the government. But it's not so easy because maybe in the Hungarian mind after the socialism there's no such structured idea of the state that independent regulator decided. 'Who elected that independent regulator?'. That's too much power for an independent regulator who might be captured by the industry themselves - that's a risk, political capture or industry capture (NRA HUNG 2016).

Two other 'special actors', the Commission (active both in Lithuania and Romania), and the IMF (very active in Romania), were seeking Hungarian gas market liberalisation (IMF 2003). However, the channel for the IMF to influence the developments opened only in 2008 when Hungary asked for financial assistance. By then, the Hungarian gas market was already transposing the Second Natural Gas Directive.

There were to two most important actors on the sectorial hemisphere that emerged after the sector restructuring in the 1990s, when the 'former state-owned monolithic structure ownership' was 'radically changed' (Felsmann 2014, 26). It was a national energy 'champion' MOL and German investor E.ON. MOL was a successor joint stock company National Oil and Gas Trust (OKGT established in 1960 initially to produce and distribute liquefied petroleum gas), restructured by Government in 1991. In the restructuring, network companies of low- and medium-pressure gas pipelines, regional distribution companies, became 'independent' joint stock companies (still government owned), separate from MOL (Járosi and Kacsó 2004, 181–82; World Bank 1999, 45). E.ON entered Hungary when between 1995 and 1998, a massive privatization of these distribution companies (and MOL) took place (Megginson 2005, 353). In this step, MOL was also privatised, and by the end of the privatisation process, the share of state ownership remained at 25% + 1 in MOL, which later was further reduced to 12%. The company remained the sole wholesaler and the dominant producer of gas in Hungary (Kaderjak

and Antall 2005, 378), which also owned the transmission system company Földgázszállító (FGSZ). MOL until 2006 was the dominant wholesale, upstream and transmission company.

As shown further in this chapter, in 2002 onwards, MOL clearly stood on the side of implementing the EU internal market agenda. For example, already in 2000 and jumping ahead of the requirements of the First Natural Gas Directive then in place, MOL in a General Meeting decided to unbundle transmission, storage and trading operations into independent legal entities, and mandated the Board of Directors of MOL to define the timing of such actions (MOL 2000, 8). The Second Natural Gas Directive, which required legal unbundling, was only to be proposed in 2001 and adopted in 2003. In the meanwhile, the First Natural Gas Directive, in place at that time, required only to unbundle accounts. Generally, MOL was described as having a strategy of 'survival' under any Government (SE HUNG 2 2016). According one interviewee, as a 'classical tale of international business, you are not a good guy at home', thus, 'MOL did not have the negotiation power against its home government' (SE HUNG 2 2016). In 2006, after selling its storage and wholesale operations to E.ON, it narrowed down its interests in the gas sector because it detached from interests in gas wholesale operations and the long-term gas import contract with Gazprom. These changes of ownership in MOL, and then in MOL's assets and interests in the gas sector brought the Hungarian gas sector into a more balanced position in terms of distribution of interests and powers.

E.ON purchased in the 1990s shares of regional utilities and only later (2005-2006) wholesale and storage businesses from MOL. Subsequently, by 2006 E.ON's importance in the Hungarian gas sector increased. In the beginning of the research period, other actors on the sectorial side were six regional DSOs and suppliers to end-users that had been there since the end of privatisation in 1998. The main shareholders in the gas distribution companies were 'European industry players' from Germany, France, and Italy (Jászay 2010). In 2004-2005, two-thirds of the distribution companies were owned by foreign companies (mainly German,

French, Italian) (HEO 2005, 36). These 'European players' would occasionally change and merge, but the main structure remained without substantial changes during the research period. By 2010 the foreign ownership in the six Hungarian gas distribution companies was the following: German RWE held shares in the gas distributor to Budapest (Főgáz), German E.ON in Central Transdanubian Gas Provider (Kögáz) and Southern Transdanubian Gas Provider (DDGAZ) (Novak 2014; Jászay 2010, 11), French GDF-Suez in Degáz and Égáz (after consolidation became Égáz-Dégáz Földgázelosztó, distributing gas in distribution company in North-West of Hungary and Southern region), Italian ENI and RWE held shares in Tigáz. The geographical spread of those distribution companies is presented in Figure 8 below. In the figure, yellow colour represents ENI and RWE, light blue – GDF, red – E.ON, and dark blue – RWE (Főgáz shares held with the Budapest municipality).

Figure 8 Hungarian gas distribution companies and their owners in 2010 (Jászay 2010)

Despite the fact that Főgáz covered a small geographic area, it had one of the biggest

numbers of clients among the regional distribution companies, because it served the capital of Hungary. Főgáz was the only regional distribution operator where a foreign investor (RWE) got a hold only over minority shares (49%), whereas the Budapest municipality had held a majority (Felsmann 2014, 26; Daily News Hungary 2014).

There also was the incumbent holder of the main import agreement with Gazprom, Panrusgáz. The only official business of Panrusgáz was to purchase gas from Gazexport for onward sale to MOL (later E.ON), and in this regard Panrusgáz was the long-term intermediary between Gazprom and Hungary (European Commission 2005, 4–9). The majority of gas via Panrusgáz came from the pipelines running in to Hungary from Ukraine. Even though interviewees occasionally mentioned the structural importance of Panrusgáz in the supply chain of gas to end-users, none recalled it as an actor that would try to make impact on internal gas sector regulation. Therefore, Panrusgáz in this thesis is not profiled as an influential actor.

As emerges from some interviews, by 2007-2008, the *interest structure* was nearing a dominant pro-liberalisation configuration. As one interviewee, who at that period worked for the Hungarian state, said, 'for everybody who worked in the state administration, it was clear that Hungary had to do this at that time'. He also noted that the gas sector players also supported this: 'All of the market players agreed on the date that in the electricity market we will open at the beginning of 2008, and in gas market at the beginning of 2009. There was a consensus for that' (SE HUNG 2 2016). Yet, this image of consensus was on the surface. Strong opponents of liberalisation were to come back to power in mid-2010. The *interest structure* in 2002-2010 Hungary is presented in Table 4 below. Green colour means that interests in favour of a specific aspect are more expressed, yellow – dubious or changed position, and grey – no or non-identified position.

Table 4 *Interest structure* in with regard to gas price deregulation and cross-border diversification in 2002-2010 Hungary (based on multiple media and interview sources)

Type	Actor	Power	Stance vis-à-vis liberalisation of household consumers	Stance vis-à-vis cross-border diversification
Executive actors	President	A President cannot become real counterbalance to Parliament, because Parliament elects him or her	Both presidents in the research period, Ferenc Mádl and László Sólyom, were considered to be 'opposition' (Fidesz) presidents	Both presidents in the research period, Ferenc Mádl and László Sólyom, were considered to be 'opposition' (Fidesz) presidents
	Governments	Fragile ruling majorities from 2002 to 2008, and then minority governments until mid-2010	First Natural Gas Directive (of 1998) transposed in 2003, started the liberalisation process, which was accomplished with the transposition of the Second Natural Gas Directive in 2008	MSZP governments signed IGAs for the Romanian and Croatian interconnectors, and also involved into Nabucco and South Stream mega pipeline projects
Legislative actors	National Parliament	Fragile majorities from 2002 to 2008, and then minority governments until mid-2010	A vocal opponent of increasing gas prices Fidesz was the strongest opposition party in Parliament in 2002-2010	Officially in favour of diversification but initially no strategies
Special actors	National energy regulator	Considered powerful because it would prepare the first draft of legislation	In favour	At least formally in favour
	European Commission	Uses all the power it can	Very much for	Very much for
	IMF	The first stand-by agreement in 2008, after the liberalisation was implemented.	Supporting liberalisation and end-user price increase to reach cost-effective levels	n/a
Large consumers	n/a	There are no fertiliser producers or other large consumers that would have a single significant effect on Hungary's economy	n/a	n/a
Vertically integrated gas company	MOL	Until 2006, it was a vertically integrated monopoly, which produced gas, owned FGSZ (transmission) and gas storages. After it sold the wholesale and storage business to E.ON, as well as with	High(er) gas prices bring more value to shareholders; Transmission tariffs are a part of the final consumer tariff;	Sought it, especially when focusing its attention to transmission after selling its wholesale and storage businesses to E.ON in 2006. FSGZ built most interconnectors that were opened in the next research period.

		increased potential supply of gas from other sources, the role of MOL became smaller, its power decreased.	Traders and suppliers that appear to serve liberalised consumers used storages that belong to MOL to keep gas.	More interconnections allow to turn gas storages into regional storages, and no longer local. Thus, it increases utilisation of storages
	Gazprom	Supplied the majority of gas to Hungary and co-owned Panrusgáz, which had the main gas import contract; With increased potential supply of gas from other sources, the role became smaller	No particular stance was identified	Based on the information in some interviews that the argument of planned interconnectors was used to negotiate cheaper prices of gas from Gazprom, is assumed that Gazprom did not fully support the diversification of routes; However, no evidence of resistance towards diversification was found
Wholesale/retail	E.ON	From 2006, in addition to the involvement in the retail, it acquired storage and wholesale businesses from MOL, so its role increased.	On one hand, interviewed former state administration officials expressed their uneasiness to proceed with deregulation of end-user consumer prices in late 2000s because of potential resistance from the main holder of the import contract, E.ON; On the other hand, they did not recall any particular actions coming from E.ON to stop it.	On one hand, more supply routes increase the value of storages (from 2006 owned by E.ON); On the other hand, more diversification puts the holder of the main gas import contract at price risk
Retail	Five regional suppliers and DSOs besides the one owned by E.ON	Less powerful than E.ON	Liberalised (higher) consumer prices bring larger shareholder value and increase the rate of return	More supply routes bring more options to purchase gas
	EMFESZ (2003-2010) served business consumers and partially household)	Increasing market share	EMFESZ very successfully used the liberalised market and rapidly increased its portfolio; On the other hand, it benefited from still regulated prices which by the end of 2000s rose, and entered the regulated segment	Although EMFESZ mostly sold Russian gas via the pipeline with Ukraine, more diversification ensured less risk
	Other suppliers to business consumers	Appearing on the market	In favour	In favour

4.2 Push to deregulate gas prices

Even though the general record of transposing EU directives in Hungary was not perfect, Hungary used to be 'the good pupil' concerning the liberalisation of the energy sector compared to other 'new' EU member states, and complied with the EU requirements even before they are enacted and even before the country joined the bloc. For example, Hungary established an energy regulatory agency exceptionally early in the Central and South-East European (CSEE) region, back in 1994, whereas most other CSEE countries did it in 1999-2002. On the retail level, liberalisation of the energy sector was implemented gradually from 2003 and fully achieved in 2009 (Horváth 2012, 37). By the end of the research period, the Hungarian gas sector had been slowly but steadily liberalised up to the degree that it showed 'traces of genuine competition even on the household level, which was partly due to a relatively conducive regulatory framework' (EX HUNG 2 2016).

After the general election in April 2002, the *interest structure* in Hungary changed from *status quo*-prone to more reform-prone. The new Government started increasing regulated gas prices (and electricity) prices ("Keynote Address" 2003; MVM 2004, 13). A keynote speech given at an Energy Regulation and Investment Conference in Budapest in May 2003 by Deputy State Secretary of the Hungarian Ministry of Energy and Transportation, Gyorgy Hatvani, shows that increasing gas prices for the sector to become more market-like was deemed a painful necessity. Household consumers were to be compensated for the increases via subsidies. He said:

> […] some words about the hot issue of proper pricing. It is very clear that this is the most sensitive question, and it is a clear political question as well... I think it is the most difficult task especially in the period of market transition from monopoly towards competition. The most painful step in the last longer period was the creation of new cost covering prices for electricity and gas. The starting situation that means the highly subsidized price, was certainly one of the biggest problems for the countries in transition in our region. In the gas sector […] the gas price is far away from the necessary level today. […] The

> negative social burdens of the higher price will be handled through welfare policy, and the relevant social compensation of the gas prices is under preparation and will enter into force before the winter heating season this year ("Keynote Address" 2003).

Gyorgy Hatvani also admitted that Hungary had had 'a close cooperation with [the Commission's] DG-TREN thanks to them for their help' ("Keynote Address" 2003). The interests towards liberalisation was especially notable in the early 2000s, and by the late 2000s Hungary was continuing to liberalise the market because of a feeling that it was obliged to do so by the EU, and 'for everyone who worked for the state administration it was clear that Hungary had to do this at that time' (SE HUNG 2 2016).

The approach of the Hungarian energy policy makers was corresponding to MOL's needs. MOL was eager to have a more cost-effective price structure and less socially oriented rates. There is evidence, dating to November 2002, that MOL saw the country's accession to the EU as a way out from the political interventions into its business. In a presentation of MOL's strategy for 2003-2005, MOL listed 'reducing influence of politics with EU convergence' as a part of its 'evolving strategic environment' (MOL 2002).

Based on interviews, it was MOL that conceived an idea of how to liberalise the consumer market. The industrial consumers were intended to become free to choose energy suppliers. A person related to the company at that time said in an interview: 'Everything happened in the background of this scheme. Of course we, the MOL specialists, prepared this version as politicians had no ideas what to do, but we already wanted to achieve the normal liberalised market' (UPS HUNG 2016).

As Gyorgy Hatvani expressed, 'after a relatively long reconciliation with every actor in the natural gas market', the Hungarian Government, led at the time by Péter Medgyessy, approved the new draft gas act and submitted it to Parliament in 2003 ("Keynote Address" 2003). The Act XLII of 2003 on Natural Gas Supply (GET), consequently adopted by the

Hungarian Parliament on 14 June 2003, and the subsequent government decrees divided the closed gas market into two parallel markets, a public utility market (where households remained under regulated prices) and a competitive one (where industrial consumers could enter gradually). The Hungarian gas sector became a hybrid model with the coexistence of a regulated segment of the market (or 'public utility market'), resulting from the old gas regime in Hungary, and a liberalised segment of the market (or 'open segment of the market') (European Commission 2005, 14). However, until 2009, even the customers that were eligible to switch suppliers and enter the competitive market part were still able to remain under the framework of public utility services and pay administratively set (regulated) prices.

The Natural Gas Act of 2003, had one more provision beneficial for MOL in addition to liberalising a part of the consumer market: the Hungarian state ceased to administratively set prices for gas production. In exchange, MOL started paying larger royalties from the gas production fields developed before 1998 (required by the changes in the Mining Act). 1998 was 'a threshold when MOL became more private owned as state owned', meaning, much more shares were owned by private companies. The gas production fields developed before 1998, were deemed as 'financed by the Hungarian state and people' and after 1998 as financed by MOL, thus MOL started paying more royalties for the former ones (SE HUNG 1 2016). The income to the budget from the royalties were earmarked and further distributed to the household end-users as a subsidy to offset rising gas prices. Some interviewees identified that the proposal to have an additional mining royalty came from MOL in exchange for price liberalisation (IND HUNG 3 2016).

The degree of gas market opening chosen by Hungary indicates a zealous approach towards the transposition of EU regulations at the national level. The foreseen market opening from January 2004 following the adoption of the law was around 40% ("Keynote Address" 2003). This degree of opening widely overstepped the minimum requirements of the market

opening set in the First Natural Gas Directive of 1998 in effect at that time, even though the law claimed to transpose this directive (Hungarian National Assembly 2003, para. 86). As written in CH 2, the absolute minimum market opening required by the First Gas Directive was 20% as from 10 August 2000, increasing to 33% by 2008. The market opening degree chosen by the Hungarian policy makers more resembled the Second Natural Gas Directive, which was still under discussion in the EU and was adopted on 26 June 2003 – more than a week later when the Hungarian Parliament adopted the Act XLII of 2003. The HEO in its very first national energy market report to the Council of European Energy Regulators (CEER) indeed acknowledged that the draft Second Natural Gas Directive was taken into account while preparing the law: 'When developing each provision of the GET [Natural Gas Supply Act], we had taken into account the contents of the draft EU Directive which had been known at the beginning of 2003' (HEO 2005, 1).

Still, as a candidate country to the EU, Hungary overstepped even the requirements of the Second Natural Gas Directive. By the Decree No. 112/2003 (VII. 2) on the enforcement of certain provisions of Natural Gas Supply Act, Government made all non-household consumers eligible in a single step half a year earlier than even the Second Natural Gas Directive of 2003 required. All non-household consumers became free to choose a supplier from January 2004, even though the Directive required it from 1 July 2004 (Kaderjak 2015, 378–79). Moreover, although the Second Natural Directive left some 'degrees of freedom' to the member states to choose either regulated tariffs or negotiated for access to storage and the system, Hungary chose the option preferred by the EU – regulated tariffs (Cameron 2005, 9; EX HUNG 1 2015).

The market opening and gradual liberalisation of 2003 reduced the scope of the administrative price setting in general, but the final decision on the electricity and gas end-user prices remained in the hands of the Minister of Economy and Transport, which stemmed from a law in 1990 (HEO 2005, 21). The HEO had the responsibility of developing the methodology

for price regulation and proposing prices and tariffs to be set by the Minister of Economy and Transport (Kaderjak and Antall 2005, 401–2; Hungarian National Assembly 2003, para. 49). The Minister had to specify administrative prices and tariffs, as well as the conditions of applying the prices and the tariffs, in agreement with the Minister for Finance (Hungarian National Assembly 2003, para. 56). The Minister was also free to overrule the proposal of the HEO without public explanation. Gas companies, however, had the right to initiate a price review procedure at HEO, and, if deeming the HEO decisions on the price review as unfavourable, to appeal in a local court (Kaderjak and Antall 2005, 401–2). The appointment of the President and the Vice-president of the HEO did not allow for much independence either: these two officials could be appointed and dismissed by the actors in only one political institution, the Prime Minister at the proposal of the minister (Hungarian National Assembly 2003, para. 87).

Following the transformation of the state controlled gas sector into a hybrid model, the distribution companies acquired licences themselves or via separate subsidiaries trading licences for supplying gas in the open segment of the market in addition public utility supply (European Commission 2005, 16). Based on interviews, subsequent regulatory changes removed geographical limitations for the clients to buy gas only from their regional distribution company. Thus, these regional companies were enabled to compete with each other as well and to extend their supply services outside of their 'native' region. In addition to this, due to gas release programme starting from 2006, enforced by the Commission in relation to German E.ON acquiring storage and wholesale businesses from MOL, from 'people suddenly could get hold of some free [uncommitted] gas' (EX HUNG 2 2016). The appearance of available gas on the market attracted new traders, including Emfesz, which by 2009 became the major player in the competitive Hungarian gas market (UPS HUNG 2016). Following this further market opening, by 2009 Emfesz became the gas supplier of more than a fifth of Hungary's domestic

customers and 80% of the country's chemical industries, but after some questionable transactions within the company by 2010 lost its gas trading license and gone bankrupt (Global Witness 2009). By 2010 these regional distribution companies, household, small commercial and industrial customers combined, were the biggest players in the Hungarian gas market together with Emfesz (Jászay 2010, 23).

Between 2003 and 2008, when the Hungarian Parliament again changed the natural gas laws, two things happened that were important to the gas sector. First, in May 2004 Hungary joined the EU; this means it had to transpose the Second Natural Gas Directive by a given time (July 2004). Second, in March 2006 MOL sold its wholesale, marketing and trading (MOL Földgázellátó) and storage (MOL Földgáztároló) companies to German investor E.ON, as well as shares in Panrusgáz – its joint venture with Gazprom (E.ON 2007, 32; European Commission 2005). One consequence of the E.ON-MOL gas deal was the requirement by the Commission to implement a gas release programme in Hungary for eight years from 2006. Each year, 1 billion cubic meters of gas had to be released at auctions (European Commission 2005, 156).

In 2005, the Hungarian Parliament made some changes in the Natural Gas Act of 2003 and added the legal unbundling requirements set in the Second Natural Gas Directive, but the more coherent process of transposition of this directive was yet to come. In 2007, the socialist Government presented a proposal for the new energy strategy until 2020 (the previous strategy was adopted in 1993). One explanation for the need to update the strategy was the EU. The justification was that 'Hungary is a market economy country where the production of goods and services, trade and selling is done on a competitive basis. Energy cannot be an exception from these general principles; therefore, an operating model and regulatory frameworks need to be established and operated, which meets these requirements. It is not only the Hungarian national economic interest but European Community law also requires this' (Kákosy 2008, 3).

An interview with a former Hungarian state administration official of that period showed that the state administration wanted to proceed with further reforms in the gas sector, but in a manner adjusted to the national needs. He said: 'At that time, we read the Hungarian and English translation of the Second Natural Gas Directive, and we came to the conclusion that this should be a bottom-up solution, since the Directive said that the prices should be cost reflective' (SE HUNG 1 2016).

The state started preparing the further gas market reform, which would mean that the majority of the consumers would be fully liberalised, but a certain protected group of customers would remain (households and SMEs) who would be entitled to get a universal supply service. There would be a regulated margin for each market player, and the companies that give this universal service were entitled to set the price based on the detailed price regulations set in law (IND HUNG 4 2016). Despite some interviewees that used to work for the state administration explaining the changes in the law with the requirements of the Second Natural Gas Directive, another one, from the energy industry, called the approach a 'local specialty'. He said: 'This universal service has nothing to do with the transposition of the Third Energy Package; it was in line with EU energy law, but it was a kind of local specialty' (IND HUNG 4 2016).

At the same time, based on an interview, those drafting the further liberalisation felt bounded by 'the main problem of the gas market liberalisation', which was the long-term supply contract with Gazprom. According to an interviewed former state administration official, they were worried that if Hungary too quickly and too fully allowed all customers to change to alternative suppliers importing gas from Western Europe through Baumgarten, 'then the long-term gas contract holder, E.ON who had acquired it from MOL, would come to the Hungarian state and claim losses due to not being able to sell gas quantity of the market because the state allowing to the customers to choose an alternative supplier' (SE HUNG 1 2016). Another former state administration official also considered that at that stage of liberalisation

the possible losers could have been companies 'with the strongest involvement with long-term contracts with the Russians. […] because the liberalisation also means the liberalisation of import routes, and the value of the long-term contract decreased' (SE HUNG 2 2016). These interviewees, however, did not recall any active lobbying or press statements by E.ON in order to slow-down the liberalisation process taking place.

The Hungarian Parliament passed the Act XL of 2008 on Natural Gas (hereinafter Natural Gas Act of 2008), which came fully into force on 1 July 2009. The new act ceased hybrid model and public utility supply, replaced the public utility by 'universal service provision' to supply small customers (HEO 2010, 6). Based on the Natural Gas Act of 2008, starting from 2009, 'only consumers who lacked any real bargaining power (residential customers and several small consumers) and found themselves in a defenceless situation were entitled to universal service provision', whereas others had to leave and buy gas in the competitive market (Horváth 2012, 37). The consumers eligible for gas universal services were households and 'minor' consumers (micro-enterprises) under a certain consumption capacity. As seen from the viewpoint that it neither started an infringement procedure for late, nor incorrect, transposition of the Second Natural Gas Directive, the Commission accepted this bottom-up price regulation approach (SE HUNG 1 2016). As a former state administration official evaluated, at this point of time, based on 'statistical, market opening point of view, Hungary was one of the pioneer countries compared to all EU, with its share of the free market segment in [the] Hungarian gas market'. Moreover, according to him, nearly everybody in the market agreed on the schedules and when the next steps for opening would happen (SE HUNG 2 2016).

Only the Gas Act of 2008 meant that for the first time in Hungarian history the HEO, and no longer a Minister, was allowed to approve by administrative resolutions the individual end-user prices upon the requests of gas UPS. Even then the principles regarding the calculation

of the benchmark prices and maximum commercial margins were still determined by the Minister's Decree (issued upon the HEO's recommendations), but the actual individual prices applied by each of the gas USPs were approved at the HEO's request (Hungarian National Assembly 2008, sec. 107).

The competitive market side was increasingly attracting new, mainly international and fewer Hungarian, entrants and gaining momentum. Such international companies like AXPO, RWE Supply & Trading GmbH, Shell, EconGas and more, especially those who were active in the Baumgarten facility in Austria, Romania or generally in the region, were having a smaller portfolio in Hungary (IND HUNG 1 2016). The growing rivalry was partly due to the competition between the incumbent multinational energy companies for the industrial consumers and partly due to new entrants with a strong regional industrial background, such as CEZ and MOL (Felsmann 2014, 26). One interviewee summarized the Hungarian gas market situation in the following way: 'One signal of this market opening was the number of customers and also the other parallel to this one is the getting more regional approach, so then the players who were acting on the Hungarian market became more international and also others came from the neighbouring markets, and I would say that this tendency was going on until 2010-11' (IND HUNG 1 2016). The upsurge of competition and trading activities on the market was also seen from the increased number of companies that would store gas at the E.ON Gas Storage: while in 2008 where we just a couple of clients, by 2010, there as more than a dozen (IND HUNG 1 2016).

Households and small enterprises remained predominantly supplied by universal service providers, but they could also choose to buy gas from the competitive market part of the sector if they so wished. The household sector, however, attracted new market entrants. For example, Magyar Telekom, the local subsidiary of Deutsche Telecom, took advantage of the opportunity and entered the household and small and medium enterprises energy retail market

in 2011 proposing to supply energy as a part of its bundled services (Felsmann 2014, 31). In 2010 alone, resolutions issued by the HEO enabled the start of operation of 9 new natural gas traders, thus increasing the overall number of natural gas trader licensees by almost a third to 40 in 2010 (HEO 2011, 37).

In the meanwhile, in 2009, the EU adopted the Third Natural Gas Directive, and the first 'transposition' of the Third Natural Gas Directive of 2009 (eventually, there turned out to be many of those) happened in December 2009. The Hungarian Parliament made the first changes to the Act XL of 2008 on Natural Gas in December 2009 (Hungarian National Assembly 2009). This was just five months after the Directive itself was adopted in Brussels, and one and a half years before the deadline of the transposition (European Parliament and Council of the EU 2009, Art. 54). The act (No VII of 2010) was officially published in January 2010 and contained an amendment to the Gas Supply Act related to the unbundling of activities to accommodate the provisions of the Third Energy Package of the European Union (HEO 2011, 39), namely, it chose only the ITO model of unbundling. The proposal for an amendment came not from the Government, but from some individual Parliament Members. A quote in the press by Zoltan Matos, the head of the Hungarian Energy Office at the time, shows that such an overzealous implementation of the Third Energy Package was not favoured by the HEO:

> Parliament has voted in favour of amending the Act on Gas and Electric Power Energy on the basis of a motion submitted by an individual MP, which, among other things, contains some directives from the third energy package accepted by the EU. It is interesting to point out that so far, we have introduced several EU energy directives with delay, but when it came to this amendment, we beat all the member states. In our view, we would have needed professional consultations and appropriate preparation by the Government for the endorsement because the amendment to the law approved by Parliament does not completely incorporate the guidelines set by the EU (Dekany 2009).

In addition to the speed, one more interesting aspect of the adoption of this particular law is the tandem of political adversaries that jointly proposed the amendment: György Podolák

from the socialist party, who acted as the head of the Parliamentary Economic Committee, and János Fónagy from Fidesz. The law passed almost without any significant public debate (Hargitai 2010), and introduced only an ITO model in the gas transmission in addition to regulations in the electricity sector.

The reason for the speedy implementation again was intertwined with the interests of large energy companies, one of them being MOL. It was perceived by the market players that officials from HEO and the Hungarian Competition Authority wanted to transpose the aspect of the unbundling from the Third Energy Package that would entail the electricity company MVM either to divest its grid under the OU model or to hand over the management of the grid under the ISO model. One interviewee explained:

> Because at that time some officials in the energy office had the idea that Hungary should introduce ISO or a full OU model. The vice-president of the Competition Authority also had such an opinion. This idea was against MVM, the electricity company. Moreover, the idea was to introduce the same model for the gas market. At that time this amendment proposal was tabled by the members of Parliament. There was a huge scandal in the media that MOL and MVM were behind it. The argumentation of this amendment proposal was that the time was very close to the general election of 2010, and if there is a new government, it would not be its first task to deal with this issue and then we would not be in time to implement the Third Energy Package (IND HUNG 3 2016).

As another interviewee commented, since the HEO wanted to transpose the 'whole repertoire' of the unbundling models from the Third Natural Gas Directive, 'it was totally opposed by MOL and MVM, each of which had a transmission system operator in gas or electricity [FGSZ and MAVIR], and they were afraid that someone in HEO may be in the position that MOL/MVM should disinvest FGSZ/MAVIR, and it should be fully ownership unbundled operator owned by, for example, E.ON'. The Ministry of Development, for whom HEO was advising on the draft law transposing the Third Natural Gas Directive, did not have the power to stop this law adoption, as members of Parliament do have a right to legislate and

to initiate laws in the Parliament (SE HUNG 1 2016). Based on the framework given by the legislation, FGSZ (Földgázszállító), a legally unbundled subsidiary of MOL was certified with the approval of the Commission as the operator of the high-pressure transmission pipeline system under the ITO model, which did not require divestment (European Commission 2011). Moreover, since 2002, Fidesz (which was to return to power in mid-2010), preferred state-ownership of natural gas companies. One interviewee, who used to work for the Hungarian gas industry, recollected:

> There was also some intention from the Government to own all gas business in Hungary. It was in the very beginning of 2002, right before the election. It was a big internal campaign within MOL as we had to prepare much material for the Government and Mr. Zsolt Hernadi [MOL CEO] to convince not to take this business from MOL. That time Mr. Orbán was the first time when he wanted to own all these businesses, including DSOs till the gas production (UPS HUNG 2016).

As presented in CH 7, in 2011 the Hungarian Parliament 'transposed' the Third Natural Gas Directive one more time, and allowed all three models of unbundling, including the ownership unbundling. By that time, however, there was less speculation among the market players that the Government would attempt to take over FGSZ from MOL, exactly because it was a transmission system operator, which are particularly regulated by the Third Natural Gas Directive. One interviewee reflected: 'The European regulations are unique for all. Moreover, you have to comply. EU regulations dictate for you, so why would [a transmission system] be deemed as a strategic asset?' (IND HUNG 3 2016).

4.3 Changing focus to cross-border diversification

MOL selling of the wholesale and storage businesses in 2006 meant that MOL's indirect exposure to the gas downstream level decreased, and subsequently, the focus shifted to the transmission issues, as MOL remained the owner of FGSZ. This was reflected in MOL, and subsequently, Hungary, embarking on pipeline mega-projects and cross-border

interconnections. Before 2006, new supply routes would have 'decreased the value of their contract' (SE HUNG 2 2016), which they held via the wholesale unit in Panrusgáz. After the divestiture, MOL started progressing with route (and possibly supply) diversification with the Hungarian gas transmission system interconnectivity programme, which 'the Commission liked very much' and 'MOL had a very good record at the Commission, because they were pushing for this internal market very much' (Deák 2015).

Hungary joined both Nabucco and South Stream projects, even though they were competing. In 2002 Austria's OMV and a consortium of European companies, including MOL, launched a concept for the Nabucco pipeline (Posaner 2016, 10). Initially, via Nabucco, the Caspian natural gas to Europe would primarily come from Azerbaijan's Shah Deniz II field, but there were plans to deliver gas from Turkmenistan (IHS CERA 2010). South Stream emerged in 2006 (Posaner 2016, 10). Like its northern counterpart Nord Stream, it was Gazprom's project intending to bypass Ukraine and bring Russian gas via Bulgaria, Serbia, Hungary, and Austria to Western Europe (RFE/RL 2013). In 2008, the Hungarian Government joined the South Stream, but initially left MOL out of the deal, despite the fact it owned the Hungarian transmission system (Orban 2008, 155–57).

Besides the participation in the mega pipeline projects that never materialised, from 2006 Hungary embarked on smaller scale projects to interconnect its gas system with the neighbouring countries, which again was related to MOL's interests. Despite the fact that there were commercial storages (at that time already owned by E.ON) Hungary also focused on creating a strategic gas storage. During the early market opening the holding company of the TSO, MOL, had a major interest in and dominant position in the wholesale gas market. Even though the market opening and consumer liberalisation progressed, MOL remained the main monopoly in production, wholesale, and transmission, and also supplied gas directly to large and very large industrial customers (HEO 2005, 37). As experts worried at the time, the

incumbent transmission company FGSZ, even though legally unbundled, had a vested interest in protecting its mother company's gas market from competitors. The simplest means to get to this end was deemed creating or retaining shortages in infrastructure capacity (Kaderjak and Antall 2005, 385). In concluding the first year of opening up the gas consumer market, HEO noted, that in 2004 'only approximately 3% of the natural gas market moved from the scope of supply of the dominant market player (MOL Földgázellátó)' (HEO 2005, 10). At that time the Hungarian state still held around 12% of share capital in MOL, plus a golden share (European Commission 2005, 3). In 2006, the last state-owned shares were also sold to MOL by the socialist government.

MOL changed its focus in 2006 when in March it sold its wholesale, marketing and trading (MOL Földgázellátó) and storage (MOL Földgáztároló) companies as well as shares in Panrusgáz – its joint venture with Gazprom - to German investor E.ON (E.ON 2007, 32; European Commission 2005). The decision by MOL to sell some parts of the gas business came as a repercussion of previous losses from the price regulation by the First Viktor Orbán Government. Based on one interview, initially, MOL only wanted to sell shares of the wholesale unit, which was bound to import Russian gas, but E.ON required in addition the storage facilities (UPS HUNG 2016). One of the interviewees interpreted the selling of the part of the business because of MOL's realisation that 'as of a local company its lobby power to Government is very weak, […] if you are a local company, it is a huge risk for you, because if the politicians decide not to increase the prices, the losses will accumulate in your balance. An international investor is a bigger lobby power: in case of doing the same with an international company after two years the latest the German minister for foreign affairs will definitely travel to Budapest and tell something to the Hungarians' (SE HUNG 2 2016).

The divestment of interests by MOL in the wholesale sector (and attached long-term gas import contract with Gazprom) and storage, balanced the *interest structure* towards

diversification and interconnectors. After the transaction, in the gas sector MOL kept only the transmission system company FGSZ and its gas exploration and production business. I did not find any evidence that before 2006, when still vertically integrated, MOL resisted cross-border diversification. However, it was only from 2006 that Hungary became very active in developing gas infrastructure interconnections. They mostly stemmed from the initiatives of MOL, the owner of at the time the only transmission system company, FGSZ. According to a Hungarian energy expert, 'the big Hungarian interconnectivity programme [from 2006] was the point where this kind of corporate action and policy action met somewhere' (Deák 2015). After selling the assets in storage and wholesale, MOL focused on infrastructure interconnections with the neighbouring countries, and in this way started fulfilling the EU aims to have an integrated single energy market. Another interviewed energy expert, at that time heavily involved in the Hungarian gas sector, explained:

> This was the point when more or less the ownership unbundling of transmission that remained in MOL was separated from wholesale, from the long-term contract and gas storage, and the Hungarian market. So MOL became a transmission operator and retained some interest in domestic production, but its attitude in building interconnectors with different countries changed dramatically after this case. Before that MOL as an integrated company was very much blocking building new infrastructures, because potential competitors would have meant competition to its trading interests and would compete for its own long-term contract. Now, after selling that, they understood that the business and the gas sector for MOL remained transportation, and the more interconnection you have - the more opportunities the FGSZ might have in shipping gas around and becoming a hub and all these ideas (EX HUNG 1 2015).

A Hungarian company MOL and Romanian state owned transmission company Transgaz initiated the project by signing a MoU in January 2008, followed by a Development Agreement in July 2008. The companies in their announcement claimed to be ensuring compliance with the Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, (FGSZ 2008) which was a predecessor of the Security

of Supply Regulation of 2010. MOL also embarked on building interconnectors to Slovakia and Croatia.

Despite increasingly friendly political relationship with Russia, the socialist governments supported the interconnecting activities of the FGSZ on a political level. Russia-friendly policy trace back to the visit of Vladimir Putin to meet Ferenc Gyurcsány in February 2006, just before the 2006 election, which was heavily criticized by the then-opposition Fidesz (IND HUNG 2 2016). Regardless of this, Hungary joined the South Stream project. The Socialist-led Government of Gordon Bajnai in May 2010 signed an intergovernmental agreement to build a Hungarian-Romanian cross-border pipeline (Arad-Szeged), the project works of which started in 2008 (FGSZ 2016). The pipeline was officially inaugurated in October 2010. The project was co-financed by the European Energy Programme for Recovery. The Hungarian-Croatian pipeline, operational since June 2011, was also initiated during the socialist ruling in 2008.

This chapter reviewed the developments in the Hungarian gas sector from 2002 to mid-2010, when the general election resulted in the Socialist party returning to power in Parliament and Government. Just as in the Lithuanian case study presented in the next chapter, there is plenty of evidence that domestic actors tended to implement EU requirements very zealously, according to the deadlines and even before them in some cases. This chapter finishes in 2010 and CH 7 goes into a detailed assessment of changes in the Hungarian gas sector after 2010, when the *interest structure* became dominant and the Europeanisation mechanism turned from 'EU opportunism' to 'EU leverage'.

5 LITHUANIA'S STRATEGIC APPROACH TOWARDS EU ENERGY POLICY TOOLS[21]

This chapter firstly analyses how, as a result of EU energy instruments available, after a long period of inertia, rapid changes happened in the Lithuanian gas market; and secondly, how the power scales surrounding the country's natural gas sector rebalanced in the period starting from 2008. Even though the initial intention of the empirical research was to investigate the internal domestic mechanisms and reasons of the reforms, almost all of the interviews were coming back to the role and actions of Gazprom and the Lithuanian executive politicians attempting to curb its power on the national level. The chapter examines a power game around the reform among the main domestic and international actors: Lithuanian governments, the President, the Russian Gazprom and German E.ON, the Commission and other actors. The chapter shows that Lithuanian government's proactive approach not only towards EU energy regulations, but also towards the Commission competition policy tools and the Commission's assistance, was instrumental to the political actors' ideas of how Lithuania's gas market should look. This chapter is structured as follows. Firstly, it identifies *actor coalitions* that were active in the Lithuanian gas sector during the research period. Subsequently, it presents the chain of events that led to the gas market reform, starting from a short excurse to the political events of 2006-2007 that later proved to be significant in implementing the Directive.

5.1 Fluid Interest structure in 2008-2016

During the research period, the balance of *interest structure* in Lithuania was fluid and fragile, and can be loosely divided into two periods of 2008-2012 and 2012-2016 referring to two different terms of the Lithuanian parliament (also called Seimas). After many years in the opposition, the 2008 election brought Homeland Union – Lithuanian Christian Democrats (TS-

[21] The early version of this chapter, 'Lithuania's Strategic Use of EU Energy Policy Tools: A Transformation of Gas Dynamics' was published in September 2016 at Oxford Institute for Energy Studies: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2016/09/Lithuanias-Strategic-Use-of-EU-Energy-Policy-Tools-A-transformation-of-Gas-Market-Dynamics-NG-111.pdf.

LKD, conservatives) back to the power, and the 2012 election returned the government formation to the Lithuanian Social Democrat Party (LSDP, a successor of a former wing of the Lithuanian Communist Party before the 1990s). There were two salient questions in Lithuania in the research period, namely, implementation of the ownership unbundling option of the Third Natural Gas Directive and creating alternative supplies via a LNG terminal. The gas sector reform that commenced in 2010 followed alongside these two lines. End-user gas price regulation (a topic of utmost importance in the Hungarian and Romanian cases), having been a significant topic in the media discussions before 2009, was overshadowed by the other two issues in the research period. A year after the Baltic States joined the EU, Gazprom started changing gas import prices to them 'in order to bring them to pricing levels equivalent to those charged in Europe by 2007' (Gazprom 2007, 11). Also, due to the closure of the Ignalina Nuclear Power Plant by January 2010, Lithuania was to become more dependent on gas to produce electricity. The import price increase brought the issue of the dependence on the single supplier to the realm of 'high politics' (Masiulis 2015). By 2008, a cleavage between the left-leaning and the right-leaning parties was based on the question of how to manage the import price increase.

The conservative-coalition Government decided to attempt to take back the ownership of the Lietuvos Dujos. The ownership unbundling option by conservative politicians was seen as means to limit the rising gas prices of the Russian gas exporter giant Gazprom. The determination of then a leader of the Conservatives, Andrius Kubilius, was also fuelled by his broader political beliefs that Lithuania's energy dependence on Russia was a geopolitical threat. This view of the Conservatives was openly expressed in their monograph 'Russia's Retention Strategy' issued during the period of preparation for the 2008 parliamentary election (Kubilius 2007, 2015). In their rhetoric and actions, LSDP multiple times expressed their stance against the implementation of the Third Natural Gas Directive and defended the interest of

Lietuvos Dujos or Gazprom (LSDP Political Group 2010; Vėsaitė 2010). The reform prone *actor coalition* was in support of the two main issues together – the ownership unbundling and the new LNG project. However, the *status quo* prone actors were more divided: some resisted the ownership unbundling, others – the LNG project. In the political hemisphere, the reform prone *actor coalition* consisted of the 2008-2012 Government headed by the TS-LKD and the President Dalia Grybauskaitė elected in 2009. Lithuania is a semi-presidential democracy, and a country's president, elected by a popular vote, could strengthen or counter balance the government's policies. Considering that Dalia Grybauskaitė was not associated to any political party, it is more difficult, but not impossible, to evaluate the type of cooperation within the executive branch. As Köker pointed out, for most of her first presidency, Dalia Grybauskaitė 'served alongside the Government of Andrius Kubilius whose party had supported her candidacy in the 2009 presidential election despite her running as an independent candidate', and 'there were no major policy differences between the Government and the President, intra-executive relations can be described as neutral, even friendly' (2014). Thus, the 2008-2012 period was marked as a 'unified executive' period, in which both the President and Government were balancing out the resistance of the opponents of the reforms in the gas sector. According to a former member of the President Dalia Grybauskaitė office, after Grybauskaitė's meeting with the Russian president Vladimir Putin back in 2010, it became clear to her that there was a need to act:

> Russia's aggressive tone towards the plans to build a new nuclear plant, as well as towards the gas market will be relatively strong. […] As a consequence, the political elite had to mobilise, and especially encouraged by the President, to whom it was obvious that the country would have to take its own steps to decrease energy dependence, and this would have impact on [energy] price competitiveness. But the most important was the independence. Therefore, the political attention to those strategic projects increased both internally and when talking to the foreign partners. There was one more challenge was to use the Third Energy Package for the Lithuanian interests without even waiting for the efforts of the Commission, and sometimes even acting against those efforts, in attempt

for Lithuania to build an LNG terminal on its own (PRES LT 2015).

The *status quo* inclination in 2008-2012 from the view of the LSDP can be partially explained by the fact that it was their order of the gas market that the reformers targeted. Except for a few episodes, the LSDP had been in power for the majority of the time in Lithuania before 2008 (Government of Lithuania 2016). It was them who had sold the main natural gas company and owner of the transmission and distribution networks Lietuvos Dujos to Gazprom and E.ON in a two-step privatisation process back in 2002-2004, which the TS-LKD reform later attempted to cancel via implementing the Third Natural Gas Directive. According to LSDP, one of the reasons of the privatisation of Lietuvos Dujos was an attempt to ensure 'fair' gas prices for Lithuania (Lithuanian Parliament 2003)[22]. The term of 'fair prices' had even been written in the privatisation contract (Gazprom and Lithuanian State Property Fund 2004, sec. 7.4). When the gas import prices increased further in 2007, the approach of the LSDP was to continue their cooperative behaviour and negotiations with Gazprom rather than taking a hard line (BNS 2007).

The views between the two main political parties also differed about the cross-border integration and the LNG terminal. Generally, the LNG project attracted less opposition in the political hemisphere, at least in public. As one interviewee related, this project, 'out of all the energy projects implemented in Lithuania during many years, was the only one that was built rather collectively' (SE LT 2 2016), meaning, regardless of the political differences of the local politicians. This was confirmed in an interview with a Member of the Parliament, who was in the opposition in 2008-2012 and stated that overall an LNG terminal was necessary for the

[22] As may be inferred from the provisions of the privatisation agreement of 2004 and the public statements of the Social Democrat Prime Minister at the time, Algirdas Brazauskas, a part of the reasons to sell shares of Lietuvos Dujos to the Russian supplier of gas, Gazprom, was an attempt to purchase gas from it cheaply. Another reason, which appeared to be a very important issue at that time, was and to ensure uninterrupted supply. In September 2003, Algirdas Brazauskas, when reporting about the negotiations with Gazprom to the Parliament, claimed that the government was 'trying to turn this privatisation that it brings long-term benefits to Lithuania and stable prices, and the necessary gas demand would be ensured'

country. He said that 'we had to diversify – of course, we could have done it together with Latvians or with the Poles' (MP LSDP LT 2015). Social Democrat governments before 2008 had attempted to build the LNG terminal together with the other Baltic countries. Such discussions date back to the early 1990s, and also were the subject of some EU-sponsored studies. However, the idea eventually resulted in Lithuania, Latvia, and Estonia each having one or two separate competing LNG project proposals without substantial progress in any of them 2008 (Pakalkaitė 2012b, sec. II.2.3.). The 2008-2012 Government decided to go ahead and build a 'local' LNG terminal without applying for a status of a project of common interest in the EU and subsequent negotiations with the other Baltic States. [23]

The LSDP did not challenge the necessity for alternative gas suppliers and the LNG terminal *per se.* For example, already in 2011, a year after the reform to unbundle Lietuvos Dujos and build an LNG terminal had started, LSDP even issued a press release in which they blamed the conservative Government for building the terminal rather slowly (Butkevičius 2011). What LSDP contested, however, was the coupling the LNG terminal project with the ownership unbundling. Whereas TS-LKD claimed that the two processes were mutually necessary, the Social Democrats attempted to disconnect those two issues. However, the actions of some LSDP members, such as creating a temporary Parliament commission to investigate the energy sector led by a social democrat Artūras Skardžius (Lithuanian Parliament 2013a, 200), posed a threat to the LNG terminal project. The Social Democrats many times publicly regretted that TS-LKD dismantled the joint company with the main domestic fertiliser producer and the single largest consumer of gas in the country to build the LNG terminal (for example, Vėsaitė 2011). LSDP in 2008 had attempted to put this project on the agenda of TS-LKD in case they take over government formation after the parliamentary election. Less than a month before the election of October 2008, the social-democrat Government appointed the

[23] In its public communications and presentations, Lithuania started promoting the idea of using the LNG terminal in Klaipėda as the Regional Baltic LNG Terminal only in 2015, after the terminal was already built. (Pumprickaitė 2014).

Ministry of Economy to create a company to build an LNG terminal together with the largest Lithuanian fertiliser producer Achema (Government of Lithuania 2008b). One the next day, after losing the election to the Conservatives, the Ministry established a company named Gamtinių Dujų Terminalas with Achema (Registrų centras 2016). While TS-LKD were building a ruling coalition to create the new Government in 2008, the temporary Social Democrat Prime Minister Gediminas Kirkilas was rushing to increase the capital of Gamtinių Dujų Terminalas by injecting the Government owned 17.7% shares of Lietuvos Dujos in its capita by the mid-December 2008 – essentially, by the time the new government formation had to be finalised (TV3 2008). However, in mid-November, the Lithuanian Special Investigation Service launched a pre-trial investigation on alleged violations related to the establishment of the new company and this investigation prevented the temporary social-democrat Government from finalising the injection of the shares of Lietuvos Dujos (Vaida 2008). Finally, the conservative Government in 2009 liquidated the joint company.

Based on the voting behaviour in the Parliament on important natural gas acts in 2008-2012, the loosely related parties were the Labour Party and the Order and Justice Party. In public they criticised the unbundling process, but occasionally voted in favour when the ruling coalition was short of members in the Parliament. The Commission was a very significant pro-integration actor in the research period. Possibly, the Commission's investment and involvement in the reform also stopped the return of the *actor coalition* to the anti-integration status after the 2012 parliamentary election. In this way, the Commission 'entered into a transnational alliance with domestic reformers' (Schneider 2001, 77). However, not all of the aspects that the Lithuanian officials wished to implement were supported by the Commission, for example, it avoided to negotiate gas price. The National Commission for Energy Control and Prices of Lithuania (NCC), appeared rather neutral about both questions. As Köker suggests, after the 2012 election in which the Social Democrats were victorious, already in the

Government formation phase Grybauskaitė 'actively intervened' and this highlighted 'the beginning of a period of cohabitation' with the LSDP (2014). Her still being in power when the Social Democrats came back to power can partly explain why the dual gas market reform started in the first period of 2008-2012 continued in the second phase as well.

Status quo-prone actors, such as Gazprom and E.ON dominated the sectorial hemisphere until mid-2014 when the Lithuanian state purchased the main natural gas company Lietuvos Dujos from E.ON and Gazprom. E.ON and Gazprom attempted to protect their investment in Lietuvos Dujos and stop the implementation of the Third Natural Gas Directive. E.ON and especially Gazprom openly contested the choice of the unbundling model in Lithuania; the latter entered into multiple international arbitration proceedings against Lithuania. Also, a fertilizer producer Achema and the Lithuanian District Heating Association challenged the LNG terminal project.

The combined power of E.ON and Gazprom manifested in the co-ownership of the main vertically integrated gas company Lietuvos Dujos, the 2000-2015 long-term gas import contract of Lietuvos Dujos, consolidation in the Lithuanian Gas Association, and lobbying in the Parliament. Gazprom had additional channels for power exertion, namely, 100% gas import dependence in Lithuania and ownership of Kaunas Heat and Power Plant (KTE) (Gazprom 2013b), which in turn, belonged to the Lithuanian District Heating Association (KTE 2014). Even though initially after the privatisation of Lietuvos Dujos, each E.ON and Gazprom had 34% of the shares of this company, by 2011 it was 38.91% by E.ON Ruhrgas and 37.1% by E.ON (the state being a minor shareholder with 17.7%). Even though neither of the international shareholders had had over one half of the shares in Lietuvos Dujos, together they held more than three quarters of the shares, which allowed these companies to make the major decisions in Lietuvos Dujos (Pakalkaitė 2012b, 12). Based on the privatisation agreement of 2004, Gazprom had to supply Lietuvos Dujos not less than 70% of the Lithuanian gas demand

minus the consumption of the fertiliser producer, Achema, and that of KTE. The agreement also forbade Achema and KTE to resell the gas that Gazprom supplied directly (Gazprom and Lithuanian State Property Fund 2004, para. 2). Another privately owned gas intermediary company, Dujotekana, filled in the remaining around 30% of gas demand by also providing Gazprom gas. The strong position in the Lithuanian gas sector of Lietuvos Dujos which resulted from this market partitioning is visible from the small number of suppliers in wholesale and retail segments. Achema and KTE purchased gas directly from Gazprom and used the gas for their own needs. The remaining three suppliers, Lietuvos Dujos, Dujotekana, and Haupas (insignificant market share) supplied gas to the customers and smaller gas distribution companies (NCC 2005, 57). Although soon joining the EU gas import price differences between the Baltic States emerged, this did not instigate trade between the different price zones, and there was not a single instance of a gas trade by Lithuania with either Estonia or Latvia, Gazprom was a monopoly gas exporter to all three Baltic States.[24]

The other simultaneous project, the LNG terminal in Lithuania, was meant to bring the alternative gas supply, and was threatening to decrease the market share and income of Lietuvos Dujos that was co-owned by Gazprom and E.ON. Yet, in public (statements or media articles) none of these shareholders expressed their negative statements about it. On the other hand, the Lithuanian Gas Association, which represented gas companies that imported and supplied gas for re-sale to the national wholesale and retail markets, submitted a complaint to DG COMP arguing that the LNG terminal in Lithuania would be receiving illegal and incompatible state aid. The main members of the Association had ownership and/or long-term supply relations with Gazprom; moreover, it was officially registered to the address of Lietuvos Dujos. The President of the Association at the time was Viktoras Valentukevičius, the CEO of Lietuvos Dujos (Lithuanian Gas Association 2016). The Vice-president of the Association was

24 There was the transmission infrastructure across the borders of the Baltic States; technically, gas trade between them could have taken place.

delegated by Dujotekana, the second largest natural gas supplier both in the wholesale and retail markets, which had a take-or-pay supply contract with LT Gas Stream AG, an intermediary seller of natural gas fully owned by Gazprom (European Commission 2013h, 17–18). In 2012, the Lithuanian District Heating Association also submitted a complaint to the Commission about some aspects of the LNG project (Lithuanian District Heating Association 2012).

Achema rather focused on criticising and submitting complaints about the LNG terminal project than on the ownership unbundling. Achema's resistance to the LNG terminal could have originated because of two reasons. One was that the conservative Government of 2008 scrapped earlier plans of Achema to build its own LNG terminal; and the second could have been a direct dependence of Achema on Gazprom's gas via a long-term gas supply agreement. Unlike the whole of Lithuanian household consumers and the majority of business companies that received Gazprom gas via intermediaries, such as Lietuvos Dujos or Dujotekana, the largest gas consumer in the country, Achema, had a direct 10-year gas supply agreement until the end of 2015 (BNS 2016).

The discussion above is summarised in the Table 5 below. Red colour means a position against, green – for, yellow – dubious or changed position, and grey – no or non-identified position towards a certain issue. Lietuvos Dujos and Lietuvos Energija in this research period are not treated as separate actors, as mostly they were serving interests of their shareholders. For example, following the legal battles by the 2008-2012 government, state-owned Lietuvos Energija (the future owner of Lietuvos Dujos) joined the line of complainants against Gazprom, when it filed a complaint to the Lithuanian Competition Council.

Table 5 *Interest structure* with regard to the implementation of the Third Natural Gas Directive and supply route diversification via LNG in Lithuania (based on multiple media and interview sources)

Type	Actor	Power	Stance vis-à-vis implementation of the Third Natural Gas Directive	Stance vis-à-vis new LNG terminal
Executive actors	President	President Dalia Grybauskaitė was in power for two consecutive terms 2009-2019	Strongly for	Strongly for
	Governments	2008-2012 reform-prone conservative Government, which needed to pass all the reforming laws, had a slim majority or even minority in Parliament. Ownership of Lietuvos Energija strengthened the position of the Government	The 2008-2012 Government strongly for; The leader of the 2012-2016 Government Algirdas Butkevičius used to be strongly against in 2008-2012	The 2008-2012 Government strongly for building the Klaipėda LNG; The LSDP that returned to power in 2012 used to express their resentment towards the TS-LKD for dismantling their previous LNG project with Achema
Legislative actors	National Parliament	2008-2012 conservative Government had a slim majority or even minority in Parliament	While the conservative ruling coalition had a slim majority in Parliament, the Social Democrats did their utmost to stop the implementation of the Third Natural Gas Directive.	From June 2013 to April 2014 Parliament formed a temporary commission to investigate the energy sector, which was led by Social Democrat Artūras Skardžius. This commission, according to interviewees, posed a threat to the LNG terminal project
Special actors	National regulatory authority (NCC)		For	Unclear
	European Commission		Strongly for	Strongly for
Large consumers	Achema	Around 1/5 of national gas consumption	Unclear/no direct interest	Complaints to the Commission, public statements and refusal to pay the security of supply add-on for the LNG terminal
	Lithuanian District Heating Association	By the share of their gas consumption, less important than Achema	Unclear/no expressed direct interest	Complaints to the Commission

Upstream, midstream, downstream	E.ON	Co-ownership of the main vertically integrated gas company Lietuvos Dujos, which also owned the whole transmission system; Belonging to the Lithuanian Gas Association; (only Gazprom): Lithuania's 100% gas import dependence; Shares in KTE	Very strongly against	Attempts to slow the progress of the LNG project expressed via the Lithuanian Gas Association
	Gazprom		Very strongly against	Attempts to slow the progress of the LNG project expressed via the Lithuanian Gas Association
	Dujotekana	Market concentration	Unclear	Attempts to slow the progress of the LNG project expressed via the Lithuanian Gas Association

5.2 Opposition 'in Government' in 2006-2008

The developments in Lithuania preceding the adoption of the Third Energy Package in Brussels could be called 'the butterfly effect'[25] or the 'knock-on effect'.[26] Following these minor events in 2007-2008, Lithuania embarked on the gas market reform in 2010-2012 when the time came to transpose the Third Natural Gas Directive. What we observe here is a short-term redistribution of powers across opposing *actor coalitions*. Below is shown how even though the Social Democrat Government sought a derogation from the Directive, they allowed to powerful committee positions the Conservatives that wanted the *status quo* to change, which used this opportunity for their aims.

The Commission proposed the Third Energy Package in September 2007, and the European Parliament and the Council adopted it almost two years later. During the period of the negotiations in Brussels in 2007-2009, Lithuania was clearly eligible to receive derogation from its main requirements. Lithuania could qualify as an isolated natural gas market based on the criteria in the draft Directive. First, there were no gas infrastructure connections to the interconnected system of any other member state,[27] but only to Latvia, which also was an isolated market. Second, Gazprom supplied 100% of natural gas to the market, which was well above the 75% market share outlined in the Directive (IEA Natural Gas Information Statistics 2015). Nevertheless, in June 2008, during discussions in Luxemburg, Lithuanian officials expressed the request not be derogated from certain provisions, e.g. unbundling, consumer liberalisation , of the Directive (Committee on European Affairs 2008a). This decision to be excluded from the section on derogations in the draft Directive obliged future policy makers of the country to implement the Directive once it comes in force. They also created limited

[25] The "butterfly effect' is a term attributed to an American professor of meteorology Edward N. Lorenz in 1960s-1970s and means that that small initial changes can have large effects later on.
[26] A knock-on effect is observed when an event or situation causes other events or situations, but not directly.
[27] Lithuanian natural gas transmission system was directly connected to Belarus which is not a Member State of the EU and to Latvia, which is not an interconnected market itself.

timeframe for changing the gas sector structure. One interviewee explained: 'To implement the Directive, we had to change the laws. Secondly, the fact that Lithuania did not ask for the derogation was successfully used. Because of these reasons a big time pressure was created, that the Directive has to be implemented under Lithuanian conditions' (PRES LT 2015).

A step to forego an opportunity for derogation was unusual at the time because all other EU Member States that were eligible for the derogation as isolated markets, Estonia, Latvia, and Finland, used this opportunity to postpone liberalisation of their natural gas markets. This was also unusual compared to the previous history of energy policy in Lithuania. Lithuania had been 100% dependent on Russian gas for half a century in total, and the dependence continued throughout the first two decades of the country's independence from the Soviet regime. Moreover, in 2007-2008, the initial position of Lithuania's Ministry of Economy was to ask for a derogation and prolonged transposition time. The Ministry of Economy argued that Lithuania had been an isolated energy market and breaking up the companies would negatively affect the financing of strategic energy projects. The Ministry claimed that the unbundling option for Lithuania was limited, because of the country's obligations based on the privatisation agreement of Lietuvos Dujos and transit of gas to the Russian enclave of Kaliningrad at the Baltic Sea (Ignotas 2007, 20).

However, an earlier unrelated chain of events led Lithuania to abandon the possibility of derogation. In May 2006, the social democrat coalition Government failed because of internal clashes, but the next election was not scheduled until October 2008. The Social Democrats formed a minority Government and signed a cooperation agreement with the main opposition party, TS-LKD. As the press metaphorically commented at that time, the 'opposition stepped into the government' and acquired a right to co-govern Lithuania on crucial issues (Nikitenka 2006).

Based on the agreement, the TS-LKD leader, Andrius Kubilius, became the chairman

of the European Affairs Committee in the Parliament, which later had a major influence on Lithuania's position towards the draft version of the Third Natural Gas Directive. By the end of 2007, the Conservatives terminated the cooperation agreement with the Social Democrat minority coalition government, but, despite the disapproval of the Social Democrats, retained the leading positions in some Parliamentarian committees, including the European Affairs Committee. Andrius Kubilius decided to push for full implementation of the Directive. According to him, the turning point for him was a five-page memo by a Lithuanian energy expert. Andrius Kubilius said in an interview:

> Following our request, an expert presented a conclusion that it was not worthwhile for Lithuania to ask for derogation because then the status quo would remain. If we asked for derogation, everything would stay the same: one pipeline, Gazprom, and its monopoly. After an internal discussion, the Committee stated that Lithuania should not ask for a derogation (Kubilius 2015).

He explained the underlying logic being similar to the movement towards the country's independence back in the 1980s: 'First let's act and go forward. Once we are there, we will somehow figure it out. The only thing we were sure of was that the situation would not remain as usual, but it was obscure how it would evolve'.[28] After half a year of discussions between the Government and the European Affairs Committee, the Committee used a possibility provided in the Statute of the Parliament and, one day before the Council of the EU (Transport, Telecommunications and Energy) meeting in Luxemburg in June 2008, overruled the government's resistance (Committee on European Affairs 2008a, 2008b). As a consequence, on the next day in Luxemburg, unlike Estonia, Latvia and Finland, Lithuania opted out from the derogation option in Article 49 of the Directive and had to transpose the Directive in a timely manner and in full. As archival materials of the Committee show, in that period, the

[28] The former Prime Minister actually used a phrase in Russian "вперед, а там разберемся" from the book Alice The Girl from Earth by the Russian author Kir Bulychev

ownership unbundling option was not yet chosen as a preferred option. The European Affairs Committee indicated in its decision that for the first five years Lithuania would choose the ITO solution having in mind the final aim to implement the OU (Committee on European Affairs 2008a).

Thus, even though this episode may not have been significant in causing any immediate changes in the Lithuanian gas market and during the following three years, and no major changes took place in the gas sector in Lithuania, the tools to reform the market were set up.

5.3 Turnaround in Lithuanian gas policies in 2008-2009

After the general election of October 2008, Lithuania's approach to the structure of its natural gas market changed. This was because the election changed the composition of the government from centre-left to centre-right, when TS-LKD led by Andrius Kubilius were victorious. From opposition, Andrius Kubilius stepped into power as the Prime Minister and could implement his agenda in the energy sector. After the election, the political groups of TS-LKD, National Revival Party, Liberals Movement, and Liberal and Centre Union formed the ruling coalition. Those parties that formed the earlier ruling majority of 2004-2008, the Lithuanian Social Democrats, Labour Party (in government before summer 2006), and Order and Justice Political Groups, remained in the opposition (Lithuanian Parliament 2012a). Andrius Kubilius in 2009 restored the Energy Ministry, which had been abolished in 1997 (Ministry of Energy of Lithuania 2015b). The change of political power in Lithuania after the national election in October 2008 coincided with the adoption of a set of EU energy policy instruments.

Arvydas Sekmokas, a minister of the newly created Energy Ministry at the time, stated initially that the gas and LNG questions were nowhere near the top of policymakers' minds. The important questions were related to the controversial LEO LT private-public nuclear project company created by the previous Government, the closure of the old RBMK type

Ignalina nuclear power plant at the end of 2009, electricity prices after the closure and planning a new nuclear power plant. The dismantling of LEO LT set an appetite for a more challenging project.

The conservative Government focused on the organisation of the Lithuanian gas markets step-by-step, and it gained inertia by the mid-2010. First, in May 2009, before the Third Natural Gas Directive was enacted in Brussels, Parliament started questioning the privatisation of Lietuvos Dujos. The Lithuanian Parliament (then ruled by TS-LKD) voted on a decision to request the Lithuanian Constitutional Court to analyse the privatisation agreements of Lietuvos Dujos against the Constitution (Lithuanian Parliament 2009a). By the end of 2009, the Conservative Government concentrated on ensuring alternative gas supplies. To create alternative supplies, an LNG terminal was a necessity, and the future terminal had to be fully connected to the gas transmission system of Lithuania. Disagreements arose between the Government and the transmission system operator Lietuvos Dujos, co-owned by E.ON, Gazprom and, as a minority shareholder, Lithuanian Government, about finalising the gas transmission grid and connecting Klaipėda to Jurbarkas (Samoškaitė 2010) In turn, the Lithuanian Government wanted to take control of the transmission system (Sekmokas 2014; Kubilius 2015) Arvydas Sekmokas told in an interview:

> I got a wish: if we could dismantle LEO LT, why should we not try to hunt a larger animal down? When we decided to implement the Third Energy Package by opting for an ownership unbundling model, the prime minister was shaking his head: Gazprom's annual budgets were larger than Lithuania's annual budgets. Yet he gave us a green light – at the end it was our ministry that had to do the hard part of the job (Sekmokas 2014).

In parallel, after the Ukraine gas crisis of January 2009, in July the same year, the EU finalized the adoption of the Third Natural Gas Directive and proposed the draft Regulation on Gas Supply Security. A former high-level official from Lithuania told: 'For Lithuania, a very convenient path was laid down, and it was possible to make use of it. However, no reforms

would have happened without the political will. The EU legislations coincided with a good combination of the Government, the strong institution of the President and possibly a weaker Parliament' (SE LT 2 2016).

The contents of the concept of the future Law on Natural Gas, approved by the centre-right Government in May 2010, indicates that the Government had made a political decision to move on with the reform and consolidate the EU legal instruments available at the time for the implementation, even those for which there was no immediate need. The concept of the future Law on Natural Gas was aimed to ensure the implementation of both the Third Natural Gas Directive of 2009 by choosing the ownership unbundling option and the 2004 Council Directive of Security of Supply. The transposition deadline for the Directive of the Security of Supply of 2004 had expired four years prior, in May 2006 (European Council 2004, Article 11). The previous Government of 2004-2008 had adopted a set of rules transposing it in February 2008 (Government of Lithuania 2008a). The 2010 concept also referred to the future Security of Supply Regulation, which the EU adopted five months later (Government of Lithuania 2010). This evidence that the Government of 2008-2012 had also been aware of the draft regulation discussed in Brussels, which, unlike directives, was applied directly and binding in its entirety (Grohs 2012, 58), shows even more that there was no immediate need to transpose the earlier (2004) Directive of Security of Supply. Based on this concept, the Government started preparing the relevant draft Law on Natural Gas and the Law on Implementation of the Law on Natural Gas (Committee on Economics 2011c).

The reform started by the Government was dual: implementation of ownership unbundling and building a new LNG terminal in a port adjacent to Klaipėda city on the Baltic Sea. It used the unbundling provisions of the Third Energy Package to make sure that Lietuvos Dujos created the missing pipeline link between the coast of Lithuania and the main gas transmission system (Klaipėda-Jurbarkas). When the Security of Supply Regulation was

adopted in Brussels in October 2010, the Government started justifying the LNG terminal as a tool to ensure the 'N-1' security of supply criterion envisaged in the Regulation to be implemented by December 03, 2014. An interviewed legal expert explained that the real reasons to build the terminal was ensuring physical security of supply in the cases of disruptions and creating competition of sources:

> Everybody understood the aim, and then there was a need for as many arguments as possible. Therefore, legal arguments also appeared. We had to tie [the date] to something. With such as complex project which attracted so much resistance, it would be easy to be delay. But when the time is tied, you have no right to be late (LEGS LT 2 2016).

Even though one of the aims of these EU legal instruments were consumer choice, the Lithuanian policy makers used them for their purposes to ensure the security of supply as they understood it. The Prime Minister of Lithuania 2008-2012, Andrius Kubilius, expressed in an interview how Lithuania benefited from being able to use European and not just national instruments against Gazprom. He said: 'Our membership in the EU since May 2004 was very beneficial to us, because we had a chance to participate in the creation of the European instruments which we later could use individually against Gazprom, but this time as a *European* instrument' (Kubilius 2015). A former advisor of Andrius Kubilius seconded him: 'All of these [legislations] were related. Since we did not ask for derogation [in the Security of Supply Regulation of 2010], we had to have alternative supplies at the end of 2014. But for the terminal to be operational, we had to implement the Third Natural Gas Directive fully, so Gazprom would not create obstacles for [alternative] supplies' (Škiudas 2015). Another politician, an Energy Minister 2014-2016, related, 'if you are eager to fight, you will find a stick to use' and – with regard the availability of the EU instruments when they were needed a 'luck of the draw' (Masiulis 2015). He said:

> The EU demanded for us to fulfil the 'N – 1' requirement, thus, to have an alternative supply. We had to implement by December 2014. Thus, we chose the same date, 03 December 2014, a gas terminal to be operational, so we fulfil the regulations. But the real

> motive, of course, was, that Lithuanians had decided that instead of simply waiting, they have to do something (Masiulis 2015).

According to the 2008-2012 Energy Minister, the key domestic moment for the fate of the unbundling and LNG terminal was an invitation to present the plans to the President, Dalia Grybauskaitė, when they reached the public discussion level. The minister and his lawyers had made extensive preparations for the presentation in front of the President because he understood that it would be a 'cornerstone decision-making point how to implement the Third Energy Package' (Sekmokas 2014). After the successful meeting with the President, the Government acquired a powerful domestic actor supporting the reform and in this way expanded their pro-integration oriented *actor coalition.*

Regardless, what made it harder for the conservative Government was that in the Parliament their reform-prone *coalition* was very slim. In March 2010, TS-LKD had lost the majority in the Parliament by only a few parliamentarians. When almost a year later, in February 2011, the Government submitted the draft laws to transpose the Third Natural Gas Directive (Government of Lithuania 2011a), the adoption of such complex laws relied much on the opinion of the opposition.

The resistance against the reforms started consolidating early. Based on the TS-LKD information, the first statement from E.ON and Gazprom came within a couple of weeks from the concept, in June 2010. In this statement, the shareholders of Lietuvos Dujos reportedly claimed that the ownership unbundling option would increase the costs of Lietuvos Dujos and asked to analyse all the unbundling alternatives possible in the Third Natural Gas Directive (TS-LKD 2016). LSDP explicitly supported the interests of Lietuvos Dujos in their public communication (LSDP Political Group 2010), attempted to postpone the adoption of the relevant laws, and, including the future Prime Minister 2012-2016, Algirdas Butkevičius (Lithuanian Parliament 2011b), consistently voted against those laws. Even though much

resistance to the reform was in the public domain, some of it was not visible to an outsider or not directly relatable to the choice of an ownership unbundling model, such as an attempt to remove the energy minister, Arvydas Sekmokas. The Parliamentary opposition consolidated to call for the removal Arvydas Sekmokas by December 2010, to which they submitted 25 questions about the whole Lithuanian energy sector. The initiator of the procedure, the Order and Justice Political Group, collected 70 signatures (Order and Justice Political Group 2010), which meant that half of the Parliament members, mainly the whole opposition, signed to start the procedure. However, in March 2011, they failed to collect the necessary amount of votes to remove the minister (Lithuanian Parliament 2011a).

In addition to the resistance coming from the Parliamentary opposition, the shareholders of Lietuvos Dujos, E.ON Ruhrgas, and Gazprom, called the choice of the ownership unbundling model 'the most interfering option envisaged under the Directive 2009/73/EC' (Golubev and Frankenberg 2010, 1) and tried to influence the transposition of the Directive. Firstly, they attempted to persuade the parties concerned, such as the Lithuanian Parliament and the general public that Lithuania, like Latvia, Estonia or Finland, could derogate from the Third Natural Gas Directive (Golubev and Frankenberg 2010; Frankenberg 2011; Salans 2011). Secondly, if Lithuania was to implement the Third Energy Package, it should choose any other option but not that of ownership unbundling (LEGS LT 1 2014). In an open letter to the Lithuanian Government in September 2010, E.ON and Gazprom warned that 'an overhasty implementation of OU which deeply affects all processes and structures of Lietuvos Dujos through fully separating the transmission business from the rest of the company could cause disruptions of gas supply' (Golubev and Frankenberg 2010, para. 8).

There is some indication that the Gazprom's price increase from 2011 was related to the discussion of ownership unbundling as a part of its resistance strategy. At the end of 2010, it was publicly announced in the media that Gazprom had agreed to give 15% discounts for

Estonia and Latvia, but not Lithuania for 2011 (baltinfo.ru 2011; RIA Novosti 2010). The fact that Estonia and Latvia had a derogation from the Directive meant that they did not have to implement the Directive, but the derogation did not preclude them from choosing to do so. At the end of December 2010, at the meeting between Chairman of the Gazprom's Management Committee Alexey Miller and Latvian Economy Minister at the time Artis Kampars, 'the negotiating parties paid special attention to the EU gas market liberalisation and were unanimous in their opinion that the Third Energy Package should be implemented with due regard to the interests of both natural gas exporters and consumers' (Gazprom 2010). This was soon followed by a price discount (baltinfo.ru 2011). In the same month, a Deputy Chairman of the Management Committee of Gazprom, Valery Golubev, publicly related Gazprom's pricing level differences among the Baltic States, which started to emerge, to the implementation of the EU Directive in them (The Lithuania Tribune 2010; Regnum 2010). The quotes of Valery Golubev, as reported by media was 'there is no reason to reduce prices in Lithuania' (The Lithuania Tribune 2010) and 'we do not understand why Lithuania offers implementation of the Third EU Energy Package in this way, as Lithuania, Latvia and Estonia are isolated markets' (Vesti.ru 2010). The Prime Minister, Andrius Kubilius, claimed that such promises, if delivered, would be 'economic blackmailing'. He said to media: 'Based on the arguments, which Mr. Golubev gave, who is at the same time a Deputy Chairman of the Management Committee of Gazprom, and also the Chairman of the Board of Directors of Lietuvos Dujos, it appeared that it was himself he was negotiating with about the gas price to Lithuania. We should treat this as an attack, not only against Lithuania, but also against the EU' (Naujokaitytė 2010). Later in January 2011, when the import price started picking up, Russian media again quoted Valery Golubev as saying that Lithuania does not get the price discount (translated from Russian) 'due to the specific application of the country of the EU Third Energy Package' (Grib 2011).

Indeed, as is visible in Figure 9 below, from December 2010-January 2011, the Gazprom price estimates for gas exported to Lithuania departed from the gas prices for Estonia and Latvia, and rose above their level. They remained constantly higher for another four years. Based on the import price estimates, in 2011, on average Lithuania paid 20% more for Russian gas imports than Latvia and 15% than Estonia. Lithuania continued to pay more for the gas than other two Baltic States until February 2015, and since then the price has fallen.

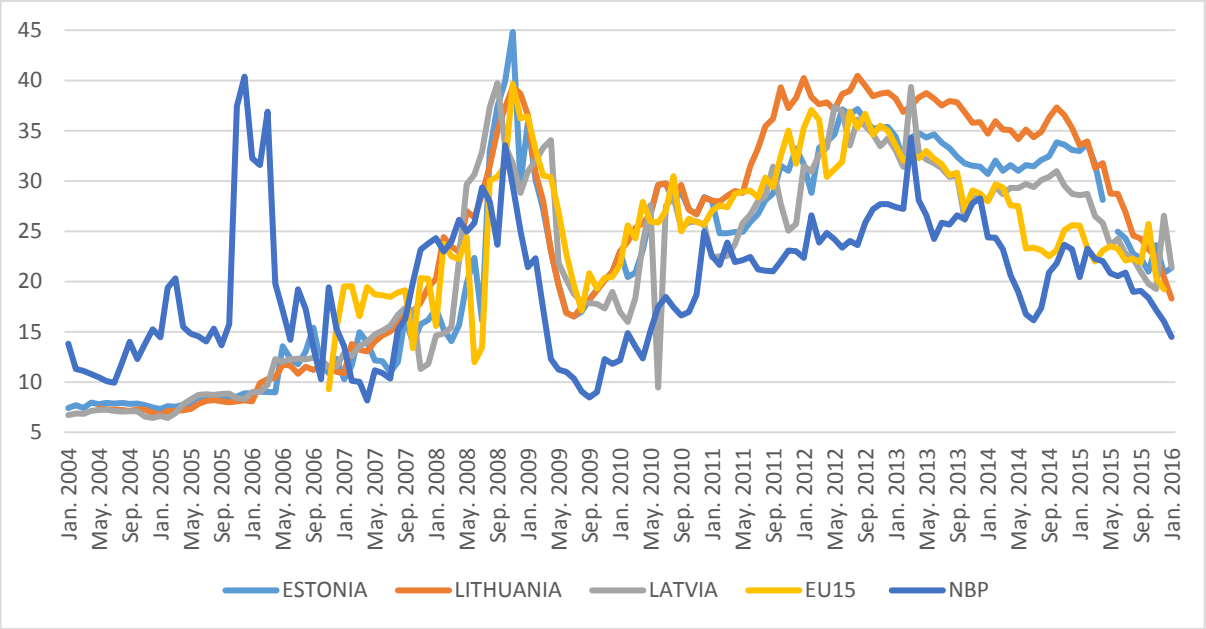

Figure 9 Russian gas import prices estimates EUR/MWh. Source: own estimates, based on COMEXT external trade data and NBP[29]

The increases of gas prices coincided with the country's slow recovery from the biggest economic crisis in Lithuania in that decade that hit in 2009.[30] Some members from LSDP blamed the implementation of the ownership unbundling for the high prices (BNS 2013a). Conversely, based on a survey in May-June 2011, the rising prices persuaded the general Lithuanian public that stronger separation and unbundling was necessary. The survey revealed

[29] The price estimates of imported Russian gas are based on external trade statistics reported by Eurostat (COMEXT), where Russian gas price estimates of the EU member states before the enlargement of 2004 (EU-15) countries were chosen as a comparative benchmark of the "European' prices. To estimate the import price, value of imported gas, which Eurostat provides after consolidating data from statistical copies of the customs declarations, was divided by the quantity of imported gas. The quantities of gas imported to EU-15 from Russia are available only starting from November 2006.
[30] In 2009, the real gross domestic product in Lithuania decreased by 15%, compared to 2008.

that 75% of the respondents believed that the price that Lithuania had paid for natural gas was 'unfair'. According to them, the prices had not corresponded to the income level in the country nor the EU average. Thus, 79% of the respondents supported the unbundling of the transmission system from the supply in order to increase competition (ELTA 2011).

When the law imposing the ownership unbundling was discussed in Parliament, members of the formal opposition (except for LSDP) sometimes would play along with the Government during the voting, but the actions by some member of the ruling coalition were undermining the Government's reform. The voting and transcripts of discussions of laws are publicly available, however, 'the biggest battles took place in the Committee of Economics [led by a member of the ruling coalition from the United Group of the Liberal and Centre Union and National Revival Party, Dainius Budrys] that was absolutely invisible' (Škiudas 2015). According to an interviewed former advisor to the Prime Minister Andrius Kubilius, during the regular sessions of the Parliament the situation was more benevolent towards the ruling coalition, but it did not have a majority in the Committee of Economics. This Committee, however, was the main committee designated to discuss the relevant natural gas legislation and to insert changes in between the discussions of the whole Parliament. However, the discussions of the draft laws in the Committee were often postponed (Committee on Economics 2011a, 2011b; Škiudas 2015) even though the parliamentary session was coming to an end. The leader of this Committee Dainius Budrys publicly expressed his negative opinion about the laws, even though he formally belonged to the ruling coalition (Čyvas 2011)[31]. In this period, the members of the President's Office also signalled the importance of the laws to the President's Institution by participating in the meetings of the Committee of Economics (GOV LT 1 2014).

The pressure surrounded the promulgation of the laws until the final days of the

[31] By spring of 2012, the year of the next elections, the head of the Committee of Economics Dainius Budrys joined the Lithuanian Social Democratic Party Political Group. In other words, he officially switched sides to another interest coalition, which his behaviour indicated earlier: http://www3.lrs.lt/docs3/kad6/w6_istorija.show6-p_r=6258&p_d=123280&p_k=1.html.

adoption: less than two weeks before the final voting, E.ON's Senior Vice President Peter Frankenberg sent an email to the members of the Committee of Economics with a legal analysis that Lithuania should ask for an derogation and proposing a meeting with the members (Frankenberg 2011). Simultaneously, members of the Committee of Economics 'for and on behalf of Gazprom' were distributed a legal assessment of the draft laws by an international law firm Salans located in Brussels (Salans 2011). In Gazprom's name, Salans required to 'suspend the accelerated procedure for adoption', or, in the opposite case, warned that the unbundling option 'could give rise to litigation in national courts, eventually leading to litigation before the European Court' (Salans 2011, paras. 32, 37).

Despite these struggles in Parliament, on the last day of the Parliament's summer session, in June 2011, it adopted the Law of Natural Gas and a related Law. The laws envisaged a separation of different operations of Lietuvos Dujos into several companies by operating segment by October 31, 2014. Interestingly, the same Law on Natural Gas, which applied ownership unbundling to the Lithuanian natural gas sector, also changed the essence of end-user price regulation (IQ 2011). The ownership unbundling question was widely publicized whereas the provisions determining end-user price regulation were passed without substantial public discussion.[32] The Social Democrat Political Group was the only one that unanimously voted against, and other political groups either unanimously voted for or had divisions (Lithuanian Parliament 2011d). In the whole period of discussions in Parliament, some members of the Labour Party and Order and Justice Political Groups, even though officially belonging to the opposition in 2008-2012, in crucial moments voted *in favour* of the Government's proposals. Members of those two political groups voted in favour in May 2009 to request the Constitutional Court to analyse the conformity of the privatisation agreement with the Constitution (Lithuanian Parliament 2009b), in June 2011 to adopt the Law on Natural

[32] There is not a single word of discussion among parliamentarians about end-user price regulation in the plenary session's transcript of June 30, 2011, when the Law on Natural Gas was adopted (Lithuanian Parliament 2011c).

Gas and the Law on Implementation of the Law on Natural Gas, which transposed the Third Energy Package and the choice of ownership unbundling (Lithuanian Parliament 2011e), and in June 2012 in favour of the Law on LNG (Lithuanian Parliament 2012c). One member of the Labour party explained in an interview that voting in favour of the Government's proposals was merely 'a finalisation of the whole process'. A politician explained: 'The fights with Gazprom had taken place, draft laws had been prepared and even the LNG boat had already been ordered at the time. It did not make sense anymore to jump in front of the running train trying to stop it. Naturally, the only way left was to implement everything till the very end' (Daukšys 2015).

As the laws that transposed the Directive required, on 28 October 2011 the Lithuanian Government adopted a resolution which tossed the ball to implement the unbundling to the main shareholders of Lietuvos Dujos, Gazprom and E.ON. They had to decide whether to implement ownership unbundling voluntarily through a commercial transaction or through a default scenario that required mandatory ownership unbundling. The choice of the shareholders had to be submitted as an action plan to the NCC by the end of March 2012 (Government of Lithuania 2011b, para. 5). On the same day in October 2011, the Ministry of Energy of Lithuania announced that it had reached 'breakthrough' and both the Commission's DG for Energy (DG Energy) and E.ON 'tuned up' the final date of unbundling (2014 October 31) and the main provisions of the unbundling procedure. The Ministry indicated that only E.ON had participated in discussions before then: 'The other shareholder of Lietuvos Dujos, Gazprom, did not submit comments regarding the implementation plan of the Law on Natural Gas and the description of the procedure; neither Gazprom participated in the discussions on preparation of these documents' (Ministry of Energy of Lithuania 2011c).

Unlike with the laws on Natural Gas, the adoption process of the Law on LNG terminal was short. This time, nearly all members of Parliament that participated in the session voted in

favour of the law, including the Social Democrat Group (Lithuanian Parliament 2012c). The Government proposed the Law on LNG terminal in May 2012, and the adoption took just little bit more than a month. Within the text of the Law, the Government obliged itself to ensure proper legal, technical and organisational conditions that the LNG terminal would start working 'not later than 03 December 2014, as envisaged in the EU Security of Supply Regulation of 2010' (Lithuanian Parliament 2012b, Art. 14). Thus, once again Lithuanian energy legislation embedded the need to implement an EU energy regulation.

5.4 Moving to the International Level

The first indications that the resolution of the conflict with regard to the implementation of the Third Energy Package would become a legally contentious matter appeared in 2010, when Gazprom notified Lithuania about investment dispute with regard to the draft Natural Gas Law implementing the EU Third energy package (Ministry of Energy of Lithuania 2016). It was Lithuania, however, who made the first step immediately after the Gazprom's import price rise from 2011. Lithuanian Government challenged the same pricing question in three different legal arenas: Commission's Directorate General for Competition (DG Competition), local court and international arbitration. The opponents of the dual reform from the sectorial hemisphere attempted to slow it down by stepping into the international arena as well. After unsuccessful attempts to persuade the Lithuanian Parliament to suspend the adoption of the Law on Natural Gas in 2011, Gazprom – a company from non-EU country – resorted to litigations and arbitrations, whereas other opponents complained to EU institutions. In addition to Gazprom, Lietuvos Dujos and its board members also joined the complainants in litigations and appeals (Supreme Court of Lithuania 2016). E.ON abstained from arbitration and litigation.

In January 2011, Lithuania submitted a complaint to DG Competition because of alleged abuse of the dominant position of Gazprom (Ministry of Energy of Lithuania 2011a). According to one interviewee, this complaint to the DG Competition was a 'high-level game'

and initially ‘shocked’ the DG, because until then the energy sector as such was ‘some kind of a taboo’ in this directorate, meaning, that larger scale antitrust investigations in gas was not an area of its ordinary engagement. Even more, the complaint came from a small country. However, the Commission must respond to all non-anonymous complaints, and therefore had to prepare an answer. If the DG Competition would have dismissed the complaint as lacking grounds, it could have been inferred as turning the blind eye to possibly anticompetitive practices (SE LT 2 2016).

Soon after, in spring 2011, the Ministry of Energy of Lithuania brought a claim before the Vilnius District Court to investigate operations of Lietuvos Dujos and to remove three members of the governing body from their offices, two of whom represented Gazprom as a shareholder in the company’s board (Gazprom 2013a, 167). The Ministry claimed that they were not acting in the best interests of Lietuvos Dujos, when negotiating gas prices with Gazprom (Wathelet 2014, para. 32). When Vilnius District Court started the case in 2012, Lithuanian officials received even more information from the investigation. They used this information in October 2012 in submitting a subsequent request to arbitration in Stockholm seeking near 1.5 billion Euro in damages for allegedly over-priced gas purchases (Škiudas 2015; PRES LT 2015). The conservative Government of Lithuania filled a claim 11 days before the parliament election of 2012, which meant that the arbitration would have to be followed up by whoever would take office after the election. Though E.ON never officially left the side of Gazprom, it reportedly proposed to a Lithuanian client cheaper gas than Gazprom using a swap arrangement (Sekmokas 2014; SE LT 2 2016), but the acquisition did not go through. The Lithuanian state used this incident as an instance of Gazprom’s restrictions in buying gas from the third parties (PRES LT 2015). In July 2012, a government-owned Lietuvos Energija submitted a complaint against Gazprom to a Lithuanian Competition Council.

The response to a complaint from the DG Competition came as a pan-Central Eastern

European ‘dawn raid’ in September 2011. DG Competition commenced inspections at the premises of at least eight Gazprom’s affiliates in central and Eastern Europe, including in two of the case studies, Lietuvos Dujos in Lithuania and Panrusgáz in Hungary. A year later, in September 2012, the Commission moved to a formal antitrust investigation into Gazprom’s operations in the EU. It alleged violations of antimonopoly laws of several European countries, in particular, in segmenting the European gas market, imposing unfair prices on customers and obstructing competition (Gazprom 2013c, 168).

Quite soon after it made a political decision to implement the ownership unbundling, Lithuania attempted to expand the arena of decision making to the Brussels level and engaged DG Energy. Firstly, in the beginning of 2010, the engagement revolved around Commission’s comments and feedback about the draft legal acts that were in preparation to transpose the Directive (GOV LT 1 2014). The Commission commented on draft laws on Natural Gas Act and LNG Law (Sekmokas 2014) in other words, it ensured ‘real-time compliance’. The former Energy Minister told: ‘The Commission was following the Natural Gas Act and the LNG Law projects very closely, analysed, criticized and challenged’ (Sekmokas 2014). By 2011, Lithuanian officials also involved the DG Energy officials into their negotiations with the shareholders E.ON and Gazprom (Ministry of Energy of Lithuania 2011b). At the time, there had been only one known precedent of the Commission’s close involvement in bilateral negotiations between a Member State and its energy suppliers – Poland’s negotiations with Gazprom in 2010 about long-term agreement on transit and extension of Russian gas supplies delivered through the ‘Yamal-Europe’ pipeline from Siberia to Poland and the rest of the EU (Brunarska et al. 2011, 45–46). As a Lithuanian lawyer that worked with the case described in an interview, the Commission was very proactive in the ‘consultations’, because ‘the Commission saw that the Lithuania's case was the Litmus test’ [of the implementation of the Third Natural Gas Directive]. The lawyer related: ‘If Lithuania did not succeed to implement

the ownership unbundling, it would have been a very strong hit to the whole Third Energy Package and would hinder its viability' (LEGS LT 1 2014). The Commission participated in the negotiations until the mid-2014, when E.ON sold the shares of Lietuvos Dujos and its spinoff Amber Grid to the Lithuanian state, soon followed by Gazprom (SE LT 1 2015). Interestingly, despite the adoption of the law and the participation of the Commission in negotiations, on 30 September 2011 the Commission included Lithuania into a package of EU Member States to which it sent formal notices of started infringement procedures for non-communication transposition of the Third Natural Gas Directive.

The reason for Lithuania's proactive attempts to involve the Commission was the feeling of 'smallness' in front of such powerful opponents as E.ON and Gazprom(GOV LT 1 2014; COMM ROM 2016; Kubilius 2015). As one interviewee told, 'if we compare our country with those two energy companies, Gazprom, and E.ON, their competences are stronger multiple times, their international experience much stronger. […] For Lithuania, it was a very difficult and complex task exactly because Lithuania was so small' (GOV LT 1 2014). Another former high level official of the Ministry explained:

> We must admit that, regrettably, in those times neither Lithuania nor Poland had such high-level specialists, especially in legal matters that could skilfully handle such top-level negotiations. Whenever Gazprom arrived, they would come with a whole group of the highest level and very well paid lawyers from very famous firms. We, as a state, as a ministry, had to rely on what we could get regarding specialists. Even though they were the best in Lithuania, they lacked experience. Now, of course, in this process we built the capacities of our lawyers, but the very beginning was incredibly difficult. In this regard, the Commission both for the Poles and for us meant expertise, knowledge, and qualified, guaranteed and free-of-charge assistance (SE LT 2 2016).

The negotiations would have the following format: Lithuanians would meet Gazprom with the participation of the Commission and E.ON with the participation of the Commission. They would also have individual bilateral meetings with Gazprom and separate bilateral

meetings with E.ON without the Commission (LEGS LT 1 2014). Lithuanians also kept European Commissioner's for Energy Günther Oettinger's Cabinet informed about the developments (SE LT 2 2016). The majority of the meetings were initiated by the Lithuanian side, with an exception of a few organised by the Commission. The Lithuanian officials made sure in their invitations to the meetings to E.ON and Gazprom to highlight that the Commission would also participate. Gazprom skipped some of the meetings, while E.ON would participate in all (SE LT 2 2016).

Lithuanians would both use the Commissions presence in the room where negotiations took place, and also written communication with Brussels. When the battle between the Government and the shareholders of Lietuvos Dujos intensified in 2011, the Lithuanian Minister of Energy published online letters from the Commission representatives to the Lithuanian officials, where the Commission had supported Lithuania's attempts to implement the Third Natural Gas Directive. They included including a letter from the Commission's president José Manuel Barroso to the Prime Minister of Lithuania (Hilbrecht 2010; Lowe 2011; Barroso 2011).

By early 2012, Gazprom started reaching out and contacted Prime Minister Andrius Kubilius' office to set up meetings with him and Alexander Medvedev, a Deputy Chairman of the Gazprom Management Committee (Kubilius 2015). In February 2012, two such meetings took place in Vilnius (Lapienytė 2012; BNS 2012). In the second meeting on 27 February 2012, where Philip Lowe from the Commission also participated, the Energy Minister Arvydas Sekmokas, Alexander Medvedev and Philip Lowe co-signed a joint statement in which they agreed to move this intermediate target date by two months to the end of May 2012. The Government, however, did not move the final date of implementation, the end of October 2014. The joint statement reads as follows:

> It was agreed today between representatives of the Lithuanian Government, Gazprom and the Commission that in the light of the objective of implementing the Government's

> decision for ownership unbundling of the Lithuanian gas transmission and distribution network by end 2014, it is necessary to enter immediately into negotiation to resolve outstanding issues relating to the unbundling process, to the transit of gas to Kaliningrad, to the future term and offtake volumes and to the valuation of the unbundled company with a view to adopting by 31th May 2012 an agreed roadmap for final implementation of unbundling. The intermediate target dates in the Action Plan adopted in the Government's resolution of 28th October 2011 will be amended accordingly (Lowe, Sekmokas, and Medvedev 2012).

By co-signing a statement between a Member State and a third country supplier in February 2012, the Commission stepped out of the zone of an 'observer' and 'advisor' in the negotiations, which signals about the increasing role of the Commission in the bilateral negotiations.

The Lithuanian officials and the Commission representatives would meet before the meetings with E.ON and Gazprom to align their positions (SE LT 2 2016). However, while they stood firmly behind Lithuania, they were concerned by some of the arguments used in the negotiations by the Lithuanian side. The Commission 'had a categorical position' that Lithuania had to implement the Third Energy Package because it did not ask for a derogation back in 2007 when the Directive was discussed (LEGS LT 1 2014). As an interviewed lawyer explained, 'the Commission put pressure on Lithuania to implement the Third Natural Gas Directive, but at the same time it rebutted Gazprom's arguments' (LEGS LT 1 2014). The Commission, however, did not want Lithuania to introduce the price of gas into the negotiation of the implementation of unbundling under the Third Natural Gas Directive (Sekmokas 2014; Lowe 2016). Also, from the viewpoint of the Commission participants, Lithuania in calling for Gazprom to give up its shareholding in Lietuvos Dujos, it 'seemed to ignore fundamental principles of international law on investment protection'. Philip Lowe, former Director-General for Energy, told in an interview: 'We were preaching to the Russians the need to respect the rule of law. "You play in Europe - you play by European rules." But you cannot

then say ‘I want structural unbundling, so I confiscate your assets. Subsequently, the situation really deteriorated as the Russian side then went to arbitration’ (Lowe 2016). The fact that Gazprom submitted an arbitration request before the Permanent Court of Arbitration in The Hague under the United Nations Commission on International Trade Law (UNCITRAL) three days later after signing the joint statement, shows that during Aleksander Medvedev’s visit to Vilnius the documents probably were under preparation. In this procedure, Gazprom claimed that in transposing and implementing that directive the Republic of Lithuania breached its obligations under the 1999 Treaty between Russia and Lithuania on the encouragement and mutual protection of investment (Gazprom 2013a, 168; Wathelet 2014, para. 36).

Subsequently, it came ‘as a surprise to the Commission’ (LEGS LT 1 2014) that two months later on May 28, 2012, the shareholders of Lietuvos Dujos convened an extraordinary shareholders meeting and approved the principles of the separation of the operations relating to gas transmission from the distribution of gas. A compromise was found a few days before the general meeting of the shareholders planned on 28 May 2012, which had to decide on the route of unbundling: voluntary or the default under the resolution of the Lithuanian Government of 28 October 2011. Gazprom and E.ON opted for the voluntary implementation, which gave them a little bit more flexibility and time in the process. In the meeting, not only E.ON, but also Gazprom cast their vote in favour of the plan ‘primarily to avoid adverse consequences, including the possibility of sanctions brought by the Lithuanian state authorities against Lietuvos Dujos, its management, and shareholders’ while reserving its arbitration rights’ (Gazprom 2013a, 168). Based on this decision, Amber Grid, a spinoff company that took over the activities of natural gas transmission of Lietuvos Dujos, was created a year later (Lietuvos Dujos 2013).

Despite the agreement to restructure Lietuvos Dujos, Gazprom kept arbitrating against Lithuania and in one period in 2012 it had three international arbitration proceedings open.

Two of them were directly related with the Lithuania's implementation of the Third Natural Gas Directive, and one formally unrelated. As one interviewee from Lithuania commented, 'after all, three international arbitrations was a difficult matter for a small country'.[33] One arbitration procedure in International Court of Arbitration of the International Chamber of Commerce in Paris (2010-2013) was related to the introduction of the Lithuanian tariff regulation of the price of KTE, the main owner of which was Gazprom (Gazprom 2013b). The second arbitration Gazprom started in June 2011 in International Chamber of Commerce (ICC) in Stockholm, requesting Lithuania to withdraw the action before the Lithuanian courts against the members of board of Lietuvos Dujos (Arbitration Institute of the SCC 2012; Wathelet 2014, para. 33). The third arbitration procedure was the aforementioned investment dispute with regard to the draft Natural Gas Law implementing in Lithuania the Third Natural Gas Directive in the Hague under the UNCITRAL. This dispute notification to the Ministry of Energy was in July 2010, and the arbitration started from March 2012 (Ministry of Energy of Lithuania 2015a, 2016). According to some interviewees, in approximately 2012-2013 there was also a diplomatic exchange with Russia, which warned Lithuania that Russia as a state would also start an investment arbitration against the Lithuanian state based on the same Bilateral investment treaty as Gazprom had done (LEGS LT 1 2014; SE LT 1 2015). This was never executed.

Other domestic actors, such as fertilizer producer Achema, the Lithuanian Gas Association and the Lithuanian District Heating Association, in various ways confronted the LNG terminal project. In the second half of 2012, after resisting the planned requirement for all the importers of gas to import at least 25% via the terminal, Achema complained to the Commission. The Commission in turn started a pilot procedure (Juršytė 2012), which lost its

[33] All of the main steps and counter steps by the Government and Gazprom are presented in the detail in a paper 'Lithuania's Strategic Use of EU Energy Policy Tools: A Transformation of Gas Market Dynamics' published by the Oxford Institute for Energy Studies in September 2016, and this section provides a broader overview only.

relevance in 2013-2014 when the Parliament cancelled the '25% rule' (Government of Lithuania 2013; Lithuanian Parliament 2013b; TS-LKD 2016). Then in November 2012, Lithuanian Gas Association, which represented gas companies that imported and supplied gas for re-sale to the national wholesale and to the retail market, filed a complaint to DG Competition arguing that the LNG terminal would be receiving illegal and incompatible state aid (European Commission 2013h, 1).

Based on this complaint and the notification of Lithuania, the DG Competition started the investigation into the case, which it concluded in November 2013 that the state guarantee and the LNG supplement, a special levy imposed on users of the transmission system, were compatible with the internal market (European Commission 2013h, 36). Lithuania also used the Commission's opinion about state aid to build the LNG terminal (European Commission 2013h) to rebut the arguments of the opponents of the terminal such as the fertilizers producer Achema (LEGS LT 1 2014).

5.5 Power redistribution and the locked-in reform

The October 2012 election was approaching before the dual reform was completed. The conservative coalition Government of 2008-2012 on purpose was attempting to reach the point of no return of the policies. In March 2012, state-owned company Klaipėdos Nafta signed an agreement with the Norwegian Höegh LNG to build a maximum 4 billion cubic meters per year (bcma) capacity LNG ship, which was later called Independence. The lease agreement of a 10-year period has a purchase option (European Commission 2013h). This agreement would have been very to reverse because of the fines in the agreement. A former advisor to the Prime Minister, Kęstutis Škiudas told: 'A point of no return was the most important for us with regard the political elections cycle. We considered having reached the point of no return when we would sign a mutually binding agreement... There were financial obligations and we did not have a way back – and then the works on the quay and the law started moving on'. According

to him, the notion of point-of-no-return came from the project management theory and practice, 'but we made it political' (Škiudas 2015). In April 2012, they unsuccessfully proposed for the parties to sign an agreement to ensure continuity of the strategy energy projects (TV3 2012).

TS-LKD lost the 2012 election and the social democrats came back to form the Government, which this time was led by Algirdas Butkevičius. After the election, the composition of the ruling party coalition that came into office became similar to the one in 2004-2008: Lithuanian Social Democratic Party, Labour Party, Party 'Order and Justice' and Lithuanian Poles' Electoral Action formed a ruling coalition. Andrius Kubilius became the leader of Opposition in the Parliament (Lithuanian Parliament 2016). However, despite the strong opposition to the gas market reform before their return to power, the new ruling majority continued the natural gas sector policy that they had inherited from the conservative coalition Government both in terms of supportive rhetoric and actions. The rhetoric of the Social Democrats became very different, compared to the period before the autumn of 2012, when they were in opposition. In early 2014, when the shares of Lietuvos Dujos and its spinoff Amber Grid still were co-owned by E.ON and Gazprom, the Prime Minister, Algirdas Butkevičius, spoke strictly against Gazprom's attempts to question the implementation of the Third Natural Gas Directive. The response of Algirdas Butkevičius in an interview in a Lithuanian media outlet shows that he was non-aligning with Gazprom: 'They are very unhappy that Lithuania goes down the path of the Third Energy Package and raised this issue multiple times. The question of arbitration also worries them. But we highlighted very clearly, that all this Energy Package, envisaged by the previous Government, does not change, and our Government is not planning to turn the horses around' (Jačauskas 2014).

There was one exception by the social democrats from the new general reform-prone line from June 2013 to April 2014, when the Parliament formed a temporary commission to investigate energy, which was led by Social Democrat Artūras Skardžius (Lithuanian

Parliament 2013a). This commission was perceived as posing threat to the LNG terminal project by some of the interviewees from the reform prone coalition: if the commission would have managed to remove the top-level LNG project managers, it could have slowed the project down (Sekmokas 2014). However, when, by the end of 2013, the leader of the commission became vocal against the Norwegian Höegh LNG that owned the boat (BNS 2013c; Zinkuvienė 2013) and the Norwegian ambassador sent a letter to the Lithuanian politicians (Bakutis 2013; BNS 2013b), the Prime Minister, Algirdas Butkevičius, asked his party counterpart Artūras Skardžius to downscale to discussions (ELTA 2013).

The new ruling majority also continued the litigation and arbitration proceedings against Gazprom, the negotiations with E.ON and Gazprom and building the LNG terminal. The final stages of the reform, which the previous conservative coalition ruling majority started, were reached in the mid-term of the social democrat ruling coalition. In August 2013 Lietuvos Dujos transferred assets, liabilities and rights related to gas transportation to Amber Grid, in accordance with the provisions of the Third Natural Gas Directive, regarding the split between the gas transmission and distribution activities. When, following the unbundling requirements, Gazprom and E.ON sold the shares in Lietuvos Dujos and its spin-off Amber Grid in 2014, the government-owned Lietuvos Energija acquired the shares. In 2014 the Lithuanian Litgas concluded a 5-year contract with Statoil for the delivery of LNG gas at a level of 0.5 billion cubic meters/annually and later extended it by five years (and decreased the minimum amount). The LNG terminal arrived at Klaipėda in December 2014 and became operational by the beginning of 2015. Moreover, Lithuania started shipping small amounts of gas across Latvia to Estonia. As soon as the long-term agreement with Gazprom expired, Achema has also chosen Statoil via the LNG terminal instead of Gazprom via pipelines to provide gas for 2016. In this way, Achema changed sides in opposing *actor coalitions* and stepped into the side of the reformers. This tipped the scales of gas supply balance, and in 2016

Norway is expected to supply more gas to the Lithuanian market than Gazprom (Reuters UK 2016).

By the time of finishing this thesis, only the DG Competition case was still going on. Two years after Lietuvos Energija complaint, the Competition Council found that Gazprom created obstacles for Lietuvos Energija to acquire alternative gas and in this way breached concentration requirements and imposed a 36 million EUR fine (Competition Council of Lithuania 2014). Gazprom also challenged this fine in courts (Vilnius Regional Administrative Court 2015; BNS 2015), and by the time of writing this thesis the case was in the Supreme Administrative Court of Lithuania (BNS 2015). Gazprom withdrew the investment arbitration claim in the Hague under UNCITRAL in April 2015, after earlier selling all the shares in the Lithuanian gas sector to the Lithuanian state (Ministry of Energy of Lithuania 2015a). In June 2016, almost four years from the beginning of the arbitration, it was announced that Lithuania lost its case against Gazprom in the Arbitration institute of the SCC. The arbitration court ruled that the term 'fair price' in the privatisation agreement was too vague to assess losses and award the compensation. Also in 2016, Lithuanian officials withdrew the claim against the board members of Lietuvos Dujos at local court in 2016, after the prolonged arbitration and litigation, and the case reaching the European Court of Justice, the Lithuania state buying the shares of Lietuvos Dujos and liquidating it, and the members in question leaving company (Supreme Court of Lithuania 2016).

The locking-in effect may be explained by several mutually reinforcing causes. Primarily, it can be explained that even though the 2012-2016 Government was formed by similar configuration as before 2008, the President Dalia Grybauskaitė stayed in office until 2014; moreover, then she was re-elected for one more five-year term. Another powerful member of pro-integration *actor coalition*, the Commission, also remained. It would have been difficult for a new Government to explain to the Commission, why after so much effort the

reform was reversed, especially since the Commission reportedly continued participating in the negotiations with E.ON and Gazprom until 2014. Moreover, the geopolitical context has changed, and the previous Government reached some intentional point of no return.

To summarise, the change of political power in Lithuania after the national election in October 2008 coincided with the adoption of a set of EU energy policy instruments. The conservative politicians that replaced the left-leaning representatives in forming the ruling majority used the EU's Third Natural Gas Directive 2009 and the Security of Supply Regulation of 2010 as they became available and the general EU competition policy tools. Exploitation of these EU tools, or changes in domestic *opportunity structures* became possible, because at the critical junctures, such as when the Directive was negotiated in Brussels in 2007-2008, or had to be transposed to the national level from 2009, Lithuanian political actors that were inclined towards gas market integration occupied power positions in the country.

6 ROMANIA AND THE COMMISSION PLAYING A 'CAT AND MOUSE' GAME

Romania also had a general election in 2008, but, unlike in the two previous cases, it did not result in major reforms of its natural gas sector. This chapter shows three things. First, in Romania consumer liberalisation and gas export questions were coupled. Second, even though Romania, among the three analysed countries, had the most frequent changes in governments in between the elections, the questions of keeping end-user prices low via regulation, and not exporting domestic gas to neighbouring countries travelled from one political formation to another. Yet, Romania was supposed to liberalise gas consumers and to remove obstacles to export gas as a part of the obligations to allow free flow of goods coming from its membership in the EU. Third, as both consumer liberalisation and free cross-border flow of goods are prescribed by EU principles and instruments, resistance to these requirements by the dominant anti-integration *interest structure* in Romania resulted in this country chronically not complying with relevant EU requirements. Consequently, changed opportunity structures with joining the EU did not act as a catalyst to give an impetus for pro-liberalisation reform in Romania. Thus, this chapter establishes that the 'EU Leverage' causal process tracing mechanism was in place.

6.1 Consensus in the interest structure

Salient questions pertaining to the natural gas sector were easy to identify in Romania. At the end of the day, all interviewees and media analysis brought up the question of the (low) end-user prices as the issue of the highest political salience. In this regard, throughout the whole research period Romania was similar to 2010-2016 Hungary. The question of keeping end-user prices low was coupled with (questioning) the need to export gas produced in Romania to higher price zones, the neighbouring countries and further to the west. The coupling of liberalisation with exports was confirmed by various interviewees. For example, one said: 'First you have this national sentiment among some politicians: they think that liberalisation is

coupled with the issue of gas exports, and they say why we do not want to export gas, therefore, liberalisation is not good for us. Romanian gas should be domestic and kept for Romanian consumption' (EX ROM 2 2016). Another person commented:

> I would say it was more because of political, public pressure, because first, it is not something that appeals to the public, this idea that you would have to liberalise. Also people thought that liberalisation would come together with exports. You know, they are very resource nationalist. […] And everyone has impression that this is one of the treasures of Romanian soil, and we should be able to enjoy it. For free if possible (UPS ROM 1 2016).

With regard to one more aspect that more or less played a role in Hungary or Lithuania – position towards Russia and its supplier Gazprom – Romania was in a special situation. On one hand, as Dąborowski summarised, 'almost the entire spectrum of the Romanian political class treats [Russia] as a traditional enemy and a rival for influence in neighbouring Moldova' (Dąborowski 2016). In Romania, the views towards Russia were intertwined with the proximity of Romania to both Ukraine and Moldova. Moreover, Romania suffered dropping gas volumes during both the Russia-Ukraine gas crisis of January 2006 (Agence Europe 2006; Belgrade IRNA 2006; Stern 2016, 7–8) and of January 2009 (Agence Europe 2009b). Last, there was a deep concern shared by nearly all political spectrum regarding consequences to Moldova from the war in Ukraine, and regional stability in EU's eastern neighbourhood and the very high concern with regional conflict (Inscop-Adevarul 2014; Agerpres 2014c). In 2014, the Romanian Prime Minister at the time, social democrat Victor Ponta, assessed Russia as posing 'highest security risk' to the region, and claimed that Romania's 'legit interest' was to support the neighbouring Moldova in joining the EU, 'the Russian Federation wants to prevent it from that' (Agerpres 2014e; Adevarul 2014). However, on the other hand, Russia's impact in the Romanian gas sector among the three analysed countries was the smallest both in terms of the import share and in ownership of the shares in important domestic gas companies. Conversely, attempts to decrease 100% gas import dependence on Gazprom were fuelling much of the EU

guided reforms in Lithuania.

The structure of the Romanian actors and their relationships that had influence in the country's natural gas sector was much more complex than in Hungary or Lithuania. This difference firstly was because in Romania the IMF and the WB joined the efforts of the Commission to bring the Romanian gas sector in line with EU regulations. Secondly, a special tool, i.e. emergency ordinances, allowed the Romanian government to have one foot in the legislature branch while keeping another in the executive. Thirdly, Romania produced a big share of its own gas and subsequently had more private actors on the upstream level, the interests of whom also have to be taken into account. The analysis of actors and their positions starts with the interests and powers in the political hemisphere, the initial legislative and regulative actions in which may or may not give impetus to changes in the gas sector. The analysis is summarised in a table of the Romanian *interest structures* at the end of the section.

Throughout almost all the research period, the interests in the political hemisphere were predominantly against liberalisation and exports of gas. The main domestic institutional stakeholders active in the Romanian gas sector were the executive institutions, such as Government, [34] the President, the legislature, the Romanian Parliament, and its two committees, and the National Agency for Energy Regulation (ANRE). In the majority of the research period all of them, except for ANRE, acted or non-acted (when action was necessary to move forward) to delay liberalisation and exports. The position of ANRE was not so straightforward. According to some interviewees, ANRE at times, especially from mid-2012, sought liberalisation (GOV ROM 2016). Below the roles and positions of those actors are presented in a greater detail.

During the research period in Romania, there was no 'traditional' left and right political party competition in Romania, were one side would form a government, and another remains

[34] Ministries that dealt with the gas sector changed with time with changing ministerial configurations of the Romanian governments. It was Ministry of Economy, Commerce and Business Environment at some point.

in opposition. Romanian political parties often formed 'broad coalitions', where at least left and right parties, and sometimes also liberals, seeking together to win elections. This also ensured the non-contestation of the political will to regulate end-user prices. Therefore, neither the 2008 nor the 2012 general election brought significant reforms to Romania's natural gas sector.

For the entire research period, political parties in Romania tended to split, merge and form party coalitions. This subsection presents several examples of left-liberal-right cooperation, and Figure 10 illustrates a broader overview of the never ending fluctuations among political parties. Party coalitions are at the top part of the figure, and parties at the bottom part. Red arrows indicate party spinoffs, red – party mergers, dotted – coalitions of parties. The party list is not all inclusive and neither includes government coalitions that sometimes were formed without specific parties going into more formalised alliances. Generally, for the majority of the research period, the Romanian conservatives (the Conservative Party, PC) belonged to one or another party coalition with the Romanian Social Democratic Party (PSD). In 2011, even wider left-liberal-right coalition was formed. The Conservatives joined the National Liberal Party (PNL) and the Social Democratic Party to form the Social Liberal Union (USL) (Chiriac 2011). Between the collapse of the Mihai Răzvan Ungureanu Government at the end of April 2012 and the general election in December the same year, USL formed a Government, led by Victor Ponta. Later joined by National Union for the Progress of Romania (UNPR), the four-party coalition won about two thirds of the seats in both the Senate and the Chamber of Deputies in December 2012. In between May 2012 and November 2015 when Victor Ponta resigned, he formed four governments, each of which included at least the PSD and PC. Even in June 2015, when the Conservative Party (PC) merged with the Liberal Reformist Party to create the Alliance of Liberals and Democrats (ALDE), it reportedly remained in a political coalition that supported Victor Ponta's (PSD) Government

(Romania Insider 2015). This has been the political context in the background of which the Commission was trying to achieve Romania's compliance with the EU single gas market regulations.

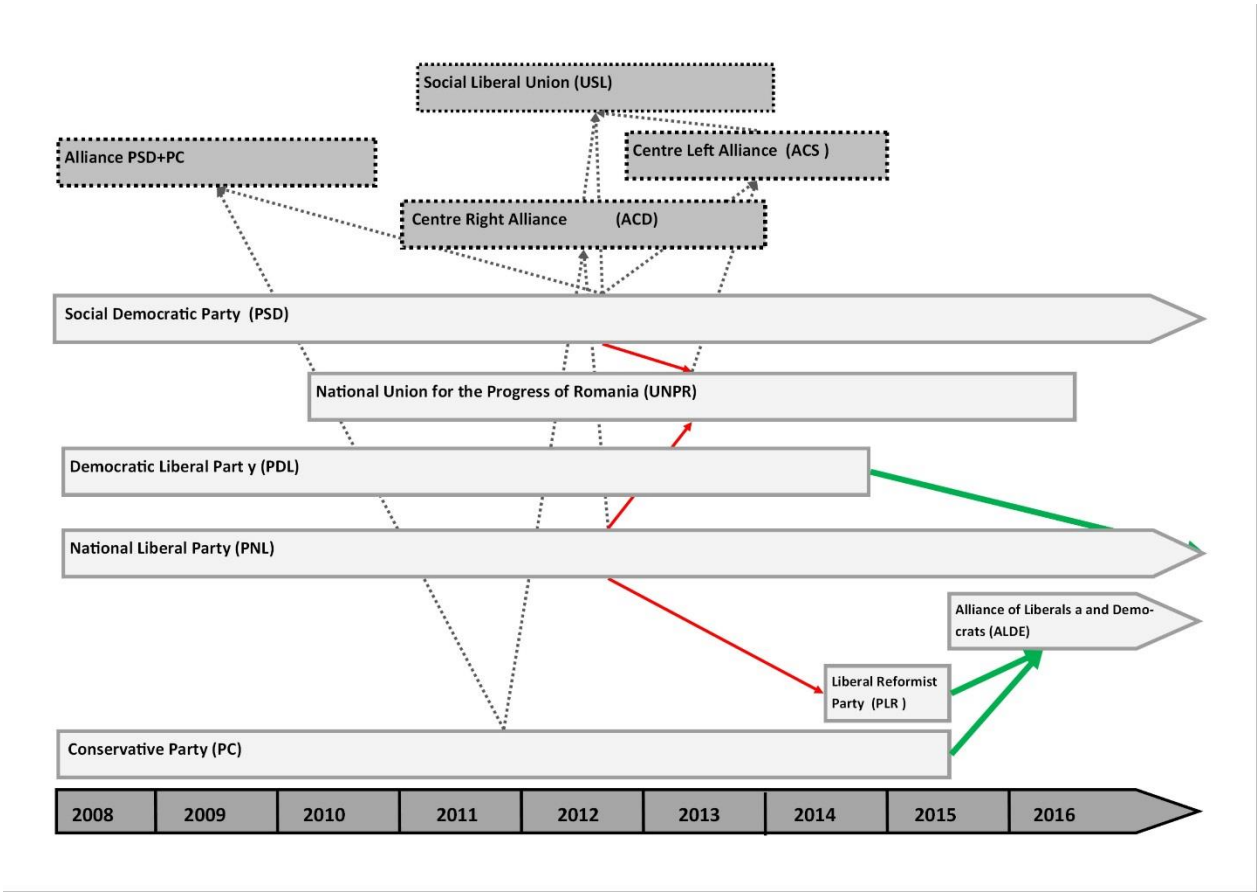

Figure 10 Relationships among political parties in Romania 2008-2016

One side of the Romanian executive power were consecutive governments, which were permeated with interests of keeping end-user price regulation and not exporting gas. The majority of interviewees saw a question of end-user prices low via administrative measures as the question of a long-term consensus between different domestic political actors. This happened despite the fact that during the research period, due to many political controversies in Romania, Romanian governments frequently failed and did not last until the scheduled elections. Whereas in post-2010 Hungary, two main opposing parties, the right-wing Fidesz and the social democrats, converged towards regulating end-user prices to the lowest possible only by the second part of the research period, in Romania this convergence seems to have

existed throughout the majority of the research period. Another view on which Romanian policy makers, no matter who was in power, seemed to coincide was the approach to the energy security, where the energy security was seen as 'energy independence'. This was understood as making the best use of the indigenous resources, with no necessity to import or export to the EU gas market (Natural Gas Europe 2015; *Reuters* 2014).

The only thing that differed among the interviewees discussing governments was different reasoning they provided behind this consensus. The listed reasons mainly fell into three groups. The first was a fear of Romanian politicians that the Romanian public would simply not afford higher prices (GOV ROM 2016; SE ROM 1 2016). One interviewee from the Commission commented that as it seemed, 'all of them were not very keen on deregulating prices, because of arguments that the consumers would be the ones to suffer (COMM ROM 2016). Another person contemplated:

> For every Government ensuring the so-to-say, wellbeing of its citizens, consumers, is a priority. I think postponing and maintaining regulated prices was a concern in order to make it sure […] because the salaries are quite low, there was also a risk that the [gas] prices would go up, and then they would not be able to pay. […] I don't recall major differences. [among different governments]. Many governments changed, but I think the policy, the direction, was always maintained and followed (SE ROM 1 2016).

The second group of reasoning was self-interests of politicians to be (re)elected to office and expectations to be 'punished' by the electorate if price liberalisation caused price increase (UPS ROM 1 2016). The third implied reason was not related to domestic consumers at all. It was rather the protection of interests of the largest fertiliser producer InterAgro by politicians. InterAgro was established in 1994 and insolvent by 2016. This company, before it bankrupted after its owner went to jail, consumed nearly as much gas as all households together and from 2009 to 2012 reportedly benefited from gas sector regulation (EX ROM 1 2016; EX ROM 2 2016).

Romanian governments had at their disposal one more measure that would allow them to influence the gas sector in their way even if there were disagreements with presidents or Parliament and in this way to dominate the *interest structure*. A specific legal tool, called 'emergency ordinances' gives leeway to governments to circumvent other political powers in the political hemisphere and to avoid involving stakeholders into decision making processes via public consultations. Generally, the Romanian gas sector is regulated on a political level via the following tools: (1) laws that are passed in Parliament, which can be proposed either by Government or Parliament, (2) governmental decrees, and (3) emergency ordinances. Issuance of emergency ordinances by Government is a form of 'legislative delegation': by doing so, Government also becomes a legislator (Selejan-Gutan 2016, D: The Relationship between the Government and the Parliament). Emergency ordinances become valid immediately from the moment of adoption by Government and the publication in the Official Gazette: 'they generate immediate action.'[35] As the Romanian Constitution stipulates, 'Government can only adopt emergency ordinances in exceptional cases, the regulation of which cannot be postponed, and have the obligation to give the reasons for the emergency status within their contents' ("Romanian Constitution" 2003, Art. 115). Yet the Romanian Government was seen by an interviewee from the Commission as deciding 'everything' in the gas market with emergency ordinances (COMM ROM 2016).

Unlike in Hungary and similarly to Lithuania, Romania being a semi-presidential democracy gives more powers to its presidents, so they also play a role in energy policy (SE ROM 1 2016). The involvement of the President institution in the gas sector can be seen from the fact that the Traian Băsescu was meeting with the Commission and IMF about the gas price deregulation with transnational institutions (Posirca 2012), and in 2012 vetoed a law of the gas

[35] Emergency ordinances need to be passed within five days to the Parliament, which may confirm, modify or reject the ordinance. The Romanian Constitution does not regulate the time frame for the Parliament to analyse emergency ordinances, thus, sometimes they may spend a year or more in a drawer in Parliament (MP ROM 1 2016).

export ban adopted by Parliament, possibly as a promise to these transnational institutions (IMF 2012, 16). The participation of the presidential institution in the gas sector is also visible from Traian Băsescu's multiple trips, speeches and comments in media on the gas sector issues (Rompres 2006, 2007a, 2007b; Agerpres 2009; Adevarul 2013b; Agerpres 2014d).

The difference from Lithuania, where the President's pro-reform position 'balanced out' the resistance to the reforms, was that based on the publicly expressed positions the 2004-2014, Romanian President Traian Băsescu was rather in the camp of the pro-*status quo actor coalition* that was both against consumer (at least household) deregulation and gas exports. For example, in 2012, after meeting representatives of the Commission, the IMF and the WB, Traian Băsescu complained that he would not be able to pay the bills himself, were the prices liberalised. He was quoted in the press as saying, 'if we deregulated energy prices tomorrow, I would have difficulties in paying my energy bills, although my housing and car are provided by the Presidency' (Posirca 2012). On another occasion, after receiving news that later the same year the Commission started an infringement procedure for ban of exports in 2012, Traian Băsescu claimed that Romania 'simply cannot export gas'. He was quoted as saying that since Romania entered the EU and must 'play by the rules', but 'there are no technical conditions for Romania to export gas. Romania can only receive gas' (Agerpres 2012). According to one interviewed Member of Parliament, after DG Competition dawn-raids in summer 2016, unconfirmed information surfaced that Traian Băsescu had repeatedly asked the CEO of state-owned transmission system operator Transgaz to slow constructions of interconnectors down and decrease pressure in the transmission system, especially in winters. As the interviewee commented, 'if the TSO exported gas, especially in winter, the risk to not covering consumers would be too high, and all the unpleasant consequences are against his Government and himself' (MP ROM 1 2016). This claim, however, was not confirmed in any other sources. Some analysis related the delays of the planned steps to phase out end-user price regulation in

2014 to the timing of presidential election: 'the incumbent Traian Băsescu does not want to alienate voters by raising prices, which was originally expected to take place next month' (Samuel 2014).

Traian Băsescu was in power for two consecutive terms from 2004 to 2014, which means that during this period hardly any attempts to deregulate the gas sector and to allow exports could have come from the Romanian President's institution. Moreover, from December 2008 to April 2012 (the period of the implementation of the Third Natural Gas Directive of 2009 and the Security of Supply Regulation of 2010) his presidency period was described as a 'unified government'. This means the President and the prime ministers belonged to the same party, Democratic Liberal Party (PDL[36]), which had won the general election in December 2008 (Bucur 2014). This decreased the plausibility of disagreements between the President and the Government. It is possible to place Traian Băsescu in the same *interest constellation* as the Prime Minister Victor Ponta (PSD) even afterwards, during the period of 'cohabitation' from May 2012 to the end of the presidential term in 2014, when the party associated with Traian Băsescu was not represented in government. Even though Victor Ponta had a history of personal disagreements and even personal resentment with Traian Băsescu (Agerpres 2014a, 2014b; Adevarul 2013a), their publicly expressed views and actions towards keeping end-user prices low converged.

Regardless of who formed political coalitions and governments, the most important committee in Romanian Parliament to deal with energy issues, the Committee for Industries and Services in the Chamber of Deputies[37], was led by a social democrat politician Iulian Iancu, who in multiple attempts tried to restrict gas exports from Romania. This committee was

[36] Initially the Democratic Party (PD) was associated with Traian Băsescu. A merger of PD and the Liberal Democratic Party (PLD) in December 2007 created the Democratic Liberal Party (PDL).

[37] (Romanian Parliament 2016); There were two committees that dealt with energy questions within Parliament, which, unlike in Hungary or Lithuania, consisted of two chambers: Committee for Industries and Services in the Chamber of Deputies and Energy and Transport Committee in Romanian Senate. The latter committee was rarely mentioned by interviewees if at all.

deemed by interviewees as very important and influential with regard to the Romanian gas sector (Dudau 2016; COMM ROM 2016; Sîrbu 2016). One interviewee said that 'regarding drafting law and promoting amendments, […] it [was] definitely much more important than the ministry' (Sîrbu 2016). One of the reasons was that the Chamber of Deputies was the decisional chamber in terms of energy law within Parliament. Moreover, it was this Committee where even the emergency ordinances with regard to the gas sector 'at the end of the day' ended-up (Sîrbu 2016).

A number of interviewees pointed to Iulian Iancu's, who led the Committee from 2006 until at least the end of the research period[38], actions as hindering liberalisation and especially exports of gas (EX ROM 1 2016; UPS ROM 2 2016; COMM ROM 2016; EX ROM 2 2016). A person from the Commission noted that Iulian Iancu 'knew energy quite well and was quite influential, unfortunately not always to the right direction' (COMM ROM 2016). Another interviewee commented:

> He [Iulian Iancu] kind of spearheaded this ant-liberalisation […], and it is very strange, because he is the man with significant energy acumen and knowledge; he is the president of the Romanian Chapter in the World Energy Council. So he knows energy, but in his career as a member of Parliament in various critical matters and controversial topics in the energy fields he acted sometimes contrary to the spirit of European directions (EX ROM 2 2016).

According to one interviewee, it was also Iulian Iancu who in October 2009 registered an amendment to Gas Law no. 351/2004 in place at the time to outright ban gas exports from Romania in primary legislation (EX ROM 2 2016). Parliament voted positively on this amendment at the end of 2011, but as mentioned before the President vetoed the law and sent it back to the parliament (publics.bg 2011; UPS ROM 2 2016). It eventually did not come into

[38] At the time of the finalising this thesis, in late 2016, Iulian Iancu was still chairing the parliamentary Committee for Industries and Services.

force.[39] The leadership position in the influential Committee occupied for more than a decade by a politician who resisted exporting Romanian gas strengthened the anti-integration *interest structure* in Romania.

There were more 'special' actors attempting to influence the Romanian gas market than in Hungary or Lithuania. In addition to the Commission, the IMF and the WB joined the domestic *interest structure* in the gas sector, especially starting from 2011, after they gained insights into the Romanian gas sector while providing financial assistance to the Government in 2009-2011. Three 'arms' of the Commission attempted to influence the status of the sector, DG Energy, DG Economic and Financial Affairs (DG ECFIN) in general financial assistance and DG Competition by executing unannounced inspections in state-owned gas companies Romgaz and Transgaz and the private OMV Petrom in 2016 (Yun Chee and Ilie 2016). As seen in stand-by agreements with Romania, other documents and press releases, all those transnational actors were seeking liberalisation of the Romanian gas sector, and, especially the Commission, exports of gas.

The actions of one more 'special' actor, ANRE, have shifted towards more liberalisation from mid-2012 (GOV ROM 2016), when ANRE was moved from under Government to under Parliament. The electricity regulator (ANRE) and the natural gas regulator (ANRGN) used to be under the coordination of the energy minister, then under the direct coordination of the Prime Minister (ANRE 2007). The president and a vice-president of ANRG were appointed by the Prime Minister of Romania for a five-year mandate (ANRGN 2004, 1) Among other things, the ANRGN was responsible for 'full liberalisation of natural gas internal market' (Parliament of Romania 2004, Article 8). Yet, when the NRA was under

[39] The amendment stipulated that domestic production natural gas should be sold exclusively on the domestic gas market, except for the case when the production of natural gas shall exceed the domestic gas consumption for a certain period. This proposal initially has been voted positively by the Senate and by a big parliamentary majority in the end of 2011. However, it was not promulgated by the Romanian president Traian Băsescu, who sent it back to the Senate for re-examination in January 2012. Eventually this initiative was rejected.

the governmental supervision, it 'felt the pressure and set the prices according to the pressure – it was like politically driven price-setting mechanism' (Sîrbu 2016). Officially, it was ANRE, which had much say in setting the end-user prices. However, it was ultimately Government, and not the NRA, which decided the level of end-user prices for households (and until January 2015 for the share of non-household consumers before they were liberalised) every July. Thus, even though it is deemed as more independent and pro-liberalisation, ANRE may not have enough tools to push for liberalisation. As seen by a Commission official, in practise the final decision was made by Government by 'putting the regulator under pressure that they are not allowed to regulate above a certain amount'. The interviewee shortly added: 'if you do not do what the Prime Minister wants – you will be gone' (COMM ROM 2016). Indeed, between 2005 and 2010, ANRE's president was changed five times, despite five-year mandates (Murafa 2011, 46). However, after the reform in 2012, the turnover of the leaders of the regulator stabilised, and ANRE since then has had the same president Niculae Havrilet (ACER 2015a). One expert commented:

> Even though he had been appointed before the law [changes in 2012], he remained. Now the Government changed, but he remained, and so on. Now he has some independence because of that. He actually pushed for the liberalisation of the gas market. Probably they didn't want to [remove him] because it was somehow under the radar of the Commission, it continues to be under the radar. I think it was much easier to change the people when they were in the end of the Government (EX ROM 1 2016).

Under the leadership of Niculae Havrilet, ANRE indeed acted as a pro-integration actor, at least in public. For example, in June 2014, ANRE suggested to the Government that it should move to the next step in liberalisation of the non-household consumers segment starting July 1, 2014, and not the end of 2014, as had been planned (EnergyWorld Magazine 2014).

The shares that the Romanian state held in important Romanian gas companies added these companies to the dominant *interest structure*. The Romanian state controlled the

Romanian gas transmission system operator, Transgaz (European Commission 2013b, 2), and one of the two main gas producers Romgaz (ANRE 2013, 105; Romgaz 2016). Romgaz was a vertically integrated gas company having activities on many levels of the gas sector, natural gas exploration and production, supply, storage and power generation and supply (Romgaz 2014, 4), and it also occupied 90% of the storage market share (Romgaz 2014, 5).

Gas producers in Romania were deemed by many interviewees as having a strong interest to export (Dudau 2016; UPS ROM 1 2016; UPS ROM 2 2016), especially the private OMV Petrom. An interviewee from an upstream business commented that as an upstream company (even Romgaz, which was state-owned) could not just say 'it is fine with the regulated prices now'. The person said: 'No way. You need to have a perspective, an assurance that at some point the price will be covered by market conditions' (UPS ROM 1 2016). OVM Petrom openly sought a possibility to export gas, and also benefited from end-user liberalisation by being able to sell gas directly to end-users on the competitive segment. OVM Petrom became especially in favour of a liberalised market and the possibilities to export gas after it, together with the US ExxonMobil, discovered potentially large resources of gas in the Black Sea's Neptun block in 2012. The profitability in gas production very much depends on transportation possibilities of this gas and where it can be sold (IND ROM 1 2016). For example, in a conference in Brussels in 2015, Alexandru Maximescu from OMV Petrom claimed:

> We need a free market – not only free market rules respected, and we have a price liberty that should be there, but also to have interconnections with other member states. […] Romania is subsidising the households via gas price. Despite your income and size of the house, households are benefiting from subsidised price for gas. It discourages energy efficiency. Politicians should change their mindset and strategies should target the vulnerable consumers (Natural Gas Europe 2015).

Being a state-owned company, Romgaz was more silent in public about gas exports. Moreover, it even saw 'social pressure due to increase in price [in end-user liberalisation]' as a threat to

its business in its SWOT analysis (Romgaz 2014, 16). This company thus remained in the anti-liberalisation actor coalition with the government. OVM Petrom, on the other hand, can be identified as belonging to the same pro-liberalisation 'actor coalition' with the European Commission, IMF and WB.

Russia's Gazprom's role in Romania was dual. On the one hand, due to the large share of domestic gas production, Gazprom's share and gas supply contract was less important in Romania than in Hungary and Lithuania. On the other hand, as Romania is a transit country for Russian gas, Gazprom's exercised its limitations by booking the transit pipelines from the both sides, Ukraine and Bulgaria.

The downstream (retail) gas sector in Romania consisted of so-called competitive and regulated segments. The former included trading on wholesale level (between suppliers) or retail level (between suppliers and eligible customers) using prices based on demand and supply. The latter one included natural monopoly activities and gas supply at regulated tariffs established by ANRE (ANRE 2013, 104, 2015b, 37). On the retail side, there were the same foreign investors present in the Romanian DSOs sector and regulated supply as used to be in Hungary, but more concentrated. GDF SUEZ Energy Romania and E.ON Energie Romania shared almost 90% of the regulated market segment (ANRE 2016, 95). Downstream companies belong to the Federation of Associations of Energy Utility Companies (ACUE 2016).

The positions about liberalisation of the two main regulated suppliers, owned by E.ON and GDF Suez, has changed with time, according to some interviewees. In an early period, they sought liberalisation, but in the later period return of some of their financial losses depended on whether, conversely, their clients remain regulated. In 2009, when the financial crisis hit Romania, companies that served domestic consumers were bound between the more expensive price for gas and the requirement to keep a fixed share of domestically produced gas supplied to their consumers. During the crisis, large gas consumers, mainly a large fertiliser producer

InterAgro due to favourable regulation started receiving cheaper gas than suppliers that bought gas for households. The large consumers could get only 'fresh production' from the gas producers, whereas the suppliers to households had to buy gas held in storages, thus, the storage tariff was added to the price. Moreover, as the pattern of the household consumption is more fluctuating than the of the industry, the suppliers covered a much bigger share from imported gas in peak times. ANRE, however, allowed to pass through the costs only according to the 'basket' principle – as if the much larger share (70% as required) came from the cheaper domestic production. These suppliers had a 'huge loss', and later ANRE reportedly calculated tariffs that helped the aforementioned regulated suppliers to return what they had lost in the period. This return is only possible as long as prices remain regulated (EX ROM 1 2016). Indeed, in 2014, high level officials of these regulated suppliers were quoted in media as seeking to extend the consumer liberalisation deadline, rather than to implement it faster. For example, president of E.ON Romania Frank Hajdinjak in 2014 claimed that if non-households get deregulated a half a year earlier, 'This step is very dangerous for the industry and for all operators in the gas sector, because consumption will drop, the quantity supplied will drop and we will lose consumers' (EnergyWorld Magazine 2014).

Larger non-household energy consumers in Romania were more or less pro-liberalisation, except for a very important actor which, mentioned above, InterAgro. Based on the information provided by some interviewees, it could be placed in the anti-integration *actor coalition*. As one interviewee said, the early steps of consumer liberalisation in Romania were marked by 'very opportunistic behaviour by medium size and large customers, who very quickly became eligible and started negotiations, whereas among small enterprises and households the process was much more reluctant' (Sîrbu 2016). At the early stages of gradual liberalisation, which started from 10% of the total gas consumption and the largest consumers, 'there was quite a fight from big customers to be there [liberalised]'. However, when the market

opening reached 40-50%, and smaller business consumers could enter the free market, 'we did not have any more customers [that wanted] to be there' (Sîrbu 2016). Interestingly, even though large business consumers benefited from becoming eligible to switch gas suppliers, the co-existence of free and regulated prices, especially during the period when they could still come back under the umbrella of the NRA, was beneficial to them. This was because 'regulated prices was always functioning as references; so basically the power of the companies to negotiate their prices is based on the reference price, from which they are asking for discounts, price reduction or more advantageous contractual conditions' (Sîrbu 2016). Conversely, InterAgro 'was getting a lot of cheap regulated gas' as long as it remained non-liberalised (EX ROM 1 2016).

Table 6 summarises the most relevant actors and their stances in Romania. It shows that the political hemisphere was fully dominated by anti-integration *actor* coalition, whereas other actors were more varied in their interests.

Table 6 *Interest structure* with regard to sector liberalisation and cross-border gas trade in Romania (based on multiple media and interview sources)

Type	Actor	Power	Stance vis-à-vis liberalisation	Stance vis-à-vis exports
Executive actors	Presidents	For two consecutive terms from 2004 to 2014 the President was Traian Băsescu	Vocal against it	Vocal against it
	Governments	Frequently changing governments, but all of them seemed to favour to regulating end-user prices and slowing down gas exports; Often broad coalitions that entail no left-right competition; Making use of emergency ordinances	Actions postponing phasing-out regulated prices	Inaction to allow exports
Legislative actors	National Parliament	The most influential Committee for Industries and Services led by Iulian Iancu from 2006	Actions to delay liberalisation	Actions to delay exports
Special actors	National energy regulator (ANRE)	Frequently changing leaders before mid-2012; Under the Prime Minister before mid-2012	From mid-2012 more vocal pro-liberalisation	Not identified
	European Commission	Uses all the power it can	Very much for	Very much for
	IMF and World Bank	Financial conditioning	Very much for	For
Large consumers	InterAgro	Largest single gas consumer of Romania before 2015-2016	Against (for preferential prices)	Not identified
	Other large consumers	Less important by the share of their consumption than InterAgro	They wanted to be liberalised, but the co-existence of the regulated prices was beneficial to them in price negotiations with the suppliers as a 'reference price'	Unclear
Producer	OMV Petrom	From 2016 may increase because of large gas deposits found	Has been seeking it	Has been seeking it actively, but has been under the DG Competition investigation

	Romgaz	State-owned; thus, strengthens political interest	Silent	Silent, DG Competition investigation
Transmission	Transgaz	State-owned, thus, strengthens political interest	Silent	Inaction to interconnect; DG Competition investigation
Retail	E.ON subsidiary	Market concentration	Pro-liberalisation before 2013	Unclear
	Engie subsidiary	Market concentration	Pro-liberalisation before 2013	Unclear

6.2 The Commission vs. Romania

Just as a 'Cat and Mouse' game is defined as 'a contrived action involving constant pursuit, near captures, and repeated escapes' (Merriam-Webster 2017), the relationships between the Commission and Romanian politicians with regard to the Romanian natural gas market did not bring a definite victory to any of the two sides. When it seemed that one side had made the final step, the other side made one more.

Having identified the dominant *interest structure* in Romania, the rest of the chapter shows that the next three steps of the 'EU leverage' mechanism were also in place in Romania. However, since the divergence from EU single gas market policies in Romania was coming from many different directions at different time periods, it would take too much space to lay down all the stories and all the actions by the Commission. Therefore, actions both from Romanian domestic actors and from transnational actors are bundled by topic, and are presented in a chronological manner only in part.

Romania joined the EU almost three years later than Lithuania or Hungary, on January 1, 2007. The country, however, underwent the pre-accession process, where it had to comply with the EU rules, including the ones regarding the internal market legislation (Trauner 2009, 9). In spite of spending almost a decade in the EU at the end of the research period, Romania's natural gas market was picking the momentum to comply with relevant EU regulations and moved towards market integration slowly. The approach towards regulating gas market in Romania possibly the best can be described by a quote by one interviewee: 'It's a very complicated thing. We can do things like that until we confuse everybody, including the Commission' (EX ROM 1 2016). There were two main EU requirements with which Romania's compliance was stalling: consumer liberalisation (phasing-out regulated prices) and cross-border gas trade. As there is a variety of reasons that lead to those issues, Figure 11 attempts to combine the main groups of them. They are explained in the rest of this section. In

the figure, grey colour indicates physical reasons, yellow- regulatory, blue – legal and green- a combination of legal and regulatory.

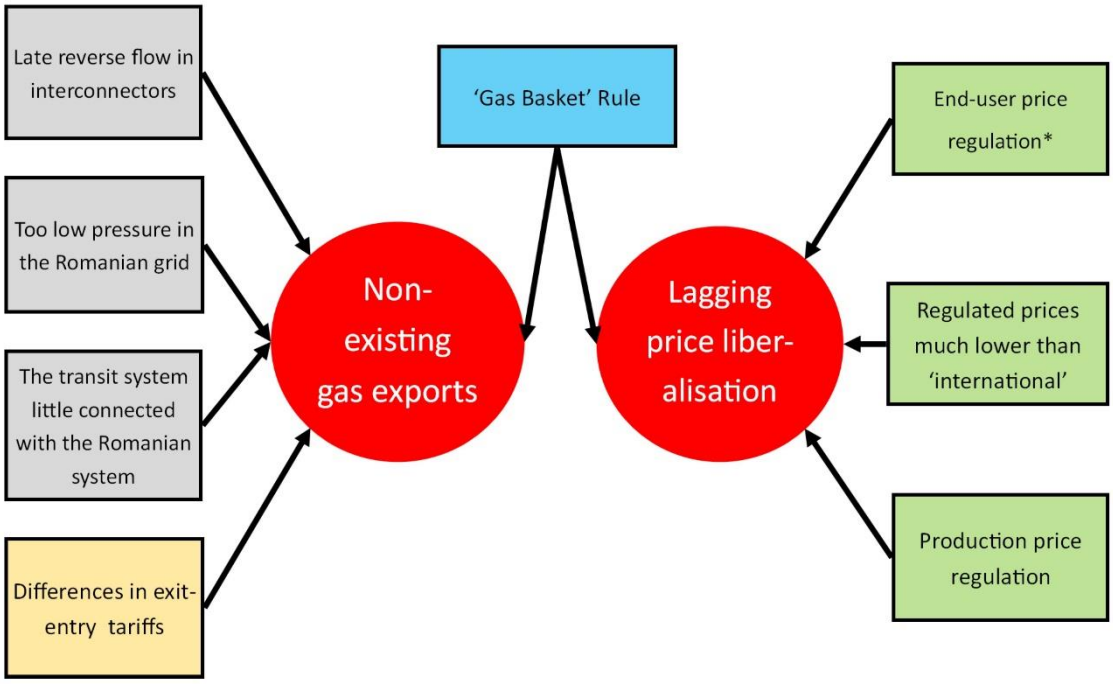

Figure 11 Two main most contentious issues between the Commission and Romanian policy makers and what led to them

Romanian politicians for a number of years avoided final liberalisation of consumers, especially household, and phasing-out regulated prices in Romania had a long history of promises and attempts. Gas prices in Romania were regulated on two levels – on end-user level and on production level for the share of gas that went to regulated end-users. The share of regulated production prices initially was 100% in line with the share of regulated end-users. By the end of 2016 of around 40% of Romanian gas production, which was destined to households and district heating, had its price regulated. The regulation of production prices was meant to be phased out by 31 March 2017, which falls out of scope of this dissertation. Before mid-2015, ANRE was putting an upper limit on the price paid for domestic gas producers when it recognised only a certain price level for the domestic gas in the regulated end-consumer price

(UPS ROM 2 2016).

Gas prices in Romania had been regulated for decades, not only during the communist period but also during the transition period after the 1989 revolution. The process of formally liberalising the Romanian natural gas market lasted from 2001 to July 1st 2007 (ANRE 2015a). Two and a half years before the EU accession, in July 2004, the Romanian Parliament approved the Gas Law no. 351/2004, which stipulated a progressive elimination of regulated tariffs first to non-household consumers, and then to household consumers, following the requirements of the Second Natural Gas Directive. Based on this law, all industrial consumers formally became eligible to switch suppliers from January 2007, and 100% for all customers (including household consumers) on July 1, 2007 (ANRGN 2004, 27). In practise, however, it was different. For example, data on the share of consumers eligible to switch suppliers reported by the Romanian energy regulator shows that the share of natural gas sold under eligible terms from 26.38% in January 2003 increased to 66.57% in December 2015, which is far from 100% which was supposed to be reached already by July 2007.

Therefore, phasing out regulated gas prices was recorded in almost every financial support agreement to this country from 2011 as a part of conditions required by the European Commission, IMF, and the World Bank to receive assistance. As an interviewee from the Commission said that even though the natural gas directives do not exactly prescribe deregulation of prices, the Romanian approach was very much not in line with the EU requirements. The interviewee said:

> If regulated prices were above costs and other companies could compete on the price below that, then we don't have such a big problem. But at least in Romania we are talking about the prices that are regulated below costs, and that's not something which is in line with the spirit of the directives (COMM ROM 2016).

Moreover, as was written in the third chapter of the thesis, the ECJ in its decision made clear that the regulated prices for business were especially non-acceptable. Yet Romania, even unlike

post-2010 Hungary, kept regulating prices even for non-households eventually until 1 January 2015.

The discrepancy between formally and the really liberalised share of consumers was caused my multiple factors. First, regulated end-user gas prices remained much lower than freely negotiated prices, especially for households and other smaller consumers. Therefore, regulated consumers, especially smaller ones, had little initiative to leave the umbrella of regulated prices. The divergence between domestic regulated and 'international' prices was one of the main subjects that the Commission, IMF and WB approached. One interviewee explained the reasons behind this: 'Companies still have to buy gas on the market – if you can call it like this in Romania – they have distribution costs and other costs, and the regulated prices squeeze the margin to the degree that it sometimes becomes negative. Costs of the system sometimes are higher than the regulated price they get by the regulator' (COMM ROM 2016). Second, the impact of price regulation on free market consumers was also transferred to consumers in the competitive segment because even those that had switched suppliers could go back under the umbrella of price regulation until 2012 (EX ROM 1 2016). This was because before 2012 (adoption of the Electricity and Natural Gas Law no. 123/2012), non-household consumers could choose to enter the free market, but they did not have to do it. Moreover, if fulfilling certain conditions (only once per year, and more) the ones buying gas in the free market could go back to the regulated prices. Such regulation favoured the position of non-household consumers that got liberalised with early waves. One interviewee told:

> The regulated price is always functioning like reference. Basically, the negotiation power of the [consumer] companies that negotiate their prices is based on the reference price for which they are asking for discounts or price reduction. Or can speak about some other advantages, contracting conditions, like more relaxed times paying the bills. [The possibility to come back to ANRE helped with that] because they would negotiate the contracts, while the others would be on a fixed contracts established by the regulator (Sîrbu 2016).

An interviewed energy sector expert explained that as long as large consumers in the competitive segment could 'at any time switch back to old suppliers', all suppliers in the competitive segment were interested to 'keep the regulated price, […] so in fact nobody was liberalised' (EX ROM 1 2016). Only after Parliament adopted the Electricity and Natural Gas Law no. 123/2012 in June 2012, any natural gas consumer who has exercised his right of eligibility (has changed the supplier) could no longer claim the right to return to the regulated market (Stanciu 2015). Still, from 2012 to 2015, as long as they did not exercise this right, non-household consumers could stay regulated. Only from the beginning of 2015 these consumers had only one choice left – they were forced to leave and enter the free market (Sîrbu 2016).

However, when from 1 January 2015 the entire commercial and industrial consumer segment lost the right to be supplied at regulated prices and was forced into the free market segment, Government put a stronger grip on the prices of locally produced gas that would be sold for those remaining under the regulated umbrella. At this time, the regulated supply for households and district heat producers remained. In July 2015 a government decision replaced upstream price regulation previously conducted by ANRE, 'in order to maintain the price of natural gas and heat supplied to households at a manageable level' (Stanciu 2015), as Government was seeking for a solution to keep the costs of district heating low (UPS ROM 2 2016). According to one interviewee, it was actually the first time the domestic producers price was officially and legally set by Governmental Decision and not via lower level energy regulatory tools (UPS ROM 2 2016). This decision laid down an exact annual purchase price for natural gas from domestic production for household clients and district heating companies between 1 July 2015 and 30 June 2021.

Thirdly, from 2001 to 2016, Romanian state imposed on the participants in the gas sector a unique regulatory framework, referred to as the 'Gas Basket Rule', which ensured that

even the officially eligible consumers in one or another way remained regulated indirectly. The 'Gas Basket Rule' meant that the natural gas suppliers had a requirement to sell to all, regulated and not, consumers a certain mixture of domestic and imported natural gas ('Gas Basket'). Suppliers subsequently had to buy a certain share of import and domestic gas. The regulated consumers paid a weighted average price for the 'basket'. The price consisted of a large share of the (cheaper) locally produced gas and a smaller share of (more expensive) gas imported from Gazprom. The requirement even to those suppliers that sold gas to the consumers in the competitive market segment to use the regulated mix of domestic and imported gas translated into indirect regulation even of the free market consumers.

As long as there 'Basket Rule' and the end-user price regulation remained, it discouraged competition among the gas producers. Each month ANRE would set necessary quantities for households. The suppliers that have households in their portfolio had to make sure that they have that gas sourced from the gas companies, who in turn were obliged to sell first to household consumers. Producers, thus, needed to keep the gas available for such purposes, but this 'saved' gas eventually was purchased from each of them for exactly the same price if it was destined for regulated end-users. One interviewee rhetorically asked: 'And then how can you even compete when the price is regulated? If the price is the same? Because they both sell for the same price, and the necessary quantities are set by ANRE' (UPS ROM 1 2016).

With regard to the other major aspect of contestation by the Commission, cross-border trade, there were three main groups of obstacles for Romanian companies to export domestically produced gas to neighbouring countries in different periods: physical, legislative and regulatory. This resulted in Romania being the only EU country that produced significant amounts of gas (actually being the fourth largest producer in Europe), but did not export any (Enerdata 2016). Main physical reasons that hindered exports were two. First, the gas transit system from Ukraine to Bulgaria was 'not linked to the national system, which also made it

difficult to export gas because all the export pipelines are former transit pipelines' (COMM ROM 2016). Russian gas is transited north-south from Ukraine (Isaccea) to Bulgaria (Negru-Voda) and further to Turkey and the Balkans through three networks built in 1974-1996. Those three networks 'are totally separated from the National Transport System of Romania's Transgaz' (Cireasa 2013). There is a connection close to Mangalia which only allows off-take from Transit I (Bulgarian line) (UPS ROM 2 2016). Second, the pressure in pipelines on the Romanian side is almost twice lower than on the Bulgarian and Hungarian sides. The historical origins of this low pressure are explained by the fact that Romania is a 'gas producing country, and low pressure in the system pushes gas production' (UPS ROM 2 2016). Leaving those reasons aside, some of more informed interviewees claimed that the pressure issue could be solved by building several compressor stations which would neither take very long, nor be very expensive compared to building interconnectors or doing other infrastructure investments. An interviewee from the Commission concluded: 'The pressure issue is an excuse' (COMM ROM 2016). Another one commented: 'By creating a volume pressure you automatically create a price pressure' (UPS ROM 2 2016). An expert linked those delays with intentional actions from the Romanian side: 'The thing was that we had to make some compressor stations to push the gas outside. If we delayed, we found all the possible means to delay. We were so happy that we changed the Procurement law and we could not do this' (EX ROM 1 2016).

The third reason was the lack of bi-directional flow on interconnectors (reverse flow) in the interconnector with Hungary, which in turn was the connection with the Western Europe. Even though in theory the newly built in 2010 Romania-Hungary interconnector was bi-directional, the real flow possibilities in the direction Romania-Hungary were minuscule. This was again related to differences in pressures.

Legal obstacles to export domestic gas from Romania, such as laws or ministerial orders, also came from several directions. One was the effects of the aforementioned 'Basket

Obligation'. As producers of typically cheaper gas than imported from Russia had to make it available on the national market within the regulated mixture, this obligation indirectly restricted exports of locally produced gas (UPS ROM 2 2016). Second was the export restriction was related to the 'Basket Regulation'. Several legal tools directly obliged domestic gas producers to make their production available for the domestic market. Under Order No. 102136/2006, holders of petroleum permits are, with few exceptions, obliged to make available their entire gas production for the domestic market so as to ensure the domestic production components of the Gas Basket. In June 2011, an order issued by the Ministry of Economy, Trade and Business Environment, ANRE and National Agency for Mineral Resources together, again stated that the holders of petroleum agreements were required to make available the *entire* natural gas production from domestic resources to ensure components in gas mixture structure (another name of the 'basket') set out / approved by ANRE.[40] In April 2013 it was repealed, as one interviewee told, 'by the pressure of the European Commission' (Vosganian et al. 2013; UPS ROM 2 2016).

The regulatory obstacles were related to differences in entry-exit tariffs charged on the same border points by regulators of both Romania and the bordering country. A study showed that in 2015 the Romanian side charged approximately twice bigger entry-exit tariff than the Hungarian regulator for the same interconnector on the border (5.42 EUR/MWh compared to 2.6 EUR/MWh end of January 2016 (Kaderják 2016, 6–9). As one interviewee from Hungary claimed that the differences in tariffs were intentional. He said:

> For Romania, this sort of interconnector is a diversification option, because they have a domestic production and Russian import and through this Hungarian interconnector they have an access to the German and Western market. But they do not want to export cheap domestic gas; this is why they find ways to object trading on this. First, they did not want to make this interconnection bidirectional, but then the IMF came and others came and

40 In effect from 23/06/2011 to 01/04/2013, repealed by Order no. 622/2013 issued in 28/03/2013 (Ministry of Economy of Romania 2011).

> they finally put in place physically the bidirectional thing. How can you further deteriorate this? They established very high tariffs for gas exports with Hungary (EX HUNG 1 2015).

As shown below, the Commission actively tried to enforce compliance of EU gas policies in Romania.

6.3 Infringement procedures and financial conditionality

The Commission was intervening in the way Romanians manage their natural gas market in two ways. The first way was relating the gas sector liberalisation to financial support to Romania, be it general financial support to the Romanian budget or specific support for energy projects of Romanian interests (CESEC). The second way is to act as a watchdog in regard to 'enforcement' instruments available to the European Commission. During the research period, the Commission both started infringement procedures against the Romanian state and executed 'dawn-raids' in Romanian natural gas companies. As the Commission at some periods of time applied several different actions with regard to the same aspect at once, the actions by the Commission are analysed chronologically and not by type. The further analysis is synthesised in Figure 12 on the next page, which visualises the massive amount actions that the Commission held in order to pressure Romania to liberalise its natural gas market and/or allow gas exports. Many of the actions targeting the same spheres even overlapped. In the figure, blue code indicates that the Commission enforces compliance according to the internal market (liberalisation) rules, red – to diversification (cross-border trade) and violet – rules related to the both aspects.

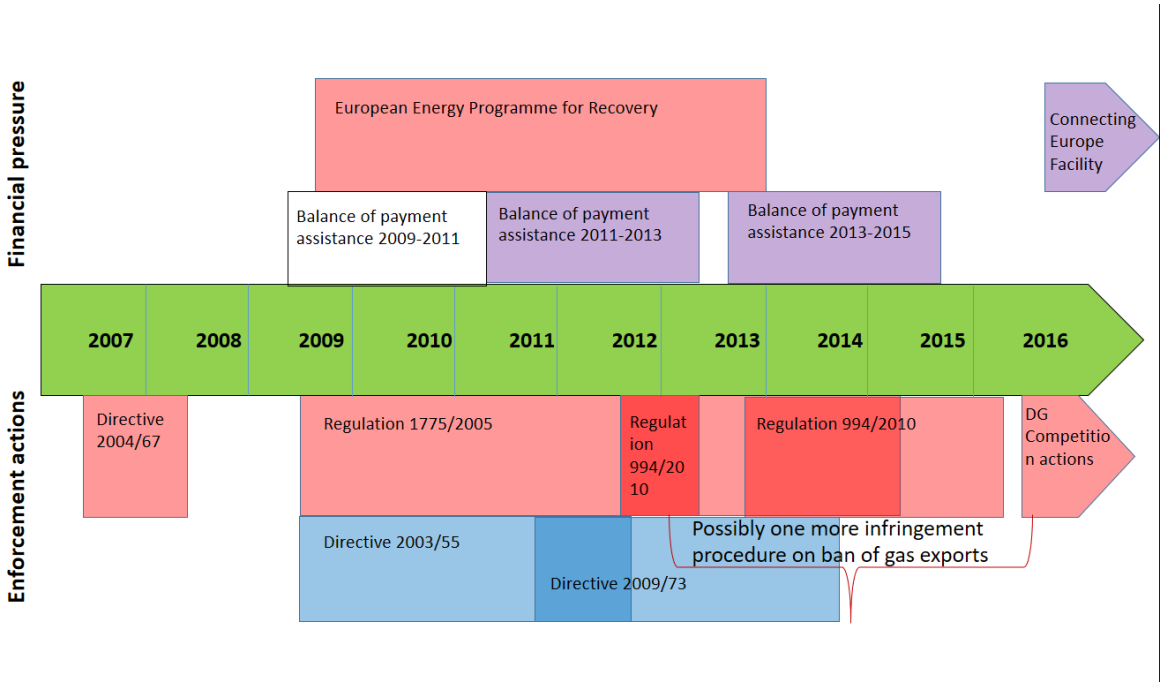

Figure 12 Infringement procedures and financial pressure by the Commission regarding the Romanian natural gas sector

Romania has been facing multiple procedures from the Commission, three of them moving to the stage in the European Court of Justice. The Commission had infringement procedures open against Romania both with regard to the internal market directives (Second (2003) and Third Natural Gas Directives (2009) and, unlike in Hungary and Lithuania, the EU-level security of supply legislation (the Security of Supply Directive of 2004 and the subsequent Regulation of 2010) (European Commission 2015a). With regard to the latter regulation, the Commission opened infringement procedures twice. First it was opened at the end of September 2012 (closed at the end of February 2013). The second procedure about the same regulation was opened in November 2013 and closed just at the end of April 2014, after earlier it reached the third stage, referral to the ECJ.

In June 2009, the Commission started an infringement procedure with regard to the Second Natural Gas Directive (2003/55) because of regulated prices. This first procedure was closed only at the end of September 2012, a year after the Commission opened an infringement for the subsequent, Third Natural Gas Directive (European Commission 2015a). On the same

day when the aforementioned infringement procedure was opened, the Commission started an infringement procedure on the transparency of conditions for access to the natural gas transmission networks based on Regulation that define the conditions (1775/2005) (European Commission 2009c, 2009a, 2009b). According to media, Romania was accused of failing to supply a reverse flow (from Bulgaria), connect the pipelines dedicated exclusively to the Russian gas to the Transgaz National Transport System, and make the contract with Gazprom transparent.

These transit networks are referred to as I, II and III pipelines. The commercial agreement between Transgaz and Gazprom for 'Transit II' was supposed to expire at the end of 2015, and to become free of obligations, need to allow third-party access and reverse flow, comply with the EU Third Energy Package. However, so far it does not comply with the EU regulations, as the 'Transit II' contract was prolonged until the end of September 2016 (Energy News 2016). Moreover, those transit pipelines on the Ukrainian side had been booked until 2019, and on the Bulgarian side the capacities are booked by Gazprom until 2030, thus, as one interviewee summarised, 'the capacities are booked up and down' (SE ROM 1 2016). As Transgaz did not publish Russian transit gas flow data at entry and exit points with Ukraine and Bulgaria, it was against the transparency requirements by EU legal order and attracted criticism from EU officials and a possibility of an infringement procedure by the European Commission (ICIS 2015). Transgaz explained its failure to publish data on the entry and exit points of the transit pipelines because of its contractual obligations to Gazprom (ICIS 2015). This means that Gazprom was strong enough to contain Romania from complying with the EU transparency requirements. According to one interviewee from the European Commission, Romania attempted to start negotiations with Gazprom about applying the EU rules on one of the transit pipelines and invited the European Commission: 'The Commission was invited to take part because they would not have been able [without]... But Russia has never accepted the

renegotiation' (COMM ROM 2016). This infringement procedure was very long and was terminated 2015 after a referral to the ECJ (European Commission 2015a).

As Romania did not have derogation from the Third Natural Gas Directive, the same deadline for transposition of the Third Natural Gas Directive applied as for any other member state, namely March 3, 2011. However, in absence of communication about transposition, the Commission started an infringement procedure in September 2011. Lithuania, who at that time was still involved in disputes with Gazprom and E.ON because of the ownership unbundling option it chose, was also included in the same infringement package. On February 27, 2012, the Commission moved the infringement of Romania and seven more member states (but not Lithuania) to the second stage, reasoned opinion, for not transposing the Third Natural Gas Directive (European Commission 2012a, 2012b). In June 2012 Romania adopted an Electricity and Natural Gas Law no. 123/2012, which was meant to transpose the Third Natural Gas Directive. However, on 21 March 2013, continuing the same infringement procedure the Commission referred Romania to the ECJ for only partial transposing the Directive. The Commission noted that even though Romania had at that time 'adopted a considerable amount of legislation required by the electricity and gas Directives, […] some provisions still remain to be transposed into national law'. In particular, these provisions relate to the protection of consumers and some duties of the NRA (European Commission 2013c). The Commission proposed a daily penalty to Romania for incomplete transposition of 30,228.5 Euro (European Commission 2013c). It closed this infringement procedure only in October 2014 (European Commission 2015a).

Moreover, even though there is no such information in the Commission infringement decisions database, media accounts and press releases hint that in November 2012 the Commission started one more infringement procedure because of Romania's 'ban on gas exports' (Agerpres 2012; Natural Gas Europe 2012). It moved to the second stage in July 2014.

The Commission stated, that, by obliging the producers in Romania to give priority to sales on the domestic market and by submitting gas transactions to prior control and approval, the Romanian legal framework created 'unjustified barriers to exports of gas from Romania'. In the opinion of the EC, Romania failed to fulfil its obligations under the Treaty on the Functioning of the European Union and under Directive 2009/73/EC (European Commission 2014b).

The Commission 'enforcement' strategies in Romania did not stop with the multitude of infringement procedures. When all the above listed procedures were closed, in summer 2016 the Commission DG Competition executed unannounced inspections ('dawn-raids') because of alleged collusion between Romanian companies OMV Petrom, Romgaz and Transgaz to block gas exports (European Commission 2016e; Yun Chee and Ilie 2016; Intellinews 2016). The Commission antitrust investigation here was only at the starting stages during the finalisation of the thesis; thus, the effects of this investigation cannot be discussed here. It is important to note, though, that unlike in Lithuania or Hungary where in 2011 the Commission dawn raided mostly privately owned companies in suspicions that they hindered the internal market, in the Romanian case two out of three raided companies were state-owned.

The story of the Commission participating in co-financing with the IMF general economic recovery of Romania shows that the Commission first was learning about the Romanian gas sector and later, in the next stages of the financial support, conditioned it with the liberalisation of the sector. By the beginning of 2009, Romania was severely hit by the global financial crisis (IMF 2009a). Altogether, during the research period, the EU in addition to the support by the IMF and WB, assigned three general financial assistance programmes to Romania, referred to as Balance of Payments (BoP) programmes. In March 2009, the IMF announced about its intentions to lend 12.95 Billion EUR loan to Romania as part of coordinated financial support. The EU was simultaneously announced as ready to provide a

loan of 5 billion EUR, following approval by the Commission and the European Council (IMF 2009b). A two-year Stand-By Arrangement was organised within a couple of months by May 2009 (IMF 2009c). The first programme was fully disbursed. The energy sector was rarely mentioned in the letters of intent or the frequent reviews of the Stand-By Arrangement in the 2009-2011 period. However, as one interviewee expressed, because of this 2009-2011 macro-economic stabilisation programme, the IMF, the Commission and the WB went 'very deeply into structural reforms and started pushing the energy package, reform of the health care and so on, so in 2011-2012 the whole thing started again towards [the gas sector's] liberalisation' (EX ROM 1 2016).

The situation has changed when the 2009-2011 Stand-By Arrangement ran out, and Romania in spring 2011 requested one more arrangement. In those programmes, DG Energy accompanied DG ECFIN (GOV ROM 2016). The new financial support programme by the transnational institutions for 2011-2013 aimed at 'deep-rooted reforms in the energy and transport sectors, including pricing reforms, improved regulation, and the restructuring and privatisation of energy and transport state-owned enterprises' (IMF 2011, 4). The IMF required to restore the ANRE's 'operational and financial autonomy in accordance with the Third Energy Package' and 'complete removal, according to EU directives, of regulated prices for non-households in electricity and gas before the end of 2013 and complete the process by end-2015' (IMF 2011, 58). In addition to the IMF's new wave of support to Romania by about 3.5 billion EUR, in summer 2011, the Commission designated 'precautionary' 1.4 billion EUR. The Commission made this financial assistance available for activation until 31 March 2013 with 'conditional upon the implementation of a comprehensive economic policy programme' (Boc, Rehn, and Ialomitianu 2011, para. 1). This included deregulation of the price-setting, increased market access and transport capacity to build a 'fully functioning, integrated and interconnected internal market in electricity and gas' and creation of a strong and independent

energy regulator (Boc, Rehn, and Ialomitianu 2011, pt. E). Strengthening ANRE's powers and independence, as the Commission and IMF demanded in unison, would have brought the regulator to the pro-integration *actor coalition.* In addition, Romania had to present by September 2011 a roadmap for phasing out gas price regulation and by December 2011 eliminate barriers for cross-border trade of electricity and gas and open negotiations with the Russian Federation to review historical Intergovernmental agreements concerning the 'gas transit' pipelines through Romania as soon as possible (Boc, Rehn, and Ialomitianu 2011, 11–12). In 2011, when these requirements were published, the EU-wide deadline to transpose the most of the requirements of the Third Natural Gas Directive just finished (March 2011), but Romania was getting late.

Despite the Commission leverage to make funding available, Romania was simply missing multiple deadlines to phase-out regulated end-user prices and ensure cross-border trade. Within the period of the second BoP programme, the Commission and Romania updated the MoU's a couple of times, in which the Commission was getting increasingly stricter in demanding to comply, but would agree to move deadlines for the end-user liberalisation further and further. In December 2011, the Commission demanded a notification of the Third Natural Gas Directive as soon as possible, which 'should ensure a full and correct transposition of Directive' and should reflect 'the commitments of Romania under the Memorandum of Understanding' (Boc and Rehn 2011, para. 22). The Commission, however, gave time until end-of January 2012, and no longer September 2011, for the Romanian Government to prepare a detailed roadmap for the phasing out of regulated prices in electricity and gas for non-domestic and domestic customers. This roadmap had to be agreed by the Government with ANRE, the Commission and the IMF, after which the Government had to adopt a decision and submit it to Parliament 'for adoption through national legislation as soon as possible' (Boc and Rehn 2011, para. 23).

The wording of the Second Supplemental MoU, in June 2012, was very similar to the previous supplement of December 2011, only the dates when Romania had to comply were moved again. The requirement to remove legal and regulatory barriers to the export of gas had to take place 'as soon as possible', and no longer by December 2011, which had passed already. Now the adoption of a detailed roadmap for phasing out regulated prices in gas for non-domestic and domestic customers through a government memorandum was required by mid-June 2012, and no longer by January 2012. The deadline to deregulate prices for non-household consumers was moved to 'as soon as the price for domestically produced gas converges with the average European market price for gas, but not later than by 2014'. If a large gap remained between the average European price and the import price, deregulation could be postponed until end-2015 for non-domestic consumers. For households, regulated gas prices had to be increased starting in July 2013 and converge to international gas prices no later than December 2018 (Ponta et al. 2012, para. 26).

The MoU for the BoP assistance programme of 2013-2015 was signed already after Romania in mid-2012 adopted a law to transpose the Third Natural Gas Directive, in November 2013. Prescriptions for action in the gas sector were less detailed than in the previous BoP programme, but Romania is still obliged to implement 'outstanding measures agreed under the two previous programmes, […] among which the implementation of the roadmaps for the gas and electricity market liberalisation' (Ponta et al. 2013, sec. E). As one interviewee noted, in the process of giving the BoP support to Romania, the Commission 'was not taken as seriously as IMF, [it could be seen] from the way they treated the people, and also the most of the money came from the IMF' (COMM ROM 2016). This observation, if the perception of the interviewee was correct, would confirm that the Romanian politicians that negotiated with 'the transnational institutions were following the logic of consequentiality.

When the period of the BoP support was over, the Commission used another avenue to

influence the functioning of the Romanian gas sector, namely, the direct financing of natural gas projects. This was done via two funds, the European Energy Programme for Recovery (EEPR) and via Connecting Europe Facility (CEF) which was created for the period 2014 and 2020.

In 2009-2010, the Commission started four projects of support by the EEPR in the Romanian territory, namely, Nabucco (unclear amount of funding), reverse flow on the transit pipeline crossing Romanian territory to Bulgaria (EEPR support 1.56 Million EUR), and building the Romania-Hungary (EEPR support 16.5 Million EUR) and Romania-Bulgaria (EEPR support 8.9 Million EUR) interconnectors (European Commission 2013d, 2013e, 2013g, 2016c). The promoter of these projects on the Romanian side was the state-owned TSO Transgaz.

All four projects met problems in one way or another. Nabucco was cancelled for the reasons beyond Romania's control. However, the remaining three projects had difficulties of their own. Only one of the three other projects was accomplished on time: it was the Romania-Hungary interconnector (Csanadpalota), commissioned by the Hungarian FGSZ and the Romanian Transgaz, inaugurated in October 2010. It was the first interconnection between the high pressure pipeline networks of the two countries. However, despite the time length since it was commissioned, by the time of writing no significant amounts of gas were exported from Romania, whereas occasional imports from Hungary took place (Transgaz 2017). The Romanian-Bulgarian interconnector (Ruse-Giurgiu) was repeatedly delayed over the years and inaugurated only in November 2016 (Leviev-Sawyer 2016), instead of the end of 2013 as it had been planned (European Commission 2013e). Even at the end of February 2017, there has not been recorded a single instance of flow of exports or imports in the newly opened interconnector with Bulgaria Ruse-Giurgiu (Transgaz 2017).

The reverse flow project on a transit pipeline crossing the Romanian territory to

Bulgaria was delayed for so long that the Commission cancelled the support for it. As the third project aimed to enable the using on the transit pipeline crossing Romanian territory to Bulgaria (Isaccea (border with Ukraine), Negru Vodă (border with Bulgaria), had not been implemented 'due to technical and commercial difficulties', the Commission terminated the EEPR Financial aid by September 2014 (European Commission 2014c, 13). The aim of the project was to ensure gas supply to Bulgaria from Romania's domestic production and reserves, if natural gas supply from Russia disrupts and to allow reverse flow between Romania and Bulgaria (European Commission 2013h0.) In the 2015 reports about the implementation of the EEPR, the Commission noted that this project was the only project of all reverse flow and interconnections projects in Central and Eastern Europe from the funding programme that has not been completed. Even in mid-2016, it was reported that although a virtual reverse flow was to become available one Tranzit 1 (Isaccea – Negru Vodă) pipeline, physical reverse flows were not (Gheorghe 2016). The aforementioned infringement procedure on transparency of access of conditions to the network was also related to the same pipelines.

The Commission came back once again with funding of the Romanian energy projects in September 2016 when it granted 179 million Euro (CEF) for the development of the Romanian section of the Bulgaria-Romania-Hungary-Austria (BRUA) gas transmission corridor (European Commission 2016g). The BRUAH corridor has been very important for the Romanian policy makers, when the Nabucco project collapsed (Natural Gas Europe 2015). What made the BRUAH grant special was that the CESEC High Level Group, which is chaired by the European Commission, immediately conditioned the BRUAH grant with the *internal* developments of the Romanian natural gas sector. For example, the CESEC High Level Group conclusions paid a special attention (or 'welcomed' as it was written) to 'imminent commencement of work that will ensure effective bidirectional connections between Bulgaria, Romania and Hungary'. It also 'welcomed' 'the legislative, regulatory and operational

measures being taken in Romania by the Government, the National Regulatory Authority and the Transmission System Operator to enable free flow of gas to the regional markets' and paid attention to the Ruse-Giurgiu interconnector (still in construction at that time). Moreover, among the list of regulatory actions which came together, Romania had to resolve the 'gas export restrictions (national law obliges producers to make available with priority their entire gas production for the domestic market (households)' by September 30, 2016 (European Commission 2016f).

6.4 Moving towards gas sector integration

The story so far has shown that the Romanian dominant anti-liberalisation coalition resisted liberalising consumers and exporting gas, whereas the Commission did the utmost to enforce compliance with the EU requirements. There is evidence showing that the Romanian policy makers were aware that, for example, gas exports ban may have financial consequences to the country. This is for example seen in a letter of intent and memorandums submitted to the Commission at the end of February 2012 in order to secure further financial assistance to the country by the representatives of the Mihai Răzvan Ungureanu led Government and the Central Bank. They wrote: 'Finally, we are fully aware that a parliamentary override of the presidential veto of the gas export ban law *could lead to the suspension of the program,* as it contravenes basic principles of the EU single market. We will actively seek to avoid such an override' (Government of Romania 2012). They also promised to submit the legislation to transpose the Third Energy Package for gas by the end of 2012 (Government of Romania 2012, 11). The question, however, arises whether the Commission attempts had any results besides the awareness of possible consequences.

There were at least three bigger occasions when the Romanian policy makers succumbed to the Commission's pressure, although they seemed to take one step forward and two steps back. The first was the transposition of the Third Natural Gas Directive, which took

place in mid-2012 by changing laws related to natural gas and to the NRA, some provisions of the former causing an infringement procedure. Another occasion was in June 2012, when the Government agreed with the Commission and the IMF on the calendar of phasing-out regulated gas prices, which later it delayed. And the third occasion was an emergency ordinance 64/2016 issued in October 2016 by the 'technocrat' Government (in place for one year after the collapse of the Victor Ponta Government in November 2015 (Marinas 2015)) to initiate changes to the Electricity and Natural Gas Law no. 123/2012, the destiny of which were not yet defined by the time of finishing this thesis. These three occasions are analysed below.

Firstly, the transposition of the Third Natural Gas Directive took place when the combination of the pressure by the Commission and collapsing governments in 2012 prompted the Romanian Parliament to capture the initiative. In February 2012, the Prime Minister Emil Boc resigned (Patran and Cage 2012), and was replaced by Mihai Răzvan Ungureanu (Bivol 2012). After less than three months, in April 2012, the Government led by Mihai Răzvan Ungureanu also collapsed (Ciobanu 2012). The new government, led by the social democrat Victor Ponta, came in force in May temporarily before the election planned in December 2012. Despite the political turmoil, in June 2012 the Romanian Parliament passed the Electricity and Natural Gas Law no. 123/2012, which was intended to transpose the Third Energy Package. When asked by whose initiative this happened, an interviewed member of the Romanian Parliament related the transposition to the aforementioned political developments. He said:

> In the end it was our initiative, the parliamentarian, because the Government of country had changed in May 2012, and we had a deadline [to transpose the Directive] in June 2012. So I personally was forced to create pressure together with my party colleagues. […] We collaborated to realise in one month, the last month, all the provisions necessary to approve the law. So it was in the end our initiative, but with the support from the new government, which came in charge in May (MP ROM 1 2016).

He added that since in early 2012 even two governments changed, they were 'enough

blocked with their changeovers', so the Parliament was 'alone on the subject, trying to create the pressure to approve the law' (MP ROM 1 2016).

A part of the law 123/2012, however, required the Romanian natural gas producers first of all to cover the demand on the regulated market, meaning, the households and small and medium enterprises, then to suppliers obliged to use of such quantities of natural gas, and only the rest of its production, to the competitive market segment (Parliament of Romania 2012, Art. 124). In this way, by giving priority to the domestic consumers, it became a part of the bundle of reasons that restrict exports from Romania that were presented in the beginning of this chapter.

The initiative by the Parliament also allowed it to take over the control of ANRE. As it was continuously required by the transnational institutions to ensure independence and powers of ANRE as a part of the transposition of the Third Natural Gas Directive, the Parliament in October 2012 passed one more law, the Law regarding the organisation and functioning of ANRE (Law No.160/2012). According to one interviewed expert, in doing so the Parliament took use of an old emergency ordinance which merged ANRE and the natural gas regulator ANRGN into a single regulator ANRE in 2007 but was never formally discussed in the Parliament. The person said: 'Then, in 2012, Parliament simply took it out, changed every single word of it, and made the new regulator's law' (EX ROM 1 2016). Since then, the Regulatory Committee of ANRE has been nominated and assigned by the Parliament. This changeover, however, resulted in increased pro-liberalisation inclinations of ANRE, according to many accounts. On the other hand, as one person commented responding to a question about the independence of ANRE, 'If you have in mind that ANRE has occasional clashes with the Energy Minister, it does not mean that it can afford to clash with the head of the Industries and Services committee in the Parliament, Mr. Iancu' (Dudau 2016).

The second occasion of the Romanian policy makers conforming with the

Commission's requirements was in the same year, when the temporary Romanian Government (led by Victor Ponta) in June provided the projected increases of regulated natural gas supply prices from 1 January 2014, 1 April 2014, 1 July 2014 and 1 October 2014 and agreed about the liberalisation calendar (ANRE 2015b, 42). Two years later, however, another government, (again led by Victor Ponta) first froze the scheduled price increase for households in July 2014. Then, in September the same year moved their liberalisation to as far as 1 July 2021 (ANRE 2015b, 42). The latter step reportedly came from a Minister of Energy at the time (GOV ROM 2016). Even though the media and the Parliament were informed that the Commission agreed about the delay until 2021 (MP ROM 1 2016), the representative of the Commission said in an interview that they 'did not actually bother to consult us before' (COMM ROM 2016). The same motive appeared in an interview with a Member of Parliament:

> The Minister of Energy from our country informed us […] that they [the Commission] approved in a direct conversation with him the request […] that we have to postpone the roadmap of prices on gas until 2021, because the level of the prices on Romania it was too high to be affordable for consumers. He informed us that this was the status, and he said that we had to change the Law 123 according with this approval. But he unfortunately offered us information which was not realistic one (MP ROM 1 2016).

The important thing is that in 2014 the BoP programmes were over, and at subsequently Romania no longer risked to lose this funding in case of reneging on its promises. This tool of the Commission was gone, and the Third Natural Gas Directive does not explicitly forbid regulation of household prices. The Government was aware of this. One person, close to the Government at that time, when asked whether the Commission threatened with infringements for this issue, responded: 'Infringements for what? I know the European legislation perfectly' (GOV ROM 2016). This occasion is especially consistent with the expectations of the 'EU Leverage' causal process mechanism that anti-integration actors that dominate the *interest structure* would attempt to fulfil minimum EU requirements only or even breach them, as long as it is not costly.

The third significant occasion of the Romanian policy makers seemingly complying with the EU requirements was an emergency ordinance 64/2016 in 2016, which was set to use opportunities of 'international' gas prices falling below the regulated ones and to deregulate all consumers by the end of March 2017. Moreover, it intended to change the article in the gas law adopted in 2012, which stipulated that all natural gas producers had to make available, with priority, for the regulated market the amounts necessary. Niculae Havrilet, the president of ANRE, was quoted as saying that the request for changes 'came from the European Commission' (www.cotidianul.ro 2016). Another interviewee, when asked whether this ordinance was some kind of agreement between the Government and the Commission said, 'I would not call it an agreement because the Commission enforced it' (UPS ROM 2 2016). The emergency ordinance became effective immediately. One person, interviewed in the autumn of 2016, commented that by then 'the balance of power has shifted and now because the largest consumer going to jail and the gas producers not having enough market' (EX ROM 1 2016). The fact that OVM Petrom together with Exxon discovered potentially big resources of gas in the Black Sea may increase the power/leverage of those companies in promoting free-flow of gas across the borders.

However, on the political hemisphere the balance of power not necessary shifted. The technocrat Government was replaced after the general election of December 2016 was won by PSD (Dąborowski 2016). Following this, at the very end of finishing this thesis, when only a month was left for full consumer liberalisation in Romania, some former interviewees indicated that they started getting signals from the Committee for Industries and Services in the Chamber led by Iulian Iancu about the intentions to reject the emergency ordinance. The results of this process are not known at the time of finishing this thesis.

Generally, unlike in 2002-2010 Hungarian or especially the Lithuanian case, every single interviewee described pro-liberalisation changes in the Romanian mainly as response to

pressures rather than pro-active intentions. One expert commented: 'I think that pressure from the Commission, the infringements from non-application and improper transposition of EU Energy acquis has put the pressure required, so the process goes ahead despite some local initiatives to obstruct it.' This person also added the 'train' of liberalisation was already moving in 2016, and had some 'very strong supporters, drivers, pressure being exercised from international financial institutions' (EX ROM 2 2016). Another interviewee, while acknowledging that none of the parties that formed Romanian governments even by 2016 was really in favour of either consumer liberalisation or exports, added that 'this is overdue' and 'they are kind of forced to do it' by the Commission'. Asked whether the Commission factor was enough to finalise the liberalisation in Romania and open gas exports, the person responded positively, via infringement procedures. The interviewee further noted: 'Also in terms of exports, you might have heard that the Commission has just granted the Romanian TSO Transgaz a non-refundable grant of around 170 Million Euro for BRUA. So this is also the kind of leverage that is going to push exports further' (UPS ROM 1 2016). In any case, an interviewee from the Commission expressed deep doubts whether the Commission alone would have gotten so far if the IMF would 'not have pushed in the same direction' (COMM ROM 2016).

Such comments are in favour of confirming the last step in the causal process tracing mechanism of 'EU leverage'. They show that for the majority of the research period Romanian political actors rather reacted to infringement procedures started by the Commission or were incentivised to liberalise and interconnect its natural gas markets by EU funding. The next chapter explores the 'EU leverage' mechanism in the Hungarian natural gas sector from 2010 to test the possibilities to generalise the 'EU leverage' mechanism further.

7 POST-2010 HUNGARY: DIVERSIFICATION VS. RETAIL LIBERALISATION

CH 4 has shown that by 2010 the Hungarian gas sector was approaching consumer liberalisation and cross-border interconnectivity. This was partially due to a combination of MOL's interests and available EU instruments in the balanced *interest structure*. This chapter shows that in mid-2010, the *interest structure* that became dominant towards household prices regulation and managed to reverse the ongoing liberalisation in this segment. The effects of the retrenchment process from liberalisation in the household segment spilled over into the free market segment. As an interviewed former high-level official of the Hungarian Government shortly concluded, 'In Hungary, since 2010 there has been *only* domestic interest, not European' (GOV HUNG 2015). Yet, regardless of the political measures that diverged from the EU aims in the household segment, the EU still had an impact on the cross-border diversification of the country. Fidesz continued the diversification of natural gas supply routes, started by FGSZ during the times of the previous socialist governments; a new state-owned company MGT opened a new interconnector to Slovakia.

This chapter is structured as follows. The following section shows that not only the anti-integration *actor coalition* became dominant in Hungary due to the election results in 2010, but the dominance was also reinforced because of the political opposition falling into pieces, the NRA moving under the Prime Minister's Office and nationalising parts of the natural gas sector. The other two parts of the chapter process-trace the events during the second and third Viktor Orbán Government (2010-2014 and 2014 onwards).

7.1 Shifting balance of power after the 2010 election

From 2010 significant changes happened in the Hungarian *interest structure* on the political side. In this election, the right-wing party, Fidesz, gained 53% of the votes, which due to the peculiarities of the elections system were translated into a 68% share of the seats in the Parliament (National Election Office 2010). This made Fidesz the single dominant actor in

regulating the energy sector. Right after the election, a CEC Government Relation analyst, Tamas Sardi, waved off the previous quasi-balance of political interests: 'The days of the former quasi-two-party structure with the Socialists on one end of the political spectrum and the right-wing Fidesz on the other, are gone (Sardi 2010, 1). Not only that the political party, which prior to 2010 attacked the left-leaning governments for too high end-user prices gained a 'supermajority' in Parliament but, unlike in Lithuania or Romania, it also could elect the state's President. Even though the Hungarian Constitution in place at that time gave little powers to presidents, they could still send laws back to the Parliament for reconsideration or ask the Constitutional Court for a review. First, as Krasztev and Van Til wrote, 'without changing the laws, the Fidesz Government changed the person (2015, 40). In 2010, the Hungarian President became former Fidesz vice-chairperson Pál Schmitt. In 2011, Fidesz also changed the Constitution, but presidents still retained some power and could send adopted draft laws for reviews. After Pál Schmitt had to step down because of a plagiarism scandal, Hungary's President since May 2012 has been a cofounder of Fidesz, János Áder. This has added one more institutional actor to the anti-integration *actor coalition*, even if with little powers.

At the same time, potential political and private opposition to Fidesz regulations became fragmented as compared to pre-2010. Since 2010, the politically left, the socialists, were shattered. Ferenc Gyurcsány and others left the socialist and formed DK (Democratic Coalition) while Gordon Bajnai and others formed Együtt ('Together'). The turn of the *interest structure* towards dominance was reinforced by changing views of the previously opposing political sides. When returned to power, Fidesz has revoked its party's previous Russia-hostile communication and continued warm relationship with Russia on the state-level as the previous socialist governments, including energy projects. The MSZP in the meanwhile increasingly started claiming of a necessity to keep end-user prices low, which was the communication line

of Fidesz (Nepszabadsag 2015). Even an interviewed MSZP Member of Parliament, in opposition since mid-2010, admitted that the context surrounding the Fidesz organised utility price cuts 'was a very good communication basis, with much success'. As he claimed, as soon as MSZP would publicly comment on the gas prices, Fidesz would respond back that the socialist governments increased the gas price 'fifteen times' when MSZP was the ruling party. He also said: 'People are thinking about it in a very simple manner. I do not see any chances that public opinion about the energy prices will change' (MP MSZP HUNG 2016).

The gas industry was also fragmented. For example, from 2010, the Grid Code Committee, consisting of TSOs, DSOs, storage companies, open market traders and the HEO, significantly decreased the number of meetings to discuss network operations. The association of gas companies, Magyar Gázipari Egyesülés (MGE, formerly the Association of Gas Distribution Companies), was also dissolved. An interviewed previous executive of the Hungarian Gas Storage explained: 'Since 2010, there was no demand for such discussions because everybody was waiting and lobbying in his or her own way to be less hit by this gas price moratorium. […] what is also surprising is that there were no joint activities of the industry against the Government's initiatives […] and somehow the market was more divided, everybody went independently and used independent strategies, and there was no common voice of the industry' (IND HUNG 1 2016).

The initial 'dominance' of the anti-integration *actor coalition*, described by Sardi in 2010, expanded even more by 2016 because of the changes that Parliament imposed on the Hungarian NRA. First its powers to set end-user prices were moved to a Minister of Development, then the NRA was moved under the Prime Minister's Office and simultaneously it became possible to challenge some of the decrees in the Constitutional Court only. Even though the Hungarian NRA for most of its existence except for 2009-2010 had not had the authority to regulate end-user prices, it was nonetheless deemed by some interviewees as a

strong institution through another channel of power, the 'power of the first draft'. After Fidesz restructuring of the NRA, state capture of the regulator was acknowledged in an interview with one of its employees: 'So I think it [the industry capture] is a real problem, but not in Hungary, because we are more or less captured by the political rather than the industrial needs' (NRA HUNG 2016).

The return of the state to the ownership structure of gas companies, which accelerated in 2013, also strengthened the dominance of the anti-integration inclined Government in the gas sector. With the renationalisation of this sector, almost all important gas companies, except for those belonging to MOL group, fell under the umbrella of the Hungarian state (MTI-Econews 2011). Subsequently, by default (even if sometimes silently they were against certain aspects) those companies had to implement the new Fidesz government energy policy (IND HUNG 4 2016). In this period, four new sectorial actors joined the *interest structure*, and three of them were state owned, MET, MVM, MGT and ENKSZ.

Following the changes in the regulatory environment, the number of private investors in energy companies decreased. Owners of companies starting from upstream (E.ON: import contract with Gazprom), midstream (E.ON: storage and wholesale) and followed by retail (mainly in DSO business and household supply, but also in the free market segment) left the Hungarian gas sector. This departure by foreign investors was visible from 2013. In the household segment, all the regional suppliers for households that were privatised in 1995-1998, fell back into the hands of the state by 2015-2016. As the free market segment was still deemed viable (SE HUNG 2 2016), the departure by the foreign investors was partially counterbalanced by a new company MET, established in 2010 by MOL and offshore shareholders, entering the market and increasing its trading portfolio rapidly (MET Holding 2016). MET, however, was criticised in the media and by some interviewees for the non-transparency of who its final shareholders actually were. One person commented about MET being established in

Switzerland: 'It means that MET is not an EU company, and the majority of the owners are offshore, so you will not be able to find out the end' (SE HUNG 2 2016). In addition to leaving the regulated segment, universal supply market, some foreign companies also left the free, unregulated market (consisting of non-household consumers). For example, in February 2015, French GDF Suez decided to leave the free natural gas market and sell its portfolio to MET (GDF Suez and MET 2015).

From 2013, state-held electricity incumbent Magyar Villamos Művek (hereafter, MVM), involved in the gas sector and became an important actor in there. MVM was ultimately controlled, through the state owned the Hungarian National Asset Management (MNV), by the Ministry of National Development (European Commission 2015c, 3). The private MOL owned TSO was joined by a second TSO established to manage the Hungarian-Slovak interconnector, Magyar Gáz Tranzit (MGT) (European Commission 2013f; MGT 2012). The sole owner of MGT initially was MVM, later it was moved under the Hungarian National Asset Management. Thus, Hungary found itself in a unique situation as a small country that has two, and not one, TSOs. In 2015, the Hungarian Government created a state monopoly in the utilities, called First National Public Utility (ENKSZ), the aim of which was to supply energy to households in a non-profit manner.

To summarise, as seen in Table 7, the political hemisphere predominantly turned against liberalisation of household consumers and this was transferred to the regulator and the increasing share of state-owned companies in the sectorial hemisphere. In this table, red colour means a position against, green – for, yellow – dubious or changed position, and grey – no or non-identified position towards household consumers' liberalisation or cross-border interconnectivity. MOL group, which remained pro-integration, had less power than in the beginning of the CH 4 because of selling Földgáz Trade and Földgáz Storage to E.ON. Moreover, in the 2010-2016 research period, these two businesses were acquired by the state.

Table 7 also shows decoupling of interests. It could be said that actors remained predominantly in favour of cross-border diversification, even though they were against the household segment liberalisation.

Table 7 *Interest structures* with regard to the household segment liberalisation and cross-border diversification in 2010-2016 Hungary (based on multiple media and interview sources)

Type	Actor	Power	Stance vis-à-vis liberalisation of household consumers	Stance vis-à-vis cross-border diversification
Executive politicians	Presidents	Presidents cannot become real counterbalance to Parliament, because Parliament elects them	The two presidents since the Fidesz return to power were Fidesz party members Pál Schmitt and János Áder; therefore, the same interest assumed as of the Government	The same interest assumed as of the Government
	Governments	A single-party Government, supported by a two-thirds majority in Parliament; Gas companies acquired by Government strengthened its role in the energy industry	Many actions to decrease liberalisation of household consumers	In favour of diversification
Legislative politicians	National Parliament	Two-thirds majority by Fidesz	Many actions to decrease liberalisation of household consumers	In favour of diversification
Special actors	National energy regulator	Loss of power the set end-user tariffs, gain of power in upgrading some of the decisions to a decree level	Due to the change of leaders in 2010 and 2013 and NRA restructuring in 2013, mostly follows the Government's interests	Formally in favour of diversification, but end-user price cuts ensured by the NRA almost stopped the Slovakia-Hungary interconnector
	European Commission	Uses all the power it can;	Very much for	Very much for
	IMF and World Bank	Financial conditioning;	Did not condition gas sector in its financial support	Did not condition gas sector in its financial support
Large consumers	n/a	There are no fertiliser producers or other large consumers that would have a single significant effect on Hungary's economy;	n/a	n/a
Producers/Upstream	MOL	With increased potential supply of gas from other sources, the role is smaller;	Transmission tariffs are a part of the final consumer tariffs. The series of utility price cuts from 2012 also concerned the	Very much for: FGSZ built most interconnectors

		FGSZ (transmission) owned by MOL	transmission part of tariffs and negatively affected the income of the FGSZ	
	Gazprom	With increased potential supply of gas from other sources, the role has become smaller; Government and Gazprom started co-owning Panrusgáz, which held the gas import contracts	Not identified	Based on the information in some interviews that the argument of planned interconnectors was used to negotiate cheaper prices of gas from Gazprom, is assumed that Gazprom did not fully support the diversification of routes; However, no evidence of resistance towards diversification was found
Midstream	MGT (transmission)	State-owned, thus, strengthens political interests	MGT did not have much connection points with the downstream level	For, but with limited focus (MGT was established only for Hungary-Slovakia interconnector)
	MVM	State-owned, thus, strengthens political interests	Representation of the Government's anti-liberalisation interests; It would seek deregulation if it could, because owning the main gas import contract puts MVM at risk of regulated end-user prices falling below the gas import prices	Representation of state's anti-integration interests is assumed; On the other hand, more diversification helps MVM to decrease the gas import price
Retail	ENKSZ (household retail)	100% concentration on this segment; State-owned, thus, strengthens political interests;	ENKSZ was established to provide cheap energy to household consumers ('non-profit')	Having an official role to supply households with cheap gas, ENKSZ is in favour of more import routes
	MET (business consumers)	Increasing market share	It took over business consumers that other suppliers abandoned while exiting the Hungarian market	HAG pipeline provided many business opportunities to MET
	Other suppliers to business consumers	Decreasing market shares/leaving the market	For	For

7.2 Retrenchment in liberalisation of household consumers

From mid-2010, Fidesz tested the patience of the Commission, which eventually resulted in an infringement procedure against Hungary. The redistribution of the political power from mid-2010 brought three major stages of changes to the Hungarian natural gas sector. First, Fidesz in changing gas laws, imposing a utility price moratorium and subsequently cuts, taxation and communication turned against the (mostly) privately owned energy companies. Second, these in turn started leaving the Hungarian gas sector, which strengthened the dominance of the anti-integration *actor coalition.* Third, the Commission started an infringement procedure for incorrect transposition of the Third Natural Gas Directive, but only after the whole reconfiguration of the gas sector. Even though these changes were related to the energy sector, many interviewees saw the energy sector only as an object for political communication, and not a subject that was in need of reforms. For example, one interviewee said: 'I do not think that they [Fidesz] really wanted to do something with the energy markets. The whole story was about political communication and not the energy markets. They wanted to win the next election [in 2014]. They looked for something easy to communicate and a story into which everybody was incorporated. From a political point of view, it was a fantastic idea' (SE HUNG 2 2016).

Based on an interpretation of the events by one interviewee, Fidesz would mend the laws and configurations of the market as long as the Commission did not challenge such steps in an infringement procedure. As he commented, the Government 'used the strategy to go up to the edge, not knowing exactly, where the border was, […] it was clearly a testing phase' (SE HUNG 3 2016). He also explained that the ambiguity by the Commission gave room for 'testing the ground' as well: 'I think, the Commission was not clear whether and on which cases it would start an infringement procedure […] and it was not clear whether the Commission would be hard on some points or not. So, this is always a thing to negotiate with

the Commission. However, it was clear that for the Third Energy Package they were very hard' (SE HUNG 3 2016). Another interviewee had a strikingly similar understanding about the Hungarian government's approach towards a possibility that the Commission may open an infringement procedure. He commented: 'The Hungarian politicians manage this game very well because it is a slow reaction. They changed the laws in 2012, and the infringement procedure only after four years is in the status that they need to change something here. This means that if you do something, the slow EU bureaucracy will react only after four years' (SE HUNG 2 2016).

The Fidesz ruled Hungarian Parliament made the first steps into a 'grey zone' of possible non-compliance with the Third Energy Package in both the gas and electricity sectors within two months after the general election of 2010 by imposing a *de facto* end-user energy price moratorium. In June 2010, by adopting Gas Act LV of 2010, the newly elected Fidesz ruled Parliament again amended the Act XL of 2008 on Natural Gas, which had been recently changed by the previous Government.[41] The amendments moved the power to set end-user universal service tariffs for households and 'minor' consumers (typically micro-enterprises) back to the Minister of National Development.[42] As a core feature, the Act provided that actual gas USP prices (not only the principles and the maximum margin) should be determined directly by the Minister in his or her decree relying on the recommendations presented by the HEO.[43] Moreover, the Minister and not the regulator gained authority to set transmission and distribution, the network, tariffs, other terms of access to networks and transmission cross-border infrastructure, as well as balancing service.

Returning the right to determine universal supply prices to the Minister of National

[41] 21 June 20 IO Act LV of 2010; The most recent changes of the law at the time were made by the end of 2009 under the previous configuration of Parliament as presented in the previous chapter.
[42] Hungarian Energy Office, "Annual Report 2010 to the European Commission," 44; Act No LV of 2010 amending Act No XL of 2008 on natural gas supply and Act No LXXXVI of 2007 on power supply effect on 21 June 2010.
[43] Section 107 of the Gas Act (as in force on 1 January 2014).

Development meant that until a new ministerial instruction was made, the most recent at the time (by April 2010) published universal service prices had to stay in force (REKK 2010b), in other words, frozen. Before that, from 2009 to mid-2010, the prices were set based on a bottom-up approach: the HEO would approve administrative resolutions upon individual price amendment requests by the various providers of universal services (IND HUNG 4 2016). Thus, end-user prices could change based on changes in fundamentals that influenced them. All in all, the HEO had the power to set end-user tariffs in gas for less than two years between the end period of the MSZP 'technocrat' Government in 2009 and mid-2010.

Gas prices remained unchanged between April 2010 and January 2011 when new tariffs came into force. In April 2011, prices for residential users were frozen again (International Energy Agency 2011, 65). The Minister of National Development approved a price adjustment equal to annual inflation at the beginning of 2012, and this, according to the Commission, 'created a mismatch between the level of regulated retail prices and the wholesale import price' in the context of rising gas import prices. Moreover, based on the Commission, from January 2012, HEO was obliged to calculate gas tariffs using the methodology imposed by the Ministry (European Commission 2014a, 108).

The Fidesz-ruled Hungarian Government started targeting the independence of the NRA by changing its top management. The previous head of the HEO, Zoltan Matos, left after serving less than a year in the HEO, despite the fact that his term had to last six years (MTI 2013a). He was replaced by Péter Horváth.

In 2013, one year before the next general election in Hungary, the Fidesz-ruled Parliament adopted a series of laws that enforced utility price cuts and conferred more power to the energy regulator. Viktor Orbán reportedly called the then forthcoming 2014 'year of fighting utilities'. Media reported him as saying: 'Foreign-owned energy service providers and the political forces behind them will march against us, however, we will conclude this era

once and for all, in which energy providers profit from the people' (MTI 2013b). By adopting Act LIV of 2013 on the Implementation of Utility Cost Reduction, the Hungarian Parliament in May 2013 introduced the so-called 'utility cost reduction' program to household customers eligible for universal service for power and gas, in Hungarian known as 'Rezsicsökkentés.' In total, in three consecutive steps, regulated prices for household consumers in the gas sector were decreased by around 25% compared to the prices on 1 December 2012. An interviewee explained that the Fidesz ruled Parliament did not change much compared to the previous system of price-setting, but they used the existing structures. He said: 'with the universal service the original agenda was not this current aggressive price setting, but the price regulation in the submarket, fall-back market, for the entitled customers. […] And this universal service was in line with the EU energy law, but it was a kind of local specialty. Then came Fidesz and started to transform this universal service. What came to their mind was what a wonderful political tool price setting was' (IND HUNG 4 2016). Moreover, as is explained in CH 2, the Third Natural Gas Directive does not explicitly forbid regulating end-user prices and subsequently, it would be more difficult for the Commission to justify an infringement procedure based on this mere fact (and end-user price regulations are usually 'dealt with' in using implicit 'naming and shaming' in the annual reports by ACER). However, the actions of stripping the regulator of powers constituted a part of the basis for an infringement procedure.

In line with the political decision on prices, the HEO prepared a 10% cut of end-user household prices for natural gas, electricity and district heating, effective from 1 January 2013 to 31 October 2013. As of 1 November 2013, the prices were further reduced by 11.1%, which totalled a 20% price decrease in comparison to the 'base' end user prices in 2012 (HEPURA 2014, 9). This reduction was followed by a further 5% cut in the month of the general election, in April 2014. As one interviewee, at the time of the interview working for the Hungarian

state, said, ‘more or less in line with the market flows, the gas prices went down, and the Government decided to use it as a political tool, to sell it as a political achievement, so the prices were structured in a way which does not completely conform to the European logic’ (SE HUNG 3 2016).

Moreover, From July 2013, the universal service providers had to emphasise the ‘savings of the utility price cuts on the invoices. As law determined this obligation, private companies had to do it and effectively promote the government policies in the utility sector. According to an interviewee from the opposing, MSZP, party, ‘that is why they made that law.' He also drew attention to the fact that the colour to emphasise ‘savings’ in the natural gas bills had to be orange (Figure 13), and this colour was associated with Fidesz (MP MSZP HUNG 2016).

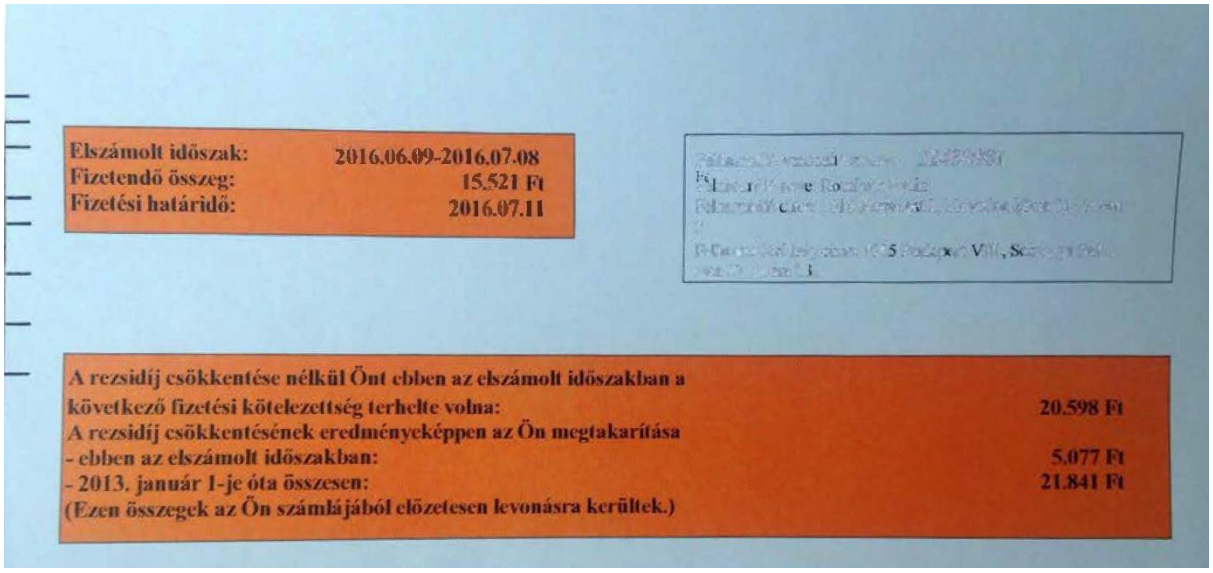

Figure 13 An example of the natural gas bill for a household in Hungary, where the ‘savings’ because of the Government's utility costs cut programme must be emphasized

The energy regulator, which had more expertise than politicians in the sector, had to find from which parts of the price structure, consisting of production/imports, transmission, storage, distribution, and supply profit margin to cut. An interviewee from the Hungarian

NRA revealed:

> In Hungary, it is very easy, if the Government decides on, for example, a 10% cut in gas prices, it just puts it into the law, and that is it. If they are not confident that it is a good idea, they make a committee, and the President of the NRA is invited. Moreover, in this case, we make figures, we make calculations, we make analysis, and in the committee meeting the President in front of the Prime Minister or something like that (it's an ad hoc thing, it's not institutional), says that we think about that. Finally, the Prime Minister and other guys reflect on that, and say that is okay if the President, who is loyal, asks the things. He is not stupid, he has the staff, and we make that consideration, and we would like another 10% cut, but we just cut by 2% because that is acceptable (NRA HUNG 2016).

The interviewee also compared the new situation to a 'Jenga' game: 'So we find the way, like the game Jenga, to try to pull some elements out of it without collapsing the whole *monstrum*' (NRA HUNG 2016). A part of the solution was to 'set-up' a USD/HUF exchange rate by the Minister to be allowed to pass-through to the final price, and not the real exchange rate (NRA HUNG 2016). Moreover, in attempts to find room to cut the regulated utility prices, the Hungarian NRA came up with a two-tier transmission tariff system. The transmission part of the tariffs became lower for universal supply (households) than for business consumers. As the interviewee said, 'which is not a good thing, but in that way you can have the possibility to lower the price for the household consumers and a little bit raise the price for the others, and you can keep the prices under control for the household which the Government wants (NRA HUNG 2016). Another interviewee explained: 'Before we had a universal service provider margin regulation, but from this time we have a full price regulation. […] From the legal side, they did not change the formula, but on the practical side, they changed it because they declared the end-user price, moreover, they had control over the wholesale [after acquiring Földgáz Trade wholesale company from E.ON], and also they declared the [profit] margin. It means that the state controlled all three elements' (SE HUNG 2 2016).

Universal service providers active in Hungary subsequently saw 'their margins

decrease due to their inability to make money when the set price was below the price of importing gas' (US Bureau of Economic and Business Affairs 2012), so some of them went to local courts. Subsequently, the Hungarian Parliament adopted the Act XXII of 2013 on the Hungarian Energy and Public Utility Regulatory Authority and made some of the decisions of the regulator impossible to challenge at local court. As the name of the law suggests, the HEO was transformed into the Hungarian Energy and Public Utility Regulatory Authority (HEPURA).

The concluding remarks of the law stated that it 'served the compliance' with the Third Natural Gas Directive (Hungarian National Assembly 2013, para. 26), but it was the opposite. Firstly, the new status conferred legislative powers to the regulator. After the reform, certain gas sector decisions (decisions on connection prices and system use charges) were determined by a decree of the HEPURA's President, which was a legal regulation, and not an administrative resolution. These decrees could no longer be challenged before ordinary state courts, but only in the Hungarian Constitutional Court. This court only revises whether the challenged laws and regulations are against the Hungarian Constitution. Moreover, differently than in ordinary court litigation, there is no further remedy available against the Constitutional Court's orders and rulings. As written in CH 2, the Third Natural Gas Directive requires to ensure that 'suitable mechanisms exist at national level under which a party affected by a decision of a regulatory authority has a right of appeal to a body independent of the parties involved and of any government' (European Parliament and Council of the EU 2009, Art. 41 (17)). The change of status of the energy regulator, conversely, removed the possibility for a judicial review of its decisions. As an interviewed employee of the Hungarian energy regulator concluded, 'the main change was that we have now the power to issue decrees, which is a legal power, but I do not think that it is very important regarding that the ministry has the real power to set the tariffs and set the principles' (NRA HUNG 2016).

Secondly, the HEPURA had explicitly stated 'power of the first draft' in legislating. The law reads as follows: 'The Authority *may propose to the Minister in charge* in the subject area to *adopt or amend legislation*, and *has the right to be consulted* during the preparation of decisions and legislation regarding individuals and entities and their scope of duties and powers' (emphasis added) (Hungarian National Assembly 2013, para. 2).

Now, when alleviating the status of the regulator, Fidesz limited its possibilities to be independent from state capture. The law allowed the Prime Minister solitarily to appoint the HEPURA's President for seven years with a possibility to reappoint or dismiss. The HEPURA's President would appoint 'no more than five Vice Presidents' for seven years as well, with a possibility to reappoint (Hungarian National Assembly 2013, paras. 6–8). This, according to an interviewed employee of the Hungarian energy regulator, was the way how the new public sector administration worked after Fidesz came to power: 'it needs legal power, and it needs loyal leaders' (REG Hung 2016). In three years from the first leadership changeover of the regulator, in July 2013 Prime Minister Viktor Orbán appointed a new leader. It became Lajos Dorkota, who had been member of the Hungarian Parliament for fifteen years from 1998 to mid-2013 for the most of the time as a party member of Fidesz (HEPURA 2015). The previous leader Péter Horváth became the Head of MVM's natural gas activities and had to 'prepare and organize the MVM comprehensive natural gas activities' (MTI 2013a). In other words, from being the chairman of the regulator, Péter Horváth right away stepped into the business he regulated, without a cooling off period.

As visible from the interview with an employee of HEPURA, the 2013 changeover removed even theoretical possibilities that the regulator would withstand the Government policies on how to manage the natural gas sector. He described the situation:

> The Prime Minister nominates the President of the regulator, and he was a party member of the Fidesz and had several other connections with that Fidesz world, which is the ruling party. So there are a lot of business connections, who knows who, it is a network.

> It would be a serious mistake by the President of the regulator if he thought that he could challenge the Prime Minister with any serious questions. However, in my opinion, if the President thinks that some issues are very important or worth challenging, he can find a way to consult the Prime Minister or other guys who are very close to the Prime Minister to know that everything is okay (NRA HUNG 2016).

The questionable independence of the Hungarian NRA could be seen in its political campaigning. For example, during the election campaign in 2013, advertisements of the Fidesz Government's reduction in utility prices appeared on the website of the regulator, as presented in Figure 14 below.

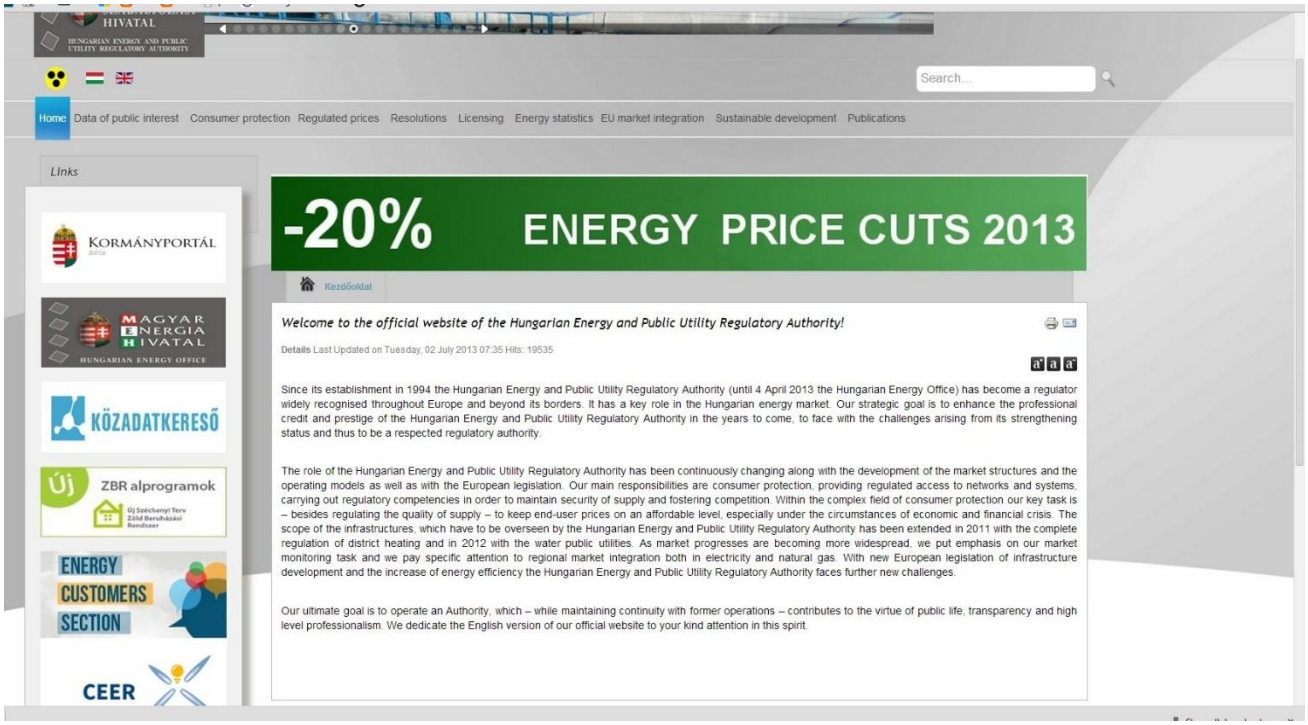

Figure 14 The website of the Hungarian energy regulator in 2013, which placed an advertisement of the Hungarian Government's utility price cut programme

While freezing and then cutting the prices, the Parliament increased the scope of application and rate of taxes to energy companies. From December 2010 and January 2013 it imposed a Sectorial Tax Act on, among others, natural gas traders and gas universal supply providers (Economist Intelligence Unit 2012; REKK 2010a). Starting from January 2013,

Parliament imposed Utility Line Tax on infrastructure owners, which among others affected gas DSOs, and later the TSO. At a similar time, Parliament extended the scope and amount of one more tax, referred to as the Extraordinary tax on energy providers (so-called 'Robin Hood' tax[44]), so it covered almost all players operating in the Hungarian natural gas market, except for the gas TSO, and more profitable companies had to pay 31% from profit before taxation instead of previously 8%.

Because of the changes in the regulatory environment, profitability of incumbent multinationals decreased and/or their equity position worsened. A quantitative analysis by Felsmann (2014) of a dataset that represented most of the Hungarian energy (gas and electricity) retail market shows that the overall operational earnings of the incumbent multinational energy companies radically decreased from 2011 to 2012. In contrast, the state-controlled firms increased their profit in the same period. Similar changes occurred in the free-market segment between the local and foreign entities. The local companies were able to increase their average profit, and experienced 'the year of great success,' while the foreign-based traders faced decreasing profitability (Felsmann 2014, 27–28). A similar trend, although less dramatic, continued in 2013 and later (Felsmann 2014, 29).

From 2013, the Hungarian Government accelerated the process of rolling back privatisation in the natural gas market. The first natural gas asset to be bought back under the Second Viktor Orbán Government was a stake at MOL from Surgutneftegas in May 2011 (MTI-Econews 2011). This step was deemed as positive in an interview with an energy expert, 'because of the risk that was presented by Surgutneftegas with a potential takeover of control of how the transmission grid had to be operated' (EX HUNG 1 2015). In 2012, in the National Energy Strategy 2030, published by the Hungarian Ministry of National Development ideas appeared about strengthening the role of the state in the natural gas sector and this was

[44] This tax was introduced in 2008 by the socialist Government and was supposed to be temporary.

justified by the security of supply argument – long-term contract with Gazprom. The Ministry advocated 'asserting the government's priorities through regulatory instruments' in the 'market-oriented, liberalised and highly privatised energy economy', 'with particular regard to the expiry in 2015 of the long-term natural gas contract between Hungary and Russia'. The Ministry saw a potential for state action in the natural gas market via 'granting of new authorisations to the MVM, creating a new state-owned natural gas trading company or acquiring a controlling interest in a company with a high market share' (Ministry of National Development of Hungary 2012, 15). Interviewees, however, related the nationalisation of gas assets to the political communication of Fidesz and not the security of supply concerns. For example, one said ironically that it appears good for the Hungarian state to own energy assets when international gas prices are falling. He commented: 'They say: "I am going to make it possible to pay less at the end of the month, because I am a very strong Government and have nationalised the companies, which were privatised in the beginning of the 1990s by the socialist government". It [the communication] is simple, it is working' (SE HUNG 1 2016). Another one had a similar opinion:

> Beyond this price reduction element, which of course has benefits from the customer point of view (electricity and gas become cheaper, that is quite obvious), they also said that 'we don't like first of all foreigners, but even more in general private companies operating in this business'. 'So-called natural monopoly' as they say. Which means that they need to function on a state control including state ownership and there should be non-profit organisations whatever that means. 'It is kind of truly public service that Government will offer at zero profit', if you want. Moreover, to be able to achieve this goal, they need to make sure that the current owner surrenders their ownership, and they just hand it back to the state where it belonged 15 years before that policy kicked in (EX HUNG 3 2016).

Following the vision by the Ministry, MVM started acquiring assets that the private investors were relinquishing. In September 2013, MVM Group acquired from German E.ON a stake in Földgáz Trade (100%)[45] and Hungarian Gas Storage, altogether four commercial

[45] The company Hungarian Gas Trade is active both on the wholesale level (sells gas to distribution companies) and in the retail level (end consumer market) (MVM Group 2014, 20).

storage facilities. Földgáz Trade had a 'special role in terms of price regulation and security of supply, possessing a long-term contract to Russian import sources' (HEPURA 2014, 50). The Commission projected that after this acquisition MVM would become 'the number one natural gas provider in Hungary, with a market share of 60-65% on wholesale gas markets' (European Commission 2013a, 7), but MVM did not stop there. In December 2013, it acquired a 49.8% stake in Főgáz from German utility company RWE (Feher and Gulyas 2013); the co-owner of Főgáz for that period remained the Municipality of Budapest (RWE 2013). Also in December 2013, the state-owned Hungarian Development Bank acquired 51% of shares in the Hungarian strategic gas storage facility MMFB from MOL (MMFB 2016). The remaining 21.46% stakes held by MOL was purchased by the Hungarian Hydrocarbon Stockpiling Association, which together with this stake increased its ownership to 49% (MOL Group 2013; MMFB 2016). In spring 2015, MVM expanded its gas portfolio by acquiring E.ON's 50% stake in Panrusgáz. MVM became a vertically integrated group of companies in multiple areas of the energy sector, present in electricity production, transmission system operation and trade, and natural gas infrastructure (MVM Ltd. 2014).

Interviews with Hungarian energy industry specialists have shown an array of inefficiencies, lack of strategy, constantly changing political figures that were responsible for the gas sector and the borderline with corruption (IND HUNG 1 2016). Instead of gaining efficiency, the consolidation of energy companies in state hands in Hungary made this area susceptible to fights between different political interests in the dominant *actor coalition*, and in this way, it pushed the energy sector policy, business, and efficiency strategies lower on the priority list. As one interviewee, who witnessed an early transition of one of the previously privately owned energy companies to the state hands in 2013, commented, there was 'no clear business strategy, and that no one was really caring about that, it was most shocking.' To his view, instead of being based on an encompassing energy policy strategy, 'activities were very

ad-hoc, driven by the international traveling of politicians.' He added that 'the worst thing that can happen, is if you are in this vacuum without strategy, then very soon some private interest will find their way' (IND HUNG 1 2016). The interviewee remembered occasions of the newly state-owned companies ordering, as he considered, heavily overpriced or unnecessary services, such as expensive billboard campaigns for business-to-business storage and wholesale services that do not need advertising (IND HUNG 1 2016). Even though MET was a private company, its involvement in business with state-owned company MVM also resulted in a public scandal. Based on media accounts and interviews, MET used HAG pipeline capacities from Austria booked by the Government decree for MVM, which MVM 'had no capacity to handle' (Heti Válasz 2015), and acquired cheaply in Austria gas which was resold for a much bigger price in Hungary (SE HUNG 2 2016; MP MSZP HUNG 2016).

The management strategies of the newly state-owned energy business could hardly consolidate as time passed, as by 2014-2016 internal fights and reconfigurations emerged among the people close to the Government. As reported by media, after the general election of 2014, a long-term financial supporter of Fidesz, Lajos Simicska, and Viktor Orbán fell apart (Kovacs 2015). Lajos Simicska was deemed to control 'the whole Ministry of National Development' (Hungarian Spectrum 2016), which in turn was one of the institutions responsible for the energy sector, and controlled MVM. One interviewee called the further process 'non-Simicska-sation' of the industry' (IND HUNG 1 2016).

Indeed, the institutional owners of the state-owned gas companies has kept changing. Even though it had been MVM (under the Ministry of National Development) that was buying up the assets when foreign investors sold them back, the property began moving to other state structures. Many of the gas projects on which MVM had initially embarked, such as MGT (more in the next section) or Főgáz, were taken over from it by other state structures. In the end of 2014, the Government approved measures allowing the Hungarian Development Bank

(MFB) under the Prime Minister's Office to acquire Főgáz. In the transaction of 'strategic importance for the national economy,' MVM sold to the MFB the package of shares of Főgáz it held (Hungarian Development Bank 2015). A couple of months later, the Hungarian Government created a state monopoly in the utilities, a non-profit company called First National Public Utility (ENKSZ), which aimed 'to make energy available at fair prices and increase the security of supply' (Politics.hu 2015). ENKSZ, established together by the state agency Hungarian National Asset Management (MNV) and by the MFB wielding the ownership rights, immediately entered the natural gas universal service provision and gas retail markets; it also planned entering the electricity and district heating markets. The new owner of Főgáz, MFB, transferred the ownership rights, but not the shares of this company to ENKSZ. Főgáz became, as the media wrote, 'the bridgehead into the gas market for ENKSZ' (BBJ 2016). The first head of ENKSZ in February 2015, while until July 2015 keeping his Board membership position at MVM, became the same Peter Horvath, the former President of the Hungarian energy regulator (ENKSZ 2016).

In the meanwhile, facing decreasing profitability, foreign-owned energy companies chose one of three ways. First, some of them optimised the cash flows of owners by cost reduction and postponement of investments and increased levels of dividends. Others left the Hungarian retail subsidiaries in a permanent underperforming financial situation. Third, some of them decreased their exposure to the regulated services (USP) through selling or offering their investments to state entities (Felsmann 2014, 39). They also started 'simply disappearing' from keeping their gas in storages (IND HUNG 1 2016), which signalled that they had ceased to trade. The majority of the international investors left the Hungarian gas sector without extensive litigation. The French investor GDF (Engie), however, turned to arbitration against Hungary based on the Energy Charter Treaty to protect investments regarding the supposed damages caused by the Hungarian state to their DSO and universal

service provider (ICSID 2016). In April 2015, the Hungarian unit of E.ON, E.ON Energy Services Ltd, returned to the regulator its 'universal service provider' license to supply gas to households to (bbj.hu 2015). E.ON was followed in the same week by the Hungarian unit of GDF Suez (Hungary AM 2015), even though earlier in press releases it had been signalling its intention to remain a universal service provider (GDF Suez and MET 2015). GDF Suez had sold its business clients' portfolio to MET a couple of months earlier. Magyar Telekom first decided to decrease its exposure in the sale of gas and electricity to business consumers by finding a joint venture with MET in March 2015 and moving its business segment clients to this joint venture (MET Group 2015). Then a couple of months later Magyar Telekom announced its exit from the residential part of the gas market from July 31, 2015, 'following changes in the energy market environment' (Portfolio.hu 2015). The process of relinquishing household service licenses ended up only when all regional distribution companies returned them. Subsequently, HEPURA approved then already state-owned Budapest-based household gas retailer Főgáz to supply all households in Hungary (LaBelle and Georgiev 2014, 14). This effectively meant that there was no more competition for the provision of gas for households, other than the state. By 2016, MVM, which because of its ownership of the main gas import contract, remained the main wholesaler of gas to the household sector, and in this way had to 'take all the burden of price cuts for households' (IND HUNG 4 2016).

7.3 Infringement procedure for incorrect transposition

In February 2015 the Commission started an infringement procedure against Hungary with regard to the Third Energy Package (Keszthelyi 2015). In responding to my request to access information to documents about infringements submitted in 2015, the Commission agreed to provide information only about the finalised infringement procedures. Thus, the information below about the details of the recent procedure were collected in a handful of interviews with people that were familiar with one or another aspect of the latest infringement

procedure.

Based on this information, in the 2015-onwards infringement procedure, the Commission questions only a part of the changes in the Hungarian gas sector. This was because not all the changes, even though they negatively impacted private energy companies, went against the EU rule of law. As the Third Natural Gas Directive does not explicitly control end-user price regulation, the infringement procedure did not concentrate on the end-user price regulation in itself. It touched the utility price cuts indirectly via challenging the possible lack of independence of the Hungarian NRA. Another indirect way the Commission chose was challenging the application of discriminatory tariffs between consumers of universal services (households and small businesses), and other customers by using the two-tier transmission charges (NRA HUNG 2016). It also challenged the exclusion of certain costs from calculating the tariffs, provisions of national laws that restricted the entry of new suppliers in the market by requiring them to register and be established in Hungary and some other aspects. Additionally, the Commission challenged the removal of the exclusive EU assigned competences from the Hungarian energy regulator to set the transmission and distribution tariffs, setting other terms and conditions for connection and access to networks, and access to cross-border infrastructure. It also challenged restrictions on the scope of the right to appeal the regulator's decisions in local courts. The Commission *did not* challenge the taxation of energy companies and their nationalisation. Such questions are exclusive competences of the member states, and the Commission does not have direct tools to approach taxation, and the state ownership *per se* is not a breach of any EU requirements.

After the infringement procedures had started, the Hungarian Government reportedly became very cooperative and started meeting the representatives of the Commission both in Brussels and Budapest (SE HUNG 3 2016; IND HUNG 4 2016). One current high-level worker for the Hungarian state said that the Ministry of National Development was working

on ‘a strategy to avoid the infringement’ (SE HUNG 3 2016). Interviewees listed many possible reasons for cooperation by the Hungarian Government, despite the overall negative rhetoric of the same Viktor Orbán Government towards the EU. For example, one reason was the fear that if the Commission found out that infringement took place, the former or current owners of the DSOs that suffered the loss would have a strong legal basis to claim compensation, which would be costly for the state budget. One interviewee, well informed about the developments in the state-owned energy companies, explained:

> A lot of interests were harmed by this ‘Rezsicsökkentés’ (utility fees reduction). Not exactly by ‘Rezsicsökkentés’ itself but what came after, the manipulation of the tariffs; the TSOs, the DSOs were harmed badly by this […] And the Government took it [the infringement procedure] very seriously and immediately took really fundamental steps to correct in a good faith. […] In the current situation in Hungary, the contents of this ongoing infringement include improper tariff setting. If the infringement procedure goes forward, and suspicion becomes a fact of law that EU law was infringed when it comes to tariff setting, that is a perfect case study for lawsuits by any of the DSOs against Hungary (IND HUNG 4 2016).

The Hungarian Government risked to get fined by the ECJ if the infringement was not settled, and ‘when you expect to govern at least one more term, sooner or later it falls back on you’ (IND HUNG 2 2016).

Moreover, the Hungarian state actions that constituted the infringement procedure were deemed a tool to win the 2014 election. Since the infringement procedure started after this election, a part of the regulations could partially go back to the previous state. As one interviewee said, ‘you have to understand that this whole procedure was already ‘sold’ politically, because they were already after the election. It had a great influence on the election results. So after the election, the government, of course, was cooperative, because it was already done’ (SE HUNG 3 2016).

It was also expected that by 2016 when the state owned a large part of the Hungarian

gas sector in total and 100% of the supply segment to households, the further price cuts would hurt the state budget and no longer the budgets of private companies. An interviewee added: 'They go against EU energy law, but until they kill energy companies, they do not care' (EX HUNG 3 2016). Thus, as interpreted by this interviewee, in the case of gas import prices rising again, Fidesz could 'shift the blame' to Brussels and the EU regulations to increase end-user prices (EX HUNG 3 2016). Because of the infringement procedure, the Hungarian Parliament in 2016 made some adjustments in the laws. Authority to set DSO and TSO tariffs was returned to the regulator. Network prices were again defined in decisions (and not decrees) that can be challenged before the court (NRA HUNG 2016; IND HUNG 4 2016). The corresponding changes to the Natural Gas Act of 2008 did not return the power to regulate end-user prices to the HEPURA, because this question 'was not a part of the infringement procedure' (IND HUNG 4 2016). A person in the national energy regulator expressed quite a positive attitude towards the EC's infringement procedure, as it could result in bringing back the powers to set the end-user and other tariffs to the regulator (NRA HUNG 2016). Regardless of these adjustments, by the time of finishing this thesis the infringement procedure was still open.

7.4 Continued diversification of gas supply routes

Even after coming back to power in mid-2010, Fidesz Government reversed the previous order of the retail gas market and ownership of the gas sector in general, it continued supply route diversification projects that were started during the previous, socialist, governments. Fidesz-ruled Hungary continued both pipeline megaprojects that would cross the Hungarian territory, such as Nabucco and South Stream, and smaller projects to interconnect the Hungarian transmission system with the neighbouring countries.

In October 2010, the same year when Viktor Orbán came back to power, FGSZ inaugurated the Hungary-Romania interconnector (European Commission 2016c). The

pipeline to Croatia, also promoted by FGSZ, entered into operation in August 2011 (European Commission 2016b). As one interviewee observed, the Fidesz Government simply 'did not stop' those projects, as they were 'already in the pipeline' (GOV HUNG 2015). With regard to the mega-pipelines, the motivation of the Hungarian Government could have come from the wish 'to bring transit to the country and fears being left out if any of these pipelines are built' (Ámon and Deák 2015, 91). According to one interview, Hungary even attempted to invite the Commission into its negotiations with Gazprom about the South Stream. In 2012 Hungary asked the Commission 'either to participate or to elaborate together with us the frame contractual requirements, which should be valid for every country that would be touched by the South Stream' (UPS HUNG 2016). The logic behind the wish of the Hungarians to invite the Commission is similar as in the Lithuanian case. Hungary wanted leverage in negotiations vis-à-vis Russia that the Commission could bring in. As the interviewee explained, 'The Commission several times promised to think about it, but they refused. It means that Russians had information, I am sure, that Mr. Lowe and others would not support the Hungarian, Bulgarian and other governments in that. So Russians immediately smelled that these countries were alone' (UPS HUNG 2016). Despite Hungary's involvement, neither Nabucco, nor South Stream were built for the reasons beyond Hungary's reach.

The Slovakia-Hungary pipeline episode, however, shows that the Hungarian state actors did their utmost to comply with certain requirements of the Commission when they wanted to secure the EU funding for this project. Unlike in the Romanian case, where the Commission conditioned the support to the BRUAH pipeline with removing obstacles to export gas, Hungary changed a beneficiary of EU funding recipient in 2011-2012, *before* the Hungarian Government and Parliament started the utility price cuts and nationalisation of the gas sector. This was the only interconnector project that gained momentum during the Viktor Orbán governments. This interconnector was reportedly deemed to be personally important

for the Prime Minister, Viktor Orbán (GOV HUNG 2015). Between the end of 2010 and beginning of 2011, Viktor Orbán visited Slovakia a couple of times. During one of the visits, he and the Slovak Prime Minister, Iveta Radičová, signed an agreement to build this interconnector. However, the political drive of Fidesz to keep the end-user prices down initially almost derailed this project. According to information collected from various interviewees, the HEO was under pressure coming from Viktor Orbán to keep end-user prices down, but new interconnectors are partially paid by an addition to consumer tariffs (GOV HUNG 2015; SE HUNG 3 2016). Thus, HEO proposed to the project promoters, FGSZ, a rate of return that was deemed too low by them, even though they already secured some EU funding and included it into the 10-year development plan for the European Network of Transmission System Operators for Gas (ENTSOG) (IND HUNG 5 2016; SE HUNG 3 2016; ENTSOG 2011, 18). Eventually, FGSZ decided to relinquish this project.

Despite the difficulties that came with FGSZ leaving the project, the Hungarian state continued it. By March 2011, due to FGSZ's unwillingness to continue the project, it was understood by the people working on the projects that the state had to take it over. Only if the Slovak-Hungarian Interconnector was built by FGSZ, could it have been certified under ITO or ISO models. Based on the requirements of the Third Natural Gas Directive, only those companies that belonged to a vertically integrated structure before September 2009, could be certified as TSOs under other models than ownership unbundling (European Parliament and Council of the EU 2009, para. 14). Thus, any other operator of the Slovakia-Hungary interconnector but FGSZ had to be certified under the ownership unbundling model or be formally exempted from this requirement by the Commission.

As the previous transposition of the Third Natural Gas Directive (end of 2009) had only one model of certification of gas TSOs, ITO, foreseen for FGSZ, certification of TSOs under any other models required changing the Natural Gas Act of 2008 again. At a similar

time, when it was clear that FGSZ would not build the Slovakia-Hungary interconnector, 'after a three-month debate,' the Hungarian Parliament adopted a package of energy laws, among which it again claimed to transpose the Third Natural Gas Directive by changing the Gas Act of 2008 (Pásztor 2011). It was the third change of this law from the end of 2009, and the second time when Hungary 'transposed' the Third Natural Gas Directive. This time, in addition to the ITO model, the law permitted ISO and OU models. The choice to opt for full ownership unbundling of their TSOs was left to the 'vertically integrated undertakings', meaning, to the gas transmission companies themselves (Pásztor 2011). The amended Gas Act of 2011, however, retained the changes to the Gas Act dating from 2010 on the end-user price setting mechanism. One of the main reasons to change the law again seems to have been so that the Hungarian state takes over the Hungary-Slovakia interconnector project (GOV HUNG 2015), or at least to leave 'the gate open' for certification of a TSO that would build it (IND HUNG 5 2016).

In September 2011, the General Assembly of the state-owned MVM, which at that time was still involved only in the electricity business, decided to establish a project company which would engage in the construction of a Slovak-Hungarian interconnector. Subsequently, MVM established MGT in January 2012 (European Commission 2013f; MGT 2012). Approximately a half of its shares were owned by MVM, and another half by a subsidiary of the state-owned Hungarian development bank MFB, MFB Invest Befektetési és Vagyonkezelő (European Commission 2013a, 3). According to one interviewee, MVM, as a state-owned company, 'was not in the position to say "no", and if you can build [the interconnector] for no profit, but you can still build it, then you have to' (IND HUNG 5 2016).

One of the reasons why the Hungarian state was rushing to build the Slovakia-Hungary interconnector against all the odds, and the contradicting will of Fidesz to keep down end-user prices, was the possibility of leverage with Gazprom. The long-term contract with

Gazprom was to expire in 2015, and a new supply route would be a good tool for negotiations (IND HUNG 5 2016; SE HUNG 3 2016). One interviewee said that according to the National Energy Strategy issued at that time, it was clear that the major problem of the Hungarian market was a unilateral import dependence on Russia and the major task was to build new infrastructures; build physical diversification and fully integrate into the European gas market. This, according to him, was the reason why the Slovakia-Hungary interconnector became a priority project for the government. The interviewee said: 'It was thought that once the Slovakia-Hungary interconnector was built, and if you add the import capacity of the HAG pipeline to Austria, then you can argue that you can purchase gas for Hungary or import gas to fulfil 100% of Hungarian import need from the Western direction, as well as from the Eastern direction. Hungary gets better leverage against Russia just by having the physical option to import gas not from Russia-Ukraine direction, but also from the Western direction, and this was also the argument for completing the Romanian-Hungarian interconnector (EX HUNG 1 2015). Another industry source explained:

> In 2015, the long-term contract for Russian gas was due to expire, and it had to be renegotiated. Moreover, if you are able to buy gas from different sources, then you have a better bargaining position. I would say that even if you do not use the pipeline, but achieve a better price for the next ten years, then the investment paid off. This is the national approach […]. Maybe a project does not pay off as standalone, but from a geopolitical perspective, it really makes sense. Even empty pipelines can be very useful (IND HUNG 5 2016).

However, the envisioned better leverage in negotiations with Gazprom was questionable as the only reason to build the interconnector to Slovakia. Fidesz continued friendly relationship of Hungary with Russia as the socialist governments. As soon as Viktor Orbán and his conservatives returned to forming Government after having spent eight years in the opposition, he visited Vladimir Putin in Moscow in December 2010 (Nepszabadsag 2010). The was returned in February 2015, when Vladimir Putin's visited Budapest (RFE/RL

2015). The positive approach towards Russia can also be seen from Hungary's behaviour during the 2014 Russia-Ukraine gas dispute. When in June 2014, right after Viktor Orbán formed the Third Government, Russia cut off its supplies to Ukraine for half a year (Agence Europe 2015; Euronews 2014). Hungary initially supplied gas to Ukraine via eastward reverse flows of its pipelines that feed into the Brotherhood system (FGSZ 2014). However, soon after Hungary temporarily stopped reverse flows to Ukraine in September 2014, after the visit of Gazprom's CEO Alexei Miller to Budapest (Buckley 2014; Lewis 2015).

Despite the fact that the right-wing Fidesz may be seen as prioritising energy security vis-à-vis Russia (Nosko 2013), in reality, even the first Fidesz Government of 1998-2002 had not built any new gas interconnectors, and the ones finished after Fidesz came back to power in 2010 were actually started during the previous socialist governments. Moreover, despite the previous negative rhetoric towards Russia and Gazprom, Viktor Orbán has held pragmatic, if not friendly, relations with Russia since the end of 2010. According to Ámon and Deák, despite its harsh criticism of South Stream in opposition, Fidesz had changed sides by 2013 and was a forceful advocate of the Russian pipeline' (Ámon and Deák 2015, 91). South Stream would have increased the dependence of the Hungarian gas sector on Gazprom's gas. As one interviewee, who at that time was involved in the project said, the EU funding was decisive for the destiny of this interconnector. Asked if the state would have continued the interconnector without the EU money, he said: 'No. Surely not. That is 100 percent. So that was a very good motivation to do that' (SE HUNG 3 2016). Hungary risked to lose already assigned EU funding and did the utmost to comply with the requirements of the Commission.

Hungary entered a 'very hard and bumpy road to find the structure acceptable for the EU, and acceptable for the Hungarian Government' (SE HUNG 3 2016). As the previous recipient of the promised EU funding for the interconnector was FGSZ (Slovak Spectator 2010; Budapest Business Journal 2011), Hungary asked to change the recipient of the EU

funding for the interconnector to MGT (European Commission 2013f). The final deadline to make the new interconnector operational was December 2015, or the EU funding would have been lost. Thus, the project works had to start in 2011, and 'there was no room for starting later' (IND HUNG 5 2016). It had a short period to prove to the Commission that the newly established, unknown, and 'nobody' company, MGT, would be able to build the interconnector. Commission asked MGT to fulfil many requirements, and one of them was ownership unbundling (IND HUNG 5 2016).

The wish to build the interconnector using the EU funding is visible from the ardency of the Viktor Orbán Government to persuade the Commission that MGT could do it. Unlike in Lithuania, where the new LNG terminal increased the 'N-1' rate by a large degree because the starting position was low, the promoters of the Slovak-Hungarian pipeline had fewer arguments in this regard. Hungary was already interconnected to Austria, Romania and Croatia, and the 'N-1' criterion was already above 100%. Despite this, Hungary used even this argument, claiming that the Slovakian-Hungarian interconnector would 'help the overall Hungarian gas system to comply better with the 'N-1' requirement of Regulation 994/2010, which foresees that, in the event of a disruption of the single largest gas infrastructure element, the capacity of the remaining infrastructure shall still be able to satisfy peak gas demand. The pipeline will increase the existing 'N-1' value by 12 percentage points and enable the overall Hungarian gas system to cover 124% of peak demand' (European Commission 2013a, 5). The Hungarian state actors also used a sort of 'rhetorical entrapment' of the Commission (Schimmelfennig 2001). The EU supported North-South (East) gas corridor, which would connect European gas supply sources from the Baltic, Adriatic, and Black Seas 'to the rest of Europe' (European Commission 2016h), and the Slovak-Hungarian interconnector was a 'missing element' in this picture (IND HUNG 5 2016; European Commission 2013a, 5). An interviewee said:

> That was a very good argument. There was a big regional project that the Commission liked, we would build one element, and the Hungarian part would be completed because the Croatian interconnector was done, the Slovak would be done. It was difficult for the Commission to say that they like the North-South project, but they do not support a certain element of this project. The EU was in a sense under pressure. They always communicated that one of the most important projects in the South Eastern region was the North-South interconnector, which actually was against the Russian [gas] flow (IND HUNG 5 2016).

As the Commission had concerns that the co-owner of MGT, MVM, by that time had a strong presence not only in the electricity but also in the gas sector (European Commission 2013a, 7–9), in late 2014 Hungarian National Asset Management (MNV), purchased MGT from MVM and MFB. The Hungarian energy regulator in 2015 certified MGT by the ownership unbundling model under separate public bodies as the ownership rights in MGT (but not the ownership) were transferred to the Ministry of Interior (European Commission 2015c).

To summarise, this chapter has shown that when the 'EU Opportunism' mechanism was broken in Hungary in mid-2010 due to reconfigurations of interests, a new causal mechanism emerged. There is a crucial difference from the mechanism of 'EU Opportunism' in Post-2010 Hungary: instead of proactively using EU regulations as 'opportunity structures' to maximise their aims, the governments after 2010 were mostly reactive to pressures built by the Commission. It has shown that because of the political changes in Hungary, the *interest structure* became dominantly against EU instigated gas sector liberalisation and private companies in the sector. They continued the cross-border diversification efforts. The Hungarian Government was 'testing the ground' as to how far it could go without triggering repercussions from the Commission. The Commission could commence an infringement procedure only on the aspects where it found avenues in EU energy laws; thus, it did not target the utility price cuts, taxation or nationalisation of the Hungarian gas sector. As soon as the

Commission started an infringement procedure, the Hungarian Government became cooperative; thus, its approach towards regulatory EU tools was reactive rather than proactive. The dominant *interest structure*, however, did their utmost to comply with EU requirements proactively in one case, the Slovak-Hungarian Interconnector, where only in the case of compliance with the requirements could it receive EU funding for the project.

8 COUPLING AND DECOUPLING OF INTERNAL MARKET AND CROSS-BORDER DIVERSIFICATION

This chapter compares four cases by plotting each of them alongside one of the two expected process tracing causal mechanisms; 'EU opportunism' and 'EU leverage'. The first part of the chapter discusses a connection between political interests to regulate gas prices and the role of NRAs. The second part has a process-oriented structure. This chapter reiterates that the cases of 2002-2010 Hungary and 2008-2016 Lithuania were characterised by balanced *interest structures,* which triggered the 'EU opportunism' causal mechanism. In Romania in 2008-2016 and Hungary in 2010-2016, dominant *interest structures* were identified that set in motion the 'EU leverage' mechanism. The orientation to processes in the case studies comes from this thesis' research interest in the 'how' questions of EU influence, and consequently the research method of process-tracing. I can only confirm that I found an expected mechanism in a case study if I confirm that each of the expected parts existed (the whole inference is as strong as the weakest link). In this chapter, only main observations are summarised in each step of the causal process tracing mechanisms, whereas the more detailed evidence can be found in the empirical chapters. Placing the mechanisms next to each other shows that in some cases they are more pronounced than in others, which depends on specific configurations of interests.

8.1 Political agendas influencing NRAs and sectorial interests

Because of their special position, national regulatory authorities of EU natural gas sectors become targets of domestic politicians, who attempt to have regulators on their side or at least to keep them from disturbing the political goals / system. The way of political actors interfering with NRAs depends on the most salient questions surrounding national gas sectors. In three out of four cases, Hungary 2002-2010 and 2010-2016 and Romania 2008-2016, the two most salient issues were related to end-user price regulation (internal market category)

and cross-border interconnectors (diversification category). In Hungary, the price regulation issue mostly revolved around household consumers and SMEs, whereas end-user price deregulation for business consumers was less contested. In Romania, deregulation of end-user prices for both domestic and business consumers was a very contestable topic. In the Lithuanian case, most political and legal disputes concerned the implementation of the ownership unbundling option foreseen in the Third Natural Gas Directive (internal market category) and building a new LNG terminal on the seacoast of the Baltic Sea (diversification category). Even though before the start of the research period, the end-user price regulation had been a principal question in Lithuania as well, after 2009 it was overshadowed by matters of ownership unbundling and the LNG terminal project.

In both Hungarian cases, the internal market aspect (end-user price deregulation) and cross-border diversification were rather decoupled. Whereas price-regulation of household consumers was a disputed topic, there seemed to be more consensus on developing cross-border infrastructure. In both research periods, Hungarian domestic actors attempted to build cross-border interconnectors and participated in pipeline mega-projects that would have made Hungary a gas transit country, such as Nabucco and South Stream. The result of the decoupling of these issues was that in the second research period, 2010-2016, the Hungarian policy makers retrenched the sector liberalisation efforts made by the previous governments, but continued the interconnectivity projects. All three of new interconnection projects that started in the first research period, and interconnectors from Hungary to Romania, Slovakia and Croatia, were finished in the second research period. These interconnectors created more possibilities both for gas import and export.

In Lithuania and Romania, internal market and cross-border interconnectivity questions were related, but they went to different directions. In Romania, deregulation of end-user prices was coupled with cross-border diversification. This was because for Romania, as

a large gas producer, integrated gas infrastructure would very likely mean exports of cheaper domestic gas to possibly higher price areas. In Lithuania, the implementation of the ownership unbundling and the LNG project were considered coupled by the interviewed representatives of the reform, for example, by the former Energy Minister Arvydas Sekmokas or the former Prime Minister Andrius Kubilius. In the beginning of the reform, the Lithuanian transmission system lacked an internal connection from the seacoast to the rest of Lithuania, which had to be built by Lietuvos Dujos (Samoškaitė 2010). When disagreements between the 2008-2012 Government and Lietuvos Dujos about creating a 'ring' in the transmission system arose, in turn, the Lithuanian Government wanted to take control of the transmission system via implementing the ownership unbundling option (Sekmokas 2014; Kubilius 2015). During most of the period, cross-border integration aspect meant ensuring new routes of import only, and just at the end of the research period, when Lithuania became able to export, it also started to mean export.

Different interests of politicians resulted in the policy makers' actions towards NRAs, who also shape the gas sectors themselves. Here, 2002-2010 Hungary and 2008-2016 Romania cases can be especially compared, as both implemented the early stage of liberalisation of end-users, required by the Second Natural Gas Directive. There are similarities, such as the creation of dual markets, consisting of a competitive segment and a household and SMEs segment.

In post-2010 Hungary and Romania, NRAs underwent legal changes. In both cases, the reforms were justified as to fulfil the requirements set out in the Third Natural Gas Directive. Romania in 2012 and Hungary in 2013 upgraded their regulators from 'government authorities' to 'autonomous/independent regulatory bodies/authorities' (ANRE 2013, 6). However, while the Romanian reform made ANRE more independent (albeit with some limitations), Hungarian NRA was given more powers and at the same time fell deeper under

Government control. Yet, the larger the power the regulator has, the more important is its independence from industrial or political interests. In reforming the regulator in 2013, the Hungarian Parliament claimed to strengthen the independence and competences of their regulator, but the legislative changes actually decreased the independence and presumably went against the EU requirements.

Eventually, the NRA in Hungary had a right to set-end user prices from 2009 to mid-2010, at the very end of the last MSZP government. From 2010, not only the regulator lost powers to set end-user and gas transportation prices, general approach to price setting changed from bottom-up to top-down. Moreover, after the reform in 2013, certain decisions of the Hungarian NRA could be challenged only in the Constitutional Court. This created many obstacles for a judicial review of its decisions, because the Constitutional Court analyses only decisions in light of their compliance with the Constitution, and not its economic effects.

In 2012 in Romania, Parliament used the combination of pressures to transpose the Directive coming from the Commission and the political difficulties of failing governments in 2012. It changed the law concerning the NRA, which resulted in the Parliament getting more control over the regulator. Romanian NRA was moved from Prime Minister's control to the Parliament control in 2012. After the reform, Parliament obtained power to nominate and appoint the main staff of the regulator.

The most influential committee regarding the Romanian gas sector in the Parliament, Committee for Industries and Services, was led for more than a decade by a PSD party member, who had a record of attempts to slow down full integration of the Romanian gas sector according to EU policies. However, many of the interviewees indicated that after transferring ANRE in 2012 from the Government to the Parliament control, its independence from political interests generally increased. It was also noted that ANRE remained partially aligned with the interests of the Parliament. One interviewee believed that since 2012 the

ANRE had been considerably more independent from the Parliament than it used to be from the government, but he noted that ANRE would have had difficulties to make drastic changes in the sector that could initially result in end-user price rise. He said:

> In fact, it is very difficult for the regulator to be against its people. Parliament is the result of an election; that means that voting will have been expressed through the Parliament. If Parliament says that people are poor and you do not have to increase the prices because they believe that it is not correct, it means that regulator goes against the will of the people (Sirbu 2016).

Another interesting aspect is how end-user price regulation shapes interests of natural gas companies that are affected by it. On one hand, the situation of partial liberalisation, when wholesale prices are free to float or defined by long-term contracts, but the retail prices are regulated with a very low margin, is harmful to them (IND ROM 2 2016). Thus, gas companies may seek further deregulation. On the other hand, in two case studies there were occasions when governments or NRAs via tariff would 'return' historical losses of disadvantageous price regulation, which would make it in the interest of regulated companies to remain regulated. Such situations were observed in both Hungarian and in the Romanian cases.

In Hungary, by 2002-2003, the holder of the main long-term gas import contract and a dominant wholesaler owned by MOL sought deregulation because of the former situation. However, by 2006 it turned to the second situation. Then Földgáz Trade (the same company but already owned by E.ON) accumulated losses because of the discrepancy between the rising import price and the regulated end-user price. Therefore, after the negotiations with the wholesaler, the Hungarian state agreed on a gradual compensation of the losses in the forthcoming years in a tariff. A former state worker recalled:

> The wholesaler said that he had more and more costs on the import side and let's accept it, because the price was accepted by decree. […] In 2006 there were negotiations between the wholesaler and the Government how to compensate them for these losses

> and both parties agreed that with a soft landing in every quarter it will somehow accept these historic losses and calculate as a special item in the fee structure these historical losses for the accepted gas price (SE HUNG 2 2016).

According to the interviewee, the MSZP Government wanted to find a compromise with E.ON, 'because at that time we had seen that wanted to open the market at the beginning of 2009, so somehow we must solve all the problems of the history before that period' (SE HUNG 2 2016). The MSZP Government proceeded with the full liberalisation of end-user consumers later than was prescribed by the Second Natural Gas Directive, after settling the historical losses. A similar arrangement was made in Romania in 2011-2014, when the Romanian NRA started calculating in tariffs a compensation for the 2008-2009 losses for the main retail companies which were owned by E.ON and GDF (and other suppliers to the regulated segment) in a tariff (Chisăliță 2016). Some interviewees pointed out that as a result, these suppliers started expressing doubts about further liberalisation of end-users. Radu Dudau noted: 'A couple of years back they were the vocal advocates of liberalisation, now they tend to be more conservative. If you deregulate the wholesale market, they would have to make sure that the market prices they pay to acquire gas will be fairly transferred upon the final consumers, as they operate under a regulated revenue margin' (Dudau 2016). Other interviewees acknowledged that large incumbent end-user suppliers, which are also holding DSOs, may express some reluctance to market liberalisation if they deem the market as insufficiently liquid and feel the lack of trading instruments (Sîrbu 2016). The two latter cases show that the political interest to keep regulated prices low translates later into changing the incentive structure for private actors (which may be in favour of price regulation as long as it compensates them for the past losses).

The Lithuanian pro-reform politicians, preoccupied with legal and political fights to implement ownership unbundling and build an LNG terminal, but not with the end-user price regulation, did not try to change the status or setup of the NCC. When the NCC was

established in 1997-1998, its aim was to be an 'independent commission [which] should be in charge of energy prices' (NCC 2005, 3), however, by the research period its role was wider, the regulation of the energy sector and not (only) prices. The nomination and appointment of the NCC leaders changed right at the beginning of the research period in November 2008. Since then the leadership of the NCC are appointed by the Parliament on the nomination of the President for five years (NCC 2015). The potential role by the Government apparatus in influencing the decisions of the regulator decreased, but even before, unlike in Hungary and Romania, different institutional actors nominated and appointed the NCC commissioners. The Prime Minister used to nominate and the President to appoint them for five years and the NCC regulations were approved by the Government (NCC 2005, 3). An interview with a person from the NCC indicated that the regulator was aware of potential 'short term interests' of the politicians to decrease energy prices, and recently resisted them on several occasions. The NCC also resisted decreasing Lietuvos Dujos prices too much in 2013, this time initiative came from the company itself in order to preserve its market share (NRA LT 2014). Moreover, as was written in CH 5, while adopting the law that transposed the ownership unbundling option in the Lithuanian gas sector in 2011, the policy makers 'silently' (as media dubbed at that time) deleted direct references to price regulation of all end-users. This law defined that only household and non-household consumers that consume less than 20,000 cubic meters of natural gas per year, receive 'guaranteed supply services' and are regulated by setting price caps (Lithuanian Parliament 2014). The regulatory activities of NCC continued to be applied to those obliged to 'guarantee supply services', as based on the Law on Natural Gas, when once in six months natural gas companies set the tariffs to the household customers, which they submit to NCC for approval (ERRA 2013, 24–25). The law entitled the NCC to resume regulating prices if it identifies that due to the lack of efficient competition a company is either charging excessively high prices, or exerts price pressure, that causes damage to the market

participants. This means, that the decision to regulate end-user prices was left to the NCC and based on market, and not political conditions.

Provisions of the Natural Gas Law of 2011 gave powers to the NCC to ensure that E.ON and Gazprom indeed complied with ownership unbundling requirement. This law enabled the NCC to fine natural gas transmission system operator up to 10% of its revenues from transmission and limit some of its rights until it was unbundled properly, if it did not fulfil the requirements of ownership unbundling by a certain date (Lithuanian Parliament 2011b). Thus, the NCC received rights to independently enforce the ownership unbundling requirement. The interviewee from the President's Office explained that this was done on purpose: 'Those law projects [Law on Natural Gas and Law on Implementing Natural Gas] that obliged Gazprom to divide Lietuvos Dujos and envisaged fines if Gazprom would not do it, created a precedent, a legal pressure, for the executive institutions to act accordingly' (PRES LT 2015).

On the other hand, initially when speeding up to launch the LNG terminal project, the same Government of 2008-2012 left the NCC out of it. Based on the Law on Natural gas of 2012, Klaipėdos Nafta, which was assigned to be the project implementation company, and its planned investments in the LNG terminal initially were not subject of regulation by the NCC (NRA LT 2014). The interviewed NCC representative was unhappy about the latter part. He said in summer 2014: 'From our point of view maybe it is not the best decision because the regulator should participate up to a certain level. The current situation is that the regulator already after the investments have to fine-tune the investment. […] The NCC will do that only in autumn 2014 when information will be submitted and analysed. Such a situation would *not* be added to the textbooks as an exemplary situation' (NRA LT 2014). The NCC confirmed the Klaipėdos Nafta investment in the LNG terminal just in October 2014 – when the LNG cargo ship Independence was about to arrive to Klaipėda (NCC 2014b).

As reiterated in CH 2 and the next part of this chapter, even though the ECJ ruling forbade regulating prices for business consumers, none of the EU legal instruments could prohibit regulating household prices. Therefore, even though the Commission and private actors in 2010-2016 Hungary or 2008-2016 Romania could have preferred deregulated prices, the Commission could only enforce it via other channels, for example, by challenging the status and rights of the NRAs.

8.2 Proactivity or reactivity of domestic actor coalitions

There is one set of indicators which allows to visually place all the case studies in one of the two causal process mechanisms that is a log of infringement procedures and other way of enforcement that the Commission used vis-à-vis the countries of interest. One of the core differences between the 'EU opportunism' and 'EU leverage' mechanism is the direction of action to implement certain EU regulations. If the 'EU opportunism' mechanism is in place, a pro-reform *actor coalition* from a member state is expected to proactively use EU opportunities, which are not necessarily incentivised by EU-funding. The story, thus, more revolves about separate actors in a member state. If 'EU leverage' mechanism is in place, the story becomes about the Commission and its actions to enforce compliance. The fingerprints of such enforcing actions by the Commission can be found in analysing infringements and financial assistance by the Commission towards a member state. The length of the enforcement actions, such as infringement procedures, provide additional information about the willingness of the member state in question to comply with the requirements or wait until the case reaches the ECJ when the country risks to pay penalties if it loses the case.

Figure 15 plots the Commission actions in making Hungary, Lithuania and Romania comply with EU requirements in their natural gas sectors, based on the information accessible in the Commission infringement decisions database. Below the horizontal timeline some, but not all, of the most important EU legal instruments that were in place at that time are plotted.

The infringement procedures mostly were related to these EU legal instruments. A table with the exact titles, time and the stages of these infringement procedures and the stages they reached is in the annexes in Table 8.

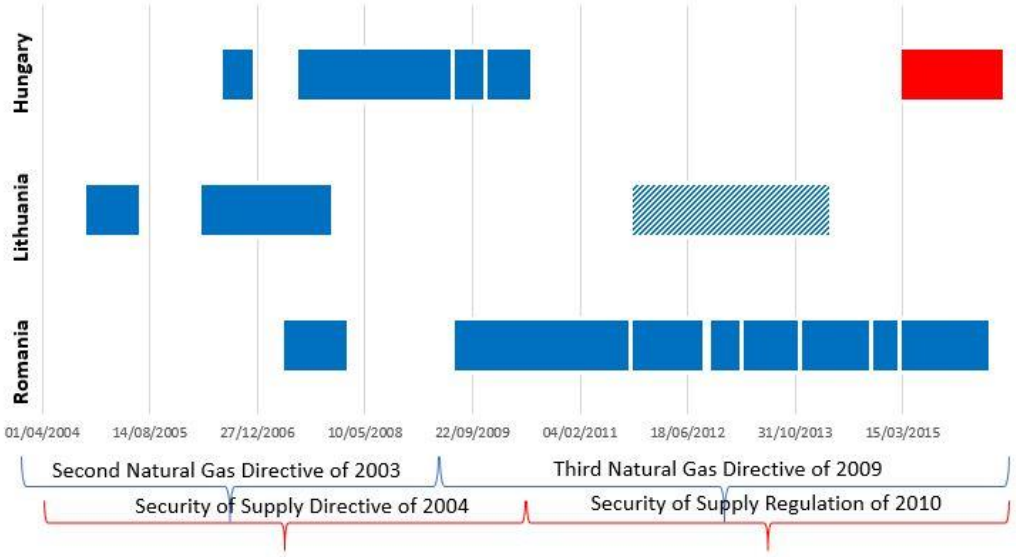

Figure 15 Visualisation of the infringement procedures related to the security of supply or internal market in gas in Hungary, Lithuania and Romania[46]

In this figure, a strong difference is seen in the amount of the infringement procedures that the Commission started against the respective member states. In Hungary, all three infringement cases before mid-2010 (balanced *interest structures*) were short and were closed after the first stage formal notice. The first of those infringement cases in 2007 because of the Security of Supply Directive of 2004 lasted only around five months. On 30 September 2011, when the Commission 'routinely' sent notifications to a number of EU member states (Lithuania and Romania included) for the non-communication of the transposition of the Third Energy Directive, the deadline of transposition of which was six months prior, Hungary did not receive this notification. As presented in CH 4 and 7, by then Hungary had

46 The infringement procedure of compliance with the provisions of the Third Energy Package in Hungary that is coloured in red was continuing at the end of the research period.

'transposed' this directive at least twice. However, the infringement procedure that the Commission started against Hungary because of this directive, was because of 'incorrect transposition' and not delays in doing it. A break in between the infringement procedures in Hungary before the one that started in February 2015 is explained in CH 7 as a time lag for the Commission to react to domestic legal changes.

In Lithuania, the last infringement procedure before a break in gas was concluded by December 2007. Two first infringement procedures reached a second stage, reasoned opinion. The Commission has never opened an infringement procedure against Lithuania for non-compliance with the Security of Supply Directive of 2004 or the Security of Supply Regulation of 2010. It was slightly puzzling to find an infringement procedure under the Third Natural Gas Directive of 2009 opened against Lithuania *during* the Lithuania's negotiations with Gazprom and E.ON and taking into account that the Commission reportedly gave extensive feedback on draft natural gas laws. However, it appears to be a 'routine' infringement procedure which was opened against many EU member states at once (not Hungary, as mentioned above) on 30 September 2011 for the non-communication of transposition of the Third Energy Directive. In Lithuania, this procedure was later qualified as a partial transposition.

Romania presents the largest contrast to the other two countries, as series of infringement procedures started very soon after the country joined the EU. Moreover, the 'routine' set of infringement procedures that started on 30 September 2011 reached the third stage, referral to the ECJ, for Romania. In Romania, three out of at least six infringement procedures reached the referral to the ECJ stage, whereas in Hungary and Lithuania none did. The detailed mechanisms further are presented in the same order as the case studies in the thesis.

In ensuring compliance with competition policy rules the Commission targeted private

actors in the Lithuanian case and state-owned actors in the Romanian case. The Commission strengthened the case of the Lithuanian Government by executing 'dawn raids' in Gazprom affiliates when Lithuania complained to the DG Competition, whereas in Romania it targeted mostly government-owned companies. In September of 2011, after an earlier complaint by Lithuania to the Commission, DG Competition launched a series of 'dawn raids' in the premises of Gazprom affiliates in central and eastern European states (Lithuanian Ministry of Energy 2011; Gotev 2012). At least the following companies were investigated: Gazprom Germania in Germany, EuroPolGas in Poland, Vemex in the Czech Republic, GWH Gashandel in Austria, Overgas Inc. AD in Bulgaria, Panrusgas in Hungary, Latvijas Gaze in Latvia, Eesti Gaas in Estonia, and Lietuvos Dujos in Lithuania (Gazprom 2013c, 19). Another example of enforcement of antitrust with regard to agreements between companies was 'dawn raids' in the premises of Romania's Romgaz, Transgaz, OMV Petrom in mid-2016 (Yun Chee and Ilie 2016).

Lithuania did not request a BoP assistance, but both Hungary and Romania did. By asking for this kind of financial assistance, both countries opened a room for the Commission to condition them with regard to their energy sectors.

8.3 'EU opportunism' in 2002-2010 Hungary and 2008-2016 Lithuania

The research has shown that the mechanism of 'EU opportunism' was more expressed in the Lithuanian case than in the pre-2010 Hungary case, possibly because different types of actors used EU opportunities. In Lithuania, it was high-level politicians that used combined available EU-level opportunities to seek natural gas supply independence from Gazprom in their interpretation of this independence. In 2002-2010 Hungary, it was the domestic natural gas 'champion' MOL, which saw new strategic options to cease loss making regulated business activities if Hungary deregulated end-user consumers according to the EU requirements.

Hungary 2002-2010: MOL seeing opportunities in EU membership

Step 1: Balanced *interest structure* coincide with existence of relevant EU instruments

In pre-2010 Hungary, due to the larger number of private actors in gas, the relevant *actor coalitions* were spread in both the political and the business areas. In Hungary, the 2002 general election brought the Hungarian Socialist Party (MSZP) back in power after one term in opposition. Right-wing Fidesz, which had intentions to nationalise the domestic natural gas incumbent MOL and to keep end-user prices low, as, according to Viktor Orbán, 'neither multinationals nor domestically owned firms will be permitted to impose unbearable burdens on Hungarians' (Hungarian Radio 2000c) went to opposition. This party, which strongly preferred end-user price regulation, losing a possibility to form the government, coincided with the approaching Hungary's EU accession. Hungary had to implement the First Natural Gas Directive of 1998; the draft Second Natural Gas Directive of 2003 was already discussed in Brussels.[47] During the MSZP period, the Second Natural Gas Directive was adopted in Brussels in 2003 and had to be transposed by July 2004. Moreover, the MSZP was still in power after the 2006 election (until April 2010), when another important EU instrument came in place, the Third Natural Gas Directive was adopted in Brussels in 2009. The visualisation of the *interest structure* based on the findings in CH 4 is presented below in Figure 16. The period of 2002-2004 marked a very fragile balance of power in the political arena. In 2002 MSZP and the Alliance of Free Democrats secured a narrow, ten-seat parliamentary majority over a coalition of Fidesz and Hungarian Democratic Forum (MDF). As seen in the figure, in 2002-2010 Hungary, the Government was more or less following the EU requirements to liberalise the gas sector. However, the Government took its time with the transposition of the Second Natural Gas Directive, which was transposed in 2008 (this Directive had to be

47 The European Commission proposed to revise the First Natural Gas Directive in 2001: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2001:0125:FIN

transposed in all member states by mid-2004, but like in many new EU member states it was delayed in Hungary). A big share of the Parliament was occupied by an anti-integration actor Fidesz. The Hungarian President was neither directly elected and/or had much say in the energy politics of the country. Between the country's executive powers, the President's role in the energy policy, unlike in the Lithuanian or Romanian cases, was weaker, which came from the constitutional configurations of the country. Hungary, unlike Lithuania or Romania, did not have single large gas consumers like fertiliser producers.

The *interest structure* in 2002-2010 is presented in Figure 16 below. In this and the following figures, the position between the axes indicates the interest of the actors and the size of the bubbles indicates their inferred power. If a position of an actor towards a certain question was not identified or neutral, it is placed in the middle of the respective axis. Positions of the political actors are coloured in darker colours. E.ON and MOL are presented twice in different colours, because it is assumed that the interests and power positions of both companies were influenced by the E.ON's purchase of the storage and wholesale affiliates from MOL in 2006. The position of the Hungarian Presidents Ferenc Mádl and László Sólyom is not presented in the figure because it is assumed that they did not have an independent interest towards the gas sector of their own, but being 'opposition presidents', generally weakened the MSZP and strengthened the Fidesz power positions.

Figure 16 The *interest structure* in 2002-2010 Hungarian natural gas sector (their power positions are represented by the size of the bubbles)

As seen in Figure 16, the major left-right division of interests were between two main political parties, MSZP and Fidesz, whereas the sectorial actors and the NRA were rather in favour of the liberalisation of end-users. There was less division among the actors with regard to interconnectivity (top-down). It is, however, assumed that MOL remaining only with the production and transmission companies in gas and incentivised its focus on cross-border interconnectivity projects. Subsequently, an acquisition of a wholesale company from MOL on one hand increased the power of E.ON, on the other hand, narrowed E.ON's interests with regard to liberalisation and interconnectivity. A quick liberalisation and alternative import sources could threaten the holder of the major long-term import contract, which E.ON became in 2006.

Step 2: Reform-prone *actor coalition* seizes opportunities provided by EU instruments

In 2003 the national energy champion MOL soon came up with propositions to liberalise natural gas sector. At that time, end-user prices were regulated for both business and household consumers, and this also resulted in regulation of gas production prices. In that period, MOL was active both in gas production and end-user supply. MOL's motivation to make consumers eligible to choose suppliers stemmed from the experiences in the late 1990s-early 2000s when it had suffered losses from price regulation under the 1998-2002 Government of Viktor Orbán. Hungary had to soon join the EU and accordingly sort its legal order. Even though interviewed former state administration officials would not explicitly mention the MOL's role, interviews from the gas sector highlighted this fact. For example, one claimed that it was MOL specialists who prepared the draft framework versions, 'as politicians had no ideas what to do, but we already wanted to achieve the normal liberalised market' (UPS HUNG 2016). A high-level official in a Hungarian Energy Company said:

> The [socialist] Government had liberal approach and supported market establishment. It was not just for gas but for other sectors as well. What was special for the gas market that Government at that time was brave enough to touch that market and change what was introduced by the First Viktor Orbán Government, which wanted to put their hands on this market, which happens now again. When politicians agreed that household prices would be under control and would not be skyrocketing, for them it was then acceptable (IND HUNG 3 2016).

Arguably, Hungary's transposition of the Third Natural Gas Directive at the end of 2009 was also beneficial to MOL. However, as seen in CH 4, only weak inferences can be done about MOL using the opportunities to push for a more benevolent option of the Directive. None of the interviews confirmed direct involvement of MOL, except for acknowledging that MOL did not want the ownership unbundling option. As the MSZP was still in power, but the general election was coming, and the party had lost its face in eyes of

the electorate after the Prime Minister Gyurcsány's speech in September 2006, where he had confessed about lying about the Hungarian economic situation. The traditional opponent Fidesz was very likely to come back to power, and in the past it had already attempted to nationalise MOL. Had the Third Natural Gas Directive been implemented with the ownership unbundling option, MOL could have been forced to lose the ownership of the gas transmission system. Even though, as can be understood from media and interviews, the socialist Government with the help of the national energy regulator was preparing the draft law to among others transpose the ownership unbundling option. This model did not enforce a vertically integrated gas company to sell transmission system (which was MVM in electricity and MOL in gas).

Step 3: Reform-prone *actor coalition* gains more power because of used 'European' opportunities

In 2002-2010 Hungary**,** this step has been less expressed than in Lithuania. It can be implied that MOL's interests to stop having regulated (and loss making) consumers was met rather positively by the MSZP, which was ruling the country on the onset of Hungary entering the European Union. Moreover, once the new order according to the EU spirit is in law, this is harder to change and gives more predictability that the price regulation would not change overnight.

Step 4: Reform-prone *actor coalition* changes the gas sector towards the direction of spirit and rule of EU regulations

2002-2010 Hungary complied with EU natural gas directives in three waves. First, was the adoption of the Act XLII of 2003 on Natural Gas Supply on 14 June 2003, and the subsequent government decrees divided at that time closed gas market into two parallel

segments, a public utility segment (where households remained under regulated prices) and a competitive one (which the industrial consumers could enter with gradual opening). Even though the Hungarian law claimed to transpose the First Natural Gas Directive of 1998 at that time (Hungarian National Assembly 2003, para. 86), it greatly surpassed the minimum requirements of the market opening. The absolute minimum market opening required by the First Gas Directive was 20% as from 10 August 2000, increasing to 33% by 2008 (EC Directorate-General for Energy and Transport 2000, 3). The requirements for the opening of the market that the Hungarian policy makers set up more resembled the Second Natural Gas Directive, which was still under discussion in the EU and was adopted on 26 June 2003 – more than a week later when the Hungarian Parliament adopted this act. Secondly, in 2007 the socialist Government initiated the next wave of electricity and natural gas market liberalisation, planned for completion in 2009. The Hungarian Parliament passed the Act XL of 2008 on Natural Gas (hereinafter Natural Gas Act of 2008), which came fully into force on 1 July 2009. The new act ceased hybrid model, and 'universal service' supply replaced the public utility supply to small customers (HEO 2010, 6).

The end-user prices for households never ceased to be regulated under any of the governments of Hungary after the socialism. The socialist governments of Medgyessy, then continued by Gyurcsány, deregulated the prices for the business consumers and in combination with a social policy offsetting price increases for the households, implemented a programme that brought the household prices from below the costs to resembling the market prices.

Lithuania 2008-2016: Government and President *vs.* E.ON and Gazprom

Step 1: Balanced *interest structure* coincide with existence of relevant EU instruments

The reform in the natural gas sector in Lithuania created two 'camps', those making and supporting the reform, and those resisting it. The reform or status-quo prone coalitions in the natural gas market of Lithuania were identified based on the stance of different actors on two key issues in the sector, ownership of the main gas transmission company and the LNG terminal project, and the political and legal disputes about them. In the research period, the two major conflicting points among the political and business elites from 2009 were changes in the ownership of the main natural gas company via implementing a certain choice of the Third Natural Gas Directive and the security of gas supply (mostly the new LNG terminal).

Since the Lithuanian gas sector had the least amount of private actors involved, the relevant *actor coalitions* were concentrated on the political level. This was because Lithuania does not produce gas and subsequently does not have upstream companies and also because the Lithuanian gas sector was mainly a vertically integrated monopoly dominated by Lietuvos Dujos, co-owned by E.ON and Gazprom. On the retail level to business customers there was also Dujotekana but it also had a direct contract with Gazprom.

For this reason, when the Third Natural Gas Directive of 2009 and the Security of Supply Regulation of 2010 came into force, political changes ensured that they were met by a balanced *interest structure* on the domestic level. In Lithuania, the general election in 2008 resulted in the Homeland Union – Lithuanian Christian Democrats taking over the Government formation from the Lithuanian Social Democrat party, which had been forming governments from 2001. The Prime Minister of Lithuania became the leader of the Conservative's Andrius Kubilius, who a couple of years earlier, in 2007-2008, while being the chairman of the European Affairs Committee in the Parliament, managed to force the Lithuanian Social Democrat Government to abandon the idea to ask for a derogation of Lithuania from certain aspects of then draft Third Natural Gas Directive that later became crucial. Andrius Kubilius assumed premiership in December 2008 with an agenda to change

the *status quo* in the Lithuanian natural gas sector, which, according to the interview with him, at that period was 'one pipeline, Gazprom, and its monopoly' (Kubilius 2015). Six months later, in May 2009 a former EU commissioner Dalia Grybauskaitė was elected to be the President of Lithuania by popular vote. Being a non-party candidate, she was to become one of the supporting forces of the reform in the Lithuanian natural gas market. The 2008-2012 Government of Andrius Kubilius did not enjoy a wide majority in Parliament, and in fact for some period of the term he was part of minority Government and had to rely on the support of opposition parties in passing the important reforms. A former high-level official from Lithuania said: 'For Lithuania, a very convenient path was laid down, and it was possible to make use of it. However, no reforms would have happened without the political will. The EU legislations coincided with a good combination of Government, strong institution of the President and possibly a weaker Parliament (SE 1 2016). There was a configuration of the *interest structure* in Lithuania in July 2009, when the Third Natural Gas Directive came in force in Brussels and had to be transposed to the national level in approximately two years, later followed by the Security of Supply Regulation, which came in force in October 2010.

The Social Democrats, then in opposition, actively sought to halt changes in the Lithuanian legal order that would have entailed ownership unbundling of the main natural gas company, Lietuvos Dujos. Based on the voting behaviour in the Parliament, the 'loosely related' parties were the Labour Party and Order and Justice Political Groups in the Parliament. In public they criticised the unbundling process, but occasionally voted in favour when the ruling coalition was short of members in the Parliament.

On the sectorial hemisphere, resistance to the implementation of the ownership unbundling came from Lietuvos Dujos, its owners E.ON and Gazprom, the Lithuanian Natural Gas Association, which was registered to the address of Lietuvos Dujos, but involved more natural gas companies. Opposition towards the reform also came from non-energy actors,

such as the Russian State, which warned about its intentions to arbitrate when the implementation of the Third Natural Gas Directive was taking off. The largest Lithuanian fertilizer producer, Achema, which had been promised to build its own LNG terminal by the earlier Social Democrat government, openly resisted the future LNG terminal built by the Lithuanian government.

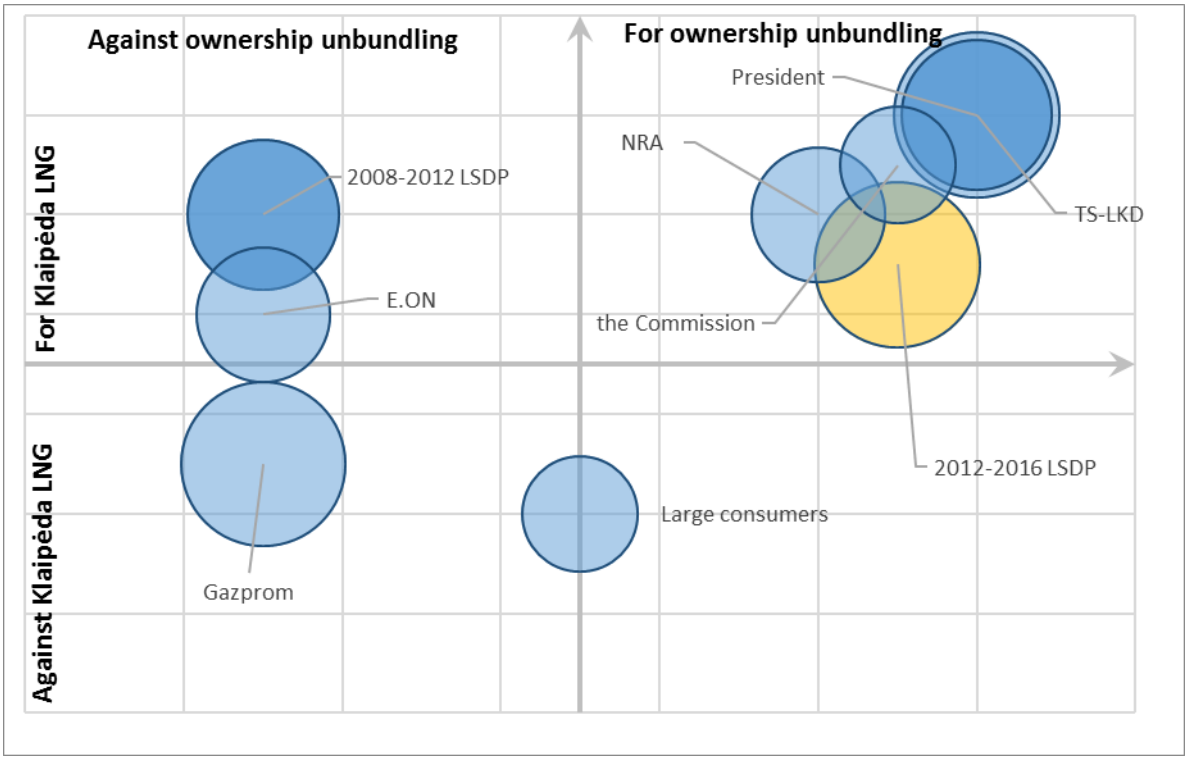

Figure 17 The *interest structure* in the 2008-2016 Lithuanian natural gas sector (their power positions are represented by the size of the bubbles)

Based on the actor interests and power positions identified in CH 5, the *interest structure* in 2008-2016 Lithuania is presented in Figure 17 above. The size the position between the axes indicates the interest of the actors and the size of the bubbles indicates their power. As the position of LSDP changed in 2012, when they returned to forming the Government, the new position is indicated in orange. Actors, whose positions towards a certain question were not identified or were neutral, are placed on the respective axes of the issue. The category 'large consumers' contain both Achema and Lithuanian District Heating Association that submitted complaints to the Commission challenging certain aspects of the

LNG project.

Step 2: Reform-prone *actor coalition* seizes opportunities provided by EU instruments

There is generous evidence in CH 5 that the Lithuanian 2008-2012 Government used opportunities provided by the EU instruments in place during the research period. They chose the strictest unbundling model in the Third Natural Gas Directive of 2009 and exceeded in implementing the requirements of the Security of Supply Directive of 2010. The majority of the Third Natural Gas Directive had to be transposed by March 2011, within the period of the 2008-2012 when the Government also wanted to implement their own reforms. Even though the Directive provided a choice of four models of ownership of transmission system operators, the Lithuanian Government chose the one which entailed that Gazprom and E.ON would have to leave the ownership structure of Lietuvos Dujos, ownership unbundling. One person who worked with the Government at that time said that 'it seemed that the Third Natural Gas Directive was written for Lithuania':

> Lithuania was a textbook example of how energy supplier controlled the transmission system owner and nothing is done about it to create competition, except for some imitations of actions. The Directive, which forbade supplier to dominate infrastructure, seemed like it was written for the Lithuanian needs (LEGS LT 2 2016).

As shown in the CH 2, another EU instrument that came into force in that period, the Security of Supply Regulation of 2010, did *not* explicitly oblige EU member states to invest in infrastructure. The Lithuanian government, however, closely tied the need to implement the Regulation with its plan to build the new LNG terminal on the Baltic seacoast with the requirements of this Regulation. They even decided to open an LNG terminal on 03-04 December 2014 the latest – exactly the same day when the Security of Supply regulation of 2010 required the member states 'to take all the necessary measures to ensure that in the event

of a disruption of the single largest gas infrastructure, the capacity of the remaining infrastructure is ensured' (so-called 'N-1' formula).

Lithuanian politicians also took use of other possibilities of personal assistance by the European Commission. By 2010, they involved the Commission into the negotiations with Gazprom and E.ON (representatives of DG Energy). The former Prime Minister Andrius Kubilius said in the interview that the Commission was invited because of 'a natural wish not to stand alone against Gazprom'. He said: 'We felt that we were not so large and strong [country]. So involving the Commission on our side was a very big achievement for us' (Kubilius 2015). By the end of the writing period of this thesis the European Parliament and the Council of the EU were about to agree on a new EU legislation which was to institutionalise the Commission's involvement in similar negotiations with energy supplier. However, in 2010 there had been only one previous precedent. It was Poland, who invited the Commission into the negotiations with Gazprom in early 2010. Moreover, in January 2011, the Lithuanian Energy Minister submitted the complaint to the DG Competition because of alleged abuse of the dominant position of Gazprom (Ministry of Energy of Lithuania 2011a). Lithuania complained about Gazprom possibly relating import prices to the implementation of the Third Natural Gas Directive, which from the start in 2010 resulted in Lithuania paying more for gas than Estonia and Latvia that were not implementing this directive (baltinfo.ru 2011; RIA Novosti 2010).

Andrius Kubilius said in an interview that the idea to trigger the Commission antitrust investigation was initially inspired by an article in the Financial Times he had read in 2006-2007 about the European Commission's antitrust case against the USA IT giant Microsoft. He said: 'This article had really gotten into my head […], and later I even met the author of the article. It was explained that the DG Competition may come with *black gloves* and make a raid. So, we decided to try that' (Kubilius 2015).

Step 3: Reform-prone *actor coalition* gains more power because of used EU opportunities

The EU instruments helped the reform-prone actors to force the single gas supplier at that time selling shares in the main gas company Lietuvos Dujos and subsequently to build an LNG terminal. Presence of the Commission as an actor strengthened the position of the Lithuanian negotiators that otherwise considered Lithuania to be very small compared to Gazprom. The quote by Andrius Kubilius shows how the membership in the EU and the related instruments helped the Lithuanian Government of 2008-2012 to push its interests. He said: 'Our membership in the EU since May 2004 was very beneficial to us, because we had a chance to participate in the creation of the European instruments which we later could use individually against Gazprom, but this time as a *European* instrument' (Kubilius 2015). However, the dual gas market reform met huge resistance from the onset. LSDP constantly voted against during the promulgation stages of the transposition law in Parliament in 2011. Gazprom – a company from non-EU country – resorted to arbitrations, whereas other opponents in the gas sector to complaints in Brussels. Until the last moment when the law was accepted in June 2011, LSDP, E.ON and Gazprom attempted to derail the transposition and prove that Lithuania could still derogate from the Directive even *post factum.* The main motive of the reform-prone *coalition* was that Lithuania, as a member state, must implement the Directive, because it had not asked for derogation. The Commission helped strengthening this case of inevitability of the transposition by sending the official letters to the Lithuanian politicians demanding Lithuania to transpose the Directive. In addition to this, the European Commission's participation in the negotiations with Gazprom and E.ON from 2010 to 2014 was deemed as 'expertise, knowledge, and qualified, guaranteed and free-of-charge assistance' (SE 1 2016). Another interviewee said that the Commission's presence in negotiations 'helped very much', because 'Commission behaved like an arbitral judge, but

somehow on our side'. He said:

> For example, if in the negotiation meetings, the shareholders of Lietuvos Dujos would claim that by 2014 they would not be able to finalise the unbundling, but the head of DG Energy Philip Lowe would respond that no way, he would not accept delays. It was very useful. Without the Commission, we may have enforced the unbundling but would not have found a compromise with the shareholders. For us it was important to find a compromise; we did not want to fight with everyone all the time (LEGS LT 2 2016).

Another law, designed for building an LNG terminal, passed in Parliament much more smoothly. The Government proposed this law in May 2012, and the adoption process lasted just a couple days longer than a month. This time, nearly all members of Parliament that participated in the session voted in favour of the law, including the Social Democrat Group (Lithuanian Parliament 2012c). The opponents of the terminal, such as Achema, Lithuanian Natural Gas Association, complained about the possibly illegal state aid to the future terminal. The Lithuanian policy makers, however, themselves informed the Commission to support the terminal via transmission tariff. When the Commission allowed this state aid, Lithuanian politicians then started using this decision by the Commission in the discussions with the opponents of the terminal in justifying the financial support by using the tariff.

Step 4: Reform-prone *actor coalition* changes the gas sector towards the direction of spirit and rule of EU regulations

Both reforms had to be finalised after the next general election planned for 2012. The government, the Commission and the shareholders of Lietuvos Dujos agreed that final date of the unbundling would be 31 October 2014. The deadline to ensure the security of supply 'N-1' standard according to the Security of Supply Regulation was in December 2014. Thus, both processes had to be finished two years after the term of the Government was due to expire. In addition to the gas market reform, the Government was implementing austerity measures

because of the global financial crisis, and them losing in the 2012 election was likely. Indeed, in 2012, LSDP came back to forming the Government. However, despite their earlier resistance to the implementation of the Third Natural Gas Directive, they did not reverse the dual reform in the gas sector. The Prime Minister of 2012-2016, the LSDP leader Algirdas Butkevičius, continued the unbundling process and the LNG terminal, despite the fact he had consistently voted against the ownership unbundling. As came up in the interviews, this continuity could be explained by the continuous balance in the *interest structure*, which was ensured by multiple factors. Firstly, the term of presidency by a strong proponent of the reforms President Dalia Grybauskaitė finished in May 2014 only; moreover, the Lithuanian population elected her for the second term due to expire in 2019. In addition, according to the sources, the Commission continued participating in the negotiations and with the shareholders of Lietuvos Dujos and consultations until 2014. It could also be due to changed geopolitical context and the social democrats adjusting to the new order. As one of the interviewees commented, it would be very unpopular to openly support Russian state company Gazprom's interest after the events that unfolded in Ukraine.

When Algirdas Butkevičius formed a new Government by December 2012, the President Dalia Grybauskaitė listed the continuing efforts to decrease dependence on the single energy supplier and finalisation of the LNG terminal project as one of the top priorities for the freshly elected Government (Grybauskaitė 2012; PRES LT 2015). A quote by a member of the ruling coalition 2012-2016 from an interview shows that the new ruling majority understood how difficult it could be reverse the reforms:

> The project of our Government [Gamtinių Dujų Terminalas with Achema in 2008] was ruined, agreements [for the new terminal] were made without possibility to reverse them. We can see the agreement in the Secretariat of the Parliament, and it is written on it 'irrevocable contract', and a daily payment is recorded […] I discussed those issues with the Prime Minister. […] In the new context, a geopolitical situation, events in Ukraine and general feeling of insecurity. […] And even though the situation in Ukraine

> escalated later, when we took office we did not want to fight with the initiations of the project, the President's Office. Thus, we finalised the LNG project. Nevertheless, it could have been cheaper' (LSDP LT 2015).

Another interviewee, the Energy Minister 2014-2016, Rokas Masiulis, explained the locking-in effect as a reflection of the maturity of Lithuanian democracy rather than a logic of consequentiality. He said:

> I think that Lithuania is maturing as a state. And we have matured enough for the political parties to agree among each other about the essential issues. I would say, that this is one of the first examples where the main projects of the state are supported by all political forces. If one started, another can finish it. I consider this to be a stage in a state's maturity (Masiulis 2015).

In August 2013 Lietuvos Dujos transferred assets, liabilities and rights related to gas transportation to Amber Grid, in accordance with the provisions of the Third Natural Gas Directive, regarding the split between the gas transmission and distribution activities. Subsequently, following the unbundling requirements, Gazprom and E.ON sold the shares in Lietuvos Dujos and its spin-off Amber Grid in 2014 to the government-owned Lietuvos Energija.

8.4 'EU leverage' in 2008-2016 Romania and 2010-2016 Hungary

In the 'EU leverage' mechanism I expected to see a reactive approach to the compliance pressures coming from the Commission and other transnational actors. Other than that, I expected domestic actors to merely fulfil the minimal requirements of the EU regulations applicable to the gas market, or even being late, or stepping in the zone of non-compliance by incorrect application of EU regulations. I expected to find more proactive actions only in the cases which are related to opportunities to receive EU funding, where the actors involved may very much comply with certain specific EU regulations to receive funding. Like Hungary after 2010, for most of the research period Romania rather reacted to

infringement procedures started by the Commission or was incentivised to liberalise or interconnect its natural gas markets based on the EU financing opportunities. Thus, the expected mechanism of Leverage (EU infringements and funding) was in place in Romania, just as it was found in Post-2010 Hungary. In Romania, against the backdrop of the infringement procedure because of the Third Natural Gas Directive for late transposition and failing Governments, the Parliament benefited from taking the initiative to transpose the Directive and taking over the Romanian energy regulator. In Post-2010 Hungary, there appeared to be a dichotomy between the internal market/liberalisation questions and interconnectivity: the actions of the dominant political interest structure decreased the competition in the gas sector, but the interconnectors planned from before were finalised.

2008-2012 Romania: 'Cat and mouse' game with the Commission

Step 1: Anti-integration coalition becomes dominant

In Romania, presidents are powerful, but their independence from political party interests is not ensured. Because of the unwillingness of the majority of the relevant actors to liberalise the Romanian market to avoid possible gas price increase, they also did not hurry up with the interconnector projects to possible higher price zones. The interest structure in the Romanian case is presented in Figure 18. The size the position between the axes indicates the interest of the actors and the size of the bubbles indicates their power.

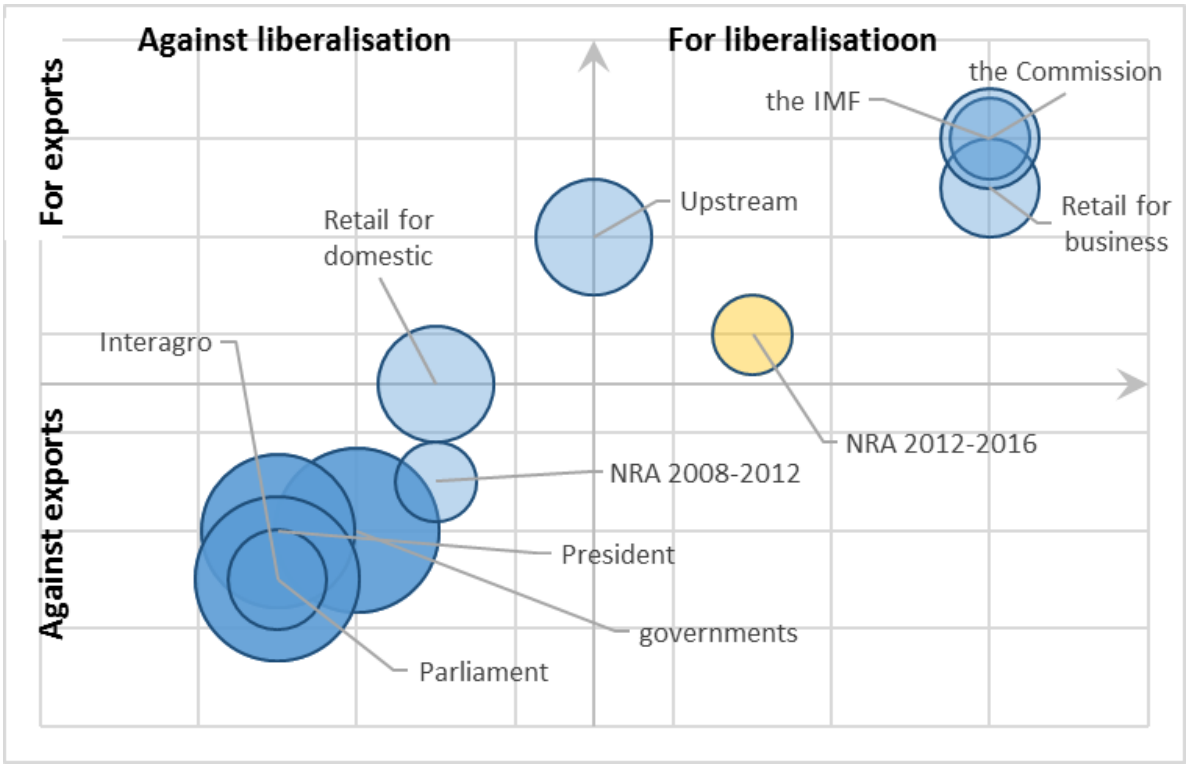

Figure 18 The *interest structure* in the 2008-2016 Romanian natural gas sector (their power positions are represented by the size of the bubbles)

Step 2: Anti-integration *coalition* steers the gas sector away from EU goals

Just as a 'Cat and Mouse' game is defined as 'a contrived action involving constant pursuit, near captures, and repeated escapes' (Merriam-Webster 2017), the relationship of the Commission and Romania with regard to the Romanian natural gas market did not bring a definite victory to any of the two sides. When it seemed that one side had made the final step, the other side made one more. In Romania, phasing out regulated end-user prices (consumer liberalisation) was coupled with non-exporting gas produced in Romania (cross-border integration). As extensively presented in CH 6, Romanian politicians for a number of years avoided final liberalisation of consumers, especially household market, which in Romania had a long history of promises and attempts. Regarding cross-border trade, there were three main groups of obstacles for Romanian companies to export domestically produced gas to neighbouring countries in different periods: physical, legislative and regulatory.

Step 3: The Commission starts infringement procedures and/or customises EU funding to 'correct' the divergences from the EU aims

The infringement procedures against Romania were discussed earlier in this chapter, which shows that in 2008-2016 Romania enforcement strategies by the Commission were used to the greatest degree among the case studies. It is important to add that, just as in 2010-2016 Hungary, the lack of enforcement powers by the Commission to cease end-user price regulation limited the Commission. Policy makers seem to have understood that the Commission could not directly interfere in the end-user price regulation for household consumers.

In Romania, there was a difference from the 2010-2016 Hungary in how the Commission customised EU funding. As non-compliance with the EU requirements took place before Romania applied for the funding for BRUAH pipeline, the Commission used this avenue to condition not only requirements directly related to the interconnectors, but also to the domestic regulations of the Romanian gas sector. The Commission relate the projects implemented via the CESEC and funded by Brussels with the changes of domestic gas regulations in Romania.

Substantial evidence was found that the Commission conditioned provision of funding to post-2010 Hungary and Romania (starting from 2011) to certain steps that these countries had to take in their natural gas markets. In the Romanian case, even the Balance of Payment (BoP) assistance from 2011 to 2015 was conditioned to required changes in its natural gas sector. For countries seeking assistance, the Commission signs memoranda of understanding (MoU) that outline the economic policy conditions that must be met before funds are released (European Commission 2016h). In many countries, these conditions are rather related to the financial sector of the economy and not the energy. Even though both Hungary and Romania

(not Lithuania[48]) received BoP assistance that was meant to generally help those countries to overcome budgetary difficulties posed by the global economic crisis, Romania had conditions prescribed with regard to its natural gas sector. As shown in CH 7, the Commission used the first part of the BoP assistance in 2009-2011 to get insights into the Romanian natural gas sector. The second set (2011-2013) came back with requirements to phase out regulated end-user gas prices and to allow natural gas exports.

Step 4: The anti-integration *actor coalition* partially complies with regulations as non-compliance may be costly

There is additional evidence that responsiveness of the actors in Romania to comply with the EU requirements to phase out regulated end-user prices and enable gas exports was linked with the possible financial repercussions for non-compliance. Unlike the 2009-2011 part of the financial aid disbursed by the European Commission, the 2011-2013 and 2013-2015 parts were only precautionary. They would have been activated only in case of 'unforeseen market deterioration' and if Romania fulfilled the requirements set in the MoU. Thus, the 2009-2011 BoP programme, which was disbursed, had no requirements in the natural gas sector, and the 2011-2015 programmes had requirements, but Romania did not activate the disbursement. Instead, it updated the 2011 MoU twice. In each revision, the provisional dates to start phasing out regulated gas prices (providing a roadmap of the process) were moved upwards, until the delivery of the roadmap was foreseen mid-June 2012, instead of the initial plan by September 2011. Removal of obstacles for cross-border gas trade was demanded 'as soon as possible' in the second revision signed in summer 2012.

[48] Hungary and Romania received BoP financial assistance starting from 2009. Lithuania did not require such; therefore, in the Lithuanian case this avenue for action by the European Commission was not open. In any case, taking into account that Lithuania willingly and proactively involved the European Commission in restructuring its natural gas sector, it is unlikely that the European Commission would enforce compliance with the EU's instruments in the natural gas sector via BoP.

2010-2016 Hungary derailed liberalization, but continued diversification

Step 1: Anti-integration coalition becomes dominant

2010 onwards brought significant changes in the Hungarian *interest structure* on the political side. In the 2010 election, the right-wing party, Fidesz, gained 53% of the votes, which due to the peculiarities of the elections system, translated into a 68% (more than two-thirds) share of the seats in Parliament (National Election Office 2010). This made Fidesz a single dominant actor in regulating the energy sector. Evidence supporting that Fidesz was an anti-integration actor was shown throughout the CH 4 and CH 7. The 2014 election reinforced the dominance of Fidesz. Moreover, shares of important gas companies and the national energy regulator were consolidated in the Hungarian state's hands. An indirect indication of dominance of a certain *actor coalition* is a lack or little resistance to their anti-integration actions on the domestic level was also found in post-2010 Hungary. A quote by one interviewee possibly best describes the lack of opposition in Hungary. He said: 'Who could challenge? Don't forget that in the 2010 election they won two thirds of Parliament. It means that two-thirds of the people thought that they were a good Government. Who can challenge them? Nobody can challenge them' (SE HUNG 2 2016).

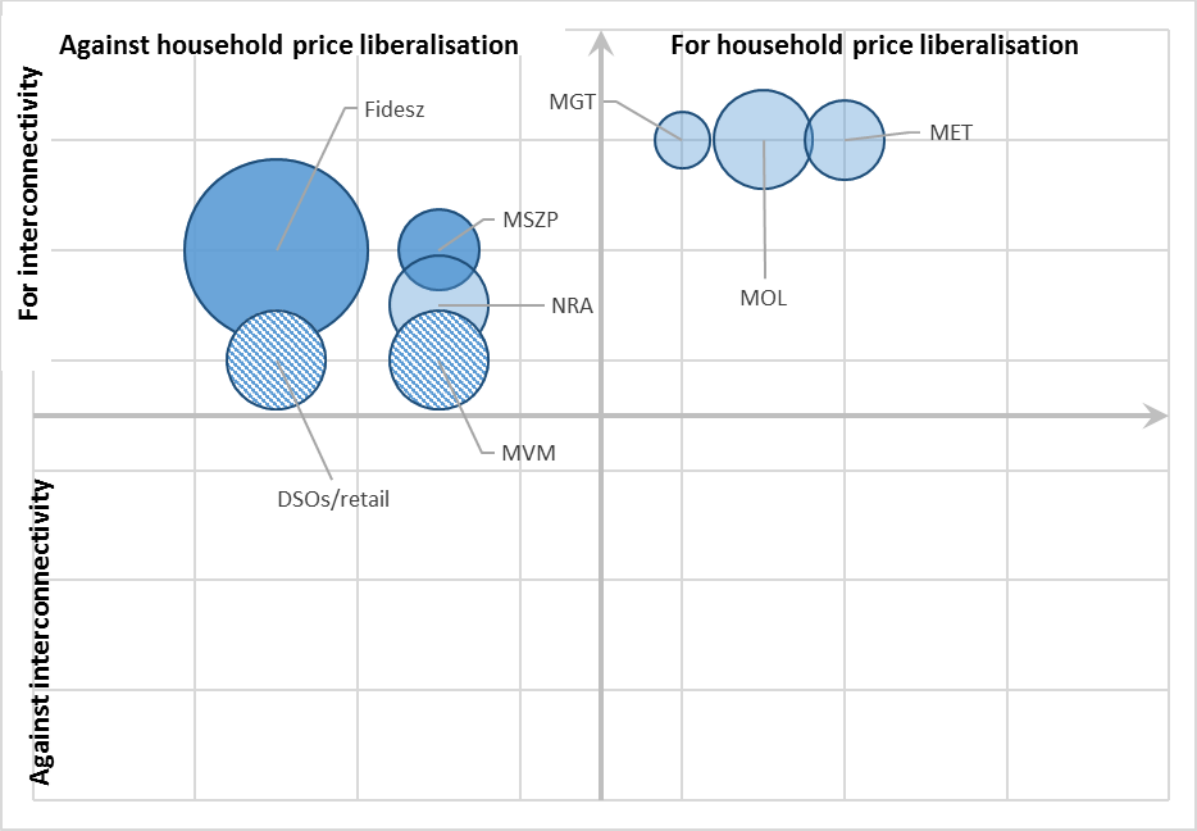

Figure 19 The *interest structure* in the 2010-2016 Hungarian natural gas sector (their power positions are represented by the size of the bubbles)

The *interest structure* in 2010-2016 Hungary is presented in Figure 19 above. The interests to keep regulated (household) consumer prices are clearly regulating the Hungarian natural gas sector. DSOs/retail and MVM are in stripes because they present the state interests in the gas sector, which during the research period is considered to be equal to Fidesz interests. By DSOs/retail is meant the monopoly owner of DSOs and gas supplier to households ENKSZ.

Step 2: Anti-integration *coalition* steers the gas sector away from EU goals

In post-2010 Hungary, the dominant *interest structure* derailed the liberalisation of household consumers, but continued cross-border diversification. Fidesz Government 'did not stop' the Hungary-Romania and Hungary-Croatia interconnection projects, as they were 'already in the pipeline' (GOV HUNG 2015), but also took over the building of the Hungary-Slovakia interconnector.

Step 3: Commission starts infringement procedures and/or customises EU funding to 'correct' the divergences from the EU aims

In Hungary, which in the previous period in 2002-2010, was rather a good performer in terms of compliance with the EU energy regulations and liberalisation of the market, the Commission did not explicitly condition the funding for the Hungarian state-built Slovak-Hungarian interconnector, as the 'retrenchment' from liberalisation came after the Commission assigned funding to the interconnector. Neither the MoUs between Hungary and the Commission had specific requirements in the Hungarian energy sector when Hungary received BoP assistance provided by the Commission (together with the IMF). Even though the Hungarian policy makers, unlike the Romanian, did not hinder cross-border flow of gas and mostly focused on cutting household prices, increasing taxes for energy companies and nationalising the gas sector (none of which infringed EU rules), the Commission found a way to start an infringement procedure in 2010-2016 in Hungary. The main reason for the infringement procedure started in 2015 was tampering with the powers of the national energy regulator and discriminatory tariff setting, which resulted from Fidesz cutting end-user prices.

Step 4: The anti-integration *actor coalition* partially complies with regulations as non-compliance may be costly

In the post-2010 Hungary case, firstly, when the Hungarian Government's attempts to keep the end-user prices low almost derailed the Slovak-Hungarian interconnector project, the state took the project over from a private developer, FGSZ, and did all it could to be reassigned as a beneficiary of EU funding to this interconnector, including *one more* 'transposition' of the Third Natural Gas Directive in 2011. When in 2015 the Commission started an infringement procedure with regard to the Third Natural Gas Directive, Hungary

became ‘cooperative’ to change certain regulations. The infringement procedure commenced only after the general election of 2014, when Fidesz used utility price cuts to win the election. Thus, the benefits of the contents for infringement were already ‘used,' but the potential costs to pay for the infringement increased.[49] The Hungarian state actors understood that if the Commission rules that Hungary’s actions constituted an infringement, private companies that suffered from the sector regulation may use the fact of an infringement in claiming compensation.

This chapter illustrated the main claim of this thesis that it is the balance or dominance of domestic *interest structures* that define the impact of the EU on natural gas sectors of the EU member states. Having compared the four case studies, the thesis moves to the conclusion.

[49] The Commission had a ‘pilot’ procedure, which preceded the infringement. Moreover, if the ECJ prescribed a fine to a country, its size also depends on the length of the infringement.

CONCLUSION

This dissertation examined a particular case of differential domestic impact of EU natural gas policies in Hungary, Lithuania and Romania. It focused on causal conditions explaining the diverging outcomes among new EU member states, as well as on the mechanisms behind them. In the EU, there are cases where EU member states go much further in restructuring their natural gas sectors than the existing EU legislation requires to do. This suggests that the reforms are driven by something else than EU policies. There are also cases where member states openly or covertly resist implementing EU regulations regardless of the external pressure applied by supranational institutions, or where they implement EU regulations on time, but later absolutely reverse the earlier trajectories. Despite the differences, their explanation is the same: the interplay of preferences and power of domestic and supranational actors, such as political parties, regulators, gas companies, their consumers, the Commission and others, which is impacted by EU constraints and opportunities.

Starting from the First Natural Gas Directive of 1998, the majority of the EU policies related to the gas sectors of EU member states can be summarised as focusing on two segments. First, downstream level liberalisation/internal market, and second, diversification of routes and/or supply/exports/imports/security of supply (upstream level). EU member states have, however, followed very different routes in implementing these policies. By analysing four cases, the gas sectors in 2002-2010 Hungary, in 2008-2016 Lithuania and Romania, and in Hungary in 2010-2016, this thesis has explained why, despite similar exposure to the directives, EU competition policy tools and other EU instruments establishing the internal natural gas market, EU countries still diverge in market liberalisation and interconnectivity across EU countries. It also explained the mechanisms of how the divergence appears.

A review of seemingly very different theoretical standpoints, such as classical EU

integration theories, policy diffusion, Europeanisation and interest-based political economy approaches, showed that despite coming from different fields, each of these approaches, except for liberal intergovernmentalism and (neo)functionalism, could have value added in explaining heterogeneity among EU member states. The choice of fitting theoretical approach came from combining the specific conceptual model of Europeanisation by Knill and Lehmkuhl (2002) and interest-based approach from political economy.

The Europeanisation model by Knill and Lehmkuhl explains how Europeanisation affects domestic structures and what obstacles and facilitating forces it creates for domestic actors that seek either reform or remaining with the *status quo.* Following this, the central claim of the dissertation is that the EU legislation and other tools in the natural gas sector change the *opportunity structures* for domestic actors by redistributing the power resources in favour of reform-prone actors. The divergence among EU member states regarding the natural gas market integration comes from the power configurations and interests of domestic actors who may win or lose because of the implementation of EU policies. The analysis of EU policies in CH 2 from the first significant Directive in 1998 to 2016 showed that these mostly boost the liberalisation and diversification of natural gas sectors in EU member states. Consequently, they mostly strengthen domestic actors advocating these objectives and constrain those sustaining the *status quo.* However, the EU impact depends on their power positions, and, following Knill and Lehmkuhl, reforms happened only in cases of balanced *interest constellation,* where at certain times none of the reform-prone or *status quo* prone *actor coalitions* had significant power over one another. In such cases actors that support gas market integration did not have to dominate the *interest structure* to reform the sector. EU policies that came into force during these periods changed *opportunity structures* for the reform-prone actors and they used them for their aims, which did not even have to be liberalisation or interconnectivity, but other aims in internal politics. In somewhat

asymmetrical manner, in the cases of dominant *interest structures* no or little change according to EU policies are expected.

This dissertation is part of a growing body of literature on Europeanisation. It is the first one to comprehensively analyse the developments in the natural gas sector in Fidesz (post-2010) ruled Hungary, Lithuania after 2012 and Romania in mid-2000s in English. The theoretical and empirical contribution of this thesis is related to testing Europeanisation theories via the case studies, developing methodology and providing in depth empirical analysis of the EU legal instruments and developments of natural gas sectors.

The empirical developments demonstrated the need for updating the two-step conceptual framework of Knill and Lehmkuhl. Their approach had sufficient explanatory power in the case of the reforms that take place in shorter time horizons. This thesis used the framework for the longitudinal analysis. The case of 2008-2016 Lithuania and Romania and post-2010 Hungary showed that changes in actor positions need to be taken into account. Moreover, simply seeing Europeanisation in the gas sectors in EU countries as a stimulus for a single reform, in which one stable group of actors would stand in a reform-prone *coalition* and others in a *status quo coalition*, is not possible and too simplistic. This is why this dissertation introduced and tested the concepts of interests and power, taken from political economy. EU-induced reforms in the gas sectors of the member states are multifaceted, and the same actors who support some of their elements could resist other aspects of the reform at the same time, and even change their positions with time. This limitation was resolved by creating a strategy to identify (in CH 3) and visualise (in CH 8) identification of *interest structures*. In order to identify *actor coalitions* in each of the cases, it is important to delineate what actors may influence the gas sectors at the domestic level, what their interests are (thus, which *coalition* they join) and what power positions they occupy. Interests of the same actors may change with time as well, for example, interests of regulated gas companies may switch

from seeking deregulation to regulation of gas prices, if regulation ensures return of historical losses. Thus, *actor coalitions* were identified based on the analysis in the following order: what actors, what are their positions towards what questions, in what period. The balance or dominance of *interest structures* in all four cases were identified based on the positions of the most important domestic actors on two main categories of EU gas policy aims that united or turned them against each other. More than one division line between the actor positions had to be considered because EU instruments instigated multifaceted reforms in domestic natural gas sectors. Based on those aspects, actors in each case were identified as belonging to reform-prone (pro-integration) or *status-quo*-prone (anti-integration) *actor coalitions*.

The choice of *interest structures* as a central point of research instead of ideologies of political parties does not limit possible application of the mechanism developed in this thesis to the new EU member states. On the contrary, application of *interest structures* allows disregarding ideological divisions between parties into left-centre-right. This allows further testing of the causal process tracing mechanisms in all EU member states, and not only in 'new' ones. It is also possible to test the mechanisms in other structurally similar sectors to the natural gas that belong to network industries, such as electricity or telecommunications.

In addition to the theoretical contribution, this thesis also advanced the increasingly popular method of process-tracing in political science. Even though it is often dismissed by political scientists as 'word-intensive', this thesis applies process-tracing to a substantial amount of interview and document-based empirical data and shows the method's usefulness for generating answers to mechanism-driven 'how' questions. The thesis developed the concepts/mechanisms of 'EU opportunism', visible in the cases of 2002-2010 Hungary and 2008-2016 Lithuania, and 'EU leverage', visible in 2008-2016 Romania and 2010-2016 Hungary. Alongside the 'EU opportunism' mechanism, reform-prone actors push the natural gas sector closer to the EU objectives by using the EU *opportunity structures*. Subsequently,

this dissertation also took a unique approach to analyse EU natural gas policies in light of providing opportunities and limitations to domestic actors. The 'EU leverage' mechanism predicts that in dominant *interest structures* actors choose non-action, fulfilling only minimal requirements of EU policies, delaying transposition of EU legal instruments or transposing them incorrectly. One of the main differences to the 'EU opportunism' causal mechanism is reactive actions by domestic players (to infringement procedures and funding) instead of proactive use of changed *opportunity structures* when EU policies come into force.

Even though the evidence collected in the empirical chapters showed that the cases indeed fall into one of the two mechanisms, there are differences between the cases. For example, even though the causal process tracing mechanism is the same, in one case study more activism towards EU policies may come from political actors and in others from private actors. In the 2008-2016 Lithuanian case, the 'EU opportunism' mechanism was more expressed than in 2002-2010 Hungary, both characterised by balance in its *interest structure*. Unlike in Lithuania, where the push for the reforms mainly came from the Government in place between 2008-2012, in Hungary it was the interests of energy companies, mainly the national gas 'champion' MOL, that were the main driving forces in the early stage. MOL saw opportunities in Hungary's EU accession and supported the Government in deregulating gas production and a part of consumer prices in implementing the First and Second Natural Gas Directives. It also embarked on building cross-border interconnectors. Lithuania was eligible to be derogated from implementation of the main provisions of the Third Natural Gas Directive as an isolated market but did not use this possibility. This shows proactivity of the policy makers to use EU opportunities. Even though the ownership unbundling requirements of the Third Natural Gas Directive were not aimed at energy security *per se*, the Lithuanian authorities used the transposition of it to reform the Lithuanian gas sector and ensure security of supply as they perceived it. Lithuanian policy makers also used the need to fulfil the

requirements set in the Security of Supply Regulation of 2010 to justify their necessity to build the Klaipėda LNG terminal, although the Regulation did not directly prescribe such an investment and allowed to use appropriate market-based demand-side measures in cases of gas supply disruptions.

Even in the cases where dominant anti-integration *interest structures* were identified, such as in 2008-2016 Romania and 2010-2016 Hungary, the EU still had impact, but based on another logic. Instead of proactively using *opportunity structures*, domestic actors were reactive to Commission's pressures that were expressed via infringement procedures or conditions necessary to fulfil to receive funding. After mid-2010, the fundamental changes in Hungarian politics derailed the country's trajectory in terms of consumer liberalisation, but cross-border diversification continued. In Romania, throughout nearly the whole period, both liberalisation and diversification lagged, and responded only to pressure of transnational institutions. Sluggish cross-border integration in 2008-2016 Romania was different from 2010-2016 Hungary. However, in essence, these cases were similar: dominant *interest structures* that have interests not according to relevant EU instruments find ways to not comply or delay compliance for as long as non-compliance is not too costly or punishable.

In conclusion, this dissertation analysed the puzzle of differentiated impact of EU policies on national gas markets in new EU member states. By doing so, it contributed to the Europeanisation literature by reframing political economy concepts developed for the Western European contexts (left vs. right) into more generalizable dimensions of *interest structures*, applicable not only in Central and Eastern Europe, but potentially more broadly. This contribution came from the development of the concepts of 'EU opportunism' and 'EU leverage' referring to domestic developments which lead to convergence or divergence of national gas sectors regulation with regard to EU policies. It also contributed to the policy knowledge of natural gas sector regulation and the methodological arsenal of political science.

Its findings should be of interests not only to students of EU energy policy and Europeanisation, but possibly also to its practitioners looking to anticipate its implementation in EU member states.

ANNEXES

Table 8 Infringement procedures against Hungary, Lithuania and Romania with regard to their gas sectors

Country	From	To	Stage	EU legal instrument
Hungary	11/07/2006	12/12/2006	Formal notice Art. 258 TFEU (first stage)	Council Directive 2004/67 / EC of 26 April 2004 concerning measures to ensure safety of natural gas supply (text with interest to the EEA)
	27/06/2007	20/11/2009	Formal notice Art. 258 TFEU	Lack of conformity with Directive 2003/55/EC on the internal market of natural gas
	25/06/2009	24/06/2010	Formal notice Art. 258 TFEU	Transparency of conditions for access to the natural gas transmission networks
	26/02/2015	ongoing	Reasoned opinion Art. 258 TFEU (second stage)	Compliance with the provisions of the Third Energy Package in Hungary
Lithuania	13/10/2004	05/07/2005	Reasoned opinion Art. 258 TFEU (second stage)	Non-transposition Directive 2003/55/EC
	04/04/2006	11/12/2007	Reasoned opinion Art. 258 TFEU (second stage)	Non-conformity of the transposition of the internal market directive
	30/09/2011	16/04/2014	Reasoned opinion Art. 258 TFEU (second stage)	Directive 2009/73 / EC of the European Parliament and of the Council of 13 July 2009 on common rules for the internal market in natural gas and repealing Directive 2003/55/EC (Text with EEA relevance)
Romania	20/04/2007	28/02/2008	Formal notice Art. 258 TFEU (first stage)	Directive 2004/67 / EC on measures to safeguard security of natural gas supply
	25/06/2009	26/02/2015	Referral to Court Art. 258 TFEU (third stage)	Transparency of conditions for access to the natural gas transmission networks
	25/06/2009	27/09/2012	Reasoned opinion Art. 258 TFEU (second stage)	Directive 2003/55 concerning common rules for the internal market in natural gas – regulated prices
	30/09/2011	16/10/2014	Referral to Court Art. 258 TFEU- 260(3) TFEU (third stage)	Directive 2009/73 / EC of the European Parliament and of the Council of 13 July 2009 on common rules for the internal market in natural gas and repealing Directive 2003/55/EC (Text with EEA relevance)
	07/09/2012	21/02/2013	Formal notice Art. 258 TFEU (first stage)	Regulation (EU) No 994/2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC – Non-compliance with obligations to notify certain information to the Commission
	20/11/2013	28/04/2016	Referral to Court Art. 258 TFEU (third stage)	Regulation 994/2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC – Non-compliance with obligations to notify

Table 9 List of the interviews conducted for this dissertation

Case discussed	Name	Role	Code	Date of the first interview
Hungary	András Deák	Politics and international energy policy researcher	-	July 1, 2015.
Hungary	-	Former High-Level Official of the Hungarian Government	GOV HUNG	July 21, 2015.
Hungary	-	Expert of the Hungarian Energy Sector	EX HUNG 1	August 28, 2015.
Hungary	-	Employee of the Hungarian Energy Regulator	NRA HUNG	February 1, 2016
Hungary	-	Previous Executive of the Hungarian Gas Storages	IND HUNG 1	February 1, 2016
Hungary	-	Source Familiar with the Hungarian Gas Sector	EX HUNG 2	February 11, 2016.
Hungary	-	Source Familiar with the Hungarian Gas Sector	EX HUNG 3	February 11, 2016
Hungary	-	Hungarian Energy Industry Source	IND HUNG 2	June 7, 2016.
Hungary	-	Parliament member of Hungarian Socialist Party (MSzP)	MP MSZP HUNG	July 4, 2016.
Hungary	-	Former High-Level Executive for the State Energy and Oil&Gas Upstream	UPS HUNG	August 8, 2016.
Hungary	-	Legal Expert	LEGS HUNG	August 9, 2016
Hungary	-	High Level Official in a Hungarian Energy Company	IND HUNG 3	August 10, 2016
Hungary		A High-Level Worker of a Hungarian State Owned Company	IND HUNG 4	August 10, 2016
Hungary	-	Former Hungarian state administration official	SE HUNG 1	September 20, 2016
Hungary	-	Former Hungarian state administration official	SE HUNG 2	October 3, 2016
Hungary	-	Industry Source	IND HUNG 5	October 6, 2016
Hungary	-	High-Level Hungarian State Employee	SE HUNG 3	October 6, 2016
Lithuania	-	A Member of the Lithuanian NRA	NRA LT	July 22, 2014
Lithuania	Arvydas Sekmokas	2009-2012 Energy Minister of Lithuania	-	July 22, 2014
Lithuania	-	A Lithuanian lawyer that worked with the cases	LEGS LT 1	July 23, 2014
Lithuania	-	Former Vice-Minister of Energy	GOV LT 1	July 24, 2014
Lithuania	-	Former official from the Lithuanian President's Administration	PRES LT	February 7, 2015
Lithuania	-	A member of the Ruling Coalition of 2012-2016	MP LSDP LT	February 10, 2015
Lithuania	-	Vice-Minister for Energy 2010-2012	GOV LT 2	February 10, 2015
Lithuania	Rokas Masiulis	2014-2016 Lithuanian Energy Minister	-	June 3, 2015

Lithuania	Andrius Kubilius	2008-2012 Lithuanian Prime Minister	-	June 8, 2015
Lithuania	Kęstutis Škiudas	Former advisor of the Prime Minister	-	June 8, 2015
Lithuania	Kęstutis Daukšys	Member of Labour Party Political Group in Parliament	-	June 9, 2015
Lithuania	Dominykas Tučkus	CEO of Litgas	-	June 11, 2015
Lithuania	-	Former high-level official of the Ministry of Energy after the 2012 election	SE LT 1	October 13, 2015
Lithuania	Philip Lowe	2010-2013 Director-General of Commission's Directorate-General Energy	-	April 6, 2016
Lithuania	-	Former high-level official of the Ministry of Energy of Lithuania	SE LT 2	April 7, 2016
Lithuania	-	Legal expert	LEGS LT 2	December 28, 2016
Romania	-	Diplomatic source from Romania	SE ROM 1	February 11, 2016
Romania	-	European Commission Official	COMM ROM	February 15, 2016
Romania	-	Energy industry source	IND ROM 1	September 12, 2016
Romania	-	Energy expert	EX ROM 1	September 22, 2016
Romania	-	Energy expert	EX ROM 2	September 23, 2016
Romania	-	Upstream segment source	UPS ROM 1	September 26, 2016
Romania	Radu Dudau	Associate Professor, University of Bucharest Director, Energy Policy Group	-	September 27, 2016
Romania	Dumitru Chisăliţă	Energy expert	-	September 27, 2016
Romania	-	Source close to the one of the former governments	GOV ROM	September 27, 2016
Romania	-	Parliament member of National Liberal Party (PNL)	MP ROM PNL	September 27, 2016
Romania	Gabriel Sîrbu	Head of Regulatory Affairs Department in a gas downstream company	-	September 28, 2016
Romania	-	Member of the Romanian Parliament	MP ROM 1	September 29, 2016
Romania	-	Gas retail sector source	IND ROM 2	September 29, 2016
Romania	Emil Calota	ANRE Vice-president	-	September 30, 2016
Romania	-	Upstream segment source	UPS ROM 2	November 16, 2016

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