

Gazprom's interests hit by CJEU judgment on OPAL pipeline

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On 10 September, the Court of Justice of the European Union (CJEU) annulled a decision issued by the European Commission on 28 October 2016 allowing the Russian Gazprom to send greater volumes of gas through the OPAL pipeline. The CJEU judgment was issued following a complaint submitted on 16 December 2016 by Poland, supported by Lithuania and Latvia, against the Commission's decision, which on the other hand was formally supported by Germany. The CJEU found in favour of Poland and overturned the Commission's decision, saying that it had been issued in breach of the principle of energy solidarity provided for in art. 194 of the TFEU. The judgment means that the OPAL capacity available to Gazprom has now been reduced, effective immediately, by 12.8 bcm per year, as has transmission via Nord Stream and Germany, as a result.

The judgment will probably remain in force, and this is a good outcome for Poland and all parties/sides interested in Gazprom's domineering position on the European gas market being reduced, and opposed to new Russian export pipelines such as Nord Stream 2 being built. The decision will hurt Germany above all, which benefits from the increasing volume of gas being sent through the country, but will also hurt the Czech Republic and other actors that buy gas via Nord Stream. At the same time, the decision exacerbates the already existing divisions between member states. The CJEU's judgment is

evidently a blow to Gazprom and Russia, limiting Russia's export capacity at an already difficult time (talks to negotiate a gas deal with Ukraine, and winter approaching). If it remains in force, it will mean that in the next few years, Gazprom cannot afford to stop transit through Ukraine, which is one of the main objectives of Russia's energy policy. The ruling might also have negative consequences for Nord Stream 2, as there is less chance of the project being granted EU law exemptions. This also raises the question of if and how the principle of energy solidarity, reinforced by the CJEU ruling, can be applied to the project. For the duration, the ruling will strengthen Ukraine's position, and that of the EU as well, in talks with Russia about transit through Ukraine in the future and the forthcoming trilateral negotiations. At the same time, it could trigger some sort of retaliation on the part of Russia.

State of play before the CJEU decision and context

The OPAL pipeline, which goes from Greifswald in the North-East of Germany, to Brandov on the German-Czech border, is the largest onshore leg of Nord Stream. Its capacity at the entry point is approximately 36.5 bcm per year, and approximately 32 bcm at the exit point. It is 80% owned by WIGA (jointly owned by Gazprom and Wintershall), and its subsidiary E.ON owns the remaining 20%. The terms for using OPAL, including how the third energy package and third-party access (TPA) rule apply to the pipeline, have been under discussion and a cause of controversy for more than a decade. Even before the pipeline was completed and commissioned in 2011, Gazprom, supported by the German regulator Bundesnetzagentur (BNetzA), tried to obtain exemption from EU rules for 100% of OPAL capacity a guarantee of long-term use of the entire pipeline. In 2009, the EC agreed to exempt from the TPA rule for transit capacity of the OPAL pipeline (capacity from Germany to the Czech Republic): over 50% of the capacity (even as much as 100%) provided that the 3 bcm per year gas release programme was implemented (sale to third parties by auction at any point of the pipeline) or 50% of capacity without the programme. Due to the fact that Gazprom never introduced that programme, up until the end of 2016 50% of OPAL capacity was exempted from the TPA obligation and the pipeline was used (mainly by Gazprom) below its true potential. Approximately 12.8 bcm of capacity remained unused each year.

Gazprom tried to get this changed with support from Germany (BNetzA), arguing that as there were no third parties interested in the unused 50% of OPAL capacity, it should be allowed to use it. After a few years of avoiding the decision and prolonging the administrative procedure, the EC approved the

German regulator's decision changing the rules for OPAL capacity booking and allowing increased use by Gazprom^[1]. Even though the EC's decision was promptly contested by Poland (and PGNiG SA, PGNiG Supply & Trading GmbH) and complaints were filed for a stay of execution of the EC's decision, EU and German courts gave permission for use of OPAL capacity to be increased temporarily under the new rules, while awaiting the CJEU's final judgment in the case.

This led to a distinct increase in the volumes of Russian gas transmitted via Nord Stream and OPAL. In December 2016, the first auctions were held for the additional capacity available due to the EC decision. Since 2017, the route has mostly been used at almost 100% (at times above the maximum technical capacity), which affected among other things levels of gas transit through Ukraine and Slovakia. As EU imports of Russian gas were on the increase, these also rose, but the increases would have been higher if OPAL (and Nord Stream) had been exploited to a lesser extent. Nord Stream continues to be Gazprom's preferred export route, and is used to the maximum extent possible. While, prior to the EC's 2016 decision, it transmitted 43.8 bcm of gas in that year, by 2018 transmission had reached 58.7 bcm, exceeding the pipeline's nominal capacity of 55 bcm annually.

What does the CJEU judgment mean?

When annulling the EC's October 2016 decision, the CJEU found that the EC had breached treaty (TFEU) provisions by not referring in its decision to the principle of energy solidarity, and not examining that principle. Among other things, the EC was found not to have considered the impact the new OPAL regime and greater use of OPAL capacity would have on the security of supply in third countries including Poland, the consequences of transferring to the Nord Stream – OPAL route the portion of gas previously transmitted via the Yamal and Brotherhood pipelines, and not having weighed these consequences against the benefits that increased use of OPAL would have for security of supply at EU level. The CJEU judgment also stated that the principle of energy solidarity was not applicable solely in crisis situations (described in the 2017 regulation on security of gas supplies), as the EC had claimed, but also applied in the normal circumstances in which the EU gas market functions and also includes the EU's and member states' obligation to account for the interests of other parties active on that market.

The CJEU judgment takes effect immediately, retrospectively (from the time the EC adopted the decision), and to all parties. As a result, the OPAL pipeline capacity available to Gazprom will fall to 50% of Gazprom's

attributable capacities (6.4 bcm is attributable to E.On), which is approximately 12.8 bcm per year. At the same time, according to previous EC and German BNetzA decision, the Russian company will retain the option of access to 100% of capacity, if it implements a release programme for 3 bcm of gas. The EC has two months and ten days to appeal against the CJEU's judgment, but the EC would probably not be able to seek a stay of execution of the judgment for the duration of review of the appeal (to reinstate the October 2016 decision). This is because this is ruled out under art. 60 of the CJEU statute.

In the context of the CJEU's ruling, the status of the additional OPAL capacities that Gazprom booked in advance (for consecutive days/months) remains unclear. The CJEU judgment does however seem to open the way for parties that suffered losses due to the EC's decision being implemented and greater temporary use of OPAL (and Nord Stream) by Gazprom, to seek compensation.

At the moment it is difficult to foresee when and how, if at all, the new EC will decide to appeal against the CJEU judgment. If the EC were to do this, this would call into question the primary law principle of energy solidarity, one of the fundamental issues for how the EU functions. Contesting the CJEU judgment, it would also hinder its own activities in short-term issues crucial for the EU gas market and security of supply in the next few weeks and months. In fact, the EC's response is not helped by the process of a new EC being formed under Ursula von der Leyen, and that the new commissioners have to orientate themselves in complex issues regarding the rules for using OPAL and Nord Stream and the market and political implications of the measures taken.

What the CJEU judgment means for the EU

The judgment is a major victory for Poland, and Lithuania and Latvia, which supported Poland, and all actors seeking full application of EU law with respect to Gazprom's export infrastructure in the EU (to Nord Stream 2 as well as OPAL). It is also a definite success for Ukraine and all those in favour of sustained transit through Ukraine. At the same time, it is a defeat not only for the EC, but also, perhaps even to a greater extent, for Germany. In its decision of October 2016, the Commission gave the green light for a new form of regulation of the access to OPAL, which was proposed by the German regulator, and Germany formally supported the EC in the dispute with Poland. Germany also derives considerable profits from the increasing transmission of

Russian gas through its territory, and clearly wishes to increase it further (by building Nord Stream 2 and EUGAL).

The CJEU's decision is also costly however for others, such as the Czech Republic. Gas from OPAL is transmitted southwards through the Czech gas network. Moreover, the reduced OPAL capacity available to Gazprom is sometimes interpreted as another challenge to safeguarding of stable gas supplies for the coming winter. Thus the judgment highlights, and could potentially exacerbate as well, the differences in interests and positions of Poland (and some CEE and Scandinavian countries) and Germany (and some other EU countries).

At the same time, the CJEU judgment on OPAL significantly reinforced applicability of the principle of energy solidarity in activities and decisions of EU institutions and member states. The need pointed out in the ruling for weighing profits and losses arising from specific projects/measures and/or decisions for security of supply or functioning of the gas market, not only of the EU as a whole but also individual countries, is an important element complementing hitherto EU practice. It is also in line with the increasing emphasis the EC is placing on the regional aspects of EU energy policy and the requirement for member states to work together, provided for among other things in the security of gas supply regulation, but also in the new, tool,, crucial for the EC, for the Energy Union governance, the national energy and climate plans (NECPs).

The stress placed on the principle of solidarity in the CJEU ruling could potentially increase the EC's role in the case of projects seen as controversial by EU countries, such as Nord Stream 2 or the European section of TurkStream. It is possible that in light of the wording of the CJEU judgment, other member states will also raise claims based on the principle of energy solidarity (Slovakia, which has seen a distinct decrease in gas transit since Nord Stream and OPAL started operating, and Bulgaria, where transit through the trans-Balkan pipeline is expected to fall once the first line of TurkStream comes onstream, which is scheduled for December 2019).

Gazprom's reduced access to the OPAL pipeline, and therefore lower level of use of the company's preferred route for gas exports to the EU (Nord Stream) in the context of the continued controversies surrounding future use of Nord Stream 2 (question of the gas directive) and surrounding gas transit through Ukraine, could further complicate gas relations between the EU and Russia. This will also definitely have an impact on the agenda and directions of the newly formed EC's gas policy. Even though climate issues, including the role gas plays in the EU energy transition, have now indisputably become and will

be top priority for the new EC, secure stable gas supply to the EU and devising a cohesive framework for cooperation with Russia and Ukraine in the gas sector will continue to be an important topic, at least in the near future.

Implications for gas transit through Ukraine

The OPAL CJEU judgment comes at a crucial moment for the EU and the gas market. Due to the ongoing conflict between Russia and Ukraine, and Gazprom's continued construction of new export routes (Nord Stream 2 and TurkStream) the issue of the future of gas transit from Russia through Ukraine remains unresolved. At the end of 2019, the 11-year-old transit contract between Russia and Ukraine will expire. Apart from questions about future routes and the strategy for Russian gas exports to Europe, this is causing concern about stability and security of gas supplies for the coming winter. On 19 September, the long-awaited trilateral gas talks between the EU, Ukraine, and Russia on the future of transit (and other issues) are due to be held. The restriction placed by the CJEU OPAL ruling on capacities available to Gazprom in the route via the Baltic sea and Germany, which is an alternative to Ukraine pipelines, will make transit through Ukraine more important, especially at the time of highest gas demand in the winter. It will thus strengthen Kyiv's position in the forthcoming negotiations, but will also provide the EC with additional arguments, which for a long time has been aiming to guarantee secure transit and formulate a long-term agreement underpinning it. Even if an appeal process is were launched, the continued uncertainty surrounding the rules of access to OPAL and Nord Stream would work to Ukraine's advantage.

Although the judgment does not guarantee by itself that a new Russian-Ukraine transit agreement will be reached and that Russia will not temporarily stop gas transmission through Ukraine from 1 January 2020, this is sustaining Russia's already relatively high dependency on Ukrainian pipelines, even once the new export routes (Nord Stream 2 and TurkStream) are in operation. In the best case scenario for Gazprom, (rapid construction of Nord Stream 2, both lines of TurkStream and full access to their capacities) it will have to transmit through Ukraine in the next few years (depending on total exports to Europe) between 30 and 50 bcm of gas. In the worst case scenario (the restrictions on Nord Stream access due to the ruling on OPAL, limited options for use of Nord Stream 2 and a delay in opening the second line of TurkStream) – it could be forced to transmit through Ukraine between 70 and almost 100 bcm/y.

According to Ukrainian experts, a minimum of 30–40 bn m³ of gas has to be transmitted per year in order to sustain the Ukrainian transit pipeline system. Transit of Russian gas remains a crucial source of revenue for Ukraine (approximately USD 3 bn per year).

Implications for Gazprom and Nord Stream 2

The CJEU judgment will have a range of adverse consequences for Gazprom, not only related to having to maintain transit through Ukraine. Firstly, the Russian company will have to substantially reduce the volume of gas transmitted via Nord Stream, and this will decrease its profit (according to media reports the EC decision of October 2016 resulted in increased incomes for Gazprom of approximately EUR 300 mn per year).

Secondly, the judgment may also result in adverse consequences for the Nord Stream 2 project. This project seems to be in breach of the principle of energy solidarity, which was given significant legal status in the CJEU judgment. Although the project is formally being implemented by a Swiss –registered company (wholly owned by Gazprom), in practice it is a joint undertaking between the Russian company and Western European companies, also receiving political support from some EU member states, principally Germany. In addition, construction of Nord Stream 2 within the EU required Nord Stream 2 AG to obtain permits and clearances from public authorities in the member states through which it runs. Due to the fact that work on the project is underway despite opposition from some EU countries, the CJEU judgment could potentially be used to directly contest the lawfulness of Nord Stream 2 in the context of the principle of energy solidarity provided for in the TFEU (under EU law member states can file complaints against other member states for breach of EU law). The CJEU ruling and stress on the need to respect the principle of energy solidarity could also inspire Denmark to prolong the ongoing process of granting the permit for construction of the pipeline in its waters, or - considering the controversy surrounding NS2 - the Danish side could submit a question for a preliminary ruling to the CJEU asking whether issuing a permit for the project would be a breach of the principle of energy solidarity in the EU underlined by the CJEU.

Even if construction of Nord Stream 2 is not found to be unlawful, the CJEU ruling reduces the chances that the infrastructure under construction will be granted EU law exemptions, in particular the Third-Party Access (TPA) rule. According to an amendment to the gas directive, TPA should apply to the section of the pipeline running through German territorial waters. This would mean that Gazprom could use 50% of the transmission capacity of Nord

Stream 2, which would be approximately 27.5 bcm per year. The result would be not only less flexibility with respect to the Russian firm's export options; it would also mean less revenues from transit fees, in turn rendering the entire project less profitable.

Responses and possible action on the part of Russia

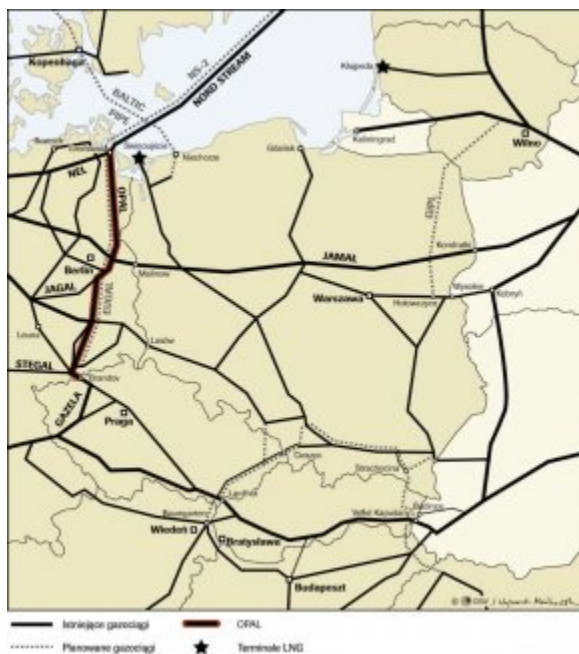
To date, Russia's reactions to the ruling have not been substantial. Gazprom Export (a subsidiary of Gazprom) representatives have said that they are looking at the legal and commercial implications of the judgment. The CJEU's judgment was criticised however by Russian experts and commentators, some suggesting that the ruling was politically motivated. The ruling will most likely lead the Russian authorities and Gazprom management to adopt a more severe tone regarding future gas cooperation between Russia, Ukraine, and the EU. Another possibility is demonstrative measures towards the EU or Ukraine. The CJEU judgment will also probably lead Russia to take a more rigorous stand in the next rounds of trilateral talks on gas and increase the likelihood that any agreement forged will be signed at the turn of 2019 and 2020 at the earliest. Although Russia will definitely adopt stalling tactics during the talks and try to use a real possibility of a gas crisis after 1 January 2020 as leverage, ultimately it will have no choice but to enter into a new transit agreement.

At the same time, the Russian company will certainly take specific measures to adapt. The simplest means of counteracting the harmful effects of the CJEU ruling and increasing the potential for use of the OPAL and Nord Stream pipelines would be for Gazprom to introduce a gas release programme, which is a condition for Gazprom to regain 100% access to the OPAL capacities. What is not clear is on what conditions and within what kind of timeframe Gazprom would be willing to implement such measures, especially as it has not chosen to take them before. This is because it would probably entail disclosure of trade secrets such as the price of gas transmitted through the OPAL pipeline. This might mean therefore that in order to circumvent the restrictions imposed in the ruling, the company would try to use the option of sale of gas by auction (a special electronic platform was launched by Gazprom Export on 17 August 2018), enabling flexible agreement of gas take-off points. Gas sales at the beginning of the off-shore section of the pipeline would resolve some legal issues relating to applicability of the third energy package, primarily TPA restrictions, which might solve problems both with operation of both Nord Stream and of Nord Stream 2, now under construction. This would require however a fundamental change to Gazprom's current practices and giving third parties access to transmission of gas using off-shore pipelines, and would also entail not only making a new

method of purchasing gas attractive for users of Russian gas in Europe, but also making sure they were willing to cover the cost of transmitting gas to the European market from the Russian point of entry to Nord Stream.

To date there have not been many official comments on the CJEU ruling concerning OPAL. Most of the positive responses came from the Polish authorities and PGNiG, who were pleased with the ruling. The matter met with surprisingly little reaction in Ukraine. One of the few reactions came from the vice-president of Naftogaz, Yuri Vitrenko, who described the judgment as a pleasant surprise. The EC has not adopted a formal position. According to a vague comment for Reuters, it is currently analysing the CJEU judgment. Answering media questions, an EC press officer stated that due to the 2016 decision being annulled, at the moment Gazprom has a reservation for 50% of the OPAL capacity and gave an assurance that the court decision would be implemented and executed.

Map. OPAL pipeline.



[1] Agata Łoskot-Strachota, with contributions by Szymon Kardaś, Tomasz Dąborowski, *OPAL dla Gazpromu? Decyzja Komisji Europejskiej w sprawie niemieckiej odnogi gazociągu Nord Stream*, “Komentarze OSW”, no. 226, 09.11.2016,

https://www.osw.waw.pl/sites/default/files/komentarze_226.pdf.