

January 2017



THE OXFORD
INSTITUTE
FOR ENERGY
STUDIES

The OPAL Exemption Decision: past, present, and future

Executive Summary

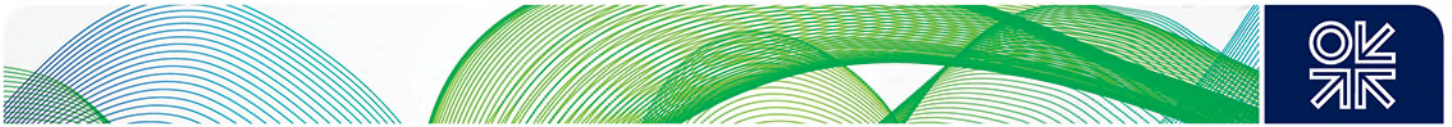
Katja Yafimava

Gazprom's ability to utilise full capacity in the Nord Stream 1 pipeline system – two offshore pipelines, running from Russia to Germany across the Baltic Sea – has remained limited due to a regulatory cap, imposed by the EC in its June 2009 OPAL exemption decision, which has prevented Gazprom from being able to utilise more than 50% of capacity in the OPAL pipeline – one of Nord Stream 1's onshore extensions. In October 2016 the EC revised its decision and allowed Gazprom to bid for the remaining 50 per cent of OPAL capacity alongside third parties at an auction while guaranteeing that the latter would have access to 20 per cent of OPAL capacity. Increased access to transportation capacity in OPAL – enabling increased utilisation of Nord Stream 1 – is an important achievement for Gazprom, as it increases the flexibility of its European exports and reduces its dependence on transit countries.

The October 2016 decision manifests a (belated) recognition (albeit not openly acknowledged) on the part of the EC that there was no rationale, rooted in either the energy or completion *acquis*, for not allowing Gazprom to utilise more than 50% of OPAL's capacity when a) capacity at OPAL's entry point, Greifswald, was of no interest for third parties which did not – and could not – have the gas available at Greifswald, and b) provided that Gazprom's gas would be competing with third parties shipping their gas from GASPOOL to OPAL's exit point at Brandov.

Effectively, the 50 per cent cap placed on Gazprom, favoured traders in their shipments from GASPOOL to Brandov as even if Gazprom had priced its gas at the same level as GASPOOL (or lower), it would not be able to compete with the traders due to its access to capacity at Brandov being artificially constrained. Although capacity available to the traders at Brandov was interruptible rather than firm, the presence of the cap made the probability of interruption negligible. Ultimately, this led to a situation where European buyers were getting their gas at prices potentially higher than might have been available had it not been for the OPAL cap, thus going against its original *raison d'être* of preserving and enhancing competition. Therefore, the continuing preservation of the OPAL cap has become increasingly illogical, unjustifiable on the grounds of the *acquis*, and prone to criticisms of having being imposed on political grounds.

The EC has spent many years developing the legislative and regulatory framework, which sets the rules and procedures for allocation and utilisation of pipeline capacity. Any exemption from these rules is itself a part of the legal/regulatory process and must be justified on regulatory grounds. Politicisation of this process – specifically in respect of Russia – threatens to undermine the credibility of the EU legal and regulatory gas framework. The EC appears to have recognised the danger and attempted to rectify it in its October 2016 decision, bringing itself back into the comfort zone of rules-based regulatory decision-making. Poland's legal challenge to this decision on the basis of generalised statements is an attempt to move in the opposite direction and risks creating a precedent in which political objectives are allowed to override regulatory rules.



The October 2016 decision attempts to strike a fine balance between the interests of all parties involved, in line with the *acquis*. While the decision allows Gazprom to have access to OPAL in excess of 80 per cent of its capacity, it effectively guarantees that third parties will have access to at least 20 per cent of its capacity as Gazprom is not allowed to outbid third parties for that share. Given that this 20 per cent of OPAL capacity now effectively “ring-fenced” constitutes around two thirds of the Czech Republic’s demand, the decision alleviates any concerns about Gazprom’s potential dominance on the Czech wholesale upstream market (which was the EC’s initial concern in 2009). On these grounds, the 2016 exemption decision – although long overdue – appears balanced and is to be welcomed.

Its importance cannot be overestimated in the light of significant uncertainty as to whether Gazprom and the Ukrainian gas company, Naftogaz, will be able to agree a mutually acceptable contractual arrangement for continuing gas transit across Ukraine post-2019, once the existing contract between the two companies – under which around half of Gazprom’s exports to Europe were transited in 2016 – expires at the end of 2019. Should such an arrangement prove impossible, full utilisation of OPAL would enable Gazprom to meet its existing contractual commitments in respect of north west and central east European countries without transiting gas across Ukraine (but not in respect to southern Europe and western Turkey).

As such, the October 2016 decision signifies an important turning point in how Russian gas will be transported to Europe in the future. It could serve as an enabler for finding a new contractual arrangement between Gazprom and Naftogaz, with mediation from the EC, for continuing transit across Ukraine post 2019, assuming that Gazprom is assured of its ability to utilise more capacity in Nord Stream 1. This would reduce the urgency for the construction of Nord Stream 2 and/or the Turkish/South Stream pipelines. However, should either the exemption decision or the arrangement with Naftogaz fail or be further delayed by legal proceedings, the opposite could be the case. In any event, the decision may have created a precedent and could serve as a guidance for any future regulatory treatment of onshore extensions of Nord Stream 2 and/or Turkish/South Stream.