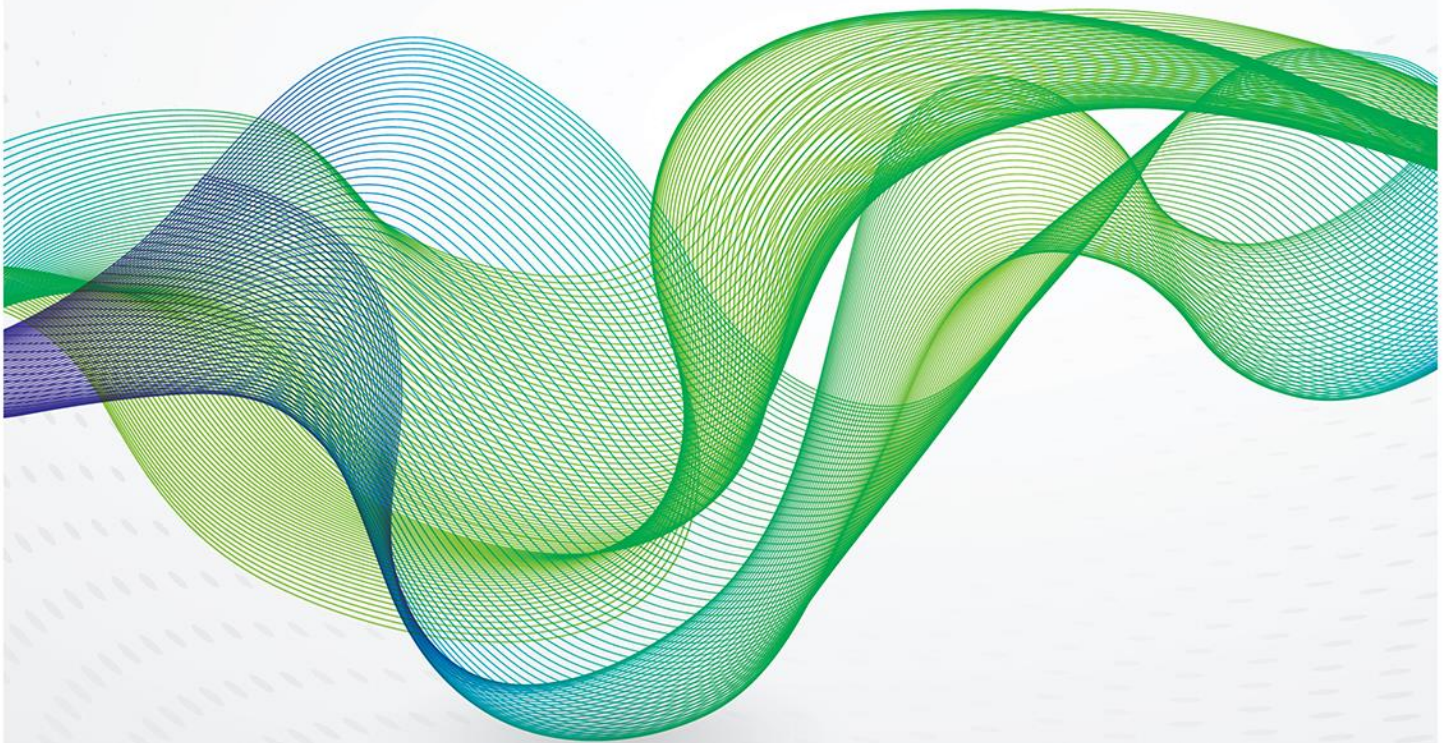




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# The OPAL Exemption Decision: past, present, and future





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## Preface

To the casual gas reader, the dispute over the use of OPAL pipeline capacity is an issue for regulatory experts. But nearly eight years after the first regulatory decision and more than five years after the pipeline started operating it seems extraordinary that the share of capacity that Gazprom can use (if not required by other parties) remains unresolved. Indeed as we entered 2017, the controversy became even greater with the Commission being sued by a member state for having attempted to resolve this long-running problem causing the case to be referred to the European Court of Justice (CJEU).

How and why we arrived at this point are the questions Katja Yafimava's paper is designed to answer. Few of us, if we have only followed the headlines of the OPAL story, will have appreciated the complexity of the (competition and energy) regulatory issues, and in particular the impact of the evolving capacity allocation framework and development of capacity auction platforms, on the different options for resolving the dispute. The eventual extent to which OPAL capacity will be utilised, and by which parties, will potentially set a precedent for the treatment of Nord Stream 2 capacity, given the stated intention of Gazprom and its European partners to build two additional offshore lines (with onshore extensions).

But aside from purely gas regulatory dimensions, the OPAL story raises another, more fundamental issue, whether the legal/regulatory framework should be used to obstruct transportation of Russian gas to Europe. Objections to Russian gas supplies and pipelines on political and security grounds have a long history and should be argued on their own merits. This paper raises the question of whether it is valid for such objections to be used to distort a natural gas regulatory framework which has been many years in the making.

Jonathan Stern

Oxford, January 2017



## Acknowledgements

Researching and writing this paper has been a challenge not only due to the complexity of the subject itself but also due to the scarcity of the data (with some documents becoming publicly available shortly before publication) and linguistic challenges (with many documents not being available in English or any other language this author is sufficiently familiar with). An additional challenge was presented by an ever-changing political context whereby regulatory issues have become politicised to such an extent that, at the time of this paper being published, it is not at all clear whether the October 2016 OPAL exemption decision – which has been in the making for seven years – will remain in force.

Given the complexity of the task, I was privileged to be able to test my views on the matter against those of Professor Jonathan Stern, a Distinguished Research Fellow on the OIES Natural Gas Research Programme, to whom I am very grateful for the time he spent on reading and commenting on the paper. I am also grateful to sponsors of the Gas Programme for their helpful comments. I am also thankful to Liz Henderson for editing and to Kate Teasdale for administrative support. Responsibility for all the views expressed and all the conclusions reached is solely mine.





## List of Abbreviations

ACER - Agency for the Cooperation of Energy Regulators  
BNetzA – Bundesnetzagentur (German Regulatory Authority)  
BZK – Coupled capacity  
DZK - Dynamically allocable capacity  
CAM - Capacity Allocation Mechanism  
CMP – Congestion Management Procedures  
CJEU – Court of Justice of the European Union  
CMP - Congestion Management Procedures  
DG COMP - EC Competition Directorate  
EC – European Commission  
ENTSOG - European Network of Transmission Systems Operators for Gas  
ERU - Energetický regulační úřad (Czech Regulatory Authority)  
EU – European Union  
FZK - Firm freely allocable capacity  
ISO – independent system operator  
ITO – independent transmission operator  
LBTG - Lubmin-Brandov Gastransport  
NEL - Nordeuropäische Erdgasleitung  
OIES – Oxford Institute for Energy Studies  
OPAL – Ostsee-Pipeline-Anbindungsleitung  
OU – ownership unbundling  
PGNiG - Polskie Górnictwo Naftowe i Gazownictwo SA (Polish oil and gas company)  
PRISMA - European gas capacity trading platform  
TPA – third party access  
TSO – transmission system operator  
UIOLI – use-it-or-lose-it  
UOKiK - Urząd Ochrony Konkurencji i Konsumentów (Polish Competition Authority)  
VIU - Vertically integrated undertaking

## Units of Measurement

bcm - Billion cubic metres  
bcma - Billion cubic metres per annum  
GCV - Gross Calorific Value  
GWh/h - Gigawatt hours per hour  
kWh/h - Kilowatt hours per hour  
mcm -Thousands of cubic metres  
mn - million



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## Executive Summary

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 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 shipping 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 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, maintaining 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 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 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 upstream wholesale 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 of southern Europe and western Turkey for which Nord Stream 2 or Turkish/South Stream would be required).

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.





## Introduction: the rationale for and significance of the Nord Stream pipelines

The Nord Stream 1 pipeline system (consisting of two offshore pipelines, running from Russia to Germany across the Baltic Sea) constitutes a key element of Gazprom's transit diversification strategy, adopted in the early 2000s in respect of its European gas exports. Adoption of this strategy was effectively an acknowledgment of Gazprom's failure to resolve its disputes over gas prices and transit fees with Ukraine, Belarus, and Moldova which in turn endangered transit security of its exports to Europe.<sup>1</sup> In 2015 Gazprom revived its previously shelved plans to expand the existing Nord Stream 1 system by building two additional pipelines (Nord Stream 2) which would double its capacity to around 110 bcm/year.

Nord Stream 1 has been in operation since 2011 but Gazprom's ability to utilise its full capacity has remained limited due to a regulatory cap, imposed by the European Commission (EC) in its June 2009 exemption decision, which has prevented Gazprom from being able to utilise more than 50 per cent of capacity in the OPAL pipeline – one of Nord Stream 1's onshore extensions (NEL being the other) – which connects the Nord Stream 1's landing point at Greifswald with Brandov at the German-Czech border. The October 2016 EC exemption decision removed the cap and allowed Gazprom to bid for the remaining 50 per cent of OPAL's capacity alongside the third parties on the PRISMA capacity trading platform. This would allow Gazprom to utilise at least 80 per cent (and possibly more) of OPAL's capacity which would be an important step towards its coveted aim of fully utilising Nord Stream 1 capacity.

The October 2016 exemption decision ended more than seven years of negotiations and many failed attempts to find a mutually acceptable solution that would be compliant with the EU law (Community *acquis*). The significance of this decision cannot be overestimated in the light of significant uncertainty as to whether Gazprom would be able to agree a mutually acceptable commercial and legal arrangement with the Ukrainian national gas company, Naftogaz, for the continued transit of its gas across Ukraine once the existing contract – under which around half of Gazprom's exports to Europe were transited in 2016 – expires at the end of 2019. Should the arrangement not be made, the full utilisation of OPAL would mean that Gazprom would be able to meet its existing contractual commitments in respect of both north west and central east European countries without transiting gas across Ukraine (but not in respect of southern Europe and western Turkey for which Nord Stream 2 or Turkish/South Stream would be required).<sup>2</sup>

The 2016 OPAL exemption decision therefore signifies an important turning point in respect of how Russian gas will be transported to Europe in the future. It could pave the way to finding a new mutually acceptable 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) thus reducing the urgency for the construction of either the 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 outcome of the OPAL exemption decision could serve as a guidance for any future regulatory treatment of onshore extensions of Nord Stream 2 (and/or Turkish/South Stream).

The paper is structured as follows: Section 1 provides a description of Nord Stream 1 and its onshore extensions, OPAL and NEL, including information on routes, capacities, and ownership structure. Subsequent sections focus on major milestones of the exemption decision-making process during 2008-2016, including the original February 2009 exemption decision, the amended July 2009 exemption decision, and the October 2016 exemption decision, as well as the corresponding October 2013, May

<sup>1</sup> Yafimava (2011).

<sup>2</sup> Pirani and Yafimava (2016), pp. 41-46.



2016, and November 2016 settlement agreements (sections 2-11). In addition to analysing the substantive provisions of these documents, the paper explains their evolution in relation to the changing commercial, regulatory and political context. In parallel, the paper analyses their impact on the physical flows through OPAL and NEL. We then explain European reactions to the October 2016 exemption decision, focusing on Poland's legal action contesting the decision, and its potential impact (section 13), and finally present our conclusions.

## 1. Nord Stream 1, OPAL and NEL: routes, capacities, and ownership structures

Nord Stream 1 consists of two offshore pipelines connecting Russia (Vyborg) and Germany (Lubmin, near Greifswald) under the Baltic Sea. The first pipeline became operational in 2011 and the second in 2012. The total capacity of both pipelines is around 55-58 bcm. At the Greifswald receiving terminal, the Nord Stream offshore pipeline connects with two onshore pipelines, OPAL and NEL, which transport gas from Russia onwards to European customers. The terminal consists of two sections: the 'offshore section' for the incoming Nord Stream offshore pipeline and an 'onshore section' for OPAL and NEL. OPAL (36.5 bcm) has been in operation from October 2011 whereas NEL (21.8 bcm) has been in operation since late 2013 (Fig. 1).<sup>3</sup>

OPAL transports Nord Stream gas 470 km southwards across Germany to Olbernhau/Brandov at the German-Czech border, from where it is transported by the Gazelle pipeline across the Czech Republic to Waidhaus at the Czech-German border. OPAL consists of two sections: OPAL-Nord and OPAL-Süd. OPAL-Nord connects Lubmin/Greifswald to Groß Köris/Brandenburg (south of Berlin), where it links into the GASCADE Gastransport system. OPAL-Süd connects Groß Köris/Brandenburg to Olbernhau/Brandov at the border (Fig. 1). Entry capacity of OPAL-Nord is 36.5 bcm whereas exit capacity at Groß Köris/Brandenburg is 4.5 bcm thus resulting in 32 bcm entry capacity in OPAL-Süd.

NEL transports Nord Stream gas from Lubmin 440 km westwards in Germany to Rehden where it is linked with the Rehden-Hamburg pipeline (part of the MIDAL system), where it further connects to the gas transport networks of WIGA and Uniper (formerly E.ON Ruhrgas).<sup>4</sup>

Both the OPAL and NEL pipelines were built by Wingas (a joint venture between BASF's subsidiary Wintershall and Gazprom), and were jointly owned by Wingas (80 per cent and 75 per cent respectively) and E.ON Ruhrgas (20 per cent and 25 per cent respectively). In 2010, Wingas's existing pipeline network was transferred into ownership of Wingas Transport, now known as GASCADE Gastransport. OPAL NEL Transport (jointly with E.ON Ruhrgas) became network operators for the new OPAL and NEL pipelines. OPAL NEL Transport was subsequently separated into two companies – OPAL Gastransport and NEL Gastransport – both of which (together with GASCADE Gastransport) became part of W&G Transport. The latter was subsequently renamed WIGA Transport (indirectly owned and jointly controlled by Wintershall and Gazprom).<sup>5</sup> At present, OPAL Gastransport is the operator of the OPAL pipeline and NEL Gastransport is the operator of the NEL pipeline.<sup>6</sup> OPAL Gastransport is a majority shareholder in OPAL (80 per cent) with the remaining 20 per cent share owned by Lubmin-

<sup>3</sup> NEL was scheduled to start operations in 2012 but was delayed due to local environmental opposition in Germany. 'German citizens challenge planning approval for NEL pipeline', *Gas Strategies*, 21 April 2011.

<sup>4</sup> In 2003 E.ON merged with Ruhrgas thus forming a new company - E.ON. Ruhrgas, which was subsequently renamed E.ON; this was followed in June 2016 by demerger of E.ON into two new companies – E.ON and Uniper.

<sup>5</sup> According to the EC the joint control of OPAL Gastransport was *not* replaced by *sole* control of Gazprom in the course of the Wintershall acquisition, see EC (2013a).

<sup>6</sup> In corporate terms, OPAL Gastransport operates the WIGA share in OPAL, and LBTG operates the Uniper share in OPAL. In technical terms, OPAL Gastransport operates the entire OPAL pipeline. Therefore physical gas flows via (both shares of) OPAL are listed on the OPAL Gastransport website, whereas capacities and nominations for respective shares are listed separately on OPAL Gastransport and LBTG websites, <https://www.opal-gastransport.de/en/> and <http://www.lbtg.de>



Brandov Gastransport (LBTG), which is an infrastructure affiliate of Uniper. Uniper sold its share in NEL Gastransport, which is now owned by NEL Gastransport, Gasunie Deutschland (formerly GOAL), and Fluxys Deutschland. Gazelle, which connects with OPAL at Brandov at the German-Czech border and transports gas across the Czech Republic to Waidhaus at the Czech-German border before connecting into the GASCADE Gastransport system, is operated by RWE Transgas.

**Figure 1: Nord Stream 1, OPAL, and NEL pipelines**



Source: ENTSOG website (adapted)

## 2. The February 2009 BNetzA OPAL Gastransport exemption decision

According to the Second Gas Directive (Art. 22) ‘major new gas infrastructures, i.e. interconnectors between member states, LNG and storage facilities, may, upon request, be exempted from the provisions on third party access (TPA) (Art. 18, 19, 20) and tariffs (Art. 25.2, 25.3, 25.4)’. In order to be exempted, infrastructure must meet the following criteria: enhance competition in gas supply and enhance security of supply; be too risky to be invested in unless exempted; be owned by an entity legally separate from the system operators in whose systems it would be built; levy charges on its users; and the exemption should not be detrimental to competition or the effective functioning of the internal gas





market or the efficient functioning of the regulated system to which it is connected (Art. 22.1.a, b, c, d, and e).

In 2008, OPAL NEL Transport and (then) E.ON Ruhrgas applied to the German regulatory authority Bundesnetzagentur (BNetzA) for two separate exemptions under Art. 22 from the provisions on regulated TPA (Art.18) and regulated tariffs (Art. 25.2, Art. 25.3, Art. 25.4) in the Second Gas Directive, in respect of both OPAL and NEL pipelines, with a view to having these exemptions approved by the time scheduled operations started.<sup>7</sup>

Following an oral hearing on 20 November 2008, BNetzA issued two decisions on 25 February 2009: one to OPAL NEL Transport (BK7-08-009)<sup>8</sup> and another to E.ON Ruhrgas (BK7-08-010).<sup>9</sup>

Given that OPAL NEL Gastransport was later separated into OPAL Gastransport and NEL Gastransport, and E.ON Ruhrgas's shares in OPAL were transferred to Uniper's affiliate LBTG, this paper refers to these two exemptions as 'The February 2009 OPAL Gastransport exemption decision' and 'The February 2009 LBTG exemption decision' respectively. NEL (as a domestic transmission pipeline) was refused an exemption and therefore had to be operated as a regulated pipeline under a TPA regime. OPAL (as an interconnector) was granted an exemption for a period of 22 years from the date of the start-up of operations.<sup>10</sup>

BNetzA has only granted a partial exemption to OPAL. It stated that the exemption only applies to transportation of gas through the OPAL pipeline from Nord Stream 1 directly to the German-Czech border at Olbernhau/Brandov, and excludes 'domestic transports and possible reverse flow transports from the Czech Republic to Germany'.<sup>11</sup> In other words, the exemption would apply exclusively to OPAL interconnection capacities with entry on German territory and exit in Brandov (Art. 1.a).

BNetzA published its February 2009 OPAL Gastransport and LBTG exemption decisions only in German, with parts of the documents being blacked out (presumably to preserve confidentiality). The data on exempted capacities stated below reflects our understanding based on references made by the EC in its subsequent decisions.

It is our understanding that the OPAL Gastransport exemption decision covered 31,729,064 kWh/h (~25.4 bcma<sup>12</sup>) of entry capacity at Greifswald and exit capacity at Brandov (that would be offered as BZK, i.e. coupled capacities<sup>13</sup>) out of OPAL Gastransport's total technical capacity of 36,315,801 kWh/h (~29.1 bcma). The remaining 4,586,737 kWh/h (~3.7 bcma) would be regulated (and offered as DZK i.e. separately bookable dynamically allocable capacities<sup>14</sup>).

It is also our understanding that the LBTG exemption decision covered 7,932,260 kWh/h (~6.3 bcma) of entry capacity at Greifswald and exit capacity at Brandov (that would be offered as BZK) out of LBTG's total technical capacity of 9,078,944 kWh/h (~7.3 bcma). This suggests that the remaining 1,146,684 kWh/h (~1 bcma) would be regulated (and offered as DZK).<sup>15</sup>

The combined OPAL Gastransport and LBTG exempted BZK capacities equals the exit capacity at Brandov (31,729,064 + 7,932,260 = 39,661,324 kWh/h ~ 31.7 bcma). The combined OPAL

<sup>7</sup> OPAL Gastransport (2008).

<sup>8</sup> BNetzA (2009a).

<sup>9</sup> BNetzA (2009b).

<sup>10</sup> BNetzA (2009c).

<sup>11</sup> BNetzA (2009c).

<sup>12</sup> Gross calorific value (GCV) of 10.95 kWh / m<sup>3</sup> (a lower limit of the 10.95-11.7 range stated by OPAL Gastransport, see OPAL Gastransport (2016d)) is used for conversion here and everywhere in this paper.

<sup>13</sup> Coupled capacity which can only be used for entry at Greifswald and exit at Brandov.

<sup>14</sup> Firm entry at Greifswald and firm exit at Brandov, combined with interruptible access to GASPOOL.

<sup>15</sup> LBTG website, <https://gasdata.transparency-lbtg.de/>





Gastransport and LBTG regulated capacities equals the exit capacity at Groß Köris/Brandenburg (4,586,737 + 1,146,684 = 5,733,421 kWh/h ~ 4.6 bcma).

The Gas Regulation 715 defines 'technical capacity' as the 'maximum firm capacity that the transmission system operator (TSO) can offer to the network users, taking account of system integrity and the operational requirements of the transmission network' (Art. 2.1.18).<sup>16</sup> Thus the TSO can only offer and sell capacity that it can guarantee (even for some entry-exit combinations that are too unlikely to be credible). Furthermore, the German legislation appears to define firm capacity very restrictively thus potentially resulting in a lower level of de jure firm capacity.<sup>17</sup> The remaining capacity is offered as interruptible, whereas de facto the latter might be firm. Notably, OPAL Gastransport only lists technical (and thus firm) capacity on its website (36,315,801 kWh/h). LBTG, in addition to technical (and thus firm) capacity, also lists 3,966,130 kWh/h of (presumably interruptible) capacity at Lubmin/Greifswald entry.

In its decision, BNetzA imposed various obligations in respect of congestion management procedures (CMP) on the OPAL pipeline. For example, the obligation to apply 'market-based, transparent and non-discriminatory procedure' in the event of congestion (Art. 1.c). It also introduced both short- and long-term use-it-or-lose-it (UIOLI) CMP to prevent capacity hoarding (Art. 1.d.aa, Art. 1.d.bb). BNetzA also imposed certain obligations in respect of OPAL's (functional and legal) unbundling. For example, it stated that the exemption could be revoked if the applicant is not separated from Wingas Transport or a third network operator (Art. 1.d.f.cc);<sup>18</sup> such separation has since been accomplished.

Notably, Gazelle, the pipeline to which OPAL is connected, was exempted from both TPA and tariff regulation in May 2011, and from ownership unbundling in December 2011 (under Art. 36 of the Third Gas Directive).<sup>19</sup> It is worth noting that Gazelle, the function of which is very similar to that of OPAL, was granted its exemptions both by the Czech regulatory authority (ERU) and the EC very quickly over the course of 2011, and faced none of the difficulties faced by OPAL, the exemption decision-making process in respect of which had continued during 2008-2016, and which is the main subject of this paper.

### 3. The June 2009 EC OPAL Gastransport exemption decision

On 13 March 2009 BNetzA notified its draft January 2009 OPAL Gastransport and LBTG exemption decisions to the EC in line with the Second Gas Directive (Art. 4).<sup>20</sup> The Second Gas Directive stipulates that within two months of receiving a notification, the EC 'may request' that the national regulatory authority (or the member state concerned) 'amend or withdraw' an exemption decision (Art. 4); the two month period may be extended by one additional month 'where additional information is sought' by the EC.

In line with this requirement, the EC assessed both exemption decisions. Meanwhile, third parties, whose comments on the draft decision the EC had invited in line with the procedure, stated that the conditions for an exemption were not met.<sup>21</sup> Subsequently the EC requested additional information from

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<sup>16</sup> Gas Regulation 715.

<sup>17</sup> EC (2016a), p. 31.

<sup>18</sup> Subsequently, both OPAL Gastransport and NEL Gastransport had been separated from Wingas Transport.

<sup>19</sup> EC (2011a) and EC (2011b).

<sup>20</sup> Notably, the Third Gas Directive requires the national regulatory authority to notify the EC not only about each exemption decision but also about each exemption request (the latter requirement was absent in the Second Gas Directive).

<sup>21</sup> EC (2009a).



BNetzA as well as from the ERU and extended its original two-month deadline by one month, resulting in a new deadline of 15 June 2009. The EC finally issued its decision on 12 June 2009.

In respect of NEL, the EC approved the BNetzA's decision not to grant an exemption in its entirety which meant that NEL would be fully subject to regulation. In respect of OPAL, the EC requested the February 2009 OPAL Gastransport exemption decision be amended (as explained below) while approving the February 2009 LBTG exemption decision in its entirety.

In respect of the 2009 February OPAL Gastransport exemption decision, the EC accepted BNetzA's reasoning that OPAL is an interconnector and that it meets most of the exemption criteria listed in Art. 22.1, except the criteria on its impact on competition (Art. 22.1.a, Art. 22.1.e) (see Section 2).<sup>22</sup> On its part, BNetzA concluded that OPAL would have no impact (positive or negative) on competition in the German market and would lead to improved competition in the Czech downstream wholesale gas market.<sup>23</sup> According to the EC, the latter conclusion appears to have been based on BNetzA's argument that the exemption would lead to an increased share (from 1 to 5 per cent in 2015) for Wingas and Vemex and a decreased share for RWE Transgas (which at the time of assessment stood at 99 per cent) of the Czech market thus reducing its degree of concentration.<sup>24</sup>

However, the EC disagreed with this reasoning and stated that BNetzA did not provide 'sufficient evidence' that competition in the Czech downstream wholesale market would improve as a result of the exemption. In particular, the EC questioned BNetzA's assumptions on the size of future sales by Wingas and Vemex in the Czech Republic. It also noted that Gazprom had extended its contract with RWE Transgas until 2035<sup>25</sup> and that its gas constituted 78 per cent of RWE Transgas' portfolio in 2007 and also cited a lack of evidence of the sufficient likelihood that OPAL would be used to supply gas to the Czech Republic. On this basis, the EC concluded that the exemption would have a negative impact on competition in the Czech market.

Furthermore, the EC concluded that the exemption might worsen competition in the Czech upstream wholesale market. In particular, the EC argued that no other producing countries apart from Russia would be able to supply gas to the Czech Republic at 'comparable conditions and without the difficulties of transport', and that the exemption would only reinforce Gazprom's position. Thus the EC rejected BNetzA's argument that the producer (upstream) market should be at least EU-wide, on the basis that such definition did not take 'sufficient account of the different market conditions in Europe and obstacles facing Czech customers' in accessing non-Russian gas supplies. The EC also cited concerns expressed by the ERU in this respect.

Overall, the EC concluded that the February 2009 exemption decision did not give 'sufficient evidence' that the exemption would have 'positive effects on competition' in the Czech downstream wholesale market and provided no 'required certainty' that it would not result in Gazprom's strengthened competitive position on the Czech upstream wholesale market.<sup>26</sup> On that basis the EC concluded that the February 2009 exemption decision does not meet criteria set in Art. 22.1.a and Art. 22.1.e requiring enhancement of, and lack of detrimental effect on, competition.

Upon concluding its assessment procedure, the EC requested BNetzA to amend its draft exemption decision by imposing a 50 per cent cap on the amount of OPAL's exit capacity at Brandov (31,729,064 kWh/h (~25.4 bcma)) which could be booked by Gazprom (or any dominant undertaking), thus reducing

<sup>22</sup> EC (2009b).

<sup>23</sup> EC (2009b).

<sup>24</sup> It is notable that in its 2009 exemption decision, the EC does not appear to be clear on whether Wingas and Vemex were controlled by Gazprom as it refers to both of them as 'controlled or jointly controlled' ('kontrollierte bzw. Mitkontrollierte'). However, in its 2013 assessment, the EC clearly states that Wingas is jointly controlled by Wintershall and Gazprom, and does not dispute the fact that Gazprom only exercises 'joint control' over Vemex, see EC (2013a), sections (4), (51), (69), and (71).

<sup>25</sup> It is our understanding that the Gazprom-RWE supply contract was suspended as of 2014.

<sup>26</sup> EC (2016a), p. 3.



it to 15,864,532 GWh/h (~12.7 bcma). (Notably bookings of dominant companies or groups of companies bound by long-term gas supply agreements (contracts) e.g. as between Gazprom and RWE Transgas, are considered aggregated<sup>27</sup>). As long as gas entering OPAL at Greifswald was owned by Gazprom Export and there was no ownership change before the gas exits at Brandov, the cap de facto had an effect only on Gazprom's capacity bookings. The EC also stated that such cap would be lifted should Gazprom offer 3 bcm of gas to a market in an open, transparent, and non-discriminatory manner, while also guaranteeing corresponding transport capacity with a freely selectable exit point. In short, Gazprom's ability to book OPAL's 'transit' capacity for its own use would be limited by 50 per cent unless it conducted gas and capacity release programmes in which case the cap would be lifted.

It is our understanding that the EC requested no amendments to be made in respect of the February 2009 LBTG exemption decision (thus suggesting that 7,932,260 kWh/h (~6.3 bcma) would continue to be exempted in line with the latter.

It must be noted that the Second Gas Directive did not provide any quantitative criteria for granting an exemption, including in respect of its impact on competition thus suggesting that the EC was able to exercise a significant degree of discretion while making its assessment. Furthermore, the Second Gas Directive provided for very limited transparency of the decision-making process itself. It is also worth noting that the EC only published the OPAL Gastransport exemption decision in German. This is unusual as all EC's previous exemption decisions – including that for the Nabucco pipeline – were also published in English, in addition to a national language of the applicant). Also certain parts of the decision were blacked out (presumably to preserve confidentiality) but this is also unusual as all previous exemption decisions were published in full.

#### 4. The July 2009 BNetzA OPAL Gastransport exemption decision

Under the Second Gas Directive, BNetzA had two months to comply with the EC request and amend its draft decision, or else withdraw it altogether. BNetzA chose the former, and on 7 July 2009, it issued an amended decision, which complied with the EC's request ('The July 2009 OPAL Gastransport exemption decision'). In particular, the amended decision included a new section, which stated that capacity bookings by dominant companies should be capped at 50 per cent (Art. 1.j.aa) while allowing for a cap to be lifted should gas and capacity release programme take place (Art. 1.j.bb).<sup>28</sup>

Meanwhile construction of Nord Stream 1's first and second offshore pipelines in the Baltic Sea had progressed, with the first pipeline becoming operational in late 2011 and the second in late 2013. Construction of OPAL on German territory was also completed in late 2011, in time to receive gas from the Nord Stream's first pipeline. (Nord Stream 1's second pipeline became operational in late 2013, matching the commissioning of NEL.) First gas flowed through Nord Stream 1's first pipeline in September 2011 followed by full-scale commercial deliveries in November.

According to the EC, Gazprom discussed and agreed the main principles of the gas release programme with BNetzA in 2011.<sup>29</sup> However, it is understood that Gazprom had since decided not to participate and the programme was never implemented. Given that entry capacity at Greifswald is only of interest to Gazprom – as it is the only shipper with gas at Greifswald - a significant part of OPAL's capacity remained underutilised. In line with the July 2009 Opal Gastransport exemption, Gazprom's ability to utilise OPAL's exit capacity at Brandov was capped at 50 per cent (i.e. ~12.73 bcm) and remained such

<sup>27</sup> The EC established the dominant position of Gazprom on the Czech wholesale upstream market and of RWE Transgas on the Czech downstream wholesale market.

<sup>28</sup> BNetzA (2009d).

<sup>29</sup> EC (2016a), p. 7.



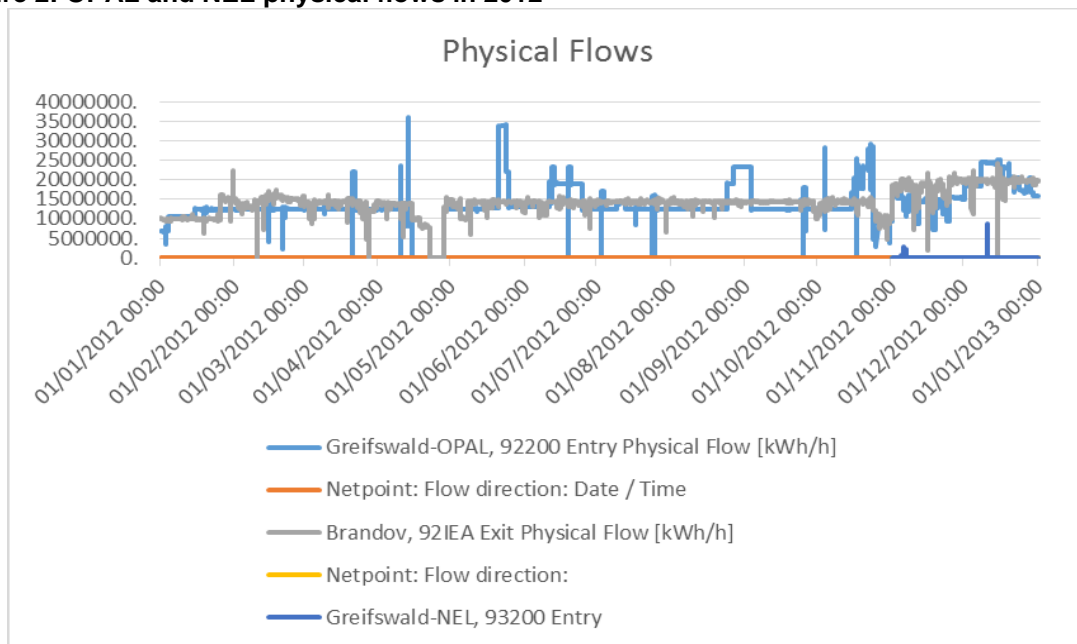


until 28 October 2016, when the EC approved the exemption decision, which removed the 50 per cent cap (see Section 9). (However, this decision was subsequently suspended as of 1 January 2017, pending a court decision, see Section 13). Accordingly Nord Stream 1 itself remained underutilised.

## 5. OPAL and NEL physical flows in the aftermath of the July 2009 decision

OPAL Gastransport’s total technical entry capacity at Greifswald is 36315801 kWh/h of which 4,586,737 GWh/h is regulated, 15,864,532 kWh/h is exempted and a further 15,864,532 kWh/h is restricted (i.e. cannot be used by Gazprom or any other company dominant on the Czech market as long as gas release is not conducted). LBTG’s total technical entry capacity at Greifswald is 9,078,944 kWh/h of which 1,146,684 kWh/h is regulated and 7,932,260 kWh/h is exempted. By 2013, gas flows at the OPAL’s entry point at Greifswald had reached 24 GWh/h (~19 bcma) i.e. the level of combined exempted capacity for both OPAL Gastransport (15,9 GWh/h) and LBTG (7.9 GWh/h) (Fig. 2). By March 2013, gas flows reached the level of ~30 GWh/h i.e. the combined level of exempted and regulated technical capacity.

**Figure 2: OPAL and NEL physical flows in 2012**



Source: OPAL Gastransport website data (adapted), NEL Gastransport website data (adapted)

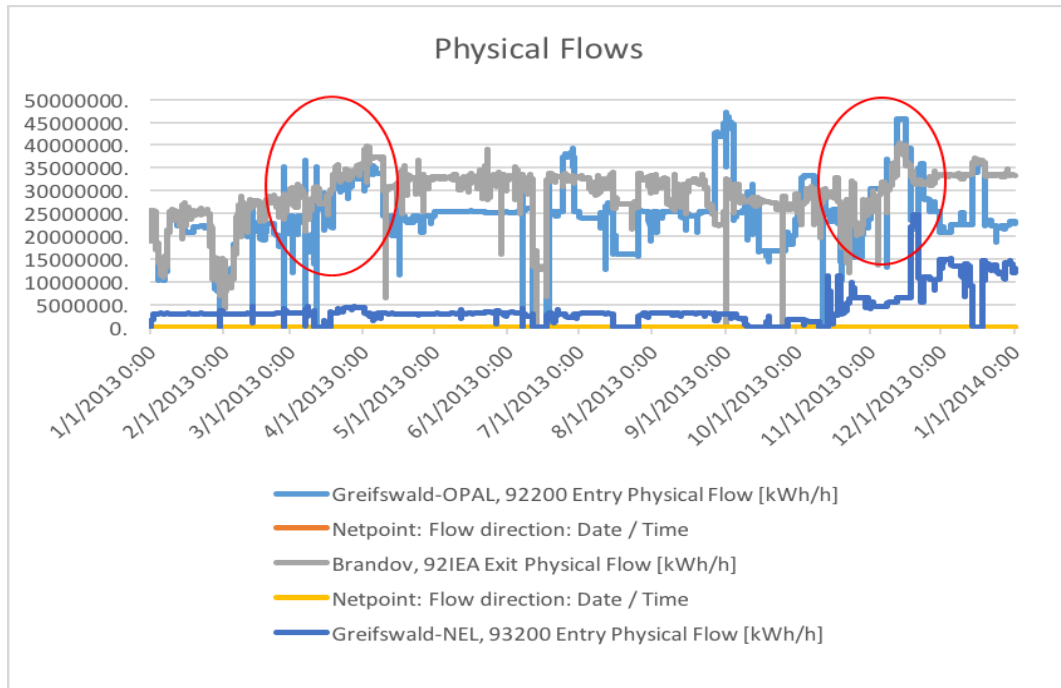
Although the flow’s median remained around 24-25 GWh/h throughout 2013 (Fig. 3), occasionally utilisation of entry capacity at Greifswald went above that level (March-April, June, August, October-November) – even hitting 45 GWh/h on few occasions – thus suggesting that OPAL Gastransport’s restricted capacity was also being used. Given that Gazprom was not allowed to use it short of carrying out a gas release programme, other parties must have been utilising this capacity but they are not possible to identify. The degree of near perfect correlation between an increase in utilisation of entry capacity at Greifswald and exit capacity at Brandov in March-April and October-November 2013 suggests that gas was transported to the Czech Republic. Also, the OPAL Gastransport data on gas nominations clearly shows that not only exempted and regulated capacity but also restricted capacity





was nominated (sometimes to a maximum).<sup>30</sup> Whether or not this was Gazprom’s gas transported to Gazprom’s buyers by third parties is not clear. In any event, this situation was of limited duration and by 2014 utilisation of entry capacity at Greifswald returned to the level of ~24-25 GWh/h where it remained for most of post-2013 period.

**Figure 3: OPAL and NEL physical flows in 2013**



Source: OPAL Gastransport website data (adapted), NEL Gastransport website data (adapted)

Thus apart from short periods when restricted capacity was used the overall median level of utilisation of total technical capacity at Greifswald/OPAL in 2013 was around 52.9 per cent (24 GWh/h out of 45.4 GWh/h) whereas the level of utilisation of exempted and restricted technical capacity was 60 per cent (24 GWh/h out of 39.7 GWh/h).

Notably, in 2013 exit flows at Brandov were within the range of 25-33 GWh/h for most of the time. Except for March-April and October-November, when exit flows out of Brandov were very close to entry flows at Greifswald, exit flows out of Brandov were above entry flows at Greifswald by some 5-9 GWh/h suggesting that in addition to gas entering at Greifswald, gas entering from GASPOOL was also exiting at Brandov. The fact that exit flows out of Brandov nearly coincided with entry flows at Greifswald during the periods when entry capacity at Greifswald was utilised in excess of exempted levels (March-April, October-November), but were mostly above outside these periods, appears to suggest that gas entering at Greifswald was competitive with gas entering from GASPOOL. Overall the level of utilisation of technical exit capacity at Brandov in 2013 was ~63-83 per cent (25-33 GWh/h out of 39.7 GWh/h). It is worth noting that under the terms of July 2009 OPAL Gastransport exemption decision, no regulated firm capacity on OPAL was available for booking from GASPOOL for exiting at Brandov, with such capacity being offered as interruptible.<sup>31</sup>

<sup>30</sup> OPAL Gastransport website, <https://www.opal-gastransport.de/en/>

<sup>31</sup> EC (2016a), p. 8.



Gas deliveries through NEL started in late 2013 and reached the level of 25 GWh/h in early 2014, i.e. close to 100 per cent capacity utilisation (Figs. 3 and 4). Since then gas flows have mostly stayed at that level, except for the winter of 2014/15 when capacity utilisation almost halved (Figs. 4 and 5, see Sections 6 and 7).

## 6. The October 2013 OPAL Gastransport (Failed) Settlement Agreement

Persistent underutilisation of OPAL's entry capacity in 2012-2013, as shown in Section 2, allowed Gazprom to argue that the EC decision to deny it access to full capacity (unless a gas and capacity release programme was carried out) was illogical because no other supplier but Gazprom had additional gas available at Greifswald to deliver into OPAL. The data on physical flows clearly supports this argument. Gazprom continued its negotiations with the EC in an attempt to agree a compromise solution that would allow for the capacity cap to be removed without triggering a gas release programme. After nearly three years of negotiations, Gazprom and the EC reached a solution which would allow Gazprom to use 100 per cent of OPAL capacity unless it was required by third parties (the interest of third parties was to be determined through an auction on the European capacity trading platform, PRISMA, where both Gazprom and third parties would be allowed to bid).<sup>32</sup> A settlement agreement to this effect was concluded on 31 October 2013 by BNetzA, OPAL Gastransport, Gazprom, and Gazprom Export ('The October 2013 OPAL Gastransport settlement agreement').<sup>33</sup>

According to the October 2013 settlement agreement, the amended exemption would also be partial (just as the February 2009 and July 2009 exemption decisions were) as it would only apply to OPAL Gastransport capacity from Greifswald to Brandov (31,729,064 kWh/h or ~25.4 bcma), of which half would be exempted and half partly regulated, in line with the conditions which would allow Gazprom to access the latter unless wanted by third parties.<sup>34</sup>

The EC's approval of the October 2013 settlement agreement was necessary for amending the July 2009 exemption decision in line with the substantive changes agreed in the former. The EC had to assess the October 2013 settlement agreement in line with the exemptions procedure set out by the Third Gas Directive (Art. 36), which repealed the Second Gas Directive from 3 March 2011 (under which the EC assessed the BNetzA's February 2009 draft exemption decision (Art. 22)). It is worth noting that the Third Gas Directive allows the EC more time for assessment (at least four months but potentially more, Art. 36.9) compared to the Second Gas Directive (at most two months, (Art. 22.4)).

Despite the generous amount of time allowed by the Third Gas Directive for exemptions assessment, the EC repeatedly delayed its decision, thus leading OPAL Gastransport to announce on 28 February 2014 that auctioning of OPAL capacity on PRISMA – originally scheduled to be carried out on 3 March 2014 – would be postponed (with no new auction date being provided).<sup>35</sup>

The EC continued to postpone its decision, citing unspecified 'technical aspects' while providing no specific reasons for the delay.<sup>36</sup> This is especially puzzling given that it is understood that the EC had

<sup>32</sup> These negotiations took place within a working group, established by the EC and the Russian Energy Ministry, which also included Gazprom and BNetzA.

<sup>33</sup> BNetzA (2013). The October 2013 settlement agreement was originally published by BNetzA on its website but has since been replaced by the most recent November 2016 settlement agreement, and is therefore no longer available.

<sup>34</sup> The October 2013 settlement agreement appears identical to the May 2016 settlement agreement, which is analysed in section 8.

<sup>35</sup> OPAL Gastransport (2014).

<sup>36</sup> 'European Commission delays ruling on new Gazprom bid for German gas link OPAL use', *Platts*, 14 July 2016.



itself participated in negotiations of the substantive changes that were incorporated into the October 2013 settlement agreement, and had verbally approved the latter.

Importantly, the October 2013 settlement agreement was set to expire at the end of 2014. It is understood that Gazprom, having waited for more than a year for the EC to issue its opinion on the agreement, had not extended its deadline and the agreement lost validity. This, in turn, had enabled the EC to deem the substantive changes agreed in the settlement agreement void, and to terminate the OPAL review procedure. It is plausible that the EC, well aware of the agreement's expiry date, continued to postpone the decision until expiry to avoid making any decision.

It is not clear why the EC took more than a year to conduct the OPAL review procedure, and ultimately failed to complete it. It is likely that this could be due to a sharp deterioration of political relations between the EU and Russia in the aftermath of the 2014 Ukraine political crisis and Russia's take-over of Crimea in March 2014. The EC might have been unwilling to approve an exemption decision that would have been seen as favourable towards Russia at a time when the EU was introducing various political and economic sanctions against Russia. However, the EC repeatedly denied any political delay in conducting the OPAL review procedure. Notably had the EC been willing to approve the settlement agreement, it had sufficient time to do so between October 2013 and March 2014 when the bilateral relationship deteriorated to an extent unprecedented in the post-Cold War period.

It is possible that commercial considerations were also at play. It is worth noting that due to Gazprom's limited ability to utilise OPAL capacity in full, the European traders were able to flow gas from GASPOOL and utilise exit capacity at Brandov (Section 5) at the time of growing tendency of commercially flowing gas into the Czech Republic. Notably Gazprom's own gas exports to the Czech Republic fell sharply in 2014.<sup>37</sup>

It is also not clear why Gazprom decided not to extend the deadline set in the October 2013 settlement agreement. It is possible that Gazprom interpreted the EC's prolonged delay as a de facto refusal to approve the agreement before the end of 2014, and decided to accept it as such. Notably, the EC's approval would have allowed Gazprom to re-route some of its European exports via Nord Stream 1 in the event of a transit dispute with Ukraine during the winter of 2014/15. By deciding not to extend the settlement agreement, Gazprom might have wanted to signal to the EC that should there be a transit crisis with Ukraine (the likelihood of which was not insignificant given that a trilateral EC-Russia-Ukraine 'winter package', signed in October 2014, was deemed necessary), the EC would bear significant responsibility as it would be seen as failing to approve the agreement, which would have significantly reduced the impact of any such crisis.

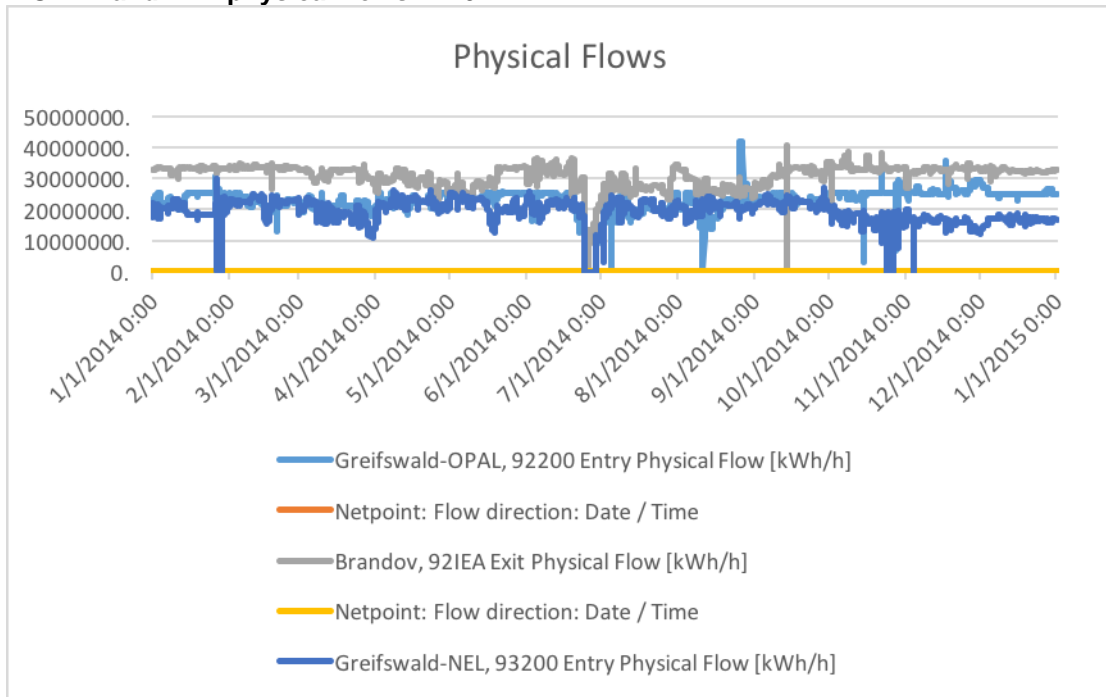
In any event, the EC failure to approve the October 2013 settlement agreement resulted in a situation whereby Gazprom continued to be unable to use more than 50 per cent of OPAL capacity, even if there was no other demand for this capacity. In 2014 physical flows via OPAL's entry at Greifswald were mostly at the level of 24-25 GWh/h which corresponded to the level of combined exempted capacity for OPAL Gastransport and LBTG, thus suggesting that OPAL Gastransport's restricted entry capacity at Greifswald was hardly used. In 2014, as in 2013, physical flows exiting Brandov were still largely within the 25-34 GWh/h range suggesting that the level of capacity utilisation remained within ~63-83 per cent. Exit flows out of Brandov remained higher than entry flows into Greifswald by some 5-9 GWh/h.

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<sup>37</sup> Gazprom (2015).



**Figure 4: OPAL and NEL physical flows in 2014**



Source: OPAL Gastransport website data (adapted), NEL Gastransport website data (adapted)

## 7. Gazprom’s Auctions: August-September 2015 and 2016

As Gazprom failed to secure an amendment of the July 2009 OPAL Gastransport exemption decision during 2013-2014 which would enable it to transport more gas through OPAL, it announced that it would hold an auction for gas to be sold at Greifswald during 7 - 10 September 2015. Out of 3.2 bcm offered, around 1.2 bcm was sold, of which only 0.17 bcm was sold with delivery via OPAL. The results of this auction provided Gazprom with additional evidence demonstrating the lack of third party interest in entry capacity at Greifswald.<sup>38</sup> Gazprom held another auction during 31 August - 2 September 2016 which demonstrated similar results. According to Gazprom’s deputy CEO, Alexander Medvedev, out of around 2 bcm being sold ‘not a single lot was sold at the OPAL direction’.<sup>39</sup>

Given that the EC’s *raison d’être* for the 50 per cent cap was to promote competition and allow third parties access to OPAL Gastransport’s capacity, the results of the auctions made the EC decision look increasingly illogical, strongly suggesting that it was based on non-regulatory considerations.

Meanwhile, in 2015 the level of utilisation of OPAL’s entry capacity at Greifswald remained largely at (and at times below) the level of combined exempted capacity of OPAL Gastransport and LBTG of 24 GWh/h. Capacity utilisation at Brandov increased compared to 2014 and was within the range of 30-40 GWh/h, averaging ~35 GWh/h but occasionally reaching ~40 GWh/h i.e. the level of combined technical exit capacity of OPAL Gastransport and LBTG at Brandov (Fig. 5). In 2016, the situation remained

<sup>38</sup> ‘Gazprom sells 1.23 bcm of gas for 250 mln euro at auction, average value of \$231 mcm’, *Interfax, Russia & CIS Oil and Gas Weekly*, September 10-16, 2015.

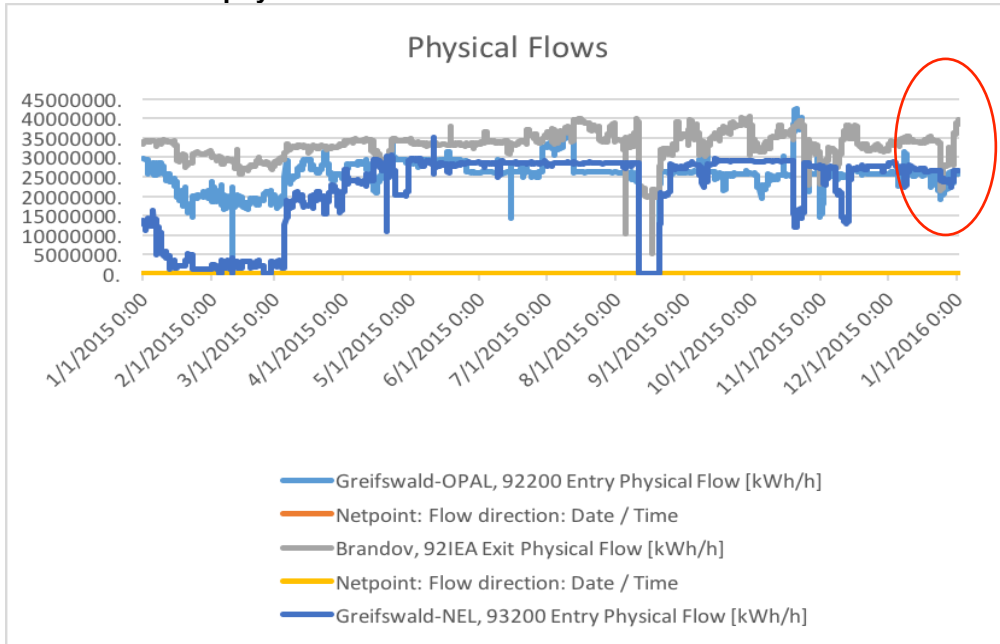
<sup>39</sup> Gazprom Export (2016).





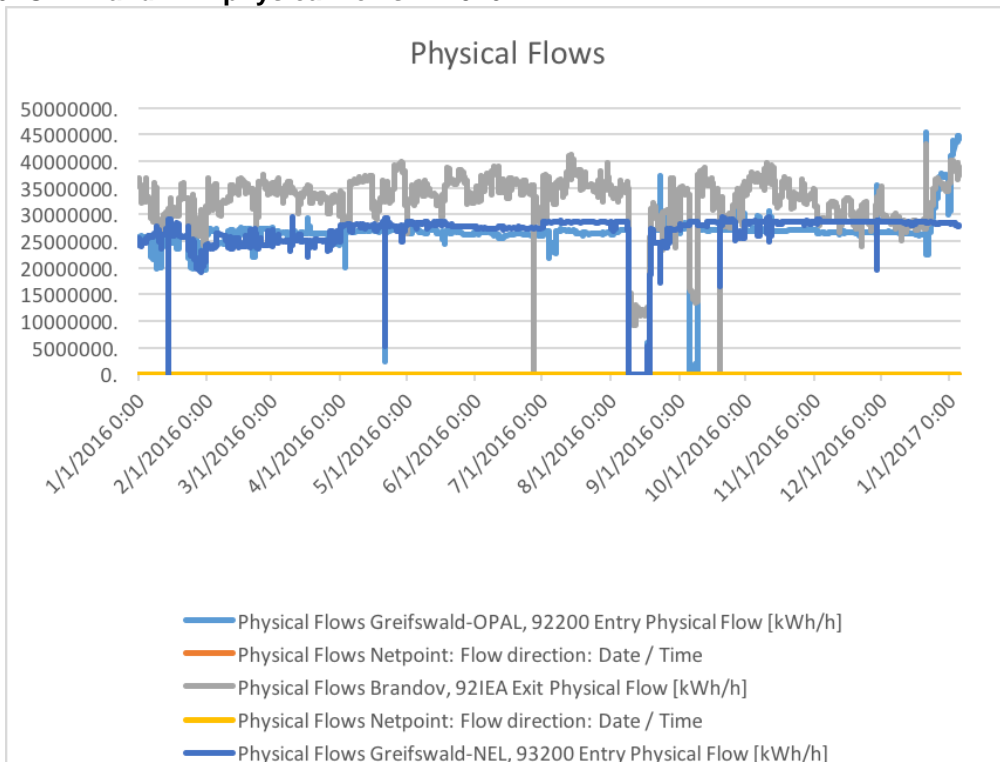
essentially the same until it changed at the end of the year when the amended OPAL Gastransport exemption decision was approved (Fig. 6) (See Section 12).

**Figure 5: OPAL and NEL physical flows in 2015**



Source: OPAL Gastransport website data (adapted), NEL Gastransport website data (adapted)

**Figure 6: OPAL and NEL physical flows in 2016**



Source: OPAL Gastransport website data (adapted), NEL Gastransport website data (adapted)



## 8. The May 2016 OPAL Settlement Agreement

With the September 2015 auction having demonstrated the strength of Gazprom's argument by showing no third party interest in OPAL's capacity, Gazprom made another attempt to find a solution that would allow it an increased degree of utilisation of OPAL and, subsequently, of Nord Stream 1.

This proved successful and resulted in the conclusion on 11 May 2016 of a new settlement agreement between BNetzA, OPAL Gastransport, Gazprom, and Gazprom Export (replacing the expired October 2013 agreement, see Section 6), which was subsequently notified to the EC by BNetzA. Notably, the May 2016 settlement agreement has 'mainly the same contents' and is largely identical to the October 2013 settlement agreement.<sup>40</sup>

The May 2016 settlement agreement divides 31,729,064 kWh/h (around 25.4 bcma) of OPAL's 'transit' capacity into two groups:

- 15,864,532 kWh/h (12.7 bcma) of coupled (bundled) interconnection capacity (BZK capacity), which can only be used for entry at Greifswald and exit at Brandov, and
- 15,864,532 kWh/h (12.7 bcma) of decoupled (unbundled) interconnection capacity, which is in turn divided into two groups:
  - DZK, i.e. separately bookable dynamically allocable capacity (which is firm if gas entered at Greifswald and exited at Brandov and is interruptible if gas entered/exited at the GASPOOL hub),
  - FZK, i.e. separately bookable freely allocable capacity (which is firm capacity that can be used unrestrictedly to transport gas from GASPOOL to the exit point of Brandov).

In line with the May 2016 settlement agreement, the 15,864,532 kWh/h (12.7 bcma) of coupled interconnection capacity (BZK) that could only be used for entry at Greifswald and exit at Brandov would be exempt from TPA for 22 years (although specific CMP would apply (Section 2)). Another 15,864,532 kWh/h (12.7 bcma) of DZK and FZK capacity would be partly regulated, more specifically such capacity would be auctioned on the PRISMA platform in the following way (Art. 1.d.aa):

- entry capacity at Greifswald is only supplied as DZK in the amount of 15,864,532 kWh/h (12.7 bcma) ;
- exit capacity at Brandov is only supplied as DZK in the amount of 14,064,532 kWh/h (11.3 bcma), or ~44.3 per cent;
- exit capacity at Brandov is only supplied as FZK in the amount of 1,800,000 kWh/h (1.4 bcma), or ~5.7 per cent.

The agreement also stated that if demand for FZK capacity at Brandov exceeds supply of 1,800,000 kWh/h in two consecutive annual auctions for annual capacities, the supply of FZK capacity must be increased to the extent necessary to satisfy demand up to a maximum of 3,600,000 kWh/h (2.9 bcma, or ~11.3 per cent), provided that such an increase is 'economically reasonable'. The agreement also states that an obligation to supply additional FZK capacity would not apply should there be 'reasonable grounds' for assuming that the aforementioned demand increase for FZK capacity was speculative. The

<sup>40</sup> OPAL Gastransport (2016b).



agreement also states that should the supply of FZK capacity be increased, the supply of DZK capacity could only be decreased (by a maximum of 1,800,000 kWh/h) if and to the extent that such a reduction is technically necessary. Importantly, the agreement stated that OPAL Gastransport was not only entitled but also *obliged* to supply DZK capacities of at least 12,264,532 kWh/h at the Brandov exit point, and at least 15,864,532 kWh/h at the Greifswald entry point, thus suggesting that these could not be decreased in the future.

The May 2016 agreement also stated explicitly that Gazprom, Gazprom Export and associated companies may participate in capacity auctions for partly regulated decoupled capacity, and book and utilise such capacity on the same terms as third parties. Both unregulated BZK and partly regulated DZK and FZK capacities would be exempt from tariff provisions applied to fully regulated capacity. The agreement requires that tariffs charged to all users for DZK and FZK capacities must be non-discriminatory and transparent, and must correspond exactly to the charges applied to BZK capacity (unless differences are technically justified with regard to the capacity product concerned and the particular form it takes).

## 9. The October 2016 EC OPAL Gastransport exemption decision<sup>41</sup>

The May 2016 settlement agreement was subsequently notified by BNetzA to the EC for assessment. As in the case of the October 2013 settlement agreement, the EC had to assess it in line with the exemptions procedure set out by the Third Gas Directive (Art. 36). In July 2016, the EC announced that it had sent a request for additional information to BNetzA, thus extending its initial two-month consideration period.<sup>42</sup> The delay gave rise to doubts over whether the EC was ever going to make a decision (or continue to postpone, as was the case with the October 2013 settlement agreement).

However, the EC proved doubters wrong, and on 28 October 2016 it made a decision to approve the May 2016 settlement agreement subject to certain amendments. It published a press release<sup>43</sup> to this effect but the decision itself was published only on 9 January 2017<sup>44</sup> (as this paper is being finalised) i.e. more than two months after the decision was adopted. Although a failure to publish the decision on the day of adoption appears to be a departure from the EC's usual practice, publication was not required for such decision to be valid. The decision, once adopted, became binding on BNetzA with immediate effect. Nonetheless, several third parties, in particular central European member states voiced their concerns about the lack of publication. Moreover, the Polish 100 per cent state-owned gas company, PGNiG, formally appealed to the EC to publish the decision. As noted above, the decision was finally published on 9 January 2017.

In its decision, the EC approved the May 2016 settlement agreement in principle, thus allowing Gazprom (and any other undertakings with a dominant position in the Czech Republic) to access more than 50 per cent of OPAL capacity through participation at auctions organised at the PRISMA platform alongside third parties (without conducting a gas release programme). However, it imposed additional conditions aimed at safeguarding the interests of third parties which would not only enable but also guarantee their access to 20 per cent of OPAL (FZK) capacity in the event of demand.

Firstly, the EC requested that the minimum level at which FZK capacities are to be offered to third parties must be set at 3,200,000 kWh/h (10 per cent of the total capacities) thus suggesting an increase

<sup>41</sup> Most of this paper was written before the EC exemption decision became publicly available. In particular, this section had originally been written on the basis of the 28 October 2016 EC press release on the exemption decision being adopted, and was re-written in January 2016, once the EC decision itself was published on 9 January 2017.

<sup>42</sup> 'European Commission delays ruling on new Gazprom bid for German gas link OPAL use', *Platts*, 14 July 2016.

<sup>43</sup> EC (2016b).

<sup>44</sup> EC (2016a).



from 1,800,000 kWh/h set in the May 2016 settlement agreement. The EC stated that such an increase reflects the increased liquidity of GASPOOL and would serve to improve the functioning of the EU internal market through increased trading and arbitrage between hubs.

In Art. 2 of the decision, the EC stipulated a mechanism for further increases of FZK capacities from the level of 3,200,000 kWh/h depending on third parties demand. In particular, it specified that if at an annual auction the demand for FZK capacities is 'equal or greater than 90 per cent of the offer', the total amount of FZK capacities offered in subsequent annual auctions is to be increased by 1,600,000 kWh/h 'in an economically feasible way' and 'up to a maximum of' 6,400,000 kWh/h (20 per cent of the total capacities). This suggests that such capacity increases are to be made in one (3,200,000 + 1,600,000 = 4,800,000 GWh/h) or two (4,800,000 + 1,600,000 = 6,400,000 GWh/h) subsequent steps, each allowing for a 5 per cent increase. Notably, although the EC decision states that capacity increases are to be offered 'in economically feasible way' (Art. 2), the decision's preamble (paragraph 147) notes that it is the EC's view that provision of additional FZK capacities at least up to the limit of 20 per cent should 'in principle always be economically feasible'.<sup>45</sup>

The EC argued that the imposition of the 20 per cent cap is justified due to a) a restrictive definition of firm capacity used by the German regulatory authority (see Section 2) as a result of which not placing a cap might lead to economically unjustified investment in additional pipeline infrastructure and b) a 20 per cent capacity reservation for short-term and annual capacity products is required by the EU Capacity Allocation Mechanism (CAM) network code.<sup>46</sup>

Notably, the EC exemption decision is not clear in respect of what happens if demand for FZK capacities exceeds 6,400,000 kWh/h (20 per cent of the total capacities), as its Art. 3, which outlines a corresponding mechanism, appears to provide for multiple interpretations.

Specifically, Art. 3 states that

'if demand for FZK capacities at an annual auction exceeds 6,400,000 kWh/h (or the current threshold, if it has been increased before), the threshold for FZK capacities under Art. 2 shall be increased by 3,200,000 kWh/h in the following annual auction provided a further increase in FZK capacities is technically feasible, the changes to the competitive situation are such as to justify an increase, and the benefits of an increase outweigh the costs thereof.

Art. 3 further clarifies that 'the Commission [EC] shall confirm whether the above requirements for an increase are met' and that 'lack of technical feasibility or disproportionate costs need to be demonstrated by OGT' [OPAL Gastransport]'.<sup>45</sup>

In our view there are two possible interpretations of Art. 3. One interpretation is that it established a mechanism which simply allows for a steeper increase of FZK capacities from the level of 3,200,000 kWh/h up to the level of 6,400,000 kWh/h in the following annual auction. This sidesteps the 5 per cent annual incremental increases (envisaged in Art. 2) thus reaching the same maximum level of 6,400,000 kWh/h sooner. This interpretation would suggest that under the October 2016 decision it would not be possible for the EC to request an increase in FZK capacities beyond 6,400,000 kWh/h (20 per cent).

Another interpretation of Art. 3 is that it established a mechanism which allows for FZK capacities to increase above 6,400,000 kWh/h (or the current threshold, if it has been increased before) by requesting to increase these capacities from that level by a further 3,200,000 kWh/h, thus resulting in FZK capacities above 6,400,000 kWh/h (and therefore removing the 20 per cent cap). This interpretation would suggest that under the October 2016 decision it would be possible for the EC to request an increase in FZK capacities beyond 6,400,000 kWh/h if such an increase is 'technically feasible, the

<sup>45</sup> EC (2016a).

<sup>46</sup> CAM Network Code.





changes to the competitive situation are such as to justify an increase, and the benefits of an increase outweigh the costs thereof'. Furthermore, this interpretation would suggest that in theory, there would be no limitation on an FZK capacity increase beyond 20 per cent and potentially up to 50 per cent (as the remaining 50 per cent of OPAL capacity is exempt). However, in practice, it is unlikely that demand for FZK capacities would increase beyond (or even up to) 6,400,000 kWh/h. Therefore, it is unlikely that the EC would request OPAL Gastransport to offer FZK capacity in excess of 6,400,000 kWh/h unless this capacity is needed on a long-term basis, thus allowing OPAL Gastransport enough time to demonstrate whether such an increase would be technically feasible and whether its costs would not be disproportionate.

It would appear that there are legal arguments in support of both interpretations, and hence it is not possible to confirm definitively which one is 'correct'. It is possible that the EC might have deliberately allowed for this ambiguity. In fact, the exemption decision's preamble and press release appear to be consistent with both interpretations. For example, the preamble states that the EC 'must be able to adapt' the decision 'on its own initiative, to the potential future circumstances and adjust the amount of capacity which would be offered to third parties' should 'the situation on the relevant markets' change and 'demand for the access to the OPAL pipeline' increase beyond 20 per cent.<sup>47</sup> This appears to imply that should the decision not be adapted (i.e. changed) it would not allow the EC to request an increase beyond 20 per cent. This is consistent with the first interpretation of Art. 3. On other hand, the press release states that the EC 'can request further increases of this capacity' provided that it is 'technically feasible, changes to the competitive situation are such as to justify an increase, and the benefits of an increase outweigh the costs thereof'.<sup>48</sup> This is consistent with the second interpretation of Art. 3.

In any event, irrespective of which interpretation of the decision is 'correct', it appears certain that it guarantees third parties' access to FZK capacities in OPAL to the amount of at least 20 per cent.

Secondly, the EC requested that Gazprom (and any other undertakings with a dominant position in the Czech Republic or which controls more than 50 per cent of gas arriving at Greifswald) could 'submit their bid for FZK capacities on OPAL only at the base price' (albeit excluding any successful bidding in case of congestion)<sup>49</sup> thus suggesting that such bids would only participate in the first bidding round and hence would be unable to outbid third parties' bids. According to the decision, the base price 'shall not be set higher than the average base price of regulated tariffs on transmission networks from the GASPOOL area to the Czech Republic in the same year for comparable products' (Art. 4).<sup>50</sup> The EC justified this request on the basis that it would prevent Gazprom from excluding third parties from booking FZK capacities and using them for accessing the Czech market.

Thirdly, the EC requested OPAL Gastransport to be certified under the provisions of the Third Gas Directive and the Third Gas Regulation (Art. 3), ordering BNetzA to assess the OPAL Gastransport compliance with the unbundling rules envisaged in the Second Gas Directive (i.e. functional and legal unbundling) and with the exemption decision itself (provisions concerning the unbundling requirements aimed at safeguarding a degree of independence between the OPAL Gastransport management and its shareholders).<sup>51</sup> The EC has requested BNetzA to notify its certification decision by 28 February 2017 so that a certification procedure can be completed prior to the first general annual auction, which is expected to be held by OPAL Gastransport in March 2017. This paper analyses possible certification scenarios in Section 11.

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<sup>47</sup> EC (2016a), p. 32.

<sup>48</sup> EC (2016b).

<sup>49</sup> EC (2016a), p. 33.

<sup>50</sup> EC (2016a), p. 40.

<sup>51</sup> EC (2016a), p. 39.



## 10. The November 2016 OPAL Gastransport settlement agreement

Although approved by the EC's October 2016 decision (subject to the aforementioned changes), the May 2016 settlement agreement had to be signed by all of its parties – BNetzA, OPAL Gastransport, Gazprom, and Gazprom Export – to become legally binding for all of them.

Although Gazprom has invested significant time in reaching an arrangement that would allow it to use more capacity in OPAL, its initial reaction to the EC's exemption decision was rather cautious, if not outright negative. Gazprom's deputy CEO, Alexander Medvedev, speaking to Interfax on 1st November 2016, noted that the substantive changes requested by the EC had not been discussed when the settlement agreement was signed in May 2016.<sup>52</sup> He noted that such changes meant that the terms of the agreement, to which all parties agreed previously, were changed, and that Gazprom would need time to analyse these changes to determine their potential impact on its contractual obligations. Notably, he complained that such post-factum changes go against the norms of 'civilised process'. Nonetheless, it is understood that Gazprom eventually accepted the changes as, according to OPAL Gastransport, the parties agreed to amend the agreement in line with the EC's decision and the amended agreement was signed on 28 November 2016 ('The November 2016 settlement agreement').

Once the settlement agreement was signed, BNetzA published it on its website in December 2016.<sup>53</sup> Just as the May 2016 settlement agreement, the November 2016 settlement agreement provides only for a partial exemption, which only applies to OPAL's cross-border ('transit') transport capacity from Greifswald to Brandov (31,729,064 GWh/h or ~25.4 bcma). Half of this capacity is exempt and half is partly regulated, as explained below.

As was envisaged by the May 2016 agreement, the November 2016 agreement divides 31,729,064 kWh/h (around 25.4 bcma) of OPAL's 'transit' capacity into two groups:

- 15,864,532 kWh/h (12.7 bcma) of BZK capacity, which is fully exempt for 22 years, and
- 15,864,532 kWh/h (12.7 bcma) of decoupled capacity (divided into two groups: DZK capacity and FZK capacity) which is partly regulated, as explained below.

According to the November 2016 settlement agreement, 15,864,532 kWh/h (12.7 bcma) of decoupled DZK capacity and FZK capacity would be auctioned on the PRISMA platform in the following way:

- entry capacity at Greifswald is only supplied as DZK in the amount of 15,864,532 kWh/h (12.7 bcma) (hence no change compared to the May 2016 settlement agreement);
- exit capacity at Brandov is only supplied as DZK in the amount of 12,664,532 kWh/h (10.1 bcma), or ~40 per cent (hence a decrease compared to the May 2016 settlement agreement);
- exit capacity at Brandov is only supplied as FZK in the amount of 3,200,000 kWh/h (2.6 bcma), or ~10 per cent (hence an increase compared to the May 2016 settlement agreement).

Furthermore, the November 2016 settlement agreement states that if demand for FZK capacity at Brandov constitutes at least 90 per cent of the offer of FZK capacity at Brandov in an annual auction where annual capacity is offered, the overall offer of FZK capacity at later annual auctions must be

<sup>52</sup> 'EC unilaterally submits changes to agreement on Opal, Gazprom mulls whether to sign', *Interfax Russia & CIS Oil and Gas Weekly*, October 27 – November 2, 2016.

<sup>53</sup> BNetzA (2016a).



increased by 1,600,000 kWh/h 'in an economically reasonable way', but at most to 6,400,000 kWh/h, thus bringing the maximum amount of FZK capacity to 20 per cent of OPAL's 'transit' capacity. This is a significant difference compared to the May 2016 settlement agreement, which set a maximum amount of FZK capacity at a level of 3,600,000 kWh/h, or 11.3 per cent of OPAL's 'transit' capacity. An increase stipulated by the May 2016 agreement was also subject to stricter conditions, e.g. demand for FZK capacity at Brandov had to exceed supply in two consecutive auctions rather than be at least 90 per cent of supply in one auction (see Section 8). Furthermore, the May 2016 agreement stated clearly that any such increase could only be done provided that it was 'economically reasonable'; the amended November 2016 agreement appears to suggest that it should *always* be economically feasible to offer an increase up to 20 per cent of OPAL capacity.

The November 2016 agreement further states that if demand for FZK capacity in the annual auction exceeds 6,400,000 kWh/h (or the current threshold value it was previously increased), the offer of FZK capacity should be increased at the following annual auction by further 3,200,000 kWh/h, 'insofar as' a further increase is 'technically feasible, changes to the competitive situation are such as to justify an increase, and the benefits of an increase outweigh the costs thereof'. (It is worth noting that the November 2016 settlement agreement preserved the ambiguity of the EC October 2016 exemption decision in respect of the applicable procedure in the event that demand for FZK capacities exceeds 6,400,000 kWh/h, see Section 9). If demand for FZK capacity at an annual auction exceeds 6,400,000 kWh/h (or the current threshold value if it was previously increased), the EC is obliged to determine whether the aforementioned conditions for an increase are met, taking due account of the opinions of BNetzA and OPAL Gastransport.

The agreement stated that, subject to the EC decision, OPAL Gastransport is entitled (but *not* obliged) to supply DZK capacities of at least 9,464,532 kWh/h at Brandov (thus suggesting that they could potentially be reduced in the future).

In short, under the November 2016 settlement agreement, Gazprom would be guaranteed 50 per cent (as exempt) of OPAL's 'transit' capacity (not offered at an auction) and guaranteed either a) a further 40 per cent (if it outbids third parties for DZK capacity and if there is low demand on the part of third parties for FZK capacity) or b) a further 30 per cent (if it outbids third parties for DZK capacity and there is high demand on the part of third parties for FZK capacity), i.e.:

- a.  $12.7 \text{ bcma} + 10.1 \text{ bcma} = 22.8 \text{ bcma}$ , or
- b.  $12.7 \text{ bcma} + 7.6 \text{ bcma} = 20.3 \text{ bcma}$ .

The November 2016 settlement agreement states that should supply of FZK capacity be increased, supply of DZK capacity could only be decreased if and to the extent that such reduction is technically necessary.

The November 2016 agreement upheld the terms of the May 2016 settlement agreement, envisaging that decoupled DZK and FZK capacities are to be auctioned on PRISMA, subject to general regulations. It also stated explicitly that Gazprom, Gazprom Export, and their associated companies would be able to participate in PRISMA auctions to book and utilise these capacities. However, the November 2016 settlement agreement introduced a new requirement, in line with the request expressed by the EC in its October 2016 exemption decision, according to which any undertaking (or groups of undertakings) which have a dominant position in the Czech Republic or control more than 50 per cent of gas entering at Greifswald will not be allowed to bid for FZK capacity at a price other than the base price. The exemption decision notes that 'the base price for partly-regulated decoupled capacities awarded at the auctions is determined by non-discriminatory, transparent pricing' whereas 'non-discriminatory means that the prices must correspond exactly to the charges for the exempted, coupled interconnection capacities [BZK], unless departures from those charges are technically justified'. It further states that the base price for FZK capacity must not be set lower than the average base price, which applies to





comparable regulated capacity products from the GASPOOL area to the Czech Republic in the same year. Effectively, this means that Gazprom would not be able to outbid third parties in their demand for FZK capacity.

Importantly, whereas the October 2013 settlement agreement stated that OPAL Gastransport is obliged to supply DZK capacities at the Greifswald entry point of at least 15,864,532 kWh/h, the November 2016 settlement agreement states that OPAL Gastransport is entitled but *not obliged* to do so, thus suggesting that it could potentially be reduced in the future.

## 11. The October 2016 EC exemption decision and the November 2016 settlement agreement: TSO certification request and implications for OPAL

As noted in Section 9, in its October 2016 exemption decision the EC requested OPAL Gastransport to be certified under the provisions of the Third Gas Directive and Gas Regulation 715 (Art. 3), ordering BNetzA to assess the OPAL Gastransport compliance with the unbundling rules envisaged in the Second Gas Directive and with the exemption decision itself. This appears to be an entirely new condition imposed by the EC on OPAL Gastransport. A TSO certification request was not – and could not be – part of the original February 2009 exemption decision, or the subsequently amended July 2009 exemption decision, as these were made under the (then in force) Second Gas Directive, which did not envisage certification of TSOs and hence did not spell out any certification procedures. As such, TSO certification was first introduced by Third Gas Directive and Gas Regulation 715 (which entered into force in March 2011). Notably a certification request does not appear to have been part of either the October 2013 or May 2016 settlement agreements.

The November 2016 OPAL Gastransport settlement agreement confirmed that an application for certification must be made according to the Third Gas Directive (without specifying whether it is to be made under Art. 10 or Art. 11) and Gas Regulation 715 (specifying that it is to be made under Art. 3). At the same time, the November 2016 settlement agreement stated that compliance of such a certification decision must be checked against the unbundling provisions set in the Second Gas Directive. In addition, compliance is also to be checked against the February 2009 and July 2009 exemption decisions, as amended by the October 2016 exemption decision.

Importantly, the Second Gas Directive only required legal unbundling of TSOs (Art. 9). In particular, it stated that where the TSO is part of a vertically integrated undertaking (VIU) it must be independent ‘at least in terms of its legal form, organisation and decision making from other activities not relating to transmission’ (Art. 9.1). However, it made clear that this ‘shall not create obligation to separate the ownership of assets’ of the transmission system from the VIU. It further specified a set of specific minimum criteria that must apply for ensuring the independence of a TSO (Art. 9.2). Notably, the Second Gas Directive (Art. 22) did not provide for the possibility of being exempted from Art. 9 of the Second Gas Directive. This suggests that when OPAL Gastransport had first applied for an exemption under the Second Gas Directive in 2008, it could not have possibly applied for an exemption from Art. 9 and hence had to be compliant with it ever since it started operating OPAL in 2011.

Thus whereas WIGA Transport’s two other subsidiaries – NEL Gastransport and GASCADE Gastransport – have been certified by BNetzA under the Third Gas Directive, OPAL Gastransport appears to have never been certified.<sup>54</sup> In February 2016, EU Climate and Energy Commissioner, Miguel Arias Canete, while answering parliamentary questions, stated that GASCADE and NEL were

<sup>54</sup> Answer given by Mr Arias Canete on behalf of the Commission Parliamentary Questions at the European Parliament, 12 February 2016, E-015336/2015.





certified as compliant with the 'independent transmission operator' (ITO) whereas 'OPAL is subject to an exemption decision'. Thus it is not entirely clear why the EC, having not been overly concerned with OPAL Gastransport operating without certification for five years, decided to request certification in its October 2016 exemption decision.

It should be noted that by comparison with every other exemption decision ever granted by the EC in respect of gas infrastructure, the decision making process in respect of OPAL has been uncharacteristically long, taking in total nearly eight years (and possibly still not complete, see Section 13). During this period a new substantive set of legislation, including the Third Gas Directive (which repealed the Second Gas Directive under which the February 2009, and the subsequently amended July 2009, exemption decisions were granted) entered into force.

The Third Gas Directive stipulated significantly stricter unbundling requirements under its Art. 9 compared to those set by the Second Gas Directive in its Art. 9. Although the Third Gas Directive (disappointingly for the EC) fell short of mandating ownership unbundling for all TSOs,<sup>55</sup> it introduced distinct unbundling models including independent system operator (ISO) and ITO models (in addition to the ownership unbundling (OU) model. A TSO seeking to operate under a model other than OU would have to meet a plethora of independence criteria, significantly stricter than those envisaged by the Second Gas Directive.

Furthermore, the Third Gas Directive and Gas Regulation 715 introduced a notion and a process of TSO certification whereby a national regulatory authority would adopt a certification decision stating that a TSO complies with relevant criteria and operates under one of the aforementioned models. In turn, the EC is empowered to issue opinions on national regulators' certification decisions, although its power falls short of overruling them as a national regulator is not obliged to comply with the EC's opinion, although has to take 'utmost account' of it (Art. 3.2 of Gas Regulation 715).

TSO certification could be carried out either under Art. 10 or Art. 11 of the Third Gas Directive. The aim of TSO certification under Art. 10 is to ensure compliance with the unbundling requirements of Art. 9 of the Third Gas Directive. In addition to ensuring compliance with the unbundling requirements of Art. 9, the aim of TSO certification under Art. 11 is also to ensure that certification 'will not put at risk the security of energy supply of the Member State or the Community' (Art.11.3.b). Certification is carried out under Art. 11 where certification is 'requested by a transmission system owner or a transmission system operator which is controlled by a person or persons from a third country or third countries'. In all other cases certification is carried out under Art. 10.

It is not clear why the October 2016 exemption decision and, subsequently, the November 2016 settlement agreement requested OPAL Gastransport certification to be carried out under the Third Gas Directive (where its procedure under Art. 10 envisages assessment of compliance with unbundling requirements under Art. 9 of the Third Gas Directive and where its procedure under Art. 11 in addition envisages assessment of impact on security of supply) for assessment of compliance with unbundling requirements of Art. 9 of the Second Gas Directive. (Notably the November 2016 settlement agreement does not specify whether certification is to be carried out under Art. 10 or Art. 11.) More fundamentally, it is not clear how it might be at all possible to certify a TSO under one set of rules on the basis of its compliance with another (and rather different) set of rules.

Furthermore, the request for certification to be carried out in line with the Third Gas Directive seems even more peculiar given that the latter (unlike the Second Gas Directive) envisages a possibility of exemption from the unbundling provisions of Art. 9 (Art. 36).

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<sup>55</sup> Third Gas Directive.



This paper argues that the ambiguous wording of the certification request might well have been deliberate on part of the EC as it would allow it a very significant degree of discretion while issuing its opinion on future BNetzA's certification decision.

It is worth recalling that the EC's attitude towards BNetzA's certification decisions made in respect of two other WIGA Transport subsidiaries – GASCADE Gastransport and NEL Gastransport – has been lukewarm. The EC's opinions in respect of GASCADE (2012)<sup>56</sup> and NEL (2013)<sup>57</sup> certification decisions suggest that the EC was not entirely satisfied.

In respect of GASCADE Gastransport, although it approved it being certified as an ITO, the EC expressed numerous concerns inter alia in respect of the independence and ownership of the network, and the definition of a VIU. In particular, it criticised co-ownership of the network (operated by GASCADE, which owns the largest part), arguing that if the co-owner 'does not have the same degree of independence from production and supply interests' as the TSO which seeks to be certified as an ITO (i.e. GASCADE Gastransport), compliance with Art.17.1.a of the Third Gas Directive (requiring that transmission assets are owned by the transmission system operator) 'cannot be ensured'. The EC also disagreed with BNetzA's exclusion of BASF and Gazprom from the definition of a VIU (BNetzA only included Wintershall as a VIU). In particular, the EC questioned whether the definition of a VIU in the German legislation which 'seems to exclude categorically and without apparent justification companies which are located outside the European Union', is 'in compliance with the [Third] Gas Directive', as the EC's interpretation of the Directive is such that it 'does not foresee a specific geographic restriction' in the definition of a VIU.

In respect of NEL Gastransport, the EC stated that it should be certified as an OU TSO, and not as an ITO as certified by BNetzA, on the grounds that NEL is a new network (rather than an extension of the existing network, as suggested by BNetzA) and hence OU is the only model available to it.<sup>58</sup> Notably, in its NEL certification opinion, the EC is even more assertive in its criticism of the definition of a VIU in the German legislation, which excludes companies located outside the EU.

It is understood that, although entitled (Art. 3.1 of the Third Gas Regulation), the EC did not request the Agency for Cooperation of Energy Regulators' (ACER) opinion either on the NEL or GASCADE certification decisions.

It would appear that BNetzA did not address all of the EC's concerns while adopting its final certification decisions of GASCADE and NEL. Thus in February 2015 the EC sent a letter of formal notice to Germany, followed by a reasoned opinion, 'requesting to ensure a correct implementation of ... the [Third] Gas Directive', stating that 'Germany has incorrectly transposed into national law several requirements concerning the independent transmission operator (ITO) unbundling model'.<sup>59</sup> In particular, the EC stated that 'the rules on the independence of the staff and the management of the ITO do not fully respect these Directive[s] and the definition of vertically integrated undertaking excludes activities outside the EU'. Furthermore, it stated that 'Germany has not ensured full respect of some rules concerning the powers of the national regulatory authority (e.g. the regulator does not enjoy full discretion in the setting of network tariffs and other terms and conditions for access to networks [...]); the competence of the regulator to impose penalties of up to 10 per cent of the annual turnover of the transmission system operator of a vertically integrated undertaking is not fully ensured'. Ultimately, the EC threatened to refer the case to the Court of Justice of the European Union (CJEU)<sup>60</sup> should the aforementioned concerns not be remedied.

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<sup>56</sup> EC (2012).

<sup>57</sup> EC (2013b).

<sup>58</sup> The ITO model is only available to companies that were part of a VIU on 3 September 2009 when NEL neither existed nor even its FID was taken (Art. 9.8 of the Third Gas Directive).

<sup>59</sup> EC (2016c).

<sup>60</sup> Previously known and still commonly referred to as the European Court of Justice (ECJ).



Given the EC's critical attitude towards BNetzA's certification decisions in respect of GASCADE and NEL, it is possible that the EC might raise concerns in respect of the forthcoming OPAL certification decision by BNetzA. The ambiguity of the OPAL Gastransport certification request, as stated in the October 2016 exemption decision and the November 2016 settlement agreement, might strengthen the EC's hand. One potential issue could be whether the EC would consider that OPAL Gastransport should be certified under Art. 10 or Art. 11 of the Third Gas Directive. As noted earlier, in its October 2016 decision, the EC did not specify whether certification is to be carried out under Art. 10 or Art. 11. However, in 2013, the EC competition directorate (DG COMP) confirmed that the joint control of OPAL Gastransport has not been replaced by sole control of Gazprom (in the course of the Wintershall acquisition) thus suggesting that OPAL Gastransport is not 'controlled' by Gazprom. Given that 'control' by a third party is a necessary condition for certification under Art. 11, it would be very difficult for the EC to argue that OPAL Gastransport should be certified under Art. 11. Also it is worth noting that the EC raised no concerns in respect of GASCADE Gastransport being certified under Art. 10.<sup>61</sup> Nonetheless the possibility of the EC arguing that OPAL Gastransport certification should be carried out under Art. 11 could not be excluded.

In respect of the certification timeline, the November 2016 settlement agreement states that the application for certification must be submitted to BNetzA by 15 December 2016 at the latest, whereas BNetzA is required to notify its certification decision to the EC by 28 February 2017. It is worth noting that this deadline is two times shorter than the four-month period to which the national regulatory authority is entitled under the Third Gas Directive (Art. 10, Art. 11). Once the EC receives the certification decision, it is entitled to a two-month period (which may be extended by two months should the EC decide to seek ACER's opinion) (Art. 3.1 of the Third Gas Regulation) within which to issue its opinion. As noted earlier, BNetzA is obliged to take 'utmost account' of it but not obliged to amend its decision accordingly.

## 12. Implementation of the November 2016 settlement agreement

As the November 2016 settlement agreement was signed, OPAL Gastransport announced that 'the way has been cleared for the full use of transit capacities that have been only partially available in the past'.<sup>62</sup> OPAL Gastransport has subsequently published its changed supplementary terms and conditions and a new price list for the use of OPAL's capacities, active as of 19 December 2016 for the transportation of gas as of 1 January 2017.<sup>63</sup>

On 19 December 2016, OPAL Gastransport held an auction on the PRISMA capacity platform for OPAL's capacity in line with the amended exemption decision. According to OPAL Gastransport website, OPAL Gastransport's capacities were offered in line with the amended exemption decision and allocated as follows (Table 1):

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<sup>61</sup> Notably, the EC issued its opinion on certification of GASCADE in 2012, i.e. *before* confirming in 2013 that GASCADE, OPAL Gastransport and NEL Gastransport were jointly controlled by Wintershall and Gazprom.

<sup>62</sup> OPAL Gastransport (2016c).

<sup>63</sup> OPAL Gastransport (2016c).



**Table 1: OPAL Gastransport capacity allocation for January 2017, kWh/h**

		OPAL Greifswald			OPAL Brandov	
		Regulated	Partly- Regulated and Non-Regulated		Regulated	Partly Regulated and Non-Regulated
Technical capacity		4,586,737	31,729,064		0	31,729,064
BZK	Max			15,864,532		15,864,532
	Booked			15,864,532		15,864,532
DZK	Max	4,586,737	15,864,532			12,664,532
	Booked	4,586,737	15,864,532			12,664,532
FZK	Max					3,200,000
	Booked					3,200,000
uFZK	Booked	1			2,262,500*	

\* Reflects booked uFZK capacity for 4.01.2017-31.01.2017 whereas slightly more capacity was booked for 1.01.2017-4.01.2017 (3822500-4165500 kWh/h).

Source: OPAL Gastransport website data (adapted)

According to LBTG website, offer and allocation of LBTG capacities for January 2017 is as follows (Table 2):

**Table 2: LBTG capacity allocation for January 2017, kWh/h**

		Lubmin-Brandov Gastransport (Lubmin/Greifswald)		Lubmin-Brandov Gastransport (Brandov)	
Technical capacity		9,078,944		7,932,260	
		Regulated	Non-Regulated	Regulated	Non-Regulated
BZK	Commercial		7,932,260		7,932,260
	Booked		7,932,260		7,932,260
DZK	Commercial	1,146,684			
	Booked	1,146,684			
FZK	Commercial				
	Booked				
u	Commercial	3,966,130			
	Booked	3,966,130			

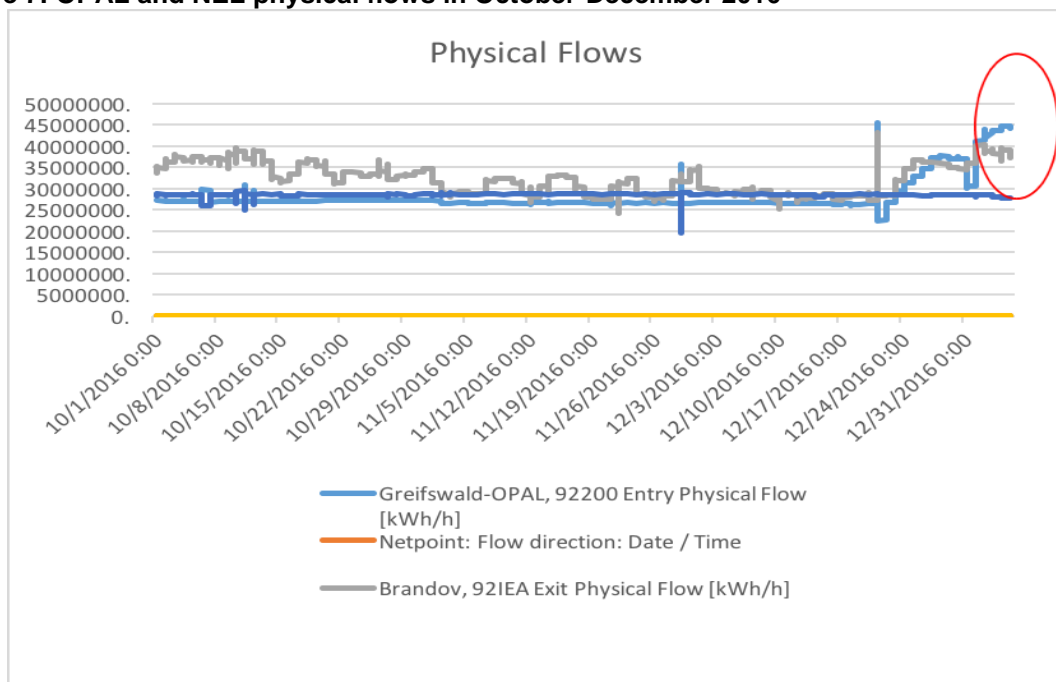
Source: LBTG website data (adapted)





The data, showing physical gas flows during the period of 1 October 2016 to 5 January 2017, suggests that as of 23 December 2016 gas flows entering at Greifswald began to increase and continued to increase steadily (though levelling off slightly over 31 Dec 2016) reaching 44.8 GWh/h on 5 January 2017 (having been at the level of ~26 GWh/h throughout 2016) (Fig. 7). Notably, as of 1 January 2017, gas flows entering at Greifswald were above gas flows exiting at Brandov, for the first time since 2014 (by comparison, gas flows exiting at Brandov were consistently above gas flows entering at Greifswald during 2014-2016, Figs. 4, 5 and 6). This suggests that as of 1 January 2017 gas flows entering at Greifswald were exiting not only at Brandov but also into GASPOOL. This in turn suggests that gas entering at Greifswald is competitive with gas that otherwise would have entered the Czech Republic from GASPOOL.

**Figure 7: OPAL and NEL physical flows in October-December 2016**



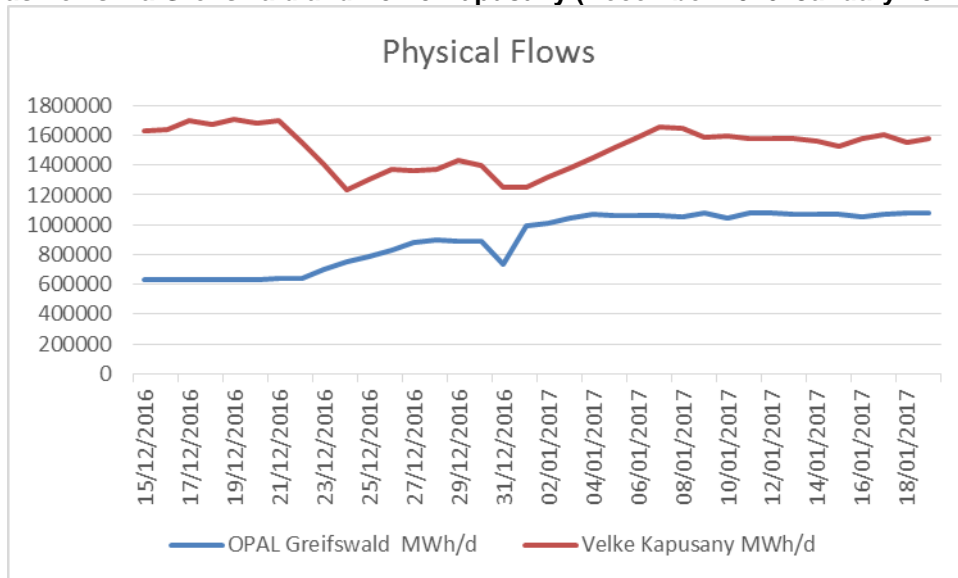
Source: OPAL Gastransport website data (adapted), NEL Gastransport website data (adapted)

Notably, as gas flows via OPAL/Greifswald started to increase in late December 2016 following the removal of the cap,<sup>64</sup> gas flows arriving via the Ukrainian gas system at Velke Kapusany decreased accordingly. As flows via Greifswald stabilized in early January 2017, flows at Velke Kapusany started to increase and nearly reached their mid-December 2016 level, as overall exports increased (Fig. 8). This illustration suggests that Gazprom has a preference for exporting its gas via Nord Stream 1 rather than via the Ukrainian corridor, and is also a useful indicator of its future preferences in respect of Nord Stream 2 and its onshore extensions (if and when built). The strength of such preferences will ultimately be based on the cost of transportation via each corridor.

<sup>64</sup> 'OPAL gas pipeline running at 87% capacity, Nord Stream at 100% for first time', *Interfax Russia & CIS Oil and Gas Weekly*, 22-28 December 2016.



**Figure 8: Gas flows via Greifswald and Velké Kapušany (December 2016–January 2017)**



Source: OPAL Gastransport website, Eustream website

### 13. European reactions to the October 2016 EC OPAL exemption decision

The October 2016 EC exemption decision, which allows Gazprom to utilise OPAL capacity in excess of 50 per cent while effectively guaranteeing third parties' access of up to 20 per cent of FZK capacity at a base price, appears to be sensible and balanced (albeit long overdue). It effectively ring-fences some transportation capacity for third parties and guarantees that there will be sufficient capacity for them to supply around 5 bcm of gas to the Czech Republic (around two thirds of its demand in 2015) thus alleviating concerns about Gazprom's position on the Czech market.<sup>65</sup> Furthermore, the October 2016 exemption decision allows the EC significant room for manoeuvre, both in respect of judging whether the conditions for a further increase of FZK capacity offered to third parties are met as well as in respect of OPAL Gastransport certification.

Nonetheless, the EC decision has been met with an avalanche of criticism from central east European countries, which argued that it would undermine their energy security. Especially sharp criticism was expressed by Poland and Ukraine, and their 100 per cent state-owned gas companies, PGNiG and Naftogaz respectively. Even before the EC's decision was officially announced on 28 October 2016 (as some of its unconfirmed aspects had been circulated by the media a few days earlier), PGNiG threatened to sue the EC over the decision.<sup>66</sup> Furthermore, on the same day as the November 2016 settlement agreement was signed, PGNiG demanded BNetzA to suspend it.

Having received no 'positive answer', on 4 December 2016 PGNiG Supply & Trading (a PGNiG wholly-owned subsidiary operating in the German market) filed a complaint in the CJEU against the EC's decision.<sup>67</sup> It has also submitted a motion of relief to suspend its effects. The charges have been brought under the Treaty on European Union, the Treaty on the Functioning of the European Union, and the

<sup>65</sup> Furthermore, there are three more (in addition to Brandov) interconnection points at the Czech-German border – two at Hora Svate Kateriny (where physical reverse flows are possible and where, according to the EC, free capacities amount to ~1 bcma) and one at Waidhaus (where only virtual reverse flows are possible). See EC (2016a), p. 21.

<sup>66</sup> 'EU lifts cap on Gazprom's use of Nord Stream link', *Reuters*, 28 October 2016.

<sup>67</sup> PGNiG (2016a).



Third Gas Directive on various grounds including EU completion and energy *acquis*. Curiously, PGNiG also alleged the decision's non-compliance with the EU-Ukraine Association Agreement despite the latter not even being in force yet (and at present doubts remain as to whether it will enter in force due to continuing difficulties with ratification by the Dutch parliament). Furthermore, on 16 December 2016, the Polish government referred the EC decision to the CJEU in a separate procedure.

According to PGNiG, on 27 December 2016 the CJEU 'issued a decision to suspend execution' of the EC's decision,<sup>68</sup> where the CJEU requested the EC to present 'detailed explanations with respect to the proposed procedure of capacity allocation on the OPAL pipeline' and requested PGNiG Supply & Trading – to submit 'an in-depth analysis of the EC's decision impact on the security and competitiveness of gas supplies to Poland'. In January 2017 the CJEU confirmed that its General Court had indeed suspended the EC's decision, and that suspension would be in place until other interim measures are decided or it is lifted by the president of the General Court.<sup>69</sup> The CJEU is expected to clarify its position on the interim measures in late January or early February 2017 (this has not been done at the time of this paper's publication). Such clarification could contain an indication of whether the CJEU is minded to dismiss the complaint altogether or, on the contrary, believes the complaint to be serious. The CJEU could adopt an interim decision providing a guideline as to how and whether the EC's decision is to be applied until a final decision has been made by the CJEU (it is worth noting that it takes between one and two years on average for the CJEU to adopt a final decision).

On 15 December 2016, PGNiG and PGNiG Supply & Trading also filed a complaint in respect of the November 2016 settlement agreement in the German Higher Regional Court in Düsseldorf under an urgent appeal procedure. On 30 December 2016, the Polish media reported that in its interim decision the Düsseldorf court did not approve the November 2016 settlement agreement, thus suggesting the old July 2009 exemption decision, under which Gazprom could not utilise more than 50 per cent of OPAL, remains in place.<sup>70</sup> According to PGNiG's CEO, Piotr Woźniak, the court ordered BNetzA to suspend any additional auctions by OPAL Gastransport. The suspension will remain in place until the Düsseldorf court makes its final decision; it is not known when that might happen. Given that the Düsseldorf court made its interim decision only after the CJEU's preliminary decision became known, it is reasonable to expect it not make its final decision before the CJEU decides on interim measures. Should the CJEU indicate that it is minded to dismiss the complaint, it is reasonable to expect the Düsseldorf court to approve the November 2016 settlement agreement. However, should the CJEU indicate that the complaint is serious, it would be extremely difficult for the Düsseldorf court to approve the settlement agreement.

Subsequently, in early January 2017, BNetzA confirmed that it was obliged by the Düsseldorf court interim decision (Az. VI-3 Kart 1203/16 [V]) to prohibit with immediate effect OPAL Gastransport from carrying out further auctions of daily, weekly, monthly and annual capacities on OPAL.<sup>71</sup> On 30 December 2016 BNetzA issued a corresponding decision (BK7-08-009-E1) to implement the aforementioned provisional arrangement.<sup>72</sup> The decision could be appealed within one month (but in any event such an appeal would not have a suspensory effect on the court's interim decision). It is not known whether the appeal has been made or whether it will be made. Importantly, the court's interim decision has no impact on the shippers' rights to utilise OPAL capacity that has already been auctioned and booked (e.g. January 2017 capacity booked at the December 2016 PRISMA auction). However, no new auctions for 50 per cent of OPAL capacity (i.e. restricted capacity under the July 2009 exemption

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<sup>68</sup> PGNiG (2016b).

<sup>69</sup> 'Gas industry awaits clarity on OPAL capacity issue', *Interfax Natural Gas Daily*, 12 January 2017.

<sup>70</sup> 'Niemiecki sąd przeciwko decyzji Komisji na korzyść Gazpromu' (in Polish), *Biznes Alert*, 30 December 2016, available at <http://biznesalert.pl/niemiecki-sad-przeciwko-decyzji-komisji-korzysc-gazpromu/>

<sup>71</sup> BNetzA (2016d).

<sup>72</sup> BNetzA (2016b).





decision) can be held until the court makes its final decision; this also includes annual auctions for annual capacity scheduled to be held in March 2017.

It is not clear whether the Polish government and PGNiG had access to the EC's decision (despite it not being public at the time) before filing their complaints. However, it should be noted that upon receiving the May 2016 settlement agreement, the EC had officially invited third parties to comment on it, while preparing its decision.<sup>73</sup> Therefore, the Polish government and PGNiG should have had time to submit their views on the May 2016 settlement prior to the EC issuing its decision.

It seems clear that the Polish government and PGNiG have orchestrated their course of action very carefully and had been preparing for some time in anticipation of the EC's decision. Without such preparation, it would have been impossible to carry it out in an organised manner, just days after the EC announced its decision, and also over the Christmas holiday period. In fact, PGNiG appears to have confirmed this by stating that such actions constitute 'a series of carefully-planned legal steps'.<sup>74</sup>

For Poland, which appears to view the EC's OPAL exemption decision as a de facto political and regulatory clearance for Nord Stream 2, the action against OPAL is part of its broader political and legal 'warfare' against Nord Stream 2. There have been many examples of this 'warfare'. For example, in 2015-2016, Poland is believed to have initiated multiple letters to the EC on behalf of several (but not all) central east European member states' governments, asking for Nord Stream 2 to be stopped. In 2016, the Polish competition authority, UOKiK, refused to approve the Nord Stream 2 shareholders agreement and raised objections in respect of the concentration it would cause and its possible negative impact on competition (following which the shareholders withdrew their application and the agreement was dissolved).<sup>75</sup>

It is argued here that the October 2016 EC's exemption decision does not constitute a 'green light' for Nord Stream 2, as the decision only applies to OPAL rather than to any new potential onshore 'extensions' of Nord Stream 2 e.g. EUGAL. If anything, the EC is likely to use its OPAL exemption decision as an argument against Nord Stream 2. Indeed, the EC official was quoted as saying that the exemption decision further 'reduces the rationale for a new big pipeline'.<sup>76</sup> Furthermore, on the same day as the exemption decision was announced, EC vice president for Energy Union, Maroš Šefčovič, made it clear that the EC continues to oppose any additional Russian export pipelines towards Europe – including Nord Stream 2 – by stating that 'preservation of a gas transit route through Ukraine also in a post-2019 period is a top political priority' and there is 'a unanimous decision on this from all member states'.<sup>77</sup> However, the October 2016 decision could serve as a guidance for any future regulatory treatment of onshore extensions of Nord Stream 2 and/or Turkish/South Stream *when and if* these are built.

The main goal of the Polish political and legal 'warfare' appears to be a curtailment of Gazprom's ability to transport gas to Europe by any route other than the existing Ukrainian and Belarusian/Polish (Yamal) corridors. In addition to the political rationale of preserving transit across Ukraine, the apparent commercial rationale is the preservation of Poland's status as a transit country for Russian gas, whereby such status is viewed as providing a transit revenue as well as bargaining power for securing Russian gas supplies. In so doing, Poland is defending its own national gas security – as it understands it – with little consideration for overall European gas security. The EU, while subscribing to the political rationale of preserving transit across Ukraine, views gas security as a European as well as a regional issue, whereby national gas security is to be achieved through increased integration and liberalisation across

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<sup>73</sup> EC (2016d).

<sup>74</sup> PGNiG (2016a).

<sup>75</sup> UOKiK (2016).

<sup>76</sup> 'EU lifts cap on Gazprom's use of Nord Stream pipeline link', *Reuters*, 28 October 2016.

<sup>77</sup> 'Geopolitics and Energy: getting it right for Europe': EU Vice-President for Energy Union, Maroš Šefčovič, speaking at the GLOBSEC Tatra summit, Bratislava, 28 October 2016.





national borders. Poland, on its part, has made very limited progress in opening up its gas market, with PGNiG having a near-monopoly status.

Ukrainian Naftogaz appears to have followed PGNiG's footsteps in its actions in respect of the EC's exemption decision (possibly in coordination with PGNiG). Curiously, Naftogaz attempted to position itself as a guardian of the EU energy and competition *acquis*. A day before the exemption decision was announced, Naftogaz said it was 'hopeful' the EC decision would be 'fully in line' with the EU *acquis* and the principles of the Energy Community, while stating that a decision allowing Gazprom to use more than 50 per cent of OPAL's capacity would 'support Russia's plans to destroy Ukraine's gas transmission system as a competitor in the delivery of gas to the EU consumers'.<sup>78</sup> It stated further that it could lose \$425 mn per year in transit revenues should Gazprom redirect some of its European exports via Nord Stream away from the Ukrainian corridor.<sup>79</sup> On 10 November 2016, Ukraine's president, Petro Poroshenko, complained to the EU commissioner for European neighbourhood policy, Johannes Hahn, that the EC decision 'did not comply with the spirit of the Association Agreement between Ukraine and the EU and the Energy Community Treaty' (the Association Agreement is not yet in force).<sup>80</sup> On 1 December 2016, Naftogaz demanded BNetzA suspend the settlement agreement but, like PGNiG, received 'no positive response'.<sup>81</sup> On 6 December 2016, Naftogaz requested an administrative procedure to be applied to the settlement agreement and demanded to be invited to participate with a view of presenting its position on the EC decision.<sup>82</sup> It is not clear whether Naftogaz had access to the text of the EC's decision at the time.

## Conclusions

Increased access to transportation capacity in OPAL is an important element of Gazprom's long-running transit diversification strategy, aimed at increased flexibility of its European exports and improved ability to export its gas via different routes – in this case, Nord Stream 1 – thus reducing dependence on individual transit countries. For this reason, the October 2016 EC exemption decision, which allows Gazprom to utilise OPAL capacity at least at 80 per cent (and potentially up to 100 per cent in the absence of third party demand) is very important. This 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 per cent 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 in respect of OPAL utilisation, favoured traders shipping gas from GASPOOL to Brandov as even had Gazprom priced its gas at the same level as GASPOOL (or below), 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 cap made the probability of interruption negligible. Ultimately, this led to a situation where European buyers were getting their gas at the prices potentially higher than might have been the case had it not been for the OPAL cap, thus going against its original *raison d'être* of preserving and enhancing competition. Therefore, maintaining the OPAL cap has become increasingly

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<sup>78</sup> Naftogaz (2016a).

<sup>79</sup> Naftogaz (2016a).

<sup>80</sup> 'President had phone conversation with EU Commissioner for European Neighbourhood Policy & Enlargement Negotiations', President of Ukraine website, 10 November 2016.

<sup>81</sup> PGNiG (2016a).

<sup>82</sup> Naftogaz (2016b).



illogical, unjustifiable on the grounds of the *acquis*, and prone to criticisms of being imposed on political grounds.

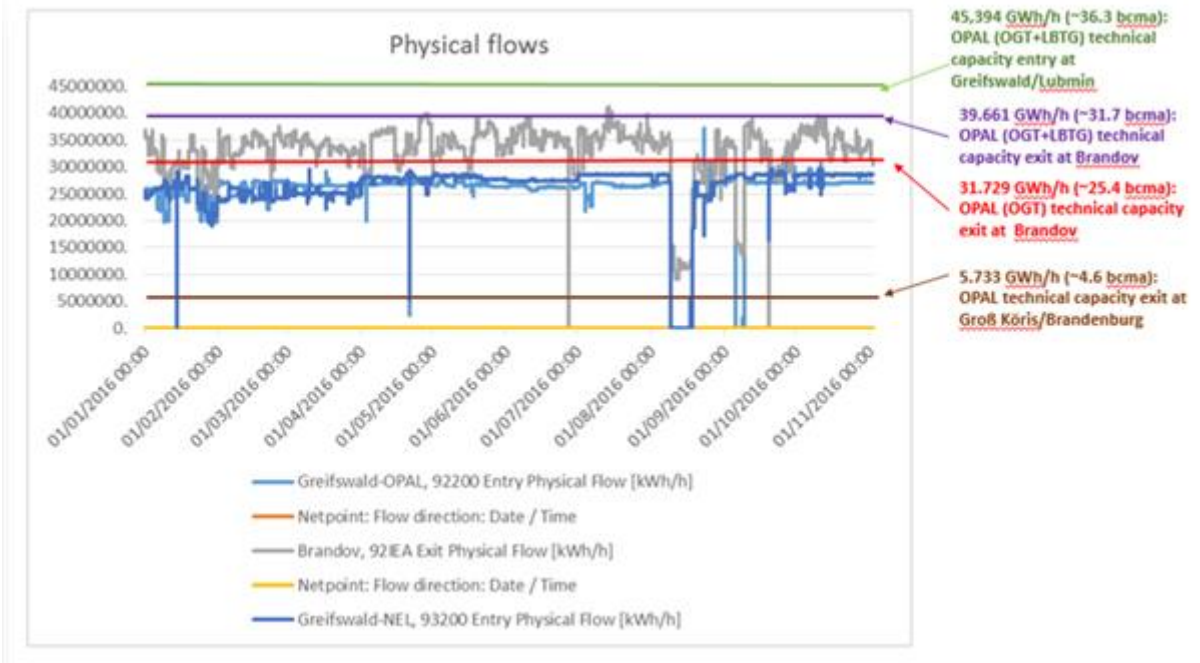
The October 2016 exemption decision aims to rectify this by attempting to strike a fine balance between the interests of all parties involved, in line with the *acquis*. While the decision allows Gazprom to have access to OPAL in excess of 80 per cent of its capacity, it effectively guarantees that third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

The EC has spent many years to develop the legislative and regulatory framework, which set the rules and procedures for allocation and utilisation of pipeline capacity in the EU. This framework was first laid out by the Third Gas Directive and Gas Regulation 715, and developed further in the Network Codes on Capacity Allocation Mechanisms, Tariffs, Balancing, and Interoperability. Any exemption from (some of) these rules is itself a part of legal process and must be justified on regulatory grounds. The June 2009 exemption, which limited Gazprom’s access to on OPAL’s capacity at 50 per cent, has become impossible to justify on regulatory grounds, thus suggesting it is a political decision. Politicisation of regulatory decision-making process – specifically in respect of Russia – threatens to undermine credibility of the EU legal and regulatory gas framework. The October 2016 exemption, which removed the 50% cap and allowed Gazprom to utilise more capacity in OPAL while guaranteeing that third parties would have access to 20 per cent of its capacity, suggests that the EC has understood the danger and moved back to 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 objections are allowed to override regulatory rules.



## Annex

**Figure A: Physical flows via OPAL and NEL in 2017: comparison with technical capacities**





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