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Reorganization of the gas sector in Czechia

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In Czechia, under the influence of the Russian Federation's full-scale attack on Ukraine, there has been a change in the operation of energy companies, which are supposed not only to meet business objectives but also to strengthen the state's energy security. In this context, in the past few months, we have seen the implementation of two acquisitions by companies wholly owned by the state.

Strengthening the state's position in the gas sector. A hallmark of the Czechia government's policy over the years has been limited ownership oversight of key elements of the energy infrastructure, with a concomitant emphasis on measures in the regulatory sphere. The Russian-Ukrainian war has sparked a debate over natural gas cooperation with Russia, which has played a key role in energy policy to date. Czechia's high energy dependence on Russia had two dimensions, and thus concerned both natural gas supplies (the level of dependence was almost 100%) and Gazprom's control over part of the energy infrastructure (control of the underground natural gas storage facility in Dambóřice). As a consequence of the Russian-Ukrainian war, there have been significant changes, manifested in a modification of the philosophy towards the energy sector, resulting in two recent acquisitions. First – in August 2023, the government in Prague approved the purchase for EUR 360 mln by the state-owned ČEPS a.s. (the electricity grid operator) from Germany's RWE AG of RWE Gas Storage CZ. Second – the government agreed in late September 2023 for ČEPS a.s. to also purchase Net4Gas Holdings, the country's natural gas network operator (with an exclusive license to transport the commodity).

Investment in energy security. ČEPS a.s.'s purchase of RWE Gas Storage CZ significantly increases the extent of state ownership control in the natural gas sector. RWE Gas Storage CZ owns six underground natural gas storage facilities, including Dolní Dunajovice (905 bcm), Tvrdonice (550 bcm), Třanovice (530 bcm), Štramberk (470 bcm), Lobodice (177 bcm), and Háje (75 bcm). The total storage capacity acquired from RWE Gas Storage CZ was 2.707 bcm (about 78%), and the remaining amount – at 0.793 bcm – belongs to smaller Czechia companies, namely Moravia Gas Storage a.s.¹ (Dambóřice storage with a capacity of 448 bcm) and MND Gas Storage (Uhřice storage with a capacity of 345 bcm). Also important in this context is the planned purchase of Net4Gas Holdings², which operates an extensive system of natural gas pipelines and transmission stations and thus plays a special role in the field of gas transportation and supply to Czechia customers. In this case, the total amount of the purchase of Net4Gas Holdings will be about EUR 250 mln, payable in two tranches (EUR 150 mln upon finalization of the transaction, followed by EUR 100 mln in two instalments if Net4Gas Holdings' financial parameters specified in the agreement are met). Importantly, the company has about EUR 1.35 billion in debt, incurred as a result of Gazprom's failure to pay for natural gas transported from Russia. The company's documents show that it was heavily dependent on Russian natural gas, with 75% of its revenues coming from contracts with Gazprom (the company filed for international arbitration in April 2023). Currently, 72% of Czechia's natural gas supply comes from the FSRU-type LNG terminal located in Eemshaven, the Netherlands (ČEZ a.s. has a contract to reserve 40% of the capacity at this terminal as of September 2022).

Energy security vs. financial risk. Net4Gas certainly does not represent an easy investment for the state. On the one hand, the measures to increase participation in the natural gas sector are expected to translate into increased energy security for Czechia. On the other hand, due to such large investments in recent years, Net4Gas is

¹ JV between Gazprom and MND (Moravske naftove doly), which is part of the KKCG holding company of Czechia billionaire Karel Komarek.

² Net4Gas is owned by a German-Canadian consortium of Allianz Infrastructure Luxembourg I S.a r.l. and Borealis Novus Parent B.V.

burdened with long-term loans of CZK 33 billion, in particular, bonds worth CZK 18.5 billion and loans of CZK 14.5 billion. In the first half of 2023, Net4Gas generated revenues of just CZK 1.6 billion, and it currently has cash of just under CZK 7 billion. The parliamentary opposition noted, however, that if the purchase is approved by regulators, ČEPS a.s. will acquire 100% of Net4Gas, including the company's liabilities and receivables. Former Industry Minister and current Deputy Speaker of the Lower House, Karel Havlicek pointed out that the purchase of Net4Gas is risky for the state, as the company is heavily in debt and the investment will not pay off in the future. He added that the government's actions regarding this purchase thus constitute a gamble and indicate irresponsibility. Daniel Křetínský, a Czech lawyer and businessman who controls the natural gas infrastructure in Slovakia through his companies, was also interested in the purchase of Net4Gas.

Energy security and political concepts. The steps taken by the government to strengthen the state's participation in the natural gas sector are part of an ongoing, long-running debate in Czechia on energy security, including natural gas supplies. This debate has been accompanied by measures to diversify natural gas supplies, which have resulted firstly in a reduction and then in a total reduction in Russia's share of natural gas supplies, with the simultaneous signing of new contracts to import this commodity from Norway and in the form of LNG from a terminal in the Netherlands. At the same time, the balance of natural gas imports and exports in Czechia to July 2023 amounted to 3,960.63 bcm, 20% less than the average of previous years. Currently, the filling level of storage facilities is at a record high of 98%. Currently, natural gas is supplied to Czechia via Germany, mainly from Belgium and the Netherlands (regasification terminals are used for this purpose).

Conclusions

- There is a lively debate in Czechia about the need to strengthen the state's position in the energy sector. Among the comments, taking into account the acquisitions that have been made, there are claims that it was a good time for such a move. The purchase of Net4Gas is possible because the company's original operating model was to use its existing infrastructure for the transit of natural gas from the Russian Federation to Western Europe (which will be completed by 2024). Thus, the company is currently only responsible for transporting natural gas to domestic consumers. Under these conditions, the company's profits would be lower and lower, so grounds for the sale of assets by foreign investors have emerged.
- In addition to strengthening the state's presence in the area of natural gas storage and transmission through two already completed transactions, the government is considering an option to purchase GasNet³ (the owner of the natural gas distribution network) through ČEZ a.s. Importantly, GasNet is responsible for the distribution of natural gas in Czechia to a total of about 2.3 million customers, excluding Prague (the company Pražská Plynárenská Distribuce a.s.) and the South Bohemian country (the company EG.D a.s. of the German E.ON SE Group).
- The reorganization of the natural gas sector is a departure from the long-standing practice of lack of ownership control over this part of the economy. Through the acquisitions made, the position of the state will increase, and thus some of the investments made may be dictated not only by business considerations but also by political ones. In this context, there is a chance that the Poland-Czechia interconnector (Stork II gas pipeline) will be realized, and thus the concept of Poland fulfilling the role of a natural gas hub for Central European countries (including the supply of this commodity through the planned FSRU-type LNG terminal in the Gulf of Gdansk)⁴.

³ GasNet is owned through the company Czech Gas Network Investments S.a r.l. by Macquarie European Infrastructure Fund, British Columbia Investment Management Corporation and Allianz Capital Partners.

⁴ Two FSRU-type LNG terminals are to be built as part of the investment, i.e., one with a regasification capacity of 6.1 bcm per year for customers in Poland, and another with an import capacity of 4.5 bcm per year for customers from Central European countries.