KYLLINGSTAD KLEVELAND

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Supreme Court rejects appeal over Gassled tariff reduction

In 2014, four owners of the Norwegian gas transport system Gassled initiated legal proceedings against the Norwegian government regarding the Ministry of Petroleum and Energy's decision to amend the tariffs for the transportation of gas through the Norwegian upstream gas pipelines – leading to one of the biggest cases in Norwegian legal history in terms of value. After both Oslo District Court and Borgarting Court of Appeal ruled in favor of the government, the Supreme Court has finally determined that the Ministry of Petroleum and Energy had the required legal basis for the 2013 tariff reduction.

BACKGROUND

Gassled was established in 2003 by a merger of several gas transportation systems owned by separate joint ventures, and is considered the world's largest offshore transportation system with 8,829 kilometers of gas pipelines at the bottom of the Norwegian Sea and the North Sea, including receiving facilities in Germany, France, the UK and the Netherlands.

For the transportation and processing of gas in Gassled, the shippers pay to the owners a predefined tariff fixed by a formal regulation called the Tariff Regulation, which was enacted in conjunction with the establishment of Gassled in 2003.

The tariffs consist of several variables, and are ultimately fixed based on a principle where the owners shall be ensured a reasonable return on invested capital. As a result, the original Tariff Regulation aim to yield a return of 7% before tax. In order to remunerate the owners for their initial capital investment, allowing them to make such reasonable return, the tariff formula includes an element called the capital element (K-element).

NEW INFRASTRUCTURE INVESTORS

The owners of Gassled have previously also been shippers of gas in Gassled, meaning that any cut in the tariffs and subsequent reduction of such income would be equalized through lower shipping costs. This principle of balanced ownership was abandoned in 2010-2011, when the four infrastructure investors and non-shippers of gas – Solveig Gas Norway AS, Silex Gas Norway AS, Infragas Norge AS and Njord Gas Infrastructure AS (renamed to CapeOmega AS in 2017) – acquired approximately 45% of Gassled for around 32 billion NOK. Pursuant to the Petroleum Act section 10-12, the Ministry of Petroleum and Energy (MPE) approved the mentioned transfer of ownership interests, as required by said provision.

AMENDMENT OF THE TARIFF REGULATION

In January 2012, Gassco (the operator of Gassled) submitted a report to the MPE concerning future gas infrastructure on the Norwegian continental shelf, which caused the MPE to notify the owners and users of Gassled that the ministry had started to assess the future tariff levels.

The analysis provided by Gassco concluded that by the end of the current license period in 2028, a return of 10.5% before tax would be achieved, based on historic capital tariff revenues and future capital tariff from transport agreements already entered into.

As such return would exceed the intended reasonable return of 7%, the MPE wanted, as a means to facilitate good resource management, to reduce the K-element. Thus, the MPE reduced the fixed capital element in the tariffs by up to 90% by an amendment to the Tariff Regulation in 2013. It is important to note that tariffs for capacity booked prior to the amendment were not affected, meaning that solely the tariffs for future capacity bookings were reduced.

LEGAL PROCEEDINGS AGAINST THE NORWEGIAN GOVERNMENT AND THE MPE

The new infrastructure owners challenged the validity of the amendment, claiming that the MPE did not have legal basis to amend the tariffs before the expiration of the current license period. In addition, they asserted that the future tariff revenues would no longer be in accordance with the legitimate expectation they claimed to have, upon their investment in Gassled in 2010-2011.

Principally, the infrastructure owners claimed that the amendment was invalid, and alternatively, they claimed damages equivalent to their alleged losses caused by the reduction of the tariff.

In September 2015, Oslo District Court rejected the claim. The judgment was appealed, and in June 2017, Borgarting Court of Appeal agreed with the District Court that the MPE had the required legal basis for reducing the tariffs, consequently stating that the amendment to the Tariff Regulation was valid and that the infrastructure owners had no basis to claim damages.

The infrastructure owners decided to appeal the decision to the Supreme Court, which decided to hear the case in May and June 2018.

LEGAL QUESTIONS – SUPREME COURT DECISION

The Supreme Court rejected the appeal and confirmed the judgment from Borgarting Court of Appeal, stating that the Petroleum Act section 4-8 first paragraph was the correct legal basis.

The Supreme Court emphasized that changes to the K-element of the Tariff Regulation had to be done in accordance with the Petroleum Regulation section 63 fourth paragraph, which states that consideration shall be given to promote the best possible management of resources and that the K-element must be stipulated so the owner can expect a reasonable return on the capital invested. Furthermore, the provision states that other special circumstances may also be taken into account.

The Supreme Court found that the promotion of the best possible resource management was duly taken into account by the MPE. An important principle in the management of resources is that as much as possible of the revenue shall be realized on field, and not through the transportation system. In addition, lower tariffs would contribute to lower transport costs, consequently leading to more effective resource exploitation and extended tail production.

Regarding the reasonable return on invested capital, the new infrastructure owners claimed that the MPE had to take into consideration the acquisition costs related to their investment in Gassled. The Supreme Court concluded that the return is to be calculated based on the historic investments in the physical gas infrastructure, leaving later transfer of owner rights and purchase prices irrelevant.

The Supreme Court did not rule out that the MPE could have had the opportunity to take into consideration the valuation in connection with the transfer of owner rights in 2010-2011, but the MPE did not have any obligations in this regard.

The Supreme Court found it well substantiated to not take the purchase prices into consideration – and emphasized that it would be difficult to understand why commercial transaction should affect the general tariff level as fixed by regulations or limit the MPE's regulative authority over the same tariffs.

The appeal to the Supreme Court also questioned whether the tariff cut violated property protection under the European Convention on Human Rights Protocol 1 (ECHR) Article 1. Even though the Supreme Court

criticized the MPE for not having established a more transparent system for monitoring the accrued rate of return, the Supreme Court found that no infringements of the property protection under ECHR had occurred.

The Supreme Court found it crucial that, at the time of the acquisition, it was clear to the new infrastructure owners that the tariffs were based on rate of return with an accompanying regulatory risk attached to this. Furthermore, as the appeal to the Supreme Court only comprised the application of the law, meaning that the Supreme Court based its assessment of evidence on the Borgarting Court of Appeal's assessment, it was also found evident that the MPE had informed the new Gassled owners of the ministry's power to amend the tariffs as set in the Tariff Regulation, in connection with its approval of the transfer of ownership pursuant to the Petroleum Act section 10-12.

The new infrastructure owners also addressed that they were non-shippers of gas and therefore the tariff reduction would affect them particularly harshly. The Supreme Court stated that the new owners had to take this increased exposure into consideration in their investment decision, as they – in contrast to the existing owners and sellers – were non-shippers and therefore would not receive have any compensating benefits from reduced tariffs.

The Supreme Court did not consider the new infrastructure owners to be particularly harshly hit by the 2013 tariff reduction, as the greater part of the capacity until end of the current license period in 2028 already was booked before the tariff reduction in 2013 and such agreements are not affected. Based on their own information, the new infrastructure owners would still achieve a real return on their respective purchase prices in the region of 4.5% to 5% before tax.

CONCLUSIVE REMARKS

The decision from the Supreme Court emphasizes the importance of taking the Norwegian government's wide-ranging competence to alter framework conditions within the petroleum industry into account before making an investment decision relating to investment in infrastructure or assets on the Norwegian continental shelf (NCS).

As stated in the Petroleum Act section 1-1, the Norwegian State has the proprietary right to subsea petroleum deposits and the exclusive right to resource management. History clearly show that the government has played an active role when it comes to resource management of the petroleum resources and they will surely continue to do so.

The decision by the Supreme Court in the Gassled case illustrate that investors needs to acknowledge a fundamental legal axiom; the legislator may amend legislation and any investment made in reliance on legislation is therefore subject to political risk. That said, the NCS has over time proven politically stable. The Gassled tariff changes aimed to optimize resource management in line with long established goals steaming from the maturing state of the NCS. On that basis we do not see the Government's decision to amend the tariffs, nor the Supreme Court's decision to uphold the decision, as a threat for future investors on the NCS.

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