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Strategic stalling

Czechia delays decoupling from Russian energy

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KEY FINDINGS

- **Every dollar for the Kremlin counts:** Czechia continued sending money to the Kremlin by buying Russian crude oil, Russian-made petroleum products from Slovakia, and maximising Russian gas imports in 2024. Czechia has spent over EUR 8.2 billion on Russian oil and gas — more than six times the EUR 1.32 billion it has provided in aid to Ukraine since the start of Russia's full-scale invasion of Ukraine. Czechia's crude oil imports have resulted in over EUR 2.75 billion in tax revenues for the Kremlin since the start of the invasion.

- **Excuses, excuses:** The Czech government and the Polish state-owned petrochemical company Orlen are laying blame on each other for who is responsible for the full phaseout of Russian oil. The Czech state-owned oil pipeline and storage operator, MERO ČR, has also failed to expedite the commissioning of the expanded Trans-Alpine pipeline (TAL) pipeline for imports of non-Russian crude, and Orlen has claimed it cannot stop buying Russian crude because of limited infrastructure. Yet, neither the Czech state nor Orlen have tried to significantly reduce Russian oil purchases, even when alternatives are available and underutilized and other EU countries dependent on the Druzhba pipeline, including Poland itself, have banned Russian oil purchases immediately after the EU oil ban came into force.

- **Tapping the loophole:** In 2024, Czechia expanded the imports of petroleum products from Slovakia and Hungary, made by refining Russian crude oil, taking advantage of another exemption from the EU ban on Russian oil product reexports. Even after the Czech government said it does not want to renew the derogation after its expiration date of 31 December 2024, the exemption was extended by another six months, which means at least another 350,000 tons of Russian fossil fuels, which are worth around a quarter of a billion euros in revenue to Russia, can enter Czechia.

- **Devouring Russian gas as if there is no tomorrow:** Czechia imported four times more Russian natural gas in 2024 (2.9 bcm) than it did in 2023 (0.6 bcm), benefitting state and private interests linked to the Russian gas supply that have benefited from the Gazprom discounts on pipeline exports.

- **No more excuses:** There have never been technical or economic reasons to continue importing Russian fossil fuels. Czechia needs to overcome the resistance from Russia-linked networks in the country to immediately ban imports of Russian crude oil and oil products made from Russian crude. There are ample petroleum stocks that can be released on the market to bridge the transition period during the TAL certification process, which will also reduce the incentive to stall the last steps of the diversification process. This can strip the Kremlin from at least EUR 1 billion in additional revenues before mid-2025.

Czechia continues stalling on completing the phaseout of Russian oil imports. On the basis of an exemption from the EU ban on Russian oil imports as of 5 December 2022, Czechia has continued buying large quantities of Russian crude via the Druzhba pipeline crossing Ukraine. Czechia has attempted to justify its decision to keep importing Russian crude oil stating its inability to import sufficient quantities of alternative oil from the Trans-Alpine pipeline (TAL) due to its lower capacity.

Yet, the operator of the country's two refineries, the Polish state-owned company Orlen, has not fully utilised the TAL pipeline, and has instead chosen to maximise the purchase of large volumes of discounted Russian crude, which was on average 21% cheaper than Azeri crude in 2023 and 2024. It is noteworthy that the cost savings resulting from the high reliance on discounted Russian crude were not reflected in lower consumer gasoline prices in Czechia. This strategy of maximising discounted Russian crude contributed to surplus profits for Russia of around EUR 1.2 billion.

Meanwhile, Czechia's pipeline and storage operator, MERO ČR, has completed a project for the expansion of the TAL at the end of 2024 although it remains unclear whether the infrastructure upgrade was actually necessary. Taking nearly two years to build, it seemed that a relatively simple pipeline capacity expansion was never a priority for the government. The end result has been that Czechia has spent over EUR 8.2 billion on Russian oil and gas — more than six times the EUR 1.32 billion it has provided in aid to Ukraine. Czechia's crude oil imports have resulted in over EUR 2.75 billion in tax revenues for the Kremlin since the start of the invasion.

After reducing the imports of Russian crude in the first half of 2024 due to unexpected maintenance at the Litvinov refinery caused by the discovery of an unexploded World War II bomb and technical problems on the Druzhba pipeline, Orlen accelerated Russian oil purchases in Q4 of 2024, increasing imports 30% year-on-year. Despite the completion of the TAL pipeline expansion and MERO ČR's announcement that Czechia can now fully replace Russian crude oil from other suppliers, Orlen has indicated that it will continue buying Russian crude under a long-term contract with Rosneft ending in mid-2025. In addition, the Czech government said that it will need six months to complete the tests and certification procedures on the upgraded pipeline, which again appears to be a strategy to stall the diversification process.

Czechia can and should immediately stop buying Russian crude oil by making the TAL pipeline fully operational immediately, by increasing the imports of petroleum products from Germany, by banning the reexport of Russian-made fuels from Slovakia (now more than a quarter of total purchases), and by tapping into the country's six-month supply of Russian crude stocks. Analysis reveals once again that to complete its strategic decoupling from Russian oil, the EU should close all sanctions gaps including the exemptions for the Druzhba pipeline and the refining loophole, which has allowed third countries to maximise Russian crude purchases and sell the surplus petroleum products back to the EU.

AN ENDLESS BLAME GAME WITH THE CZECH GOVERNMENT

Orlen Unipetrol, a subsidiary of the Polish state-owned energy giant Orlen, is the sole oil refiner in Czechia and is responsible for all imports of crude oil into the country. The company claims it is bound by a contract with Russia's largest oil company, Rosneft, to import up to 5 mn tonnes of Russian crude oil annually until mid-2025. There is no detailed information available about the contract's clauses but the implication is that there is a take-or-pay arrangement meaning that Orlen is contractually obliged to buy a certain minimum amount of Russian oil. This is unlikely as Czechia has never bought anywhere close to 5 mn tonnes annually from Russia, and take-or-pay clauses are rare in oil agreements due to the fungibility of the oil market that allows buyers to easily switch to an alternative supplier as Orlen has done on many occasions over the last decade.

Without an intervention from the Czech government in the form of an executive order to ban Russian oil imports, Orlen can continue importing Russian oil, citing the Rosneft contract. This strategy has been very successful for the Polish oil major. In 2022 and 2023, Orlen Unipetrol reported annual operating profits (EBITDA LIFO[1]) upwards of EUR 600 mn as their imports of discounted Russian crude oil hit decade-high volumes.

Orlen's insistence on remaining contractually bound to Rosneft reflects the Polish company's decades-long strategic relationship with the biggest Russian oil company, now partially under EU and U.S. sanctions. Orlen played the role of intermediary between Rosneft and the German government after the latter took all Rosneft assets under state supervision in September 2022 and stopped purchasing Russian oil. In addition, on 1 July 2024, Orlen appointed a former senior executive from Rosneft Germania as the president of Orlen's Management Board, which reflects the Polish company's ongoing talks with Germany to acquire Rosneft's 54.17% stake in Germany's Schwedt refinery.

The purchase of cheap Russian crude has not benefited Czech consumers through lower fuel prices, as shown in our recent report. Instead, Orlen Unipetrol's imports of Russian crude oil earned an estimated EUR 68 mn per month in Russian tax revenues for Russia, financing the Kremlin's war-chest. The Czech government has used Orlen Unipetrol's long-term deal with Rosneft as an excuse not to force a complete phase-out of Russian oil. Bulgaria has already demonstrated that direct government intervention is feasible; at the start of 2024, Bulgaria banned the import of Russian crude oil one year before its exemption to the EU ban was due to expire, invoking a force majeure clause with Lukoil. This neither led to oil supply security risks nor to an increase in domestic fuel prices despite the fact that Bulgaria relied on Russian oil for around 90% of its crude oil imports in 2023.

1 Earnings before interest, taxes, depreciation, and amortisation (EBITDA), using the Last-In, First-Out (LIFO) inventory method. The LIFO valuation methodology assumes the most recently purchased inventory will also be the highest cost. This method likely underestimates Orlen Unipetrol's profits as it assumes higher costs.

As the Czech government has itself repeatedly stated, Czechia does not rely on Russian crude oil. The Czech state-owned oil pipeline operator MERO ČR has confirmed that even before its final completion in February/March 2025, the TAL-plus project has already opened up sufficient capacity along the TAL pipeline to fully cover Czechia's annual crude oil demand. Why, then, is MERO ČR — and by extension the Czech government — not pressuring Orlen to stop Russian oil purchases? One explanation could be that the Czech government may be attempting to secure financial support from Orlen to cover half of the costs of the TAL-plus pipeline project. MERO ČR was denied funding from the EU's Resilience and Recovery Fund and has so far financed the project independently. Therefore, the Czech government may be willing to accommodate Orlen's lucrative position as a way to receive some of the funding back from the company. Even if true, such a strategy denies the enormous national and energy security benefits linked to the strategic decoupling from Russian oil. Acting now would also prevent the likely stockpiling of Russian crude ahead of the exemption's proclaimed termination in mid-2025, and the associated tax revenues for the Kremlin.

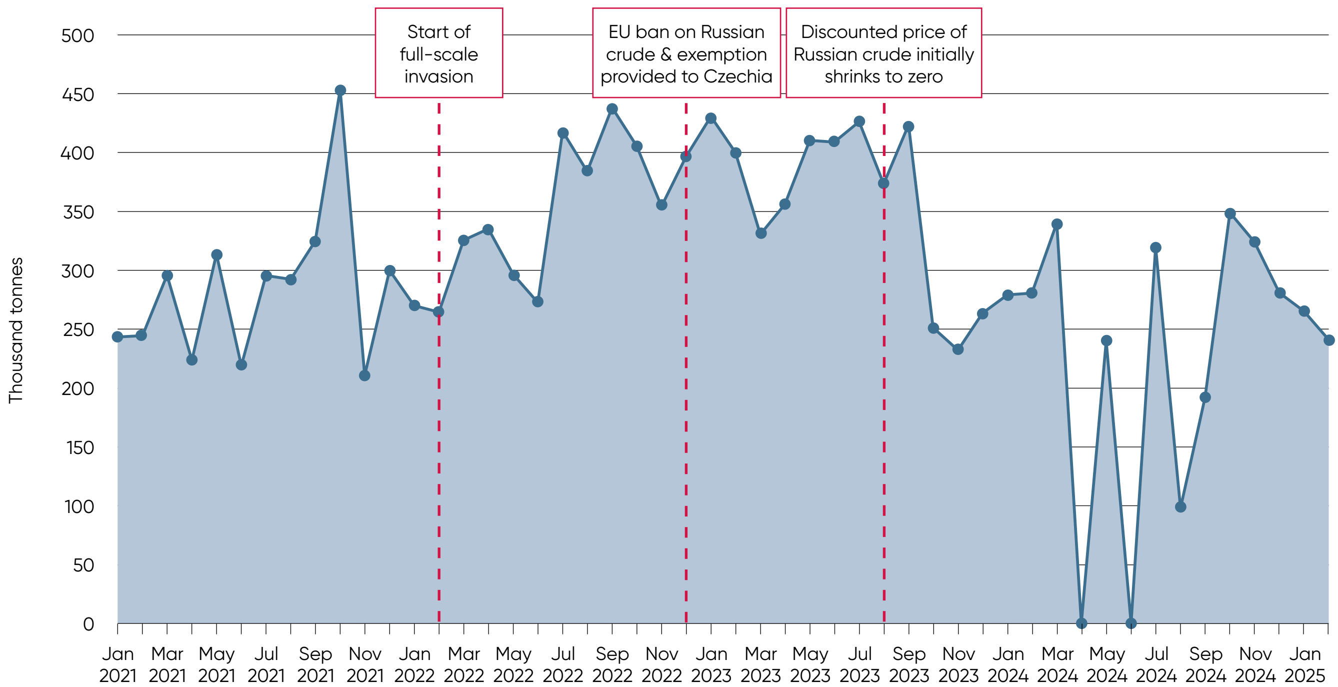
One thing is clear though — the barrier to ending reliance on Russian crude oil is neither technical nor legal but the result of a lack of political will. The upcoming Czech parliamentary elections have also been used as an excuse to avoid this discussion. The ruling coalition has feared that a potential increase in fuel prices may cut into their voters' support. This cannot be farther from the truth. Halting imports of Russian crude would only upset the profits of Orlen and several other fuel traders with links to Russian oil or oil product imports.

CZECHIA'S IMPORT VOLUMES OF RUSSIAN CRUDE OIL SURGE IN Q4, 2024

In 2024, Czechia imported 2.7 mn tonnes of Russian crude oil (valued at roughly EUR 1.5 billion) — a 30% decrease in volume terms compared to 2023. The cut in Russian crude oil imports is not due to a proactive policy to phase out Russian crude but largely due to three major disruptions to the Druzhba pipeline that practically halted Czechia's imports of Russian crude oil for several months. In April and June, the Druzhba pipeline experienced two unexplained interruptions, while at the end of August, the discovery of an unexploded WWII bomb near the Litvínov refinery — which primarily processes Russian crude — resulted in a complete shutdown of its operations until the 9th of September. If these months had received the same average monthly import volumes as the unaffected months in 2024, Czechia's annual Russian crude imports would have reached 3.4 mn tonnes over the course of the year — matching its pre-invasion import volumes from 2021.

Figure 1. The Czech Republic's monthly import volume of Russian crude oil via pipeline

January 2021 to February 2025 I Thousand tonnes



Source: CREA analysis.

Note: The significant drop in pipeline oil imports observed in April and June 2024 was due to an unexplained disruption to oil supply via the Druzhba pipeline, while the decrease in August 2024 was due to a disruption at the refinery that processes Russian oil.

In fact, in the final quarter of 2024, Czechia imported 991 thousand tonnes of Russian crude oil, 30% more than it did in Q4 2023 (747 thousand tonnes). In October 2024, likely in response to the shutdown of the Litvínov refinery, monthly Russian crude oil imports rose to 370 thousand tonnes

(EUR 186 mn), the highest monthly volume since September 2023. The Czech Republic could have used this opportunity to increase imports via the TAL pipeline or even withdraw from its ample stores of crude oil. However, Orlen Unipetrol has clearly used this as an excuse to earn more profits for discounted Russian crude (the discount on Russian crude compared to Azeri crude — Czechia's second-largest supplier — has widened significantly, from EUR 26 per tonne, 4%, in July to EUR 71 per tonne, 12%, during August-October). Hence, average reliance on Russian crude oil during the first three quarters of 2024 sat at 38% but increased to 52% in the final quarter.

TAPPING THE PRODUCTS LOOPHOLE

On 22 November 2024, the Czech Ministry for Industry and Trade (MPO) confirmed that they will not seek to extend the duration of the exemption from the European ban on the import of oil products made from Russian crude in Slovakia and Hungary. The Czech Ministry stated that due to "*...steps that Czechia is taking to secure independence from imports of oil from Russia, the Czech Republic does not see a reason why the exemption should be extended*". Despite this announcement, on 16 December 2024, the EU — under its agreed 15th sanctions package against Russia — allowed Czechia to continue importing oil products made from Russian crude in other Member States until 5 June 2025.

Slovakia is the obvious beneficiary, and has likely pressured Czechia not to ban imports of their oil products made from Russian crude, revealing again how private interests have captured the EU member-states' energy policy to extract enormous profits from the loopholes in the EU's sanctions against Russia. In 2024, Slovakia exported 710 thousand tonnes of oil products, worth EUR 520 mn, to Czechia — accounting for 46% of Slovakia's total oil product exports. Slovnaft, owned by the Hungarian oil major, MOL, with close ties to the Hungarian Prime Minister Orban, is the main exporter of Slovak fuels to Czechia. MOL has maximised Russian crude imports in Slovakia under a contract with the second-largest Russian oil company Lukoil.

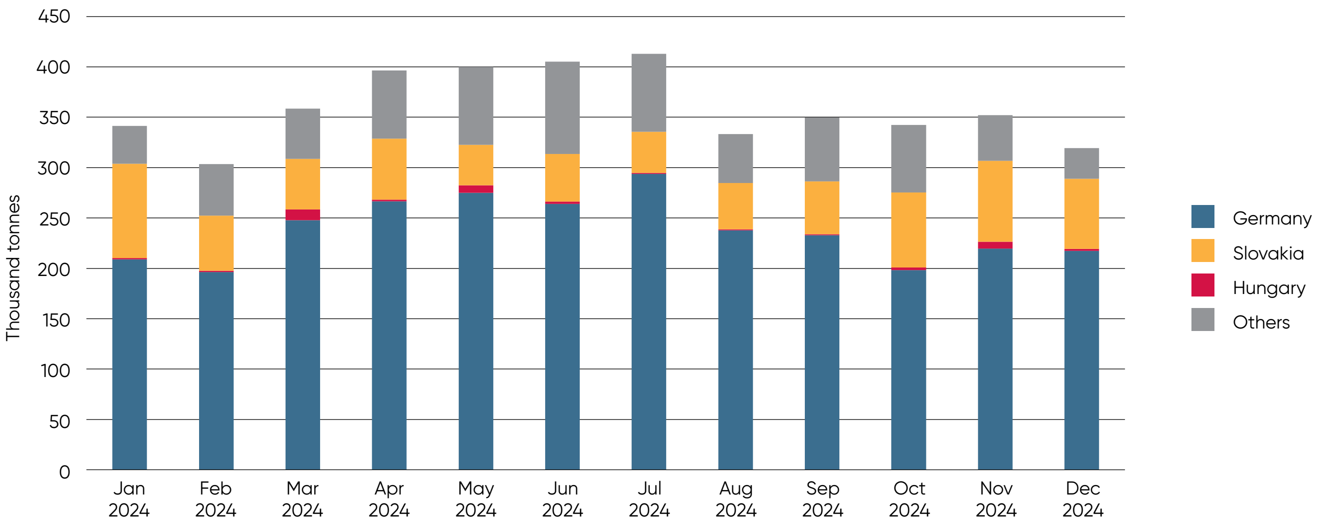
Box. Devouring Russian gas ahead of the Ukrainian gas transit halt

Ukraine stopped transiting Russian gas on 1 January 2025, after its long-term contract with Gazprom expired. In anticipation of this cessation, and to take advantage of discounted Russian natural gas, Czechia significantly increased its imports via Ukrainian pipelines during the final quarter of 2024. Overall, Czechia imported four times more Russian natural gas in 2024 (2.9 bcm) than it did in 2023 (0.6 bcm). Imports have skyrocketed in the final quarters, surging to over 0.34 bcm per month, representing a 62% increase compared to the January-September average.

The Slovak government has claimed that the Russian oil imports are necessary due to security of supply concerns. Yet, the large sales to Czechia show that the reason for the bigger Russian imports are the private interests of MOL and Russia-linked Hungarian interests. MOL exported another 39,000 tonnes also directly from Hungary to Czechia, adding indirectly another EUR 40 million to Russian oil revenues. Furthermore, on the receiving end in Czechia, Orlen owns the largest network of gas stations in Czechia, meaning any profit earned from selling discounted Slovakian oil products ends up benefitting Orlen as well. In 2024, the average price of gasoline and that

Figure 2. Countries exporting oil products to the Czech Republic

January 2024 to December 2024 I In thousand tonnes I Top 3 countries



Source: CREA based on analysis of Eurostat data.

of diesel in Czechia was EUR 1,490 and EUR 1,450 per tonne, respectively. Traders of Slovakian gasoline and diesel have paid on average around EUR 750 euros per tonne, which means that they have scored an almost 100% sales markup.

Slovakia offers only modest discounts compared to Germany (Czechia's biggest supplier with 67% of the total imports) for both fuel types: a 6% discount (EUR 47 per tonne) on gasoline and a 7% discount (EUR 53 per tonne) on diesel. This means that if traders switched to only selling German fuels, their markup decreases by only around 11-12%. This is a small cost to pay for ending Czechia's reliance on oil products made from Russian crude that sends tens of millions of euros each month to the Kremlin war chest.

WHAT'S NEXT?

- **Act now to phase out Russian oil.** The Czech government has already stated it can survive without Russian crude oil, and it needs to issue an executive order to ban Russian imports immediately as there is currently no EU legal mechanism to stop Druzhba oil purchases and Orlen Unipetrol is already increasing its imports of Russian crude oil ahead of its planned phase out in mid-2025. This could add at least another EUR 1 billion in Russian oil revenues in 2025.

- **Czechia should complete the phaseout of Russian oil before the TAL-plus project certification ends.** Czechia is already able to survive without Russian crude oil imports via the Druzhba pipeline. The country can draw upon its 3.6 mn tonnes of crude oil stocks, which could cover around half of its total annual imports. Furthermore, MERO ČR confirms that even before its final completion in February/March 2025, the TAL-plus project has already opened up sufficient capacity along the TAL pipeline to fully cover Czechia's annual crude oil demand. There is no justification for continuing these imports, especially considering that the discounted Russian crude does not translate into lower fuel prices for end consumers. Instead, the financial benefits are going to Orlen Unipetrol.

- **Orlen Unipetrol's crude oil contract with Rosneft should not justify the delay of the Russian oil phaseout.** The existence of an oil supply contract with Rosneft running until mid-2025 should not be used as an excuse to delay ending Russian crude oil imports. The Russian company is under EU and U.S. sanctions and Orlen has facilitated the preservation of its market share in Germany and Central Europe. Instead, Czechia should ban the imports of Russian crude oil on the grounds that it is a breach of EU regulations and a risk to the country's national security, similar to how Bulgaria justified its ban on Russian crude imports in December 2023.

- **Czechia should stop importing Slovak oil products made from Russian crude.** These fuels are produced by the Hungarian oil and gas major MOL, which controls the country's refining capacity and sources crude from Lukoil. By extending this exemption, the EU missed a critical opportunity to target MOL — Europe's largest buyer of Russian oil. Now, the responsibility lies with Czechia to distinguish itself from Hungary and Slovakia — who maintain close political ties with Russia — by halting imports of Slovakian oil products well before the exemption is officially terminated in June 2025.

METHODOLOGY

The CREA and CSD analysis is based on an array of different sources including: Eurostat, Global Energy Monitor, Gas Infrastructure Europe, Eurostat, ExPro Consulting data and the Entsog Transparency platform. Units were converted between tonnes and barrels using UnitConverters.net data. For further information on methodology used for this piece, please review our previous report here. Throughout this report we have used the name Czechia and the Czech Republic interchangeably.