

RUSSIA-UKRAINE GAS DISPUTE

What happened?

On December 22, 2017, the Arbitration Institute of the Stockholm Chamber of Commerce has delivered the final award in the case concerning the gas purchase contract between Naftogaz and Gazprom. It provided, inter alia, for the compensation to be made by Naftogaz to Gazprom for the residual payments for gas delivered in 2014 and 2015 at slightly above 2 bn USD and for the obligation to purchase at least 5 bcm of gas annually from Gazprom (as 5 bcm is the annual contract quantity (ACQ), with the allowed deviation up to 20%, the mandatory volume to be purchased might amount to 4 bcm).

On February 28, 2018, the Stockholm arbitration has made decision in the case concerning the gas transit contract between Naftogaz and Gazprom. It demands from the Russian company to compensate 4.6 bn USD for the volumes of gas to be transported, which it failed to provide.

These two awards combined have obliged, inter alia, Naftogaz to purchase from Gazprom at least 4 bcm of gas annually and Gazprom to pay 2.56 bn USD to the Ukrainian party.

Under these obligations, Naftogaz has submitted the respective request for gas purchase from March 1 and, as reported by the media, made an advance payment for 0.5 bcm of March gas supply; Gazprom, however, refused to perform delivery hours before the planned supply. Also, in the breach of its obligations under the transit contract, Gazprom has abruptly decreased gas pressure at entry to the Ukrainian gas transmission system – down to 50 atm from 60-65 atm prescribed by the contract.

Along with peak storage withdrawal because of low temperatures, this has led to less gas supplies than planned to be available in March, and thus to the state of emergency. As much as the EU countries experienced low temperatures as well, purchasing gas on Ukraine's western borders turned to be much more expensive. At the same time, a contract for emergency gas imports to Ukraine has already been signed with the Polish PGNIG.

What to do? DiXi Group proposals

1. Gazprom's conduct should be duly assessed not only in Ukraine, but also by all viable consumers of the Russian gas. Manipulations and poorly disguised revenge like this must be addressed in a comprehensive and consistent way by all the consumers which purchase gas and services from Gazprom.

For this purpose, we recommend to **develop, as part of the early warning mechanism, a joint position of Ukraine and the European Union on the unconditional performance by all the respective parties of the Stockholm arbitration decisions** related to contract on gas supply and gas transit, including the financial settlements.

2. Gazprom's initiative to change the rules in its favor and drag other parties to its side should receive a symmetrical response from Ukraine and the EU. Gazprom's position – either to delay the execution of current transit contract (by filing another lawsuit to the Stockholm arbitration), or to impose its own version of the new rules (by the proposal of a new transit contract).

The position of Ukraine and the EU could be the **unconditional implementation of the Treaty establishing the Energy Community and the Association Agreement, which both provide for the creation of a common gas market of Ukraine and the EU.** Given the termination of the contract with Gazprom creates appropriate conditions, the parties (Ukraine and the EU) could come up with an initiative to review the entire system of contracts regulating the issue of Russian gas transit to consumers in the EU through the territory of Ukraine, including:

- a) early termination of the contract on gas transit between Naftogaz and Gazprom;
- b) the conclusion by the European gas companies of contracts for gas transit with the Ukrainian TSO (PJSC "Ukrtransgaz"). This would require:
 - the NEURC to revise tariffs for natural gas transportation for entry and exit points of the gas transmission system located on the state border of Ukraine, i.e. to set them at a level sufficient for the effective operation of the TSO and commercial interest of the system users;

- the Ukrainian TSO to hold an 'open season' procedure for booking of the entry points located on the eastern and northern border of Ukraine with the Russian Federation and Belarus respectively (Valuyki, Kobryn, Mozyr, Pysarivka 1400, Sudzha 1200, and Sudzha 1400);
 - the Ukrainian TSO to conclude contracts for natural gas transportation, with the mentioned points of gas receipt/delivery.
- c) change of the points of gas receipt/delivery for the European consumer companies in gas purchase agreements with Gazprom (its subsidiary Gazprom Export or others). This would require:
- to identify as points of gas receipt/delivery the corresponding entry points on the eastern and northern border of Ukraine;
 - to ensure an adequate level of gas metering at the respective points;
 - to determine the transition to new pricing under the principle of netback (i.e. current export price of Gazprom minus the cost of gas transportation through the territory of Ukraine).
- d) conclusion of agreements on technical cooperation between the Ukrainian TSO (PJSC "Ukrtransgaz") and Gazprom (its subsidiaries, in particular "Gazprom transgaz Belarus") in order to resolve issues of balancing, pressure, physical and chemical parameters of gas, etc.
- e) ensuring the regime of transparency is applied for the conclusion of these agreements, including their assessment by the European Commission, as defined by the Decision (EU) 2017/684 on establishing an information exchange mechanism with regard to intergovernmental agreements and non-binding instruments between Member States and third countries in the field of energy.

3. The gas crisis shall be taken into account for the future energy security of the EU, in particular, **to determine the probability of such Gazprom conduct also for consumers of Russian gas in the EU, as well as to revise the feasibility of constructing additional routes for the supply of Russian gas to the EU.**

Also, in the framework of introducing additional security measures for supplies between Ukraine and the EU, to consider:

- a) conclusion of interconnection agreements at all cross-border points between ENTSOG operators and the Ukrainian TSO, incl. Velké Kapušany;
- b) extending the application of solidarity mechanisms within the Energy Union (defined by the Regulation (EC) No. 2017/1938 concerning measures to safeguard the security of gas supply) by means of including Ukraine to the relevant regional group and development of joint crisis response plans in the cases of supply disruptions;
- c) conducting joint studies and simulations of crisis situations in order to identify and study the bottlenecks of Ukraine's gas transmission system, which should be strengthened as a priority;
- d) accelerating the implementation of the Poland-Ukraine gas interconnector construction, incl. providing loans and other forms of financial support.

4. To explore the possibility of **speeding up the consideration of the European Commission proposal regarding amendments to the Gas Directive** (application of the principles of EU legislation to all gas pipelines from third countries to the EU jurisdiction) in order to improve the functioning of the internal energy market and to strengthen solidarity among Member States.

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