

Saga on trilaterals

My accounts of the negotiations over gas transit

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What I signed with Miller in December 2019


Settlement Agreement

- Gazprom paid outstanding amount under the Stockholm arbitration award in full with interest (USD 2.9 bln)
- All disputes under the 2009 Gas Supply and Gas Transit contracts (with total value of USD 300 bln) are settled

New Gas Transit contract

- 2020-2024
- Full compliance with EU Rules
- USD 7.2 bln “ship or pay”



U.S. Embassy Kyiv 
@USEmbassyKyiv

Congratulations to Ukraine for securing a gas transit contract with Russia and receiving \$2.9 billion for the Stockholm arbitration. These are significant accomplishments.

[Перекласти твіт](#)

4:19 пп · 31 груд. 2019 · [Twitter Web App](#)

7 ретвітів 19 вподобань

Chain of Events

Trilateral negotiations Ukraine, EU, Russia



Bilateral negotiations Ukraine, Russia



Besides, the European Commission, active involvement of the German government and the Energy Community Secretariat

Stumbling blocks for the trilaterals

Original position of Gazprom

- “Zero scenario”: settlement of the disputes over the old (2009) contracts without any payments
- Volume commitments to buy gas from Gazprom
- Then (!) extension of the old (2009) transit contract
 - As Gazprom claimed, no volume commitments;
 - Gazprom as a “super operator” of the Ukrainian Gas Transmission System

Stumbling blocks for the trilaterals

Our leverage

- Enforcement of the 2018 Stockholm arbitral award
- New arbitration with USD 12,2 bln (plus interests claims)
- No critical dependance on gas supplies from Russia
- Political blame on Russia under if there there is no transit through Ukraine

Stumbling blocks for the trilaterals

My concerns

- Ukraine would be pushed to accept Russia's position
 - Outright political pressure "to find a compromise", especially after the presidential elections in 2019
 - Attempts to "fool"
 - Political stakeholders would be fooled/corrupted/exploited to do UA TSO unbundling in a way that would ruin our legal position in the new arbitration
 - Management of the unbundled TSO would be fooled to sign a disadvantageous contract
- Or Ukraine would be blamed (by the EU stakeholders) for no transit
- Both options would open the way for NS2 that many actors wanted

In order to see if my concerns were grounded we need to go to 2014

On the Brink of the Abyss (April 2014)

Breakdown of Naftogaz's debts claimed by Russia in April 2014

Debt for gas offtaken in Q4'2013 and Q1'2014 = \$ 2.3 bn
Prepayment for gas transit = \$ 1.25 bn
Debts related to 'take-or-pay' for 2012-2013 = \$ 19.4 bn
Prepayment for the Black Sea fleet = \$ 10.8 bn

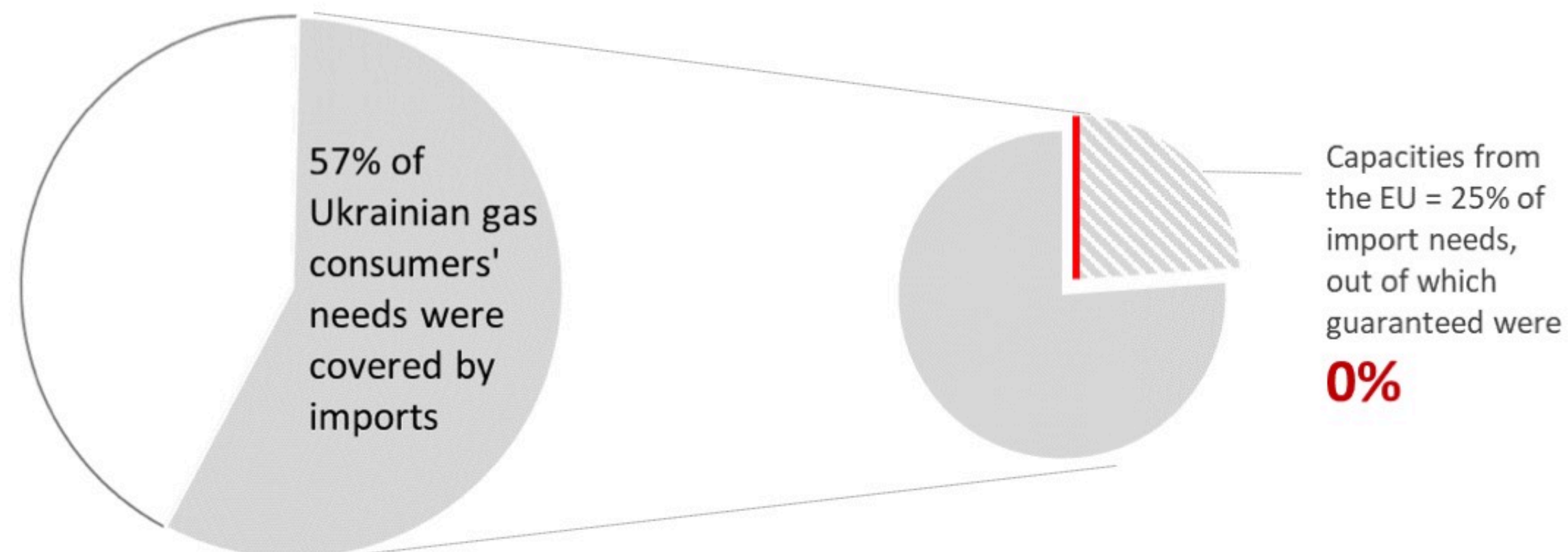
Total = \$ 34 bln

In April 2014 Gazprom has increased the gas price for Ukraine to the level higher than the fair market price:



* - Gazprom's gas price for Naftogaz in March 2014
** - based on "hub minus" price

It was not possible to cover consumers' needs for gas by using available capacities of non-Russian gas imports



Stolen Prosperity of the Nation of 40 Million People

Major negatives of 2009 Gas Contracts

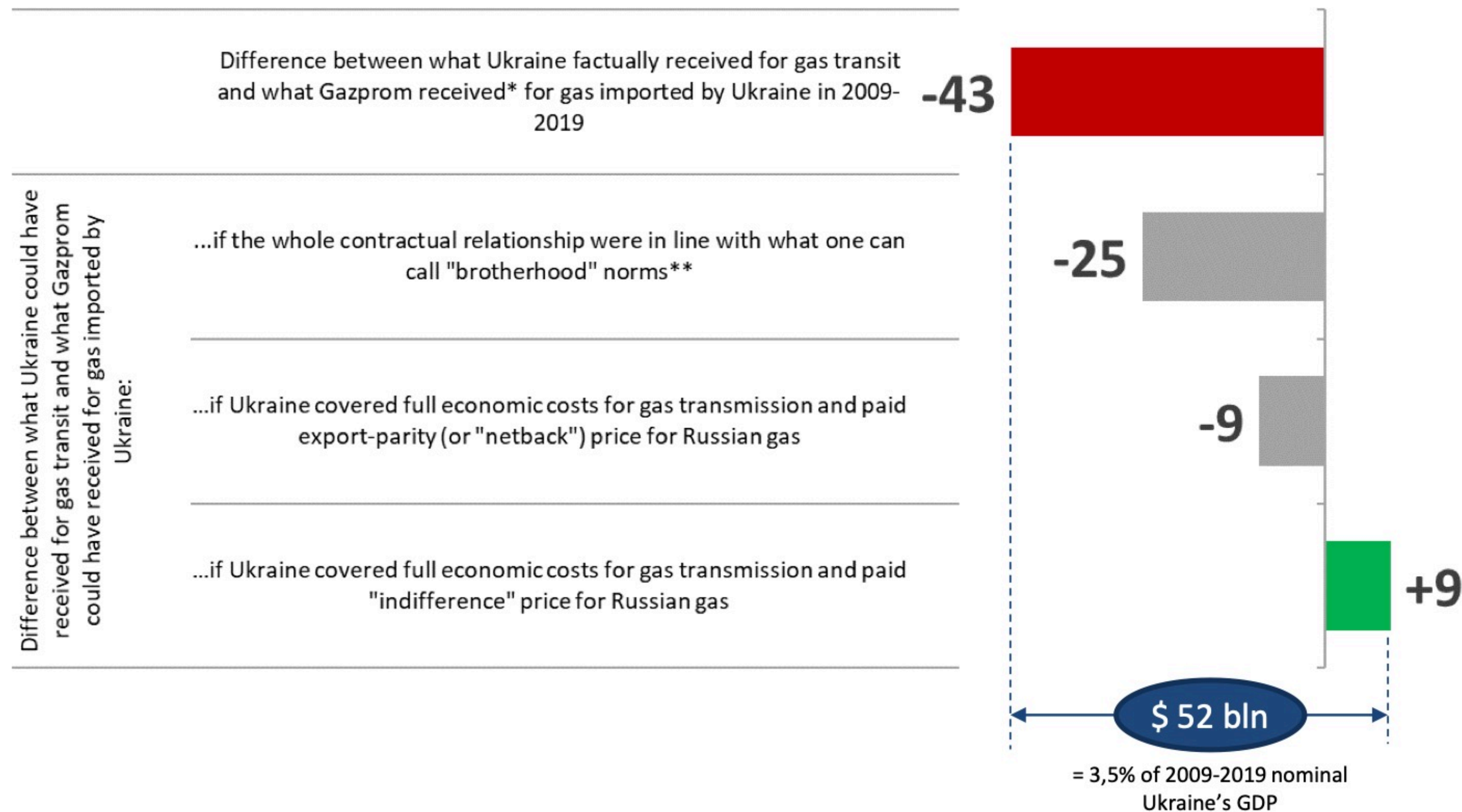
- Price for Russian gas was not based on truly European market terms for long-term contracts prevailing at that time. Agreed gas pricing formula was not based on the 'indifference price', not even on the 'netback price'.
- Unconscionable Take-or-Pay provision.
- The formula for gas transit tariff was agreed at the level of Putin-Tymoshenko. Gazprom referred to a so-called "Slovak Formula" when this formula was negotiated – but maybe Ukrainian delegation was also allowed to be fooled. Bypassing pipeline projects had to be taken into account, but it was not done.

Positive side of 2009 Gas Contracts

- Use of Swedish law and the reference to Stockholm arbitration.
- Such references were proposed by Igor Didenko, not Yulya Tymoshenko.

Stolen Prosperity of the Nation of 40 Million People (cont'd)

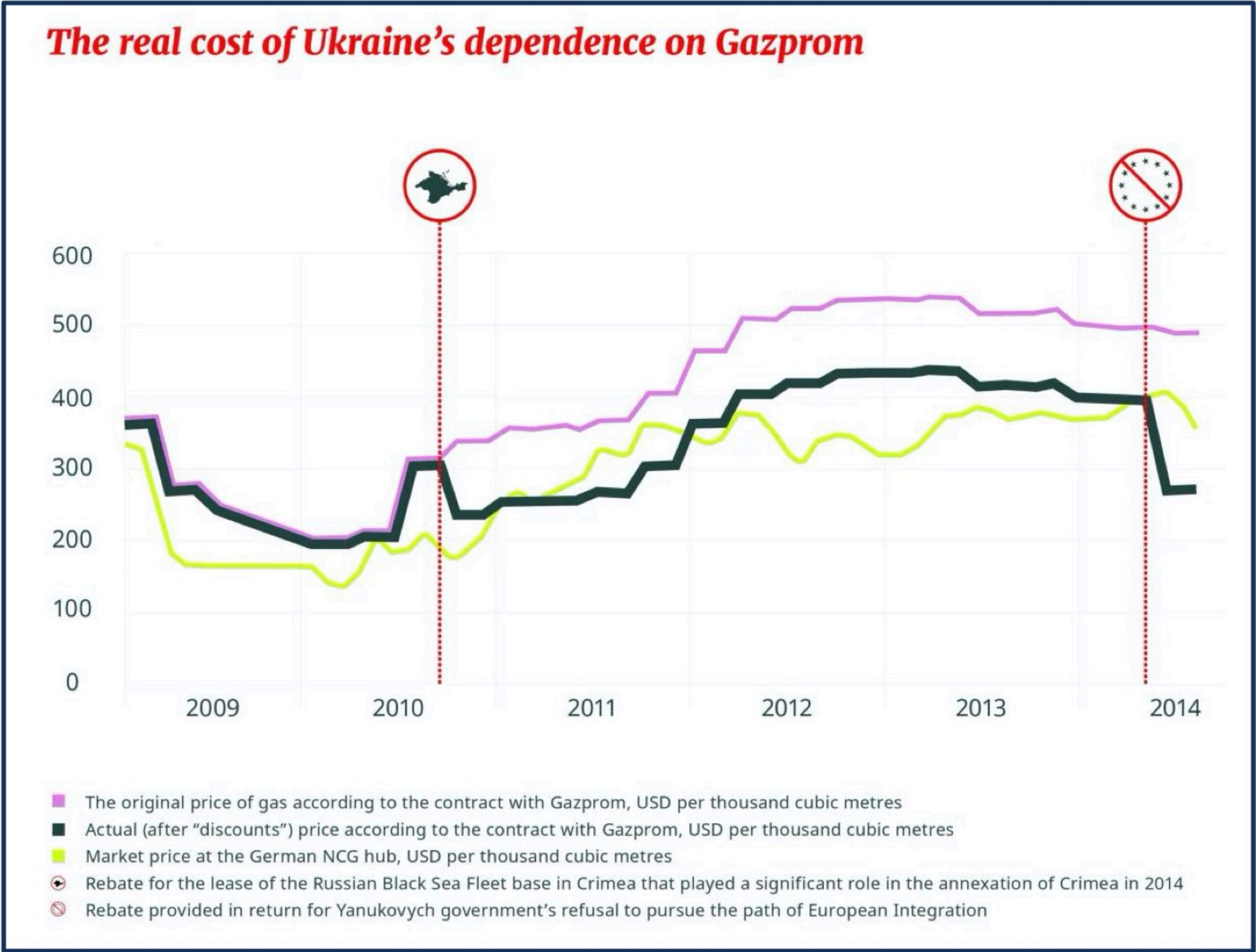
The contracts were not fully in line with European principles even after the 2014 Stockholm Arbitration. It costed Ukrainian people \$ 52 bln:



* - including estimated revenues from gas sold by Gazprom to European off-takers, who resold this gas to Ukraine

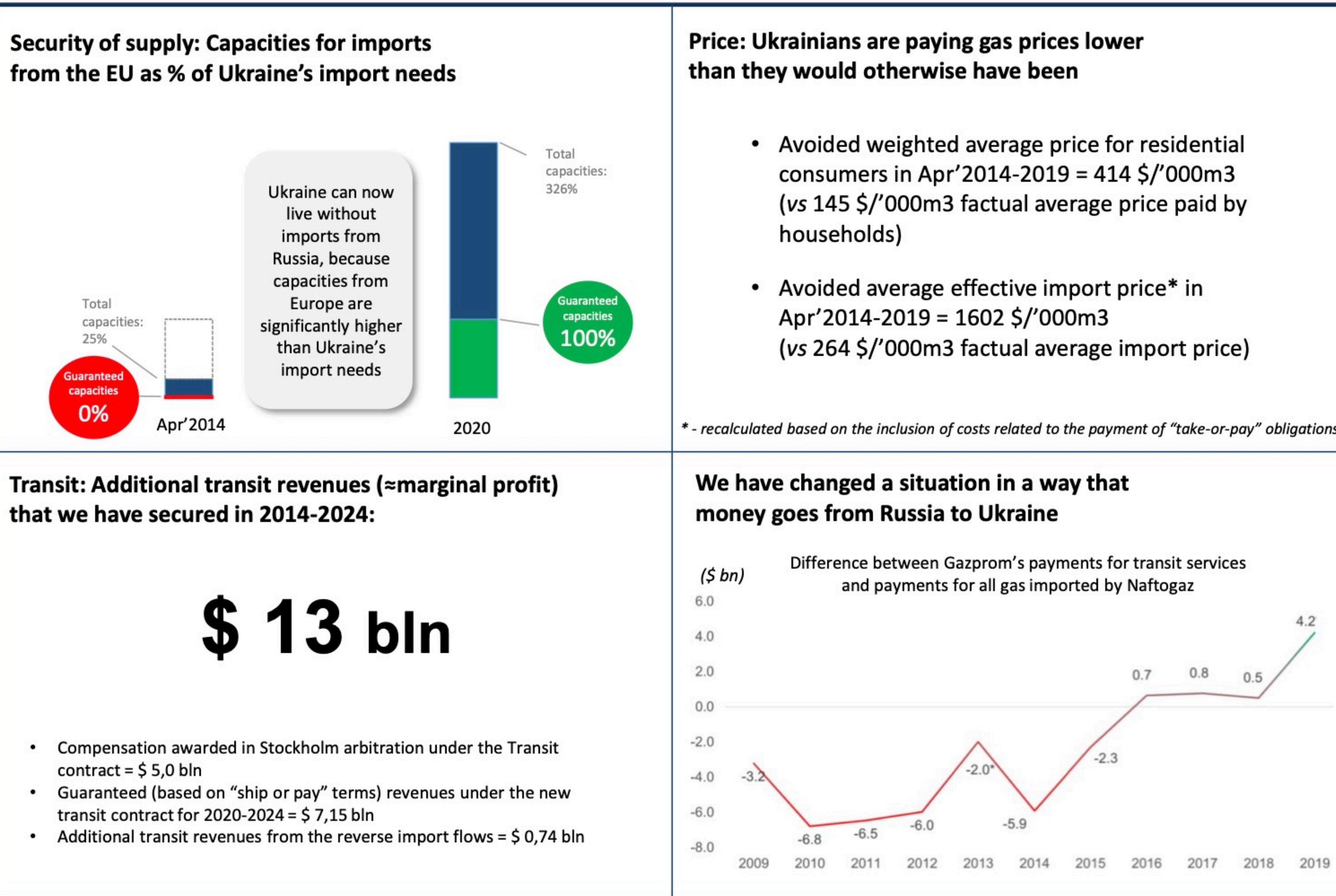
** - if Ukraine paid the price equal to long-run marginal costs of imported gas, Russia paid the tariff equal to long-run marginal costs of gas transit

Stolen Prosperity of the Nation of 40 Million People (cont'd)



**When it is clear what we faced in
2014, let's see how we got out**

Getting out of the Abyss



Getting out of the Abyss: Security of Supply

We got rid of the critical dependence on supplies from Gazprom, and without any concessions to Putin managed to provide security of supply of gas to Ukrainian consumers

“So what?”

- Secured warmth at Ukrainian homes, with no interruption of gas transit to the EU
- Industry can work: secured workplaces and contribution to GDP
 - **Otherwise:** either on our knees before Putin negotiating exchanging independence for gas, or some parts of Ukraine will heroically try to live through winters without heating, while other parts will follow the path of Russia-backed separatists, “people republics” in Eastern Ukraine.
- Dignity of Ukrainians, lower country risk, prestige were secured – since we are not critically dependent on Russian gas.
- Example of winter 2014/15, when Russia spent \$ 6 bln on vain attempts to block supplies from the EU to Ukraine, shows such supplies do improve security of supply for Ukraine even though it is a reverse of “Russian gas” that got into Europe.
- In case of interruption of transit of “Russian gas” through Ukraine to the EU, flows of gas in the EU will be rerouted, and Ukraine will be able to get gas from other sources available in the EU.
- European companies avoided penalties for a shortfall in their take-or-pay obligations by selling gas to Ukraine.

Quantitative Effect

- Capacities for imports from the EU were enough to cover 25% of Ukraine’s import needs in 2014 and 326% in 2020 (including guaranteed capacities, which were enough to cover 0% in 2014 and 100% in 2020).
- Decrease in hidden subsidies leading to a decrease in inefficient consumption and lower costs for the State Budget:
 - Value of direct and hidden subsidies decreased from 24% of State Budget in 2014 to 5% in 2019.
 - Almost 2x decrease in residential gas consumption from 2014 to 2019.
- Increase in gas production by 2.2% p.a. in 2016-2018.
- Imports of gas from Russia decreased from 26 bcm in 2013 to 0 in 2016-2019.

Getting out of the Abyss: Price

We significantly decreased the price consumers would have had to pay (and/or the State Budget expenses if the State covered a part of the price)

“So what?”

- Consumer had to pay less for gas, thus keeping more money to spend on other stuff
- And/or more money in the State Budget to spend on defense, social and health care etc.
- More predictable and lower price for industrial consumers
- More competitive economy – economic growth and, again, even more money in the state budget
- Dignity of Ukrainians (proved that Ukraine was overpaying for Russian gas, contrary to Russia’s narrative that it was subsidizing Ukraine)
- We have even contributed to the price decrease in the EU market
- More money for the investments in gas production/energy independence (due to lower transmission tariffs in 2020-2024 compared with a tariff in zero gas transit scenario)

Quantitative Effect

- Avoided price for households and industrial consumers:
 - Avoided weighted average price for residential consumers in Apr’2014-2019 = 414 \$/’000m³ (vs 145 \$/’000m³ factual average price paid by households)
 - Avoided average import price in Apr’2014-2019 = 1602 \$/’000m³ (vs 264 \$/’000m³ factual average import price)
- Avoided costs for Naftogaz:
 - Avoided payment for off-taken and unpaid gas = \$ 2.07 bn
 - Effect from the price revision = \$ 1.76 bn
 - Savings on the supplies from the EU = \$ 2.90 bn
 - Savings on take-or-pay = \$ 73.2 bn
- Current wholesale price in Ukraine is 2.5x lower than the price under old Gazprom’s formula.
- Lower gas transmission tariff in 2020-2024 because on continued gas transit:
 - tariff for gas consumers is 2.4x lower compared with a tariff in zero gas transit scenario
 - tariff for gas producers is 4x lower compared with a tariff in zero gas transit scenario

Getting out of the Abyss: Gas Transit

We made Gazprom pay more for gas transit and to sign a new 5-year transit contract

“So what?”

- Vital revenues for Ukraine: more money in the State Budget to spend on defense, social and health care etc.
- Contribution to the energy security for the EU.
- Lower chances that Russia will wage a full-scale war against Ukraine.
- Dignity of Ukrainians was defended (we have proved that Gazprom was underpaying for transit).
- Ukraine’s reputation as a reliable and less problematic partner.
- Lower country risk.
- We have created the opportunities to earn additional transit and storage revenues, to have a lower import price.

Quantitative Effect

- Compensation awarded in Stockholm arbitration under the Transit contract (\$ 5,0 bln)
- Guaranteed (based on “ship or pay” terms) revenues under the new transit contract for 2020-2024 (\$ 7,15 bln)
- Additional transit revenues from the reverse import flows (\$ 0,74 bln)
- Transit payments in January 2020 were equal to 33% of Ukraine’s State Budget revenues

Read more on
**[https://www.vitrenkolibrary.com/en/
longread/](https://www.vitrenkolibrary.com/en/longread/)**

Unsuccessful attempt to stop reverse to Ukraine cost Gazprom \$ 5 billion

Gazprom, which limited supplies to the EU, received less than \$ 5.5 billion in revenue and paid up to \$ 400 million in fines, this amount greatly exceeds the debt of Naftogaz

🕒 There is an update from 01:32 [EU Leaders Agreed to Launch Energy Union](#)
→



Success Factors

Key Success Factors

- Removed physical bottlenecks and administrative hurdles to access the EU market
- Rapid business development in imports from the European market by Naftogaz, in particular breakthrough contract with a Norwegian gas producer as alternative to Gazprom
- Commercial arbitration against Gazprom (under the Arbitration Institute of Stockholm Chamber of Commerce):
 - Price revision to the level of market prices on the German hub
 - Adjustment (annulment for periods preceding the arbitral award) of the take-or-pay obligation based on market rules (contractual obligations recognized as unconscionable based on practice in competitive markets)
 - Compensation for “under-deliveries” for transit based on market rules
 - Claims in the new arbitration (USD 12,2 bln) that Naftogaz de-facto exchanged for the new transit contract (especially for the “ship-or-pay” provision)
- Discontinuation of price regulation in the wholesale segment
- Decrease of the difference between the market and regulated price in the retail segment
- At least some shift to market practices in the upstream subsidiary of Naftogaz

Supporting Role

- Trilateral (Ukraine-EU-Russia) negotiations over supplies of gas by Gazprom (“winter package”)
- Negotiations on the political level: Ukraine-Russia, Ukraine-EU-Russia, Germany-Russia
- US Sanctions against Nord Stream 2
- Implementation of the EU market rule of unbundling (separating) gas transmission from other activities. It had a limited effect – allowed us to apply EU rules (other than ship-or-pay).