

Ukraine seeking fair price for gas from Stockholm court

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The numbers keep getting bigger. On June 16, Ukraine and Russia finally decided to sue each other in a Stockholm arbitration court, with Ukraine asking for a just price for gas as well as \$6 billion in compensation for overpayment, while Russia says Ukraine's debt is \$4.5 billion.

The crux of the matter, however, is whether Russian state-owned Gazprom's murky pricing policy regarding Ukraine can be drawn onto the cleaner shores of market relations.

Gas diplomacy between Ukraine and Russia since the collapse of the Soviet Union has been based less on economic principles than on geopolitical ambitions. Namely, the Kremlin has wanted to restrict Ukraine's sovereignty by

making it energy dependent on Russia. To ensure this, gas supply negotiations have been private, personal affairs between the Kremlin and Kyiv. Suspicious intermediaries were used for distribution and accusations of illegal siphoning

and suspension of supply were regularly exchanged.

Prime Minister Arseniy Yatsenyuk wants to get rid of all that. That is why on June 11 he flatly rejected Russian Energy Minister Alexey Novak's \$100 per 1,000 cubic meter rebate, which would have lowered the price to \$285, just a touch above Ukraine's asking price of \$268.

In the end, Ukraine might end up paying more than \$285 for gas.

The Ukrainian side fundamentally distrusts its Russian counterparts, since time and again it has unilaterally altered or suspended the contract between the two nations. For example, the now infamous 2009 gas contract negotiated by then-Prime Minister Yulia Tymoshenko reveals the arbitrary nature of the agreement.

"The price formula for gas was applied only for a few months," explains Alexey Kot, Managing Partner of Antika Law Firm. "For the rest of the time, there were so called 'discounts' determined and applied by political leaders of Russia. Moreover, the political point of such 'discounts,' or their non-market nature, was not a secret."

What was a secret, though, was the formula Gazprom used to determine the price. "We have not seen the contract," says Lavrynovych & Partners managing partner Maksym Lavrynovych. By 2010, the gas price for Ukraine had gone up to \$400 per 1,000 cubic meters instead of going down from \$360, which was promised. This is what the Ukrainian side is claiming as "overpayment".

The government of former President Victor Yanukovich continued

the tradition of secret negotiations. After condemning the 2009 contract as unfavorable, Ukraine let Russia anchor its Black Sea Fleet at Sevastopol for an extra 25 years in exchange for a \$100 gas price discount. Yet again prices continued to rise until Dec. 17, 2013, when Yanukovich got Russian President Vladimir Putin to set the gas price at \$268 in exchange for what amounted to fealty to Russia. Around the same time, Yanukovich unexpectedly rejected a far-ranging political pact and free-trade agreement with the European Union.

Getting serious

Since the EuroMaidan Revolution, Russia has treated gas negotiations with Ukraine as a joke by trying to dictate terms to its own geopolitical advantage.

So the new Ukrainian government got serious.

On May 28, it retained a prestigious

Norwegian law firm that specializes in energy-related disputes to provide representation against Gazprom in the Arbitration Institute of the Stockholm Chamber of Commerce.

The dispute is technically between Naftogaz and Gazprom, both state-owned yet independent legal entities, although it is actually between the Ukrainian and Russian states.

The parties are contractually obligated to turn to the Stockholm court to resolve disputes.

Naftogaz made it clear on June 1 why it was going to court: "Russia again proposed returning to a mechanism for forming the price unilaterally via the Russian government's regulation of the export duty on natural gas supplied by Gazprom to Ukraine."

Even European Commission energy officer Gunther Oettinger, who is mediating negotiations between Ukraine and Russia, said on June 11 that Russia is offering a price that is closer to a fair market one.

More proof that getting the lowest price possible is not the main aim can be found in the June 13 statement by Naftogaz head Andriy Kobolyev, when he said Ukraine was prepared to pay \$326 per 1,000 cubic meters for Russian gas. "This price proposed by the EU is not market level,"

he said, "but Ukraine is ready to compromise and fix it for a year and a half, so that during this period we can reach a final agreement with Gazprom and resolve the matter in court."

Should Stockholm rule in favor of Ukraine, it would clear the ground for a new gas relationship.

Ukraine may have strong case

Arbitrators in Stockholm will take into account the economic part of the legal relationships, including the situation on the gas market, explains Kot of Antika Law Firm. "Due to this, Ukraine may, for instance, state that Gazprom has a monopolistic position on the market and try to prove the fact that it may use such a position howsoever."

The Europeans do not look favorably on monopoly. In 2013 and again this year Lithuania filed with the same Stockholm court a lawsuit against Gazprom for overcharging the country since 2004, oilprice.com reports. The Baltic state was paying an astounding \$470-480 per 1,000 cubic meters for Russian gas until it won its first arbitration suit this year for a 20 percent price reduction.

Poland's state gas firm PGNiG went that route back in 2010, and settled out of court for not only lower gas prices, but also for Gazprom to link its pricing formula to market prices, worldoil.com reported. Ukraine wants the same thing.

Lavrynovych told the Kyiv Post: "Russia has previously recognized the jurisdiction of this court, so we are hopeful."

Roman Marchenko of Ilyashev & Partners agrees that Naftogaz may prevail. "Such claims to the Russian monopolist are repeatedly considered by arbitration," he says. "Typically, Gazprom does not like going to court, preferring to settle instead in order to avoid the possibility of an adverse ruling."

No one can be certain, however, how the judges will decide, which may prompt an out-of-court settlement, Lavrynovych said.

Energy Research Institute's Yuriy Korolchuk argues that it is always better to go to court over gas pricing after all debts are settled. However, this remains a complicated issue since the size of Ukraine's gas debt depends directly on the pricing.

Gazprom claims Ukraine owes it \$1.45 billion for gas supplied in November and December and \$3 billion for April and May.

On May 30, Naftogaz paid off its first quarter gas debt of \$786 million.

Ukraine is also suing Russia for stealing 2.2 billion cubic meters of gas stored in Crimea when its armed forces occupied the peninsula.

Separately, on June 3, the Ukrainian government filed a lawsuit in the European Court of Human Rights against Russia for \$90 billion in compensation for Russia's illegal annexation of Crimea on March 18. ■

Ukrainian Minister of Energy and Coal Industry Yuriy Prodan (L) and head of Russia's state gas firm Gazprom Alexei Miller (R) arrive for talks over Russia's gas supply to Ukraine in Kyiv on June 14. (Ukrainian News)

