

# Legal Battles between Russia and Ukraine

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# Ukrainian-Russian Crisis: Milestones

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- **Winter 2013-2014** - anti-government demonstrations in Kyiv (800 000 people)
- **Feb'14** - pro-Russian gunmen seize key buildings Crimea
- **March'14** - referendum in Crimea (97% vote for joining Russia)
- **May'14** - pro-Russian separatists in Donetsk and Luhansk declare independence
- **July'14** - Malaysia Airlines flight MH17 from Amsterdam is shot down in Donetsk region
- **Sep'14** – Minsk Protocol (Ukraine, Russia, Donetsk and Luhansk People's Republics)
- **Feb'15** – Minsk II (summit of Ukraine, Russia, France, and Germany)  
**A ceasefire is in place, but levels of violence increase dramatically (9,200 people have died since April'14).**

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# New Phase of Ukrainian-Russian Standoff: Legal

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## Legal Battles Between Russia and Ukraine

Cases pending	Damages sought from Russia (\$B)	Damages sought from Ukraine (\$B)
Russia vs Ukraine	–	3.08
Ukraine vs Russia	37.00	–
Naftogaz vs Gazprom	26.00	–
Gazprom vs Naftogaz	–	32.00
Oschadbank vs Russia	0.57	–
Total	63.57	35.08

Source: Bloomberg reporting

Bloomberg 

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# Russia vs Ukraine

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- Russia seeks repayment of USD 3 bil Eurobond (sold to Yanukovych in Dec'13) + USD 75 mil in interest and legal fees
- In 2015 Russia refused to take part in restructuring negotiated by Ukraine with its other Eurobond holders
- Dec'2015 - Ukraine declared a moratorium on paying this debt
- Gottlieb Steen & Hamilton LLP, represents Russia in the London High Court
- The case could take 18-24 mon.



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# Ukraine vs Russia

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- **ECHR:** 3 applications lodged by Ukraine against Russia
  - **No 20958/14** (annexation of Crimea and subsequent developments in Eastern Ukraine – Mar'-Sep'14)
  - **No 43800/14** (alleged abduction of three groups of children in Eastern Ukraine and their temporary transfer to Russia)
  - **No 42410/15** (events in Crimea and Eastern Ukraine as from Sep'15)
- In addition – 3 thous. individual applications re events in Crimea and Eastern Ukraine + individual application *Savchenko v. Russia*
- **ICJ:** according to the Government's announcements Ukraine will file its suit against Russia in 2016 (USD 37 billion in damages)
  - The main issue - legality of the Crimean annexation
  - ICJ are generally very slow moving and can take years to complete!

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## Other Ukrainian companies v. Russia

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- *Oschadbank v. Russia*
  - over assets lost in Crimea (arbitration in Stockholm)
  - Damages - USD 0.6 bil
- Arbitration cases against Russia in the Hague - over losses related to Crimea, under 1998 Russia-Ukraine BIT:
  - Ukrnafta PJSC, Privat Bank and Aeroport Belbek LLC and personal lawsuit filed by Ihor Kolomoyskyi – proceedings commenced in Jan'2015
  - DneprAzot, Ukrinterinvest, Lugzor, Lisbet and Aberon Ltd. (PrivatGroup) – pending.
- The issues a tribunal will have to examine include:
  - whether the dispute in question relates **to covered investments**;
  - whether the investments relate **to Russia's territory**; and
  - whether the dispute concerns a breach of **an obligation under the BIT**.

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# Gas War in Stockholm between Naftogaz and Gazprom

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# History of Naftogaz-Gazprom Relations

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- Naftogaz-Gazprom contracts signed on 19 January 2009 for 2009-2019:
  - Contract on Sale and Purchase, of the Natural Gas (“**Supply Contract**”)
  - Contract on Volumes, Terms and Conditions for Transit of the Natural Gas (“**Transit Contract**”)
- 2009-2013 – stable gas supplies (USD 260-413.5 per 1000 cm)
- April’14 - Russia cancelled the discount => USD **485.5** per 1000 cm
- June’14 - Gazprom switched Naftogaz to prepayment, called for repayment of USD 4.458 billion in outstanding debts and halted gas supplies to Ukraine
- October’14 – execution of the Binding Protocol (gas supplies until 31 March’15)
- September’15 – execution of the 2<sup>nd</sup> Binding Protocol (gas supplies until 31 March’16)

**IS THE NEXT PROTOCOL ON AGENDA IN 2016?**



## Gas Prices in 2009-2014

Year	Average price of the gas, USD per 1000 cm	Comments
2009	260	20% discount is applicable
2010	260	During Q1 2010 the price was applicable without any discounts and amounted to USD305. 100 USD discount became applicable starting from Q2 2010 by virtue of the so-called “Kharkiv Accords” executed between Ukraine and the Russian Federation
2011	330	
2012	424	
2013	413.5	
Q1 2014	311	
April-May 2014	485.5	The price without any discounts.

**Source: mass media, statistical data published by the Ministry of Economy of Ukraine**

# Dynamics of Gas Prices (2005-2016)



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# Arbitration Case

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- July'14 - cases *Naftogaz v. Gazprom* and *Gazprom v Naftogaz* were consolidated => **Case V2014/129 (supply contract)**
  - Jan' - May'15 – Naftogaz filed statements
  - April'16 – commencement of the hearings
  - June'16 - verdict
- **Transit contract case:**
  - Oct'15 – Naftogaz's request for arbitration was submitted
  - Sep' - Oct'16 – hearings
  - Jan'17 - verdict



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# Dispute over the Supply Contract

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# Overview of the Supply Contract

	Basic Provisions
<b>Governing Law</b>	Swedish
<b>Subject Matter</b>	Sale & purchase of gas of the Russian, Kazakh, Uzbek, Turkmenian origin (starting from 2010 the contractual volume amounts to <b>52 bcm per year</b> )
<b>Gas Price</b>	The basic price (USD 450) is correlated to gasoil and sulphur oil (mazut) prices (as published in <i>Platt's Oilgram Price Report</i> ) on a quarterly basis
<b>Payment</b>	Following the month of supply on the basis of the preliminary invoice (in case of any violations – the parties switch to the 100% prepayment mechanism)
<b>Price review Clause</b>	allows the request of revision of the contractual price if the contractual price no longer reflects “ <i>market prices</i> ” for gas as a result of a change of situation on the energy market
<b>Take-or-pay Clause</b>	Naftogaz is required to pay for 80% of the contractual volume (i.e. 41.6 bcm of gas) whether or not it actually needs it

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# Parties' Claims and Damages Sought

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## Naftogaz

- Cancel take-or-pay clause
- Revise pricing formula (i.e. de-link it with gasoil and mazut) based on the price re-opener clause
- Cancel prohibition of re-export
- Compensation of USD 6 bil of overpayment since 2010

## Gazprom

- Payment of USD 29.2 bil, including:
  - USD 2.6 bil for gas deliveries in 2013 and 2015,
  - USD 0.2 bil for gas deliveries to southeast Ukraine, and
  - USD 26.4 for “take-or-pay” fines (2012-2014)

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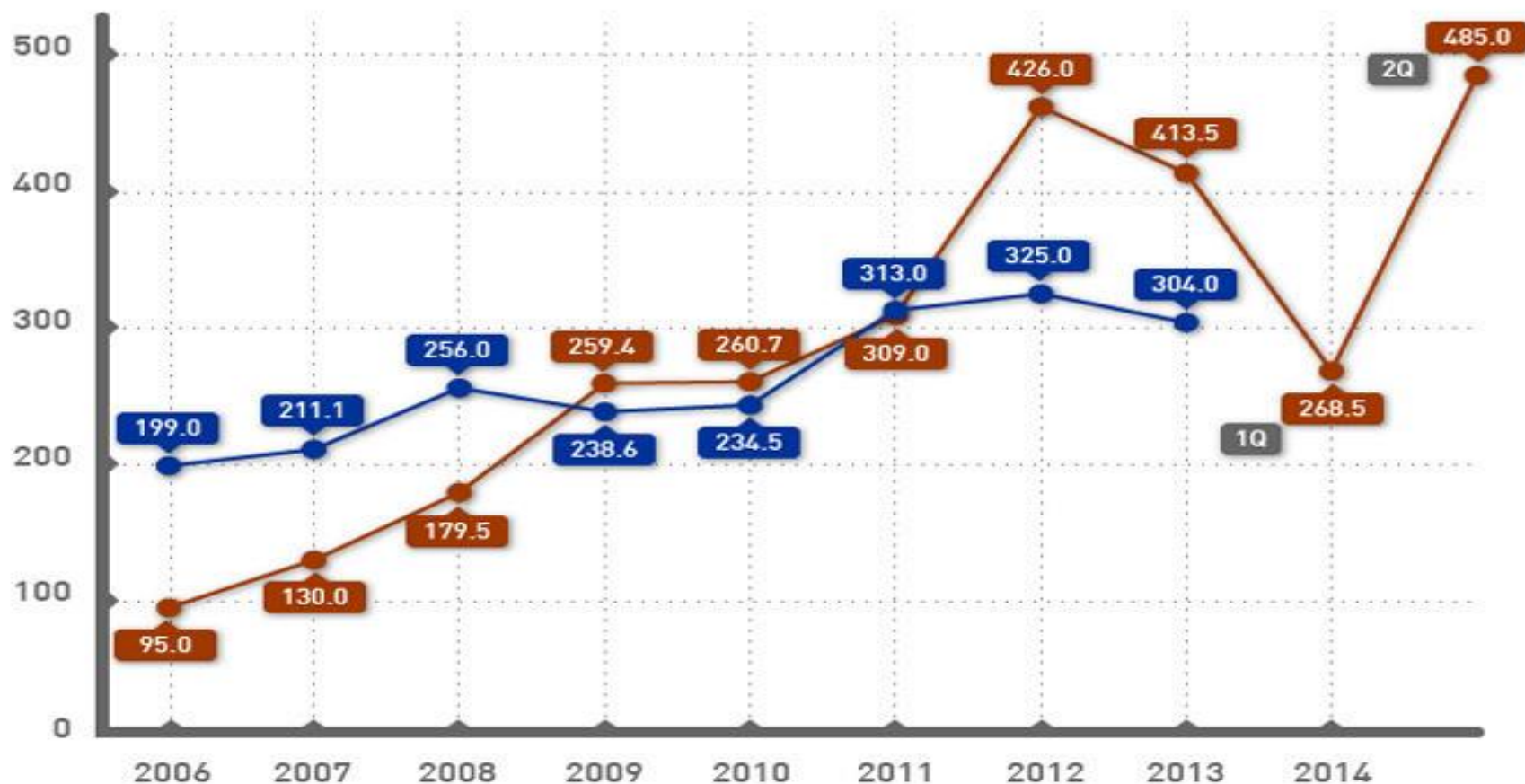
## The Parties' Positions: Price

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- Previously - oil-indexed formulas were common (crude oil had more reliable market indicators), now - a big gap between the spot price and the oil-indexed price => abolishment of oil-indexed formulas:
  - i2011-2012 - negotiations with EU gas suppliers (GDF Suez, Edison, etc.)
  - 2012 - *E.ON v Gazprom* (amicable settlement)
  - 2013 – *RWE Transgaz v Gazprom* (price was “untied” from oil prices and reduced in accordance with spot market gas prices)
- Price review mechanism (according to the contract):
  - price review at any time during the contract’s term based on the “market price”;
  - Crucial point – what is the “**market price**”? EU gas market data?
  - The tribunal will have to determine!
  - If yes - gas price for Naftogaz was significantly higher than any prices established by Gazprom for EU (see next slide)

# Gazprom export prices for Europe and Ukraine

USD per 1,000 cubic meters



Europe



Ukraine



Source: Gazprom, RIA Novosti



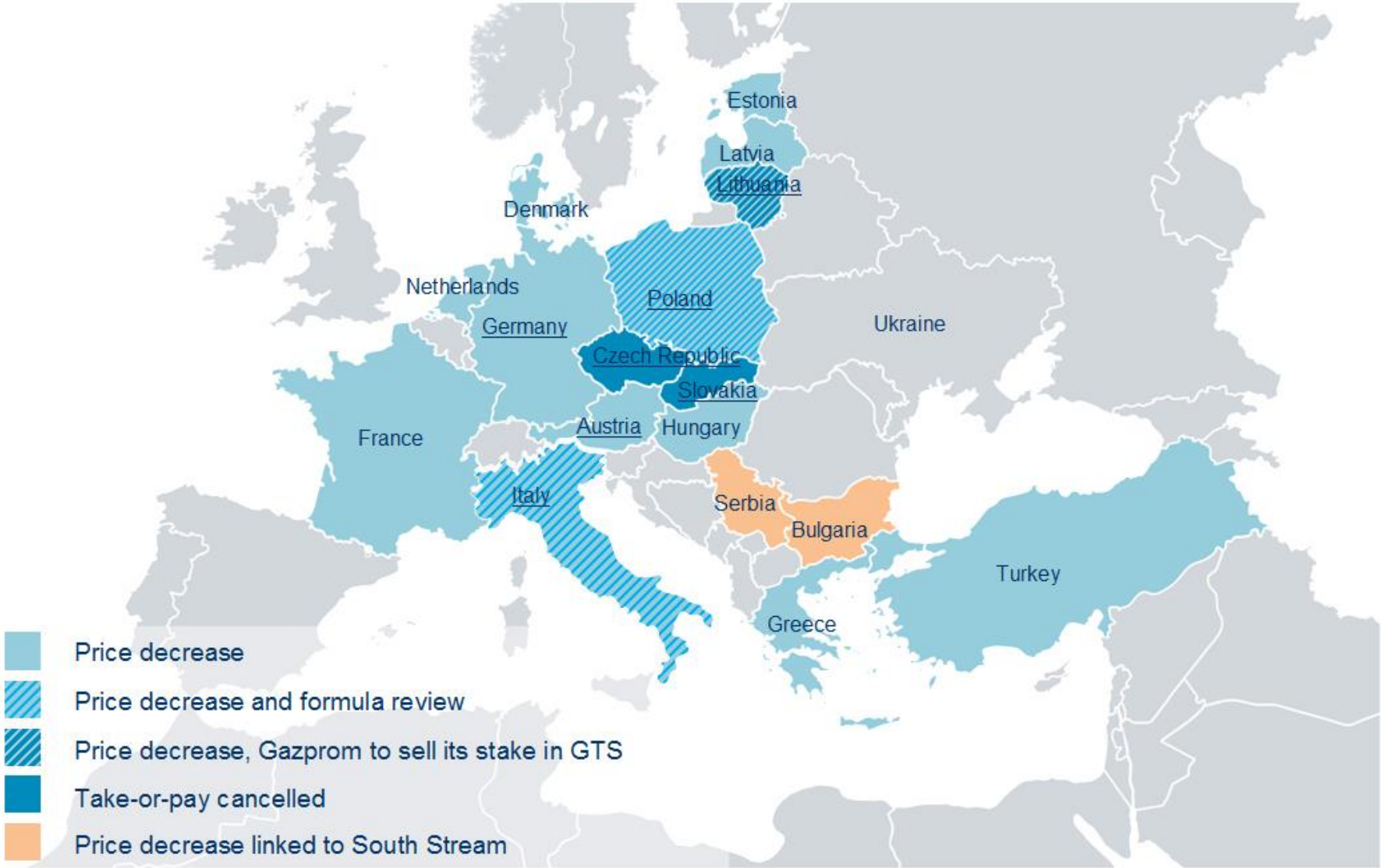
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## The Parties' Positions: Take-or-Pay Clause

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- Abolishment of TOP clauses - trend set by the EU gas importers:
  - Gazprom lost lawsuits launched in 2010 aimed at collecting USD 524 million owed by RWE Transgas for TOP commitments;
  - Transgas may reduce its TOP obligations;
  - no ban on export of gas imported from Gazprom.
- Gazprom has never even tried to enforce TOP penalties against Naftogaz before (reason – Ukrainian-Russian crisis)
- **EU Commission** (*2007 Distrigas decision*): impact of the long-term gas supply contracts must be appreciated, in order to determine whether they **restrict competition to an unacceptable extent.**

# Gazprom contract review, 2010-2014



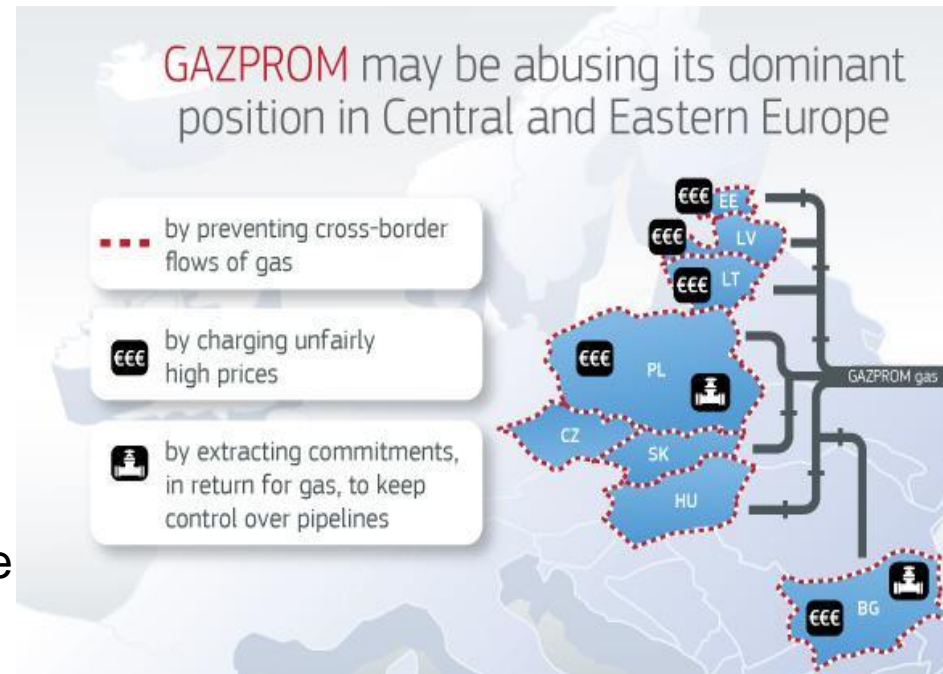
Note: underlined are countries where companies have filed lawsuits against Gazprom  
Source: Mass media, public reports

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# Consequences & Implications

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- Naftogaz seems to have **good chances** in arbitration
  - rebate for the excessive payments.
  - adjustment of the oil-indexed price
  - reduced TOP obligations
- Gazprom
  - review of contracts (France, Finland, Poland)
  - annual TOP levels reduced from the traditional 85 to 70%
- EU Commission:
  - 2015 - Gazprom in CEE abuses its dominant market position
  - 2016 – gas supply abuse in Bulgaria



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# Dispute over the Transit Contract

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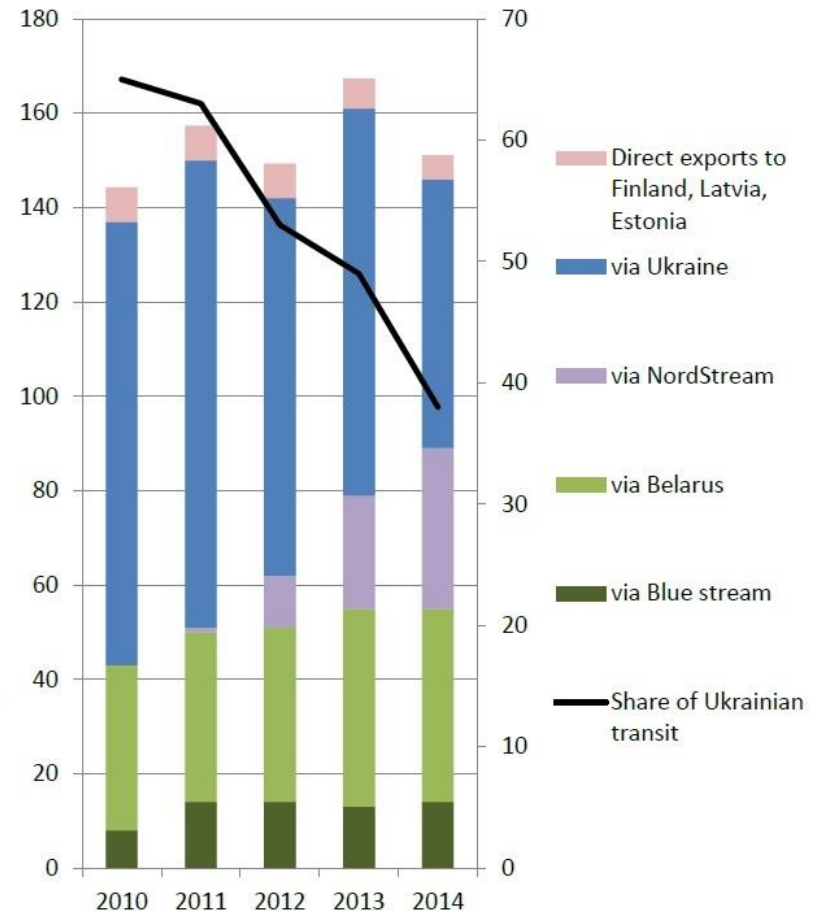
## Overview of the Transit Contract

	Basic Provisions
<b>Governing Law</b>	Swedish
<b>Subject Matter</b>	Transit of gas (no less than <b>110 bcm per year</b> ) from Russia, Belorussia, Moldova within the territory of Ukraine to EU and Moldova
<b>Service Provider</b>	Naftogaz (Ukrtransgaz is not a party to the contract, only technical implementation)
<b>Price of the Services</b>	The basic tariff (USD 2.04 per 1000 cm per 100 km) correlated to inflation published by Eurostat and % of the gas price under the Supply Contract
<b>Payment</b>	Following the month of transit (no options for switching to prepayment mechanism)
<b>Price review Clause</b>	allows the request of revision of the contractual price as a result of a material change in the mechanism for transit tariff calculation of at the EU market
<b>Ship-or-pay Clause</b>	No

# Naftogaz's Claims

- rights and obligations of Naftogaz must be transferred to “Ukrtransgaz” (TSO under the new Gas Market Law);
- revise transit tariff in accordance with the basic principles of EU law
- compensation for shortfall of the transit volumes (average 94 bcm vs 110bcm) since 2009
- compensation for non-supplied transit volumes of gas (USD 10 bil)

*Russian gas exports to Europe & share of Ukrainian transit*



Source: International Energy Agency, 2015

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# The Parties' Positions: Revision of Tariffs & Provisions

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## **Naftogaz's arguments may be:**

- Assignment of rights is allowed subject to the parties' consent
  - Precedents in EU: in 2013, RWE Supply & Trading CZ a.s. transferred its contract to Net4gaz in accordance with agreements reached by the parties.
- implementation of the Third Energy Package => need to redraft provisions in line with the antitrust provisions of EU and Ukrainian law;
  - In a report in 2014 ECS concluded that the transit contract may be considered incompliant with European competition and energy law.
- Under the contract parties must agree on replacement of the invalid provision by a new one with "as close as possible" economic result;
- Transit tariffs have been changed by the Ukrainian Government (entry-exit system) and must be reflected in the contract in line with Swedish law.

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# The Parties' Positions: Compensation to Naftogaz

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- **What arguments Naftogaz may have?**
  - 110 bcm per year mentioned in the clause re subject matter as the minimal volume
  - the capacity of the Ukrainian transportation system is fully contracted by Gazprom
- **Gazprom's strongest arguments may be:**
  - No ship-or-pay clause
  - No penalties for Gazprom for lesser volumes
  - No direct obligation of Gazprom to supply 110 bcm per year



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# Consequences & Implications

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- **Naftogaz:**
  - has good chances to win the dispute over amendments to the contract;
  - the tribunal also may agree with a need to revise tariffs;
  - Naftogaz's chances to win the compensation may be estimated as the low ones
- **Gazprom:**
  - If tariffs are changed, shall be required to pay up to 50% more
  - Transit diversification!
- **EU:**
  - on which terms a new post-2019 transit contract will be agreed?

Zones	Countries	Rate, USD per 1000 cm
Entry	from Russia, Poland, Belarus, Slovakia, Hungary	12.47
Exit	to Poland, Slovakia, Hungary, Romania, Moldova	16.74 – 32.8

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