Legal Battles between Russia and Ukraine

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Ukrainian-Russian Crisis: Milestones

- **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 Luhansksk 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).
New Phase of Ukrainian-Russian Standoff: Legal

<table>
<thead>
<tr>
<th>Cases pending</th>
<th>Damages sought from Russia ($B)</th>
<th>Damages sought from Ukraine ($B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia vs Ukraine</td>
<td>–</td>
<td>3.08</td>
</tr>
<tr>
<td>Ukraine vs Russia</td>
<td>37.00</td>
<td>–</td>
</tr>
<tr>
<td>Naftogaz vs Gazprom</td>
<td>26.00</td>
<td>–</td>
</tr>
<tr>
<td>Gazprom vs Naftogaz</td>
<td>–</td>
<td>32.00</td>
</tr>
<tr>
<td>Oschadbank vs Russia</td>
<td>0.57</td>
<td>–</td>
</tr>
<tr>
<td>Total</td>
<td>63.57</td>
<td>35.08</td>
</tr>
</tbody>
</table>

Source: Bloomberg reporting

Bloomberg
Russia vs Ukraine

- 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.
Ukraine vs Russia

- **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 thou. 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!
Other Ukrainian companies v. Russia

- **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.
Gas War in Stockholm between Naftogaz and Gazprom
History of Naftogaz-Gazprom Relations

- 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\textsuperscript{nd} Binding Protocol (gas supplies until 31 March’16)

\textbf{IS THE NEXT PROTOCOL ON AGENDA IN 2016?}
## Gas Prices in 2009-2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Average price of the gas, USD per 1000 cm</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>260</td>
<td>20% discount is applicable</td>
</tr>
<tr>
<td>2010</td>
<td>260</td>
<td>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</td>
</tr>
<tr>
<td>2011</td>
<td>330</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>424</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>413.5</td>
<td></td>
</tr>
<tr>
<td>Q1 2014</td>
<td>311</td>
<td>Starting from February the gas price was equal to USD268.5 due to the discount provided by the Russian Federation</td>
</tr>
<tr>
<td>April-May 2014</td>
<td>485.5</td>
<td>The price without any discounts.</td>
</tr>
</tbody>
</table>

*Source: mass media, statistical data published by the Ministry of Economy of Ukraine*
Dynamics of Gas Prices (2005-2016)
Arbitration Case

- 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
Dispute over the Supply Contract
## Overview of the Supply Contract

<table>
<thead>
<tr>
<th>Basic Provisions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governing Law</strong></td>
<td>Swedish</td>
</tr>
<tr>
<td><strong>Subject Matter</strong></td>
<td>Sale &amp; purchase of gas of the Russian, Kazakh, Uzbek, Turkmenian origin (starting from 2010 the contractual volume amounts to <strong>52 bcm per year</strong>*)</td>
</tr>
<tr>
<td><strong>Gas Price</strong></td>
<td>The basic price (USD 450) is correlated to gasoil and sulphur oil (mazut) prices (as published in <em>Platt’s Oilgram Price Report</em>) on a quarterly basis</td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>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)</td>
</tr>
<tr>
<td><strong>Price review Clause</strong></td>
<td>allows the request of revision of the contractual price if the contractual price no longer reflects “market prices” for gas as a result of a change of situation on the energy market</td>
</tr>
<tr>
<td><strong>Take-or-pay Clause</strong></td>
<td>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</td>
</tr>
</tbody>
</table>
## Parties’ Claims and Damages Sought

<table>
<thead>
<tr>
<th>Naftogaz</th>
<th>Gazprom</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cancel take-or-pay clause</td>
<td>• Payment of USD 29.2 bil, including:</td>
</tr>
<tr>
<td>• Revise pricing formula (i.e. de-link it with gasoil and mazut) based on the price re-opener clause</td>
<td>• USD 2.6 bil for gas deliveries in 2013 and 2015,</td>
</tr>
<tr>
<td>• Cancel prohibition of re-export</td>
<td>• USD 0.2 bil for gas deliveries to southeast Ukraine, and</td>
</tr>
<tr>
<td>• Compensation of USD 6 bil of overpayment since 2010</td>
<td>• USD 26.4 for “take-or-pay” fines (2012-2014)</td>
</tr>
</tbody>
</table>
The Parties’ Positions: Price

- 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:
  - 2011-2012 - 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)
The Parties’ Positions: Take-or-Pay Clause

- 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
Consequences & Implications

- 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
Dispute over the Transit Contract
## Overview of the Transit Contract

<table>
<thead>
<tr>
<th><strong>Basic Provisions</strong></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Governing Law</strong></td>
<td>Swedish</td>
</tr>
<tr>
<td><strong>Subject Matter</strong></td>
<td>Transit of gas <em>(no less than 110 bcm per year)</em> from Russia, Belorussia, Moldova within the territory of Ukraine to EU and Moldova</td>
</tr>
<tr>
<td><strong>Service Provider</strong></td>
<td>Naftogaz <em>(Ukrtransgaz is not a party to the contract, only technical implementation)</em></td>
</tr>
<tr>
<td><strong>Price of the Services</strong></td>
<td>The basic tariff <em>(USD 2.04 per 1000 cm per 100 km)</em> correlated to inflation published by Eurostat and % of the gas price under the Supply Contract</td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>Following the month of transit <em>(no options for switching to prepayment mechanism)</em></td>
</tr>
<tr>
<td><strong>Price review Clause</strong></td>
<td>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</td>
</tr>
<tr>
<td><strong>Ship-or-pay Clause</strong></td>
<td>No</td>
</tr>
</tbody>
</table>
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 110 bcm) since 2009
- compensation for non-supplied transit volumes of gas (USD 10 bil)
The Parties’ Positions: Revision of Tariffs & Provisions

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 incompatible 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.
The Parties’ Positions: Compensation to Naftogaz

- **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
Consequences & Implications

- **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?

<table>
<thead>
<tr>
<th>Zones</th>
<th>Countries</th>
<th>Rate, USD per 1000 cm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry</td>
<td>from Russia, Poland, Belarus, Slovakia, Hungary</td>
<td>12.47</td>
</tr>
<tr>
<td>Exit</td>
<td>to Poland, Slovakia, Hungary, Romania, Moldova</td>
<td>16.74 – 32.8</td>
</tr>
</tbody>
</table>
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