

## NAFTOGAZ V GAZPROM: THE ROLE OF COMMERCIAL ARBITRATION IN THE MODERN WORLD

Dmitriy Kamensky, PhD, head of legal courses department, Berdyansk State  
Pedagogical University

Julia E. Sullivan, attorney at law and fellow in the Chartered Institute of Arbitrators,  
Annapolis, Maryland, USA

In February 2018, an arbitral tribunal in Stockholm, Sweden issued its final award in an epic, four-year legal battle between Ukraine's Naftogaz and Russia's Gazprom. The Russian energy giant had asserted \$81.4 billion in total claims against Ukraine's state-owned energy company, amounting to about 75% of the developing nation's gross domestic product. In a stunning legal victory for Ukraine, the tribunal instead ordered Gazprom to pay Naftogaz \$2.56 billion.

The arbitration handed Ukraine a significant win, but it didn't end this David and Goliath fight. Within 24 hours of issuance of the final award, Gazprom cut off essential gas deliveries to Ukraine for the seventh time [1]. This retaliatory action was consistent with Russia's long history of using its vast energy resources to carry out a sanctions and incentives regime against Ukraine, granting steep price discounts and generous credit terms to administrations it considers cooperative and punishing administrations that pursue more nationalistic policies. Since 2014, Russia's energy sanctions have been combined with military operations to directly threaten the political independence and territorial integrity of Ukraine.

With its most recent supply cut-off, Gazprom seems to have abandoned all pretense that its contract administration decisions will be based on reasonable commercial considerations or the rule of law. Given that the European Union (EU) relies upon Russia for close to 40% of the gas it consumes [2], the broader implications are sobering. Like Ukraine, the EU and its member states should take bold steps to develop competitive supply options to mitigate Russia's growing economic and political leverage.

During the soviet era, Russia supplied Ukraine with abundant quantities of natural gas at highly subsidized prices. The ready availability of abundant energy at low prices enticed Ukraine to build its economy around energy-intensive products such as petrochemicals and heavy industry [3]. Consumers became accustomed to inexpensive Russian energy and lagged behind other economies in energy efficiency and conservation. By 2015, Ukraine's energy intensity was comparable to that of Russia and twice that of the United States. Comparisons with Germany and Japan are perhaps more relevant, because those countries, like Ukraine, rely heavily upon energy imports. Ukraine is three times more energy intense than Germany or Japan.

Historically, Ukraine imported about three-quarters of its natural gas from Russia. For years, Russia kept gas prices artificially low, charging Ukraine only about \$50 per thousand cubic meters (kcm) until 2004, far less than the \$235/kcm it then charged its customers in Western Europe. It allowed Ukraine to buy even cheaper natural gas from Turkmenistan through the Russian pipeline system, something it was



not obligated to do. It also allowed Ukraine to take a large amount of gas as payment for allowing Russia to ship gas through Ukraine to Western Europe. Russia also offered generous credit terms, and complained only weakly as Ukraine's debt piled up.

The political nature of these subsidies became all too clear when Ukraine broke an un-stated condition of the arrangement: total alignment with Moscow [4]. In 2004, following a tumultuous series of events that would become known as the "Orange Revolution," Viktor Yushchenko became President of Ukraine. The new leader, after surviving an assassination attempt during the election, moved Ukraine into "sharp political conflict" with the Kremlin. Yushchenko's most provocative moves included efforts to gain admission into NATO and the EU [5].

Vladimir Putin made it perfectly clear that if Ukraine continued to seek a closer alliance with the West, Russia would no longer supply energy on favorable terms. When Ukraine's long-term contract for Russian gas expired at the end of 2005, Russia cut off all gas shipments to the country. Commentators on Russian state-owned television openly acknowledged that the gas cut-off was retribution for the Orange Revolution. Previously, Russia had never dared to cut off gas shipments because fully 80% of Russian gas flowing to Western Europe passed through Ukraine. Going forward, Russia would accept the reputational risk.

In order to get the gas flowing again, Ukraine agreed to double the price it had been paying for gas. This imposed a massive economic drain on the Yushchenko regime. With rising economic discontent, President Yushchenko's party did worse than expected in the March 2006 parliamentary elections, stalling the progress of the Orange Revolution. Moreover, due to the continued dependency on Russia for critical energy supplies, "Yushchenko and the Ukraine were thus effectively held hostage, never knowing when the next economic blow would fall."

The price of gas continued to rise throughout Yushchenko's term. Ukraine paid Russia \$3.2 billion for natural gas in 2005, \$5.1 billion in 2006, \$6.5 billion in 2007, and a staggering \$8.6 billion in 2008. To put these numbers into context, Ukraine's entire government budget at the time was approximately \$40 billion.

While prices continued to rise, Russia made constant demands for payment of past gas debts, for more control of key industries in Ukraine, and especially for a Russian role in running the Ukrainian gas pipelines. Ukraine responded by demanding higher transit rates for Russian gas headed to Europe.

In March, 2008, Gazprom cut gas shipments to Ukraine by 50%. When the existing long-term contract expired at the end of the year, Gazprom cut off all gas shipments to Ukraine. The cut-off lasted until January 19, 2009, when the two prime ministers, Ukraine's Julia Tymoshenko and Russia's Vladimir Putin, agreed to a new long-term arrangement.

In December 2017, the arbitration tribunal ordered Naftogaz to purchase 5 bcm of gas per year from Gazprom in 2018 and 2019. Thus, Naftogaz's purchases from Gazprom resumed in January 2018. But within two months, Gazprom had cut off Ukraine's supplies of gas again, this time refusing to deliver volumes that Gazprom had paid for in advance. President Petro Poroshenko declared a state of emergency and

called on every family and business to cut down the consumption of gas [6]. Ukrainians responded by reducing consumption by 14% during the three-day crisis, which ended when Naftogaz secured alternative supplies from neighboring Poland [7].

REFERENCES:

1. Naftogaz press release, Gazprom refusal to supply gas violates Stockholm Tribunal ruling (1 March 2018) (available at <http://www.naftogaz.com/www/3/nakweben.nsf/0/72AFCEDE314F365EC225824300465063?OpenDocument&year=2018&month=03&nt=News&>) (site last visited March 1, 2018).

2. Henry Foy, Russia's gas exports to Europe rise to record high, Financial Times (January 3, 2018) (available at <https://www.ft.com/content/7b86f4be-f08e-11e7-b220-857e26d1aca4>) (site last visited March 22, 2018).

3. Randall E. Newnham, Pipeline politics: Russian energy sanctions and the 2010 Ukrainian elections, Journal of Eurasian Studies at pp. 115-122 (July 2013) (available at <https://www.sciencedirect.com/science/article/pii/S1879366513000110>) (site last visited January 24, 2018).

4. See generally Randall Newnham, Oil, carrots, and sticks: Russia's energy resources as a foreign policy tool, Journal of Eurasian Studies 134-43 at 138 (2011) (available at [https://ac.els-cdn.com/S187936651100011X/1-s2.0-S187936651100011X-main.pdf?\\_tid=spdf-0ee50269-f93a-4c8f-9401-25f9f54edc60&acdnat=1519063276\\_869b1258d2dba5814c1093b06c57d60a](https://ac.els-cdn.com/S187936651100011X/1-s2.0-S187936651100011X-main.pdf?_tid=spdf-0ee50269-f93a-4c8f-9401-25f9f54edc60&acdnat=1519063276_869b1258d2dba5814c1093b06c57d60a)) (site last visited February 19, 2018).

5. Kataryna Wolczuk, Ukraine after the Orange Revolution, Centre for European Reform Policy Brief (2005) (available at [http://www.cer.eu/sites/default/files/publications/attachments/pdf/2011/policybrief\\_ukraine\\_feb2005-852.pdf](http://www.cer.eu/sites/default/files/publications/attachments/pdf/2011/policybrief_ukraine_feb2005-852.pdf)) (site last visited February 19, 2018).

6. Naftohaz urges Ukrainians to reduce gas consumption as much as possible over next 3-4 days, Censor.net (March 2, 2018) (available at [https://en.censor.net.ua/news/3053456/naftohaz\\_urges\\_ukrainians\\_to\\_reduce\\_gas\\_consumption\\_as\\_much\\_as\\_possible\\_over\\_next\\_34\\_days](https://en.censor.net.ua/news/3053456/naftohaz_urges_ukrainians_to_reduce_gas_consumption_as_much_as_possible_over_next_34_days)) (site last visited March 9, 2018).

7. Naftogaz press release, Naftogaz urgently buys gas from PGNiG after Gazprom's withdrawal from starting deliveries to Ukraine (March 3, 2018) (available at <http://www.naftogaz.com/www/3/nakweben.nsf/0/3C22E1882BAEBB9EC22582440049A95C?OpenDocument&year=2018&month=03&nt=News&>) (site last visited March 13, 2018).

**ЩОДО ВЗАЄМОДІЇ ОРГАНІВ ДЕРЖАВНОЇ ВЛАДИ З ГРОМАДСЬКИМИ  
ОРГАНІЗАЦІЯМ У ПРОЦЕСІ СТАНОВЛЕННЯ МОЛОДІ**

Кобзєва І.М., методист, комунальний вищий навчальний заклад «Дніпровська академія неперервної освіти» Дніпропетровської обласної ради, Голова Правління ГО «Два береги»