



Repeated dispute over earth gas between Ukraine and the Russian Federation

Peter Ševce | 09.01.2009

Like in recent years, relations between the Russian Federation (RF) and Ukraine ended in stalemate also this time at the turn of years. This year's earth gas dispute has been lasting the longest and is at the same time the most dramatic one. Concurrently, it's marked by traditional statements about both sides fulfilling their commitments to consumers and blaming each other. The perfect image of relations is completed by the gas volume flowing into consumer countries because this isn't agreed on contractually. Even supplies have been cut off entirely for the first time in the history of consumer and supplier relations **(1)**.

Both sides simultaneously address the European Union (EU) more often in order to win its favour and make it rebuke the other one. At the beginning, however, the Union was only capable of making statements about mutual economic dispute which it wasn't willing to interfere with **(2)**. This stance wasn't far-sighted and was corrected in a couple of days.

The situation remains unclear owing to several factors the more detailed characteristics of which will be the subject matter of another part of this article. This will be preceded by a brief chronology of events, which is necessary in spite of the fact that it will turn out-of-date following the next Russian or Ukrainian statement.

Negotiations between the RF and Ukraine on earth gas supply contract in 2009 started as early as the middle of 2008. Since no agreement was reached between both sides in the course of time, Russian Gazprom proclaimed in December 2008 that unless Ukrainian side paid its dues, it would cut off supplies for its western partner from 1st January, 2009 **(3)**. In December 2008, they didn't agree on a new contract and their negotiations were accompanied by various



statements the aim of which was to exert pressure on the opposite side. In the end Russia put its threat concerning the supply cut-off into practice on 1st January, 2009, three years after similar dispute (4). They didn't achieve any progress in terms of negotiations. Even a meeting turned out to be a problem. Following the cut in supplies to Ukraine, other European countries too started to register pressure decrease in gas pipelines and later also the decrease in the amount of earth gas supplied (5). Now both countries are in dispute over who is responsible for reduced transit towards consumers. On the one hand Russia claims that Ukraine has stolen the gas, but on the other hand Ukraine maintains that it has got little gas from Russia.

The grounds of the dispute

The primary economic issue between both countries is the Ukrainian debt for supplied Russian gas. It reached the sum of USD 2.1 billion. Although Ukraine stated on 31st December, 2008, that the entire debt is paid off, Gazprom denied this information and announced that it still hadn't received a payment amounting to USD 614 million (6). This sum is the charge for late payment. The question was also whom did Ukraine owe in fact, Gazprom or the company RosUkrEnergo (RUE), which had been the intermediary in the gas business between both sides since January 2006 (7). This company is an interesting but ill element within mutual gas relations because it owns neither any infrastructure nor extraction licences, nevertheless, it mediates a highly lucrative business between both countries. Gazprom possesses half of its shares, the rest is owned officially by two Ukrainian businessmen Dmitro Firtash and Ivan Fursin. It's said that both gentlemen have close ties to President Yushchenko (8).

Another problem in the current situation between both sides is earth gas price for Ukraine in 2009. In 2008, it amounted to USD 179.5 per m³, i.e. far below European average (we cannot talk about market prices because there is no real earth gas market in Europe). However, since



the dispute became public, several price proposals have been introduced by Gazprom as well as the Ukrainian gas transporter Naftohaz. Initial Russian proposals amounted to USD 250, which Ukraine rejected suggesting USD 208. In reaction to the rejection Gazprom suggested USD 418. Naftohaz head Oleg Dubina rejected this and proposed USD 235 along with the increase of transit price into Europe from 1.60 to 1.80 (per 1,000 m³ and 100 km). This proposal again was turned down by Russian side with the explanation that transit charges were agreed on up to 2010, i.e. for a longer period than earth gas price. The last Russian proposal is USD 450 **(9)**. The price bargaining itself is interesting from the aspect that the whole of gas supplied to Ukraine flows through the intermediary. Ukrainian Naftohaz and Russian Gazprom haven't got any contractual basis for raw material supplies between them.

It's obvious that Ukraine isn't able to pay such a sum. Anyway, it is not sustainable (and correct) that it pays lower price. It is a matter of time till these prices attain average European level – prices for 1,000 m³ of gas as well as transit charges. The earth gas price level in 2008 for consumers from Eastern Europe was around USD 400/1,000 m³ **(10)**.

One has to point out that if the dispute was confined to the RF and Ukraine and if the supplies continued on the level agreed on, this dispute could be described as an economic one. The fact remains that Ukraine was taking a certain volume of gas without an existent contract and that in the case of both countries we cannot rely on a verbal contracts any longer. It means that even if Ukraine had really wanted, it couldn't have secured sufficient level of supplies for the West **(11)**. Obviously, Russia was pretty aware of it. Nonetheless, at the moment when Gazprom suspended all its gas supplies to Europe, i.e. to paying consumers as well, the dispute entered a purely political level because Russia used its energy wealth to push through own geopolitical interests. It violated severely the terms of trade, which happened for the first



time in history and this will have an impact on the trustworthiness of Ukraine as a transit country as well as Russia as an extractor state.

The row mentioned above caused that to assume a clear stance on current issue isn't possible due to the lack of relevant information. The goal of the article is to present the dispute in broader context and simultaneously suggest measures which would help to prevent similar conflicts in the future.

Proposals may be summarised into several paragraphs:

1. the question of gas and transit prices;
2. the transparency of mutual gas relations;
3. route and source diversification;
4. larger participation of both countries in European structures;
5. more extensive and better control of gas infrastructure.

1. The question of earth gas prices, which Ukraine should pay, is a rather touchy topic. According to optimal scenario, prices for raw material as well as transit should reach European level. Thus the room for the political abuse of different price levels would be restricted. Fair price for both sides would be achieved in this way. However, even this isn't the guarantee of dispute prevention because, for instance, growth proposal up to USD 450 exceeds even average prices for European consumers in 2008. But it is an important component that shouldn't be omitted. In the case of big differences between price levels Russia will be perpetually accused of either punishing or rewarding Ukraine for its political course in the form of high or low prices. And it doesn't matter whether this has a real basis or not.



This claim on paying European prices in times when some countries had to borrow financial means from international institutions is complicated anyway. Among these countries is also Ukraine, which borrowed from the International Monetary Fund **(12)**. It means that nowadays it hasn't solvency and to pay off the debt of USD 2 million is especially difficult (at present, only the rest amounting to USD 614 million). Perhaps the current dispute is meant to hide this insolvency and Ukraine has been waiting for aid from the EU. However, the financial crisis and low oil prices on global markets connected with it have affected also the RF, which gets into trouble in terms of state budget incomes **(13)**. On one level it is understandable that it has adopted a harsh posture on debts which Ukraine accumulates regularly.

2. The second factor to be improved within mutual relations is transparency. It applies to contractual basis and contract validity as well as the question of intermediary companies in mutual gas relations. Today, it seems that both sides are satisfied with the system of non-transparent contracts. Between the countries there are several valid contracts which contradict each other, have various durations and moreover, their contents are concealed **(14)**. Making this relation clearer and simpler would improve orientation in the problem as well as the prediction of possible crisis situations in the future. From this point of view it would be advantageous to conclude mutual contracts for a longer period than just one year. They should define the terms and conditions of the purchase, sale and transit of earth gas to such an extent like, for example, Slovenský plynárenský priemysel when dealing with the company GazpromExport (new long-term agreement for the period of 20 years was concluded at the end of 2008). In such contracts a certain degree of flexibility is maintained as for the assimilation to the current global price development (in principle it is about variables in the given price formula). In times when contracts are valid one year, both sides are in permanent negotiation about new conditions.



The above mentioned indicates indirectly that between countries like Ukraine and Russia (less stable and less developed market environment and legal system) long-term contracts are much more advantageous because they bestow a hallmark of stability on relations. For several decades, the entire European gas industry is based (also) on this stability.

The legitimacy of intermediary companies is a thorny issue as regards transparency. These companies have participated in mutual gas relations since the middle of the 1990s and the company RUE has been a mediator since January 2006 when its task was agreed on by Russian and Ukrainian side after last similar dispute. There are diverse rumours about the background going around. These are often linked with top Russian as well as Ukrainian political structures **(15)**. That's why it is questionable whether existent non-transparent relations are exactly what these structures want to preserve.

The basis of transparency consists also in the explanation of conflict background as well as technical matters. The RF is in a better psychological position in terms of restricting gas supplies for Ukraine. On one level it declares that it keeps supplies for the EU untouched and restricts solely supplies for Ukraine. On another level pressure decrease in pipes causes lower flow and thus also lower supplies. In the case of strongly reduced supplies compression plants shut down automatically and the gas flows just by means of gravity flow. But Ukraine isn't able to maintain this pressure by means of own supplies and therefore the system collapses. And if it wants to ensure further transport to Europe as a transit country, it has to draw technical gas for driving compression plants **(16)**. This condition is to be explained as a gas theft committed by transit country no matter if it is true or not. Nonetheless, in this dispute the situation is complicated by the fact that Ukraine really did take the gas illegally, without any valid contract. Although it promised to return the gas back into the network, it didn't fulfil its promises.

3. Among further measures, which would protect the EU from similar disputes and subsequent supply shortage, is the frequently mentioned diversification of transport routes and

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earth gas sources. We have already handled this topic in several articles on DespiteBorders websites. To sum it up: alternative routes lead through the northern and southern corridor of Europe. Both branches, Nord Stream and South Stream, however, are financially extremely demanding and Russia presses the EU also by means of current crisis to provide more financial means. Meanwhile, more probable seems the route Nord Stream, which is European priority project. Both routes were mentioned as a supplement to European energy security also during the press conferences of the Czech EU presidency **(17)**. From the point of view of Slovakia, however, both routes are disadvantageous because every bypass of Ukraine stands automatically for a transit drop across the Slovak Republic **(18)**. The Ministry of Economy as well as SPP itself counts on this fact already. Therefore the Slovak side should take advantage of its contacts when pushing through national interests and engage itself more in mediating talks between Ukraine and Russia all the more that the Czech Republic (CR), which is equally affected by the supply cut, has been currently presiding the EU. However, the CR imports 25 per cent of gas consumption from Norway and there are also plans to interconnect Czech gas network and the gas pipeline Nord stream via the project Gazela **(19)**.

As far as source diversification is concerned, Northern Africa, the Caspian Sea surrounds and liquefied natural gas (LNG) have been considered. But it is necessary that more European countries participate in these projects because their conduction is beyond the possibilities of a single state. The gas pipeline Nabucco project, which is supposed to transport gas as far as Austria, has been created to grant access to deposits near the Caspian Sea. None of these projects represents a competition to Slovak transit position, to the contrary, Slovak side should actively join them.

The current crisis is meant to contribute to the development of priority areas in terms of diversification and their subsequent political and financial support. Since there are also



alternatives which are at odds with the interests of the SR, the institutions involved should actively participate so that the result is as favourable as possible for us. The worst scenario is to be dependent on a single source and a single route.

4. Ukraine has signed and ratified the Energy Charter and therefore it should abide by it. The RF only signed it in 1994, but it hasn't ratified it so far because it has still objections against it. In 2006 when similar crisis with similar consequences arose, Ukraine didn't apply the Energy Charter precisely enough, but just to the extent which was advantageous for it. It resulted in a condition in which Ukraine breached the provision concerning her obligation to secure transit across its territory irrespective of circumstances. That catered to Charter objectors in Russia who referred to this very fact **(20)**. That's why it is necessary to keep on holding talks on possible charter ratification and concurrently achieve that its principles are applied regardless of own benefit.

5. The final tool, by means of which it would be conceivable to prevent similar disputes, is the establishment of a special committee that would be comprised of the representatives of Ukraine and Russia as well as the EU. Its task would be to control flows at earth gas interchange stations between Ukraine and Russia and it would also have access to all information **(21)**. Situations, where both sides present their own unverifiable data, would be prevented. This proposal is logical and was mentioned also by German as well as Czech representatives. A proposal from 2002 might be discussed at the negotiating table according to which an international consortium would administer Ukrainian transit network while the ownership would remain in Ukrainian hands **(22)**. Of course, Ukraine has certain objections against this proposal, but in Germany this option is being discussed as well. These proposals are supposed to be a part of more complex solution which is to be launched as late as the termination of the current dispute and restoration of contractual supplies.



Impact on Slovakia

The position of the Slovak Republic is one of the worst in Europe. Slovakia is fully dependent on a single supplier and a single transporter which top political representatives have proclaimed absolutely reliable so far. Even our strong position within earth gas transit doesn't serve as the precondition for Slovak energy security any longer. In spite of various statements of several Slovak governments, no practical steps concerning the diversification of supplies to Slovakia have been realised to date. The main objection is the price. For instance, Norwegian gas is more expensive. Supplemental and alternative supplies, however, step up the energy security of a state and it is necessary to reconcile oneself with partially higher price. The main conclusion for the SR is that energy security isn't for free and one has to invest in it. Therefore the fight against monopolies and dominant companies for the maintenance of prices for earth gas as well as electric energy seems to be a wrong step from this standpoint. These finances are supposed to return to a greater extent in the form of investments in energy infrastructure and cross-border connections. It is the correct adjustment of financial means flow that the Government of the Slovak Republic alongside the Regulatory Office for Network Industries should aim at. Obviously, one has to take into account the prices and protect those who are worst affected by their growth. This, however, isn't achieved via blanket price regulation.

Apart from several industrial enterprises' announcements about the restriction or even the shutdown of production, a much bigger spectre of electric energy blackouts entered the foreground. Earth gas power plants which provide flexible output and supportive services for Slovenská elektrizačná a prenosová sústava belong to wholesale consumers that are affected by the restriction of supplies in the period of emergency regime. That's why such a situation may arise in which we won't have enough electric power in peak consumption and the so-



called blackouts will occur (outages in certain areas). Similar situation pertains also to heating companies that generate heat from earth gas. But these are catastrophic scenarios.

The Slovak Republic has to face challenges within power engineering and search along with the companies involved for adequate solutions. In this situation the state and semi-national companies with their shareholders are on the same side and synergic cooperation is the best they can do.

Conclusion

Nowadays, it is difficult to find the genuine instigator of the situation. Both sides conduct their PR activities with the aim of foisting own problem explanations on us irrespective of the facts. The European Union at the same time must present itself as an active subject and restore trilateral negotiations among all the states involved. People's preferences about which country they find the most likable are important as well. Nonetheless, the energy security of a country or the EU cannot be based on this. First and foremost they have to renew supplies to individual countries according to the agreed level and afterwards it is necessary to find a long-term and sustainable solution. This encompasses the application of international agreements, the transparency of gas relations, the interconnection of European gas networks and access to new sources as well as existent sources through several ways, i.e. diversification. The worst situation is to be dependent on a single supplier and a single import route.

Notes:

(1) See for instance: Russia forced to end gas supplies to Ukraine, RIA NOVOSTI, 07.01.2009,

<http://en.rian.ru/russia/20090107/119391463.html>



(2) See for instance: Vondra: Rusko a Ukrajina se musí rychle dohodnout o dodávkách plynu, ČT24, 3rd January, 2009,

<http://www.ct24.cz/domaci/40602-vondra-rusko-a-ukrajina-se-musi-rychle-dohodnout-o-dodavkach-plynu/>,

<http://www.economy.gov.sk/index/index.php?ida=1524>

(3) Russia's Gazprom may halt gas supplies to Ukraine over debt, RIA NOVOSTI, 18th December, 2008,

<http://en.rian.ru/russia/20081218/118929537.html>

(4) Gazprom zastaví dodávky plynu na Ukrajinu, Hospodárske noviny, 1st January, 2009,

<http://hnonline.sk/c1-32054780-gazprom-zastavi-dodavky-plynu-na-ukrajinu>

(5) Rusko zastavilo dodávky plynu do Evropy, ČT24, 7th January, 2009,

<http://www.ct24.cz/ekonomika/40931-rusko-zastavilo-dodavky-plynu-do-evropy/>

(6) Gazprom to receive Ukraine's \$ 1,5 bln gas debt payment Jan. 11, RIA NOVOSTI, 2nd January, 2009,

<http://en.rian.ru/russia/20090102/119335474.html>

(7) Ševce, P.: Úloha sprostredkovateľských spoločností vo vzťahoch medzi Ruskom a Ukrajinou a implikácie pre krajiny strednej Európy, 1st November, 2006,

http://despiteborders.com/clanok.php?subaction=showfull&id=1177875705&archive=&start_from=&ucat=2,4,9,47&

(8) Rill, B.: Die Ukraine: Partner der EU, Akademie fuer Politik und Zeitgeschehen,



<http://www.hss.de/downloads/AMZ61-Ukraine.pdf>

(9) More about individual proposals

<http://en.rian.ru/trend/gasrow/>

(10) For example

<http://en.rian.ru/russia/20080314/101336197.html>

(11) Pozri napríklad: Hirman, K.: Rusi škrtia Európu, eTrend, 7th January, 2009,

<http://blogy.etrend.sk/karel-hirman/rusi-skrtia-europu/154230.html>

(12) Menový fond zachraňuje našich susedov, SME, 27th October, 2008,

<http://ekonomika.sme.sk/c/4145337/menovy-fond-zachranuje-nasich-susedov.html>

(13) Analytik Duleba: Rusko-ukrajinskému sporu dávam mesiac, SME, 7th January, 2008,

<http://ekonomika.sme.sk/c/4252462/analytik-duleba-rusko-ukrajinskemu-sporu-davam-mesiac.html>

(14) EU plays down impact of gas row, BBC, 5th January, 2009,

<http://news.bbc.co.uk/1/hi/world/europe/7811013.stm>

(15) Ševce, P.: Úloha sprostredkovateľských spoločností vo vzťahoch medzi Ruskom a Ukrajinou a implikácie pre krajiny strednej Európy, 1st November, 2006,

http://despiteborders.com/clanok.php?subaction=showfull&id=1177875705&archive=&start_from=&ucat=2,4,9,47&



(16) There is a dispute also whether technical gas necessary for transit is a part of the transit contract between the RF and Ukraine or if Ukraine is supposed to take it from its own raw material supply; see for instance:

<http://www.iht.com/articles/2009/01/07/europe/union.php>,

http://news.yahoo.com/s/ap/20090108/ap_on_bi_ge/eu_ukraine_russia_gas

(17) Vondra: Rusko a Ukrajina se musí rychle dohodnout o dodávkách plynu, ČT24, 3rd January, 2009,

<http://www.ct24.cz/domaci/40602-vondra-rusko-a-ukrajina-se-musi-rychle-dohodnout-o-dodavkach-plynu/>

(18) Stratégia energetickej bezpečnosti SR,

<http://www.rokovania.sk/appl/material.nsf/0/FB11425C0A0BFE5FC12574DD0042B8AD?OpenDocument>

(19) Plynovod Gazela se má v ČR stavět za rok a pol,

www.finance.cz

27th February, 2008,

<http://www.finance.cz/zpravy/finance/153419-plynovod-gazela-se-ma-v-cr-stavet-za-rok-a-pul/>

(20) Stern, J.: Spor medzi RF a Ukrajinou nebol najväčšou hrozbou pre energetickú bezpečnosť EÚ

http://despiteborders.com/clanok.php?subaction=showfull&id=1212257731&archive=&start_from=&ucat=9,10,47&



(21) This proposal is already up-to-date – EU observers to arrive in Ukraine Friday to monitor gas transit, RIA NOVOSTI, 8th January, 2009,

<http://en.rian.ru/world/20090108/119398300.html>

(22) Russland und Ukraine muessen reden, Michael Glos,

www.faz.de

6th January, 2009,

<http://www.faz.net/s/Rub0E9EEF84AC1E4A389A8DC6C23161FE44/Doc~E375EBBFF999C4AA0B7AB23F800ABECB6~ATpl~Ecommon~Scontent.html>