Background Note:

Outline of NaftoHaz/GazProm

Issues Ahead of 12/31/2019

Transit Agreement Expiration

Max Pyziur

December 2019
Background:
The current Ukraine-Russia natural gas transit agreement is set to expire on 12/31/2019.
- Ukraine's NaftoHaz, Russia's Gazprom, and the EU have been negotiating a new ten-year natural gas transit agreement.
- The EU and Ukraine have agreed to terms; Russia has not.
- The last meeting that was held was 10/28/2019 in Brussels

- EU consumes 45/50 BCF/d (465-517 BCM/y); produces ~12BCF/d (125 BCM/y); consequently requires storage and imports to make up the balance

- Transit capacities
  -- 15 billion cubic feet per day (BCF/d) (155 BCM/y) can be transited through Ukraine to the EU; compared to
  -- 7 BCF/d (72 BCM/y) from North Africa,
  -- 4 BCF/d (41 BCM/y) through Belarus/Poland or Lithuania,
  -- 3.6 BCF/d (37.2 BCM/y) (which includes NS1) direct from Russia to EU,
  -- 18 BCF/d (186 BCM/y) in LNG Terminals

- Ukraine is seeking a ten-year, minimum 5.8 BCF/d (60 BCM/y), plus another 2.9 BCF/d (30 BCM/y) available on flexible terms; the minimum amount for transit that NaftoHaz requires is $3 billion/year for ten years

Other terms in play:
- Russia wants a more flexible arrangement with shorter time frames
- EU prefers long-term, ten-year contract, thereby ensuring lowest possible transit fees
- NaftoHaz has received favorable judgements against GazProm from the Stockholm Chamber of Commerce for $2.56 billion from previous claims/counter-claims in transit and supply agreements
- Ukraine's anti-monopoly committee has imposed a $6.7 billion fine against GazProm for abuse of its monopoly position
- Ukraine has another arbitration claim of $12 billion against GazProm for not paying market-based tariffs in 2018-2019.
- Russia is seeking to settle these out-of-court, possibly through a gas-for-dollars swap
- War in DonBas

Other Matters
- Nord Stream 2 (NS2)
  -- On 10/30/2019 the Danish Energy Agency approved the Nord Stream 2 route across its continental shelf; this was the last impediment to getting the route; this will boost Russia's direct transit capacity by 5.3 BCF/d (55 BCM/y); the NS2 construction can potentially be completed by the end of the year
  -- The European Commission can appeal the Danish decision; it has one month (from 10/30/2019) to do so.
  -- Impediments to NS2 - EUGal pipeline from northern Germany to the Chechia (Czech Republic) w 5 BCF/d (51 BCM/y) still need to be completed; expected 2021

- Other pipelines
  -- Turkish Stream, another two-pipe pipeline transit system bypassing Ukraine; one line is complete; each line has/will have 1.5 BCF/d (15.5 BCM/y) capacity; fully operational by 2021-2022
- **Intra-Ukraine**
  -- Ukraine's NaftoHaz is seeking to comply w EU regulations, and is in the process of unbundling its various operations: separate pipeline/transit/storage/logistics operations, exploration & production operations. NaftoHaz logistical components will be placed in GTSOU (Gas Transmission System Operator of Ukraine)

**EU/Ukraine Natural Gas market developments**
- all major countries (total EU, Germany, Ukraine) are have stocked their natural gas inventories in excess of the five-year average in anticipation of a cut-off; charts below through 11/8/2019
- because of high inventories European natural gas prices expected to be soft through the winter

**Hypothetical outcomes**
- Transit deal gets signed
- Direct Russian natural gas exports to Ukraine
- No deal, or short-term deal, more natural gas bypasses Ukraine resulting in partial decommissioning of Ukraine's transit system

**Possibility of a new deal**
- hard to assign probabilities, but parties are preparing for no deal with increased gas storage, hence there is strong chance of a disruption

![European Union: Weekly Natural Gas Inventories](image1)
![Ukraine: Weekly Natural Gas Inventories](image2)
![Germany: Weekly Natural Gas Inventories](image3)
ABOUT EPRINC
The Energy Policy Research Foundation, Inc. (EPRINC) was founded in 1944 and is a not-for-profit, non-partisan organization that studies energy economics and government policy initiatives with special emphasis on oil, natural gas, and petroleum product markets. EPRINC is routinely called upon to testify before Congress as well as providing briefings for government officials and legislators. Its research and presentations are circulated widely without charge through posts on its website. EPRINC’s popular Embassy Series convenes periodic meetings and discussions with the Washington diplomatic community, industry experts, and policy makers on topical issues in energy policy.

EPRINC has been a source of expertise for numerous government studies, and both its chairman and president have participated in major assessments undertaken by the National Petroleum Council. In recent years, EPRINC has undertaken long-term assessments of the economic and strategic implications of the North American petroleum renaissance, reviews of the role of renewable fuels in the transportation sector, and evaluations of the economic contribution of petroleum infrastructure to the national economy. Most recently, EPRINC has been engaged on an assessment of the future of U.S. LNG exports to Asia and the growing importance of Mexico in sustaining the productivity and growth of the North American petroleum production platform.

EPRINC receives undirected research support from the private sector and foundations, and it has undertaken directed research from the U.S. government from both the U.S. Department of Energy and the U.S. Department of Defense. EPRINC publications can be found on its website: www.eprinc.org.

EPRINC welcomes comments and discussion on all our research.

Lucian Pugliaresi, President.