

Background Note:

*Outline of NaftoHaz/GazProm
Issues Ahead of 12/31/2019
Transit Agreement Expiration*

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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

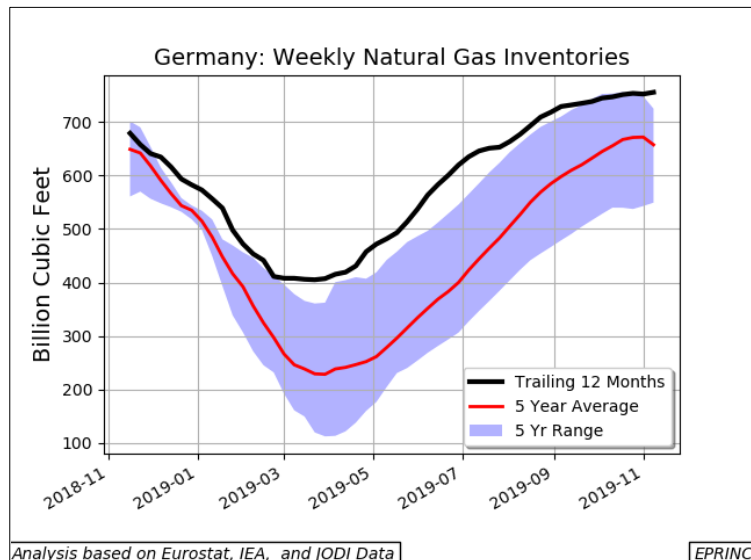
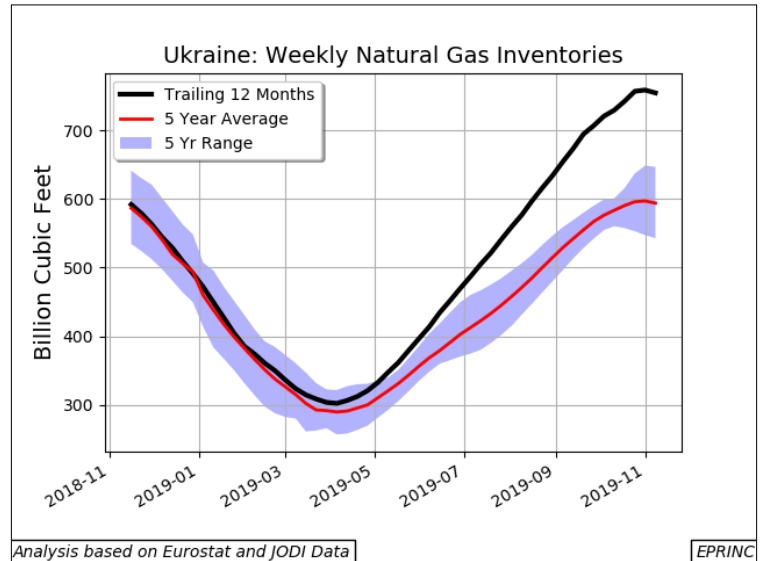
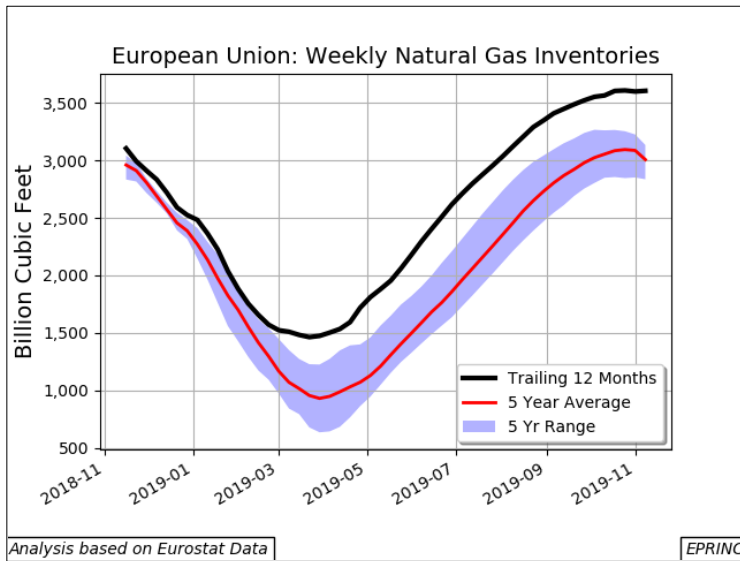
- all major countries (total EU, Germany, Ukraine) are have stocked their natural gas inventories in excess of the five-year average in anticipation of a cut-off; charts below through 11/8/2019
- because of high inventories European natural gas prices expected to be soft through the winter

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



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