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South Stream Dragged into Russia-Ukraine Gas Spat as Rhetoric Spikes

By Alexander Panin

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Alexander Medvedev, deputy head of Gazprom Export.

Just as it seemed that a solution to the gas dispute between Ukraine and Russia was near, Ukraine has returned to its old price demands and the European Union has set to sabotaging Russia's South Stream pipeline to Europe, darkening the prospects of a deal with only days to go before Gazprom could cut supplies.

On Monday, Gazprom agreed to delay switching Ukraine to prepayment for gas deliveries until June 9, giving it a week to settle debts over which it threatens to cut supplies to Kiev, possibly resulting in disruption of gas transit to Europe.

But as the heads of Russia's Gazprom and Ukraine's Naftogaz sat down for a new round of gas price negotiations in Berlin on Tuesday, Ukrainian acting Prime Minister Arseniy Yatsenyuk took to the podium in Ukraine's parliament in Kiev to say that the "right" price for both Gazprom and Ukraine would be $268 per thousand cubic meters, far below the average price

of $370 paid by European buyers.

"Under any circumstances we will not pay Russia $500 per thousand cubic meters. This is not a market price, this is a political price," television channel NTV broadcast Yatsenyuk saying.

Ukraine used to get Russian gas for $268 per 1,000 cubic meters, before Gazprom hiked the price in April to over $485 — in strict accordance with the contract, according to Gazprom.

On Monday, following hours of negotiations in Berlin, European Energy Commissioner Gunther Oettinger said the chief executives of Gazprom and Ukraine's Naftogaz had agreed on a plan that could avoid continued price disputes. He said a fair price for Ukraine would mirror the European average — in the range of $350 to $380 per thousand cubic meters. Yatsenyuk's statement yanks the carpet from underneath that agreement, returning Ukraine to a bargaining position that went nowhere.

Alexander Medvedev, director general of Gazprom Export, told a news conference Tuesday that the price for Ukraine referred to by Oettinger "corresponds with our own conception."

But Yatsenyuk is not enthusiastic. "If Russia thinks Ukraine is a cow for milking, it is making a big mistake," he said, NTV reported.

He also said that canceling a take-or-pay agreement — which obliges a buyer to pay for a certain volume of gas, whether or not they use it — and lifting the ban on gas re-exports should become part of the final deal. This would effectively free up Ukraine to redirect Russian gas westward to Europe, undercutting Gazprom on the European market and making a tidy profit.

Gazprom's spokesman Sergei Kupriyanov sounded a diplomatic note at Tuesday's press conference, saying the most important result of Monday's negotiations was that the sides had agreed to move forward.

Behind that progress, he said, was Ukraine's partial payment of its gas debt. Ukraine has acknowledged debts of $2.2 billion for gas supplies in the first three months of the year — Gazprom claims that the country owes $3.5 billion for first quarter deliveries — and on Monday Gazprom said it had received $786 million of the sum.

"A further move for Ukraine would be to pay out the remaining debt," Kupriyanov said, adding that deliveries over April and May are also unpaid.

According to Gazprom, Ukraine soaked up a seasonal record of 3.5 billion cubic meters of gas in May, bringing the Ukraine's total tally of unpaid gas to of 9.8 billion cubic meters. Ukraine appears to be building up reserves of gas big enough to weather a supply cut, analysts say.

And with politicians escalating the rhetoric, that cushion might be necessary. "With Yatsenyuk taking a public role in the negotiations and top Russian politicians having made it clear that the price for Ukraine will not be a subsidy, both Russia and Ukraine have to come away from the table with a face-saving deal that stands up to domestic political scrutiny," said Kyle Davis, partner at law firm Goltsblat BLP.

Asymmetric Response

Gazprom and the EU had been colluding in a pipeline project to bypass Ukraine and provide alternative gas supply route to Europe — South Stream. One of the engines of that project had been the instability of Ukraine, which is a transit country for much of Europe's gas. But now, instability in Ukraine threatens to derail it.

EU authorities on Tuesday asked Bulgaria, where the first inland section of the South Stream pipeline enters Eastern Europe, to suspend the work on the project on the grounds that it breaks EU law.

"Whilst discussions with the Bulgarian authorities are taking place and until there is full compliance with EU law, we have asked the Bulgarian authorities to suspend the project," European Commission spokeswoman Chantal Hughes told Reuters.

The Commission is referring to an EU rule stating that energy suppliers cannot own the infrastructure they deliver it through. But not everyone sees that as a sticking point — the law does not directly prohibit Gazprom from building the pipeline.

"I do not see grounds for drama ... it is just a matter of time and a dialogue with the European Commission to find the best solution," Bulgaria's Energy Minister Dragomir Stoynev said, Reuters reported.

He also said Bulgaria was unlikely to be sanctioned by its fellow EU countries for being strongly supportive of the project.

Bulgaria, which largely depends on Russia's gas for energy supplies, gave the green light for the construction of the South Stream pipeline on its territory in 2012, despite skepticism from EU authorities.

See also:

EU Calls On Bulgaria to Halt Gazprom's South Stream Pipeline Construction

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