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As Gas Deal Expires, Ukraine's Discount at Stake if EU Talks Fail

By The Moscow Times

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BRUSSELS / LONDON / MOSCOW — With less than four weeks until its deal for Russian natural gas imports ends, Ukraine risks losing its current discount unless it can agree on a new pact, something that took six months and help from the European Commission to achieve last time.

Gas has become a double-edged sword in the dispute between Ukraine and Russia after Moscow's seizure of Crimea a year ago.

Russia needs the European Union as its biggest market, while the EU relies on Russia for roughly a third of its gas, of which some 40 percent is shipped via Ukraine.

But EU efforts to follow a winter gas deal with an agreement to guarantee Russia continues supplying Ukraine are likely to be thwarted, stoking deeper tensions between Moscow and Kiev, and leaving a question mark over gas supplies next winter.

Late last year, the commission helped negotiate a winter gas package that expires on March 31. The EU executive says it is working on arranging a new round of talks with Russia and Ukraine before the end of the month, but has not specified precisely when or where.

The commission wants a new deal to cover the summer months and preferably the period until a Stockholm court delivers its ruling on Ukraine's disputed gas debts to Moscow. The verdict is not expected before next year.

EU officials are gloomy, saying that reverting to Russian supplier Gazprom's original contract, signed in 2009 for a 10-year period, is likely — at least in the near term.

Commission Vice President Maros Sefcovic said there was value in talks for talks' sake. "That should hopefully ease the tension in the relationship between Ukraine and Russia," he said at a Brussels seminar this week.

Asked about the consequences of not securing a deal, he said the long-term contract would reapply. For Kiev, that would mean a return to take-or-pay clauses that require it to purchase a minimum volume of gas, and higher prices.

Ukraine would almost certainly lose a discount of $100 per thousand cubic meters (tcm) Russia gave it in return for using its Crimea naval facilities, which Russia now claims as its own territory.

Deal or No Deal?

The winter package took roughly six months to negotiate. Under its terms, Ukraine paid $378 per tcm in the fourth quarter last year and $329 per tcm this year, after a drop in oil prices led to cheaper gas.

Ukraine's state-owned gas company Naftogaz said on Thursday it had paid Gazprom $15 million for this month's gas supplies of 45.6 million cubic meters — expected to last for five days.

"Without a [summer] deal we will just be stopping the clock until next winter to do this all over again," said Andrew Neff, principal analyst of the petroleum sector risk group at IHS Energy.

"Gazprom has to ask if it is better to squeeze blood out of a stone or recognize they have to let Ukraine breathe a bit to get its economy back on track."

This winter, Ukraine reduced its reliance on Russian gas. In total, it bought 19.5 billion cubic meters (bcm) of gas last year, 5 bcm of which came via reverse-flow shipments from the EU, according to Naftogaz figures.

In 2013, Ukraine imported 27.9 bcm, of which 25.8 bcm was from Russia and 2.1 bcm from the EU.

This year it plans to buy 7-8 bcm of gas from Russia, out of a total 20 bcm, with the rest coming from Europe.

Ukraine cut demand this winter through improved efficiency and energy rationing. Its storage sites are around a quarter full at 8 bcm. Ukraine has started to inject gas into storage and needs to fill those sites by up to 20 bcm by mid-October to avoid shortages next winter and ensure smooth transit to Europe.

Meanwhile, traders in Europe have held off buying Russian gas and been taking more out of storage as they wait for lower oil prices to filter through to oil-indexed gas prices.

This could mean an increase in demand for Russian gas from European traders through the summer, analysts say, weakening Kiev's negotiating stance.

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