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Gas Supply and Transit Contracts

In January 2009, Naftogaz and Gazprom signed two ten-year contracts – one dealing with the supply of gas from Russia to Ukraine, and the other with the transit of gas via Ukraine to Europe. Although closely related, each contract has given rise to separate arbitrations which have allegedly produced different results. The specific details regarding these agreements are highly confidential, but reports in the industry press, as well as statements by the parties and in legal publications, have shed some light on their contents.

- Gas supply contract. Gazprom agreed to provide gas to Naftogaz at a price linked to that of other petroleum products. In addition to paying the contract price, Naftogaz agreed to a number of additional obligations, including most notably a take-or-pay clause and a destination clause.
 - Take-or-pay clause: a clause which specifies a minimum volume of gas to be purchased. Out of the annual contract quantities of 52bcm per year, Naftogaz had to take at least 80% (42bcm) or be subject to penalties for the proportion of this volume that it does not purchase. As a result of this clause, Naftogaz had to pay for at least 42bcm a year, whatever the volume it required or used.
 - Destination clause: a provision precluding the purchaser from reselling the gas, i.e. Ukraine has to be the 'final destination'.^[1]
- Gas transit contract. This contract covered the transit of gas through Naftogaz's pipelines in Ukraine to other importers further west.^[2] It contained minimum volume obligations for transport by Gazprom which were set at 110 bcm per year (120.08 bcm for 2009).^[3] The transit element explains the wider international interest in the case, since the performance of the transit contract affected multiple European countries importing gas via the Naftogaz pipeline.

The Naftogaz-Gazprom relationship has deteriorated in light of the geo-political changes of the last nine years, including the changes in oil prices and Ukraine's efforts to join the EU (and thus to ensure the conformity of its energy market with the European one), followed by Russia's annexation of Crimea. A number of disagreements over price and minimum purchase/transit obligations ultimately resulted in the numerous arbitrations and related enforcement proceedings.^[4]

Commercial Arbitrations

In May and December 2017, a three-member arbitral tribunal issued two awards in settling the issues which had arisen in the arbitration related to the natural gas supply contract between Naftogaz and Gazprom.^[5] These decisions were followed by a final award rendered on 28 February 2018 by the same panel^[6] with regard to the gas transit contract. All of these proceedings were administered by the Arbitration Institute of the Stockholm Chamber of Commerce and seated in Stockholm, Sweden.^[7] The resulting awards have since led to enforcement proceedings in multiple European jurisdictions.

1. Supply Contract Arbitration

In June 2014, both Naftogaz and Gazprom lodged claims against one another in relation to the gas supply contract, which were consolidated into a single arbitration.^[8] Naftogaz sought to review the price index retroactively in order to claim the sums that had been allegedly overpaid to Gazprom starting in May 2011.^[9] Naftogaz also requested the annulment of the destination and take-or-pay clauses which were no longer economically viable given the shifts in the oil and gas market.^[10] Gazprom, on the other hand, claimed damages for non-payment by Naftogaz and penalties under the take-or-pay clause due to Naftogaz's alleged failure to purchase the minimum volumes of gas specified in the contract.

In an interim award rendered on 30 May 2017, the tribunal accepted the principle of price index revision (linking it to the German gas hub NetConnect Germany), which was later quantified in a final award in December 2017.^[11] Yet, the tribunal only revised the price as from 2014, thus ignoring the retrospective aspect of Naftogaz's claim for overpayment. Contrary to Naftogaz's request, the take-or-pay clause remained in force but was revised to bring the minimum volume down from 42 bcm to 4bcm a year. Similarly to price revision, the tribunal excluded the retroactive application of the revised take-or-pay provision. The arbitrators justified the revision of these clauses by reference to market developments, namely oil-linked pricing no longer being the standard practice. Finally, the tribunal also granted Naftogaz's application to declare the destination clause null and void.^[12]

Taking into account the validity of the take-or-pay clause and its revision as from 2014, the tribunal ordered Naftogaz to pay damages in the amount of US\$2.02 billion for volumes not taken between 2010 and 2017 and applied a penalty of US\$600,000 a day for non-payment.^[13] The supply contract arbitration award allowed both parties to claim victory - Gazprom received part of the damages claimed and Naftogaz obtained the revision of some contract clauses for the remaining two years of contract performance.

1. Transit Contract Arbitration

In this second dispute, relating to the gas transit contract, the parties' positions were reversed. Gazprom was under an obligation to transport the minimum volumes set out in the contract.^[14] Hence, Naftogaz claimed damages for Gazprom's alleged breaches of the minimum shipment obligations, whereas Gazprom sought revision of the same obligations and applicable tariffs.

Naftogaz also requested the tribunal to order the transfer of its rights and obligations under the transit contract to its subsidiary, Public Joint Stock Company 'Ukrtransgaz' (Ukrtransgaz). The request can be explained by Naftogaz's efforts to separate its purchase and transport activities in order to comply with the EU energy law standards.^[15]

In a final award rendered on 28 February 2018, the tribunal refused to revise the minimum transport obligations provided for by the contract. It held that Gazprom had indeed breached these obligations and ordered it to pay US\$4.63 billion in damages. In relation to Naftogaz's transmission of contract rights and obligations request, the tribunal considered it to be outside its competence. Accordingly, until the end of 2019, Naftogaz cannot transfer its contract rights and obligations to Ukrtransgaz absent Gazprom's acceptance.^[16]

Enforcement proceedings in the Netherlands, Switzerland and the UK

The netting off of the supply and transit final arbitration awards resulted in an obligation on the part of Gazprom to pay damages of US\$2.56 billion to Naftogaz.^[17] The Ukrainian company thus started a series of enforcement proceedings in various jurisdictions in which Gazprom has assets. So far, these jurisdictions include the Netherlands, Switzerland, and England and Wales.

Gazprom has strategically important assets in Switzerland, where the Nord Stream and Nord Stream 2 project entities (which are entrusted with the construction of the gas pipelines running from Russia to Europe and bypassing Ukraine) are headquartered.^[18] In May 2018, Naftogaz sought orders from a court in the Canton of Zug for the seizure of Gazprom's shares in Nord Stream and Nord Stream 2, as well as claims of debts against Gazprom.^[19] This application was contested by the project entities based on the fact that they are located not only in the Canton of Zug and, as such, fall outside of the court's jurisdiction.^[20] There are contradictory reports by both parties on the status of these proceedings: Naftogaz claims that the Swiss court ordered seizure of the Nord Stream shares on 29 June 2018;^[21] Gazprom states that the court's decision merely suspended the exclusion of these shares from a list of assets subject to interim measures.^[22]

With respect to Naftogaz's claims in the Netherlands, it appears that Gazprom has registered a number of subsidiaries there, including South Stream, Blue Stream, Sakhalin Holdings, E&P International and Gazprom Finance.^[23] According to a statement issued by Naftogaz, which does not name the specific companies, Gazprom's Dutch subsidiaries have refused to comply with the attachment order issued by the Dutch courts.^[24]

On 19 June 2018, the Commercial Court in London issued a freezing order in respect of Gazprom's assets in England and Wales.^[25] In order to comply with this order, Gazprom had to provide Naftogaz with a list of all of its assets with a value greater than US\$50,000, which it did after obtaining the requisite permission from the Russian government.^[26] The freezing order has had important consequences for Gazprom's line of credit, since banks and financial institutions are wary of lending it money that could be seized if it passes through England.^[27]

Annulment of the arbitration awards

While Naftogaz has been seeking interim measures to secure payment obligations against Gazprom's European assets, the latter has been pursuing the annulment of the aforementioned awards before the Swedish courts.^[28] Before the issuance of the transit contract award, Gazprom had already begun proceedings to set aside the supply contract award before the Svea Court of Appeal^[29] on the grounds of serious procedural irregularities and "overreaching" by the tribunal.^[30]

On 29 March 2018, Gazprom submitted a request to annul the transit contract award on similar grounds to those invoked in respect of the supply award. In May 2018, Gazprom also filed new arguments in support of its petition, based on the allegedly extensive role of the tribunal secretary in drafting a significant part of the award.^[31] On 13 June 2018, the Svea Court of Appeal in Sweden ordered a stay of enforcement pending the determination of the validity of the award. Naftogaz has appealed this interim order, claiming that it had been issued ex parte. The Ukrainian company has also continued enforcement proceedings abroad, considering that the Court of Appeal's decision merely amounted to a temporary stay.^[32]

Further disputes

In parallel, in March 2018, Gazprom started yet another arbitration to terminate both the supply and transit contracts that would otherwise remain in force until the end of 2019.^[33] Gazprom is notably seeking to constitute a new tribunal different from that which heard the two previous arbitrations relating to the two agreements. Naftogaz followed suit in July 2018 by filing its own claim to revise tariffs under the transit contract, a claim which was not advanced in the first transit arbitration.^[34]

Some commentators have pointed out that the arbitral awards rendered to date in the Naftogaz-Gazprom legal battles in Stockholm reflect a conscious effort by the arbitrators to avoid political considerations and to rule on a purely commercial basis.^[35] Nonetheless, the Gazprom-Naftogaz saga is clearly very far from being over, as the parties have commenced a new wave of arbitrations^[36] and multiple enforcement proceedings are taking place in different jurisdictions.

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[1] M Grossman & L Unigovsky, The Naftogaz vs. Gazprom arbitration: one multibillion dollar plot, two perspectives, Natural Gas World (2018), available at <https://www.naturalgasworld.com/ggp-the-naftogaz-vs.-gazprom-arbitration-one-multibillion-dollar-plot-two-perspectives-58601> (last accessed on 8 August 2018).

[2] S Pirani, After the Gazprom-Naftogaz arbitration: commerce still entangled in politics, Oxford: OIES (2018), p 2, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/> (last accessed on 8 August 2018).

[3] Ibid, p 5.

[4] S Pirani, After the Gazprom-Naftogaz arbitration: commerce still entangled in politics, Oxford: OIES (2018), pp 1-2, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/> (last accessed on 8 August 2018); K Karadelis, Russia-Ukraine gas dispute heads to SCC, GAR (2014), available at <https://globalarbitrationreview.com/article/1033471/russia-ukraine-gas-dispute-heads-to-scc> (last accessed on 8 August 2018); Y Butusov, Stockgolmskaya bitva: hronika gazovoy pobedy Ukrainy 2018 goda, Censor.net (2018), available at https://censor.net.ua/resonance/3053725/stokgolmskaya_bitva_hronika_gazovoyi_pobedy_ukrainy_2018_goda (last accessed on 8 August 2018).

[5] See generally, S Pirani, After the Gazprom-Naftogaz arbitration: commerce still entangled in politics, Oxford: OIES (2018); M-A Eyl-Mazzega, The Gazprom-Naftogaz Stockholm Arbitration Awards: Time for Settlements and Responsible Behaviour, Edito Energie, Ifri (2018), available at <https://www.ifri.org/en/publications/editoriaux-de-lifri/edito-energie/gazprom-naftogaz-stockholm-arbitration-awards-time> (last accessed on 8 August 2018).

[6] The arbitral tribunal was comprised of two Swedish nationals – Tore Wiwen-Nilsson (chair) and Johan Munck (appointed by Gazprom) – and Jens Rostock-Jensen of Denmark (appointed by Naftogaz). See L Yong, Naftogaz declares win against Gazprom, GAR (2017), available at <https://globalarbitrationreview.com/article/1142219/naftogaz-declares-win-against-gazprom> (last accessed on 8 August 2018); L Yong, Gazprom attacks tribunal secretary role in Naftogaz award, available at <https://globalarbitrationreview.com/article/1170040/gazprom-attacks-tribunal-secretary-role-in-naftogaz-award> (last accessed on 8 August 2018).

[7] See L Yong, Naftogaz declares win against Gazprom, GAR (2017), available at <https://globalarbitrationreview.com/article/1142219/naftogaz-declares-win-against-gazprom> (last accessed on 8 August 2018).

[8] K Karadelis, Russia-Ukraine gas dispute heads to SCC, GAR (2014), available at <https://globalarbitrationreview.com/article/1033471/russia-ukraine-gas-dispute-heads-to-scc> (last accessed on 8 August 2018); L Yong, Gazprom attacks tribunal secretary role in Naftogaz award, available at <https://globalarbitrationreview.com/article/1170040/gazprom-attacks-tribunal-secretary-role-in-naftogaz-award> (last accessed on 8 August 2018).

- [9] S Pirani, *After the Gazprom-Naftogaz arbitration: commerce still entangled in politics*, Oxford: OIES (2018), p 3, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/>(last accessed on 8 August 2018).
- [10] Ibid, pp 3-5; M Grossman & L Unigovskyi, *The Naftogaz vs. Gazprom arbitration: one multibillion dollar plot, two perspectives*, *Natural Gas World* (2018), available at <https://www.naturalgasworld.com/ggp-the-naftogaz-vs.-gazprom-arbitration-one-multibillion-dollar-plot-two-perspectives-58601>(last accessed on 8 August 2018).
- [11] S Pirani, *After the Gazprom-Naftogaz arbitration: commerce still entangled in politics*, Oxford: OIES (2018), p 3, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/>(last accessed on 8 August 2018); L Yong, *Gazprom attacks tribunal secretary role in Naftogaz award*, available at <https://globalarbitrationreview.com/article/1170040/gazprom-attacks-tribunal-secretary-role-in-naftogaz-award>(last accessed on 8 August 2018).
- [12] S Pirani, *After the Gazprom-Naftogaz arbitration: commerce still entangled in politics*, Oxford: OIES (2018), pp 3-5, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/>(last accessed on 8 August 2018).
- [13] M Grossman & L Unigovskyi, *The Naftogaz vs. Gazprom arbitration: one multibillion dollar plot, two perspectives*, *Natural Gas World* (2018), available at <https://www.naturalgasworld.com/ggp-the-naftogaz-vs.-gazprom-arbitration-one-multibillion-dollar-plot-two-perspectives-58601>(last accessed on 8 August 2018). See also S Pirani, *After the Gazprom-Naftogaz arbitration: commerce still entangled in politics*, Oxford: OIES (2018), p 5, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/>(last accessed on 8 August 2018); D Thomson, *Naftogaz and Gazprom both declare win in pricing dispute*, *GAR* (2018), available at <https://globalarbitrationreview.com/article/1152787/naftogaz-and-gazprom-both-declare-win-in-pricing-dispute>(last accessed on 8 August 2018).
- [14] But see S Pirani, *After the Gazprom-Naftogaz arbitration: commerce still entangled in politics*, Oxford: OIES (2018), pp 5-6, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/>(last accessed on 8 August 2018), stating that there was no express ship-or-pay clause which had been discussed but ultimately discarded by the parties.
- [15] See generally M Sysoiev & M Rabij, *The unbundling of Naftogaz Ukraine – tactical and strategic priorities and challenges*, *IELR* (2017, Issue 2) 54.
- [16] W Powell, *Stockholm ruling delays Naftogaz unbundling*, *Natural Gas World* (2018), available at <https://www.naturalgasworld.com/naftogaz-ruling-delays-unbundling-62882>(last accessed on 8 August 2018).
- [17] S Pirani, *After the Gazprom-Naftogaz arbitration: commerce still entangled in politics*, Oxford: OIES (2018), p 5, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/>(last accessed on 8 August 2018): “Taking into account the US\$2.02 billion owed by Naftogaz to Gazprom under the supply contract, and the US\$4.63 billion owed by Gazprom to Naftogaz under the transit contract, the net payment required at the end of the arbitration was estimated at US\$2.56 billion. This figure may have included some interest owed by Naftogaz.”
- [18] See the Nord Stream website, available at <https://www.nord-stream.com/about-us/>(last accessed on 8 August 2018).
- [19] M Smedley, *Naftogaz seeks to freeze Gazprom’s NS2 assets*, *Natural Gas World* (2018), available at <https://www.naturalgasworld.com/naftogaz-seeks-to-freeze-ns2-assets-61599>(last accessed on 8 August 2018).

[20] Gazprom refutes Naftogaz's claims of Nord Stream share seizure by Swiss court, Sputnik News (2018), available at <https://sputniknews.com/europe/201807051066065611-russia-gazprom-naftogaz-court>(last accessed on 8 August 2018).

[21] Swiss court reinstates attachment of Gazprom's assets, Unian (2018), available at <https://economics.unian.info/10175552-swiss-court-re-instates-attachment-of-gazprom-s-assets-naftogaz.html>(last accessed on 8 August 2018).

[22] Gazprom refutes Naftogaz's claims of Nord Stream share seizure by Swiss court, Sputnik News (2018), available at <https://sputniknews.com/europe/201807051066065611-russia-gazprom-naftogaz-court>(last accessed on 8 August 2018).

[23] W Powell, Gazprom rejects Dutch court's asset request: Naftogaz, Natural Gas World (2018), available at <https://www.naturalgasworld.com/gazprom-rejects-dutch-asset-seizure-request-61723>(last accessed on 8 August 2018).

[24] Ibid.

[25] Naftogaz says British court grants Gazprom asset freeze in UK, Reuters (2018), available at <https://uk.reuters.com/article/uk-ukraine-naftogaz-gazprom/naftogaz-says-british-court-grants-gazprom-asset-freeze-in-uk-idUKKBN1JF1U7>(last accessed on 8 August 2018); V Dolnyk, UK court seeks Gazprom's asset list, Natural Gas World (2018), available at <https://www.naturalgasworld.com/uk-court-seeks-gazproms-asset-list-62083>(last accessed on 8 August 2018).

[26] Russia's Gazprom discloses information on its assets in Great Britain, UAWire (2018), available at <https://uawire.org/gazprom-disclosed-information-on-its-assets-in-great-britain>(last accessed on 8 August 2018).

[27] O Kobzeva & S Bradley, «Арест активов Газпрома по иску Нафтогаза ограничил ему займы на международном рынке», Reuters (2018), available at <https://ru.reuters.com/article/businessNews/idRUKBN1KR1R0-ORUBS>(last accessed on 8 August 2018); Aresht aktyviv "Gazpromu" za pozovom "Naftogazu" perekryv yomu dustup do mizhnarodnyh pozik – Reuters, Mind UA (2018), available at <https://mind.ua/news/20187450-aresht-aktiviv-gazpromu-za-pozovom-naftogazu-perekryv-jomu-dostup-do-mizhnarodnih-pozik-reuters>(last accessed on 8 August 2018).

[28] Under the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958, annulment in the jurisdiction of the seat of arbitration is one of the grounds allowing the courts not to enforce the award internationally. As such, if the Swedish courts set aside the award, it will be very difficult for Naftogaz to enforce it elsewhere. One of the prominent exceptions to this rule is France, where annulment at the seat has no bearing on the enforcement.

[29] Challenges against international awards are heard almost exclusively by the Svea Court of Appeal. See Section 43 of the Swedish Arbitration Act, available at <https://sccinstitute.com/media/37089/the-swedish-arbitration-act.pdf>; S Bonde, The European, Middle Eastern and African Arbitration Review: Sweden, GAR (2016), available at <https://globalarbitrationreview.com/insight/the-european-middle-eastern-and-african-arbitration-review-2016/1036960/sweden>(last accessed on 8 August 2018).

[30] A Didkovskaya & A Torokov, «Газпром» подал апелляцию на решение суда по договору с «Нафтогазом», Vedomosti (2018), available at <https://www.vedomosti.ru/business/articles/2018/03/22/754603-gazprom-reshenie-po-naftogazu>(last accessed on 8 August 2018).

[31] Gazprom adduced evidence of an expert report that evaluated the text of the award and concluded that a significant part of it had been written by someone other than the three members of the arbitral tribunal. See L Yong, Gazprom attacks tribunal secretary role in Naftogaz award, available at <https://globalarbitrationreview.com/article/1170040/gazprom-attacks-tribunal-secretary-role-in-naftogaz-award>(last accessed on 8 August 2018).

[32] Swedish court suspends enforcement of multibillion Gazprom award to Naftogaz, Concorde (2018), available at https://concorde.ua/rs/daily/item_73194/ (last accessed on 6 August 2018); «У“Газпрома” появился шанс оспорить решение о выплате \$2,6 млрд “Нафтогазу”», Vedomosti (2018), available at <https://www.vedomosti.ru/business/articles/2018/06/14/772772-gazprom-nashel-zaschitu> (last accessed on 8 August 2018); “Gazprom” was allowed not to pay “Naftogaz”, RusLetter (2018), available at https://rusletter.com/articles/gazprom_was_allowed_not_to_pay_naftogaz (last accessed on 8 August 2018).

[33] L Yong, Gazprom reignites gas wars with Naftogaz in wake of award, GAR (2018), available at <https://globalarbitrationreview.com/article/1166304/gazprom-reignites-gas-wars-with-naftogaz-in-wake-of-award> (last accessed on 8 August 2018).

[34] L Yong, Naftogaz files new tariff claim against Gazprom, GAR (2018), available at <https://globalarbitrationreview.com/article/1171538/naftogaz-files-new-tariff-claim-against-gazprom> (last accessed on 8 August 2018).

[35] S Pirani, After the Gazprom-Naftogaz arbitration: commerce still entangled in politics, Oxford: OIES (2018), p 4, available at <https://www.oxfordenergy.org/publications/gazprom-naftogaz-arbitration-commerce-still-entangled-politics/> (last accessed on 8 August 2018).

[36] In addition to pursuing further arbitration, both Naftogaz and Gazprom have threatened Russia and Ukraine, respectively, with investor-state proceedings. See the Russia-Ukraine BIT, dated 27 November 1998, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2233> (last accessed on 8 August 2018).

In February 2016, Naftogaz sent Russia a notice of dispute under the 1998 Ukraine-Russia BIT in relation to the damages suffered from the claimed annexation of Crimea. This triggered the commencement of a six-month cooling-off period. It remains to be seen whether Naftogaz will follow through with filing the request for arbitration. See D Thomson, Naftogaz threatens treaty claim over Crimea, GAR (2016), available at <https://globalarbitrationreview.com/article/1035319/naftogaz-threatens-treaty-claim-over-crimea> (last accessed on 8 August 2018).

In March 2018, Gazprom announced that it was proceeding with its own investment claim against Ukraine, which had already been notified in June 2017. Gazprom has said that its claims relate to the fine which was imposed on it by the Ukrainian Antimonopoly Committee in April 2016. See C Sanderson, Gazprom proceeds with treaty claim against Ukraine, GAR (2018), available at <https://globalarbitrationreview.com/article/1167121/gazprom-proceeds-with-treaty-claim-against-ukraine> (last accessed on 8 August 2018).

See L Yong, Gazprom reignites gas wars with Naftogaz in wake of award, GAR (2018), available at <https://globalarbitrationreview.com/article/1166304/gazprom-reignites-gas-wars-with-naftogaz-in-wake-of-award> (last accessed on 8 August 2018); L Yong, Naftogaz files new tariff claim against Gazprom, GAR (2018), available at <https://globalarbitrationreview.com/article/1171538/naftogaz-files-new-tariff-claim-against-gazprom> (last accessed on 8 August 2018).

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