COUNCIL OF THE EUROPEAN UNION

Brussels, 10 March 2010

NOTE

from: General Secretariat of the Council

to: Delegations

Subject: International relations in the energy field between Russia and Ukraine
- Information from the Commission

Delegations will find attached an information note from the Commission.
International relations in the energy field between Russia and Ukraine

In January 2009, after a considerable mediation effort by the EU that included a monitoring mission to relevant locations in Russia and Ukraine, Gazprom and Naftogaz signed new agreements concerning both the terms for transit of Russian gas to the EU as well as for gas supply to Ukraine for domestic use. This in effect ended the gas crisis and restored gas supplies to the EU that were completely cut between 7 and 20 January.

The new agreements brought both Ukrainian domestic gas prices and gradually transit fees to market values. The gas contracts stipulate that Naftogaz needs to pay for gas imported the previous month by the 6th of each month. If payment is not made, Gazprom is entitled to demand prepayments for deliveries. The new Ukrainian President, Mr Yanukovich, has now indicated that he would like to address these contracts within the broader context of revising energy relations with Russia. Energy relations with Russia are nevertheless likely to improve and so far Naftogaz has been able to meet its gas payment obligations (latest payment was made on 4 March)

The main challenge for the new President will be to seek a solution to the structural and financial difficulties in the gas sector:

- **Financial assistance**: In the autumn of 2008 the Tymoshenko government negotiated a $16.5 Standby Arrangement with the IMF. This was de-railed in late 2009 due to political infighting and the approach of presidential elections. During the summer 2009, efforts by the international community also focused on providing Ukraine with financial assistance to pay for gas in storage in order to ensure uninterrupted gas supplies to Europe. Ukraine however failed to implement the gas sector reform conditionalities agreed between the Commission, International Financial Institutions and Ukrainian authorities at the end of July.

The new Ukrainian President will now need to take urgent steps to improve economic and financial stability by cooperating closely with the IMF to allow for the disbursement of the remaining IMF funds. This is also the pre-condition for the disbursement of EU budgetary support to Ukraine.
Support to gas market reforms: In October 2009, Ukraine and the European Commission concluded negotiations on the country’s accession to the Energy Community Treaty. In December 2009 the Energy Community ministerial approved Ukraine's accession to this Community. Accession will be effective subject to the adoption of a new gas law complying with EU gas legislation and subsequent ratification.

Energy reforms and Ukraine's accession to the Energy Community continues to be important EU priorities also under the new President.

Industry solutions: The Commission has facilitated discussions with the EU gas industry on possible solutions to the problematic gas relations between Russian and Ukraine. Options discussed have included: 1) purchases of gas by the EU industry to be put in Ukrainian gas storages; 2) the establishment of a consortium to operate the Ukrainian gas transit system; and 3) physically separate the transit system from the rest of the Ukrainian domestic gas system. None of these options have so far attained sufficient support from all involved (EU and EU gas industry, Russia/Gazprom and Ukraine/Naftogaz).

The new President is however now advocating the establishment of a consortium between Ukraine, Russia and the EU for the operation of the Ukrainian gas transportation system.

Rehabilitation and modernisation of Ukraine’s main gas transit infrastructure: An investment conference on the modernization of the Ukrainian transmission system was held on 23 March 2009 in Brussels. On this occasion, the World Bank, the EBRD and the EIB committed to provide Ukraine/Naftogaz with funds to implement a rehabilitation and modernization plan in exchange for gas market reforms. A Technical Coordination Unit has been established to oversee the implementation of the relevant projects.