SEPARATE AWARD

SCC Arbitration no. V2014/078/080

National Joint Stock Company

Naftogaz of Ukraine

Claimant

and

Public Joint Stock Company

Gazprom

Respondent

I. THE PARTIES TO THE DISPUTE AND THEIR COUNSEL

The Claimant

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The Claimant and the Respondent are collectively referred to as **the Parties**.

II. THE ARBITRATORS

The Arbitral Tribunal has been constituted as follows:

- Naftogaz has nominated as arbitrator:
  Mr. Jens Rostock-Jensen
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in accordance with Article 13(3) of the Arbitration Rules of the Stockholm Chamber of Commerce (SCC) in force as of 1 January 2010 (the "SCC Rules").

- Gazprom has nominated as arbitrator:

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in accordance with Article 13(3) of the SCC Rules.

In accordance with Article 13(3) of the SCC Rules, the Board of SCC appointed as Chairperson of the Arbitral Tribunal:

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III. THE DISPUTE

III.1 The Parties

(1) The Claimant Naftogaz is a Ukrainian wholly state owned oil and gas company with over 170 thousand employees, founded in 1998. Naftogaz is Ukraine's largest oil and gas producer as well as the major importer, transit provider through its wholly owned subsidiary Ukrtransgaz AC, and marketer of Natural Gas, covering all segments of the Ukrainian gas market, such as gas field exploration and development, production, transportation, storage and supply to final consumers, from industrial users down to direct residential and commercial customers.

(2) Naftogaz and its subsidiaries produce over 90% of the oil and gas produced domestically in Ukraine. Natural gas is the primary energy source in Ukraine, providing 40-45% of the total energy consumption.

(3) The Respondent Gazprom is the world's largest gas extracting company with over 350,000 employees. It was reorganised into a Russian joint stock company in 1993, and began the process of privatisation in 1994. It is today a publicly listed company situated in Moscow, Russia. Currently, 50.23% of Gazprom's shares are owned or controlled (directly or indirectly) by the Russian Federation (through the Federal Agency for State Property Management, OAO Rosneftegaz and OAO Rosgazifikatsiya). Gazprom is the biggest supplier of gas to Europe. Gazprom accounts for 14% and 74% of the global and Russian gas output respectively, and owns the world's largest gas transmission network – the Unified Gas Supply System of Russia – with a total length of over 168 thousand kilometres.

III.2 The Dispute

(4) On 19 January 2009, the Parties entered into Contract No. KP for the purchase and sale of natural gas for the period 2009-2019, the "Gas Sales Contract" or the "Contract", and into Contract No. TKGU on volumes and terms of transit of natural gas through the territory of Ukraine for the period 2009-2019, the "Gas Transit Contract" or the "Transit Contract". Both Contracts are now under dispute. The disputes are handled in separate arbitration proceedings ("The Sales Arbitration" and "The Transit Arbitration") but by the same Tribunal. The present Arbitration deals with the Gas Sales Contract. The Parties are in dispute about the price of gas under the Contract and about the validity of various clauses in the Contract. With regard to the price of gas, Naftogaz claims an adjustment of the price provisions of the Contract and determination of the price payable under the Contract. Naftogaz also claims that the volume and Take or Pay provision, the destination clause, the unilateral suspension right clause and the mandatory sales clause of the Contract should be declared invalid or ineffective and that the volume and Take or Pay provisions and the unilateral suspension right clause should be replaced. Naftogaz claims repayment, alternatively damages plus interest. Gazprom denies that Naftogaz is entitled to the relief sought and requests that Naftogaz' claims be rejected in their entirety. In its counterclaim, Gazprom claims payment of outstanding amounts due for gas delivered to Naftogaz and for gas accessible to Naftogaz but not off-taken by Naftogaz under the Contract, plus interest. Naftogaz requests the rejection of the relief sought by Gazprom in its counterclaim.

IV. THE ARBITRATION AGREEMENT AND APPLICABLE LAW

(5) The Contract contains the following arbitration clause:

"*ARTICLE 8. Regulation of disputes*

8.1. All disputes and controversies, which may arise concerning the interpretation and application of the present Contract or in connection with it, shall be resolved by means of negotiations and consultations.

8.2. The Parties shall seek to resolve between themselves all disputes and controversies relating to the interpretation and application of this Contract by means of negotiations. Should the Parties fail to reach a mutually acceptable solution within 30 days upon the occurrence of any dispute or controversy, any dispute, controversy or claim in connection with the present Contract either its breach, termination or invalidity shall be finally resolved by arbitration in accordance with the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce. The Arbitral Tribunal shall consist of three Arbitrators. The Arbitration shall be held in Stockholm, Sweden. The language of the arbitration proceedings shall be Russian. The arbitral award shall be final and binding on both Parties.

8.3. The award of the Arbitration Institute of the Stockholm Chamber of Commerce shall be final, not subject to appeal, and binding on the Parties.

8.4. Articles 8.2-8.3 hereof relating to arbitration shall be binding on the Parties, their authorized representatives and legal successors, and the working of these Sections will remain in force regardless of the expiration or termination of the Contract."

(6) With regard to applicable law, Article 9.4 of the Contract reads as follows: "*The present Contract is regulated exclusively by the material law of Sweden.*"

V. THE BACKGROUND OF THE DISPUTE

V.1 The Gas Industry and the Development of Gas Sales Contracts

(7) The development of the gas industry in Europe has been characterised by imports from giant gas fields, starting with the development of the Dutch Groningen field discovered in 1959. The development of the Groningen field was the first large gas export project worldwide and the principles of its contractual arrangements became the reference for all later gas imports into Europe, including from the major suppliers, Russia, Norway and Algeria.

(8) When the first agreements for sales of gas from the Groningen field were entered into in the mid-1960s, natural gas was a new energy source which was then introduced into the Dutch and European fuel and energy markets. There was no separate market or price formation mechanism for natural gas in the European fuel and energy market at the time. In the absence of a separate market and independent price formation mechanism for natural gas, the Groningen sellers, Shell, Exxon and the Dutch government, agreed to link the price of natural gas to the price of other alternative fuels for which there existed separate markets and price formation mechanisms, and which were likely to be the most competitive alternative energy source for the various types of consumers.

(9) Thus, the price of gas was linked to the price of alternative fuels likely to be substituted by the different types of consumers – for instance, gas oil for small-scale users and fuel oil for large-scale users. On the one hand, the introduction of the market value principle meant that consumers would not have to pay more for gas than for alternative fuels. On the other hand, they would not pay much less.

(10) The market value approach enabled Shell, Exon and the Dutch government to obtain much higher revenues than by pricing based on the low production costs of gas from the Groningen field. It also made sure that the growing use of gas did not abruptly jeopardise the past marketing success for oil products.

(11) The principles developed for the sales of gas from the Groningen field formed the basis for most subsequent gas exports to Europe, like the Norwegian Troll and GFU agreements and Russian exports to Europe.

(12) The Dutch export contracts served as a point of reference for most gas export contracts to Continental Europe which followed over the next four decades: (i) the first Russian gas export contracts to Germany, Austria, France, Italy in the early 1970's, (ii) Algerian Liquefied Natural Gas (LNG) to France and later Belgium, Greece, Spain and also for Algerian pipeline exports to Italy, although with some major distortions during the "gas battle" in the beginning of the 1980s when Algeria imposed FOB crude oil parity on its customers, (iii) the Norwegian gas export first under the Ekofisk and Statpipe contracts (although without review and under a multiplicative formula), (iv) additional Russian exports under the SGE IV project in the early 1980s, (v) the Troll sales to Germany, the Netherlands, Belgium, France, Austria and Spain, (vi) Algerian gas exports to Spain and Portugal via the Maghreb pipeline, (vii) Nigerian LNG, (viii) Norwegian exports via the GFU to SEP in the Netherlands, to VNG in East Germany and to the Czech Republic, (ix) UK exports to the Continent, (x) and Libyan pipeline exports to Italy. Altogether more than 250 BCM/year are imported by EU countries on the Continent under this concept.

(13) The pricing concept in these gas export contracts was what is called "netback market value", calculated on the basis of the value of competing energies netted back to the border of the buyer's country by deducting the costs of transportation and distribution of the buyer. Under this concept the base price of gas would be re-calculated at regular intervals (monthly or quarterly) in line with the absolute price movements of the competing energies.

(14) While gas oil and heavy fuel oil are the most common competing fuels, the concept would also work with a reference to other competing energies, like coal or electricity but also gas itself. Furthermore, under this concept, the delivery point and the reference point for the price would be different. The concept makes it possible to review at regular intervals (typically three years) the price conditions in order to adapt them under defined criteria to changed circumstances in the market, ensuring that the gas would remain competitive.

(15) This concept would ensure a reliable sales volume for the seller at prices as close as possible to what can be sold in competition with other energies in the market. This way the netback calculated back to the wellhead provides for the maximum specific rent which can be obtained from the market, supplied without losing competitiveness. On the other hand, it allows marketing of the gas while offering a reasonable margin to the buyer. Risks related to price movements of the competing energies are mainly carried by the producing country (changes would be reflected in the producing country's resource rent, either in the income from petroleum and royalty taxes, or, where petroleum activities are organised by state-owned companies, through changes in their financial results). In this way, the seller takes the price risk, the buyer the volume risk linked to marketing.

(16) To underwrite the substantial investments made by the sellers to develop the Groningen field and the infrastructure required to bring the gas to the market, the Dutch export agreements imposed a Take or Pay obligation on the buyers. The buyers were obliged to take and pay for, or pay for if not taken, large annual amounts of natural gas which effectively implied a significant volume risk. The compensating feature of the Take or Pay commitment was that the pricing principles were designed to ensure that the gas would be competitive in the market where it was to be sold, and would also allow the buyer to earn a reasonable margin. It is the possibility to earn a reasonable margin that allows the buyer to assume the Take or Pay obligation, i.e. the obligation to pay for large minimum volumes of natural gas over a long period of time, which is in the seller's interest.

(17) The obligation to Take or Pay for if not taken, also in situations where there is no demand for natural gas, is particularly burdensome when the total demand in the market for natural gas is sought to be covered under one long-term gas sales agreement, as it makes the buyer vulnerable to variations in demand. Such an arrangement may also lead to a foreclosure of the relevant market, as it prevents other suppliers from accessing the market.

(18) In essence, the division of risk under the Groningen type gas sales agreements implies that the seller is entitled to a share of the maximum economic rent available in the relevant market, but carries the risks and chances of the price developments determining the rent available (the price risk). In return for effectively assuming an obligation to market a large volume of gas for a long period of time through the Take or Pay obligations (the volume risk), the buyer is entitled to earn a reasonable margin on the sales of the natural gas delivered under the gas sales agreement. Thus, under the Groningen type gas sales agreements, the economic marketability was the principal feature of the risk division between the Parties.

(19) The Groningen gas sales agreements also introduced the price revision clause, recognising that the competing fuels and their values were likely to change over time, in line with the technological advances, shifts in the market shares and prices of the competing fuels and other developments in the fuel and energy markets. The price revision clause allowed for regular reviews of the price provisions to reflect such changes and to ensure that the buyer continued to be able to sell the gas at a reasonable margin. A major element in this context was the possibility to invoke arbitration in case of disagreement on the price adjustment

(20) Historically, due to the netback market value concept, the price the seller could take for natural gas from different buyers would vary while natural gas to different buyers could be delivered at the same delivery point. This opened arbitrage opportunities where a rebate granted for transportation costs could be used to under-cut prices in markets upstream of the original buyer. So-called destination clauses were therefore introduced, preventing such arbitrage.

V.2 The History of Russian-Ukrainian Gas Supply Relations up to 2007

(21) The history of Soviet gas exports starts in 1945 when natural gas exports started from the Ukrainian Soviet Socialist Republic (the Dashava and Opory fields) to Poland. In 1967, gas exports from Ukraine to Czechoslovakia and Austria commenced, raising the total amount of natural gas sales from Ukraine to Europe and other Soviet republics to around 135 billion m^3 (BCM).

(22) Gas exploration, development and transport within the Soviet Union and gas transport to the countries belonging to the Committee on Mutual Economic Cooperation (COMECON), were arranged as part of the coordinated central planning process, and centralized in the Soviet Ministry of Gas Industry, which was reorganized into the State Gas Concern "Gazprom" in 1989.

(23) The Ukrainian gas industry was regulated by the All-Union Industrial Association "Ukrgazprom", a part of the Soviet Gas Industry Ministry. When the Soviet Union was dissolved, "Ukrgazprom" was reorganized into Ukrgazprom JSC, a Ukrainian state-owned company, and subsequently formed the asset basis for creating Naftogaz and Ukrtransgaz.

(24) The major part of the Ukrainian Gas Transmission System ("GTS") was created during the Soviet period as part of the integrated system for gas supplies of the Soviet Union and its COMECON partners. Technically, the primary function of the GTS continues to be the export of natural gas, i.e. transport of natural gas from Russia and Belarus to the countries west of Ukraine.

(25) The dissolution of COMECON and the Soviet Union led to rearrangements of the transport and sales of Russian and Central Asian gas in and to the former COMECON states and former Soviet Union (FSU) states. Sales to and transport in the states in Central Europe and the Baltic states were rearranged first. In particular, the gas deliveries to Central Europe were brought in line with the standard concepts of long-term contracts for Western Europe.

(26) The East European pipeline network was designed and constructed to bring Soviet gas westwards to Europe. Ukraine holds a pivotal geographical position in the network and the large majority of Russian gas bound for Europe - around 70-80% - must pass through Ukraine. Russia/Gazprom and Ukraine/Naftogaz are consequently inextricably linked.

(27) After the dissolution of the Soviet Union in 1991, two independent states – Ukraine with one of the world's biggest pipeline systems and the Russian Federation with its natural gas deposits – were to adapt to the changed conditions.

(28) During the first years of Ukraine's independence, the two countries made a number of arrangements to ensure export of Russian gas to Ukraine as well as its transit to European countries.

(29) The first gas sales and transit arrangements were made on the inter-governmental level and were subsequently implemented by state-controlled companies: Russian Gazprom and, on the Ukrainian side Ukrgazprom until 1998, and subsequently Naftogaz.

(30) In particular, on 20 August 1992 the governments of Ukraine and Russia entered into the first such agreements to regulate the supplies of natural gas to, and the gas transit through the territory of, Ukraine. Under those 1992 agreements, Ukraine and Russia agreed the volumes of gas supply and transit as well as the price for gas and the transit tariff for 1992, and directed Gazprom and Ukrgazprom to implement the arrangements. Similar intergovernmental arrangements were made for gas prices and transit tariffs in 1993.

(31) In 1994, the governments of Ukraine and Russia concluded a 10 year agreement for gas supply and transit until 2005 (supplemented in 2000 and 2001), providing that prices and volumes were to be agreed annually in intergovernmental protocols. Such protocols were signed between Russia and Ukraine until 2005.

(32) Relying on the principles of the above mentioned 1994, 2000 and 2001 intergovernmental agreements, as well as of the 1994 Energy Charter Treaty (which Ukraine is a contracting party to since 1998 and Russia provisionally applied until 2009), Naftogaz and Gazprom entered into a separate transit contract for the period from 2003 till 2013 on 21 June 2002.

(33) The above-mentioned 2002 transit contract, *inter alia*, provided that Gazprom should transit not less than 110 BCM of gas through the territory of Ukraine to Europe and Moldova annually. The exact volumes and tariffs should be set out in annual addenda implementing the above-mentioned intergovernmental protocols.

(34) The 1992-2005 gas supply and transit arrangements described above are usually referred to as a gas-for-transit barter system: Ukraine paid for the gas supplies by providing transit services.

(35) The above arrangements did not always cover Ukraine's total gas needs. Additional gas volumes (e.g. of Central Asian/Turkmen origin) were supplied to Ukraine under separate intergovernmental agreements (e.g., with Turkmenistan in 1992-2006) through Ukrgazprom/Naftogaz or by various gas trading companies (e.g. ITERA, Eural TransGas).

(36) Since 2004, one such intermediary supplier of natural gas to Ukraine was RosUkrEnergo, a Swiss-based company co-owned by Gazprom and the group of companies owned and/or controlled by Mr. Dmytro Firtash, a businessman owning and/or controlling very large fertilizer (OSTCHEM, AZOT Cherkassy, STIROL), gas distribution (RosUkrEnergo), titanium (Crimean TITAN, Zaporizhzhya titanium) and banking (Nadra Bank) businesses in Ukraine (the "Firtash Group").

(37) Until 2005 gas transit and supply arrangements remained interconnected and interdependent, but from 2005 Gazprom announced its intention to separate gas supply and transit and introduce market prices also for Ukraine.

(38) In the years prior to entering into the Contract with Naftogaz in 2009, Gazprom to a large extent restructured the supply relationships with former COMECON countries, other former Soviet Republics in order to capture more of the economic rent. This process had in principle been initiated already in the 1990s when Russia stated that it would demand "*world market prices*" from former COMECON countries, which in practice meant German prices.[1] However, for another decade, the gas sales agreements between Russia and former Soviet Republics remained based on barter arrangements, like Ukraine's provision of transit services in return for gas supplies.

(39) In 2004/2005 Russia indicated once more that it would no longer supply former Soviet republics gas for export at non-market related prices. Initially, the Russian government decided to

[1] Stern, J., *The future of Russian gas and Gazprom*, 2005, p. 114 and footnote No. 13.

synchronize the transition in Russia and other former Soviet Republics towards European netback prices. "*European netback*" prices were generally defined as the price paid by European customers minus taxes, duties and transportation costs. However, due to the sharp increase of oil and gas prices and the economic crisis beginning in 2008, the transition period for the home market was extended. At the same time, the transition was initiated abroad, and Gazprom has since then restructured delivery arrangements with former Soviet Republics, both in relation to gas supply and by separating transit and gas deliveries. In its annual report for 2006, Gazprom stated on page 49, that its strategy for the markets in the Commonwealth of Independent States (the "CIS"), in which Ukraine is a participant, and in the Baltic states was to

"ensure that Russian gas will continue to maintain its predominant position in their energy sector while adjusting the existing agreements in order to move to contractual terms and conditions similar to those effective in the European countries."

(40) Following the expiry of the above-mentioned 1994 agreement and a failure to agree on an intergovernmental protocol governing gas supplies for 2006, Gazprom terminated gas supplies to Ukraine on 1 January 2006.

(41) Following the termination of gas supplies to Ukraine and subsequent negotiations, a new scheme for gas supplies to Ukraine was agreed:

(i) From 1 January 2006 RosUkrEnergo became the sole importer of natural gas (purchased from Gazprom's subsidiaries – Gazexport LLC and Gazprom LLC) to Ukraine;

(ii) Naftogaz and RosUkrEnergo founded a joint venture – CJSC "Ukrgaz-Energo" ("Ukrgaz-Energo") – for sales of the natural gas imported by RosUkrEnergo in the Ukrainian domestic market;

(iii) RosUkrEnergo purchased gas from Central Asian countries (Turkmenistan, Kazakhstan and Uzbekistan) at their external borders and up to 17 BCM of natural gas from Gazprom;

(iv) The above volumes of gas were resold by RosUkrEnergo to Ukrgaz-Energo;

(v) Ukrgaz-Energo resold the gas in the Ukrainian market (i) directly to industrial consumers and (ii) to Naftogaz which supplied natural gas to local distribution companies.

(42) The transit of Russian gas to Europe and Moldova continued to be regulated separately by the direct 2002 transit contract between Gazprom and Naftogaz. But the transit tariff was raised to compensate for the higher gas price, and the gas for transit barter scheme went out of use.

(43) Thus, starting from 2006, the previous transit and sales arrangements, where transit services were paid for by gas deliveries, were discontinued and split into (i) a separate supply contract scheme involving RosUkrEnergo, Ukrgaz-Energo and Naftogaz, and (ii) the 2002 transit contract between Gazprom and Naftogaz.

(44) Under the above supply arrangements, Gazprom (through its subsidiaries) remained the only actual supplier of gas to Ukraine. RosUkrEnergo had no gas deposits and production capacities. The gas supplied had to be bought from Gazprom or transported through the Russian gas transport system, controlled by Gazprom.

(45) Under the above-mentioned gas supply arrangements from 2006, RosUkrEnergo accumulated significant revenues from importing the combination of Russian gas and cheaper Central Asian gas to Ukraine. Ukrgaz-Energo accumulated significant revenues from the re-sale of such natural gas to industrial consumers. Naftogaz continuously suffered from non-payment by the local distributors. In addition, Ukrgaz-Energo had a five-year gas purchase contract with RosUkrEnergo, while Naftogaz was supplied by Ukrgaz-Energo on a monthly basis.

(46) In the light of the above, Naftogaz required a new, direct gas sales contract with Gazprom to ensure secure gas supplies to Ukrainian consumers and increase its revenues through elimination of the supply scheme involving intermediaries.

V.3 The Ukrainian Gas Transmission System and Underground Storage System

(47) The major part of the Ukrainian GTS along with most of the infrastructure for Russia's gas supplies to Europe was created during the Soviet period as part of the integrated system for gas supply of the Former Soviet Union (FSU) and its COMECON partners.

(48) The Ukrainian GTS consists of three main transit corridors that mainly traverse Ukraine from east to west:[2]

(i) The central corridor, including (a) the Urengoi-Pomari-Uzhgorod pipeline from the Urengoi gas field in western Siberia, which crosses the Russia-Ukraine border north of Sumy, and traverses Ukraine east-west, to Uzhgorod and other pumping stations on Ukraine's borders with Slovakia, Hungary and Romania; and (b) the 'Progress' pipeline from the Yamburg field in western Siberia;

(ii) The 'Bratstvo' pipelines from Briansk and Tula, which go to Kiev and then join the main westward system;

(iii) The 'Soiuz' pipeline from the Orenburg gas field in the Urals, and other lines from Aleksandrov Gai on the Russian-Kazakh border, that enter Ukraine east of Novopskov and run westward to Uzhgorod.

(49) There are also pipelines that:

a. bring Russian gas across south-eastern Belarus to the Ukrainian border to join the main pipeline system;

(ii) cross Ukraine from north-east to south, some of which traverse Moldova, to Izmail on the Ukrainian bank of the Danube river and thence to Romania, the Balkans and Turkey;

(iii)and a corridor from central Russia into eastern Ukraine, through Novopskov and Lugansk, out of Ukraine again, via Rostov, to parts of southern Russia.

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[2] Pirani, Simon, *Russian and CIS gas markets and their impact on Europe*, 2009, pages 110-111.

Map of Ukrainian gas pipelines.[3]

(50) As a consequence of the way the Ukrainian GTS was structured, natural gas enters Ukraine from Russia, and from Russia via Belarus, while it exits Ukraine to Russia, Poland, Slovakia, Hungary and Romania. Some gas also crosses Moldova and re-enters Ukrainian territory. In other words, the Ukrainian GTS was constructed to export gas westwards. The primary role of the Ukrainian GTS continues to be that of export of natural gas, i.e. supplying Russian gas to Europe.

(51) The Ukrainian GTS is the world's largest in terms of transit volumes. It comprises 37,000 km of supply pipelines and 12 underground gas storage facilities (UGSF) (in 13 sites) – five in the western complex, two in central Ukraine and five in eastern Ukraine.[4] Naftogaz subsidiary Ukrtransgaz is the major gas transmission and storage operator, controlling 36,000 km of gas pipelines and 12 UGS facilities.

(52) Ukraine's geographical location and an extensive gas transportation and storage infrastructure inherited from Soviet times make it a main transit route for Russian natural gas on its way to

[3] Map depicted as at 4 March 2014: http://longtailpipe.com/2014/03/04/ukraine-caught-in-fracking-fueled-tug/
[4] Pirani, see footnote 2, p 111.

European markets. Ukraine's GTS input capacity reaches 290 BCM/a, while the outlet capacity is actually at 178.5 BCM/a, of which 142.5 BCM could be delivered to European markets. More than 80% of Russian gas destined for European consumers is being transported through Ukrainian pipelines. As long as Russia will not be connected to main European gas consuming countries by alternative pipelines of significant capacity and circumventing Ukraine, Ukraine is to remain the most important transit corridor for Russian natural gasGas enters Ukraine from several entry points along the Russian border and from Belarus. Most of the gas transit volumes go for the Ukraine-Slovak border. In addition, Russian gas is transported to Southern Russia, Moldova, the Balkan states, Hungary and Poland.

(53) The central role played by Ukraine in the transit of Russian gas is not limited to the design of the pipeline network alone, but also revolves around Ukraine's uniquely large gas storage facilities (a key reason why Soviet-era planners elected to route the pipeline network through the country). Ukraine has around 32 BCM of underground storage, the third largest capacity of such storage worldwide and the largest in Europe after Russia (which has 65 BCM in 25 sites). (For comparison, the EU has 78 BCM in 123 sites.) Approximately 80% of Ukraine's storage capacity is located in the west of the country close to EU borders. The 2010 Report by the Energy Charter Secretariat explains the use and significance of Ukraine's underground storage facilities:

(54) Ukraine's UGS system with 12 underground gas storage facilities in 13 sites and a total capacity of around 32 BCM is equal to 21% of all European UGS volumes. When filled up, the UGS system can deliver a maximum of 254 MCM/d. This covers by far more than 50% of peak national demand on winter days. However, with shrinking filling status of the UGS, the output rate falls respectively. Consequently, in January and February, the traditionally coldest months of a year, deliverability is lower compared to the beginning of the heating season in October.

(55) Ukraine's largest gas storages are located in the Pre-Carpathian region of Western Ukraine. They are directly connected to major gas transit pipelines (Soyuz, Progress, Urengoy-Pomary-Uzhgorod). Ukraine's Western storages account for 79% of all Ukrainian UGS capacity, and for almost 80% (201 MCM/d) of the overall daily withdrawal capacity of 254 MCM/d, which corresponds to 59% of peak daily demand (427 MCM/day, in 2006). Normally, Western

Ukrainian storage capacities are used almost exclusively for balancing Russian gas transit to the EU.[5]

(56) Natural gas consumption in Ukraine is greatest in the east of the country, where industry is heavily concentrated. However, as noted above, around 80% of Ukraine's storage capacity is concentrated in the west of the country. Consequently, gas pumped from Russia through Ukraine is taken from the pipeline to supply Ukraine's industrial east, while gas in Ukraine's western storage facilities is used to supply Europe. Because the storage and transmission system is pressurised, the output rate on the western border (to Europe) is dependent upon the level of gas in storage, and this rate declines over the course of the winter as gas is withdrawn from storage and the pressure in such facilities is reduced.

(57) It is vital for transit supplies to Europe that Naftogaz pumps sufficient gas into storage during the summer period – from May to October – so as to be in a position to withdraw such gas during the winter period for supply to Europe. The storage capacity of Ukraine's eastern facilities is insufficient to meet its demand during peak consumption periods. This was illustrated during the January 2009 gas crisis (see below), when, as explained in the Report of the Energy Charter Secretariat[6], "*Ukraine exploited its Western facilities at maximum output levels and reversed the gas flow in order to cope with gas demand in the country's energy intensive Eastern parts where the available capacity and withdrawal rates of existing UGS sites could not cover the total gas need*". The reversal of the flow of the transmission system prevented Gazprom from supplying gas to Europe. The event underlined Russia's and Europe's dependence upon Ukraine and was a critical moment in defining the further relationship between Gazprom and Naftogaz. The manner in which the January 2009 gas crisis was resolved and supplies to Europe were restarted - in particular through the signing of the Supply Contract and the Transit Contract – forms the backdrop to the issues in dispute in the current arbitration proceedings.

(58) Thus, the manner in which gas is made available and supplied to Naftogaz by Gazprom, and gas is transited by Naftogaz to Gazprom's European offtakers, is a function of the structure and operation of the Ukrainian pipeline system.

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[5] Energy Charter Secretariat, *The Role of Underground Gas Storage for Security of Supply and Gas Markets*, Occasional Paper, 2010, p. 106**.**

[6] See footnote 5, p. 107.

(59) As described above, there are three main transit corridors (four major transit pipelines) passing through Ukraine. The major transit lines flow westwards, entering Ukraine on its borders with Belarus and/or Russia, and exiting Ukraine on the borders with Poland, Slovakia, Hungary, Romania and Moldova. Each pipeline is composed of several "*strings*", which are in fact separate pipelines that run along the same route. When consumption is lower, in the summer months, fewer strings are in operation; when consumption is higher, more strings are put into operation. Within Ukraine, offtake pipelines connect the transit lines to the domestic Ukrainian pipeline network. The Ukrainian pipeline operator manages the offtake of gas from the transit pipeline for supplies to Ukrainian consumers, and the pumping of gas into and withdrawal of gas out of Ukraine's storage facilities. The map below outlines broadly the routes of the main transit lines, the direction of flow and the locations of storage facilities and compressor stations.

(60) Compressor stations are facilities located along a natural gas pipeline which compress the gas to a specified pressure, thereby allowing it to continue traveling along the pipeline to the intended recipient. They also allow the gas to be rerouted into storage areas. The gas required to run the compressors is known as fuel gas, or technical gas. Each year, the Ukrainian transmission system requires approximately 7 to 8 BCM of "*technical*" or "*fuel*" gas for the purposes of powering the compressor stations.

(61) For safe operation, pressure in the pipeline must be retained at a consistent level within an established range depending on the design specifications of the pipeline. It is Gazprom's responsibility to maintain the requisite level of operational pressure at the entrance points of the transit lines, whereas within Ukraine, this is the responsibility of the Ukrainian transmission system operator, Ukrtransgaz, Naftogaz' subsidiary. The technical parameters for maintenance of the required pressure are set out in a [redacted] between the Parties, which was signed on 6 April 2009.

V.4 The Management of Gas Volumes in Ukraine

(62) The volumes supplied under Contract, i.e Contract KP or the Sales Contract, and transited under Contract TKGU, i.e. the Transit Contract, are determined based on measurements taken at the entrance points of each respective pipeline along Ukraine's borders with Russia and Belarus, and again at exit points along Ukraine's borders with Poland, Slovakia, Hungary, Romania and Moldova. The gas measuring stations are staffed by representatives of each party (in the case of Naftogaz, Ukrtransgaz), and the volumes of gas entering and leaving Ukraine are recorded on a daily and monthly basis.

(63) Gazprom’s and Naftogaz' respective dispatch centres (in the case of Naftogaz, Ukrtransgaz) are in regular, daily communication with each other in order to coordinate delivery volumes and manage the operation of the system. Volumes actually delivered are determined through the nomination process. Each day, "*nominations*" or "*orders*" are exchanged between the Parties specifying the volumes that (i) in the case of Gazprom, it intends to send for transit to European offtakers, and (ii) in the case of Naftogaz, the volumes it intends to offtake (either for domestic consumption and/or to pump into storage). In determining the total volumes of gas to deliver into the pipeline, Gazprom takes into account the daily nominations that it receives from all its offtakers including Naftogaz. Such nominations/orders are required to ensure that the pressures in the pipelines are maintained at consistent and safe operational levels and that sufficient gas is delivered into each respective pipeline.

(64) Gazprom and Naftogaz, through the nomination process, coordinate the delivery of gas supplies to Ukraine and Europe to ensure the safe operation of the gas transportation system in the following way:

(i) Gazprom's European offtakers submit to Gazprom nominations, or orders, which specify the quantities of gas to be delivered to them for offtake the following day;

(ii) Gazprom aggregates these nominations and submits to Naftogaz a nomination, or order, that specifies the volumes of gas that will be delivered to Ukraine/Naftogaz the following day for transit to European offtakers (under the Transit Contract). The nomination indicates what volumes of gas should be delivered to each respective gas metering station at the Western border of Ukraine (with Poland, Slovakia, Hungary, Romania and Moldova);

(iii)Upon receipt of Gazprom's nomination, Naftogaz sends Gazprom a nomination specifying the total volumes to be delivered to the Ukrainian transmission system the following day. This nomination of Naftogaz:

- confirms the volumes of gas nominated by Gazprom for transit to European offtakers (under the Transit Contract), and
- nominates the additional volumes of gas to be supplied by Gazprom and offtaken by Naftogaz (under the Sales Contract) for use within Ukraine;

(iv) Gazprom arranges for the aggregate volumes confirmed and nominated by Naftogaz (i.e. transit gas and deliveries to Ukraine) to be pumped into the transmission system and delivered to the relevant gas metering stations on the border of Ukraine and Russia/Belarus;

(v) Naftogaz (through Ukrtransgaz) arranges for:

- the volumes it nominated for delivery to Naftogaz to be offtaken withing Ukraine, and
- the volumes that Gazprom nominated for transit to European offtakers to be delivered to the relevant gas metering stations on the borders of Ukraine and the relevant European countries, i.e. Hungary, Poland, Slovakia, Romania and Moldova.

(65) The nomination process is a long established practice by the Parties, who have jointly managed gas supplies passing through their respective gas transmission systems for several decades. The process is critical to allow Gazprom and Naftogaz to manage the levels of pressure of in transmission system effectively and within safe parameters, and to ensure that the nominated volumes of gas are made available to offtakers at the relevant destinations. Gazprom only arranges for volumes of gas to be pumped into the transmission system for delivery to Ukraine and Europe if such volumes have first been nominated by offtakers and the aggregate delivery volumes coordinated with Naftogaz (Ukrtransgaz) as operator of the transmission system. From a technical standpoint, not to coordinate these issues with Naftogaz, and to pump more gas into the system than has been nominated and is expected by Ukrtransgaz, could potentially produce a dangerous situation.

(66) The volumes delivered to Ukraine are determined based on the data recorded at the relevant gas metering stations, as the difference between the total volumes that enter Ukraine at the entrance points on the Russian and Belarussian borders and the total volumes that exit Ukraine at the exit points on the Polish, Slovakian, Romanian, Hungarian and Moldovan borders.

V.5 The History of the Gas Supply and Gas Transit Relationship between Russia and Ukraine from 2007

(67) In late 2007 and early 2008, the then Prime Minister of Ukraine Mrs. Yulia Timoshenko arranged for changes in Naftogaz' management. Mr. Oleg Dubina was appointed as Chairman of the Board on 24 December 2007, and Mr. Igor Didenko was appointed as the Deputy

Chairman of the Board on 6 February 2008. Naftogaz' management was tasked to make new gas supply arrangements directly with Gazprom, without any middlemen.

(68) Over the course of 2008, the question of agreements for gas supplies became a politically charged topic in Ukraine and there was increasing political demand for a direct supply relationship with Gazprom. Furthermore, the issue of Naftogaz' non-payment of gas supplies escalated. Discussions took place on 12-13 February between Russian President Putin and Ukrainian President Yuschenko and after that it was announced that there was agreement on a political level for the replacement of the intermediaries RosUkrEnergo and UkrGazEnergo (the joint venture between RosUkrEnergo and Naftogaz to sell to Ukrainian industrial consumers) by a joint venture between Gazprom and Naftogaz. However, this failed to resolve the debt issue, and Naftogaz' outstanding debts climbed to USD 1,5 billion. On 3 March 2008, Gazprom reduced supplies to Naftogaz by 25%. Naftogaz answered by threatening to divert gas destined for Gazprom's European offtakers.

(69) The conflict over non-payment was further exacerbated by the rivalry between President Yushchenko and Prime Minister Yulia Tymoshenko, with Tymoshenko seeking to renege on the agreement that Ukrainian President Yushchenko had reached with Russian President Putin in early February to replace RosUkrEnergo and UkrGazEnergo with a Gazprom-Naftogaz joint venture, suggesting instead that Naftogaz should take sole control of the Ukrainian distribution market. (Prime Minister Tymoshenko: "*We have decided firmly that not a single cubic metre of gas will be supplied through anyone other than Naftogaz*".)[7]

(70) This rivalry was to continue until the end of 2008 and obstruct the negotiation of new supply and transit arrangements between Gazprom and Naftogaz, ultimately causing a breakdown in negotiations and leading to the January 2009 supply disruption.

(71) The tense situation in early 2008 was diffused by discussion between Ukrainian President Yushchenko and Russian President Putin, further to which, on 12 March 2008, Naftogaz and Gazprom entered into the Agreement on Development of Relations in the Gas Sector (the "*12 March 2008 Agreement*"). The 12 March 2008 Agreement was aimed at (i) resolving the issue of supplies to Ukraine in 2008 (both retrospectively and prospectively), and (ii) establishing the

[7] Belton, Catherine and Roman Olearchyk, "*Gazprom limits Ukraine supply over unpaid bill*", *the Financial Times*, 4 March 2008..

basis on which the Parties could proceed to the negotiation of a direct supply arrangement. It provided, *inter alia*:

(i) for Naftogaz and either RosUkrEnergo or Gazprom to enter into an agreement to cover supplies of 49.8 BCM of Central Asian gas in 2008 at the price of USD179.50 ;

(ii) for Naftogaz and RosUkrEnergo to enter into an agreement to cover the (extra-contractual) supplies of Russian gas taken by Naftogaz in early 2008, providing for the return of such volumes by Naftogaz;

(iii) for Naftogaz, as of 1 April 2008, to "*enter into a long-term contract with a subsidiary or affiliate of Gazprom to be established in the territory of Ukraine for the purchase and sale of natural gas supplied from Central or Middle Asia in 2008 and subsequent years in the amount of not less than 7.5 BCM annually*" for sales to the industrial consumers in Ukraine at a magin not higher than 0,01 USD per 1000 m^3 ;

(iv) for Naftogaz to render assistance to Gazprom in establishing a subsidiary in Ukraine ;

(v) for Naftogaz to procure that RosUkrEnergo be able to withdraw and transit the gas it held in Ukrainian storage facilities to European offtakers ;

(vi) for Naftogaz to procure that Gazprom/Gazprom Export be able, under the 2002 Transit Contract, to transit the additional volumes of Central Asian gas that had previously been supplied by RosUkrEnergo to European offtakers ;

(vii) for Gazprom and Naftogaz to use their maximum efforts to ensure repayment of the debt owed by RosUkrEnergo to the Gazprom group (i.e. which debts were a direct result of Naftogaz' outstanding debts to RosUkrEnergo); and

(viii) that the natural gas delivered to Naftogas was intended for Ukrainian consumers and was not to be (re)exported from Ukraine.

(72) In summary, the 12 March 2008 Agreement was aimed at establishing the basis for the removal of RosUkrEnergo from the supply chain and for the assumption by Gazprom (or a Gazprom subsidiary) of RosUkrEnergo's existing business.

(73) In accordance with the 12 March Agreement, on 14 March 2008 Naftogaz and RosUkrEnergo entered into a contract which provided for the supply of 49.8 BMC of Central Asian gas at the price of USD 179.50 per TMC over the period from 1 January 2008 to 31 December 2008 ("*Contract 198*"). There were therefore over nine months for Gazprom and Naftogaz to negotiate new supply and transit contracts before expiry of Contract 198 on 31 December 2008.

(74) Having removed one of the intermediaries – Ukrgaz-Energo – and secured gas supplies for 2008, Naftogaz proceeded to seek direct long term supply and transit contracts with Gazprom from 2009.

(75) During 31 March – 01 April 2008 meeting in Moscow, Naftogaz and Gazprom agreed in principle that Naftogaz could be the sole importer of Russian gas to Ukraine, and that RosUkrEnergo could be removed from the gas supply arrangements.

(76) After the above agreement in principle was reached, the Parties commenced the negotiations which, *inter alia*, resulted in the conclusion of the Contract.

(77) On 13 June 2008, Naftogaz wrote to Gazprom, attaching a draft agreement for the supplies by Gazprom to Naftogaz over the period 2009 to 2019 in the volume of no less than 55 BCM anually in order to initiate the transition to direct and long-term gas supply and transit relations with Gazprom. However, save for putting in place contracts for supplies in 2008, little progress had been made in relation to the other issues outlined in the 12 March 2008 Agreement. In particular, no progress had been made on payment in full by Naftogaz of its outstanding debts to RosUrkEnergo, which as of early July 2008, totalled over USD 2 billion. The issue of new supply and transit agreements between Gazprom and Naftogaz did not gain momentum again until later in the year, following the summer period.

(78) The history of supply and transit arrangements between Russia and Ukraine meant that a decision by Gazprom to agree to the demands of the Ukrainian leadership for a direct supply arrangement was not one that Gazprom entered into without reservations. The difficulty in recovering payment for supplies to Ukraine was according to Gazprom the reason why, until 2008, supplies had largely been delivered to Ukraine either (i) by Gazprom in exchange for transit services, or (ii) by third party intermediaries that took on the non-payment risk. To Gazprom, the use of RosUrkEnergo offered a number of benefits, and the Ukrainian proposal to remove RosUrkEnergo from the supply chain would deprive Gazprom of such benefits.

(79) On 2 October 2008, the Government of the Russian Federation and the Cabinet of Ministers of Ukraine concluded a Memorandum on cooperation in the gas field (the "*2 October 2008*

Memorandum"). The Russian and Ukrainian governments welcomed the transition to direct long-term relations between Gazprom and Naftogaz. The Memorandum foresaw a three-year, stepwise transition to market, economically reasonable and mutually agreed gas prices (item 2). Furthermore, the governments confirmed Naftogaz' intention to become the sole importer of natural gas supplied to Ukrainian consumers (item 3).

(80) On 10 October 2008, Gazprom provided Naftogaz with a package of draft documents considered necessary by Gazprom to implement the above-mentioned Memorandum, including a draft gas sales contract.

(81) Further to the signing of the above Memorandum, on 16 October 2008, Naftogaz and Gazprom entered into the Agreement on the principles of long-term cooperation in the gas sector (the "*16 October 2008 Agreement*"), in which they agreed, *inter alia*, as follows:

(i) Naftogaz agrees that the transition to direct relations in respect of supply of gas will be conditional on the payment of debts owed to Gazprom for natural gas supplied to Ukrainian consumers, timely payment for future supplies and the possibility of the companies of Gazprom group to supply natural gas to Ukrainian consumers;

(ii) The Parties agree that from 1 January 2009 Naftogaz will be the sole importer of all volumes of natural gas to the territory of Ukraine;

(iii) Simultaneously with the fulfilment of the provision above under *b),* Naftogaz shall sign a long-term contract on supply of natural gas with "*Gazprom Sbyt Ukraina*" LLC for its further sales to industrial consumers of Ukraine in the volume of 7.5 BCM. In addition, Naftogaz shall render its assistance in Gazprom Sbyt Ukraina' LLC obtaining the license for the right to sell natural gas on the territory of Ukraine to industrial consumers for the volume of not less than 7.5 BCM, and with a period of validity equal to period of validity of the Contract for the purchase and sale of gas between Gazprom and Naftogaz;

(iv) The Parties shall sign by 1 November 2008 a long-term contract for supply of natural gas. By this, a transition to market, economically substantiated and mutually agreed prices on the imported natural gas for Ukrainian consumers will be done within the next three years; the natural gas supplied to Ukraine by Gazprom is intended for Ukrainian consumers only, and is not subject to sale outside the territory of Ukraine.

(v) The Parties will agree on joint gas supplies to European markets; and

(vi) The Parties shall enter into a short term contract for gas supplies in November-December 2008 at the price of USD 179.5 per 1000 m^3

(82) Subsequent to the signing of these agreements, there was an exchange of draft contracts between Gazprom and Naftogaz in late November and early December 2008. By December, the issue of putting in place a direct supply agreement between Gazprom and Naftogaz was urgent. Whilst the 2002 transit contract between Naftogaz and Gazprom would continue in effect after the New Year, the supply agreement between Naftogaz and RosUrkEnergo was to conclude on 31 December 2008. After this date there would be no contractual basis upon which Gazprom (or RosUrkEnergo) had to supply gas to Ukraine.

(83) On 23 October 2008, Naftogaz provided Gazprom with a set of draft documents intended to implement the 16 October 2008 Agreement, including a new draft gas sales contract for 2009-2019. The draft gas sales contract was primarily based on Naftogaz' previous draft of 13 June 2008 and also incorporated the main principles in the 16 October 2008 Agreement, including the three-year period for transition to market-reflective pricing. However, the draft did not include a price formula or a fixed price. Instead, the price was to be agreed between the Parties in addenda to the Contract.

(84) In response, Gazprom provided its own set of draft documents, including a new draft gas sales contract, to Naftogaz on 29 October 2008.

(85) Naftogaz sent questions to Gazprom related to Gazprom's draft sales contract, and on 13 November 2008 Gazprom sent a letter to Naftogaz with a new draft sales contract attached. The disagreement between the Parties was mainly about the price formula.

(86) One of Gazprom's conditions to agreeing to move to a direct supply relationship with Naftogaz was payment in full by Naftogaz of all its debts to RosUrkEnergo (thereby enabling RosUrkEnergo to extinguish its debts to Gazprom).

V.6 The Situation at the End of 2008

(87) Towards the end of 2008, Naftogaz understood that the Parties would be unable to agree on all issues in a long-term agreement, in particular on the price formula proposed by Gazprom before the end of the year. Naftogaz therefore proposed to fix the Contract price and delivery volumes for 2009, and resolve all other issues, including the price formula, in the course of 2009. This approach was preliminarily approved by Gazprom's representatives, on the condition of full payment of debts to Ukrainian consumers. According to Naftogaz, Naftogaz paid all its debts for gas deliveries from RosUkrEnergo by the end of 2008. According to Gazprom, full payment did not occur by the end of 2008 or thereafter. According to Gazprom, it is correct that Naftogaz eventually did make a payment for supplies under Contract 198 on 31 December 2008. However, according to Gazprom, even taken into account the 31 December payment, Naftogaz was still indebted to RosUrkEnergo for hundreds of millions of dollars.

(88) On 30 December 2008, Gazprom received a letter from Naftogaz, in which Naftogaz informed that it would divert Gazprom's supplies to European offtakers, if agreement was not reached on new supply and transit arrangements (according to Gazprom, this happened despite the fact that Gazprom had prepaid approximately USD 396 million for transit services in 2009).

(89) In the last week of December 2008, a delegation of Naftogaz representatives travelled to Moscow and negotiations took place over the course of several days. On 31 December 2008, representatives of the Parties met in Gazprom's offices in Moscow. Around lunchtime, the Parties had managed to agree on the main details of the future contracts, except the gas price and the transit tariff for 2009. According to Naftogaz, the preliminary understanding was that the gas price would be around USD 230-250 per 1000 m^3, but Gazprom's representatives then started to indicate new gas prices of around USD 320. According to Gazprom, this is not correct. Instead, according to Gazprom, the negotiating positions with regard to the price was:

(i) Gazprom - USD 250 per TCM; and

(ii) Naftogaz - USD 179.50 per TCM.

(90) There was no agreement, and around 22:00 in the evening, Naftogaz' representatives returned to Kiev.

V.7 The January 2009 Gas Crisis

(91) At 10 am Moscow time on 1 January 2009, Gazprom halted all deliveries of natural gas to Ukraine. Gazprom's central dispatching department informed Ukrtransgaz (Naftogaz' affiliate responsible for operation of Ukraine's gas transport system, the GTS) of the interruption by telefax.

(92) According to Gazprom, the reason for this was that there was no existing supply contract between Gazprom and Naftogaz as at the end of 2008, and Contract 198 between Naftogaz and RosUrkEnergo expired on 31 December 2008.

(93) Subsequent to its letter of 30 December 2008, according to Gazprom, Naftogaz made its intention to take additional volumes of "*fuel gas*" from the transit flows explicit. On the evening of 1 January 2009 at 09:14 pm, Gazprom received a fax from Ukrtransgaz confirming the volumes of gas Naftogaz / Ukrtransgaz would transit to Gazprom's European offtakers the following day, but also expressly stating that Naftogaz intended to offtake additional volumes for its own use:

> "*At the same time, the natural gas will be additionally offtaken in the volume of up to 21 million cubic metres per day for the production and technological needs of the Gas Transportation System of Ukraine in order to ensure the above-mentioned gas transit volumes.*
>
> *Please provide for gas resources required in order to ensure gas transit to European consumers.*"[8]

(94) According to Naftogaz, Gazprom reduced and cut supplies unilaterally, without consultation with Ukrtransgaz' dispatching services. The result was, according to Naftogaz, that Ukrtransgaz had to significantly shift the gas flows and the operation of the GTS in an improvised fashion. Supplies to the inhabitants and industry in the largest industrial region of Ukraine were threatened. According to Naftogaz, as the specialists in Gazprom's dispatching services knew very well, the situation was also a significant threat to the transit of Russian gas through Ukraine to Europe.

(95) According to Naftogaz, the situation in 2009 was very difficult because of Gazprom's cuts of deliveries through the Eastern regions of Ukraine, which could lead to a humanitarian and technological disaster, and because Gazprom first limited, and then completely cut, gas deliveries into the GTS for transit to Europe.

(96) Under the circumstances, according to Naftogaz, it had to reverse the gas flow in the GTS, to supply Ukrainian gas from storage and own production to the eastern regions. This was a risky emergency measure, which had not been theoretically considered or tested to such an extent before.

[8] Facsimile No. 04-D from Ukrtransgaz to Gazprom dated 1 January 2009.

(97) Naftogaz reiterated its intention to offtake additional volumes in a fax (signed by Mr Didenko) sent to Gazprom on 5 January 2009, stating:

"*Due to the non-signing of the Contract for the supply of imported gas to Ukraine, [Naftogaz] has no resources of fuel gas, as in accordance with the laws of Ukraine, the gas purchased by the company solely from external sources is used for technological needs of the gas transportation system of Ukraine. For this reason to ensure the reliable and stable transit of Russian natural gas [Naftogaz] is forced to offtake on a daily basis for technological needs about 21 million cubic meters of gas from the whole volume of gas received at the entrance point of the gas transportation system of Ukraine. …*"[9]

(98) According to Gazprom, these faxes were a thinly veiled attempt by Naftogaz to justify taking gas that was not intended for it and to which it was not entitled. "Fuel gas" (also known in the former Soviet Union as "technical gas") is industry parlance for gas required to run the compressor stations. General practice is that fuel gas is provided by the transportation / transit company and included in the tariff charged to the shipper i.e. there is no separate price or tariff charge for this gas. According to Gazprom, there was no contractual basis under the 2002 Transit Contract for Naftogaz to take technical gas as compensation for transit services.

(99) From 2 to 5 January 2009, Gazprom's supply reductions affected gas deliveries to several EU states, notably Poland, Slovakia, Hungary, and above all Bulgaria and Romania. On the night between 6 and 7 January 2009, all supplies from Russia through Ukraine to the EU were cut. There were no gas supplies from Russia to Europe from 7 January to 20 January.[10]

(100) The EC Commission invited the Parties to meet in Brussels on 8-12 January 2009 to facilitate an agreement between the Russian government / Gazprom and the Ukrainian government / Naftogaz. This meeting resulted in an agreement providing for independent monitors from all the involved Parties to oversee the gas transit on Russian and Ukrainian territory.[11]

(101) The final negotiations of the Contract took place against the background of the supply interruption described above. These final negotiations took place between government delegations on 17-18 January 2009 in the Russian Government Building in Moscow, and continued between representatives of Naftogaz and Gazprom from 18 to 20 January in Gazprom's Moscow headquarters.

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[9] Fax from Naftogaz, signed by Mr Didenko, sent to Gazprom on 5 January 2009.

[10] Commission Staff Working Document SEC (2009) 977 final. «The January 2009 Gas Supply Disruption to the EU: An Assessment», dated 16 July 2009, pp. 3-4. Naftogaz' Statement of Claim (539)-(544).

[11] Commission Staff Working Document, p. 4.

(102) The intergovernmental negotiations mainly took place behind closed doors, directly between the Ukrainian and Russian Prime Ministers, Mrs. Yulia Timoshenko and Mr. Vladimir Putin, sometimes joined by Gazprom's Chairman of the Board Mr. Alexey Miller alone or together with Naftogaz' Chairman of the Board, Mr. Oleg Dubina. At around 02:00 am on 18 January, Naftogaz' representatives were informed that the base price would be USD 450 per 1000 m^3, and that the Contract price would be calculated pursuant to a formula based on Gazprom's standard contracts with European buyers, and would be USD 360 per 1000 m^3 for 2009. The Naftogaz representatives were instructed to formalize the agreement and finalize the Contract in cooperation with Gazprom's representatives. On 19 January 2009, there was an official signing ceremony. The negotiations of the Contract continued, however, into the early morning of 20 January, when the actual Contract was signed.

(103) The January 2009 gas crisis, which involved a serious disruption of gas supplies to Europe and resulted in the signing of the Contract and the Transit Contract, was the culmination of almost two decades of what might colloquially be called the legal and economic "*decoupling*" of Russia and Ukraine's gas supply and transit relationship.

<u>V.8 Request for Price Revision</u>

(104) According to Naftogaz, it requested a price revision for the first time in a letter dated 20 May 2011. The request pointed to the developments in the fuel and energy market which by then had resulted in a situation where, according to Naftogaz, the Contract Price no longer corresponded to the then current price levels of natural gas.

(105) In a letter dated 8 June 2011, Gazprom alleged that Naftogaz' letter of 20 May 2011 did not contain the necessary substantiation for a request for price revision. Further letters were exchanged between the Parties regarding the gas delivery volumes, the price and the postponement of the payment for the gas and they met several times after Naftogaz' request of 20 May 2011 but no final written agreement was reached.

(106) The mandatory three months of negotiations set out in Article 4.4.2 of the Contract passed and the possibility pursuant to Article 8 of the Contract to refer the dispute to final determination by arbitration was then open according to Naftogaz.

(107) In accordance with Article 8.2 of the Contract, Naftogaz sent a notification to Gazprom on 27 April 2014 (in the Request for Arbitration referred to as a letter of 28 April 2014). In the notification, Naftogaz stated its views on the need for price revision and on certain disputes and controversies, and made it clear, that it would submit to arbitration these issues, if an agreement was not reached within the 30 days stipulated in Article 8 of the Contract.

(108) On 13 May 2014, Gazprom responded to Naftogaz' notification. In its answer, Gazprom rejected any and all claims of Naftogaz concerning the Contract.

(109) The 30-day period for negotiations provided for in Article 8.2 of the Contract expired on 28 May 2014. Further negotiations did not result in any agreement.

(110) On 16 June 2014, Naftogaz submitted its claims for price revision and also its other claims in a request for arbitration (Request: Case no. V2014/080).

(111) On the same day, i.e. on 16 June 2014, Gazprom submitted a request for arbitration (Request: Case no. V2014/078) claiming that Naftogaz should be ordered to pay to Gazprom all the sums due arising out of or in connection with the Contract and that the preliminary claim was in excess of USD 4.5 billion.

(112) On 19 July 2014, the Parties agreed that the two arbitrations were to be consolidated into one arbitration and that the language of the arbitration should be English. The arbitral proceedings then commenced, see further below under Procedure.

VI. THE CONTRACT

VI.1 General Information About the Contract

(113) The Contract is a longterm sales contract for Natural Gas of Russian, Kazakh, Uzbek or Turkmen origin, dated 19 January 2009. On the same day, the Parties also entered into the Transit Contract regarding the volumes and terms of transit of Natural Gas through the territory of Ukraine for the period 2009-2019. The Transit Contract is subject to another arbitral procedure with the same tribunal as the Tribunal (the "Transit Arbitration"). However, certain evidence from the Transit Arbitration has also been invoked in this Arbitration.

(114) The language of the Contract is Russian. The Parties disagree on how the wording of some of the provisions of the Contract ought to be translated into English.

(115) According to Article 1.1, the Contract also includes the following [redacted] that have been incorporated by reference.

(i) [redacted]

(ii) [redacted]

(iii) [redacted]

(iv) [redacted]

(v) [redacted]

(vi) [redacted]

(vii) [redacted]

(viii) [redacted]

(ix) [redacted]

(x) [redacted]

(xi) [redacted]

(xii) [redacted]

(xiii) [redacted]

(xiv) [redacted]

(xv) [redacted]

(xvi) [redacted]

(xvii) [redacted].

(xviii) [redacted].

(xix) [redacted]

(xx) [redacted]

(xxi) [redacted]

(xxii) [redacted]

(xxiii) [redacted]

(xxiv) [redacted].

(xxv) [redacted].

(xxvi) [redacted]

(xxvii) [redacted]

[redacted]

(xxviii [redacted]

(xxix) [redacted]

(xxx) [redacted]

(xxxi) [redacted]

(xxxii) [redacted]

(xxxiii [redacted]

(xxxiv) [redacted]

VI.2 The Provisons of the Contract That Are Relevant in The Dispute

(116) Below follows a presentation of the provisions of the Contract, which are subject to dispute or otherwise relevant in this Arbitration.

VI.2.1 Article 2. Subject matter of the Contract

VI.2.1.1 Article 2.2-2.4.

(117) According to Article 2.2 of the Contract, Gazprom (the Seller) undertakes to deliver and Naftogaz (the Buyer) undertakes to accept the Natural Gas during the period from 1 January 2009 to 31 December 2019 on DAF conditions at the border of the Russian Federation / Ukraine and/or border of the Republic of Belarus / Ukraine (Incoterms 2000) at the Points of Delivery in the quantity of 40 billion m^3 in 2009, and, beginning from 2010, 52 billion m^3 per year (the 'Annual Contract Quantity' or 'Annual Contract Volume', 'ACQ' or 'ACV'), "*and pay for all the delivered Gas in accordance with the terms and conditions hereof*".

(118) According to Article 2.2.3, the ACQ/ACV specified in Article 2.2 may be amended by agreement of the Parties no later than six months prior to the beginning of the relevant delivery year. Such an agreement shall be made in writing. The ACQ/ACV change shall not exceed 20% of the quantity specified in Article 2.2.

(119) Pursuant to Article 2.3, the Seller undertakes to deliver the Natural Gas to the Buyer in a common gas stream at the Points of Delivery at the border of the Russian Federation / Ukraine and/or the border of the Republic of Belarus / Ukraine.

(120) Under Article 2.4, the Buyer undertakes to accept the Natural Gas from the Seller at the points of delivery at the border of the Russian Federation / Ukraine and/or the border of the Republic of Belarus / Ukraine.

VI.2.1.2 Take or Pay Provision

(121) Article 2.2.5 contains the following Take or Pay obligation:

(122) In Gazprom's translation:

*"Within each Year of Delivery Naftogaz is obliged to offtake and pay for, or pay for if the volume was made available by Gazprom but not off-taken by Naftogaz, not less than the following Minimum Annual Volume (the "**MAV**") of the Natural gas:*

MAV = 0.8 x ACV"

(123) In Naftogaz' translation:

"During each Delivery Year, the Buyer shall take off and pay for, or only pay for, if the quantity was delivered by the Seller but not offtaken by the Buyer, at least the following Minimum Annual Quantity (the ***'MAQ'****) of the Natural Gas*:

MAQ = 0.8 x ACQ"

VI.2.1.3 Provision regarding the quality of the Natural Gas

(124) Article 2.5 prescribes the quality of the gas to be delivered by the Seller as regards physical and chemical characteristics.

VI.2.2 Article 3. Gas Delivery and Acceptance

VI.2.2.1 The Destination Clause

Article 3.10 contains a destination clause prescribing that

"The Natural Gas delivered herunder is intended for consumers in Ukraine and the Buyer may not sell it outside Ukraine."

VI.2.3 Article 4. Contract Price for Gas

VI.2.3.1 The Price Provisions

(125) Article 4 of the Contract contains the provisions for how the "*Contract Price for Gas*" shall be calculated. This shall be done according to a price formula building on the prices for fuel oil and gas oil. The central price provisions are found in Articles 4.1 to 4.3.

(126) Article 4.1 provides for how *"(t)he Contract Price for the Natural Gas having the basic net calorific value of 8,050 kcal/m^3 and delivered hereunder shall be calculated on a quarterly basis…*".

(127) Structurally, the Price Formula in Article 4.1 consists of three main parts; a base price, an escalation supplement and a coefficient.

(128) Pursuant to Article 4.1 as amended by Addendum No. 27 (which amendment introduced only editorial changes with no material effect for the Price Formula), the Contract Price, P_n, "*shall be calculated on a quarterly basis according to the following formula:*

$$P_n = P_0 \, (0.5 \text{ x } G/G_0 + 0.5 \text{ x } M/M_0) \text{ x } k$$

where P_n is the contract price in US dollars per 1,000 m^3 of the Gas".

(129) Further, pursuant to article 4.1:

(i) The Contract Price, "P_n" is to be determined as of 1 January, 1 April and 1 October of each Delivery Year and shall be valid within the corresponding quarter of the Delivery Year and the Contract Price P_n valid in the 1st quarter of 2009 amounts to USD 360 per 1,000 m^3 of the Gas;

(ii) "P_0" is the base price (by Gazprom called "*the reference price*") in the amount of USD 450 per 1,000 m^3 of the Gas;

(iii)"G" and "M" represent the prices of gas oil and fuel oil, respectively, calculated every quarter, on 1 January, 1 April, 1 July, 1 October, as the arithmetic mean of gas and fuel oil prices over the preceding nine-month period as published by Platts Oilgram Price Report;

(iv)"G_0" and "M_0" represent prices of gas oil and fuel oil respectively over the nine month period from April 2008 to December 2008, and are fixed over the life of the Contract as follows:

- "G_0" is fixed at USD 935.74 per tonne, being the arithmetic mean of gas oil prices over the nine month period from April 2008 to December 2008; and

- "M_0" is fixed at USD 520.93 per tonne, being the arithmetic mean of fuel oil prices over the nine month period from April 2008 to December 2008; and

(v) Coefficient "k" is, in 2009: 0.8. and from 2010 "k" is: 1.

(130) Thus, the formula consists of a base price (reference price) P_0, plus a quarterly adjustment, the escalation supplement, reflecting the movements in the price of the index-fuels, gasoil (G) and fuel oil (M), and a coefficient "k" introduced to make the price formula reflect the level of market prices in January 2009. In January 2009, the USD 360 per 1000 m^3 Contract Price reflected the level of market prices which was then USD 360.6 per 1000 m^3. The escalation supplement also incorporates the weights of the index-fuels (0.5).

(131) The Contract Price Formula is a multiplicative formula, where the base price (reference price) is multiplied by the changes in the value of the escalators over time and by the coefficient, resulting in the Contract Price P_n.

(132) The Contract Price, P_n, is the product of the multiplicative formula. For the first quarter of 2009, P_n, was fixed at USD 360 per 1000 m^3 consistently with multiplying the P_0, USD 450, with the coefficient k, 0.80. Thus, in the first quarter of 2009, the escalation supplement added zero to the Contract Price P_n. P_n reflected the level of market prices on 1 January 2009.

(133) P_0 is the base price (reference price) in the amount of USD 450 per 1,000 m^3 of Natural Gas.

(134) Article 4.2 of the Contract regulates where the net calorific value (the energy content) of the delivered Natural Gas diverges from the agreed base net calorific value. Article 4.2 determines how to calculate P_x, the Factual Price (also called the Actual Price) of Natural Gas, which is the final price to be paid for specific deliveries of Natural Gas.

(135) It is this Factual Price of the Contract, which is adjusted by Addenda No. 3 and No. 29 (see further below). Thus, Article 4.2 (as subsequently amended by Addendum No. 2, dated 24 February 2010) regulates the consequences of quality variations for the "Factual Price", P_x, to be paid under the Contract. The Factual Price is the ajusted price to be paid in case the net calorific value (the energy content) of the delivered Natural Gas in a Delivery Month is higher or lower than the basic net calorific value as provided in Article 4.1. The calcultion of the Factual Price, P_x, is the following

$$P_x = P_n \text{ x Q fact.}/8050$$

Where P_x is the Factual price of Natural Gas, P_n is the Contract Price of Natural Gas and "Q fact." (kcal/m^3) is the weighted average factual monthly net calorific value.

(136) Article 4.3 sets out the price to be paid if the Buyer off-takes an amount exceeding the Monthly Delivery Volume by more than six percent of Natural Gas.

(137) The Contract Price shall also be adjusted to take into account any applicable taxes payable in the Russian Federation, as provided for by Article 4.5 as follows:

"The price for gas, pursuant to which its actual delivery shall be effected, includes all taxes and charges (including VAT) due and payable in the Russian Federation."

(138) The Contract Price in Article 4.1 can be subject to revision/adjustment according to Article 4.4 of the Contract which provides the following:

(139) According to Naftogaz' translation:

"*If any of the Parties declares, that the circumstances in the fuel and energy market have changed significantly compared to what the Parties had reason to expect at the conclusion of this Contract, and if the Contract Price provided in Article 4.1 of this Contract, does not reflect the level of market prices, then the Parties shall enter into negotiations regarding an adjustment of the Contract Price in accordance with the provisions of this Contract.*"

(140) According to Gazprom's translation:

"If either Party declares that the fuel and energy market conditions have materially changed in comparison with the conditions reasonably anticipated by the Parties when concluding this Contract, and the contract price specified in Article 4.1 of this Contract does not reflect the level of prices in the market, the Parties shall proceed to negotiations to reconsider the contract price in accordance with the provisions of this Contract ".

(141) The conditions for price revision may be summarized as two cumulative requirements. Thus, a price revision may be requested in the event of/if:

(i) A significant (material) change in circumstances (the conditions) in the fuel and energy market, compared to what the Parties had reason to expect (reasonably anticipated) when they entered into the Contract; and

(ii) The Contract Price in Article 4.1 of the Contract does not reflect the level of market prices.

(142) Article 4.4.1 contains the following:

(143) In Naftogaz' translation:

"*The request for price revision shall be made in writing and be properly substantiated by the requesting Party. Upon receipt of the above-mentioned request by the Party concerned, the Parties shall enter into negotiations within 20 days and, if an agreement is reached, sign the respective addendum to this Contract."*

(144) In Gazprom's translation:

"The request to reconsider the price shall be submitted in writing and shall be duly justified by the Party submitting it. Upon receipt by the corresponding Party of the above-mentioned request, the Parties shall enter into negotiations within 20 days and, if an agreement is reached, sign a corresponding supplement to this Contract."

(145) Article 4.4.2 provides the following:

(146) In Naftogaz' translation:

> *"If a written agreement on the revision of the Contract Price cannot be reached within 3 (three) months from the date of the beginning of the negotiations, each of the Parties has the right to dispute the other party's performance of the present Contract and submit the matter to arbitration in accordance with Article 8 of the Contract for the passing of a final decision*."

(147) In Gazprom's translation:

> *"If a written agreement to reconsider the contract price is not reached within three (3) months from the date of the beginning of negotiations, each of the Parties has a right to challenge the actions of the other Party to perform this Contract and to submit the matter to arbitration in accordance with Article 8 of the Contract for the adoptation of a final resolution*."

(148) Since 19 January 2009, there have been [redacted] These include the following:

- [redacted] [redacted]
- [redacted] [redacted];

[redacted]

- [redacted] [redacted].

(149) Article 4.6 estimates the value of Natural Gas to be delivered in the first Delivery Year, 2009 at more than USD 14.4 billion, and requires similar estimates to be made for every Delivery Year that follows. Article 4.6 also clarifies that the total value of the Contract amounts to the total costs of the Natural Gas delivered under the Contract during its entire term.

VI.2.4 Article 5. Payment Procedure

VI.2.4.1 The Unilateral Suspension Clause

(150) Article 5.3 contains the following provision:

"*In case of a failure to perform or untimely performance by the Buyer of its obligations under this Contract, including the payment terms provided in Articles 5.1 and 5.8 hereof, the Seller is entitled to unilaterally cease partially or fully or suspend the performance of its obligations hereunder by submitting a notice to the Buyer, and the performance of the Contract shall be suspended from the date of the receipt of such notice*."

VI.2.5 Article 6. Liability of the Parties

VI.2.5.1 Liability Clause

(151) Article 6.1. reads:

"*The Parties shall be responsible for their performance of the terms and conditions hereof. Should the Parties fail to perform the terms and conditions hereof, each of the Parties shall reimburse the other Party for any proven damages caused by such failure to perform*."

VI.2.5.2 Interest

(152) Article 6.2 contains the following provision about delay interest:

"*In the event of delay in payments for the Gas delivery hereunder, the Seller may charge a late payment interest to the Buyer equal to 0.03% of the amount overdue for each day of delay in payment*."

VI.2.5.3 Penalty provisions

(153) At the time of signing, the Contract provided, in Articles 6.5 and 6.6, for reciprocal penalties to be payable:

by Gazprom, in the event of a shortfall of deliveries in an amount exceeding 6% of the monthly delivery volume (Article 6.5); and

by Naftogaz, in the event of a failure to offtake the monthly delivery volume in an amount exceeding 6% of the monthly delivery volume (Article 6.6).

(154) Articles 6.5 and 6.6 of the Contract were [redacted]

VI.2.6 Article 8. Regulation of disputes

VI.2.6.1 Arbitration Clause

(155) Article 8 of the Contract contains the arbitration clause, see Section IV above.

VI.2.7 Article 9. Miscellaneous

VI.2.7.1 Addenda Clause

(156) Article 9.3 reads in relevant parts: *"All supplements, supplementary agreements, and addenda to this Contract, properly signed by the Parties and exchanged by facsimile, shall have the legal force provided that the Parties subsequently confirm them by the originals of such documents within the period agreed upon by the Parties*."

VI.2.7.2 Applicable Law

(157) Article 9.4 contains the clause setting forth the applicable law, see Section IV above.

VI.2.7.3 Invalidity and Ineffectiveness

(158) Article 9.5 regulates the consequences in case a provision of the Contract becomes invalid or ineffective:

"If any of the provisions hereof becomes legally invalid or ineffective, it shall not affect the validity of other provisions of this Contract. In case of invalidity or termination of any provision of the Contract, the Parties shall agree (in Gazprom's translation: "endeavour to reach an agreement") *to replace such invalid or ineffective provision with a new provision that would have the economic effect as close as possible to that of the invalid or ineffective provision*.

VI.2.7.4 The Mandatory Sales Clause

(159) Article 9.7 contains the following provision:

"The Buyer undertakes to enter into a long-term contract with OOO "Gazprom Sbyt Ukraina" (Ukraine) (hereinafter - "GSU") for gas delivery effective from 1 January 2009 to 31 December 2019 in the annual volume of 25% of all the volume of the Gas being imported for sale to industrial consumers in Ukraine.

VI.2.8 Article 10. Contract Period

(160) Pursuant to Article 10, the Contract is valid from 1 January 2009 to 31 Decmber 2019.

VI.2.9 Addendum [redacted]

(161) On 20 April 2010 the Presidents of Ukraine and the Russian Federation, accompanied by the heads of Naftogaz and Gazprom, met in Kharkiv, Ukraine, to discuss the relations between Ukraine and Russia and the extension of the lease for the Black Sea naval base for an additional 25 years commencing from 28 May 2017, i.e a prolonged presence of the Russian Federation's Black Sea Fleet on Ukrainian territory.

(162) Following the agreements reached during the above meeting, on 21 April 2010, Ukraine and the Russian Federation entered into the Kharkiv Treaty.

(163) The Kharkiv Treaty provided as follows:

"The Russian Federation and Ukraine,

developing the relationships on the basis of the principle of strategic partnership set out in the Agreement on friendship, cooperation and partnership between the Russian Federation and Ukraine of 31 May 1997,

in accordance with article 1 of the Agreement between the Government of the Russian Federation and the Government of Ukraine on free trade of 24 June 1993,

expressing willingness to mutually consider the interests of both Parties when addressing matters of bilateral relations in various areas,

relying on the currently effective basic agreements on the Black Sea Fleet,

have agreed as follows:

Article 1

The Parties extend the Agreement between the Russian Federation and Ukraine on the status and conditions of the presence of the Black Sea Fleet of the Russian Federation in the territory of Ukraine of 28 May 1997, the Agreement between the Russian Federation and Ukraine on the parameters of the division of the Black Sea Fleet of 28 May 1997 and the Agreement between the Government of the Russian Federation and the Government of Ukraine on the payments associated with the division of the Black Sea Fleet and the presence of the Black Sea Fleet of the Russian Federation in the territory of Ukraine of 28 May 1997 by twenty five years from 28 May 2017 with subsequent automatic extension for successive five year periods, unless either *of the Parties gives written notice to the other Party of their termination not later than one year prior to their expiry.*

Article 2

The rent for the Black Sea Fleet of the Russian Federation staying in the territory of Ukraine starting from 28 May 2017 will consist of payments by the Russian Federation to Ukraine in the amount of one hundred million US dollars per year, and from additional funds received as a result of the reduction, from the effective date of this Agreement, in the price in the amount of up to one hundred US dollars off the price set by the currently effective contract between [Gazprom] and [Naftogaz] per [TCM] of gas supplied to Ukraine, based on the agreed-upon discounted volume of deliveries provided by such contract, using the following formula: where the price is three hundred and thirty three US dollars or more per [TCM] of gas, the reduction will be equal to one hundred US dollars, and where the price is less than three hundred and thirty three US dollars, the reduction will be equal to thirty percent of such price. These additional funds shall be accounted for based on the results of each calendar year during which such reduction is applied, on an accrual basis, and shall be recognised as Ukraine's liabilities set off by performing the provisions of article 1 of this Agreement."

(164) Thus, pursuant to the Treaty, the presence of Russian Federation's Black Sea Fleet was allowed from 28 May 1997 to 25 years from 28 May 2017 (until 2042) with an option to automatically extend for further 5-years periods. For this allowed presence, the Russian Federation was to pay rent to Ukraine. The rent under this Treaty consisted of two units, one of which was a price reduction for the natural gas delivered under the Contract. According to the Treaty, the size of such price reduction will depend on the price of natural gas under the Contract. If the price of natural gas delivered under the Contract were to become higher than 333 USD/1000 m^3, the reduction in the Factual Price shall amount to 100 USD/1000 m^3. If the price of natural gas sold under the Contract is below 333 USD/1000 m^3, the reduction in the Factual Price shall amount to 30 % of the Contract Price.

(165) This agreement on price reduction for the natural gas delivered under the Contract was implemented by the Parties through the entering into Addendum [redacted] to the Contract which provides for Article 4.2 of the Contract to be amended as follows (Gazprom's translation):

[redacted]

[redacted]

[redacted]

(166) According to Naftogaz' translation, Addendum [redacted] reads as follows:

[redacted]

[redacted]

[redacted]

(167) The Russian Government issued a decree of 30 April 2010, Decree No. 291, whereby the export customs duty on natural gas delivered from the Russian Federation to Ukraine in the volume of 30 BCM for 2010 and from 2011 to 2019 in the volumes of 40 BCM, was to be determined depending on the Contract Price according to the above described calculation. The Decree no. 291 was the Russian Federation's practical implementation of the Treaty.

(168) On 2 April 2014, the Russian Federation passed Federal Law No. 38-FZ of 2 April 2014 "*On terminating the agreements relating to the presence of the Black Sea Fleet of the Russian Federation in the territory of Ukraine*", which took effect on the same day and provided as follows:

"[The following agreements] shall cease to be effective:

1) the Agreement between the Russian Federation and Ukraine on the parameters of the division of the Black Sea Fleet signed in the city of Kiev on 28 May 1997;

2) the Agreement between the Russian Federation and Ukraine on the status and conditions of the presence of the Black Sea Fleet of the Russian Federation in the territory of Ukraine signed in the city of Kiev on 28 May 1997;

3) the Agreement between the Government of the Russian Federation and the Government of Ukraine on the payments associated with the division of the Black Sea Fleet and the presence of the Black Sea Fleet of the Russian Federation in the territory of Ukraine signed in the city of Kiev on 28 May 1997;

4) the Agreement between the Russian Federation and Ukraine on the questions of the presence of the Black Sea Fleet of the Russian Federation in the territory of Ukraine signed in the city of Kharkiv on 21 April 2010. "

(169) On the same date, 2 April 2014, the Russian Government passed Resolution No. 260 "*On declaring Resolution No. 291 of the Government of the Russian Federation of 30 April 2010 to be no longer in force*" ("Resolution 260"), which revoked Resolution 291, with effect from 2 April 2014, as follows:

"The Government of the Russian Federation resolves:

1. that [Resolution 291] (Collected Legislation of the Russian Federation, 2010, No. 19, article 2322) be declared to be no longer in force.

2. This resolution shall become effective upon the expiry of 30 days after the date of its official publication and shall apply to the legal relationships arising from 2 April 2014".

(170) The Kharkiv Treaty was one of in total four treaties between Ukraine and the Russian Federation, which were terminated by the Federal Law "*On termination of the treaties, concerning the presence of the Black Sea Fleet of the Russian Federation on Ukrainian territory*" No 38-FZ. The Law was signed by the President of the Russian Federation and published on 2 April 2014, and took effect on the same day. The Treaty was terminated after the Russian Federation annexed the Autonomous Republic of Crimea and the city of Sevastopol on Ukrainian territory, with the passing of the Federal Constitutional Law "*On adoption of Crimea to the Russian Federation and formation of the new subjects within the Russian Federation - The Republic of Crimea and the city of federal significance Sevastopol*" No. 6-FKZ of 21 March 2014.

(171) Thus, on 2 April 2014, the Russian Government declared the Decree No. 291 void and thereby revoked the reduced export customs duty on natural gas exported to Ukraine. A further USD 100 reduction in export duties has since been implemented in respect of the period from

1 November 2014 until 30 June 2015 by means of separate resolutions of the Russian government, and is further reflected in Addenda No. 33 and 34.

VI.2.10 Addendum [redacted] of 17 December 2013

(172) Addendum [redacted] was signed by the Parties on 17 December 2013 after negotiations between the respective leaders of Russia and Ukraine.

(173) Addendum [redacted] provides for the following amendment with respect to Articles 4.1 and 4.2 of the Contract:

[redacted]

(174) [redacted]

VI.2.11 Addenda [redacted] and [redacted]

(175) Further to the signing of Addendum No. 29, on 9 January 2014, Naftogaz and Gazprom signed Addendum [redacted] which provided as follows:

[redacted]

(176) [redacted]

(177) [redacted]

(178) [redacted]

VI.2.12 Supplementary Agreements for [redacted]

(179) At the time of entering into the Contract and the Transit Contract in January 2009, Gazprom and Naftogaz were parties to an existing transit contract that had been signed on 21 June 2002, and was to cover transit services over the period from 2003 to 2013 (the "2002 Transit Contract"). Pursuant to supplementary agreements to the 2002 Transit Contract, Gazprom made over USD 3 billion in advance payments for transit services. Such advance payments were made in connection with the settlement of Naftogaz' outstanding debts to Gazprom for gas supplied in preceding periods. As of the end of 2008, the balance of the advance payments remaining totalled USD 395.9 million, as confirmed by reconciliation statements reflecting the position as of 31 December 2008, signed between Gazprom and Naftogaz. Consequently, as of the date the Contract and the Transit Contract were signed, Gazprom had in effect prepaid USD 395.9 million for transit services to be provided by Naftogaz in 2009.

(180) These prepayments for transit services were taken account of in the Transit Contract. In particular, the Transit Contract provides as follows:

[redacted]

(181) Gazprom has made advance payments for transit services of over USD 7.7 billion in total (including the advance payments referred to above). The purpose of these advance payments was either to settle outstanding debts due from Naftogaz to Gazprom in relation to gas supplied, or to assist Naftogaz, which has suffered from liquidity issues, to make payments for gas to be supplied under the Sales Contract. So as to ensure that the funds received by Naftogaz from Gazprom as advance payments for transit services were not used for any purpose other than as payment for gas supplies, the Parties signed parallel supplementary agreements to this Contract and the Transit Contract, which provided for advance payments to be made by Gazprom for transit services under the Transit Contract, and for the funds to be returned by Naftogaz to Gazprom for gas supplies under this Contract.

(182) Over the course of 2013 and 2014, on several occasions Naftogaz asked Gazprom to agree to defer the due date for payment for gas delivered. Gazprom agreed to defer the due date for payment at the interest rate of 6% per annum.

VI.2.13 The Binding Protocol

(183) On 16 June 2014, Gazprom suspended all deliveries of natural gas to Naftogaz. Transit of Russian gas through Ukraine to Europe continued as usual.

(184) Subsequently, Naftogaz, Gazprom, Ukraine, the Russian Federation and the European Commission entered into negotiations to find an interim solution for deliveries of Russian natural gas to Ukraine. The European Commission was *inter alia* motivated by a wish to secure uninterrupted transit of natural gas through Ukraine during winter.

(185) Through these negotiations, Ukraine, the Russian Federation, the European Commission, Naftogaz and Gazprom agreed on an interim mechanism for resumed gas supplies to Ukraine in the period from November 2014 to March 2015. This mechanism was implemented through a number of documents in addition to [redacted]

(186) On 30 October 2014, Ukraine, the Russian Federation and the European Commission entered into a Binding Protocol regarding the conditions for gas delivery from the Russian Federation to Ukraine for the period from November 2014 until 31st of March 2015 (the "Binding Protocol").

(187) This Binding Protocol sets out the framework enabling the delivery of gas volumes from Gazprom to Naftogaz necessary to cover the domestic consumption in Ukraine over the winter period from November 2014 until 31 March 2015 in order to safeguard the security of gas supply in the upcoming winter season.

(188) Pursuant to the Binding Protocol, the price of Natural Gas supplied by Gazprom to Naftogaz under the Contract in the period from November 2014 until 31March 2015 should be decreased by the amount of export duty decrease provided by the Government of the Russian Federation. The decrease of the export duty should be calculated according to the following formula: at a price of USD 333 per 1000 m^3 of natural gas the reduction was USD 100, at a price lower than USD 333, the reduction was 30% from such price.

(189) Pursuant to item 1.2 of the Binding Protocol, Gazprom would forgo invoking the Contract's Take or Pay clause for the period from 1 November 2014 to 31 March 2015. In a letter of 30 October 2014, Gazprom confirmed to Naftogaz that it would not apply the Take or Pay provisions in Article 2.2.5 of the Contract in the period from 1 November 2014 to 31 March 2015.

(190) The Russian Federation's obligations in the Binding Protocol were implemented by the Decree "*On the export duty rate of delivery of gas from the territory of the Russian Federation to the territory of Ukraine*" dated 1 November 2014, decree No. 1137.

(191) Decree No. 1137 provides for an export duty decrease essentially similar to the decrease in Decree No. 291 of 30 April 2010.

VII. THE PROCEDURE

(192) The procedural steps are listed below.

(193) On 16 June 2014, Naftogaz and Gazprom each filed a Request for Arbitration with the Secretariat. (Naftogaz' Request: Case no. V2014/080 and Gazprom's Request: Case no. V2014/078.)

(194) On 26 June 2014, Naftogaz filed a request for consolidation of the two cases in one arbitration under one arbitral tribunal.

(195) On 1 July 2014, Gazprom filed its Answer to Naftogaz' Request for Arbitration and Naftogaz filed its Answer to Gazprom's Request for Arbitration.

(196) On 19 July 2014, The Parties agreed that the two arbitrations were to be consolidated into one Arbitration, that the language of the Arbitration should be English, and that each of the Parties should appoint one Arbitrator and that the Parties should jointly appoint the Chairperson of the Tribunal within 10 days from the day of the appointment of the second party appointed Arbitrator.

(197) On 21 July 2014, on Gazprom's request, Mr Johan Munck re-confirmed his availability.

(198) After having initially nominated another arbitrator in its Request for Arbitration, on 25 July 2014, Naftogaz appointed Mr. Jens Rostock-Jensen as arbitrator, and the Parties attempted to reach an agreement on the joint appointment of Chairman.

(199) On 25 August 2014, Naftogaz informed the SCC that the Parties had been unable to "*agree on the joint appointment of Chairman, nor on an extension of the deadline in this respect. The Chairman will therefore be appointed by the Board of the SCC.*"

(200) On 12 September 2014, the SCC Board appointed Mr. Tore Wiwen-Nilsson as Chairperson, pursuant to Article 13 (3) of the SCC Rules.

(201) The Tribunal was thus constituted consisting of Mr. Jens Rostock-Jensen, Mr. Johan Munck and Mr. Tore Wiwen-Nilsson.

(202) On 12 September 2014, the SCC decided on the Advance on Costs.

(203) Both Parties paid the advance on costs by 26 September 2014.

(204) On 29 September 2014, the SCC referred the case to the Tribunal.

(205) On 2 October 2014, Naftogaz submitted a Request for Interim Measures.

(206) On 7 October 2014, Gazprom submitted a request for time extension. A time extension beyond 10 October was granted by email of the Tribunal on the same day. In the same email, the Tribunal requested Gazprom to be more specific on the grounds for the objection on the jurisdiction of the Tribunal.

(207) By letter of 9 October 2014, Gazprom commented on Naftogaz' Request for Interim Measures and also requested a time extension for its submission in response to Naftogaz' application and proposed a procedural timetable for the interim measures proceedings

(208) On 10 October 2014, the Tribunal presented a time schedule for the Parties' written submissions and oral hearing.

(209) On 21 October 2014, the Tribunal presented a revised time schedule according to which an oral hearing was to take place in Stockholm on 20-21 November 2014.

(210) On 30 October 2014, Ukraine, Russia and the Europen Commission agreed on a Binding Protocol regarding the conditions for gas delivery from the Russian Federation to Ukraine for the period from November 2014 until March 2015. On the same date, Naftogaz and Gazprom agreed on an [redacted] Together with the Russian Federation's decree implementing the Binding Protocol and a letter from Gazprom confirming that Gazprom would not invoke Take or Pay obligations from 1 November 2014 to 31 March 2015, these documents constitute a [redacted]

(211) By letter of 31 October 2014, Gazprom informed the Tribunal of the [redacted]

(212) In an e-mail of 2 November 2014, the Chairperson reminded Gazprom of its request for further substantiation of the jurisdictional objection and the original deadline of 31 October 2014 for such submission.

(213) On 3 November 2014, Gazprom responded to the Chairperson's reminder *inter alia* stating that:

"It is not possible for Gazprom to provide a full statement of its jurisdictional objections until Naftogaz has presented its Statement of Claim."

(214) In an email of 3 November 2014 the Chairperson stated that:

"In view of the fact that the Parties have agreed on an interim solution for the winter 2014/2015 there is no need, for the time being at least, to proceed with a hearing on the request for interim measures. However, the Tribunal has still found that a hearing is required to plan the continued proceedings, including in relation to the jurisdictional objections of Gazprom."

(215) On 19 November 2014, Gazprom presented an additional claim (the "June 2014 Claim") for payment from Naftogaz for gas delivered by Gazprom and off-taken by Naftogaz in June 2014. On the same day, Gazprom also made an additional claim (the "Take or Pay Claim") for payment of Natural Gas made available by Gazprom, but not off-taken or paid for by Naftogaz in 2012 and 2013.

(216) On 20 November 2014, a case management conference was held in Stockholm where the Tribunal and the Parties agreed in principle on the terms of Procedural Order No. 1 and the dates for the procedural timetable included as Annex 1 thereof. At this case management meeting, the Parties also stated their joint understanding that the question of the Tribunal's jurisdiction should not be treated as a separate procedural matter, but should be dealt with in the course of the regular proceedings.

(217) On 1 December 2014, the Tribunal issued Procedural Order No. 1.

(218) On 17 December 2014, Naftogaz noticed Gazprom of further disputes and requested negotiations and consultations. By this notice, Naftogaz claimed a revision of the volume and Take or Pay provisions in Article 2.2 of the Contract, a revision of Article 5.3 providing Gazprom with a unilateral right to suspend fulfilment of its contractual obligations, a revision of the mandatory sales clause in Article 9.7 of the Contract and revision of the Contract Price provisions based on competition law.

(219) According to Naftogaz, no agreement was reached in the subsequent negotiations and the mandatory 30 days of negotiation before a claim may be submitted for arbitration pursuant to Article 8 had passed.

(220) On 23 December 2014, Gazprom requested consolidation of SCC Arbitration case V2014/129 concerning the Gas Transit Contract with the SCC Arbitration Case V2014/078/080 concerning the Gas Sales Contract. The request was sent to the SCC and Naftogaz directly.

(221) On 28 January 2015, the Board of the SCC decided not to consolidate the SCC Arbitration Case V2014/129 with the SCC Arbitration Case V2014/078/080.

(222) On 31 January 2015, Naftogaz submitted its Statement of Claim, including supporting documents, witness statements and expert reports. The following witness statements of witnesses of fact were submitted: Witness statements of 1) Mr. [redacted], 2) Mr. [redacted] 3) Mrs. [redacted], 4) Mr. [redacted], and 5) Mr. [redacted] The followoing expert reports were submitted: Expert report of 1) Dr Serena Hesmondhalgh and Mr. Anthony Way and 2) Mr Carlos Lapuerta.

(223) On 20 April 2015, the SCC decided on additional Advance on Costs. On 26 May 2015, the Procedural Timetable was amended. On 12 June 2015, Gazprom submitted its Statement of Defence and Counterclaim, including supporting documents, witness statements and expert reports. The following witness statements of witnesses of facts were submitted: Witness statement of 1) Mr [redacted] 2) Mr [redacted] 3) Ms [redacted] and 4) Ms [redacted]. The following expert reports were submitted: Expert report of 1) Dr Boaz Moselle, 2) Dr Lorenzo Coppi, and 3) Mr Bernhard Witschen. Between 28 June and 30 July 2015, the Parties exchanged Document Requests and on 30 July 2015 the Parties submitted a Joint Submission of Requests for Document Production.

(224) On 11 August 2015, the Tribunal decided on the Requests for the Production of Documents.

(225) On 10 September 2015, the Parties produced Documents as ordered by the Tribunal.

(226) On 8 October 2015, Naftogaz submitted its Statement of Reply and Defence to Counterclaim, including supporting documents, witness statements and expert reports. The following witness statements of witnesses of fact were submitted: 1) Second witness statement of Mr [redacted] 2) second witness statement of Mr [redacted] 3) Second witness statement of Ms [redacted], 4) second witness statement of Mr [redacted], and 5) second witness statement of Dr [redacted]. The following expert reports were submitted: 1) Second expert report of Dr Serena Hesmondhalgh and Mr Anthony Way and 2) Second expert report of Mr Carlos Lapuerta.

(227) On 30 November 2015, a telephone conference was held with the Parties.

(228) On 4 December 2015, with agreement of the Parties, the SCC appointed Professor Boel Flodgren as Administrative Secretary of the Tribunal.

(229) On 17 December 2015, a case management meeting was held in Stockholm where the Parties and the Tribunal agreed on certain adjustments to the Procedural Timetable.

(230) On 5 February 2016, Mr Matthew Saunders confirmed that he was resigning from DLA Piper but only after "*a lengthy contractual notice period*".

(231) On 11 February 2016, Gazprom submitted a Request for Document Production.

(232) On 13 February 2016, after consultations with the Parties, the Tribunal adopted a new Procedural Timetable for the hearing subject to the availability of the Parties.

(233) On 16 February 2016, Naftogaz submitted its response to Gazprom's 11 February Request for a Document Production Order.

(234) On 23 February 2016, Gazprom submitted its response to Naftogaz' 16 February letter regarding the Request for a Document Production Order.

(235) On 24 February 2016, the Tribunal requested clarification of the Request for Document Production.

(236) On 24 February 2016, Gazprom requested extension of the time for submission of Gazprom's Rejoinder to 14 March 2016 and informed the Tribunal that the Parties were in agreement on this request. On the same day the request was granted by the Tribunal.

(237) On 26 February 2016, Gazprom submitted clarification regarding the Request for Document Production.

(238) On 2 March 2016, DLA Piper submitted information about Mr Matthew Saunders no longer being involved in this Arbitration.

(239) On 7 March 2016, a new Timetable for the hearing was established.

(240) On 15 March 2016, Gazprom submitted its Statement of Rejoinder and Reply to Defence to Counterclaim, including supporting documents, witness statements and expert reports. The following witness statements of witnesses of fact were submitted: 1) Second witness statement of Mr [redacted], 2) second witness statement of Mr [redacted] 3) second witness statement of Ms [redacted] 4) first witness statement of Mr [redacted] and 5) first witness statement of Mr [redacted] The following expert reports were submitted: 1) Second expert report of Dr Boaz Moselle, 2) second expert report of Dr Lorenzo Coppi, 3) second expert report of Mr Bernhard Witschen, and 4) expert report (legal oipinion) of Professor Lars Henriksson.

(241) On 31 March 2016, Gazprom submitted further clarification of its Request for Document Production.

(242) On 1 April 2016, the Tribunal issued instructions for the procedure regarding the Request for Document Production.

(243) On 11 April 2016, after request from the Parties, the Tribunal accepted that the Parties submit additional written pleadings which would not affect the Procedural Timetable.

(244) On 15 April 2016, the Parties submitted a Joint Submission in relation to Gazprom's Request for Document Production.

(245) On 27 April 2016, the Tribunal decided on the Request for the Production of Documents.

(246) On 4 May 2016, the Tribunal submitted a request to the SCC for an extended time limit for the final award.

(247) On 11 May 2016, the Chairperson reminded the Parties of still outstanding items of the Procedural Timetable.

(248) On 17 May 2016, the SCC decided that the Final Award should be rendered by 31 March 2017.

(249) On 31 May 2016, Gazprom submitted and Naftogaz confirmed the Parties agreement on the outstanding items of the Procedural Timetable

(250) On 1 June 2016, the Tribunal confirmed the Procedural Timetable agreed by the Parties. The Chairman suggested that a telephone conference on 14 September 2016 ought to be added to the Procedural Timetable which the Parties confirmed on 6 June 2016.

(251) On 1 June 2016, Naftogaz submitted its Statement of Sur-Reply and Rejoinder to Counterclaim including supporting documents, witness statements and expert reports. The following witness statements of witnesses of fact were submitted: 1) Third witness statement of Mr [redacted] 2) third witness statement of Mr [redacted], 3) third witness statement of Ms [redacted], 4) third witness statement of Mr [redacted], and 5) third witness statement of Dr [redacted]. The following expert reports were submitted: 1) Third expert report of Dr Serena Hesmondhalgh and Mr Anthony Way and 2) third expert report of Mr Carlos Lapuerta. A legal opinion of Sir Francis Jacobs was also submitted.

(252) On 26 August 2016, Gazprom submitted its Statement of Sur-Rejoinder including supporting documents, witness statements and expert reports. The following witness statements of witnesses of fact were submitted: 1) Third witness statement of Mr [redacted], 2) third witness statement of Mr [redacted], 3) third witness statement of [redacted], 4) third witness statement of [redacted] 5) second witness statement of [redacted], and 6) first witness statement of [redacted]. The following expert reports were submitted: 1) Third expert report of Dr Boaz Moselle, 2) third expert report of Dr Lorenzo Coppi, and 3) third expert report of Mr Bernhard Witschen. A second legal opinion of Professor Lars Henriksson was also submitted.

(253) On 1 September 2016, the Chairperson requested from each Party, with expected response at the latest in connection with the Pre-Hearing Submissions, among other things, (i) confirmation of the correctness of amounts claimed by the other party, including interest, (ii) specification of the Party's objections as to the jurisdiction of the Tribunal and relief sought with regard thereto, (iii) information of further calculation required to clarify monetary claims, (iv) a time-line of events of relevance to the claims in the Arbitration, preferably a joint time-line, and (v) updated powers of attorneys to the extent that they have expired.

(254) On 8 September 2016, Gazprom informed that its legal team had been supplemented to include Alan Gourgey QC, Kassie Smith QC and Thomas Sebastian, all of whom are self-employed barristers.

(255) On 12 September 2016, Gazprom submitted its response to the Chairperson's request of 1 September 2016 plus confirmation that appropriate powers of attorney are in place for Gazprom's legal representatives.

(256) On 12 September 2016, Naftogaz submitted its response to the Chairperson's request of 1 September 2016 together with updated powers of attorney for Wikborg Rein, Aequo and Gernandt & Danielsson.

(257) On 12 September 2016, for ease of reference, the Parties, through Naftogaz, submitted an overview of the bundles submitted in this Arbitration and information about the organisation of documents for the oral hearing plus a chronological list of documents submitted in this Arbitration.

(258) On 12 September 2016, Naftogaz submitted its Pre-Hearing Written Submission.

(259) On 12 September 2016, Gazprom submitted its Pre-Hearing Written Submissions with supporting document.

(260) On 14 September 2016, the Parties and the members of the Tribunal held a Pre-Hearing Planning Meeting in the form of a telephone conference at which also the Administrative Secretary was present.

(261) On 19 September 2016, the Tribunal decided, as regards the issue whether the new claims introduced by Naftogaz in its Sur-Reply of 31 May 2016 at para (26) and the new and alternative ground referring to the Ukrainian competition law introduced by Naftogaz in the same submission paras (134)-(140), should be dismissed or, if not dismissed, how to proceed with them

(i) that the Tribunal would decide whether or not to dismiss, or, if not dismissed, how to proceed with the new claim and the new ground, later during the course of the arbitration, and

(ii) that neither Party could make any further submissions on these issues, neither as to facts or law nor as to evidence.

(262) On 20 September 2016, the final version of the Notes from the Planning Meeting of 14 September 2016 was distributed to the Parties.

(263) On 20 September 2016, Gazprom submitted an amended version of its Pre-Hearing Written Sumissions with no substantive changes having been made.

(264) Between 25 September and 11 October 2016, the hearing took place in Stockholm.

(265) During the hearing, the following persons appeared before the Tribunal at the request of Naftogaz:

as witnesses of fact: [redacted]

as expert witnesses: Dr Serena Hesmondhalgh, Mr Tony Way, Mr Carlos Lapuerta, and Professor, Sir Francis Jacobs.

(266) During the Hearing, the following persons appeared before the Tribunal at the request of Gazprom:

as witnesses of fact: [redacted]

as expert witnesses: Dr Boaz Moselle, Dr Lorenzo Coppi, Mr Bernhard Witschen, and Professor Lars Henriksson.

(267) On 9 October 2016, during the Hearing, the Tribunal decided not to dismiss the new claim and the new ground introduced by Naftogaz 31 May 2016 but to try them on the merits on the basis of what had already been submitted.

(268) On 2 October 2016, during the hearing, Naftogaz submitted its Submission On Claimant's Claim, (Claimant's Pleading No. 10).

(269) On 9 October 2016, during the Hearing, it was clarified, with regard to Naftogaz' claim for damages in Relief Sought, that it also has a claim for damages based on competition law.

(270) On 11 October 2016, during the hearing, Naftogaz submitted its Submission On Contract Law Grounds (Claimant's Pleading No. 11).

(271) On 11 October, during the Hearing, the Tribunal decided, after consultation with the Parties, that the Parties should submit their Arbitration Cost Submissions on 15 December 2016.

(272) On 25 October 2016, Gazprom submitted its Reply regarding Naftogaz' new claims, in response to Naftogaz' amended Relief Sought and Naftogaz' Submission on Contract Law grounds (Naftogaz' Pleading no 11) dated 11 October 2016.

(273) On 26 October 2016, Naftogaz was invited to comment on Gazprom's Reply of 25 October 2016 on 8 Novemer 2016 at the latest.

(274) On 8 November 2016, Naftogaz responded to Gazprom's submission of 25 October 2016 (Claimant's Pleading No. 12).

(275) On 16 November 2016, Naftogaz submitted its Post Hearing Brief.

(276) On 16 November 2016, Gazprom submitted its Post Hearing Brief.

(277) On 20 December 2016, the Tribunal – with the concurrence of the Parties – requested extension of the date for rendering the Award until 30 April 2017.

(278) On 20 December 2016, SCC decided that the Final Award should be rendered by 30 April 2017.

(279) On 17 January 2017, Gazprom notified the Tribunal that it had invoiced Naftogaz under Article 2.2.5, i.e. the Take or Pay provision, of the Contract for 2016 for the amount of USD 5,318,903,523.78 and that, upon the failure by Naftogaz to pay for the amount by the stipulated date, Gazprom reserves the right to update its other claims for relief so as to take account of its 2016 Take or Pay Claim.

(280) On 23 January 2017, Gazprom requested permission to respond to what it alleged to be new issues raised by Naftogaz in Naftogaz' Post-Hearing Brief – among other things – allegations of misrepresentation and new arguments in relation to storage capacity in Ukraine.

(281) On 26 January 2017, Naftogaz requested for leave to comment – wihin one week from the Tribunal's decision to grant leave – on Gazprom's letter of 17 January with Gazprom's updated Take or Pay claim for the period from 1 April to 31 December 2016.

(282) On 28 January 2017, the Tribunal granted Naftogaz the leave requested in its letter of 26 January 2017 to submit its comments on Gazprom's letter of 17 January to Gazprom and the Tribunal no later than on 6 February 2017.

(283) On 30 January 2017, Naftogaz requested leave to comment on Gazprom's letter of 23 January by which Gazprom requested permission to submit a brief response to what Gazprom argued was new issues raised in Naftogaz' Post Hearing Brief.

(284) On 30 January 2017, the Tribunal granted Naftogaz leave for a brief response to Gazprom's letter of 23 January no later than on 6 February 2017.

(285) On 30 January 2017, the Tribunal notified Gazprom that the Tribunal would address Gazprom's request in its letter of 23 January when the comments of Naftogaz on Gazprom's letter have been received on 6 February 2017.

(286) On 6 February 2017, Naftogaz submitted its response to Gazprom's 17 January 2017 letter with Gazprom's Take or Pay claims for 2016.

(287) On 6 February 2017, Naftogaz submitted its response to Gazprom's 23 January 2017 letter containing a request for permission to submit further pleading on Take or Pay issues.

(288) On 15 February 2017, Gazprom requested leave to comment on Naftogaz' letter dated 6 February 2017 setting out Naftogaz' comments on Gazprom's letter requesting permission to submit a brief response to what Gazprom alleges to be new issues raised in Naftogaz' Post-Hearing Brief. Gazprom requested leave to submit such a comment by 22 February 2017.

(289) On 15 February 2017, Gazprom was granted leave to respond to the assertions made by Naftogaz in its letter dated 6 February 2017 that Naftogaz has not introduced new claims, arguments or legal authorities. Gazprom was not granted leave for response in substance to what Gazprom asserts is new. In accordance with Gazprom's request, the response should be submitted by 22 February 2017.

(290) On 22 February 2017, Gazprom submitted its response to Naftogaz' letter of 6 February 2017. Gazprom asked for leave to respond to what Gazprom alleges to be new issues raised by Naftogaz.

(291) On 28 February 2017, Naftogaz, in an email, referring to bilateral discussions between the Parties' experts, requested leave to submit at brief pleading along with an expert report for the adjustment of its monetary claim.

(292) On 28 February 2017, the Tribunal asked Naftogaz for an explanation regarding the request for adjustment of the monetary claim in its letter 28 February 2017 letter and the reason for the adjustment.

(293) On 1 March 2017, Naftogaz, in an email responding to the Tribunal’s letter of 28 February 2017, submitted a brief explanation of the background to what most likely would result in a downword adjustment of its monetary claim.

(294) On 3 March 2017, Gazprom, with reference to Naftogaz' emails of 28 February and 1 March 2017, in an email proposed, since the adjustment of Naftogaz' monerary claims should be uncontentious and, as such, should not require further submissions, that Naftogaz (Dr Hesmondhalgh) send its draft report to Gazprom (Dr Moselle) in advance of its submission in order for Gazprom (Dr Moselle) to check the calculations on a purely technical basis prior to Naftogaz' submission of the report to the Tribunal.

(295) On 3 March 2017, the Tribunal, while informing of its intention to close the proceedings pursuant to Article 34 of the SCC Rules, also informed the Parties that before doing so the Tribunal would address the following outstanding issues:

(i) The alleged new issues raised by Naftogaz in its Post-Hearing Brief

(ii) Naftogaz' request for leave regarding an adjustment of its monetary claim

(iii)The cost submissions

(296) The Tribunal also expressed its wish to be informed of other matters which the Parties considered should be addressed before the closure not later than on 10 March 2017.

(297) On 5 March 2017, the Tribunal informed the Parties that the Tribunal found Gazprom’s proposal in its 3 March 2017 email regarding the way forward in the issue regarding Naftogaz' adjustment of its monetary claim to be a good solution and that the Tribunal expected Naftogaz to submit the report with the corrected calculations no later than by 10 March 2017.

(298) On 10 March 2017, in an email answering the Tribunal’s 3 March 2017 letter, Gazprom noted that submissions in relation to its 2016 Take or Pay claims were not yet concluded and that Naftogaz' submission of 6 February 2017 included new evidence and new calculations which Gazprom was still in the process of analyzing. Gazprom also notified that it intended to make a formal submission in relation to its 2016 Take or Pay Claim and that it intended to respond to Naftogaz' submission of 6 February 2017. Gazprom requested leave to make such a submission by 24 March 2017. Gazprom, considering the burden on the Tribunal to make the complex and difficult calculations and given the magnitude of the sums involved, invited the Tribunal to seek the assistance of the Parties in making the calculations and suggested that at telephone conference could be arranged for a discussion of this issue.

(299) On 10 March 2017, in an email, Naftogaz notified that it had provided Gazprom with adjusted calculations of Naftogaz' monetary claims, and that Naftogaz intended to submit a new Brattle 4 report and a new version with the markups of Dr Moselle regarding Gazprom's Take or Pay claims. Naftogaz reserved the possibility to request leave to briefly revert on issues raised in such submissions. Naftogaz also agreed that the Tribunal could seek assistance from the Parties for the calculations of the Parties' claims and that a telephone conference for this matter could be helpful.

(300) On 13 March 2017, the Tribunal responded that the suggestion about assistance with the calculations was well taken and that the Tribunal would discuss the matter within short.

(301) On 14 March 2017, the Tribunal suggested that a telephone conference should take place between the Chairperson and the Parties for discussing the rendering of the Award and the Parties' assistance in making the calculations.

(302) On 17 March 2017, Gazprom – referring to the Chairperson's email of 3 March 2017 – submitted its response to what it alleges to be new issues in Naftogaz' Post-Hearing Submissions and – for ease of reference – an attachment containing Gazprom's Reply in relation to the new issues dated 25 October 2016.

(303) On 21 March 2017, the Chairperson and the Parties (Mr Mjaaland and Mr Chong) held a telephone conference where the following possible ways forward were discussed: 1) The rendering by the Tribunal of a Partial Award on 31 May 2017 on all outstanding issues, except the caculations, with an opportunity for the Parties to, on the basis of the Partial Award, agree on the necessary calculations. If the Parties are unable to agree on the calculations within, say, three months, the Tribunal would get assistance from the Parties' experts for the termination of the case. It was made clear to the Parties that a Party may resist the rendering of a Partial Award and that a Party is always entitled to a Final Award, for instance for the purpose of execution. 2) Is it in the Parties' interest to have Awards in both cases, i.e. the Supply case and the Transit case, issued at the same time? If so, a possible date could be 31 October 2017 (instead of, as is now the decided date for the Transit Award, 30 June 2017). The Parties were asked to consider if they would like a Partial Award also in the Transit case. The Parties are now going to discuss these options between themselves and come back, within a week or so, to the Chairperson with a notification regarding how they want to proceed.

(304) On 22 March 2017, Naftogaz requested leave to submit a brief response by 7 April 2017 to Gazprom’s submission of 17 March 2017 regarding the alleged new issues in Naftogaz' Post-Hearing Brief.

(305) On 23 March 2017, Gazprom, referring to its email of 10 March 2017, repeated its request to make a formal submission in relation to its Take or Pay Claim, and to respond to Naftogaz' submissions of 6 February 2017, and asked for extension of the time for such a submission to 29 March 2017 (instead of 24 March 2017 as earlier requested).

(306) On 24 March 2017, Gazprom was granted leave – in accordance with its request of 23 March 2017 – for the submission to be made by no later than on 29 March 2017.

(307) On 29 March 2017, the Tribunal notified the Parties’ of its intension to request an extension of the time for the rendering of the Final Award until 30 June 2017 and asked for the Parties’ support for such a request.

(308) On 30 March 2017, Gazprom submitted a submission on its 2016 Take or Pay Claim and Response to Naftogaz' submission on Take or Pay dated 6 February 2017 together with a fourth expert report of Dr Boaz Moselle. The exhibits and supporting documents were provided as part of a bundle called “S-A 18”.

(309) On 30 March 2017, the SCC submitted a request for information about costs and a decription of, among other things, work performed by the Tribunal, no later than two weeks before the award is to be rendered.

(310) On 31 March 2017, Naftogaz – referring to the Chairperson’s email 3 March 2017 indicating its intention to close the proceedings and asking the Parties to, before then, address outstanding issues – submitted a Pleading (Pleading No. C-14) together with a Fifth expert report regarding Naftogaz' claims related to price revision and price determination and an adjusted Fourth expert report concerning Gazprom’s Take or Pay counterclaim, referred to in Gazprom’s submission of 30 March 2017. Naftogaz also recalled its 22 March 2017 request for leave to submit a response to Gazprom’s 17 March 2017 submission regarding alleged new issues, by 7 April 2017.

(311) On 31 March 2017, Naftogaz, in an email, referring to its email earlier the same day, requested leave to respond to Gazprom's pleading of 29 March 2017 on "*Gazprom's 2016 Take or Pay Claim, and response to Naftogaz' submission on Take or Pay dated 6 February 2017*" (the "*29 March 2017 Submission*"). According to Naftogaz, Gazprom in its 29 March 2017 Submission goes far beyond the scope previously indicated in its request for leave; the 29 March 2017 Submission appears as a comprehensive, fullfledged pleading on the alleged bases for all of Gazprom's Take or Pay claims with new arguments and a further detailed argumentation based on previous arguments. Naftogaz requests leave to submit its response to Gazprom's 29 March 2017 Submission by 21 April 2017.

(312) On 31 March 2017, Gazprom confirmed its consent to the Tribunal's intended request for an extension until 30 June 2017 for the Award in this Arbitration.

(313) On 31 March 2017, Naftogaz confirmed its consent to the Tribunal's intended request for an extension until 30 June 2017 for the Award.

(314) On 3 April 2017, the Tribunal informed the Parties that Naftogaz was granted leave, in response to its request of 31 March 2017, to submit a response to Gazprom's 29 March Submission no later than on 21 April 2017, and that the Tribunal did not expect there to be any further submissions on this issue.

(315) On 3 April 2017, the Tribunal informed the Parties that Naftogaz was granted leave to submit a response to Gazprom's 17 March 2017 submission regarding alleged new issues no later than 7 April 2017, and that the Tribunal did not expect there to be any further submissions on these issues.

(316) On 3 April 2017, the Tribunal, with the concurrence of the Parties, asked the SCC Board for extension according to Article 37 of the SCC Arbitration Rules of the time limit for the redering of the Award until 30 June 2017. The Tribunal also informed the SCC that the proceedings had not yet been closed in accordance with Article 34 of the SCC Arbitration Rules but that the closure was expected to occur soon.

(317) On 3 April 2017, the SCC decided that the Final Award should be rendered by 30 June 2017.

(318) On 3 April 2017, Gazprom, in an email, expressed concern over the Tribunal's email of 3 April 2017, granting Naftogaz leave to respond to Gazprom's 29 March 2017 submission regarding the 2016 ToP claim and notifying that the Tribunal did not expect there to be any further submissions on this issue. Gazprom reserved the right to seek permission to respond to any new issues or misstatements of Gazprom's position, or of the evidence, set out in the submission that is to be served by Naftogaz by 21 April 2017.

(319) On 3 April 2017, Gazprom, in an email, in response to the Tribunal's email of 3 April 2017 granting Naftogaz leave to respond to Gazprom's submission on the alleged new issues in Naftogaz' Post-Hearing Brief by 7 April 2017 and notifying that the Tribunal did not expect any further submissions on this issue, reserved the right to seek the Tribunal's permission to respond to Naftogaz' submission, in the event that Naftogaz puts forward further new issues, or misstates Gazprom's position or the evidence.

(320) On 4 April 2017, the Chairperson responded to Gazprom's email of 3 April 2017 where Gazprom reserved the right to seek permission to respond to the submission that is to be served by Naftogaz by 21 April 2017.

(321) On 4 April 2017, the Tribunal, in an email, in response to a request for clarification from Naftogaz of 31 March 2017, informed the Parties that it contemplated to render a separate award on specific issues, listed in the email, no later than 30 May 2017.

(322) On 7 April 2017, Naftogaz submitted its (non-signed) response to Gazprom's pleading of 17 March 2017 concerning alleged new issues in Naftogaz' Post-Hearing Brief (Claimant's Pleading No. C-15).

(323) On 10 April 2017, Naftogaz submitted a signed version of its 7 April 2017 submission (Claimant's Pleading No. C-15).

(324) On 12 April 2017, Naftogaz confirmed that the Tribunal's 4 April 2017 clarification was satisfactory to Naftogaz and that Naftogaz agrees to the Tribunal's suggested approach as per the telephone call on 21 March 2017.

(325) On 13 April 2017, the Tribunal informed the Parties about remaining issues (leave granted for submissions yet to be submitted, right to update monetary claims and cost submissions and cost rebuttal submissions) and the Tribunal asked for the Parties' advice regarding any other matters to be considered by the Tribunal.

(326) On 21 April 2017, Gazprom – with reference to Naftogaz' email of 12 April 2017 – responded to the Tribunal's letter of 4 April 2017 in which the Tribunal provided clarification as to the issues that would be the subject of a separate award. Gazprom expressed a number of concerns regarding the scope of the separate award. Gazprom concluded that it was not at this time prepared to agree to the Tribunal's proposal of a separate Award and that Gazprom considered that it must reserve its rights. Gazprom expressed a willingness to assist the Tribunal with calculations prior to a final award.

(327) On 21 April 2017, Gazprom confirmed that it agreed with the Tribunal's summary of 13 April 2017 of the current status of these proceedings. Gazprom also requested – in the event that the Tribunal decides that Gazprom should make a payment to Naftogaz and that Naftogaz should make a payment to Gazprom – that the Tribunal should deduct the amounts against each other with the result that a single net amout should be ordered to be paid by one party in the Final Award.

(328) On 21 April 2017, Naftogaz – in accordance with the Tribunal's 2 (3) and 4 April 2017 instructions – submitted its response to Gazprom's 27 March 2017 submission regarding the Take or Pay Claims together with a sixth expert rreport by Dr Serena Hesmondhalgh ("Brattle 6", Exhibit C-230).

(329) On 24 April 2017, the Tribunal responded, in an email, to Gazprom's concerns expressed in Gazprom's 21 April 2017 email in response to the Tribunal's 4 April 2017 clarification as to the issues that would be the subject of a separate award.

(330) On 24 April 2017, Gazprom, in an email, in response to Naftogaz' 7 April 2017 submission ("New Issues Reply") requested the Tribunal's permission to respond to Naftogaz' submission in response to Gazprom's 17 March 2017 submission. Gazprom requested permission to make a submission of no longer than five (5) pages.

(331) On 25 April 2017, Gazprom, in an email, in response to the Tribunal's clarification of 24 April 2017 regardig the proposed issue of a separate award, expressed its concerns and declared that it was not at this time prepared to agree to the issue of a separate award in the terms currently proposed by the Tribunal and Gazprom continued to reserve its rights.

(332) On 28 April 2017, Naftogaz responded to Gazprom's 24 April 2017 request to make a new submission and Naftogaz concluded that Gazprom should not be allowed to submit such a further submission.

(333) On 28 April 2017, the Tribunal, in an email to Gazprom, responded to Gazprom's 25 April 2017 submission and asked for "*clear examples of what [Gazprom] was worried about*".

(334) On 28 April 2017, Gazprom, in an email, responded to Naftogaz' 28 April 2017 submission and concluded that if the Tribunal would grant Gazprom's 24 April 2017 application for leave to respond, Gazprom's submission will be limited to five pages.

(335) On 28 April 2017, Gazprom, referring to its 21 April 2017 submission, asked for Naftogaz' indication as to whether Naftogaz consents or objects to the request set out in that email.

(336) On 28 April 2017, Naftogaz responded to Gazprom's email of 28 April 2017 asking for an indication from Naftogaz and Naftogaz declared that it would provide a response "*after the weekend*".

(337) On 29 April 2017, Gazprom, in an email, responded to the Tribunal's 28 April 2017 request for "*clear examples of what Gazprom was worried about*" and Gazprom maintained its position as set out in the earlier emails.

(338) On 4 May 2017, Gazprom, in an email, asked for Naftogaz' consent or objection to Gazprom's request of 21 April 2017.

(339) On 4 May 2017, Naftogaz responded to Gazprom's request of 21 April 2017, indicating that granting Gazprom's request would jeopardize the time schedule and would require further specification and clarification and substantiation from Gazprom and that it would, very likely, give rise to substantial legal argumentation from both sides as well as time-consuming calculation exercises. Naftogaz objected to the request, since

- it was advanced too late,

- it was unspecified and unclear, and

- it lacked grounds.

(340) On 4 May 2017, Gazprom, noting Naftogaz' objections to Gazprom's 21 April 2017 request, requested permission to submit a submission of no more than 15 pages, by Friday 12 May 2017, in support of Gazprom's 21 April 2017 request.

(341) On 4 May 2017, the Tribunal informed Naftogaz and Gazprom that the Tribunal would address Naftogaz' and Gazprom's 4 May 2017 submissions and Gazprom's 28 April 2017 request in the beginning of the following week and the Parties were requested not to make any further submittals as to the merits of the arbitration.

(342) On 8 May 2017, the Tribunal decided to render a Separate Award disposing of the issues of fact and law required to decide as regards the issues of principle (with all the remaining issues and any resulting monetary claims to be left to be resolved in the Final Award):

(i) Whether there is a right to price revision;

(ii) Whether there is a right to price determination;

(iii) Whether Gazprom has a right to Take or Pay payments;

(iv) What the price will be for off-taken gas but not paid for;

(v) Whether one or more contractual provisions shall be declared void or ineffective.

The Tribunal informed the Parties of the decision in an email. On the same day, the Parties confirmed receipt of the decision.

(343) On 11 May 2017, Gazprom, in relation to its 21 April 2017 request for set-off, maintained its request for permission to – within three working days – submit at short submission setting out its request that the Tribunal perform a set-off as between the amounts it finds to be payable by each party to the other in the final award. Gazprom also stated that – if the Tribunal considers it more appropriate to consider the submission in support of Gazprom's application for set-off after it has delivered the separate award, Gazprom would be content to make the submission following the separate award, provided that a) the delay in making the submission will not be held against Gazprom, and b) the close of the proceedings under Article 34 of the SCC Arbitration Rules 2010 will take place at some stage between the separate award and the final award.

Gazprom also looked forward to the Tribunal's response to Gazprom's 28 April 2017 email regarding Gazprom's application for leave to briefly respond to what Gazprom calls Naftogaz' "*NAK New Issues Reply*" dated 7 April 2017 which – according to Gazprom – involves either new issues, or misstatements of Gazprom's position or the evidence.

(344) On 12 May 2017, the Tribunal – in response to Gazprom's requested leave – granted Gazprom leave as follows:

"*1. In its email of 24 April 2017, regarding what Gazprom has called the NAK New Issues Reply. The Tribunal grants leave for Gazprom*

(i) to respond to the issue A. 1. regarding Naftogaz' possibilities to reduce production, and only on that issue, at a maximum of three pages, and

(ii) to the issue A.3. to present its arguments regarding Astra Zeneca, at a maximum of three pages.

The submission on these issues must not contain any new evidence and shall be received by the Tribunal no later than on 17 May 2017.

2. In its email of 4 May 2017, regarding netting of amounts ordered by the Tribunal. As the Tribunal has decided to render a Separate Award leaving quantum to the Final Award, this request is denied for the time being. Gazprom is free to make the same request for leave after the Separate Award has been rendered."

(345) The Tribunal noted, in its email of 12 May 2017, that there were no further requests for leave. On this basis, the Tribunal instructed the Parties that they should not make any further submissions on the merits until otherwise decided by the Tribunal.

(346) On 17 May 2017, Gazprom submitted its "*Further Submissions in relation to the New Issues in Naftogaz' Post-Hearing Submissions*" together with legal authority RLA-228.

VIII. THE PARTIES' CASES

VIII.1 Introduction

(347) The Parties have various claims and counterclaims but the single most important claim in terms of its economic value is Gazprom's Take or Pay claims of around USD (37) billion (as at 29 March 2017), excluding interest, and Naftogaz' claim for price revision amounting to around USD (14) billion (ast at 30 March 2017), excluding interest.

(348) The description of the Parties' cases is in many instances summeries (the total number of pages of the main body of the Parties' main written submissions is more than three thousand pages) of what the Parties have submitted in their written submissions. The fact that some arguments or statements of fact or law or arguments are not described shall not be understood to mean that the Tribunal has not considered them. It follows from the logic of the relationships among issues that the answer to one issue may eliminate the need to consider other issues. As stated in the Introduction to the Reasons, if and to the extent that facts, witness/expert statements, legal authorities, or arguments are not addressed, they would not have changed the Tribunal's conclusions.

(349) As can be seen from the description of the Procedure, the Parties have, with the concurrence of the Tribunal, up until 17 May 2017 made further submissions. These submissions are mostly reflected in the Award and always to the extent that the Tribunal has found them of relevance to the issues and claims resolved by this Award. The Parties have by these submissions in some instances up-dated figures and amounts. The Parties have also made reservations to the effect that they may further up-date their claims. As this Award does not deal with quantum and some issues where figures and amounts may be relevant, the Tribunal has not always up-dated the Parties' cases in these respects.

(350) VIII.2 Naftogaz' Case

VIII.2.1 Introduction

(351) Essentially, Naftogaz claims revision of the Contract Price formula in Article 4.1 of the Contract, or, alternatively, a determination of the Contract Price, and the invalidation or adjustment of some provisions of the Contract. If the Tribunal will accept a price revision or price determination, Naftogaz claims repayment of what it alleges are "*overpayments*", or in the alternative to repayment, damages for breach. Naftogaz also claims damages for violations of competition law, in the alternative to the extent the Contract Price is not revised or adjusted, and, in the alternative to price determination pursuant to [redacted] for breach of [redacted]

(352) Naftogaz rejects Gazprom's jurisdictional objections. It rejects Gazprom's counterclaims in their entirety, and, to the extent the Tribunal does not reject Gazprom's Take or Pay claim, claims a set-off against Naftogaz' damages claim for breach of competition law.

(353) Naftogaz also claims interest and compensation for its cost of arbitration.

VIII.2.2 The structure of Naftogaz' claims regarding price

(354) Naftogaz has structured its claims regarding price as follows:

(i) Price revision based on Article 4.4;

Alternatively,

(i) Price revision based on its alleged inherent right to economically market the gas;

(ii) Alternatively,

(iii) Price revision based on a price formula revised pursuant to Section 36 of the Swedish Contracts Act;

Alternatively,

(iv) Price revision based on competition law and Article 9.5;

Alternatively,

(v) A determination of the Contract Price based on [redacted].

(355) Naftogaz claims that, in the application of a new formula resulting from the application of Article 4.4, the reduction provided by [redacted] shall be included as an additional price element reducing the Factual Price resulting from the formulas to the extent a reduction according to [redacted] would be accepted by the Tribunal.

(356) As an alternative to this claim, Naftogaz claims the application of a formula without the application of [redacted] This means that even if price determination is in the alternative to price revision, the Tribunal will have to decide on [redacted] if the Tribunal finds that it shall revise the price on that basis. The request as regards [redacted] applies with effect from [redacted] (the first date of applicability of [redacted]. The reduction of the [redacted] applies also if Naftogaz' request for revision of the Contract Price is granted with effect from 20 May 2011 or any other date prior to the second quarter of 2014.

(357) The application of the claims under (ii), (iii) and (iv), all results in the same price revision as would be the result of the application of Article 4.4.

(358) Naftogaz' claim for price determination based on [redacted] is thus a claim in the alternative to the price revision claims. In such case, Naftogaz requests the Tribunal to declare that the [redacted]. Further, In the event that both the price revision claims and the claim for price determination pursuant to Addendum [redacted] should fail, Naftogaz still in the alternative requests the Tribunal to determine the [redacted]

(359) The structure has the consequence that, if the Tribunal were to find for Naftogaz pursuant to a claim listed above, the Tribunal would not be required to try claims lower in the list, except as concerns [redacted]

VIII.2.3 Naftogaz' requests for declararatory relief concerning price revision

(360) Naftogaz' requests for declaratory relief concerning revision of the Contract Price have three different legal bases.

(361) The first basis is the price revision clause in Article 4.4 of the Contract.

(362) The second basis is Naftogaz' inherent right to economically market the Natural Gas supplied under the Contract, alternatively Section 36 of the Contracts Act, or the two combined, leading to a claim for a fair and equitable price.

(363) The third basis is competition law which renders the Contract Price in Article 4.1 of the Contract invalid, in conjunction with Article 9.5 of the Contract which provides for replacement of invalid or ineffective provisions.

(364) All three legal bases may lead to the same result(s) in terms of the effective date of price revision, the level of the revised P_0 and the introduction of a gas price index in the escalation supplement of the Price Formula. Therefore, Naftogaz formulates only one set of price revision claims under request 1), with alternatives based on the economically most favourable outcomes for Naftogaz in terms of the effective date and level of the revised Contract Price and major includit minor, set out in requests 1.1) to 1.5), while the various legal bases are specified in the heading of request 1).

(365) The implication according the Naftogaz is that the Tribunal is empowered and requested to consider each request for amendment of the price provisions based on all three legal bases (or possible combinations thereof) before moving on to the alternative request with a less economically favourable result for Naftogaz. This may, for example, be practical if the Tribunal should find that the request for price revision may not be granted based on Article 4.4 of the Contract with effect as of 20 May 2011, because Naftogaz' 20 May 2011 letter to Gazprom did not fulfil the formal requirements to a price revision request, but may be granted as of this date based on Section 36, because the letter is considered a notice that application of Article 4.1 has become unconscionable. If the Tribunal would not grant price revision with effect as of 20 May 2011 on either of the two above mentioned bases, it would still have to consider whether Article 4.1 was rendered invalid or ineffective by the mandatory provisions of competition law as of that date, and would have to be replaced pursuant to Article 9.5 of the Contract. (Conversely, if the Tribunal finds that the Contract itself and/or Section 36 allows for a revision of the Contract Price to a non-abusive level and indexation as from a given date, the Tribunal will not have to rule on the invalidity/ineffectiveness and replacement of Article 4.1 as from that date.)

VIII.2.4 Naftogaz' monetary relief based on price revision claims

(366) In the context of price revision, the Factual Price paid is relevant for the calculation of repayment.

(367) Naftogaz claims repayment or damages for overpayments of gas deliveries by Gazprom in the period from 20 May 2011, to 31 December 2016 (and until the date of the Award, if any purchases were to be made from now until then).

(368) The repayment claimed is the difference between the payments which would have been made under the revised price provisions and the payments actually made by Naftogaz in the price revision period. Thus, Naftogaz' monetary (capital) claims in general terms, is the amount of money equating the part of all monthly payments made since the effective date of the price revision claims to the date of the Award exceeding the applicable Factual Price calculated pursuant to the price provisions as determined by the Tribunal's award.

(369) Naftogaz explains the relationship between the requests for declaratory relief in respect of price and the requests for monetary relief in the following way. The requests for declaratory relief are primarily designed to clarify the position on pricing going forward. However, the request for declaratory relief refers to the relevant effective dates for price revision from which the amended/determined price is applicable and therefore also look back to earlier dates than the date of the award. The calculation of the claim for monetary relief is then made on the basis of the declaratory relief and the payment actually made. The main request for relief as to any period prior to the Award is therefore the claim for monetary relief. The primary grounds for the requests for monetary relief reflect the requests for declaratory relief concerning price, but are not limited thereto.

(370) Naftogaz' grounds for monetary relief are twofold.

(371) First, for every partial contract period for which payment has been made, Naftogaz has in fact paid a higher price than Naftogaz should have paid, and is entitled to repayment of the difference ("*refund of excessive payments*"). The correct lower price which Naftogaz invokes is the price which follows from the price provisions which Naftogaz argue shall be applied and which are described in its Requests for Relief 1.1) to 1.4), 2.1) and 2.2), and 3.1) and 3.2). Requests 1.1) to 1.4) and 2.2) (the latter by reference) are subject to *major includit minor* pursuant to request 1.5). However, for any partial contract period it is possible that the Tribunal may find that Naftogaz has indeed paid a too high price, yet should not pay the price reflected in the price formulae that Naftogaz asks the Tribunal to declare applicable pursuant to requests 1.1) to 1.4) and 2.2) and finds itself unable to declare an applicable price pursuant to requests 1.5), e.g. for evidentiary reasons. Therefore, even if the Tribunal would deny all of Naftogaz' requests for declaratory relief in this respect, it is still free to award Naftogaz monetary relief pursuant to Request 4) (which, as a monetary claim, is inherently subject to *major includit minor*) for any and all partial contractual periods.

(372) Second, Naftogaz alternatively invokes that it is entitled to compensation as damages (as opposed to repayment), for breach of competition law and/or the obligation to reach a written agreement on price revision pursuant to Articles 6.1 and 4.4.2 of the Contract, or for breach of [redacted] The damage claims based on competition law mirror requests 1.1) to 1.4), which are subject to *major includit minor* pursuant to Request for Relief 1.5). The damage claims based on breach of contract also mirror the declaratory Requests for Relief 1.1) to 1.4) and 3.1), but have a different starting point for accrual of the claims, i.e. from the (later) point in time that Gazprom was in breach of its obligations under Article 4.4.2 or [redacted]

(373) The consequence of the relationship between the requests for declaratory relief and the requests for monetary relief described above is that if the Tribunal would find that Naftogaz is not entitled to repayments from 20 May 2011, it would still have to consider whether mandatory competition law entitles Naftogaz to repayments or damages from 20 May 2011 and until the date (if any) from which Naftogaz receives monetary relief on another basis. Similarly, if the Tribunal finds that Naftogaz is not entitled to repayments or damages based on the Contract or contract law to the extent claimed on these bases, the Tribunal will have to consider whether further monetary relief will have to be granted based on competition law. Conversely, if Naftogaz is granted full monetary relief on another basis, the Tribunal may not have to consider the damage claims based on competition law.

(374) In terms of timing, Naftogaz principally claims monetary relief from the earliest point in time the monetary claims started to accrue, i.e. the date when price revision was requested, 20 May 2011. The calculations are further arranged in descending order of priority according to the date on which the claims started to accrue, i.e. from and including:

(i) 17 June 2011 based on Naftogaz' elaboration of the price revision request in its letter of that date;

(ii) 8 September 2011 based on Gazprom's failure to reach a written agreement on price revision pursuant to Article 4.4.2 and Gazprom's letter of 8 June 2011 as the start of negotiations;

(iii) 5 October 2011 based on Gazprom's failure to reach a written agreement on price revision pursuant to Article 4.4.2 and the 5 July 2011 working meeting as the start of negotiations;

(iv) 27 April 2014 based on Naftogaz' 27 April 2014 Notification of dispute and request for negotiations; and

(v) 13 August 2014 based on Gazprom's failure to reach a written agreement on price revision pursuant to Article 4.4.2 and Gazprom's letter of 13 May 2014 as the start of negotiations.

(375) Each of the alternative calculations arranged according to the starting date for accrual has further alternatives based on the level of the amended Contract Price. The level of the Contract Price on the relevant effective date comes in two alternatives on each date, i.e. principally based on the end of period methodology, alternatively based on the delta of deltas methodology.

(376) Further, each calculation for a given starting date and Contract Price level comes in two alternatives, principally assuming that Naftogaz' claim for determination of the Factual Price pursuant to Addendum [redacted] in addition to the price revision claims is awarded, alternatively assuming that it is not. This is because the level of the Factual Price payable from 1 April 2014 (when Gazprom stopped honouring its obligations under Addendum [redacted] with reference to the illegal actions of its largest owner, the Russian Federation) differs depending on whether the request that the Factual Price be reduced according to Addendum [redacted] is awarded.

VIII.2.5 Alternatively, monetary relief based on price determination claims

(377) Naftogaz has also calculated its monetary claim in case only Naftogaz' claim for price determination (or damages) pursuant to Addendum [redacted] is awarded. Like for Naftogaz' other monetary claims, this calculation is limited to the period until and including 31 August 2015 for practical reasons.

(378) Naftogaz has not calculated an individual monetary claim in relation to its claim for declaratory relief based on Addendum [redacted] only. Payments made for deliveries under the Contract between 1 April and 16 June 2014 have been made pursuant to the [redacted] determined by Addendum [redacted] which incorporates the [redacted] reduction pursuant to Addendum [redacted]. Similarly, payments for deliveries between 1 November 2014 and 30 June 2015 have incorporated a reduction of the [redacted] calculated in the same manner as pursuant to [redacted] but on a different and temporary legal basis, [redacted] If the Tribunal should award only the alternative based on [redacted], this will therefore not result in a monetary claim, unless a [redacted] is calculated to give a higher price and applied prior to the Award, e.g. based on a similar arrangement as under [redacted] and [redacted] governing deliveries in [redacted].

VIII.2.6 Alternatively, damages based on breach of contract

(379) If the Tribunal should find that Article 4.4 does not entitle Naftogaz to a retroactive adjustment, Naftogaz alternatively claims damages pursuant to Artitcle 6.1 due to Gazprom's breach of Article 4.4.2.

(380) The ground for damages is Gazprom's failure to perform its obligation to agree to market based pricing. The loss suffered equals the difference between the price paid by Naftogaz and the price which should have been agreed (market level), and is compensable and a foreseeable consequence of Gazprom's breach. The difference from the repayment claim is that the loss incurs from the day after the latest day on which Gazprom should have agreed to a revised Contract Price. The time limit principally expired on 8 September 2011, i.e. three months after Gazprom initiated negotiations by written response to Naftogaz' 20 May 2011 request for price revision, alternatively on 5 October 2011, i.e. three months after the 5 July 2011 working group meeting concerning inter alia pricing, and further in the alternative on 13 August 2014, three months after Gazprom initiated negotiations by responding to Naftogaz' 27 April 2014 notice of dispute and arbitration in writing.

VIII.2.7 Alternatively, damages based on breach of competition law

(381) The right to receive damages for breach of Articles 101 and 102 TFEU is an established principle under EU competition law. The ECJ has clarified that EU Member States are required as a matter of EU law to allow claims for compensation for breaches of Articles 101 and 102, as well as enforcing the illegality of the infringing conduct, cf. paragraphs 26-31 of *Courage v Crehan* (Exhibit CL-112).

(382) Swedish law safeguards this requirement through Chapter 3, Section 25 of the Swedish Competition Act, according to which damages shall be awarded if someone intentionally or by negligence breaches the prohibitions against anti-competitive agreements and abuse of dominance as laid down in the Swedish Competition Act and in Articles 101 and 102 TFEU.

(383) As a dominant undertaking on the market for natural gas, Gazprom has been obliged to have knowledge of market prices on the gas market. Hence, Gazprom has at least been negligent when imposing an excessive price on Naftogaz.

(384) The right to compensation includes the full real value of the damage suffered and comprises factual loss, loss of profit and interest from the time when the damage occurred.

(385) Based on the above principles for the calculation of the damage suffered, the damages amount awarded relating to factual loss under Chapter 3, Section 25 of the Swedish Competition Act in relation to excessive pricing, corresponds to the difference between the pricing under the relevant contract and the pricing which would have applied in compliance with Articles 101 and 102 TFEU.

(386) Since Naftogaz claims that Article 4.1 shall be replaced with a new article, which is in line with EU competition law, its repayment claim is not a consequence of the invalidity as such, but is based on the subsequent establishment of a new price and thereby of an overpayment. Alternatively, Naftogaz is entitled to damages under Chapter 3, Section 25 of the Swedish Competition Act to compensate for the loss suffered as a consequence of Gazprom's breach of applicable competition law.

(387) The price invoked by Naftogaz in relation to the replacement of Article 4.1 by virtue of Article 9.5 of the Contract is in accordance with competition law and is also as close as possible to the current price without violating European competition law. Therefore, the damages should correspond to the difference between the price paid by Naftogaz under the Contract during the relevant period and the price that Naftogaz would have paid should Article 4.1 have been replaced pursuant to Article 9.5 in accordance with the Relief sought.

(388) In this case, no Party claims that the Contract is invalid. The compensation claimed by Naftogaz is not a return of the Parties' performances following invalidity of the Contract. It is primarily a refund of excess payment after the application of Article 9.5 and secondarily damages for Gazprom's breach of competition laws.

(389) Naftogaz claims compensation for Gazprom having charged excessive prices from 20 May 2011 in breach of European competition law. The right to damages rest on Chapter 3, Section 25 of the Swedish Competition Act.

(390) It is only if the Tribunal finds that Article 4.1 is to be revised with an effective date after 20 May 2011, or not revised to the extent requested by Naftogaz, that the Tribunal will have to determine whether Article 4.1 was invalid and must be replaced based on competition law from 20 May 2011 and until such effective date. Similarly, Naftogaz does not claim repayments or damages based on competition law for time periods when Naftogaz receives monetary relief on another legal basis.

(391) Naftogaz' compensable loss in relation to excessive pricing corresponds to the difference between the price paid by Naftogaz and the price which would have applied in compliance with Arts. 101 and 102 TFEU. The price invoked by Naftogaz in relation to the replacement of Article 4.1 by virtue of Article 9.5 is as close as possible to the current price without violating European competition law.

(392) Alternatively, Naftogaz claims damages for breach of Ukrainian competition laws (Article 18 EnCT and Articles 5, 6 and 13 of the Ukrainian Competition Act) based on Ukrainian law. The facts, reasoning and quantum of loss is *mutatis mutandis* the same as in the claim under EU/Swedish law. As to Ukrainian competition laws and the right to damages.

VIII.2.8 Monetary relief based on Section 36 of the Swedish Contracts Act

(393) The consequences of the unconscionability of the volume and Take or Pay provisions is that Articles 2.2 and 2.2.5 shall be set aside in their entirety for the period from 19 January 2009 to the date of the Award.

(394) For the period after the Award, the consequence depends on the Tribunal's findings on revision of the Contract Price and the validity of the destination clause. Assuming that the Tribunal revises the Contract Price as claimed by Naftogaz and strikes out the destination clause, there is room for a revised Take or Pay regulation. In such case, Articles 2.2 and 2.2.5 should be revised to provide for a significantly lower volume commitment, and a reasonable Take or Pay obligation, which will allow for a balanced and reasonable division of risks between the Parties going forward Naftogaz' monetary claim based on Section 36 of the Swedish Contracts Act is the same as the claim based on applicable competition law.

(395) Naftogaz' monetary (capital) claim is the amount of money equating the part of all monthly payments made since the effective date of the price revision/price determination claims to the date of the Award exceeding the applicable Factual Price calculated pursuant to the price provisions of the Contract based on the Contract Price and/or, as the case may be, the Factual Price, as revised/determined by the Award.

(396) In addition, Naftogaz claims both yield interest and delay interest.

(397) The monetary claim is a payment claim of USD 14.051 billion for overpayments during the period from 20 May 2011 to and including 30 April 2016. The corresponding interest claim amounts to USD 2.59 billion. Naftogaz further has a similar payment claim for overpayments for the period from and including 1 May 2016 to the date of the Award plus a corresponding interest claim.

(398) Naftogaz has specified its capital claims for payments made until and including 30 April 2016. The claim is specified as the highest claim for payment requested by Naftogaz, and, according to Naftogaz, may be granted in full or in part, pursuant to the *major includit minor* principle.

Naftogaz also submits a generally formulated request for monetary relief in relation to payments made after 1 May 2016 to the date of the Award,

VIII.2.9 The Relief Sought

(399) Naftogaz' Relief Sought can be found in Section IX.1 below.

VIII.3 The Mandate of the Tribunal

(400) According to Article 8.2 of the Contract, disputes shall be finally resolved by arbitration in accordance with the SCC Rules, and the arbitration shall be held in Stockholm, Sweden. Consequently, the relevant procedural rules are the SCC rules and the procedural rules of Sweden as *lex arbitri*. In respect of the arbitration agreement, the relevant law is also Swedish law by virtue of the fact that the Parties have not chosen a law specifically to govern the arbitration agreement and the place of arbitration is Stockholm, Sweden, cf. section 48 of the Swedish Arbitration Act.

(401) Article 9.4 provides that the Contract is regulated exclusively by the material law of Sweden. Since the rules concerning the jurisdiction of the Tribunal are of a procedural nature, and long-term Continental European gas sales agreements like the Contract generally distinguish between material and procedural rules, Article 9.4 does not regulate the application of procedural rules.

(402) This implies that the applicable law relevant to the issue of jurisdiction are the SCC Rules and practice under the SCC Rules, and the Swedish Arbitration Act as applied in international arbitration. It also means that international arbitral practice under other institutional rules, like the ICC Rules, may be relevant.

(403) The relevant legal sources are consequently the sources discussed above (the SCC Rules and related practice, the Swedish Arbitration Act as applied in international arbitration, and arbitral practice under other institutional rules).

(404) The other and primary source is the Contract itself and the intentions of the Parties. The Contract also needs to be interpreted in a wider context, in particular against the background of relevant usages, in this case the Groningen model for long-term gas sales agreements, which in the present case is binding on the Parties.

(405) The Tribunal has the power to address issues of public international law as preliminary matters in the contractual dispute between Naftogaz and Gazprom. Naftogaz is not seeking an award against the Russian Federation, and neither the Russian Federation nor Ukraine would be bound by the Tribunal's preliminary determination in the Arbitration between Naftogaz and Gazprom. However, an arbitral tribunal seated in Sweden no doubt has the power, under the SCC Rules and Swedish arbitration law, to address issues concerning the relationship between the Russian Federation and Ukraine as preliminary matters in, and relevant to, the contractual dispute between Naftogaz and Gazprom. Since Naftogaz' claims relate to the application of the Contract and [redacted] Naftogaz' claims also fall within the scope of the arbitration agreement.

VIII.4 Price Revision Claim Pursuant to Article 4.4

VIII.4.1 Construction and application of Article 4.4

(406) Article 4.4 reads as follows according to Naftogaz' translation of the Russian text of the Contract:

(407) The Contract Price in Article 4.1 can be subject to revision/adjustment according to Article 4.4 of the Contract which provides the following:

"*If any of the Parties declares, that the circumstances in the fuel and energy market have changed significantly compared to what the Parties had reason to expect at the conclusion of this Contract, and if the Contract Price provided in Article 4.1 of this Contract, does not reflect the level of market prices, then the Parties shall enter into negotiations regarding an adjustment of the Contract Price in accordance with the provisions of this Contract.*"

(408) Article 4.4.1 contains the following:

"*The request for price revision shall be made in writing and be properly substantiated by the requesting Party. Upon receipt of the above-mentioned request by the Party concerned, the Parties shall enter into negotiations within 20 days and, if an agreement is reached, sign the respective addendum to this Contract.*"

(409) Article 4.4.2 provides the following:

"If a written agreement on the revision of the Contract Price cannot be reached within 3 (three) months from the date of the beginning of the negotiations, each of the Parties has the right to

dispute the other party's performance of the present Contract and submit the matter to arbitration in accordance with Article 8 of the Contract for the passing of a final decision."

(410) Article 4.4 of the Contract with sub-articles 4.4.1 and 4.4.2, regulate under which circumstances a Party has a right to invoke a revision of the Contract Price, and the procedure that shall be followed in that respect.

(411) Article 4.4 sets out the two material conditions that must be fulfilled to trigger a Party's right to request and the counterparty's obligation to accede to a revision of the Contract Price:

(i) circumstances in the fuel and energy market must have changed significantly compared to what the Parties had (well founded) reason to expect; and

(ii) the Contract Price provided in Article 4.1 of the Contract must fail to reflect the level of market prices.

(412) If these two substantive conditions have been fulfilled, the Parties shall enter into negotiations regarding an adjustment (revision) of the Contract Price.

(413) Article 4.4.1 regulates the first part of the procedure to be followed by a Party seeking to invoke a price revision. A requesting Party shall submit its request for price revision in writing and properly substantiate it. Upon receipt of the request for price revision, the Parties shall enter into negotiations regarding whether and how the Contract Price shall be revised, within 20 days.

(414) Article 4.4.2 regulates the subsequent and final step. If the Parties do not reach a written agreement on whether and how the Contract Price shall be revised within three months from the beginning of the negotiations, Article 4.4.2 gives each of the Parties the right to refer the same question, i.e. whether and how the Contract Price shall be revised, to arbitration for a final decision.

(415) Each of the elements set out above shall be considered in accordance with regular interpretation principles under Swedish Contract Law. In this respect, Naftogaz notes that the matter to consider under all three Articles is the revision of the Contract Price.

(416) The brevity of the Contract, and the price revision provision in particular, demonstrates that the Parties apparently consciously left parts open for the backdrop law – Swedish law – to fill in. Apparently, they trusted the generally accepted principles for European gas contracts / the

Groningen model and Swedish backdrop law more than their respective counterparty and therefore refrained from trying to regulate matters in much detail.

VIII.4.2 Article 4.4 is a price revision clause, not a price renegotiation clause

(417) Article 4.4 of the Contract is a price revision clause which grants each of the Parties the option to refer a dispute over whether and how the Contract Price shall be revised, to arbitration for a final decision by an arbitral tribunal.

(418) The Russian term "*peresmotr*" used in Art. 4.4, means "*review"/"revise*" with the aim to adjust, change, not only "*reconsider*" as (initially) alleged by Gazprom. Gazprom applies the same understanding when interpreting expressions used in the draft contracts from October 2008. Gazprom acknowledges that the verb "*peresmotret*" also means "*change*".

(419) Gazprom's view that Art. 4.4 is a renegotiation clause, where the Tribunal's sole function apparently is to rule on whether the Parties are obliged to enter into negotiations, is contrary to the Contract text. That would not, as Art. 4.4.2 requires, result in a "*final decision*" of "*the matter*" by the Tribunal. It would return the matter back to the Parties for further negotiations where the Parties may yet again fail to agree. Generally, a clause expressly allowing a matter to be referred to arbitration if the Parties cannot agree following negotiation makes no sense if the Tribunal cannot settle the matter to be negotiated.

(420) To empower an arbitral tribunal to decide on the price revision was the Parties' intention. Gazprom's own depiction of the negotiation history shows that the crises of 2006 and 2009 were good reasons to ensure that future pricing disputes would be resolved by an independent third party. The Parties moreover chose Swedish governing law and Stockholm as the place of arbitration to enable revision. Gazprom itself even today maintains that the simultaneously agreed and essentially similarly worded provision in the Transit Contract is a tariff revision clause empowering the Tribunal to revise the tariff. Gazprom's argument that changes made in the wording of the various drafts of Article 4.4.1 implies that Article 4.4 is not a price revision clause, fails, as the relevant wording in Article 4.4.1 Contract and Article 8.7.1 Transit Contract is *verbatim* the same.

(421) Gazprom's argument that Article 4.4 does not empower the Tribunal to revise the Contract Price is based on that the "*matter*" to be referred to arbitration is not whether and how the Contract Price shall be revised, but only "*the actions of the other Party*"/"*the other party's performance of the Contract*". This argument is artificial and incomprehensible. No reasonable person in the gas industry would have understood this difference between Article 4.4.2 and Article 8.7.2 Transit Contract to mean that the Tribunal under Article 4.4, unlike Aricle 8.7 Transit Contract, would not be able to render a final decision on the revision of the Contract Price, as Gazprom alleges.

(422) The minor difference in the wording of the two provisions does not mean that Article 4.4 is not an effective price revision provision. Rather, the additional formulation included in Article 4.4.2 but not in Article 8.7 of the Transit Contract (“*dispute the other Party's performance under this Contract”*), solely highlights that a Party that does not agree to a price revision, although the material conditions under Article 4.4 have been fulfilled, is in breach of his contractual obligations, and can be liable to damages.

(423) In any event, Naftogaz interpreted the clause as allowing the arbitrators to revise the Contract Price. Gazprom could not have been unaware of this, but did not before signing express a differing view.

(424) Each of the elements set out above shall be considered in accordance with regular interpretation principles under Swedish Contract Law. In this respect Naftogaz notes that the “*matter”* to consider under all three Articles is the revision of the Contract Price.

(425) The purpose of a price revision clause is to reinstate the commercial balance as it was when the Contract was entered into, *"in accordance with the provisions of this Contract"*. This is confirmed by the implicit requirement in the second material condition for price revision that the Contract Price shall "*reflect*" the level of market prices in the fuel and energy market. In short, the result of a revision of the Contract Price shall be that the Contract Price "*again reflects"* the prices of gas in the fuel and energy market. This can be achieved either through negotiations or by decision of an arbitral tribunal.

(426) In the three years before the conclusion of the Contract, Gazprom interrupted gas supplies to Ukraine and Europe twice (in January 2006 and 2009), essentially due to price disputes. Therefore, it made perfect sense for the Parties to provide for a neutral third party to resolve potential future price disputes. There is also no conflict between the initial political agreement to apply a European market price and the Tribunal's power to subsequently revise the Contract Price if the European market price changes.

(427) The jurisdiction of the Tribunal to adjust the price pursuant to the price revision clause follows clearly from the intentions of the Parties when the Contract was negotiated. In particular, Naftogaz made it clear that this was considered an important issue, and Gazprom confirmed that an arbitral tribunal would have such jurisdiction.

(428) The intentions of the Parties in this respect is also expressed in the plain wording of the price revision clause, cf. Article 4.4.2:

"*If a written agreement on the revision of the Contract Price cannot be reached within 3 (three) months from the date of the beginning of the negotiations, each of the Parties has the right to dispute the other party's performance of the present Contract and submit the matter to arbitration in accordance with Article 8 of the Contract for the passing of a final decision*."

(429) The wording of the Contract on this point is also very similar to the wording of other long-term gas sales agreements based on the Groningen model, which provides for the jurisdiction of an arbitral tribunal to adjust the price in price revision with retroactive effect. In the negotiations of the Contract and subsequently, the Parties have agreed that the Contract is based on the Groningen model. There is also ample case law and literature evidencing the jurisdiction of the tribunal under agreements of the Groningen model, including agreements to which Gazprom is a party, cf. e.g. the RWE Transgas vs. Gazprom export award of June 2013.

(430) This practice also extends to the retroactive effect of price revision, which in any event follows from the systematic context of the price revision clause. In the light of the agreement that the Contract should be based on the Groningen model, and assuming the Tribunal finds that retroactivity does not follow from interpretation (in the narrow sense) of the Contract, this would appear to be a typical example of a situation when Swedish courts and tribunals would imply retroactivity into the agreement.

(431) The starting point in respect of price revision is consequently whether the price revision clause in Article 4.4, read in conjunction with the arbitration agreement in Article 8, has referred price revision to arbitration pursuant to Section 1 of the Swedish Arbitration Act.

(432) Article 4.4 essentially provides that if certain conditions are fulfilled, the Parties shall enter into negotiations regarding a review and an adjustment of the Contract Price in accordance with the provisions of the Contract. Article 4.4.1 then provides that if an agreement is reached, the Parties shall sign an addendum to the Contract. If an agreement cannot be reached, each of the

Parties has the right to dispute the other Party's performance of the Contract and submit the matter to arbitration for a final decision.

(433) This overall structure clearly implies that the Parties are obliged to reach a specific result in the form of an adjustment based on the criteria of the Contract, i.e. the criteria set out in the first part of Article 4.4. When these criteria are fulfilled, the requesting Party is entitled to a corresponding adjustment pursuant to Article 4.4, which may be enforced in arbitration. Thus, and this is not disputed, the Parties may clearly adjust the price provisions through agreement, cf. the formulations in Article 4.4., 4.4.1 and 4.4.2, where revision ("*пересмотр*") implies review as well as adjustment.

(434) When Article 4.4.2 then provides that if no such agreement is reached, the matter may be referred to arbitration, the assumption is clearly that the Tribunal may make the adjustment - in line with the customary understanding of such clauses.

(435) According to Article 4.4.2, failing agreement on an adjustment, "*each of the Parties has the right to dispute the other party's performance of the present Contract…*". The "*performance*" of the Contract in this context means the refusal to sign the addendum concerning adjustment of the Contract Price and applying the Contract based on the existing price provisions.

(436) The "*matter*" that may then be referred to arbitration for a final decision is obviously this disagreement about an adjustment of the Contract Price. The Tribunal is then empowered to decide whether and how an adjustment shall be made, based on the criteria set out in the first part of Article 4.4. Effectively, the Tribunal's final decision takes the place of the written agreement on revision of the Contract Price which the Parties are obliged to conclude, an obligation which one Party in this case has refused to perform.

(437) Article 4.4.2 clearly presupposes that price revision disputes, including adjustment of the price, belong to the "*disputes*" and "*controversies*" dealt with in the arbitration agreement in Article 8 of the Contract, since the "*matter*" may be referred to "*arbitration in accordance with Article 8 of the Contract for the passing of a final decision*". Consequently, the power of the Tribunal to adjust the price in arbitration primarily follows from the price revision clause.

(438) It therefore does not matter how the arbitration agreement in Article 8 precisely defines the relevant disputes that can be finally resolved by arbitration. In any event, price revision is arguably "interpretation" in the Swedish tradition. Alternatively, a price revision dispute concerns the "*application*" of the Contract, and is also "*a claim in connection with the present Contract*".

(439) Section 1 of the Swedish Arbitration Act reads in the translation of SCC:

"*Disputes concerning matters in respect of which the parties may reach a settlement may, by agreement, be referred to one or several arbitrators for resolution. Such an agreement may relate to future disputes pertaining to a legal relationship specified in the agreement. The dispute may concern the existence of a particular fact.*

In addition to interpreting agreements, the filling of gaps in contracts can also be referred to arbitrators.

Arbitrators may rule on the civil law effects of competition law as between the parties."

(440) Naftogaz notes that "*the filling of gaps in contracts*" in Section 1, 2nd paragraph, reads "*komplettera avtal*" in the original Swedish text of the Act.

(441) Parties may agree to refer a dispute to arbitration for decision in respect of interpretation of an agreement or also with regard to the filling of gaps of an agreement. In the present case, Gazprom apparently argues that price revision is gap filling, and that this has not been referred to arbitration.

(442) The question is consequently whether price revision has been referred to arbitration, irrespective of whether it may be qualified as gap filling or not. As already discussed, based on the wording, structure and intentions of the Parties, as well as custom and practice in the industry, the price revision clause of the Contract refers price revision to arbitration for decision, including adjustment of the Contract Price.

(443) According to the preparatory works of the Arbitration Act, it is also sufficient if the authority to fill gaps in a contract is implicit, cf. Government Bill 1998/99:35 page 62. There is no requirement that the Parties should have classified a particular matter as gap filling. The only requirement is that they have either explicitly or implicitly agreed that an arbitral tribunal should have the power to issue an award in respect of the particular subject matter.

(444) The authorisation given in Article 4.4 of the Contract is explicit. Hence, even if Article 4.4 would include gap filling, the arbitrators would also be authorised to settle the dispute.

(445) The above interpretation is also the general practice of arbitral tribunals applying Swedish procedural law, whether sitting in Sweden or not, under various institutional rules and according to various price revision clauses. This general practice is also commonly accepted both by sellers and buyers in the industry, apparently with the exception of Gazprom.

(446) In any event, price revision is not gap filling at all.

(447) However, even if the Tribunal should find that it would engage in gap filling when revising the Contract Price, a separate authorisation in accordance with Section 1 2nd paragraph of the Swedish Arbitration Act has been given by the Parties, since the Parties have explicitly agreed to refer the matter of agreement on a Contract Price revision to arbitration for a final decision. The Tribunal is then authorised to finally decide on the revision of the Contract Price, whether that is considered gap filling or not.

(448) Naftogaz rejects the objection that the revised price formula was never subject to prior negotiations. The objective of the negotiations under Article 4.4 is to agree to a revision as per Article 4.4 as applied to the facts, not to any specific proposal from the counterpaty.

(449) Article 4.4.2 should be interpreted as referring solely to an agreement which alters the definition of the Contract Price in Article 4.1. Addendum No. 29 was entered into unrelated to Naftogaz' price revision requests and there was no reason for reserving any rights. Addendum No. 29 altered the Factual Price but not the Contract Price and, for this reason, Naftogaz is not precluded from proceeding to arbitration.

(450) Naftogaz rejects the objection that it should have lost its right to submit the case to arbitration because of its conduct and because of its failure to pursue its claims. The price revision proceedings initiated on 20 May 2011 are still open.

VIII.4.3 The formal and procedural conditions have been fulfilled

VIII.4.3.1 Requests for price revision

(451) Pursuant to Article 4.4.1 of the Contract, a request for price revision shall be in "*writing*" and be "*properly substantiated*", and upon receipt of the price revision request the "*Parties shall enter into negotiations within 20 days*". The procedural conditions of Article 4.4.1 have been fulfilled.

(452) Naftogaz first requested a request for price revision by its letter of 20 May 2011. Gazprom responded by letter of 8 June 2011, rejecting Naftogaz' request, since it allegedly did not "*contain any reasonable substantiation*". Naftogaz responded, further substantiating its request for price revision by its 17 June 2011 letter. This letter apparently satisfied Gazprom's demands for substantiation, as demonstrated by the Parties' subsequent entry into negotiations on 5 July 2011, within the 20 days limit. The entry into negotiations on 5 July is confirmed in Gazprom's 27 July 2011 response to Naftogaz' 17 June 2011 letter, which did not include any reservations regarding substantiation.

(453) Gazprom argues that Naftogaz' price revision claim nevertheless cannot be considered since allegedly "*the grounds for price revision advanced by Naftogaz in this arbitration and the price revision that it seeks are not set out even in outline form in its price revision request*".

VIII.4.3.2 Request for price revision as of 20 May 2011

(454) The letter dated 20 May 2011 was sufficient to serve the purpose of notifying Gazprom to prepare for negotiations. In the letter Naftogaz states:

"*Changes in the fuel and energy market affecting the price formation of energy carriers have resulted in the failure of the Contract Price, calculated under the Contract, to correspond to the prevailing prices.*

In view of the foregoing, we suggest to enter into negotiations to revise the Contract Price in accordance with the provisions of the Contract".

(455) Gazprom disputed that Naftogaz' request for price revision as of 20 May 2011 fulfilled the formal requirement to substantiation in accordance with Article 4.4.1 of the Contract.

(456) The wording of Article 4.4.1 does not call for the submission of a comprehensive explanation of the grounds for the request, nor is there a requirement to explain the grounds in a detailed manner, as is the case in some similar agreements. Article 4.4.1 does not require documentation or proof that the material conditions to adjust the price as a result of price review are fulfilled. The requirement for a properly substantiated request is meant to initiate a negotiation process, where the Parties together will consider market developments and the economics under the Contract.

(457) Thus, the requirement to substantiate the underlying reasons in a request for price revision is not strict, it is rather meant as a formality to prepare the other contract party for the subsequent procedure. This is further supported by the fact that the Parties are both professional, operating in the gas market in different countries, and are both well aware of the market developments. Thus, the level of detail necessary to enable the counterparty to prepare for negotiations following the request could be kept on a low level.

(458) The letter dated 20 May 2011, was sufficient to serve the purpose of notifying Gazprom to prepare for negotiations.

(459) Naftogaz specifically requested negotiations concerning the Contract Price and identified the main driver, that changes in the fuel and energy market had affected the price formation of energy carriers, and led to a situation where the Contract Price no longer reflected the level of market prices. A professional gas seller such as Gazprom, well informed about market developments in Europe, would immediately understand that the change in price formation referred to is the unexpectedly rapid and complete shift from oil-linked to market based pricing of Natural Gas which had taken place in Continental Europe and the subsequent effects on gas market prices since the Contract was concluded. The changes were widely debated in the gas industry as they occurred, and must also have been known to Gazprom from its dealings with other customers.

(460) Gazprom's response dated 8 June 2011 also shows that Gazprom understood the letter to be a request for price revision pursuant to Article 4.4.1 of the Contract and entered into discussions on the merits, in which Gazprom stated that

"[h]aving reviewed the Requests of National Joint Stock Company "Naftogaz of Ukraine" ("Naftogaz") dated 20 May 2011 No. 24-3171/1-11 and No. 24-3172/1-11 concerning negotiations for revision of the price for gas delivered to the consumers in Ukraine under Contract No. KP dated 19 January, […]

[…]

We would like to note in this respect that the allegation by Naftogaz, that the gas price calculated under the Contract is much higher than the prevailing prices is not true, since the current prices for natural gas delivered under the Contract executed by OJSC Gazprom to Germany and countries of Eastern Europe are either equal to or higher than the price (without discount) for gas delivered to Ukraine."

(461) This demonstrates that Gazprom understood Naftogaz' position. By referring to gas prices Gazprom considered to be market prices, Gazprom also demonstrated the obvious, that it was aware of gas price levels in Europe and their relationship to the Contract Price. Thus, Gazprom effectively identified the main areas for the subsequent negotiations, i.e. the level of gas market prices and the method to be applied when assessing these.

(462) In other words, the 20 May 2011 letter sufficiently enabled Gazprom to prepare for subsequent negotiations, and the 20 May 2011 letter must be considered as a request for price revision in accordance with Article 4.4.1 of the Contract.

(463) Naftogaz invoked the same changes under the substantive Condition No 1, as is invoked in these proceedings. In the 20 May 2011 letter, Naftogaz further explained that these changes resulted in the Contract Price failing to correspond to, i.e. to "*reflect*", the level of market prices.

(464) Since Gazprom had disputed that Naftogaz' original request for price revision as of 20 May 2011 fulfilled the formal requirement to substantiation, on 17 June 2011, Naftogaz supplemented the 20 May 2011 request in a further letter.

VIII.4.3.3 Alternative request for price revision as of 17 June 2011

(465) In the 17 June 2011 letter Naftogaz continued the discussion initiated by Gazprom's 8 June 2011 letter, by pointing out that Gazprom's direct comparison between its other prices and the price paid by Naftogaz was misleading, because Gazprom failed to take into account the differences in transport costs, cf. the first four paragraphs quoted by Gazprom. Effectively, this discussion also refers to the then current level of gas market prices, which Naftogaz maintains is lower than the Contract Price.

"In its letter No. 05-676 dated 8 June 2011, OAO Gazprom stated that the prices of gas delivered under the contracts executed by OAO Gazprom to Germany and countries of Eastern Europe are equal to the price without discount (i.e. the Contract Price) for the gas delivered to Ukraine.

It should be noted that the price for gas delivered by OAO Gazprom to Ukraine, Germany, countries of Eastern Europe and other consumers includes, in particular, the cost of gas deliveries from the border of the Russian Federation to the point where gas is transferred to the Buyer. Such point is usually GMS at the border of the buyer's country.

While delivering gas, e.g. to Germany, OAO Gazprom incurs costs of gas delivery from the border of the Russian Federation / Ukraine to the border of Germany, with the distance between them equal to *about 2,000 km. These costs are included in the gas price for Germany. However, OAO Gazprom incurs no such costs when delivering gas to Ukraine, since Naftogaz buys gas directly at the border of the Russian Federation / Ukraine.*

The allegation by OAO Gazprom that the current prices of natural gas delivered under the contracts executed by OAO Gazprom to Germany and countries of Eastern Europe are either equal to or higher than the price without discount (i.e. the Contract Price) of gas delivered to Ukraine confirms the position of Naftogaz regarding the necessity to revise the price downwards."

(466) Further, in the fifth paragraph, Naftogaz described the reasonable expectations of the Parties when the Contract was entered into, i.e. that oil prices would remain stable, and that oil and gas prices would remain linked in the context of developments in the (oil-linked) Contract Price:

"In the course of negotiations preceding the execution of the Contract, the Parties reached an agreement to apply a 20% discount in 2009 to the Contract Price for Natural Gas delivered to Ukraine. In this connection, the coefficient "k" was included in the formula for calculation of the Contract Price, which was equal to "0.8" in 2009 and was set at the level of "1" with effect from 2010. Thus, Ukraine had good reasons to expect a 25% increase in the Contract Price in 2010 compared to the Contract Price applied in 2009. However, the actual circumstances taking place in the fuel and energy market resulted in the following situation."

(467) Based on the coefficient "k" in the Price Formula (0.8 in 2009, subsequently 1), the reasonable expectation was a Contract Price increase of 25 % between 2009 and 2010, or, in other words, that oil prices at least would remain stable. In the sixth and seventh paragraphs, Naftogaz further explains and quantifies the significant oil price increase from 2009 to 2011, which contributed to the above mentioned change in price formation for natural gas, by reference to the massive increase in the Contract Price from 2009 to 2011:

"The actual weighted average Contract Price based on the results of gas deliveries in 2009 amounted to USD 232.47 per 1,000 cub. m. of gas. The weighted average Contract Price of gas in 2010, which was expected to equal USD 290 per 1,000 cub. m. of gas (+25% of the price in 2009), amounted to USD 338.26 per 1,000 cub. m. of gas, implying an increase of 45.7% from the level of the Contract Price in 2009.

At the same time, based on the gas deliveries for the 5 months of 2011, the weighted average Contract Price of gas amounted to USD 371.11 per 1,000 cub. m. of gas and actually accounts for an increase *of 60% from the level of the Contract Price in 2009, a situation which in no way could be anticipated by the Parties at the date of signing of the Contract."*

(468) Naftogaz concludes, "*Therefore*" ("*Thus*", in Gazprom's translation), that the conditions in the fuel and energy market which affect the pricing for energy commodities have materially changed.

"Therefore, the circumstances in the fuel and energy market affecting the prices of energy carriers have changed substantially, with the result that the Contract Price neither reflects the price level anticipated as of the signing date of the Contract, nor corresponds to the prevailing market prices, with regard to the delivery point for gas."

(469) In other words, the relevant change is the decoupling of gas market prices (as discussed in paragraphs one to four of the letter) from oil prices and oil-linked gas prices (as discussed in paragraphs five to seven of the letter). With this letter, Gazprom was given ample opportunity to prepare itself for subsequent negotiations pursuant to Article 4.4.1.

(470) If the 20 May 2011 letter is not considered to be a request for price revision pursuant to Article 4.4.1 of the Contract, Naftogaz' letter of 17 June 2011 certainly must be considered as such.

(471) If the Tribunal should agree with Gazprom's formal objections to Naftogaz' request for price revision as of 20 May 2011, Naftogaz will in the alternative claim a revision of the Contract Price as of 17 June 2011.

(472) However, the Contract Price as well as the market prices applied to calculate Naftogaz' claim are prices applicable throughout the second quarter of 2011, and were consequently the same in May and June 2011. Therefore, Naftogaz' claims for revision of the base price are the same as of 20 May and 17 June 2011 in terms of price level, and the amended definitions of P_0 are consequently also the same.

(473) Irrespective of whether the content in the letters of 20 May 2011 and 17 June 2011 fulfilled the substantiation requirements pursuant to Article 4.4.1, Gazprom entered into negotiations on the merits (referring to price levels in other contracts) with Naftogaz subsequent to the 20 May 2011 request by its letter of 8 June 2011. Gazprom followed up with further negotiations after the 17 June 2011 letter, in the 5 July 2011 working meeting referred to in Gazprom's letter of 27 July 2011. Notably, in the 27 July 2011 letter, Gazprom did not repeat or refer to its reservations regarding substantiation in the 8 June letter. Thereby Gazprom acknowledged that a price revision procedure had been initiated. Naftogaz had no reason to conclude that the request for price revision was not accepted. Gazprom must therefore in any case be considered to have waived its right to object to the alleged lack of substantiation at the latest on 17 June 2011.

(474) The price revision process has subsequently never been closed.

(475) With regard to Naftogaz' subsequent letter of 17 June 2011, Gazprom alleges in the Arbitration that "*with regard to trigger Condition 2 the letter does not refer to a market price derived from German hub prices net back to delivery points on the Ukrainian border with a further deduction for wholesale margins*". Naftogaz does not accept that such specificity is required in a price revision request. But in any event, the 17 June 2011 letter *does* refer to German market prices net of transportation costs as the relevant benchmark. Thus, Naftogaz argues in the letter that Gazprom in delivering gas to Germany incurs costs of transporting the gas approximately 2000 km farther, and concludes:

"*The allegation by OAO Gazprom that the current prices of natural gas delivered under the contracts executed by OAO Gazprom to Germany and countries of Eastern Europe are either equal to or higher than the price without discount (i.e. the Contract Price) of gas delivered to Ukraine confirms the position of Naftogaz regarding the necessity to revise the price downwards*".

(476) In other words, if the Contract Price is the *same* as the price of gas *delivered* to Germany, then it does *not* reflect the level of market prices, because the correct comparison is between the Contract Price and the price to Germany *less* the costs of delivering the gas to Germany (the German net-back price).

(477) The increase in the Contract Price of 40 % in 2010 and 60 % in the first five months of 2011 compared to 2009 described in Naftogaz' June 2011 letter demonstrates the unexpected and extreme oil price increase which contributed to the decoupling. As regards wholesale margins, Naftogaz specifically requested negotiations under Article 4.4 with the aim to revise the Contract Price by using a formula which would take into account *inter alia* the *wholesale nature of gas purchases*.

(478) Thus, Gazprom's allegation that the price revision Naftogaz seeks is not set out in its price revision request, is wrong. The facts Naftogaz has subsequently invoked in these proceedings are all within the scope of the factual circumstances identified in Naftogaz' letter of 20 May 2011 and further elaborated on in its letter of 17 June 2011. In other words, the circumstances invoked by Naftogaz in these proceedings are "*all within the scope of the request for price review and are sufficiently connected to the* [circumstances identified in the request]".

(479) Furthermore, there is nothing in precedence or in industry practice that obliges a requesting party to solely rely on the factual circumstances invoked in a request for price revision. On the contrary, it is regular practice that a party to a price dispute under a long term gas sales contract, further develops its case in the subsequent negotiations and possible arbitral proceedings. This is demonstrated by ICC Case 13504 (2007) concerning the same contract as in ICC Case 9812, which acknowledges that further substantiation may be provided during arbitral proceedings, as well as relevant jurisprudence and other case law. The purpose of the substantiation requirement is to prepare the other party for negotiations, not to restrict the scope of subsequent arbitral proceedings. The possibility to provide further factual grounds also follows from the very decision Gazprom invokes, ICC Case 9812, where the tribunal acknowledged that additional *and different* factual substantiation may be submitted in arbitration. The reasoning in ICC Case 9812 only justifies preclusion of legal grounds, and the preclusion of factual grounds in that case was apparently motivated by other factors, (or simply materially incorrect).

(480) The main focus in ICC Case 9812 was whether the circumstances relied on in the proceedings were within the scope of the request for price review, and not whether other related circumstances should be precluded. There is nothing in the text of Article 4.4 which limits the Tribunal to consider only "grounds" advanced in the price revision request.

VIII.4.3.4 Alternative request for price revision as of 27 April 2014

(481) Still further in the alternative, and as a precautionary measure, Naftogaz will claim price revision with effect as of 27 April 2014, the date of Naftogaz' Notification of dispute and request for negotiations and consultations, and also notification of arbitration. In this Notification, Naftogaz, *inter alia*, reminded Gazprom of Naftogaz' price revision claim.

(482) VIII.4.3.5 Summary

(483) To sum up, Naftogaz, requested a revision of the Contract Price by letter of 20 May 2011. Gazprom responded to Naftogaz' request by letter dated 8 June 2011, *inter alia* alleging that Naftogaz' 20 May 2011 letter did not contain any reasonable substantiation of Naftogaz' request for price revision. Naftogaz supplemented the 20 May 2011 letter and responded to Gazprom's

8 June 2011 letter in its letter of 17 June 2011, which elaborated on the changed circumstances in the fuel and energy market and the Contract Price's failure to reflect the level of market prices. Thereafter, the Parties entered into negotiations, with a working meeting taking place on 5 July 2011, as confirmed by Gazprom's letter of 27 July 2011. In the alternative, Naftogaz' 27 April 2014 Notification reminded Gazprom of Naftogaz' price revision claims. In other words**,** the formal and procedural conditions for price revision are fulfilled.

(484) However, although the Parties have entered into several addenda since 2011, the price revision requested by Naftogaz in 2011 has never been agreed on. Thus, the mandatory three months of negotiations pursuant to Article 4.4.2 of the Contract have passed, and the price revision dispute could be referred to arbitration on 16 June 2014.

(485) In any event, Naftogaz alternatively continues to rely on its 27 April 2014 letter as a price revision request.

(486) Naftogaz relies on the same contractual provision (Article 4.4) and the same factual circumstance (change in price formation of gas resulting in the Contract Price not reflecting the market price of gas), as set out in its letters of May and June 2011.

VIII.4.4 The conditions pursuant to Article 4.4

VIII.4.4.1 The price formula

(487) The Contract is based on the traditional Continental European gas sales agreements following the development of the Dutch Groningen field which have been discussed by the Energy Charter Secretariat in *Putting a Price on Energy International Pricing Mechanisms for Oil and Gas ("Putting a Price on Energy") from 2007.*

(488) In accordance with the Parties' intentions and as has later been confirmed by Gazprom in both correspondence with Naftogaz and an external press release, the Contract and its price revision provision are based on European principles for long-term gas sales and in particular the Groningen model. As a matter of fact, the Parties agreed that the Contract should be a European contract based on the Groningen model. Thus, the Parties intended that the price revision clause should operate in the same manner as the price revision clauses in other European long-term gas sales agreements based on the Groningen model.

(489) The price revision clause is very similar to the price revision clauses in other Groningen type agreements. The Price Formula in Article 4.1 of the Contract shows that the basic concept was consistent with the Groningen model and similar to other sales to Former Soviet Union States, *viz.* the principle of European netback, i.e. that the Contract Price in absolute terms should be lower than the gas prices in Germany and Eastern Europe because of the difference in transportation costs from the Russian border. Notably, the escalation supplement is highly stylized with 50/50 weights of gas oil and fuel oil prices, and the level of the Contract Price was in line with European netback prices in January 2009.

(490) The Contract Price provided in Article 4.1, in practice the entire Price Formula used to calculate the Contract Price and its individual elements, is subject to revision. These terms are central to the effects of Article 4.4 of the Contract.

(491) The indices used in the Price Formula are gas oil and fuel oil prices. At the time the Contract was concluded, the level of market prices for natural gas in Western Europe was largely determined by the price of oil products. Thus, at the time, the Parties could reasonably expect that an indexation to these oil products would result in a fair price during the lifetime of the Contract, unless the way gas prices were set in the fuel and energy market should change significantly.

(492) First, in order to establish any changes in the prices of the relevant energy source (gas oil and fuel oil) the current prices are divided by the historical prices, (G/G_0) and (M/M_0) where G and M are the current prices of gas oil and fuel oil, and G_0 and M_0 are the historical prices of gas oil and fuel oil.

(493) The historical prices are defined as fixed amounts in Article 4.1 of the Contract and as the arithmetic average of prices over the nine-month base period from April to December 2008. In the industry, such fixed, historical prices are often referred to as "base values". The base values correspond to the current prices as defined in Article 4.1 of the Contract, calculated over the nine-month reference period for the base date of 1 January 2009. Thus, the current prices (G and M) are calculated averages of published reference prices from agreed reference periods, as defined in Article 4.1 of the Contract. The reference period is the nine months immediately preceeding each quarterly recalculation of the Contract Price, P_n. For example, to calculate P_n as of 1 January of the Delivery Year, the arithmetic average values of gas oil and fuel oil prices in April-December of the previous year are used.

(494) Pursuant to Article 4.1, “k” is the coefficient equal to 0.8 in 2009, and from 2010 equal to 1.

(495) The coefficient "k" is an unusual element in the Price Formula, but the application of the coefficient "k" was required to make the Contract Price, P_n, reflect the level of market prices in January 2009. Similarly, in January 2009, according to Naftogaz, the Parties had reason to expect that the increase of the coefficient "k" from 0.80 to 1 in January 2010 was necessary to maintain a reasonable relationship between the Contract Price and the level of market prices.

(496) The coefficient "k" was changed with [redacted], at USD [redacted] per 1000 m^3.

(497) Since the Contract was entered into, gas oil and fuel oil have lost their relevance as competing energies, and the level of market prices for natural gas is predominantly determined by the price of gas traded at transparent market places, also known as "hubs". The scope and pace of this change in circumstances in the fuel and energy market was extraordinary, and significant compared to what the Parties had reason to expect in January 2009. The wholly oil product price indexed Contract Price does not reflect the level of market prices.

(498) In Naftogaz' opinion, Naftogaz' translation and Gazprom's translation of Article 4.4, 4.4.1 and 4.4.2 of the Contract are materially identical.

(499) In particular, the apparent difference between "*an adjustment of the Contract Price*" in Naftogaz' translation of Article 4.4 and "*reconsider the Contract price*" in Gazprom's translation of the same provision, is immaterial. The decisive Russian term for "*adjustment/reconsider*" is "*пересмотр[у]*" "*peresmotr[u]*", which in English literally means "*revision*", "*reconsideration*", "*review (of a sentence)*" and "*retrial*".

(500) All of the above English definitions imply review as well as adjustment. However, the last two definitions have very narrow and specific meanings, and are not applicable in the present case. Hence, the lexical understanding of the Article implies that there is a right to adjust the price when the conditions in Article 4.4 are fulfilled. This is also in line with the purpose of the price revision clause, reasonableness and also conforms with market practice relating to long-term contracts in general (and, as will be shown below, with the Groningen model).

(501) Also, the apparent difference between "*the right to dispute the other party's performance of the present Contract*" in Naftogaz' translation of Article 4.4.2 and "a right to challenge the actions of the other Party to perform this Contract" in Gazprom's translation of the same provision, is immaterial. While Gazprom's translation is the more literal on this point, "*performance*" and "*the actions [..] to perform*" have the same meaning.

(502) Structurally, the price revision clause consists of two parts spread over three paragraphs. The first part, Article 4.4, sets out two material cumulative conditions for price revision, ("*If…"/"если*"), and then goes on to set out the consequential effects where such conditions have been met ("*then…"/"mo")*. The second part, Articles 4.4.1 and 4.4.2, consist of formal and procedural provisions.

(503) The effects of price revision set out in the first paragraph after the word "*then*" ("то") are procedural as well as material.

(504) Procedurally, the Parties shall enter into negotiations, as they did in the present case in June/July 2011. If no written agreement on the revision is concluded within 3 months from the start of the negotiations, either Party may submit the case to arbitration.

(505) Materially, the aim of the negotiations is revision of the Contract Price, which implies an adjustment of the Contract Price.

(506) The price revision clause in the Contract is similar to other continental European price revision clauses, but Gazprom in this arbitration appears to distance itself from its previous statements that the Contract belongs to the classical Groningen model of Continental European gas sales agreements.

(507) However, as previously implied by Gazprom and confirmed by various sources, *inter alia, the Energy Charter Secretariat's reference work "Putting a Price on Energy"*,[12] also Russian gas sales agreements belong to the classical Groningen model of Continental European gas sales agreements. This also means that there is no specific "*West European*" model price revision clauses in Continental European gas sales agreements of the Groningen model, including in respect of the arbitral tribunal's powers to adjust the price.

(508) The question is therefore whether the price revision clause in the Contract is similar to price revision clauses in Continental European gas sales agreements of the Groningen model.

[12] Pp. 143. 144. 152. 153, 173 and 174.

(509) Stylised provisions of a price review clause of the Groningen model are set out in *"Putting a Price on Energy"*, and are reproduced below for ease of reference:

"If the circumstances beyond the control of the Parties chance [sic!] *significantly compared to the underlying assumptions in the prevailing price provisions, each Party is entitled to an adjustment of the price provisions reflecting such changes. The price provisions shall in any case allow the gas to be economically marketed based on sound marketing operation.*

Either Party shall be entitled to request a review of the price provisions for the first time with effect of dd/mm/yyyy and thereafter every three years.

Each Party shall provide the necessary information to substantiate its claim.

Following a request for a price review the Parties shall meet to examine whether an adjustment of the price provisions is justified. Failing an agreement within 120 days either Party may refer the matter to arbitration in line with the provisions on arbitration of the Contract.

As long as no agreement has been reached or no arbitration award has been rendered all rights and obligations under the agreement – including the price provisions – shall remain applicable unchanged. Unless otherwise agreed or decided by the arbitral award, differences to the newly established price shall be retroactively compensated inclusive of interest on the difference calculated at a rate reflecting the conditions on the international financing market."

(510) As a starting point, the overall structure of the stylised price review provisions is very similar to the overall structure of the price revision clause of the Contract in Articles 4.4., 4.4.1 and 4.4.2. Thus, both clauses contain conditions for and effects of price revision (significant change in circumstances/adjustment of the price provisions), provisions concerning substantiation of the price revision request/claim, a mandatory negotiation period, and the right of each party to refer the matter to arbitration for a final decision if no agreement can be reached within the negotiation period. Hence, most of the elements often included in price revision clauses which are based on the principles in the Groningen model are included in the Contract.

(511) The difference between the clauses is essentially that the price revision clause in the Contract in some respects, and with limited relevance for the power of the Tribunal to adjust the price, is simpler. Thus, unlike the stylised price review clause, the Contract Price revision clause does not contain a so-called "*in any case*" clause, codifying the buyer's entitlement to be allowed to economically market the gas purchased, the number and frequency of price reviews are not restricted, and the Contract Price revision clause does not expressly provide for the continued applicability of the prevailing price provisions pending an agreement or an award, nor for retroactive effect of the award.

(512) Further, while specific limitations on the number and frequency of price reviews vary between agreements and cannot be assumed unless specifically stated, gas sales agreements of the Groningen model are generally understood to incorporate an inherent entitlement to economically market the gas purchased under the relevant agreement, without any explicit provision to this effect.

(513) Likewise, the fundamental principles concerning the continued applicability of the prevailing price provisions pending an agreement or an award, and the retroactive effect of the award, must be assumed to apply without express regulation.

(514) The principal claim for price revision results in an adjustment of the base price as well as the escalation supplement, based on hub prices with an effective date of 20 May 2011, reflecting the date of Naftogaz' request for price revision in the current price revision.

(515) The simplest, and also a commonly used, way to revise the level of the Contract Price is to adjust the base date for the base price to the effective date of the price revision, and the base price to equal the revised Contract Price on that date. The revised base price on the effective date can, however, be calculated under two different methodologies.

VIII.4.4.2 "*delta of deltas*" or "*end of period*"

(516) The first methodology – the "*delta of deltas*" approach or the "*delta change*" approach – entails a comparison of the change in the market price over the price revision period to the change in the Contract Price over the price revision period. The claim for reduction in the Contract Price is then equal to the difference between these two changes. This approach restores the exact mathematical relationship between the market price and the Contract Price observed at the start of the price revision period at the end of the price revision period, in the sense that the difference between the market price and the Contract Price observed at the beginning of the price revision period is restored at the end of the revision period. The same result can in practice be achieved by simply adding the change in the market price to the Contract Price at the start of the price revision period.

(517) The second methodology – the "*end of period*" approach to the calculation of the claim – is to calculate the claim for reduction of the Contract Price as the difference between the market price, less transport costs and a reasonable margin, and the Contract Price at the end of the price revision period. This approach restores the relationship between the Contract Price and the market price at the end of the price revision period in the more general sense that the Contract Price again reflects the level of market prices.

(518) Based on the facts, Naftogaz has calculated that the end of period approach results in a larger reduction of the price than the delta of deltas approach. The principal price revision claim is for a base price P_0 as of 20 May 2011 at USD [redacted] 1000 m^3 of Gas.

(519) Naftogaz has an alternative claim for price revision, identical to the principal claim but instead based on the delta of deltas approach where the base price amounts to USD [redacted] per 1000 m^3 of Gas.

(520) Naftogaz also has a further alternative price revision claim, based on a small adjustment of the effective date for price revision to 17 June 2011, otherwise identical to the price revision claims above.

(521) In addition, Naftogaz' has a further alternative price revision claim based on a more significant adjustment of the effective date for price revision to 27 April 2014. This results in a different and higher base price than under the preceding claims, USD [redacted] (delta of deltas) and, USD [redacted] (end of period) per 1000 m^3 of Gas as well as a different definition and base value of the base price, P_0 (see further below).

(522) The material effects of price revision under Article 4.4, is the entitlement to an adjustment of the Contract Price in the form of a written Addendum to the Contract or a final decision by an arbitral tribunal.

VIII.4.4.3 Condition 1 has been fulfilled – there have been significant changes in circumstances in the fuel and energy market compared to what the Parties had reason to expect

VIII.4.4.3.1 Steps required to make a claim based on the price revision clause

(523) The following steps are required to make a claim based on the price revision clause:

(i) Demonstrate that there have been significant changes in the fuel and energy market compared to what the Parties had reason to expect when they concluded the Contract (the “Trigger”);

(ii) Determine what the market price was at the start of the review period (January 2009) and the end of the price review period i.e. May 2011 or April 2014. The market price can, in principle, be derived from prices in Germany, the Czech Republic and Slovakia, but given the very large volumes covered by the Contract and the lack of liquidity in the other markets, the most relevant indicator of market prices are German prices;

(iii) Netback the market prices to the Contract delivery point on the Russian border by deducting the costs associated with transiting all the relevant intermediate countries and Ukraine;

(iv) Compare the netted back market prices to the Contract Price to ascertain whether the Contract Price reflects the level of market prices.

(v) If the Contract Price does not reflect market prices, then

- Adjust the Contract Price so that it reflects the market price, allowing for transit costs and for Naftogaz to earn a margin on its gas sales (end of period methodology).

- Alternatively, adjust the Contract Price so that the change in the Contract Price over the price review period equals the change in the netted back market price over the same period (delta of deltas methodology).

- Determine what other adjustments to the Contract Price may be necessary to reflect changes in the way that market prices are formed. This, for example, includes considering whether changes to the indices used in the price formula are required.

(524) There are three terms which are relevant under Condition 1, namely the “*fuel and energy market*”, the requirement that “*the circumstances have (…) changed significantly*” and the additional requirement that this shall be “*compared to what the Parties had reason to expect at the conclusion of the Contract*”.

VIII.4.4.3.2 The fuel and energy market

(525) The term "*fuel and energy market*" is both Parties' translation of the Russian term "*рынке топливно-энергетических товаров*".

(526) A market is a place for the sale and purchase of goods. A fuel and energy market is a broad term which encompasses places for the sale and purchase of gas, oil products, electricity, district heating and renewable energy sources.

(527) This understanding is consistent with the original Russian wording. The Russian term "*топливно-энергетических*", which the Parties have translated to "*fuel and energy*" is composed of two adjectives. The first, "*топливно*" literally means "*fuel-*" and encompasses liquid, gaseous as well as solid fuels, such as oil, coal and wood.

(528) The second, "*энергетических*" means "*energy-*" and is derived from "*энергетика*" which means the energy sector of the economy, power industry.

(529) In other words, the market for all fuels and energy sources and carriers, like oil, coal, wood, natural gas, electricity and district heating are covered by the term. Read in conjunction with the second material condition for price revision, that the Contract Price does not reflect the level of market prices, a main subject for assessment is how market prices for natural gas in the relevant market are formed, in particular in relation to the prices of other fuels and energy sources and carriers (price formation).

(530) The term "*market*" excludes areas where there is no free price formation, e.g. due to subsidies, price regulation or one or a few dominant market actors. Ukraine is excluded for these reasons, i.e. Gazprom's and Naftogaz' dominant positions and the use of regulated pricing.

(531) The Contract does not specify which geographical area the "*fuel and energy market*" refers to. However, when interpreting the wording of the Contract the intention of the Parties at the time of entering into the Contract shall be given considerable weight.

(532) The intention of the Parties was to align the Contract Price with market prices in other European countries, specifically the countries to the West of Ukraine. Gazprom sought to achieve the same economic rent for natural gas delivered to Ukraine, as it achieved on sales to Western Europe. This intention indicates that the "*fuel and energy market*" refers to the Western European fuel and energy market.

(533) Notably, Naftogaz' request for a Contract Price which reflected the competitive situation between natural gas and other energy sources in the Ukrainian market, was effectively rejected by Gazprom. Thus, the negotiation history confirms that the Contract Price relies on the modified netback principle applied by Gazprom for sales to former Soviet republics, i.e. the replacement value of another importing country at the end of the pipeline corrected for transportation costs, rather than the value of the Natural Gas in the buyer's market, cf. "*Putting a Price on energy*".

(534) Consequently, Ukrainian market prices (which in any event did not exist in the regulated market of 2009, and hardly exist today) are not relevant.

(535) The next question is whether it is possible to determine which country or countries at the end of the pipeline is/are relevant. Other documentation provides further guidance in this respect. Thus, in its 20 January 2009 press release on the Contract, Gazprom stated that the Contract Price was the European market price. In the press release, Gazprom also equated Europe with the countries supplied with Russian gas transited through Ukraine:

"Russian gas transit to Europe across Ukraine and gas supplies to Ukrainian consumers were initiated under the agreements reached at night on January 18 by Russian Prime Minister Vladimir Putin and his Ukrainian counterpart Yulia Timoshenko. These agreements stipulate that starting from 2009 both countries switch in their relations in the gas sector to the generally accepted and transparent European gas pricing rules".

(536) Countries which received significant supplies of Russian gas transited through Ukraine in 2009 were, *inter alia,* Slovakia, the Czech Republic, Germany, Austria and Italy.

(537) In its 8 June 2011 letter in response to Naftogaz' request for price revision, Gazprom referred to prices in "*Germany and the countries of Eastern Europe*", as a relevant yardstick. Naftogaz essentially agrees with Gazprom's apparent position on the geographical scope of the market indicated in the 8 June 2011 letter, i.e. that the relevant country at the end of the pipeline is Germany, and also that the Eastern European countries through which Russian gas transits to Germany, Slovakia and the Czech Republic, are relevant. In these countries, the German gas market is by far the largest and most developed, and Naftogaz' claim is quantified on the basis of Natural Gas market prices in Germany, corrected for transportation costs.

(538) The Parties agree on the choice of Germany, Slovakia and the Czech Republic. They disagree, however, on which data from Slovakia and the Czech Republic may be relevant. Naftogaz rejects Gazprom's use of Czech and Slovak import prices to determine the level of market prices.

(539) Poland and Hungary should be excluded from the geographical scope of "*the fuel and energy market*" under Article 4.4 of the Contract, because they cannot be considered to have a "*market*" in the meaning of Article 4.4. While both countries arguably are situated in "*Eastern Europe*", they do not have functioning "*fuel and energy market[s]*". Gazprom has a dominant position in both markets. Gazprom is presently being investigated by the European Commission for abuse of dominant position in, *inter alia*, Poland and Hungary. In Poland, the Commission is also investigating Gazprom for excessive pricing.

(540) Neither France nor Italy can be said to be in the region "*Germany and Eastern Europe*", and should therefore be excluded based on the Parties' previously expressed understanding of the relevant geographical market.

(541) In addition, Italy did not have a "*market*" in the meaning of Article 4.4 in 2011. A lack of access to import infrastructure meant that prices in Italy were moving out of step with the European market. Thus, Italy has to be excluded from the geographical scope of the "*fuel and energy market*" under Article 4.4 of the Contract also for this reason.

(542) However, in the light of Gazprom's widening of the scope of the relevant market, Naftogaz has considered the potential implications of including market prices from further European countries in its analysis in the following way. For 2009 and 2011, prices from France, Great Britain and the Netherlands in addition to Germany have been included. In 2014, also Italy has been included (see above for the reasons why Italy is excluded in 2009 and 2011). These are the five countries with the highest gas demand, accounting for around two thirds of all EU gas demand since 2009. The conclusion is that that the result would be slightly higher claims for Naftogaz.

(543) In Naftogaz' interpretation, the geographical scope of the “*fuel and energy market*” in Article 4.4 is a reference to the fuel and energy markets in Germany, Czeck and Slovak fuel and energy markets.

(544) The interpretation is essentially based on the wording itself ("*market*" excludes Ukraine, Poland, and Hungary, since none of these countries have properly functioning markets, and nor did Italy before 2014), contemporaneous documents, in particular Gazprom's various statements in press releases and letters, the explanations of all of Naftogaz' fact witnesses, and literature explaining Gazprom's pricing policy towards CIS countries.

VIII.4.4.3.3 The relevant changes in circumstances

(545) With regard to the prerequisite that "*the circumstances have changed significantly*" in Article 4.4 in the Contract, the verb "*change*" is a literal translation of the Russian word "*изменились*". The adverb "*significantly*" is a literal translation of the Russian term "*существенно*", which serves to indicate the degree of changes that qualifies under the provision.

(546) Circumstances may change gradually or rapidly over time, as well as suddenly due to specific events. This is confirmed in the 1999 award regarding another Continental European long-term agreement, where the tribunal stated that:[13]

"The words 'if the economic circumstances … should change' cover any fluctuation, variation or modification. Examples of such changes are a devaluation or revaluation of the [currency], a changed competitive situation, a tax on one or several sources of energy, an imposed price control and a changed legal environment with an economic effect, e.g. new environmental requirements".

(547) Naftogaz relies on both legal and factual changes in circumstances in the present case.

(548) The phrase "*compared to what the Parties had reason to expect at the conclusion of this Contract*" is a translation of the original Russian wording *"по сравнению с тем, что Стороны обоснованно ожидали при заключении настоящего Контракта*". *"What*" refers back to the change in circumstances in the preceding formulation. The verb "*expect*" is a literal translation of "*ожидали*" which implies a consideration of what the Parties had reason to expect when they entered into the Contract. The question is then which circumstances "*the Parties had reason to expect at the conclusion of the Contract*".

(549) The Russian adverb "*обоснованно*", which Naftogaz has translated as "*had reason*" (literally and as translated by Gazprom: "*reasonably*"), is derived from the adjective "*обоснованный*" which means "*well founded, well grounded*". The underlying verb "*обосновать*" means "*to substantiate*".

(550) Thus, only circumstances which the Parties had well founded, substantiated, reasons to expect when they concluded the Contract are relevant to the factual basis for assessing change. The assessment must consequently be objective. The circumstances which the Parties reasonably expected at the conclusion of the Contract, they presumably also reflected in the Contract itself,

[13] The final award in ICC case 9812 rendered in August 1999 and partly published in ICC International Court of Arbitration Bulletin, Vol 20/2 - 2009", p. 2.

notably in the Contract Price Formula. From the Price Formula, it is obvious that the Parties expected the level of gas market prices to continue to be determined mainly by oil product prices.

(551) The wording therefore has two implications:

(i) The starting point in time for assessing change is the point in time when the Parties concluded the Contract, 19 January 2009; and

(ii) Only circumstances which the Parties had well founded reasons to expect on 19 January 2009 serve as the starting point for assessing change, and the circumstances incorporated in the Contract Price Formula are a main source for the Parties' reasonable expectations.

(552) Usually, but not always, change requires developments over a defined period of time. The relevant time period to consider here commences when the Contract was entered into, and ends on the effective date, the date when Naftogaz requested a price revision, 20 May 2011.

(553) While the Contract does not define the period to which the "*reason to expect*" test should apply, standard industry custom and practice would be to consider whether a development was expected to happen between January 2009 and the date at which the price review was triggered. According to Naftogaz', its price revision claim is based on significant unforeseen changes in circumstances between 19 January 2009 and 20 May 2011. The period of time between these dates is referred to as the "*price revision period*".

(554) It makes no commercial sense to apply the "*reason to expect*" test to the lifetime of the Contract. The reasonable assumption is to apply the test to developments that have occurred by the date when the first price revision request is submitted. This is consistent with the way criteria referring to expectations/foreseeability are applied in long-term contracts.

(555) The main ground for the requested price review, decoupling, was not taken into account in setting the Contract Price formula. According to Naftogaz, the subject was not discussed during the negotiations, while the Parties were discussing a future drop in oil prices, they did not foresee a decoupling of oil and gas prices. It would also have been impossible to take decoupling into account as there was no certainty over the magnitude or direction of the decoupling that would occur. The question of price formation becomes relevant only because of the decoupling of gas and oil prices. If there had been no decoupling of oil and gas prices, then it would not have mattered whether hub prices or oil prices determined the level of market prices. Oil-linked gas prices (such as the Contract Price) would have continued to reflect the level of market prices, even if the market prices were set at the hubs.

(556) Gazprom argues that it was foreseeable that the decoupling would occur, in particular over the lifetime of the Contract, which Gazprom alleges to be the relevant period for considering change.

(557) Naftogaz denies that decoupling was anticipated when the Contract was entered into in 2009.

(558) According to Naftogaz, when the Contract was concluded, the Parties had reason to expect that oil prices would continue to drop and remain low for the foreseeable future. Gas market prices, on the other hand, were not expected to remain low for as long as oil prices. These expectations are objective and founded on prices for future deliveries of oil and gas agreed around the time when the Contract was concluded, so-called forward prices. It was only by the late summer of 2009 that the first wave of price reviews was initiated as buyers sought to include hub prices in their contract formulae as a result of an abundance of natural gas, a "*gas glut*", in Europe and the decline in industrial demand caused by the 2008 financial crisis which provided the necessary impetus to change the price formation for natural gas.

(559) Furthermore, the development in shale gas extraction in the United States was the most important factor for creating the gas glut. The dramatic rise in the exploitation of unconventional gas sources, i.e. gas extracted from impermeable shale and coal seams, in the US has had two impacts: US imports of natural gas had increased in absolute terms between 2008 and 2010 and the 2009 forecast suggested that imports would continue to rise. However, as a result of the shale gas extraction in the US, contrary to the expectations in 2009, in 2011 natural gas imports to the US had dropped by 30 % from their 2009 level and were forecasted to continue declining and gas intended for import to the US were redirected to other markets, including Europe. Shale gas also displaced coal in many uses in the USA, leading to a sharp rise in US coal export, including to Europe. The result was reduced gas consumption in the European power sector compared to expectations, contributing further to the "*gas glut*".

(560) Changed regulation encouraging competition and the unexpected gas glut led to a significant and unexpected change in the price formation for natural gas. The supply-demand imbalance forced gas importing companies across Europe, with Take or Pay obligations in excess of their requirements, to turn to European gas trading hubs as the only place where it was possible to sell their excess natural gas and thereby minimize the losses imposed on them by their volume obligations.

(561) The increased liquidity made the hubs a robust and reliable alternative market place for the sale and purchase of natural gas and the excess gas made the prices fall sharply. However, oil product prices did not decline to the same extent. These suddenly liquid market places and their significance for the level of gas prices in the fuel and energy market constitute significant changes in circumstances compared to what the Parties had reason to expect in January 2009. The Contract Price no longer reflected the market price.

(562) In summary, these factors, and the resulting "*gas glut*", together with changed regulation encouraging competition, led to significant increases in the volumes of gas traded on the European gas trading hubs and in the number of companies trading at the hub, which in turn caused hub prices to fall and, given that oil prices did not decline to the same extent, resulted in decoupling of the market price of natural gas from the oil price. Naftogaz relies on the suddenly liquid market places and their significance for the level of gas prices in the fuel and energy market as significant changes in circumstances compared to what the Parties had reason to expect in January 2009 for the purposes of fulfilling the first condition under Article 4.4.

(563) The development of gas to gas competition, coupled with the widespread availability of cheap wholesale gas has fundamentally changed market price formation across Europe. By mid-2009 larger customers - resellers and industrial end users - expected to receive offers, whose price level reflected the published hub gas prices. This in turn resulted in a situation from around October 2009 where it was only by sourcing natural gas from hubs or at hub prices that suppliers could hope to obtain a margin on further sales to end users.

(564) The experts conclude that in 2008 and probably in 2009, suppliers would have anticipated that they could make higher margins from buying gas on oil-linked terms rather than at hub prices.[14] However, from 2010 onwards, it was clear that only by purchasing gas at hub prices could suppliers hope to earn a reasonable margin. The development of competition meant that customers could receive prices whose level reflected hub prices rather than oil prices. The rapid development of gas to gas competition was not expected.

[14] Expert Price Report, Figures 20, 22 and 23.

(565) Thus, the oil-indexed price determination mechanism was replaced at all market levels by hub prices as the main determinant of market prices. The increased importance of traded natural gas markets and the emergence of gas to gas competition also impacted on the price formation under long-term gas sales agreements. Natural gas importers who were forced to sell natural gas at hub prices to their customers, initiated price revisions and arbitrations to pass the change in price formation and level on to their producers. Since 2009, almost all long-term European import contracts are likely to have been the subject of at least one price revision or arbitration.

(566) The Parties agree that the starting point in time for considering change is the date the Contract was entered into, 19 January 2009. However, the Parties apparently disagree on the material starting point for assessing change, i.e. the Parties' reasonable expectations at that point in time. The Parties appear to understand the Russian term "*обоснованно ожидали*" ["*obosnovanno ozhidali*"] differently. Naftogaz has translated this term with "*had reason to expect*" and Gazprom has translated the term with "*reasonably anticipated*". The Russian expression "*obosnovanno*" implies that only circumstances which the Parties had "*well founded, well grounded*" reasons to expect when they concluded the Contract are relevant to the factual basis of assessing change.

(567) Gazprom states that "*[w]hile the exact timing of these developments may have been difficult to predict in January 2009, it was certainly foreseeable that they would occur within the Contract term […]*". Thus, while it in principle agrees with the 29-month price review period for these proceedings, Gazprom actually considers potential changes over eleven years. This consideration has no basis in the system of the Contract, and also makes no sense from a commercial perspective.

(568) Gazprom's actual application of the price revision clause on this point also ignores the *"significance*" criterion ("*changed significantly compared to"*) in Article 4.4. The significance criterion implies that even if for example increased prominence of hub pricing before 2019 could be expected in 2009, also the speed, scope and consequences of the switch from oil-linked to hub pricing which actually occurred must be considered. If a change has occurred sooner, to a larger extent and/or with larger consequences than the Parties had reason to expect, that change is significant compared to what the Parties reasonably expected.

(569) The requirement for significant change compared to the Parties' expectations implies that if the change occurs earlier, or has greater effects, than the Parties had well-founded reasons to expect when they concluded the Contract, then it is significant compared to the Parties' expectations. The significance of the change must also be assessed in the light of the impact on the level of market prices. If the changes have caused market prices at the time of the request to deviate significantly from the Contract Price, the changes are presumably significant compared to the Parties' reasonable expectation that the Price Formula would keep the Contract Price in line with the market prices.

(570) Thus, the significance of a change in circumstances must also be seen in the light of its impact on the level of market prices. The two conditions in the price revision clause are cumulative and must be read in conjunction with each other. The significant change in circumstances compared to what the Parties had reason to expect in January 2009 is primarily the lasting and very significant drop in gas market prices compared to oil-linked prices, rather than the increased importance of hub pricing *per se*. In price revision clauses where the significance criterion is related to the change in circumstances, the significance of the change may best be assessed by reference to the effect of the change on the value of the gas.

(571) The coefficient "*k*" is consistent with a reasonable expectation in January 2009 that oil prices were going to remain lower for some time than gas prices and so it would not be unreasonable for Gazprom to ensure that it did not continue to suffer from that very low oil price by adjusting the "*k*" factor, which is after all a parameter that can be adjusted, to bring it back broadly into the position that had been agreed in terms of 2009, where the coefficient "*k*" was 0.8.

(572) According to Gazprom, with regard to the period of consideration (the "*price review period*"), Gazprom agrees with Naftogaz that the relevant starting point for what market conditions could be reasonably anticipated by the Parties is the date of entering into the Contract and that the date for comparison is the date when Naftogaz submitted its request for price revision, 20 May 2011. However, when considering which changes were reasonable to anticipate, Gazprom instead applies the yardstick "*during the life of the Contract*". Gazprom argues that it was clearly foreseeable as at January 2009 that hub prices would become a prominent, if not dominant, price formation mechanism for LTCs in Western European markets such as Germany and the Netherlands during the life of Contract, although the exact pace of the transition would have been difficult to predict.

(573) By applying the lifespan of the Contract instead of the price review period, and totally ignoring the "*significance*" criterion, Gazprom bases its discussion of foreseeability on incorrect premises with no basis in the Contract, jurisprudence or case law.

(574) On this flawed basis, Gazprom discusses whether it was foreseeable that European hubs would develop over the lifespan of the Contract, and thereby misses the target.

(575) The relevant question is not whether hubs would develop in the period from 2009-2011. The development of hubs as such is only part of the picture. Some European hubs had been functioning for years when the Parties entered into the Contract. However, the volumes traded on the hubs were small and the gas sold at these hubs were sold at more or less the same price as gas sold at oil-linked prices, and had little effect on the market price of gas. Thus, until the middle of 2009, the hub prices, also at the NBP in Britain, were heavily correlated with oil-linked gas prices.

(576) The issue at hand is whether the Parties in January 2009 had well founded reasons to expect that, in the course of only a few months, the market price of gas would lastingly decouple from the prices of oil products, to which it had been connected since the first gas sales agreements in the early 60's.

(577) The Price Formula in Article 4.1 is the best evidence of what the Parties reasonably expected when they concluded the Contract. If the Parties had reason to expect that gas market prices and oil product prices would lastingly disconnect shortly after the Contract was concluded, they would not have indexed the Contract Price to oil product prices.

(578) Naftogaz relies on all the changes in circumstances resulting in the lasting decoupling of gas prices from oil products prices in the second half of 2009.

VIII.4.4.4 Condition 2 has been fulfilled – the Contract Price provided in Article 4.1 did not reflect the level of market prices at least since 20 May 2011

(579) As from mid-2009, a lasting decoupling of hub gas prices from oil-indexed gas contract prices emerged in Europe. This development of hub gas prices was driven by the large volumes of gas being made available on the hubs.

(580) Divergences between hub prices and oil-indexed prices had been seen before 2009. However, such divergences had been relatively transitory. Notable divergences occurred in early 2006 when a fire at the main UK gas storage facility exacerbated the effects of a long, cold winter and for around six months in 2007 when significant new gas supplies arrived in Europe. The current decoupling is very different in nature, due to its prolonged duration.

(581) The decoupling of forward prices emerging from the middle of 2009 was of particular relevance. A forward price is the price on a given date at which a commodity for delivery over some future period can be purchased. The decoupling of forward prices, which did not occur until after the Contract had been concluded, is more important than decoupling of spot prices because it is customers' calculations of the price at which they can purchase hub gas over the period for which they wish to contract that determines the price they are willing to pay.

(582) The second condition for a price revision under Article 4.1 is that "*the Contract Price does not reflect the level of market prices*" must be read in conjunction with Condition 1, as the wording introduces a requirement for causality in that the significant changes in "*circumstances in the fuel and energy market*" shall lead to the situation where the "*Contract Price […] does not reflect the level of market prices*".

(583) The verb "*reflect*" is a literal translation of the Russian term "*отражает*". The wording implies that the Contract Price shall mirror "*the level of market prices*", and if the two move out of step, a price revision is justified. However, to reflect or mirror does not necessarily mean equal. This distinction confirms that the level of market prices observed in the relevant geographical market, primarily Germany, must be corrected for transport costs and the reasonable margin a gas importer would require under a Take or Pay contract. This understanding is in accordance with the intention of the Parties when they entered into the Contract.

(584) Thus, when the Contract Price does not reflect the level of market prices and Condition 1 is fulfilled, either Party is entitled to an adjustment of the Contract Price so that it once more reflects the level of market prices. Market prices observed at the end of the pipeline in Germany must be reduced by the costs of transporting Natural Gas from the border between Ukraine and Russia/Belarus and a reasonable margin, to result in the same revenue for Gazprom as if it had sold the Natural Gas to Germany, in conformity with the modified netback principle incorporated in the Contract.

(585) "*The level of market prices*" is Naftogaz' translation of the Russian expression "*уровень цен рынка*", literally meaning "*level of prices of the market*". The meaning and syntax of the Russian phrase is more correctly expressed in English by "*the level of market prices*".

(586) The second condition requires a comparison between the Contract Price, which is a price for Natural Gas, and the level of market prices. Consequently, the "*market prices*" are market prices for Natural Gas. However, when read in conjunction with the "*fuel and energy market*" relevant to the first condition, also market prices of other energy carriers may possibly be considered under the second condition, to the extent they are relevant for the market price of Natural Gas. This possibility was practical when the Contract was concluded, and Natural Gas market prices to a very significant extent were determined by the prices of other energy carriers. When market prices for Natural Gas is set by supply and demand at transparent market places, these market prices are the relevant benchmark also for the Contract Price pursuant to the price revision clause.

VIII.4.4.5 The correct subject for comparison with the level of market prices is the Contract Price, not the Factual Price

(587) Article 4.4 explicitly refers to the Contract Price (P_n) in Article 4.1. Gazprom argues that the subject for comparison under Article 4.4 should be the factual price (P_x) and that comparison with the Factual Price is the correct approach, since the Factual Price is the "*actual price paid under the Contract*". However, the correct subject for comparison with the level of market prices is the Contract Price, not the Factual Price.

(588) Gazprom fails to acknowledge that since [redacted] entered into force, [redacted] the Contract incorporates part of the rent to be paid for naval bases on Crimea. Thus, the price *actually paid* under the Contract is the grant of use of Ukrainian territory *and* the Factual Price. One cannot compare the price of gas under a contract which includes the rent of a naval base with a price of gas which does not include the rent of a naval base.

(589) Gazprom's failure to take account of the naval bases in the price paid under the Contract, by applying the Contract Price (P_n) as Naftogaz has done, leaves all of Gazprom's considerations of price under Article 4.4, Section 36 and Competition Law incorrect.

VIII.4.4.6 The level of market prices is a reference to wholesale prices not import prices

(590) The wording of Article 4.4 provides guidance for where the relevant gas prices can be observed in three respects: (i) the gas prices must be "*market*" prices, (ii) the prices must primarily be observed in "*the fuel and energy market*" and (iii) there is no explicit reference to import prices or other long-term gas supply contracts in Article 4.4.

(591) The wording "*level of market prices*" refers to the prices in the "*fuel and energy market*". This implies a market where various energy sources are traded, not only where gas is imported. Furthermore, it is obvious that the "*the fuel and energy market*" in the trigger for price revision is the wholesale market. It is similarly clear that it is the fuel and energy market in which the relevant changes occur, which shall be considered as the yardstick for the level of market prices.

(592) Market prices are set in transactions and do not necessarily equal paid prices. A market price is the prevailing price at which something is sold in a specific market.

(593) Thus, the market price of a product, *in casu* gas, at a particular point in time is the price at which a seller is ready and willing to sell and a buyer is ready and willing to buy the product at that same point in time. The prices which are paid under existing contracts, in particular under long-term contracts, are therefore not necessarily market prices. They only show the price sellers and buyers were ready to sell and buy for in the past, not what sellers and buyers would agree to today.

(594) The best place to measure market prices is in a market where a lot of sellers and buyers are active and make many transactions. In such a market, the observed level of prices is more likely to show the point at which supply and demand generally intersect, and less likely to be affected by peculiar circumstances of one or a few deals.

(595) The import level of the Continental European gas market was and to a large extent still is dominated by only a few actors on the buyers' side (the national or regional gas transmission companies or "*gatekeepers*"). There were also only a few actors on the sellers' side (mainly Russia, Norway, the Netherlands and Algeria), and most gas was and to a large extent still is sold under long-term contracts. Consequently, import prices have generally been, and are to a large extent still, set by only a small number of transactions among few actors, and are therefore not "*market prices*". The fact that the price paid under a long-term gas import contract is likely to deviate from the gas market price over time is the reason why such contracts generally contain price revision clauses.

(596) Import prices are also an unreliable indicator of the level of market prices, in particular in times of rapid changes in market circumstances and price levels, which mainly are fed through to the import prices through lengthy and cumbersome price revision proceedings.

(597) The criterion "*level of market prices*" must be read in conjunction with the first condition for price revision, i.e. changes in the "*fuel and energy market*". The fuel and energy market is not limited to the gas market, and also the prices of other fuels and energy carriers may be relevant.

(598) The implication is that the level of market prices primarily must be assessed in the downstream market where natural gas faces direct competition from other fuels and energy carriers (e.g. from coal in sales to power producers). Gas importers will not usually consider importing for example coal instead of gas, and there is little or no such competition between gas and other fuels and energy carriers at the import level.

(599) Also for this reason, import prices are not "*market prices*" in the meaning of Article 4.4 of the Contract.

(600) Against this background, the use of import prices as a benchmark in price revision deviates from the usual practice in the industry, and requires a specific basis in the relevant price revision clause. Some price revision clauses in Russian gas sales agreements contain such specific references to import prices, essentially as a proxy for market prices.

(601) Article 4.4 does not contain any such specific reference to import prices. The Parties were or must be considered to have been aware of this practice when they concluded the Contract. The failure to include a reference to import prices in the price revision clause therefore excludes import prices from relevance in price revision under the Contract.

(602) Import prices do not constitute a reliable indicator of market prices even if the German BAFA import price has fallen to levels relatively close to hub prices over time. This reflects partly that an increasing percentage of gas imported to Germany no longer relates to long-term contracts. One outcome of the wave of negotiations and price reviews is that contract volumes were reduced, leaving producers free to trade the gas as they see fit. This means that import prices are no longer a good proxy for the price in large-scale long-term import contracts. Second, long-term contract prices have become increasingly linked to hub prices, providing further confirmation of the change in price formation mechanism.

(603) The conditions for price revision in Article 4.4 are cumulative and must be read in conjunction with each other. The significance of changes in economic circumstances must be assessed in terms of their impact on market prices. Similarly, relevant changes in circumstances may require the use of different market price sources at the beginning and the end of the review period.

(604) In the present case, the formation of market prices has changed from a link to oil product prices to hub-based pricing. The best way to capture the effect of this change on the level of market prices is to use an oil-linked benchmark (as the Platts NWE Index) at the start of the price review period, and hub prices (such as the [redacted] prices) at the end of the review period. Naftogaz' methodology is therefore consistent and correct.

(605) Hub prices are the best indicators of wholesale market prices. For instance, retail prices moved from being set by reference to oil-linked prices at the start of 2009 to being set by reference to hub prices in 2011. Consistency requires that one finds benchmarks for market prices at the start as well as the end of the period. It does not mean that the same index has to be used at both points, if that index has lost its relevance at the end of the period.

(606) The relevant benchmark for market prices changed irreversibly between January 2009 and May 2011. In January 2009, market prices were overwhelmingly set by oil-linked indifference calculations, for which the NWE Index is representative. By May 2011, market prices were set by reference to hub prices. To use the NWE Index in 2009 and the [redacted] hub price in 2011 is then perfectly consistent, and required to capture the change in the level of market prices.

(607) Summing up, the material effects of price revision are the adjustment of the Price Formula in Article 4.1 to reflect the changes in circumstances and to calculate a Contract Price which reflects the level of market prices.

(608) The effects of price revision must address the significant changes which have taken place in the fuel and energy market and the failure of the Contract Price to reflect the level of market prices triggering the price revision, i.e. to realign the Contract Price and Price Formula with the prevailing circumstances in the fuel and energy market and the level of market prices.

(609) It is the prices in the wholesale market that is the object of comparison with the Contract Price. There is nothing hypothetical over the prices to which Naftogaz compares the Contract Price. The wholesale prices for gas in the German market are actual prices agreed in actual transactions, in competition with both various supplies of gas and alternative energy sources. Thus, German wholesale prices is the perfect indicator as to what price levels buyers are willing to buy and sellers willing to sell gas. This is true today, it was true when the Contract was entered into, and it was true in May 2011.

(610) As long as import prices exceed the prices in the wholesale market, import prices per definition cannot be taken as a relevant indicator of market prices. Prices are logically higher the further up the value chain one gets, and in the long run, wholesale prices should be higher than import prices.

(611) When this is not the case, reported import prices diverge from the market, and cannot be relied on as an indicator of the level of market prices. In short, the import prices for 2011-2014, are not market prices, at which buyers were *willing* to buy and sellers willing to sell, but prices at which buyers historically *had* to buy and subsequently (at least partly) have been reimbursed for through price revisions. To apply import prices as the relevant benchmark at the end of the reference period would yield an unrealistically high market price, with no relation to what buyers were actually willing to pay in May 2011, or to what was actually paid when taking into account subsequent price revisions with retroactive effect.

VIII.4.4.7 The netback principle

(612) The netback principle implies that the price the buyer under a long-term gas import contract pays is calculated based on the gas market price in the relevant market less the costs of transportation and distribution. In this way, the price paid reflects the market price in the relevant market.

(613) The wording "*reflect*" requires a deduction of transportation costs from the market to the delivery point.

(614) Deducting transportation costs from the relevant market to the delivery point under a given contract when setting the Contract Price, i.e. the netback principle, is common practice in the European gas industry. Gazprom applied the netback principle as a pricing policy when the Contract was concluded. The Parties actually applied the netback principle when agreeing on the price level under the Contract. A netback exercise is in conformity both with the legal basis (the Contract, the Parties' intentions as presented in negotiations and in public statements), and industry practice.

(615) The term "*reflect*" in Article 4.4 implies that the Contract Price shall mirror "*the level of market prices*" in the relevant geographical market, primarily Germany, corrected for transport costs. Thus, the netback approach is provided for in the text of the Contract.

(616) Gazprom alleges that there is no basis for deducting transport costs from Germany to the Russian border, since there is no provision to that effect in the Contract. Instead, Gazprom advocates an allegedly "*balanced approach*" of ignoring transport costs, which in reality is unfair and unbalanced.

(617) Gazprom's approach deviates from its own contemporaneous statements. In particular, Naftogaz recalls that Gazprom's original motivation for relying on market prices netted back from Western Europe to set prices to former Soviet republics was to increase its sales prices to these countries. When changed circumstances in Western Europe now mean that this methodology results in price reductions, Gazprom conveniently forgets about the netback part.

(618) Gazprom, in its legal interpretation of the term "*reflect*" argues that Naftogaz' position is arbitrary and that the term might just as well imply the market price *plus* transport. However, since the Contract Price applies at the Russian-Ukrainian border, the comparison with market prices can only meaningfully be made on a like-for-like basis if the relevant market prices are netted back to the Russian-Ukrainian border, since the Contract gas would have to travel from the Russian-Ukrainian border to Germany in order to be compared to the relevant indicator of the fuel and energy market. Naftogaz made this point very early in its 17 June 2011 letter to Gazprom.

(619) Deducting transportation costs from a market price (i.e applying the netback principle) is the industry standard, and Gazprom has applied the netback principle as a pricing policy from 2005 to 2009.

(620) There can be no doubt as to the existence and application of the netback principle in the European gas industry. In the gas industry, the netback principle essentially implies that the price under any gas sales contract must be the relevant market price less the transportation cost from the delivery point to the market place.

(621) Thus, it is clear that both the European gas industry in general and Gazprom applies the netback principle when pricing gas. The rationale is that to the buyers, this is essential for them to be able to sell the gas in the relevant market(s), and for the sellers to obtain the highest possible price that any buyer willingly can pay.

(622) The Parties applied the netback principle when they agreed on the Contract Price in Artice 4.1 of the Contract.

(623) Gazprom has only alluded to an argument along the lines that the base price USD 450 in itself indicates that the Parties did not apply a netback approach.

(624) During the Contract negotiations, the aim was to transition to market, economically substantiated and mutually agreed gas prices, i.e. European market based pricing. Netback pricing is an integrated part of European market based pricing of gas.

(625) The base price formula set out in Gazprom's draft contract of 29 October 2008, and which was repeated in all subsequent drafts of 2008, would have yielded a base price of USD 460 in October 2008.

(626) Gazprom argues that this demonstrates that there was no netback involved. That is a hypothetical question as the base price formula was not intended to take effect until after a transition period of three years. However, and more importantly, Gazprom's argument is incorrect. A base price of USD 460 in October 2008 is perfectly reconcilable with a German market price netted back to the delivery points in Eastern Ukraine.

(627) The oil prices in the first three quarters of 2008 were high. When the Parties started negotiating in October 2008, the expected year ahead price of gas in Germany was around USD 500/1000 m^3. If this market price was netted back to the delivery points in Eastern Ukraine, it would yield a price similar to USD 460/1000 m^3, the base price resulting from Gazprom's draft base price formula.

(628) However, the Contract was finalised during a period of turmoil and rapidly falling oil prices. In the course of the last three months of 2008 the oil price fell significantly. The oil price was expected to fall further in 2009, before it was expected to steadily increase somewhat and stabilise in 2010.

(629) Thus, while a base price of USD 450-460/1000 m^3 would be reflective of the German market price less transportation costs in October 2008, it was not a European (German) netback price in January 2009. In January 2009, part of the drop in oil prices in 2008 had fed through to the gas price, and the German netback price was around USD 360/1000m^3. In January 2009, the Parties had reason to expect that the Contract Price with the coefficient "*k*" equal to 0.8 in 2009 and 1 from 2010, would drop to slightly less than USD 200 in the second half of 2009, before it would increase to USD 250 from January 2010 and steadily increase in the course of 2010 and yielding a price somewhat below USD 300 by the end of 2010. This fits with Naftogaz' own explanation in its letter of 17 June 2011 of the price expectations when the Contract was concluded, i.e. an average Contract Price of USD 290 for 2010.

(630) Having demonstrated that the netback principle was Gazprom's approach during the autumn of 2008, the remaining question is then why the base price was set to USD 450 in January 2009, if the correct netback price from Germany as at January 2009 was USD 360.

(631) This may first and foremost be explained by the Parties' reasonable expectations with respect to oil price developments, and hence to the development of the then oil-linked gas price in Germany. A base price of USD 360 would, based on the then expected oil price development, have yielded an unreasonably low Contract Price in 2010. It was necessary to device a mechanism for an increase in the Contract Price in the beginning of 2010 for the Contract Price to reflect the expected level of market prices.

(632) Further, the political and business leaders involved had made prior decisions and statements which had to be accommodated in the presentation of the final deal, allowing both sides to "*save face*" and claim victory.

(633) It may first be recalled that the Russian and Ukrainian governments had agreed on a three years transition period from favourable prices to market prices. Thus, to the Ukrainian political leaders it was imperative to be able to present the Contract Price as a favourable price compared to other European prices, at least during a "*transitional*" period.

(634) Similarly, Gazprom's CEO Alexander Miller publicly stated on 4 January 2009 that Gazprom had offered Naftogaz a Contract Price of USD 450, allegedly a netback price from Eastern European countries bordering Ukraine. This figure therefore had to appear in the Contract.

(635) The solution was to apply the base price of USD 450 and reduce its impact by the coefficient "*k*" of 0.8, rather than setting the base price at USD 360 which in any event quickly could turn out to be unreasonably low. This way, Mr Miller had his public price offer reflected in the Contract (although the Contract Price, of course, was lower), and Ms Tymoshenko could publicly announce that she had secured a "*discount*" for the first year (instead of admitting that Ukraine had lost the transition period).

(636) Naftogaz strongly rejects Gazprom's allegation that Naftogaz has not "*any meaningful explanation*" as to coefficient "*k*" 0.8 in 2009.

(637) The fixed, low, transit tariff agreed for 2009 was not a *quid pro quo* for the coefficient "*k*" 0.8 in the first year of the Contract. The low transit tariff was compensation for cheap fuel gas provided to Naftogaz for 2009 from gas storages.

(638) Thus, as a result of the rapidly falling oil price observed in autumn 2008, a base price of USD 450-460, the coefficient "*k*" of 0.8, the reference period of nine months, and based on available forward oil product prices, the Contract Price in January 2009 would equal an annual weighted average price of approximately USD 235.

(639) Specifically, the combination of the various factors would roughly yield a contract price of USD 360, USD 190, USD 230 and USD 280/290 in the four quarters of 2009 respectively. All in all, and in retrospect, this resulted in an annual weighted average contract price of USD 232 for 2009, in perfect alignment with Naftogaz' position in the negotiations on 31 December 2008.

(640) It should be recalled that, at the time, the implementation of netback pricing yielded a significantly higher price than what Gazprom had previously obtained from Naftogaz. By implementing netback pricing policy in former CIS countries, the gas sales price to these countries increased by 273.6% from 2005 to 31 December 2009. In 2008, Naftogaz paid Gazprom a fixed price of USD 179,5 per 1000m^3 (via RosUkrEnergo). Thus, the agreement to apply a German netback price from 2009, expected to be around USD 235 per 1000 m^3 in 2009, meant an expected year on year price increase of USD 55,5 per 1000 m^3 or around 30%, and a USD 180,5 per 1000 m^3 or more than 100%, price increase from December 2008 to January 2009. Thus, agreeing to a German netback price was a major concession by Naftogaz at the time, and was obtained in exchange for other European principles regulating European gas sales. Gazprom now seeks to move away from its previous pricing policy, to obtain an even higher profit. However, Gazprom has not provided any explanation as to why Naftogaz would have entered into such an unbalanced contract. Notably, a German netback price would also correspond to the price which could be obtained from other sellers further east, like Turkmenistan, and would be competitive in the European market.

(641) Naftogaz rejects Gazprom's argument that it might be just as reasonable to consider the market price plus transport. That argument is the basis for Gazprom's present approach where it argues for a price which is not the market price net of transport cost. However, the argument is based on a wrong premise and is only possible due to Gazprom's control over the gas flows entering and exiting Ukraine. Had Gazprom not controlled almost all physical and virtual flows of gas to and through Ukraine, Naftogaz could have swapped gas in Ukraine against gas in Germany (i.e. bought gas in Germany but, instead of physically moving this gas from Germany to Ukraine, contractually exchanged it for gas within Ukraine), and thus not paid any transport costs from Western Europe (Germany) to Ukraine. Thus, Gazprom is relying on its own illegal and obstructive behaviour as a basis for arguing against a deduction for transport cost. In fact, not deducting transportation costs from the market price would result in a significant windfall profit for Gazprom, and lead to a contract price for Naftogaz where it actually pays Gazprom for a transportation service that Gazprom does not provide.

(642) There is no basis for the exclusion of transportation, storage, overheads and a profit margin for Naftogaz when comparing the level of market prices to the Contract Price. When assessing the price level under the Contract, the transportation costs from the Delivery Points under the Contract to the reference market and a profit margin for Naftogaz have to be deducted from the market price in the relevant market, i.e. Germany.

(643) When Gazprom refuses to acknowledge and apply the netback principle in the present case, it is in effect seeking to obtain an unjustified additional profit equal to its costs of transportation from the Delivery Points to the relevant markets in addition to the potential revenues from gas sales to Europe. Effectively, Gazprom would receive a higher price from Ukraine than from its other European customers, because its costs of supplying Ukraine are lower, which is arbitrary and unfair.

(644) Netback costs only play an important role under the "*end point*" approach to calculating the claim. Under the "*delta of deltas*" approach it is only the change in netback costs between the start and end of a price review period that is relevant. Accordingly, if netback costs were to be ignored, this would reduce Naftogaz' claims by 6% for the May and June 2011 review dates and increase the claim by 9% for the April 2014 review date.

(645) In this Arbitration, Naftogaz asks the Tribunal to decide on the costs of transit, calculated pursuant to the standard approach to netback calculations of transiting the Contract gas through

Ukraine in 2009, 2011 and 2014 respectively, as part of the assessment of whether the Contract Price reflected the level of market prices, and the subsequent adjustment of the base price revision. In this case, the experts are not bound by the Regulator's decision on the tariff in 2016.

(646) Naftogaz relies on the Expert Reports of Dr Hesmondhalgh and Mr. Way and the calculations made by them of the cost of transporting the gas from the Russian border within Ukraine and the relevant European markets.

(647) Consistently, with the Parties' agreement on a Contract Price which would result in the same revenues from sales to Naftogaz as from sales in Western Europe, the experts have deducted transport costs from Germany to the Russian border and a wholesale gross margin from the [redacted] prices. A wholesale gross margin is required to cover the internal costs incurred by a wholesaler and cover the risk involved in purchasing gas under a long-term, take-or-pay contract and selling it into the wholesale market. Based on data from the Italian regulator and their own experience, the experts conclude that a reasonable wholesale margin in May 2011/April 2014 is 4%.

(648) For example, if a French gas buyer bought natural gas from a Norwegian gas producer at Emden, Germany, the price would be calculated based on the market value of natural gas in the French market, but with a deduction for the transport costs from Emden to the buyer's customers in France, cf. page 156 of *Putting a Price on Energy*.

(649) Gazprom's expert Dr Moselle describes netback market value pricing in paragraph 6.9 of the Moselle Report.

(650) In its 2006 annual report, Gazprom stated that its strategy in the Baltic states and CIS (Commonwealth of Independent States, the former Soviet Union minus Georgia and the Baltic states) was to

"ensure that Russian gas will continue to maintain its predominant position in their energy sector while adjusting the existing agreements in order <u>to move to contractual terms and conditions similar to those effective in the European countries</u>", cf. page 49 of Gazprom's 2006 Annual Report,.

(651) The intention of Gazprom was to reach a financial return on its export operations to former Soviet states on an equal level to its exports to EU countries, cf. *Putting a Price on Energy* page

167. Such financial returns would be calculated based on the European netback gas price level, cf. *CIS Gas Pricing: Towards European Netback?* pages 191-192:

In late 2006 the Russian government adopted a strategy of achieving a European netback gas price level for western CIS by 2011 (in other words, the oil-indexed prices specified in Gazprom's European LTSCs [Long-Term Sales Contracts], *minus transportation costs and applicable custom duties). It designated 2007-10 as a transition period during which discounts to market prices would be phased out (see the section 'Gas Pricing under Russia-Western CIS Contractual Frameworks in the late 2000s and early 2010s' later in this chapter.).*

Initially, the Russian government decided to synchronize transition towards European netback prices both domestically, in Russia, and in western CIS countries. However, as noted above, because of the sharp increase of oil (and hence gas) prices, and because of the economic crisis and financial recession of 2008, the government decided to extend the transition period for domestic transition. The price differential between Russian domestic prices and western CIS import prices has persisted with the latter being two to four times higher than the former (Table 5.2)

Although Gazprom succeeded in imposing price increases on, and securing payment from, all western CIS countries, as well as getting ownership rights in Belarusian and Moldovan transportation networks, the way this transition was accomplished provoked a string of transit disputes in the 2000s (with Ukraine in January 2006, March 2008, and January 2009; Belarus in February 2004 and January 2007; and Moldova in January 2006). All of these disputes weakened Gazprom's reputation as a reliable gas supplier to international markets – the January 2009 Ukrainian crisis, when supplies to Europe were cut for two weeks in the winter, caused the greatest damage.

This damage was the price Gazprom paid to achieve its aim of making western CIS countries – but especially Ukraine – pay European netback prices. By 2011 all three western CIS countries had become valuable markets for Gazprom, with prices similar to those charged to European buyers, and two to four times higher than Russian domestic prices."

(652) *Putting a Price* describes the transition as follows:

"During 2005 and 2006 Russia took the first step in bringing its deliveries to other former Soviet countries into line with the contractual structures in Western Europe, e.g., by separating

transit and supply into separate contracts paid in cash with a duration of several years. Russia agreed with most of these countries on a transition which brings their prices to a level on par with the netback from EU countries […]. In this way the structure of long-term contracts is also applied to gas deliveries to the Eastern part of Europe, although with a different kind of netback principle compared to the original Dutch concept. The reference point for Russian contracts is not the replacement value at the buyer's market but the replacement value of another importing country at the end of the pipeline, corrected for transportation costs; this yields a higher net-back for Russia." (page 174).

(653) With regard to the Parties' understanding, in 2010 (i.e. after the decoupling of gas and oil prices had brought the Contract Price out of step with the market) "[Ukrainian] *President Yanukovych stated that the contractual price was 'unfair', the fair price in his view being the price at which Gazprom sells its gas at the German border minus the cost of transportation."*, (cf. page 195 of *IS Gas Pricing: Towards European Netback*)**.**

(654) In Gazprom's press release dated 4 January 2009, Gazprom's CEO, Alexey Miller, stated:

"Let's hope that the offer to deliver gas to Ukraine in January at USD 450 per 1,000 cubic meters, which is a gas price for the Eastern European countries bordering Ukraine minus costs of gas transit across Ukraine, will return Naftogaz Ukrainy to the negotiating table in the shortest possible time".

(655) Gazprom has also applied netback pricing principle in its negotiations with suppliers.

(656) Consequently, the "European netback" concept has strong support in the evidence. There is no basis for Dr Moselle's statement that he is not aware of any principle in economics or industry practice that would support Naftogaz' deduction of transport costs from Ukraine to Germany when establishing the level of market prices. Dr Moselle does not present any economic theory or industry practice to support his assumption that the market price of a commodity should include a surcharge corresponding to the additional costs of delivering that same commodity to another buyer further from the same source.

(657) In the Transit Arbitration, Naftogaz essentially asks the Tribunal to decide on regulated tariffs for the Ukrainian transit system from 2010 to 2015, derived from the tariff set by the Regulator for 2016. The experts are consequently bound by the Regulator's decision.

(658) There are principled differences in terms of methodology and timing between the use of transit costs in this Arbitration and the Transit Arbitration, which means that even though some of the underlying data are the same, the decisions to be made by the Tribunal are different, and therefore incapable of prejuding each other. The main differences relate to timing and to the relevance of the Regulator's decision.

VIII.4.4.9 Application of Article 4.4 when the procedural and material conditions for price revision have been met

(659) Pursuant to Article 4.4 of the Contract, if the procedural and material conditions for a revision of the price have been met:

"then the Parties shall enter into negotiations regarding an adjustment of the Contract Price in accordance with the provisions of this Contract".

(660) Naftogaz' translation "*then the Parties shall enter into negotiations regarding an adjustment of the Contract Price"* is a very close translation of the original Russian wording "*то Стороны вступают в переговоры по пересмотру контрактной цены*". The differences in the Parties' translations, like Naftogaz' "*shall enter into negotiations*" and Gazprom's "*shall proceed to negotiations*" are immaterial. The apparent difference in the choice of wording "*adjustment/reconsider*" has been explained above where Naftogaz claims to have shown that the more literal translation "*revision*", implies review/reconsideration as well as adjustment.

(661) If the material conditions for price revision are fulfilled, the wording obliges the Parties to initiate negotiations in order to revise the Contract Price and thus realign it with the circumstances in the fuel and energy market and the level of market prices.

(662) The "*Contract Price*" is a product of the Price Formula and all its parameters provided in Article 4.1, and all the parameters of the Price Formula can consequently be revised.

(663) The English translation, "*in accordance with the provisions of this Contract*", is a literal translation of the original Russian wording "*в соответствие с положениями настоящего Контракта*". Gazprom's office translation "*in accordance with the terms and conditions hereof*", is materially similar.

(664) The wording implies that the adjustment which shall be performed if the conditions are fulfilled, shall be made on the basis of the contract terms and the underlying contractual relationship, by restoring the balance of the Contract as it was when the Contract was entered into.

(665) Consequently, the result of the present price revision shall be an adjustment of the Price Formula reflecting the relevant changes and the role assumed by gas prices in traded markets for the price formation in the fuel and energy market, to calculate a Contract Price reflecting the level of market prices following from this new price formation mechanism.

(666) To reflect this new price formation mechanism and the consequent level of prices, it is necessary to introduce new elements in the Price Formula, which refer to the level of gas market prices in the fuel and energy market, and adjust the level of the Contract Price to restore the relationship between the level of gas market prices and the Contract Price when the Parties concluded the Contract.

(667) The formulation "*in accordance with the provisions of this Contract*" means that the adjustments to be made to the Contract Price shall be made on the basis of the contract terms and the underlying contractual relationship. The adjustments claimed do not imply a "*complete rewriting*" of the Price Formula, but an adaptation of the base price level P_0, so that it once more reflects the level of market prices, and a replacement of the previously relevant fuel prices indices, gas oil and fuel oil ("*G*" and "*M*" in the Contract), with a new fuel price index (the gas price index "*H*") which reflects the market conditions as of 20 May 2011. This is well within the limits of standard practice in price revisions both under European long-term gas sales agreements based on the Groningen model as well as more generally.

(668) Thus, the conclusion is that from the middle of 2009, the natural gas market was the subject of dramatic, unexpected and enduring changes. The oil-indexed price determination mechanism was replaced at all market levels by hub prices as the main determinant of market prices. This development was driven by increased availability of natural gas outside of long-term gas contracts. The level of market prices for natural gas was determined by hub prices at least from 2011 onwards and is determined by hub prices today. The consequence of these changes is that the price under the Contract does not reflect the level of market prices.

(669) With respect to the determination of market prices in May 2011 and April 2014, the alternative effective date for price revision, prices at the [redacted] was representative of the level of market prices. Under the Contract, the Contract Price is to be recalculated quarterly, on 1

January, 1 April, 1 July and 1 October. Therefore, the Contract Price is the same in April, May and June. To ensure a consistent comparison between the Contract Price and the [redacted] prices in May 2011, [redacted] prices for deliveries in April, May and June 2011, so-called quarter-ahead prices, quoted prior to the 1 April 2011 Recalculation Date can be used. Similarly, [redacted] prices for delivery in April, May and June 2014 can be used for the comparison with the Contract Price in April 2014.

(670) Further, and consistently with the Parties' agreement on a Contract Price which would result in the same revenues from sales to Naftogaz as from sales in Western Europe, transport costs from Germany to the Russian border and a wholesale gross margin from the [redacted] prices should be deducted. A wholesale gross margin is required to cover the internal costs incurred by a wholesaler and cover the risk involved in purchasing gas under a long-term, Take or Pay contract and selling it into the wholesale market. A reasonable wholesale margin in May 2011/April 2014 was 4%.

(671) The Contract Price increased from USD 360 per 1000 m^3 in January 2009 to USD 412.3 per 1000 m^3 in May/June 2011 and to USD 484.9 per 1000 m^3 in April 2014. At the same time, the market price netted back to the Russian border declined from USD 360.6 per 1000 m^3 in January 2009 to USD [redacted] per 1000 m^3 in May 2011. By April 2014, the market price was [redacted] per 1000 m^3 at the Russian border.

(672) Consequently, when the Contract was concluded, the Contract Price almost perfectly reflected the level of market prices, with a difference of only USD 0.6 per 1000 m^3. However, by May/June 2011, there was a difference between the Contract Price and the level of market prices of [redacted] and by April 2014, the difference had increased to [redacted] Consequently, at all possible ending points of the price revision period, the Contract Price did not reflect the level of market prices.

(673) A Contract Price indexed to oil products would quickly once more move out of step with the level of market prices for natural gas. Therefore, to ensure that the price for subsequent deliveries of natural gas reflect the level of market prices, also the indexation in the Price Formula in Article 4.1 of the Contract must be revised. As has been demonstrated above, the level of market prices for natural gas was determined by hub prices on the effective date, 20 May 2011, and is determined by hub prices today. The most liquid hub in the relevant geographical market is the [redacted] Naftogaz therefore propose that the two oil product indices be replaced with an index representing the [redacted].

(674) Naftogaz finds that the use of the bid price, i.e. the price at which gas always can be sold, is most consistent with Naftogaz' approach to valuing the Contract gas by considering what alternative price Gazprom could have received.

(675) Naftogaz' calculations are made pursuant to standard industry custom and practice.

(676) The Factual Price was never intended to reflect the market price of gas, and therefore cannot serve as a comparator price.

VIII.4.4.10 Recalculation dates and reference periods

(677) Pursuant to paragraph 3 of Article 4.1 of the Contract, the Contract Price shall be recalculated every quarter of each year. As part of the definitions in paragraphs 5 and 6, the reference period for calculating the changes in the prices of the prevailing oil-indices is nine (9) months.

(678) The changes in indexation create no need for adjustment of the recalculation dates. However, most of the trading in quarter ahead products take place in the three months leading up to the start of deliveries and these prices are therefore the most reliable. Therefore, Naftogaz' recommendation is to use a reference period of three months for the gas market prices to be used in the revised indexation.

VIII.4.4.11 How the adjustments shall be made

VIII.4.4.11.1 A revised Contract Price

(679) Naftogaz' position on how the adjustments of the Contract Price to which Naftogaz is entitled shall be implemented is based on Dr. Hesmondhalgh's and Mr. Way's findings in respect of how the prevailing price provisions shall be adjusted, taking into account the relevant legal framework. The adjustments are fully reflected in the Relief Sought.

(680) All the adjustments are made while retaining the original structure of the Price Formula in Article 4.1 of the Contract. Thus, the end result is a revised Contract Price which is calculated pursuant to a [redacted] Price Formula. However, the individual parameters of the Price Formula have been adjusted so that the Contract Price again reflects the level of market prices and can be reasonably expected to do so also in the future.

(681) The Price Formula consists of two elements. The base price P_0 determines the initial relationship between the Contract Price and the level of market prices. The escalation supplement seeks to bring this relationship forward by replicating the circumstances in the fuel and energy market determining the level of market prices

(682) The level of P_0 can then be revised to establish a reasonable relationship between the Contract Price and the level of market prices on the revision date. The escalation supplement can be revised to reflect changes in the fuel and energy market and the level of market prices, by removing (or reducing the weight of) the price indices for fuels/energy carriers that no longer (or to a lesser extent) determine the level of market prices, and replacing them by price indices for the fuels/energy carriers which determine the level of prices on the revision date. In this way, the Contract Price can be reasonably expected to continue to reflect the level of market prices also going forward.

(683) If the existing fuel price indices can be retained with a reduced weight, and there is no obvious basis for reducing the weight of one index more than the other, the weights may be reduced pro-rata. For example, if the Tribunal in the present case should find that oil products still were relevant to the level of market prices in 20% of the fuel and energy market and that gas prices only determine the level of market prices in 80% of the market, the weight of the gas price index to be introduced in the revised Price Formula would be 0.8, while the current weights of the fuel oil and gas oil indices, 0.5, would be reduced to 0.1 (0.5*0.2).

(684) The prevailing Price Formula in Article 4.1 provides that the Contract Price (P) in US dollars (USD) per 1000 m^3 applicable at the delivery point shall be calculated as follows:

$$"P_n=P_0 \times (0.5 \times (G/G_0) + 0.5 \times (M/M_0)) \times k"$$

(685) This formula consists of a *base price* P_0, plus a quarterly adjustment, the *escalation supplement*, reflecting the movements in the price of the *index-fuels*, gasoil (G) and fuel oil (M), and a *coefficient* "*k*" introduced to make the price formula reflect the level of market prices in January 2009. In January 2009, the USD 360 per 1000 m^3 Contract Price almost perfectly reflected the level of market prices, USD 360.6 per 1000 m^3. The escalation supplement also incorporates the *weights* of the index-fuels (0.5).

VIII.4.4.11.2 Adjustments to the base price

(686) The base price, P_0, is a fixed figure related to a specified date, the base date. In the Contract, the Contract Price resulting from the base price and the other elements of the price formula was considered to reflect the level of market prices for Natural Gas when the Contract was entered into.

(687) Thus, the relationship between the Contract Price in January 2009 and the level of market prices in January 2009 constitutes the original commercial balance of the agreement.

(688) The simplest, and also a commonly used, way to revise the level of the Contract Price is to adjust the base date for the base price to the effective date of the price revision, and the base price to equal the revised Contract Price on that date. The revised base price on the effective date may be calculated under two different methodologies.

(689) Under the end of period methodology, the Contract Price is adjusted to equal the relevant market price less transportation costs from the delivery point to the relevant market on the effective date.

(690) The basis for the application of the end of period methodology is the wording that the Contract Price shall "*reflect the level of market prices*", cf. Article 4.4, on the effective date. Thus, the approach is founded expressly on the wording, and is therefore the most natural approach to apply under the Contract. Also, and as explained in Hesmondhalgh and Way 1, it is the most natural approach to apply when the price revision clause does not explicitly specify the need to measure changes in value or price levels.

(691) Also, the application of the delta of deltas approach is founded on the wording that the Contract Price shall "*reflect the level of market prices*" cf. Article 4.4. Since the Contract Price reflected the level of market prices when the Contract was entered into, and shall be adjusted so that it again reflects the level of market prices, the wording may also support the application of a delta of deltas approach. However, the application of the delta of deltas approach is not as clearly founded as the end of period approach.

(692) Under the delta of deltas approach, Naftogaz' experts have compared the change in the netted back market price over the relevant price revision period to the change in the Contract Price (P_n). Naftogaz' claim for adjustment of the level of the Contract Price is equal to the difference between these two changes.

(693) Irrespective of which approach that is taken, the final result under both the end of period and the delta of deltas approaches as set out by Naftogaz' experts is a competitive price for Naftogaz at the Russian-Ukrainian border.

(694) However, Naftogaz posits that the end of period methodology has the most solid foundation in the wording of Article 4.4, which is also why that approach is used to calculate Naftogaz' principal claim.

(695) The simplest method for adjusting the Contract Price level on the effective date (the day price revision was requested) is to change the base date to the effective date of price revision, in this case principally 20 May 2011, and deduct Naftogaz' claim for reduction of the Contract Price from the prevailing Contract Price on this date. The base price is then revised to equal the adjusted Contract Price. This method may be used under the end of period approach as well as under the delta of deltas approach.

(696) The adjustments of the Contract Price to which Naftogaz is entitled shall be implemented in the following way. All the adjustments are made while retaining the original structure of the Price Formula in Article 4.1 of the Contract. Thus, the end result is a revised Contract Price which is calculated pursuant to a [redacted]. However, the individual parameters of the Price Formula have been adjusted so that the Contract Price again reflects the level of market prices and can be reasonably expected to do so also in the future.

(697) The Contract Price as well as the market prices applied to calculate Naftogaz' claims are prices applicable throughout the second quarter of 2011 and the claims for price revision were consequently the same in May and in June 2011.

(698) Naftogaz requests price revision based on the end of period approach according to the following.

(699) The netback calculations rely on the actual costs of transporting natural gas from the delivery points to the relevant markets. The end of period approach results in a larger reduction of the price than the delta of deltas approach, and Naftogaz principally claims a revision of P_0 based on the end of period approach.

(700) With regard to the adjustment of the base price, P_0, the revised Contract Price is set to be equal to P_0 on the effective date of the price revision Naftogaz' claims for revision of P_0 as of 20 May

2011, under the end of period methodology, the principal price revision claim is for a base price as of 20 May 2011 at US [redacted] per 1,000 m^3 of Gas.

(701) The revised base price as of 20 May 2011 under the delta of deltas approach amounts to USD [redacted] per 1,000 m^3 of Gas.

(702) Under the end of period methodology, the base price as of the alternative effective date 27 April 2014 amounts to USD [redacted] per 1,000 m^3. The definition of P_0 in The Contract shall alternatively be amended accordingly.

(703) The revised base price as of the effective date 27 April 2014 under the delta of deltas approach amounts to USD [redacted] per 1,000 m^3. The definition of P_0 in the Contract shall alternatively be amended accordingly.

(704) The end of period approach yields higher claims than the delta of deltas approach, and Naftogaz' principal claims for price revision are based on the end of period approach instead of the delta of deltas approach.

VIII.4.4.11.3 Adjustments to the escalation supplement

(705) To reflect the change in the fuel and energy market from oil-based to hub-based pricing, Naftogaz' claim introduces a new index in the price formula, i.e. the price of Natural Gas on the traded markets represented by the [redacted] for [redacted]. The starting price is set to the new base date, 20 May/17 June 2011, alternatively 27 April 2014.

(706) The new index [redacted], or the gas index, with a weight of [redacted] ([redacted], is intended to ensure that the Contract Price following the price revision moves in step with gas market prices in the fuel and energy market, for which [redacted] is representative.

(707) The weight [redacted] is derived from the fact that the market prices for Natural Gas in the fuel and energy market in May 2011 were fully determined by traded gas markets. The [redacted] index shall be defined in Article 4.1 as a [redacted] quotation, for deliveries [redacted] as published in "*ICIS Heren European Spot Gas Markets*", which is a reliable and commonly used source for gas prices. Using [redacted] for the indexation is consistent with the quarterly recalculation of the Contract Price, which effectively is a [redacted].

(708) Article 4.1 of the Contract shall be amended to include an appropriate currency conversion element for the [redacted] index, which is quoted in Euro, to USD, the currency of the Contract. The reference period shall be the [redacted] preceding the [redacted] delivery.

(709) Pursuant to Article 4.1 of the Contract, the Contract Price shall be recalculated every quarter. [redacted]

(710) The base value for the [redacted] index, [redacted] equals the average price for [redacted] deliveries starting on the relevant recalculation date during the [redacted] preceding the relevant recalculation date. i.e. 1 April 2011 or 1 April 2014.

(711) The new escalation supplement then takes the form:

[redacted]

where [redacted]

(712) The coefficient "*k*" will remain 1 under the price revision claim, and therefore has no impact on the Contract Price. Based on the general principle confirmed in relevant case law, that the adjustments made should not go further than warranted by the relevant changes in the market, "*k*" is retained for possible future reference.

(713) Below, Naftogaz sets out a table, with the revised Price Formula in the bottom row, directly below the prevailing formula. As will be seen, the revised formula maintains the same structure and its elements are of the same nature as the elements in the prevailing formula. The revision does not imply a "*complete rewriting*" as alleged by Gazprom.

<table>
<tr><td>Contract Price</td><td colspan="6">Price Formula</td></tr>
<tr><td rowspan="4">$P_n =$</td><td>Base price</td><td colspan="4">Escalation supplement</td><td>Coefficient</td></tr>
<tr><td rowspan="3">P_0</td><td>Weight of Index</td><td>Current price of Index fuel (Numerator)</td><td>Historic price of Index fuel (Denominator)</td><td>Index</td><td rowspan="3">x k</td></tr>
<tr><td>x 0.50</td><td>x (G</td><td>/ G_0)</td><td>No. 1</td></tr>
<tr><td>x 0.50</td><td>x (M</td><td>/ M_0)</td><td>No. 2</td></tr>
<tr><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td></tr>
</table>

VIII.4.5 The price can be revised retroactively

(714) Given the absence of any provision to this effect in the Contract, Naftogaz claims that fundamental principles concerning the retroactive effect of the award must be assumed to apply.

(715) Gazprom's objection against the Tribunal's jurisdiction to adjust the price provisions with retroactive effect is only relevant if the Tribunal generally is deemed to have the powers to adjust the price provisions. This presupposes, as it is often said, that "the Tribunal steps into the shoes of the Parties", applying the same material criteria for the adjustment as the Parties. The issue of retroactive effect is consequently essentially an issue of the material criteria applicable to both the Parties, and the Tribunal, and must be resolved in the same manner, as also confirmed by recent, relevant case law.

(716) While the price revision clause of the Contract does not expressly refer to the retroactive effect of the price adjustment, it follows in Naftogaz' view from the systematic context of the price revision clause that the Parties and the Tribunal shall adjust the price provisions with effect as of the request for price revision (generally referred to as the "*effective date*" under Continental European long-term gas Sales agreements like the Contract).

(717) The wording of the price revision clause also expresses the intentions of the Parties that an arbitral tribunal may adjust the price retroactively in price review if no agreement can be reached between the Parties.

(718) The Parties agree that 20 May 2011 is the date for comparison of any change. The implication is that the Contract Price shall be revised to reflect the market situation on this date, i.e. 20 May 2011. Gazprom has not later retracted from its statement on the date of comparison. The disagreement between the Parties only pertains to how to treat the overpayments Naftogaz has made between the date of the price revision and the date of the award.

(719) Gazprom argues that because a clause explicitly governing retroactive reimbursements following price revision (allowing the Parties to agree not to apply a price revision retroactively) in the draft contract of 29 October 2008 was intentionally removed in the subsequent draft of 13 November 2008, there is no right to retroactive payments for overpayments made during the price revision dispute. Naftogaz denies that the removal is an expression of joint intent. Naftogaz commented extensively on the 29 October 2008 draft without any objections to the draft provisions on monetary settlements following price revision, so the removal in the subsequent draft was not made on Naftogaz' initiative. The removal was not marked in the draft or mentioned in Gazprom's cover letter, and was never noticed by Naftogaz. Further, when the Parties met in Moscow to finalise the Contract in January 2009, the discussion was solely based on the drafts then presented by Gazprom.

(720) Repayments for overpayments made is the main rule under Swedish Contract Law. "*Retroactive effect*" is the industry standard both from a legal perspective, and a factual perspective.

(721) Gazprom has not explained why a contract price revised to reflect the market situation as of the effective date 20 May 2011, only shall take effect going forward from the date of the award, or possibly from the date of the Request for Arbitration.

VIII.5 Alternative Claim for a Fair and Equitable Price

VIII.5.1 Introduction

(722) Alternatively to Naftogaz' claim for adjustment of the Contract Price based on a regular application of the price revision clause in Article 4.4 of the Contract, Naftogaz claims an adjustment of the Contract Price provisions to establish and obtain a fair and equitable Contract Price.

(723) Naftogaz' alternative claim for a fair and equitable price leads to the same revised Contract Price as the claim for price revision based on Article 4.4, as well as the same repayment claims.

(724) The objective of Naftogaz' alternative claim for a fair and equitable Contract Price is to establish a fair and reasonable contractual balance between the Parties' rights and obligations under the Contract, including a Contact Price which reflects the inherent risk division under the Contract.

(725) Naftogaz' alternative claim for a fair and equitable Contract Price is principally based on the buyer's inherent entitlement under long-term gas sales agreements, like the Contract, to economically market the supplied Natural Gas.

(726) Alternativly, Naftogaz claims a revision of the Contract Price based on Section 36 of the Swedish Contracts Act.

(727) These distinct legal bases may also be applied in conjunction with each other.

VIII.5.2 Naftogaz' inherent right to economically market the gas

(728) The development of the Dutch Groningen field established contractual principles which became the reference for all later gas imports to Europe, including from the major suppliers, Russia, Norway and Algeria.

(729) The contractual principles include the principle of netback market value pricing and the concept of Take or Pay. As described, the compensating feature of the buyer's Take or Pay obligation under the Groningen type gas sales agreements is that the pricing is designed to offer the buyer the opportunity to earn a reasonable margin. Importantly, this economic marketability of the gas supplied was the principal feature of the risk division between the Parties under the Groningen type gas sales agreements.

(730) Naftogaz and Gazprom agree that the Contract is based on the basic concepts of traditional Continental European gas sales agreements, and thus incorporates the contractual principles and risk division established under the Groningen type gas sales agreements. Consequently, Naftogaz has an inherent entitlement to economically market the Natural Gas supplied under the Contract.

(731) Naftogaz submits that the buyer's entitlement to market the gas with a reasonable profit is inherent in the risk division under gas sales agreements based on the Groningen model. The entitlement to economically market the gas is also expressed in the formulation *"the Contractc Price…does not reflect the level of market prices"* in Article 4.4, which presupposes that the Contract Price shall reflect market prices. A price which reflects market prices will normally give the buyer a possibility to make a profit on his resale in the relevant market.

(732) This inherent entitlement is relevant both to the application of Article 4.4, when adjusting the Contract Price, and as a circumstance relevant to the consideration of whether any term(s) of the Contract (in particular the Contract Price) are unconscionable and shall be revised pursuant to Section 36. Naftogaz also invokes the entitlement as a separate basis for price revision, on its own or in conjunction with Section 36.

(733) It is inherent in a Groningen style contract, that the buyer should make a profit, in line with the risk division where the seller takes the price risk, and the buyer takes the volume risk. This entitlement is not dependent on an "*in any case*" or "*economically market*" clause in the Contract. It is simply the result of the risk division between buyers and sellers under long-term gas sales contract based on the Groningen model, as the Contract. In order for a buyer to be able to undertake any Take or Pay liability, the buyer has to be secured a reasonable profit. Otherwise the Contract is commercially unviable. There *is* a reference to this entitlement in Article 4.4, as explained above.

(734) As regards the facts, Gazprom argues that Naftogaz has not "*begun to show that it would even have a claim*". This is patently incorrect. What is necessary for Naftogaz to be able to economically market the gas, is a revision as described above. Naftogaz' claim for price revision, applying German wholesale prices as the starting point and deducting a margin of 5 % before further deducting for transport costs would imply that Naftogaz can profitably market the gas in the relevant fuel and energy market (i.e. the Czech Republic, Germany and Slovakia), earning a margin of 5 %. Thus, Naftogaz claims the same revision pursuant to its right to economically market the gas, as pursuant to Article 4.4 of the Contract.

(735) This essentially rebuts Gazprom's other arguments on the merits. While Naftogaz strongly rejects that "*Naftogaz has not acted efficiently*", the argument is irrelevant, since the relevant fuel and energy market under the Contract is the Czech Republic, Germany and Slovakia, not "*the market where you are trying to market the gas*" (which is the term Gazprom apparently uses for Ukraine). Naftogaz' opportunity to economically market the gas does thus not depend on whether or not Naftogaz has acted as a "*prudent and efficient operator*" (or any other term along the same lines), in Ukraine.

(736) It is also incorrect that "*the effect of Naftogaz' claim would be to enable it to make a windfall profit.*" Naftogaz claims a Contract Price which will enable it to market the gas purchased under the Contract, earning a margin of 5%, which is hardly a windfall. Naftogaz is not claiming a far lower Contract Price than hub prices.

(737) Finally, Gazprom's argument that "*there is no evidence in the case indicating that Naftogaz cannot market the gas in Ukraine simply because hub prices in Germany have deviated from oil prices*" is confused. The Parties agreed already in Statement of Claim and Statement of Defence that the Ukrainian energy market is irrelevant. The relevant fuel and energy market is, as explained above, the Czech Republic, Germany and Slovakia.

(738) Gazprom has since 2006 relied on prices in Western Europe, netted back to the relevant delivery points, when establishing the price level under gas sales contracts with former Soviet republics. Under this approach, Gazprom has been able to secure the same revenues from the former Soviet republics as from gas sold to the European countries at the end of the pipeline. For Gazprom to recover the same economic rent from Natural Gas sales to Ukraine as on sales to other European buyers, the natural and logical starting point for Gazprom when assessing the price level under the Contract was the alternative prices it could obtain by selling in the markets farther down the pipeline system from Ukraine.

(739) This modified netback concept is also incorporated in the Contract Price and price revision provisions. Thus, Gazprom principally assumed the price risk in the markets downstream of Ukraine, and Naftogaz' ability to actually earn a profit on the resale of the Natural Gas purchased under the Contract would depend on whether Ukrainian market circumstances aligned with the market in Western Europe. The consequence is that Naftogaz' ability to economically market the Natural Gas supplied under the Contract has to be assessed in the markets downstream of Ukraine, i.e. Slovakia, the Czech Republic and Germany, with Germany as the most developed market offering a transparent and reliable market price for Natural Gas.

(740) Gazprom disputes that the Contract "*incorporates the contractual principles and risk division established under Groningen type gas sales agreement*". This position appears to be based on Gazprom's mistaken belief that Naftogaz has referred to a standard form of contract rather than a set of contractual principles and a customary risk division. Gazprom's allegation that the "*Groningen model*" referred to as the basis for the Contract in its 13 May 2014 letter to Naftogaz only is shorthand for oil price indexation, is wrong.

(741) The buyer's entitlement to a reasonable net profit under long-term gas sales agreements is commonly accepted in the gas industry.

VIII.5.3 Alternative claim for price revision pursuant to Section 36 of the Swedish Contracts Act

(742) Naftogaz claims that the price formula shall be revised pursuant to Section 36 of the Contracts Act and that Gazprom shall pay compensation following the revision of the price formula. Contra Gazprom, neither Naftogaz' Section 36 claims nor its repayment claims following revision of the price formula have been waived.

(743) In support of its claim for price revision based on Section 36 of the Swedish Contracts Act, Naftogaz has referred to legal authorities and a number of cases from the Swedish Supreme Court.

(744) Upon the determination of whether a contract term or condition must be modified or set aside as unconscionable in accordance with Section 36 first paragraph of the Contracts Act, attention shall be paid to the need to protect the party who holds an inferior bargaining position in the contractual relationship, cf. the second paragraph of Section 36. Naftogaz clearly holds the inferior bargaining position in the contractual relationship between the Parties. This must generally be taken account of in the assessment of revision pursuant to Section 36 of the Contracts Act. While the basic concepts of the Contract are consistent with the Groningen model, the Contract also contains special features which may be deemed to deviate from the Groningen model.

(745) In particular, if the Tribunal should find that the Contract Price revision clause cannot provide Naftogaz with effective relief from the failure of the Contract Price to reflect the level of market prices since 1 January 2010, e.g. because it is too generally formulated, does not impose any enforceable obligation to adjust the Contract Price on Gazprom, or does not provide for retroactive effects, the continued application of the Contract Price provisions would be unconscionable. A revision of the price provisions based on Section 36 of the Contracts Act would then be justified for the reasons set out below.

(746) Pursuant to Swedish case law (NJA 1983 p. 385), also contracts which contain price adjustment mechanisms are susceptible to revision. If the price adjustment mechanism turns out to be imperfect and unable to fulfil its purpose, the mechanism as such can be adjusted or replaced.

(747) The Contract Price is unconscionable in itself. The Contract Price has since 1 January 2010 increasingly failed to reflect market prices. It moved out of step with the then still to some extent oil-linked market prices as of that date.

(748) Gazprom rejects Naftogaz' claim that the Contract Price is unconscionable in itself and alleges that there is no proof of the Contract Price being unconscionable "*from the beginning of the contract term*", and that Naftogaz considered the price to be market reflective.

(749) Gazprom's objections are based on a misunderstanding of Naftogaz' argument. The argument that the Contract Price is unconscionable in itself does not refer to the circumstances when the Contract was concluded, but the price when Naftogaz requested revision. Naftogaz has not argued that the Contract Price did not reflect market prices "*from the beginning of the contract term*". The Contract Price increasingly failed to reflect market prices since 1 January 2010. In addition, from May 2011, when Naftogaz requested price revision, also the factual price failed to reflect the level of market prices and imposed a significant financial burden on Naftogaz.

(750) Further, Naftogaz claims revision of the Contract Price pursuant to Section 36 of the Swedish Contracts Act in the alternative to the claim for price revision based on Article 4.4 of the Contract. Thus, the assumption in this (alternative) case is that Article 4.4 does not constitute an effective and enforceable price revision clause. The combined effect of such (alleged) absence of an effective price revision clause, and a Price Formula which is inherently unable to reflect all conceivable changes in the level of market prices, would be a significant imbalance between the Parties' performances, which would be unconscionable.

(751) In any event, we note that Gazprom's argument that the Contract Price is not unconscionable having regard to circumstances that existed when the Contract was concluded can never be decisive in and of itself, because Section 36 also applies to subsequent developments, which in the present case have caused the Contract Price to turn unconscionable, cf. below, Section V, 5.2 SoC and Section V, 1.4.4 above.

(752) However, from May 2011, when Naftogaz requested price revision, also the Factual Price has failed to reflect the level of market prices and imposed a significant financial burden on Naftogaz. Thus, Naftogaz has overpaid around USD 6.47 billion compared to market prices, even taking into account the relief granted by [redacted] (which Gazprom now refuses to maintain).

(753) The imbalance between the Parties' performances, *viz*. the price Naftogaz is asked to pay and the value of the product Gazprom sells is even more acute in respect of the Contract Price. To illustrate, in May 2011, the Contract Price was USD 397.6 per 1000 m^3 of gas, whereas the market price was USD [redacted] per 1000 m^3 of gas. In April 2014 when Gazprom had broken the agreements to reduce the Factual Price in [redacted] and [redacted] and Naftogaz again requested negotiations, the imbalance was even larger, with a Contract Price of USD 484.9 per 1000 m^3 of gas and a market price of USD [redacted] per 1000 m^3 of gas.

(754) A significant imbalance between the Parties' performances may be considered unconscionable in itself under Section 36 of the Contracts Act. Thus, the Contract Price must be deemed unconscionable in itself and must be revised pursuant to Section 36 of the Contracts Act.

(755) As regards the circumstances subsequent to the entry into of the Contract, which have caused the Contract Price to not reflect the level of market prices, Gazprom denies that these have made the Contract Price unconscionable.

(756) To support its arguments, Gazprom relies on certain findings in Dr Moselle's Report, which, however, are based on wrong or misleading factual assumptions. In particular, Gazprom asserts that the factual price has broadly reflected the level of market prices since 2009, based on Dr Moselle's calculations. In his report, however, Dr Moselle uses the wrong terms of comparison, making his findings irrelevant. Dr Moselle compares solely the factual price (which he calls "*Actual Price*") with import prices to cherry-picked European countries. This comparison is irrelevant for three reasons.

(757) *First*, Naftogaz' claim relates to the Contract Price, not the factual price.

(758) *Second*, import prices are not reliable benchmarks for market prices, and are therefore not a relevant benchmark for assessing whether the Contract Price is conscionable. Import prices may have been set long ago, under completely different market circumstances, and react slowly to market change through lengthy price revision proceedings.

(759) *Third*, the selection of countries is biased, with overrepresentation of markets where Gazprom has a strong or event dominant position. The worst case is arguably Poland, where Gazprom's wholly owned subsidiary Gazprom Export supplied 80% of imported gas in 2012, and where Gazprom is investigated by the European Commission for charging unfair prices.

(760) For the same reasons, Mr. [redacted] comparison between the price paid by Naftogaz and Gazprom's average European price is irrelevant.

(761) The circumstances under which the Contract was concluded make provisions of the Contract unconscionable. The Contract contains special features which may be deemed to deviate from the Groningen type gas sales model. Gazprom is a dominant supplier, given its large market share, and that Ukraine depends on Gazprom as there currently is no other way to meet the total Ukrainian gas demand. Gazprom was only able to insist on including certain special features related to Take or Pay, a destination clause, a unilateral termination right and a mandatory sales clause in the Contract due to its dominant position as supplier and that these put excessive burdens on Naftogaz.

(762) The Contract was negotiated and signed during a total cut-off of gas supplies to Ukraine, in the middle of winter, and in a situation where Ukraine had no other (alternative) sufficient sources of gas supply and in which Naftogaz' management did not know for how long they would be able to cover the needs for gas with the limited volumes of gas in storages. At the same time, Naftogaz and Ukraine were under constant political pressure from the Russian government, and the EU, which also was affected by the Russian gas supply cut-off.

(763) Gazprom argues that the Contract Price is not unconscionable having regard to circumstances existing when the Contract was concluded. Essentially, Gazprom appears to be seeking to depict the supply interruption in January 2009 as a deliberate attempt by Naftogaz to twist Gazprom's arm during the negotiations. Gazprom goes as far as to allege that Naftogaz caused the interruption of supplies not only to Ukraine, but also to the rest of Europe, "*in an apparently deliberate and premeditated attempt to precipitate a European gas crisis*". This misleading description serves Gazprom's assertion that Naftogaz had a countervailing bargaining power during the negotiations of the Contract, which, as Gazprom would have it, makes Gazprom's dominant position irrelevant. Gazprom's factual description is comprehensively rejected, like its argument about countervailing buyer power.

(764) Section 36 of the Swedish Contracts Act is regarded as the most important tool to adjust long-term contracts due to changed circumstances and the argument for price-adjustment in long-term contracts is very strong. Hence, if the price revision clause does not offer (sufficient) relief, the Contract Price must be revised pursuant to Section 36 of the Contracts Act. Subsequent to the entry into of the Contract, gas markets have experienced an unexpectedly rapid and significant decoupling of gas market prices from oil product prices. As a consequence, the Contract Price does not reflect the level of market price. In turn, it is not possible for Naftogaz to economically market the Natural Gas supplied under the Contract, and Naftogaz has made significant overpayments under the Contract. The decoupling of gas market and oil product prices and its effects lead to an unconscionable high Contract Price.

(765) Gazprom contends, with reference to Dr Moselle's expert report, that the decoupling of gas market and oil product prices was foreseeable even before the Contract was entered into, concluding that the occurrence of such decoupling does not justify the application of Section 36 of the Contracts Act. Gazprom's allegation has no basis in the facts presented in Dr Moselle's report.

(766) The decoupling invoked by Naftogaz and described by Dr. Hesmondhalgh and Mr. Way in their expert reports does not refer to any change in the price formation mechanism in long-term gas supply contracts. The change in circumstances which brought the relationship between the Parties' performances under the Contract out of balance was the decoupling between the hub-based market prices at which importers could sell gas and the oil-linked prices (in long-term contracts) at which importers bought gas. The problem was not the change in price formation as such, but the fact that the gas market prices formed at the hubs dropped significantly and persistently below oil-linked prices. In any event, the decoupling occurred after the signing of the Contract is very different in nature from the divergences between hub prices and oil-linked prices which had been seen before. Both the speed with which the decoupling occurred as well as its impact on prices were in themselves unforeseeable and unexpected.

(767) Gazprom's argument that it would be inappropriate to apply Section 36 taking into account price fluctuations at a single point in time lacks legal foundation as there is no prerequisite of "*appropriateness*" in Section 36. Section 36 is not a provision in the discretion of the courts or arbitral tribunals. It is a provision which is mandatory and shall be applied if the prerequisites are fulfilled. If a clause is unconscionable, adjustment shall be made. There is therefore no additional prerequisite of "*appropriateness*" (whatever Gazprom means by this).

(768) Gazprom disputes that an adjustment of the Contract Price pursuant to Section 36 of the Swedish Contracts Act may be sought with retroactive effect.

(769) Gazprom concedes that Section 36 "*allows a court or tribunal to adjust a contract in order to restore the balance in the event that it is determined that a particular contract term is* *unconscionable*". However, Gazprom fails to explain how such "*restoration*" may occur if an adjustment made to a contract pursuant to Section 36 may not have effect from the point in time in which the contract provision turned unconscionable.

(770) The correct position is that Section 36 contains no limitation regarding the time from which the adjustment shall apply. Therefore, an adjustment of a contract term can be made as from a point in time prior to the award or the request for arbitration. It may also apply to periods in respect of which the Parties already have performed its obligations.

(771) Further, once again, Gazprom seeks to set forth arguments without any legal basis in the prerequisites of Section 36, in this case alleging that it would not be "*appropriate*" to revise a contract in respect of obligations already performed.

(772) Gazprom also argues that Naftogaz in any event has lost the right to claim retroactive adjustment. The reason for this loss of right would be that Naftogaz has failed to bring a claim and to notify Gazprom of its claims under Section 36 of the Swedish Contracts Act.

(773) As to the alleged failure to give notice or bring a claim, there is simply no statutory support whatsoever for any of these alleged requirements (except for the general time bar rules)

(774) In order for any waiver to be established under Swedish law it is required that the passive conduct or actions can be regarded as creating a binding unilateral confirmation or waiver under normal rules of contract law. Gazprom's defence therefore fails already as Gazprom has not invoked that it *de facto* has got the impression that Naftogaz has waived its right to retroactive adjustment and as it has not argued that Naftogaz understood that Gazprom had the justifiable impression that Naftogaz' right to claim retroactive adjustment was waived.

(775) Gazprom cannot have got a reasonable impression that Naftogaz had waived any claims based on Section 36. Naftogaz has continuously challenged the price throughout the time period between May 2011 and May 2014

(776) It is a general principle of Swedish law that a party may always make a new legal classification of invoked facts without such classification being time barred, see NJA 2005 p. 843. Therefore, the fact that Naftogaz initially challenged the price only on the basis of the price revision clause of the Contract is irrelevant. Hence, Naftogaz has not been passive during the time period from June 2011 until June 2014.

(777) Additionally, even if Naftogaz had been passive in this period, a time period of three years is far too short to give any impression of a waiver

(778) Gazprom notes that Naftogaz repeatedly has performed under the Contract by making payments, relied upon "*the pricing terms*" of the Contract (such as Article 4.4) and agreed on adjustment to the Contract Price at successive points in time. By doing so, Naftogaz would according to Gazprom have lost its right to claim retroactive adjustment of Article 4.1 of the Contract.

(779) Gazprom has not clarified in what way the actions taken by Naftogaz allegedly have resulted in that Gazprom would have got a justifiable impression of a waiver and has not maintained that it actually got this impression or that Naftogaz should have realised this. Instead, Gazprom only maintains that Naftogaz has acted in certain ways and that under Swedish law, a party may be deemed to have expressed an intention to have waived a right by acting inconsistently with such claim.

(780) The first point here is that the argumentation in such case is fundamentally flawed as it is based on principles regarding rescission and restitution. These are irrelevant here as no rescission is claimed.

(781) A contractual provision can be retroactively adjusted under Section 36 of the Swedish Contracts Act after the relevant obligations have been performed. It follows that performance of a disputed obligation cannot bar the application of Section 36. It is instead for the Tribunal, in the context of the assessment of unconscionability, to assess what impact it may have that the obligations have already been performed.

(782) Furthermore, Gazprom cannot have got the impression that Naftogaz, while pursuing its price revision, waived its claims under Section 36 of the Contracts Act, and it would be unreasonable for Gazprom to think that Naftogaz' payment of invoices was a sign of such waiver.

(783) The Contract does not provide Naftogaz with a right to refuse to pay the invoices from Gazprom until the price is adjusted by the Tribunal. Hence, no conclusion can be drawn from the fact that the invoices were paid by Naftogaz.

(784) Moreover, even if Gazprom had a justifiable impression that Naftogaz had waived its right to claim retroactive adjustment, Naftogaz has not had knowledge of Gazprom's impression.

(785) As for the alleged agreements on the adjustments of the Contract Price, Naftogaz disputes that the Parties have agreed to adjust the Contract Price. The only price adjustment agreed, as per Addendum No. [redacted], concerned the factual price. Addendum No. [redacted] is only a discount on the factual price. Addendum [redacted] is a document that seeks to regulate the factual price from the first quarter of 2014 and onwards.

(786) There is nothing therein to suggest that Addendum [redacted] settles the claims for revision of the Contract Price and repayment of overpaid amounts for previous periods and the Addendum does not compensate Naftogaz for its overpayments during such periods. In fact, the Addendum explicitly covers only the period from 1 January 2014 and onwards.

(787) If Gazprom wanted (which is disputed) Addendum [redacted] to operate in a way which would exclude any adjustment of the Contract Price it should have proposed language to that effect for Naftogaz to consider. It cannot now claim that Addendum [redacted] implicitly bars retroactive adjustment of Article 4.1 for previous periods and that Naftogaz without apparent reason has forfeited repayment claims of several billion dollars through Addendum [redacted]

(788) Neither can Addendum [redacted] be construed as a waiver of Naftogaz' rights under Section 36 of the Swedish Contracts Act for any future period. The Addendum was merely an attempt to mitigate the losses that would otherwise be suffered by Naftogaz in the future on account of the overpricing in the Contract. Moreover, the negotiations between the Parties in 2014 show that Gazprom was well aware that Naftogaz continued to hold the view that the Contract Price was too high and that Naftogaz maintained the position that was set out in its letters from 2011 irrespective of Addendum [redacted]

(789) In fact, Gazprom's combined position as to Addendum [redacted] and waiver of rights under Section 36 of the Swedish Contracts Act is not credible.

(790) Moreover, Naftogaz informed Gazprom in its notification of 27 April 2014, that it continued to press for revision of the Contract Price and considered several of the contractual terms, including the pricing provision, to be unconscionable in accordance with Section 36 of the Swedish Contracts Act. Naftogaz also reserved its right to claim compensation for overpayments under the Contract. Also Naftogaz' rights under Addendum [redacted] were discussed in this letter. In its response of 13 May 2014, Gazprom did not indicate that Addendum [redacted] would bar any application of Section 36. Hence, Gazprom de facto was not of such opinion.

(791) Finally, even if Gazprom held the justifiable impression that Naftogaz had waived its right to retroactive adjustment under the Contract based on the activities referred to above, Gazprom has by its own conduct given Naftogaz the justifiable impression that it has waived any right to invoke this objection.

(792) In 2014 Gazprom engaged in discussions concerning the merits of the price adjustment and repayment claims. Gazprom has not indicated that it was of the impression that Naftogaz had already waived any retroactive adjustment of the pricing provisions or the repayment claims. If Gazprom actually held the view it now (maybe) claims to hold, the natural response to the claims for retroactive price adjustment would of course be that these were academic as there could never be any repayment for historic periods anyway. Gazprom apparently gave the impression that these issues were far from academic. Hence, Naftogaz got the justifiable impression that Gazprom did not and would not invoke any objections relating to waiver of the claims and Gazprom must have understood that this was Naftogaz' view.

(793) To sum up, nothing in Naftogaz' conduct can reasonably be interpreted as a will to waive Naftogaz' rights under Section 36 of the Swedish Contracts Act. In any event, Gazprom did in fact not have this impression and Naftogaz did not and had no reason to think that Gazprom on its part had gotten the impression that Naftogaz had waived its rights under Section 36.

(794) The effects of revision of the Contract Price under Naftogaz' alternative claim for a fair and equitable Contract Price based on Section 36 of the Contracts Act are principally the same as under Naftogaz' regular price revision claim as presented above, with retroactive effect from the point in time when Naftogaz first requested relief from Gazprom, i.e. 20 May 2011. The effects of revision pursuant to Section 36 of the Contracts Act are thus similar to the effects of adjustment based on Naftogaz' inherent right to economically market the natural gas supplied under the Contract.

(795) To sum up, alternatively to Naftogaz' claim for adjustment of the Contract Price based on a regular application of the price revision clause in Article 4.4 of the Contract, Naftogaz is entitled to an adjustment of the Contract Price provision to establish and obtain a fair and equitable Contract Price based principally on Naftogaz' inherent right to economically market the Natural Gas supplied under the Contract, alternatively revision pursuant to Section 36 of the Contracts Act.

VIII.5.4 Naftogaz is entitled to repayment following adjustment under Section 36 of the Contracts Act

(796) Naftogaz is entitled to a revision of the Contract Price with effect as of 20 May 2011. If this claim succeeds, Naftogaz will have paid an excessive price under the Contract as from that date. The Parties agree that a party who has made a payment without there being a legal ground for the payment may be entitled to repayment.

(797) Naftogaz' principal monetary claim is for an amount of approximately USD 14 billion, plus interest. This corresponds to the repayments due if Naftogaz' principal price revision claim is granted and the price reduction under Addendum [redacted] remains in force.

(798) The repayments are thus calculated as the difference between the Factual Price which Naftogaz actually paid, and the Factual Price which Naftogaz should have paid. The latter is derived from the adjusted Contract Price claimed under Naftogaz' price revision claims by taking into account the calorific value adjustment specified in Article 4.2 and applying the price reduction under [redacted] where appropriate.

(799) With respect to the calculation of the damages, which equal the difference between the price paid by Naftogaz and the price which should have been agreed (market level), the difference from the repayment claim is that the loss incurs from the day after the latest day on which Gazprom should have agreed to a revised Contract Price. This time limit principally expired on 8 September 2011, i.e. three months after Gazprom initiated negotiations by written response to Naftogaz' 20 May 2011 request for price revision, alternatively on 5 October 2011, i.e. three months after the 5 July 2011 working group meeting concerning inter alia pricing, and further in the alternative on 13 August 2014, three months after Gazprom initiated negotiations by responding to Naftogaz' 27 April 2014 in writing.

(800) Gazprom asserts that Naftogaz cannot claim "*restitution*" as Naftogaz has not "*claimed invalidity*".

(801) Gazprom has sought to rely on a statement concerning "*återgång av prestationer*" – translated as "*restitution*" – in connection with a total invalidity of the Contract. Naftogaz does not submit that the Contract is invalid. And Naftogaz does not claim "*återgång*", i.e. that the Parties' respective performances shall be returned (gas and money). Gazprom appears to be confusing legal concepts.

(802) Moreover, Naftogaz' claim does not rest on restitution (Sw. "*återgång av prestationer*"). Naftogaz' repayment claim is based on the simple fact that there exists no payment obligation (legal ground) for the disputed amount after an adjustment has been made of the Contract Price. Such excessive payments shall be repaid by the receiver. It is only if the prejudiced party has waived its rights to repayment by a binding contractual arrangement that this right is forfeited. Naftogaz has not done so.

(803) Naftogaz has not lost its right to repayment. On the contrary, Naftogaz is entitled to repayment and has reserved its right to such repayment.

(804) Gazprom has also invoked that Naftogaz has lost its right to claim "*restitution*" as it has not given notice within a "*reasonable time*". The basis for the requirement to give notice is, according to Gazprom, that – in "*restitution*" situations – invalidity of contracts may be compared to cancellation (resulting in an obligation to give notice). However, as already noted, Naftogaz' payment claim is not based on invalidity of the Contract as such and Naftogaz does not claim restitution (Sw. "*återgång av prestationer*"). Therefore, the references to cancellation and the obligation to give notice are completely misplaced.

(805) Moreover, an obligation to give notice on pains of forfeiture of the claim requires express statutory support under Swedish law. There is no such support for a notice requirement in the current situation. There is further no basis for alleging that Naftogaz has lost any claim based on passivity and Naftogaz has, despite this not being necessary, given Gazprom notice.

(806) Gazprom has also argued that Naftogaz has lost its right to repayment as Naftogaz has not reserved its right to such repayment.

(807) In order for any such effect to arise, the requirements for such effect under Swedish law must be fulfilled. Moreover, in this particular case, the claim for repayment is intrinsically linked to the adjustment of the price term as such. Naftogaz simply is not in a position to be awarded repayment until it is established that the price term shall be adjusted in accordance with Section 36 of the Swedish Contracts Act. Naftogaz can therefore never be deemed to have waived its right to repayment before it is even established by the Tribunal that the price should indeed be revised and Gazprom cannot have been given any justifiable impression that such repayment claim was waived.

(808) Naftogaz also invokes the same arguments as set out above regarding its rights to claim retroactive adjustment in relation to the payments made by Naftogaz. Hence, Gazprom cannot have been given the justifiable impression that Naftogaz had waived its right to repayment and, at least, Naftogaz has not had any knowledge of Gazprom's impression. Moreover, Gazprom's response by its letter of 13 May 2014 in relation to Naftogaz' notification clearly shows that Gazprom *de facto* did not believe that Naftogaz had waived its right to repayment and, even if it did, Gazprom has waived any right to invoke this fact.

VIII.5.5 Alternative claim for a revised price leading to a favourable economic result for Naftogaz

(809) The claim for a revised price leading to a favourable economic result for Naftogaz is an alternative to all other price revision claims and is designed to allow relief to be granted that lies within the framework of Naftogaz' claims, but which may not be caught by their exact formulation.

(810) Naftogaz disagrees with Gazprom's contention that Naftogaz' alternative claim should be dismissed as unspecified, alternatively, rejected on its merits

(811) This is a *major includit minor* claim for revision of the Contract Price set out in Article 4.1. of the Contract. The claim is not unspecified, as it is restricted by Article 4.4. of the Contract and by Swedish law. More specifically, the Tribunal may only grant relief that lies within the framework of Naftogaz' claims.

(812) This claim may apply in situations where the Tribunal may find that, in accordance with the criteria in Article 4.4 of the Contract and/or pursuant to Swedish Contract Law and/or applicable competition law, Naftogaz is in fact entitled to a revision of Article 4.1 only from a later date, different from the alternative dates indicated in Naftogaz' Relief Sought or where the Tribunal doea not find that Po shall be higher than what is claimed by Naftogaz or where the Tribunal finds that the price formula shall be different from the ones claimed by Naftogaz.

(813) As to the merits, Naftogaz has effectively addressed and rejected Gazprom's arguments in the context of the other price revision claims.

VIII.5.6 Claims for repayment or damages based on the revised Contract Price

(814) Naftogaz is principally entitled to a refund of excessive payments as from 20 May 2011. The repayment claimed is the difference between the payments which would have been made under the revised price provisions and the payments actually made by Naftogaz in the price revision period.

(815) Gazprom argues that the Parties have not agreed that any price revision should have retroactive effect, and that such a *"far-reaching effect"* as refund of excessive payments requires an express provision in the Contract. In support of this position, Gazprom notes that a specific regulation of repayments was contained in two draft contracts sent by Gazprom to Naftogaz in October 2008, but that these provisions were removed from Gazprom's draft sent to Naftogaz on 13 November 2008. Allegedly, this would show that the Parties did not intend the price revision clause to have retroactive effects in the sense of repayments.

(816) Gazprom repeated jurisdictional objections against Naftogaz' price revision claim as an additional defence against the repayment claim. have been rejected in connection with Gazprom's objections against the price revision claim, and are be addressed again in this context.

(817) It is trite Swedish law that a party who has overpaid shall receive the overpayment back. Further, the provisions governing the opening and closing of a price revision in Article 4.4 means that the Party receiving a claim for price revision will be put on notice that the other Party is overpaying or is underpaid (as the case may be), and may limit its exposure by referring the matter to arbitration for a final decision.

(818) Furthermore, the Party requesting price revision is not entitled to pay a lower price or collect a higher price during the price revision proceedings.

(819) The exclusion of repayments would be far-reaching and draconian. The requesting Party would effectively be deprived of its entitlement to a lower or higher (as the case may be) Contract Price following from the price revision until the date of an agreement or award. Conversely, the receiving Party would have a strong incentive to delay and complicate negotiations and arbitral proceedings as much as possible.

(820) The requesting Party's entitlement to repayments from the date of the price revision request follows from the system of the price revision clause.

(821) A request for price revision under Article 4.4 refers to the situation in the fuel and energy market at the specific point in time it is submitted, compared to the prevailing price provisions at the same point in time. If it is proven that the Contract Price at that point in time does not reflect the level of market prices, the Contract Price shall be adjusted to reflect the level of market prices on the date of the request. This follows already from the requirement to properly substantiate the request in writing in order to prepare the other Party for the coming negotiations.

(822) If the Contract Price were to be adjusted with effect only from an agreement between the Parties or a final award, as Gazprom would have it, the adjustment would not reflect the situation at that point in time, but at a much earlier point in time. Such an approach would contradict the basic idea of price revision, to adjust the price provisions to reflect the value of gas in the market.

(823) In this respect, Brautaset concludes in *Norsk Gassavsetning* that it follows from the system of price review requests and the continued validity of the prevailing price provisions during the negotiations, that a recalculation of the consideration for the negotiation period and a monetary settlement have to be carried out if the revision results in an adjustment of the Price Formula. This common understanding of the nature and purpose of price revisions confirms Naftogaz' principal position, *viz.* that repayments are due for excessive payments made as from the date of the request.

(824) The Parties agreed that the Contract should be a European contract based on the Groningen model. Thus, the Parties intended that the price revision clause should operate in the same manner as the price revision clauses in other European long-term gas sales agreements based on.

(825) The Parties agreed that the Contract should be a European contract based on the Groningen model. Thus, the Parties intended that the price revision clause should operate in the same manner as the price revision clauses in other European long-term gas sales agreements based on the Groningen model, including the system of monetary settlements described here.

(826) The drafts exchanged between the Parties in October/November 2008 do not prove any intent to exclude repayments of overpaid (or underpaid) amounts following the settlement of a price revision. The price revision clause was not a topic for specific discussion in November 2008, and Gazprom did not make Naftogaz aware of its deletion of the relevant provisions since the October discussions. Further, when the Parties met again in Moscow to finalise the Contract in January 2009, the discussion was solely based on the drafts then prepared by Gazprom in which the provision was not included.

(827) The deletion of the relevant provisions may have been accidental or intentional by Gazprom, but Naftogaz never noticed this and never intended or accepted that the operation of the price revision clause should be limited in this or any other respect, cf. Mr [redacted], Mr [redacted] and Ms [redacted] second witness statements. In particular, as explained by Mr [redacted] in his second witness statement, Naftogaz sent detailed comments to Gazprom's 29 October 2008 draft contract, but made no objections to the provisions concerning monetary settlement of price revision. The deletion was therefore not motivated by any feedback from Naftogaz. Consequently, the drafts exchanged in October/November 2008 are not an expression of any common intent.

(828) The repayment claims arising from the price revision claim pursuant to Article 4.4. amount to the difference between 1) the Factual Price P_x paid under the Contract and 2) the Factual Price claimed under Naftogaz' price revision and price determination claims.

VIII.5.7 In the alternative, Naftogaz claims damages pursuant to Articles 4.4.2 and 6.1

(829) If the Tribunal should find that Article 4.4 of the Contract does not directly provide for repayments, Naftogaz alternatively claims damages accrued since the end of the negotiation period in September/October 2011 pursuant to Articles 4.4.2 and 6.1 of the Contract.

(830) Naftogaz' alternative damages claim is based on a straightforward application of the wording of Articles 4.4.2 and 6.1 of the Contract. Pursuant to Article 4.4.2 "*each of the Parties has the right to dispute the other party's performance*" (in Gazprom's translation: to dispute "*the actions […] to perform*") if a written agreement on the revision of the Contract Price has not been reached within three months from the beginning of negotiations. The "*performance*" referred to under Article 4.4.2 thus includes conclusion of a written agreement on price revision within three months from the start of negotiations. Pursuant to the material price revision provisions, the revised Contract Price shall reflect the level of market prices. If a party does not "*perform*", i.e. agree to a revision of the Contract Price to reflect the level of market prices within the time limit in Article 4.4.2, the other Party will suffer from paying more (or getting paid less) than it is entitled to after the expiry of the time limit.

(831) The consequences of a failure to perform are regulated in Article 6.1, which provides that

"The Parties shall be responsible for their performance of the terms and conditions hereof. Should the Parties fail to perform the terms and conditions hereof, each of the Parties shall reimburse the other Party for any proven damages caused by such failure to perform."

(832) Thus, reimbursement of damages is the general remedy for failure to perform under the Contract. By failing to agree to market based pricing, Gazprom failed to perform under the Contract and is liable to reimburse Naftogaz for the damages suffered. In this case, the loss suffered equals the difference between the price paid by Naftogaz and the price which should have been agreed (market level), and is a foreseeable consequence of Gazprom's breach.

(833) Naftogaz' loss is the difference between the price which should have been agreed and the price which came to apply due to Gazprom’s breach. The breach is a failure to conclude an agreement on a revised price within a time specified in the Contract, i.e. delay. The breach is not of a momentary nature, but continuing.

(834) Gazprom raises three defences against this alternative claim, viz. (i) that Gazprom was not obliged to agree to a revision of the Contract Price, (ii) that Naftogaz did not during the negotiations present a revised Price Formula – at least not corresponding to Naftogaz' current revision claims – which Gazprom should have agreed to, and (iii) that Naftogaz has not demonstrated that it has suffered any damages from Gazprom's refusal to agree.

(835) Defence (i) is only a reiteration by reference to Gazprom's defences against Naftogaz' price revision claim as such, which have been rejected above.

(836) Similarly, defence (ii) is only a variation of Gazprom's allegation that the Parties' entitlement to revision of the Contract Price is limited by the scope of the price revision negotiations, and has been rejected above.

(837) Defence (iii) is based on a misunderstanding of Naftogaz' claim. The damages suffered are, similarly to the repayments claimed pursuant to Article 4.4, the difference between the payments made by Naftogaz and the payments it should have made pursuant to the revised price provisions. The difference from the repayment claim is that the damages only incur from the day after the latest date on which Gazprom should have agreed to a revised Contract Price. To clarify this, we explain the legal basis for the damages claim in some further detail below.

(838) Article 4.4.2 of the Contract provides that:

"*If a written agreement on the revision of the Contract Price cannot be reached within 3 (three) months from the date of the beginning of the negotiations, each of the Parties has the right to dispute the other party's performance of the present Contract and submit the matter to* *arbitration in accordance with Article 8 of the Contract for the passing of a final decision*." (emphasis added)

(839) Thus, each Party has the right to "*dispute the other party's performance*" (in Gazprom's translation: to dispute "*the actions […] to perform*") unless a written agreement on the revision of the Contract Price has been reached within three months from the beginning of negotiations. The "*performance*" of the Contract is "*written agreement on the revision of the Contract Price*", cf. also Section VI, 2.12.2 above. If one Party does not perform, i.e. agrees to a revision of the Contract Price within the time limit in Article 4.4.2, the other Party will suffer from paying more (or getting paid less) than he is entitled to after the expiry of the time limit.

(840) The consequences of a failure to perform are regulated in Article 6.1, which provides that:

"*The Parties shall be responsible for their performance of the terms and conditions hereof. Should the Parties fail to perform the terms and conditions hereof, each of the Parties shall reimburse the other Party for any proven damages caused by such failure to perform.*"

(841) Thus, reimbursement of damages is the general remedy for failure to perform under the Contract. The damages caused to Naftogaz by Gazprom's failure to agree on the revision of the Contract Price requested by Naftogaz correspond to the overpayments made by Naftogaz under the Contract since the expiry of the time limit of the three months from the start of negotiations.

(842) In the present case, the time limit principally expired on 8 September 2011, i.e. three months after Gazprom initiated negotiations by responding to Naftogaz' 20 May 2011 request for price revision in writing, alternatively on 5 October 2011, i.e. three months after the 5 July 2011 working group meeting concerning inter alia pricing, and further in the alternative on 13 August 2014, three months after Gazprom initiated negotiations by responding to Naftogaz' 27 April 2014 in writing.

(843) Naftogaz' claim for repayment is intact even though it has not expressly reserved its right to such repayment.

(844) The Contract Price in Article 4.1 of the Contract shall principally be revised as of 20 May 2011. Accordingly, Naftogaz has a repayment claim related to any excess payments made by Naftogaz as from May 2011.

(845) Gazprom has argued that Naftogaz has forfeited the right to repayment because Naftogaz did not reserve its right to repayment when paying the invoices issued by Gazprom. Gazprom purportedly "*has had reasons to see the payments as an expression of a binding confirmation from Naftogaz that it was liable to pay these amounts*".

(846) A party will only lose its right to repayment if the recipient justifiably believed that the payer waived all its potential rights to repayment and the payer must have understood that the recipient was under this impression.

(847) It is not clear to Naftogaz if Gazprom actually alleges that it got the impression that Naftogaz had waived the right to repayment and that Naftogaz knew or must be considered to have known of Gazprom's (possible) impression (Gazprom only states that it "*has had reasons*" to see the payments as such a waiver). Even if Gazprom actually makes these allegations, Naftogaz rejects Gazprom's defence on several independent grounds.

(848) According to Article 4.4 of the Contract, the Parties shall first enter into negotiations regarding the revision of the Contract Price. If the Parties cannot agree on an adjusted Contract Price, the matter shall be referred to arbitration for a final decision. Hence, it is the Tribunal which decides on the revised Contract Price. Moreover, until such new Contract Price has been decided by the Tribunal, Naftogaz is in principle liable to pay the invoices issued by Gazprom corresponding to the original Contract Price, although it may subsequently get a repayment claim based on the Tribunal's decision. The price revision can only give rise to a repayment claim, not an objection against the payment as such.

(849) Hence, the very procedure under Article 4.4 of the Contract means that the price applied during the price revision period as well as the payments are preliminary. They payments are already by their nature made with the self-evident, implicit reservation that the sums will be reclaimed following the decision on price. This is well known to Gazprom who is well acquainted with price revision procedures.

(850) Gazprom's understanding is reflected in its letter from 13 May 2014. In the letter, Gazprom states that "*[s]eparately it should be noted that, in accordance with the conditions of the Contract, fulfilment of the buyer's obligation to pay for natural gas presupposes payment of invoices issued by the seller in accordance with the prevailing provisions of the Contract, not amounts determined by the buyer itself*". Thus, Gazprom emphasised that there was simply no choice for Naftogaz to reduce its payment even though Naftogaz had a justified price revision claim.

(851) Hence, there has never been any dispute as to whether Naftogaz in spite of its price revision claims was liable to pay on the basis of the then prevailing price provisions. Accordingly, payment of such amounts cannot be taken as any evidence of a waiver of repayment.

(852) Gazprom has always been well aware of the fact that Naftogaz pursues the price revision. It would be entirely illogical if Naftogaz at the same time as it pursues the price revision constantly waives any repayment claims for the historic periods.

(853) Thus, Gazprom cannot possibly have believed that Naftogaz had waived its rights to claim repayment for the past.

(854) This is further shown by the fact that Gazprom has never (not even in its letter of 13 May 2014) indicated that it believed the repayment claims to be waived until it claimed so in the Defence. Gazprom's position appears to be a late invention.

(855) For the very same reasons as set out above it would also not be justifiable on the part of Gazprom to believe that Naftogaz had intended to waive these rights.

(856) Moreover, even if Gazprom in fact held the view that Naftogaz had waived its right to repayment, Naftogaz has never known that Gazprom held this view. Gazprom has not even alleged that Naftogaz knew as much.

(857) As for the time elapsed since the price revision was initiated, suffice to say that if the Tribunal has already found (as it will have if the current issue needs to be analysed) that Naftogaz has not failed to pursue its claim for price revision, it cannot be deemed to have forfeited its repayment claim for inactivity either. Moreover, as explained above, it is simply not possible to bring a repayment claim based on a revised price under Article 4.4 of the Contract before the Tribunal has set the revised price so there has not been anything to pursue. Finally, as explained in Section VI, 2.12.8 above, the time used for negotiations is not extraordinary in the context of price revisions.

(858) Additionally, even if Gazprom held the justifiable impression that Naftogaz had waived its right to repayment and Naftogaz should have realised this, Gazprom has by its own conduct given Naftogaz the justifiable impression that it has waived any right to invoke this objection. As late as in 2014 Gazprom engaged in discussions concerning the merits of the price revision and repayment claims. Gazprom did not indicate that it was of the impression that Naftogaz had already waived any repayment claims. If Gazprom actually held the view it now (maybe) claims to hold, the natural response to the claims for retroactive price revision would have been that these were academic as there could never be any repayment for historic periods anyway. Gazprom gave the impression that these issues were far from academic. It cannot now take a position that suggests the exact opposite. Hence, Naftogaz has gotten the justifiable impression that Gazprom did not and would not invoke any objections relating to waiver of the claims, and Gazprom must have understood that this was Naftogaz' view.

(859) Finally, all of Gazprom's arguments regarding the effects of payment are related to Naftogaz' repayment claim under Article 4.4 of the Contract. Naftogaz has an alternative claim for damages for overpayments. The damages claim is a standalone claim and none of the arguments advanced by Gazprom are therefore relevant to the damages claim.

(860) Gazprom has southgt dismissal of Naftogaz' repayment claims for lack of specificity. Naftogaz has since then specified its monetary claims to the extent possible

VIII.6 Claims for Invalidity/Ineffectiveness and Replacement of Provisions of the Contract Based on Competition Law

VIII.6.1 The basis for the application of Competition Law

VIII.6.1.1 Introduction

(861) In addition to its claims for price revision and price determination, Naftogaz brings a claim for invalidity/ineffectiveness and replacement of the Contract price provisions in Article 4.1 of the Contract. This claim is submitted pursuant to EU competition law (Article 102 TFEU), as well as the Energy Community Treaty ("EnCT" or "ECT") and mandatory Ukrainian law.

(862) The concept "European Competition Law", when used by Naftogaz, means EU competition law and the EnCT.

(863) Naftogaz also brings other claims under European Competition Law (mainly under Article 101 TEUF), according to the following:

(i) Naftogaz claims that the Volume and Take or Pay provisions (Articles 2.2 and 2.2.5), the Destination Clause (Article 3.10), the Unilateral Suspension Right Provision (Article 5.3), and the Mandatory Sales Clause (Article 9.7) are invalid from 19 January 2009 pursuant to EU competition law, as well as mandatory Ukrainian law and the EnCT.

(ii) Further, Naftogaz claims that the Volume and Take or Pay provisions (Articles 2.2 and 2.2.5) and the Unilateral Suspension Right Provision (Article 5.3) should be replaced with the effect from the date of the Award pursuant to EU competition law, as well as mandatory Ukrainian law and the EnCT.

(864) Naftogaz also brings a claim for repayment/damages and interest.

(865) There are four parallel and independent legal bases for applying European competition law to the Contract:

(i) The direct application of EU competition law

(ii) EU competition law applicable as Swedish law

(iii) Article 18 EnCT applicable as Swedish law

(iv) Article 18 EnCT as part of Ukrainian law

(866) A common feature of the application of all these legal bases is that they prescribe the application of Articles 101 and 102 TFEU, i.e. the prohibitions against anti-competitive agreements and abuse of a dominant position respectively.

(867) In respect of Naftogaz' request for monetary relief based on *damages* for breach of competition law (which is alternative to the repayment claim), Naftogaz invokes a ground based on Gazprom's breaches of EU competition law (incl Art 18 EnCT) and Naftogaz' loss and right to damages under Swedish law.

(868) Naftogaz also invokes an *alternative* ground for its damages claim, namely that Gazprom has breached *Ukrainian* competition laws and shall pay damages under Ukrainian law. The other facts invoked are the same as invoked to support (a) that Contract clauses breach specified provisions of Ukrainian competition law and (b) that Naftogaz has suffered a loss due to breach of EU law (the loss being calculated in the same way).

(869) The basis for applying Ukrainian law to the alternative damages ground despite the choice of law clause of the Contract is the Rome II Regulation. Under Art 6(4) Rome II, a contractual choice of law provision cannot operate to avoid a law that applies under the choice of law rule in Art 6(3) Rome II. Art 6(3), provides that "*the law applicable to a non-contractual obligation arising out of a restriction of competition shall be the law of the country where the market is, or is likely to be, affected*".

(870) A damages claim for breach of competition law is a "*non-contractual obligation*" under Rome II, as the obligation to pay damages for breach of competition law is not one which the defendant has freely assumed (i.e. contractual), see p. 180, paras 67-68 in Huber, *Rome II Regulation, Pocket Commentary* (2011), pp. 142-201.

(871) Naftogaz' non-damages claims, even to the extent they rely on competition law, are contractual and not affected by the damages ground (e.g. the invalidity of unlawful clauses, the obligations under Art 9(5) to replace invalid or ineffective clauses and the obligation to repay excess amounts upon adjustment of the price clause). The interplay between Rome I and Rome II can lead to concurrent liability for contractual and non-contractual obligations under the same facts and the applicability of different laws to contractual and non-contractual claims.

(872) The choice of law rule in Art 6(3) Rome II is triggered by a "*restriction on competition*". This autonomous concept includes, in particular, all activities that would be prohibited under Articles 101 and 102 TFEU. The applicable law is "*the law of the country where the market is, or is likely to be, affected*", which can be a non-Member State law.

(873) In the present case, the actions of Gazprom which fall to be assessed constitute restrictions of competition, and Ukraine is a country where the market is or is likely to be affected. Hence, Article 6(3) points to Ukrainian law. A non-Member State national law identified by Art 6(3)(a) Rome II governs all aspects of the damages claim: the violation of competition law as such and quantum.

(874) Gazprom challenges Naftogaz' competition law claims on all counts, asserting that

(i) there is no legal basis for the application of competition law to the Contract,

(ii) the Contract does not breach competition law,

(iii) there is no legal basis for invalidating the relevant contractual provisions,

(iv) the claims for replacement of some of the provisions should be rejected,

(v) the Contract should be adjusted in order to maintain and/or restore its equilibrium if the Tribunal were to find that any of its provisions should be declared invalid and/or replaced, and

(vi) Naftogaz' claim for refund of excessive payments/damages and interest should be rejected.

(875) Gazprom denies the relevance of the competition rules in Articles 101 and 102 TFEU, in the EnCT and in Ukrainian law. Thus, it appears that Gazprom is of the opinion that the Contract exists in a "*competition law vacuum*". This can clearly not be the case.

(876) Naftogaz is not suggesting that the Tribunal should apply either EU law or any other law simply because there would otherwise be a legal vacuum. Naftogaz agrees with Gazprom that the applicable laws must be determined by applying the relevant rules. However, the relevant rules are the private international law rules of Sweden, more particularly those in the Rome I and Rome II Regulations. Those rules point inescapably to EU law and/or Ukrainian law. They do not contemplate a situation in which a party is prevented from bringing a claim at all because no national laws apply to it.

VIII.6.2 Applicable law

(877) According to Naftogaz, Gazprom argues that, by choosing Swedish law as the governing law of the Contract, the Parties have successfully excluded the possibility of claims based on Ukrainian competition law without the Tribunal having any ability to apply Swedish/EU competition law because of alleged public international law constraints. This is inconsistent, and wrong.

(878) Under Swedish law, a choice of law clause cannot have the effect of successfully avoiding the application of all national laws other than the chosen law unless the choice of law at the same time results in the application of the law chosen. That would be tantamount to choosing a legal vacuum and that is not possible.

(879) The relevant private international law rules are as follows:

(i) Article 3(1) of Rome I provides that "*A contract shall be governed by the law chosen by the Parties*".

(ii) Article 9(2) of Rome I provides that "*Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum*".

(iii) Article 9(3) of Rome I provides that "*Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the Contract unlawful.*"

(iv) Naftogaz' non-contractual claims are governed by Article 6(3)(a) of Rome II which provides that "*The law applicable to a non-contractual obligation arising out of a restriction of competition shall be the law of the country where the market is, or is likely to be, affected.*" By Article 6(4) of Rome II, the law applicable under Article 6(3) may not be derogated from by agreement.

(880) The effect of those provisions is as follows.

(881) First, Article 12.1 of the Contract provides that it is governed by the substantive laws of Sweden. Accordingly, by Article 3(1) of Rome I, the applicable law is *prima facie* Swedish law, which necessarily includes EU law. EU law is an "*integral part*" of the laws of the Member States and therefore of Sweden, cf. *Costa v. ENEL*.

(882) It follows, straightforwardly, that Articles 101 and 102 TFEU are part of Swedish law, and must be applied by the Tribunal. Gazprom has failed to explain why Articles 101 and 102 TFEU should not be regarded as part of EU law for the purposes of determining the applicable law. They plainly are part of EU law and applicable on that basis.

(883) Secondly, in addition to being an "*integral part*" of the *lex causae* and applicable under Article 3(1) of Rome I, Articles 101 and 102 TFEU have the status of mandatory public policy within the EU and must be given effect by courts and tribunals sitting in an EU Member State, cf. *Eco Swiss*. This is the effect of Article 9(2) of Rome I (for contractual claims) and Article 6(3) of Rome II (for non-contractual claims). Thus, to the extent that the market in the EU is affected, EU competition law is automatically applicable.

(884) Thirdly, by Article 9(3) of Rome I, the Tribunal may give effect to Ukrainian competition law, as overriding mandatory law of the place of performance. The obligations under the impugned Contract clauses (including Articles 2.2, 2.2.5, 3.10 and 9.7) fall to be performed in Ukraine and the performance required by these clauses is unlawful under Ukrainian law.

(885) To the extent that the Contract attracts remedies under EU law pursuant to Articles 3(1) and 9(2) then it will not be necessary for the Tribunal to apply Ukrainian law as well because

Ukrainian competition law is in substance the same as EU competition law. However, if EU law does not provide adequate remedies for Naftogaz then there will be an overwhelming case for applying Ukrainian law under Article 9(3) in view of the Contract's close connections with Ukraine and its profound effects on competition and trade in Ukraine. For Naftogaz' non-contractual claims, the Tribunal would have to apply Ukrainian law in accordance with Article 6(3) of Rome II.

(886) Ukrainian mandatory law is relevant as a *fact* in two ways.

(887) First, the fact that the impugned Contract clauses and the performance thereof are unlawful under Ukrainian mandatory competition laws renders each offending clause invalid/unenforceable under an independent principle of Swedish *contract law*. Under Swedish contract law, a party is not required to perform a clause if performance would be unlawful (i.e. breaches mandatory laws) in the country where it is to be performed.

(888) Second, Ukrainian mandatory law is relevant upon a direct and regular application of Art 9.5, without any need to establish that Ukrainian law *applies*. Article 9.5, is triggered by invalidity as well as by ineffectiveness of a contract term. The term "*invalid*" in Article 9.5, is qualified by the words "*pursuant to the applicable legislation*" but the term "*ineffective*" is not. Hence, the latter is primarily a function of legislation that is not as such "*applicable*". It therefore concerns the operation of laws other than the law chosen to govern the Contract. Properly construed, therefore, a contract term is "*ineffective*" under Article 9.5 if the clause, or the performance of it, would breach a mandatory rule of law at least in the country where the impugned clause falls to be performed (in this case Ukraine). Hence, Article 9.5 basically reflects the same notion as Article 9(3) Rome I. The difference is however that the Tribunal has no discretion as to whether it should apply Article 9(5) of the Contract. It *must*. It must therefore first declare the impugned clauses "*ineffective*" and it must then replace them. Finally, if the Tribunal has found that a particular Contract clause is invalid or ineffective the Tribunal will need to observe the limitations contained in Ukrainian law when deciding on a replacement provision under Article 9.5 because the replacement provision must itself be valid and effective.

VIII.6.3 Applicable competition law

(889) As a Member of the European Energy Community, Ukraine is obliged to implement the EU *acquis* on competition in the field of energy, as set out in Articles 18 and 19 of the Energy Community Treaty ("*EnCT*"). Under Article 18(1) and (2) ECT, agreements between undertakings that are restrictive of competition and abuse of a dominant position are incompatible with the ECT. Such practices are assessed on the basis of Articles 101 and 102 of the Treaty on the Functioning of the European Union ("*TFEU*") (former Articles 81 and 82 EC).

(890) The provisions of the EnCT form part of the internal EU legal order, and are part of the substantive law of Sweden by virtue of its status as a Member State of the European Union. The EnCT is applicable to the territory of Ukraine when applied under Swedish substantive law.

(891) For the sake of simplicity, references to Articles 101 and 102 TFEU, as it is the law and practice under these provisions are relevant also under the corresponding provisions of the EnCT. Any reference to Articles 101 and 102 TFEU in the following are also references to the corresponding provisions of the EnCT.

(892) Naftogaz' primary legal basis for its competition law claims is the direct application of EU competition law. EU competition law is directly applicable to the Contract, and has horizontal direct effect. EU competition law also applies to the Contract as an integral part of Swedish law. Naftogaz relies on the direct effect of Articles 101 and 102 TFEU independently of and in parallel with the ECT.

(893) It is immaterial whether Articles 101 and 102 TFEU are applied in their capacity as EU law by virtue of their direct applicability to the Contract or if they are applied as being part of Swedish law, since the conditions for their applicability and their content are the same in either case, whether as mandatory EU law or the applicable law according to the Contract.

(894) Articles 101 and 102 TFEU apply, as the Contract and Gazprom's abusive and restrictive conduct affect trade between EU Member States. The abusive and restrictive nature of the Contract affects trade not only within the Energy Community, but also within the EU as such. This is the case even though the Contract is between companies in two countries which are not part of the EU, i.e. Ukraine and Russia.

(895) The application of the EU rules on competition to the Contract is recognised under the principles of public international law, even though the Parties are both established outside the EU and the Contract was concluded outside the EU. EU competition law applies because the Contract and the practices of Gazprom have effects within the EU.

VIII.6.4 Ukrainian Competition Law

(896) Main Ukrainian legislation implementing Ukraine's obligations under the Treaty relevant to the Contract is:

(i) Law of Ukraine on the Protection of Economic Competition (the “Ukrainian Competition Law”), dated 11 January 2001, No. 2210-III; providing for a competition regulation applicable also to the gas supply in Ukraine;

(ii) Law of Ukraine on Oil and Gas (the “Ukrainian Oil and Gas Law”), dated 12 July 2001, No. 2665-III, as amended, establishing the legal framework for business activities in the oil and gas sectors in Ukraine, including development of competition in oil and gas field, protection of rights of all subjects of relations arising in connection with production, transportation, storage and distribution of oil and gas; and

(iii) Law of Ukraine on Fundamentals of the Functioning of the Natural Gas Market (the “Ukrainian Gas Market Law”), dated 8 July 2010, No. 2467-VI, as amended, establishing the legal, economic and organizational basis for the functioning of the Ukrainian gas market and the Ukrainian GTS as well as the state control thereof.

(897) Articles 101 and 102 TFEU are implemented in the Ukrainian Competition Law.

(898) Article 101 TFEU is implemented in Articles 5 and 6 of the Ukrainian Competition Law, which prohibits anticompetitive concerted practices.

(899) According to Article 6 (1) of the Ukrainian Competition Law, concerted actions "*which have resulted or may result in prevention, elimination or restriction of competition*" shall be deemed anticompetitive and are directly prohibited under Article 6 (4).

(900) Concerted action is defined in Article 5 (1) of the Ukrainian Competition Law and covers, in particular, "*conclusion of agreements in any form by undertakings, making decisions in any form by associations, as well as any other concerted competitive behaviour (activity, inactivity) of undertakings*". Specific instances where concerted action shall be considered anticompetitive are also indicated in Article 6(2) of the Ukrainian Competition Law.

(901) The prohibition of abuse of dominant position pursuant to Article 102 TFEU is implemented in Article 13 of the Ukrainian Competition Law. In particular, according to Article 13(3) of the Ukrainian Competition Law "*abuse of monopoly (dominant) position on the market shall be prohibited and entails responsibility pursuant to the legislation*".

(902) Pursuant to Article 13(1) of the Ukrainian Competition Law "*abuse of monopoly (dominant) position on the market shall mean actions or inactivity of the undertaking, holding a monopoly (dominant) position on the market, which have resulted in or may result in the prevention, elimination or restriction of competition, or in the infringement of interests of other undertakings or consumers, which would be impossible provided that there existed a considerable competition on the market*".

(903) Article 13(2) of the Ukrainian Competition Law sets forth the particular actions and practices which are deemed to constitute abuse of a dominant position.

(904) In line with Ukraine's obligations under Article 18 of the EnCT, Article 7 of the Ukrainian Oil and Gas Law provides that the state regulation of the oil and gas market shall be performed by establishing common rules for business entities and by issuing licenses for conducting certain types of the activities. Such regulation is aimed at "*facilitating the competitiveness in the oil and gas complex* ".

(905) Furthermore, pursuant to Article 9(1) of the Ukrainian Gas Market Law, the natural gas market functions on a competitive basis, except for natural monopolies. Article 9(2) provides for the basic principles on which the natural gas market is based, such as "*free choice of the natural gas supplier*", "*free trade of natural gas, including on the auctions and stocks"*, and *"fair competition between the participants of the natural gas, where the equal rights and opportunities apply*", which ensure proper functioning of the Energy Community Treaty under Article 18(1).

(906) In the light of the applicable provisions of the *Acquis Communautaire*, including Directive 2009/73/EC, Part VI of the Ukrainian Gas Market Law established a gradual and coherent transition to the full scale natural gas market by (a) separation of functions of supply and transit of natural gas; and (b) designation of eligible consumers and guaranteed suppliers of gas in Ukraine. Consequently, Naftogaz was formally stripped of its gas import monopoly. Additionally, Naftogaz was required to assign its functions on transit of the natural gas to UkrTransGas, the operator of the Ukrainian GTS.

(907) As it follows, both the EC/EU *acquis* on competition and the Ukrainian competition legislation referred to above, require that the terms and conditions of the Contract be adapted to conform with protection of competition requirements as well as render a number of its provisions invalid.

VIII.6.5 Violation of mandatory public law

VIII.6.5.1 Ordre public

(908) The competition law provisions at issue are of an *ordre public* character. The Tribunal has an obligation to apply Articles 101 and 102 TFEU.

(909) Agreements that are contrary to the abovementioned competition law provisions are void, and thus not enforceable. Therefore, when deciding on the annulment or enforceability of an arbitration award, national courts must raise a question of competition law, even of their own initiative if necessary, so as to ensure that the arbitration award does not permit a violation of competition law.

(910) This also means that arbitrators need to ensure that their awards can be enforced in jurisdictions where competition law rules are public policy, as in any country within the Energy Community, including Sweden and Ukraine. Accordingly, contracts subject to the laws of a member of the Energy Community should be applied and interpreted by arbitrators in a manner which would not bring them into conflict with mandatory requirements of public law, in particular competition law rules.

(911) This is expressed in a judgement by the Court of Justice of the European Union ("ECJ") concerning annulment of an arbitral award contrary to Article 101 TFEU (former Article 81 EC):

"However, according to Article 3(g) of the EC Treaty (now, after amendment, Article 3(1)(g) EC), Article 81 EC (ex Article 85) constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market. The importance of such a provision led the framers of the Treaty to provide expressly, in Article 81(2) EC (ex Article 85(2)), that any agreements or decisions prohibited pursuant to that article are to be automatically void.

It follows that where its domestic rules of procedure require a national court to grant an application for annulment of an arbitration award where such an application is founded on failure to observe national rules of public policy, it must also grant such an application where it is founded on failure to comply with the prohibition laid down in Article 81(1) EC (ex Article 85(1)).

That conclusion is not affected by the fact that the New York Convention of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards, which has been ratified by all the Member

States, provides that recognition and enforcement of an arbitration award may be refused only on certain specific grounds, namely where the award does not fall within the terms of the submission to arbitration or goes beyond its scope, where the award is not binding on the parties or where recognition or enforcement of the award would be contrary to the public policy of the country where such recognition and enforcement are sought(Article V(1)(c) and (e) and II(b) of the New York Convention).

For the reasons stated in paragraph 36 above, the provisions of Article 81 EC (ex Article 85) may be regarded as a matter of public policy within the meaning of the New York Convention.

Lastly, it should be recalled that, as explained in paragraph 34 above, arbitrators, unlike national courts and tribunals, are not in a position to request this Court to give a preliminary ruling on questions of interpretation of Community law. However, it is manifestly in the interest of the Community legal order that, in order to forestall differences of interpretation, every Community provision should be given a uniform interpretation, irrespective of the circumstances in which it is to be applied (Case C-88/91 Federconsorzi [1992] ECR I-4035, paragraph 7). It follows that, in the circumstances of the present case, unlike Van Schijndel and Van Veen, Community law requires that questions concerning the interpretation of the prohibition laid down in Article 81(1) EC (ex Article 85(1)) should be open to examination by national courts when asked to determine the validity of an arbitration award and that it should be possible for those questions to be referred, if necessary, to the Court of Justice for a preliminary ruling."

ECJ Case C-126/97 Eco Swiss China Time Ltd v Benetton [1999] ECR I-3055, [2000] 5 CMLR 816, paras 36-40.

(912) The same principles apply to arbitral awards contrary to Article 102 TFEU (former Article 82 EC).

VIII.6.5.2 Factual background

(913) Part II, 1 of the assessment of the Energy Community Secretariat provides some general information on Ukraine's natural gas market in particular that;

(i) Ukraine's economy is largely dependent on natural gas as a primary source of energy. Domestic natural gas production is unlikely to satisfy Ukraine's entire demand in the short and medium term.

(ii) Since disintegration of the Soviet Union in 1991, Russia (Gazprom) has exported the major bulk of natural gas imported into Ukraine, which amounts on a constant annual basis to over 50% of the total natural gas consumption in Ukraine and in certain years exceeded 70% (e.g. in 2011).

(iii) Ukraine is subject to an ongoing liberalization of the market for natural gas. In October 2012, Naftogaz was formally stripped of its monopoly status, and all imports of natural gas, as well as further sale of imported gas became an activity open to all eligible enterprises holding the relevant license.

(iv) Naftogaz still maintains some important public functions which cover a considerable part of the gas consumption in Ukraine.

(914) Background information on Russian Gas Sales to former Soviet Republics and Ukraine in particular is provided in Sections V2, V3 and V5 above.

VIII.6.5.3 The relevant market

(915) Market definition is a tool to identify and define the boundaries of competition between firms. The objective of defining a market in both its product and geographic dimension is to identify the actual competitors of the undertakings involved that are capable of constraining those undertakings' behaviour and of preventing them from behaving independently of effective competitive pressure. The market definition is the starting point for the assessment under both Article 101 and 102 TFEU.

(916) In general, and with some clarifications in the following, we agree with the considerations in Part IV, 2.1 on the relevant market in the assessment by the Energy Community Secretariat, cf. also the references included therein:

(i) The gas market is a separate product market, and thus needs to be distinguished from other sources of energy like electricity and oil.

(ii) The Contract concerns upstream supply of gas in or to Ukraine. Foreign gas reaches the Ukrainian wholesale market via either Naftogaz or a group of independent importers.

(iii) The infrastructure for import of gas to Ukraine is in practice controlled to a large degree by Gazprom due to its contractual relations with Naftogaz, based on the Contract subject to these proceedings and the Transit Contract. Under the current contractual regime, the potential for imports from other countries is limited.

(iv) In principle, the relevant market could include suppliers from the Energy Community and Norway, in addition to Ukraine and Russia. On the other hand, the competitive pressure from suppliers in many of these countries is non-existent or very limited.

(v) It may be debatable whether the relevant market shall be separated from the upstream activities of independent importers. The Secretariat is of the opinion that the relevant market is the market for natural gas procured to satisfy the demand of Naftogaz in performing its public utility functions. We agree with this assessment, since independent importers do not currently act as competitors to Gazprom, as pointed out by the Secretariat.

(vi) The precise market definition, both as regards the product and the geographic dimension, can however be left open, as Gazprom has clearly a dominant position in any case, with a consistent market share well above 50%, which gives a presumption of dominance according to established practice by the ECJ:

- ECJ Case C-62/86 AKZO Chemie BV v Commission [1991] ECR I-3359, [1993] 5 CMLR 215, para 60

VIII.6.6 Pricing under the Contract

(917) Article 4 of the Contract contains a detailed regulation of the Contract Price. The central price provisions are found in Articles 4.1 to 4.3 of the Contract. Article 4.1 contains the price formula, while Article 4.2 regulates the consequences of quality variations for the Factual Price to be paid under the Contract. Article 4.3 sets out the price to be paid if the Buyer off-takes excessive amounts of Natural Gas. Only Article 4.1 may be adjusted pursuant to the price revision provisions in Article 4.4. Article 4.5 relates to taxes and fees (including VAT), whereas Article 4.6 estimates the costs for Natural Gas to be delivered in the first year of delivery. Article 4.7 concerns a discount to be applied under certain water dew circumstances.

(918) The Contract Price was market reflective when it was entered into in 2009, but has subsequently totally decoupled from the relevant market, *inter alia*, due to significant and unexpected changes in the market.

VIII.6.7 The expert reports

(919) The key findings by Mr Carlos Lapuerta in his Expert Competition Report (the "Expert Competition Report") are as follows as regards Gazprom's dominant position and the abusive nature of the price provisions of the Contract:

(i) Gazprom is a dominant supplier, given its large market share. Furthermore, Ukraine depends on Gazprom because currently there is no other way to meet total Ukrainian gas demand.

(ii) The oil price indexation in the Contract Price is anti-competitive. Oil price indexation can be a reasonable way of setting the price for gas in certain circumstances, but the particular oil price indexation in the Contract reflects an abuse of a dominant position by discriminating against Ukrainian customers.

(iii) The unreasonably high price operates in conjunction with the extended duration and Take or Pay obligations to impose a severe burden on Naftogaz.

(920) The key findings in his Expert Price Report (the “Expert Price Report”) in this respect are as follows:

(i) Since at least 2011, the Contract Price has no longer reflected market prices. That mismatch between the prices is due to significant changes in the fuel and energy market that the Parties had no reason to expect in January 2009.

(ii) The Report estimates the adjustment to the Contract price that is required to ensure it reflects market prices netted back to the delivery point of the Contract (the Russian border).

VIII.6.8 Application of Article 102 TFEU

VIII.6.8.1 Dominant position

(921) Naftogaz agrees with the Energy Community Secretariat's conclusion in Part IV, 3.2 that Gazprom clearly has a dominant position in the relevant market. Gazprom's position approximates the one of a monopoly, as pointed out by the Secretariat. Gazprom's historical dominance has been cemented through the Contract.

(922) As mentioned above, also the Expert Competition Report finds that Gazprom has a dominant position. The Report considers Gazprom's position based on a wider market definition than that of the Energy Community Secretariat. Still, the evidence of dominance is clear.

(923) According to the Expert Competition Report (cf. its Section II.B), Ukrainian natural gas production is approximately 20 BCM per year. Naftogaz and its subsidiaries control about 90% of all domestic production. According to the Report, the relevant market includes the remaining 10% of domestic natural gas production, or approximately 2 BCM per year as of 2012.

(924) Independent imports constitute another component of the relevant market, according to the Report. Beginning in 2012, several industrial companies received licenses to import gas independently for their own supply. In 2012 and 2013 they imported 8-9 BCM per year. Naftogaz had previously supplied these customers; barring any contractual commitments, Naftogaz could supply them again if the price proved competitive.

(925) Within the relevant market defined by the Report, Gazprom has had a share ranging from 84% to 95% over time, cf. Table 1 of the Report. This range of market share is well above the presumption of dominance mentioned in Section 5.3 above, even though it is based on a wider market definition than that applied by the Energy Community Secretariat. To the author of the Expert Competition Report, Mr Lapuerta's knowledge *"there is no precedent in the natural gas industry where a producer supplied more than 80% of the market yet escaped a finding of dominance by the competition authority."*

(926) The Expert Competition Report also considers the "pivotal supplier" test applied to Gazprom and the relevant market, cf. its Section II.C. If any question remains over dominance, this test shows that Gazprom remains pivotal, i.e. other sources do not suffice to meet demand if Gazprom withdraws its supplies from the market, even after extending the size of the market to include supplies that are not currently economic.

VIII.6.8.2 The abuse

(927) In general, and with some clarifications in the following, Naftogaz agrees with the considerations in Part IV, 3.3 d on the application of Article 102 TFEU in the assessment by the Energy Community Secretariat, cf. also the references included therein. The oil price indexation clause in Article 4.1 of the Contract is based on a calculation mechanism which is unreasonable and thus unfair:

(i) Oil indexation of gas prices suffers from flaws. It does not reflect the evolution of the global natural gas market as distinct from the market in oil. Furthermore, the trailing average technique used in the Contract fails to capture contemporary developments in the demand/supply equilibrium.

(ii) Price review negotiations featuring major upstream gas suppliers such as Gazprom have become commonplace, due to an emerging disconnect between oil and natural gas markets and press for departure from traditional oil-tying. Overpayment has in many cases resulted in either renegotiation or arbitral awards to the same effect. These cases confirm that the oil-indexed gas prices do not meet the market level.

(iii)The oil price indexation clause in the Contract establishes prices above the economic value provided by the supplied gas and discriminates between trading partners of Gazprom.

(928) As noted by the Energy Community Secretariat in Part IV, 3.4 of its assessment, the practices being treated here and below, are cumulatively directed at obstructing the emergence of an integrated Energy Community market in natural gas. Thus, trade within the Energy Community is clearly affected by the disputed practices.

(929) Furthermore, as noted by the Secretariat in Part IV, 3.5 of its assessment, none of the disputed practices can be justified by objective necessity or substantial efficiencies. In particular, the oil price indexation clause is not reasonably related to any objective economic benefits.

(930) The findings of the expert reports as summarized in Section 7 above are in line with the assessment of the Energy Community Secretariat. According to the Expert Competition Report, oil price indexation can be a reasonable way of setting the price for gas in certain circumstances, but the particular oil price indexation in the Contract discriminates against Ukrainian customers along two dimensions, cf. Section III.D of the Report.

(931) First, the price formula includes different oil products that would seek to discriminate among different customers within Ukraine based on their alternatives to consuming natural gas. Including multiple oil products within a price formula used to be common, because it did not present competitive problems in contracts with buyers who enjoyed legal monopolies prior to the liberalisation of the European natural gas industry. Prior to liberalisation economists rationalised the references to multiple fuels as an efficient way to maximise the consumption of natural gas. However, including multiple fuels in a formula no longer makes sense after the elimination of buyer monopolies, as happened in Ukraine in 2012.

(932) According to the Report, price indexation is also discriminatory along a second dimension: it would force Naftogaz to pay a significant premium for gas, which does not reflect the lower costs of serving the Ukrainian market compared to the costs of serving other markets for Russian gas.

(933) The Report also finds that the unreasonably high price would operate in conjunction with the extended duration and Take or Pay obligations to impose a severe burden on Naftogaz.

(934) According to the Expert Price Report (cf. its Section I.A.2), since at least 2011 the Contract Price has no longer reflected market prices. This mismatch between the prices is due to significant changes in the fuel and energy market that the Parties had no reason to expect in January 2009. A combination of developments in the fuel and energy market led to a structural change in the way that market prices are set between January 2009 and May 2011 (and beyond). In January 2009, oil product prices were, directly or indirectly, the key determinant of European market prices for gas but by May 2011 market prices were overwhelmingly determined by gas-to-gas competition and the price at which gas could be bought at the various trading hubs across Europe.

(935) As mentioned above, the Expert Price Report estimates the adjustment to the Contract Price that is required to ensure it reflects market prices netted back to the delivery point of the Contract (the Russian border).

VIII.6.9 The Energy Community Treaty

(936) The EnCT is binding upon Sweden, and has horizontal direct effect as Swedish law. Thus, Article 18 ECT, which incorporates Articles 101 and 102 TFEU, applies to the Contract as a part of Swedish law.

(937) The competition rules of the EnCT also have status of mandatory Ukrainian law. Even though the EnCT as Ukrainian law is not the law applicable to the Contract, it affects the performances of the obligations under it, independently of and in parallel with the application of EU competition law (whether as such or as Swedish law) and with the application of the EnCT as a part of Swedish law.

(938) Treaties to which Ukraine is a party have direct effect in Ukraine without any need for implementing legislation. The provisions of the EnCT are mandatory Ukrainian law. Pursuant to Article 9.5 of the Contract, Article 18 EnCT renders provisions in violation of European competition law ineffective.

(939) Gazprom's abusive and restrictive practices, as evidenced by Gazprom's conduct and in several provisions of the Contract, affect trade both between EU Member States and between Ukraine and other Member States of the Energy Community, including several EU Member States.

VIII.6.10 The individual bases for application of competition law

VIII.6.10.1 The application of EU competition law

VIII.6.10.1.1 Introduction

(940) Articles 101 and 102 TFEU apply to agreements and practices which are capable of affecting trade between EU Member States. Article 101 prohibits anticompetitive agreements, whereas Article 102 prohibits abusive practices by undertakings holding a dominant position.

(941) Articles 101 and 102 TFEU apply also to agreements and practices which are entered into or conducted by undertakings established outside the EU, in so far as they have economic effects within the EU and are capable of affecting trade between EU Member States.

(942) Articles 101 and 102 TFEU are directly applicable provisions with direct effect that create rights for individuals which can be invoked before national courts. Gazprom does not elaborate on the effects of breaches of Articles 101 and 102 TFEU, but apparently agrees that Article 101 is sanctioned by invalidity under EU law, and perhaps Article 102 as well.

VIII.6.10.1.2 Effect on trade

(943) The effect on trade criterion confines the scope of application of Articles 101 and 102 TFEU to agreements and practices that are capable of having a minimum level of cross-border effects within the EU.

(944) In the case of Article 101 TFEU, it is the agreement as such which must be capable of affecting trade. If the agreement as a whole is capable of affecting trade between EU Member States, Article 101 applies to the entire agreement, including any parts of the agreement that individually do not affect trade.

(945) In the case of Article 102 TFEU, it is the abuse as such which must affect trade between EU Member States. This does not mean that each element of the behaviour must be assessed in isolation. Conduct that forms part of an overall strategy pursued by the dominant undertaking must be assessed in terms of its overall impact. Where a dominant undertaking adopts various practices in pursuit of the same aim, for instance practices that aim at eliminating or foreclosing markets or competitors, in order for Article 102 TFEU to be applicable to all the practices forming part of this overall strategy, it is sufficient that at least one of these practices is capable of affecting trade between EU Member States, cf. para 17 of the Effect on Trade Guidelines.

(946) When analysing the concept of affecting trade three aspects in particular need to be addressed:

(i) *Trade between EU Member States*: The concept of "trade" is not limited to traditional exchanges of goods and services across borders. It is a wider concept, covering all cross-border economic activity, including establishment. This interpretation is consistent with the fundamental objective of the TFEU to promote free movement of goods, services, persons and capital. The requirement that there must be an effect on trade "between EU countries" implies that there must be an impact on cross-border economic activity involving at least two EU countries;

(ii) *May affect*: The function of the notion "may affect" is to define the nature of the required impact on trade between EU countries. According to the standard test developed by the Court of Justice of the European Union, the notion "may affect" implies that it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or fact that the agreement or practice may have an influence, direct or indirect, actual or potential, on the pattern of trade between EU countries. In cases where the agreement or practice is liable to affect the competitive structure inside the EU, EU law jurisdiction is established;

(iii) *Appreciability*: The effect on trade criterion incorporates a quantitative element, limiting EU law jurisdiction to agreements and practices that are capable of having effects of a certain magnitude. Appreciability can be appraised in particular by reference to the position and the importance of the relevant undertakings on the market for the products concerned. The assessment of appreciability depends on the circumstances of each individual case, in particular the nature of the agreement and practice, the nature of the products covered and the market position of the undertakings concerned.

VIII.6.10.1.3 Contracts between undertakings in non-EU countries

(947) EU competition law has jurisdiction if the agreement or practice is either *implemented in* or *produces effects* within the EU, cf. paragraph 100 of the *Effect on trade Guidelines* of the European Commission. If either criterion is fulfilled, the jurisdiction of EU law is compatible with the requirements of public international law according to established case-law of the ECJ, cf. the *Effect on trade Guidelines*, paragraphs 100-109; and paragraph 23 of *Courage v Crehan*.

(948) The notions of "*implemented*" and "*effects*" within the EU have been interpreted in two leading cases before the EU courts – *Woodpulp* and *Gencor*.

(949) In *Woodpulp*, the ECJ laid down the basis for the *implementation* doctrine which means that when companies established outside the EU take steps to implement an agreement or a practice within the territory of the EU, Articles 101 and 102 TFEU are applicable, provided that there is an effect on trade between Member States.

(950) The ECJ went on to state that the EU's jurisdiction to apply its competition rules in a situation like the one described is covered by the territoriality principle as recognised in public international law. The territoriality principle may be invoked where conduct either takes place within a nation's borders or the effects of the conduct are felt within the borders, cf. *Prosecutions of Extraterritorial Criminal Conduct and the Abuse of Rights Doctrine*.

(951) In *Gencor*, the General Court elaborated further on issues concerning the jurisdiction of the EU rules on competition. When considering the compatibility of the European Commission's decision on appeal with public international law the Court stated (paragraph 90):

"Application of the [Merger] Regulation is justified under public international law when it is foreseeable that a proposed concentration will have immediate and substantial effect in the Community."

(952) In Gencor, the General Court extended the scope of EU jurisdiction to also include the *effects doctrine*. According to the *effects doctrine*, jurisdiction may be established when an agreement or practice has economic effects within a certain territory. It has thus been accepted that if it is foreseeable that an agreement or a practice will have substantial effect within the EU, EU law applies by virtue of the territoriality principle as recognised by public international law.

(953) In the current matter, the Contract and the practices of Gazprom clearly produce economic effects within the EU as both the object and effects thereof is to foreclose the Ukrainian market from the EU market by hindering exports into the EU from Ukraine and by hindering suppliers located within the EU from marketing their gas on the Ukrainian market.

(954) This not only affects trade between Ukraine and individual EU Member States, but also between EU Member States, as Ukraine is an integral part of the internal energy market of the EU through the ECT. Thus, trade flows between EU Member States are also affected by the

Contract and related practices. The territoriality principle is therefore satisfied, and EU competition law applies to the Contract and the practices connected to it.

(955) Gazprom objects to Naftogaz argumentation for the following reasons. The Contract is implemented outside the EU between two parties established outside the EU. As a matter of public international law, EU competition law is in such circumstances only applicable if the agreement (or the abuse) has an immediate, substantial and foreseeable negative effect on competition within the European Union under the qualified effects test. The qualified effects doctrine referred to by Naftogaz is controversial. There has been no definitive statement from the CJEU on whether such a doctrine exists in EU law. It is therefore not definitively established as a matter of EU law.

(956) Gazprom further argues that the test adopted by the General Court (the EU court of first instance) is a stringent one.

(957) According to Gazprom, Naftogaz has failed to establish that the Contract has such an effect on competition within the EU. Accordingly, EU competition law is not applicable to the Contract or to the claims put forward by Naftogaz.

(958) According to Naftogaz, although the qualified effects doctrine has not yet been endorsed by the ECJ, it is accepted and applied by the European Commission and the General Court, and there is a broad consensus that the qualified effects doctrine forms part of current EU law.

VIII.6.10.2 EU competition law applicable as Swedish law

(959) The competition chapter of the TFEU and its articles (including Articles 101 and 102) have formed part of Swedish law since the date of the Swedish accession to the European Community on 1 January 1995. The EU rules on competition, including Articles 101 and 102, have direct effect and form part of and are directly applicable as Swedish law. Since Swedish law applies to the Contract, Articles 101 and 102 TFEU forming part of Swedish law, are therefore applicable to the Contract.

(960) The content and the conditions for the application of Articles 101 and 102 TFEU as Swedish law remain the same as set out above. Thus, an agreement or practice must be capable of affecting cross-border economic activity inside the EU, and thus patterns of trade between EU Member States.

(961) It is thus immaterial whether Articles 101 and 102 TFEU are applied in their capacity as EU law by virtue of their applicability to the Contract or if they are applied as being part of Swedish law, since the conditions for their applicability are the same.

VIII.6.10.3 Article 18 EnCT applicable as Swedish law

VIII.6.10.3.1 Introduction

(962) Gazprom asserts that the EnCT does not have direct effect or give Naftogaz enforceable rights, with reference to what it claims is the EnCT's status as an international agreement under Swedish law.

VIII.6.10.3.2 Binding international agreement

(963) The European Union is a Contracting Party to the EnCT, and not the individual EU Member States. The authority for the EU to enter into international agreements was introduced through the Treaty of Lisbon. This right and capacity is laid down in Article 216 TFEU:

"1. The Union may conclude an agreement with one or more third countries or international organisations where the Treaties so provide or where the conclusion of an agreement is necessary in order to achieve, within the framework of the Union's policies, one of the objectives referred to in the Treaties, or is provided for in a legally binding Union act or is likely to affect common rules or alter their scope.

2. Agreements concluded by the Union are binding upon the institutions of the Union and on its Member States."

(964) It is thus not correct to assert, as Gazprom does that the EnCT is not an EU agreement, as it exists on the official list of such agreements. It is further immaterial to the question of direct effect that the EnCT does not establish an EU institution which Gazprom for some reason points out. The core question is whether the act in question is binding upon the Member States and if it fulfils the criteria for direct effect. The establishment of an EU institution is of no relevance. It can be noted in this respect that, as under the EEA Agreement, the EU institutions necessary to enforce compliance on the part of the EU of the relevant competition rules are already in place, i.e. the European Commission and the EU Courts.

(965) From the wording of Article 216 (2) TFEU, it follows that international agreements entered into by the EU are binding on the Member States (and the EU institutions). Gazprom interprets Article 216 differently, and asserts that an international agreement is only binding on the

Member States if the agreement is mixed, i.e. if the Member States are contracting parties together with the EU.

(966) Member States are bound by international agreements entered into by the EU according to EU law, even though the Member States themselves are not contracting parties. Since Sweden is an EU Member State and the binding effect follows from EU law, there can be no doubt that Sweden is bound by the EnCT.

(967) [redacted] confirms in his second witness statement that the EnCT is binding on Sweden, cf. its paragraphs 25 and 28.

"With respect to the status of the Treaty under Swedish law and the relevance of Energy Community competition rules, Gazprom accepts that "as a matter of EU law, the EnCT is binding on Sweden as a member state of the EU" (paragraph 761 of the Defence). Still, Gazprom reaches the conclusion that "the EU (and, to the extent relevant by extension, Sweden) ... has no obligations under the EnCT" (paragraph 764 of the Defence), and that a private party cannot rely on it under Swedish law. This conclusion is again based on a wrong understanding of Energy Community law and its relevance for the present case.

[…] Agreements concluded by the EU – no matter whether they are "mixed" or not – form "an integral part of the European legal order", without any act of incorporation by the EU Member State being necessary. In accordance with the principle of supremacy of EU law over national laws of its Member States, this puts an obligation on Sweden to respect and apply (not: to transpose!) the Energy Community Treaty's rules in its internal legal order. Contrary to what Gazprom claims in paragraph 761 of the Defence, Article 216(2) TFEU does not differentiate between "mixed" agreements or agreements being entered into solely by the Union as such."

VIII.6.10.3.3 Direct effect and enforceability

VIII.6.10.3.3.1 Introduction

(968) Gazprom alleges that Articles 18(1) and (2) EnCT do in fact not incorporate Articles 101 and 102 TFEU. Furthermore, Gazprom asserts that the ECT is a "*political*" treaty which does not afford private parties such as Naftogaz enforceable rights that would form the basis of claims against another private party such as Gazprom.

(969) In line with this, Gazprom claims that Article 18 is not sufficiently clear and precise to have direct effect, even though the provision refers explicitly to the EU competition rules, i.e.

Articles 101 and 102 TFEU, which Gazprom agrees have such direct effect. Gazprom also claims that the enforcement procedures under the EnCT speak in favour of the EnCT not having direct effect. In Section XI, A 3 of the Defence, Gazprom asserts that the EnCT is not *ordre public*, although accepting that the corresponding EU competition rules are.

VIII.6.10.3.3.2 Legal in nature

(970) In spite of the assertion that the EnCT is a "political" treaty which does not afford private parties enforceable rights, Gazprom acknowledges that *"[t]he key aim of the European Energy Community was to extend the EU internal energy market to South East Europe and beyond"*. To accept the assertions made by Gazprom as just mentioned, would clearly be in contradiction of this aim. The EnCT clearly envisages the same application of inter alia competition rules in the Energy Community as that of the EU. According to the Preamble of the EnCT, its Contracting Parties are

"[d]etermined to create a single regulatory space for trade in gas and electricity that is necessary to match the geographic extent of the concerned product markets". Furthermore, *"to achieve these aims, a broad ranging and integrated market regulatory structure needs to be put in place supported by strong institutions and effective supervision, and with the adequate involvement of the private sector"*.

(971) Notably, Gazprom also refers to inter alia these excerpts from the EnCT, but erroneously claims that they speak in favour of *not* affording the competition rules therein, which refer to EU competition law explicitly, the same effect in the Contracting Parties to the EnCT not Member States of the EU. It is inconceivable that the EU would include Ukraine and other non-EU Member States in its internal energy market without making sure that the competition rules are afforded similar protection and enforcement. This is also the case with respect to the EEA Agreement, another agreement with third party countries (Iceland, Liechtenstein and Norway) which are included in the internal energy market of the EU.

(972) [redacted] comments on Gazprom's claim that the EnCT is political and not legal in nature, cf. paragraphs 20-21 of his second witness statement:

"In paragraphs 751 and 768 of the Defence, Gazprom puts emphasis on the fact that "the Contracting Parties' obligations under the EnCT are aspirational in nature", as the Treaty establishes implementation deadlines for its acquis communautaire. It is unclear how this can be used as an argument against direct effect. In this respect, the Energy Community legal order

fully corresponds to that of the EU, which also sets deadlines for the implementation of its secondary legislation (in particular Directives).

As EU competition law, Article 18 of the Energy Community Treaty was to be implemented and enforced upon the entry into force of the Treaty, and is thus far from being "aspirational". According to Ukraine's Accession Protocol, the implementation deadline also concurred with the entry into force of its accession, namely in 1 February 2011.Gazprom's assumption that "the Contracting Parties ... were to take steps towards the implementation of certain aspects of the EU acquis on energy and competition" clearly misinterprets both the binding character of Energy Community law in general as well as the clear and unequivocal wording of Article 18 of the Treaty.

VIII.6.10.3.3.3 No need to transpose

(973) Being binding on Sweden, the EnCT may in its capacity of an international agreement create direct effect. An international agreement entered into by the EU is part of EU secondary legislation, and it has long been established by the ECJ that EU secondary legislation may have direct effect. The issue of direct effect of an international agreement must be interpreted against the background of the purpose of the international agreement in question.

(974) As pointed out by [redacted] in paragraph 25 of his second witness statement it is not necessary for Sweden to transpose the EnCT into its legal order for it to be binding and have direct effect:

"As it stems directly from EU law, the applicability of Energy Community provisions as part of Swedish substantive law does not depend on whether or not Sweden has "implemented" the Energy Community Treaty. Contrary to Gazprom's contention, Sweden's dualistic approach to international treaties (paragraph 762 of the Defence) is also irrelevant in that respect, as the effect of Energy Community law in Sweden applies by virtue of EU law. Furthermore, the argument that the Energy Community Treaty "establishes inter-state obligations as a matter of public international law" (paragraph 763 of the Defence) is evidently wrong as it suggests that Sweden – not a Party to the Treaty – would have any options with regard to accepting or not the European Union's commitments taken under the Energy Community Treaty. It actually has not."

VIII.6.10.3.3.4 Gazprom's emphasis on inter-state obligations

(975) The basic aim of the EnCT is to create an integrated market in natural gas and electricity between the EU (including all its Member States) and the other Contracting Parties to the EnCT, of which Ukraine is one. For this purpose, the EnCT contain a number of commitments and requirements directed towards the Contracting Parties which have the character of inter-state obligations as Gazprom points out. However, as the aim and goal of the EnCT is to establish a well-functioning and integrated energy market, it is essential that also private interests are addressed. This is expressed in paragraphs 15-16 of the preamble of the EnCT:

"Determined to develop gas and electricity market competition on a broader scale and exploit economies of scale,

Considering that, to achieve these aims, a broad ranging and integrated market regulatory structure needs to be put in place supported by strong institutions and effective supervision and with the adequate involvement of the private sector"

(976) Therefore, the EnCT has been equipped with provisions which are directly aimed at the private subjects which play a role on the energy market, namely the provisions on competition laid down in Article 18 of the EnCT. This structure of the EnCT is in many ways a direct parallel to the structure of the TFEU. The TFEU, which *inter alia* aims at the creation and strengthening of the internal market, rests upon the pillars of the rules on competition which shall prevent its distortion by private subjects. The competition rules are essential in order to establish and maintain the internal market.

(977) [redacted] discusses in his second witness statement the direct effect of Article 18 ECT under Swedish law:

"Moreover, Gazprom erroneously claims that the Energy Community Treaty is not directly applicable to EU Member States. As a matter of fact, there is no such thing as a 'reluctance' in the case law of the European Courts to grant international agreements direct effect. The direct effect of many international treaties in the EU (and thus: Swedish) legal order has been positively assessed by the EU Court of Justice. For instance, direct effect was accorded by the EU Courts to agreements establishing relations of association, pre-accession, cooperation etc. between the EU and third countries, free trade agreements, or the EEA Agreement (another example for an agreement based on the export of EU law to third countries).

The Energy Community – both in terms of substantive law and the institutional design – is clearly modelled on the EU template. It thus passes the test for direct applicability within the EU (and consequently Swedish) legal order without doubt. This is in particular true for Article

7 of the Treaty, which obliges Sweden to assess contracts concluded by Naftogaz in the very same way as a contract entered into by a Swedish or EU company. The provision corresponds to Article 18 TFEU, the direct effect of which has been established already early on in European integration history. Article 94 of the Energy Community Treaty, requiring an interpretation of terms and concepts used by the Energy Community Treaty "in conformity" with the case law of the EU Court of Justice, explicitly requires an identical interpretation of both provisions."

(978) The point made by Gazprom when referring to a number of obligations directed at the Contracting Parties as evidence for the EnCT not being capable of creating direct effect, is misplaced. It is not surprising that the absolute majority of the articles in the EnCT are directed towards the Contracting Parties, since the goal is to establish an integrated, inter-state, energy market which requires comprehensive efforts from the Contracting Parties in terms of infrastructure, technical requirements and rules to maintain efficiency, environment and safety. But an essential part of this project is the safeguarding of undistorted competition on that market, with rules which apply directly to and have direct effect for the undertakings, as is the case under EU competition law.

VIII.6.10.3.3.5 Conditions for direct effect

(979) Gazprom also asserts that the necessary conditions for a treaty provision to have direct effect are not satisfied by Article 18 EnCT. It is stated that Article 18 simply provides that certain circumstances are *"incompatible with the proper functioning of the ECT"*. Further, Gazprom states that is unclear what action any court or arbitrational tribunal should take if it should conclude that an agreement or practice is anticompetitive in the meaning of Article 18(a) to (c) EnCT.

(980) First, Article 18 (1) comprises the same elements, concepts and terms as those found in Articles 101 and 102 of the TFEU, albeit not citing the entire provisions. It should also be noted that the entire provisions of Articles 101 and 102 are found in Annex III to the Treaty, which Article 18 (2) EnCT refers to explicitly. The only difference between the competition rules of the EU and the EnCT respectively then, is the technical inclusion in the treaties, as expressed by [redacted] in paragraph 17 of his second witness statement:

"The fact that Articles 101 and 102 were annexed to the Treaty and not reproduced in full inside Article 18 is an issue of Treaty editing, not substance. The Annexes form integral parts of the Energy Community Treaty (see also Article 31(2) of the Vienna Convention: "The context for

the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes...")."

(981) Furthermore, the interpretation of the concepts and terms of the EnCT (which are derived from EU law) shall, according to Article 94 ECT, be made *"in conformity with the case law of the Court of Justice or the Court of First Instance of the European Communities"*, cf. also the reference to EU practice in Article 18 (2). Thus, the material assessment of any possible breach of the rules on competition as laid down in Article 18 EnCT is intended to be uniform with that of EU competition law.

(982) In so far as the material assessment is concerned, the application of Article 18 EnCT is therefore sufficiently precise and clear to be able to have direct effect as it does not deviate in this regard from its models Article 101 and 102 TFEU, which no doubt have direct effect.

(983) Secondly, Gazprom argues that the text of Article 18 EnCT differs from Articles 101 and 102 TFEU in so far as the text "*shall be prohibited"* which is found in Articles 101 and 102 and "*shall be automatically void"* which is found in Article 101, is not contained in Article 18 EnCT. From this, Gazprom draws the conclusion that this omission shows that there is no clear intention in the EnCT language as to the legal consequences of being in breach of the rules on competition in Article 18 EnCT. This is, however, not correct.

(984) Article 18 (2) EnCT reads as follows:

"Any practices contrary to this Article shall be assessed on the basis of criteria arising from the application of the rules of Articles 81, 82 and 87 of the Treaty establishing the European Community (attached in Annex III)."

(985) The wording of this provision lays down that when a practice *has been found to be contrary* to Article 18 (1), the consequences thereof shall be assessed in the light of the full *acquis communautaire* on competition. The same criteria as those developed by the EU Courts and the European Commission when applying Articles 101 and 102 TFEU to agreements and practices which have been found to violate those Articles, shall thus be used when assessing the legal consequence of a breach of Article 18 (1) EnCT. The consequences of violating Article 18 EnCT are thus the same as under the EU rules on competition, no more and no less and there is no uncertainty whatsoever in this regard which prevents Article 18 from having direct effect.

(986) Article 18 (2) refers to Annex III to the EnCT, which contains the full texts of Articles 81 and 82 EC (now Articles 101 and 102 TFEU), including the formulations "*shall be prohibited*" and "*shall be automatically void*". This further shows that the purpose of Article 18 is the incorporation of Articles 101 and 102 TFEU, without any of the limitations claimed by Gazprom. Annex III is part of the EnCT, and the difference in wording between Article 18 (1) and Articles 101 and 102 TFEU is in any case of no significance.

(987) In line with the above, [redacted] discusses this issue as follows in his second witness statement:

"Gazprom's statement that Article 18 "reflects, but does not specifically incorporate the provisions of Articles 101 and 102 of the TFEU" is clearly based on a wrong understanding of Energy Community law. As under the TFEU, Article 18(1) states that anti-competitive agreements (lit a) and abuses of dominance (lit b) constitute breaches of the Treaty. As Articles 101 and 102 TFEU, this prohibition is clear and unequivocal, and thus directly applicable to undertakings of Contracting Parties such as Naftogaz.

[…]

In paragraph 770 of the Defence, Gazprom tries to reject this by reference to the wording of Article 18(1), according to which the anti-competitive behaviour listed in that Article is "incompatible with the proper functioning" of the Treaty. Gazprom fails to see "what action any court (or in this case, arbitration tribunal) should take in the event that it determines that the circumstances listed in Articles 18(a) to (c) (anti-competitive agreements, abuse of a dominant position and state aid) exist."

(988) To find the answer to that question, Gazprom should have looked into Annex III to the Treaty to which Article 18(2) of the Treaty explicitly refers. That Annex contains the EU competition rules in full text, including the legal consequences of a breach relevant for any court or tribunal assessing compliance with Article 18: "*shall be prohibited*"/"*shall be automatically void*" (Article 18(1)(a)) and "*shall be prohibited*" (Article 18(1)(b)).

VIII.6.10.4 Article 18 EnCT as part of Ukrainian law

VIII.6.10.4.1 Introduction

(989) Article 18 EnCT constitutes mandatory Ukrainian law, independently of and in parallel with the other legal bases discussed above. While not being a law applicable to the Contract per se, the provisions of Ukrainian law and the prohibitions therein are facts that render the provisions of the Contract which violate Article 18 EnCT ineffective pursuant to Article 9.5 of the Contract, which reads:

"If any of the provisions hereof becomes legally invalid or ineffective, it shall not affect the validity of other provisions of this Contract. In case of invalidity or termination of any provision of the Contract, the Parties shall agree to replace such invalid or ineffective provision with a new provision that would have the economic effect as close as possible to that of the invalid or ineffective provision."

VIII.6.10.4.2 The status of ratified treaties under Ukrainian law

(990) Ukraine acceded to the EnCT on 1 February 2011. The EnCT is applicable to the territory of Ukraine by virtue of Ukraine's status as a Contracting Party to the EnCT, and pursuant to the Law of Ukraine on Ratification of the Protocol concerning the accession of Ukraine to the ECT ("Protocol on Ukraine's accession to the ECT") No. 2787-VI, dated 15 December 2010.

(991) Pursuant to Article 9 of the Constitution of Ukraine, the EnCT became an integral part of the national legislation of Ukraine on 1 February 2011. The Ukrainian legal system acknowledges the precedence of an international treaty (ratified by the Ukraine's Parliament) over national laws and regulations, cf. Article 19 (2) of Law of Ukraine on International Treaties of Ukraine.

(992) Therefore, the provisions of the EnCT are mandatory Ukrainian law, and take precedence over any contradicting rules of the national laws of Ukraine on competition and energy. Ukrainian law does not require any further internal legislative measures to implement provisions of the EnCT, unless otherwise specified by the EnCT or the Protocol on Ukraine's accession thereto.

(993) While the Protocol on Ukraine's accession to the EnCT provides for a particular timetable for the implementation of the *acquis communautaire* and application of certain EnCT provisions (e.g., Articles 15 and 19), Ukraine is subject to all obligations and all other provisions of the EnCT from the date of accession (i.e. 1 February 2011), including Article 18, where no specific reference is made as to application features.

VIII.6.10.4.3 Direct effect and enforceability in Ukraine

(994) Direct effect and enforceability applies in the case of Ukraine as well.

(995) The competition rules in Article 18 EnCT are sufficiently precise both as to their material content and to the consequences of their violation. Therefore, concerning their applicability and effect as mandatory Ukrainian law, there can be no doubt that the provision can be readily applied in Ukraine, producing rights and obligations for private undertakings which have the same effect in Ukraine as when a legal provision has direct effect under EU law, cf. also [redacted] to this effect in paragraph 18 of his second witness statement:

"There is thus no basis for claiming that (1) Ukraine as a Contracting Party to the Energy Community Treaty is not under the same obligation to apply and enforce European competition law, i.e. Articles 101 and 102 TFEU, in the very same was as any EU Member State is, and (2) that Ukrainian companies would not directly be bound by those competition rules in the very same way as undertakings established in the EU."

VIII.6.10.4.4 Conclusions

(996) Article 18 ECT constitutes mandatory Ukrainian law, and the prohibitions therein are facts that render the provisions of the Contract which violate Article 18 EnCT ineffective pursuant to Article 9.5 of the Contract.

VIII.6.10.5 Expert Reports

(997) Naftogaz has submitted the Preliminary Assessment of the Energy Community Secretariat as evidence, and a witness statement by [redacted]

(998) As part of the Defence, Gazprom has submitted expert reports by Dr Coppi (the "*Coppi Report*") and Mr Witschen (the "*Witschen Report*"), which both discuss issues of relevance to the competition law claims. The expert report by Dr Moselle (the "*Moselle Report*") also raises competition issues, even if it does not specifically address the competition law aspects.

(999) Naftogaz has also submitted the Expert Competition Reply and a second witness statement by [redacted] as evidence.

VIII.6.10.6 The Expert Competition Reply

(1000) The Expert Competition Reply of Mr. Lapuerta exposes the lack of engagement in the expert witness statements of Gazprom’s experts, Dr Coppi and Mr Witschen, and stresses the importance of looking at the Contract as a whole. It is misleading to view this case as involving nothing more than a price that was perfectly reasonable in 2009, but that may have unfortunately gone awry due to the inaccuracies of the oil price formula. The Contract in many respects was a reasonable way of implementing the Groningen model, but the Contract also placed Naftogaz in the position of bearing disproportionate risks from the possibility of "*de-coupling*" that has since occurred, unless the price revision clause is applied as claimed by Naftogaz.

(1001) It is similarly misleading to view Gazprom as the mere passive enforcer of contractual rights. The Expert Competition Reply explains that part of the "*conduct*" in this case involved the signature of a long-term contract for more than the entire consumption of gas by Ukraine, which has since deprived Naftogaz of the possibility of a balanced portfolio of natural gas import contracts, whose diversity would have provided Naftogaz an important tool to mitigate against the risks of excessive prices and Take or Pay penalties. In such a competitive scenario, Gazprom would have been far more active since 2009, competing for new business in Ukraine, instead of simply sitting back and demanding payment under the Contract.

(1002) The Expert Competition Reply provides further clarification on the "*active*" role that Gazprom is now playing in the price revision process, defending an excessive and discriminatory Contract Price in part by proposing inappropriate competitive benchmarks, and by applying the concept of "foreseeability" in a way that would deprive Naftogaz of the ability to protect itself from above-market prices.

(1003) Finally, the Expert Competition Reply provides additional useful empirical evidence, and points to the existing evidence that Gazprom and its witnesses have ignored. The Expert Competition Reply provides additional data and analysis allaying any concerns that Naftogaz has failed to define the relevant market appropriately. The report justifies the inclusion of Poland, Slovakia and Hungary in the definition of the market, and explains that Gazprom is dominant under alternative definitions of the geographic market. The Expert Competition Reply also provides additional evidence that the proposed Contract Price would be discriminatory.

VIII.6.11 Background, market definition and dominance

VIII.6.11.1 Background

(1004) Gazprom effectively refers to five factors that it alleges should be taken into account when considering Naftogaz' claims for revision of the Contract pursuant to European competition law, which can be summarised as follows, (i) the legacy of the Soviet era gas supply and transit arrangements, (ii) Ukraine's high annual gas consumption and reliance on imports of energy, (iii) Ukraine's gas storage capacity and its role as a transporter of natural gas from Russia, (iv) Naftogaz' historical financial difficulties, and (v) the supply interruption from 7 to 20 January 2009.

(1005) Factors (i) and (ii) above are closely related. Ukraine's consumption of and reliance on natural gas is a result of the Soviet era when the infrastructure for the use of gas in Ukraine was put in place. It is correct that Ukraine historically has used large quantities of gas. Like the absolute majority of European countries, Ukraine is also reliant on imports of natural gas to cover its needs. The Russo-Ukrainian gas sales prior to the Contract often had left Naftogaz short of gas supplies needed to cover Ukrainian consumers' gas demand.

(1006) Thus, as reflected in the negotiation history Naftogaz' position in the negotiations of the Contract was to secure maximum gas volumes for consumption in Ukraine. However, the fact that Ukraine is dependent on gas imports to cover its energy needs only serves to further emphasise Gazprom's dominant position in the Ukrainian market.

(1007) With regard to factor (iii), i.e. Ukraine's gas storage capacity, Gazprom essentially argues that 1) that the volume and take-or-pay provisions are justified as a means to encourage Naftogaz to maintain adequate levels of gas in storage and a form of insurance against future gas crises, cf. paragraph 64 of Mr [redacted] witness statement and 2) that there was no need for a make-up provision in the Contract given that any excess gas volumes Naftogaz has committed to take under the Contract could be injected into the underground gas storage facilities for use at a later date.

(1008) Ukraine's gas storage capacity is clearly irrelevant for the consideration of the abusive and restrictive nature of the volume and take-or-pay provisions as well as the absence of a make-up provision pursuant to Articles 101 and 102 TFEU. The storage capacity gives Naftogaz flexibility with regard to transporting natural gas to other European countries further down the pipeline and with regard to supplying the Ukrainian market with gas in accordance with market fluctuations. However, the storage capacity does not alter the fact that Gazprom had a dominant position prior, during and subsequent to the entering into of the Contact. Contrary to what's indicated by Mr [redacted] in his witness statement, Naftogaz has not off-taken gas quantities from storage that were not its own.

(1009) Gazprom denies that it holds a dominant position. Essentially, Gazprom argues that Naftogaz exercised countervailing buyer power during the negotiations with Gazprom that led to the conclusion of the Contract in January 2009. This argument, i.e. that Naftogaz exercised countervailing buying power, is based on Naftogaz' role as a transporter of natural gas from Russia to Europe, cf. factor (iii), and by reiterating Gazprom's distorted version of the supply interruption that took place in January 2009, cf. factor (v). The issue of Gazprom's dominance and Naftogaz' alleged countervailing buyer power is further discussed below. Contrary to what Gazprom alleges, Naftogaz did not close the system for deliveries of Russian gas in January 2009.

(1010) In fact, it was Gazprom which did not deliver gas to the Ukrainian pipelines, neither for transit to Europe nor supply of Ukrainian customers, cf. Mr [redacted] witness statements. Also, as explained in Mr [redacted] witness statements, Gazprom violated the nomination procedures established between the Parties' dispatching services and then unilaterally reduced and cut gas supplies. In other words, Gazprom seeks to establish that Naftogaz has countervailing buyer power by referring to a situation that in fact arose due to Gazprom's own actions and violations of the established practices between the Parties.

(1011) In regard to factor (iv), Gazprom fails to demonstrate how Naftogaz' historical financial position is relevant to the application of Articles 101 and 102 TFEU.

VIII.6.11.2 Market definition

VIII.6.11.2.1 Introduction

(1012) Gazprom claims that Naftogaz has failed to define the relevant market. As pointed out in paragraph 37 of the Expert Competition Reply, however, no empirical analysis is necessary to establish that natural gas constitutes a separate product market from other energy products such as fuel oil, coal or electricity.

(1013) This market definition is well established, and the Expert Competition Report contains more empirical analysis than in many of the cases before the European Commission, which regularly bases its market definition on logical reasoning rather than statistical analysis (cf. paragraph 40 of the Expert Competition Reply). Furthermore, Gazprom would have a market share well above 50% under any conceivable market definition, which gives a presumption of dominance.

(1014) The relevant market could in principle include suppliers from the Energy Community and Norway, in addition to Ukraine and Russia, although the competitive pressure from suppliers in many of these countries is non-existent or very limited. The Energy Community Secretariat found in its Preliminary Assessment that the relevant market is the market for natural gas procured to satisfy the demand of Naftogaz in performing its public utility functions. In the Expert Competition Report, the relevant market was considered as extending to actual imports into Ukraine, but not to potential or actual imports from Western Europe nor to gas that domestic Ukrainian producers must supply to Naftogaz.

(1015) Gazprom has retained two economists, Dr Moselle and Dr Coppi, and neither has critiqued the market definition in the first Expert Competition Report, or the finding of dominance. Dr Coppi, who appears to be Gazprom's principal competition expert, voices no objections to our definition of the relevant market, our calculation of market shares, our "*pivotal supplier*" analysis, or our conclusions that Gazprom has a dominant position.

VIII.6.11.2.2 The relevant product market

(1016) The relevant product market for the gas supplied under the Contract is the market for the upstream production and sale of natural gas, which comprises the development, production and upstream supply of gas to large importers/wholesalers. This market has been delineated in the European Commission's decisional practice, cf. paragraphs 83-91 of the M.6910 *Gazprom / Wintershall / Target Companies* case; and,

Case M.6984 *EPH / Stredoslovenska Energitika*, paragraphs 21-23, and

Case M.6910 *Gazprom / Wintershall / Target Companies.*

(1017) This product market is separate from the worldwide market for the exploration of crude oil and natural gas, cf. para 83 of the M.6910 *Gazprom / Wintershall / Target Companies* case; and,

Case M.6801 *Rosneft / TNK-BP*, paragraph 12.

(1018) It is also separate from the market for downstream wholesale supply of gas, in which wholesalers resell gas to other wholesalers and local distributors, cf. *Gazprom / Wintershall / Target Companies*, paragraphs 60 *et seq.*; and, *EPH / Stredoslovenska Energitika*, paragraph 21.

(1019) Refer in this respect also to the Expert Competition Reply, according to which it is well established that natural gas is a separate product market, cf. paragraphs 37-40 of the report.

VIII.6.11.2.3 The relevant geographic market

(1020) In merger proceedings before the European Commission under the EU Merger Regulation, Gazprom has taken the position that the market for the upstream production and sale of natural gas is EEA-wide, cf. para 87 of the *Gazprom / Wintershall / Target Companies* case:

"The Parties submit that the market is EEA-wide, including all imports […]"

and para 20 of the *Gazprom / A2A / JV* case:

"The notifying Parties submit that the wholesale supply of natural gas has an EEA scope."

Case M.5740 *Gazprom / A2A / JV,* para 20.

(1021) However, as pointed out by the European Commission, due to restrictions resulting from *inter alia* absence of pipeline connections to suppliers and lack of import capacity, each gas supplier does not exert the same level of competitive pressure throughout Europe.

Case M.4545 *Statoil / Hydro* paras 14-15.

(1022) Consistent with this, the Commission has in recent decisional practice indicated that the geographic market may be regional within Europe (that is, extending to a region covering several countries) rather than EEA-wide, cf. paragraph 12 of *Rosneft / TNK-BP*.

(1023) In a recent merger decision, the Commission indicated that

"*from a supply-side perspective, the Commission considers that the geographic scope of the market might be limited to the relevant pipelines systems and would therefore rather be regional or national*".

Case M.7316 *Det Norske Oljeselskap / Marathon Oil Norge*, paragraph 7.

(1024) In another recent decision, which involved Germany, the Commission referred to its market investigation in which a majority of the respondents had indicated *"that Germany forms part of a regional geographic market rather than the entire EEA territory"*, cf. para 88 of *Gazprom / Wintershall / Target Companies.*

(1025) In the same case the Commission emphasised that there were "*no indications of restricted interconnection capacity restraining the amount of gas that can flow between the Netherlands, Norway and Germany*", cf. para 90 of the decision. The Commission ultimately did not form a conclusion on the geographic market in that case (cf. para 91 of the decision), while the factors referred to suggested a regional market.

(1026) Against this background, the European Commission's decisional practice confirms that pipeline systems play a crucial role to the definition of the relevant geographic market, and that, depending on the pipeline systems, the geographic market may be regional, or in some cases national.

(1027) The Expert Competition Reply provides evidence that the relevant geographic market includes Poland, Hungary and the Slovak Republic, in addition to Ukraine. While the Expert Competition Report did not perform the so-called SSNIP test separately for Poland, Hungary and the Slovak Republic, paragraphs 31 to 33 and Appendix A of the Expert Competition Reply performs such analysis.

(1028) As explained in the Expert Competition Reply (cf. its paragraph 34),

"Gazprom has exercised control of the Ukrainian transportation network in such a manner as to impede virtual reverse flows. Gazprom has therefore isolated Ukraine."

(1029) Moreover, as also noted by Mr Lapuerta (cf. paragraph 163 of the Expert Competition Reply):

"In practice we do not see discounted tariffs for virtual reverse flows in Ukraine or in the countries that take Russian gas via Ukraine. However, there is a logical explanation for the absence of discounted tariffs: Gazprom refuses to permit virtual reverse flows. Gazprom's conduct has therefore permitted the emergence of the tariffs that would provide a definitive answer to the SSNIP test."

(1030) The basis on which Mr Lapuerta's analysis has been carried out, given the absence of concrete information on tariffs, is described in Appendix A of the Expert Competition Reply (cf. in particular paragraphs 164 *et seq.*).

(1031) Mr Lapuerta's analysis demonstrates that, on the assumption of reasonable harmonised tariff system, transportation costs only have an impact of 5% or less on bringing gas from Slovakia, Poland and Hungary to the western border of Ukraine (cf. paragraph 31 of the Expert Competition Reply). On the basis of this analysis, Slovakia, Poland and Hungary must be included in the relevant geographic market.

VIII.6.11.2.4 Conclusion

(1032) The relevant product market is clearly the upstream production and sale of natural gas. The relevant geographic market extends beyond Ukraine even though Gazprom's abusive and restrictive practises have to a large degree succeeded in keeping the Ukrainian market separate by impeding both exports and imports. Based on a SSNIP test, the relevant geographic includes Ukraine, Slovakia, Poland and Hungary.

VIII.6.11.3 Gazprom's dominant position

VIII.6.11.3.1 Introduction

(1033) Gazprom holds a dominant position on the market for the development, production and upstream supply of gas to large importers/wholesalers, irrespective of the exact geographic market definition. Gazprom has a market share well above 50% under any conceivable market definition, and clearly has a dominant position. None of the experts retained by Gazprom have criticised the market definition of Naftogaz and the Competition Report, or the finding of dominance therein.

VIII.6.11.3.2 Market shares

(1034) Gazprom holds a dominant position in a market that includes Ukraine, Slovakia, Hungary and Poland. Reference is made to Figure 1 on page 5 of the Expert Competition Reply, which shows that Gazprom supplies roughly 50% or more of all gas consumed in Slovakia, Hungary and Poland (cf. paragraph 36 of the Expert Competition Reply). In Ukraine, Gazprom has had a share ranging from 84% to 95% (cf. Table 1 in the Export Competition Report of the SoC).

(1035) In Appendix A to the Expert Competition Reply, Mr Lapuerta has calculated Gazprom's market shares for a market consisting of Ukraine, Slovakia, Poland and Hungary, cf. Table 4 of the Expert Competition Reply:

	2009	2010	2011	2012	2013
Russian imports (bcm)					
Ukraine	24.15	33.03	40.54	29.76	25.13
Hungary	7.20	6.47	5.66	4.79	5.90
Poland	7.15	9.08	9.28	9.00	9.64
Slovakia	5.40	5.47	5.33	3.79	5.33
All of above	43.90	54.05	60.82	47.34	46.00
Romania	2.05	2.15	2.56		
Total	45.95	56.20	63.38		
Consumption (bcm)					
Ukraine	46.77	52.17	53.75	49.54	44.99
Hungary	12.73	12.57	10.31	10.24	8.56
Poland	14.42	15.51	15.72	16.55	16.68
Slovakia	4.92	5.56	5.15	4.85	5.39
All of above	78.83	85.82	84.92	81.19	75.63
Romania	13.26	13.58	13.93		
Total	92.09	99.40	98.85		
Russian imports as a percentage of consumption					
Ukraine	52%	63%	75%	60%	56%
Hungary	57%	51%	55%	47%	69%
Poland	50%	59%	59%	54%	58%
Slovakia	110%	98%	104%	78%	99%
All of above	56%	63%	72%	58%	61%
Romania	15%	16%	18%		
Total	50%	57%	64%		
Notes and sources					
All data from BP Statistical Reviews of World Energy, 2010 to 2014 editions					

(1036) As follows from the table, Gazprom has a market share exceeding 50% irrespective of the exact market definition (cf. paragraph 167 of the Expert Competition Reply).

(1037) According to the ECJ's well-established practice, a market share exceeding 50% gives rise to a presumption of dominance.

VIII.6.11.3.3 Countervailing buyer power and unavoidable trading partner

(1038) Gazprom argues that Naftogaz exercised buyer power during the negotiations with Gazprom that led to the conclusion of the Contract in January 2009. Specifically, Gazprom refers to Naftogaz' role as a transporter of Russian gas to Europe, which Gazprom claims was used by Naftogaz as a *"powerful weapon"* during the negotiations.

(1039) Naftogaz agrees in principle that buyer power can represent a relevant factor in the assessment of whether a firm holds a dominant market position. However, Gazprom's argument that it must be considered as not dominant as a result of buyer power on the part of Naftogaz cannot succeed, for three reasons.

(1040) First, Naftogaz disputes Gazprom's assertions regarding the negotiations above. In particular, the gas supply interruption was a result of Gazprom's constant re-routing of gas deliveries for transit 1-6 January and its subsequent complete halt in deliveries at 8.44 am. on 7 January 2009 [redacted] and thereto (transcript of the Ukrainian dispatcher's audio record from 7 January 2009).

(1041) Second, Gazprom was an unavoidable trading partner for Naftogaz when the Contract was entered into in January 2009. Naftogaz could not turn to other suppliers as an alternative to purchasing gas from Gazprom. Where a supplier represents an unavoidable trading partner, its buyers will not have relevant buyer power that could prevent the supplier from being considered as dominant. This obvious point has been emphasised in the Commission's decisional practice. In its *Tomra* decision, the Commission made the following observation: *"The existence of buyer power on the demand side requires that there are either credible alternative suppliers to which the customers could turn, or that customers are able to sponsor new entrants."*

Commission decision of 29 March 2006 in case COMP/E-1/38.113 *Tomra*, para 89.

(1042) The decision was upheld on appeal to the General Court in

Case T-155/06 *Tomra Systems ASA and others v Commission*, ECR 2010 II-04361, ECLI:EU:T:2010:370.

and on further appeal to the Court of Justice of the European Union in

Case C-549/10 P *Tomra Systems ASA and others v Commission* [2012], ECLI:EU:C:2012:221.

(1043) Similarly, in its *Telekomunikacja Polska* decision, the Commission pointed out that for the supplier's strong market position to be constrained by countervailing buyer power, customers *"must be able to credibly threaten to switch their demand away from [the supplier]"*, cf. paragraphs 657 and 662 of:

Commission decision of 22 June 2011 in case COMP 39.525 *Telekomunikacja Polska*.

(1044) The allegation of countervailing market power relies entirely on a highly disputed vision of Naftogaz' conduct in 2009. In paragraphs 15-23 of his witness statement, Mr [redacted] gives an account of those events, but Naftogaz does not agree with his version of the events; the gas supply interruption at 8.44 am on 7 January 2009 was caused by Gazprom ([redacted] If the Tribunal has any doubts about competing portrayals of the events in 2009, it may be useful to focus on the Contract itself, which in several respects is one-sided in favour of Gazprom. The outcome is not consistent with a notion of "countervailing" market power.

(1045) Finally, it must be emphasised that a market share in excess of 50% gives rise to a presumption of dominance, so that it would be up to the *prima facie* dominant player to demonstrate that other factors, such as countervailing buyer power, would warrant a different conclusion.

(1046) Against this background, Gazprom cannot escape dominance as a result of alleged buyer power on the part of Naftogaz.

VIII.6.11.3.4 A dominant position within the internal market or in a substantial part of it

(1047) The application of Article 102 TFEU requires *"a dominant position within the internal market or in a substantial part of it"*. According to established case-law of the EU Courts, a dominant position covering one or more countries clearly fulfils this criterion. For example, in *Michelin I* the ECJ stated that the territory of the Netherlands was sufficient to constitute a *"substantial part"* of the internal market (paragraph 28 of the judgment).

Case C-322/81 *NV Nederlandsche Banden Industrie Michelin v Commission*, ECR 1983 03461, ECLI:EU:C:1983:313.

(1048) In light of the regional market definition and Gazprom's dominant position in that market, this criterion is clearly fulfilled. This is the case both for the direct application of EU competition law to the Contract and for the application of the EnCT.

(1049) Also in the event of a national market definition, the criterion is fulfilled both for EU competition law and for Article 18 EnCT. One would only reach the conclusion of a national market limited to Ukraine as a result of Gazprom's dominant position across countries and systematic abuse of those positions in order to keep the markets in the different countries separate. As pointed out in paragraph 8 of the Expert Competition Reply, Gazprom has isolated Ukraine through the Gas Transit Contract, erecting barriers to trade with other countries.

(1050) Thus, the application of Article 102 TFEU can obviously not be limited because of successful abusive and restrictive behaviour on the part of Gazprom. The criterion of "*a dominant position within the internal market or in a substantial part of it*" is in any event fulfilled for the EnCT, since the Energy Community includes Ukraine.

VIII.6.11.3.5 The relevant point in time for assessing abuse

(1051) Gazprom claims that *"[t]he only point in time at which an abuse, such as an excessive price abuse, can take place is at the time that the price is negotiated"*. As a basis for this postulate, Gazprom claims that "*this is the only point in time when the dominant seller can exercise its market power, and thus can impose an abusive term on its customer*". No case-law or other legal sources are offered in support of this position.[15]

(1052) In 2009, the price was reasonable in the sense that it was in line with market conditions, but several terms of the Contract were abusive from the start, and foreclosed competition. Those other terms have interacted with the Contract price. There was always a risk that the Contract Price could become excessive in comparison to European benchmarks, even if in 2009 it was not foreseeable how, when and to what extent that risk might materialise. It was "abusive", and not simply "inefficient" for Gazprom to impose a combination of different terms such as the destination clause, the Take or Pay clause, the extended duration and other terms, which magnified the risks on Naftogaz if the price ever exceeded relevant market benchmarks.

(1053) The consequence of Gazprom's argument would be that if the conclusion of the Contract in January 2009 did not constitute an abuse, no abuse can occur during the life of the Contract and Gazprom would be free to exercise its rights under the Contract to their full extent and refuse any renegotiations that are not required by the Contract.

(1054) Both Naftogaz and its owner, the Ukrainian state, repeatedly requested Gazprom to have the Contract Price P_n revised, cf. ([redacted]). However, Gazprom either ignored the requests or refused to enter into negotiations, cf. Naftogaz' letter of 1 October 2013.

(1055) The position that no abuse can occur during the life of the Contract would be impossible to reconcile with the well-established principle in EU competition law that a dominant market

[15] Subsequently, Naftogaz has pointed to the Astra Zeneca case, the relevance of which Gazprom has rejected. Naftogaz further has referred to the Continental Can case, the relevance of which Gazprom has also questioned.

player has a *"special responsibility not to allow its conduct to impair genuine undistorted competition"*.

Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB*, ECR 2011 I-00527, ECLI:EU:C:2011:83, paras 24 and 53.

(1056) This principle implies that "*undertakings in a dominant position may be deprived of the right to adopt a course of conduct or take measures which are not in themselves abuses and which would even be unobjectionable if adopted or taken by non-dominant undertakings*", cf. paragraph 139 of:

Case T-111/96 *ITT Promedia v Commission*, ECR 1998 II-02937, ECLI:EU:T:1998:183.

(1057) It is therefore not surprising that the position invoked by Gazprom has been rejected by the EU Courts.

(1058) The Court of First Instance (hereinafter referred to by its current name, the General Court) has made clear that the implementation of an agreement and the insistence that the terms of an agreement be complied with may constitute an abuse of a dominant position, even if the conclusion of that agreement did not in itself constitute an abuse. This follows from the judgment in *Compagnie Maritime Belge.*

Judgment of 8 October 1996 in joined cases T-24, 25, 26 and 28/93 *Compagnie Maritime Belge Transports SA and others v Commission*, ECR 1996 II-01201, ECLI:EU:T:1996:139, paras 99 and 109.

(1059) The judgment was upheld on appeal to the ECJ.

Judgment of 16 March 2000 in joined cases C-395/96 P and C-396/96 P *Compagnie Maritime Belge Transports SA and others v Commission*, ECR 2000 I-01365, ECLI:EU:C:2000:132, paras 72 et seq.

(1060) Moreover, the General Court has stated that: "*A claim for performance of a contractual obligation may also constitute an abuse for the purposes of Article 86 [now Article 102 TFEU] of the Treaty if, in particular, that claim exceeds what the parties could reasonably expect under the Contract or if the circumstances applicable at the time of the conclusion of the Contract have changed in the meantime.*", cf. paragraph 140 of *ITT Promedia v Commission*.

(1061) Gazprom's claim that changed circumstances since the conclusion of a contract are irrelevant thus directly contradicts the EU courts' clear statements, and must be rejected. It follows from this case-law that the implementation of a contract and the exercise of contractual rights by a dominant player may constitute an abuse, irrespective of whether the conclusion of the Contract constituted an abuse.

(1062) As indicated above, the price revision claim based on competition law has been calculated from the earliest date of invalidity claimed by Naftogaz, i.e. 20 May 2011, corresponding to the effective date of the principal price revision claim, the latest day on which the pricing under the Contract became abusive, and in respect of which Naftogaz has provided comprehensive evidence in conjunction with the principal price revision claim. The other claims based on competition law were in violation of Articles 101 and 102 TFEU as of the date the Contract was concluded, i.e. 19 January 2009.

VIII.6.11.3.6 Gazprom is not simply passive

(1063) As mentioned above, Gazprom argues that as a matter of principle, *"[t]he only point in time at which an abuse, such as an excessive price abuse, can take place is at the time that the price is negotiated"*. As demonstrated above, this position in not in accordance with the EU courts' case-law. Gazprom does not take any position as to whether it has been a passive counterparty. However, Dr Coppi argues that he does *"not consider that Gazprom could have exploited its alleged dominance when the supplementary agreements were entered into"* (cf. Coppi Report, paragraph 2.18).

(1064) As pointed out by Mr Lapuerta, Dr Coppi does not directly assert that Gazprom has been a passive counterparty, but his testimony presumes a possible finding that Gazprom has been passive (cf. Section 63 of the Expert Competition Reply).

(1065) The image of a passive counterparty does not withstand closer scrutiny. First, any appearance of passivity is in fact the result of foreclosing competition in Ukraine, as further explained by Mr Lapuerta in Part V.A of the Expert Competition Reply. Second, the mandatory sales provision is not compatible with the image of a passive producer, as Gazprom has taken advantage of the high Contract price to sell the same gas twice and to enter the Ukrainian market in competition with Naftogaz, as further discussed in Part V.B of the Expert Competition Reply. Finally, as described in Part V.C of the Expert Competition Reply, Gazprom has an active role in the price revision process and is making proposals which, if accepted, would result in excessive pricing and abuse of dominance.

(1066) Gazprom therefore cannot invoke as a defence under Article 102 that it has simply been passive since the conclusion of the Contract.

VIII.6.11.3.7 Effect on trade

(1067) Gazprom's abusive and restrictive practices, as evidenced in several provisions of the Contract, affect trade both between EU Member States and between Ukraine and other Member States of the Energy Community, including several EU Member States.

(1068) Under Article 101 TFEU it is the agreement as such which must be capable of affecting trade between EU Member States. If the agreement as a whole is capable of affecting trade between EU countries, Article 101 applies to the entire agreement, including any parts of the agreement that individually do not affect trade between EU Member States.

(1069) The Contract involves very significant volumes of natural gas. Absent the Contract, Gazprom would have higher volumes available for sale in the EU and Naftogaz would have to source (all or parts of) its requirements of natural gas from other suppliers, including from suppliers in the EU. Alternative suppliers available to Naftogaz are also actual or potential suppliers to EU countries. Accordingly, even without considering the specific restrictions in the Contract, which in themselves affect trade, the significant volumes under the Contract clearly affect trade between Ukraine and EU countries, and thereby also the patterns of trade between EU countries.

(1070) Moreover, Section VIII of the Expert Competition Reply provides further detail on how the Contract affects trade both within the Energy Community and the EU. Mr Lapuerta emphasises the importance of Ukraine to trade flows in neighbouring countries, cf. paragraph 138 of the Expert Competition Reply:

"The effects of the Contract go beyond the relatively straightforward flows between Ukraine and each of the other three countries identified above: Slovakia, Poland and Hungary. Each of these countries can conduct trade with the other two using Ukraine as a bridge, even in the absence of direct pipeline connections. Suppliers in Slovakia and Poland can serve consumers in Hungary. Suppliers in Poland and Hungary can serve Slovakia. Finally, suppliers in Slovakia and Hungary can serve Poland. Any effects on competition, consumption or prices in Ukraine will therefore have repercussions on trade between all of the countries."

(1071) Finally, the concluding paragraph of Section VIII of the Expert Competition Reply summarises the situation as follows:

"If competition is allowed to operate without restraint, incremental sales from Polish suppliers to customers in Slovakia and Hungary would continue until the market prices in those countries equilibrated with Polish market prices. The economic equilibrium would entail similar market prices in each country, with relatively small exceptions reflecting the transportation costs associated with cross-border flows. More generally, any of the effects identified in paragraphs "a" through "f" above should have ripple effects on trade between all the countries discussed."

VIII.6.12 Breaches of competition law

VIII.6.12.1 Introduction

(1072) As pointed out above, Dr Coppi voices no objections to our conclusions that several terms of the Contract were abusive, i.e. the destination clause, the volume and Take or Pay provisions, the unilateral suspension right and the mandatory sales clause.

(1073) Furthermore, the Coppi report relies heavily on the reasonableness of the price in 2009 to dismiss the possibility of any anti-competitive consequences that could arise today. One cannot look solely at the price in isolation at the date of contract signature, while ignoring all subsequent anti-competitive consequences that have in fact materialised.

(1074) Gazprom relies on the Witschen Report for other issues than pricing. Mr Witschen is not a competition expert, but mostly relies on his general perception of practice in the industry. Moreover, Mr Witschen addresses the non-price terms, but fails to defend several of them, limits himself to commenting on the frequency or uniqueness of others, and never engages with the underlying competitive analysis.

VIII.6.12.2 The oil price indexation clause

VIII.6.12.2.1 Introduction

(1075) Gazprom argues that Naftogaz has not established that excessive pricing has taken place under the Contract, and asserts that neither the Expert Competition Report, the preliminary assessment of the Energy Community Secretariat nor the witness statement by [redacted] contain any of the economic analysis which would be required to establish excessive pricing. Furthermore, Gazprom argues that Naftogaz has also failed to establish that discriminatory pricing has taken place under the Contract.

(1076) The excessive and discriminatory nature of the oil price indexation clause is documented in detail the Expert Competition Report and the Expert Price Report.

(1077) The relevant benchmark to which Gazprom's prices under the Contract should be compared is competitive market prices, netted back to the border with Russia. There is no requirement that a dominant company's costs and margins be assessed in order to establish that it charges an excessive price, as long as relevant price comparisons can be made.

(1078) The inclusion of different oil products in the Price Formula discriminates between different customers within Ukraine based on their alternatives to consuming natural gas. Thus, the prices under the Contract not only discriminate against Naftogaz compared to other buyers, but also involve discrimination between gas users within Ukraine.

(1079) Dr Coppi claims that the reasonableness of the Contract Price depends solely on the initial P_0, as opposed to its evolution over time, and that we have not provided evidence of an excessive P_0 (cf. Coppi Report, paragraphs 2.9 and 2.28). Naftogaz disagrees on the need to demonstrate the excessive nature of P_0. Instead, Naftogaz accepts that P_0 was in line with market benchmarks at the time. Naftogaz focuses instead on how higher oil prices have made the Contract Price excessive over time in light of decoupling of gas and oil prices in Western Europe. In addition, we discuss how the current high price interacts with other contract terms.

(1080) Dr Moselle apparently concludes that an event was "*foreseeable*" even if only a minority of market participants believed that it would arise, and even though its magnitude or timing was uncertain (cf. Moselle Report, paragraphs 1.30 and 6.43). Such a strict interpretation of "*foreseeable*" puts large stress on a company like Naftogaz to negotiate a discounted price before events arise, as insurance against future risk. However, given that Naftogaz had to negotiate with a dominant producer, Naftogaz had little leverage to negotiate discounts to offset future risks.

(1081) Gazprom’s position is that in order to prove that the oil-indexed price under the Contract is unfair within the meaning of Art 102 TFEU, Naftogaz must provide evidence of Gazprom's costs in producing and supplying natural gas to Naftogaz. Gazprom misrepresents Naftogaz' position by confusing the overall test in para 250 of United Brands ("*no reasonable relation to the economic value of the product supplied*") and the specific cost-based approach applied in paras 251-252 of the judgment. Gazprom refers to both of these together as "*the United Brands test*". Naftogaz' position is very clearly set out in §§ 1358-1361 Reply.

VIII.6.12.2.2 Excessive pricing

VIII.6.12.2.2.1 The legal test

(1082) Gazprom refers to the ECJ's statement that a price achieved by a dominant company is abusive if *"it has no reasonable relation to the economic value of the product supplied"*. Naftogaz agrees that this is the appropriate legal test.

(1083) Gazprom further refers to one approach to establishing that a price meets this test. This approach was applied by the ECJ in *United Brands* in the context of alleged excessive pricing of bananas, and involved establishing (i) that the profit margin was excessive and, if so, (ii) that the price was unfair "*in itself or when compared to competing products*" (Case 27/76 *United Brands Company and United Brands Continental BV v Commission*. However, it follows from the judgment itself that this approach, while appropriate in the context of the pricing of Chiquita bananas, is not an exhaustive, "*one-size-fits-all*" legal test for every type of product and in all scenarios. In particular, the ECJ stated that:

"This excess [that is, the difference between the price charged and the economic value of the product] <u>could, inter alia,</u> be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, […]" (emphasis added), cf. para 251.

(1084) The ECJ also noted that: "*Other ways may be devised – and economic theorists have not failed to think up several – of selecting the rules for determining whether the price of a product is unfair.*", cf. para 253.

(1085) A purchaser harmed by a dominant company's pricing is therefore not required to provide comprehensive evidence of the dominant company's cost structure and profit margins. Such evidence will normally not be available to the purchaser.

(1086) In a more recent judgment, the ECJ made clear that the assessment of whether a price is unfair may be based on a comparison with the price charged by other players in other geographic areas.

Case 30/87 *Corinne Bodson v SA Pompes funèbres des régions libérées*, ECR 1988 2479, ECLI:EU:C:1988:225.

(1087) The *Bodson* case concerned burial services, which in a number of communes in France were subject to exclusive concessions to a single company. In order to assess whether the prices charged by that company for burial services were excessive, the ECJ devised a comparison with prices in other geographical areas. The ECJ pointed out that since a significant number of French communes had not granted exclusive concessions to provide such services, *"but have left that service unregulated or operate it themselves, it must be possible to make a comparison between the prices charged by the group of undertakings which hold concessions and prices charged elsewhere"*, cf. paragraph 31 of the judgment. The ECJ went on to note that: *"Such a comparison could provide a basis for assessing whether or not the prices charged by the concession holders are fair."* The ECJ did not require that any additional comparisons be carried out before the dominant company's prices could be deemed to be excessive, such as a comparison with the dominant company's costs or margins.

(1088) This approach was confirmed by the ECJ in a case involving royalties set by SACEM, the society that manages copyright in musical works in France.

Joined cases 110/88, 241/88 and 242/88 *François Lucazeau and others v Société des Auteurs, Compositeurs et Editeurs de Musique (SACEM) and others*, ECR 1989 02811, ECLI:EU:C:1989:326.

(1089) The ECJ clarified that royalty levels in other EU countries may form a basis of comparison in order to assess whether the royalty levels set by SACEM were unfair and abusive. The ECJ stated that if SACEM's fees were "*appreciably higher*" than in other EU countries, that difference was "*indicative of an abuse of a dominant position*", so that it was up to SACEM to "*justify the difference by reference to objective dissimilarities*" between France and other EU countries, cf. paragraph 25 of the judgment. In line with the *Bodson* case, the ECJ did not require that a comparison be made between prices and costs, or other comparisons.

(1090) It follows from the *Bodson* and *SACEM* judgments that comparing the price set by the dominant undertaking with competitive prices charged by other suppliers in other geographic areas may demonstrate that the dominant player's price is excessive. It also follows from these judgments that a finding that a price is excessive does not require that data on the dominant company's costs and margins be obtained and assessed.

(1091) On this basis, Naftogaz disagrees with Gazprom's position that "*Naftogaz would at a minimum have had to carry out a detailed analysis of the prices charged by Gazprom and the relative* *costs incurred by Gazprom in supplying Naftogaz*" to show that the difference is excessive. As shown above, Gazprom's position is not in line with EU case-law.

(1092) Gazprom acknowledges that it follows from United Brands that in order to determine whether a price is unfair "*other ways may be devised*" than the cost-based approach used in that case, but argues that there is "*no reason*" why it should not be applied in the present case. Naftogaz disagrees. Unlike in the banana market at issue in United Brands, a market price can be established in this case, namely, German hub prices (less transportation costs). Since a market price can be established, this is the most appropriate comparator against which to measure the Contract Price. Moreover, Gazprom supplies gas to purchasers in Western Europe at the market price and discriminates between those purchasers and Naftogaz, further evidencing that the Contract Price is unfair. Also, should Gazprom claim that the Contract Price does not involve a significant profit margin, it would be for Gazprom to provide evidence on its own costs. It has not done so. However, Elena Burmistrova, the CEO of Gazprom Export, has recently indicated that Gazprom's marginal production costs are considerably below prevailing hub prices, cf. Section V.A Lapuerta 3, implying that also on this basis the price is unfair.

(1093) As to the SACEM and Bodson judgments, Gazprom argues that the ECJ "*did not reject the test set out in United Brands*", cf. §§1045-1046. This is correct, in the sense that United Brands explicitly states that "*other ways may be devised*" than the approach used in that case. However, these two judgments are impossible to reconcile with Gazprom's (incorrect) reading of United Brands under which a cost comparison should allegedly constitute a necessary step in determining whether a price is unfair. Both cases illustrate that this is not a precondition for a finding that a price is unfair. Such a reading of United Brands has also been rejected by leading authors.

(1094) Gazprom refers to the fact that the European Commission has collected information on Gazprom's costs as part of its excessive pricing investigation against Gazprom, cf. § 2.41 Coppi 2 and § 1042 Rejoinder. However, it follows explicitly from the Commission's press release that it has taken a broad approach during its investigation, comparing Gazprom's prices "*to a number of different benchmarks, such as Gazprom's costs, prices in different geographic markets or market prices*" (Exhibit CL-155). The Commission's analysis of several possible benchmarks is no evidence that a cost-based approach is necessary to establish unfair pricing, but instead confirms the Commission's established position that there is "*no single formula for determining whether a price is excessive*" (cf. § 1093 Transit Arbitration Reply). Moreover, the

Tribunal should ignore Gazprom's references to the contents of the Commission's on-going investigation.

(1095) Gazprom's summary of some cases on excessive prices does not sustain its conclusion that "*it is evident that prices typically have to be substantially higher than the relevant benchmark to be considered excessive*", cf. § 1052. While it may be difficult in many markets to establish an appropriate market price for a product, the case-law does not provide a single example in which a relevant market price has been established, and the ECJ has concluded that the difference between this market price and the price charged by the dominant player has been too small to be considered as excessive. In other words, there is no basis at all in the case-law to support a position that a dominant supplier is free to overcharge by up to 100% above the market price. In the table, Gazprom refers to a statement in United Brands that a difference of 7% "*cannot automatically be regarded as excessive*". This statement indicates that a difference at this level may be sufficient, depending on a case-by-case assessment. Moreover, this percentage was not the difference from a market price, but the difference between the price of Chiquita bananas (a premium brand) and the average price of various other branded bananas – a price difference that United Brands claimed was justified due to genuine differences in quality (para 266, cf. para 246 of the judgment). Consequently, the judgment does not establish a "*permitted*" price premium that a dominant supplier is free to charge compared to the market price. As per Gazprom's own table (§ 1052), a price difference exceeding 25% between cross-border tariffs charged by Deutsche Post and its estimated average cost was considered excessive in the Commission's decision in Deutsche Post II.

(1096) Gazprom claims that a close look at Mr Lapuerta's price comparisons "*reveals that they fail to prove that Gazprom charged excessive prices*". However, the comparison with the Factual Price (cf. §§ 2.59-2.62 of Coppi 2) is of no relevance. By contrast, Dr. Coppi's comparison in §§ 2.63-2.64 with the Contract Price confirms a very significant overcharge of 17-20%, cf. V.B Lapuerta 3. In the case of gas imports, paying even a small premium above the market price can lead to significant losses, cf. VI Lapuerta 3. As a result, prices exceeding the market price by more than 10% can suffice to bankrupt buyers of natural gas and cannot reasonably escape the prohibition of unfair prices in Art 102. The unfairness of the Contract Price is reinforced by the other onerous terms of the Contract, cf. IV Lapuerta 3. Gazprom's analysis is apparently based on the false premise that a dominant supplier is free to charge up to 100% above the market price (cf. § 2.36 Coppi 2).

(1097) The Contract Price is significantly higher than the net-back hub prices, as explained in Part IV.D of the Expert Price Report. As seen in Figure 34 of that report, the difference is very significant. Consequently, Gazprom obtains very significant margins on its sales under the Contract compared to its sales at hub prices.

(1098) There is no basis for a high threshold. With respect to the significant price premium under the Contract, Gazprom claims that "*it would not have been enough for Naftogaz to establish that Gazprom had priced above costs: the threshold at which a high price is typically considered excessive is very high, in some cases, 100% higher than in comparable markets*", cf. paragraph 844 of the Defence.

(1099) However, there is no basis in case-law that a dominant player is free to overcharge as long as the overcharge is less than 100%. No such threshold has been established in case-law. Whether a price is excessive must be assessed on a case-by-case basis.

(1100) In the case of Gazprom's pricing under the Contract, there would be no basis for a particularly high threshold for a finding that the prices are excessive. The arguments which are often used in support of a high threshold for intervening against a dominant player's pricing have little weight, if any, in the case at hand.

(1101) While Gazprom argues that "*[t]he standard of proof for establishing excessive pricing is very high*", there is no basis for applying a particularly high threshold in this case. On the contrary, none of the arguments that have typically been put forward against a wide application of the prohibition of excessive prices are present in this case.

(1102) To assess whether the prices charged by Gazprom are excessive, the market price of natural gas is a more appropriate benchmark than the costs of producing natural gas from a particular well or field.

(1103) The market price does in fact provide insight into Gazprom's costs, since Gazprom's sales at market prices indicates that it can produce natural gas at less than German market prices.

(1104) Gazprom discusses three possible approaches to transportation costs: deducting them, ignoring them, or adding them to German hub prices (cf. Moselle Report, paragraph 8.15 et seq.). Since deducting transaction costs produces the lowest possible price for Naftogaz, Gazprom conveys the impression that the deduction is self-serving. However, it is the only one of the three alternatives that reflects a competitive outcome, as discussed in paragraphs 74 et seq. of the Expert Competition Reply.

VIII.6.12.2.2.2 Evidence on Gazprom's costs and margins

(1105) Naftogaz does not have access to detailed cost data for Gazprom's production and transport of natural gas. However, as noted in paragraph 118 of the Expert Competition Reply, Gazprom does supply gas to customers in Germany. It can be assumed that Gazprom does not sell natural gas at a loss, and on this basis Gazprom's costs must be lower than the hub prices (less transportation costs to such hub, i.e. netted back).

(1106) The Contract Price is significantly higher than the net-back hub prices, as explained in Part IV.D of the Expert Price Report (Exhibit C-176). As seen in Figure 34 of that report, the difference is very significant. Consequently, Gazprom obtains very significant margins on its sales under the Contract compared to its sales at hub prices.

(1107) Should Gazprom claim that the Contract Price does not involve a significant profit margin it would be up to Gazprom to provide relevant evidence. Such evidence would be in Gazprom's possession and is not available to Naftogaz. However, as discussed above, there is no requirement that a dominant company's costs and margins be assessed in order to establish that it charges an excessive price, as long as relevant price comparisons can be made.

VIII.6.12.2.2.3 No basis for a high treshold

(1108) With respect to the significant price premium under the Contract, Gazprom claims that "*it would not have been enough for Naftogaz to establish that Gazprom had priced above costs: the threshold at which a high price is typically considered excessive is very high, in some cases, 100% higher than in comparable markets*".

(1109) However, there is no basis in case-law that a dominant player is free to overcharge as long as the overcharge is less than 100%. No such threshold has been established in case-law. Whether a price is excessive must be assessed on a case-by-case basis.

(1110) In the case of Gazprom's pricing under the Contract, there would be no basis for a particularly high threshold for a finding that the prices are excessive. The arguments which are often used in support of a high threshold for intervening against a dominant player's pricing have little weight, if any, in the case at hand.

(1111) Firstly, in many markets excessive prices will not be sustainable, since high prices will attract new entry in the market. New entrants will drive prices down. However, Gazprom is able to extract monopoly profits from Naftogaz without any risk. Naftogaz is prevented from purchasing gas from alternative sources as a result of the long-term Take or Pay obligation under the Contract and the restrictions resulting from the pipeline systems which are controlled by Gazprom. As a result, Gazprom's excessive prices under the Contract are not driven down through normal competition. The fact that Naftogaz' imports from other countries have increased recently, does not alter this. In any event, the relevant point in time for the assessment is not now, but the effective date(s) of the price revision.

(1112) Secondly, in many markets it is difficult to establish a meaningful benchmark price to which the dominant player's price can be compared. However, natural gas is a commodity and with the evolution of the gas market over the last years a market price can be established for natural gas delivered at a hub.

(1113) Finally, where a monopoly position is a result of significant innovation or investments, monopoly profits may be a reasonable reward and may encourage further innovation or investments. However, the Contract was entered into in 2009, and the monopoly profits do not reflect investments made by Gazprom in order to supply Naftogaz under the Contract. As noted by Mr Lapuerta, Gazprom has to date not identified any specific investments that support its provision of supplies to Ukraine (Expert Competition Reply, paragraph 116).

(1114) Gazprom's excessive prices under the Contract harm Naftogaz and its customers, which are business and households in Ukraine, and also actual and potential trade partners in other countries, including several EU Member States.

(1115) While Gazprom argues that *"[t]he standard of proof for establishing excessive pricing is very high"*, there is no basis for applying a particularly high threshold in this case. On the contrary, none of the arguments that have typically been put forward against a wide application of the prohibition of excessive prices are present in this case.

VIII.6.12.2.2.4 Prices significantly exceed market prices

(1116) To assess whether the prices charged by Gazprom are excessive, the market price of natural gas is a more appropriate benchmark than the costs of producing natural gas from a particular well or field, as further explained by Mr Lapuerta in his report (cf. paragraphs 117-119 of the Expert Competition Reply). As noted above, the market price does in fact provide insight into

Gazprom's costs, since Gazprom's sales at market prices indicates that it can produce natural gas at less than German market prices.

(1117) As explained in paragraphs 120 and 122 Expert Competition Reply, German hub prices (less transportation costs) are a relevant benchmark to which Gazprom's price under the Contract should be compared, irrespective of whether gas exports from Germany should be too expensive to compete in the Ukrainian market.

(1118) At least since 2011, the Contract Price has been significantly higher than market prices for natural gas. This is documented in Part IV.D of the Expert Price Report.

(1119) In the calculations in the said report, transportation costs have been deducted from German hub prices. This is the correct approach, as explained in the following paragraphs.

VIII.6.12.2.2.5 Inappropriate references for Gaxprom's prices

(1120) In his report, Dr Moselle discusses three possible approaches to transportation costs: deducting them, ignoring them, or adding them to German hub prices (cf. Moselle Report, paragraph 8.15 *et seq.*). Since deducting transaction costs produces the lowest possible price for Naftogaz, Dr Moselle conveys the impression that the deduction is self-serving. However, it is the only one of the three alternatives that reflects a competitive outcome, as discussed in paragraphs 74 *et seq.* of the Expert Competition Reply.

(1121) There is no justification for ignoring transportation costs, while to add them would be abusive. As pointed out by Mr Lapuerta, to add costs to German hub prices is to accept that Gazprom should now collect money based on the costs that Naftogaz would have to incur if Gazprom interrupted all supplies (cf. Expert Competition Reply, paragraph 76). In such a case we agree that Naftogaz would have to pay the costs of transporting natural gas from German hubs. However, it is abusive to collect money based on a hypothetical scenario of a supply interruption. As explained in paragraph 78 of the Expert Competition Report, such an approach would run afoul of the "cellophane fallacy" described in the Competition Expert Report of the SoC.

(1122) In contrast, the Expert Price Report supports deducting transportation costs from German hub prices. As noted by Mr Lapuerta (cf. Expert Competition Reply, paragraph 79), this approach implicitly answers the following question: what would be the market price of natural gas in Ukraine if, instead of having one dominant Russian supplier, a group of numerous smaller

Russian suppliers all competed with each other to serve Ukraine? In that scenario competition would prevent any one supplier from insisting on a German hub price plus transportation costs. Competition would put pressure on each Russian supplier to reduce the price to levels consistent with German hub prices *minus* transportation costs. Suppliers would see the possibility of saving substantial transportation costs by delivering the gas to Ukraine instead of Germany, and competition would put pressure on them to transfer the savings to customers in Ukraine. After deducting transportation costs, the market would reach a competitive equilibrium in which each supplier made the same profit whether it sold the gas in Ukraine or Germany, and the differences in market prices between Ukraine and Germany would reflect nothing more than the differences in the costs of transporting natural gas.

(1123) Dr Moselle suggests a comparison to Gazprom's sales to other CEE countries (cf. Moselle Report, paragraph 2.18). Gazprom is currently under investigation for the abuse of dominance in those countries, in part due to its policy of oil price indexation. Prices in those countries do not provide a reliable proxy. As noted in paragraph 82 of the Expert Competition Reply, Dr Moselle's recommendation would risk another variant of the "*cellophane fallacy*".

(1124) Dr Coppi suggests yet another comparison: establishing whether the Contract Price is in fact less than the costs of alternative fuels to end-users in Ukraine (cf. Coppi Report, paragraph 2.41). However, this suggestion would in effect imply a massive step backwards from established case law. Mr Coppi refers to *"other fuels, which compete with natural gas in meeting the energy needs of Ukrainian consumers"* (cf. Coppi Report, paragraph 2.41), but the idea of other fuels "competing" has been decisively rejected by cases deciding that natural gas is itself a separate product from oil and other fuels, precisely because those other fuels do not exert sufficient competitive pressure. Dr. Coppi's recommendation would be yet another version of the "*cellophane fallacy*", as pricing with respect to alternative fuels is a recognised monopolistic practice (cf. paragraph 83 of the Expert Competition Reply).

VIII.6.12.2.2.6 No objective justification for the excessive prices under the Contract

(1125) As a result of the significant difference between the Contract Price and market prices, the Contract Price must be considered as excessive under Article 102 unless Gazprom can objectively justify the significant difference from market prices.

(1126) In defence of the oil indexation clause, Gazprom has claimed that there can be no assumption that an oil-indexed price will be excessive, since oil prices may vary, cf. paragraph 843 of the

Defence. Gazprom points out that had oil prices been low, the oil-indexation could have led to prices under the Contract below the market price for natural gas.

(1127) In order to claim that the oil indexation clause is objectively justified, it would be up to Gazprom to demonstrate that its conduct either:

(i) is objectively necessary; or

(ii) produces substantial efficiencies that outweigh its anti-competitive effects.

(1128) These alternative conditions are reflected in paragraph 28 of the European Commission's guidance on its enforcement priorities under Article 102 (previously Article 82 of the EC Treaty).

Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009/C45/02), dated 24 February 2009.

(1129) Gazprom has not put forward any explanation that the oil indexation clause meets any of these criteria. As a result, it must be concluded that there exists no objective justification for the excessive prices under the Contract.

VIII.6.12.2.3 Discriminatory pricing

VIII.6.12.2.3.1 The notion of discrimination

(1130) The inclusion of different oil products in the Price Formula discriminates between different customers within Ukraine based on their alternatives to consuming natural gas. As a result, the prices under the Contract not only discriminate against Naftogaz compared to other buyers, but also involves discrimination between gas users within Ukraine.

(1131) In his report, Dr Coppi emphasises that price discrimination is common (Coppi Report, paragraph 3.23). Nagtogaz agrees. However, as noted by Mr Lapuerta, price discrimination takes many forms, some of which are considered relatively benign, such as discounted cinema tickets for senior citizens (Expert Competition Reply, paragraph 132). There is no relevance of his point to assessing the particular type of price discrimination embodied in the Contract formula. The European Commission and other organisations, including the International Energy Agency, have clearly associated the "*market value principle*" with monopolistic abuse.

(1132) To support the notion that discrimination is common, Dr Coppi provides evidence of different gas prices paid by different types of end-users in Western Europe (cf. Coppi Report, paragraph 3.25). As emphasised in paragraph 133 of the Expert Competition Reply, the evidence is not informative, because the data do not control for the significantly different costs that arise in transporting and storing natural gas to smaller consumers relative to large industrial consumers. The first Competition Report discussed such distinctions, and defined price discrimination as differences in price that do *not* reflect the inherently different costs of serving customers.

(1133) France, Portugal, Spain and Italy have regulated tariffs for smaller users, which are designed to *prevent* price discrimination (cf. Expert Competition Report, paragraph 134). The regulations set higher tariffs for small users based either on competitive auctions, or on hub prices, or an estimate of the average gas purchase costs for the entire country. Either approach impedes the sort of discrimination implied by the "*market value principle*" that is embedded in the Contract Price.

(1134) Dr Coppi cites Ukrainian regulations as preventing price discrimination in practice (Coppi Report, paragraphs 3.19 to 3.22). However, he has overlooked the "*reasonable margin*" part of the analysis in the Competition Report—the price compels Naftogaz to discriminate in Ukraine in order to preserve a reasonable margin, as noted in paragraph 135 of the Expert Competition Reply. Naftogaz agrees that Naftogaz has not discriminated in the manner suggested by the Contract's Price Formula, but the Price Formula does not become reasonable simply because the buyer refrains from discriminating among its end-users. Instead, the Ukrainian Government to date has made a difficult choice: protecting Ukrainian consumers while sacrificing the ability of Naftogaz to earn a reasonable margin.

(1135) Mr Coppi claims that the first Competition Report did not provide sufficient evidence of discrimination by Gazprom itself (Coppi Report, paragraph 3.6). However, as pointed out in paragraph 123 of the Expert Competition Reply, Mr [redacted] acknowledges that the Contract Price has exceeded the average Gazprom sales price to Europe for more than three years now. His response is to state that the Ukrainian price was not "*significantly*" higher in 2012, and he is silent on the increase in the gap in 2013, 2014 and 2015. As shown in Appendix B to the Expert Competition Reply and illustrated in Figure 5 in that appendix, the existing Contract Price significantly exceeds the average price of Russian gas sold to Western Europe. In 2014, the Contract Price was roughly 20% higher than the price at which Russian gas sold in the

European country with the *highest* price obtained for such gas (paragraph 171 of the Expert Competition Reply).

VIII.6.12.2.3.2 Inclusion of different oil products in the price formula discriminates between different types of consumers

(1136) The inclusion of different oil products in the price formula discriminates between different customers within Ukraine based on their alternatives to consuming natural gas.

(1137) Gazprom refers to Article 102 (c) TFEU, which prohibits a dominant firm from *"applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage"*. However, this specific prohibition applies only to separate transactions with different trading parties. It is accordingly not applicable where transactions with a single trading party (Naftogaz) leads to discrimination between that trading party's customers. Such discrimination between consumers affected by the practice constitutes abusive pricing pursuant to Article 102.

(1138) Gazprom further refers to certain other arguments made in the Coppi Report (paragraph 849 of the Defence), which will be addressed in the following paragraphs.

(1139) Dr Coppi states that *"[t]here is no indication, let alone evidence, that P_0 was set on the basis of the 'indifference principle' (i.e. the principle that the price of gas should make end-users indifferent between using gas and the alternative sources of energy), as the Brattle Report appears to assume."* (cf. paragraph 3.13 of the Coppi Report). However, oil price indexation emerged in Europe as a way to implement the "*market value principle*" (which Dr Coppi calls the "*indifference principle*") and which is widely understood to discriminate inappropriately among consumers. This is further explained in paragraphs 124 and 125 of the Expert Competition Reply.

(1140) Moreover, Dr Coppi states that: *"the oil products in the formula only determine the price escalation or trajectory, i.e., how the Contract price evolves in future, not the level of prices with regard to alternative oil products (which is determined by P0). So – unless the initial reference price P_0 was set on the basis of the indifference principle – the presence of fuel and gas oil prices in the formula does not imply that the Contract Price is set to make end-users indifferent between using gas and the two oil products."* (Coppi Report, paragraph 3.15). As noted in paragraph 126 of the Expert Competition Reply, Dr Coppi's argument may rely on a distinction between the indexation in the formula and the P_0. Dr Coppi's argument is refuted by Mr Lapuerta in paragraphs 127 and 128 of the Expert Competition Reply:

"First, gas companies have no independent business reason to index a contract price to multiple oil products unless they seek to implement the market value principle. Second, the market value principle never implied a P_0 that made end-users perfectly indifferent to alternative fuels. […] Third, the First Lapuerta Report showed that the Contract Price, including both its P_0 and its indexation parameters, was in fact in line with historical German prices before the development of effective gas-to-gas competition, when it was widely accepted that German prices indeed reflected the market value principle."

(1141) Finally, Dr Coppi expresses further doubts that the Contract Price reflects the market value principle, in part by pointing out that the Contract's weights for different fuels do not match the percentage consumption of those fuels in Ukraine (cf. Coppi Report, paragraph 3.16). He refers to Mr Witschen, who simply suggests that 100% oil indexation does not reflect the 10% weight of oil consumption in Ukraine (cf. paragraph 152 of the Witschen report).

(1142) As noted in paragraph 130 of the Expert Competition Reply, Mr Witschen has ignored that many contracts in Western Europe have applied the market value principle to derive 100% oil indexation, even though oil represented a small percentage of primary energy consumption in the relevant countries. The market value principle contributed to the widespread penetration of natural gas in the energy sectors of the importing countries. Natural gas displaced oil, precisely because the market value principle ensured that natural gas would always be slightly cheaper than oil. However, a small actual share of oil consumption does not prevent oil from being the best other *alternative* than natural gas. The focus of the market value principle is to set prices by reference to the best alternative, not to reflect the distribution of fuels actually consumed in a particular country.

(1143) Moreover, Naftogaz does not see the importance of establishing that the Parties chose the weights to reflect the specifics of the Ukrainian market, and in fact chose not to rely on the Ukrainian market. As Mr Lapuerta points out in his report, the Parties may have borrowed the weights from formulae that applied the market value principle in other countries (paragraph 131 of the Expert Competition Reply). It is in any event clear that the oil Price Formula drew upon the principle of price discrimination. Dr Hesmondhalgh has demonstrated, for example, that the prices were close to German prices, and weights of 50% gasoil and 50% fuel oil are common.

Neither Dr Coppi nor Mr Witschen has identified any other business rationale for using different fuels in the formula.

VIII.6.12.2.3.3 Gazprom discriminates between Naftogaz and other purchasers

(1144) The oil price indexation clause discriminates between Naftogaz and other customers of Gazprom, as prices under the Contract exceed Gazprom's own prices to purchasers in Western Europe. Furthermore, the prices under the Contract do not reflect lower costs of supplying Ukraine.

(1145) Gazprom claims that in order for discrimination to constitute an abuse of a dominant position within the meaning of Article 102, the discrimination must affect competition in the form of a "*competitive disadvantage*" in the related market of the customer. As a basis for this position, Gazprom refers to the fact that Article 102 (c) lists as one form of abuse the following: *"applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage"*.

(1146) However, if the dominant firm has taken steps to prevent its customers (or "*trading parties*") from competing with each other, the fact that they do not compete directly cannot be invoked by the dominant firm as a defence for discriminating between its customers. This follows from the ECJ's judgment in the *United Brands* case (Case 27/76 *United Brands*).

(1147) United Brands had prevented its customers (banana distributors) from exporting bananas by forbidding them from reselling bananas while still green, which in itself constituted an abuse of United Brands' dominant position (paragraphs 130 to 162 of the judgment). As a result, its customers had been prevented from competing against other customers. Despite this lack of competition between United Brands' customers, the ECJ concluded that by charging different prices to customers in different countries United Brands placed certain customers "*at a competitive disadvantage*" and abused its dominant position (paragraph 233 of the judgment).

(1148) The judgment shows that a dominant company's discrimination between its customers must be deemed to place its customers (specifically, the customer or customers which are charged higher prices) at a competitive disadvantage compared to other customers if it is the dominant company who has prevented the customers from competing against each other.

(1149) Since it is Gazprom's illegal and abusive restrictions which prevent Naftogaz from reselling gas in competition with Gazprom's customers in Western Europe, charging higher prices from

Naftogaz than from customers in Western Europe involves placing Naftogaz at a competitive disadvantage within the meaning of Article 102 (c).

(1150) Gazprom further refers to arguments made in the Coppi Report to the effect that Mr Lapuerta has failed to show that Gazprom charges significantly higher prices to Naftogaz than to other buyers. However, as noted in paragraph 117 of the Expert Competition Reply, the existing Contract Price significantly exceeds the average price of Russian gas sold to Western Europe. The Contract Price in fact exceeds the price in 18 of the 19 European countries to which Gazprom delivers gas. The only "*outlier*" is Macedonia, which represents a small portion of Gazprom's European portfolio. Appendix B of the Expert Competition Reply provides the supporting evidence.

VIII.6.12.2.4 Effect on trade

(1151) Abuse of a dominant position infringes Article 102 if it *"may affect trade between Member States"*, i.e. between EU countries. As pointed out in Section V, 3.4, conduct that forms part of an overall strategy pursued by the dominant undertaking must be assessed in terms of its overall impact. Where a dominant undertaking adopts various practices in pursuit of the same aim, for instance practices that aim at foreclosing markets or competitors, it is sufficient that at least one of these practices is capable of affecting trade between EU Member States.

(1152) Moreover, Gazprom's abuse of its dominant position manifests itself in the various provisions of the Contract. Seen together, they form part of an overall strategy to isolate the Ukrainian market and to force Naftogaz to accept business methods and arrangements which produces effects on competition within the EU and on trade between EU Member States. In this respect, reference is made to the previously mentioned press release from the European Commission regarding its Statement of Objections against Gazprom, in which the Commission stated that Gazprom is *"pursuing an overall strategy to partition Central and Eastern European gas markets"*.

(1153) Since it is sufficient that only one of Gazprom's practices is capable of affecting competition and trade within the EU, it is clear that Article 102 TFEU applies to each practice of Gazprom which is a result of the Contract. Reference is made to Section VIII of the Expert Competition Reply, which provides several examples of effects on trade.

(1154) While it is therefore no requirement that the oil indexation clause in itself affects trade between EU countries, it can be added that this clause in itself affects trade between EU countries. As noted in paragraph 137 of the Expert Competition Reply,

"[a]*n excessive price reduces total natural gas demand in Ukraine, both by harming the competitiveness of Ukrainian industry and by the simple operation of the natural elasticity of demand: demand always falls in response to higher prices. Reduced natural gas demand in Ukraine makes higher volumes available to Gazprom for sale in EU countries. Gazprom can even take advantage of other Contract provisions to sell the unwanted gas a second time. A higher natural gas volume sold to EU countries affects prices in those countries".*

(1155) In this context, it should be pointed out that a practice which affects the pattern of trade between EU countries affects trade within the meaning of Article 102 irrespective of whether the practice in question causes a reduction or an increase in trade between EU countries. This has been made clear by the European Commission in the *Effect on trade Guidelines*, paragraph 34:

"The term "pattern of trade" is neutral. It is not a condition that trade be restricted or reduced. Patterns of trade can also be affected when an agreement or practice causes an increase in trade. Indeed, Community law jurisdiction is established if trade between Member States is likely to develop differently with the agreement or practice compared to the way in which it would probably have developed in the absence of the agreement or practice." [References to case-law omitted.]

(1156) Against this background, the effect on trade criterion is met, both as regards trade between EU countries and in the context of trade within the Energy Community.

VIII.6.12.3 The volume and Take or Pay provisions

VIII.6.12.3.1 Introduction

(1157) Naftogaz claims that the volume and Take or Pay provisions in the Contract infringe Articles 101 and 102.

(1158) Pursuant to Article 2.2 of the Contract, Naftogaz has to take, or pay if not taken, 80 % of the Annual Contract Quantity ("ACQ") (52 BCM per year from 2010) from 1 January 2009 to 31 December 2019.

(1159) Naftogaz' Take or Pay obligation is found in Article 2.2.5 of the Contract, which provides for an annual Take or Pay obligation. The Minimum Annual Quantity ("MAQ") amounts to 80 %

of the ACQ. Thus, Naftogaz is obliged to Take or Pay for a quantity of Natural Gas not less than 80 % of the ACQ in any Contract Year. Gazprom's maximum annual delivery obligation is 106 % of the ACQ.

(1160) The assessment of the Energy Community Secretariat of the volume provisions and Take or Pay obligations under Article 102 TFEU refers in large part to the assessment of the same under Article 101 TFEU, cf. Part IV, 3.3 a and c of the assessment. Naftogaz notes in particular that the Secretariat considers that tying a high share of the customer's demand for a protracted time period can constitute abuse of dominance, which is the case here. Naftogaz also notes that the Secretariat considers the Take or Pay clause to have both exclusionary and exploitative aspects.

(1161) The findings of the Expert Competition Report in relation to this provision are in line with the assessment of the Energy Community Secretariat. According to the Report (cf. its Section I.A), the 11-year duration of the Contract and its 80% Take or Pay level restrict competition in the Ukrainian gas market.

(1162) Extended durations and Take or Pay clauses are typical of Gas Sales Agreements (“GSAs”) that were signed prior to the development of competition in Europe, but the old GSAs had clear business justifications that do not apply to this case. Old GSAs involved sales to monopoly buyers. Producers sought extended durations and Take or Pay clauses to justify new investments in significant gas production and transportation assets, preventing them from potential “stranding” if the monopoly buyer did not want to take the gas. However, Gazprom has not identified any new investments undertaken to serve the Contract, and by 2011 competitive liquid markets had developed further west of the point where Gazprom delivers gas to Naftogaz. Competitive markets in Austria, Germany, Italy, France and elsewhere provide outlets for any natural gas that Naftogaz does not take.

(1163) Prior to liberalisation, long-term Take or Pay contracts could have no material adverse impact on competition, given that they largely involved purchases by buyers holding legal monopolies. Naftogaz used to be a monopoly buyer, but Ukrainian law introduced competition in 2012. Once the law has opened the door to competition, a large long-term Take or Pay contract with a dominant producer can impede the development of competition.

(1164) The Take or Pay provisions in the Contract are unusual because they do not grant Naftogaz any credit for Take or Pay payments. Older GSAs supplement their Take or Pay obligations with provisions allowing the buyer to take more than the annual contract quantity at a future date, and allow the buyer to apply past Take or Pay payments as credits against the purchase of incremental volumes. In effect, typical Take or Pay clauses operate like a bank account; industry observers use expressions like "*banking*" gas and receiving "*make-up*" gas. The absence of any credits or make-up gas provisions imposes an unusually severe burden on Naftogaz.

(1165) The destination clause compounds the problem, denying Naftogaz the ability to sell any unwanted gas in competitive markets further west of the delivery point. No reasonable buyer would have accepted the severe provisions if it had enjoyed the leverage to choose among competing natural gas suppliers when negotiating the Contract. No seller could have insisted on such provisions unless it enjoyed a dominant position.

(1166) The Expert Competition Report recommends the following (cf. its Section IV.B):

"*I recommend reducing the annual contract quantity, and reducing the ToP commitment, so that it continues to reflect 80% of the reduced quantity. The Preliminary Assessment cited the precedent set by a case decided by the German competition authority, in which it limited the gas contracts between a large importer and its distribution customers to 50%-80% of their total consumption for up to four years. The decision is well known, and many industry analysts cite it and subsequent similar cases by the German competition authority as playing an influential role in promoting the development of effective competition in the German natural gas market. That is, the measures have been tested in practice. If there was any doubt that the contracts restricted competition, the effectiveness of the remedies have provided confirmation.*"

VIII.6.12.3.2 The legal tests under Articles 101 and 102 TFEU

VIII.6.12.3.2.1 The legal test under Article 102

(1167) It follows from EU case-law that dominant companies are prohibited from entering into exclusive agreements that prevent its customers from obtaining parts of its supplies from alternative suppliers. This was established by the ECJ already in 1979 in the well-known *Hoffmann-La Roche* judgment.

Case 85/76 *Hoffmann-La Roche & Co. AG v Commission*, ECR 1979 00461, ECLI:EU:C:1979:36.

(1168) The ECJ established the following rule, cf. paragraph 89 of the judgment:

"An undertaking which is in a dominant position on a market and ties purchasers - even if it does so at their request - by an obligation or promise on their part to obtain all or most of their requirements exclusively from the said undertaking abuses its dominant position within the meaning of Article 86 of the Treaty [now Article 102 TFEU]*, whether the obligation in question is stipulated without further qualification or whether it is undertaken in consideration of the grant of a rebate."*

(1169) In other words, a dominant company is prohibited from entering into a supply agreement under which a customer is obliged to obtain *"all or most"* of its requirements from the dominant supplier.

(1170) The *Hoffmann-La Roche* judgment does not explicitly stipulate what proportion of a buyer's requirements will represent *"most"* of its requirements. However, the case involved contractual obligations to the effect that 75% to 80% of the buyer's total requirements of a number of vitamins had to be purchased from the dominant supplier, which was considered sufficient (paragraph 83 of the judgement).

(1171) Similarly, in the recent *Intel* judgment, the General Court considered that a rebate which would only be achieved by the buyer if it purchased at least 80% of its requirements of the product in question (so-called central processing units, or CPUs) from the dominant supplier, was sufficient.

Case T-286/09 *Intel Corp. v European Commission*, judgment of 12 June 2014, not yet reported, ECLI:EU:T:2014:547.

(1172) The General Court stated (cf. paragraph 135 of the judgment, which is currently under appeal to the ECJ):

"As regards the rebates granted to NEC, it must be observed that the percentage of 80% covered by the exclusivity condition is sufficient to constitute 'most' of its requirements within the meaning of Hoffmann-La Roche [reference omitted] *(paragraph 89). In that context, it should be noted that, in that judgment, the conduct in question included purchasing obligations concerning inter alia 80% or 75% of a customer's requirements (*Hoffmann-La Roche [reference omitted]*, paragraph 83)."*

(1173) In order to claim that an otherwise abusive practice is objectively justified, it would be up to the dominant company to demonstrate that its conduct either:

a) is objectively necessary; or

b) produces substantial efficiencies that outweigh its anti-competitive effects.

VIII.6.12.3.2.2 The legal test under Article 101

(1174) As noted above, Article 102 prohibits dominant suppliers from entering into agreements that require a customer to obtain all or most of its requirements from the dominant supplier. By contrast, where a supplier is not dominant, the prohibition in Article 101 of anti-competitive agreements will not automatically prohibit the supplier from entering into such exclusive agreements with its customers.

(1175) However, competition will be restricted within the meaning of Article 101 if the cumulative effect of the supply agreements entered into in the relevant market makes it difficult for new competitors to access the market. Consequently, to assess the legality under Article 101 of an agreement that requires a buyer to purchase all or most of its requirements from only one supplier, the agreement normally cannot be considered in isolation. Instead, all such exclusive agreements entered into in the relevant market – whether by the supplier in question or by other suppliers – must normally be considered cumulatively.

(1176) This approach is set out in paragraph 83 of the judgment of the General Court in the *Van den Bergh Foods* case, in which the court stated that:

"In order to determine whether HB's exclusive distribution agreements fall within the prohibition contained in Article 85(1) of the Treaty [now Article 101(1) TFEU], *it is appropriate, in accordance with the case-law, to consider whether all the similar agreements entered into in the relevant market and the other features of the economic and legal context of the agreements at issue, show that those agreements cumulatively have the effect of denying access to that market to new competitors."*

(1177) The judgment was upheld on appeal to the ECJ.

Case T-65/98 *Van den Bergh Foods Ltd v European Commission*, 2003 II-04653, ECLI:EU:T:2003:281.

Case C-552/03P *Unilever Bestfoods (previously Van den Bergh Foods) v European Commission*, 2006 I-09091, ECLI:EU:C:2006:607.

(1178) The assessment under Article 101 of the cumulative effect of the agreements entered into by the suppliers in the relevant market shall not be a purely formal examination of contractual restrictions. Instead, the assessment must take into account (cf. paragraph 84 of the General Court's judgment in *Van den Bergh Foods*)

"the specific economic context in which the agreements in question operate, including the particular features of the relevant market, which may, in practice, reinforce those restrictions and thus distort competition on that market"

(1179) Where, exceptionally, there exists a dominant supplier in the relevant market which operates exclusive customer relationships, this will be a "*particular feature*" of the market of a very significant importance. This obvious point was confirmed in *Van den Bergh Foods* in the assessment of exclusivity arrangements under Article 101 (cf. paragraph 90 of the judgment):

"The Court considers that the Commission, when assessing the effects of the exclusivity clause on the relevant market, could legitimately take into account the fact that HB held a dominant position on it in order to assess the conditions prevailing on that market and that the assessment was not, contrary to HB's submission, distorted."

(1180) In the *Van den Bergh Foods* case, the exclusive supplier relationships operated by the dominant supplier HB were held to be in breach of both Article 101 and Article 102.

(1181) Consequently, Gazprom's dominant position is not only a prerequisite for the application of Article 102 to the volume and Take or Pay provisions, it is also a key factor in the assessment of those provisions under Article 101.

VIII.6.12.3.2.3 The German E.ON case

(1182) The application of Article 101 to gas supply agreements was tested by the German E.ON case. The Germany's competition authority, the *Bundeskartellamt*, concluded that E.ON's long-term gas supply agreements with regional and local gas distributors were in breach of Articles 101 and 102 (previously Articles 81 and 82 of the EC Treaty) to the extent that the agreements covered more than 80% of a distributor's actual gas requirements (Article 1 of the decision). Such agreements had to be terminated within a short deadline set by the authority (Article 2 of the decision).

(1183) The infringement of Article 101 resulted from the combination of long-term purchase obligations and volumes under the agreements, as follows from the *Bundeskartellamt's* press release of 17 January 2006. A large proportion (more than 70%) of the regional and local gas companies connected to E.ON's network had long-term contracts with E.ON Ruhrgas which covered all or most of their requirements, which foreclosed third party suppliers from access to a large part of the market, as noted by the *Bundeskartellamt* in its press release of 13 December 2005.

(1184) As for the conclusion of new supply agreements, the authority's decision prohibited E.ON from entering into new agreements with a duration exceeding 4 years if the agreement covers more than 50% of the distributor's actual volume requirements. An agreement covering more than 80% of a distributor's actual needs could not exceed 2 years (Article 3 of the decision). The prohibition was subject a time-period defined in the decision (Article 4 of the decision) and an exception for agreements with small customers as also defined in the decision.

(1185) As a consequence of the decision, should E.ON wish to enter into new long-term supply agreements with a duration exceeding 4 years, the volume under the Contract would have to represent less than 50% of the customer's actual requirements.

(1186) The *Bundeskartellamt's* decision was upheld by the higher regional court (*Oberlandesgericht*) in Düsseldorf and the Federal Court of Justice.

(1187) In the meantime, the gas transmission companies Wingas, Gasunion and Saarferngas, had accepted binding commitments to the same effect as set out in E.ON decision. The companies' gas supply contracts had been investigated by the *Bundeskartellamt* under Article 101 in parallel with the E.ON investigation.

Press release of the German *Bundeskartellamt*, dated 27 November 2006.

(1188) The German E.ON case shows that if a dominant supplier enters into long-term supply agreements covering a large share of customers' requirements and such agreements cover a large share of the market, those agreements are not only caught by Article 102 but are also in breach of Article 101. Such long-term agreements must either be terminated or be limited to a small share of the customer's requirements; in the decision the threshold was set at 50% of the customer's requirements.

(1189) The principles which the solution in the E.ON was based on, were applied by Naftogaz with respect to the contents of the claim for replacement of the Contract's volume and Take or Pay provisions.

VIII.6.12.3.3 The abusive and restrictive nature of the volume and Take or Pay provisions

VIII.6.12.3.3.1 Introduction

(1190) Gazprom has offered little discussion or evidence to the opposite effect, but simply alleged that Naftogaz has failed to establish that the duration, volume and Take or Pay requirements *"have as their object or effect the prevention, restriction or distortion of competition"*.

VIII.6.12.3.3.2 Foreclosure effects

(1191) The volume obligations and Take or Pay provisions of the Contract lead to market foreclosure by effectively requiring Naftogaz to obtain all or the majority of its demand for gas from Gazprom.

(1192) The Contract effectively ties Naftogaz to purchase its gas requirements exclusively or almost exclusively from Gazprom. The volume and Take or Pay provisions imply that Naftogaz has to take the entire minimum volume (the MAQ) stipulated in the Contract, since Naftogaz otherwise would have to pay for gas not taken.

(1193) Had the MAQ represented only a limited share of Naftogaz' total gas requirements, Naftogaz would be free to obtain the remaining volume from other suppliers. However, the MAQ is in fact likely to *exceed* Naftogaz' actual demand. As a result, the share of Naftogaz' demand left to be supplied by competing suppliers is small or non-existent, and Naftogaz is forced to obtain all or most of its requirements from Gazprom in order to comply with the volume and Take or Pay provisions of the Contract. Consequently, the test for abuse set out in *Hoffmann-La Roche* is met.

(1194) On this basis, the volume and Take or Pay provisions are in breach of Article 102.

(1195) In order to assess whether the volume and Take or Pay provisions also infringe Article 101, the cumulative effect of the agreements entered into by the suppliers in the relevant market must be considered. In the case at hand, it is sufficient to consider Gazprom's own supply agreements, which cover a very significant share of total demand in the relevant market.

(1196) Table 5 on page 47 of the Expert Competition Reply provides details on the volumes contracted by Gazprom under the Contract and other gas supply contracts with customers in Ukraine, Hungary, Poland, Slovakia and Romania. On the basis of data for consumption in each country, the table further sets out calculations of Gazprom's volumes covered by such long-term contracts as a share of consumption. The calculations show that *"Gazprom contracts cover on* *average 87-88% of total demand in the two broader market definitions, and 82% of demand in Ukraine"* (cf. paragraph 169 of the Expert Competition Reply).

(1197) The very significant share of total demand covered by a single, dominant supplier clearly gives rise to a significant foreclosure effect. New suppliers wishing to enter the relevant market only have access to a small share of the market. Consequently, the cumulative effect of Gazprom's contracted volumes in the relevant market, together with Gazprom's dominant position, entail a significant barrier to new entry which restricts competition within the meaning of Article 101.

VIII.6.12.3.3.3 Exploitative nature

(1198) The volume and Take or Pay provisions also constitute exploitative abuse of Gazprom's dominant position. They allow Gazprom to impose unfair trading practices by obliging Naftogaz to purchase significantly more natural gas than is needed, in light of Naftogaz' demand for imported natural gas and the MAQ Naftogaz has to Take or Pay for under the Contract.

(1199) The volume obligations and Take or Pay provisions should be seen in conjunction with other restrictions, in particular, the destination clause which prevents Naftogaz from selling the gas outside of Ukraine, the absence of a make-up provision, as well as the excessive and discriminatory pricing. Furthermore, as noted by Mr Lapuerta (cf. paragraph 95 of the Expert Competition Reply), Gazprom controls the exit points on the Ukrainian transportation network to other countries, and has blocked efficient cross-border flows by assuming an obstructive role as a "matching partner" with neighbouring TSOs, as further explained by Naftogaz in the Gas Transit Arbitration. This adds to the effective foreclosure of the gas market in Ukraine, impeding imports to Ukraine, as well as exports. These restrictions exacerbate the exploitative effects of the volume and Take or Pay provisions.

(1200) The cumulative effect of all those restrictions (assuming that Gazprom were permitted to fully enforce them) is, *inter alia*, that Gazprom is able to exploit Naftogaz by selling the same gas first to Naftogaz and then to other buyers. As pointed out by Mr Lapuerta (cf. paragraph 71 of the Expert Competition Reply),

"since 2009 Gazprom's European sales have actually increased at the same time that purchases from Naftogaz have decreased, so it is reasonable to believe that Gazprom is in effect reselling elsewhere a substantial portion of the gas that Naftogaz has not taken". [footnote omitted]

VIII.6.12.3.3.4 No justification

(1201) Gazprom refers to the duration of the Contract being in line with normal commercial practice, and that Take or Pay clauses are a normal feature of long-term European gas supply contracts.

(1202) While a contract duration of 11 years or more is common in Europe, and Take or Pay clauses are common, they have no legitimate business justification in the particular context of the Ukrainian natural gas market. They do not reflect investments made by Gazprom in order to supply Naftogaz under the Contract, and Gazprom can in any event sell further downstream in Western Europe any gas that Naftogaz does not purchase. None of Gazprom's experts engage with the analysis in the Expert Competition Report, which demonstrated that the volume and Take or Pay provisions have no legitimate business justification.

(1203) Gazprom relies on Mr [redacted] general assertion that his company makes investments to guarantee deliveries. His statement does not claim that Gazprom actually made any investments to satisfy the Contract, and does not consider that Gazprom can sell further downstream in Western Europe any gas that Naftogaz does not purchase. This is discussed in paragraph 88 of the Expert Competition Reply:

[redacted] *refers in general terms to the exploration and investment that Gazprom undertakes to be in a position to supply such large volumes, but he does not identify any specific or new investment that Gazprom undertook or committed to Naftogaz. The relevant negotiations occurred over three months between October 2008 and January 2009, but three months is not enough to plan and commit to new investments. Gazprom must have had sufficient capacity in place to produce the relevant volumes. There is no indication that the capacity would somehow be stranded if Naftogaz failed to purchase the full volumes."* [footnote omitted]

(1204) As pointed out by Mr Lapuerta, it is evident that Gazprom did in fact not need to make investments of mentionable size to enter into the Contract (Expert Competition Reply, paragraph 19). Given the size of Gazprom's counterclaim based on the Take or Pay provisions of the Contract, it is remarkable how little evidence Gazprom has provided to support it. In fact, the only evidence is the vague and unsubstantiated remarks made by Mr [redacted] in his witness statement. Furthermore, the issue finds no mention in the Coppi Report, and is hardly addressed in the Witschen Report.

(1205) The contrast between Gazprom's call for elaborate empirical analysis on all counts from Naftogaz and the apparent comfort that a declaratory sentence by [redacted] is all the evidence needed to justify billions in Take or Pay liabilities, is striking.

(1206) As noted in paragraph 89 of the Expert Competition Reply, Mr [redacted] also justifies the Take or Pay obligation as a reasonable measure to ensure the security of Gazprom exports through Ukraine to other countries. He states in paragraph 64 of his Witness Statement that

"We considered the Take or Pay provision a means of encouraging Naftogaz to maintain adequate levels of gas in storage and a form of insurance against future gas crises."

(1207) Thus, he expresses concerns that Naftogaz might take too little gas in the summer, failing to fill domestic storage levels, and would then interrupt transit to Western Europe in the winter in the event of insufficient natural gas. According to Mr [redacted] the Take or Pay commitment enforces the discipline for Naftogaz to inject summer gas into storage.

(1208) As a point of departure, Naftogaz notes that disciplining customers to put gas into storage at their own cost goes beyond the regular objective of Take or Pay provisions, and that storage should be handled separately and paid for by the requesting party.

(1209) Also, as pointed out in paragraph 90 of the Expert Competition Reply, summer storage issues do not explain the failure of Naftogaz to take the annual contract quantity. Rather, Naftogaz has consumed less gas over the course of each year due to a massive contraction in the Ukrainian economy, which has reduced winter consumption as well as summer consumption. In addition, Naftogaz has not been the only importer of gas to Ukraine, as large industrial consumers of Ukraine have received gas supplies from Ostchem.

(1210) To the factual dispute we can add a disagreement with the underlying logic in Mr [redacted] statement. As explained in paragraph 91 of the Expert Competition Reply,

"the take-or-pay commitment is actually superfluous to the goal of incentivizing summer gas storage. As long as Gazprom limits the maximum consumption of Naftogaz in winter, Naftogaz will have efficient incentives to respond by taking more gas under the Contract than it needs in the summer, and storing the excess for use in winter."

(1211) Mr [redacted] logic fails the burden of showing that Gazprom has no "*less restrictive alternative*" than the Take or Pay commitment. As pointed out by Mr Lapuerta (cf. paragraph 92 of the Expert Competition Reply), since the Take or Pay provision restricts competition, Gazprom should demonstrate that it has no available "*less restrictive alternative*" that would incentivise summer storage. However, a simple cap on winter consumption is far less restrictive of competition (cf. paragraph 92 of the Expert Competition Reply). It would incentivise

Naftogaz to store Gazprom's gas in the summer, unless Naftogaz could find a superior competitive offer for either summer storage or winter consumption. A cap on winter consumption would not foreclose competition.

(1212) Moreover, as pointed out in paragraph 93 of the Expert Competition Reply:

"Mr. [redacted] logic also ignores Gazprom's ability to respond if it ever decides that Ukraine needs to store more gas. If Naftogaz nominates insufficient summer gas, then Gazprom can always respond by injecting more gas itself into Ukrainian storage facilities. Then in the winter when Naftogaz needs more gas, the storages will be full and Gazprom will be able to satisfy both Naftogaz and other European customers."

(1213) If Naftogaz ever exceeds such a cap on winter consumption, then it would be taking more gas than allowed under the Contract, and would have to pay for any additional amounts. If Gazprom in fact anticipates the problem by storing extra gas, it should be able to claim compensation for any incremental storage fees associated with the inappropriate extraction of extra winter gas by Naftogaz. Such an approach would represent another alternative with a "*less restrictive*" effect on competition than the Take or Pay provision.

(1214) Gazprom claims that Naftogaz can tolerate the Take or Pay commitment, because Naftogaz could "*make room*" for excess Russian volumes by channeling the domestic production for export. However, as pointed out in paragraph 94 of the Expert Competition Defence, Ukrainian law prohibits Naftogaz from exporting domestic production, which is not even large enough to avoid take-or-pay liabilities. Moreover, Gazprom controls the exit points on the Ukrainian transportation network to other countries and has blocked efficient cross-border flows.

VIII.6.12.3.4 The absence of a make-up provision

(1215) Gazprom furthermore argues that there was no need for a "*make-up*" provision in the Contract, since Ukraine is able to inject any excess volumes it has committed to take under the Contract into its underground storage facilities for use at a later date.

(1216) In contracts with a Take or Pay provision, there is normally a make-up provision. Take or Pay provisions without make-up rights are effectively contractual penalties of a completely different and unconscionable nature than the "*gas bank*" arrangement implied under a normal Take or Pay clause. Thus, an important aspect of the abuse of dominance and restriction of competition in this regard is the absence of a make-up provision in the Contract.

(1217) Mr Witschen recognises that the absence of any "*make-up*" gas provision is highly unusual, but he and Mr [redacted] justify it, given the abundance of storage in the Ukraine (Witschen Report, paragraph 142). However, there is no logical connection between the abundance of storage and the absence of "*make-up gas*" provisions.

(1218) The abundance of storage is relevant solely to the buyer's ability to tolerate a Take or Pay commitment, which is a completely separate issue from make-up gas. That is, excess storage capacity could at most enable Naftogaz to take gas that it does not actually need in a particular year, which it could put into storage. However, the concept of "*make-up*" gas only applies once a company like Naftogaz has filled its storage capacity to the maximum, can no longer take more gas, and has no alternative but to pay the penalty. In that case, it is only logical that, having paid for gas not used, the buyer should receive a credit toward future purchases of natural gas, as noted in paragraph 97 of the Expert Competition Reply.

(1219) Ukrainian storage facilities do not have sufficient spare capacity to take the enormous Take or Pay volumes that are now in dispute. Moreover, as noted in paragraph 98 of the Expert Competition Report, make-up gas provisions are standard for contracts that import natural gas into other European countries with abundant storage capacity, such as Germany. There is no general European practice of offering more generous make-up gas provisions in countries with less storage capacity, and of insisting on stricter provisions in countries with more storage capacity.

(1220) Mr [redacted] also defends the absence of any make-up gas provision as an incremental disciplinary measure to the Take or Pay commitment, to ensure summer storage, stating that *"[t]he inclusion of a make-up provision, whereby Naftogaz could consume volumes at a later time would not have accomplished this objective"* (cf. Mr [redacted] witness statement, paragraph 64). However, this argument confronts the same problems as Mr [redacted] analysis of the Take or Pay commitment, as the argument fails the test of showing that no "*less restrictive alternative*" exists.

VIII.6.12.3.5 Effect on trade

(1221) As explained above, the effect on trade criterion of Article 101 is satisfied.

(1222) Moreover, it is sufficient under Article 102 that only one of Gazprom's practices is capable of affecting competition and trade within the EU, since the various practices form part of an overall infringement of that article.

(1223) In the event that one or more of Gazprom's practices should not be deemed to form part of the same overall infringement as the volume and Take or Pay provisions, these provisions at the very least form part of the same overall infringement as the destination clause. The volume and Take or Pay provisions and the destination clause clearly form part of an overall strategy on the part of Gazprom to divide markets, by preventing natural gas sales between Ukraine and other countries (seeking instead to supply each country separately). The combination of the volume and Take or Pay provisions and the destination clause clearly affects trade between EU countries, as restrictions on sales between Ukraine and EU countries affect trade patterns between EU countries, as explained in further detail in Section VIII of the Expert Competition Reply.

(1224) Against this background, the application of Article 102 does not require that the volume and Take or Pay provisions in themselves affect trade between EU countries.

(1225) It should be added, however, that the foreclosure effect of the volume and Take or Pay provisions, as discussed and evidenced the Expert Competition Report, in itself affects the flow of trades within the EU and in the single European energy market, cf. to this effect paragraph 137 c of the Expert Competition Reply:

"the extended duration and ToP commitment together foreclose competition to supply gas to consumers in Ukraine, impeding Naftogaz from importing alternative gas supplies from Poland, Hungary and Slovakia that could otherwise compete effectively in Ukraine. Impeding exports from EU countries affects their price levels and trade."

(1226) On this basis, the effect on trade criterion in Article 102 is satisfied, both in the context of trade between EU countries and in the context of trade within the Energy Community.

<u>VIII.6.12.4 The destination clause</u>

VIII.6.12.4.1 The destination clause is a hard core restriction of competition

(1227) Gazprom claims that Naftogaz has failed to establish that the destination clause is restrictive or abusive pursuant to Articles 101 and 102 TFEU, and that the clause is in any event objectively justified by the special, preferential trading and pricing arrangements that have characterised the contractual supply, transit and storage relationships between Naftogaz and Gazprom since the 1990s.

(1228) However, Gazprom's argument that the destination clause has its origins in the preferential nature of supply and pricing arrangements between Russia/Gazprom and Ukraine/Naftogaz and was intended to prevent Naftogaz from selling gas acquired from Gazprom at discounted prices is not relevant to the Contract, which was intended to implement market reflective pricing.

(1229) Gazprom accuses Naftogaz of failing to provide any firm evidence in its critique of the destination clause, calling the critique *"purely theoretical"*. However, as mentioned above, the counterclaim for take-or-pay liabilities is itself evidence of a serious adverse impact of the destination clause on competition. In the absence of the destination clause, Naftogaz would have been able to sell the unwanted gas elsewhere, competing with Gazprom supplies, and reducing the competitive price of natural gas.

(1230) Moreover, the European Commission has declared that destination clauses are so-called *"hard core"* restrictions of competition, which means that they should be set aside without any requirement whatsoever to provide empirical evidence of their effects in practice. Calling destination clauses a "*hard core*" restriction is reasonable competition policy and clear law, because they have no plausible legitimate business purpose. Requiring someone to compile empirical evidence would be a waste of time, which could only lead to the mistaken acceptance of a clause that is anti-competitive by its very nature.

(1231) Naftogaz notes that neither Dr Coppi nor Dr Moselle defends the destination clause. As pointed out in paragraph 85 of the Expert Competition Reply, Gazprom's Defence conveys the mistaken impression that Mr Witschen defends the reasonableness of the destination clause. However, a close reading of his report indicates that he recognises the widespread illegality of destination clauses in Europe. Mr Witschen states that the destination clause in the Contract was "*apparently agreed in a different commercial and political environment*" (Witschen Report, paragraph 162) without specifying the relevant differences. His use of the word "*apparently*" abdicates direct responsibility for any firm conclusions on the matter.

(1232) Mr Witschen's only other comment is that the destination clause would "*would have the effect of preventing Naftogaz from reexporting volumes bought under preferential rates to other markets in case of higher prices achievable there*" (also paragraph 162). As noted above, this argument is not relevant to the Contract, which was intended to implement market reflective pricing. Moreover, as noted in paragraph 86 of the Expert Competition Reply, Mr Witschen's statement is a rather diplomatic way of saying that the destination clause supports Gazprom's attempt to discriminate between the price of gas sold to different European countries. Such discrimination is itself illegal, and is one of the European Commission's key concerns in the ongoing investigation of Gazprom. Oddly, Mr Witschen's support is in fact a footnote referring to the existing investigation.

VIII.6.12.4.2 Effect on trade

(1233) As noted above, it is sufficient that only one of Gazprom's practices is capable of affecting competition and trade within the EU, since the various practices form part of an overall infringement of Article 102. Also, the destination clause at the very least form part of the same overall infringement as the volume and Take or Pay provisions.

(1234) Against this background, the application of Article 102 does not require that the destination clause in itself affects trade between EU countries. However, this is the case. As noted by Mr Lapuerta (cf. paragraph 137 b of the Expert Competition Reply):

"The destination clause prevents Ukraine from exporting unwanted gas to EU countries such as Slovakia, Hungary and Poland in competition with supplies to those countries from Russia and elsewhere. If, on the other hand, Gazprom has the sole right to market the unwanted gas, it will ensure that any sales of unwanted gas do not displace or compete with its other sales. Restrictions on sales to EU countries end up affecting both competition and prices in those countries."

VIII.6.12.5 The unilateral suspension right

(1235) Gazprom claims that Naftogaz has failed to establish that Gazprom's unilateral suspension right under the Contract is abusive under Article 102 TFEU, and that the suspension right is in any event reasonable and objectively justified, *inter alia*, by Naftogaz' allegedly long history of failing to pay for gas deliveries and accumulating huge debts to Gazprom.

(1236) The unilateral suspension right for Gazprom is unusual and unreasonable. The fact that such a clause is unusual has been acknowledged by Mr Witschen (cf. Witschen Report, Section 6.14). Moreover, as noted by Mr Lapuerta, all gas suppliers have concerns over non-payment, and they design the standard gas sales agreement to facilitate enforcement (cf. Expert Competition Reply, paragraph 101). A unilateral suspension right does not contribute to enforcing payment. All it does is deprive the buyer of a right in the event that the seller fails to perform. Concerns over non-payment cannot justify such a clause.

(1237) Gazprom further argues that Naftogaz must provide "*actual empirical evidence that* the unilateral suspension right has any detrimental effect on competition or that it *constitutes an abuse pursuant to Article 102 TFEU"* and that *"Naftogaz' case in this regard is purely theoretical and pays no regard to the factual and economic context"*.

(1238) As emphasised by Mr Lapuerta, as a result of the unusual suspension right under the Contract, Naftogaz faces a handicap that other importers of natural gas do not face (cf. paragraph 104 of the Expert Competition Reply). Mr Lapuerta explains (Expert Competition Reply, paragraph 104):

"If Naftogaz cannot suspend the Contract then it cannot offer the same security to its customers as other suppliers. In the event of sustained underperformance by Gazprom, Naftogaz would not have the same contractual freedom and certainty as others to arrange for alternative substitute supplies. Moreover, the unilateral suspension right puts Naftogaz at a disadvantage compared to Gazprom as both firms compete directly in Ukraine."

(1239) In the event of a supply failure, the Contract would presumably continue for an indefinite period until Gazprom chooses to resume deliveries. In the interim, Naftogaz would not be able to arrange for substitute long-term supplies despite the material breach by Gazprom. Such a one-sided arrangement is extremely unusual in the gas industry.

(1240) Moreover, the fact that Gazprom has not exercised the right to date clearly does not imply that Naftogaz lacks relevant evidence that the clause may affect competition. As noted by Mr Lapuerta, the mere existence of the right has an impact by introducing asymmetric risks (cf. Expert Competition Report, paragraph 105). Until Naftogaz seeks and fails to suspend the Contract it could be impossible to quantify any damages with *"actual empirical evidence"*, but bearing the risks of an asymmetric arrangement has to affect competition adversely.

(1241) Naftogaz agrees with Gazprom that Swedish law, by way of CISG provides Naftogaz with a right to suspend performance in *certain circumstances* even without a specific clause to that effect in the Contract. The clause is nevertheless anti-competitive and must be replaced, also to obtain legal clarity.

(1242) Finally, the effect on trade criterion is met under Articles 101 and 102. It is sufficient under Article 102 that only one of Gazprom's practices is capable of affecting competition and trade within the EU, since the various practices form part of an overall infringement of Article 102.

Accordingly, the application of Article 102 does not require that the unilateral suspension right in itself affects trade between EU countries. However, as explained by Mr Lapuerta, this right does affect trade between EU countries in itself (cf. Expert Competition reply, paragraph 137 e):

"The unilateral suspension right puts Naftogaz at a competitive disadvantage with respect to potential sales to EU countries, and will place suppliers in those countries at an advantage in competing with Naftogaz to supply customers in Ukraine."

(1243) Accordingly, the effect on trade criterion is satisfied, both in the context of trade between EU countries and in the context of trade within the Energy Community.

VIII.6.12.6 The mandatory sales clause

VIII.6.12.6.1 Introduction

(1244) Gazprom rejects the claim that the mandatory sales clause is in breach of Articles 101 and 102 TFEU on three bases; (i) by asserting that a violation has not been established by Naftogaz, (ii) that Naftogaz' sales would not have been different absent the provision and (iii) that Naftogaz took action to exclude Gazprom Sbyt from the Ukrainian market. Each of these defences will be addressed in turn below.

VIII.6.12.6.2 The anti-competitive nature of the mandatory sales clause

(1245) The restrictive and abusive nature of the mandatory sales clause is documented in the Competition Report (Section X, 10, of the SoC; Section III.F of the Expert Competition Report). The clause contributes to the strengthening of Gazprom's dominant position in the upstream market by providing it with considerable direct influence on the downstream market in Ukraine through forced sales by Naftogaz to a Gazprom subsidiary. Reference is made to Mr Lapuerta's more detailed discussion of the mandatory sales clause in paragraphs 106 *et seq.* of the Expert Competition Reply.

VIII.6.12.6.3 The situation absent the mandatory sales clause

(1246) Gazprom alleges that *"even if Gazprom Sbyt had not existed and there had been no mandatory sales provision in the Contract, Naftogaz' sales (and the annual contract volume) would not have been different"*. So according to Gazprom, Article 9.7 of the Contract made no difference to Naftogaz' sales, since Ukrainian consumers who were supplied by Gazprom Sbyt would otherwise have had to acquire gas from Naftogaz.

(1247) While making the above assertions, Gazprom side-tracks a discussion over Article 9.7 from Gazprom's interests in having it in the Contract. Under Article 9.7 of the Contract and the gas supply agreement with Gazprom Sbyt No. 14/136/09-DKP-01/09 dated 11 February 2009 and respective addenda thereto, Naftogaz shared its direct profit on the Ukrainian market with Gazprom without any market-based reason.

(1248) Naftogaz was obliged to supply gas to Gazprom Sbyt under a low cap price established by Ukraine's government for Ukrainian consumers with an additional discount thereto. Gazprom Sbyt could then make a profit on further sales to quite solvent industrial consumers in Ukraine.

(1249) In particular, a price under the gas supply agreement with Gazprom Sbyt was determined by application of a discount in the amount of UAH 15.40 to a standard cap price established by the government or other state authorities for different categories of industrial consumers, cf. Article 4.1 of the Supplementary Agreements Nos. 1-3 to the gas supply agreement No. 14/136/09-DKP-01/09 dated 11 February 2009,.

(1250) Thus, if Gazprom Sbyt had not existed and there had been no mandatory sales provision in the Contract, the sales and profits of Naftogaz would indeed have been different. The difference in profit would amount to UAH 15.40 per every 1,000 m^3 of natural gas supplied by Gazprom Sbyt to industrial consumers in Ukraine, which would be:

(i) approximately UAH 49.4 million in 2010 (i.e. circa USD 6.2 million);

(ii) approximately UAH 51.6 million in 2011 (i.e. circa USD 6.5 million);

(iii) approximately UAH 31.4 million in 2012 (i.e. circa USD 3.9 million);

(iv) approximately UAH 5.9 million in 2013 (i.e. circa USD 0.7 million).

VIII.6.12.5.4 Naftogaz took no action to exclude Gaxprom Sbyt from the Ukrainian market

(1251) Gazprom claims that Naftogaz took "*action to exclude Gazprom Sbyt from the market in Ukraine and, as from 1 March 2013, has refused altogether to sell gas to Gazprom Sbyt*". The only basis for this claim seems to be [redacted] witness statement (cf. paragraphs 32 to 35 of [redacted] witness statement).

(1252) However, this claim is contradicted by other evidence, as well as by Mr [redacted]

(1253) Firstly, under the gas supply agreement No. 14/136/09-DKP-01/09 dated 11 February 2009, Naftogaz is to supply gas volumes in accordance with annual supplementary agreements and Gazprom Sbyt's applications for gas. Naftogaz followed this procedure and provided the volumes in accordance with the annual additional agreements on the basis of Gazprom Sbyt's orders, cf. paragraph 40 of Mr [redacted] second witness statement.

(1254) *Secondly*, in 2013 Naftogaz was not able to perform Gazprom Sbyt's application for gas supplies in March 2013 due to the absence of any supply in that period under the Contract. In March 2013, Gazprom supplied gas directly to Ostchem Gaz Trading AG in Ukraine, and no gas volumes were intended for supply to Naftogaz under the Contract which was duly reported by Naftogaz to Gazprom Sbyt, cf. the following communications:

Letter from Gazprom Sbyt to Naftogaz No. 03-41-112, dated 22 February 2013 (Russian original with English translation).

Letter from Naftogaz to Gazprom Sbyt No. 6-1031/1-2-13, dated 26 February 2013 (Russian original with English translation).

(1255) In any event, Gazprom Sbyt has never raised or pursued the above issue, and has never claimed any breach of the gas supply agreement No. 14/136/09-DKP-01/09 by Naftogaz.

VIII.6.12.5.5 Effect on trade

(1256) As noted above, it is sufficient under Article 102 that only one of Gazprom's practices is capable of affecting competition and trade within the EU, since the various practices form part of an overall infringement of Article 102. Accordingly, the application of Article 102 does not require that the mandatory sales clause in itself affects trade between EU countries.

(1257) However, as pointed out by Mr Lapuerta, this clause does in itself affect trade between EU countries, as it gives Gazprom an advantage in the sale of gas to customers in Ukraine (cf. Expert Competition reply, paragraph 137 f). As a result, potential suppliers from EU countries such as Slovakia, Poland and Hungary are put at a disadvantage, which affects trade patterns between EU countries. On the same basis, trade patterns within the ECT are affected.

(1258) Consequently, the effect on trade criterion is met under Articles 101 and 102, both as regards trade between EU countries and in the context of trade within the Energy Community.

VIII.6.13 Invalidity and ineffectiveness and their consequences

VIII.6.13.1 The basis for invalidity

(1259) Gazprom has submitted that Article 18 EnCT does not provide that a provision which contradicts Article 18 ECT is automatically void. It has also asserted that, if the Tribunal declares any provision of the Contract void, the Contract should be adjusted in such a manner as to maintain and/or restore its equilibrium.

(1260) As discussed above, Naftogaz primarily relies on a direct application of Articles 101 and 102 TFEU as basis for its competition law claims, as such and as Swedish law. Naftogaz also relies on Article 18 EnCT as Swedish law, by virtue of its direct horizontal direct effect. Any breaches of Article 101 or Article 102 TFEU and Article 18 ECT (which incorporates Articles 101 and 102 TFEU), clearly result in the relevant provision being invalid.

(1261) Furthermore, Article 18 EnCT applies to the Contract as mandatory Ukrainian law, rendering restrictive and/or abusive provisions ineffective, cf. Article 9.5 of the Contract.

(1262) It falls on Swedish law as applicable law to determine the consequences of any invalidity in accordance with Articles 101 and 102 TFEU and Article 18 ECT.

(1263) The date of invalidity/ineffectiveness claimed for the provisions in violation of competition law are the dates of invalidity in the Relief Sought to reflect the facts that Naftogaz applies the price revision claim based on competition law in parallel with the contractual price revision claim, and primarily relies on the direct application of Articles 101 and 102 TFEU, as follows:

(1264) *The price provisions:* For evidentiary reasons, Naftogaz, in the alternative to 1 February 2011 (the entry into force of the EnCT for Ukraine), claims invalidity and replacement of the price provisions from 20 May 2011, corresponding to the effective date of the principal price revision claim, alternatively from the later dates from which Naftogaz claims price revision based on the Contract or general principles of contract law, with corresponding claims for damages/repayments.

(1265) *The non-price provisions:* As discussed above, Naftogaz primary legal basis for its competition law claims is the direct application of EU law. In the case of the non-price provisions, Articles 101 and 102 TFEU were consequently violated as of the date the Contract was concluded. Thus, the date of invalidity for these provisions has been changed to 19 January 2009 in the Relief Sought. The date of effectiveness of the replacements is, as in the SoC, the date of the award.

VIII.6.13.2 Application of Swedish law

(1266) Article 9.5 of the Contract governs the consequences of invalidity of one or more elements of the Contract. According to Article 9.5 of the Contract, an invalid/ineffective provision shall be replaced with a new provision that shall have an economic effect as close as possible to that of the invalid provisions.

(1267) Article 9.5 regulates the impact on the Contract of invalidated provisions. Article 9.5 only provides that the offending clause shall be replaced. It does not provide that any other changes should be made to the Contract. Hence, Article 9.5 excludes the type of exercise that Gazprom seems to want to engage in, somehow rewriting other parts of the Contract as a consequence of the replacement of new clauses for those that are invalid.

(1268) Therefore, to succeed, Gazprom would also need to prove that Article 9.5 is unconscionable. However, this is a boilerplate clause common in gas sales contracts as well as other types of contracts. It is reasonable *per se*. There is nothing in the facts that would render the provision unconscionable in this situation.

(1269) Gazprom has argued that Article 9.5 of the Contract shows that the Parties' intention was that any invalidated provisions should not affect the equilibrium of the Contract. Moreover, Gazprom has asserted that the consequences of invalidity under Swedish law (for the remainder of the Contract) are determined by application of the doctrine of assumptions and by Section 36 of the Swedish Contracts Act. However, Gazprom has not explained how in its view other parts of the Contract should be adjusted. Nor has it invoked any assumptions or any other circumstances relating to the doctrine of assumptions or Section 36 of the Swedish Contracts Act (other than the allegation that that the equilibrium of the Contract would be altered by the invalidity of the relevant provisions).

(1270) According to Gazprom, the reasons for not making any additional arguments in this respect is that it is not possible for Gazprom to state in specific terms what adjustment would be appropriate unless Naftogaz "*sets out the basis for its case in more detail*". This is a pretence.

(1271) Naftogaz has not made any changes to the requests for relief based on competition law as set out in the SoC, other than expressly stating that the new Contract Price shall apply as of 20 May 2011 (or alternatively 17 June 2011 or 28 April 2014), and changing the date of invalidity for the non-price provisions, is now 19 January 2009. Naftogaz has also clearly stated what provisions are invalid and if and how they are to be replaced.

(1272) According to Article 9.5 of the Contract, the Parties shall replace invalid or ineffective provisions with new ones that would have the same economic effect *as close as possible* to that of the invalid or ineffective provision. Thus, the intention of the Parties was only to replace any invalid/ineffective provision with one which is as close as possible to the invalidated or ineffective provision. It is also self-evident that a new provision cannot be included in the Contract, unless the new provision is compliant with applicable competition law and hence valid itself.

(1273) In line with the above, Naftogaz has requested that the invalidated provisions under the Contract shall be replaced with new provisions based on Article 9.5 of the Contract whenever possible. Any such new articles are also as close as possible to the invalidated provisions (taking into consideration that the new provisions shall be valid under competition law). The new provisions which shall replace the invalidated provisions of the Contract are consequently in line with Article 9.5 of the Contract.

(1274) The legal bases invoked by Gazprom for adjusting the remainder of the Contract are not applicable. First of all, the doctrine of assumption is not applicable at all in this situation, as it would arguably lead to the invalidation of the entire agreement, which is not what Gazprom is seeking. In any event, it is not applicable for the following reasons:

(1275) Under the doctrine of assumptions, an agreement may in *exceptional* circumstances be held to be invalid if:

(i) a party had an "assumption" when it entered into the agreement;

(ii) that assumption was material;

(iii) the assumption and its materiality were evident to the other party;

(iv) the assumption was incorrect;

(v) there are extraordinary circumstances that make it equitable that the party that did not make the assumption should bear the risk of the assumption being incorrect (there must be "*extraordinary circumstances*", as the ordinary principle is that each party bears the burden of its own assumptions unless they have become part of the Contract); and

(vi) the assumptions is not dealt with either in the Contract or under the background law (*Swedish: "dispositiv rätt"*).

(1276) Accordingly, the doctrine of assumption cannot be relied on where the parties have excluded its application, or if they have dealt with the consequences of the assumption in the Contract, specifically or more generally. Thus, the doctrine does not apply, e.g., where there are provisions under the Contract that deal with the assumption.

(1277) Consequently, and importantly, the doctrine of assumptions is not applicable in the current situation. The Swedish Supreme Court has clearly stated that under Swedish law, the doctrine of assumptions does not apply when the relevant assumption is covered by the parties' agreement. In the present case, this is precisely the situation, as Article 9.5 of the Contract governs the situation where a contractual clause is declared invalid (i.e. it governs the assumption that the contract clauses are valid). Additionally, there are no failed assumptions under the Contract which have been essential to Gazprom or which make any adjustment of the Contract reasonable or appropriate (especially as the invalid/ineffective provisions, whenever possible, shall be replaced by new provisions).

(1278) Section 36 of the Swedish Contracts Act is not applicable either for reasons to be explained below. As a starting point, however, Naftogaz is surprised by the fact that Gazprom argues that Section 36 is not applicable due to CISG in respect of Article 4, yet apparently argues that Section 36 can be applied in the present context.

(1279) Any provisions of the Contract which are in breach of competition law are invalid. Section 36 of the Swedish Contracts Act obviously cannot operate to reinstate any such invalidated provisions. Moreover, Section 36 applies to unconscionable contractual provisions. In order for Section 36 of the Contracts Act to be applicable, therefore, it is not sufficient that the equilibrium between the parties has been altered. Its application requires that there is an unconscionable contractual provision.

(1280) However, Gazprom has not, as far as Naftogaz can ascertain, argued that any particular provision is or would become unconscionable and shall be adjusted, let alone how. As a matter of fact, there are none following replacements pursuant to Article 9.5, which also ensures a rebalancing of the Contract in conformity with custom and practice in the industry.

VIII.6.13.3 The individual breaches and invalidity

VIII.6.13.3.1 Introduction

(1281) Contractual provisions which are restrictive of competition (Article 101 TFEU) or which are exclusionary (Article 102 TFEU), serve to eliminate or weaken possible competitors on the relevant market, and do not affect the relationship between the parties as such. The invalidity of such provisions does not therefore affect the equilibrium between the parties.

(1282) Exploitative provisions in a contract are unconscionable *per se* and lead to an unacceptable (im)balance between the Parties to the Contract. Following invalidity of an exploitative provision, any adjustment of other parts of the Contract which restores the original and illegal imbalance will therefore generally defeat the very purpose of the invalidity. It would indirectly allow the dominant actor to abuse its dominance.

(1283) Contractual elements which are in breach of Articles 101 and/or Article 102 TFEU are invalid as of the entering into of the Contract. However, if the relevant contractual provision is not invalid when the Contract is entered into, e.g. as the contractual party is not dominant at such time or as the pricing is not excessive when the Contract is entered into but such dominance or excessive pricing is established at a later time, the contractual provision will be invalid as of such later date.

VIII.6.13.3.2 The Contract Price

(1284) Naftogaz' price revision claim is, in the alternative to the grounds claimed as price revision based on Article 4.4 and favourable economic result, also based on Article 102 TFEU and on Article 9.5 of the Contract. The basis for the invalidity of Article 4.1 of the Contract under Article 102 TFEU is that it is exploitative and discriminatory, i.e. that it constitutes an unfair trading condition.

(1285) As already noted, if a contractual provision is regarded as exploitative, the provision is by its very nature unfair and there is an unequal balance between the Parties under the Contract. Any adjustment of the Contract to restore the same (im)balance ("equilibrium"), would therefore undermine the purpose of the competition regime. It would indirectly allow the dominant actor to continue to abuse its dominance.

(1286) Moreover, the new provision which shall replace the current Article 4.1 of the Contract in fact restores the intended equilibrium between the Parties. What Gazprom appears to want, however, is to restore the (im)balance that currently exists, but which did not exist at the conclusion of the Contract. No provision can become unconscionable on account of the original balance being restored by the application of competition law and Article 9.5.

(1287) As discussed above, Naftogaz also finds it difficult to understand which provision(s) might become unconscionable after the inclusion of a new Contract Price which is market reflective. The new Article 4.1 clearly cannot be unconscionable, since it is market reflective, which *a priori* must be regarded as fair. It is equally difficult to see another provision that has become unconscionable due to the inclusion of market reflective pricing, and none have been identified by Gazprom.

VIII.6.13.3.3 The volume and Take or Pay provisions

(1288) The volume and Take or Pay provision in Article 2.2 and Article 2.2.5 of the Contract are invalid under EU competition law and shall be replaced with new provisions. The invalidity of Articles 2.2 and 2.2.5 of the Contract is a consequence of the fact that the provisions are restrictive of competition (Article 101 TFEU) and exclusionary (Article 102 TFEU).

(1289) Hence, the basis for the invalidity is the effects on the market as such. Therefore, as previously noted, there can be no question about restoring the "equilibrium" within the Take or Pay provision itself, because it is exactly this position that is problematic from a competition law standpoint.

(1290) Moreover, the provisions which shall replace Articles 2.2 and 2.2.5 of the Contract are as close as possible to the current Articles 2.2 and 2.2.5 without being in breach of Articles 101 and 102 TFEU and are in line with market practice.

(1291) At the same time, there are no other provisions under the Contract, such as the Contract Price, which will be particularly favourable to Naftogaz, and which do not correspond to market practice. Nor are there any provisions that can be said to become unconscionable as a consequence of the replacement of the volume and Take or Pay provisions, and no such provisions have been identified by Gazprom. Naftogaz therefore fails to see that the new volume and Take or Pay provisions may be subject to any further adjustment or that any other provisions of the Contract have become unreasonable based on the invalidity and replacement of Article 2.2 and Article 2.2.5 of the Contract.

VIII.6.13.3.4 The Destination Clause

(1292) Also the Destination Clause in Article 3.10 in the Contract is invalid based on competition law. As in the case in respect of Articles 2.2 and 2.2.5 of the Contract, the invalidity is based on the provision being restrictive of competition (Article 101 TFEU) and exclusionary (Article 102 TFEU).

(1293) Destination clauses are notorious under competition law and are strictly prohibited as they artificially separate national markets and undermine their integration. As any destination clauses are strictly prohibited under EU competition law it is not possible to include a new, revised, destination clause in the Contract.

(1294) Naftogaz also fails to see that there are any other provisions of the Contract which have become unreasonable due to the invalidity of Article 3.10 of the Contract, and none has been identified by Gazprom.

VIII.6.13.3.5 The Mandatory Sales Clause

(1295) Article 9.7 of the Contract is invalid under Articles 101 and 102 TFEU, as it is restrictive of competition and exclusionary. Article 9.7 strengthens Gazprom's hold in the Ukrainian market and also strengthens Gazprom's dominant position in the upstream market. In addition, it limits the gas available on the Ukrainian market, contravening the purpose of the liberalisation of the natural gas market in Ukraine. It is the effect on the market which is decisive, and there is no balance or equilibrium between the Parties under the Contract to restore.

(1296) Moreover, as it is the obligation to enter into a long-term contract with OOO "Gazprom Sbyt Ukraine" that is abusive, it is not possible to include a new, revised, clause to the same effect as the present Article 9.7. Naftogaz also fails to see that any other provisions of the Contract have become unreasonable, or which give Naftogaz an unreasonable benefit based on the invalidity of Article 9.7, and none have been identified by Gazprom.

VIII.6.13.4 Ineffectiveness based on breach of Article 18 EnCT as part of the Ukrainian law

(1297) Article 18 ECT constitutes mandatory Ukrainian law. As described and documented in the Expert Competition Report, as well as in the Expert Competition Reply, several provisions of the Contract violate Article 18 EnCT. Thus, these provisions are prohibited when Article 18 EnCT is applied as Ukrainian law.

(1298) While Ukrainian law as such is not applicable to the Contract *per se* pursuant to Swedish law, Ukrainian law nevertheless affects the performance of the obligations under the Contract. The Contract is to be performed in Ukraine, but applying the provisions in question is prohibited and illegal in Ukraine. Hence, while not being the law applicable to the Contract, the provisions of Ukrainian law and the prohibitions therein are facts that render provisions of the Contract ineffective.

(1299) According to Article 9.5 of the Contract, an invalid *or ineffective* provision shall be replaced with a new provision that shall have an economic effect as close as possible to that of the invalid or ineffective provision. The consequences of the ineffective Contract provisions are the same as those set out above, concerning the consequences of invalidity under the other relevant legal bases.

VIII.6.14 Repayment/damages claim following invalidity of Article 4.1 of the Contract under competition law

VIII.6.14.1 Introduction

(1300) The unrevised/unadjusted Article 4.1 of the Contract is invalid under European competition law. Hence, if Article 4.1 of the Contract is not revised or adjusted as of 20 May 2011 based on Article 4.4 of the Contract, Naftogaz' inherent right to economically market the supplied gas and/or Section 36 of the Swedish Contracts Act in a way which makes the price under the Contract compatible with European competition law, Article 4.1 is invalid under European competition law as of 20 May 2011 (or such later date as the Tribunal will determine).

(1301) Following invalidity of Article 4.1 of the Contract, Article 4.1 of the Contract shall be replaced with a new Article 4.1 in accordance with Article 9.5 of the Contract as of 20 May 2011 or such later date as determined by the Tribunal. If Article 4.1 is replaced with a new Article 4.1 in accordance with Naftogaz' requests for relief for any historic period, Naftogaz has made overpayments for such historic period. As no legal ground for such overpayments following replacement of Article 4.1 exists, Naftogaz has a right to repayment of the excessive amounts.

(1302) Should Article 4.1 of the Contract not be replaced with a new provision following invalidity of Article 4.1 or as of a later date than the invalidity of Article 4.1, Gazprom is obliged to pay damages to Naftogaz for any loss suffered by Naftogaz as a consequence of Gazprom's breach of applicable competition law during such period.

(1303) Naftogaz' right to damages is discussed in further detail below. Gazprom's defences against Naftogaz' claims for repayment/damages are also addressed below.

VIII.6.14.2 The right to damages

(1304) The right to receive damages for breach of Articles 101 and 102 TFEU is an established principle under EU competition law. The ECJ has clarified that EU Member States are required as a matter of EU law to allow claims for compensation for breaches of Articles 101 and 102, as well as enforcing the illegality of the infringing conduct, cf. paragraphs 26-31 of *Courage v Crehan*.

(1305) Swedish law safeguards this requirement through Chapter 3, Section 25 of the Swedish Competition Act, according to which damages shall be awarded if someone intentionally or by negligence breaches the prohibitions against anti-competitive agreements and abuse of dominance as laid down in the Swedish Competition Act and in Articles 101 and 102 TFEU.

(1306) As a dominant undertaking on the market for natural gas, Gazprom has been obliged to have knowledge of market prices on the gas market. Hence, Gazprom has at least been negligent when imposing an excessive price on Naftogaz.

(1307) The right to compensation includes the full real value of the damage suffered and comprises factual loss, loss of profit and interest from the time when the damage occurred. Case C-536/11 *Donau Chemie and others* ECR [2013], paragraph 24

Case C-295-298/04 *Manfredi ECR* [2006] I -6619, paragraphs 95-97 and 100.

OJ 2013/C 167/07, *Communication from the Commission on quantifying harm in actions for damages based on breaches of Article 101 or 102 of the Treaty on the Functioning of the European Union.*

(1308) Based on the above principles for the calculation of the damage suffered, the damages amount awarded relating to factual loss under Chapter 3, Section 25 of the Swedish Competition Act in relation to excessive pricing, corresponds to the difference between the pricing under the relevant contract and the pricing which would have applied in compliance with Articles 101 and 102 TFEU.

(1309) The price invoked by Naftogaz in relation to the replacement of Article 4.1 by virtue of Article 9.5 of the Contract is in accordance with competition law and is also as close as possible to the current price without violating European competition law. Therefore, the damages should correspond to the difference between the price paid by Naftogaz under the Contract during the relevant period and the price that Naftogaz would have paid should Article 4.1 have been replaced pursuant to Article 9.5 in accordance with the Relief Sought.

VIII.6.14.3 Gazprom's defences against Naftogaz' claims for repayment/damages

(1310) According to Gazprom, Naftogaz is not entitled to a refund of excess payments in the event that the Tribunal should hold that Article 4.1 of the Contract is invalid and should be replaced.

(1311) As set out above, Naftogaz' primary claim based on competition law is two-fold. Naftogaz both asks the Tribunal to declare Article 4.1 invalid and to replace Article 4.1 with a new article pursuant to Article 9.5 of the Contract.

(1312) Since Naftogaz claims that Article 4.1 shall be replaced with a new article which is in line with EU competition law, its repayment claim is not a consequence of the invalidity as such, but is based on the subsequent establishment of a new price and thereby of an overpayment. Alternatively, Naftogaz is entitled to damages under Chapter 3, Section 25 of the Swedish Competition Act to compensate for the loss suffered as a consequence of Gazprom's breach of applicable competition law, cf. below.

(1313) Gazprom seeks to invent a defence against these grounds by referring to principles for rescission of invalid contracts, as in relation to Naftogaz' request for relief relating to Section 36 of the Swedish Contracts Act. However, we recall that Naftogaz does not claim that the Contract is invalid, and it does not claim that the Parties' performances shall be reversed.

(1314) As Naftogaz interprets Gazprom, Gazprom appears to argue, albeit not explicitly, that principles of *pactum turpe* would exclude the right of Naftogaz to reclaim excess payments.

(1315) First of all, the excerpt from the doctrine quoted by Gazprom concerns the situation where an agreement is invalid on account of *pactum turpe*. In this case, no party claims that the agreement is invalid. The compensation claimed by Naftogaz is not, as the excerpt discusses, a return of the Parties' performances following invalidity of the Contract. It is primarily a refund of excess payment after the application of article 9.5 and secondarily damages for Gazprom's breach of competition laws.

(1316) Moreover, the essence of Naftogaz' claim, whether based on replacement of Article 4.1 by virtue of Article 9.5, or damages for Gazprom's breach of competition laws is compensation for losses suffered by Gazprom's excessive pricing.

(1317) It is of course anything but a contravention of fundamental principles of law and morality that Gazprom shall compensate Naftogaz for this excessive pricing. On the contrary, the right of an aggrieved party to claim damages from a party such as Gazprom is a necessary and fundamental element of the body of EU and national laws that police anti-competitive and abusive behaviour, see e.g. Government Bill 1992/93:56 p. 34, Government Bill 2004/05:117 p. 28.

Government Bill 1992/93:56 page 34.

Government Bill 2004/05:117 pages 34-35.

(1318) Hence, the right to seek repayment or compensation for overpayments is in *furtherance* of fundamental principles of law (EU competition law) not in contravention of them. As set out above, the right to such compensation (by way of damages) follows directly from Swedish law, Chapter 3, Section 25 of the Swedish Competition Act.

(1319) It is therefore absurd to propose that Gazprom's obligation to compensate Naftogaz for the overcharged gas fees as a consequence of the application of Article 9.5 or by virtue of Chapter 3, Section 25 of the Swedish Competition Act would be restricted by principles of *pactum turpe*. It would diminish the efficiency of EU competition law considerably if a dominant undertaking could retain amounts obtained through its transgressions of competition laws by referring to its own breach as *pactum turpe*. It would also be contrary to the principle that the offender should not be able to benefit from his violations of competition law.

(1320) In addition, Gazprom for its defence has also relied on the same arguments as made in relation to the price revision claim regarding implicit recognition of debt, i.e. that Naftogaz has allegedly lost its right to repayment, because Naftogaz has not reserved its right to repayment.

(1321) In this respect, Naftogaz relies on the same arguments as made regarding its claim being intact though not expressly reserved and regarding its entitlement to retroactive adjustment under Section 36 above. Several additional arguments may also, in this context be made against Naftogaz' payments being seen as waivers of its rights to repayment on account of excessive pricing.

(1322) Naftogaz has in fact given Gazprom ample notice that it considers that the Contract Price has not reflected the market price. It has also quite clearly shown that it seeks to recoup the excess payments by initiating the price revision procedure which customarily is to be followed by a repayment claim.

(1323) Thus, Gazprom has been fully aware that Naftogaz has been paying the amounts invoiced by Gazprom on the condition that any excess amounts would be reclaimed following a determination of the applicable price by a competent arbitral tribunal. Gazprom has never had any reason to believe that these payments were regarded as final by Naftogaz.

(1324) The fact that Naftogaz first in 2014 suggested an alternative legal principle (invalidity of Article 4.1 and replacement by virtue of Article 9.5) to apply to the same basic facts to achieve the same practical result as price revision under Article 4.4 cannot give rise to any justifiable impression that Naftogaz has waived claims of billions of dollars for no apparent reason.

(1325) The Swedish Supreme Court case, NJA 1989 p. 224, also shows that the knowledge or suspicion of the recipient that there may not be any payment obligation associated with the relevant amount paid (i.e. the recipient's bad faith) is of relevance. In this context, we recall that Gazprom, as a dominant undertaking and responsible for its market behaviour, has been obliged to have knowledge of the level of market prices under European competition law. Hence, Gazprom must have been aware that the price has been excessive (which also follows from the fact that Naftogaz notified Gazprom of the excessive pricing in 2011). Accordingly, also for this reason Gazprom cannot have had a justifiable impression that the payments made by Naftogaz were final.

(1326) Moreover, distinction must always be made between defences/repayment grounds that are the subject of discussions between the parties at the time of payment and other grounds. Hence, a payment cannot be regarded as a waiver of all possible repayment claims and can only be invoked in relation to claims which have been discussed between the parties prior to the payment.

(1327) In any event, Gazprom's request for monetary relief is also based on damages. None of Gazprom's objections have any relevance in relation to such damages claim.

VIII.7 Revision of the Volume and Take or Pay Provisions based on Section 36 of the Swedish Contracts Act

VIII.7.1 Introduction

(1328) Naftogaz claims that Articles 2.2 and 2.2.5 are invalid or ineffective based on competition law, and shall be replaced, with effect from the Award, with new, fair provisions.

(1329) However, if Articles 2.2 and 2.2.5 are not invalid or ineffective under applicable competition law, Articles 2.2 and 2.2.5 are in any event unconscionable and shall be adjusted under Section 36 of the Swedish Contracts Act such that Articles 2.2. and 2.2.5 are rendered inapplicable up to the date of the Award and are then replaced in the same manner as claimed based on competition law.

(1330) The declaratory reliefs therefore cover, firstly, the period from 19 January 2009 up to the date of the Award, during which period Articles 2.2 and 2.2.5 simply shall be set aside and, secondly, from the date of the Award and onwards where new replacement provisions shall apply.

(1331) Articles 2.2 and 2.2.5 were unconscionable from 19 January 2009 up to the date of the Award. The Take or Pay provision was drafted by Gazprom and it was introduced and imposed by Gazprom on Naftogaz at the last minute of the negotiations. Naftogaz had no practical ability to reject it or modify it, *inter alia*, due to the inequality of bargaining powers at the time. Naftogaz recalls here that Gazprom had interrupted the gas deliveries to put additional pressure on Naftogaz and Ukraine.

(1332) The negotiation history of the clause is a factor in its own right. The Take or Pay provision was drafted by Gazprom and it was introduced and imposed by Gazprom on Naftogaz at the last minute of the negotiations. Naftogaz had no practical ability to reject it or modify it, inter alia, due to the inequality of bargaining powers at the time. We recall here that Gazprom had interrupted the gas deliveries to put additional pressure on Naftogaz and Ukraine.

(1333) The contents of the Take or Pay regulation itself was exceptional and unreasonable already *ab initio*. Contrary to standard Take or Pay clauses, Article 2.2.5 does not grant Naftogaz any credit for payments where gas is not offtaken. In other words, the current Take or Pay provision does not enable the Buyer to take additional gas at a later stage and pay by setting off its previous payment ("make-up gas"). This is an unreasonable feature in its own right.

(1334) Furthermore, the Take or Pay provisions in the Contract are in practice unworkable. Unlike other Continental European gas sales agreements, the Contract contains no proper provisions for the calculation of the annual Take or Pay volume, nor for the calculation of the payment.

(1335) The Take or Pay clause is even more excessive as it operates in tandem with the destination clause which denies Naftogaz the right to sell the gas outside of Ukraine. Hence, as Naftogaz did not need the excess gas to deliver to its Ukrainian customers, it could neither pay and use the payment as credit for future gas, nor sell the gas on to customers outside Ukraine. Thus, another material feature which renders Take or Pay clauses acceptable in the normal cases, the ability of the purchaser to freely market the gas to potential customers, is absent here.

(1336) This feature becomes even more unconscionable in the light of subsequent developments. The Take or Pay provisions were introduced at a time when the assumption was that the volumes agreed could be sold to Ukrainian customers alone. However, this assumption subsequently failed because of changed circumstances in the market. The consumption in Ukraine fell due to the global recession. This development was entirely outside the control of Naftogaz as also confirmed by the statements made in April 2009 by the (then) Prime ministers Ms Yulia Tymoshenko and Mr Vladimir Putin. Thus, starting from a situation where Naftogaz' ability to market the gas subject to the Take or Pay was already artificially limited by the destination clause, market developments in Ukraine made it impossible for Naftogaz to sell the necessary volume.

(1337) Naftogaz subsequently lost its monopoly on gas imports in Ukraine. When the Contract was entered into, Naftogaz was the sole importer of gas in Ukraine and could at least be reasonably certain that it could sell the entire volume of gas which was demanded by the Ukrainian population from time to time without competition. However, when Naftogaz' monopoly position ceased in 2012, Naftogaz could not be certain of selling even those volumes. Again, this development was outside of Naftogaz' control.

(1338) Gazprom aggravated the effects of this development by its actions. While Gazprom refused to reduce the gas price to Naftogaz, it allowed other importers to buy gas more cheaply from Gazprom. Hence other importers were able to undercut Naftogaz on the Ukrainian market, thereby further limiting Naftogaz' ability to sell the gas which it was required to offtake. Consequently, Gazprom was instrumental in bringing about a situation where Naftogaz was even more prejudiced by the Take or Pay clause.

(1339) The reason why Naftogaz did not offtake the volumes for 2012, 2013 and 2014 that were prescribed by the Take or Pay provision was that Gazprom for these years contrary to its previous commitments refused to set the ACQ to a level which conformed to Naftogaz' actual needs. Pursuant to the wording of Article 2.2.2 this meant that the previous ACQ automatically applied also for the next Delivery Year. Hence, it was Gazprom's refusal to agree to reasonable ACQ's that caused the volume of the Take or Pay obligation to be higher than what Naftogaz could manage. This amounts to an abuse of legal rights and is in fact a situation when it is Gazprom that caused the Take or Pay to be triggered.

(1340) Gazprom refused to revise the Contract Price even though it became increasingly clear that price under the Contract did not reflect the level of market prices. This action by Gazprom is a factor which in itself compels an adjustment of the Take or Pay clause such that it is rendered inapplicable for the time during which the excessive Contract Price applied.

(1341) This observation has two facets, depending on whether the Tribunal chooses to revise the Contract Price retroactively as argued by Naftogaz or not.

(1342) If the Tribunal does not revise the Contract Price, the Take or Pay clause would operate to further defeat the risk division principles inherent in the Groningen type agreements although the Parties agreed that the Contract would be of the Groningen type. Under the Groningen type agreements, the seller carries the (majority) of the price risk, whereas the buyer carries the (majority) of the volume risk through the Take or Pay obligations. In return for assuming the volume risk, the buyer is entitled to earn a reasonable margin on the sales of the gas delivered under the gas sales agreement ("*economically market*").

(1343) If the Take or Pay clause thus required Naftogaz to pay (permanently) for the gas not offtaken at levels far exceeding the applicable market prices, the unreasonable nature of the clause is obvious. Naftogaz would then have been compelled to purchase gas that it could not market due to the combined effect of the destination clause and the shrinking Ukrainian domestic customer base at prices far exceeding market prices.

(1344) However, even if the Tribunal now revises the Contract Price retroactively, the Tribunal must assess the situation as it *de facto* was in 2012-2014. The revision today of the Contract Price will not make the application of the Take or Pay provisions less unreasonable. During 2012-2014, Naftogaz would thus have been compelled to purchase gas at a price level which was excessively high and which could only be revised through arbitration that would take several years and where Gazprom would raise every conceivable objection. Until such price revision was concluded Naftogaz could not avoid paying the price as per the existing price clause. Fulfilling that provisional obligation would be extremely damaging for Naftogaz given the enormous amounts involved and the massive strain on liquidity that it would impose until, several years later, Naftogaz would be able to recoup the excess portion of the price. Moreover, during the very same period, the destination clause still applied.

(1345) The *de facto* situation was therefore that Naftogaz was compelled to provisionally pay the applicable, excessive Contract Price, yet could not sell the gas outside Ukraine (due to destination clause) at the same time as the ability to market the gas in Ukraine (at a considerable loss) was significantly reduced due to reduced consumption, and due to the fact that Naftogaz' competitors were helped by Gazprom to take market shares from Naftogaz. In this light, the Take or Pay clause was still draconian. Such a contractual set up is also an *anathema* to the principles of fairness and balance of risk that underlies the Groningen model, a deviation from market practice which in itself compels the application of Section 36 of the Swedish Contracts Act.

(1346) The current Take or Pay provision is a penalty. Essentially, the clause provides that if Naftogaz does not purchase a certain volume of gas, it has to pay a fixed sum for such gas without the ability to use the payment as a credit. This is a penalty clause.

(1347) The penalty imposed on Naftogaz for not taking gas is far higher than Gazprom's loss. Contractual penalties may be set aside or adjusted where there is a significant discrepancy between the actual loss and the fixed amount payable. This is indeed the case here. Gazprom's loss calculated under normal principles for calculation of damages would equal the payment (of the price) which Gazprom does not receive less the market value of the gas it need not deliver. However, the penalty that Naftogaz is compelled to pay is equivalent to the price which Gazprom does not receive for the gas without any deduction for the undelivered gas. Hence, it can never be said to be a reasonable pre-estimate of Gazprom's loss. It will inevitably be higher.

(1348) In the present case, the penalty is rendered even more unconscionable by the fact that there was in practice no ability for Naftogaz to avoid the penalty (i.e. to take). The decrease in consumption of gas in Ukraine and Gazprom's support to Naftogaz competitors enabling them to take market shares in Ukraine made it necessary for Naftogaz to be able to sell such gas to customers outside Ukraine. However, this was prevented by the destination clause imposed by

Gazprom. Additionally, Gazprom refused to reduce the ACQ. Hence, the choice for Naftogaz was to take gas for which it would be unable to find customers or pay the penalty. But since Naftogaz could not sell the gas on, the financial effect would be that Naftogaz would pay enormous amounts for gas that would be unmarketable, and would remain so due to continued Take or Pay obligations. The Take or Pay clause in the current contract therefore left Naftogaz with no practical ability to avoid being severely financially penalised, one way or the other.

(1349) The Parties have in fact agreed that the Take or Pay provisions are unreasonable. The unreasonableness of the Take or Pay clause was effectively recognised publicly by Mr Putin already in 2009 and prompted Mr Putin to instruct Gazprom's management to reduce the ACQ for 2010 and 2011.

(1350) *At a press conference of 29 April 2009, the (then) Prime Minister Yulia Tymoshenko stated that "[Naftogaz] cannot sustain the demand for those volumes that were specified in the contracts", and Mr Putin confirmed that "smaller gas consumption compared with those specified in our contractual obligations" are due to "the objective situation caused by the world economic crisis and the production decline in Ukraine itself", and that therefore an "agreement between Gazprom and NAK Ukraine exists" whereby Gazprom did not impose "any fine or sanctions", cf. Section XII, 3.3 below.*

(1351) Given that both Parties have effectively agreed on the unreasonableness of the Take or Pay provisions and that they should not be applied, it is Naftogaz' opinion that the Tribunal may apply Section 36 already on the basis of this agreement without even making its own assessment as to unreasonableness. In any event, the fact that both sides have previously recognised that the provision rendered unreasonable results distinguishes the current situation from other disputes concerning the application of Section 36, where this circumstance almost without exception is and has always been in dispute.

VIII.7.2 Articles 2.2 and 2.2.5 are unconscionable from the date of the Award, even if the Contract Price is revised and even if the Destination Clause is set aside

(1352) Most of the arguments set out above in respect of the period before the date of the Award, some of which are also relevant to the corresponding claim based on competition law, remain valid from the date of the Award (and are invoked here also, *mutatis mutandis*). However, the argument regarding excessive price may be moot if Naftogaz is successful in revising the price, and the arguments based on the destination clause may be used only in part if the clause is held to be invalid. The Take or Pay provisions are, however, still unconscionable and shall be adjusted for the future.

(1353) The volume and Take or Pay provisions will still have unreasonable consequences for Naftogaz and are significantly imbalanced to Naftogaz' detriment and Gazprom's benefit.

(1354) In particular, all of the following arguments are still relevant for the period after the award: the negotiation history; the lack of a make-up right in the Take or Pay regulation; the subsequent developments whereby the demand from customers in Ukraine plunged; and Naftogaz' monopoly on gas imports in Ukraine was ended, all whilst Gazprom sold cheaper gas to Naftogaz' competitors; Gazprom's conduct in respect of the ACQ and its ability to repeat this conduct; the penal nature of the Take or Pay clause and the size of the penalty vis-à-vis Gazprom's actual loss; Mr Putin's and Gazprom's statements to the effect that the Take or Pay clause should not be applied; and, the fact that the Parties effectively agreed that it was unreasonable to penalise Naftogaz for not taking more gas than it required.

(1355) The arguments based (wholly or partially) on the destination clause need to be somewhat adjusted for the period after the award in the event that the destination clause is held to be invalid by the Tribunal. In such case, Naftogaz will no longer be contractually prohibited from selling gas outside Ukraine. However, the volume commitment would still exceed Naftogaz' demand for gas to sell within and outside Ukraine. That means that the provisions would in any event force Naftogaz to pay each year for volumes which it objectively cannot dispose of. This will be aggravated by the fact that demand for gas in Ukraine is still steadily declining.

(1356) Therefore, to achieve fairness and align the provisions with market standards, the provisions shall be adjusted going forward as claimed in Naftogaz' requests for declaratory relief.

(1357) The consequence of the unconscionability of the volume and Take or Pay provisions is that Articles 2.2 and 2.2.5 shall be set aside in their entirety for the period from 19 January 2009 to the date of the Award. This also entails that Gazprom's Take or Pay Claims will fail.

(1358) For the period after the Award, the consequence depends on the Tribunal's findings on revision of the Contract Price and the validity of the destination clause. Assuming that the Tribunal revises the Contract Price as claimed by Naftogaz and strikes out the destination clause, there is room for a revised Take or Pay regulation. In such case, Articles 2.2 and 2.2.5 should be revised to provide for a significantly lower volume commitment, and a reasonable Take or Pay obligation, in the updated Relief Sought, which will allow for a balanced and reasonable division of risks between the Parties going forward.

VIII.7.3 Adjustment of other contract clauses based on Contract Law and corresponding declaratory relief

VIII.7.3.1 The Destination Clause

(1359) Naftogaz also asks the Tribunal to set aside the destination clause by the operation of Section 36 or 38 of the Swedish Contracts Act. As described in Section 4 of Naftogaz' response to Gazprom's reply regarding "*new claims*", Naftogaz has since the Request for Arbitration argued that the destination clause is unconscionable and should be set aside by the operation of the Swedish Contracts Act. Admittedly, it has never mentioned Section 38 in addition to Section 36, but in Naftogaz' view that does not matter. In relation to clauses restricting competition Sections 36 and 38 will operate in exactly the same manner. Section 38 however underscores that there is a presumption that clauses restricting a party from conducting a particular activity are unreasonable and that it is up to the party relying on such a clause to prove that it does not go beyond what is reasonable.

(1360) It became clear during Mr [redacted] cross-examination that the clause aims at preventing Naftogaz from competing with Gazprom outside of Ukraine and not only in 2009 but until 2019. It was also made clear that Naftogaz had resisted the destination clause to the extent it went beyond any transition period.

(1361) The unreasonable effects of the destination clause have been explained in Naftogaz' submissions, in the Lapuerta expert reports as well as in the final hearing through Naftogaz' opening statement and Mr Lapuerta's testimony. Its interaction with the volume, price and Take or Pay provisions is also explained below.

(1362) Of course, the destination clause is a hard core restriction prohibited under competition law. This in itself suffices as a reason to set it aside also by the operation of contract law irrespective of whether and what competition law applies, see Section 6.7.9 above with reference to legal sources.

VIII.7.3.2 The Unilateral Suspension Right

(1363) The reasons for setting aside the mandatory sales clause were set forth in Naftogaz' 11th pleading dated 11 October 2016. Essentially, Naftogaz relies on Gazprom's own statement that

CISG allows Naftogaz a corresponding and symmetrical suspension right as Gazprom and therefore simply seeks to get that admission legally confirmed in the award. Naftogaz cannot see any reason for Gazprom rejecting this as it merely entails rubber-stamping Gazprom's own assertion.

VIII.7.3.3 The Mandatory Sales Clause

(1364) The reasons for setting aside the mandatory sales clause were set forth in Naftogaz' 11th pleading dated 11 October 2016. Essentially, Naftogaz asserts that the clause is obsolete and that this was accepted (Sw. vitsordat) by Gazprom. Naftogaz notes that it introduced this ground (admittedly late) simply as a means of simplifying for the Tribunal. As Gazprom in the context of its competition law argumentation stated that the clause has no effect and cannot in the future have any effect, it follows that Gazprom's factual statement amounts to a recognition that the clause is obsolete under contract law. Given that, the Tribunal should be able to pronounce legally on the basis of that assertion and declare it ineffective. If Gazprom would deny Naftogaz' request for relief as to this clause on the merits and detract from its statement on Day 2 by claiming that the clause actually can have effects in the future, the Tribunal would be forced to engage with the competition law validity of the clause. And it would need to do so on the premise that the clause can have effects in the future. In this respect, Naftogaz is intrigued by the fact that Gazprom on the one hand claims that the clause can have no further effects and on the other hand refuses to allow the Tribunal to declare it ineffective. It would seem that Gazprom's only conceivable reason for not accepting that declaration is that it sees a possibility of invoking the clause in the future.

VIII.8 Claims for Price Determination

VIII.8.1 Introduction

(1365) Naftogaz claims a reduction of the Factual Price pursuant to Addendum [redacted] to the Contract. The trigger for such a reduction, the reduction of customs duty, has occurred and the fact that customs duty subsequently was raised as a consequence of Russia's invasion of Crimea does not mean that the reduction of the factual price was reversed.

(1366) As an alternative claim, Naftogaz requests (i) a determination of the factual price pursuant to Addendum No. [redacted] or, in the alternative, (ii) damages based on Gazprom's breach of its obligation to determine coefficient "*k*" such that the factual price becomes USD [redacted] per 1000 m^3 and to sign a supplemental agreement. Naftogaz position is that the Tribunal need not limit itself to awarding damages, but may in fact proceed to determine the factual price to be

USD [redacted] per 1000 m^3. The claim for price determination based on Addendum No. [redacted] is Naftogaz' principal price determination claim. The request applies with effect from 1 April 2010 [redacted] The purpose is to clarify that the reduction of the Factual Price pursuant to Addendum No. [redacted] applies also if Naftogaz' request for revision of the Contract Price is granted with effect from 20 May 2011 or any other date prior to the second quarter of 2014. Naftogaz therefore principally requests the Tribunal to render an Award declaring that the factual price shall be reduced as agreed in Addendum No. [redacted] in addition to the price revision claims for a reduced Contract Price.

(1367) However, exactly because the price revision claims and the price determination claims are independent of each other, the Tribunal may conceivably grant Naftogaz relief pursuant to Addendum No. [redacted] without granting the price revision claims. Also, Gazprom's obligations pursuant to Addendum No. [redacted] predate and are independent of Gazprom's obligations pursuant to Addendum No. [redacted] and the Tribunal may find that the Factual Price shall continue to be reduced as agreed in Addendum No. [redacted], without finding that the Factual Price agreed in Addendum No. [redacted] still applies.

(1368) Consequently, and again to clarify that the price revision claims and the price determination claims are independent of each other, Naftogaz still further in the alternative to all the preceding claims concerning price, requests the Tribunal to determine the Factual Price pursuant to Addendum No. [redacted].

(1369) If the price revision requested above by Naftogaz establishes a new Contract Price Formula, the price reduction in Addendum [redacted] to the Contract shall also apply from 1 April 2010. i.e. [redacted]

(1370) If, however, the Factual Price is established according to Addendum [redacted] i.e. a Factual Price amounting to USD [redacted] per 1,000 m^3 of Gas, then this should be the price payable under the Contract.

VIII.8.2 The factual background for Naftogaz' price determination claim

(1371) After the Contract was concluded, two major additional pricing arrangements were entered into, in the form of Addenda No. [redacted] and No. [redacted]

(1372) Ite [redacted] of Addendum [redacted] provides for the addition of the following wording to article 4.2 of the Contract in Naftogaz' translation:

[redacted]

[redacted]

[redacted]

(1373) The operative paragraphs of [redacted] read:

[redacted]

[redacted]

[redacted]

[redacted]

(1374) The first of the two arrangements, Addendum [redacted], is peculiar in the sense that its purpose was not to adapt the pricing under the Contract to the market, but rather to arrange payments for the Russian Federation's Black Sea Fleet's use of Ukrainian territory to Ukraine.

(1375) [redacted] of Addendum No. [redacted] implies a [redacted]

(1376) Such adjustment to the Factual Price P_x was also performed through Addendum No. [redacted] by which the [redacted]

(1377) Pursuant to Article 4.2 of the Contract, as amended [redacted]

(1378) [redacted]

(1379) [redacted]

(1380) The price reduction introduced by Addendum No. [redacted] brought the Factual Price into line with the market at the time. Thus, the same price, USD [redacted], was offered to other Ukrainian buyers at the time. The fixed Factual Price was also broadly commensurate with the level of market prices.

(1381) For the first quarter of 2014, the Parties' agreement to fix the Factual Price P_x at USD [redacted] was implemented in Addendum No. [redacted] which set the coefficient "*k*" t [redacted]. However, after the regime change in Kiev in the first quarter of 2014, for the second quarter of 2014 and all subsequent quarters, according to Naftogaz, Gazprom has refused to fulfil its obligations pursuant to Addendum No. [redacted]

(1382) The Russian Federation unilaterally denounced the Kharkiv Treaty in April 2014 following its annexation of Ukrainian territory in March 2014. The Kharkiv Treaty contains no provision regarding its termination, denunciation or withdrawal, and the Russian Federation also failed to provide the necessary notice of its intent to withdraw from the Treaty.

(1383) The Russian Government on the same date declared the Decree void, thereby revoking the reduced export customs duty on Natural Gas exported from the Russian Federation to Ukraine. Gazprom then proceeded to notify Naftogaz that the price reduction implemented through Addendum No. 3 was reversed and the price consequently increased.

(1384) The Russian Government's denunciation of the Treaty and repeal of the Decree were direct consequences of the Russian Federation's illegal occupation and subsequent annexation of Ukrainian territory. Thus, Russia's military occupation of the Crimea in March 2014 was in breach of the principle of territorial integrity, as inter alia expressed in Article 2.4 of the Charter of the United Nations.

(1385) Furthermore, the Russian Federation's actions were in breach of specific commitments towards Ukraine set out in the 7 December 1994 Memorandum on Security Assurances in Connection with Ukraine's Accession to the Treaty on the Non-Proliferation of Nuclear Weapons (the "Memorandum") and the 31 May 1997 Treaty on Friendship, Cooperation and Partnership between the Russian Federation and Ukraine (the "Friendship Treaty").

(1386) The background for the Russian Federation's denunciation of the Treaty and consequently of the Decree was thus a breach of the Russian Federation's obligations towards Ukraine under international law. A party cannot terminate or withdraw from a treaty based on its own international obligations owed to the other party under the treaty, cf. Articles 61.2 and 62.2 (b) of the Vienna Convention.

(1387) For the sake of good order, Naftogaz does not ask the Tribunal to decide on any disputes between Ukraine and the Russian Federation. However, the legality of the Russian Federation's actions is relevant on a preliminary basis, when deciding on whether the apparent ineffectiveness of Addendum No. [redacted] is caused by unexpected changes in circumstances and therefore justifies a restrictive interpretation of Addendum No. [redacted], as well as in the assessment pursuant to Section 33 and 36 of the Contracts Act.

(1388) On 16 June 2014, Gazprom suspended all deliveries of natural gas to Naftogaz. Transit of Russian gas through Ukraine to Europe continued as usual.

(1389) Subsequently, Naftogaz, Gazprom, Ukraine, the Russian Federation and the European Commission entered into negotiations to find an interim solution for deliveries of Russian natural gas to Ukraine. The European Commission was *inter alia* motivated by a wish to secure uninterrupted transit of natural gas through Ukraine during winter.

(1390) Through these negotiations, Ukraine, the Russian Federation, the European Commission, Naftogaz and Gazprom agreed on an interim mechanism for resumed gas supplies to Ukraine in the period from November 2014 to March 2015. This mechanism was implemented through a number of documents in addition to Addendum No. [redacted].

(1391) The Binding Protocol sets out the framework enabling the delivery of gas volumes from Gazprom to Naftogaz necessary to cover the domestic consumption in Ukraine over the winter period from November 2014 until 31 March 2015 in order to safeguard the security of gas supply in the upcoming winter season.

(1392) Pursuant to the Binding Protocol, the price of Natural Gas supplied by Gazprom to Naftogaz under the Contract in the period from November 2014 until 31March 2015 should be decreased by the amount of export duty decrease provided by the Government of the Russian Federation. The decrease of the export duty should be calculated according to the following formula: at a price of USD 333 per 1000 m^3 of natural gas the reduction was USD 100, at a price lower than USD 333, the reduction was 30% from such price.

(1393) Effectively, therefore, the Binding Protocol temporarily reinstated the export duty reduction and consequent reduction of the Factual Price under the Contract implemented in Addendum No. [redacted].

(1394) The purpose of Addendum No. [redacted] was obviously to bring the Contract back into line with the market.

VIII.8.3 The price reduction relating to Addendum No. [redacted] still applies

(1395) Naftogaz' claim for determination of the price provisions is intended to maintain the above price arrangements despite Gazprom's refusal to fulfil its obligations pursuant to Addenda No. [redacted] and No. [redacted]. Thus, the claims are essentially a matter of contract interpretation.

(1396) However, due to the practical implementation of the above price arrangements, upholding them may in the alternative require the application of principles of Swedish contract law extraneous to the Contract, in particular Sections 33 and 36 of the Contract Act.

(1397) Naftogaz has, among other, the following objections to Gazprom's arguments with regard to Addendum No. [redacted].

(1398) The two main issues are whether or not Addendum No. [redacted]

(1399) The text of Addendum No. [redacted] regulates when the price shall be reduced. The situation which triggers the reduction is when a [redacted]. This occurred when [redacted] was enacted.

(1400) The text of the Addendum also prescribes how the price shall be reduced, [redacted]

(1401) [redacted]

(1402) The question will therefore be whether a term should be implied into Addendum No. [redacted] which would allow or result in a reversal of the price reduction, if customs duties are subsequently increased due to a unilateral revocation of the Decree as a result of the annexation of Crimea by the Russian Federation and the purported revocation of the Treaty (or whether a term should be implied to the effect that the price reduction shall not be reversed in these circumstances). In Naftogaz' view it is self-evident that no term shall be implied to allow revocation. There are a number of reasons for this.

(1403) First of all, the arrangement between Ukraine and Naftogaz, on the one side, and the Russian Federation and Gazprom, on the other side, is one where a land lease is granted as quid pro quo for, *inter alia*, a price reduction on Natural Gas. It would be contrary to the very purpose of this bargain if one side could unilaterally revoke its part of the bargain, in this case the Russian side revoking the price reduction.

(1404) Furthermore, when implying terms into contract, Swedish law will not allow a term to be invoked which would allow one side to benefit from its own wrongdoings. This follows from e.g. NJA 1971 p. 474. In our case, it is the Russian annexation of Crimea - itself an illegal act - which served as pretext for the Russian Federation's purported revocation of the Treaty - also an illegal act - which then were invoked to increase the customs duty and purportedly raise the price. Hence, it is a string of illegal acts and breaches of public international law by Gazprom's shareholder, all of which have been directed against Ukraine, that would serve as the trigger for the purported price increase to the detriment of Naftogaz and Ukraine. Such a term cannot be implied.

(1405) Finally, if the Parties, hypothetically, would have contemplated such a development and sought to regulate it in [redacted], it is quite obvious that they would never have agreed that the price should be increased (to the former level) under these circumstances (i.e. if Crimea were annexed by the Russian Federation, Gazprom would be entitled to a higher payment from Naftogaz).

(1406) Therefore, there is no support for implying a term into the Addendum which would support Gazprom's purported reversal of the price reduction in the current situation.

(1407) If, however, the Tribunal would instead find that the text in Addendum No. [redacted] is simply unclear, the above arguments mean that the Addendum in any event cannot be interpreted to mean that the price reduction may be revoked in the current situation. This would run contrary to the very purpose of the Addendum and would be deeply inequitable and unjust. This is in fact the case regardless of whether the actions of the Russian Federation are legal or not.

(1408) The current situation, where the Russian Federation has annexed Ukrainian territory and then used the annexation as an argument for purporting to revoke its treaty obligations thereby prompting Gazprom to seek to revoke the price reduction, was clearly never contemplated by the Parties at the time. In fact, between the second world war and the Russian annexation of Crimea, no European country had annexed a part of another European country. In 2010, no one would have expected such a thing to happen less than four years later. Naftogaz and Gazprom have therefore no common intention to allow a reversal of the price reduction in such a situation.

(1409) Following this reasoning, it must surely have been implicit that the price reduction could not be undone by, or as a consequence of, the Russian Federation annexing Crimea and seizing de facto control of the land where the Sevastopol navy base is located. This was a most natural and typical assumption at the time. Gazprom must have or should have understood that this typical assumption also applied to Naftogaz (and Ukraine).

(1410) Had Gazprom been of the opinion that Gazprom would - contrary to the typical assumption described above - be entitled to revoke the price reduction under the current set of facts, the onus would have been on Gazprom to make this abundantly clear to Naftogaz (and Ukraine). As Gazprom did not make this clear, Gazprom's interpretation cannot prevail.

(1411) In this context, Naftogaz also wants to draw the attention to the fact that several transnational compilations of general principles of law underline the importance of interpreting agreements in line with "good faith and fair dealing", see e.g. UNIDROIT Principles Arts 4.8(2c), PECL 5:102(g) and DCFR II-8:102(1)(g). Such transnational principles are important sources under

Swedish law and have frequently been referred to by the Swedish Supreme Court. Gazprom's interpretation would quite evidently run counter to good faith and fair dealing.

(1412) In fact, even if the [redacted] would have contained express and ostensibly unqualified reversal language, i.e. under which the price reduction would be automatically reversed upon a subsequent revocation of the Decree or when no equivalent decree would be in force (which the [redacted] certainly does not contain), the [redacted] would still have been inapplicable to the current set of facts.

(1413) All of these factors and arguments require that the Addendum be interpreted such that the current situation is not regulated by the Addendum regardless of whether the situation is covered by the text as such. Hence, the question will be whether a term should be implied to allow Gazprom revoking the price reduction on the current facts. As discussed above, the answer to this question is clearly no.

VIII.8.4 Gazprom is in any event estopped from reversing the price reduction

(1414) Section 33 of the Swedish Contracts Act contains a relevant legal rule, under which a party may not rely on a particular legal act (Sw. *rättshandling*) if the circumstances at the time are such that it would be against faith and honour to rely on the legal act. Gazprom's notice to Naftogaz that the price reduction should be reversed is a legal act. Under the facts and for the reasons set out above, it would clearly be against faith and honour for Gazprom to rely on its notice to achieve a price increase. Therefore, the notice is invalid and the price reduction remains in force.

(1415) The Tribunal would, in Naftogaz' view, reach the same conclusion by virtue of fundamental principles of Swedish law.

(1416) Under Swedish law, a legal right cannot be enforced, if the enforcement of this legal right would run against fundamental principles of law and morality in Sweden (the notion behind the principle of *pactum turpe*).

(1417) Furthermore, Swedish law provides, as a general principle, that a person seeking to rely on a right is estopped from doing so, if this would amount to benefitting from its own or related parties' wrongdoings. The notions behind this principle has been applied by the Swedish Supreme Court in several cases, such as in NJA 1971 p. 474 but also recently in the judgement in NJA 2014 p. 332 (where the court stated that it was a general principle that the defendant could not raise its own wrongdoing in one respect as defence against liability for other wrongdoings).

(1418) The price increase sought by Gazprom in relation to [redacted] would mean that Gazprom would benefit from breaches of public international law by its controlling shareholder, i.e. the Russian side would reap the benefit of its own wrongdoings. At the same time, Swedish law regards the obligation to respect Treaty obligations as a fundamental principle of law and morality. Hence, for this reasons, and by application of these rules or the notions on which they are based, Gazprom cannot utilize any right that it would have under the Contract to revoke the price reduction under the current set of facts.

VIII.8.5 Revision of [redacted] pursuant to section 36 of the Contracts Act

(1419) Further, in the alternative, should the Tribunal find that the price reduction agreed in Addendum No. 3 to the Contract shall not remain in force following the Russian Government's repeal of the Decree, Naftogaz claims a revision of Addendum No. 3 based on Section 36 of the Contracts Act.

(1420) In relation to [redacted] circumstances arising later, in particular the Russian Federation's unexpected and illegal termination of the Treaty and subsequent termination of the Decree, are the primary basis for application of Section 36. These unexpected and extraordinary changes in circumstances lead to unconscionable results if [redacted] is applied as argued by Gazprom.

(1421) In addition, allowing Gazprom the ability to revoke the price reduction would mean that the Russian side of the legal arrangement involving the Kharkiv Treaty, [redacted] and [redacted] ould, with impunity, have been able to withdraw its payment in the bargain (the price reduction) yet would remain able to utilize the performance of the Ukrainian side, the Sevastopol navy base. In fact, the Russian side has *de facto* and unilaterally taken infinitely more than the initial bargain ever involved, it has taken not only the lease to the Sevastopol navy base, but the entire Crimea.

(1422) Thus, should the Tribunal find that [redacted] does not entitle Naftogaz to a factual price (P_x) of USD [redacted] per 1000 m^3 independently of the price reductions foreseen in decrees from the Russian Government, Naftogaz is pursuant to [redacted] in any case entitled to a reduction of the factual price (P_x) as indicated above.

VIII.8.6 The Factual Price agreed in [redacted] still applies

(1423) As an alternative claim, Naftogaz requests (i) a determination of the [redacted] pursuant to [redacted] or, in the alternative, (ii) damages based on Gazprom's breach of its obligation to determine [redacted] such that the [redacted] becomes USD [redacted] per 1000 m^3 and to sign a supplemental agreement. Naftogaz position is that the Tribunal need not limit itself to awarding damages, but may in fact proceed to determine the [redacted] to be USD [redacted] per 1000 m^3.

(1424) According to [redacted] the Parties have agreed to [redacted]

(1425) [redacted]

(1426) [redacted]

(1427) [redacted]

(1428) On 9 January 2014, the Parties signed [redacted] to the Contract where the coefficient "*k*" in the Contract Price formula is equal to [redacted] for the [redacted] resulting in a factual price of USD [redacted] per 1000 m^3.

(1429) By letters dated 4, 7 and 15 April and 12 May 2014, Naftogaz fulfilled the obligation to agree on the [redacted] set out in [redacted] for the [redacted] and requested Gazprom to do the same. In particular, Naftogaz attached to the 7 April letter a draft Addendum signed by Naftogaz determining the [redacted] in accordance with [redacted]

(1430) Gazprom has refused to sign the addendum attached to Naftogaz' 7 April 2014 letter. In its 13 May 2014 response to the Notice, Gazprom refers to [redacted] but does not indicate any reasons for its own refusal to sign the Addendum. However, [redacted] This unilateral and unfounded attempt to increase the [redacted] should be rejected.

(1431) Pursuant to item 1, first sentence of [redacted] to the Contract, the Parties [redacted] the [redacted] The Russian original as well as the literal translation "[redacted] The future effect of the agreement is confirmed by the remaining text of item 1, which specifies that the [redacted]

(1432) That the Parties are contractually obliged to determine the [redacted] at [redacted] is further confirmed by the [redacted] which provides that [redacted]

(1433) [redacted]

(1434) [redacted]

(1435) [redacted]

of [redacted]. The wording leaves no discretion to Gazprom and Naftogaz with respect to the result of the determination.

(1436) Second, and as also follows directly from the wording of [redacted] In the event that such reduction should amount to zero, which Gazprom argues is the case following the Russian Government's cancellation of the Decree, the [redacted] shall in any case amount to USD [redacted] per 1000 m^3.

(1437) The second sentence of [redacted] to the Contract regulates the effects should no supplementary agreement on the [redacted] be signed [redacted]

(1438) [redacted]

(1439) [redacted]

(1440) [redacted]

(1441) Further, the purpose of [redacted] and allow for [redacted]. The starting point and prevailing principle of any interpretation of a contract under Swedish law is the mutual intention of the parties at the time of the execution of the Contract. Accordingly, also the intention of the Parties suggests that the wording of [redacted] shall be interpreted in accordance with Naftogaz' understanding.

(1442) Moreover, any interpretation of [redacted] allowing Gazprom to unilaterally change the Contract Price would mean that Gazprom, in practice, would have a unilateral right to refuse to enter into an addendum without any requirement of consistency, loyalty or reasonableness. The Swedish Supreme Court has censored – by way of contract interpretation – provisions that purport to give one party a unilateral decision making right under the Contract, and required that such powers always must be exercised consistently, loyally and generally in a reasonable manner.

(1443) In conclusion, the wording [redacted] [redacted]" must, taking into account the Parties' rationale for entering into the [redacted] its purpose, reasonableness, considerations of consistency and effective provisions, be interpreted to mean reasons related to the relationship between the [redacted] and the level of market prices. [redacted]

(1444) The [redacted] agreed in [redacted] still applies. [redacted]

(1445) [redacted]

(1446) In the case at hand, Gazprom has refused to sign the draft [redacted] attached to Naftogaz' letter of [redacted].

(1447) However, this non-fulfilment of Gazprom of its obligations [redacted] cannot create any rights for Gazprom. Consequently, the [redacted] agreed in [redacted] still applies and Naftogaz is not obliged to pay a [redacted] exceeding USD [redacted] per 1000 m^3.

(1448) In essence [redacted] is an agreement to agree, which can be directly enforceable under Swedish law, "*if the subject the parties are to agree on is evident and the agreement to agree is sufficiently complete*". [redacted] constitutes a binding preparatory contract (Sw. *föravtal*).

(1449) The subject Naftogaz and Gazprom have agreed to agree on is evident and sufficiently complete. They will every [redacted]. Hence as the time for performance has passed, Naftogaz is entitled to the benefit of the end result which the Parties were to agree on, namely a [redacted] of USD [redacted] per 1000 m^3, aligning the Contract with the market.

VIII.8.7 Revision of [redacted] based on section 36 of the Contracts Act

(1450) Alternatively, in the event the Tribunal should find that [redacted] to the Contract entitles Gazprom to unilaterally increase the agreed [redacted] of USD [redacted] per 1000 m^3 for reasons not related to the market or simply without reason at all, such entitlement would be unconscionable pursuant Section 36 of the Contracts Act, and that [redacted] must be amended so that [redacted] requires a market-based reason.

(1451) For a term of 11 years, from 1 January 2009 to 31 December 2019, the Contract stipulates that Naftogaz shall purchase Natural Gas from Gazprom, effectively the sole supplier of natural gas to Ukraine when the Contract was concluded, on a Take or Pay basis. The original ACQ under the Contract was 52 BCM, i.e. approximately 103.3 % of the total natural gas consumption in Ukraine of 50.53 BCM in 2013. Natural gas dominates Ukraine's energy mix, holding 40 % of the energy market as of 2011. The size and structure of the Contract makes it the most important contract in the Ukrainian economy and decisive for the continued existence of Naftogaz.

(1452) Being the effective sole supplier of Natural Gas to Ukraine in 2009, Gazprom was, and to some extent still is, allowed to dictate the terms for sales of Natural Gas. [redacted] was entered into at a time when the Contract Price had become unreasonably high, and imposed acute financial problems on Naftogaz. Gazprom's interpretation of [redacted] would imply that Gazprom has a choice between [redacted] leading to a price totally unreflective of the market price, and [redacted] leading to USD [redacted] per 1000 m^3. It would be entirely unconscionable to interpret [redacted] as giving Gazprom an option to decide the price at different levels, and thus an opportunity to unilaterally increase the price.

(1453) With reference to Section 36, second paragraph, Naftogaz clearly holds an inferior bargaining position in the contractual relationship between the Parties. This must be taken into account to when determining the applicability of Section 36 first paragraph.

(1454) Gazprom's refusal since April 2014 to sign the supplementary agreements required to fix the factual price at the agreed USD [redacted] per 1000 m^3 effectively amounts to a unilateral amendment by Gazprom of the market reflective pricing arrangement agreed in [redacted] to the Contract, with a huge negative financial impact on Naftogaz. Such an application of [redacted] would be unconscionable in itself.

(1455) Furthermore, Gazprom's refusal to implement [redacted] without giving any reason was apparently motivated by unjustifiable political considerations. In particular, the decision followed immediately upon the major political changes in Ukraine in February/March 2014, which saw Kiev move from alignment with the Russian Federation towards cooperation with the European Union and the West, resulting in a hostile Russian reaction, culminating in the annexation of Crimea and the denunciation of the Kharkiv Treaty and the [redacted]. In this context, the refusal to implement [redacted] appears as just another way of putting pressure on Ukraine. This is in our view relevant "*subsequent circumstances*" in the meaning of Section 36.

(1456) Against this background, Gazprom's purported unilateral right to cancel the pricing arrangement agreed in [redacted] to the Contract is unconscionable and must be set side. [redacted] must be amended to include the qualification that non-signature requires a justifiable reason related to the purpose of [redacted]

VIII.8.8 Summary regarding the price reduction pursuant to [redacted]

(1457) It follows that Naftogaz, pursuant to the Contract and/or Section 36 of the Contracts Act, is entitled to continue to pay a [redacted] of USD [redacted] per 1000 m^3.

(1458) First, pursuant to [redacted] Naftogaz is entitled to pay a [redacted] of USD [redacted] per 1000 m^3 independently of the actual price level foreseen in decrees from the Russian Government. In this case it is therefore not necessary for the Tribunal to decide on whether the price reduction under [redacted] remains in force in order to grant Naftogaz' principal claim for a continued [redacted] which is equal to the [redacted], of [redacted] per 1000 m^3.

(1459) Should, however, the Tribunal find that Gazprom may refuse to sign the supplementary agreements to make [redacted] applicable and thereby avoid the application of the Factual Price of USD [redacted] per 1000 m^3, Naftogaz is in any case entitled to the price reduction agreed in [redacted]. Thus, Naftogaz would then be entitled to a [redacted]

VIII.8.9 Waiver

VIII.8.9.1 Gazprom's objections regarding passivity and implicit waiver

(1460) Gazprom has asserted that Naftogaz cannot succeed with its claims relating to retroactive revision/adjustment of Article 4.1 or with its different repayment claims *inter alia* because Naftogaz has allegedly failed to give notice or bring a claim against Gazprom, has acted passively, and/or has acted inconsistently with such claims. Gazprom has in particular argued that Naftogaz has paid the invoices issued by Gazprom, and that this would mean that the right to claim retroactive revision/adjustment and the right to repayment has been forfeited.

VIII.8.9.2 Failure to give notice or make a claim

(1461) In relation to the alleged failure to give notice or make a claim, Swedish law requires express statutory support for a party to lose rights on account of failed notices or that it has not made a claim within a certain time limit, cf. the award in *Profilgruppen AB v KPMG AB*; Lindskog, *Betalning*, page 128; and, NJA 2002 p 630. There is no statutory support whatsoever for such a requirement in relation to any of the legal grounds invoked by Naftogaz.

VIII.8.9.3 Generally regarding passivity and waiver by conduct

(1462) Moreover, there is no rule under Swedish law providing that passivity or any actions taken by a person which are "*inconsistent*" with a claim brought by that person would in and of itself be regarded as a waiver of such a claim (and for the sake of good order Naftogaz disputes that it has been passive and that any of its actions has been inconsistent with its claims).

(1463) In order for any such effect to occur, it is required that the passivity or the actions taken by the party can be regarded as creating a binding unilateral confirmation or waiver under general rules of contract law, cf. e.g. NJA 1961 p. 26, NJA 1982 p. 244, NJA 1992 p. 243 and NJA 2002 p. 630.

(1464) Hence, it is required that (i) the other party has - in fact - interpreted the actions/passivity as the expression of an intention of a waiver, (ii) this impression must be justifiable/reasonable, and (iii) the person who has taken the relevant actions, or has been passive, must have understood the other person's impression, cf. e.g. Lindskog, *Betalning*, page 122.

(1465) It follows from the above, that if the other person was aware or should have been aware that the person acting or being passive did *not* intend to express a unilateral binding confirmation or waiver by virtue of its action/passivity, the action/passivity does not create these legal effects. Moreover, even if the other person can prove that it actually interpreted the action/passivity as the reflection of a confirmation or waiver, the action/passivity still cannot form a waiver or confirmation unless the other person's impression was justified.

(1466) The starting point when determining the justifiable impression is of course that a person does not normally waive rights that the person may have without meaningful consideration. Therefore, the counterparty would not normally draw the conclusion that the action/passivity is a unilateral waiver of rights. If it nevertheless draws that conclusion, it will seldom be reasonable.

(1467) Further, depending on the relevant action/passivity, an important issue when determining the justifiable impression is what the actions/passivity allegedly is a confirmation or waiver of.

(1468) It is theoretically possible that certain actions/passivity could be perceived as a total waiver of all possible claims relating to a Contract, but that would be extremely implausible. And in such situations it would hardly ever be justifiable to view the relevant actions/passivity as having such far-reaching effect.

(1469) Moreover, a distinction must be made between rights/repayment grounds that are the subject of discussions between the parties at the relevant time and other grounds. This is reflected in the *votum* of Justice Lind in NJA 1989 p. 224 and in Lindskog, *Betalning*, page 123. It would normally seem very unlikely that any actions/passivity could be regarded as a waiver – even more so if made without apparent consideration – of rights and repayment grounds that were not at all subject of discussion between the parties at the relevant time.

(1470) Even if there are, in a particular case, some reasons to consider a certain action/passivity in isolation as a waiver or confirmation of a right, the specific circumstances may exclude such conclusion. The party may for instance have taken other actions that show that it intends to invoke certain rights, that it seek a repayment or that it does not regard the payment as final.

(1471) In particular, if a party takes certain actions which could be viewed as inconsistent with it retaining a claim yet continues to argue that its previously held view as to the disputed issue remains correct, the counterparty cannot conceivably believe that the first party has meant to forfeit the rights.

(1472) Hence, in a specific situation many circumstances may lead to the conclusion that it would not be reasonable to believe that certain actions taken by a person or passivity are the expression of a will to waive rights. The same circumstances would in addition, *a fortiori*, exclude the conclusion that the person taking the actions or being passive must have realised that the other person had gotten the impression that the actions/passivity was the expression of a waiver of confirmation.

VIII.8.9.4 Specifically regarding passivity

(1473) As set out above, in order for passivity to have any relevance in relation to the forfeiture of rights, it is required that the passivity can be regarded as a contractually binding waiver under normal rules of contract law. However, specific considerations apply in relation to passivity.

(1474) In general, a party cannot be regarded as having been given a justifiable impression that a right has been waived based only on passivity. Therefore, there must normally be additional circumstances – such as active conduct – which can be invoked in favour of such a justifiable impression. Accordingly, specific circumstances must exist in order for passivity to be interpreted as giving a justifiable impression of a waiver, cf. e.g. Adlercreutz and Gorton, *Avtalsrätt II*, page 102, NJA 1993 p. 570 and NJA 2002 p. 630.

(1475) In Swedish case law, there is no support for passivity, even for several years, being decisive. The only cases where passivity has been regarded as giving such a justifiable impression of a waiver have been where one party was silent for a very long time without there being any explanation for the passivity, cf. NJA 1993 p. 570 where this existed for 24 years. Otherwise, the Supreme Court has required circumstances which gave the passive party reason to be active, cf. NJA 1961 p. 26 (see also NJA 2002 p. 630 and NJA 1993 p. 302).

VIII.8.9.5 Specifically regarding waiver by making payments

(1476) As indicated above, the main argument relied on by Gazprom in relation to Naftogaz' supposed waiver of its repayment claims is that Naftogaz has paid the invoices issued by Gazprom after May 2011 without reserving the right to repayment. Gazprom maintains that payment of a disputed claim without making express reservation of the right to repayment constitutes implicit recognition (Sw. "*konkludent erkännande*") of a payment liability. This is, however, not the law of Sweden (and is not even relevant given the fact pattern in this case).

(1477) Under Swedish law, a payment is not regarded as a legal act (Sw. *viljeförklaring*) but merely as a fact, see e.g. Karlgren, SvJT 1940 page 337. Moreover, a payment is not its own *causa* and can therefore not create rights or obligations *per se*, see Lindskog, *Betalning*, page 120 and H. Karlgren, "Kvittning och condictio indebiti", (1940) *Svensk Juristtidning* 331, page 337.

(1478) There is also no requirement under Swedish law that a payer must reserve the right to repayment (even in respect of disputed debts) to be able to advance claims in respect of historic periods and repayment claims, cf. Rodhe, *Obligationsrätt*, page 84. Further, in NJA 1989 p. 224, Justice Lind, expressly rejected the notion that a payment without objection would normally ("often") be regarded as a confirmation of debt. He stressed that it will depend on the circumstances in the individual case what legal effects, if any, may flow from a payment without objection and K. Rodhe, *Obligationsrätt* (Stockholm, 1956), page 84.

(1479) There is therefore no standalone rule, as Gazprom envisages, that payment of a disputed claim without making express reservation of the right to repayment constitutes implicit recognition. A waiver of rights to claim repayment – in every case or in respect of a specific ground for repayment – would therefore only arise by virtue of a normal contract law analysis that results in the conclusion that the payer made a binding commitment.

(1480) Moreover, Gazprom fails to distinguish cases where a party's legal ground entitles it to both object to the payment as such and, if it nevertheless pays, reclaim the payment and cases where the legal ground can only, and only subsequently, give rise to a repayment claim. This is the situation in respect of Naftogaz' monetary price revision claim. (Naftogaz must always pay the current price until a new price has retroactively been set by agreement or an arbitral award.) Naftogaz cannot see how a contract law analysis could ever lead to the conclusion that payment in the latter case could give any impression whatsoever regarding the repayment claim, as there was never any choice to make. As stated above, even in the former situation a payment is not automatically an expression of a commitment not to raise repayment claims. The Swedish Supreme Court case NJA 1989 p. 224 is illustrative. It shows that if the recipient of a certain payment could not justifiably feel certain that it would not receive a repayment claim from the counterparty subsequent to the payment, the recipient was not under the justifiable impression that the payment was final. This was the case even though the payer, *in casu*, actually labelled the payment as final settlement (Sw. "*slutavräkning*").

(1481) There is furthermore no Swedish case law in which the Supreme Court has held that a payment had the effects of waiving *any conceivable grounds for repayment*.

(1482) NJA 1961 p. 18, which Gazprom invokes, does not support Gazprom's conclusion. In this case, the payer recognised that it had a potential legal defence for refusing to pay. Nevertheless, it chose to pay because it had concluded after legal analysis that it was after all liable to pay. Hence, the payment was a consequence of the *actual and intentional rejection of a particular legal defence against liability*. The bank subsequently understood that it had made a misjudgement and tried to backtrack. It invoked the previously discarded defence to claim repayment. Thus, the case was one where the payment – indisputably – expressed the actual intent not to pursue a particular defence, not one where the recipient was given some sort of impression that the payer actually did not want to convey. Secondly, there is nothing in the case suggesting that the bank was barred from claiming some other ground for repayment than the ground previously and intentionally discarded. There is in fact no similarity between NJA 1961 p. 18 and the present case.

VIII.8.9.6 Forfeiture of the right to invoke that a claim is waived

(1483) The *recipient*'s own actions can be relevant when determining if a party has a right to invoke a certain claim. If the recipient is faced with a claim against which it could defend by arguing that the claim has already been waived, it may, on its part, give the justifiable impression that it has waived the right to raise this defence. That would be the case for instance when the counterparty fails to timely invoke that the claim has already been waived. This then is an application of the exact same legal principle as is alleged to apply against the claim as such.

(1484) This principle is reflected in the Swedish law principle that a seller who may invoke that the buyer's notice of defect was time barred yet acts such that it gives the impression that it will not raise the time bar defence, is precluded from subsequently raising this defence, see e.g. NJA 1993 p. 436 with extensive references to case law. The principle was expressed in NJA 1993 p. 436 as whether "*the seller by its conduct gave the buyer particular reason to believe that it had opted not to claim that notice was given too late*".

(1485) In any event, the recipient's failure to timely claim that it was under the impression that the person already had waived its rights is obviously also very strong evidence to the fact that the counterparty never actually got this impression in the first place. Naftogaz notes that Gazprom's defence regarding waiver was only raised in its Defence despite numerous contacts between the Parties from 2011 to 2014 as to revision of the price from 2011 and onwards. The fact that this was never raised gave Naftogaz the justifiable impression that Gazprom did not regard the different claims as waived and that it had unconditionally opted not to argue that the claims had already been waived.

VIII.8.9.7 Gazprom's objections are irrelevant for Naftogaz' damages claims

(1486) As explained below, Naftogaz' monetary claim is not only based on repayment. It is also based on damages.

(1487) In relation to a damages claim, a party is obviously not precluded from bringing such claim by the fact that it has paid for some commodity under a contract. There is no obligation of a party to inform the other party in connection with a payment that the payer reserves the right to subsequently claim damages for breach of contract. That is a given. As an example, payment of the price is neither in CISG, nor under Swedish law, nor otherwise, a waiver of the right to claim damages for defects, delays or other breaches of contract.

(1488) For this reason, no payment or any other actions by Naftogaz can affect its entitlement to damages for breach of contract.

VIII.8.9.8 Summary

(1489) In summary, Gazprom's objections are entirely irrelevant to Naftogaz' damages claims, and for the other claims Gazprom must prove:

(i) that it actually got the impression that Naftogaz intended to waive any retroactive application of the price revision provisions and Section 36 of the Swedish Contracts Act and all potential grounds for repayment when Naftogaz made its payments/acted in other ways/was passive;

(ii) that this impression was reasonable; and

(iii) that Naftogaz knew or must be considered to have known that Gazprom actually got such an impression.

(1490) In any event, Gazprom's defence must fail if Gazprom itself has lost its right to raise the defence.

VIII.8.9.9 Interest

(1491) Naftogaz claims both yield interest in accordance with Section 2 of the Swedish Interest Act and delay interest in accordance with Section 4 of the Swedish Interest Act on overpaid amounts. Yield interest is principally payable from 20 May 2011 (from the date of payment) until and including 17 June 2014. Delay interest is principally payable from and including 18 June 2014. Naftogaz has further specified the dates from which, alternatively, interest should be calculated

(1492) Since the issue of interest on excessive payments is not regulated by the Contract, the Swedish Interest Act (*Räntelag* (1975:635)) applies to such payments.

(1493) The Swedish Interest Act (*Räntelag* (1975:635).

(1494) Under the Swedish Interest Act, two distinct types of interest apply: yield interest (Sw.*avkastningsränta*) and delay interest (Sw. *dröjsmålsränta*).

(1495) Yield interest is generally payable on amounts which one party has received from the other party, but without legal basis. It is designed as a hard and fast rule to compensate for the loss of the ability to make a yield on the particular sum of money. Yield interest is calculated from the date the amount was received until the earlier of the date when delay interest is payable instead and the repayment. It accrues at a rate equivalent to the Swedish reference rate plus two per cent per annum.

(1496) Delay interest is payable from the due date until payment is made. It accrues at a rate equivalent to the Swedish reference rate plus eight per cent per annum.

(1497) According to Section 2 of the Swedish Interest Act, yield interest accrues on claims for repayment on account of termination of a contract for cause and claims for repayment on similar grounds (i.e. it is sufficient if the claim relates to "repayment … on similar grounds"), cf. Walin och Herre, *Lagen om skuldebrev m.m. En kommentar,* 2011, page 281. *Inter alia,* it applies to claims for repayment of overpayments under a contract; see the Supreme Court decision in NJA 2005, p. 142 (concerning repayment of overpaid leasing fees). The yield interest is calculated in accordance with Section 5 of the Swedish Interest Act.

(1498) Under Section 4, paragraph 4, of the Swedish Interest Act, delay interest accrues on any claim for payment which is due from (but not including) the date when the debtor was served with a writ of summons (Sw. *ansökan om stämning*). Section 4, paragraph 4, of the Swedish Interest Act applies by analogy to claims in arbitrations. In such cases, the relevant date is the date when Respondent received the request for arbitration, in this case, 17 June 2014. The delay interest is calculated in accordance with Section 6 of the Swedish Interest Act.

(1499) Naftogaz requested price revision on 20 May 2011. Gazprom therefore has been on notice from this point in time that Naftogaz considers the price to be too high and consequently, that Gazprom has the obligation to repay any excess amount to Naftogaz.

(1500) To the extent that the Tribunal finds that any monthly payment in the period from 20 May 2011 (or a subsequent effective date as determined by the Tribunal) to the date of the award constitutes an excessive payment, Naftogaz has a claim for refund of such payment.

(1501) On payments made by Naftogaz until and including 17 June 2014, Naftogaz is entitled to yield interest pursuant to Sections 2 and 5 of the Swedish Interest Act on each payment from the date of payment until and including 17 June 2014. From and including 18 June 2014, the day after the day when Respondent received the Request for Arbitration, Naftogaz is entitled to delay interest pursuant to Section 4, paragraph 4, and Section 6 of the Swedish Interest Act until payment is made by Gazprom.

(1502) On payments made by Naftogaz after 17 June 2014, Naftogaz is entitled to delay interest pursuant to Section 4, paragraph 4, and Section 6 of the Swedish Interest Act. The delay interest on each payment, shall in accordance with Section 4 of the Swedish Interest Act, accrue from the date of payment of each such amount (as the obligation to repay cannot arise earlier than the payment itself), cf. Walin och Herre, *Lagen om skuldebrev m.m. En kommentar*, 2011, page 307. Hence, delay interest is payable on any payments made by Naftogaz after 17 June 2014 from the date of each payment until payment is made by Gazprom.

(1503) The same principles as set out above regarding interest on refund of excessive payments in relation to the price revision claims apply in respect of the price determination claims. The difference is that the effective date for the repayment claims in this case is 1 April 2014, the date from which Gazprom has refused to apply the prices [redacted].

(1504) If delay interest is not awarded from and including 18 June 2014, delay interest is instead payable in accordance with Section 4 of the Swedish Interest Act from and including 1 February 2015 (the date after Gazprom received Naftogaz' Statement of Claim), alternatively from and including 9 October 2015 (the date after Gazprom received Naftogaz' Reply and Defence to Counterclaim), or alternatively as from the date of the awardYield interest is payable until the date delay interest starts accruing.

(1505) Apart from Naftogaz' monetary claims relating to the price revision/adjustment claims and the price determination claims, Naftogaz also has monetary damages claims.

(1506) Section 2 of the Swedish Interest Act is applicable to repayments claims following termination of a contract for cause and to claims for repayment on similar grounds. In addition, it is explained in the preparatory works to the Swedish Interest Act and Swedish case law that Section 2 of the Swedish Interest Act can be applied by analogy (Sw. *analogiskt*) also in other instances, cf. Government Bill 1975:102, page 94, NJA 1988 p. 363 and NJA 2014 p. 1006.

(1507) The damage claim related to Gazprom's violation of Articles 101 and 102 TFEU is a result of Gazprom having charged an excessive price from (at least) 20 May 2011. Similarly, the damage claim under Articles 4.4 and 6.1 of the Contract, is a result of Gazprom having denied Naftogaz a Contract Price which corresponds to market price. Hence, both damages claims are effectively claims for repayment of overpaid amounts. If yield interest would not be payable on said amounts, Naftogaz would be refused compensation for its loss of the ability to earn a yield on the amounts (and Gazprom would benefit accordingly) even though there is no practical difference from the situation where Naftogaz seeks interest on repayment of overpaid amounts based on price revision/adjustment and/or price determination. Yield interest in accordance with Sections 2 and 5 of the Swedish Interest Act is therefore payable on any damages amounts payable by Gazprom (as from the date of payment of the relevant amounts) in analogy with Section 2 of the Swedish Interest Act.

(1508) It also follows from applicable EU principles that interest or damage shall be awarded for the loss of opportunity for the injured party to have the relevant capital at its disposal in cases of violations of Articles 101 and 102 TFEU, cf. Karlsson & Östman, page 1056, Commission Staff Working Document Practical Guide, page 11, opinion of Mr. Saggio in joined cases C-104/89 and C-37/90 and case C-271/91 Marshall. As set out above, yield interest shall accrue on Naftogaz' damages claims as Section 2 of the Swedish Interest Act is applicable by analogy. However, if interest would not have been payable, damage for loss of opportunity to have the relevant capital at Naftogaz' disposal would have been payable instead. Such damage would have been payable from the time the damage occurred (i.e. in this case as of the date of each payment made by Naftogaz) and would (if calculated based on the same principles as set out in Section 2 and Section 5 of the Swedish Interest Act) accordingly principally correspond to Naftogaz' interest claim. To simplify the proceedings, Naftogaz has therefore chosen to only invoke an interest claim in relation to its loss of opportunity to have the relevant amount at its disposal even though a corresponding damage claim could also have been invoked by Naftogaz.

(1509) In accordance with the above, Naftogaz has included requests for relief for both yield interest and delay interest on the damages amounts in the Request for Relief. Yield interest on the damages amounts is principally payable from the date of payment of the relevant amounts until and including 17 June 2014. Delay interest is principally payable from and including 18 June 2014 (from the date of payment or, if payment has been made prior to 18 June 2014, from and including 18 June 2014). If delay interest is not awarded from and including 18 June 2014, delay interest is instead payable in accordance with Section 4 of the Swedish Interest Act from and including 1 February 2015 (the date after Gazprom received Naftogaz' Statement of Claim), alternatively from and including 9 October 2015 (the date after Gazprom received this submission), or alternatively as from the date of the award Yield interest is payable until the date delay interest starts accruing.

(1510) The relief sets out the different partial capital amounts and the respective payment dates as well as Naftogaz' calculation of each capital amount based on Naftogaz' highest monetary claim (which is the same for the highest repayment and damages claims). However, in accordance with the principle of *major includit minor*, the request for interest includes any lower amount of repayment (or lower damages) in each specified period that the Tribunal may arrive at.

VIII.9 Gazprom's Counterclaims

VIII.9.1 Introduction

(1511) Naftogaz rejects Gazprom's counterclaims in their entirety.

(1512) Gazprom's Interest Claims must fail because the payment claims and Take or Pay claims shall be rejected.

(1513) The counterclaims are without any legal basis and totally unreasonable.

(1514) Gazprom divides its counterclaims into three categories:

(i) Claims for payment of outstanding amounts due for gas delivered;

(ii) Take or Pay claims; and

(iii) Claims for interest.

VIII.9.2 The Payment Claims

(1515) Gazprom specifies its claims concerning the "*payment of outstanding amounts due for gas delivered*". These claims are divided into two sub-claims, which concern the alleged outstanding balance for gas delivered in November and December 2013 in the amount of circa USD 1.5 million, and for gas delivered in April, May and June 2014 in the amount of circa USD 2.2 billion.

(1516) Naftogaz ha already made a payment of USD 3.1 billion in respect of deliveries during those periods.

(1517) With regard to the Payment Claims, Naftogaz essentially bases its defence on the fact that, taking into account the reduced price resulting from Naftogaz' principal price claims, all payment claims have been settled in accordance with the Schedule of Payments agreed upon in the Binding Protocol of 30 October 2014. In addition, Naftogaz has a claim for repayments or damages for overpayments, which shall be set off against Gazprom's Payment Claims. Naftogaz does not rely on the Binding Protocol for its defence.

VIII.9.3 The Take or Pay Claims

VIII.9.3.1 Introduction

(1518) Naftogaz' defences are based on competition law and Section 36 of the Swedish Contracts Act, These defences have been dealt with above.

(1519) Futher Naftogaz claims:

(i) That Gazprom has relinquished its Take or Pay claim;

(ii) That Gazprom has not proven that it made available the gas not taken;

(iii) That Gazprom caused Naftogaz not to off-take the gas;

(iv) That the Take or Pay provision is not workable; and

(v) That in any event the Take or Pay claims are much smaller than claimed by Gazprom.

(1520) In addition, The Take or Pay claim should be set off against Naftogaz' damages claim for breach by Gazprom of competition law.

(1521) These defences relate to the monetary claims by Gazprom. The defence relying on Section 36 of the Swedish Contracts Act is, however, for invalidity or adjustment of the Take or Pay and volume provisions.

(1522) An invalidation of the volume provision and, thereby, the annual contract quantity (ACQ) and/or the Take or Pay clause based on competition law from a point in time prior to 31 December 2011 will in itself automatically defeat the Take or Pay claims. If the volume provision is invalid because it covers more than all or most of Naftogaz' relevant requirements, then, under the formula in Article 2.2.5, there will be no ACQ to multiply with 0.8 to achieve a MAQ number. It may be noted here that there cannot be any "residual" volume or Take or Pay obligation left after competition law invalidity has struck. This is because the competition law invalidity sanction causes the invalidity of the *entire* contractual element (in this case the volume and Take or Pay provision), it does not result in merely partial invalidity up to the acceptable level.

(1523) If this is not the case, or the Tribunal would rather reject the Take or Pay claim on the basis of contract law alone, the Tribunal will presumably first determine to what extent Gazprom at all has a claim. This means that the Tribunal would determine if and to what extent Gazprom actually delivered or made the gas available and whether Gazprom's claim is barred under article 80 CISG.

(1524) The Tribunal could approach this in many ways, but it is worth noting that the Take or Pay claim will be defeated already if the volume provision as such is adjusted as Naftogaz' requests for declaratory relief presuppose, e.g. because the volume requirement on Naftogaz is excessive and unconscionable having regard to e.g. the principles of competition law. If so, the ACQ for each year from 2012 and onwards would be reduced to a level that when multiplied by 0.8 (to form the MAQ) would be lower than Naftogaz' actual yearly offtake. Gazprom's Take or Pay claim would then be defeated. Although the Section 36 argument is based on an overall assessment of the many extraordinary circumstances in the present case, there is another strand within it that primarily focuses on the remedy under Article 2.2.5 in itself. Hence, the tribunal could also reject the Take or Pay claims without adjusting the volume elements by finding that Gazprom should not be entitled to its payment because, inter alia, it has not suffered any loss.

VIII.9.3.2 Gazprom has relinquished the Take or Pay Claims

(1525) Naftogaz asserts that Gazprom has relinquished the Take or Pay Claims by its actual conduct in several ways, as also suggested by the late submission of the claim.

(1526) Already in 2009 the Parties became aware that the Take or Pay clause was unreasonable and could not be applied. Gazprom therefore agreed to relinquish any claim under the Take or Pay clause and committed to not apply it in the future. This was confirmed by the statements made by Mr Vladimir Putin and Ms Yulia Tymoshenko at a joint press conference dated 29 April 2009.

(1527) The (then) Prime Ministers of the Russian Federation and of Ukraine, spoke on that occasion as de facto proxies for Gazprom and Naftogaz, respectively.

(1528) When asked about the implementation of the Contract, Ms Tymoshenko stated that "*due to the economic crisis, which has affected both countries, we cannot sustain the demand for those volumes that were specified in the contracts. According to the agreement with Gazprom, we pay for the amount of gas that we actually consumed*", cf. page 4 in fine of the official translation into English of the transcript of the press conference, published on the webpages of the government of the Russian Federation (emphasis added).

(1529) Commenting on the same question, Mr Putin confirmed agreement with "*our Ukrainian partners*" that "*smaller gas consumption volumes compared with those specified in our contractual obligations*" are due to "*the objective situation caused by the world economic crisis and the production decline in Ukraine itself*". He further reiterated that, notwithstanding the inclusion in the Contract of Take or Pay principles, "*by mutual agreement [we] are not imposing any fine or sanctions. This agreement between Gazprom and NAK Ukraine exists. That's the point*" (emphasis added).

(1530) Mr Putin's statement also leaves no doubt in respect of the validity of this agreement between the Parties for subsequent years. After explaining that "*[t]he contract allows the option of not imposing fines, and that is what Gazprom is doing*", Mr Putin was specifically asked whether any sanctions or fines would be applied in the future in connection with reductions in gas demand. The simple answer was "*No*".

(1531) Mr Putin and Ms Tymoshenko held another joint press conference on 20 November 2009, and the official translation into English of the transcript of the press conference, published on the official site of the Prime Minister of the Russian Federation. At the press conference, Mr Putin discussed, inter alia, cooperation between Russia and Ukraine in the gas field, and answered questions concerning the Gas Sales Contract and the Gas Transit Contract. With regard to the Gas Sales Contract, Mr Putin stated the following:

"*About what we agreed on and what the problem is in our view: our Ukrainian colleagues have repeatedly voiced concerns over the penalties for failure to purchase the agreed amounts of gas under take-or-pay contracts.*

This is an accepted international practice. Gazprom has such contracts with all European partners, not just Ukraine. I would like to stress this – it is not an exclusive approach to Ukraine. It is a general rule.

Second, we all understand that natural gas consumption has shrunk as both Ukrainian and Russian economies contracted due to the global recession. Therefore, considering the special relations between Russia and Ukraine, between Gazprom and Naftogaz, we decided not to impose these penalties. Let me repeat this publicly – no sanctions will be applied.

Third. What do we have to do to avoid a similar situation next year? We decided today that, despite the earlier agreements on purchase volumes, Gazprom and Naftogaz will adjust the amount for next year. No extra gas in the Contract, no sanctions. This is a very simple decision, which suits everyone and does not violate existing contracts." (emphasis added)

(1532) This statement further confirms Gazprom's commitment not to apply the Take or Pay provisions. In particular, Mr Putin refers to the concerns on the Ukrainian side about application of the "*penalties for failure to purchase the agreed amounts of gas under take-or-pay contracts*", i.e. the obligation to pay for the Minimum Annual Quantity even if not taken by Naftogaz, cf. Article 2.2.5 of the Contract. He then describes the Take or Pay penalties as "*accepted international practice*", before confirming that they would not be imposed "*considering the special relations between […] Gazprom and Naftogaz*".

(1533) Mr Putin then refers to an agreement reached with Ms Tymoshenko "*that, despite the earlier agreements on purchase volumes, Gazprom and Naftogaz will adjust the amount for next year*". This agreement was subsequently incorporated by the Parties in Addendum No. 1 to the Contract of 24 November 2009.

(1534) It follows from the statements, and the overall context, that the penalties discussed by Mr Putin differ from the "*penalty*" provided for under Article 6.6 of the then prevailing version of the Contract. The "*penalty*" under Article 6.6 applied in addition to and independently of the Take or Pay obligation under Article 2.2.5 to pay for the gas made available, if not taken.

(1535) This additional "*penalty*" was not the subject matter of the discussions in November 2009, and Article 6.6 was deleted from the Contract several months later, cf. item 4 of Addendum No. 3 to the Contract. In Addendum No. 3, the Parties agreed to delete from the Contract also Article 6.5, which provided for identical penalties to be paid by Gazprom "*[i]n case of shortfalls of Natural Gas by the Seller in a volume exceeding 6% of the Monthly Delivery Volume*". Thus, Articles 6.5 and 6.6 constituted a particularly severe, albeit "*balanced*", system of sanctions which the Parties decided to exclude from the Contract.

(1536) That Mr Putin specifically referred to Naftogaz' Take or Pay obligation to pay for the gas made available, even if not taken, is confirmed by the fact that Mr Putin describes this obligation as "*an accepted international practice*". He further clarifies that such a clause is present in Gazprom's contracts "*with all European partners, not just Ukraine*". Therefore, Mr Putin could not possibly have intended to refer to the penalty in Article 6.6 (and 6.5), which was peculiar to the Contract, and did not constitute an accepted international practice.

(1537) Moreover, [redacted] in his second witness statement explains that Gazprom confirmed its relinquishment of any future Take or Pay claim in the discussion of Addendum No. 1 of 24 November 2009, which reduced the Annual Contract Quantity for Delivery years 2009 and 2010. Gazprom's CEO, Mr Miller, personally assured the then CEO of Naftogaz, Mr Dubina, "*that the Take or Pay clause would not be applied to Naftogaz, and that Gazprom would always be willing to agree to reduced volume obligations*", cf. paragraph 23 of [redacted]

(1538) As demonstrated above, Mr Putin, de facto acting on behalf of and binding Gazprom, and Mr Miller made a commitment to the effect that the Take or Pay provisions would not be applied in the future. This is a binding contractual commitment in its own right. It cannot subsequently be revoked unilaterally by Gazprom. In any event, it is quite clear that these statements on behalf of Gazprom gave Naftogaz the justifiable impression that Gazprom had permanently relinquished its rights under the Take or Pay provisions. Gazprom could not have been unaware that this was the impression provided to Naftogaz, and Gazprom did not without delay object to Naftogaz' perception. It follows, by application of CISG and/or general principles of Swedish contract law that Gazprom cannot rely on the Take or Pay provisions.

(1539) Moreover, Gazprom's subsequent conduct is further testimony to Gazprom being aware that no Take or Pay claims remained. This is why Gazprom did not invoice any Take or Pay until 15 January 2013.

(1540) Gazprom's subsequent purported reliance on the Take or Pay provision, starting in 2012 was apparently motivated by a desire for free storage of gas in Ukraine, cf. witness Statement of [redacted] paragraphs 66-70.

VIII.9.3.3 Gazprom failed to deliver or make available the gas

(1541) The expression "*make available*" consists of two parts: "*available*", which reasonably means that the gas in the required volume actually existed and was physically in a state that it was ready to be delivered to a particular location at a particular time, and "*made [available] to*" which implies some positive action of the seller to dedicate that specific gas to the buyer. In this case, Gazprom has not proved that the required volumes of Take or Pay gas existed and were ready to be delivered to Naftogaz in time if Naftogaz had asked for it during the relevant periods. And it has not shown that the gas was dedicated to Naftogaz.

(1542) Gazprom claimed that it "*has a perfect record of fulfilling nominations under the Contract between 2012 and 2015*" and that this "*suffices to dispel any doubt about its ability to supply during the relevant period*". Both these statements are evidently wrong.

(1543) First, Gazprom certainly does not have a perfect record of fulfilling nominations under the Contract for the period in question. On the contrary, Gazprom has periodically been unable to make gas available to buyers including Naftogaz. And the shortage in February 2012 was not caused by Naftogaz withdrawing gas from the transit flow, (as wrongly alleged by Gazprom). The shortfall was solely caused by Gazprom's under-deliveries.

(1544) Second, even if Gazprom's assertion regarding the nominations under the Contract is factually true, it could only ever evidence that Gazprom could deliver the gas that was actually delivered. It proves nothing about the volume which Gazprom would have had to deliver on top of that:

what extra volume it had readily available, whether it could have delivered it to Naftogaz' Points of Delivery or when it could have delivered such extra volume and whether there were any such volumes which were or could be dedicated to Naftogaz.

(1545) Third, the evidence presented by Naftogaz proves that Gazprom during this period – already without having to supply Naftogaz' additional Take or Pay volumes – was unable to deliver all the gas required by its customers. As a defence, Gazprom has sought to label the failed deliveries "*over nominations*", i.e. volumes allegedly in excess of the customer's "*real*" needs. It also seeks to make some distinction between its contract obligations and "*additional requests*" which it could not satisfy. That is, however, totally irrelevant. Since Gazprom demonstrably could not deliver the gas its other customers asked for, it would apparently have been unable to deliver vast, additional, Take or Pay volumes to Naftogaz. The fact that Gazprom failed on at least those occasions, shows that Gazprom's ability to meet customer demand was stretched to its limits and that it very likely would have failed several more times if Gazprom also had to supply more gas to Naftogaz.

(1546) Naftogaz did not have any obligations towards Gazprom in January-February 2012 in respect of storing volumes of gas in the "*western storage facilities*" to "*balance peak demand across Europe*". Equally unpersuasive is the argument that since Naftogaz was "*at the front of the line*" it could take gas. If Gazprom could not supply Naftogaz the Take or Pay volumes, it would not be open to Naftogaz to take someone else's gas that was transited through Ukraine. Gazprom would not fulfil its "*make available*" requirement by directing Naftogaz to take gas belonging to third parties (which it never directed Naftogaz to do).

(1547) To conclude, Gazprom has proved neither that it delivered nor that it made available the Take or Pay gas in the required manner. Hence, Gazprom is not entitled to any payment already for this reason.

(1548) Gazprom has not met its burden of proof, and its claims must therefore fail.

VIII.9.3.4 The Take or Pay Provisions are unworkable

(1549) As indicated by Gazprom in its letter of 19 November 2014 concerning the Take or Pay Claim, Take or Pay is regulated in one very brief provision, Article 2.2.5 of the Contract:

"*Within each Year of Delivery [Naftogaz] is obliged to offtake and pay for, or pay for, if the volume was made available by [Gazprom] but not off-taken by [Naftogaz], not less than the following Minimum Annual Volume (the "MAV") of the Natural gas:*

MAV = 0.8 x ACV [Annual Contract Volume]."

(1550) This is very different from the system in other Continental European gas sales agreements, which generally provide for a comprehensive regulation of Take or Pay obligations.

(1551) Thus, unlike other Continental European gas sales agreements, the Contract contains no provisions for the calculation of the annual Take or Pay volume, except for the percentage share of the Annual Contract Quantity applicable. Furthermore, the Contract contains no provisions for payment of the Take or Pay volumes, e.g. concerning which Contract Price is to apply (quarterly, annual average?), and what settlement procedures are to be followed.

(1552) Gazprom states that:

"*the amounts invoiced by Gazprom were calculated based on the actual annual weighted average price in each relevant year, as follows:*

Actual annual weighted average price in each relevant year =

Total invoiced amounts in the year in TCM / Total gas deliveries in the year in US$"

(1553) This solution does not have any basis in the Contract, and Gazprom does not provide any justification as to why it has chosen to calculate the invoiced amounts in this manner.

(1554) Thus, it is not possible to define in a precise manner, on the basis of the Contract, the relevant Take or Pay volumes, their price, and how payments shall be effected. In practice this means that the Take or Pay provisions under the Contract are unworkable, and Gazprom's claims are unfounded and must therefore be rejected.

VIII.9.3.5 Gazprom is not entitled to any payment as it caused Naftogaz not to offtake the gas

(1555) Article 80 CISG states that

"*a party may not rely on a failure of the other party to perform, to the extent that such failure was caused by the first party's act or omission*".

(1556) This reflects a fundamental principle of Swedish and international contract law, namely that whenever non-performance of a party is triggered by an act or omission of its counter-party, the non-performing party is exempted from all legal consequences arising from the non-performance.

(1557) A party cannot rely on a penalty clause to the extent it caused, directly or indirectly, the other party to break its obligations and trigger the penalty or it triggered the penalty by disloyally relying on other contractual rights, NJA 2012 p. 597

(1558) This principle applies not only where the actions of the first party were directly causative, but also where the actions of the first party were disloyal and motivating for the other party. This is the case if the first party has acted contrary to the purpose of their mutual agreement, cf. Olsen, page 168. For instance, in NJA 1948 A 19, a party was relieved from paying a penalty for its failure to fulfil its obligation to vote for the counterparty as director to a board when the counterparty had acted disloyally towards the company.

(1559) In the present case, Gazprom's Take or Pay Claims must be rejected because the underlying prevailing price is unreasonable and contrary to the very nature and justification of a Take or Pay obligation, if the price is not revised in a market reflective manner. Furthermore, the price is excessive under competition law, and Gazprom's excessive pricing of gas supplies to Ukraine must be deemed to have contributed to the decline in Ukrainian industrial gas demand, NJA 1948 A 19.

(1560) Gazprom's imposing of the destination clause and its failure to relinquish it are breaches of competition law. Gazprom's failure to revise the price and the favourable prices it granted to Naftogaz' competitors, allowing them to undercut Naftogaz and take market shares, were contrary to the basic principle of a Groningen type agreement, namely to allow the buyer to economically market the gas.

(1561) Hence, as Gazprom both prevented Naftogaz from accessing the European market and made Naftogaz competitively disadvantaged domestically by applying disadvantageous prices for Naftogaz, Gazprom disloyally, and even in contravention of the law, made it financially impossible for Naftogaz to take the entire Take or Pay volume. For this reason, too, Gazprom is not entitled to the penalty.

(1562) The principle does not however provide any remedy to the failing party (it is "*a shield, not a sword*"). This is important to bear in mind, because Naftogaz only argues that Gazprom cannot be allowed to rely on Naftogaz' failure to perform to the extent this failure was in fact caused by Gazprom itself. Naftogaz is not invoking any positive contractual rights of its own; it is only trying to shield itself from Gazprom's impermissible claim.

(1563) Naftogaz' inability to offtake the Take or Pay volumes primarily relates to the following three factors:

(i) the destination clause, which was imposed and relied upon by Gazprom,

(ii) the excessive price, which Gazprom refused to adjust during the period when the alleged failures to offtake Take or Pay volumes occurred, and

(iii) the excessive volume Gazprom demanded that Naftogaz should take, and in particular Gazprom's wrongful, disloyal and bad faith insistence on an annual ACQ of 52 BCM following Naftogaz' price revision request on 20 May 2011

(1564) Gazprom argues – with reference to the wording "*to the extent that*" in article 80 – that the destination clause was not causative to the entire volume which Gazprom claims that Naftogaz failed to offtake (a counter-argument for which Gazprom obviously bears the burden of proof). In essence, Gazprom suggested that Naftogaz were in fact able to offtake greater volumes of gas than it actually did. This argument is incorrect for two reasons.

(1565) First of all, since 2009, a mandatory statute regulates how the gas needs of the Ukrainian population shall be secured. Article 10 of the Law on Principles of Natural Gas Market Operations applies to Naftogaz. Under article 10.4, Naftogaz must first secure the needs of the Ukrainian population (households) by domestically produced gas. Hence, to the extent domestically produced gas is required for that purpose, such gas may not be exported. Only if there would be an amount of domestically produced gas left after the households' needs are satisfied would there be a theoretical possibility to receive an export permit. In 2012, the amount available for export by Naftogaz and/or its subsidiaries (domestically produced gas less consumption by the Ukrainian population) was 2.1 BCM. In respect of 2013, Naftogaz showed in the cross-examination of [redacted] that the excess volume of domestically produced gas after supply to the public was only 2 BCM and that the imported gas from sources other than Gazprom was 4 BCM. Hence, only 6 BCM of non-Gazprom gas could legally have been exported in 2013 even if an export quota could have been obtained.

(1566) Second, even without the Ukrainian legislation, if an amount of gas had been exported, that would have caused a breach of the destination clause and would in any event have caused Gazprom to claim a breach of contract. The destination clause was – according to Gazprom's own witness, [redacted] – designed to prevent Naftogaz from exporting gas which became available to Naftogaz through its purchase from Gazprom. Further, the Contract as such was designed to secure the gas balance of Ukraine only after the domestically produced gas had provided the first "*delivery*" to the population. Hence, even without the Ukrainian legislation, Naftogaz would have been prevented by the destination clause from exporting gas (the origin of which can never be factually determined) and claiming that it was sourced from the domestically produced gas and that the gas supplied to the Ukrainian population was Gazprom's. Please see Naftogaz' Closing Statement for a more comprehensive explanation.

(1567) Even if Naftogaz would have filled the storage to the brim in 2012, there would still be 1.5 BCM left which physically could not go anywhere. And, most importantly, if the storage would have been filled in 2012, the capacity in following years is virtually non-existent. For 2013 it would be about 0.9 BCM (as compared to the remaining Take or Pay balance of 28.69 BCM (!)), and in 2014 it would be about 2.6 BCM (as compared to 20.78 BCM). In 2015, Naftogaz would in fact have been forced to decrease its purchase by 2.6 BCM, because in that year there was actually a net increase of gas in storage which would not have been possible had the storage been full in 2014. In another demonstrative exhibit, Naftogaz has added columns showing the capacity each year if storage would have been filled in 2012.

(1568) Finally, even if a minor part of the volume under the Take or Pay claim could have been stored, the destination clause prevented Naftogaz from selling the excess volume abroad. Without the ability to export, it was financially impossible to take and pay for the gas. Simply tucking away excess gas is not and was not commercially reasonable or feasible. This means that the destination clause clearly was causative in the required sense to Naftogaz' alleged failure to offtake all the claimed Take or Pay volumes. Therefore, Gazprom's entire Take or Pay claim must be rejected under article 80.

(1569) Gazprom's refusal since 2011 to revise the Contract Price also contributed to Naftogaz' not offtaking more gas from Gazprom. The Contract Price was far higher than it should have been which made it prohibitively expensive for Naftogaz to offtake the volume which Gazprom claims payment for. As elsewhere shown by Naftogaz, this failure was a breach of Article 4.4. And even if it was no breach it is an act of Gazprom that was causative (alongside the destination clause) to Naftogaz' taking lower volumes.

(1570) A further and related contribution was Gazprom's action to sell gas to Naftogaz' competitors at lower prices, causing Naftogaz to lose customers and volume.

(1571) Gazprom also sought to impose the highest Take or Pay volume possible, with the intention of claiming maximum Take or Pay penalties.

(1572) In any event, the Take or Pay Claims (if any) are much smaller than claimed by Gazprom.

VIII.9.3.6 Introduction

(1573) Naftogaz submits that Gazprom's Take or Pay Claims should be rejected in their entirety for the reasons set out above.

(1574) Alternatively, the Tribunal may find that Naftogaz' defences may only lead to a reduction of Gazprom's Take or Pay Claims.

(1575) In any event, Gazprom's Take or Pay Claims should be significantly reduced for the following reasons:

VIII.9.3.7 Based on contract interpretation

(1576) The Annual Contract Quantity ("ACQ") – in Gazprom's wording: Annual Contract Volume (ACV) – and Minimum Annual Quantity ("MAQ") – in Gazprom's wording: Minimum Annual Volume (MAV) – used by Gazprom as bases for calculating its Take or Pay Claims are wrong.

(1577) The ACQ may be amended by agreement between the Parties no later than six months prior to the subsequent Delivery Year, and that such change shall not exceed 20 % of the stipulated ACQ, cf. Article 2.2.3 of the Contract.

(1578) Since the Contract was entered into, the consumption of Natural Gas in Ukraine has dropped significantly, and on 24 November 2009 the Parties agreed to adjust the ACQ for [redacted]

(1579) In [redacted]. This amount was confirmed on [redacted]

(1580) In conformity with the agreement between the Parties, Naftogaz requested reductions in the ACQ in the [redacted] Delivery Years of 2012-2014, both ordinary adjustments pursuant to Article 2.2.3 and extraordinary adjustments due to significant changes in the market. Gazprom, however, now refused to reduce the ACQ, and no Addenda on the ACQ were signed for these Delivery Years.

(1581) In accordance with Article 2.2.2, the quarterly distribution agreed on in [redacted] applies also for the years 2012-2014, which implies that the ACQ for these years amounts to 41.6 BCM per year, with a Take or Pay obligation of 33.28 BCM (both volumes being subject to revision). However, without support under Article 2.2.2, Gazprom calculates Take or Pay obligation of 41.6 BCM for the years 2012 and 2013.

(1582) Gazprom [redacted] calculates the MAQ for the period from 1 January 2014 to 31 October 2014 accordingly.

(1583) However, in addition to the reduction in MAQ to exclude the months of November and December 2014, Naftogaz submits that the MAQ applicable in 2014 should be further reduced to take into account Gazprom's interruption of gas deliveries as from 16 June 2014. Consequently, the MAQ applicable in 2014 is 21.3 BCM.

VIII.9.3.7 Based on Naftogaz' claims for price revision and price determination

(1584) Naftogaz has submitted claims for revision of the price provisions and determination of the factual price which will significantly reduce the factual price used by Gazprom to calculate its Take or Pay Claims.

(1585) Gazprom's Payment Claims, Naftogaz' principal price claims consist of revision of Article 4.1 with effect as of 20 May 2011, together with the determination of the [redacted] based on [redacted] in the Relief Sought.

(1586) Also for the purpose of rejecting Gazprom's Take or Pay Claims, one may assume that Naftogaz' principal claims are successful, being mindful, however, that the Tribunal may ultimately grant a lesser relief.

(1587) Naftgoaz’ calculations of the relevant price are consequently made on the assumption that Article 4.1 is revised as requested the Relief Sought, and that the factua [redacted]. For the purpose of comparison with Gazprom's claim, the calculations are made according to the same method as employed by Gazprom, i.e. based on the actual annual weighted average price, as set out in the Expert Price Reply. However, Naftogaz' principal position in this regard is that this method does not have any basis in the Contract, and that the Take or Pay provisions are unworkable.

(1588) Based on these premises, the annual weighted average price for each relevant year would be:

for 2012: USD 162.23 per 1,000 m3;

for 2013: USD 177.65 per 1,000 m3;

for 2014: USD 179.32 per 1,000 m3.

VIII.9.3.8 Calculation of Gazprom's Take or Pay Claims (if any)

(1589) A MAQ of 33.28 BCM is applicable in the years 2012-2014, subject to a further reduction in 2014 to 21.3 BCM.

(1590) Consequently, based on this lower MAQ, the actual volumes offtaken by Naftogaz, as indicated by Gazprom and on the adjusted price indicated above, the recalculated Take or Pay obligations are as follows:

in respect of 2012: USD 1,358,917,002.95;

in respect of 2013: USD 3,618,024,611.86;

in respect of the period from 1 January 2014 to 31 October 2014: USD 1,337,733,318.18.

(1591) Gazprom's Take or Pay Claim for the period 1 July to 30 September 2015, bringing its total Take or Pay Claim to USD 29.2 billion, is rejected for the same reasons as Gazprom's other Take or Pay Claims. No gas was made available to Naftogaz in this period. Gazprom overstates the new ToP Claim by ignoring the quarterly volume distribution. The lower summer volumes, cf. item 2 Addendum No. 4 and Art 2.2.2 of the Contract, reduce the July – September 2015 ToP Claim from USD 2.55 billion to USD 1.37 billion, cf. Table 16 Expert Price Sur-Reply.

(1592) As regards Gazprom's claim for 2016, Naftogaz has the same objections and requests that it should be rejected.

<u>VIII.10 Gazprom’s Case</u>

VIII.10.1 Gazprom’s Counterclaims

<u>VIII.10.1.1 Gazprom's claims for payment of outstanding amounts due for gas delivered (“Supply Claims”)</u>

VIII.10.1.1.1 Claim for amounts outstanding for gas delivered in November-December 2013

(1593) Article 5.1 of the Contract (as amended) provides as follows:

[redacted]

[redacted]

[redacted]

…" (Emphasis added.)

(1594) On 20 December 2013, the Parties entered into [redacted], which provided for the deferral of payments for gas delivered in the period October to December 2013. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

(Emphasis added.)

(1595) In accordance with article 5.1 of the Contract (as supplemented and amended by [redacted], Gazprom invoiced Naftogaz in respect of gas delivered in November and December 2013 as follows:

(i) in respect of 1,819,966.720 TCM of gas delivered in November 2013 (at the price of USD389.88 per TCM), Gazprom invoiced USD709,568,624.79;[16] and

(ii) in respect of 1,905,586.980 TCM of gas delivered in December 2013 (at the price of USD389.36 per TCM), Gazprom invoiced USD741,959,346.53.

(1596) The total amount invoiced for November and December 2013 is USD 1,451,527,971.32.

[16] Invoice No. 38 from Gazprom to Naftogaz dated 10 December 2013.

(1597) In breach of article 5.1 of the Contract (as supplemented and amended by [redacted] , Naftogaz failed to make payment of the above invoiced sums for November and December 2013 by 25 January 2014.

(1598) On 30 October 2014, the Parties entered into [redacted], paragraph 1 of which provides, *inter alia*, as follows:

[redacted]

[redacted]

[redacted]

(Emphasis added.)

(1599) In accordance with paragraph 1.1 of [redacted] on 5 November 2014, Naftogaz paid Gazprom USD 1,450,000,000.00 in respect of gas delivered in November and December 2013.

(1600) The outstanding balance for gas delivered in November and December 2013 is calculated as follows (allocating Naftogaz' 5 November 2014 payment to the oldest invoice first, i.e. for deliveries in November 2013 in full and December 2013 in part):

Total due for gas deliveries in November and December 2013:	USD 1,451,527,971.32
Less amount paid on 5 November 2014:	USD 1,450,000,000.00
Outstanding amount:	USD 1,527,971.32

(1601) Accordingly, in respect of gas delivered in November and December 2013, Gazprom claims payment of the outstanding balance of USD 1,527,971.32 for gas delivered in December 2013.

VIII.10.1.1.2 Claim for amounts outstanding for gas delivered in April, May and June 2014

(1602) In accordance with article 5.1 of the Contract, Gazprom invoiced Naftogaz for natural gas delivered in April, May and June 2014, as follows:

(i) in respect of 2,585,525.955 TCM of gas delivered in April 2014 (at the price of USD 491.52 per TCM), Gazprom invoiced USD 1,270,837,717.40;

(ii) in respect of 3,527,576.158 TCM of gas delivered in May 2014 (at the price of USD 492.28 per TCM, Gazprom invoiced USD 1,736,555,191.06; and

(iii) in respect of 1,699,624.102 TCM of gas delivered in June 2014 (at the price of USD 492.86 per TCM), Gazprom invoiced USD 837,676,734.91.

(1603) The total amount invoiced for deliveries in April, May and June 2014 was USD 3,845,069,643.37.

(1604) In breach of the Contract (as subsequently amended), Naftogaz failed to make payment for gas delivered in April, May and June 2014 by the relevant due dates.

(1605) In accordance with paragraph 1.2 of [redacted] (see above), on 24 December 2014, Naftogaz paid Gazprom USD 1,650,000,000.00 in respect of gas delivered in April, May and June 2014.

(1606) The outstanding balance for gas delivered in April, May and June 2014 is calculated as follows (allocating Naftogaz' 24 December 2014 payment to the oldest invoices first, i.e. payment for0020deliveries in April 2014 in full and May 2014 in part):

Total due for gas deliveries in April, May and June 2014:	USD 3,845,069,643.37
Less amount paid on 24 December 2014:	USD 1,650,000,000
Outstanding amount:	USD 2,195,069,643.37

(1607) Accordingly, in respect of gas delivered in April, May and June 2014, Gazprom claims payment of the outstanding balance of USD 2,195,069,643.37 for gas delivered in May and June 2014.

VIII.10.1.1.3 Total amount claimed for gas delivered

(1608) The total amount outstanding for gas delivered in December 2013 and May and June 2014 is calculated as follows:

Outstanding amount for December 2013:	USD 1,527,971.32
Outstanding amount for May and June 2014:	USD 2,195,069,643.37
Total for December 2013, May and June 2014:	USD 2,196,597,614.69

(1609) Accordingly, Gazprom claims USD 2,196,597,614.69 from Naftogaz in respect of gas delivered in December 2013, May 2014 and June 2014.

(1610) Gazprom claims interest for the late payment of Naftogaz of overdue sums due in relation to gas deliveries in July 2015 pursuant to Articles 5.1.2 and 6.2 of the Contract at a rate of 0.03% of the overdue amount for each day of delay in payment.

(1611) In respect of gas deliveries in July, August and September 2015 Gazprom issued the following preliminary invoices:

(1612) Preliminary invoice No. 34 dated 16 June 2015 for gas deliveries in July 2015 in the amount of USD 1,022,986,980;

(1613) Preliminary invoice No. 45 dated 15 July 2015 for gas deliveries in August 2015 in the amount of USD 873,534,120; and

(1614) Preliminary invoice No. 49 dated 14 August 2015 for gas deliveries in September 2015 in the amount of USD 845,355,600.[17]

[17] Preliminary invoice No. 49 dated 14 August 2015 for September 2015 for USD 845,355,600.

(1615) Pursuant to Article 5.1.2 of the Contract, the preliminary invoices for gas deliveries in July, August and September 2015 should have been paid by the following due dates:

(1616) Preliminary invoice No. 34 for July 2015 - by 7 August 2015;

(1617) Preliminary invoice No. 45 for August 2015 - by 7 September 2015; and

(1618) Preliminary invoice No. 49 for September 2015 - by 7 October 2015.

(1619) In breach of Article 5.1.2 of the Contract, Naftogaz failed to pay the preliminary invoices for July, August and September 2015 by their respective due dates.

(1620) Pursuant to Articles 5.1.2 and 6.2 of the Contract, late payment interest of 0.03% of the amount overdue accrues for each day of delay in payment as follows:

(i) in relation to the preliminary invoice for gas deliveries in July 2015, over the period from 8 August 2015 to 10 August 2015 (noting that, on 11 August 2015, Gazprom issued an invoice for gas actually delivered);

(ii) in relation to the preliminary invoice for gas deliveries in August 2015, late payment interest does not accrue (noting that, on 8 September 2015, Gazprom issued an invoice for gas actually delivered); and

(iii) in relation to the preliminary invoice for gas deliveries in September 2015, late payment interest does not accrue (noting that, on 8 October 2015, Gazprom issued an invoice for gas actually delivered).

VIII.10.1.2 Gazprom's Take or Pay claims ("Take or Pay Claims")

(1621) Article 2.2 of the Contract (as amended by [redacted]) provides, *inter alia*, as follows:

"*[Gazprom] undertakes to deliver, and [Naftogaz] undertakes to accept, within the period from 1 January 2009 to 31 December 2019, Natural gas, DAF the border of the Russian Federation and Ukraine and/or the border of the Republic of Belarus and Ukraine (Incoterms 2000), at the Delivery Points…* [redacted] *of the Natural gas per year (the "Annual Contract Volume" or "ACV") and pay for the Gas delivered in accordance with the terms and conditions hereof.*"[18]

[18] [redacted]

(Emphasis added.)

(1622) Article 2.2.5 of the Contract provides as follows:

"*Within each Year of Delivery [Naftogaz] is obliged to offtake and pay for, or pay for, if the volume was made available by [Gazprom] but not off-taken by [Naftogaz], not less than the following Minimum Annual Volume (the "MAV") of the Natural gas:*

MAV = 0.8 x ACV [Annual Contract Volume]."

(1623) Accordingly, pursuant to article 2.2.5 of the Contract, from 2010 Naftogaz is obliged to offtake annually and pay for, or pay for, if the volume of gas is made available by Gazprom but not offtaken by Naftogaz, not less than the Minimum Annual Volume, or "MAV", of natural gas, calculated by reference to the formula in article 2.2.5 of the Contract.

(1624) The MAV for the years 2012 and 2013 is calculated as follows:

(i) 2012: 0.8 x 52 BCM (being the ACV for 2012) = 41.6 BCM; and

(ii) 2013: 0.8 x 52 BCM (being the ACV for 2013) = 41.6 BCM.

(1625) In a letter dated 30 October 2014, Gazprom confirmed that it would not apply article 2.2.5 of the Contract in the period from 1 November 2014 to 31 March 2015.[19] Accordingly, the MAV for the period from 1 January 2014 to 31 October 2014 is calculated as follows:

0.8 x 52 BCM (being the ACV for 2014) x 304/365[20] = 34.647671233 BCM.

(1626) In breach of article 2.2.5 of the Contract, Naftogaz failed to offtake and to pay for, or to pay for, the MAV of natural gas made available by Gazprom for each relevant period (being, in 2012 and 2013 respectively, 41.6 BCM, and in the period from 1 January 2014 to 31 October 2014, 34.647671233 BCM).

(1627) The actual volumes offtaken by Naftogaz in the relevant periods were:

(i) In 2012, 24,903,536.369 TCM (or approximately 24.9 BCM);

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19 Letter No. 01-714 from Gazprom to Naftogaz dated 30 October 2014.

20 365 being the total number of days in the year 2014.

(ii) in 2013, 12,914,236.152 TCM (or approximately 12.9 BCM); and

(iii) in the period from 1 January 2014 to 31 October 2014, 13,872,136.124 TCM (or approximately 13.9 BCM).

(1628) The difference between the MAV and the actual volume offtaken by Naftogaz, for each relevant period, is as follows:

(i) for 2012, MAV of 41.6 BCM less 24,903,536.369 TCM = 16,696,463.631 TCM;

(ii) for 2013, MAV of 41.6 BCM less 12,914,236.152 TCM = 28,685,763.848 TCM; and

(iii) for the period from 1 January 2014 to 31 October 2014, MAV of 34,647,671.233 TCM less 13,872,136.124 TCM = 20,775,535.109 TCM.

(1629) In respect of each of the years above, the amounts invoiced by Gazprom were calculated based on the actual annual weighted average price in each relevant year, as follows:

Actual annual weighted average price in each relevant year =

Total invoiced amounts in the year in TCM / Total gas deliveries in the year in USD.

(1630) The aggregate delivery volumes and invoiced amounts for each relevant year (2012, 2013 and 2014) are set out in the following table:

Aggregate delivery volumes and invoiced amounts in the years 2012, 2013 and 2014

Month/ Year of Delivery	**Delivery volume (TCM)**	**Invoiced amount for delivery (USD)**	**Delivery volume (TCM)**	**Invoiced amount for delivery (USD)**	**Delivery volume (TCM)**	**Invoiced amount for delivery (USD)**
	2012		**2013**		**2014**	
January	1,979,126.453	818,032,336.82	2,430,094.885	992,645,158.62	2,457,615.508	659,869,763.90
February	2,885,146.323	1,192,402,123.83	412,274.645	168,888,308.32	1,637,154.487	439,575,979.76
March	1,283,076.545	530,731,782.07	515,871.738	211,724,078.71	1,959,369.996	526,090,843.93
April	1,487,399.915	632,695,301.84	2,500.000	1,021,850.00	2,585,525.955	1,270,837,717.40
May	1,541,827.233	657,280,949.43	331,866.723	135,889,467.07	3,527,576.158	1,736,555,191.06

June	2,480,861.265	1,062,056,707.55	299,256.075	123,254,599.61	1,699,624.102	837,676,734.91
July	2,192,692.250	938,888,894.53	1,496,936.017	590,840,645.91	1,654.365	819,340.81*
August	2,101,177.662	898,274,462.28	2,238,671.278	882,439,444.36	1,719.248	857,423.36*
September	2,500,328.402	1,068,315,316.32	32,361.759	12,707,168.29		
October	2,539,771.770	1,093,879,701.34	1,428,849.332	555,822,390.15	1,896.305	921,401.96*
November	1,981,736.191	850,798,981.52	1,819,966.720	709,568,624.79		
December	1,930,392.360	828,099,714.59	1,905,586.980	741,959,346.53		
TOTAL	**24,903,536.369**	**10,571,456,272.12**	**12,914,236.152**	**5,126,761,082.36**	**13,872,136.124**	**5,473,204,397.08**

** Adjusted to exclude applicable penalties.*[21]

(1631) Accordingly, the actual annual weighted average price for each relevant year (rounded to two decimal points) is calculated as follows:

(i) for 2012:

10,571,456,272.12 TCM / USD 24,903,536.369 = USD 424.50 per TCM

(ii) for 2013:

5,126,761,082.36 / 12,914,236.152 = USD 396.99 per TCM

(iii) for 2014:

5,473,204,397.08 / 13,872,136.124 = USD 394.55 per TCM

[21] In the months July, August and October 2014, Naftogaz made unauthorised withdrawals of transit gas from the pipeline. Such withdrawals are covered by clause 10.4 of Contract TKGU, which provides for such gas to "*be documented as gas purchased under [The Contract]*" and that "*[t]he price of such Gas shall be set in accordance with [clause 4.3 of The Contract]*". Pursuant to clause 4.3 of The Contract, the price of such withdrawals of transit gas shall be the Contract Price multiplied by 1.5 (in respect of transit gas offtaken during the months April to September) or by 3 (in respect of transit gas offtaken during the months October to March). The "invoiced amount" for July, August and October 2014 reflected in the table and used to calculate the actual annual weighted average price has been adjusted to exclude these penalties, i.e. the relevant price in the given month is multiplied by the volume of delivery in the given month.

(1632) Gazprom's Take or Pay Claim in respect of 2015 extends only to the period 1 July 2015 to 30 September 2015; it does not extend to the period 1 January 2015 to 30 June 2015, or to the period from 1 October 2015 to 31 December 2015, as a result of the following written confirmations given by Gazprom to Naftogaz:

(i) In a letter to Naftogaz dated 30 October 2014, Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of the period from 1 November 2014 to 31 March 2015;[22]

(ii) In a letter to Naftogaz dated 3 April 2015, Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of delivery of gas during the period from 1 April 2015 to 30 June 2015;

(iii) In a letter to Naftgaz dated 24 September 2015, Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of delivery of gas during the period from 1 October 2015 to 31 March 2016.

(1633) The MAV for the period from 1 July 2015 to 30 September 2015 may be calculated as follows:

0.8 x 52 BCM (being the ACV for 2015) x 92/365[23] = 10.485479452 BCM.

(1634) In breach of Article 2.2.5 of the Contract, Naftogaz failed to offtake and to pay for, or to pay for, the MAV of natural gas made available by Gazprom for the relevant period, (i.e. from 1 July 2015 to 30 September 2015).

(i) The actual volumes offtaken by Naftogaz in the period from 1 July 2015 to 30 September 2015 was 169,932.842 TCM (or approximately 0.2 BCM).

(ii) The difference between the MAV and the actual volume offtaken by Naftogaz during the period from 1 July 2015 to 30 September 2015 is:

MAV of 10,485,479.452 TCM less 169,932.842 TCM =

10,315,546.610 TCM

[22] See Gazprom's Defence and Counterclaim, paragraph 279, and Letter No. 01-714 from Gazprom to Naftogaz dated 30 October 2014.

[23] 365 being the total number of days in the year 2015.

(1635) In respect of prior years, the amounts invoiced by Gazprom were calculated based on the actual annual weighted average price in each relevant year, as follows:

Actual annual weighted average price in each relevant year =

Total invoiced amounts in the year in TCM / Total gas deliveries in the year in USD

(1636) The aggregate delivery volumes and invoiced amounts used to calculate the annual weighted average price for each relevant year (2012, 2013, 2014 and 2015) are set out in the table at Appendix 1 of Gazprom's Statement of Rejoinder and Reply to Defence to Counterclaim.

(1637) Accordingly, the actual annual weighted average price for 2015 (rounded to two decimal points) is calculated as follows:

42,003,999.89 / 169,932.842 = USD 247.18 per TCM

(1638) Gazprom claims payment of the amounts due in respect of the difference between the MAV of gas made available by Gazprom and the actual volume offtaken by Naftogaz in the period from 1 July 2015 to 30 September 2015. Gazprom claims the sum of USD 2,549,796,811.06.[24]

(1639) Accordingly, Gazprom claims payment of the amounts due in respect of the difference between the MAV of gas made available by Gazprom and the actual volume offtaken by Naftogaz in each relevant year, which amounts have been calculated by, for each relevant year, multiplying the difference (set out above) by the actual annual weighted average price (set out above), and which have been invoiced by Gazprom to Naftogaz, as follows:

(i) in respect of 2012, Gazprom claims the sum of USD 7,087,648,811.36;

(ii) in respect of 2013, Gazprom claims the sum of USD 11,387,961,390.02; and

(iii) in respect of the period from 1 January 2014 to 31 October 2014, Gazprom claims the sum of USD 8,196,987,377.26.

(iv) in respect of 2015 Gazprom claims the sum of USD 2,549,796,811.06.

(v) in respect of 2016 Gazprom claims the sum of USD 5,318,903,523.78.

[24] Invoice No. 5 from Gazprom to Naftogaz dated 19 January 2016.

(1640) In the event that the Tribunal is minded not to grant Gazprom's ToP Claims in full, Gazprom asks the Tribunal to limit the effects of invalidity as far as possible. Below, Gazprom has set out, on the basis of the 50% figure for Naftogaz' needs which even Naftogaz accepts as permissible, how the ToP Claims would fall to be adjusted. Such adjustment would result in a claim no lower than the following figures.

(i) USD 1,059,748,811 for 2012;

(ii) USD 4,857,475,890 for 2013;

(iii) USD 1,493,312,637 for 2014; and

(iv) USD 1,007,799,934 for 2015,

In total: USD 8,418,337,273

(1641) Gazprom's Take or Pay Claim in respect of 2016 extends only to the period 1 April 2016 to 31 December 2016; it does not extend to the period 1 January 2016 to 31 March 2016, as a result of a letter from Gazprom to Naftogaz dated 24 September 2015, in which Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of delivery of gas during the period from 1 October 2015 to 31March 2016.

(1642) Accordingly, the MAV for the period from 1 April 2016 to 31 December 2016 is calculated as follows:

0.8 x 52 BCM (being the ACV for 2016) x2756/3667 = 31.256830601 BCM

(1643) In breach of Article 2.2.5 of the Contract, Naftogaz failed to offtake and to pay for, or to pay for, the MAV of natural gas made available by Gazprom for the relevant period (i.e. from 1 April 2016 to 31 December 2016).

(1644) In the relevant period, from 1 April 2016 to 31 December 2016, the volume of gas supplied by Gazprom to Ukraine was 1,395,481.377 TCM (or approximately 1.4 BCM). In relation to this volume, Gazprom refers to the following comments in NAK's Take or Pay Submission:

"*First, according to $ 7 of Gazprom's 17 January 2017 letter, Naftogaz allegedly offtook approximately 1.4 BCM in 2016. Gazprom argues that Naftogaz is liable to pay for the difference between the MAQ calculated for Q2-Q4 2016 (31.3 BCM) and the actual volumes* *allegedly off-taken by Naftogaz in the same period, i.e. approximately 29.9 BCM. Contrary to what Gazprom alleges, Naftogaz neither requested deliveries nor off-took any volumes in 2016, cf. the fourth witness statement by* [redacted] *(Annex I to this letter). The off-taken volumes referred to by Gazprom are most likely volumes that have been delivered to the temporarily occupied areas of Ukraine at the request of unauthorized third parties.*" (Emphasis added.)

(1645) In relation to the above, Gazprom notes that:

(i) no claim for payment for supplies under the Contract of the approximately 1.4 BCM referred to above has been made by Gazprom in these arbitration proceedings nor has Gazprom otherwise received payment for such supplies. (The subject of what party is responsible for offtaking the 1.4 BCM is the subject of dispute between the Parties, but this question does not form the basis of a claim in these arbitration proceedings); and

(ii) the effect of taking account of the 1.4 BCM supplied to Ukraine in the period April to December 2016 in the calculation of Gazprom's 2016 Take or Pay Claim is to reduce Naftogaz' liability by a corresponding amount, as explained below, not to increase it. Accordingly, taking account of the 1.4 BCM supply in Gazprom's Take or Pay Claim operates in Naftogaz' favour.

(1646) In calculating its 2016 Take or Pay Claim, Gazprom subtracted the volume supplied to Ukraine (1,395,481.377 TCM) from the MAV for the relevant period (i.e. 1 April 2016 to 31 December 2016) as follows:

MAV of 31,256,830.601 TCM less 1,395,481.377 TCM = 29,861,349.224TCM.

(1647) In calculating Gazprom's Take or Pay Claims in respect of the preceding years (2012, 2013, 2014 and 2015), the amounts invoiced by Gazprom for supplies to Ukraine were calculated based on the actual annual weighted average price in each relevant year, as follows:

Actual annual weighted average price in each relevant year =

Total invoiced amounts in the year in respect of supplies to Ukraine, in USD / Total gas deliveries in the year, in TCM.

(1648) Gazprom has adopted this same approach in calculating its Take or Pay Claim for 2016. The aggregate volumes supplied to Ukraine and invoiced amounts used to calculate the annual weighted average price for 2016 are set out in the table at Appendix 1.

(1649) The actual annual weighted average price for 2016 (rounded to two decimal points) is calculated as follows:

USD 248,566,827.07/1,395,481.377 = USD 178.12 per TCM

(1650) Accordingly, Gazprom claims payment of the amounts due in respect of the difference between the MAV of gas made available by Gazprom and the volume of gas supplied to Ukraine in the relevant period from 1 April 2016 to 31 December 2016. That amount has been calculated by multiplying the difference in volumes (set out in paragraph 14 above) by the actual annual weighted average price (set out in paragraph 17 above), and was invoiced by Gazprom to Naftogaz by way of its letter dated 17 January 2017. On this basis, Gazprom claims the sum of USD 5,318,903,523.78.10.

VIII.10.1.3 Gazprom's claims for interest (the "Interest Claims")

(1651) Gazprom seeks the following Interest Claims (these claims correspond to the claims set out in its Defence and Counterclaim, with the addition of an interest claim in respect of gas delivered in July 2015, together with alternative interest claims based on the Swedish Interest Act in respect of the Take or Pay Claims).

(1652) Articles 5.1.1 to 5.1.4 of the Contract (as subsequently amended) provide as follows:

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted]

(Emphasis added.)

(1653) Article 6.2 of the Contract provides as follows:

"*In the event of delay in payments for the Gas delivery hereunder, [Gazprom] is entitled to charge late payment interest to [Naftogaz] equal to 0.03% of the amount overdue for each day of delay in payment.*"

(1654) Accordingly, late payment interest accrues on outstanding amounts under the Contract as follows:

[redacted]

[redacted]

<u>VIII.10.1.4 Gazprom's Interest Claim in relation to gas delivered in February and March 2014</u>

VIII.10.1.4.1 Preliminary invoices for February and March 2014

(1655) In respect of gas deliveries in February 2014 and March 2014, Gazprom issued the following preliminary invoices:

(i) Preliminary invoice No. 3 dated 31 January 2014 for gas deliveries in February 2014 in the amount of USD 857,052,000; and

(ii) Preliminary invoice No. 7 dated 26 February 2014 for gas deliveries in March 2014 in the amount of USD 948,879,000.

(1656) Pursuant to article 5.1.2 of the Contract, the preliminary invoices for gas deliveries in February 2014 and March 2014 should have been paid by the following due dates:

(i) Preliminary invoice No. 3 for February 2014 - [redacted] and

(ii) Preliminary invoice No. 7 for March 2014 - [redacted].

(1657) In breach of article 5.1.2 of the Contract, Naftogaz failed to pay the preliminary invoices for February 2014 and March 2014 by their respective due dates.

(1658) Pursuant to articles 5.1.2 and 6.2 of the Contract, late payment interest of 0.03% of the amount overdue accrues for each day of delay in payment as follows:

(i) in relation to the preliminary invoice for February 2014, over the period from [redacted] (noting that, on 12 March 2014, Gazprom issued an invoice for gas actually delivered).

(ii) in relation to the preliminary invoice for March 2014, for the [redacted] (noting that, [redacted] Gazprom issued an invoice for gas actually delivered).

VIII.10.1.4.2 Invoices for actual deliveries in February and March 2014

(1659) In respect of gas deliveries in February 2014 and March 2014 Gazprom issued the following invoices for actual deliveries:

(i) Invoice No. 8 dated 12 March 2014 for actual deliveries in February 2014 for the amount of USD 439,575,979.76; and

(ii) Invoice No. 11 dated 9 April 2014 for actual deliveries in March 2014 for the amount of USD 526,090,843.93.

(1660) Pursuant to article 5.1.4 of the Contract, invoices for the actual deliveries in February 2014 and March 2014 should have been paid by the following due dates:

(i) Invoice No. 8 dated 12 March 2014 for actual deliveries in February 2014 - [redacted] and

(ii) Invoice No. 11 dated 9 April 2014 for actual deliveries in March 2014 - [redacted]

(1661) In breach of article 5.1.4 of the Contract, Naftogaz failed to pay invoices for gas actually delivered in February and March 2014 by their respective due dates. The invoices for actual deliveries in February 2014 and March 2014 were paid in full only on 30 May 2014.

(1662) Pursuant to articles 5.1.4 and 6.2 of the Contract, late payment interest of 0.03% of the amount overdue accrues for each day of delay in payment as follows:

(i) in relation to the invoice for actual deliveries in February 2014, over the period from [redacted] (the date of payment in full); and

(ii) in relation to the invoice for actual deliveries in March 2014, over the period from [redacted] (the date of payment in full).

VIII.10.1.5 Interest claimed in relation to invoices in respect of gas deliveries in February and March 2014

(1663) Accordingly, Gazprom claims interest for late payment by Naftogaz pursuant to article 6.2 of the Contract at the rate of 0.03% of the overdue amount for each day of delay in payment in the total amount of USD 13,076,056.27.

(1664) A table setting out the details of the dates of payments by Naftogaz of sums due for gas delivered in February 2014 and March 2014, and the late payment interest accruing on sums, is set out in Appendix 2 to Gazprom's Statement of Defence and Counterclaim.

VIII.10.1.6 Gazprom's Interest Claim in relation to gas delivered in April, May and June 2014

VIII.10.1.6.1 Preliminary invoices for April, May and June 2014

(1665) In respect of gas deliveries in April, May and June 2014 Gazprom issued the following preliminary invoices:

(i) Preliminary invoice No. 10 dated 08 April 2014 for gas deliveries in April 2014 in the amount of USD 1,646,821,200;

(ii) Preliminary invoice No. 12 dated 15 April 2014 for gas deliveries in May 2014 in the amount of USD 1,713,495,240; and

(iii) Preliminary invoice No. 16 dated 13 May 2014 for gas deliveries in June 2014 in the amount of USD 1,658,221,200.

(1666) Pursuant to article 5.1.2 of the Contract, the preliminary invoices for gas deliveries in April, May and June 2014 should have been paid by the following due dates:

(i) Preliminary invoice No. 10 for April 2014 - [redacted]

(ii) Preliminary invoice No. 12 for May 2014 - [redacted] and

(iii) Preliminary invoice No. 16 for June 2014 - [redacted]

(1667) In breach of article 5.1.2 of the Contract, Naftogaz failed to pay the preliminary invoices for April, May and June 2014 by their respective due dates.

(1668) Pursuant to articles 5.1.2 and 6.2 of the Contract, late payment interest of 0.03% of the amount overdue accrues for each day of delay in payment as follows:

(i) in relation to the preliminary invoice for gas deliveries in April 2014, over the period from [redacted] (noting that, on 13 May 2014, Gazprom issued an invoice for gas actually delivered);

(ii) in relation to the preliminary invoice for gas deliveries in May 2014, over the period from [redacted] (noting that, on 11 June 2014, Gazprom issued an invoice for gas actually delivered); and

(iii) in relation to the preliminary invoice for gas deliveries in June 2014, for [redacted] (noting that, on 9 July 2014, Gazprom issued an invoice for gas actually delivered).

VIII.10.1.6.2 Invoices for actual deliveries in April, May and June 2014

(1669) In respect of gas deliveries in April, May and June 2014, Gazprom issued the following invoices for actual deliveries:

(i) Invoice No. 15 dated 13 May 2014 for actual deliveries in April 2014 in the amount of US$ 1,270,837,717.40;

(ii) Invoice No. 22 dated 11 June 2014 for actual deliveries in May 2014 in the amount of US$ 1,736,555,191.06; and

(iii) Invoice No. 30 dated 9 July 2014 for actual deliveries in June 2014 in the amount of US$ 837,676,734.91.

(1670) Pursuant to article 5.1.4 of the Contract, invoices for gas actually delivered in April, May and June 2014 should have been paid by the following due dates:

(i) Invoice No. 15 dated 13 May 2014 for actual deliveries in April - [redacted];

(ii) Invoice No. 22 dated 11 June 2014 for actual deliveries in May 2014 - [redacted] and

(iii) Invoice No. 30 dated 09 July 2014 for actual deliveries in June 2014 - [redacted]

(1671) In breach of article 5.1.4, Naftogaz failed to pay the above invoices for gas actually delivered in April, May and June 2014 by their respective due dates. The invoice for gas actually delivered in April 2014 was paid in full on 23 December 2014. The invoice for gas actually delivered in May 2014 has been paid only in part. The invoice for gas actually delivered in June 2014 remains unpaid and the full invoiced amount is outstanding.

(1672) Pursuant to articles 5.1.4 and 6.2 of the Contract, late payment interest of 0.03% of the amount overdue accrues for each day of delay in payment as follows:

(i) in relation to the invoice for actual deliveries in April 2014 - over the period [redacted] to [redacted] (the date of payment in full);

(ii) in relation to the invoice for actual deliveries in May 2014 - over the period from [redacted] to the date of payment in full (the invoiced amount is outstanding in part); and

(iii) in relation to the invoice for actual deliveries in June 2014 - over the period from [redacted] to the date of payment in full (the full invoiced amount remains outstanding).

VIII.10.1.6.3 Interest claimed in relation to invoices in respect of gas deliveries in April, May and June 2014

(1673) Accordingly, Gazprom claims interest for late payment by Naftogaz of overdue sums due in relation to gas deliveries in April, May and June 2014 pursuant to article 6.2 of the Contract at the rate of 0.03% of the overdue amount for each day of delay in payment (allocating Naftogaz' 23 December 2014 payment to the oldest invoices first, i.e. to the invoice for actual deliveries in April 2014 in full and to the invoice for actual deliveries in May 2014 in part) as follows:

(i) in respect of the period from 8 May 2014 until 30 May 2015, Gazprom claims late payment interest in the sum of USD 326,635,833.75;

(ii) in respect of the period from 31 May 2015 until the date of payment in full, Gazprom claims late payment interest that is continuing to accrue on the overdue and outstanding amount, which as of 31 May 2015 is USD 2,195,069,643.37.

(1674) A table setting out the details of the dates of payments by Naftogaz of sums due for gas delivered in April, May and June 2014, and the late payment interest accruing on such sums, calculated as at 30 May 2015, is set out in Appendix 2 to Gazprom's Statement of Defence and Counterclaim.

(1675) In addition and in respect of gas delivered in July 2015, Gazprom claims an ORDER that Naftogaz makes payment to Gazprom of late payment interest (accrued pursuant to Article 6.2 of the Contract on the overdue amount at the rate of 0.03% on the overdue amount for each day of delay in payment) over the period from 8 August 2015 to 10 August 2015 in the amount of USD 920.688.27.

VIII.10.1.7 Gazprom's Interest Claim in relation to its Take or Pay Claims

(1676) As explained above, pursuant to Gazprom's Take or Pay Claims, Gazprom has invoiced Naftogaz for gas made available by Gazprom but not offtaken or paid for by Naftogaz in 2012, 2013 and January to October 2014.

(1677) In addition, Gazprom claims payment of the amounts due in respect of the difference between the MAV of gas made available by Gazprom and the actual volume offtaken by Naftogaz in the period 1 July 2015 to 30 September 2015.

(1678) Gazprom's also claims interest in relation to its Take or Pay Claim for 2016, see below.

(1679) According to Sections 4 and 6 of the Swedish Interest Act, interest at a rate corresponding to the Swedish reference rate plus eight percentage points accrues on any debt for which payment has not been made during the period for payment, from the day which occurs 30 days after the creditor has dispatched his invoice until payment is made.

(1680) On 15 January 2013, Gazprom invoiced an amount of USD 7,087,648,811.36 to Naftogaz for the MAV of gas made available by Gazprom but not offtaken or paid for by Naftogaz in 2012.

(1681) On 23 April 2014, Gazprom invoiced an amount of USD 11,387,961,390.02 to Naftogaz for the MAV of gas made available by Gazprom but not offtaken or paid for by Naftogaz in 2013.

(1682) On 26 May 2015, Gazprom invoiced an amount of USD 8,196,987,377.26 to Naftogaz for the MAV of gas made available by Gazprom but not offtaken or paid for by Naftogaz from January to October 2014.

(1683) Naftogaz has failed to make payment in accordance with the invoices. Gazprom claims interest pursuant to article 6.2 of the Contract at the rate of 0.03% of the amount overdue for each day of delay in payment. Accordingly:

(1684) In respect of its Take or Pay Claim for 2012, Gazprom claims payment of late payment interest accruing pursuant to article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 7,087,648,811.36 for each day of delay in payment from 1 February 2013 until full payment has been made; or alternatively;

an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 7,087,648,811.36 from and including 16 February 2013 until full payment has been made.

(1685) In respect of the Take or Pay Claim for 2013, Gazprom claims payment of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 11,387,961,390.02 for each day of delay in payment from 4 May 2014 until full payment has been made; or alternatively

an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 11,387,961,390.02 from and including 24 May 2014 until full payment has been made.

(1686) In respect of the Take or Pay Claim for 2014, Gazprom claims payment of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 8,196,987,377.26 for each day of delay in payment from 8 June 2015 until full payment has been made; ; or alternatively

an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 8,196,987,377.26 from and including 27 June 2015 until full payment has been made.

(1687) In respect of the Take or Pay Claim for 2015, Gazprom claims payment of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of

USD 2,549,796,811.06 for each day of delay in payment from 30 January 2016 until full payment has been made; or alternatively

an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 2,549,796,811.06 from and including 20 February 2016 until full payment has been made.

(1688) Pursuant to Gazprom's Take or Pay Claim for 2016, Gazprom has invoiced Naftogaz for gas made available by Gazprom but not offtaken or paid for by Naftogaz in April to December 2016.

(1689) On 16 January 2017, Gazprom invoiced the amount of USD 5,318,903,523.78 to Naftogaz for the MAV of gas made available by Gazprom but not offtaken or paid for by Naftogaz from April to December 2016.

(1690) Naftogaz has failed to make payment in accordance with the invoice.

(1691) Gazprom claims interest pursuant to Article 6.2 of the Contract at the rate of 0.03% of the amount overdue of USD 5,318,903,523.78 for each day of delay in payment from 27 January 2017 until full payment has been made; or alternatively

an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of US$5,318,903,523.78 from and including 17 February 2017 until full payment has been made.

(1692) Gazprom has further developed its counterclaims as follows.

VIII.10.1.7.1 Gazprom's claim for dismissal of Naftogaz' defence

(1693) Gazprom requests that the Tribunal dismisses Naftogaz' action (Sw. *talan*) in relation to Gazprom's counterclaim for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust or in any other way amend the Contract pursuant to (i) competition law and Articles 4.4 to 4.4.2 of the Contract, (ii) Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(1694) Naftogaz' defences are "*mainly based on*" Naftogaz' main claim for relief (Sw. *huvudkäromål*). Accordingly, what Gazprom has stated above regarding the Tribunal's jurisdiction and substantive power, applies *mutatis mutandis* to Naftogaz' defence. All these matters are therefore relied upon also in relation to Naftogaz' defence to Gazprom's counterclaim, and Naftogaz' action (Sw. *talan*) in this respect should be dismissed accordingly.

VIII.10.1.7.2 Gazprom's alternative claim to limit the effects of any alleged invalidity

(1695) Gazprom's position is that there is no basis for any provisions of the Contract to be declared invalid or ineffective, and that Naftogaz' claims in that respect should be rejected accordingly. Gazprom has also claimed that such claims should be dismissed in certain respects, as set out in detail above.

(1696) If, however, the Tribunal were to find that (contrary to Gazprom's position) certain provisions of the Contract were, or should be declared to be, invalid or ineffective, Gazprom asks that the Tribunal should not reject the Take or Pay Claims, but should limit the effects of any alleged invalidity so far as possible. This request is made both as an alternative position in response to Naftogaz' defence, and as a separate claim as set out below.

(1697) In particular, and without prejudice to Gazprom's primary position that competition law is not applicable in the manner claimed by Naftogaz, Gazprom maintains that it is only insofar as, and to the extent that, a clause in question is contrary to competition law that the clause should be set aside. Alternatively, Section 36 of the Swedish Contracts Act provides a flexible approach by which the Tribunal should seek to obtain the same objective. In short:

(i) It is only the contract content which is prohibited that is tainted by any invalidity under competition law (Prop. 1992/93:56, p. 77);

(ii) Section 36 can be used to modify a contract term that is contrary to a mandatory provision (Prop. 1976/77:81, p. 121);

(iii) To quote Professor Ulf Bernitz: "The Nordic courts are given a broad pwer to model the effects of unenforceable contract clauses on the rest of the Contract, including the possibility to let clauses remainin force after adjustment. Thus, the court can adjust an excessive price by lowering it to a level considered reasonable."[25] See also Prop. 1981/82:165, p. 235; [26]

(iv) See also case T 559/94, in which Sundsvall District Court declined to strike down an offending clause in its entirety on the basis that to do so would have unreasonable consequences.[27]

(1698) Accordingly, and without prejudice to Gazprom's primary position that its Claims should be upheld in full, Gazprom maintains that its Claims should in any event be upheld so far as possible, except insofar as, and to the extent that, they are found to be contrary to competition law and/or are found to be subject to adjustment pursuant to Section 36 of the Swedish Contracts Act.

(1699) Gazprom responds to Naftogaz' comments on the counterclaims in the following order: 1) Gazprom's claims for payment of outstanding amounts for gas delivered, 2) Gazprom's Take or Pay claims, and 3) Gazprom's claims for interest.

VIII.10.2 Gazprom's claims for payment of outstanding amounts for gas delivered ("Supply Claims")

(1700) Naftogaz' defence to these claims is predicated on the assumption that it will succeed in (at least one of) its claims to change the price payable by Naftogaz for gas supplied by Gazprom under the Contract, and thereby retroactively change the price payable for gas supplied in November and December 2013, and April, May and June 2014.

(1701) All of Naftogaz' claims to change the price under the Contract must fail.[28] If that is the case, Naftogaz' defence to the Supply Claims must also fail, and Naftogaz must be ordered to pay Gazprom the amounts claimed.

(1702) In support of its defence, Naftogaz seeks to rely on a Binding Protocol regarding the conditions for gas delivery from the Russian Federation to Ukraine for the period from November 2014 until 31 March 2015 dated 30 October 2014 between the Government of Ukraine, the Government of the Russian Federation and the European Commission (the "**Protocol**"). However, the Protocol simply records, on behalf of the governments of Russia and Ukraine, the

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25 Bernitz, Ulf, *Europarättens genomslag*, 2012, p. 279.

26 Prop. 1981/82:165, p. 235.

27 Sundsvall District Court final decision in Case T 559/94.

28 Alternatively, where the Tribunal is satisfied that the Contract Price should be amended as Natogaz claims, such amendments should not be applied retroactively.

respective positions of Naftogaz and Gazprom as to whether the payments made by Naftogaz on 5 November 2014 and 24 December 2014 were in full (as Naftogaz claims) or partial (as Gazprom contends) settlement of the debts due to Gazprom for gas supplied in November and December 2013 and April to June 2014, as follows:

"*For Naftogaz, the payment of 3.1 billion US dollars under the schedule of payments constitutes the full payment of the unpaid invoices (calculation based on a price of 268.5 US dollars per* [TCM]*).*

For Gazprom, the payment of 3.1 billion US dollars under the schedule of payments constitutes a partial payment of the unpaid invoices of Naftogaz for the gas supplied in November and December 2013 as well as in April, May and June 2014 in accordance with [the Contract] *(calculation based on the relevant conditions of* [the Contract]*).*"

(1703) The Protocol further expressly provides that the parties "*shall sign the Addendum to* [the Contract] *outlining how the Protocol shall be implemented with regard to all issues falling under the responsibility of the* [parties]". That addendum (being [redacted] was entered into by Gazprom and Naftogaz on the same day, [redacted]

[redacted]

[redacted]

[redacted] (Emphasis added.)

(1704) Accordingly, there is nothing in the Protocol or [redacted] that prevents Gazprom from making its Supply Claims.

VIII.10.3 Gazprom's Take or Pay claims ("Take or Pay Claims")

(1705) Article 2.2 and Article 2.2.5 of the Contract (as amended by [redacted] have been presented above.

(1706) Pursuant to Article 2.2.5 of the Contract, Naftogaz is obliged to offtake annually and pay for, or pay for, if the volume of gas is made available by Gazprom but not offtaken by Naftogaz, not less than the Minimum Annual Volume, or "MAV", of natural gas, calculated by reference to the formula in Article 2.2.5 of the Contract.

(1707) Gazprom maintains its Take or Pay Claims in relation to gas supplies in 2012, 2013 and 2014. In addition, as set out above, Gazprom claims payment of the amounts due in respect of the difference between the MAV of gas made available by Gazprom and the actual volume offtaken by Naftogaz in the period 1 July 2015 to 30 September 2015.

VIII.10.3.1 Gazprom's Take or Pay Claim in relation to gas supplies in 2015

(1708) Gazprom's Take or Pay Claim in respect of 2015 extends only to the period 1 July 2015 to 30 September 2015; it does not extend to the period 1 January 2015 to 30 June 2015, or to the period from 1 October 2015 to 31 December 2015, as a result of the following written confirmations given by Gazprom to Naftogaz:

(i) In a letter to Naftogaz dated 30 October 2014, Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of the period from 1 November 2014 to 31 March 2015;

(ii) In a letter to Naftogaz dated 3 April 2015, Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of delivery of gas during the period from 1 April 2015 to 30 June 2015;

(iii) In a letter to Naftgaz dated 24 September 2015, Gazprom confirmed that it would not apply Article 2.2.5 of the Contract in respect of delivery of gas during the period from 1 October 2015 to 31 March 2016.

(1709) The MAV for the period from 1 July 2015 to 30 September 2015 may be calculated as follows:

0.8 x 52 BCM (being the ACV for 2015) x 92[29]/365[30] = 10.485479452 BCM.

(1710) In breach of Article 2.2.5 of the Contract, Naftogaz failed to offtake and to pay for, or to pay for, the MAV of natural gas made available by Gazprom for the relevant period, (i.e. from 1 July 2015 to 30 September 2015).

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29 92 being the number of days from 1 July 2015 to 30 September 2015.

30 365 being the total number of days in the year 2015.

(i) The actual volumes offtaken by Naftogaz in the period from 1 July 2015 to 30 September 2015 was 169,932.842 TCM (or approximately 0.2 BCM).

(ii) The difference between the MAV and the actual volume offtaken by Naftogaz during the period from 1 July 2015 to 30 September 2015 is:

MAV of 10,485,479.452 TCM less 169,932.842 TCM =

10,315,546.610 TCM

(1711) In respect of prior years, the amounts invoiced by Gazprom were calculated based on the actual annual weighted average price in each relevant year, as follows:

Actual annual weighted average price in each relevant year =

Total invoiced amounts in the year in TCM / Total gas deliveries in the year in US$

(1712) The aggregate delivery volumes and invoiced amounts used to calculate the annual weighted average price for each relevant year (2012, 2013, 2014 and 2015) are set out in the table at Appendix 1 to Gazprom's Statement of Rejoinder and Reply to Defence to Counterclaim.

(1713) Accordingly, the actual annual weighted average price for 2015 (rounded to two decimal points) is calculated as follows:

42,003,999.89 / 169,932.842 = USD 247.18 per TCM

(1714) Accordingly, Gazprom claims payment of the amounts due in respect of the difference between the MAV of gas made available by Gazprom and the actual volume offtaken by Naftogaz in the period from 1 July 2015 to 30 September 2015. That amount has been calculated, for each relevant year, by multiplying the difference by the actual annual weighted average price, and which has been invoiced by Gazprom to Naftogaz. On this basis, Gazprom claims the sum of USD 2,549,796,811.06.

VIII.10.3.2 Response to Naftogaz' Defence to Gazprom's Counterclaims

VIII.10.3.2.1 Naftogaz' principal defence based on competition law must fail

(1715) Naftogaz' principal defence[31] is that the volume and Take or Pay provisions of the Contract are invalid or ineffective under competition law, or should be replaced. This defence fails.

(1716) Alternatively, but without prejudice to Naftogaz' principal defence, in the event that the Tribunal were to find that (contrary to Gazprom's position) certain provisions of the Contract were, or should be declared to be, invalid or ineffective, the Tribunal should not reject the Take or Pay Claims, but should limit the effects of any invalidity as far as possible.

VIII.10.3.2.2 Gazprom has not relinquished its Take or Pay Claims

(1717) Save in relation to those periods expressly referred to in Gazprom's Defence and Counterclaim and Rejoinder, Gazprom did not agree to relinquish any claim under Article 2.2.5 of the Contract or make any commitment not to apply it in future.

(1718) The question pursuant to Article 8 of CISG is how statements made by Gazprom and its conduct are to be interpreted.

(i) Under Article 8(1), such statements and conduct "*are to be interpreted according to [Gazprom's] intent where [Naftogaz] knew or could not have been unaware what that intent was*".

(ii) Alternatively, under Article 8(2), if Article 8(1) is not applicable, such statements and conduct "*are to be interpreted according to the understanding that a reasonable person of the same kind as [Naftogaz] would have had in the same circumstances*".

(iii) Under Article 8(3), in applying Article 8(2) "*due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties*".

(1719) As regards the statements made by Mr Putin and Mr Miller in relation to the Take or Pay Claims, these statements should be interpreted by reference to what these individuals actually said and the context in which the respective statements were made.

(1720) In any event, statements by Mr Putin cannot be considered to be statements made by Gazprom.

i) No "assurance" was given by Mr Miller

[31] Naftogaz' Reply, paragraph 1656.

(1721) Naftogaz' witness, [redacted] suggests in his witness statement that Gazprom's Chairman, Mr Miller, personally assured the then Chairman of Naftogaz, Mr Dubina "*that the Take or Pay clause would not be applied to Naftogaz, and that Gazprom would always be willing to agree to reduced volume obligations*".[32]

(1722) This is denied. As explained by [redacted] and [redacted] in their second witness statements, if Mr Miller had made any assurances or representations in relation to the alleged amendment of the Contract (which Gazprom denies), these would have been communicated to [redacted] and also to [redacted] and the rest of the Gazprom in-house legal team.[33] No such communication was received.

(1723) It is unclear from [redacted] witness statement how he became aware of the assurances he alleges were given by Mr Miller to Mr Dubina, and, save for [redacted] allegation, Naftogaz has presented no other evidence of any such assurances.

ii) No legally effective waiver / relinquishment of rights was given or could be given by Mr Putin

(1724) Naftogaz seeks to allege that, in 2009, after the conclusion of the Contract, Gazprom agreed that the volumes of gas to be supplied to Naftogaz would be reduced for the remainder of the life of that contract until its expiry in 2019 and that Gazprom would not enforce its rights under the Take or Pay provisions in Article 2.2.5 of the Contract.

(1725) If any agreement had been reached in respect of the remainder of the eleven year term of the Contract, then it would have been communicated to [redacted] No such information was communicated to [redacted] [34]

(1726) In its Reply, Naftogaz mischaracterises statements made by (then) Russian Prime Minister Putin during two press conferences held with (then) Ukrainian Prime Minister Tymoshenko in 2009, before the execution of SA1 on 24 November 2009, in order to support its allegation that Gazprom has in some way "*relinquished*" its right to rely on the Take or Pay provisions.[35]

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32 [redacted] paragraph 23.
33 [redacted], paragraph 58 and [redacted] paragraphs 7, 14, 16 and 38.
34 [redacted], paragraphs 87 to 94.
35 Naftogaz' Reply, paragraphs 399 to 401 and 1662 to 1669.

When read in their proper context, it is clear that Mr Putin's statements constitute no such "*relinquishment*".

A) Mr Putin emphasised the importance of complying with the terms of the existing written contractual agreements

(1727) In a joint press conference given by Prime Minister Putin and Prime Minister Tymoshenko on 29 April 2009 (the "April 2009 Press Conference"), when reporting on discussions he had had with Ms Tymoshenko, Mr Putin emphasised the importance of compliance with the terms of the contractual agreements in place between Naftogaz and Gazprom:

"[…] *we have confirmed once again that we will base our relations solely on market principles <u>with strict compliance with agreements, contracts and other available understandings</u>.*"[36] (emphasis added.)

(1728) Mr Putin reiterated this stance in a second press conference held on 20 November 2009 (the "November 2009 Press Conference"), just four days before [redacted] to the Contract was signed:

"*Our countries have an effective interaction mechanism and <u>practical agreements and contracts in</u>* <u>[the gas]</u> *<u>sphere</u>. <u>Strict compliance with them</u> will ensure stable and uninterrupted work of the gas transportation systems of both Russia and Ukraine.*

We wholeheartedly hope that all <u>signed agreements</u> will be honoured."[37] (emphasis added.)

(1729) During the April 2009 Press Conference, when asked whether the parties' commitments were in fact being complied with in accordance with the terms of the Contract, Mr Putin explained:

"*<u>These commitments for gas purchases [pursuant to the Contract] are not being completely fulfilled</u>. Ms Tymoshenko has already mentioned this. In accordance with international practice the Contract was agreed on principles of "Take or Pay". That's international practice. <u>But we have agreed with our Ukrainian partners that smaller gas consumption volumes compared with those specified in our contractual obligations, were not down to any slackness on behalf of the companies involved, but are explained by the objective situation caused by the world economic crisis and the production [sic: consumption] decline in Ukraine itself</u>.*

36 Exhibit C-213, internal page 2.

37 Exhibit C-214, page 1.

A similar process is taking place in Russia. That is why we approach this with understanding, and by mutual agreement are not imposing any fines or sanctions. That agreement between Gazprom and [Naftogaz] exists."[38] (emphasis added.)

(1730) Mr Putin explained that there was a mutual understanding that the reduced off-take of gas by Naftogaz in 2009 was the result of a reduction in consumption and the global financial crisis. When asked about his reference to Gazprom not imposing fines or sanctions, and specifically as to when such agreement would be recorded in written form, Mr Putin offered the following clarification:

"*Response: Could you tell me please when this agreement will be sealed in a document form? When will the document be corrected and in such a form as to…*

Vladimir Putin: It exists as a document. The contract allows the option of not imposing fines, and that is what Gazprom is doing".[39] (emphasis added.)

(1731) Mr Putin was not representing that Gazprom had in some way "*relinquished*" a contractual right in a way that was not expressly anticipated by the Contract. He in fact emphasised that the Contract expressly permitted Gazprom the "*option*" of not imposing fines. Indeed, Article 2.2.3 of the Contract provides that any agreement to change the ACV is to be expressed "*in writing*" or "*in the form of a written confirmation by one of the Parties in response to the corresponding written request of the other Party*". In fact, no written agreement was entered into between Gazprom and Naftogaz to reduce the ACV under the Contract until six months later, in the days immediately following the November 2009 Press Conference.

B) The only written agreement entered into further to the April 2009 Press Conference was Addendum No. 3 to the Transit Contract

(1732) What was agreed and formalised in writing following the April 2009 Press Conference, was [redacted] to the Transit Contract. On 30 April 2009, immediately after the 29 April 2009 Press Conference, Gazprom and Naftogaz entered into a written addendum to the Transit Contract, being [redacted] thereto, which provided for [redacted]

38 Exhibit C-213, internal page 5.
39 Exhibit C-213, internal page 6.

[redacted] [40] It follows logically that, had the Parties, following the comments of Mr Putin on 29 April 2009, in fact reached agreement with regard to a reduction of the ACV, or otherwise to amend Naftogaz' Take or Pay obligation under Article 2.2.5 , then they would have reflected such agreement in writing, as they did in relation to the Transit Contract. However, no supplementary agreement to the Supply Contract was signed until November 2009.

C) Nothing in Prime Minister Putin's remarks suggests that the agreement to adjust the ACV was to extend beyond that expressly agreed in Addendum No. 1 to the Supply Contract

(1733) Mr Putin did not in any way represent (as Naftogaz seeks to imply) – in his remarks in either the April 2009 or November 2009 Press Conferences – that Gazprom had agreed to any permanent reduction of the volumes of gas to be supplied under the Contract or that the Take or Pay provision would be disapplied for the remaining 11 year term of the Contract. In fact, Mr Putin emphasised that, from the perspective of international practice, there was nothing objectionable in principle about the concept of Take or Pay – the problem that had presented itself was the reduced consumption in Ukraine resulting from the world economic crisis.

(1734) Naftogaz cites the following remarks by Mr Putin at the November 2009 Press Conference:

"Question: I have a gas-related question. <u>You said you have reached an agreement today to adjust some of the existing agreements to avoid future problems</u>. Could you elaborate on this, please?

…

Vladimir Putin: About what we agreed on and what the problem is in our view: <u>our Ukrainian colleagues have repeatedly voiced concerns over the penalties for failure to purchase the agreed amounts of gas under take-or-pay contracts</u>.

This is an accepted international practice. Gazprom has such contracts with all European partners, not just Ukraine. I would like to stress this - it is not an exclusive approach to Ukraine. It is a general rule.

<u>Second, we all understand that natural gas consumption has shrunk as both Ukrainian and Russian economies contracted due to the global recession. Therefore, considering the special</u>

40 [redacted]

relations between Russia and Ukraine, between Gazprom and Naftogaz, we decided not to impose these penalties. Let me repeat this publicly - no sanctions will be applied.

Third. What do we have to do to avoid a similar situation next year? We decided today that, despite the earlier agreements on purchase volumes, Gazprom and Naftogaz will adjust the amount for next year. No extra gas in the Contract, no sanctions. This is a very simple decision, which suits everyone and does not violate existing contracts."[41] (emphasis added.)

(1735) It is perfectly clear from Mr Putin's remarks that the agreement reached in relation to the disapplication of the Take or Pay provision was in relation to the years 2009 and 2010 only. And this agreement was in fact, pursuant to Article 2.2.3 of the Contract, recorded in writing by way of a supplementary agreement to the Contract: on 24 November 2009, six months after the April 2009 Press Conference and four days after the November 2009 Press Conference, Gazprom and Naftogaz signed [redacted] to the Contract, pursuant to which the ACV was amended as follows:

[redacted]

[redacted]

[redacted].[42]

(1736) [redacted] to the Contract expressly provided that the ACV from 2011 was to be 52 BCM (albeit this was the result of subsequent amendment pursuant to further agreements between the parties). However, the express wording of [redacted] It therefore cannot logically be the case that, at the time [redacted] was entered into on 24 November 2009, Naftogaz understood that, as a result of Mr Putin's comments as set out above, that Gazprom's agreement to reduce the ACV extended, at that time, beyond 2010.

(1737) Naftogaz' interpretation of Mr Putin's comments is opportunistic at best. Mr Putin was specifically discussing the sanctions for Naftogaz' failure to off-take the required volumes of gas in April 2009 when he was asked, during the April Press Conference, whether the contractual sanctions would be applied in the future. As [redacted] explains, it is clear that

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[41] Joint press conference between Russian Prime Minister Putin and Ukrainian Prime Minister Tymoshenko on 20 November 2009.

[42] [redacted]

Mr Putin was only confirming that Gazprom had agreed to amend the volumes of gas to be supplied during 2009, and that it would not enforce its contractual rights against Naftogaz in relation to those 2009 gas volumes.[43]

(1738) It follows that Mr Putin did not represent, promise or otherwise state that there was any agreement in existence at that time pursuant to which the Parties agreed that Gazprom would not enforce the Take or Pay provisions in relation to gas supplied in future years.

(1739) Mr Putin was merely making reference in the press conferences to amendments to the written wording of the Contract that were subsequently expressly executed as [redacted] He was <u>not</u> – as Naftogaz is now trying to suggest – making any additional oral commitments on behalf of Gazprom.

(1740) A reasonable person in the same circumstances as Naftogaz would not have read into Mr Putin's words an unqualified and binding commitment never to apply the Take or Pay provisions in any circumstances for the remainder of the contract term.

(1741) In any event, it is important to note that, pursuant to Article 9.2 of the Contract, any amendments to the Contract need to be made in writing and signed by the Parties' authorised representatives.

iii) Mr Putin and Ms Tymoshenko understood that any agreed amendments to the Contract would not have long-term effect

(1742) Moreover, contrary to Naftogaz' position, the comments of both Mr Putin and Ms Tymoshenko demonstrate that neither government considered that any of the agreed amendments to the Contract would have a long-term effect. In particular, at the November Press Conference, Mr Putin noted that a further agreement had been reached in relation to performance of the Contract during 2010:

"*Third. What do we have to do to avoid a similar situation next year? We decided today that, despite earlier agreements on purchase volumes, Gazprom and Naftogaz will adjust the amount <u>for next year</u>. No extra gas in the Contract, no sanctions*." (emphasis added.)

(1743) If, as Naftogaz claims, Gazprom had already relinquished its rights under the Take or Pay provisions (either as a result of Mr Putin's comments at the April Press Conference or in some

[43] See [redacted] paragraphs 87 to 94.

other way), no such agreement would have been required. As [redacted] notes, if the agreement to which Mr Putin was referring was an agreement not to apply the Take or Pay provisions for the remainder of the Contract:

"*it would have made more sense simply to amend the Contract by: (a) removing the Take or Pay provision on article 2.2.5 in its entire, and (b) revising / removing Gazprom's commitment to supply the volumes identified in article 2.2*"[44]

(1744) Ms Tymoshenko's comments during the April Press Conference reinforce this position, making clear that the Parties had not concluded an agreement with "*long term*" effects, or even with effects "*for the foreseeable future*", since this was a solution which she considered still needed to be discussed:

"*And in order that we have guarantees for the long term, for the foreseeable future, we have suggested that the intergovernmental agreement be discussed as an option* […]."

iv) Mr Putin's comments cannot bind Gazprom

(1745) In any event, nothing that Mr Putin did say in the context of a press conference addressed to the general public can be construed as a "*binding contractual commitment*", as asserted by Naftogaz in paragraph 1674 of its Reply. Pursuant to Article 9.2 of the Contract, "*all amendments and supplements hereto shall be made in writing and signed by the Purchaser's and Seller's authorised representatives*".

v) Conclusion

(1746) Naftogaz and Gazprom signed [redacted] to the Contract on [redacted] after the November Press Conference. This document recorded the only terms which had been agreed between the contracting Parties as a result of the effect of the global financial crisis on Ukraine's demand for gas in 2009.[45] [redacted] which was originally

44 [redacted], paragraph 96.
45 See [redacted] paragraph 91.
46 [redacted]

contemplated (and, in fact, demanded by Naftogaz[47]) at the time of execution of the Contract in January 2009.

(1747) It is plain from the above that Naftogaz' argument that Gazprom has "*relinquished*" its Take or Pay claims is based on an opportunistic and misconceived interpretation of Mr Putin's comments at the 2009 Press Conferences. At no point did Mr Putin state that the volumes of gas to be supplied to Naftogaz under the Contract had been, or would be, permanently reduced. Moreover, as set out above, Mr Putin clearly stated that he expected the terms of all written agreements executed by Naftogaz and Gazprom, including the Contract and [redacted] to be "*strictly*" complied with.

VIII.10.3.2.3 Agreements not to apply the Take or Pay provisions were temporary

(1748) The agreements concluded between the Parties pursuant to which Gazprom agreed not to apply the Take or Pay provision in Article 2.2.5 of the Contract were temporary. This is clear from the express wording of each of the agreements.[48]

VIII.10.3.2.4 The Parties' subsequent conduct does not demonstrate that they considered Gazprom's Take or Pay Claims to be relinquished

(1749) Naftogaz asserts that "*Gazprom's subsequent conduct is further testimony to Gazprom being aware that no Take or Pay claims remained. This is why Gazprom did not invoice any Take or Pay until 15 January 2013.*"

(1750) This is denied. Gazprom has consistently asserted its claims pursuant to Article 2.2.5 of the Contract in correspondence.[49]

(1751) Furthermore, in January 2011, the Parties concluded a Memorandum of Understanding in Relation to gas supplies[50] pursuant to which Gazprom agreed to supply gas to Ostchem Holding

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47 [redacted] paragraphs 51 and 52.

48 See [redacted]

49 See, for example: Letter No 05-676 from Gazprom to Naftogaz dated 8 June 2011. Exhibit R-90. Letter No 05-83 from Gazprom to Naftogaz dated 1 February 2012. Letter No 05/1200-1937 from Gazprom to Naftogaz dated 10 October 2012. Letter No 05-34 from Gazprom to Naftogaz dated 21 January 2013, enclosing invoice for outstanding Take or Pay volumes in 2012. Letter No 05-231 from Gazprom to Naftogaz dated 18 March 2013. Letter No 05-317 from Gazprom to Naftogaz dated 29 March 2013. Letter No 05-662 from Gazprom to Naftogaz dated 17 July 2013. Letter No 05-735 from Gazprom to Naftogaz dated 3 September 2013. Letter No 05-318 from Gazprom to Naftogaz dated 23 April 2014, enclosing invoice for outstanding Take or Pay volumes in 2013. Letter No 05-455 from Gazprom to Naftogaz dated 28 May 2015, enclosing invoice for outstanding Take or Pay volumes in 2014. Letter No 05-434 from Gazprom to Naftogaz dated 5 June 2014. Letter No 05-28 from Gazprom to Naftogaz dated 19 January 2016 enclosing invoice for outstanding Take or Pay volumes in 2015.

50 Memorandum of Understanding in Relation to gas supplies dated January 2011.

Limited ("Ostchem") for consumers in the Ukraine, "*in addition to the volumes of natural gas delivered by Gazprom to Naftogaz* [...] *under* [the Contract]".

(1752) Pursuant to article 5 of that Memorandum, Naftogaz "*acknowledges and warrants that the delivery of natural gas by* [Gazprom] ... *to Ostchem will not result in* [Naftogaz] *failing to perform its obligations owed to Gazprom in relation to the offtaking and/or payment of all the gas volumes provided for in Contract No. KP, and will not serve as a basis for* [Naftogaz] *requesting Gazprom to reduce the volumes and/or price of gas purchased under Contract No. KP*".

(1753) It is accordingly apparent that, even in January 2011, Naftogaz acknowledged that it was bound by the Take or Pay provisions in Article 2.2.5 of the Contract.

VIII.10.3.3 Gas was made available to Naftogaz

(1754) Naftogaz claims that Gazprom has "*provided no relevant evidence that the gas not taken by Naftogaz was effectively made available to Naftogaz by Gazprom*".

(1755) This is denied. As set out in the evidence, gas is permanently available for supply to Naftogaz, which has only to nominate the volumes to be supplied in order for them to be provided.

(1756) As [redacted] explains in his first witness statement[51] (and with which [redacted] agrees)[52], volumes delivered to Naftogaz for use a) by domestic off-takers in Ukraine and supplied under the Contract, or b) for transit to European off-takers and provided under thre Transit Contract, are determined on a daily basis by way of nominations exchanged between Gazprom and Ukrtransgaz, Naftogaz' subsidiary and operator of the Ukrainian pipeline network.

(i) In relation to gas to be transited through the territory of Ukraine to European off-takers under the Transit Contract, the European off-takers submit nominations to Gazprom specifying the quantities of gas to be delivered to them the following day. Gazprom aggregates these and submits a nomination to Naftogaz, indicating what volumes of gas should be transported to which exit station in the west of Ukraine for delivery to Europe.

(ii) In relation to gas to be supplied to Naftogaz under the Contract, it is Naftogaz which sends Gazprom a nomination, specifying the total volumes to be delivered to it the following day.

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51 [redacted], paragraph 71.
52 [redacted] paragraph 7.

(iii) It is on the basis of these nominations that Gazprom determines how much gas is to be pumped into the transmission system and delivered to the entrance points on the border of Ukraine and Russia / Belarus. As [redacted] explains:

"*Provided that it meets its payment obligation, all that Naftogaz has to do in order to receive the volumes it has contracted to take under the Contract is to nominate, or order, the relevant volumes.*"[53]

(iv) The volumes of gas which Naftogaz was obliged to pay for and off-take, or pay for if not off-taken, pursuant to the Take or Pay provision in Article 2.2.5 of the Contract, were made available to Naftogaz by Gazprom - had Naftogaz nominated these volumes, Gazprom would have delivered them.

VIII.10.4 The Take or Pay provision in the Contract is not unworkable

(1757) Naftogaz claims that the Take or Pay clause in Article 2.2.5 of the Contract is unworkable because "*it is not possible to define in a precise manner, on the basis of the Contract, the relevant Take or Pay volumes, their price, and how payments shall be effected*". This is denied.

(1758) Gazprom sets out, in relation to Naftogaz' Take or Pay obligation:

(i) how the MAV is calculated;

(ii) how the volume of gas which Nafogaz was obliged to off-take and pay for, or pay for if not off-taken is calculated;

(iii) how the annual weighted average price is calculated; and

(iv) the price of the gas which Naftogaz failed to pay for pursuant to Article 2.2.5 of the Contract.

(1759) In addition, the invoices sent by Gazprom to Naftogaz for the volumes of gas which Nafogaz was obliged to off-take and pay for, or pay for if not off-taken demonstrate how the payments due to Gazprom are to be effected.[54]

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53 [redacted] paragraph 75.

54 Invoice No. 4 from Gazprom to Naftogaz dated 15 January 2013, Invoice No. 13 from Gazprom to Naftogaz dated 23 April 2014, Invoice No. 32 from Gazprom to Naftogaz dated 26 May 2015; Invoice No. 5 from Gazprom to Naftogaz dated 19 January 2016.

(1760) It is therefore plain that Article 2.2.5 is workable, and that Naftogaz' position in this regard is untenable. Naftogaz fails to identify any specific ambiguity in the Contract which renders Article 2.2.5 inoperable. That Naftogaz understood how to calculate the actual annual weighted average price of gas supplied is apparent from the correspondence exchanged between the Parties.[55]

VIII.10.5 The volume and Take or Pay provisions are not unconscionable and cannot be set aside pursuant to Section 36 of the Swedish Contracts Act

(1761) Gazprom's response to Naftogaz' claim that the volume and Take or Pay provisions in the Contract are unconscionable and should be set aside pursuant to Section 36 of the Swedish Contracts Act is set out below and, for the reasons set out there, Naftogaz' claim that Gazprom is unable to rely on Article 2.2.5 of the Contract must fail.

(1762) Alternatively, but without prejudice to Naftogaz' principal defence, in the event that the Tribunal were to find that (contrary to Gazprom's position) certain provisions of the Contract were, or should be declared to be, unconscionable, the Tribunal should not reject the Take or Pay Claims, but should limit the effects of any invalidity as far as possible.

VIII.10.6 Gazprom did not cause Naftogaz not to off-take the gas

VIII.10.6.1 The Take or Pay provision is not a penalty clause

(1763) Gazprom's response to Naftogaz' claim that Article 2.2.5 of the Contract is a penalty clause is set out below and, for the reasons set out there, Naftogaz' claim that Gazprom is unable to rely on Article 2.2.5 of the Contract must fail.

VIII.10.6.2 In any event, Gazprom did not make it "*financially impossible for Naftogaz to take the entire Take or Pay volume*"

(1764) Furthermore, Naftogaz' defence according to which Gazprom made it "*financially impossible for Naftogaz to take the entire Take or Pay volume*" because the underlying price for the gas supplied under the Contract is unreasonable is predicated on the assumption that it will succeed in (at least one of) its claims for revision of the price payable under the Contract, whether

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[55] See, for example, Letter No. 24-3837/1-11 from Naftogaz to Gazprom dated 17 June 2011 in which Naftogaz refers to "*The actual weighted average Contract Price based on the results of deliveries in 2009 amounted to 232.47 US dollars per 1,000 cubic metres of gas. The weighted average Contract Price of gas in 2010 … turned out to be equal to 338.26 US dollars per 1,000 cubic metres of gas…At the same time, based on the results of deliveries in the [first] 5 months of 2011, the weighted average Contract Price of gas amounted to 371.77 US dollars per 1,000 cubic metres…*" (emphasis added.)

pursuant to Article 4.4.1 of the Contract, Section 36 of the Swedish Contracts Act, or European Competition Law.

(1765) Naftogaz' claims to revise the price must fail, with the result that the defence which Nafogaz raises at paragraphs 1690 to 1694 of its Reply must also fail. In any event, there is no factual basis for this contention: no evidence has been provided about Naftogaz' financial position or how that financial position was influenced by Gazprom's conduct.

VIII.10.7 The Take or Pay Claims are not smaller than claimed by Gazprom

(1766) Naftogaz submits that Gazprom's Take or Pay Claims should be significantly reduced. This is denied.

VIII.10.7.1 Gazprom's interpretation of the Contract to determine the ACV and MAV is correct

(1767) Naftogaz claims that, pursuant to Article 2.2.2 of the Contract, in the absence of an agreement for reduction of the ACV for gas supplied in 2012 to 2014, the amendment to the ACV of [redacted] apply for gas supplied in 2012 and 2013, resulting in a Take or Pay obligation of 33.28 BCM.

(1768) Article 2.2.2 of the Contract states:

"[…] *The Gas quarterly distribution in 2011-2019 shall be determined by supplemental agreements hereto that shall be signed by the Parties by 1 November of the year preceding the Year of Delivery, and if the corresponding supplemental agreements have not been signed, the quarterly distribution shall be made in accordance with the distribution in the year preceding the Year of Delivery*" (emphasis added)

(1769) As is clear from its express wording, Article 2.2.2 relates to the "*quarterly distribution*" of gas in a given delivery year. That is, the proportion of the ACV which the Parties agree will be delivered in each quarter of the year of delivery. Naftogaz is therefore incorrect to imply that Article 2.2.2 in someway obliges Gazprom to agree to reductions in the ACV. Amendments to the ACV itself are governed by a separate provision in Article 2.2.3:

"*The ACV specified in this Article 2.2 may be amended by agreement between the Parties not later than six (6) months prior to the beginning of the corresponding Year of Delivery.* […]

However, the ACV change shall not exceed 20% of the volume specified above in this Article 2.2."

(1770) Furthermore, Article 2.2.2 provides that, in the absence of an agreement as to the quarterly distribution of gas in the following year, it is the "*quarterly distribution*", or the proportions of ACV which the Parties agreed would be delivered in each quarter of the preceding year, which will apply. Article 2.2.2 does <u>not</u> provide that any amendment to the ACV agreed in a preceding year will continue to apply in the absence of a supplementary agreement.

(1771) It is therefore clear that the reduction to the ACV agreed under SA4 does not continue to apply for gas supplied in 2012 and 2013.

(1772) Alternatively, if the Tribunal found that the reduction to the ACV agreed under [redacted] did [redacted]

(1773) Naftogaz asserts that "*the MAQ applicable in 2014 should be further reduced to take into account Gazprom's interruption of gas deliveries as from 16 June 2014* […] *Consequently, the MAQ applicable in 2014 is 21.3* [BCM]".

(1774) This is denied. In June 2014, Naftogaz moved to a pre-payment regime, as provided for in Article 5.8 of the Contract. Naftogaz received all of the gas that it paid for and, as a result, Gazprom is entitled to receive payment for gas not offtaken pursuant to Article 2.2.5 of the Contract.

<u>VIII.10.7.2 No revised price is applicable</u>

(1775) In addition, Naftogaz relies on its claims for revision of the price and determination of the factual price in order to reduce the annual weighted average price for the years 2012 to 2014, and thereby reduce the price payable to Gazprom under Article 2.2.5 of the Contract. For the reasons set out below. Naftogaz' claims to revise the price and claims for price determination must fail, with the result that the defence which Naftogaz raises at paragraphs 1706 to 1710 of its Reply must also fail.

VIII.10.8 Response to Naftogaz' Defence to Gazprom's claims for interest

<u>VIII.10.8.1 No interest is claimed on sums due for November and December 2013</u>

(1776) No interest is claimed on sums due for gas supplied in [redacted]

(1777) In paying those invoices, Naftogaz thereby accepts that the principal sums claimed at paragraphs 265 and 266 of Gazprom's Defence and Counterclaim are duly owed to Gazprom.

VIII.10.8.2 Gazprom's Interest Claim in relation to gas delivered in February and March 2014

(1778) First, Gazprom notes that Naftogaz in principle accepts (Sw. *vitsordar*) Gazprom's entitlement to delay interest for late payments in respect of gas delivered in February and March 2014 and the correctness of Gazprom's calculations thereof.

(1779) Naftogaz' only defence to this claim is predicated on the assumption that it will succeed in (at least one of) its claims to change the price payable by Naftogaz for gas supplied by Gazprom under the Contract, and thereby change the price payable for gas supplied in February and March 2014 retrospectively.

(1780) Naftogaz' claims to revise the price must fail. Accordingly, Naftogaz has no defence to this Interest Claim and must be ordered to pay Gazprom the amounts claimed and set out in paragraphs 298 and 299 of Gazprom's Defence and Counterclaim.

VIII.10.8.3 Gazprom's Interest Claim in relation to gas delivered in April, May and June 2014

(1781) First, Gazprom notes that Naftogaz does not set out any specific defences to Gazprom's calculations of late payment interest as such, in respect of the invoices for gas delivered in April, May and June 2014. Thus, Gazprom understands that Naftogaz (Sw. *vitsordar*) the way Gazprom has calculated its claim for late payment interest also in respect of invoices for gas delivered in April, May and June 2014.

(1782) Naftogaz only claims that it was entitled to suspend payments to Gazprom for gas delivered in [redacted] because [redacted]

(1783) However, [redacted] does not require Gazprom to enter into a supplementary agreement to apply the price stipulated in [redacted]

(1784) In circumstances where no supplementary agreement was entered into for gas delivered in April, May or June 2014:

(i) Naftogaz was not entitled to withhold payment from Gazprom for those deliveries, and interest is due on any late payment in accordance with Articles 5.1.2 and 6.2 of the Contract, in the amounts set out at paragraphs 308 and 309 of the Defence; and

(ii) Naftogaz is not entitled to damages for any alleged breach by Gazprom of a "duty" to [redacted] [6]

(1785) Accordingly, Naftogaz has no defence to this Interest Claim and must be ordered to pay Gazprom the amounts claimed and set out in paragraphs 308 and 309 of Gazprom's Defence and Counterclaim.

VIII.10.9 Gazprom's Interest Claim in relation to its Take or Pay Claims

VIII.10.9.1 Gazprom's Interest Claim in relation to its Take or Pay Claims in 2015

(1786) As explained above, pursuant to Gazprom's Take or Pay Claims, Gazprom has invoiced Naftogaz for gas made available by Gazprom but not offtaken or paid for by Naftogaz in July to September 2015.

(1787) On 19 January 2016, Gazprom invoiced an amount of USD 2,549,796,811.06 to Naftogaz for the MAV of gas made available by Gazprom but not offtaken or paid for by Naftogaz from July to September 2015.[57]

(1788) Naftogaz has failed to make payment in accordance with the invoice. Gazprom claims interest pursuant to Article 6.2 of the Contract at the rate of 0.03% of the amount overdue for each day of delay in payment. Accordingly Gazprom claims payment of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 2,549,796,811.06 for each day of delay in payment from 30 January 2016 until full payment has been made.

VIII.10.9.2 Response to Naftogaz' Defence to Gazprom’s Interest Claim in relation to its Take or Pay Claim

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56 Naftogaz' Reply, paragraphs 1741 and 1742.

57 Invoice No. 5 dated 19 January 2016.

(1789) Naftogaz asserts that, pursuant to Article 6.2 of the Contract, Gazprom is only entitled to charge interest on late payments for "*gas delivery*" and that, since Gazprom's Take or Pay Claims relate to volumes of gas which were not delivered to Naftogaz (as Naftogaz failed to nominate and off-take these volumes in breach of its obligations under Article 2.2.5 of the Contract), no interest can be charged in relation to delays in payment for those volumes.

(1790) This is denied. The phrase "*gas delivery hereunder*" plainly relates to gas deliveries which *should have been* off-taken and paid for, or paid for if not off-taken, by Naftogaz pursuant to Article 2.2.5 of the Contract. Naftogaz cannot rely on its own failure to comply with its Take or Pay obligation in order to avoid liability for interest which has accrued as a result of that failure. Put plainly, Naftogaz should have paid for the volumes of gas for which Gazprom claims payment in its Take or Pay Claims, but did not, in breach of contract. As a result of that default, Naftogaz must now pay Gazprom the outstanding sums due, and interest on those sums as set out at paragraph 314 of its Defence and Counterclaim.

VIII.10.10 Gazprom's alternative claims for interest under Swedish law

VIII.10.10.1 Gazprom's alternative interest claim in relation to the Take or Pay Claims

(1791) In the alternative, Gazprom claims delay interest on its Take or Pay Claims pursuant to the rules of the Swedish Interest Act (SFS 1975:365) in accordance with the following.

(1792) Section 4, Paragraphs 1 and 2 of the Swedish Interest Act (SFS 1975:365) provide as follows:[58]

"*In circumstances other than those set forth in section 3, interest shall accrue on any debt which is due and payable and for which payment has not been made during the period for payment, commencing on the day which occurs thirty days following dispatch by the creditor of an invoice or some other form of demand for payment of a specified sum, indicating that failure to make payment shall subject the debtor to liability for interest. The debtor shall not be liable, however, to make payment of interest in respect of the period of time prior to his receipt of the invoice or demand for payment.*

In the creditor-debtor relationship between traders in their professional activities, interest shall be payable in accordance with the first paragraph without a requirement, when the claim is made, to state that failure to pay will result in a liability to pay interest. The aforesaid shall

[58] Swedish Interest Act, TransLegal AB Sweden, *Swedish Commercial Legislation*, available through Norstedts juridik/Zeteo.

apply where a trader, in his professional activities, has a claim against a public authority or other public body in respect of payment for goods or services." (Emphasis added)

(1793) The first sentence of Section 6 of the Swedish Interest Act provides as follows:[59]

"*In cases as referred to in sections 3 or 4, interest shall be calculated per annum according to a rate of interest equivalent to the reference rate of interest in accordance with section 9, plus eight percentage points.*"

(1794) The first sentence of Section 9 of the Swedish Interest Act provides as follows. [60]

"*The reference rate of interest pursuant to this Act shall be determined each calendar half year through a special decision taken by the Central Bank of Sweden.*"

(1795) As explained above, the interest rate pursuant to Section 6 of the Swedish Interest Act corresponds to the Swedish reference rate plus eight percentage points.

(1796) Thus, according to Sections 4 and 6 of the Swedish Interest Act, interest at a rate corresponding to the Swedish reference rate plus eight percentage points accrues on any debt for which payment has not been made during the period for payment, from the day which occurs 30 days after the creditor has dispatched his invoice until payment is made.

(1797) As explained in Gazprom's Defence and Counterclaim and above, Gazprom has invoiced Naftogaz for gas made available by Gazprom but not off taken or paid for by Naftogaz in 2012, 2013, January to October 2014 and in July to September 2015.

(1798) On 15 January 2013, Gazprom invoiced an amount of USD 7,087,648,811.36 to Naftogaz for the MAV of gas made available by Gazprom but not off taken or paid for by Naftogaz in 2012.[61]

(1799) On 23 April 2014, Gazprom invoiced an amount of USD 11,387,961,390.02 to Naftogaz for the MAV of gas made available by Gazprom but not off taken or paid for by Naftogaz in 2013.[62]

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[59] Swedish Interest Act, TransLegal AB Sweden, *Swedish Commercial Legislation*, available through Norstedts juridik/Zete.

[60] Swedish Interest Act, TransLegal AB Sweden, *Swedish Commercial Legislation*, available through Norstedts juridik/Zeteo.

[61] Invoice No. 4 from Gazprom to Naftogaz dated 15 January 2013.

[62] Invoice No. 13 from Gazprom to Naftogaz dated 23 April 2014.

(1800) On 26 May 2015, Gazprom invoiced an amount of USD 8,196,987,377.26 for the MAV of gas made available by Gazprom but not off taken or paid for by Naftogaz from January to October 2014.[63]

(1801) On 19 January 2016, Gazprom invoiced an amount of USD 2,549,796,811.06 for the MAV of gas made available by Gazprom but not off taken or paid for by Naftogaz in July to September 2015.[64]

(1802) As explained in Gazprom's Defence and Counterclaim and above, Naftogaz has failed to make payment in accordance with the invoices.

(1803) Accordingly, Gazprom claims interest pursuant Sections 4 and 6 of the Swedish Interest Act in relation to invoices for gas made available by Gazprom but not off taken or paid for by Naftogaz in accordance with the following:

(i) On USD 7,087,648,811.36 from and including 16 February 2013 until full payment has been made;

(ii) On USD 11,387,961,390.02 from and including 24 May 2014 until full payment has been made;

(iii) On USD 8,196,987,377.26 from and including 27 June 2015 until full payment has been made; and

(iv) On USD 2,549,796,811.06 from and including 20 February 2016 until full payment has been made.

VIII.11 Gazprom's defences to Naftogaz' claims

VIII.11.1 Gazprom's position regarding Naftogaz' requests for relief

(1804) The Tribunal has been presented with a plethora of claims by Naftogaz. Chief amongst these are (1) claims for a retroactive price revision of the Contract Price under the Contract, (2) claims to invalidate and replace various provisions of the Contract on grounds of alleged infringement of EU law, EnCT and Ukrainian law, and/or under Section 36 of the Swedish Contracts Act, coupled with claims for repayment and/or damages.

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63 Invoice No. 32 from Gazprom to Naftogaz dated 26 May 2015.

64 Invoice No. 5 from Gazprom to Naftogaz dated 19 January 2016.

(1805) Naftogaz' claims are all without merit and should be dismissed on jurisdictional grounds or rejected on the merits.

(1806) In advancing its price revision claim, Naftogaz seeks substantially to re-write a detailed contract that was negotiated by the Parties with care over a lengthy period of time, and with the benefit of assistance from in-house legal teams. In so doing, Naftogaz advances through its witness a number of representations/assurances which it alleges were made by Gazprom's personnel. These representations/assurances were (1) not made, (2) not reflected in the carefully drafted and negotiated contract, and (3) not supported by any contemporaneous document.

(1807) For a variety of reasons, procedural and substantive, Naftogaz has no entitlement to a price revision, let alone to have the price revised with effect from 20 May 2011 (or later dates). Whilst Naftogaz' request for arbitration was made on 16 June 2014, the price revision request upon which primarily it relies was sent as long ago as 20 May 2011. Even if, contrary to Gazprom's case, Article 4.4 of the Contract is a price revision clause rather than a price renegotiation clause, the reference of the price revision to arbitration was not made by Naftogaz until over 3 years after the price revision request and over 2 1/2 years after the 3 month negotiation period under Article 4.4 had expired.

(1808) In the period between the expiry of that negotiation period and Naftogaz' letter of 27 April 2014, there was not a single reference by Naftogaz to the existence of an ongoing negotiation in relation to its price revision request of May 2011 or even to the continued operability of that request. The reason is simple: the price revision request was not pursued after the end of the negotiation period and was superseded by the numerous amendments the Parties made over the following 2 ½ years, including, but not limited to, a change to the price payable by Naftogaz under the Contract for the gas supplied. Indeed, it was only when Gazprom refused to extend the period for the price of USD [redacted] set under Addendum No. [redacted] and Addendum No [redacted] for the [redacted] that Naftogaz sought to resurrect its long-abandoned price review request. Having done so, it then sought for the first time to seek a price revision with effect from May 2011 despite having made payment of invoices in the intervening period of nearly 3 years and despite having agreed changes to the pricing under the Contract without any suggestion that it would seek to recover part of its payments by obtaining a backdated price adjustment.

(1809) Quite apart from defences that arise as a result of such delay and conduct on the part of Naftogaz, these stark facts serve to explain the contrived nature of Naftogaz' various price-related claims. It must have appreciated when requesting this arbitration not only that its price revision request was long-since dead, but that the grounds (such as they were) specified in its follow-up letter of 17 June 2011 were unsustainable and required new grounds to be advanced. Having advanced those new grounds for the first time in this arbitration, it seeks to gloss over the change notwithstanding the contractual requirement which for obvious reasons requires the price revision request to be "*duly substantiated*".

VIII.11.2 Gazprom's Defences to Naftogaz' Price Revision Claims

(1810) Naftogaz seeks revision of the Contract Price pursuant to Claims 2.1, 2.2, 2.3.1, 2.3.2, 2.4.1 and 2.4.2. Naftogaz asserts that these claims are "*based on a regular application of the price revision clause in Article 4.4 of the Contract*".

(1811) Gazprom's position in relation to these claims, as set out in detail below, is as follows:

(i) the Tribunal has no jurisdiction over Naftogaz' price revision claims and these claims should therefore be dismissed (Sw. avvisade);

(ii) even if the Tribunal accepts jurisdiction, it does not have the substantive power to revise the price and these claims should therefore be rejected (Sw. ogillade);

(iii) even if the Tribunal does have jurisdiction and the substantive power to revise the price, the adjustments claimed by Naftogaz are misconceived and should be rejected on the merits;

(iv) further, articles 4.4 to 4.4.2 of the Contract do not in any event allow the Tribunal to revise the price retroactively and Naftogaz' price revision claims should therefore be rejected; and

(v) in any event, Naftogaz has no right to repayment and no right to damages in respect of the price revision claims and such claim (Claim 5) should therefore be rejected.

<u>VIII.11.2.1 The Tribunal has no jurisdiction over Naftogaz' price revision claims and these claims should therefore be dismissed (Sw. avvisade)</u>

(1812) The Tribunal does not have any jurisdiction over Naftogaz' price revision claims since:

(i) Naftogaz has not submitted a duly justified request to reconsider the price, meaning that the preconditions to exercise of rights under Articles 4.4 to 4.4.2 have not been met;

(ii) even if Naftogaz had submitted a duly justified request, articles 4.4 and 4.4.1 require the Parties to enter into negotiations that are limited in scope to adjustment of the Contract Price and do not include a complete revision of the price formula;

(iii) Naftogaz' price revision claims fall outside the scope of article 4.4.2. Pursuant to the wording of article 4.4.2, if the negotiations do not result in agreement, then each of the Parties has a right to "*challenge the actions of the other party to perform the Contract*". The "*challenge*" to the "*actions*" referred to here:

- can only give the Tribunal jurisdiction to compel negotiations;
- in any event, cannot include a complete revision of the price formula; and
- Naftogaz' repeated references to a "*Groningen model*" cannot transform clauses 4.4 to 4.4.2 into an orthodox price reopener provision because the clear language that would be necessary to achieve this is absent;
- the Tribunal's jurisdiction is in turn limited by the scope of the negotiations according to articles 4.4 and 4.4.1 and the actual negotiations have not included a complete revision of the price formula;
- even if the Tribunal had any jurisdiction, such jurisdiction is now precluded by the Parties' subsequent agreements;
- even if the Tribunal had any jurisdiction, such jurisdiction is now precluded by Naftogaz' failure to pursue its claims;
- even if the Tribunal had any jurisdiction, such jurisdiction is now precluded by the fact that the Contract is no longer the same as it was when the request for revision was made; and
- in any event, the Parties have not given the Tribunal any power to adjust the price pursuant to paragraph 1(2) of the Swedish Arbitration Act.

<u>VIII.11.2.2 Naftogaz has not submitted a duly justified request meaning that the preconditions to the exercise of rights under articles 4.4 to 4.4.2 of the Contract have not been met</u>

(1813) Article 4.4 of the Contract sets out procedural preconditions that must be met before the Parties enter into negotiations to reconsider the price, which are that:

(i) a written declaration must be submitted by one party to the other, duly justified by the submitting party, declaring that the fuel and energy market conditions have materially changed in comparison with the conditions reasonably anticipated by the Parties when concluding the Contract; and

(ii) the Contract Price specified in article 4.1 of the Contract does not reflect the level of prices in the market.

(1814) The requirement for submission of a "*duly justified*" request means that the party seeking reconsideration of the price must justify its declaration (pursuant to article 4.4) that the fuel and energy market conditions have materially changed in comparison with the conditions reasonably anticipated by the Parties when concluding the Contract and that the contract price specified in article 4.1 of the Contract does not reflect the level of prices in the market.

(1815) This requirement for the submission of a written, duly justified request/declaration constitutes a mandatory pre-negotiation requirement, which must be satisfied before any tribunal will have jurisdiction. It has not been satisfied in this case.

(1816) The contractual prerequisite that any request be duly justified is not merely a formalistic requirement. Rather, it is self-evidently necessary in order to ensure that the subsequent *inter partes* negotiation obligations can operate effectively and informed negotiations can take place, by providing the responding party with sufficient information to enable productive negotiations.

(1817) Naftogaz has not submitted a duly justified request to reconsider the price. Naftogaz relies on its letter dated 20 May 2011 (the "2011 Request") as its request for reconsideration of the price pursuant to the Contract. However, the 2011 Request is cursory at best and contains no justification whatsoever of Naftogaz' request for price revision, meaning it cannot properly form the basis of informed negotiations. In relevant part, it states only:

"*Changes in the fuel and energy market affecting the price formation of energy carriers have resulted in the failure of the Contract Price, calculated under The Contract, to correspond to the prevailing prices.*

In view of the foregoing, we suggest to enter into negotiations to revise the Contract Price in accordance with the provisions of the Contract."

(1818) Therefore, the 2011 Request does not fulfil the necessary pre-negotiation requirement that a duly justified request must be submitted by Naftogaz.

(1819) Both [redacted] and [redacted] confirm the lack of any justification in the 2011 Request and state that they and Gazprom did not consider the 2011 Request to have been duly justified as required by article 4.4 of the Contract.

(1820) [redacted] confirms that he responded to the 2011 Request by way of a letter dated 8 June 2011, pointing out to Naftogaz that a "*request to reconsider the price must be duly justified*" and that Naftogaz' 2011 Request "*does not contain a proper substantiation of such request to reconsider the contract price of natural gas*". (Emphasis in original.)

(1821) Naftogaz appears to rely in the alternative on its letter dated 17 June 2011 (the "*17 June 2011 Letter*") in reply to Gazprom's letter dated 8 June 2011 as a request for reconsideration of the price pursuant to the Contract, as well as it "*supplement[ing]*" the 2011 Request by "*elaborat[ing] on the changed circumstances in the fuel and energy market and the Contract Price's failure to reflect the level of market prices*" (presumably in an attempt to cover the obvious deficiency of the 2011 Request). However, in the 17 June 2011 Letter, Naftogaz again failed to provide the necessary justified explanation as to how the fuel and energy market conditions had materially changed by comparison to the conditions reasonably anticipated by the Parties at the time the Contract was entered into.

The 17 June 2011 Letter stated, inter alia, as follows:

"*In its letter No. 05-676 of 08 June 2011, [Gazprom] informed that the prices of gas delivered by [Gazprom] under contracts to Germany and East European countries are similar to the price of gas, without considering a discount (ie the Contract Price), delivered to Ukraine.*

It should be noted that the price of gas delivered by [Gazprom] to Ukraine, Germany, Eastern European countries and other consumers includes, among other things, the cost of gas delivery from the border of the Russian Federation to the point of gas delivery to the Purchaser. As a rule, such point is the [gas metering station] at the border of the purchasing country.

When delivering gas, for example, to Germany, [Gazprom] bears the costs of gas delivery from the border of the Russian Federation/Ukraine to the German border, the distance between which is about 2,000 km, such costs being included in the gas price for Germany. Meanwhile, [Gazprom] does not have to bear such costs when delivering gas to Ukraine, as Naftogaz purchases gas directly on the border between the Russian Federation and Ukraine.

[Gazprom]'s statement that, at present, the prices of natural gas delivered by [Gazprom] to Germany and Eastern European countries are either similar to, or higher than, the price without considering the discount (ie the Contract Price) of gas delivered to Ukraine, confirms Naftogaz' position that it is necessary to reconsider it [the price] towards its reduction.

During the negotiations preceding the signing of the Contract, the Parties agreed to apply in 2009 a 20% discount off the Contract Price of the natural gas delivered to Ukraine. In this regard, the coefficient "k" was introduced into the formula for calculating the Contract Price; such coefficient in 2009 was equal to "0.8", and from 2010 it was set at "1". Therefore, Ukraine could reasonably expect a 25% increase in the Contract Price level in 2010 as compared to the Contract Price level in 2009, but the actual fuel and energy market conditions resulted in the following.

The actual weighted average Contract Price based on the results of deliveries in 2009 amounted to [US$]232.47 per [TCM] of gas. The weighted average Contract Price of gas in 2010, which had been anticipated to be [USD]290 per [TCM] of gas (+25% of the 2009 price), turned out to be equal to [USD]338.26 per [TCM] of gas, which is +45.7% of the 2009 Contract Price level.

At the same time, based on the results of deliveries in the [first] 5 months of 2011, the weighted average Contract Price of gas amounted to [USD]371.77 per [TCM] and actually reached +60% of the 2009 Contact Price level, which could not have been foreseen in any way by the Parties when concluding the Contract.

Thus, the fuel and energy market conditions which affect the pricing for energy commodities have materially changed and resulted in a situation where the Contract Price of gas does not reflect the level anticipated when concluding the Contract and does not correspond the level of prices in the market, taking into account the gas delivery destination.

Considering the terms of Article 4.4 of the Contract, Naftogaz insists on starting negotiations to reconsider the Contract Price and suggests, using the formula method, to regulate the Contract Price, inter alia, by using additional coefficients reflecting the actual terms of gas delivery to Ukraine (the wholesale nature of gas purchases and the uneven nature of the seasonal delivery volumes, the share of the domestic market given over to LLC Gazprom sbyt Ukraine, etc) so that the anticipated long-term level of the Contract Prices could be reasonable, adequate as to the market conditions, and mutually acceptable for our companies.

The considerable increase in the price of imported gas, leading to a lower consumption of natural gas by Ukraine's consumers results in the reduction of the Company's receipt of monetary funds, and, therefore, in the reduction of the working capital intended for purchase of natural gas under the Contract."

(1822) As the above demonstrates, in the 17 June 2011 Letter, Naftogaz did not identify any specific fuel and energy market conditions or indicate how such conditions had changed. In fact there is no reference at all in Naftogaz' letter to any market conditions that could affect prices in the fuel and energy market. The only thing Naftogaz does do in its letter is make assertions (without basis) as to how Gazprom's prices are formulated with reference to the costs of transportation of gas. This aspect of pricing, i.e. transportation costs, is taken into account of (if at all) during negotiations at the time a Contract is concluded. It is not a condition of the fuel or energy market that is subject to change over time, i.e. the location of Ukraine and its relative proximity to Russia has not changed.

(1823) Further, Naftogaz gave no indication of what the prices in the market were as at the date of the 17 June 2011 Letter or of how the prices under the Contract did not reflect such prices. Indeed, it is not even clear from Naftogaz' letter what its position is with regard to what the relevant market(s) is/are for the purposes of assessing whether the price under the Contract corresponds with the level of market prices. It might be inferred from Naftogaz' letter that not only Germany, but also other "*Eastern European countries*" are potentially relevant markets.

(1824) Accordingly, the 17 June 2011 Letter does not fulfil the necessary pre-negotiation requirement for a duly justified request to be submitted by Naftogaz and was insufficient to remedy the defective 2011 Request.

(1825) Still further in the alternative, Naftogaz appears to rely on a letter dated 28 April 2014 (the "*28 April 2014 Letter*") , which was Naftogaz' letter notifying Gazprom that it intended to refer the price revision claim to arbitration. Such letter does not constitute a request to reconsider the price pursuant to articles 4.4 and 4.4.1 since its only content was as to the reference to arbitration (with reference back to Naftogaz' previous correspondence including the 2011 Request and the 17 June 2011 Letter). The 28 April 2014 Letter also fails to contain any due justification as required by the Contract.

(1826) Naftogaz' failure to submit a duly justified request to reconsider the price in accordance with articles 4.4 and 4.4.1 of the Contract means that a mandatory pre-negotiation requirement has not been fulfilled and the right to "*submit the case to arbitration*" pursuant to article 4.4.2 does not arise, preventing the Tribunal from having jurisdiction over Naftogaz' price revision claims.

VIII.11.2.3 Even if Naftogaz had submitted a duly justified request, articles 4.4 and 4.4.1 require the Parties to enter into negotiations that are limited in scope to adjustment of the Contract price and do not include a complete revision of the price formula

VIII.11.2.3.1 Articles 4.4 and 4.4.1

(1827) Even if (which is denied) the pre-negotiation requirements set out in articles 4.4 and 4.4.1 have been met, these articles do not oblige the Parties to negotiate a wholesale re-writing of the price formula in Article 4.1 of the Contract.

(1828) Article 4.4 provides that the Parties "*shall proceed to negotiations to reconsider the Contract Price in accordance with the terms and conditions hereof*". (In Naftogaz' translation: "*shall enter into negotiations regarding an adjustment of the Contract Price in accordance with the provisions of this Contract*".)

(1829) It follows that the only negotiations that (pursuant to articles 4.4 and 4.4.1) the Parties are required to enter into are negotiations regarding an adjustment of the Contract Price itself in accordance with the provisions of the Contract, including, inter alia, in accordance with the price formula set out in the Contract. Negotiations pursuant to articles 4.4 and 4.4.1 can only include adjustments to the formula provided in article 4.1 (for example, negotiations regarding a potential adjustment of coefficient "*k*").

(1830) The Parties are not obliged to renegotiate the price formula. Any wholesale rewriting of the entire price formula, as Naftogaz seeks, would not be "*in accordance with the provisions of this Contract*" and is therefore not permitted under article 4.4.

VIII.11.2.3.2 The meaning of the Russian word "peresmotr"

(1831) Naftogaz seeks to mislead the Tribunal as to the meaning of the Russian word "*peresmotr*" in article 4.4 of the Contract, which Naftogaz asserts should be translated as "*revision / adjustment*", and which Gazprom has translated as "*reconsideration*". Naftogaz asserts, illogically, that in its opinion "the translations are materially identical. In particular, the apparent difference between "*an adjustment of the Contract Price*" in Naftogaz' translation of Article 4.4 and "*reconsider the Contract Price*" in Gazprom's translation of the same provision, is immaterial.

(1832) There is a significant difference between the Parties' respective translations. According to the Oxford English dictionary, the root verbs of Naftogaz and Gazprom's suggested translations of the word "*peresmotr*" are defined as follows:

(i) adjust: "*1. Arrange, compose, harmonize, (differences, discrepancies, accounts); assess (loss or damages)…2. Arrange suitably in relation to something else or to some standard or purpose.*"

(ii) revise: "*2 a verb trans. Orig. (rare), condense (esp. a written text) into a more concise form. Later, examine or re-examine and improve or amend (esp. written or printed matter); consider and alter (an opinion, plan, etc.). …b verb trans. & intrans. Go over or read again (work already learned or done)…*"

(iii) reconsider: "*Consider (a thing, situation, idea, decision, etc.) again*"

(1833) To "*adjust*" something means to change something in some manner. The Russian word "*peresmotr*" does not.

(1834) Naftogaz asserts that "*[t]he decisive Russian term for "adjustment / reconsider*" is … "*peresmotr[u]*", which in English literally means "*revision*", "*reconsideration*", "*review (of a sentence) and "retrial"*"". The authority Naftogaz cites is the Oxford Russian Dictionary (at Exhibit C-170), which defines:

(i) the Russian word "*peresmotr*" as:

"*1 ([in Russian] of a program) revision. 2 ([in Russian] of a proposal) reconsideration; (law) review (of a sentence); retrial.*"; and

(ii) the Russian verb "*peresmotret*", from which the noun "*peresmotr*" is derived, as:

"*1 (a book, document) to look through; to go over again. 2 (a decision) to reconsider; (law) to review. 3 … to go through (in search of [something])*".

(1835) The word "*adjustment*" does not feature in the very Russian dictionary definition that Naftogaz cites as its authority. Similarly, "*peresmotr*" is not among the possible Russian translations of the English word "*adjustment*":

"*(regulation) [regulirovaniye]…(correction) [ispravleniye, popravka]; (fitting) [prigonka]; (adaption) [prisposobleniye]; (settlement) ulazhivaniye; (insurance) [sostavleniye dispashi].*"

(1836) Naftogaz' translation of the word "*peresmotr*" as "*adjustment*" is self-serving, unsupported by any authority and wrong.

(1837) The Russian language conveys meaning largely through changes in the composition of words, for example, by the addition of prefixes and suffixes. The word "*peresmotr*" is derived from the verb "*peresmotret*", which is made up of the prefix "*pere-*" and the verb "*smotret*".

(i) "*pere-" is translated as "indicating 1. Action across or through [something]…. 2. Repetition of an action (re-)…*"

(ii) "*smotret" is translated as "1. … to look (at) … 2. to see; to watch … 3. to examine; to review, inspect*"

(1838) In essence, "*peresmotret*" literally means "*to look at [something] again or through*". It does not mean "*to change*" something, as "*to adjust*" and "*to revise*" (in one of its meanings) do.

(1839) Russian has only three verb tenses (past, present and future), but relies on a verb's "*aspect*" to convey more specific meaning. Most Russian verbs have both a "*perfective*" aspect, which emphasises the completion of the activity, and an "*imperfective*" aspect, which emphasises the process. The word "*peresmotr*" used in article 4.4 of the Contract is not a verb, but a noun, and therefore has no aspect. Without aspect, it is not clear whether the word "*peresmotr*" focuses on the result of having reconsidered something (which may or may not entail changing something), or simply on the process of "*reconsidering*".

(1840) The following definition of "*peresmotret*" is taken from a well-known and authoritative Russian language dictionary (by S.I. Ozhegov).

"*PERESMOTRET, -otryú, -ótrish, -ótrennyi, perfective, what.[=transitive verb] 1. Examine anew, [or] many things. Look through all the books. 2. Consider anew. Rethink the project. || imperfective: peresmátrivat, -ayu, -ayesh, || noun. peresmótr, -a, Reconsideration of the case.*"

(1841) The above definition makes clear that changing or altering something is not integral to the meaning of "*peresmotret*". The emphasis is instead on the process of looking at or through something again - reconsidering, re-examining and rethinking.

(1842) The word "*revision*" is derived from "*revise*", which came into English from Middle French / Latin, meaning "*to look at again*", and only later, through usage, acquired the sense of "*to look over again with intent to improve or amend*". In its original sense ("*to look at again*"), "*revise*" is a possible translation of the Russian word "*peresmotret*"; like the word "*review*", "*revise*" and "*peresmotret*" are both derived from similar root words - the Russian "*pere*" is similar to the English "*re*" (again, anew) and the Russian "*smotret*" together with the English words "*look at*", "*see*", "*view*" and "*vision*" are all of similar derivation. "*Revision*" is an acceptable translation of "*peresmotr*" in the sense of revision for an examination, i.e. reviewing written material. However, "*revise*" in its other sense of "*to alter*" is not an acceptable translation. The multiple meanings of the English word "*revision*" make it an inappropriate translation. The word "*peresmotr*" does not mean to change or adjust. A change or adjustment may or may not be a result of the act of "*reconsidering*", but any such change or adjustment is by no means a foregone conclusion of having reconsidered something.

(1843) By asserting (without authority) that "*peresmotr*" means "*adjustment / revision*", Naftogaz is seeking to impose an interpretation of article 4.4 that the plain, literal meaning of its words does not support. Article 4.4 provides for an obligation of the Parties to reconsider and renegotiate the price; it does not provide for an obligation of the Parties to change or adjust the price.

<u>VIII.11.3.2 Naftogaz' price revision claims fall outside the scope of Article 4.4.2</u>

VIII.11.3.2.1 The Tribunal only has jurisdiction to compel negotiations

(1844) In any event, article 4.4 of the Contract limits the Tribunal's jurisdiction to compelling the Parties to conduct negotiations and does not give the Tribunal jurisdiction to revise the Contract Price.

(1845) Article 4.4.2 of the Contract provides that if a written agreement to reconsider the Contract Price is not reached within three months from the start of negotiations, "*each of the Parties has a right to challenge the actions of the other Party to perform this Contract and submit the case to arbitration in accordance with Article 8 of the Contract to adopt the final resolution*" (Emphasis added). The submission of "*the case*" to arbitration refers to a party's "*challenge to the actions of the other Party to perform this Contract*". The word "*actions*" in this context refers to the Parties' obligation to conduct negotiations in accordance with articles 4.4 and 4.4.1. Therefore, article 4.4.2 only gives the Tribunal jurisdiction in respect of a challenge by one party to the other's failure to abide by its contractual obligation to negotiate. Consequently, the Tribunal has no jurisdiction to revise the Contract Price.

(1846) [redacted] confirms, on the basis of Gazprom's intentions and his involvement in the negotiations of the Contract, that the Contract was never intended to contain "*a full price reopener provision*". [redacted] is familiar with those types of articles from his involvement with Gazprom Export (in whose gas supply contracts full price reopeners are sometimes included) and article 4.4 is "*deliberately quite different from such other price reopener provisions*". To the contrary, Gazprom's expectation was that "*if circumstances merited it*", article 4.4 would promote "*constructive dialogue between the Parties to seek to revise the price*". The wording of article 4.4 supports this understanding, i.e. that the scope of any price review was limited to negotiations.

(1847) Accordingly, article 4.4.2 does not provide that the question of the Contract Price or revision of the Contract Price can be submitted to arbitration. It was not the Parties' intention that Article 4.4.2 would give the Tribunal the power to make an order to revise the Contract Price, merely that it could compel the Parties to fulfil their obligation to negotiate. Therefore, the Tribunal lacks jurisdiction over Naftogaz' price revision claims.

VIII.11.3.2.2 The Tribunal cannot have jurisdiction to revise the price formula completely

(1848) As explained above, article 4.4.2 provides that a party has "*a right to challenge the actions of the other Party to perform this Contract and submit the case to arbitration*". Therefore, even if the Tribunal has wider jurisdiction than to compel negotiations (which is denied for the reasons set out above), Naftogaz cannot in any event submit to arbitration a "*case*" that is not in accordance with articles 4.4 and 4.4.1.

(1849) Article 4.4 only requires the Parties to enter into negotiations to reconsider the price in accordance with the price formula set out in the Contract (and not to rewrite the price formula wholesale, which would not be "*in accordance with the terms and conditions hereof*"). Consequently, to the extent the Tribunal was to find that it has a right to revise the price (which for the reasons previously explained is denied), the Tribunal is also bound by the clear limitations set out in article 4.4 i.e. it cannot rewrite the formula.

(1850) The fact that this was the Parties' intention is also obvious in light of the various provisions that are missing from article 4.4 of the Contract. Had the Parties intended to give the Tribunal a right to revise the price, then they would have included a number of provisions setting out the parameters and conditions for such a price revision, as explained below.

(1851) Article 4.4 does not provide any time periods within which price reviews may be initiated nor any limits on the number of times that the price review mechanism can be invoked. Periodic application is a necessary feature of price review mechanisms where such are incorporated by contracting Parties in the gas sector.

(1852) Timing requirements are not merely formalistic; they have the obvious commercial purpose of establishing price certainty for a specific period during the term of the agreement and preventing "*constant efforts to adjust price*". Failure to specify when the price review may be invoked and failure to limit the number of times that the price may be reviewed would mean that articles 4.4 to 4.4.2 have the commercially nonsensical effect of allowing a party to invoke the price reconsideration mechanism at any time and repeatedly, forcing the other party to engage in negotiations and resulting in constant price uncertainty throughout the entirety of the eleven year term of the Contract.

(1853) Mr Witschen comments in this regard:

"*In a Groningen style contract the date of the initial price review is set in the newly concluded contract and after this, it is open to the Parties to put in motion a price review process every three years (which is the period I have seen most often, although others may be used).*

It was important to have clearly set periods for price reviews (save where a contract allows for a "one-off" price review through use of a "joker") for several reasons; to ensure certainty as to how long a newly fixed price could apply for and to ensure that a price review is not a perpetual process giving rise to continuing uncertainty as to what the price would be and taking up huge costs and management time.

[….]

As described above, price reviews are usually agreed with a 3-year recurrence, supplemented sometimes by extraordinary reviews (wildcards/jokers) which may happen additionally once within a decade or within the duration of a contract. In contrast the Contract does not have any periodic review mechanism and no timeframe is given for the operation of a price review e.g. the period that is to be assessed, when any change may take effect from, how long for, when the next review may be instigated etc. This is absolutely unique for a large scale long term import contract." (Emphasis added.)

(1854) Further, articles 4.4 to 4.4.2 do not include any price revision mechanism in order to enable a tribunal to make a determination on: (a) whether the conditions for a price review to be invoked have been met; and (b) any appropriate revision to the Contract price (which would be essential if the Tribunal had been intended to have jurisdiction to carry out a wholesale redrafting of the price formula).

(1855) In particular, article 4.4 refers to "*fuel and energy market conditions*" and "*the market*" in the most general of terms without any attempt to clarify or define what the relevant market is, either geographically or by reference to specified comparators.

(1856) Important matters that are missing from article 4.4, demonstrating that it is not a price reopener clause, include:

(i) agreement as to what the relevant market is;
(ii) agreement as to what comparators should be considered for the purposes of determining any revised price; and
(iii) agreement as to what economic effect the price revision should have (for example, allowing gas to be sold at a level competitive with other forms of energy or such that it can be marketed economically (see paragraphs 4.23(4) to (6) of the Moselle Report and paragraph 161 of the Witschen Report).

(1857) In contrast to article 4.4 of the Contract, an example of a price reopener clause that contains such provisions was considered by a tribunal in Sweden in ICC case 9812. In this case, the relevant clause provided:

"*Price Review*

(a) If the economic circumstances in the country of the Buyer which are beyond the control of the Parties should change significantly compared to what is reflected in the prevailing price provisions under Articles 6.1-6.4 hereof, then each Party shall be entitled to an adjustment of the price provisions under Articles 6.1-6.4 hereof, reflecting such changes, in particular the value of Natural Gas in the end user market of the buyer as such value can be obtained by a prudent and efficient gas company.

In any case the price provisions hereunder shall allow the Buyer to economically market the Processed gas delivered hereunder in the market of the Buyer in competition with all competing sources of energy in the end user market always assuming sound marketing practices and efficient operations on the part of the Buyer.

(b) Either Party shall be entitled to request a review of the price provisions under Articles 6.1-6.4 hereof for the first time with effect as of 1 April 1992 or earlier if necessary in order to perform a price review six (6) months prior to start of deliveries, for the second time with effect as of 1 October 1995 and thereafter with effect as of 1 October every three (3) years

after 1 October 1995. In addition each Party shall be entitled to request a review of the price provisions under Articles 6.1-6.4 hereof one within each such three-year interval with effect from the first day of the month next following the request for price review, provided that the total number of such additional requests shall be limited to three (3) for each Party during the term of this Agreement. Any request for price review shall be made in writing substantiating the reasons for it and shall be made before the date of effectiveness of such price review and shall be ineffective if received by the other Party after such date.

Following a request for price review under this Article, the Parties shall meet to examine whether or not an adjustment of the said price provisions is justified.

(c) Each Party shall provide all necessary information to substantiate its own claim. No Party shall be required to disclose any business secrets nor to provide such information as the other Party may need to substantiate its claim.

(d) Failing agreement within a period of one hundred and twenty (120) days from the request for review, either Party may refer such matter to arbitration under the provisions of Article 15 hereof for decision in accordance with the criteria contained in lit. (a) above.….".

(1858) As the above shows, that price revision clause included, inter alia:

(i) detailed provisions allowing for periodic review;

(ii) a definition of the relevant market, i.e. "*the end user market of the buyer*";

(iii) provision for relevant comparators and the economic effect sought:

"*in particular the value of Natural Gas in the end user market of the buyer as such value can be obtained by a prudent and efficient gas company*";

"*[i]n any case the price provisions hereunder shall allow the Buyer to economically market the Processed gas delivered hereunder in the market of the Buyer in competition with all competing sources of energy in the end user market always assuming sound marketing practices and efficient operations on the part of the Buyer*"; and

(iv) critically, a clear statement of the tribunal's jurisdiction to decide to adjust the price in accordance with the agreed criteria.

(1859) In the case of the Contract, in the absence of clear provisions in article 4.4, the Tribunal is in the impossible position of being requested by Naftogaz to revise the price formula when the Parties' agreement does not specify: (i) the times when price review can be sought; (ii) the market that should be referred to by the Tribunal in order to determine whether there has been a material change in such market and whether the Contract Price is market reflective; and (iii) what market and comparators should be considered by the Tribunal in order to determine the revised price. Put simply, the Tribunal is not - by article 4.4 - given the guidance and tools that would be necessary to perform the task of refixing a price for the gas, let alone wholesale change of the price formula.

(1860) All of the provisions discussed above are missing from article 4.4 of the Contract. This does not mean that the Parties intended to give the Tribunal the authority to agree on literally anything on behalf of the Parties. It means exactly the opposite. It means that a price revision (if any) must be performed "*in accordance with the terms and conditions hereof*" pursuant to article 4.4. The Tribunal must act in accordance with the terms and conditions of the Contract and does not have jurisdiction to impose completely new and different price provisions on the Parties, as sought by Naftogaz.

(1861) As explained above, [redacted] confirms that the Contract was never intended to contain "*a full price reopener provision*".

(1862) Mr Witschen also comments, in relation to the obvious disparity between article 4.4 of the Contract and normal price reopeners:

"*In my experience LTIC's usually require that any changes that have taken place be ones that are beyond the control of the Parties. The Contract only requires that either party declares a change. The requesting party needs to duly justify its request, but the issue of a party's influence on the relevant change is not addressed.*

The Contract also lacks a precise definition of the relevant market. The wording "fuel and energy market" is very vague. Neither the products nor the regional market area nor even the market level is defined. In my experience LTIC's usually determine a regional reference or explicitly the buyer's market.

From my experience, I do not see how to interpret the requirement that the Contract Price formula should reflect the "level of prices in the market". The pricing appears more related *to an abstract price level for fuels. In my experience this is extremely vague and unhelpful for an LTIC.*

In my experience LTIC's address the marketability of the purchased gas e.g. by use of am "in-any-case clause" but this topic is not addressed at all in the Contract. The relevant market is also not named. Consequently there is also no reference to an obtainable market value which would be necessary to calculate a net back value, as would usually be done with Western European import contracts.

Overall, the lack of the provisions I would expect to see in a clause intended to operate as an orthodox "price re-opener" clause to my commercial understanding makes the Article 4.4 unworkable in the function of a review clause allowing an arbitration tribunal to adjust the contract price provisions since I cannot see from where they can find contractually agreed guidelines upon which to find a solution compliance to the initial agreement of the Parties."

(1863) Consequently, the Tribunal must conclude that it has not been given jurisdiction to revise the price.

VIII.11.3.2.3 Naftogaz' repeated references to a "Groningen model" cannot transform articles 4.4-4.4.2 into a price reopener provision

(1864) Naftogaz seeks to conceal the fact that articles 4.4 to 4.4.2 are not a price reopener provision through continued references to the Contract generally and article 4.4 specifically being "*based on European principles for long-term gas sales and in particular the Groningen model*".

(1865) Reliance on the "*Groningen model*" is repeated ad nauseam throughout the Statement of Claim, as if by fact of repetition Naftogaz' case is made stronger. In particular, Naftogaz repeatedly asserts that that article 4.4 "*largely follows the Groningen model in structure and content*" and that it should be "*interpreted and applied in conformity with the Groningen model with respect to substantive and procedural issues*". Naftogaz also "*impl[ies] terms*" in relation to price review "*based on the Groningen model*".

(1866) Gazprom does not accept that the Contract was "*based on the Groningen model*" with the implications asserted by Naftogaz and has never agreed that such was the case, including that it amounts to a binding usage pursuant to Article 9(1) CISG. In fact Gazprom does not accept that there is any such "*model*" contract at all, in the sense of there existing a standard form, elements of which are capable of incorporation by reference. Rather, it is Gazprom's case that contracts in the gas sector are bespoke documents that are carefully negotiated commensurate with their very high value and significance to the Parties and that careful regard must be had to the actual words of the Contract that the Parties did enter into and not to other contracts, between other Parties.

(1867) As Mr Witschen explains:

"*Throughout my long experience in the gas industry, I have not come across the existence of any standard contract model in regular application and of relevance for other LTIC's.*

The big LTIC's for the marketing of the supergiant Groningen field were the first of their kind in Europe and therefore they had a certain pioneer character for the following LTIC's for other gas fields and set an example for the regulation of essential contractual provisions.

However, the requirements of the contracting Parties to large LTIC's are very diverse and the economic importance of such contracts is so large that a standardisation or a generalised application of contract standards is not realistic or feasible. There is always an initial bargain depending on the specific contract and the respective parties. What ends up being negotiated is in my experience a customized bargain." (Emphasis added.)

(1868) Naftogaz relies heavily as the foundation of its arguments concerning "*Groningen*" on a single reference by Gazprom in its letter to Naftogaz dated 13 May 2014 (more than five years after the Contract was entered into) to the Contract being "*based on the classical [Dutch] Groningen model*". However, as [redacted] explains, this reference to the "*Groningen model*" was nothing more than shorthand as "*a reference to a long term gas supply contract with an oil-indexed price formula i.e. where the price is linked to a basket of oil products*", rather than having the broad and wide-ranging implications that Naftogaz seeks to infer.

(1869) [redacted] explains that the term "*Groningen*" is used by some of his colleagues in Gazprom to refer to contracts with oil-indexation, as opposed to those with fixed prices. [redacted] further confirms that, other than oil-indexed price formulae, "*there is otherwise no standard form or "model" used by Gazprom or Gazprom Export in its supply contracts*", given that supply contracts cover "*very significant obligations and monetary sums*" and are "*often the product of hard commercial negotiations with each individual offtaker*".

(1870) It follows that, as [redacted] further explains:

"*The provisions negotiated can depend on a wide variety of factors specific to that offtaker as well as to the time and circumstances under which the Contract is signed*".

(1871) Therefore, as [redacted] explains, contracts "*are very much tailored to reflect the individual agreements reached in the course of such negotiations*".

(1872) In fact, reflecting [redacted] comments, there is no such thing as a "*standard*" "*Groningen model*" contract. Mr Witschen confirms that "*a "Groningen model" for [long term import contracts] which is generally known, accepted and applied does not exist*". Mr Witschen further explains:

"*In my opinion, the most that could be said is as to the existence of a "Groningen style" of contracts, due to the pioneering character of the Groningen contracts and the adaptation and modification of important and successful contractual provisions by following LTIC's in and for Western Europe. In my opinion, it can be said that there exists a style of approach to LTIC's where elements from the original Groningen contracts have been adapted to varying degrees depending on the particular contract negotiations between the specific parties (which .. are normally extensive given the very high value and commercial significance of the contracts) ….*".

(1873) Therefore, there is no "*standard*" or "*model*" contract as suggested by Naftogaz, but only certain issues that are commonly (but not universally) addressed in such contracts (and, indeed, may be addressed in different ways). However, each contract is a result of the specific contractual bargain between those particular parties. As noted above, Mr Witschen states that:

"*…the requirements of the contracting parties to large LTIC's are very diverse and the economic importance of such contracts is so large that a standardisation or a generalised application of contract standards is not realistic or feasible. There is always an initial bargain depending on the specific contract and the respective parties. What ends up being negotiated is in my experience a customized bargain*".

(1874) The Energy Charter Secretariat, in its report "Putting a Price on Energy" (which is heavily relied on by Naftogaz) refers to the Groningen "*Dutch export contracts serving as a point of reference*" (emphasis added) for gas export contracts to continental Europe over the next four decades and describes such contracts as a "*concept*". This deliberately general and imprecise characterisation is far from the supposed fixed and binding "*standard model*" relied on by Naftogaz.

(1875) In any event, as Naftogaz itself is forced to admit (thereby undermining its argument in relation to the "*binding usage*" of the "*Groningen model*"), the Contract "*deviates from*" the "*Groningen* *model*" asserted by Naftogaz in a number of significant respects. In reality, the Contract is radically different from Naftogaz' mythical "*Groningen model*" in fundamental respects.

(1876) Mr Witschen concludes that the Contract is inconsistent with the style of approach in European long term import contracts in multiple respects, so much so that it is entirely unique:

"*As a consequence of the wide-ranging and fundamental differences between the Contract and Western European LTIC's that I am familiar with in my opinion the Contract is by no means a contract reflecting the content of the Dutch (Groningen) gas export contracts. I cannot even see that the Contract even belongs to any wider family of Western European long term contracts that I am familiar with from my years of experience in the industry. In my experience, the Contract is unique and unparalleled.*"

(1877) In particular, Articles 4.4 to 4.4.2 of the Contract are far from being typical price reopener provisions that might be found in "*Groningen style*" contracts because they do not give the Tribunal jurisdiction or substantive power to review the Contract Price. As the Energy Charter Secretariat's report "Putting a Price on Energy" suggests (by its comments in relation to Norwegian gas), this is not a unique feature of the Contract; there are other long term gas supply contracts without price review mechanisms: "*The pricing was a relative price formula pegged to heavy and light fuel oil without price review possibility*".

(1878) Further, Articles 4.4 to 4.4.2 of the Contract differ from other price reopener clauses given that numerous of the crucial elements of such a clause are missing from Articles 4.4 to 4.4.2.

(1879) Even despite Naftogaz' heavy reliance on the "*Groningen model*", Naftogaz is forced to recognise the obvious differences between Articles 4.4 to 4.4.2 of the Contract and Naftogaz' characterisation of a "*Groningen model*" clause, conceding that the "*price revision clause is somewhat simpler and more general than the standard Groningen model*".

(1880) Notably, the provisions that Naftogaz itself asserts to be "*stylised provisions of a price review clause of the Groningen model*" include:

(i) provisions for periodic application, including:

- a provision specifying the first date on which a party can request a price revision; and
- a provision stating the intervals at which price revision can be requested;

(ii) an "*in any case clause*", i.e. an express statement that the price provisions should "*in any case allow the gas to be economically marketed*"; and

(iii) an express statement that any change to the price shall be compensated retroactively together with interest.

(1881) The very word "*stylised*" (which is how the Energy Charter Secretariat (directly cited by Naftogaz) characterises the provisions of price review clauses it set out in "*Putting a Price on Energy*") demonstrates that such provisions are not universally adopted and are subject to change depending on the drafting of the particular contract. Each of the provisions referred to in paragraph 70 above, which are referred to as "*stylised*" provisions by the Energy Charter Secretariat and Naftogaz, are absent from Articles 4.4 to 4.4.2 of the Contract - reflecting the fact that the Parties did not agree to include them.

(1882) While forced to acknowledge that these critical provisions are missing from the Contract, Naftogaz adopts the self-serving position that any clauses that might restrict its ability to seek a price revision (such as limitations on the number and frequency of price reviews) "*cannot be assumed*" where they are not explicit, while other provisions that assist its claim (such as retroactivity and an inherent right economically to market the gas) "*are generally understood*" or "*must be assumed*" to apply or be incorporated into the Contract without any explicit provisions to that effect.

(1883) One of the terms that Naftogaz seeks to import from its references to the "*Groningen model*" in support of its price revision claim is that Naftogaz has an "*inherent right to economically market the gas*" supplied by Gazprom under the Contract. As stated above, Naftogaz asserts that "*gas sales agreements of the Groningen model are generally understood to incorporate an inherent entitlement to economically market the gas purchased under the relevant agreement, without any explicit provision to this effect*".

(1884) This is simply not the case. There can be no general assumption in a commercial contract that one party has some kind of inherent right to make a profit. To suggest that such a contractual right exists, in the absence of any specific provision to that effect, is preposterous.

(1885) Naftogaz does not explain why, if this is in fact a general understanding or assumption, typical price reopener clauses contain a specific provision to this effect in the form of an "*in any case*" clause. This includes the "*stylised*" price review provisions in "*Putting a Price on Energy*" that are referred to by Naftogaz, in which the "*in any case*" clause states "*The price provisions shall in any case allow the gas to be economically marketed based on sound marketing operation*". The Contract contains no such provision.

(1886) Naftogaz refers to the existence of Article 4.4 as supporting the existence of its inherent right to economically market the gas, as it "*presumes that the Contract Price shall reflect the level of market prices*" which would "*normally give Naftogaz an opportunity to market the gas with a reasonable profit*". However, as set out in paragraphs 39 to 53 above, Articles 4.4 to 4.4.2 are not price reopener provisions and do not create any presumption that the Contract prices will reflect market prices. All these provisions do is allow one party to call for and require renegotiations of the Contract Price to take place in the event of (in summary) changed market conditions and the price no longer reflecting the level of prices in the market. Neither does any wording in Articles 4.4 to 4.4.2 support the suggestion that any renegotiation pursuant to Articles 4.4 to 4.4.2 would result in prices that allow Naftogaz to make a particular profit.

(1887) Naftogaz also appears to ignore the consequences of its attempt to imply an "*in any case*" clause despite the actual wording of Article 4.4. These consequences include, if Naftogaz' argument is correct, the implication of a concomitant requirement for Naftogaz to eliminate inefficiencies and act as a prudent and efficient marketer of the gas. In this regard, Dr Moselle comments that:

"*Many contracts contain a provision which refers to the buyer's ability to market the gas. This may be worded, for example, along the following lines: "the price of gas shall allow the buyer to economically market the gas, assuming a reasonable sales policy, sound marketing and efficient (or prudent) operations", although of course in practice the specific wording will vary across contracts.*

In my experience, it is extremely rare for an LTC to offer a "margin guarantee" or to specify that the buyer must be able to make a certain level of profit." (Emphasis added.)

(1888) Mr Witschen also comments:

"*It is essential in Groningen style LTIC's that the buyer is required to operate as a prudent and efficient marketer which means he must eliminate inefficiencies, wrong strategic decisions and any failure to efficiently market the gas. An example for this could be inadequate risk management, concentration on unattractive market segments or insufficient marketing. I note there is no such requirement in the Contract which strikes me as inconsistent with a "Groningen style" approach.*"

(1889) Naftogaz has failed in this respect, in particular:

(i) Naftogaz has always (including since the Contract was signed in January 2009) sold gas at regulated prices to residential heating and energy enterprises within Ukraine at a loss;

(ii) Naftogaz could have reduced the price at which it was selling gas to industrial customers in order to stimulate demand given the risk of industrial consumers switching to cheaper alternative energy sources and did not do so;

(iii) there has historically been non-payment of debts to Naftogaz by its own customers;

(iv) there are very high levels of domestic consumption and inefficiency within Ukraine; and

(v) there are high levels of corruption within Naftogaz.

(1890) In any event, there is no basis for this term to be implied into the Contract given that, as explained above, there is no standard "*Groningen model*", only a set of principles derived from the Groningen concept, which parties to long term gas supply agreements may or may not choose to adopt. As Mr Witschen notes, the majority of such principles are noticeably lacking from the Contract given that the Parties did not agree to include them and the discrepancies between the Contract and a "*Groningen*" style of approach (or any other style of western European long term import contract) are stark:

"*In my expert opinion, the elements of Groningen style contracts … are not evident in the Contract. Compared to Groningen style contracts, the Contract is a very different and unique type of contract.*

…..

Most of the provisions in the Contract are very different from Western European LTIC's, such as the provision regarding adjustment of the annual contract volume, the take-or-pay provision with the absence of a make-up clause, the short-term flexibility and other provisions. The price formula is especially different, with its reference fuels and the price review clause without any specified revision periods and without any specific regulations regarding the trigger and price review - these are completely different from the sort of contractual provisions and regulations that I have encountered in my industry experience. The number of supplementary agreements to the Contract is also exceptionally high and the topics in them go far beyond the topics usually covered in supplements to Western European LTIC's.

In my experience and opinion, the the Contract is unique and not comparable to Western European LTIC's, whether of a Groningen style or any other."

(1891) Therefore, Naftogaz' attempt to import provisions into the Contract in order to seek to give it an effect that cannot be found in the actual wording by reference to a "*standard*" model contract is unsustainable and must fail. The wording of the Contract and, in particular, Article 4.4 represents the agreement that was reached between the Parties in the particular and specific circumstances of this "*unique bargain*" and it is that wording and agreement to which this Tribunal should give effect.

(1892) In summary, Gazprom denies that Articles 4.4 to 4.4.2 constitute price reopener provisions.

(1893) Finally, Gazprom notes the submission by Naftogaz of an "*expert witness statement*" by Dr Hesmondhalgh, in which Dr Hesmondhalgh comments as to "*whether Tribunals in cases involving long-term gas import contracts have the power to impose changes to the contract price formula*". Dr Hesmondhalgh states that "*[t]he short answer is yes*" and that "*[i]n all the arbitrations with which I have been involved, Tribunal has been of the view that is [sic] empowered to change the contract price formula*".

(1894) Gazprom's position is that no weight at all should be given to this evidence. It is nothing more than a general statement of Dr Hesmondhalgh's experience in other disputes involving completely different contracts and (appropriately, given that Dr Hesmondhalgh is not a lawyer) is made without regard to the provisions that were actually agreed in the Contract between Naftogaz and Gazprom.

(1895) In any event, it is only to be expected that in most, if not all, of the arbitrations Dr Hesmondhalgh has been involved in, tribunals have considered they have the mandate to revise the Contract Price, since logically Dr Hesmondalgh is likely to be instructed in disputes where the relevant contracts contain standard price reopeners (which, unlike Articles 4.4 to 4.4.2, allow tribunals to revise the price). It is highly unlikely, save in special cases such as this dispute, that contracts that do not provide for a tribunal to revise the price would ever get to the arbitration stage and consequently Dr Hesmondalgh would not be involved in such cases and would not have sight of such clauses. Consequently, Dr Hesmondhalgh's statement can be disregarded as adding nothing of any value - or properly admissible - to the interpretation of Articles 4.4 to 4.4.2.

VIII.11.3.2.4 Conclusion

(1896) Naftogaz' claims for price revision seek to re-write the price formula in a manner which goes far beyond the scope of Articles 4.4 to 4.4.2.

(1897) Accordingly, the Tribunal does not have jurisdiction to determine Naftogaz' price revision claims.

VIII.11.3.3 The Tribunal's jurisdiction is in turn limited by the scope of the negotiations according to Articles 4.4 and 4.4.1, and the actual negotiations have not included a complete revision of the price formula

(1898) It follows from the wording of Article 4.4.2 ("*each of the Parties has a right to challenge the actions of the other Party to perform this Contract and submit the case to arbitration*"), that a tribunal will, in any case, not have jurisdiction to consider or review actions of a party that were not identified during the process of negotiations between the parties.

(1899) This follows from the explicit wording of, and the rationale behind, the provision. As explained above, the party seeking a price revision must submit a duly justified request. This request, and the response by the other party in relation to that request, give rise to the scope of the Parties' subsequent negotiations. It follows that any "*action*" a party may have a right to challenge must be related to the duly justified request and the response to that request. Therefore, if (which is denied for the reasons set out above) the Tribunal were to have jurisdiction, such jurisdiction cannot be wider than the scope of the Parties' negotiations which preceded it.

(1900) Naftogaz' current price revision claims, which involve a wholesale revision of the price formula, had not been submitted to Gazprom before Naftogaz filed its Statement of Claim on 31 January 2015. Naftogaz had not even identified, during the Parties' negotiations, the claims and adjustments that it now asks the Tribunal to decide upon. Further, the Parties did not enter into negotiations regarding a wholesale rewriting of the price formula.

(1901) In fact, the limited discussions that took place following the 2011 Request during June and July 2011, as explained by [redacted] and [redacted], covered various issues raised by Naftogaz, including the pricing of gas supplied to Ukraine. However, no negotiations took place in which re-writing the price formula was discussed.

(1902) Therefore, the Tribunal lacks jurisdiction over Naftogaz' price revision claims.

VIII.11.3.4 Even if the Tribunal had any jurisdiction, such jurisdiction is now precluded by the Parties' subsequent agreements

(1903) Article 4.4.2 of the Contract provides:

"*If a written agreement on the revision of the Contract Price cannot be reached within 3 (three) months from the date of the beginning of the negotiations, each of the Parties has the right to dispute the other party's performance of the present Contract and submit the matter to arbitration in accordance with Article 8 of the Contract for the passing of a final decision.*" (Emphasis added.)

(1904) It follows from this provision that if a written supplementary agreement has been signed – whether such agreement has been signed within three months or not – the right to dispute the other party's performance and submit the matter to arbitration lapses.

(1905) A large number of supplementary agreements were signed after Naftogaz' 2011 Request, and the 17 June 2011 Letter, some of which concern adjustments to the price (for example, the Parties agreed a [redacted]

(1906) Therefore, even if (which is denied) Naftogaz' 2011 Request and/or the 17 June 2011 Letter can be considered as duly justified requests under Articles 4.4 and 4.4.1, the Parties have subsequently resolved the issues between them by way of supplementary agreements. Consequently, there are no issues in relation to these requests which could be subject to further dispute and referral to a tribunal.

(1907) In these circumstances, because of the wording of article 4.4.2, any jurisdiction that the Tribunal might have had to review the price has lapsed in any event. Accordingly, the Tribunal does not have jurisdiction to determine Naftogaz' price revision claims.

VIII.11.3.5 Any jurisdiction of the Tribunal is now precluded by Naftogaz' failure to pursue its claims

(1908) A period of more than three years elapsed between the dates of the 2011 Request/the 17 June 2011 Letter and Naftogaz' Request for Arbitration in June 2014.

(1909) Pursuant to Swedish law, a party who, by failing to act, gives the other party the impression that he no longer relies on a certain right or for a long period of time fails to invoke his right, should be deemed to have lost his right – in this case the (alleged) right to rely on a request for price revision (if any).

(1910) It is a necessary element in any price revision process that a claim once instituted is diligently pursued, including by commencement of arbitration proceedings, if no price can be agreed through negotiation (provided, of course, that a party is entitled to refer the price issue to arbitration). Otherwise, multiple claims for price revision could be made and simply left "*on ice*" for future deployment, causing profound commercial uncertainty.

(1911) A party seeking price revision cannot be allowed to make a request and thereafter "*wait and see*" what happens and then, if it suits the party, invoke arbitration proceedings several years later claiming that the request made a couple of years earlier is still "*open*". Such a situation would be even more absurd if the party was allowed to make general and unspecified requests, only specified the requests years later, but nevertheless claimed that the request should apply retroactively. Yet that is exactly the absurd situation that Naftogaz has sought to engineer.

(1912) It should in this context be emphasised that the Parties, by including a short 20-day period for the entry into negotiations pursuant to article 4.4.1 of the Contract and a short three month time limit in Article 4.4.2, clearly agreed that there should not be such prolonged uncertainty and that prompt and diligent action would be required by the party seeking price revision.

(1913) While Naftogaz, on its case, could have referred the claim it now asserts for reconsideration of the price to arbitration from September 2011 (no written agreement having been reached between the Parties within three months of the Parties starting negotiations in July 2011), it did not do so until June 2014, more than two and a half years later and during which period Naftogaz continued to pay Gazprom the invoiced price.

(1914) In fact, at around the same time as Naftogaz' 2011 Request and the 17 June 2011 Letter, on which it relies for its price revision claims in this arbitration, Naftogaz was, in a parallel but separate set of correspondence, requesting that Gazprom agree to a reduction in the ACV for 2011 (see Naftogaz' letters of 20 May 2011 (the same date as its 2011 Request), 8 June 2011, 16 June 2011, 29 June 2011 and 25 July 2011.

(1915) On 5 July 2011, a meeting took place in Gazprom's offices in Moscow between Mr Miller and Mr Boiko, the Ukrainian Minister of Fuel and Energy. Accordingly, Gazprom responded to Naftogaz' 17 June 2011 Letter by way of a letter dated 27 July 2011, as follows:

"*In connection with the letter of [Naftogaz] No. 24-3837/1-11 dated 17 June 2011, please be informed that [Gazprom] and [Naftogaz] have already entered into a negotiation process on a number of questions relating to cooperation in the gas sphere, including those relating to the pricing of the gas delivered to Ukraine.*

On [5 July 2011], another working meeting was held in the offices of [Gazprom], in which you took part.

[Gazprom] confirms that it is prepared to continue the negotiations on the entire set of issues relating to our cooperation."

(1916) Gazprom therefore indicated its willingness to discuss the various matters raised by Naftogaz in relation to the Parties' relationship, including the question of price.

(1917) Naftogaz continued to raise various issues in relation to the Contract with Gazprom in correspondence. In its letter dated 7 September 2011, Naftogaz referred to, amongst other things:

(i) an adjustment of the Contract Price;

(ii) a change to the ACQ;

(iii) the Take or Pay clause in the Contract, in particular the lack of a make-up provision and the prohibition on re-exports of gas supplied;

(iv) adjustments to invoicing and payment mechanisms under the Contract; and

(v) the "discriminatory" nature of the unilateral suspension right in the Contract.

(1918) As this letter demonstrates, during this period Naftogaz was far from focused on the price revision claim it now pursues and as a result Gazprom was having to consider a confusing array of different requests and demands received from Naftogaz.

(1919) The Parties' discussions further to the issues raised by Naftogaz led to the signature, [redacted], in which Gazprom agreed to accept deferred payment from Naftogaz in respect of certain deliveries under the Contract.

(1920) While Naftogaz raised the issue of the volumes of gas supplied and to be supplied under the Contract occasionally in correspondence to Gazprom in December 2011, 2012 and 2013 , Naftogaz did not raise the issue of price again until its letter dated 4 1 October 2013, more than two years after the 2011 Request.

(1921) In the 1 October 2013 letter in which the issue of price was raised again, Naftogaz stated:

"*We suggest once again discussing the issue of reconsidering the price of natural gas delivered based on the current prices of natural gas on the European energy market and sign the relevant Supplement to the Contract.*"

(1922) Naftogaz did not refer to or rely on the 2011 Request or the 17 June 2011 Letter and the wording "*once again*" makes clear its intention that new discussions on price should be started (rather than the continuation of an extant price revision request). Naftogaz also referred to the agreement of a further supplement to the Contract, evidently envisaging an agreement on price to apply for the future from the date of the supplement, not a revision to the Contract Price dating back to May or June 2011 (see further paragraphs 201 to 223 below regarding the fallacy of Naftogaz' position in relation to the retroactivity of any price revision).

(1923) Further, Naftogaz continued to pay the invoiced prices, without protesting against those invoices.

(1924) Accordingly, Naftogaz abandoned its 2011 Request as amended by the 17 June 2011 Letter (to the extent such requests were even valid) (see paragraphs 3 to 17 above) or it must be treated as having lapsed by reason of Naftogaz' failure diligently to pursue it within a reasonable period of time (particularly when viewed in the context of the tight contractual timescales in articles 4.4.1 and 4.4.2).

(1925) Therefore, the 2011 Request as amended by the 17 June 2011 Letter is no longer an extant request for price revision and there is nothing for Naftogaz to refer to the Tribunal to address under article 4.4.2. Naftogaz' attempt at "*resurrecting*" the purported 2011 Request (as amended) must fail.

(1926) In summary, given inter alia that:

(i) Naftogaz continued to accept deliveries under the Contract;

(ii) the Parties continuously discussed and regulated various issues raised by Naftogaz through a number of supplemental agreements;

(iii) Naftogaz never explained or even indicated that there were open issues in relation to the 2011 Request (as amended by the 17 June 2011 Letter);

(iv) Naftogaz continued to pay the invoiced prices until a late stage without protest;

(v) Gazprom had no reason to believe or understand that the 2011 Request (as amended) remained extant; and

(vi) a very long time – three years – has elapsed between the time of the 2011 Request (as amended) and the Request for Arbitration.

(1927) Naftogaz must be considered to have lost its right to rely on the 2011 Request and/or the 17 June 2011 Letter (to the extent they were in any event valid pursuant to articles 4.4 and 4.4.1 of the Contract).

(1928) Since there is no other request to reconsider the price (as explained in paragraph 16 above, the 28 April 2014 Letter cannot constitute a request pursuant to the Contract), the Tribunal has no jurisdiction over the price revision claims.

VIII.11.3.6 Any jurisdiction of the Tribunal is now precluded by the fact that the Contract is no longer the same as it was when the request for revision was made

(1929) Further, Naftogaz' price revision claims cannot now be pursued since the Contract is no longer the same as it was when the purported request for revision was made.

(1930) To the extent that the 2011 Request and/or the 17 June 2011 Letter are valid requests under articles 4.4 and 4.4.1 of the Contract, each of them was made on the basis of the content of the Contract and contractual relationship applying at that time. Any referral to arbitration must be based on that request and that version of the Contract, unless the Parties explicitly have agreed that subsequent amendments shall not affect the validity of a request for price revision, which they did not do.

(1931) The Parties have subsequently entered into a substantial number of supplementary agreements resulting in several amendments and changes to the Parties' contractual relationship. Simply put, the Contract as it was worded at the time of the 2011 Request or the 17 June 2011 Letter no longer exists; it has been substituted by an amended Contract as it reads today, given that more than [redacted] were concluded after the 2011 Request and the 17 June 2011 Letter.

(1932) In short, the Tribunal does not have jurisdiction to reconsider the price provisions of a Contract that no longer exists and the Tribunal could never have jurisdiction as a result of the 2011 Request or the 17 June 2011 Letter to reconsider the price provisions of the current Contract. Consequently, the Tribunal has no jurisdiction over Naftogaz' price revision claims.

VIII.11.3.7 In any event, the Parties have not given the Tribunal any power to adjust the Price pursuant to paragraph 1(2) of the Swedish Arbitration Act

(1933) Section 1(2) of the Swedish Arbitration Act provides: "*In addition to interpreting agreements, the filling of gaps in contracts can also be referred to arbitrators*" (Sw. "*Parterna får låta skiljemännen komplettera avtal utöver vad som följer av tolkning av avtal*"). Therefore, as a matter of Swedish arbitration law, an arbitral tribunal has no jurisdiction to fill in gaps in the Contract (Sw. "*komplettera*") beyond contractual interpretation without having been given express authority to do so.

(1934) A typical arbitration clause – including the SCC's standard arbitration clause and the arbitration clause in article 8 of the Contract – gives an arbitral tribunal the jurisdiction to determine disputes concerning questions of contractual interpretation.

(1935) Naftogaz' price revision claims go beyond contract interpretation. Naftogaz is asking the Tribunal to re-write the existing price provisions of the Contract, namely entirely to re-write the price formula set out in article 4.1 of the Contract. It does not fall within the ambit of contract interpretation, or implying terms (Sw. "*utfyllnad*") into a contract, for an arbitral tribunal to rewrite the entire price formula pursuant to a price renegotiation provision. This goes far beyond what a court could do.

(1936) The Government Bill expressly states that additional jurisdiction can be given to an arbitral tribunal to determine the price or other contractual terms in a long-term contract, but such additional jurisdiction needs to be provided for specifically by the Parties:

"*It is clear that arbitrators have competence to decide questions of the interpretation of contracts. In this category should be included all disputes which according to the applicable law give rise to questions considered as the interpretation of contract. Pursuant to Swedish law this includes certain filling out of the Contract's contents. However, the arbitrators' competence ought reasonably to be broadened, to include the right to fill out contracts where there is no foundation for how that discretion should be exercised and this applies regardless of whether the matter can be regarded as acting judicially. The principle of freedom of contract should be applied as far as possible. The parties ought therefore to be able to give arbitrators the right to add to contracts beyond what follows from contractual interpretation in a broad sense – for example, to decide the price or other contractual terms in a long-term contract.*"

(1937) Further, the Government Bill also states that additional jurisdiction pursuant to Section 1(2) of the Arbitration Act can either be given directly in the arbitration clause, or it can be given indirectly in the Contract:

"*The arbitrators' authority to supplement contracts in the above way can follow directly from the arbitration agreement. The Parties can also give the arbitrators this authority once the dispute has arisen. If the Parties have not done so and the Contract does not give at least indirect support for the arbitrators to have the right to supplement contracts, they ought not to have that authority. Otherwise, one would be giving the arbitrators the option of deciding the dispute rather more ex aequo et bono. It is important to maintain the fact that the disputes should in principle be decided in accordance with the applicable law. If, at the request of a party, the arbitrators would supplement a contract without any support in the Contract, this may constitute a ground for challenging the award in court due to excess of authority.*"

(1938) It follows from this passage in the Government Bill that a tribunal that fills in gaps in a contract beyond contractual interpretation without having been given the clear authority to do so would exceed its jurisdiction. Further, express authorisation is required under Article 22(3) of the SCC Arbitration Rules for an arbitral tribunal to decide a dispute ex aequo et bono: "*The Arbitral Tribunal shall decide the dispute ex aequo et bono or as amiable compositeur only if the Parties have expressly authorised it to do so*".

(1939) As regards price renegotiation clauses, Stefan Lindskog has stated: "*[a] renegotiation clause should, if in doubt, not be considered as giving a mandate to the arbitrators to supplement the Contract*".

(1940) Lars Heuman states:

"*If the Contract includes a renegotiation clause, then a contracting party can insist on negotiations in the event circumstances have changed in the way the Contract indicates, but that party cannot insist on improvements to the terms of the Contract. In this case an arbitration clause conferring express authority to fill gaps can serve a useful purpose, not primarily by enabling the arbitrators to amend the conditions through an arbitration award, but above all by putting pressure on the Parties themselves to negotiate a good solution. It is by no means certain that the arbitrators are capable of arriving at a settlement as balanced and effective as one that the Parties themselves can achieve. Given the often somewhat limited capacity of arbitrators for supplementing and amending contractual conditions, one* *should perhaps be a little wary of inferring such competence when it is only indirectly evidenced by the Contract.*"

(1941) Lars Heuman also states in an article:

"*A clause in a contract which gives a party a right to renegotiate certain terms, e.g. the price, in many cases cannot be interpreted as giving an arbitral tribunal a right to change the price or the provisions if the Parties cannot reach an agreement during the renegotiations. Such a clause can stipulate circumstances in which a party should be entitled to require negotiations, but often such a clause does not give that party an unconditional right to have the price adjusted. However, the situation is different if the renegotiation clause itself contains a stipulation that arbitrators can change the price or another term of the contact if the Parties do not reach an agreement.*"

(1942) It should also be noted that Naftogaz' references to Swedish legal authorities in its Statement of Claim regarding Section 1(2) of the Arbitration Act are not relevant, since they do not deal with the question of renegotiation clauses.

(1943) In this case, the Tribunal has not, directly or indirectly (by article 4.4.2 or elsewhere), been given the additional jurisdiction to supplement the Contract by adjusting the price. As explained in paragraphs 35 to 85 above, article 4.4.2 of the Contract merely gives the Tribunal, under certain circumstances, jurisdiction to force the Parties to seek to renegotiate the price between them. Under no circumstances does article 4.4.2 give the Tribunal the authority to fill in gaps in the Contract pursuant to Section 1(2) of the Swedish Arbitration Act that would be necessary for article 4.4.2 to become an orthodox price re-opener clause enabling the Tribunal to adjust the price, let alone to change the entire formula, as Naftogaz seeks.

(1944) In this regard, [redacted] confirms that:

"*… the provision in the Contract was never intended to be a full price reopener provision of the kind that exists in some gas supply contracts, including some of those with Gazprom Export, with which I am familiar. The clause in the Contract is deliberately quite different from such other price reopener provisions.*

….

We had anticipated that if circumstances merited it, there would be constructive dialogue between the Parties to seek to revise the price. It has always been Gazprom's preference to *negotiate and agree prices than to allow a third party to set key commercial terms of our supply arrangements.*"

(1945) Moreover, it must be emphasised that the Tribunal cannot have been given such additional jurisdiction pursuant to Section 1(2) of the Arbitration Act simply on the basis of the dispute resolution provisions in article 8 of the Contract. These provide that "*[t]he Parties shall seek to resolve all disputes relating to the interpretation and application of this Contract…*" and "*[s]hould the Parties fail to reach a mutually acceptable solution within 30 days upon the occurrence of any dispute or controvercy, any dispute, controversy or claim in connection with this Contract or its breach, termination or invalidity shall be resolved in accordance with the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce*". This wording conforms with the SCC's standard arbitration clause and does not give the Tribunal any additional competence pursuant to Section 1(2) of the Arbitration Act.

(1946) Naftogaz refers repeatedly to "*Groningen*" contracts throughout its Statement of Claim. However, Naftogaz' attempt by such repeated reference to transform the wording of article 4.4.2 by reference to a model form of contract that would give the Tribunal jurisdiction over Naftogaz' price review claim fails. There is no reference in the Contract to "*Groningen*", or to any other provisions outside specific terms of the Contract (neither is there any "*Groningen model contract*" that could in any event be incorporated even had there been appropriate language of incorporation). As explained above, additional jurisdiction to fill gaps pursuant to Section 1(2) of the Arbitration Act must be given in the actual contract. In any event, there are serious flaws in Naftogaz' attempt to equate the Contract with "*Groningen*" contracts.

(1947) In particular, Naftogaz' suggestion that "*there is ample case law and literature evidencing the jurisdiction of the tribunal under agreements of the Groningen model*" ignores the fact that there is no standard "*Groningen model*" contract (see above) and that the jurisdiction of each tribunal must be analysed on the basis of the specific provisions of the particular contract, not on the basis of one party's arguments as to what the effect of any standard clause (which, as Naftogaz admits, article 4.4 differs from) would be. In any event - since this is not a model contract of any sort (let alone a "*Groningen model*"), but rather is a bespoke "*unique bargain*" - the position that might or might not prevail under any such model contract is irrelevant and regard can only be had to the terms the Parties did actually negotiate and agree upon at the time the Contract was entered into.

(1948) As a result of all of the matters set out above, the Tribunal does not have jurisdiction to hear Naftogaz' price revision claims.

VIII.11.3.8 Even if the Tribunal accepts jurisdiction, it does not have the substantive power to revise the Price, and these claims should therefore be rejected (Sw. "ogillade")

(1949) Even if the Tribunal should decide that it has jurisdiction, it does not have the substantive power to revise the price and the price revision claims should therefore be rejected (Sw. "*ogillade*").

(1950) Accordingly, even if the Tribunal determines, contrary to the submissions above, that it has jurisdiction in respect of Naftogaz' price revision claims, the Tribunal should hold that it has no substantive power to revise the price pursuant to the provisions of articles 4.4 to 4.4.2 of the Contract, since:

(i) Naftogaz has not submitted a duly justified request, meaning that the preconditions to exercise of rights under articles 4.4 to 4.4.2 have not been met;

(ii) even if Naftogaz had submitted a duly justified request, articles 4.4 and 4.4.1 require the Parties to enter into negotiations that are limited in scope to adjustment of the Contract price and do not include a complete revision of the price formula;

(iii) pursuant to the wording of article 4.4.2, if the negotiations do not result in agreement, then each of the Parties has a right to "*challenge the actions of the other party to perform the Contract*". The "*challenge*" to the "*actions*" referred to here:

(iv) can only give the Tribunal power to compel negotiations;

(v) in any event, cannot include a complete revision of the price formula; and

(vi) Naftogaz' repeated references to a "*Groningen model*" cannot transform article 4.4 into an orthodox price reopener provision because the clear language that would be necessary to achieve this is absent;

(vii) the Tribunal's substantive power is in turn limited by the scope of the negotiations according to articles 4.4 and 4.4.1 and the actual negotiations have not included a complete revision of the price formula;

(viii) even if the Tribunal had any substantive power, such power is now precluded by the Parties' subsequent agreements;

(ix) even if the Tribunal had any substantive power, such power is now precluded by Naftogaz' failure to pursue its claims;

(x) even if the Tribunal had any substantive power, such power is now precluded by the fact that the Contract is no longer the same as it was when the request for revision was made; and

(xi) in any event, insofar as this may be seen as a substantive matter, the Parties have not been given the Tribunal any substantive power to adjust the price pursuant to paragraph 1(2) of the Swedish Arbitration Act (see paragraphs 122 to 136 above).

VIII.11.3.9 Even if the Tribunal does have jurisidiction and the substantive power to revise the Price, the price revisions claimed by Naftogaz should be rejected on the merits

(1951) Even if the Tribunal accepts jurisdiction and the substantive power to revise the Contract price, there is no substantive basis for the price revisions claimed by Naftogaz.

VIII.11.3.9.1 The "material conditions" Naftogaz asserts for price revision have not been met

(1952) Naftogaz asserts that article 4.4 of the Contract contains "*two cumulative conditions for price review*", as follows:

(i) the "*circumstances in the fuel and energy market have changed significantly compared to what the Parties had reason to expect at the conclusion of this Contract*"; and

(ii) the "*Contract Price provided in Article 4.1 of this Contract does not reflect the level of market prices*".

(1953) Contrary to the assertions of Naftogaz, even if the Tribunal does have jurisdiction and a substantive power to revise the Contract Price, the above conditions for a price revision have not been established, for the reasons set out below.

VIII.11.3.9.1.1 The relevant changes in fuel and energy market conditions could reasonably have been anticipated in January 2009

(1954) Naftogaz argues that "*only circumstances which the Parties had well founded, substantiated, reasons to expect when they concluded the Contract are relevant to the factual basis for assessing change"* and that the assessment must consequently be objective. The wording of article 4.4 of the Contract requires consideration of what was *"reasonably anticipated by the Parties*" (emphasis added). Therefore, the relevant question is what was subjectively within the anticipation of these particular Parties (i.e. Naftogaz and Gazprom) at the relevant time, qualified by the objective requirement of reasonableness. It is therefore a subjective analysis, albeit with the qualification of objective reasonableness.

(1955) Gazprom agrees with Naftogaz that, as is clear from the wording of article 4.4, the relevant starting point for considering what market conditions were reasonably anticipated by the Parties is the date that the Contract was concluded (i.e. 19 January 2009) and that the date for comparison of any changes is the date of Naftogaz' request for price revision (i.e. the 2011 Request made on 20 May 2011), subject to Gazprom's reservations as to the validity and efficacy of the 2011 Request as set out above.

(1956) Naftogaz states that "*the changes in circumstances which the Parties had reason to expect when they concluded the Contract, they presumably reflected in the price formula*", and concludes from that that the Parties expected the level of gas market prices to continue to be determined mainly by oil product prices. While the Parties no doubt had any changes that they anticipated occurring in the energy market in mind when negotiating and agreeing the price formula in the Contract, it does not necessarily follow that all such potential changes were reflected in the price formula. Therefore, the price formula itself cannot be the end of the analysis for determining what was in the Parties' reasonable anticipation.

(1957) As with the conclusion of any commercial contract, the formula agreed in this Contract was the result of a negotiation between the Parties and the balancing of commercial considerations and risks. [redacted] confirms that "*the agreed formula was not something that we insisted on or imposed on Naftogaz, but rather a matter of negotiation, which they were ultimately willing to accept and agree to*". Such a commercial negotiation would not necessarily have resulted in all potential changes that were anticipated at the time being reflected in the formula; rather each party negotiated on the basis of its own commercial position and the future developments it anticipated, and a formula was arrived at that was acceptable to both.

(1958) It is nonsensical to suggest that any changes to the market that are not reflected in the price formula were not within the reasonable anticipation of the Parties at the time. It is entirely possible that the Parties may have contemplated particular developments and decided to proceed with a price formula that did not directly reflect those developments for other commercial reasons, or that one party accepted the risk of particular anticipated changes as a concession in return for achieving other provisions it considered benefitted it (which "*give and take*" lies at the heart of all commercial negotiations). [redacted] comments:

"*It seemed to me that Naftogaz was taking a view on oil prices at that time and forecasting that they would likely go lower, in which case this element of the formula would work to their benefit.*"

(1959) To support its assertion of a significant change in fuel and energy market conditions between 19 January 2009 and 20 May 2011, Naftogaz relies on a "*structural change in the price formation for Natural Gas*", i.e. decoupling of oil-linked prices and hub prices. Naftogaz argues that this "*radical change in price formation*" was facilitated by "*both the regulatory and trading steps taken to facilitate competition*". However, Naftogaz asserts that the "*impetus*" to change the price formation for gas came from a "*gas glut*" largely attributable to the following factors:

(i) "*reduction in industrial gas demand in major markets due to the financial crisis*";

(ii) the "*change of the supply-demand balance in the US*", with a "*steep decline in import requirements (LNG)*" by comparison to what had been anticipated, "due to the advent of shale gas production"; and

(iii) the "*decline of gas consumption in the power sector in major markets due to reduced power demand, the emergence of renewables and the come-back for coal as significant competing sources of energy*".

(1960) In summary, Naftogaz asserts that these factors, and the resulting "*gas glut*", together with changed regulation encouraging competition, led to significant increases in the volumes of gas traded on the European gas trading hubs and in the number of companies trading at the hub, which in turn caused hub prices to fall and, given that oil prices did not decline to the same extent, resulted in decoupling of the market price of natural gas from the oil price. Naftogaz relies on the "*suddenly liquid market places and their significance for the level of gas prices in the fuel and energy market*" as significant changes in circumstances compared to what the Parties had reason to expect in January 2009 for the purposes of fulfilling the first condition under article 4.4.

(1961) However, the matters relied on by Naftogaz were reasonably in the anticipation of Naftogaz and Gazprom in January 2009 when the Contract was concluded. In particular and as explained in detail below:

(i) the process of liberalisation of continental European gas markets had begun significantly before January 2009 and the nature of continuing liberalisation was clear at that time (in particular the contents of the Third Energy Package were known in January 2009), as were the likely effects of such liberalisation (given, for example, the earlier development of the UK market following liberalisation). Further, the effects that followed the Third Energy Package were its intended effects i.e. the liberalization of markets and reduction of prices to consumers;

(ii) there were already liquid hubs in continental Europe by January 2009;

(iii) the increasing (although not universal) use of hub prices as a price formation mechanism for gas in western European markets during the term of the Contract was foreseeable in January 2009 (even if the exact timing was not);

(iv) the financial crisis (leading to, inter alia, a reduction in gas demand) began significantly before January 2009 (as early as mid-late 2007) and therefore it and its effects were foreseeable when the Contract was signed in January 2009; and

(v) the developments in shale gas extraction in the US and its likely impact on supplies in Europe were also foreseeable.

(1962) None of these matters constitute significant changes in circumstances in the fuel and energy market compared to what the Parties had reason to expect at the conclusion of the Contract.

(1963) Both Dr Moselle, in paragraphs 6.4 to 6.20 of the Moselle Report, and Mr Witschen, in paragraphs 170 to 198 of the Witschen Report, set out the background to the liberalisation of European gas markets and the state of liberalisation of those markets by January 2009. As Mr. Witschen and Dr Moselle explain, the liberalisation of gas markets in continental Europe began through two directives, the First Gas Directive in 1998 and the Second Gas Directive in 2003. However, following the Second Gas Directive, competition remained slow to develop. Therefore, in September 2007 the European Commission proposed the "Third Energy Package" (consisting of two directives and three regulations), which subsequently entered into force in September 2009. The Third Energy Package included the unbundling of the production and supply from transmission systems and measures to strengthen national regulators.

(1964) The fact and content of the Third Energy Package were therefore well known to players in the European gas industry by January 2009, it having been proposed in September 2007 (even if not actually adopted by that time). Dr Moselle comments that the "*salient details of the Third Gas Directive, which was a "watershed" for the development of competition and hub-based pricing, were clear in 2007*" and that "*the programme of gas market liberalisation in the EU …was well underway by 2009, and at the time the Contract was signed it was clear that further regulatory developments were expected, in the form of a third EC Directive*". The Third Energy Package was the subject of copious commentary in the gas industry in Europe.

(1965) Dr Moselle explains that several significant trends (including the global recession, an increase in global LNG supplies, the development of the US shale gas industry and the displacement of gas-fired electricity generation by renewable energy sources) had the combined effect that the price of gas traded at the main European gas hubs fell below oil-based prices typically found in long term supply contracts in late 2008 (often referred to as "*decoupling*").

(1966) In the context of the EU directives and the divergence of hub and oil based gas prices since 2008, different European countries have achieved different degrees of competition and the degree of liberalisation of gas markets has consequently varied as between national markets. In particular, different European countries have implemented - and enforced - the EU directives at different rates, resulting in a divergent level of liberalisation and competition and a varying level of development of trading hubs (i.e. the Netherlands, Germany and other western European countries have develop liquid trading hubs while eastern European countries such as Poland were slow to develop competition and still lack liquid (or any) hubs today).

(1967) However, one of the foreseeable effects of liberalisation, as foreshadowed by the earlier developments in the US and UK gas markets, was that hub prices would become increasingly prominent in liberalised markets in Europe. As Mr Witschen explains:

"*The development of hubs was an important aspect and marker of market liberalisation and the development of competition in Europe. They first evolved in the UK starting in 1996, Belgium in 1998 and the Netherlands in 2003. Germany followed suit in 2004. As a general observation, the hubs in Europe have become more mature as liquidity and churn rates have grown.*"

(1968) Mr Witschen also states that:

"*The determination of the EU Commission to create a liberalised, unified and regulated European domestic market was clear. The development of the European trading hubs was also well underway from 2006 onwards.*"

(1969) Similarly, Dr Moselle comments that "*[a]s in the UK and the US, liberalisation of the gas market, and the rise of gas-to-gas competition, has led to the development of trading hubs in continental Europe*".

(1970) Dr Moselle further explains that the degree of development of hubs into active trading markets varies widely across countries and regions. For example, in north-west Europe the TTF and the [redacted] have developed into relatively liquid markets and provide a reliable price benchmark that can be incorporated into price formulae. However, southern Europe lacks any reliable hub price benchmarks, save for possibly the Italian PSV (which still lags behind north-west European hubs). There are no liquid hub price benchmarks in Eastern Europe.

(1971) It was impossible that major participants in the gas industry, such as Naftogaz and Gazprom, would not have understood in January 2009 the consequences of the ongoing liberalisation of European markets, in terms of the development of hub pricing (and, potentially, decoupling, depending on movements in oil prices). Mr Witschen explains that the earlier liberalisation of the UK gas market was "*a good illustration of likely developments on the continent*". The development of the German gas market (and the German electricity market) also demonstrated this:

"*By 2008, the change of the German gas market due to liberalisation was irreversible and the effect of changes along the whole value chain was foreseeable. It was a good illustration of what would happen in other European gas markets as the same EU reforms were implemented. However, the speed of changes was not predictable.*

Another indicator of the future development of the gas market was the German electricity market. Its liberalisation took place in a similar sequence of events but happened earlier and faster than the gas market liberalisation.

Therefore, in my expert opinion, the European gas market development as illustrated by the German gas market liberalisation was very far advanced in 2008. Any uncertainties of the market participants regarding progress of the liberalisation beyond 2009 could have been answered by looking at the developments in the UK or on the German electricity market.

Changes in European and German gas markets beyond 2008 were certainly foreseeable, even if the exact speed of those changes was not."

(1972) Both Mr. Witschen and Dr Moselle conclude that the increase in hub-based pricing in western Europe was foreseeable in January 2009 when the Parties entered into the Contract:

(1973) (i) Mr Witschen:

"*As evident from the following figure, by 2009, liquidity and churn rates, which is the ratio of traded volumes in comparison to the actual physical delivered volumes, were already very high on the British NBP (National Balancing point) and had increased on the other European hubs. The continuous development and increasing importance of hubs was definitely foreseeable in 2009, even if the precise time frame for the development of each hub was not.*"; (Emphasis added.) and

(1974) (ii) Dr Moselle:

"*Overall, I consider that it was clearly foreseeable as at January 2009 that hub prices would become a prominent, if not dominant, price formation mechanism for LTCs in Western European markets such as Germany and the Netherlands during the life of the Contract, although the exact pace of the transition would have been difficult to predict. As can be seen by the examples of the UK and the US, hub-based pricing can be seen as a natural consequence of market liberalisation, which was well underway in the EU by January 2009.*"

(1975) While the exact timing of these developments may have been difficult to predict in January 2009, for Parties entering into an 11 year contract, it was certainly foreseeable that they would occur within the Contract term given that the factors giving rise to it (ongoing liberalisation, increasing supply and drop in demand were already known - and the intention behind the EU reforms was proclaimed by the EU authorities.

(1976) Naftogaz relies on "*the reduction in industrial gas demand in major markets due to the financial crisis*" as a relevant change in circumstances. However, Naftogaz is entirely wrong if it asserts that the financial crisis and, consequently, its effect on gas demand, was not reasonably anticipated by the Parties in January 2009. In fact, the global financial crisis had already been deepening for eighteen months before that and the downturn in the demand for gas was an entirely predictable result of it given, most obviously, the linkage between industrial activity and gas demand for power generation, as well as a feedstuff in the chemical industry.

(1977) In summary, the first events of the global financial crisis were apparent at least as early as August 2007, when the US sub-prime collapse took place (resulting in diminished liquidity in interbank markets) and the ECB injected €95 billion into the banking market to try to improve liquidity. The US was already in recession by December 2007. By the end of 2007, various major international banks, including UBS, Citigroup and Merill Lynch had announced massive losses from sub-prime related investments. On 9 January 2008 (more than a year before the Contract was signed), the World Bank predicted the slowing of global economic growth, as the richest nations felt the effect of the credit crunch.

(1978) On 15 September 2008, Lehman Brothers filed for Chapter 11 bankruptcy protection, becoming the first major bank to collapse since the start of the crisis. By 28 September 2008 the impact of the credit crunch was felt in Europe's banking sector as the European banking and insurance group Fortis was partly nationalised to ensure its survival. In October 2008, various governments announced plans to save banks and rescue the financial sector, including a €50 billion rescue plan in Germany to save one of the country's biggest banks, Hypo Real Estate. On 6 November 2008, the IMF approved a USD 16.4 billion loan to Ukraine, given the effect of the financial crisis on its economy - something of which Naftogaz cannot have been unaware. By 14 November 2008, the Eurozone had officially entered a recession.

(1979) As the above demonstrates, the financial crisis and its impact on global economies were well known by January 2009, when the Contract was concluded. With the Eurozone in recession and the other effects of the crisis on European economies, it was entirely foreseeable that there would be a decline in industrial gas demand.

(1980) Mr Witschen comments that:

"*…in the third quarter of 2008, the global economic crisis started which lead to a significant drop in gas demand in Europe and Germany. At the same time, the global supply of gas substantially increased. This was mainly due to increased US domestic production of unconventional gas and shipments of LNG being diverted from their original destination to other market places. The subsequent drop in demand and the increase in supply lead to a substantial global oversupply of gas…*

…the continued liberalisation and increasing competition in the German gas market was foreseeable in 2009. The economic crisis and its effects emerging in the latter part of 2008 and 2009 only accelerated this development."

(1981) Even Naftogaz' experts refer to the industrial output in Germany falling sharply "*from late 2008*" i.e. prior to the signature of the Contract. Accordingly, this cannot constitute a change in circumstances that was not reasonably anticipated by the Parties in January 2009.

(1982) Naftogaz also refers to the developments in shale gas extraction in the United States as "*the most important factor for creating the gas glut*", allegedly because: (i) it gave rise to a dramatic decline in US demand for liquefied natural gas ("LNG") after 2009, meaning the LNG volumes were diverted to Europe and had an indirect effect on gas availability in Germany, the Czech Republic and Slovakia; and (ii) shale gas displaced coal in many uses in the US, leading to a rise in coal export and reducing gas consumption in the European power sector. However, as Dr Moselle explains, this was a market development that was already in train by 2009:

"*By 2009, significant market developments were also in train: demand was slowing as a result of the recession induced by the 2008 financial crisis, while US shale gas developments meant that new LNG production originally intended to serve the US was being marketed in Europe. The resulting shift in the supply and demand balance contributed significantly to the development of competition.*"

(1983) Further, contrary to Naftogaz' characterisation, the correct position is that forecasts for required US LNG imports had already fallen sharply in 2008 and remained relatively low in 2009. Robert Eric Borgström and David Anthony Foti, in their 2009 paper "The Cloudy Future of US LNG Imports" refer to the US Energy Information Adminstration forecast that US LNG imports "*are expected to fall from 770 Bcf in 2007 to 350 Bcf in 2008, a reduction of 55 percent. LNG imports are expected to total about 410 Bcf in 2009*". Borgström and Foti attribute the decline to various factors, which include, significantly: "*the rapid increase in domestic production largely related to un-conventional gas production as an alternative to imported LNG*". Borgström and Foti also state (on the basis of Wood Mackenzie's Long-Term View dated August 2008) that "*consensus estimates from leading forecasters expect shale production to grow at 10% a year through 2015, with all sources of unconventional gas accounting for about 65% of total US production*". Accordingly, it was evident, earlier than January 2009, that non-conventional gas would be increasingly produced in the US and therefore that the gas previously being imported to the US would have to go elsewhere, with the consequent impact on supplies in Europe.

(1984) The development of shale gas extraction in the US and the decline in US LNG imports (together with the accompanying consequences for the European gas market) were therefore within the reasonable anticipation of the Parties when they concluded the Contract in January 2009.

(1985) Therefore, in summary, the position is that the changes in the fuel and energy market conditions referred to by Naftogaz were reasonably anticipated by the Parties when concluding the Contract and consequently there is no basis for revision of the Contract Price.

VIII.11.3.9.2 The Contract Price reflects the level of the prices in the market

(1986) Naftogaz argues that the "*price under the Contract does not reflect the level of market prices*", on the basis of the Hesmondhalgh and Way Report.

VIII.11.3.9.2.1 The market

(1987) As Naftogaz states, the analysis of this condition requires a comparison between the Contract Price and the "*level of prices in the market*". However, article 4.4 of the Contract does not define: (i) what markets or countries; or (ii) which particular market prices, should be referred to for the purposes of this price comparison.

(1988) Naftogaz cites comments by Gazprom referring to "*European market price*", "*European gas pricing rules*" and "*Germany and the countries of Eastern Europe*" with reference to the Contract, and from these makes the significant leap that "*Gazprom's apparent position*" on the geographical scope of the market is that "*the relevant country at the end of the pipeline is Germany, and also that the Eastern European countries through which Russian gas transits to Germany, Slovakia and the Czech Republic, are relevant*". Naftogaz then states that "*the German gas market is by far the largest and most developed*" and consequently its claim is calculated on the basis of German gas prices, corrected for transportation costs. Therefore, Naftogaz refers to German market prices, specifically prices at the [redacted] for the purposes of its assertion that the Contract did not reflect market prices as of May/June 2011 and April 2014.

(1989) Naftogaz' assumption that Gazprom's position is that Germany is the relevant country (with Slovakia and the Czech Republic also relevant) for the assessment of the market is wrong. Further, Naftogaz' position that of these three, only Germany should be used (because it is the largest and most developed market) is misconceived, particularly in the context of a contract concerning the supply of gas to Ukraine (a market that is self-evidently very different to Germany).

(1990) Naftogaz has given legal instructions to its experts that "*the relevant markets to consider are Germany, the Czech Republic and Slovakia*". These instructions are inappropriate in circumstances where the assessment of the relevant market is primarily an economic analysis (particularly given the lack of guidance in the Contract). Further, Naftogaz' experts appear to disregard these instructions by ignoring the Czech Republic and Slovakia and only considering Germany.

(1991) However, by contrast, Dr Moselle indicates the following criteria that he considers are reasonable for determining the relevant market in the absence of guidance in the Contract:

(i) size, in terms of volume of gas imported or volume of gas imported from Russia; and

(ii) proximity to Ukraine and to Russia, and a similar history of importing large proportions of natural gas from Russia.

(1992) Rather than mechanistically applying these criteria to arrive at a necessarily subjective determination of the relevant market, Dr Moselle considers a broad range of countries that fit some or all of the criteria, including Germany, France, Italy, Slovakia, the Czech Republic, Poland and Hungary. Consideration of these countries "*covers a broad cross section of the European market*". Consequently, this approach results in a much more representative and appropriate indication of the European market than Naftogaz' self-serving adoption of Germany alone.

VIII.11.3.9.2.2 The level of prices

(1993) In relation to market prices in January 2009, Naftogaz and its experts conclude that the Platts NWE index was representative of market prices at that time. However, as Dr Moselle explains "*[a] single, hypothetical formula does not dictate the level of market prices*". Dr Moselle considers that (on the basis of Dr Hesmondhalgh and Mr Way's reasoning), German import prices are a relevant indicator of the level of market prices in January 2009. Dr Moselle also notes:

"*…import prices are the prices paid at one of the most important steps in the supply chain. I know of no basis in economics or in industry practice to exclude them from the set of "prices in the market" . They reflect the average price that is paid for all gas imported into a given country including any volumes imported at hub prices or hub-linked prices, all volumes under*

LTCs, and all other short term volumes. Import prices are therefore a broad representation of the "level of prices in the market" at the import stage of the supply chain."

(1994) In any event, as Dr Moselle explains, following Dr Hesmondhalgh and Mr Way's reasoning, the Platts NWE index is effectively a proxy for import prices in 2009, meaning that they have effectively adopted import prices as their benchmark for the level of market prices in 2009.

(1995) In respect of market prices in May 2011 and April 2014, Naftogaz' experts conclude that prices at the [redacted] were representative of the level of market prices. However, as Dr Moselle explains:

> [redacted] *hub prices are only one of a wide range of wholesale and retail prices in the gas market (including the prices paid by household, commercial, industrial and power sector users who burn the gas, and the prices paid by wholesalers for non-standardised products.*"

(1996) Further, Naftogaz' experts switch between the use of the Platts NWE index and the use of [redacted] prices, which results in inconsistency because they are using different benchmarks for the level of prices in the market at different times (i.e. Platts NWE index in January 2009 and [redacted] hub prices from 2011 onwards). As Dr Moselle explains, this is not appropriate in the delta-delta analysis conducted by Dr Hesmondhalgh and Mr Way, which requires a consistent methodology for assessing price benchmarks.

(1997) By contrast, Dr Moselle performs his calculations using import price data as a proxy for the price of gas under other large scale long term gas supply contracts. Naftogaz' position appears to be that the lack of reference in the Contract to changes in the prices of comparable import contracts suggests that changes in import prices are of little relevance. However, this argument is at best inconsistent and at worst hypocritical, given that: (i) German hub prices as relied on by Naftogaz are not referred to in the Contract either; and (ii) various of Naftogaz' own claims and arguments rely on terms that are not stated in the Contract (for example, a right to market the gas economically/earn a reasonable profit).

(1998) In the absence of specific guidance in the Contract, import prices as a proxy for the price of gas under long term gas supply contracts are an entirely appropriate comparator for the level of prices in the market. Indeed, Dr Moselle considers that, for the purposes of this dispute, "*published import prices are a reasonable, reliable benchmark of the level of prices in the market*".

(1999) Naftogaz' experts (and Naftogaz) argue that import prices can be "*misleading*" given that they may not reflect retrospective price adjustments following price revisions and arbitrations. However, although published import prices may overestimate prices in long term supply contracts to the extent that there are a significant number of unreported retroactive downward revisions in the contracts underlying the import price data, they are also likely to underestimate prices in long term supply contracts as a result of the inclusion of imports of subsidised hub products and other short term contracts. Further, retroactive revisions can be reflected in the import price data, which in some cases has been updated to take revisions into account (for example, the Polish import price data takes into account all retrospective revisions and the Italian and German data takes into account voluntarily reported revisions).

(2000) In any event, Dr Moselle concludes that any unreported revisions would have to involve significant price reductions impacting a large proportion of total import volumes to move the average of the published import prices he considers to a level at or below the actual price. Therefore, Naftogaz' concerns in this regard are not relevant.

(2001) Additionally, Naftogaz' experts' approach appears to be based on an "*opportunity cost*" approach (i.e. the next best alternative available to Gazprom, which Naftogaz' experts assume would be transiting the gas to Germany via Ukraine and selling at the [redacted] This means that they deduct transport costs from Germany to the Russian border from the [redacted] price, resulting in a significantly lower figure for the "*level of market prices*" than the actual level of market prices in Germany. Naftogaz argues that this approach is consistent with "*the Parties' agreement on a Contract Price which would result in the same revenues from sales to Naftogaz as from sales in Western Europe*". Naftogaz provides no support for this assertion and it is not the case that the Parties agreed that the Contract Price "*would result in the same revenues from sales to Naftogaz as from sales in Western Europe*". There is no provision to that effect in the Contract. Again, Naftogaz fails to recognise the significance of what the Contract does not say.

(2002) In any event, as explained in paragraphs 8.17 to 8.18 of the Moselle Report, Dr Moselle considers this approach to be wrong, for (in summary) the following reasons:

(i) a scenario in which Gazprom transports the gas it sells to Naftogaz to the [redacted] is entirely hypothetical, given the large volumes supplied under the Contract, the likely effect of such a large supply on prices and pipeline capacity constraints;

(ii) there appears to be no principle in economic or industry practice supporting the interpretation adopted by Naftogaz' experts, which ignores other alternatives, including that the reference to "*market prices*" in the Contract could simply mean that the Contract price should be benchmarked against prices in other markets or could refer to Naftogaz' opportunity cost (i.e. the price Naftogaz would have to pay if it did not buy the gas from Gazprom); and

(iii) this interpretation fails to consider Naftogaz' opportunity cost, which would require transportation costs being added to the German price, resulting in a price that is significantly higher than German prices. Naftogaz' experts' approach "*therefore has the unfortunate effect of biasing the calculation towards a lower level of market prices*".

(2003) While Naftogaz' experts adopt the interpretation giving the lowest possible price, Dr Moselle follows a balanced approach to the treatment of transport costs, interpreting "*level of prices in the market*" as the actual level of prices in relevant markets. Dr Moselle therefore excludes transportation costs entirely from the calculation. Dr Moselle comments:

"*As one justification for this (in the context of the assumptions underlying Dr Hesmondhalgh and Mr Way's report), one could imagine a hypothetical bargaining situation between the Parties, in which they are negotiating over price and where the "fallback" in case they fail to agree terms is that Gazprom would sell the gas in Germany, and Naftogaz would buy gas from Germany. In that situation, due to Russia's proximity to Ukraine each side would save the transportation costs to or from Germany by agreeing to deal with each other. An unbiased outcome of the bargaining then would be that the Parties would split the transportation cost savings between them. This would imply excluding transport costs from the calculation entirely (as I do). I note that this outcome could also be considered a fair and equitable one*".

(2004) In addition:

(i) Naftogaz' experts deduct a "*wholesale margin*" of 4% from [redacted] hub prices when estimating the level of prices in the market. Dr Moselle considers this to be "*inappropriate in principle*" since no willing seller in Gazprom's position would agree in an arm's length transaction to sell gas at significantly below hub prices. The benchmarks used to determine the size of the proposed margin are also inappropriate (see further paragraphs 10.2 to 10.27 of the Moselle Report);

(ii) Naftogaz' experts adjust the Platts NWE index to deduct their estimate of transport costs from the Ukraine to Germany. When considering the actual unadjusted Platts NWE index, contrary to the conclusions of Naftogaz' experts:

(iii) the Contract Price in 2009 (incorporating a k-factor of 0.8 in the formula) was actually significantly below the Platts NWE index; and

(iv) since the k-factor was adjusted to 1.0 in 2010, the Contract Price has been approximately aligned with the Platts NWE index, apart from for a few brief periods

(v) (see further paragraphs 10.28 to 10.35 of the Moselle Report); and

(vi) the use of [redacted] "*bid*" prices (i.e. the lowest possible market price benchmark, being the price offered by buyers) by Naftogaz' experts is inappropriate (and leads to an overcharge of USD 60-65 million); instead mid-prices should be used (see further paragraphs 10.36 to 10.40 of the Moselle Report).

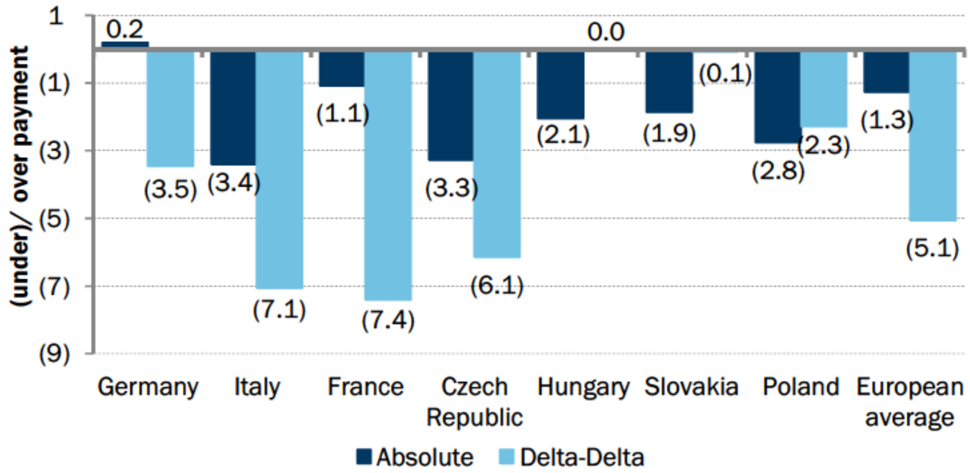
(2005) For all of these reasons, Dr Moselle's balanced approach, using published import prices as a proxy for the price of gas under long term gas supply contracts, should be preferred to the approach of Naftogaz' experts (whose approach appears to be simply to find the lowest possible market price benchmark, even where the reason for their approach and methodology is unexplained and/or inappropriate, in a manner entirely crafted to suit their client's requirements in this arbitration).

VIII.11.3.9.2.3 The Contract Price reflects, or is even lower than, market prices

(2006) In paragraphs 9.1 to 9.32 of the Moselle Report, Dr Moselle conducts a comparison between the actual Contract price paid by Naftogaz and import prices in Germany, Italy, France, Poland, the Czech Republic, Hungary, Slovakia and a volume-weighted average of those markets. Contrary to Naftogaz' characterisation that the Contract Price has increasingly become higher than market prices (asserted to be USD 155.5 per TCM higher by May/June 2011 and USD 212.1 per TCM higher by April 2014), Dr Moselle's comparison shows that the actual price paid by Naftogaz was generally significantly lower than the import prices of the relevant markets.

(2007) It is obviously appropriate to use the actual price paid by Naftogaz (which takes into account various adjustments, see paragraphs 3.12 to 3.25 of the Moselle Report) for this comparison, since this reflects the reality of what Naftogaz has actually had to pay for the gas over the life of the Contract. As Dr Moselle comments, Naftogaz paid the Contract Price in just three of the 64 months from January 2009 to April 2014.

(2008) In summary, Dr Moselle's comparison shows that for all but one of the relevant markets (the German market, and then only when using the absolute, rather than delta-delta methodology), Naftogaz has paid less than market prices, i.e. made significant underpayments relative to import prices, as the graph below summarising Naftogaz' over/underpayment relative to import prices shows.



(2009) In fact, for the period 21 May 2011 to April 2014 inclusive, Dr Moselle concludes that the actual price paid by Naftogaz was generally significantly lower on average than the import prices of the relevant markets.

(2010) Using volume weighted average European import prices for the period 21 May 2011 to April 2014 inclusive:

(i) Naftogaz has paid:

USD 1.27 billion less than market prices using an absolute approach; and

USD 5.05 billion less than market prices using a delta-delta approach; and

(ii) the actual price paid by Naftogaz was 5% below average European import prices for this period.

(2011) In relation to the specific country markets and as set out in detail in paragraphs 9.9 to 9.32 of the Moselle Report, for the period 21 April 2011 to April 2014:

(i) on average the actual price was 1% above German import prices for this period (i.e. a difference too marginal to mean that the price paid under the Contract does not reflect the level of prices in the market);

(ii) on average the actual price was 12% below Italian import prices;

(iii) on average the actual price was 9% below Polish import prices;

(iv) on average, the actual price was 4% below French import prices;

(v) on average, the actual price was 11% below Czech import prices;

(vi) on average, the actual price was 8% below Hungarian import prices; and

(vii) on average, the actual price was 7% below Slovakian import prices for this period.

(2012) Consequently, Naftogaz' argument that the Contract does not reflect the level of prices in the market because the price paid under the Contract is higher than prices in the market must fail. The price paid by Naftogaz over the period 21 April 2011 to 2014 has in fact been significantly lower than average import prices in almost all of the relevant comparison European countries and was 5% below average European import prices.

VIII.11.3.9.3 Naftogaz is not entitled to the adjustments it seeks

(2013) Naftogaz seeks various adjustments to the formula in article 4.1 of the Contract, including adjustment of the base price and replacement of the indices in the escalation supplement. Gazprom denies that Naftogaz has demonstrated that the conditions for revision of the price have been satisfied. To the contrary, neither of the relevant conditions has been satisfied and Naftogaz' claim for price revision must fail. In any event, the adjustments requested by Naftogaz would not be appropriate. Accordingly, Naftogaz is not entitled to any adjustment of the price formula in article 4.1 and its claim for such adjustments should be rejected.

VIII.11.3.10 The price cannot be revised retroactively

VIII.11.3.10.1 The Parties have not agreed that any price revision should have retroactive effect

(2014) Further and in any event, even if the Tribunal concludes (contrary to the case set out above) that Naftogaz' price revision claims should not be dismissed or rejected for the reasons set out in paragraphs 2 to 200 above, articles 4.4 to 4.4.2 of the Contract do not allow the Tribunal to revise the price retroactively.

(2015) Naftogaz seeks revision of the Contract Price from the date of the 2011 Request i.e. 20 May 2011 - or in the alternative from the 17 June 2011 Letter or the 28 April 2014 Letter - and therefore asks that the Tribunal make an order revising the price retroactively from 20 May 2011 or 17 June 2011 or 28 April 2014 onwards. Given the absence of any provision to this effect in the Contract, Naftogaz claims that "*fundamental principles concerning [..] the retroactive effect of the award [...] must be assumed to apply*". However, the reality is that such a retroactive application is not permitted by the Contract and the Tribunal has no power to make such an order.

(2016) Articles 4.4 to 4.4.2 contain no express wording granting the Tribunal the mandate to make a retroactive price revision. This is telling in circumstances where the order that Naftogaz seeks would be of such far-reaching effect i.e. allowing the revision of a critical commodity price for a period stretching back five years into the past (assuming an award on this issue is made in 2016). It is simply not credible that, if the Parties intended for the Tribunal to have such an extensive and far-reaching power, they would not have made express provision for it in the Contract. That they did not do so makes clear it cannot have been their intention to expose themselves to the risk of such draconian relief being granted.

(2017) This position is confirmed by the evidence of the Parties' negotiation of the Contract. In an early draft of the Contract sent by Gazprom to Naftogaz on 10 October 2008, the provision that later became article 4.4 did contain explicit reference to the retroactivity of any price revision. It stated, in relevant part:

"*4.3.1. The request for price revision shall be made in writing and be properly substantiated by the requesting Party and the term of entry into force of the price revision specified therein shall not be earlier than the date of notification…..*

[…]

4.3.3. Unless the Parties agree otherwise, the decision or agreement on the price revision shall apply retroactively from the date of the request for revision of the Contract Price."

(2018) The same wording was included in another draft of the Contract sent by Gazprom to Naftogaz on 29 October 2008. However, by the time that Gazprom circulated a further draft on 13

November 2008, the wording underlined in paragraph 127 had been deleted demonstrating with abundant clarity that it cannot be taken to have been the intention of the Parties to allow for retroactivity. No provisions concerning retroactivity were subsequently included in any of the drafts of the Contract and the final version, which contains no retroactivity provision, was signed on 19 January 2009.

(2019) Evidently, the Parties contemplated the possibility of the price renegotiation clause applying retroactively from the date of any request for price revision at one stage when negotiating the Contract in October 2008, but during the negotiations it was decided that it should not do so. The absence of express wording in the final Contract, in circumstances where such wording was considered and then specifically deleted during negotiations, definitively confirms that any price revision was not intended to and cannot have retroactive effect.

(2020) Further, Naftogaz' claim that retroactive effect is a "*fundamental principle*" that should effectively be imported into the Contract without express wording to that effect is nonsense. Naftogaz has not demonstrated that there is any "*fundamental principle*" of retroactivity applicable in these circumstances.

(2021) There is likewise no justification for the implication of any term providing for retroactivity on the basis of the "*Groningen model*". As set out above, reference to a so-called "*model*" of a particular type of contract cannot result in the implication of terms that the Parties specifically chose to leave out of the final agreement. This is particularly the case in circumstances where there is no "*Groningen model*" contract or price review clause as such, but only a general style or concept, with features that may or may not be adopted by contracting Parties. In this case, the Parties expressly chose not to include such a term. There is no basis for overriding such choice now.

(2022) Further, this is not a "*typical example of a situation when Swedish courts and tribunals would imply retroactivity into the agreement*", as claimed by Naftogaz. There is no basis for such an assertion.

(2023) In summary, the Tribunal cannot retroactively reconsider the price in accordance with Naftogaz' price revision claims. Accordingly, all Naftogaz' price revision claims should be rejected.

VIII.11.3.10.2 The Price cannot be revised with retroactive effect from 20 May 2011, 17 June 2011 or 28 April 2014 respectively, since the pre-negotiation requirements set out in Articles 4.4. and 4.4.1 have not been met

(2024) As stated above, Naftogaz has failed to submit a duly justified request to reconsider the price in accordance with articles 4.4 and 4.4.1 of the Contract. Naftogaz' failure to meet the pre-negotiation requirements set out in articles 4.4 and 4.4.1 also means that the price cannot be revised with retroactive effect from 20 May 2011, 17 June 2011 or 28 April 2014. Therefore, each of Naftogaz' price revision claims should be rejected.

(2025) The price cannot be revised with retroactive effect from 20 May 2011, 17 June 2011 or 28 April 2014 respectively, since the price revision provisions could not have effect before Naftogaz presented its claims to Gazprom.

(2026) Article 4.4.2 of the Contract provides that "*each of the Parties has a right to challenge the actions of the other Party to perform this Contract and submit the case to arbitration..*". Even if Naftogaz' position that the clause allows the Tribunal to revise the price is correct (which is denied), it follows from the wording of article 4.4.2 that an arbitration tribunal can only consider "*actions*" of a party that were originally identified by the claimant party.

(2027) Naftogaz' price revision claims had not been presented to Gazprom before Naftogaz submitted its Statement of Claim on 31 January 2015. Naftogaz had not even identified, during the Parties' negotiations, the claims and adjustments that it now asks the Tribunal to decide, i.e. to rewrite the entire price formula.

(2028) Further, the Parties have not entered into negotiations regarding the claims now made.

(2029) Therefore, since Naftogaz did not identify its claims before 31 January 2015, the Tribunal cannot retroactively reconsider the price in accordance with Naftogaz' price revision claims. Accordingly, each of Naftogaz' price revision claims should be rejected.

(2030) The price cannot be revised as of 20 May 2011 or 17 June 2011 since supplementary agreements have been signed thereafter.

(2031) As explained above, it follows from article 4.4.2 of the Contract that if a written supplementary agreement has been signed after the submission of a request to reconsider the price and the beginning of negotiations according to articles 4.4 and 4.4.1 of the Contract, the right to rely on such request and to submit the matter to arbitration lapses.

(2032) A large number of supplementary agreements were signed after Naftogaz' 2011 Request, and the 17 June 2011 Letter, some of which concern adjustments to the price (for example, the Parties agreed a temporary adjustment to the price in December 2013 by way of Addendum No. 29). Therefore, even if (which is denied) Naftogaz' 2011 Request and/or the 17 June 2011 Letter constitute requests pursuant to articles 4.4 and 4.4.1, the request has been superseded by subsequent supplementary agreements. Consequently, Naftogaz cannot rely upon its 2011 Request and/or the 17 June 2011 Letter and the price cannot be revised as of those dates.

(2033) Accordingly, each of Naftogaz' Claims 1.1 to 1.3.2 (originally in the Statement of Claim, Claims 2.1 to 2.3.2) (which seek price revision from 20 May 2011 and 17 June 2011) should be rejected.

VIII.11.3.10.3 The Price cannot be revised as of 20 May 2011 or 17 June 2011 since Naftogaz has failed to pursue its claim

(2034) As explained above, Naftogaz abandoned its 2011 Request and/or its request by the 17 June 2011 Letter (to the extent such requests were even valid) or they must be treated as having lapsed by reason of Naftogaz' failure diligently to pursue them within a reasonable period of time.

(2035) As there is no extant request pursuant to articles 4.4 and 4.4.1 of the Contract, there is nothing for Naftogaz to refer to the Tribunal to address under article 4.4.2 and its attempt to make such reference must fail.

(2036) Accordingly, the price cannot be revised as of 20 May 2011 or 17 June 2011 and each of Naftogaz' Claims 1.1. to 1.3.2 (originally in the Statement of Claim, claims 2.1 to 2.3.2) should be rejected.

VIII.11.3.10.4 The Price cannot be revised as of 20 May 2011 or 17 June 2011, since the Contract is no longer the same as it was when the request for revision was made

(2037) The price cannot be revised as of 20 May 2011 or 17 June 2011, since the Contract is no longer the same as it was when these requests for revision was made (to the extent such requests were valid).

(2038) Therefore, under no circumstances can the price be revised as of 20 May 2011 or 17 June 2011 and each of Naftogaz' Claims 1.1 to 1.3.2 (originally in the Statement of Claim, Claims 2.1 to 2.3.2) should be rejected.

VIII.11.3.11 Naftogaz has no right to repayment in respect of the price revision claims

(2039) Naftogaz has no right to repayment based on the price revision claims since Gazprom is entitled to the payments in accordance with the Contract

(2040) As explained above, Naftogaz has no right to price revision under the Contract. Therefore, it follows that Naftogaz has no right to repayment based on the price revision claims (Naftogaz' Claims 4 and 5 [originally Claim 5]).

(2041) In any event, Naftogaz has no right to repayment based on the price revision claims since Naftogaz is not entitled to a retroactive price revision

(2042) As explained above, Naftogaz is not entitled to price revision with retroactive effect and, accordingly, Naftogaz' price revision claims cannot be granted. Therefore, Naftogaz has no right to repayment based on the price revision claims (Naftogaz' Claims 4 and 5 [originally Claim 5]).

VIII.11.3.11.1 In any event, Naftogaz is not entitled to repayment based on the price revision claims, since Naftogaz paid without reserving its right to repayment

(2043) Pursuant to Swedish law, if a debtor pays a disputed debt without reserving its right to repayment, the debtor is generally bound by the executed payment.

(2044) Stefan Lindskog has stated:

"*If a payment claim is disputed or if there for any other reason is uncertainty whether a debt exits, the payer generally ought to be bound on contractual grounds by the payment he has made, if he does not make a reservation of his right to repayment. If the payer has not made any reservation, the recipient of the payment typically has reason to see the payment as an expression of a binding confirmation from the side of the payer that he was liable to pay at least that amount. Also in other cases, when the Parties are in dispute about the amount of a debt, and a payment is made without reservation, the payment should in a similar way be considered to create its own legal basis.*"

(2045) It also follows from Supreme Court case NJA 1961 p. 18 that payment of a disputed claim gives the recipient reason to believe that the payment has been made after a careful consideration of the legal situation.

(2046) Therefore, payment of a disputed claim without making express reservation of the right to repayment constitutes an implicit recognition (Sw. konkludent erkännande) of a payment liability.

(2047) As set out above, until [redacted], Naftogaz executed its payments based on the price provisions under the Contract without reserving its right to repayment. Since Naftogaz has paid a large number of invoices over several years without reserving its right to repayment, Gazprom has had reason to see these payments as an expression of a binding confirmation from Naftogaz that it was liable to pay these amounts. Accordingly, Naftogaz has no right to repayment in respect of the price revision claims (Naftogaz' Claim 4 and 5 [originally Claim 5]).

VIII.11.3.11.2 Naftogaz has no right to damages (Naftogaz' Claims 4 and 5)

(2048) Naftogaz has claimed compensation for damages, as an alternative to repayment, pursuant to its Claims 4 and 5 (originally Claim 5). In this regard, Naftogaz asserts that "*Gazprom has failed to perform its obligations under the Price Revision clause by failing to agree to adjust the price formula of the Contract to again reflect the market*" and therefore, is responsible for damages under article 6.1 of the Contract.

(2049) However, Gazprom has no obligation under articles 4.4 to 4.4.2 or anywhere else in the Contract to agree upon any adjustment of the price formula. Therefore, Gazprom has not breached any alleged obligation "*to agree to adjust the price formula*".

(2050) Further, Naftogaz has not, during negotiations, presented a revised price formula – at least not such that corresponds to its current price revision claims – which Naftogaz now asserts that Gazprom should have agreed to.

(2051) Moreover, Naftogaz has not demonstrated that it has suffered any damage or that any damage could have been caused by the fact that Gazprom has not agreed upon a certain price adjustment.

(2052) Accordingly, Naftogaz has no right to damages.

(2053) However, since it is unclear what damages Naftogaz actually seeks, Gazprom reserves its right to develop its case further in this regard.

VIII.11.3.12 Conclusion on Naftogaz' price revision claims

(2054) In summary, for the reasons set out above, Gazprom denies that Naftogaz is entitled to any revision of the Contract Price on the basis of article 4.4 of the Contract (or at all).

VIII.11.3.13 Naftogaz has no right to repayment

(2055) Based on an alleged retroactive price revision, Naftogaz claims repayment of more than USD 14 billion.

(2056) The issue to be determined by the Tribunal is whether Swedish contract law principles exclude a right to repayment in this case.

(2057) Even if the Tribunal would conclude that a price revision under article 4.4 should principally take effect as from 20 May 2011 or 17 June 2011, Naftogaz has – in any event – no right to repayment of amounts already paid up until 27 April 2014.

(2058) The legal principle to be applied is whether, under a contract law interpretation of Naftogaz' payments during the period 20 May 2011 to 27 April 2014, and its actions in relation thereto, these payments are binding on Naftogaz so that no right to repayment exists.

(2059) Naftogaz made 180 payments to Gazprom during the relevant period. The total amount of these payments was over 23 billion US dollars. One would expect that a party that had a pending repayment claim of around half that amount would make the effort to reserve its right to repayment. Naftogaz did not.

(2060) None of these 180 payments was accompanied by a reservation of right to repayment. Neither was any reservation of right presented orally or in any correspondence with Gazprom. Naftogaz just paid – although only after regularly having asked for deferrals of payments. Such deferrals were accepted by Gazprom, and new payment dates were agreed in written addendums to the Contract. It is undisputed that such addendums were binding on the Parties. In no such addendum did Naftogaz dispute the finality of payments or reserve its right to repayment.

(2061) On Naftogaz' case, it knew very well at the time of the payments that it had a pending price revision and a corresponding repayment claim. It would have been very easy for Naftogaz to reserve the right to claims repayments, and it would have been very valuable to Gazprom to have been informed – not least considering the large amounts involved. Still, Naftogaz actively chose not to inform Gazprom but instead let Gazprom believe that Naftogaz accepted its debts. Gazprom for its part adapted to the payments made.

(2062) Gazprom had a justified belief that all 180 payments made by Naftogaz were intended to be final. There was no sign of any pending repayment claim or suggestion that the payments were preliminary, although Naftogaz had ample opportunities to clarify this.

(2063) Gazprom submits that Swedish case law relating to condictio indebiti is of relevance even if Naftogaz' payments were not made by mistake. First, it is clear that the principle relating to *condicito indebiti* is applicable in many varying situations and is also applied by analogy.

(2064) Naftogaz has not been able to point to any facts that demonstrate why Gazprom would have understood that the payments were preliminary.

(2065) Until [redacted], Naftogaz made payments based on the price provisions in the Contract without reserving any right to repayment.

(2066) Pursuant to Swedish law, if a debtor pays a disputed debt without reserving its right to repayment, the debtor is generally bound by the executed payment.

(2067) In summary, a party can be entitled to repayment of payments made if it turns out that there was no legal ground for the payment. However, a right to repayment can be excluded based on a contract law interpretation of the payments made and the Parties' conduct in relation thereto.

(2068) There is no right to repayment if the payments constituted an implicit recognition of debt (Sw. "*konkludent erkännande av skuld*"), i.e. a contractually binding commitment to pay. The payments shall be considered as such implicit recognitions of debt if it can be established that the receiver of the payments had a justified belief that the payments constituted implicit recognitions of debt (i.e. binding commitments to pay).

(2069) Naftogaz' payments, seen in their factual context, make it clear that Naftogaz' legal intention was to make binding payments. At least, this was Gazprom's justifiable belief, which Naftogaz must have understood. Naftogaz is therefore not entitled to any repayment.

(2070) Naftogaz is not entitled to any repayment since Naftogaz is not entitled to any price revision. Gazprom is entitled to the payments in accordance with the Contract.

(2071) In addition to the above, it should also be considered that Naftogaz acted negligently. The only party believing that it had a claim for repayment was Naftogaz. Considering this one-sided belief, it was negligent by Naftogaz not to make any reservation of rights or inform Gazprom that it considered itself entitled to repayments. This is in particular so considering the large amounts involved and the long period of time during which the payments were made. Naftogaz' negligence should under the applicable Swedish contract law principles affect Naftogaz' right to repayment. Naftogaz did not reserve its rights to repayment in relation to any of its payments.

(2072) Also, as stated above, payments were made under supplements to the Contract. In these supplements Gazprom repeatedly accepted deferrals of payments. Had Gazprom known that Naftogaz had a pending claim for repayment of very large amounts, Gazprom might not have accepted such deferrals. Naftogaz has acted disloyally in this respect, which also should affect any right to repayment.

(2073) Furthermore, Gazprom has adapted to the payments made. There must be very clear grounds for a right to repayment in order to reverse payments of over USD 14 billion made over a three-year period, in a situation where the receiving party has not known of such claim for repayment and consequently has fully adapted to the payments made.

(2074) Lastly, Naftogaz made a clear reservation of rights after initiating arbitration, which demonstrates that Naftogaz understands the significance of such reservation.

(2075) Naftogaz argues that it has not waived its claim for repayment and that Gazprom has not had any reasons to understand Naftogaz' payments as a waiver of such claim. Gazprom's first comment in reply is that it did not even know that Naftogaz had a claim for repayment. The question for the tribunal is therefore not whether Gazprom understood the payments as a waiver of such claim. Instead, the only relevant question is whether Gazprom had reason to believe that the payments made were final (which it had). It is important to understand this difference in approach between the Parties when assessing Naftogaz' arguments.

(2076) Naftogaz' only real argument for why Gazprom should have understood the payments to be preliminary is that Gazprom allegedly knew of the pending price revision request and should have understood that such request included a claim for repayment as from 20 May 2011. This argument is weak. Gazprom did not know and should not have known of such a claim. There are no factual circumstances or evidence supporting Naftogaz' argument.

(2077) In summary, Naftogaz has no right to repayment in relation to the payments made during the period 20 May 2011 to 27 April 2014. Gazprom's claims for payment were based on the Contract. Naftogaz chose to pay these valid claims without reserving its right to repayment, neither in connection with the payments, nor in supplements or negotiations. Gazprom justifiably believed that the payments were final and has adapted to the payments made. Naftogaz' choice not to reserve its right contributed to Gazprom's justified belief that the payments were final, which Naftogaz must have understood. Naftogaz has been passive for three years and such passivity, which was moreover negligent, should inevitably affect the assessment.

<u>VIII.11.3.14 Naftogaz has no right to damages (Naftogaz' Claims 4 and 5 [originally Claim 5])</u>

(2078) Naftogaz has claimed compensation for damages, as an alternative to repayment, pursuant to its Claims 4 and 5 [originally Claim 5]. In this regard, Naftogaz asserts that "*Gazprom has failed to perform its obligations under the Price Revision clause by failing to agree to adjust the price formula of the Contract to again reflect the market*" and therefore, is responsible for damages under article 6.1 of the Contract.

(2079) However, Gazprom has no obligation under articles 4.4 to 4.4.2 or anywhere else in the Contract to agree upon any adjustment of the price formula. Therefore, Gazprom has not breached any alleged obligation "*to agree to adjust the price formula*".

(2080) Further, Naftogaz has not, during negotiations, presented a revised price formula – at least not such that corresponds to its current price revision claims – which Naftogaz now asserts that Gazprom should have agreed to.

(2081) Moreover, Naftogaz has not demonstrated that it has suffered any damage or that any damage could have been caused by the fact that Gazprom has not agreed upon a certain price adjustment.

(2082) Accordingly, Naftogaz has no right to damages.

<u>VIII.11.3.15 Gazprom's further defence against Naftogaz' price revision claims</u>

(2083) Gazprom has further developed its defence in various respects.

VIII.11.3.15.1 Article 4.4. is not a price revision clause, it is a price renegotiation clause

VIII.11.3.15.1.1 Naftogaz' reliance on the reference to a "*final decision*" in Article 4.4.2

(2084) Naftogaz places considerable reliance on the reference in the arbitration clause set out in Article 4.4.2 to a "*final decision*" (Naftogaz' translation) / "*final resolution*" (Gazprom's translation). It argues for an implied duty to agree to revise the Contract Price on the basis that, absent such a duty, there could be no definitive or "*final*" decision / resolution of the "*case*" (Naftogaz' translation) / "*matter*" (Gazprom's translation) referred to arbitration. This further argument by Naftogaz is misplaced for at least three reasons.

(2085) First, the reference to a "*final*" resolution in Article 4.4.2 does not assist the Tribunal in determining whether Article 4.4 is a price renegotiation clause or a price revision clause. This is because, on either interpretation, arbitration under Article 4.4.2 would lead to a "*final*" resolution of specific questions relating to the Parties' rights and obligations (although the content of those questions would differ depending on how Article 4.4 is interpreted).

(2086) If Article 4.4 is interpreted as a price renegotiation clause, then arbitration will lead to "*final*" resolutions about compliance with the obligation to negotiate and the corresponding right to require that negotiations be held. More specifically, arbitration would lead to a "*final*" resolution of the question of whether a duty to negotiate had arisen and/or the question of whether the duty to negotiate had been fulfilled by the Parties.

(2087) If Article 4.4 is interpreted as a price revision clause, then arbitration will lead to "*final*" resolutions about compliance with the obligation to reach agreement about a revised contract price. Arbitration would, therefore, lead to a "*final*" resolution of the question of whether a duty to reach agreement had arisen and/or the question of what agreement should have been reached by the Parties.

(2088) Second, Naftogaz' argument ignores the fact that it is standard practice for arbitration clauses to include references to finality. This simply reflects the fact that awards rendered by arbitrators in international commercial arbitrations are generally intended to be binding on the Parties and exempt from appeals on the merits in national courts. It is for this reason that the model clause of the SCC states that "*any dispute, controversy or claim … shall be finally settled by arbitration*" (emphasis added) and the arbitration clause in Article 8.2 of the Contract also states that "*any dispute, controversy or claim … shall be finally resolved by arbitration*" and that "*[t]he arbitral award shall be final and binding on both Parties*" (emphasis added). The Parties in this case have also chosen to repeat the point at Article 8.3 of the Contract, which states:

"*[t]he award of the Arbitration Institute of the Stockholm Chamber of Commerce shall be final, not subject to appeal, and binding on the Parties*".

VIII.11.3.15.2 The drafting history is consistent with the understanding that Article 4.4. compels negotiations and nothing more

VIII.11.3.15.2.1 Drafts of the Contract

(2089) The written drafts of the Contract indicate that Gazprom's interpretation is to be preferred over Naftogaz'.

(2090) In particular, a comparison between Article 4.4 of the Contract and corresponding provisions in the three earliest drafts circulated by Gazprom indicates that a price revision clause appears to have been envisaged at an early stage of the negotiations but was jettisoned in favour of a price renegotiation clause by 13 November 2008.

(2091) Gazprom's first draft of the Contract was dated 10 October 2008. According to Naftogaz' translation, it provided in the opening clause of Article 4.3 that in a situation of increased costs "*the Parties shall proportionally revise the Contract Price*" (emphasis added) and, more generally, in Article 4.3.1 that "*the Parties shall revise the contract price within 10 days*" (emphasis added). In other words the draft contained explicit contractual duties to agree a price revision. Article 4.3.3 of the draft contract also provided that any "*decision or agreement on the price revision shall apply retroactively from the date of the request for the revision of the Contract Price.*"

(2092) Gazprom's second draft of the Contract was dated 29 October 2008. In this draft Article 4.4.1 (but not Article 4.4) continued to impose a duty that "*the Parties shall revise the Contract Price within 10 days*" (emphasis added) and Article 4.4.3 provided that any "*decision or agreement on the price revision shall apply retroactively from the date of the request for the revision of the Contract Price*". So, in this draft as well there remained a contractual duty to agree a price revision and a clause dealing with retroactive effect of an arbitral award on price revision was retained.

(2093) Gazprom's third draft of the Contract was dated 13 November 2008 and it is radically different. Article 4.4 no longer contains any duty to agree a price revision nor does it contain any clause dealing with retroactive effect of an arbitral award. These changes made it clear that Article 4.4

of the 13 November 2008 draft, like Article 4.4 of the Contract which is identical in all material respects, is not a price revision clause: instead, it is a price renegotiation clause.

(2094) By deleting the language referencing the duty to agree to a price revision ("*the Parties shall revise the Contract Price within 10 days*"), Gazprom eliminated a necessary element of a price revision clause. As we have seen above, Naftogaz' subsequent attempt to imply such a duty into Article 4.4 of the Contract is unsustainable. There is simply no substitute for the original language proposed in Articles 4.3.1 and 4.4.1 of the 10 October 2008 and 29 October 2008 drafts. The fact that the Parties had proposed such language at one stage but had subsequently deleted it shows that Article 4.4 was no longer intended to serve as a price revision clause.

VIII.11.3.15.2.2 Naftogaz' claims about oral assurances and public statements

(2095) Naftogaz asserts that Gazprom's position that Article 4.4 is a price renegotiation clause "*is contrary to Gazprom's public statements and reassurances during and immediately after the negotiations*". Gazprom denies this assertion. In fact, the evidence shows otherwise.

(2096) Naftogaz does not refer to any written statements by Gazprom. Instead, two of Naftogaz' witnesses, [redacted] and [redacted] allege that unnamed "*representatives of Gazprom*" gave them oral assurances about the content of Article 4.4 (but it is not alleged that these oral assurances were "*public statements*" given to the general public, or otherwise formally made by Gazprom). [redacted] states that she was told during the 18-19 January 2009 negotiations that "*if the Parties fail to reach agreement on the price, the question of price revision can be resolved in arbitration*". Mr [redacted] ays that "*…Gazprom's delegation assured us that the Contract Price could be renegotiated, and if the Parties failed to agree, the matter could be resolved by arbitration*".

(2097) These allegations should not be accorded any weight:

(2098) As Articles 9.2 and 9.3 of the Contract show, the Parties intended that the written document should determine their contractual rights and obligations. This is to be expected given that Naftogaz and Gazprom are large commercial entities and because the Contract in question is both commercially important and politically sensitive. In these circumstances, any such alleged "*oral assurances*" must be given very little weight, and cannot override the language agreed in a carefully negotiated contract.

(2099) In any event, the alleged oral assurances are inconclusive because they do not specifically affirm that an arbitral tribunal acting under Article 4.4.2 would have the power to revise the price. They refer in vague terms to the tribunal's ability to deal with the "*question of price revision*" and the "*matter [of a failure to agree]*". That can equally be a reference to the ability of the tribunal to require that the Parties to enter into negotiations about price revision.

VIII.11.3.15.2.3 Further points

(2100) Naftogaz makes three further points which can be addressed briefly.

(2101) Naftogaz relies on the insertion of the term "*final*" in Article 4.4.2 of the Contract at a late stage of the negotiations of the Contract. As explained above, the insertion of the term "*final*" only signifies that the ruling of an SCC arbitral tribunal should be taken as definitive. It does not assist in defining the scope of the contractual duties that the SCC arbitral tribunal is meant to enforce.

(2102) Naftogaz refers to an alleged personal assurance communicated by Mr Putin to Ms Tymoshenko that "*if the Contract was not in line with practice or the Contract Price should move out of step with the market, it could be renegotiated*" (emphasis added) Even if this allegation were correct, it remains entirely consistent with Article 4.4 operating as a renegotiation clause rather than a price revision clause. All this assurance suggests is that renegotiations about price could occur: it does not go further and state that arbitral tribunals would be entitled to revise the price in the absence of an agreement. In any event, Gazprom makes no concession as to the correctness of this secondary evidence about the content of the discussions between Mr Putin and Ms Tymoshenko.

(2103) Naftogaz and its witnesses assert that the interpretation of Article 4.4 as a price revision clause should be preferred because Gazprom did not explicitly inform Naftogaz that Article 4.4 was a price renegotiation clause. However, it could just as easily be asserted that Gazprom's interpretation should be preferred because Naftogaz' representatives did not inform Gazprom that Article 4.4 was a price revision clause. It is apparent that this type of argument does not assist in resolving the interpretative question before the Tribunal. In any event, to put this in the terms of Article 8(2) of CISG, a reasonable person in the gas business, standing in the shoes of either party, would have understood from the text of Article 4.4 that it was a price renegotiation clause.

VIII.11.3.15.3 Naftogaz' references to a "Groningen model" are irrelevant

(2104) Naftogaz insists that the existence of a so-called "*Groningen model*" gas supply contract should lead to a conclusion that the Contract contains a price revision clause. Naftogaz argues that (1) "*Groningen model*" gas supply contracts contain price revision clauses ("*…the possibility to refer price revision disputes to arbitration for a final decision is a major part of these principles*"); (2) as a consequence, the Contract should be taken to contain a price revision clause. That argument must fail for the reasons given in Gazprom's Defence and Counterclaim. In particular:

(2105) Naftogaz is not in a position to rely on usage or the alleged "*Groningen model*". The "*Groningen model*" is not binding or relevant as usage in accordance with Articles 9(1), 9(2) or 8(3) of CISG.

(2106) The Contract, in particular Article 4.4, should be interpreted in light of the bespoke wording used by the Parties to that contract (rather than wording used in other contracts between other parties).

(2107) The Parties did not agree at any time during the contractual negotiations that their relationship should be governed by the terms attributable to any "*Groningen model*" (or any generally accepted set of principles associated with any "*Groningen model*").

(2108) One stray reference in Gazprom's letter dated 13 May 2014 (more than five years after the Contract was entered into) to a specific pricing feature of the Contract being based on the "*Groningen model*" does not show that Gazprom intended that the terms of the Parties' relationship should be derived from any so-called "*Groningen model*" rather than the specific terms of the Contract that they negotiated. In any event, Naftogaz has the burden of proving that such a vague reference in post-contractual correspondence is evidence of the Parties' common intention when they entered into the Contract five years earlier. Alternatively, Naftogaz would have to show that, in 2014, the Parties sought to alter the content of the Contract (retroactively) by agreeing to be bound by the (unspecified) terms of the alleged "*Groningen model*". However, this alternative argument cannot succeed because the Parties' authorised representatives have not executed any document under Article 9.2 of the Contract suggesting that the Contract has been modified to reflect the terms of any alleged "*Groningen model*".

(2109) Even if there were such a thing as the alleged "*Groningen model*", it is evident that the Parties did not intend to be bound by the price revision provisions of such a model. Neither the CISG nor Swedish law allow for the carefully negotiated terms of the Contract to be displaced by the terms of any alleged "*Groningen model*" merely because a stray reference was made to that concept in post-contractual correspondence.

VIII.11.3.15.4 Contrary to Naftogaz' assertions, a renegotiation clause makes good commercial sense

(2110) Naftogaz argues that Article 4.4 should not be interpreted as a renegotiation clause because this would "*make no sense*" and imply that Article 4.4 is "*meaningless*" or "*without meaningful content*". Again, this argument must fail.

(2111) It is common practice for parties to commercial contracts to include duties to negotiate if certain contingencies arise. Negotiation clauses are perfectly capable of being performed by the parties and, indeed, the Contract contains several such negotiation clauses. For instance, Article 3.3 requires that the parties "*promptly consider any issues relating to changes of the Gas delivery volumes*" in situations of accident or failure; Article 8.2 imposes a duty to negotiate in dispute situations; and Article 9.5 imposes a duty to negotiate to reach agreement on replacement provisions in situations of invalidity. Moreover, [redacted] of the [redacted] between Gazprom and Naftogaz imposes a duty to enter into negotiations about proposed amendments or supplements. It appears to be Naftogaz' position that all of these clauses are "*senseless*" and "*meaningless*". However, Naftogaz ignores the reality that negotiation clauses can be implemented by commercial parties. They are not "*senseless*" or "*meaningless*".

(2112) Moreover, in the specific context of the relationship between Gazprom and Naftogaz, there were sound reasons for preferring a duty to negotiate about prices over a price revision process which would allow third parties, i.e., an arbitral tribunal, to set prices. Given that both parties were, and are, highly dependent on each other (for energy supply in the case of Naftogaz and transit in the case of Gazprom) there was every reason to assume that negotiations on price would reach a resolution. Indeed, the parties had a history of agreeing to prices on an annual basis and, although there have been periodic crises in their relationship, the parties have a track record of invariably reaching agreement. All prior Ukrainian-Russian gas contracts have been based entirely on negotiations and have not included a price revision clause.

(2113) Furthermore, as [redacted] emphasises, given the "*symbiotic relationship of mutual dependence*" between the parties as well as the political dimensions of their relationship, Gazprom was unwilling to leave it to an international tribunal to decide on "*fundamental terms*" such as the price under the Contract. [redacted] also notes that, given the history of reaching agreement, the parties "*had no reason to believe that such agreement would not be possible in the future*".

VIII.11.3.15.5 The requirements of Article 4.4.1

(2114) In this arbitration, the basis for Naftogaz' position that the two substantive conditions set out in Article 4.4 are met is that:

(i) Fuel and energy market conditions had changed in European markes by May or June 2011 because market prices for gas were no longer determined by oil prices but rather by the altogether different price level at which gas could be bought in various trading hubs (Gazprom will refer to this as the "*decoupling ground*" in short); and

(ii) the Contract Price did not reflect market prices by May or June 2011 because gas market prices, in particular European markets, netted back to the delivery points for The Contract (on the borders between the Russian Federation/Belarus and Ukraine) were lower than the Contract Price (Gazprom will refer to this as the "*netbacked rice ground*" in short).

(2115) It follows that any price revision request that Naftogaz relies upon must contain a description of both of these grounds.

(2116) On the requirements of Article 4.4.1 Naftogaz makes three points. Those points and Gazprom's responses to them are set out below.

(2117) Naftogaz argues that there is no requirement to "*explain grounds in a detailed manner*" (emphasis added) or provide "*documentation or proof that the material conditions are fulfilled*" (emphasis added). However, this response is irrelevant to the question faced in this case. Gazprom's objection is not about the level of detail or supporting evidence supplied by Naftogaz in its price revision requests. Rather, it relates to Naftogaz' failure to provide any description at all of the basis for price revision that it now advances in this arbitration.

(2118) The requirements under Article 39(1) of CISG for a notice of non-conformity of goods, or for a notice of complaint (Sw. "*reklamation*") under Section 32(1) of the Swedish Sale of Goods Act, are not relevant in this context. What is relevant is the particular requirements as set out in Article 4.4.1 of the Contract. In any event, Article 39(1) of CISG expressly requires that there must be a notice "*specifying the nature of the lack of conformity*". A failure to provide any description at all would not be sufficient in that context.

(2119) Naftogaz argues that a price review request need only provide information to "*sufficiently enable [] [the other party] to prepare for subsequent negotiations*". This is fully consistent with Gazprom's position. It is apparent that, absent a description of the basis for requesting a price revision, the non-requesting party (in this case Gazprom) would not be able to prepare for the negotiations envisaged under Article 4.4.

(2120) Gazprom notes that Naftogaz itself appears to accept that a request under Article 4.4.1 needed to contain a reference to the decoupling ground.

VIII.11.3.15.6 The price revision requests relied upon by Naftogaz are contractually ineffective

(2121) In assessing whether the two letters that Naftogaz relies upon comply with Article 4.4.1 the crucial consideration is whether or not they contain a description of the basis for Naftogaz' price revision claim, i.e., a description of the decoupling and netbacked price grounds defined above. As demonstrated below, however, the letters that Naftogaz relies upon do not make any reference to these two grounds.

i) *Letter of 20 May 2011*

(2122) The letter of 20 May 2011 does not set out any basis at all for the assertion that the conditions set out in Article 4.4 are met. In ICC Case 9812 the tribunal held that "*… it is not sufficient only to request a price review without identifying any circumstance(s) at all*". But that is exactly what Naftogaz had done in its letter of 20 May 2011.

(2123) Naftogaz' only response appears to be that Gazprom would have guessed from the letter of 20 May 2011 that Naftogaz was referring to the decoupling point. Naftogaz cannot rely on such an argument.

(2124) First, compliance with the requirements of Article 4.4.1 must be demonstrated on the face of the request for price revision. It is irrelevant what the recipient of the request might have guessed. Naftogaz' position makes the contractual requirement that a price revision request "*be submitted in writing*" meaningless.

(2125) Second, Gazprom did not understand the letter of 20 May 2011 to be referring to the decoupling ground. [redacted] and [redacted] state that, in their view, the letter did not contain any justification at all, much less any reference to the decoupling ground. Gazprom's letter of 8 June

2011 also clearly indicates that Gazprom did not understand the letter of 20 May 2011 to contain any description at all of the basis for Naftogaz' price revision.

(2126) Third, Gazprom does not accept Naftogaz' translation of the letter of 20 May 2011 as containing referring to "*price formation*" rather than "*pricing*". In any event, a stray reference to "*price formation*" in the 20 May 2011 letter would not have led "*[a] professional gas seller such as Gazprom …[to] immediately understand…*" that Naftogaz was seeking to justify its price revision request by reference to the decoupling of gas and oil price levels in certain European markets. In this regard it is telling that Naftogaz' subsequent letter of 17 June 2011, which seeks to clarify its letter of 20 May 2011, also makes no reference to the decoupling ground.

(2127) Furthermore, the letter of 20 May 2011 contains no reference to the netbacked price ground. For this reason as well, the letter of 20 May 2011 fails to comply with Article 4.4.1 of the Contract.

ii) *Letter of 17 June 2011*

(2128) The letter of 17 June 2011 fares no better: (1) Naftogaz does not "*identify any specific fuel and energy market conditions or indicate how such conditions had changed*", i.e., there is no reference at all to the decoupling ground; and (2) Naftogaz does not provide any "*indication of what the prices in the market were as at the date of the 17 June 2011 letter or of how prices under the Contract did not reflect such prices*", i.e., there is no reference at all to the netbacked price ground.

(2129) Naftogaz maintains that the letter of 17 June 2011 complies with Article 4.4.1 because it sets out the decoupling ground. This construction of the letter of 17 June 2011 is untenable.

(2130) The first four paragraphs of the letter of 17 June 2011 deal with Gazprom's prior reference to its own German and East European gas price levels. In those paragraphs Naftogaz argues that Gazprom's prices do not support the position that no price revision would be justified (as those prices include "*costs of gas delivery*" which Naftogaz claimed should be deducted). Those four paragraphs contain no reference to the decoupling ground.

(2131) The next three paragraphs of the letter discuss Naftogaz' subjective expectations about how oil prices would develop in 2010 and the first five months of 2011 but, again, those paragraphs contain no reference to the phenomenon of decoupling.

(2132) It appears that Naftogaz' position is that the letter of 17 June 2011 discusses both gas prices and oil prices and that this somehow implies that the letter refers to the decoupling ground. This is an untenable, and indeed absurd, reading of the letter of 17 June 2011.

(2133) In addition, the letter of 17 June 2011 contains no clear reference to the netbacked price ground (although it does invoke the level of Gazprom's own prices, as opposed to German hub prices, adjusted for transportation costs, in order to "*confirm*" Naftogaz' general position that the Contract Price should be reduced).

(2134) It is important to recognise that in its letter of 17 June 2011 Naftogaz advances a specific ground for price revision: it states that the development of the Contract Price has differed from what was anticipated by Naftogaz when the Contract was executed (i.e., a 45.7% as opposed to 25% increase in 2010 prices as compared to 2009 prices). But this ground is entirely different from the decoupling ground that Naftogaz now seeks to advance in this arbitration. For this reason, the decoupling ground that Naftogaz now seeks to advance is entirely outside the scope of the 17 June 2011 request. This fundamental discrepancy between the basis notified in the letter of 17 June 2011 and the basis advanced in this arbitration implies that the Tribunal has no jurisdiction or substantive power to consider Naftogaz' price revision claims.

(2135) The decoupling ground, as well as the netbacked price ground, are outside the scope of, and not connected to, the specific ground identified in the price review request of 17 June 2011.

iii) *Letter of 27 April 2014*

(2136) Gazprom maintains that the letter of 27 April 2014 does not constitute a request to reconsider the price pursuant to Article 4.4. The letter dated 27 April 2014 fails to contain any due justification as required under that article, and since three months did not elapse between 27 April 2014 and Naftogaz' Request for Arbitration dated 16 June 2014, the letter dated 27 April 2014 cannot constitute a price revision request that could provide a mandate to the Tribunal in this Arbitration.

VIII.11.3.15.7 Gazprom has not waived its right to insist on compliance with Article 4.4.1

(2137) Naftogaz claims that Gazprom has waived its right to raise the issue of non-compliance with Article 4.4.1 of the Contract. In this regard Naftogaz refers to correspondence from Gazprom dated 8 June 2011, Gazprom's participation in a working meeting on 5 July 2011 and correspondence dated 27 July 2011 in which Gazprom did not "*repeat or refer to its reservations regarding substantiation …*".

(2138) Gazprom denies that Gazprom has waived its right to raise the issue of non-compliance with Article 4.4.1 of the Contract. In assessing this argument, it is important to recall that Gazprom's objection is that Naftogaz' price revision claim is based on grounds which were not identified in any way in the letters of 20 May 2011 and 17 June 2011. This objection only arose on 16 June 2014 (which is when Naftogaz filed its Request for Arbitration, and when Gazprom first came to know that Naftogaz would be relying on the decoupling and netbacked price grounds to support its price revision claims in this arbitration). Any assertion that Gazprom has waived this objection would have to be based on Gazprom's conduct after 16 June 2014. But the conduct that Naftogaz relies upon to establish a waiver occurred in 2011. Naftogaz' contention is based on the nonsensical proposition that a procedural objection can be waived on account of conduct before it arose. Naftogaz' argument that conduct in 2011 amounted to waiver of a procedural objection which only arose in 2014 is plainly unsustainable. Moreover, under such circumstances the Supreme Court case referred to by Naftogaz cannot have any relevance.

VIII.11.3.15.8 Conclusion

(2139) Naftogaz seeks to advance price revision claims on the basis of price revision requests which make no reference at all to the basis for price revision invoked in this arbitration. As a consequence, Naftogaz has not fulfilled the precondition for arbitration and the Tribunal lacks power to try Naftogaz' price revision case to such extent that it is based on Articles 4.4 to 4.4.2. Accordingly, Naftogaz' case must be dismissed or rejected.

(2140) This result is entirely justified: for the negotiation process envisaged in Article 4.4 to work properly it is imperative that proper notice is provided. It is precisely for this reason that Article 4.4 requires the party seeking revision file a "*duly substantiated*" price revision request. Naftogaz cannot obtain a retroactive price revision, and consequential repayments dating back to mid-2011, on grounds which were never notified to Gazprom at the relevant time.

VIII.11.3.15.9 Naftogaz' price revision claims cannot be advanced as the revised prise formula proposed was neither notified to Gazprom nor was it the subject of prior negotiations, nor did Naftogaz propose any other price formula

(2141) It is common ground that the revised price formula that Naftogaz now advances in this arbitration was neither notified to Gazprom nor was it the subject of prior negotiations between the parties.

(2142) Gazprom maintains that the jurisdiction of a tribunal acting under Article 4.4.2 is limited in scope to revisions which were proposed or considered by the parties during the course of pre-arbitration negotiations. As a consequence, the Tribunal does not have power to revise the price formula in the manner that Naftogaz now requests (because that revision was never considered by the parties prior to this arbitration).

(2143) Naftogaz responds that Gazprom's position "*has no basis in the wording [Article] 4.4*". This response fails to take into account Naftogaz' own arguments in favour of construing Article 4.4 as a price revision clause. Naftogaz' argument is that a tribunal's power to revise prices arises because of an implied contractual obligation to reach agreement on a revised price. Naftogaz states that "*[c]onsequently, the Tribunal is authorised to decide how the Parties were obliged to conclude the revision of the Contract Price*". If that is correct, the scope of a tribunal's power must be limited to proposals for revision made (by the requesting party) but rejected (by the responding party) during the pre-arbitration negotiation process provided for in Article 4.4.1.

(2144) Put another way, it would make no sense for a tribunal to conclude that a respondent has failed to comply with an implied contractual obligation to agree to a particular revised formula if that revised formula was never presented to it. Thus, on Naftogaz' own case, a Tribunal cannot uphold price revision claims which were neither proposed nor considered by the parties during the course of pre-arbitration negotiations.

(2145) Naftogaz also argues that if Gazprom's position is adopted "*each Party would have an unreasonable, arbitrary power to tailor in advance its own future jurisdictional objections in arbitration, simply by refusing to discuss whatever issues it sees (un)fit*". Naftogaz appears to have misunderstood the point that Gazprom is making. To be clear, a respondent will not have a valid objection because it has refused to discuss a particular formula during meetings convened between the parties. It will only have an objection if the proposed formula was not presented to it, either in the duly justified request or subsequently, such that it cannot be said to have improperly failed to agree to that revised price formula.

(2146) Finally, Naftogaz argues that its "*entitlement to a decision should not be limited by alleged procedural shortcomings*" and refers to the final award in ICC Case 13504 where the Tribunal allowed the submission of supplementary evidence in light of "*difficulties*" faced by the parties. That decision provides no support for Naftogaz' position. Naftogaz did not face any difficulty in presenting the revised price formula in a timely manner and its failure to do so is not a mere procedural matter: the entire basis of Naftogaz' price revision claim is that Gazprom breached implied contractual duties by improperly failing to agree to that revised price formula.

VIII.11.3.15.10 Naftogaz' price revision claims [redacted]

(2147) Article 4.4.2 provides a precondition for arbitration is that "*[a] written agreement to reconsider the Contract Price is not reached*". Gazprom and Naftogaz agree that if an agreement regarding the Contract Price is reached this precludes any subsequent recourse to arbitration.

(2148) The only remaining difference between the parties is whether a relevant agreement regarding the Contract Price has been reached in this case.

(2149) Gazprom's position is that the parties did reach written agreements regarding price subsequent to the requests presented in Naftogaz' letters of 20 May 2011 and 17 June 2011. In particular an agreement regarding price, in [redacted] was reached on [redacted]. Having entered into an agreement regarding price, Naftogaz cannot seek to proceed with a price revision arbitration.

(2150) Naftogaz' response is that Article 4.4.2 should be interpreted as referring solely to an agreement which alters the definition of the contract price in Article 4.1. It argues that [redacted] altered [redacted] and, for this reason, Naftogaz is not precluded from proceeding to arbitration.

(2151) This argument is simply wrong.

(2152) As a matter of fact, [redacted] does involve an alteration of the contract price. [redacted] Any doubt in this regard is dispelled by the [redacted] which reads: [redacted]

(2153) In any event, Gazprom maintains that an agreement on the factual price is sufficient to resolve a request for price revision. The Parties had no reason to treat agreements on the [redacted] any differently from agreements on the [redacted] and the reference to a "*written agreement to reconsider the Contract Price*" should simply be understood as a reference to the price payable under the Contract.

(2154) Gazprom maintains its position that, absent an explicit agreement to the contrary, the conclusion of a subsequent amendment on pricing terminates any pending price revision process. Indeed, Naftogaz has taken the benefit of the price reductions provided under the amending [redacted] but now insists on further alterations to the price (through its revived price revision claims). If Naftogaz intended to maintain any pre-existing price revision claims it should have inserted a specific reservation in [redacted] at the time of amendment. By failing to insert a reservation, Naftogaz must be taken to have terminated any pending price revision processes. Any other result would allow Naftogaz to have its cake and eat it too.

VIII.11.3.15.11 Naftogaz has lost the right to submit the case to arbitration because of its conduct, and by failure to pursue its claims to reconsider the Contract Price

(2155) In any event, even if the above objections are rejected, Gazprom maintains that Naftogaz has lost its right to submit the case to arbitration pursuant to Article 4.4 of the Contract because of its conduct, and by failure to pursue its claims to reconsider the Contract Price. Thus, Naftogaz cannot rely on its alleged requests for price revision in the letters dated 20 May 2011 and 17 June 2011. Pursuant to Swedish law a party who, by failing to act, gives the other party the impression that he no longer relies on a certain right or for a long period of time fails to invoke his right, should be deemed to have lost his right.

(2156) This was, inter alia, expressed in the Swedish Supreme Court case NJA 2002 p. 230 in which the court stated:

"*Loss of a right on grounds of passivity can however arise, as the restaurant [which is a party to the case] has claimed, according to general commercial law principles." … "A requirement to give notice of the fact that a claim is made can, however, exist when a party knows that the other party has acted in a certain way in reliance upon a legal judgment which is incorrect (cf section 6(2) of the [Swedish] Contracts Act) or when a party has given the opposite party reason to believe that he has given up his rights (see e.g. NJA 1961 p. 26) or when a party has failed to pursue his rights for a considerable period of time (see, for example, NJA 1933 p. 570 and Karlgren, Passivitet, 1965 p. 10 et seq).*"

(2157) Further, in the Swedish Supreme Court case NJA 1961 p. 26, the question was, inter alia, whether a pledgee could be liable for damages due to a re-pledge. The court held that no liability for damages existed since the original pledgor had failed to object to the re-pledge although he had been aware of it. The original pledgor had therefore given the counterparty the impression that he had waived his rights.

(2158) Gazprom maintains that Naftogaz' failure to act, together with its conduct (as set out below) following the alleged price revision requests in May/June 2011, gave Gazprom the justified impression that Naftogaz no longer relied on its alleged requests for price revision dated 20 My 2011 and 17 June 2011, and that Naftogaz was no longer pursuing its claims to have the Contract Price reconsidered.

(2159) In this regard, Gazprom relies on the following aspects of Naftogaz' conduct taken together:

(i) the approximately three year delay between the alleged requests to reconsider the Contract Price it invokes and the initiation of this arbitration;
(ii) Naftogaz' conduct of continuing to accept deliveries under The Contract and paying invoiced prices during that approximately three-year period without notifying Gazprom that it might seek refunds of the amounts invoiced;
(iii) Naftogaz' conduct of entering into supplemental agreements with Gazprom, including entering into [redacted], taking, inter alia, the benefit of a reduction in price but subsequently seeking to revise the price retroactively through its price revision claim; and
(iv) Naftogaz' failure to indicate that it relied upon the alleged price revision requests set out in its letters of 20 May 2011 and 17 June 2011.

(2160) Naftogaz' response regarding the conduct that Gazprom relies upon is as follows:

(2161) Naftogaz relies on the absence of a specific time limit in Article 4.4.2 for initiating arbitration and a reference in the document Putting a Price on Energy that "*some cases*" took more than 5 years to be resolved. Both of these answers are irrelevant. Gazprom does not rely on any contractual time limit in this regard. As to the reference to the statement in Putting a Price on Energy, that reference is irrelevant because it does not deal with the delay in commencing a price revision arbitration – instead it refers to a delay in concluding price revision negotiations.

(2162) Naftogaz argues that the Contract does not require a party seeking to reconsider the Contract Price to protest against invoices. Again, this response does not address Gazprom's objection which is based on Naftogaz' conduct and failure to act and the justified impression this gave Gazprom. The point is that Naftogaz' conduct of paying invoices (in total, 174 payments for deliveries of gas during the period 17 June 2011 to 30 March 2014) without any protest or reservation over an extended period of nearly three years led Gazprom to assume that Naftogaz no longer pursued any request to reconsider the Contract Price.

(2163) Naftogaz responds "*that the Parties agreed on other non-related matters while the price dispute was on-going is only natural in a long-term business relationship. It does not give Gazprom the justifiable impression that Naftogaz has relinquished its claim for price revision. Addenda signed concerning agreements on other matters do not fulfil the procedural requirement to the closing of a price revision in Article 4.4.1*" (emphasis added). This response ignores the agreement reached in [redacted] (and also supplemental agreements regarding deferred payments). These agreements are not an agreement on "*other matters*", they are emphatically agreements on price. The circumstance that the Parties concluded these [redacted] did in fact give Gazprom the impression that it had dealt with Naftogaz' various requests, as confirmed by [redacted] who states "*[o]ur understanding was that these payment arrangements had dealt with Naftogaz' requests*" and "*[i]t appeared to us that Naftogaz had elected not to pursue its June 2011 request for a price reconsideration pursuant to Article 4.4, and we assumed that this matter was closed*".

(2164) Naftogaz argues that it "*repeatedly contacted Gazprom to discuss the Contract Price*" and "*actively pursued the matter*". Naftogaz refers to:

(i) three letters from Naftogaz to Gazprom dated 7 September 2011, 2 August 2013 and 1 October 2013;

(ii) [redacted] second witness statement, paragraph 27 which makes a vague statement that "*this issue was repeatedly raised during meetings between Gazprom's and Naftogaz' representatives, as well as at the interstate level, which was widely covered by the press*"; and

(iii) press reports of statements by Ukrainian government officials dated 17 March 2012, 23 October 2012 and 19 March 2013.

(2165) However, the correspondence and press reports referenced do not actually refer to the alleged price revision requests initiated by means of Naftogaz' letters of 20 May 2011 and 17 June 2011. Indeed, they contain no reference at all to the correspondence dated 20 May 2011 and 17 June 2011. As such they cannot be taken as an indication that the price revision process or processes initiated by means of those letters remained active. They are better understood as letters which suggest that price should be renegotiated as a general matter rather than because of the circumstances cited in the letter of 17 June 2011 (i.e., the evolution of oil prices in 2010 and the first five months of 2011).

(2166) As to the recollections of [redacted] without further particulars of when, and by whom, the alleged price revision requests of 20 May 2011 and 17 June 2011 were discussed, this is not an assertion that Gazprom can respond to.

(2167) Accordingly, Naftogaz and Gazprom conducted their commercial relationship on the basis that the alleged requests for price revision arising through the letters of 20 May 2011 and 17 June 2011 were no longer being pursued. This was the clear impression Gazprom got from Naftogaz' conduct during that approximately three year period.

(2168) Consequently, in the present case it is not (as alleged by Naftogaz) a question of determining whether Naftogaz' conduct and failure to pursue its claims can be regarded as creating a "*binding unilateral confirmation*" or an alleged "*waiver under general rules of contract law*". This is simply not relevant – see the Supreme Court cases referred to above.

(2169) Moreover, Naftogaz claims that "*Gazprom's failure to raise this objection before submission of the Defence arguably means that Gazprom has forfeited the right to invoke that Naftogaz has waived the price revision claim*". In addition, Naftogaz states:

"*Naftogaz notes that Gazprom's defence regarding waiver was only raised in its Defence despite numerous contacts between the Parties from 2011 to 2014 as to revision of the price from 2011 and onwards. The fact that this was never raised gave Naftogaz the justifiable impression that Gazprom did not regard the different claims as waived and that it had unconditionally opted not to argue that the claims had already been waived.*"

(2170) Gazprom denies that it has forfeited its right to invoke this objection. As described above, Gazprom had no reason to believe that Naftogaz was going to rely on its alleged requests for price revision (letters dated 20 May 2011 and 17 June 2011). Instead, Gazprom had the justified impression that Naftogaz no longer relied on these letters, and that Naftogaz no longer pursued its claims to reconsider the Contract Price. Consequently, Gazprom had no reason to clarify to Naftogaz that Naftogaz had lost its right to rely on the letters dated 20 May 2011 and 17 June 2011 before Naftogaz advanced its price revision claims in this arbitration.

VIII.11.3.15.12 Conclusion: Naftogaz' price revision claims must be dismissed or rejected

(2171) In conclusion, even if Article 4.4 is interpreted as price revision clause, Naftogaz' price revision claims must be dismissed or rejected on the basis of the four objections set out above.

<u>VIII.11.3.16 Naftogaz' price revision claims fail on the merits</u>

VIII.11.3.16.1 Introduction

(2172) Even if Article 4.4 is interpreted as a price revision clause and the four procedural objections set out above are rejected, Naftogaz' price revision claims must fail on the merits.

(2173) In particular, Naftogaz cannot discharge its burden of showing that the two substantive conditions for a price revision are met in this case because: (1) the parties anticipated the changes in fuel and energy market conditions that Naftogaz relies upon and, in any event, those changes are outside the scope of what is relevant under Article 4.4; and (2) market prices, properly understood and calculated, were not lower than prices under the Contract at the relevant price revision dates.

(2174) In what follows, Gazprom will address the threshold question of the definition of the "*market*" under Article 4.4 of the Contract. Gazprom will then address the substantive conditions of Article 4.4 in turn.

VIII.11.3.16.2 Definition of the market for the purposes of Article 4.4

(2175) Article 4.4 refers to "*fuel and energy market conditions*" and "*the level of prices in the market*" (emphasis added). The identity of "*the market*" referenced in Article 4.4 is therefore critical for any assessment of whether the two substantive conditions for a price revision are made out.

(2176) Naftogaz proceeds on the basis that the reference to "*the market*" in Article 4.4 is a reference to a set of non-Ukrainian European markets. Naftogaz states that "*Ukrainian market data are irrelevant in this context, and … the Tribunal may focus on finding the most appropriate (Western) European data*". Naftogaz identifies three non-Ukrainian markets, Germany, the Czech Republic and Slovakia, as the relevant markets for the purposes of Article 4.4.

(2177) Gazprom recalls that Article 4.4 provides no guidance on what the reference markets are for the purposes of a price revision and that this provides a strong indication that Article 4.4 was not intended to operate as a price revision clause. Nevertheless, if Article 4.4 is interpreted as a price revision clause, Gazprom accepts that the market for the purposes of Article 4.4 will have to be a non-Ukrainian market as the Ukrainian market is highly regulated at present. However, Gazprom does not agree with Naftogaz' selection of non-Ukrainian markets in this case. Gazprom's position regarding the selection of non-Ukrainian markets is set out in detail below.

VIII.11.3.16.3 The first condition in Article 4.4. is not met: there is no material change in the relevant fuel and energy market conditions in comparison to what was reasonably anticipated by the Parties in January 2009

VIII.11.3.16.3.1 Introduction

(2178) Naftogaz cannot establish that there has been a material change in fuel and energy market conditions compared to what was anticipated by the parties.

(2179) At the outset, it is important to note that Naftogaz has revised its case significantly. In its Statement of Claim, in addition to "*decoupling*" (i.e., the divergence between gas prices at trading hubs and gas prices in contracts indexed to oil products), Naftogaz had referred to regulatory developments in Europe, the rise of hub pricing and three causative factors connected to the so-called "*gas glut*" (i.e., declines in industrial demand, the rise of shale gas in the United States and declines in gas demand in the German, Czech and Slovak power sectors) as changed market conditions. Naftogaz refers to "*decoupling of gas market prices from oil prices*" as "*[t]he main ground for price review*" (emphasis added) and goes on to criticise Gazprom's expert, Dr Moselle, for not focussing on this (newly identified) "*main ground*".

(2180) Gazprom's response is two-fold: (1) the Parties could have reasonably anticipated that decoupling, (i.e., the divergence between gas prices at trading hubs and gas prices in contracts indexed to oil products), would occur during the lifetime of the Contract; and (2) in any event, decoupling cannot be characterised as a change in market conditions which has caused the price divergence that Naftogaz invokes in this case.

VIII.11.3.16.3.2 The Parties had reason to anticipate decoupling

(2181) Dr Moselle's evidence is that at January 2009 there were well-founded reasons to expect that "*decoupling … would occur during the life of the Contract.*"

(2182) Dr Moselle refers to five such reasons:

(i) Gas and oil are generally not close substitutes in Europe. Therefore, there is no economic reason for their prices to evolve in the same manner.

(ii) Significant decoupling of oil and gas prices had occurred in the years leading up to 2009.

(iii) The correlation of oil-indexed gas prices and gas hub prices existed because of the arbitrage between gas imported under oil-indexed contracts and gas bought and sold at hubs. This mechanism, while still significant, became much less effective at aligning prices from late 2008 onwards.

(iv) As at January 2009, the EU was on the verge of completing its legislative efforts to liberalise the gas market (i.e. the third energy Directive), the salient features of which were clear in 2007. A predictable consequence of liberalisation was an increase in hub trading and hub liquidity, which would predictably reduce the likelihood that oil-indexed prices would remain aligned with hub prices.

(v) There were a number of developments that had the potential to cause a gas supply or demand shock in the near term after the date of the Contract, one result of which could have been decoupling. These include: (i) the worldwide financial crisis, which began in 2008; (ii) increased deployment of renewable energy in Europe; and (iii) increased US production of shale gas, which would increase the availability of gas supplies to Europe. The extent of these developments and the speed with which they led to the decoupling of gas prices from oil prices was not clear at the date of the Contract. While the exact timing of decoupling would have been hard to predict, each of the main factors contributing to the decoupling was evident to some degree as at January 2009.

(2183) Critically, price data from January 2009 shows that decoupling had already commenced or, at any rate, was imminent:

(2184) Figures 4.1 and 4.2 of the Moselle Report 2 show that "*the beginning of the current 'decoupling' between oil-indexed prices and hub prices*" was visible from "*around September/ October 2008*". Indeed, Figure 4.2 shows that the degree of decoupling has not significantly changed between the date of conclusion of the Contract and the price revision dates. In January 2009, oil-indexed prices were 40% higher than spot hub prices, while in May 2011 and June 2011 they were only 21% and 29% higher than spot hub prices.

(2185) Moreover, the parties would have known that significant decoupling had occurred in the past. As Dr Moselle notes, there was a "*significant divergence of hub-prices from oil-indexed prices in 2006 and 2007*."

(2186) Naftogaz' experts claim that they have been "*informed that the subject [of decoupling] was not discussed during the contract negotiations*". But one paragraph later they state that "*[f]or most of the second half of 2008, oil-linked prices were, if anything, anticipated to be lower than hub prices over the course of the next year. Indeed, this appears to be the reason why the parties agreed that the coefficient k should increase from 0.8 to 1.0 at the start of 2010*" (emphasis added). If anything, Naftogaz' account implies that a future divergence between hub prices and contract prices was not merely anticipated by it parties, it was actually considered by the parties and accommodated in the price formula (albeit for a single year).

(2187) Naftogaz makes two primary arguments in support of its position that decoupling was unanticipated.

(2188) First, Naftogaz argues that the price formula in Article 4.1 of the Contract is "*the best evidence of what the Parties reasonably expected when they concluded the Contract*" and because the price formula indexes the Contract Price to oil prices it follows that the parties did not have "*reason to expect that gas market prices and oil product prices would lastingly disconnect shortly after the Contract was concluded*". Gazprom notes that it is entirely possible for an anticipated market change to be excluded from a price formula for sound commercial reasons (in particular the parties may have taken the view that if the market change occurred, one or the other party will bear the resulting commercial risks). Naftogaz provides no response to this argument. Instead, it simply repeats its prior argument as if no response was made.

(2189) Second, accordingly to Naftogaz, Dr Moselle's analysis only shows that decoupling would occur at some point during the life of the Contract but it does not show that decoupling would necessarily have occurred during the 29 months’ price revision period in this case (January 2009 to May 2011). On Naftogaz' case, this uncertainty about whether decoupling would occur during the current price revision period suffices to demonstrate that it was an unanticipated market change. Put in more general terms, Naftogaz argues that a change will be treated as an unanticipated change unless it can be shown that the parties knew that a change would occur and that the parties knew about the exact timing of that change.

(2190) In assessing this argument, the starting point is that by including a textual requirement that anticipated changes could not lead to a price revision the parties were seeking to impose a constraint on the price revision power. However, as a factual matter, it would be difficult, if not impossible, for parties to predict both that a particular change would occur and that it would occur at a specific time. Because of the inherent difficulty of making precise predictions about the timing of market developments the result is that every market change will be treated as an unanticipated market change under Naftogaz' test. In effect, Naftogaz' interpretation denudes the unanticipated change requirement of any practical force. For this reason, it should be rejected.

(2191) A further reason for rejecting this argument is that Article 4.4 does not impose any price revision intervals. The 29 month price revision period in this case is not a contractually derived period, it is merely a consequence of when Naftogaz happened to decide to request a price revision. Naftogaz' interpretation implies that the party opposing a price revision (on the basis that a market change was anticipated) would have to show that it was anticipated within a time interval that is defined not by the Contract but unilaterally by the party seeking the price revision.

(2192) Naftogaz presents two hypothetical examples to support its interpretation. Both of those examples are unavailing.

(i) The first is the example of a change, in 2009, which was expected to occur in 2017 but which actually occurs in 2011. Assume that the change in question is a tax on a competing fuel; it is difficult to understand why, if the parties were content to leave the price formula unchanged if such a tax was imposed in 2017, the position should be any different solely because the same tax was imposed sooner. Moreover, it is not clear why the price should be revised for a period after 2017 simply because the (expected) change occurred sooner than originally assumed (i.e., sooner than 2017).

(ii) The second is a hypothetical situation where a specific market change is "*implicitly taken into account*" in a particular price review. It is not clear how a specific market change can be implicitly taken into account – basic considerations of due process imply that a market change must be explicitly identified by a tribunal before it can be treated as a trigger for a price revision. Moreover, the same event cannot be considered in a subsequent price revision period because it would outside the temporal scope of the subsequent price revision period.

For these reasons Naftogaz' claim that its hypothetical shows that Gazprom's approach would lead to "*potential double counting*" is simply incoherent.

(2193) Naftogaz also cites survey results from the FLAME Conference in 2009 to support its position that decoupling was unanticipated. However, the relevant survey question pertains to the prevalence of hub pricing rather than "*decoupling*" (as that term is used by Naftogaz in the present context - to refer to a divergence between the level of gas prices at trading hubs and the level of gas prices in contracts indexed to oil products). The precise question posed to participants was whether "*European long term contract gas prices will become decoupled from oil and determined by spot and futures prices*" (emphasis added). It is apparent that this question is about whether oil indexation will be replaced by hub indexation within long term supply contracts. It is not about whether hub price levels will diverge from oil price levels. On Naftogaz' own account, this survey question is immaterial to the "*main issue*" before this Tribunal.

(2194) For all of these reasons Gazprom maintains that decoupling was an anticipated change and cannot be used to trigger a price revision under Article 4.4.

(2195) For the avoidance of doubt, Gazprom notes that it continues to rely on its arguments that: (1) regulatory developments in Europe; (2) the rise of hub pricing; (3) declines in industrial demand; (4) the rise of shale gas in the United States; and (5) declines in gas demand in the power sector, were all either expected market developments or were already underway at the time of conclusion of the Contract. Naftogaz has not provided any substantive response at all to Gazprom's arguments on these matters.The fact that those changes could be expected or were already underway fundamentally undermines Naftogaz' position that the changes it invokes were unanticipated.

(2196) Gazprom also notes that Naftogaz had argued that Gazprom misinterpreted the "*probability standards*" to be applied under Article 4.4. Naftogaz argues that the appropriate "*probability standard*" is whether the parties had "*well founded*" reasons to anticipate the relevant change. Regardless of whether Naftogaz' position is justified, it is apparent that it would make no difference to the outcome of this case: Dr Moselle has adopted the standard proposed by Naftogaz in his second report and he concludes that the parties had "*well founded*" reasons to anticipate all of the changes that Naftogaz has invoked in this case.

VIII.11.3.16.3.3 In any event, decoupling cannot be invoked as a causative factor in this case

(2197) There is further reason why Naftogaz' reliance on decoupling, understood as the divergence between gas prices at trading hubs and gas prices in contracts indexed to oil products, goes nowhere.

(2198) Naftogaz has to establish that the change in conditions in the fuel and energy market that it cites has caused the situation where the Contract Price does not reflect market prices. However, to describe decoupling as causative of market price non-reflectivity is incoherent. Decoupling and the contention that the oil-linked prices under the Contract allegedly do not reflect German hub prices are two sides of the same coin. The former cannot be described as the cause of the latter. Given that decoupling and market price non-reflectivity describe the same underlying phenomenon (i.e., the allegedly altered relationship between oil-linked gas prices, whether in the form of the Contract prices or German import prices, and German hub prices), the former cannot be described as a separate and distinct cause of the latter.

(2199) For this reason, as well, Naftogaz' reliance on decoupling cannot justify any price revision.

VIII.11.3.16.4 The second condition in Article 4.4. is not met because contract prices reflect market prices

VIII.11.3.16.4.1 Introduction

(2200) Naftogaz' experts conclude that in the second quarter of 2011 and the second quarter of 2014 prices under the Contract exceeded market prices by USD 175.4 per TCM under the end point method and USD 147.3 per TCM under the delta-delta method. By way of contrast, Gazprom's expert, Dr Moselle, concludes that in the second quarter of 2011 factual prices under the Contract did not exceed import prices and in the second quarter of 2014 the factual prices that Gazprom claims are payable under the Contract were above import prices, while the factual prices that Naftogaz claims are payable under the Contract were not above import prices.

(2201) In Figures 2-3 and 2-5 of Dr Moselle's second report he provides an account of the major factors leading to the differing results reached by the two sets of experts.

(2202) The differences in the results reached by the experts are attributable to nine matters.

(i) The range of European reference markets used to derive market prices. Dr Moselle contends that, in addition to Germany, the Czech Republic, Slovakia, Poland, Hungary, France and Italy should be included. Dr Hesmondhalgh and Mr Way would limit the analysis of market prices to Germany.

(ii) Differences over whether the so-called "*netback approach*" should be adopted. Dr Hesmondhalgh and Mr Way propose that a netback approach should be adopted while Dr Moselle disagrees with the netback approach.

(iii) Assuming a netback approach is adopted, there is a subsidiary disagreement about how to calculate the level of transit costs across Ukraine.

(iv) The experts differ about the relevant measure of market prices. Dr Hesmondhalgh and Mr Way utilise hub prices and a mixture of hub prices and import prices. Dr Moselle only utilises import prices.

(v) Assuming that the use of hub prices is appropriate, there is a subsidiary disagreement about whether "*bid prices*" or "*mid prices*" should be used. Dr Hesmondhalgh and Mr Way use "*bid prices"* while Dr Moselle uses "*mid prices*".

(vi) The experts differ about whether a deduction of a wholesaler's margin from hub prices is appropriate. Dr Hesmondhalgh and Mr Way would make such a deduction while Dr Moselle would not.

(vii) Assuming that a deduction of a wholesaler's margin from hub prices is appropriate, there is a subsidiary disagreement about how to calculate the level of the wholesalers' margin.

(viii) The experts use different prices to calculate the price under the Contract. Dr Hesmondhalgh and Mr Way are instructed to use the Contract Price (described in Article 4.1) while Dr Moselle is instructed to use the factual price (the price actually payable under the Contract).

(ix) The experts differ over whether, for the purposes of the delta-delta analysis, it is appropriate to calculate the price under the Contract in January 2009 using the temporary k-factor of 0.8 which was only to apply until the end of 2009. Dr Hesmondhalgh and Mr Way use a k-factor of 0.8 while Dr Moselle would use the general k-factor of 1.

(2203) In what follows, Gazprom will discuss the first seven matters under the heading "*derivation of the market price*" and the remaining two matters under the heading "*derivation of the comparator price under the Contract*". However, before turning to these matters Gazprom will address the issue of the dates on which comparisons should be made.

VIII.11.3.16.4.2 Dates on which comparisons should be made

(2204) Naftogaz' position is that the comparison between market prices and the price under the Contract should be made in the quarter when a price revision request was first made. Dr Moselle has presented the results of his analysis both for the periods which he has been instructed to consider, as well as for all of the dates on which Dr Hesmondhalgh and Mr Way have conducted their analysis.

VIII.11.3.16.4.3 Derivation of the market price

i) *Reference countries*

(2205) For the purposes of deriving a market price, the remaining differences between the experts relates solely to the question of whether price data from European countries other than Germany, i.e., Poland, Hungary, Czech Republic, Slovakia, France and Italy, should be used in the analysis.

(2206) The criteria applied by Gazprom's expert, Dr Moselle, in arriving at his list of countries was two-fold: (1) size, in terms of volume of gas imported or volume of gas imported from Russia (Germany, Italy, and France were included on this basis as they import and consume significant amounts of pipeline gas in general, and Russian gas in particular); and (2) proximity to Ukraine and to Russia, and a similar history of importing large proportions of national gas consumption from Russia (the Czech Republic, Slovakia, Poland and Hungary were included on this basis). However, Dr Hesmondhalgh and Mr Way raise a number of disparate objections to the inclusion of price data from Poland, Hungary, Czech Republic, Slovakia, France and Italy.

A) *Eastern European countries*

(2207) Dr Hesmondhalgh and Mr Way object to the inclusion of Poland, Hungary, Czech Republic, Slovakia on two grounds:

(i) first, they contend that there is a "*potential circularity*" in relying on markets dominated by Russian gas to set the price for more Russian gas; and

(ii) second, they contend that Poland, Hungary, Czech Republic, Slovakia are amongst the countries cited by the European Commission in its Statement of Objections in respect of a competition case against Gazprom, and therefore prices in these four countries cannot be considered reliable.

(2208) Dr Moselle's reply to the first ground is that there is no direct circularity in relying on markets mainly supplied by Russian gas. A comparison to prices in those markets tests whether or not the the Contract Price is comparable to the price at which Gazprom sells gas to other countries. As Dr Moselle explains, there is an element of fairness in this test because it assesses whether Naftogaz pays the same price as other Gazprom customers.

(2209) Dr Moselle's reply to the second ground is that it fails to deal with the limited and ongoing nature of the European Commission's investigation. The European Commission has not made any allegations of excessive pricing with respect to Gazprom's conduct in Hungary, the Czech Republic, and Slovakia. It follows that the European Commission investigation does not furnish any basis for ignoring prices derived from those markets. An allegation of excessive pricing is made in connection with Gazprom's exports to Poland. However, the European Commission investigation has not been concluded. In the circumstances, it would be inappropriate to ignore the Polish prices.

(2210) Naftogaz (but, tellingly not its experts) makes the further argument that prices from Poland and Hungary should be excluded on the basis that those countries do not have functioning fuel and energy markets as "*Gazprom has a dominant position in both markets*". This further argument by Naftogaz must be rejected because: (1) it is fanciful to suggest that Poland and Hungary do not have fuel and energy markets; (2) as Dr Moselle points out, prices from markets where Gazprom is dominant but where Gazprom has not been found to be engaged in price-based abuse of dominance remain valid; and (3) Naftogaz' position is inconsistent in that it accepts that Slovakia and the Czech Republic, two other markets where Gazprom is alleged to be dominant, are valid reference markets, but refuses to accept that Poland and Hungary should also be valid reference markets.

B) *France*

(2211) Dr Hesmondhalgh and Mr Way do not provide any principled objection to the inclusion of France in Dr Moselle's analysis. The only point they make is that including France in their analysis result in lower market prices. This is, however, solely due to Dr Hesmondhalgh and Mr Way's netback approach. The merits of that approach and Gazprom's objections to it are discussed below.

(2212) Naftogaz separately argues that France must be excluded because of the "*Parties' previously expressed understanding of the relevant geographical market*" and refers to a single (post-contractual) letter from Gazprom dated 8 June 2011 which refers to Gazprom's own prices, rather than market prices, in Germany and Eastern Europe. However, Naftogaz' letter of 7

September 2011 refers to Ukraine as the relevant geographical market. There is simply no consistency in the post-contractual correspondence between the parties on the matter of reference markets.

C) *Italy*

(2213) Regarding the inclusion of Italy, Naftogaz repeats both of the points that it makes with respect to the inclusion of France and those points have already been dealt with.

(2214) Naftogaz' experts also argue that Italy should be excluded because Italian prices were not "*representative*" of prices in the rest of Europe during the price review dates. They go on, however, to note that Italian prices did become "*representative*" in 2014. Dr Moselle responds that: (1) as Italy is the second largest importer of gas in the EU, many price review clauses reference Italy specifically as a benchmark for the price of gas imported into Western Europe and, for these reasons, it is difficult to exclude Italy from any assessment of European gas market prices; and (2) in any event, Italian prices have consistently exhibited a premium over prices in North West European markets and there is no reason to exclude Italian price data for that reason (whether before or after 2014).

(2215) Naftogaz, but not its experts, makes the argument that Italy does not have a fuel and energy market within the meaning of Article 4.4 because "*prices in Italy were moving out of step with the European market*". This argument conflates two separate questions: (1) the extent to which the Italian market is integrated with other European markets; and (2) whether there is an Italian market for fuel and energy. It is beyond dispute that there is a market for fuel and energy in Italy.

ii) **Netback approach**

(2216) The term netback approach refers to Dr Hesmondhalgh and Mr Way's approach of making a downward adjustment to European market prices in an amount equal to the cost of transporting gas from the Russian border with Ukraine to relevant European markets. The experts continue to disagree as to whether this downward adjustment to European market prices is appropriate.

(2217) From a commercial point of view, the fundamental flaw in Dr Hesmondhalgh and Mr Way's analysis is that it only considers Gazprom's opportunity cost (i.e., the net price that Gazprom would achieve for the gas if it did not sell it to Naftogaz). The commercial and economic reality is that the price under the Contract would be in between the level that Naftogaz would have to pay to source gas from Europe from other parties (the European price plus transportation costs from Europe to Ukraine) and the comparable price that Gazprom would realise from sales to European customers (European price minus transportation costs across Ukraine to reflect the additional costs that Gazprom would have to incur to make sales to Europe).

(2218) It follows that the fair and economically rational approach to deriving a market price for the purposes of the Contract is to consider both Naftogaz' opportunity cost (i.e., the price Naftogaz would have to pay to obtain gas from alternative sources of supply in Europe) and Gazprom's opportunity cost (i.e., the net price that Gazprom would achieve for the gas from European markets if it did not sell it to Naftogaz). So, if the positions of both parties are considered, one must refrain from making either a netback adjustment or an adjustment involving the addition of transport costs from Europe to Ukraine.

(2219) Nowhere do Naftogaz' experts contest the commercial logic of this basic point. Instead, they rely on (1) Gazprom's alleged acceptance of the principle that market prices under Article 4.4 should be calculated by applying the netback approach; and (2) the view that the market price should reflect a situation where "*instead of having one dominant Russian supplier, a group of numerous smaller Russian suppliers all competed with each other to serve Ukraine.*"

(2220) Contrary to Naftogaz' argument, Gazprom has never endorsed the proposition that a netback approach should be applied to calculate market prices under Article 4.4.

(i) First and foremost, the existence of any such intention on the part of Gazprom (and Naftogaz) is impossible to reconcile with the fact that Article 4.4 makes no reference at all to netback adjustments to market prices. In Article 4.4 the parties only refer to "*prices in the market*". If the parties had wanted to refer to netbacked prices they would have included an explicit reference to a netbacked price derived from specific non-Ukrainian markets. However, they did not do so.

(ii) Second, while Gazprom may have indicated that as a general commercial matter it did not wish to sell gas at a price that was lower than its opportunity cost (and thereby subsidise certain buyers), that indication only implies that netbacked prices may operate as a floor in commercial negotiations. It does not imply that they operate as a ceiling. There is no inconsistency between any such indications about Gazprom's general commercial intentions, or Gazprom's internal use of netback calculations to assess price offers to Naftogaz, and the fact of Gazprom negotiating a price under the Contract which is above netbacked price levels.

(iii) Third, the post-contractual correspondence implies that the parties were not able to agree on whether netbacked prices should be used to determine market prices. See in particular Gazprom's letter of 8 June 2011 (where no netback adjustment is discussed) and Naftogaz' response of 17 June 2011 (endorsing the use of a netback adjustment).

(2221) Likewise, Naftogaz' assertion that the market price for the purposes of price revision under the Contract should be set in a manner that assumes that Gazprom did not exist bears no relationship to the common intentions of the parties. Gazprom cannot be deemed to have accepted a price revision clause which is meant to generate a price on the assumption that it does not and should not exist. The price revision clause cannot be used to re-write the price under the Contract to obtain outcomes which bear no connection to the intentions of the parties. As Dr Moselle points out "*… nothing in the Contract suggests that the Parties should estimate the 'level of prices in the market' according to a counterfactual scenario in which there are 100 Russian producers. I have not seen such an approach adopted in any price review clause.*"

(2222) Furthermore, Naftogaz' assertion that the price under the Contract was set on the basis of a netback from German prices is difficult to reconcile with evidence regarding German prices and transit costs in January 2009. As Dr Moselle demonstrates regardless of whether the base price (Po) or the discounted Contract Price (Pn assuming k = 0.8) is used, the netback price in January 2009 differs by more than 10% the price negotiated by the parties in the Contract.

(2223) In summary, Naftogaz' netback approach should be rejected because: (1) it is not reflected in the text of Article 4.4; (2) it does not reflect the commercial position that both parties were in when the Contract was negotiated; (3) Naftogaz' assertions that the parties set prices under the Contract on the basis of a netback from German prices and that the price under the Contract should reflect a situation where Gazprom does not exist are unsustainable.

iii) Assuming a netback approach is adopted, calculation of the level of transit costs across Ukraine

(2224) The experts disagree on the quantification of the level of transit costs across Ukraine. Naftogaz' experts propose that a hypothetical amount is used instead of the amount actually paid under the Contract in force, i.e. the Transit Contract. Dr Moselle disagrees with this resort to hypothetical figures. The experts also disagree about how any hypothetical tariff should be set and this disagreement reflects the positions adopted in the parallel transit arbitration.

iv) Relevant measure of market prices

(2225) The experts also disagree on the relevant measure of European market prices: Dr Moselle uses published import price data while Dr Hesmondhalgh and Mr Way use hub prices.

(2226) Dr Hesmondhalgh and Mr Way's primary objection to the use of published import price data is that they may not reflect retrospective price changes following price reviews and/or arbitrations. Dr Moselle's response is that unless very large unreported retrospective price changes have occurred affecting a very large proportion of total imports the outcome of the analysis will remain the same. Based on his experience and his review of report price revisions Dr Moselle considers that it is unlikely that such large revisions have occurred.

(2227) Dr Moselle also concludes that Dr Hesmondhalgh and Mr Way are wrong to exclude import prices from their analysis, especially because "*in respect of flexibility and the long-term nature of the Contract, import prices are representative of a more similar product than hub prices*" and because markets such as Slovakia, Czech Republic, Hungary and Poland do not have reliable hub prices.

v) Assuming hub prices are used, use of bid prices or mid prices

(2228) Dr Hesmondhalgh and Mr Way use the bid price for the [redacted] hub as the market price benchmark. This is the lowest price marker available (lower than "*ask prices*" or "*mid prices*"). Dr Moselle considers it more reasonable to use mid prices as this reflects the reality that parties sometimes transact at the bid price and sometimes transact at the ask price.

(2229) Dr Hesmondhalgh and Mr Way make two points in response:

(i) They argue that the use of bid prices is consistent with their view that the "*correct*" way of valuing the gas is to consider what alternative price Gazprom could have achieved from selling it. However, this assertion does not generate any cogent reason for using bid prices.

(ii) They argue that the use of bid prices is consistent with international accounting standards. Dr Moselle notes that accounting rules do not override the market reality that a seller is highly likely to receive a price which is higher than the bid price, on average, when selling gas at the hub.

vi) Assuming hub prices are used, validity of the deduction of a wholesaler's margin from hub prices

(2230) The experts differ about whether making a deduction of a margin from hub prices is appropriate. Naftogaz' experts have sought to justify such a deduction on the basis that the most comparable arrangement to the Contract is a sale by Gazprom to a wholesaler in Germany and that any such sale would occur at a hub minus price. Dr Moselle disputes the assertion that such a sale to a wholesaler would occur at hub minus prices. Dr Moselle points out that:

(i) allowing for a wholesaler to buy at hub-minus prices would give it an economic advantage over other market players that should not exist in commodity markets; and
(ii) he is not aware of any remotely comparable contracts with hub-minus pricing.

(2231) As to the first point, Dr Hesmondhalgh and Mr Way argue that a hub-minus price is required to compensate the buyer for Take or Pay risk (i.e., the risk that the buyer will not be able to sell volumes that it is required to acquire profitably) and force majeure risk (i.e., the risk that deliveries will not be made because of a declaration of force majeure but hub customers will retain rights to be supplied). Dr Moselle responds that the first risk is eliminated because volumes can be sold profitably on the hub and the second risk is quite limited because a certain amount of force majeure risk can be passed on to hub customers.

(2232) As to the second point, Naftogaz' experts refer to an unidentified supply contract into Germany with hub-minus pricing and contracts involving Azerbaijan which allegedly involve hub-minus pricing. Dr Moselle responds to these allegations and points out that there is considerable ambiguity as to whether the examples referenced by Naftogaz actually involve hub-minus pricing.

vii) Assuming the deduction of a wholesaler's margin from hub prices is valid, calculation of the level of the margin

(2233) The experts also differ about the appropriate level of any wholesalers' margin. Dr Hesmondhalgh and Mr Way impose a 4% deduction from hub prices.

(i) They rely on a regulated tariff in Italy but, as Dr Moselle, shows the current version of that regulated tariff assumes that there is hub-plus pricing. Moreover, the relevant component of that tariff: (1) is ambiguous; (2) is not derived from actual margins; and (3) relates to the Italian market which is not comparable to the German market.

(ii) They also rely on margins earned by three gas supply companies Distrigas, Econgas and Wingas but as Dr Moselle shows: (1) it is not clear that these companies provide an appropriate benchmark because nothing indicates that they purchase gas at hub-minus prices; (2) the calculations of the margins earned by these companies is highly sensitive to the time period considered – margins earned for the period 2009-2013 were significantly lower than the 4% level proposed by Dr Hesmondhalgh and Mr Way: 2.6% for Distrigas, 3.9% for Econgas, and 3.7% for Wingas.

VIII.11.3.16.4.4 Derivation of the comparator price under the Contract

i) The price under the Contract

(2234) The experts use different prices to calculate the price under the Contract:

- Dr Hesmondhalgh and Mr Way are instructed to use a price for each quarter that is calculated in accordance with the formula set out in Article 4.1 of the Contract.
- Dr Moselle is instructed to use the actual price paid under the Contract for each quarter which differs from the price calculated in accordance with the formula set out in Article 4.1 because of matters such as the price reduction agreed to in Addendum No. 3.

(2235) Naftogaz' position is based on drawing a fundamental distinction between the price defined in Article 4.1 (which is described in that provision as the "*Contract Price*") and the price that is actually paid under the Contract after the adjustments provided for in Article 4.2 are made (that price is described in that provision as the "*actual price*" or the "*factual price*").

(2236) However, in its original form, Article 4.2 only provided for one adjustment - an adjustment for calorific value. It is apparent that, in that original form, reliance on the contract price rather than the factual price would make no difference to the outcome of a price revision (as comparisons under Article 4.4 would invariably be made of prices at unit calorific value). So in its original form, the distinction made between the factual price and the contract price in the Contract was utterly irrelevant to the implementation of the price revision clause.

(2237) In contrast, Naftogaz' position is that, currently, the distinction between the contract price and the factual price is highly material to the outcome of any price revision process. If discounts or price increases are included in Article 4.2 then they must be ignored for price revision purpose but if discounts or price increases are included in Article 4.1 they will be considered by a reviewing tribunal.

(2238) This outcome is artificial and does not reflect the intentions of the parties.

(2239) Naftogaz' assertion that the text of Article 4.4 refers to the "*contract price specified under Article 4.1*" rather than the "*actual price*" or "*factual price*", while undoubtedly correct, does not resolve the issue. The issue is, given that there was no material difference between the actual price and the contract price at the time of conclusion of the Contract, why should factual prices be ignored when making determinations about the right to trigger a price revision. Naftogaz cannot provide a convincing explanation for its position that the real price that is payable under the Contract should not be used for price revision purposes.

(2240) Naftogaz' further assertion that the primary deviation between the contract price and the actual price arises from [redacted] also does not take matters further. Naftogaz does not identify any trace of a common intent to include the [redacted] in Article 4.2 with a view to ensuring that the [redacted] must be ignored by any future tribunal when assessing whether there is an entitlement to a price revision. As [redacted] points out such an outcome would not have been acceptable to Gazprom. In the absence of material suggesting that the parties had wanted such an outcome, the mere accident of whether a discount is provided for in Article 4.1 or Article 4.2 should not be allowed to alter the analysis under Article 4.4.

(2241) For these reasons, Gazprom submits that the actual price paid under the Contract is the price that should be compared against market prices for the purposes of assessing whether a price revision request is justified. The Tribunal should not utilise a price which was never paid by Naftogaz.

ii) The calculation of the price under the Contract in January 2009 for the purposes of the delta-delta analysis

(2242) For the purposes of their delta-delta analysis, Naftogaz' experts calculate the price under The Contract in January 2009 using the temporary k-factor of 0.8. Dr Moselle points out that this inappropriate given that the k-factor of 0.8 was meant to provide a time-limited discount. To utilise the k-factor of 0.8 erroneously implies that the discount granted by Naftogaz was meant to be a permanent one and fails to reflect the common intention of the parties about the relationship between contract prices and market prices as of the price revision date (which is in 2011, well after the k-factor of 0.8 was replaced by a k-factor of 1.0). As Dr Moselle notes:

"*The whole purpose of a delta-delta analysis is to maintain an initial relationship between the price of gas and another benchmark. If that initial relationship was designed by the Parties to be altered, it cannot logically be maintained in a delta-delta analysis.*"

VIII.11.3.16.5 Conclusion

(2243) For the reasons given above, Naftogaz' price revision claims should be rejected on the merits.

VIII.11.3.16.6 Naftogaz has, in any event, no right to the adjustment claimed by Naftogaz

(2244) As set out below, the price negotiation provisions do not confer any power to revise the price formula, let alone to re-write the contract in the manner requested by Naftogaz.

VIII.11.3.16.6.1 The adjustment is limited in scope to adjustment of the "Contract Price", not revision of the price formula

(2245) Articles 4.4 and 4.4.1 require the parties to enter into negotiations that are limited in scope to adjustment of the "*Contract Price*" itself "*in accordance with the provisions of this Contract*", including, inter alia, in accordance with the price formula provided in Article 4.1. This follows from the clear wording of the Contract. Article 4.4 provides that the parties "*shall proceed to negotiations to reconsider the contract price in accordance with the provisions of this Contract*" (emphasis added).

(2246) Pursuant to Article 4.1 of the Contract, the "*contract price*" is a fixed amount in US dollars, which is determined on a quarterly basis (Article 4.1 provides, inter alia, that "*The Pn contract price shall be determined as of 1 January, 1 April and 1 October of each Year of Delivery and shall be valid within the corresponding quarter of the Year of Delivery*"). Accordingly, and since Article 4.4 refers to an adjustment of the "*contract price*", it follows from the wording of the Contract that Articles 4.4 and 4.4.1 do not require the parties to enter into negotiations regarding an amendment of the price formula set out in Article 4.1.

(2247) It is evident from the clear wording that it was not the common intent of the parties to require the parties to enter into negotiations regarding anything other than the Contract Price – for example, it was not the parties' intent to require the parties to enter into negotiations regarding the wording of the price formula.

VIII.11.3.16.7 Moreover, any adjustment must be "in accordance with the provisions of this Contract"

(2248) It is undisputed that the negotiations are limited to such matters that are "*in accordance with the provisions of this Contract*" (i.e. that the negotiations which Article 4.4 and 4.4.1 require the parties to enter into are limited in scope). Article 4.4 provides that "*the Parties shall proceed to negotiations to reconsider the contract price in accordance with the provisions of this Contract*".

(2249) Naftogaz' price revision claims are not in accordance with the provisions of the Contract. It is an obvious consequence of the requirement for the negotiations to be "*in accordance with the Contract*" that the parties are not obliged to enter into negotiations that include a complete revision of the price formula.

(2250) Naftogaz complains that Gazprom's argument on this point "*would be circular and prevent any adjustment*". But Gazprom has a very simple and important procedural point that Naftogaz has missed. There is a crucial difference between a clause requiring the parties to negotiate "*to reconsider the contract price in accordance with the provisions of this Contract*" (which is the scope of Article 4.4 that the parties agreed upon) and a clause allowing for the re-writing of the contract formula (which is what Naftogaz is trying to achieve in this arbitration). Changing the price to be paid at any particular time is one thing, but changing the formula for the future is something else entirely. It is one thing to adjust the amount that Naftogaz needs to pay for past deliveries; it is something else entirely to declare that a new formula will apply in respect of the future.

(2251) Gazprom's position is that the price that Naftogaz needs to pay can be the subject of negotiations under Article 4.4, but Article 4.4 does not provide for the contract itself to be re-written. It is fully understandable that the Parties would want to limit the scope of Article 4.4 in this way.

(2252) The most fundamental factor deriving from the price formula set out in Article 4.1 is that the price for the supply of gas is linked to the oil price (this is obvious from the formula since the formula only consists of two fuel indices, namely fuel oil (M and M0) and gas oil (G and G0)). Accordingly, the parties have chosen to link the contract price to oil prices, not to gas spot prices. It follows that a substitution of the oil indices for a gas spot index would not be "*in accordance with the provisions of the Contract*".

(2253) Moreover, Naftogaz has in its price revision claims – in addition to a substitution of the factors M, M0, G and G0 – requested revision of all other elements of the price formula. Obviously, a revision whereby all elements of the price formula are substituted is not "*in accordance with the provisions of the Contract*".

(2254) In fact, Naftogaz agrees that the contractual formulation ""*in accordance with the provisions of this Contract" implies a certain limitation on the permissible revisions to the price formula*".

VIII.11.3.16.8 Article 4.4. does not entitle the Parties to an adjustment of "the price provisions"

(2255) There are some price review clauses that entitle the parties to an adjustment of "*the price provisions*". For example, it is stated in the stylised price revision clause that Naftogaz quotes in its Statement of Claim that the parties are entitled to "*an adjustment of the price provisions*". However, this wording is not used in Article 4.4 of the Contract.

(2256) Moreover, Article 4.4 of the Contract includes the express limitation that "*the Parties shall proceed to negotiations to reconsider the contract price in accordance with the provisions of this Contract*".

(2257) Naftogaz refers to a section in Putting a Price on Energy that explicitly relates to price review clauses that "*included a review clause which allowed for reviews of the pricing provisions*" (emphasis added). Again, however, this wording is different from the wording in Article 4.4 of the Contract.

VIII.11.3.16.9 There is no "industry standard" for the type of adjustment that is permitted

(2258) In order to determine whether the Tribunal has jurisdiction to try Naftogaz' price revision claims it is irrelevant what is "*normally permitted in price revisions*". In any event, it should be emphasised that Naftogaz' allegation that the requested adjustments correspond to an alleged "*industry practice*" is simply not correct.

(2259) In fact, each clause needs to be interpreted carefully pursuant to the specific wording that the parties have chosen in each case.

(2260) Naftogaz refers to Roberts. However, Roberts makes it clear that there can be very different types of mechanism for price review, depending on the particular wording adopted by the parties in each individual case.

(2261) Naftogaz also refers to Brautaset. However, Brautaset's conclusions are based upon the specific wording of the contracts that he is referring to. Moreover, Brautaset expressly states at page

262 – in the paragraph immediately after the paragraphs quoted by Naftogaz – that there is a limit to the type of adjustment that an arbitral tribunal can make:

"*Even though the agreements [i.e. the specific agreements that Brautaset has reviewed] allow for substantial changes to the price formula, certain limitations have to follow from the fact that an adjustment (Adjustment) of the price provisions shall [be] made. An adjustment will hardly include changes so extensive that they result in a new type of price format, e.g. introducing a different type of escalation. This restriction will be relevant for an arbitral tribunal – the parties, however, are here as elsewhere free to change the agreement more radically through negotiations.*"

VIII.11.4 Naftogaz' claims for repayment, damages and interest based on its price revision claims pursuant to Article 4.4 of the Contract

VIII.11.4.1 The Tribunal cannot modify the Price retroactively, i.e. for any period prior to the date of its final award, on the basis of the Contract or Swedish law

VIII.11.4.1.1 Introduction

(2262) Naftogaz claims that the requested price revision shall take effect as from 20 May 2011 (with the alternative dates 17 June 2011 and 27 April 2014 respectively) and that Naftogaz is entitled to repayment of "*overpayments*" made as from that date.

(2263) Gazprom maintains its position that no price revision can be made with retroactive effect. Gazprom refers to what has been stated, and adds the following.

VIII.11.4.1.2 The Parties have not agreed that any price reconsideration should have retroactive effect

(2264) The Tribunal can only decide that any price revision shall have retroactive effect if it can be established that the Parties have agreed in the Contract that a price reconsideration shall take effect retroactively.

(2265) The main issue to be determined by the Tribunal is thus whether the Parties have agreed in the Contract that a price reconsideration shall have retroactive effect.

(2266) It is Gazprom's position that the Parties have not agreed on any retroactivity in the Contract. The burden of proving that the parties have agreed on retroactivity lies with Naftogaz.

(2267) Naftogaz' position is expressed in negative terms; Naftogaz asserts that the parties have not agreed that price revision shall not have retroactive effect. Naftogaz further states that "*[t]he requesting Party's entitlement to repayments from the date of the price revision request follows from the system of the price revision clause*".

(2268) However, the wording of the Contract, the negotiations preceding the Contract and the Parties' subsequent conduct confirm Gazprom's position that the parties have not agreed that price reconsideration shall have retroactive effect. Further, it does not follow from the "*system*" of price reconsideration in the Contract that a price reconsideration clause shall have retroactive effect. These issues will be elaborated upon below.

VIII.11.4.1.3 The wording of the Contract

(2269) It is undisputed between the parties that the Contract does not contain any provision on retroactivity in relation to price reconsideration. The Contract says nothing about retroactivity whatsoever. Such a far-reaching effect of a claim must require express support of the Contract.

(2270) Naftogaz refers to Brautaset as support for its position that a price reconsideration shall have retroactive effect. However, any statement by Brautaset in this regard is completely irrelevant.

(2271) The wording of the Contract consequently confirms Gazprom's position that the parties have not agreed that any price reconsideration shall have retroactive effect.

VIII.11.4.1.4 The Parties' negotiations preceeding the Contract

(2272) The parties' negotiations preceding the conclusion of the Contract also support Gazprom's position that no retroactivity was agreed.

(2273) It is undisputed that a provision on retroactivity was included in previous drafts but was deleted in the final wording of the Contract.

(2274) Naftogaz asserts that "*[i]t is incorrect that the provision on retroactivity of price revision was considered by the Parties and deliberately deleted*". Naftogaz further asserts that "*the clause disappeared in the 13 November 2008 draft without anyone noticing*". However, these statements by Naftogaz are incorrect and denied.

(2275) The provision on retroactivity, included in the drafts of 10 October 2008 and 29 October 2008 respectively, was not deleted by mistake. As confirmed by [redacted] the provision was considered and deliberately deleted by Gazprom in the 13 November 2008 draft.

(2276) The provision regarding retroactivity read as follows:

"*4.3.3. Unless the Parties agree otherwise, a decision or agreement in relation to price reconsideration shall apply retroactively from the date of the request to reconsider the contract price.*"

(2277) In addition to the above provision, there was also a wording relating to retroactivity in Article 4.3.1 of the drafts of 10 October 2008 and 29 October 2008, which read:

"*4.3.1. The request to reconsider the price shall be submitted in writing and shall be duly justified by the Party submitting it, and the effective date for such reconsidered price stated in such request may not be earlier than the notice date. Upon receipt by the corresponding Party of the above-mentioned request, the Parties agree to reconsider the contract price within 10 days.*"

(2278) It is not credible, and it is disputed, that Naftogaz did not notice that the provision on retroactivity in Article 4.3.3, and the wording relating to retroactivity in Article 4.3.3, was deleted.

(2279) The drafts exchanged between the parties were short – containing approximately ten pages – and the provision on retroactivity was a separate provision contained in the section relating to pricing. This would clearly be an important section for Naftogaz to review and analyse before agreeing to any suggested changes or deletions to the contract.

(2280) Moreover, it is irrelevant whether or not Naftogaz actually noticed the deletion of the provision on retroactivity.

(2281) The relevant question (under Articles 8.1 and 8.2 of CISG) is instead whether Naftogaz (or a reasonable person in the shoes of Naftogaz) objectively could so easily have recognized Gazprom's intent to exclude retroactivity so that Naftogaz could not have been unaware of it. It is clear to Gazprom that that was the case. By a simple review of the draft of 13 November 2008 as compared with previous drafts, Naftogaz could easily have noticed that Gazprom had deleted the retroactivity provision. When noticing that, Naftogaz could not have been unaware that Gazprom's intent was to exclude any retroactive effect in relation to any price revision. There would be no other reason to delete the provision. These facts are enough under CISG to establish that the parties' intent under The Contract was that no retroactivity should apply in relation to price reconsideration provisions.

(2282) Gazprom notes that Naftogaz seems to suggest that a party must explain its amendments to the other party in order for such amendments to be binding on that party. If this is Naftogaz' position, it is incorrect and is denied. Each party is responsible for its own scrutiny of drafts that it receives from the other party. Naftogaz cannot merely rely upon its supposed omission to review the drafts sent to it by Gazprom. Gazprom had justified reasons to believe that Naftogaz would make its own review of the draft of 13 November 2008 and of subsequent drafts.

(2283) By not reintroducing the provision regarding retroactivity, or suggesting a similar provision, Naftogaz gave Gazprom justified reasons to believe that the wording of Article 4.4, including the deletion of Article 4.4.3 and the deletion of the wording relating to retroactivity in Article 4.4.1, was accepted and thus that the parties had agreed that no retroactivity would apply on requests for price reconsideration.

(2284) Moreover, Naftogaz did review the drafts carefully. This is confirmed by the drafts submitted in this Arbitration. For instance, Naftogaz commented on the 27 December 2008 draft both on 28 December 2008 and on 13 January 2009, and a number of these comments related to Article 4. Amendments were made to the drafts all the way up to the signing of the Contract on 19 January 2009. It is clear from these drafts that Naftogaz carefully reviewed the drafts received from Gazprom. Further, [redacted] confirms that the parties on the final drafting session carefully reviewed the draft provision by provision.

(2285) The content of the Contract is thus the result of negotiations where both parties have had ample opportunities to review and make suggestions for the final wording. Additions, amendments and deletions must be deemed to have been accepted by the parties upon signing the final version of the Contract.

(2286) Also, there is no suggestion in the contract negotiations that Naftogaz itself had the intention that the Contract should include a right to price revision with retroactive effect. Both [redacted] and [redacted] confirm that the issue of retroactivity was never raised by Naftogaz.

(2287) Naftogaz argues that it "*was fine with the wording*" in the draft of 29 October 2008 where the retroactivity provision was still included. According to Naftogaz this is demonstrated by Naftogaz' letter dated 31 October 2008 , in which Naftogaz did not mention anything about the price revision clause. However, the fact that Naftogaz "*was fine*" with the wording in the draft containing the retroactivity provision is irrelevant to the question whether Naftogaz accepted Gazprom's deletion of the same in the draft of 13 November 2008.

(2288) It is also important to remember that a provision on retroactivity goes both ways, i.e. deleting that provision also meant that Gazprom could not request price increases with retroactive effect, which would of course be to the benefit of Naftogaz.

(2289) In summary, the absence of a retroactivity provision in the Contract must be construed in light of the fact that such provision was considered but deliberately deleted, or – as concerns Naftogaz – accepted to be deleted. This also means that it is even more clear in the case of the Contract that no retroactivity was agreed, as compared to a contract which is likewise silent on the issue of retroactivity but where no previous drafts have contained any retroactivity provision.

(2290) The exchange of drafts preceding the Contract and the deletion of the provision regarding retroactivity demonstrate that the parties have not agreed that any price reconsideration would have retroactive effect. In the absence of such agreement, Naftogaz has no right to a retroactive price reconsideration.

VIII.11.4.1.5 The Parties' subsequent conduct

(2291) The conduct of the Parties following the conclusion of the Contract also confirms that they never intended that a price reconsideration would have retroactive effect.

(2292) If Naftogaz had the view that its request for price reconsideration of 20 May 2011 should have effect as from that date, Naftogaz had ample opportunities to inform Gazprom accordingly. However, Naftogaz did not mention anything about retroactivity until 27 April 2014, i.e. almost three years later.

(2293) There was no mention of retroactivity or repayment in Naftogaz' letter dated 20 May 2011 or its letter dated 17 June 2011. Further, Naftogaz did not mention in any discussion in the years 2011 to 2014 (before its 27 April 2014 letter) that it requested a price reconsideration as from 20 May 2011, or any other date.

(2294) During the period May 2011 to April 2014, the parties entered into [redacted] to the Contract [redacted]. As explained in the Defence and Counterclaim, most of these supplements were the result of Naftogaz' requests for deferral of payments and they typically provided for:

(i) Naftogaz to pay a portion of the amount owing under the preliminary invoice; and

(ii) in relation to the difference between the actual delivery for the relevant month and the amount paid under the preliminary invoice for Gazprom to defer the due date for payment at the interest rate of 6% per annum.

(2295) If Naftogaz was of the opinion that a price reconsideration was pending and had retroactive effect, this should have been addressed in the supplements.

(2296) Naftogaz could have stated that the payments under the supplements were preliminary, that a price review was pending which would affect the ultimate payment obligation, or some such similar statement. However, Naftogaz did not say anything to this effect. There was no mention whatsoever of Naftogaz' request of 20 May 2011 in any of the [redacted].

(2297) [redacted]

(2298) The first time Naftogaz mentioned retroactivity was in its letter of 27 April 2014. This letter was clearly a reaction to the fact that the price pursuant to [redacted] and [redacted] id not continue to apply after the first quarter of 2014. When Naftogaz did not receive the price it wished after the first quarter of 2014, it belatedly attempted to "*revive*" its request from 20 May 2011, and then for the first time Naftogaz alleged that this request should apply retroactively.

(2299) In summary, the fact that Naftogaz said nothing about retroactivity for almost three years, although it had countless opportunities to do so, demonstrates that Naftogaz never considered that a price reconsideration would have retroactive effect.

(2300) Gazprom's subsequent conduct also confirms that the parties have not agreed on any retroactivity. Had Gazprom believed that such retroactivity was agreed, it would obviously have commenced arbitration much earlier in order to preserve its rights, which it did not.

VIII.11.4.2 The system of price reconsideration in the Contract

(2301) Naftogaz also argues that "*[t]he requesting party's entitlement to repayments from the date of the price revision request follows from the system of the price revision clause*".

(2302) However, the only support for this allegation seems to be a reference to Brautaset. Gazprom has already made clear why any statement by Brautaset in relation to retroactivity is completely irrelevant for the interpretation of the Contract.

(2303) The Contract must consequently be interpreted "*as is*". There are a number of features in Article 4.4.1 of The Contract which make it clear that retroactivity does not follow from the system of the price reconsideration prescribed in the Contract. To the contrary, given the particular wording used in Article 4.4, applying retroactivity would be most inappropriate from a systematic point of view, for the following reasons.

(2304) Article 4.4.1 does not contain any express requirement to state what new price the requesting party requires. Further, it does not contain any requirement that a party sets out the date from which the request shall take effect. Moreover, it does not provide for any deadline to initiate arbitration and it does not limit the number of requests a party can make or specify which periods the request should cover.

(2305) Interpreted as Naftogaz' suggests, Article 4.4.1 would mean that a party – knowing that retroactivity had never been discussed between the parties and was not prescribed for in the contract – is fully entitled to submit a request for price reconsideration without stating the price it requires or that the price is required from the date of the request. The requesting party could then negotiate for the prescribed time (20 days), still without specifying what price it seeks, and if no agreement is reached, the requesting party could be passive for several years until it someday decides to commence arbitration. It could then request a completely new price and/or a completely new price formula – not mentioned to the other party before initiating the arbitration – and obtain that price and/or new price formula as from the date of the initial request for price reconsideration.

(2306) This would not be a balanced system of price reconsideration. This would be a completely imbalanced, unfair and unreasonable system with no predictability. On this basis, the requesting party could effective act as it liked, while the respondent party would have no chance to defend itself.

(2307) Consequently, it does not follow from the "*system*" of Article 4.4.1 of the Contract that a price reconsideration shall apply retroactively.

VIII.11.4.3 Naftogaz' repayment claims

VIII.11.4.3.1 Introduction

(2308) Naftogaz is not entitled to any repayment since Naftogaz is not entitled to any price revision and, in any event, since any price revision cannot apply retroactively.

(2309) In the event that the Tribunal were to conclude, contrary to Gazprom's position, that Naftogaz is entitled to a price revision and that such price revision can apply retroactively, then Naftogaz is still not entitled to repayment of any payment made before 27 April 2014.

VIII.11.4.3.2 Naftogaz' arguments for its repayment claim

(2310) As a general basis for its repayment claim, Naftogaz states that "*it is trite law that a party who has paid more than it should have paid has a claim for repayment of the excess*". Naftogaz further states that "*it does not matter if the payment was made without there being a legal ground for the payment or if the payment was correct once made but has become an overpayment*".

(2311) Naftogaz asserts that in this case, the payments were correct once made but later became overpayments. Naftogaz admits that it has not reserved its right to repayment but argues that there is no such requirement under Swedish law. Naftogaz also argues that the payments as such are not legal acts and do not create rights or obligations.

(2312) Naftogaz concludes that a right to repayment would only be excluded "*by virtue of a normal contract law analysis that results in the conclusion that the payer made a binding commitment*". Naftogaz then states that in a situation where the payments were correct once made but later became overpayments it "*cannot see how a contract law analysis could ever lead to the conclusion that payment in [such] case could give any impression whatsoever regarding the repayment claim […]*".

(2313) Naftogaz also asserts that a party only loses its right to repayment if the recipient "*justifiably believed that the payer waived all its potential rights to repayment and the payer must have understood that the recipient was under this impression*".

(2314) In connection with its competition law claims, Naftogaz argues that it "*...has also quite clearly shown that it seeks to recoup the excess payments by initiating the price revision procedure which customarily is to be followed by a repayment claim*". Naftogaz further states that Gazprom "*has been fully aware that Naftogaz has been paying the amounts invoiced by Gazprom on the condition that any excess amounts would be reclaimed following a determination of the applicable price by a competent arbitral tribunal*".

(2315) To summarise, Naftogaz alleges that the right to repayment follows from "*trite law*" and that such right can only be excluded based on a contract law interpretation of the payments made. According to Naftogaz, only if Gazprom justifiably believed that these payments were final and Naftogaz must have understood that Gazprom was under this impression, would Naftogaz lose its right to repayment. Naftogaz asserts that Gazprom cannot justifiably have believed that the payments were final or that this impression must be considered to have been known to Naftogaz.

(2316) Naftogaz refers to NJA 1988 p. 457 and NJA 1989 p. 224 in support of its position, and claims that NJA 1961 p. 18 does not support Gazprom's position.

(2317) Naftogaz lastly claims that Gazprom has waived its right to invoke that Naftogaz has waived its claim.

VIII.11.4.3.2 Naftogaz has no right to repayment under Swedixh law

(2318) It is correct that, under Swedish law, a party who has made a payment without there being a legal ground for the payment may be entitled to repayment. However, there are a number of exceptions to this rule. The right to repayment may inter alia be excluded based on contract law principles, or based on the principle of *condictio indebiti*.

VIII.11.4.3.3 Exclusion of right to repayment based on contract law

(2319) The right to repayment can be excluded based on contract law principles. There is no right to repayment if it can be established that the payment constituted an implicit recognition of debt (Sw. "*konkludent erkännande*"), i.e. a binding commitment to pay.

(2320) It is Gazprom's position that a contract law interpretation of Naftogaz' payments during the relevant period (i.e. 20 May 2011 to 27 April 2014) leads to the conclusion that these payments constituted binding commitments to pay. Naftogaz therefore has no right to repayment under Swedish law.

(2321) Naftogaz asserts that a payment is no legal act and cannot create rights or obligations. In support of this position, Naftogaz refers to Lindskog, Betalning. However, what Lindskog states is that payments as such – i.e. the very transfer of money – are not legal acts, but they can of course have legal effects depending on the legal intention of the payer (Sw. "*rättshandlingsvilja*") as perceivable by the recipient. Lindskog expresses this as follows:

"*An act of payment does thus not constitute its own legal basis and therefore does not in itself create a legal ground. But it can […] depending on the circumstances have contractual effects. Making a payment is thus a typical example of, and perhaps the most common form of, a legal act by conduct. But it is not then a case of the legal effects of the transfer of money, but rather the (typical and, for the recipient visible) legal intention to create a legal act that lies behind the payment (or rather how it in different ways expresses itself).*" (emphasis added, footnotes omitted)

(2322) As is clear from the above, Lindskog concludes that a payment is the most common form of an implied legal act ("*vanligaste formen av ett konkludent rättshandlande*"). He also refers to the typical, and for the recipient visible, legal intention behind the payment ("*den (typiska och för betalningsmottagaren synliga) rättshandlingsvilja som ligger bakom betalningen*"). This means that a payment has an objectively typical legal meaning, i.e. the payer's will to pay. If that was not the payer's intention, this must be explained and demonstrated by pointing at other circumstances. Absent such other circumstances, the recipient has justified reasons to believe that the payment constitutes a binding commitment to pay.

(2323) A particular factor to consider in this context is whether the payer has caused the recipient's justified belief by acting negligently. If so, this should affect the payer's right to repayment.

(2324) Naftogaz' payments, seen in their factual context, make it clear that Naftogaz' legal intention was to make binding payments. At least, this was Gazprom's justifiable impression, which Naftogaz must have understood. Naftogaz is therefore not entitled to any repayment.

(2325) The following points should be taken into consideration when assessing the legal implication of Naftogaz' payments.

i) *Naftogaz made no reservation of rights*

(2326) If a payment of a disputed claim is made without a reservation of right to repayment, the recipient typically has reason to see the payment as a binding confirmation that the payer was liable to pay such amount. Hence, the absence of a reservation of right to repayment is a circumstance, visible to the Gazprom, which demonstrates that Naftogaz intended the payments to be binding.

(2327) Naftogaz seems to suggest that the above does not apply since Gazprom's claims for payment were not disputed at the time the payments were made. This argument is, however, inconsistent with Naftogaz' position in the case. Naftogaz' case is that it requested a price revision on 20 May 2011 and that the contract price as from that date was too high. That obviously means, on Naftogaz' own case, that the invoices issued by Gazprom were disputed at the time Naftogaz made the payments.

(2328) The contract law analysis of Naftogaz' payments should consequently take into account that Naftogaz made payments of disputed claims without reserving its right to repayment. As explained in Gazprom's Defence and Counterclaim, already this fact is enough to establish that Naftogaz intended the payments to be binding commitments. This excludes any right to repayment.

(2329) Naftogaz argues that its payments were made with an implicit reservation. It says that it should be taken into consideration that it was liable to pay the invoices issued by Gazprom until a new contract price had been established. It also expresses this as: "*it had no choice but to pay the amounts invoiced during the price revision process*". This would, according to Naftogaz, mean that the payments were "*already by their nature made with the self-evident, implicit reservation that the sums will be reclaimed following the decision on price. This is well known to Gazprom who is well acquainted with price revision procedures*."

(2330) Gazprom denies these allegations.

(2331) The argument that Naftogaz was liable to pay, or that it had "*no choice*", is in contradiction with Naftogaz' position as set out in its letter of 27 April 2014. In that letter Naftogaz stated that:

"*Naftogaz reserves the right to pay a reasonable price for the deliveries of Natural Gas during any proceedings regarding the price revision. Such payment is in accordance with the provisions of the Contract and does not entitle Gazprom to require advance payments […] and/or to suspend or terminate the performance of its obligations…*"

(2332) It is clear Naftogaz did not consider in April 2014 that it was "*liable to pay*" or that it had "*no choice*" but to pay. This means that its argument that all payments were made with a self-evident reservation is flawed. It is also disputed that Gazprom would somehow understand that the payments were made with an implicit reservation of right to repayment. Naftogaz has not been able to explain how such implicit reservation would be evident to Gazprom.

(2333) According to Naftogaz, this is not a situation of payments by mistake (Sw. "*misstagsbetalning*"). It is instead a situation where Naftogaz has made intentional payments – for three years – whilst knowing, at the time the payments were made, that it had a potential claim for repayment.

(2334) If one would accept Naftogaz' position, it means that the present situation differs from most situations relating to the right to repayment described in the Swedish legal literature. Naftogaz obviously merits less protection as compared to a party who paid by mistake, or a party who paid intentionally but later found out that it had a potential repayment claim. The fact that Naftogaz already knew at the time it paid that it had a potential repayment claim, must put on Naftogaz an obligation to act in order to preserve any right to repayment.

(2335) Consequently, if Naftogaz believed that it had a price review request pending at the time the payments were made, and that such price review request would potentially result in a repayment claim, then Naftogaz should have informed Gazprom of that at the time the payments were made. It would have been very easy for Naftogaz to do so, but still it did not, not for three years. Not informing Gazprom of this "*implicit reservation*" was negligent at its best, bad faith at its worst, and it contributed to Gazprom's justified belief that the payments were final. Naftogaz has consequently caused Gazprom's justified belief by acting negligently and must therefore be bound by its payments.

(2336) To conclude, the fact that Naftogaz made 175 payments of disputed debts without reserving its right to repayment demonstrates that its legal intention was to make binding commitments. At least this was Gazprom's justified belief, which Naftogaz must have understood.

ii) *Naftogaz made no reservation* [redacted]

(2337) Gazprom's justified belief that Naftogaz' payments were final was strengthened by the fact that the parties – on Naftogaz' initiative – entered into [redacted] relating to deferral of payments and payment details. In [redacted] Naftogaz made binding commitments to pay certain amounts at certain points in time. Yet in none of these [redacted] did Naftogaz reserve its right to repayment.

(2338) It has not been contested by Naftogaz that the [redacted] were binding legal acts. Accordingly, these [redacted] are firm proof of Naftogaz' intention to make final payments, and in any event, of Gazprom's justified belief which Naftogaz must have understood.

iii) *Naftogaz made no reservation during the Parties' negotiations*

(2339) Naftogaz did not at any point in time during the parties' negotiations (before 27 April 2014) indicate to Gazprom that payments made after 20 May 2011 were preliminary or made with any reservation.

(2340) Naftogaz had ample opportunities after 20 May 2011 to clarify that it would request repayment upon an agreement between the parties – or upon a decision by a Tribunal – on a new contract price. Still, it chose not to mention this. Clearly, it would have made a huge difference for Gazprom if it had known in the discussions that Naftogaz would request repayment of amounts already paid.

(2341) If properly informed, Gazprom would inter alia have had the possibility to take a well-founded decision whether to initiate arbitral proceedings at a much earlier point in time. Further, it is clear that Gazprom would not have agreed to enter into [redacted] – or at least not in the terms set out – if it had known that Naftogaz would request repayment of amounts as from 2011, including amounts paid under [redacted]

(2342) The fact that Naftogaz did not mention anything about repayment during the parties' negotiations, including the negotiations of [redacted], is clear evidence that Naftogaz intended the payments to be final (i.e. binding commitments to pay). If it did not intend the payments to be final, but chose not to inform Gazprom hereof, it acted in bad faith or at least negligently, in particularly in connection with the conclusions of Addendum [redacted]

(2343) At least, Naftogaz' silence during the parties' negotiations after 20 May 2011 is clear evidence that Gazprom had justifiable reasons to believe that payments made up until 27 April 2014 were final.

iv) *Naftogaz' arguments in relation to Gazprom's justified belief*

(2344) Naftogaz has no real arguments for why Gazprom should have understood that the payments were not final. Naftogaz only makes general statements to the effect that Gazprom should have understood that a claim for repayment follows a request for price revision and that Gazprom should have understood that its price was excessive. These general arguments are denied.

(2345) As referred to above, Naftogaz argues that it "*has also quite clearly shown that it seeks to recoup the excess payments by initiating the price revision procedure which customarily is followed by a repayment claim*". These statements are incorrect and are disputed.

(2346) First, it is disputed that Naftogaz has initiated any proper price reconsideration procedure in accordance with the Contract.

(2347) Second, even if the Tribunal would conclude that Naftogaz has initiated a proper price reconsideration procedure, Naftogaz has definitely not "*clearly shown*" that it would seek repayment within the frame of such procedure. In fact, it stated nothing to this effect before the start of this arbitration, despite having ample opportunities to do so.

(2348) Third, it is disputed that a price revision procedure is "*customarily*" followed by a repayment claim. Naftogaz has not demonstrated any such custom – which in order to be relevant must cover agreements which do not contain any provision on retroactivity. As said above, the Contract did not contain any provision on retroactivity, which means that Gazprom did not expect any retroactivity to apply.

(2349) Naftogaz also states that Gazprom "*has been fully aware that Naftogaz has been paying the amounts invoiced by Gazprom on the condition that any excess amounts would be reclaimed following a determination of the applicable price by a competent arbitral tribunal*". This is not correct and Naftogaz does not explain what circumstances would have made Gazprom aware that Naftogaz' payments were conditional. Neither does Naftogaz provide any evidence in support of its allegation.

(2350) Naftogaz also argues that Gazprom "*must have been aware that the price has been excessive*" and therefore cannot have had any justified impression that the payments were final. Naftogaz refers to NJA 1989 p. 224 in support for its allegation. Gazprom disputes Naftogaz' statements. The price under the Contract has not been excessive. As regards NJA 1989 p. 224, this case does not support Naftogaz' position. Since the case concerns the principle of condictio indebiti, it will be discussed further below.

(2351) Naftogaz has also referred to NJA 1988 p. 457. However, it has not stated what circumstances in the case it invokes in support of its position.

(2352) In this case, a municipality had charged excess fees for water and sewerage (Sw. "*VA-avgifter*") from a property owner, i.e. higher fees than allowed according to the applicable legislation. The Supreme Court concluded that a right to repayment of illegal excessive fees was not inconsistent with the basis for the applicable legislation. The Supreme Court further concluded that there were no circumstances in the case that spoke against a right to repayment.

(2353) However, this case has no bearing on the present case. Gazprom is not a public body that has charged excessive payments in violation of any legislation. It is undisputed that Gazprom has requested payments in accordance with the Contract. Moreover, in the present case and as set out in this section, there are a number of circumstances that speak against repayment.

vii) *Naftogaz must have understood Gazprom's justified belief*

(2354) Based on the circumstances described above, Naftogaz must have understood that Gazprom believed that the payments were final. Any creditor which makes a large number of payments, during a long period of time, without reserving its right to repayment or in any other way indicting that the payments are not final, and without an express provision in the contract to support its right to repayment, must understand that the recipient will have a justified belief that such payments are final.

(i) To conclude, the following circumstances demonstrate that Naftogaz' payments up until 27 April 2014 were intended to constitute binding commitments, and in any event, that this was Gazprom justified belief which Naftogaz must have been aware of:

(ii) Naftogaz made 175 payments without reserving its right to repayment,

(iii) Naftogaz did not reserve its right to repayment i[redacted]

(iv) Naftogaz did not during the parties' negotiations mention that it would request repayment in case the contract price was reconsidered,

(v) The Contract did not contain any provision entitling Naftogaz to repayment, and

(vi) Naftogaz made a clear reservation of rights after the arbitration had commenced.

VIII.11.4.3.3.1 Exclusion of right to repayment based on condictio indebiti

(2355) Naftogaz does not expressly invoke a right to repayment based on condictio indebiti. However, it invokes case law relating to this legal principle. It is Gazprom's position that the exemptions from a right to repayment that follows from the principle of condictio indebiti are relevant to this case. At the least, Naftogaz cannot have a further right to repayment than follows from this principle.

(2356) The principle of condictio indebiti refers to situations where a party has made a payment without there being a legal ground for the payment. These payments are often referred to as payments by mistake (Sw. "*misstagsbetalning*") which clarifies that they contain a certain element of mistake, legal or factual.

(2357) The right to repayment must always be considered based on the specific circumstances of a case. Particular consideration shall be given to what is a rational solution in the economic society, and a most important aspect is the general interest of legal security and business relations. Further, the right to repayment is more extensive when it comes to consumer relationships, compared to relations between equal parties.

(2358) As clarified above, Naftogaz has not made any payments by mistake. Naftogaz confirms that the payments were made intentionally and that they were "*correct once made*". Naftogaz instead argues that the payments "*later became overpayments*". The fact that Naftogaz did not make the payments by mistake obviously speaks against a right to repayment based on condictio indebiti. In addition, Gazprom was in good faith regarding its right to receive the payments. Gazprom has also adapted to the payments made. These points will be considered in more detail below.

i) *Gazprom's good faith*

(2359) All the circumstances described above confirm that Gazprom had justified reasons to believe that Naftogaz' payments were final, i.e. that Gazprom acted in good faith.

(2360) Naftogaz has invoked NJA 1989 p. 224 in support of its position that Gazprom could not have had any justified impression that the payments were final. However, the circumstances in this case differ from the present case. In NJA 1989 p. 224 a municipal housing company had charged additional payments from a consumer relating to compensation for indexation. It was established that the charged amount had no support in the parties' agreement. The Supreme

Court concluded that the company was not in good faith in relation to the payments received. At the time of the payments, the company had already received reactions to the charged index compensation, it was aware of court proceedings pending in corresponding matters, and even aware of an award to the benefit of a consumer. In those circumstances, the Supreme Court held that the company could not have been certain of its right to charge the additional index compensation.

(2361) Unlike NJA 1989 p. 224, it is undisputed that Gazprom's claims for payments had support in The Contract. It is also undisputed that Naftogaz did not reserve its rights or convey to Gazprom that it had a potential claim for repayment. There were no other circumstances that could give Gazprom the impression that it was not entitled to the payments made by Naftogaz. Consequently, NJA 1989 p. 224 does not support Naftogaz' position.

(2362) Gazprom maintains that NJA 1961 p. 18 supports Gazprom's position. In this case the Supreme Court concluded that since the claim had been discussed between the parties, the recipient had reason to believe that the payment was made after a careful consideration of the legal situation by the payer. In the present case, the parties have discussed the price on different occasions. Gazprom consequently had all reason to believe that payments made by Naftogaz following letters and discussions between the parties relating to pricing, were made after careful consideration of the legal situation by Naftogaz.

(2363) It should also be taken into account that Naftogaz has contributed to Gazprom's position of good faith by not reserving its rights or informing Gazprom of its potential claim for repayment.

(2364) The number of payments has also contributed to Gazprom's position of good faith. The more payments Gazprom has received without any claim for repayment or reservation of rights, the more reason Gazprom has had to believe that future payments were also final.

(2365) To conclude, the circumstances in this case make it clear that Gazprom has received Naftogaz' payments in good faith.

ii) *Gazprom has adapted to the payments received*

(2366) As set out above, when assessing the adaption requirement, time is of essence. The longer time it takes before a repayment claim is made the more the recipient has adapted to the payment.

(2367) In this case, Naftogaz has been passive for three years.

(2368) Gazprom has evidently adapted to the payments made during these years. In NJA 1994 p. 177, repayment was sought after eleven days and was rejected. In NJA 1999 p. 575, repayment was sought after one hour and was rejected. In NJA 2001 p. 353, repayment was sought after nine months and was rejected.

(2369) It is clear that accepting a right to repayment after such long time, and in such high numbers, would not be a rational solution in the economic society, and it would be contrary to the general interest of legal security and business relations.

VIII.11.4.3.3.2 Gazprom has not waived any rights

(2370) Naftogaz suggests that Gazprom has waived its rights to invoke that Naftogaz has waived its rights. This is disputed both as to facts and as to law.

(2371) Further, Naftogaz misrepresents Gazprom's position. Gazprom's position is that Naftogaz has no right to repayment because it has made an implicit recognition of debt and because Gazprom has in good faith adapted to the payments made. Gazprom has not waived its right to invoke this defence against Naftogaz' repayment claims. The case referred to by Naftogaz, NJA 1993 p. 436, has no bearing on the present case.

VIII.11.4.3.4 Naftogaz' damages claims

VIII.11.4.3.4.1 Introduction

(2372) As an alternative to its claim for repayment based on Article 4.4 of the Contract, Naftogaz claims damages pursuant to Articles 4.4.2 and 6.1 of the Contract.

(2373) It is not clear what breach of contract Naftogaz suggests that Gazprom has committed.

(2374) As regards the alleged breach of contract, Naftogaz makes contradictory statements. Naftogaz states that:

"*[D]amages can be awarded against a party who generally fails to negotiate in good faith before a contract is entered into (culpa in contrahendo) […]. It follows, a fortiori, that damages can also be awarded against a party that fails to negotiate in good faith where such party has gone further and in fact contractually committed itself to negotiate, e.g. under a renegotiation clause.*" (Emphasis added.)

(2375) This statement, which is the only comment given by Naftogaz under the heading "*Renegotiation clauses and damages under Swedish law*", gives the impression that Naftogaz' position is that

Gazprom had a contractual obligation to negotiate ("…*committed itself to negotiate*") and that Gazprom has breached this obligation by failing "*to negotiate in good faith*".

(2376) This statement by Naftogaz actually fully supports Gazprom's position – that Article 4.4 of the Contract is a price negotiation clause and that consequently the parties' only obligation in Article 4.4 is to negotiate a reconsideration of the Contract Price, not to agree on a revised contract price. If this is not Naftogaz' position, Gazprom fails to understand why Naftogaz has made the statement quoted above.

(2377) However, Naftogaz also suggests that the contractual obligation, allegedly breached by Gazprom, is to agree on a revised contract price within the period prescribed in Article 4.4.2 (i.e. three months):

"*Thus, each Party has the right to 'dispute the other party's performance' […] unless a written agreement on the revision of the Contract Price has been reached within three months from the beginning of negotiations. The 'performance' of the Contract is 'written agreement on the revision of the Contract Price' […]. If one Party does not perform, i.e. agrees to a revision of the Contract Price within the time limit in [Article] 4.4.2, the other Party will suffer from paying more (or getting paid less) than he is entitled to after the expiry of such time limit.*" [Naftogaz' translation]

VIII.11.4.3.5 The relationship between Naftogaz' damages claim and its claim for price revision

(2378) Naftogaz purports to explain the relationship between its claims for declaratory relief (i.e. price revision and price determination) and its "*monetary claims*" (i.e. the claims for repayments and/or damages). Naftogaz states that "*the primary grounds*" for the monetary claims reflect the claims for declaratory relief. This means that Naftogaz' damages claim is based on the assumption that the Tribunal has first granted Naftogaz' claim for price revision and/or price determination (on one of the grounds invoked by Naftogaz).

(2379) However, it seems that Naftogaz has a claim for damages also in the situation where the Tribunal has denied all Naftogaz' claims for declaratory relief (i.e. Naftogaz' claims for price revision and price determination). Naftogaz states that: "… *even if the Tribunal would deny all of Naftogaz' requests for declaratory relief in this respect, it is still free to award Naftogaz monetary relief pursuant to request 4)*". It is not clear what legal ground Naftogaz invokes in support of such alternative damages claim. Naftogaz merely states that "*for any partial contract* *period … the Tribunal may find that Naftogaz has indeed paid a too high price*". Hence, Naftogaz does not say whether such claim is based on breach of contract, competition law or something else. Gazprom requests that Naftogaz clarifies its position in this regard. Until this has been done, Gazprom cannot respond to any such alternative damages claim.

(2380) Consequently, Gazprom only responds to the damages claim that is connected to the requests for declaratory relief.

VIII.11.4.3.6 Starting points for assessing Naftogaz' damages claim

(2381) Naftogaz' claim for damages pursuant to Articles 4.4.2 and 6.1 of the Contract is based on a revised contract price, i.e. based on the assumption that the Tribunal has granted price revision based on Article 4.4. It is further made in the alternative to its claim for repayment. This means that the Tribunal should only try the claim if (i) the Tribunal accepts Naftogaz' price revision claim based on Article 4.4 of the Contract, and (ii) denies its claim for repayment.

(2382) The right to damages under CISG (Article 74) presupposes that the following basic prerequisites are proven by Naftogaz:

(i) Gazprom must have breached a contractual obligation;

(ii) Gazprom's breach must have caused Naftogaz' damage; and

(iii) The damage must have been foreseeable at the time of the conclusion of the Contract, as a possible consequence of the breach of contract.

(2383) Any right to damages is forfeited if Gazprom's failure to fulfil the alleged contractual obligation was caused by Naftogaz' act or omission (CISG Article 80). Any right to damages will also be lost to the extent that Naftogaz has not mitigated its loss (CISG Article 77). Lastly, under general principles of Swedish contract law, Naftogaz' right to damages is forfeited if Naftogaz has failed to give notice of breach to Gazprom in due time.

(2384) Gazprom will demonstrate below that the requirements set out above are not met, and that Naftogaz' claim for damages based on a revised contract price must therefore be rejected.

VIII.11.4.3.7 Gazprom's position

(2385) Gazprom maintains its defence to Naftogaz' damages claim i.e. that:

(i) Gazprom has no obligation under Article 4.4.2 of the Contract to agree on any revised price formula;

(ii) Naftogaz has not during negotiations presented a revised price formula, in any event not any price formula which corresponds to the price formula claimed in this arbitration; and

(iii) Naftogaz has not suffered any damage.

(2386) In addition to the above, Gazprom also invokes the following basis for rejection of Naftogaz' damages claims:

(i) The alleged damage was not foreseeable;

(ii) The alleged damage was caused by Naftogaz' act or omission;

(iii) Naftogaz has not mitigated its loss; and

(iv) Naftogaz has not given timely notice of claim.

(2387) Gazprom will develop each of these defences below.

VIII.11.4.3.8 Gazprom has no obligation under Article 4.4.2 to agree on any revised price formula

(2388) Naftogaz suggests that Gazprom's defence under (1) above, i.e. that Gazprom has no obligation under Article 4.4.2 of the Contract to agree on any revised price formula, is only a reiteration of Gazprom's defence in relation to Naftogaz' price revision claim as such. Naftogaz therefore merely refers to what it has stated in relation to its price revision claim.

(2389) Naftogaz suggestion is, however, not entirely correct. Although Gazprom's underlying substantive arguments are the same, it does not follow that, if Gazprom's defence in relation to price revision fails, then Gazprom's defence in relation to the damages claim also fails.

(2390) If Gazprom's defence in relation to price revision fails and the Tribunal concludes that Naftogaz is entitled to a price revision based on Article 4.4 of the Contract, this does not mean that Gazprom has necessarily committed a breach of contract. It would only mean that the Tribunal, contrary to Gazprom's position, has interpreted the Contract to include a price revision clause and that the requirements for a price revision as requested by Naftogaz, are fulfilled.

(2391) Whether or not Gazprom has committed a breach of contract by not agreeing to the price formula requested by Naftogaz, or to any price formula, is a separate issue. It is Gazprom's position that it has not committed any breach of contract, as will be explained further below.

(2392) As Gazprom has argued above, there is nothing in Article 4.4 that stipulates that either of the parties would commit a breach of contract by not accepting the other party's proposal for a new contract price.

(2393) Another reason why it is clear that Article 4.4 cannot be interpreted to include a contractual obligation to agree on a new contract price is because it would be impossible for a party to know when it breaches such an obligation. Neither party could possibly know what price it would have to accept in order to avoid a liability for damages. This is clear already from the provision itself – which sets out vague factors in respect of which assessments are to be made – but also from the fact that two prominent teams of experts in this arbitration have completely different views on what the relevant market price is. The fact that a party would not be able to know or assess its contractual obligation is a clear indication that the provision cannot be interpreted as a contractual obligation to agree, and certainly not a contractual obligation to agree which is sanctioned by damages.

(2394) If the Tribunal were to conclude that Article 4.4 contains a procedure for determining the contract price independent of a breach of contract, the fact Article 4.4.2 does not contain any contractual obligation to accept the other party's proposal for a new contract price implies that Gazprom has not committed any breach of contract. Naftogaz' claims for damages based on Article 4.4.2 should therefore be rejected.

VIII.11.4.3.9 Naftogaz has not during negotiations presented a revised price formula, in any event not any price formula which corresponds to the price formula claimed in this arbitration

(2395) If, contrary to Gazprom's position, the Tribunal were to conclude that Article 4.4 contains a contractual obligation to accept the other party's proposal for a revised contract price, it would be necessary to investigate what price Gazprom would have been obliged to accept.

(2396) Naturally, Gazprom cannot have been under an obligation to accept a contract price that was not suggested or presented by Naftogaz during the parties' negotiations. That would be an impossible obligation to fulfil. Yet, this is exactly what Naftogaz suggests.

(2397) Naftogaz bases its damages claim on Gazprom's "*failure to agree on the revision of the Contract Price requested by Naftogaz*". It is however undisputed that Naftogaz has not presented the price formula it now seeks at any time before submitting its Statement of Claim. Naftogaz never presented this price formula during the parties' negotiations. Consequently, Gazprom has obviously not been able to agree to that price formula during the parties' negotiations.

Gazprom has therefore not failed to agree on the price requested by Naftogaz and has therefore clearly not committed any breach of Article 4.4. Naftogaz' claim for damages should also for this reason be rejected.

VIII.11.4.3.10 Naftogaz has not suffered any damage, at least not any compensable damage

(2398) Since Gazprom has not committed any breach of contract, Naftogaz has not suffered any damage. However, if (contrary to Gazprom's position) the Tribunal were to conclude that Article 4.4.2 should be interpreted to mean that Gazprom was under a contractual obligation to agree to the price formula that Naftogaz undisputedly did not present during the parties' negotiations, then Naftogaz has in any event not suffered any compensatable damage.

(2399) First, the alleged damage, i.e. the alleged "*overpayments*", are not consequences of the alleged breach. They are, if anything, consequences of the fact that Naftogaz chose to make payments without reserving its right to repayment and/or that Naftogaz chose not to initiate arbitration at a much earlier point in time.

(2400) Moreover, on Naftogaz' own case it could have initiated arbitration as early as 8 September 2011.

(2401) Had Naftogaz acted differently, it would have avoided any such alleged "*overpayments*", or at least a substantial number of them. The "*overpayments*" are consequently consequences of Naftogaz own acts and/or omissions, which excludes any right to damages under CISG Article 80.

(2402) Second, the alleged damage was not foreseeable to Gazprom at the time the Contract was concluded. Gazprom could never have foreseen that it would be liable to pay damages for not agreeing to a revised price that was not presented to it during the parties' negotiations.

(2403) Third, the omission to reserve its right to repayment and/or initiate arbitration at a much earlier point in time are also circumstances which demonstrate that Naftogaz has not mitigated its loss.

The extent of such failure could correspond to as much as the entire damage claimed, which excludes any right to damages under CISG Article 77.

VIII.11.4.3.11 Naftogaz has not given notice of breach in due time

(2404) In addition to the above, Naftogaz has lost any right to invoke the alleged breach of contract since it has not given notice of breach in due time.

(2405) CISG contains certain provisions relating to the obligation to give notice of breach. Article 39 provides that the buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller within a reasonable time after he has discovered or ought to have discovered the defect, and at the latest within two years. Article 43 contains an obligation to give notice within a reasonable time in cases of legal defects of the goods.

(2406) However, CISG does not contain any provision that covers the present situation, i.e. where the buyer relies on an alleged breach of contract not related to defects in the goods. Hence, CISG does not contain any provisions regarding a general duty to give notices of breach. Instead, Swedish general contractual principles in commercial relationships relating to the obligation to give notice of breach (Sw. "*reklamation*") apply in this regard.

(2407) Under Swedish law, a party who wishes to make claims as a result of a breach of contract, cannot stay passive. This has, inter alia, been confirmed by the Supreme Court in NJA 2007, p. 909. The existence of a general duty to give notice of breach is also widely confirmed by Swedish legal scholars.

(2408) One strong reason for such obligation to exist is that the breaching party should be informed that claims can be brought against it so that it can adapt to such claims.

(2409) In the present case, Gazprom had a justified and very clear need to be informed that Naftogaz considered Gazprom to be in breach of the Contract by not agreeing to a revised contract price as requested by Naftogaz (or even a price that was not requested by Naftogaz), and that claims for damages could follow. If it had been properly informed, Gazprom could have acted accordingly – for example, by continuing negotiations in respect of the price provisions, or by making alternative proposals in respect of other matters in an attempt to reach agreement, or by acting differently in respect of payments both under the Contract and under the related Transit Contract, or alternatively by initiating arbitration much earlier to protect its rights.

(2410) Naftogaz suggests that Swedish law requires express statutory support for a party to lose its rights on account of failed or late notices. In this respect, Naftogaz refers to the arbitral award in the case Profilgruppen AB v. KPMG AB. However, this award has been set aside by the Svea Court of Appeal. Further, it is Gazprom's position that the conclusions drawn in the award relating to the obligation to give notice do not reflect current Swedish law. The conclusions by the tribunal in the Profilgruppen-award have not been confirmed by the Supreme Court. Moreover, the conclusions have been questioned in a later arbitral award rendered by an arbitral tribunal consisting of former Supreme Court Justice Torgny Håstad, Mr Johan Scheling and Mr Christer Danielsson, in the case PCG Tools AB v. Bergenstråhle & Lindvall Aktiebolag. The tribunal in that case specifically commented on the award in Profilgruppen AB v. KPMG AB as follows:

"*The tribunal in the present case cannot agree that an unconditional loss of rights by reason of the fact that notice (Sw. reclamation) has not been given within a shorter time period would require specific support in legislation, or that there is not sufficient support in the case law of the Supreme Court for a general principle of notice (Sw. reclamation) in commercial relationships, not specifically provided for by legislation, analogous to e.g. section 32(1) of the Sale of Goods Act.*"

(2411) The tribunal also stated that the Supreme Court and the Swedish legal literature confirm that there exists a general duty to give notice of breach in commercial relationships:

"*The Supreme Court has in several cases considered that there is a requirement to give notice (Sw. reklamation) outside the contractual relationships regulated by legislation. See, inter alia, NJA 1943 p. 272 concerning construction contracts (similarly NJA 1931 p. 208), NJA 1992 p. 728 and NJA p. 142 concerning leasing and NJA 2007 p. 909 concerning distribution agreements.*"

...

And further: "*There is also support in legal literature for a general legal principle of a requirement to give notice (Sw. reclamation) which, if not complied with, gives rise to a preclusion of the right to bring a claim (see, inter alia, Johnny Herre, Något om reklamationsplikten vid köp av varor och tjänster, Festskrift till Gertrud Lennander, 2010 p. 119 ff. and Christina Ramberg, Reklamation mot advokater och revisorer, Svensk Juristtidning 2010 s. 142 ff. with references).*"

(2412) To conclude, under Swedish law there exists a general obligation to give notice of breach in commercial relationships, i.e. also without express statutory support. The effect of such failure is a preclusion of rights.

(2413) As regards the time limit for giving notice of breach, this varies depending on the parties and the circumstances of the case. In a few cases the Supreme Court has accepted that notice was given after a couple of months (NJA 1977 p. 138, NJA 1992 p. 728, NJA 2008, p. 1158). In another case the Supreme Court concluded that notice was given too late when it was given after five months (NJA 1993 p. 436).

(2414) In this case, Naftogaz has put forward three different dates as starting points for Gazprom's alleged breach of contract: 8 September 2011, 5 October 2011 and 13 August 2014. These dates correspond, according to Naftogaz, to the end of the negotiation period set out in Article 4.4.2 of the Contract. When assessing the time within which Naftogaz should have given notice of beach, these dates are the starting points.

(2415) However, Naftogaz did not give notice of breach until it submitted its Reply on 8 October 2015. Before its Reply, Naftogaz did not invoke any breach of contract in support of its claims. The notice of breach was thus given more than four years after the alleged breach of 8 September 2011 and 5 October 2011, respectively. It was further made more than one year after the alleged breach of 14 August 2014. In all these cases, notice was given far too late.

(2416) Even if Naftogaz would be considered to have given notice of breach by submitting its Statement of Claim of 31 January 2015 or its Request for Arbitration of 17 June 2014, such notices would have been made years after the alleged breach of contract in 2011 and thus be far too late. Further, in relation to the alleged breach of 14 August 2014, the Statement of Claim would also be too late.

(2417) To conclude, Naftogaz has not given notice of breach in due time. Naftogaz has therefore lost its right to invoke the alleged breach.

VIII.11.4.3.12 Summary

(2418) In summary, Naftogaz has not proved that the prerequisites for a right to damages are fulfilled. In particular:

(i) Article 4.4.2 does not contain any obligation to agree to the other party's proposal for a new contract price.

(ii) Naftogaz did not, during the parties' negotiations, present the price formula it now requests, and Gazprom has therefore not breached any obligation to agree to such price formula.

(iii) The alleged damage has been caused by Naftogaz' acts and omissions.

(iv) Gazprom could not foresee that it would be liable for damages for not agreeing to a price formula that was not presented to it during the parties' negotiations

(v) Naftogaz has not mitigated its loss.

(vi) Naftogaz has not given timely notice of breach and has therefore lost its right to invoke the alleged breach.

VIII.11.4.4 Naftogaz' interest claims

VIII.11.4.4.1 Introduction

(2419) Naftogaz claims both yield interest and delay interest pursuant to Sections 2 and 4 of the Swedish Interest Act "*on any overpaid amounts*". Naftogaz states that:

(i) "*Yield interest is principally payable from 20 May 2011 (from the date of payment) until and including 17 June 2014*"; and

(ii) "*Delay interest principally is payable from and including 18 June 2014 (from the date of payment or, if payment has been made prior to 18 June 2014, from and including 18 June 2014)*".

(2420) In the alternative, Naftogaz states that delay interest is payable from and including 1 February 2015, alternatively from and including 9 October 2015, or alternatively as from the date of the award in accordance with the requests for relief. Naftogaz furthermore states that yield interest is payable until the date delay interest starts accruing.

(2421) Naftogaz also introduces claims for yield interest and delay interest on its damages claims based either on Gazprom's alleged violation of Articles 101 and 102 TFEU or alleged breach of Articles 4.4 and 6.1 of the Contract.

(2422) Naftogaz further refers to Appendix 3 to its Reply and states:

"*Appendix 3 sets out the different partial capital amounts and the respective payment dates as well as Naftogaz' calculation of each capital amount based on Naftogaz' highest monetary* *claim (which is the same for the highest repayment and damages claims). In the same Appendix we set out Naftogaz' calculations of accrued interest up until 31 August 2015. However, in accordance with the principle of major includit minor, the request for interest includes any lower amount of repayment (or lower damages) in each specified period that the Tribunal may arrive at*".

VIII.11.4.4.2 Naftogaz' interest claims must be rejected on the merits

(2423) Naftogaz' claims regarding price revision, price determination, repayment and damages must be rejected, and consequently Naftogaz' corresponding interest claims must also be rejected.

VIII.11.4.4.3 Naftogaz' alleged payments and payment dates as set out in Appendix 3 to the Statement of Reply

(2424) Gazprom is not in a position to confirm the payments and payment dates set out in Appendix 3 to the Statement of Rejoinder. Gazprom can now state the following:

(i) the payment allegedly made on 04/11/2011 was received by Gazprom on 07/11/2011,

(ii) the payment allegedly made on 07/12/2012 was received by Gazprom on 10/12/2012,

(iii) the payment allegedly made on 04/01/2013 was received by Gazprom on 09/01/2013, and

(iv) the payment allegedly made on 30/03/2014 was received by Gazprom on 30/05/2014.

VIII.11.4.4.4 Naftogaz is not entitled to yield interest pursusant to section 2 of the Swedish Interest Act

(2425) Naftogaz' monetary claims do not relate to debts in respect of the reimbursement of payment upon termination of a contract due to a breach of contract or similar grounds. Thus, Section 2 paragraph 2 of the Swedish Interest Act is not applicable to Naftogaz' monetary claims and there is no reason to apply it by analogy in the present case.

(2426) All of Naftogaz' claims for yield interest pursuant to Section 2 paragraph 2 of the Swedish Interest Act must therefore be rejected. Thus, Naftogaz' claims 5.1.1 a), b), c), d), 5.1.2 b), c), d), 5.1.3 b), c), 5.1.4 b) and 5.2 f) must be rejected.

VIII.11.4.4.5 In any event, Naftogaz is not entitled to yield interest pursuant to section 2 of the Swedish Interest Act on any claim based on a revised price pursuant to Article 4.4 of the Contract

(2427) No interest pursuant to Section 2 of the Swedish Interest Act accrues on a claim for repayment which is based on a contractual provision.

(2428) As expressed by Stefan Lindskog:

"*When the repayment claim is based on a contractual provision it is considered that it is up to the parties to regulate the issue of interest. Thus, in such cases no yield interest accrues pursuant to the Swedish Interest Act.*"

(2429) This principle was also applied by the Swedish Supreme Court in NJA 1987 p. 763, where the Court rejected a claim for interest pursuant to Section 2 of the Swedish Interest Act on a claim for repayment based on a contract between two parties.

(2430) Naftogaz states that "*[t]he requesting Party's entitlement to repayments from the date of the price revision request follows from the system of the price revision clause*" (emphasis added), and that "*[…] the provisions governing the opening and closing of a price revision in [Article] 4.4 means that the Party receiving a claim for price revision will be put on notice that the other Party is overpaying or is underpaid (as the case may be), and may limit its exposure by referring the matter to arbitration for a final decision […]*".

(2431) Thus, according to Naftogaz the repayment claims following a price revision are based on Article 4.4 of the Contract. Consequently, the claims are based on a contractual provision, and, as noted above, no interest pursuant to Section 2 of the Swedish Interest Act accrues on such claims.

(2432) Therefore, Naftogaz' Claims 5.1.1 a), b), c), d), 5.1.2 b), c), d), 5.1.3 b), c), and 5.1.4 b) must be rejected to the extent they are based on Article 4.4 of the Contract.

VIII.11.4.4.6 In any event, Naftogaz is not entitled to interest pursuant to section 2 of the Swedish Interest Act on any claim for damages

(2433) Naftogaz also sets out claims for damages based either on Gazprom's alleged violation of Articles 101 and 102 TFEU or alleged breach of Articles 4.4 and 6.1 of the Contract. Naftogaz also claims interest pursuant to Section 2 of the Swedish Interest Act on its damages claims.

(2434) Naftogaz asserts that: "*[…] both damages claims are effectively claims for repayment of overpaid amounts. If yield interest would not be payable on said amounts, Naftogaz would be refused compensation for its loss of the ability to earn a yield on the amounts (and Gazprom* *would benefit accordingly) even though there is no practical difference from the situation where Naftogaz seeks interest on repayment of overpaid amounts based on price revision/adjustment and/or price determination. Yield interest in accordance with Sections 2 and 5 of the Swedish Interest Act is therefore payable on any damages amounts payable by Gazprom (as from the date of payment of the relevant amounts) in analogy with Section 2 of the Swedish Interest Act*".

(2435) Gazprom refutes this assertion. Section 2 of the Swedish Interest Act is not applicable to damages claims and there is no reason to apply it by analogy in the present case. See RH 1995:98.

(2436) Furthermore, Naftogaz requests the Tribunal to determine the [redacted] under the Contract for different periods based on [redacted]

(2437) On the basis of its declaratory relief sought in relation to price determination, Naftogaz then sets out its monetary claims. Insofar as Naftogaz is seeking to be paid the difference between the price allegedly paid by Naftogaz and the price it allegedly should have paid, these appear to be claims for damages. As stated above, Section 2 of the Swedish Interest Act is not applicable to damages claims.

(2438) Moreover, it is not a situation in which Gazprom has acted in bad faith. Gazprom has merely acted in accordance with the clear wording of [redacted] Therefore, Naftogaz' interest claims pursuant to Section 2 of the Swedish Interest Act must be rejected to the extent they are based on a price determined according to [redacted].

(2439) Thus, Naftogaz' Claim 5.2 s) must be rejected, and Naftogaz' Claims 5.1.1 a), b), c), d), 5.1.2 b), c), d), 5.1.3 b), c) and 5.1.4 b) must be rejected to the extent they are based on a price determined according to [redacted].

VIII.11.4.4.7 Naftogaz is not entitled to delay interest pursuant to Section 4, paragraph 4, of the Swedish Interest Act based on its Request for Arbitration of Statement of Claim

(2440) Naftogaz claims delay interest in relation to alleged "*overpaid amounts*" with different alternative start dates from which delay interest shall accrue, with 18 June 2014 as the earliest starting date and the date of the award as the latest starting date.

(2441) Further, in relation to damages, Naftogaz "*in addition*" claims delay interest on each "*Capital Amount*" on which no interest is awarded under its interest claims in relation to overpaid amounts. Also here, 18 June 2014 is the earliest starting date and the date of the award is the latest starting date.

(2442) Although Section 4, paragraph 4, of the Swedish Interest Act may apply by analogy in arbitral proceedings, Gazprom does not accept that Naftogaz' Request for Arbitration nor its Statement of Claim contained sufficient information for any of them to serve as a starting point for the accrual of delay interest.

(2443) Stefan Lindskog states:

"*In a corresponding manner, the provision is applicable when arbitral proceedings are commenced. Interest then accrues from when the other party receives the request for arbitration. However, it is probably a precondition that the request for arbitration contains a claim for payment (stating the legal grounds for this claim), which fulfils the requirements for an application for summons under the Code of Judicial Procedure. – It can, however, be questioned whether this applies without exception. It is not certain that the principles which apply in order for an application of summons not to be dismissed or in order for a request for arbitration to trigger the commencement of the arbitral proceedings, satisfy the tortfeasor's interest of clearly knowing how the claim has been calculated and what circumstances it is based on.*"

(2444) Naftogaz' Request for Arbitration and Statement of Claim did not contain any specified monetary claim and no sufficient information regarding the basis for its claims. Consequently, the Tribunal should reject Naftogaz' claims for delay interest from 18 June 2014 (from the date of payment or, if payment has been made prior to 18 June 2014, from and including 18 June 2014) and from and including 1 February 2015.

(2445) Thus, Naftogaz' Claims 5.1.1 a), b), 5.1.2 a), b), c) 5.1.3 a), b) and 5.2 a), b), c) should be rejected.

VIII.11.4.4.8 Naftogaz is not entitled to delay interest pursuant to Section 4, paragraph 4, of the Swedish Interest Act in relation to its new damages claims

(2446) Furthermore, in its Reply, Naftogaz also introduced new claims for damages. Naturally, delay interest cannot start accruing from a point in time before any claim for payment had been made by Naftogaz.

(2447) As expressed by Stefan Lindskog:

"*As regards claims which have been made during ongoing legal proceedings, interest should probably in the corresponding manner start to accrue from the point in time when the other party has received the claim.*"

(2448) Thus, in any event, no delay interest could start accruing on Naftogaz' claim for damages prior to Gazprom's receipt of such claim.

(2449) Thus, Naftogaz' Claims 5.2 a), b) and c) must be rejected also for this reason.

VIII.11.4.4.9 Specifically regarding Naftogaz' Claims 5.1.2 c) and 5.1.3 b)

(2450) In relation to each "*Capital Amount*" where the date of payment falls on or after 17 June 2014 but before 31 January 2015 and on or after 31 January 2015 but before 8 October 2015 Naftogaz (as one alternative) claims "*Yield Interest from and including the day after the Date of Payment of such amount up to and including 8 October 2015 and Delay Interest from and including 9 February 2015 until full payment is made*" (see Claims 5.1.2 c) and 5.1.3 b)).

(2451) Gazprom assumes that this is a drafting error, and that Naftogaz does not claim yield interest and delay interest simultaneously on the same amount, but for the sake of clarity the claims are nonetheless disputed as there is no basis for yield interest and delay interest to accrue on the same amounts during the same period of time.

VIII.11.4.4.10 Specifically regarding Naftogaz' Claims 5.1.4 and 5.2 d)

(2452) In its Claims 5.1.4 a), b) and c) Naftogaz claims yield interest and delay interest on each "*Capital Amount*" where the "*Date of Payment*" (as specified in Appendix 3) falls on or after 8 October 2015 but before the date of the award. Further, in its Claim 5.2 d) Naftogaz claims delay interest on "*Capital Amounts*" where the "*Date of Payment*" is before the award.

(2453) However, in Appendix 3 to Naftogaz' Reply there is no "*Capital Amount*" set out after 22 June 2015. Thus it is not clear to Gazprom on what amounts and from which dates Naftogaz claims interest.

(2454) In any event, no interest can start to accrue before the point in time when the other party has received the claim.

(2455) Therefore, Naftogaz' Claims 5.1.4 a), b) and c) and 5.2 d) must be rejected.

VIII.11.5 Objections to Naftogaz' alternative claim for a fair and equitable price

VIII.11.5.1 Introduction

(2456) As an alternative to Naftogaz' claim for price revision on the basis of article 4.4 of the Contract, Naftogaz also seeks "*adjustment of the Contract Price provisions to establish and obtain a fair and equitable Contract Price*".

(2457) Gazprom's response to this claim is that:

(i) Naftogaz has no right to an adjustment to the Contract Price on the basis of an alleged entitlement to market the gas economically, and in particular Naftogaz has no inherent entitlement economically to market the gas supplied under the Contract; and

(ii) there is no basis for applying Section 36 of the Swedish Contracts Act in these circumstances.

(2458) Accordingly, Gazprom's position is that Naftogaz' claim for an adjustment to the Contract Price to establish a fair and equitable price must fail.

VIII.11.5.2 Naftogaz has no inherent entitlement to market the gas economically

(2459) Gazprom denies that there is any legal basis, or cause of action, that gives Naftogaz the right to an adjustment to the Contract Price on the basis of an alleged entitlement to market the gas economicaly, still less to earn a reasonable profit on the sales of gas in the market. Consequently, Naftogaz' claim in this regard must fail.

(2460) Gazprom rejects Naftogaz' argument that the Contract incorporates the contractual principles and risk division established under Groningen type gas sales agreements. There is no one standard Groningen gas sales agreement, but, at most, only a recognisable "*Groningen style*" of approaching the issues that arise in long term import contracts. As admitted by Naftogaz itself, the Contract is different from the Groningen style in a number of significant respects. Consequently, there is no basis for incorporating any "*contract principles*" or "*risk allocation*" other than those expressly agreed by the parties and recorded in the terms of the Contract. If the parties had wanted to state that Naftogaz had an entitlement to economically market the gas, they would have had to agree upon specific wording to that effect. Therefore, there is no basis in the Contract for any entitlement of Naftogaz to economically market the gas, and no such entitlement can be implied. The Contract Price cannot be adjusted on that basis.

VIII.11.5.3 Claim to adjust the Price under section 36 of the Swedish Contracts Act

VIII.11.5.3.1 CISG

(2461) Naftogaz alternatively invokes Section 36 of the Swedish Contracts Act as a ground for replacing Article 4.1 of the Contract with an entirely new price formula.

(2462) It is not appropriate under CISG to apply a national law approach under Section 36 of the Swedish Contracts Act in cases of hardship. Section 36 of the Swedish Contracts Act covers both issues of whole or partial invalidity from the inception of the contract and issues of impediment or hardship due to changed circumstances. However, pursuant to Article 4(a) of CISG, issues of invalidity fall outside the scope of CISG and issues of impediment or hardship fall within the scope of CISG – in particular Article 79. Therefore, questions of potential modification of a contract by reason of changed circumstances should not be dealt with under national law.

(2463) In any event, Section 36 of the Swedish Contracts Act is only applied very restrictively and only when it is shown that a term or condition of a contract is unconscionable. Naftogaz is nowhere close to being able to make such an argument. The Contract Price is not unconscionable in itself, nor is it unconscionable with regard to circumstances that existed when the contract was concluded or with regard to subsequent circumstances.

VIII.11.5.3.2 Section 36 of the Swedish Contracts Act is only to be applied very restrictively

(2464) Naftogaz appears to be seeking to give the impression that it is always possible to obtain an adjustment of a contract under Section 36 of the Swedish Contracts Act in circumstances where the Contract does not otherwise provide "*effective relief*" or "*sufficient relief*". This presents an entirely misleading picture of the circumstances in which Section 36 of the Swedish Contracts Act can be used.

(2465) In fact, Section 36 of the Swedish Contracts Act can only be used very restrictively. Section 36 is primarily used for consumer protection and similar purposes; it cannot be used to adjust a bad bargain. A general allegation that a contract is unfair is not sufficient and exceptional circumstances are required to modify long-term contracts in the event of changed circumstances. Section 36 was not intended to function as a general price adjustment mechanism.

(2466) Naftogaz' arguments are particularly inappropriate for the use of Section 36 of the Swedish Contracts Act, for the following reasons:

(i) Naftogaz argues that it wishes to obtain "*effective relief from the failure of the Contract Price to reflect the level of market prices since 1 January 2010*". In fact, the actual Contract price reflected (or was lower than) the level of market prices over the period from 1 January 2010. However, even if the Contract price did fail to reflect market prices, Naftogaz has no right to a contractual term that "*reflects the level of market prices*". There is nothing in the Contract that would give Naftogaz that right – nor, for that matter, does Gazprom have any such right.[65] Fluctuation of market prices is a normal event, which was foreseeable and which the parties took account of in clauses 4.4 to 4.4.2 of the Contract by providing for formal inter partes negotiations. The mere fact that market prices have moved does not provide any ground for the application of Section 36 of the Swedish Contracts Act.

(ii) Naftogaz also argues that it wishes to adjust or replace the price adjustment mechanism "*[i]f the price adjustment mechanism turns out to be imperfect and unable to fulfil its purpose*". However, Section 36 of the Swedish Contracts Act cannot be used to re-write a bad bargain. If Naftogaz ends up regretting the contract drafting that it agreed to, it cannot use Section 36 in order to create a completely different contract.

(2467) Further, Naftogaz argues that Section 36 of the Swedish Contracts Act can be turned to if there is an "*imbalance between the Parties' performances*". There is no imbalance between the parties. In any event, there is nothing in Swedish law that requires contracting parties' respective performances to be balanced. Typically in the case of long-term contracts, there will be times when one party benefits more than the other, and other times when the situation is reversed. It might almost be said that certain imbalances between the parties' performances are to be expected. The mere fact of an imbalance between the parties' performances cannot provide a ground for the application of Section 36 of the Swedish Contracts Act.

(2468) Naftogaz also argues that Section 36 of the Swedish Contracts Act should be applied if the Contract contains "*a major deviation from the Groningen model*". Gazprom does not agree that there is any such thing a "*Groningen model*" contract,[66] but even if there were such a thing, Naftogaz has no right to demand, long after the Contract has been negotiated, executed and

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[65] Naftogaz (as buyer) benefits if the Contract price is lower than market prices, Gazprom (as seller) benefits if the Contract price is higher than market prices. As shown by Dr Moselle, since 2009 the Contract price has sometimes been lower than market prices and sometimes higher, but on average the Contract price has been lower than market prices, to the benefit of Naftogaz (see paragraphs 9.1 to 9.32 of the Moselle Report).

[66] See above and, *inter alia*, the Moselle Report, paragraphs 2.3 to 2.6. Dr Moselle states that there are arguably "*a number of families of contracts*" of which the Groningen "*family*" is only one, and that within each family there are significant differences. In short, "*there is no standard 'template' or 'model contract' for an LTC*".

performed, that it be adjusted to follow a particular model. In any event a deviation from such a model would not provide a ground for the application of Section 36 of the Swedish Contracts Act.

(2469) In short, there is no basis for the application of Section 36 of the Swedish Contracts Act. Section 36 could only be applied if Naftogaz could show that a term or condition of the Contract was "*unconscionable*". As will be shown below, Naftogaz is nowhere close to being able to make such an argument.

VIII.11.5.3.3 In any event, even if Section 36 of the Swedish Contracts Act could be applied, theres is no basis for its application since the Contract Price is not unconscionable

(2470) Even if, contrary to the above, the Tribunal finds that Section 36 of the Swedish Contracts Act is applicable, Naftogaz has failed to prove that the Contract Price is unconscionable and should be adapted in the manner argued for by Naftogaz.

(2471) Under Section 36 of the Swedish Contracts Act, a contract term or condition may be modified or set aside if such term or condition is unconscionable having regard to the contents of the contract, the circumstances prevailing at the time the contract was entered into, subsequent circumstances and circumstances in general.

(2472) Therefore, circumstances that may cause a contract term to be unconscionable can be divided into two groups – *either* circumstances that existed from the beginning of the contractual term, *or* subsequent circumstances occurring after the contract was entered into that have caused the contract term to become unconscionable.

VIII.11.5.3.4 The Contract Price is not unconscionable having regard to circumstances that existed from the beginning of the contractual term

VIII.11.5.3.4.1 The Contract Price is not unconscionable in itself

(2473) Under the heading, "*The Contract Price is unconscionable in itself*", Naftogaz argues that the Contract price has increasingly failed to reflect market prices since January 2010, a year after the Contract was signed, and that from the time of the 2011 Request, the factual price has failed to reflect the level of market prices and imposed a significant financial burden on Naftogaz.

(2474) Naftogaz also refers to an asserted "*imbalance between the Parties' performances*", although this in fact appears to be nothing more than repetition of its argument that the Contract price is not in line with market prices (with reference to May 2011).

(2475) The circumstances presented by Naftogaz in this regard are examples of subsequent circumstances. Naftogaz has not, in fact, provided any circumstances in support of the argument that the Contract Price was unconscionable from the beginning of the contract term (e.g. the pricing formula being inherently unconscionable).

(2476) In fact, it is clear that, at the time when the Contract was signed in January 2009, Naftogaz considered the Contract "*a victory*" and, specifically, that the Contract price was market reflective. On 21 January 2009, Naftogaz held a press conference at which Mr Didenko made, *inter alia*, the following comments:

"…having gone through such hard rounds of negotiations, probably none of the parties is 100% satisfied. Neither [Naftogaz] nor [Gazprom] have reached their primary economic aims. However, based on extensive global civilized business experience, only those agreements and negotiations are to be considered objective, when none of the parties was 100% satisfied. However, I think that in spite of all political reasons we may consider that it is a victory of Ukraine in general and [Naftogaz] in particular.

…

"As to the prices, we have a discount of 20% compared to the European prices.

…

With regard to the European prices, we have the analysis results acquired by our embassies regarding imported gas prices in European countries. In January, Latvia will pay for gas around USD 400, Lithuania, in the first quarter - USD 400, in the third quarter - USD 250, starting from March 2009 the prices in Austria will be around EUR 345-355, in Germany - approximately EUR 210.

Indeed it is a most simple algorithm for [Naftogaz]. Our contract provides for quarterly pricing. For the first quarter, we agreed upon USD 450 minus 20% which makes USD 360…."

(2477) [redacted] confirms, in relation to Naftogaz' assessment immediately after the conclusion of the Contract, that: "*we were confident that the Contract price was market reflective*".[67]

(2478) [redacted] also confirms that:

"*At the time The Contract was concluded, the price for The Contract was lower than the price Gazprom achieved in other markets. For 2009, the price that Naftogaz paid to Gazprom under The Contract was $62 lower than Gazprom's average European price...*".[68]

VIII.11.5.4.1.2 The Contract Price is not unconscionable having regard to other circumstances that existed when the Contract was concluded

(2479) Naftogaz refers to the negotiations of the Contract as having been conducted during a "*total cut-off of gas supplies to Ukraine, in the middle of winter*" and refers to the "*constant political pressure*" Ukraine and Naftogaz were under at that time.

(2480) However, the reason why no gas was delivered during the negotiation period was not that gas supplies had been cut-off under an existing contract, but that the previous supply contract had expired due to Ukraine and Naftogaz' refusal to negotiate (as a result of internal Ukrainian political power struggles). There was therefore no contractual or legal basis for Gazprom to supply Ukraine with gas.[69] [redacted] explains that for Gazprom to continue to supply gas to Naftogaz without a contract in place would not only have been a breach of customs regulations, but could also have attracted potential criminal liability for employees involved.[70]

(2481) [redacted] states that he discussed pricing with [redacted] and, in particular, the weighting between different fuels. There was a commercial negotiation between the parties, and the agreed formula was not something that was insisted on by Gazprom or imposed on Naftogaz, but a matter of negotiation that Naftogaz was ultimately willing to agree to.[71]

(2482) Further, Naftogaz asserts Gazprom's dominance and superior bargaining position in relation to the Contract but ignores its own countervailing buyer power, which it exercised during the negotiation of the Contract.

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67 [redacted], page 3.
68 [redacted], paragraph 34.
69 [redacted] paragraph 62; [redacted] paragraphs 12 to 15.
70 [redacted], paragraph 12.
71 [redacted] paragraph 28.

(2483) Naftogaz' position as the dominant transporter of Russian gas gave it significant bargaining power in the negotiations, of which it took full advantage. [redacted] explains:

"*In the early days of January 2009, Naftogaz began offtaking transit gas from the pipeline on an unauthorized basis. In other words, Naftogaz was withdrawing gas from the pipeline and not replacing the full transit volumes being sent by Gazprom. This resulted in a reduction in the transit volumes that were reaching European offtakers.*

…

On 7 January 2009, deliveries to European offtakers were stopped altogether, and Naftogaz turned the Ukrainian system into reverse flow, meaning it reversed the direction of the flow of the pipeline system from westwards to eastwards, allowing Ukraine to withdraw gas from its huge storage facilities in the west of Ukraine in order to send supplier to the east of the country, where industry is more concentrated and gas consumption is consequently higher. In reversing the flow of the pipeline system, Naftogaz prevented any transit gas from reaching European offtakers.

…

The disruption to transit supplies meant that Gazprom was sustaining huge monetary losses on a daily basis. We have estimated our losses from direct revenues and contractual penalties paid to European offtakers for failure to supply during this period at around USD 3 billion.

….

Naftogaz' putting the pipeline system into reverse flow was unprecedented. I believe that Naftogaz must have been making preparations to do it for some time - the transmission system is pressurized and such an operation is technically complex and potentially dangerous. I do not believe that Naftogaz' actions were simply a reaction to a crisis situation, but that pre-planning had taken place. In my view, Naftogaz provoked the crisis for political ends to the detriment of Gazprom."[72]

(2484) In summary, Naftogaz' disruption of European transit supplies in January 2009, in an apparently deliberate and premeditated attempt to precipitate a European gas crisis, resulted in huge financial losses to Gazprom and significant damage to Gazprom's reputation as a reliable

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[72] [redacted] paragraphs 16 to 23.

supplier to Europe. This meant that, at the time the Contract was negotiated, Gazprom was itself under enormous pressure. [redacted] states:

"*The negotiations and a resolution of the gas crisis were of fundamental importance to Gazprom. At that time, there was no contract in place which would allow for Gazprom to supply Naftogaz with natural gas and there was a disruption to Gazprom's supplies of natural gas to Europe which was costing Gazprom dearly. Estimates of the revenue lost to Gazprom during the days of disruption run into the billions of US dollars. However, the greater cost to Gazprom was its reputation as a reliable supplier of gas to Europe. We knew that the disruption would damage Gazprom's reputation as a reliable supplier which would ultimately cost Gazprom far greater sums in the longer term. Accordingly, the Gazprom team negotiating the Contract were under great pressure to conclude an agreement with Naftogaz and to resolve the crisis.*"[73]

(2485) Therefore, Naftogaz' characterisation of the circumstances of the negotiations of the Contract and Gazprom's dominant position is simply incorrect, as borne out by Mr Didenko's contemporaneous public comments, and cannot support its claim for unconscionability.

VIII.11.5.3.4.2 Circumstances in general

(2486) In support of its claim that the price is unconscionable, Naftogaz also points to the fact that the Contract includes other provisions that it asserts "*are unusual and which impose undue restrictions on Naftogaz*". It is entirely unclear how this relates to the asserted unconscionability of the price.

(2487) Naftogaz also asserts that, in the event that article 4.4 of the Contract does not offer the relief it seeks, this would "*imply a major deviation from the Groningen model*", which would be discriminatory against Naftogaz "*compared to buyers of Natural Gas under contracts with standard and well-functioning price revision clauses, including also other Gazprom customers*".

(2488) As noted above, such matters do not provide grounds for the application of Section 36 of the Swedish Contracts Act. The fact that the Contract may differ from other contracts does not make the Contract Price unconscionable, nor would it be discriminatory. The Contract was entered into after extensive negotiations between two well-advised commercial parties. It is

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73 [redacted] paragraph 62.

also notable that Naftogaz did not propose, or even suggest, that the Contract should be based on the "*Groningen model*" (whatever that may mean). Needless to say, there are many different types of contract, and no party has a right to require a particular type of contract.

(2489) In any event, contrary to Naftogaz' contention, the Contract Price is not discriminatory. Mr Lapuerta's argument that the Contract formula's reliance on two different types of oil products results in discrimination between customers is wrong.[74] Mr Lapuerta also fails to show that Gazprom charges significantly different prices to other buyers competing with Naftogaz.[75]

(2490) Further, as explained above, there is no standard "*Groningen model*" and Naftogaz' repeated references to it are simply incorrect.

VIII.11.5.3.5 The Contract Price is not unconscionable due to subsequent circumstances

VIII.11.5.3.5.1 Introduction

(2491) As noted above, Section 36 of the Swedish Contracts Act is not applicable to issues of changed circumstances when CISG applies.

(2492) In any event, for the reasons set out below, the Contract Price is not unconscionable due to subsequent circumstances, i.e. circumstances occurring after the Contract was entered into on 19 January 2009.

(2493) Naftogaz argues that the Contract Price has increasingly failed to reflect market prices since January 2010, a year after the Contract was signed, and that from the time of the 2011 Request, the factual price has failed to reflect the level of market prices and imposed a significant financial burden on Naftogaz.

(2494) Gazprom rejects this claim. In particular, as explained further below:

(i) in fact, the factual price has broadly reflected the level of market prices since 2009;

(ii) although the Contract price became higher than Gazprom's average European price in 2012, even then it was not significantly higher;

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74 Coppi Report, paragraphs 3.8 to 3.27.

75 Coppi Report, paragraphs 3.28 to 3.33.

(iii) the decoupling of gas market and oil product prices could have been anticipated since before the Contract was entered into;

(iv) this is not a situation in which the change in prices has become unconscionable; and

(v) even if the Tribunal were to conclude that the Contract price has become unconscionable at any point during the period since 2009:

- it would be entirely inappropriate for the Tribunal to try to adjust the Contract price to take account of price fluctuations at a single point in time, since prices remain highly volatile and the Contract will continue in force until 2019; and

- in any event, Section 36 of the Swedish Contracts Act cannot be used to re-write the Contract by inserting an entirely new price formula as requested by Naftogaz.

VIII.11.5.3.5.2 In fact, the factual price has broadly reflected the level of market prices

(2495) As the Moselle Report shows, this is not a situation in which the Contract Price has moved – significantly and unexpectedly – in favour of Gazprom and against Naftogaz.

(2496) Dr Moselle shows, *inter alia*, that:

(i) the actual price paid by Naftogaz was considerably lower than import prices in Germany, Italy, France, Poland, Czech Republic, Hungary, and Slovakia, and a volume-weighted average of those markets;[76] and

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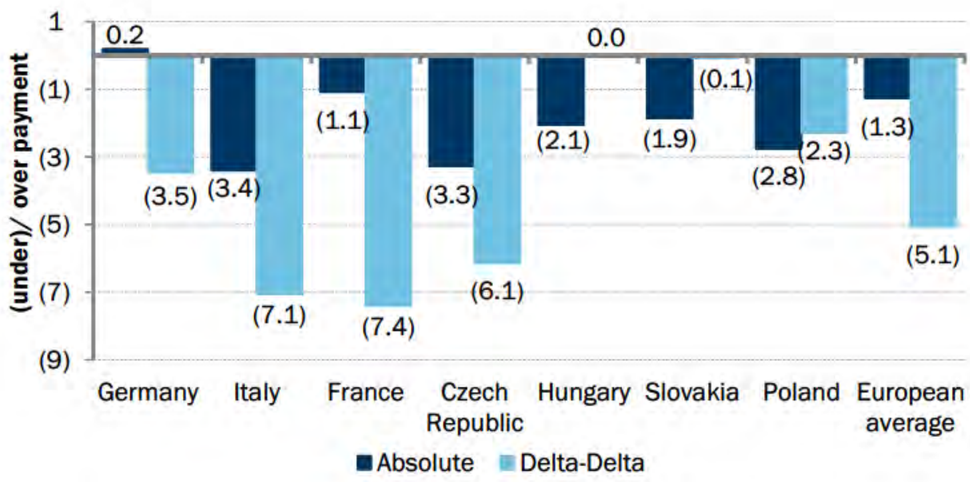
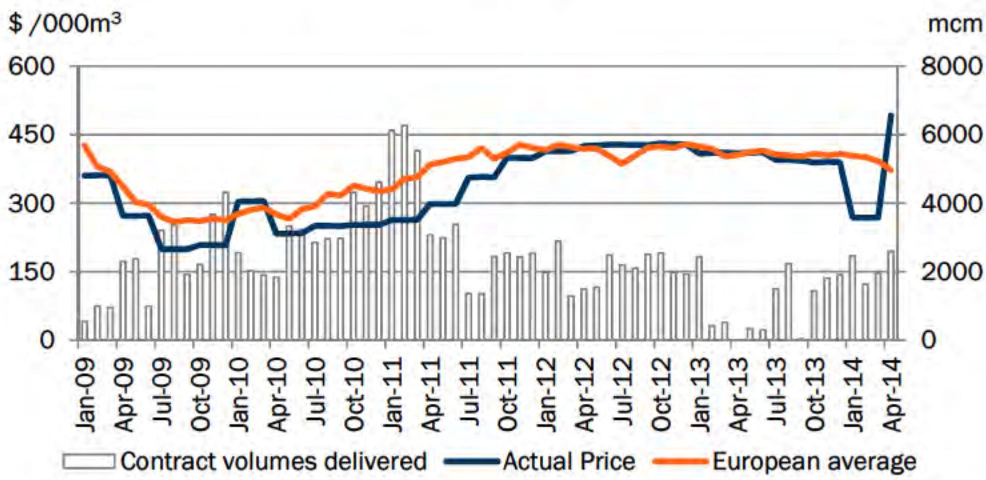
[76] Moselle Report, paragraphs 9.1 to 9.5.

Summary of Naftogaz' over/ underpayment relative to import prices[77]



(ii) alternatively, comparing the actual price paid by Naftogaz against average European import prices, again on average the actual price paid by Naftogaz was considerably lower than average European import prices:[78]

European average import prices and Actual Prices[79]



(2497) Although the details will be the subject of complex expert evidence, the general picture is very clear:

77 Moselle Report, paragraph 2.46.

78 Moselle Report, paragraphs 9.6 to 9.32.

79 Moselle Report, paragraph 9.30.

(i) as noted above, the Contract Price was "*market reflective*" when the Contract was signed in January 2009;

(ii) thereafter, in 2010, the actual Contract Price fell markedly, in favour of Naftogaz;

(iii) between 2012 and 2013, the actual Contract Price was broadly in line with market prices;

(iv) in April 2014, the actual Contract Price increased significantly; but

(v) the Contract Price continues to fluctuate as oil prices change over time.

(2498) In summary, Naftogaz simply cannot claim that the Contract Price has become "*unconscionable*". There has been a price fluctuation over time, but on average the price fluctuations have been significantly in favour of Naftogaz.

VIII.11.5.3.5.3 Although the Contract Price became higher than Gazprom's average European price in 2012, even then it was not significantly higher

(2499) [redacted] states, in relation to the Contract Price:

"*… in 2010, it was $46 lower; and in 2011 it was over $64 lower. The price only became higher than Gazprom's average European price in 2012, and even at that time it was not significantly higher*".[80]

(2500) In fact, as noted above, the price during 2012 to 2014 was broadly in line with wider market prices.

(2501) Even if the price was higher than Gazprom's average European price during that time, the price was not significantly higher, and certainly not so high as to be considered "*unconscionable*".

VIII.11.5.3.5.4 The decoupling of gax market and oil product prices was foreseeable even before the Contract was entered into

(2502) Naftogaz has also referred to the decoupling of gas market and oil product prices as a circumstance leading to unconscionability of the Contract Price.

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80 [redacted] paragraph 34.

(2503) However, as explained by Dr Moselle, the transition to hub pricing in western Europe was foreseeable at the time the Contract was entered into in January 2009. Dr Moselle considers the background in considerable detail and concludes as follows:

"*Overall, I consider that it was clearly foreseeable as at January 2009 that hub prices would become a prominent, if not dominant, price formation mechanism for LTCs in Western European markets such as Germany and the Netherlands during the life of The Contract, although the exact pace of the transition would have been difficult to predict. As can be seen by the examples of the UK and the US, hub-based pricing can be seen as a natural consequence of market liberalisation, which was well underway in the EU by January 2009.*"[81]

(2504) Given the various (foreseeable) factors creating the necessary conditions i.e. ongoing liberalisation, increasing supply and drop in demand, it was anticipated by the parties when entering into the Contract that there would be a move towards hub based pricing in western Europe, together with possibility of decoupling.

(2505) In short, the parties knew of and took account of the fact that there was likely to be a transition to market prices. They also knew of and took account of the fact that there would likely be a decoupling of gas market and oil product prices at some stage during the term of the Contract, i.e. at some stage between 2009 and 2019. The fact that such decoupling has, to some extent, occurred provides no ground for the application of Section 36 of the Swedish Contracts Act.

VIII.11.5.3.5.5 This is not a situation in which the change in prices has become unconscionable

(2506) The case law shows that, in order for Section 36 of the Swedish Contracts Act to be applied in cases of changed circumstances, the change in question needs to be exceptional.

(2507) Naftogaz refers to five Swedish Supreme Court cases in support of its argument – NJA 1983 p. 385, NJA 1923 p. 20, NJA 2005 p. 142, NJA 1994 p. 359 and NJA 1930 p. 507 I. None of these cases is similar to this case. NJA 2005 p. 142 does not even refer to Section 36 of the Swedish Contracts Act. In each of the other cases mentioned, the change in circumstances was exceptional and long-lasting.

81 Moselle Report, paragraphs 6.1 to 6.43.

(2508) In short, there is nothing unconscionable about the price development in the present case.

VIII.11.5.3.6 In any event, even if the Tribunal was to conclude that the Contract Pris has become unconscionable at any point during the period since 2009, it would be entirely inappropriate for the Tribunal to try to adjust the Contract Price to take account of price fluctuations at a single point of time

(2509) Gazprom denies that Section 36 of the Swedish Contracts Act can be applied in these circumstances.

(2510) In the event that the Tribunal were to determine that Section 36 could be applied, the question then arises as to what adjustment to the Contract, if any, would be appropriate in these circumstances.

(2511) The purpose of Section 36 of the Swedish Contracts Act is to restore the balance in the event that it is determined that a particular contract term is unconscionable. However, the Contract term will continue until 2019 and prices will continue to fluctuate until the end of the Contract term.

(2512) It follows that it would be entirely inappropriate for the Tribunal to take a "*snapshot*" at a particular date and attempt to adjust the Contract as at that date.

VIII.11.5.3.7 In any event, even if the Tribunal was to conclude that the Contract Price has become unconscionable, Section 36 of the Swedish Contracts Act cannot be used to rewrite the Contract by inserting an entirely new price formula as requested by Naftogaz

(2513) Further, and in any event, it would be entirely inappropriate for the Tribunal to completely re-write the price formula – by removing the coupling to oil prices and inserting an entirely different formula instead – as requested by Naftogaz.

(2514) Naftogaz is not asking the Tribunal to adjust the Contract in order to restore the balance in the event that it is determined that a particular contract term is unconscionable. Instead, Naftogaz is asking the Tribunal completely to re-write the price formula in a manner that would now be more preferable to Naftogaz. The Tribunal is not entitled to carry out such a task within the ambit of, and by reference to, Section 36 of the Swedish Contracts Act.

<u>VIII.11.5.4 Naftogaz cannot claim a retroactive adjustment pursuant to Section 36 of the Swedish Contracts Act</u>

VIII.11.5.4.1 Introduction

(2515) As noted above, in relation to its claim for adjustment of the Contract Price based on Section 36, Naftogaz has referred to both circumstances that existed from the *beginning* of the contractual term, and subsequent circumstances occurring *after* the Contract was entered into.

(2516) For what appear to be reasons of convenience only, Naftogaz has nevertheless claimed that the Contract Price shall be revised from 20 May 2011, and not from, e.g. 2010 (when the price, according to Naftogaz, increasingly failed to reflect market prices). This can only be explained by the fact that Naftogaz' repayment request is made from this date under its main price revision claim.

(2517) For the reasons set out below, Gazprom disputes that Naftogaz would be entitled to retroactive adjustment of the Contract Price under Section 36 of the Swedish Contracts Act.

VIII.11.5.4.2 Naftogaz is not entitled to retroactive adjustment under Section 36 of the Swedish Contracts Act

(2518) As noted above, Section 36 of the Swedish Contracts Act allows a court or tribunal to adjust a contract in order to restore the balance in the event that it is determined that a particular contract term is unconscionable.

(2519) It is not generally appropriate, in such circumstances to seek retroactive adjustment of contract terms that have already been applied. It would be inappropriate for a court or tribunal, by use of Section 36, to rewrite history as regards contractual obligations already performed.

(2520) In any event, Naftogaz has not provided any reason for why such a retroactive adjustment would be appropriate.

VIII.11.5.4.3 Moreover, Naftogaz has lost its right to claim retroactive adjustment under Section 36 of the Swedish Contracts Act

(2521) If Naftogaz considered the price to be unconscionable in May 2011, then it ought to have brought a claim under Section 36 of the Contracts Act, or at least notified Gazprom that it considered the price unconscionable. It did not.

(2522) According to Swedish law principles, where an aggrieved party fails to claim invalidity during a long period of time or acts in a manner that is inconsistent with such a claim (e.g. by making payments), such party may be deemed to have expressed an intention to have waived its right to make a claim. The consequence of such behaviour is loss of the opportunity to claim invalidity.[82] The same principles also apply to claims for adjustment under Section 36. Christina Ramberg has stated:[83]

"*If a party, who has a right to claim invalidity explicitly or implicitly, fails to invoke the invalidity after receiving knowledge of the circumstances on which the right is based or after he has been able to act free from threat, invalidity cannot subsequently be invoked. The same applies to adjustment of a contract.*"

(2523) Naftogaz did not in May 2011 state that it considered the price unconscionable under Section 36.

(2524) Moreover, in addition to being passive, Naftogaz has also since May 2011 repeatedly (i) performed under the Contract by paying the price now claimed unconscionable; (ii) relied upon the pricing terms in the contract (including the renegotiation clause of the Contract) by, *inter alia*, actively participating in negotiations regarding the price; and (iii) agreed on adjustments to the Contract Price at successive points in time, including very significant price discounts.

(2525) In summary, Naftogaz has, by its express and implied behaviour, lost any potential right to claim retroactive adjustment of the Contract prior to its Request for Arbitration pursuant to Section 36 of the Swedish Contracts Act.

VIII.11.5.5 Naftogaz cannot claim a repayment pursuant to Section 36 of the Swedish Contracts Act

VIII.11.5.5.1 Naftogaz is not entitled to repayment based on adjustment under Section 36

(2526) In the event that the Tribunal should find that the Contract Price was unconscionable since 20 May 2011, and in the event that the Tribunal also adjusts the clause according to Naftogaz' claim, Naftogaz has claimed a repayment as regards its alleged overpayments between June 2011 and June 2014.

[82] Adlercreutz, Axel and Lars Gorton. *Avtalsrätt I*, p. 272. The principle is also established in Hjalmar, Karlgren. *Passivitet*, p. 111.

[83] Ramberg, Christina. *Avtalslagen* 2010, section 5.5.

(2527) However, the right to restitution (Sw. "*återgång"*) is not an available consequence of adjustment under Section 36 of the Swedish Contracts Act, but merely arises when the contract is declared invalid. As expressed by Kurt Grönfors and Rolf Dotevall:[84]

"*Restitution of the performances may, of course, only be considered where the contract is declared invalid in its entirety. An invalidity, that merely strikes out the contract term in question or at least a minor part of the contract anyway, primarily results in a reading of the contract as if the term or terms did not form part of the contract. Where a partial invalidity becomes comprehensive, limited effects of the same type as of total invalidity may occur, e.g. total invalidity of a limited part of the contract.*"

(2528) Naftogaz has not claimed invalidity – neither as regards the Contract as a whole, nor as regards the Contract price. Instead, Naftogaz requests that the Tribunal rewrites the Contract Price. This request simply cannot result in restitution.[85]

VIII.11.5.5.2 In any event, Naftogaz has lost its right to claim a repayment

(2529) In any event, any right to restitution is lost since Naftogaz has not given notice of its claim within a reasonable time.

(2530) In terms of restitution, invalidity may be compared to cancellation (Sw. *hävning*).[86] Where the object of the contract is a fluctuating price, there is an interest in preventing speculation, and a result there is reason to conclude that the right to restitution is lost unless notice is given within a reasonable time.[87] As regards the length of the "*reasonable time*", that too is determined by the need to prevent speculation – thus, a shorter period is called for where the object of the contract is a fluctuating price.[88]

(2531) By not announcing its claim for restitution, Naftogaz was given the opportunity to speculate on the price. Naftogaz cannot now, three years after it rightfully ought to have made its claim known in May 2011, claim restitution. By waiting three years, Naftogaz has exceeded by far what can be considered a reasonable time.

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84 Grönfors, Kurt and Rolf Dotevall. *Avtalslagen – en kommentar* (2010), pp. 277-278.

85 Kurt Grönfors and Rolf Dotevall point out the difference between invalidity and adaption; whereas the predecessors of Section 36 merely allowed for what can be described as something close to partial invalidity, Section 36 allows for every possible "middle-way solution". It is merely "adjustment to zero", that coincides with invalidity, see *Avtalslagen – en kommentar* (2010), p. 196.

86 See, e.g., Torbjörn, Ingvarsson. *Ogiltighet och rättsföljd* (2012), p. 86.

87 Hultmark, Christina. *Reklamation vid kontraktsbrott* (1996), p. 158-159.

88 Hultmark, Christina. *Reklamation vid kontraktsbrott* (1996), p. 65.

VIII.11.5.5.3 In any event, Naftogaz is not entitled to a repayment since Naftogaz has paid without reserving its right to repayment

(2532) For the reasons set out above, Naftogaz has lost any possible claim for restitution by making payment without reserving its right to repayment.

VIII.11.5.6 Conclusion on Naftogaz' claim for a fair and equitable price

(2533) In summary, for the reasons set out above, Gazprom denies that Naftogaz is entitled to an adjustment of the Contract price to obtain a fair and equitable price, on the basis either of an inherent right to economically market the gas or under Section 36 of the Swedish Contracts Act. In any event, no retroactive adjustment can be made. Gazprom further denies that Naftogaz is entitled to any repayment.

VIII.11.5.7 Gazprom's further submissions on Section 36

VIII.11.5.7.1 Introduction

(2534) Gazprom has futher developed its defence to the application of Section 36 of the Swedish Contracts act as follows.

(2535) Naftogaz pleads its case under Section 36 in the alternative, in the event that Article 4.4 does not give Naftogaz the remedy it seeks. Naftogaz seeks exactly the same remedy for both claims.

(2536) However, Section 36 does not give Naftogaz an alternative route to a price revision. Section 36 does not give Naftogaz a proverbial "*second bite at the cherry*". It is, therefore, misleading for Naftogaz to refer to "*price revision pursuant to Section 36 of the Swedish Contracts Act*".

(2537) Section 36 provides for the possible invalidity or modification of a contract term in the event of extreme unconscionability. However, there is nothing unconscionable about not including a price revision clause in the Contract.

VIII.11.5.7.2 It is very rare for Swedish courts to apply Section 36 in relation to purely commercial cases

i) *The arbitral award in the case of Profilgruppen ./. KPMG*

(2538) Naftogaz takes, as one of its principal examples of the application of Section 36 in commercial cases, the arbitral award in the case of Profilgruppen ./. KPMG, Svea Court of Appeal case T 1085-11. However, this case does not support Naftogaz' argument.

(2539) First of all, it should of course be noted that the arbitral award in this case was set aside by the Svea Court of Appeal. Thus, the case has merely academic value.

(2540) Secondly, in fact, the arbitral tribunal in this case specifically stated that Section 36 should only exceptionally be applied in commercial relationships:

"*The fact that Section 36 of the Contracts Act should only exceptionally be applied in commercial relationships does not prevent it from being appropriate to adjust a limitation of liability (SOU 1974:83 s. 180 f., cf. PECL 8:109 and DCFR III. – 3:105(2)).*"

(2541) The references in brackets in the passage just quoted all concern the specific situation of an exclusion or limitation of liability clause, for which specific considerations apply as set out in e.g. PECL 8:109 and DCFR III. – 3:105(2). Thus, the tribunal in the Profilgruppen case was specifically considering the question of whether a limitation of liability could be adjusted.

(2542) Thus, this case is not authority for a general application of Section 36 in commercial cases. It is only authority for the fact that Section 36 can be applied in order to adjust a limitation of liability clause.

ii) *Other cases referred to by Naftogaz in support of the application of Section 36 in business to business relations*

(2543) Naftogaz refers to four Supreme Court cases in which Naftogaz claims that the Court "*expressly confirmed that Section 36 is applicable in business to business relations*". However, in each case the Court showed a restrictive attitude to the application of Section 36 between commercial parties.

(2544) In short, although it is indeed clear that Section 36 of the Swedish Contracts Act can be applied in business to business relations, the cases cited by Naftogaz reveal that the courts have taken a very restrictive attitude in such circumstances.

VIII.11.5.7.3 Section 36 should be applied restrictively in relation to contracts that are governed by CISG

VIII.11.5.7.3.1 Introduction

(2545) A tribunal should take a restrictive, international approach when considering Section 36 in relation to contracts that are governed by CISG.

(2546) Specifically, and despite Naftogaz' attempts to argue to the contrary, there remains a clear question mark regarding the extent to which Section 36 of the Swedish Contracts Act should be applied in order to adjust contracts governed by CISG in light of changed circumstances.

VIII.11.5.7.3.2 A restrictive, international approach should be taken

(2547) It is clear from the preparatory works in relation to Section 36 that an international approach should be taken – at least when Section 36 is considered in relation to international contracts between commercial parties. See Prop. 1975/76:81, page 131:

"*Despite the above, it can of course arise in certain cases that particular determinations should be made when a contract has an international connection. This applies first of all when a contract concerns an area in which there are international conventions. The general clause [section 36] should of course not be used in such a way that its application conflicts which mandatory rules in conventions which have been entered into by Sweden. Furthermore, and in particular in relation to contracts between commercial parties, there can be reason to take account of the practice that has been developed in relation to a particular type of international contract.*" (emphasis added)

(2548) Naftogaz appears to accept that an international approach should be taken, since it states: "*The UNIDROIT Principles are a reflection of how Section 36 would also operate*".

VIII.11.5.7.3.3 Specific international guidance in relation to the adjustment of contracts in the event of changed circumstances

i) Domestic law should be referred to as a last resort

(2549) Article 7 of CISG provides:

"*(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.*

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."

(2550) Article 7(1) seeks to secure an autonomous interpretation of the provisions of CISG and its general principles – in other words, an interpretation free from preconceptions of domestic laws.

(2551) Article 7(2) provides a means of dealing with questions "*concerning matters governed by [CISG] which are not expressly settled in it*". A solution to such questions should be found in conformity with the general principles on which CISG is based. It is only in the absence of such principles that it is permissible to fall back upon rules of domestic law. To quote from Schlechtriem & Schwenzer:

"*The wording of Article 7(2) expressly holds domestic law applicable in case gap-filling by use of general principles 'on which [the CISG] is based' fails. Recourse to domestic law thus is only an ultima ratio, ie a last resort. In particular, the possibility offered by Article 7(2) must not be interpreted – let alone used – as an easy path around the sometimes difficult task to determine general principles of the CISG.*"

ii) There is a clear question mark as to whether Section 36 should be applied to CISG contracts in the event of changed circumstances

(2552) Gazprom has raised the issue of whether questions of potential modification of a contract due to unconscionability by reason of changed circumstances should be dealt with under CISG or whether such questions should be dealt with under national law, including (where Swedish law is applicable) under Section 36 of the Swedish Contracts Act.

(2553) There are two points here:

(i) The first point concerns the characterisation of the factual circumstances. As the CISG Advisory Council explained in its Opinion No. 7, questions of unconscionability at the time when the contract was concluded fall under the rubric of validity, which is outside the scope of CISG. However, questions of hardship by reason of changed circumstances arguably fall within the scope of CISG and should therefore be dealt with under CISG rather than under national law.

(ii) The second point concerns what remedies can be applied in the event that changed circumstances render the contract unconscionable.

A) Characterisation of the factual circumstances

(2554) Naftogaz claims to be attacking Gazprom, but in fact Naftogaz is attacking the CISG Advisory Council. It is the CISG Advisory Council's Opinion No. 7 which suggests that CISG should, as far as possible, be applied in preference to national law doctrines of hardship.

(2555) The CISG Advisory Council states:

"*… the interpreter who takes seriously the CISG's confessed purpose of unifying the law of sales, as articulated in Article 7(1), will probably exhaust all technically available means to respond to the hardship problem within the "four corners" of the Convention, rather than resorting to the application of potentially disparate domestic legal rules and doctrines.*"

(2556) The point which Naftogaz tries to gloss over is that it is a matter of debate among CISG scholars to what extent Section 36 should be applied in cases of hardship by reason of changed circumstances concerning contracts governed by CISG.

(2557) To quote from one of the legal authorities which Naftogaz itself relies upon, Professor Lookofsky writes:

"*… If, for example, X [the country whose governing law has been chosen] is the Netherlands (where hardship is recognized) or Denmark (with its infamous General Clause), should Article 79 [of CISG] preëmpt the application of domestic law? Or should international and domestic rules be allowed to "compete"?*

I realize other Convention commentators have asked and answered similar questions, and that some – perhaps even the majority – of these scholars have "ruled" in favour of "preëmption" (without using that word). In other words, these commentators – like the court in the Italian hardship case – prefer to deal with hardship (if at all) within the "four corners" of the Convention, either (a) by denying the possibility of "hardship" solutions to CISG problems, (b) by applying the black letter of Article 79 to "settle" the hardship question, or (c) by describing the hardship "matter" as "governed" but not "settled" (by the CISG) and by then settling that matter on the basis of Convention general principles, including those which might be said to lie "between the lines" of Article 79.

But until we see some persuasive precedents which favor preëmption within this context, I think "competition" between an article 79 "exemption" and domestic rules of hardship remains a viable option. …

For these reasons, I predict that at least some arbiters faced with the issue in our hypothetical would opt for rule-concurrence (as opposed to preëmption), e.g., in situations where the applicable domestic law provides authority for the censorship and/or modification of contract terms which – though perhaps fair when originally agreed to – have become unreasonable."

(2558) Thus, it is at least clear that there is a debate among CISG scholars about this issue. In fact, Professor Lookofsky writes that "*perhaps even the majority*" of scholars who have looked at this issue prefer to deal with hardship (if at all) within the "*four corners*" of the Convention.

(2559) Naftogaz also refers to Schlechtriem & Schwenzer. As is pointed out by Naftogaz, those authors suggest that cases of "*gross disparity*" and "*burdensome obligations*" are issues of validity to be dealt with under domestic law. However, Naftogaz omits to mention what the same authors actually say about "*hardship*", on the following page:

"*(dd) Hardship. The concept of hardship relates to situations where after the conclusion of the contract the surrounding circumstances change dramatically so as to make performance of the contract appear overly burdensome for the debtor. The most important cases in which this concept is discussed are extreme changes of the market price for the goods to be procured and delivered by the seller. Some domestic laws contain specific provisions for this case, as do the uniform projects. Under the CISG it has been suggested to regard the respective rules within the uniform projects as usages (Article 9) and thus use them to adapt CISG contracts to changed circumstances. The better solution, however, is to deal with these situations under Articles 79, 25 CISG.*" (emphasis added)

(2560) Naftogaz mentions that violations of competition law are excluded from CISG. This is confirmed by Schlechtriem & Schwenzer under the heading "Violation of statutory prohibitions". However, breach of competition law is not the same as hardship.

(2561) Naftogaz also refers to Ramberg & Herre. However, Naftogaz fails to make it clear that the passage cited refers specifically to penalty clauses: the heading is "*Avtalsviten och andra i avtal normerade ersättningar*" (Eng. "*Contractual penalties and other contractually-stipulated compensation*"). This passage says nothing at all about cases of hardship.

(2562) In summary, there remains an ongoing debate between scholars about whether CISG should be applied in preference to national law doctrines of hardship. For more details of this debate, see Niklas Lindström. The issues are complex, they give rise to difficult questions of classification, and the position remains unclear. The Tribunal is therefore urged to approach these issues with caution.

B) Remedies in cases of hardship

(2563) Naftogaz states:

"*Finally, we recall that Naftogaz is not seeking to be excused from performance but to revise the price. CISG simply does not provide such remedies be it in respect of circumstances at the time of the contract or changed circumstances. Such remedies therefore fall outside of CISG, and consequently the domestic rules that afford such remedies are not ousted by CISG.*"

(2564) Gazprom agrees that CISG does not provide the remedy of adjustment (Sw. *jämkning*). However, Gazprom does not agree with Naftogaz' conclusion. It does not simply follow that domestic law remedies of adjustment apply in such circumstances, and it is notable that Naftogaz does not provide any legal authority in support of this bold assertion.

(2565) In the event of unconscionability at the time when the contract was concluded, this is an issue of validity, and domestic law rules on validity apply, including rules on adjustment of contracts. However, in the event of unconscionability by reason of changed circumstances, this is an issue of hardship, and a CISG approach should be taken.

(2566) The CISG Advisory Council's Opinion No. 7:

"*40. The next issue to tackle is to ascertain the contours of the remedial guidelines that may be followed to grant the most appropriate remedy or relief after hardship has been found to exist. One may infer from the obligation to interpret the Convention in good faith a duty imposed upon the parties to renegotiate the terms of the contract with a view to restore a balance of the performances. In case negotiations fail, there are no guidelines under the Convention for a court or arbitrator to "adjust," or "revise" the terms of the contract so as to restore the balance of the performances. Even if one were not ready to stretch the principle of good faith buried in CISG Article 7(1) in order to find a balance of the performances, CISG Article 79(5) may be relied upon to open up the possibility for a court or arbitral tribunal to determine what is owed to each other, thus "adapting" the terms of the contract to the changed circumstances.*"

(2567) It should be noted that the CISG Advisory Council suggests a remedy which is different from the remedy under section 36 of the Swedish Contracts Act. The primary remedy suggested is "*a duty imposed upon the parties to renegotiate the terms of the contract with a view to restore a balance of the performances*".

(2568) What would happen if the parties' renegotiations fail to arrive at a solution? The CISG Advisory Council suggests that CISG Article 79(5) may be relied upon "*to open up the possibility for a court or arbitral tribunal to determine what is owed to each other, thus "adapting" the terms of the contract to the changed circumstances*". Again, though, this is different from the remedy under section 36 of the Swedish Contracts Act. This would not give the Tribunal free hands to adjust a term of the contract. On the contrary, it would merely allow the Tribunal "*to determine what is owed to each other*". It would not be an adjustment of the contract terms as such.

(2569) In any event, it is clear that the Tribunal should approach these issues with caution in the context of a contract, such as the Contract, that is governed by CISG.

iii) Specific international guidance as regards the application of Section 36 is applied in cases of changed circumstances

(2570) It is useful in this context to consider the chapter on Changed Circumstances (Sw. "*Ändrade förhållanden*") in the new 2016 edition of Ramberg & Ramberg, Allmän avtalsrätt. As regards the application of Section 36 in the event of changed circumstances, Ramberg & Ramberg state:

"*The [Swedish] Contracts Act does not give any guidance on how the determination of unconsionability should be carried out in connection with changed circumstances. Concrete guidance is to be found in UNIDROIT Principles Arts. 6.2.1-6.2.2, PECL 6:111 and DCFR III-1:110, which are largely in accordance with Swedish law principles.*"

(2571) In the context of an international approach to these issues, as required both under CISG and pursuant to Section 36, it is also relevant to note the CISG Advisory Council's description of the truly exceptional circumstances that would be required:

"*37. If it is accepted that a situation of genuinely unexpected and radically changed circumstances, in truly exceptional cases, may qualify as an "impediment" under Article 79(1), it deserves a legal response under the Convention that would preempt the application of domestic rules on hardship.*

38. It is certainly not possible or even convenient to attempt a definition of hardship, beyond accepting that the impediment may entail a situation of "economic impossibility" which, while short of an absolute bar to perform, imposes what in some legal systems is conceptualized as a "limit of sacrifice" beyond which the obligor cannot be reasonably expected to perform.

39. In most cases market fluctuations are not to be considered an "impediment" under CISG Article 79, because such fluctuations are a normal risk of commercial transactions in general. Whether wild and totally unexpected market fluctuations in goods or currency could ever become an "impediment" is another matter. Indeed, the theoretical possibility of such radical and unexpected changes admits the application of Article 79 in those rare instances as the one exemplified above." (emphasis added)

(2572) In short, this is not the sort of truly exceptional case in which there have been wild and totally unexpected market fluctuations, and no "*limit of sacrifice*" has been reached.

VIII.11.5.8 The fact that the Contract does not include a price revision clause does not render the Contract unconscionable in itself

VIII.11.5.8.1 Naftogaz' claim is made in the alternative

(2573) Naftogaz clarifies that its claim under Section 36 is an alternative claim. It states as follows:

Thus, Naftogaz freely admits that it is seeking to use Section 36 as a means of getting an alternative route to a price revision. This alternative case would only need to be considered in the event that the Tribunal decides "*that [Article]4.4 does not constitute an effective and enforceable price revision clause*".

(2574) However, Section 36 simply does not operate in this way. It does not give a party the right to impose its preferred contractual interpretation in the event that that contractual interpretation is rejected by the court or tribunal. As is clear from the text of Section 36 itself, the section only applies where a contract term is found to be unconscionable.

VIII.11.5.8.2 The lack of a price revision clause does not constitute grounds for invoking Section 36

(2575) The case law on Section 36 expressly confirms that the lack of an "*effective price revision clause*" does not constitute grounds for invoking Section 36 (see Appendix 3, in which Gazprom has commented in detail upon each of the cases relied upon by Naftogaz in relation to Section 36).

(2576) It is notable that Naftogaz has failed to mention NJA 1979 p 731 in which the Court of Appeal (upheld by the Supreme Court) expressly made the point that the lack of an index clause is not in itself unconscionable.

(2577) The cases that Naftogaz does rely upon, NJA 1983 p 385 and RH 1980:14, are distinguishable in several important respects:

(i) NJA 1983 p 385 was a case concerning two private individuals, rather than a large commercial contract.

(ii) RH 1980:14 is a Court of Appeal case with limited precedential value.

(iii) The Courts noted in both NJA 1983 p 385 and RH 1980:14 that the index clauses had failed to do what was intended; the parties in NJA 1983 p 385 were in agreement that the index clause in that case had been intended to follow the general increase in prices, and similarly, the Court noted in RH 1980:14 that the parties had agreed that the company would be given full compensation for its cost increases. However, it cannot be said in the present case that the contract price clause has failed to do what was intended. There was no intention in the present case that the contract price would follow German gas hub prices, or that Naftogaz would be given full compensation.

(iv) The Supreme Court noted in NJA 1983 p 385 that there had been a huge, 500%, increase in prices over the previous 31 years, whereas the chosen index had gone up only 174%. By contrast in the present case, the price paid by Naftogaz under the Contract has continued to be broadly in line with market prices.

(v) The Supreme Court pointed out in NJA 1983 p 385 that there had been little knowledge of index clauses in 1950 when the lease contract was concluded. By contrast, the parties in the present case had long experience and knowledge of price indices and they knew what they were doing.

(vi) NJA 1983 p 385 concerned a 50 year property contract with many years still to run, rather than an 11 year contract with only a few more years to run (the Contract will expire on 31 December 2019). Whereas there may be a need to re-set an index where the parties will continue to be bound by the contract for many years into the future, there is far less of a need to do so where the contract will expire in the relatively near future.

(vii) The court in NJA 1983 p 385 granted only a very modest increase and the court in RH 1980:14 decided that the parties should jointly share the burden of the unforeseen costs increases, whereas Naftogaz is claiming that the Contract should be substantially re-written in a manner that would be heavily one-sided in favour of Naftogaz.

(2578) In conclusion, the lack of a price revision clause does not in itself constitute grounds for invoking section 36. Indeed, if that were the case, then every fixed price contract would be susceptible to challenge under Section 36 on that ground, which is obviously not correct.

VIII.11.5.8.3 The inclusion of the price formula "which is inherently unable to reflect all conceivable changes in the level of market prices" does not constitute grounds for invoking Section 36

(2579) Furthermore, Naftogaz does not have a contractual right to a price formula which is able "*to reflect all conceivable changes in the level of market prices*".

(2580) The parties agreed upon the terms of the price formula in the Contract. It was never expected, and could never have been expected, that the price formula would be able "*to reflect all conceivable changes in the level of market prices*".

(2581) Section 36 only applies in exceptional situations where the result of those exceptional situations is that a contract term is or has become unconscionable.

(2582) As will be shown below, the situation in the present case is not exceptional, and the contracts terms are not, and have not become, unconscionable.

VIII.11.5.9 The circumstances when the Contarct was concluded do not render the Contract unconscionable

(2583) As set out in detail above, Gazprom strongly maintains that Naftogaz' characterisation of the circumstances of the negotiations of the Contract and Gazprom's alleged dominant position is simply incorrect. There is no basis for claiming that such circumstances render the Contract unconscionable.

(2584) In any event, it would appear that Naftogaz places greater reliance upon subsequent circumstances. As explained in detail below, there are also no grounds for a claim on that basis.

VIII.11.5.10 Subsequent circumstances have not made the Contract, or the Contract Price, unconscionable

VIII.11.5.10.1 Introduction

(2585) Naftogaz has clarified that: "*The argument that the Contract Price is unconscionable in itself does not refer to the circumstances when the Contract was concluded, but the price when Naftogaz requested revision*".

(2586) Thus, Naftogaz' case is now that subsequent developments since 1 January 2010 "*have caused the Contract Price to turn unconscionable*". Naftogaz also claims that, from May 2011, "*the factual price failed to reflect the level of market prices and imposed a significant financial burden on Naftogaz*".

(2587) Applying each of the points referred to by Ramberg & Ramberg (see above), it follows from the below that there is simply no basis for the application of Section 36 in these circumstances.

VIII.11.5.10.2 The balance of the Contract has not been disturbed fundamentally

VIII.11.5.10.2.1 Introduction

(2588) As Gazprom has showed, the factual price has broadly reflected the level of market prices since 2009.

(2589) In response, Naftogaz criticises some of the findings made by Gazprom's expert, Dr. Moselle, in his first expert report. However, none of the points made by Naftogaz alters the key point – which is that the balance of the Contract has not been disturbed fundamentally:

VIII.11.5.10.2.2 Factual price vs. contract price

(i) Naftogaz claims that it is the contract price, not the factual price, which should be considered. However, in the context of Section 36, the central issue is whether the price actually paid by Naftogaz has become unconscionable by reason of changed circumstances.

(ii) With the exception of just a few months, the full contract price as such has never been paid by Naftogaz. For the purposes of Naftogaz' claim under Section 36, the contract price as such is therefore largely theoretical – and therefore largely irrelevant.

(iii) In any event, even if the contract price were to be considered, it cannot be said that there has been a wholly exceptional and long-lasting increase in the contract price. Thus, even on the basis of the contract price, it cannot be said that the balance of the Contract has been disturbed fundamentally.

VIII.11.5.10.2.3 Import prices

(i) Naftogaz criticises Dr. Moselle for using import prices. For the reasons set out in detail above, Gazprom maintains that it is fully appropriate to have regard to import prices.

(ii) Even if Naftogaz' alternative prices are used, it cannot be said that the balance of the Contract has been disturbed fundamentally.

VIII.11.5.10.2.4 The selection of countries referred to

(i) Naftogaz criticises Dr. Moselle's selection of countries. For the reasons set out in detail above, Gazprom maintains that Dr. Moselle's selection of countries is fully appropriate.

(ii) Even if Naftogaz' alternative selection of countries is used, it cannot be said that the balance of the Contract has been disturbed fundamentally.

VIII.11.5.10.2.5 Comparison with Gazprom's average European price

(i) Naftogaz criticises Gazprom for making a comparison with its average European price. In fact, Gazprom maintains that this comparison is fully justified.

(2590) In summary, it cannot be said that the balance of the Contract has been disturbed fundamentally. Ramberg & Ramberg refer to the contract effectively becoming a completely different contract (the "*different contract theory*"), because of a war or a similar serious fundamental change of circumstances, where the hardship in question goes beyond the so-called "*victim boundary*" (Sw. “*bortom offergränsen*”).

(2591) There is nothing like such a situation in the circumstances of the present case.

VIII.11.5.10.3 The hardship in question could have been foreseen or anticipated, and either party could have taken steps to guard against it

(2592) As has been stated, the decoupling of gas market and oil product prices was foreseeable even before the Contract was entered into.

(2593) Even on Naftogaz' case, the facts are very far from being sufficient to enable Naftogaz to invoke Section 36 in these circumstances:

(i) Naftogaz argues that "*the change in circumstances which brought the relationship between the Parties' performances under the Contract out of balance was the decoupling between the hub-based market prices at which importers could sell gas and the oil-linked prices (in long-term contracts) at which importers bought gas*", and that "*the problem was not the change in price formation as such, but the fact that the gas market prices formed at the hubs dropped significantly and persistently below oil-linked prices*". In fact, Dr. Moselle shows that this future divergence between oil-linked prices and hub-based prices was foreseeable in 2009.

(ii) Naftogaz also argues that the decoupling that occurred was very different from previous divergences observed, because of its prolonged duration. In fact, Dr. Moselle shows that significant divergences had occurred before.

(iii) Naftogaz also argues that the speed with which the decoupling occurred as well as its impact on prices were in themselves unforeseeable and unexpected. However, when the price divergence is considered over the whole period from 2009 until 2015, its effect on the contractual balance as a whole is with the bounds of normal price fluctuation.

(2594) In short, the parties knew of and took account of the fact that there was likely to be a transition to market prices. They also knew of and took account of the fact that there would likely be a decoupling of gas market and oil product prices at some stage during the term of the Contract, i.e. at some stage between 2009 and 2019. Yes, despite this, the parties deliberately chose a specifically-negotiated oil index clause.

(2595) The fact that such decoupling has, to some extent, occurred provides no ground for the application of Section 36.

(2596) In any event, even if (as argued by Naftogaz) the speed and magnitude of the decoupling was unforeseen and unexpected, Naftogaz could certainly have anticipated that a decoupling of such speed and magnitude might happen, and Naftogaz could easily have taken steps to guard against it.

(2597) The risk that the oil-indexed price formula would, at some stage during the 11 year term of the Contract, give rise to prices that were either too high or too low, was a risk that the parties consciously took into account at the time when they entered into the Contract. This is just the sort of conscious risk-taking that cannot be adjusted later by reference to Section 36.

(2598) It appears that Naftogaz calculated upon the oil price going down. In the short term between 2011 and 2014, that turned out to be a miscalculation by Naftogaz – although of course since 2014 the oil price has dropped very significantly indeed. Naftogaz cannot invoke Section 36 in order counteract the effect of its own mistaken speculation.

VIII.11.5.10.4 Naftogaz should bear the risk of price increases, just as Gazprom should bear the risk of price decreases

(2599) What Naftogaz relies upon is not exceptional, but a fairly normal price fluctuation in the context of an 11 year energy contract. Such price fluctuations could and should have been taken into account by the parties, and they are part and parcel of the normal risks which the parties have to bear.

(2600) Ramberg & Ramberg point out that price fluctuations are just the sort of circumstances that commercial parties need to take account of.

(2601) In conclusion, the circumstances in the present arbitration are simply not the sort of extreme circumstances as would warrant the application of Section 36.

VIII.11.5.10.5 Conclusion

(2602) Section 36 is sometimes applied in cases of changed circumstances in long-term contracts. However, a review of the relevant case law shows that the changes in circumstances need to be exceptional.

VIII.11.5.11 In any event, the adjustment requested by Naftogaz should not be ordered

VIII.11.5.11.1 The adjustment requested by Naftogaz

(2603) As can be seen from Naftogaz' requests for relief, Naftogaz asks the Tribunal to re-write Article 4.1 of the Contract fundamentally.

(2604) This is not a simple, obvious adjustment. On the contrary, there are many complex details in the various alternative re-drafts that have been suggested by Naftogaz.

(2605) As will be shown below, it is Gazprom's position that there are no grounds for the Tribunal to undertake such a fundamental re-writing of the parties' price provisions.

VIII.11.5.11.2 The purpose of adjustment (Sw. jämkning) under Section 36

(2606) The purpose of any adjustment pursuant to Section 36 is to restore the balance between the parties.

(2607) The legislature did not wish to limit the ability of courts and arbitral tribunals to find the most practical and best solution in each case. Nevertheless, the preparatory works name some specific examples of adjustment. See Prop. 1975/76:81:

Page 35:

"*The Commission underlines that the courts ought to have full freedom to choose the solutions that are most practical and which best satisfy the party's claims. The Commission provides the following examples of adjustments – reduction of the amount of a penalty or the amount of damages, increasing time limits, and placing additional requirements for a certain legal consequence to take effect, e.g. imposing a requirement of materiality in the event of a breach of contract.*"

Page 110:

"*Adjustment […] ought to be preferred [over setting aside the contract term] in the event that an unexpected or unforeseen situation occurs. Examples of adjustments are, as the Commission has suggested, reduction of the amount of a penalty or the amount of damages, increasing time limits or increasing the length of a contract's validity, and placing additional requirements for a certain legal consequence to take effect, e.g. imposing a requirement of materiality in the event of a breach of contract.*"

"*It is in the very nature of such a far-reaching discretionary freedom which the courts are now given as a result of this legislative provision that it has certain disadvantages. The parties' ability to predict the consequences of a contract are diminished, if the courts make more far-reaching changes to the contract. I would therefore like to stress that, in the event that a particular contract term is judged to be unconscionable, the possibility of adjusting the contract in another respect or setting aside the contract in its entirety ought to be used with some care.*" (emphasis added)

(2608) It is notable in this context that the types of relatively simple adjustments envisaged in the preparatory works – reduction of the amount of a penalty or damages, increasing time limits, increasing the length of a contract's validity, or imposing a requirement of materiality in the event of a breach of contract – are very different from the very considerable re-writing that Naftogaz is asking the Tribunal to undertake in this case.

(2609) Moreover, there is particular reason to be restrictive about the remedy of adjustment in an international context such as this. As noted above, CISG does not provide for any remedy of adjustment in the event of hardship. Furthermore, when considered internationally, the powers of a court or arbitral tribunal under Section 36 go considerably further than under international conventions.

VIII.11.5.11.3 Naftogaz' argument regarding "appropriateness"

(2610) Naftogaz argues:

"*…there is no prerequisite of "appropriateness" in Section 36. Section 36 is not a provision in the discretion of the courts or arbitral tribunals. It is a provision which is mandatory and shall be applied if the prerequisites are fulfilled. If a clause is unconscionable, adjustment shall be made. There is therefore no additional prerequisite of "appropriateness" (whatever Gazprom means by this).*"

(2611) It is notable that Naftogaz provides no authority for these statements. In fact, as will be shown below, the case law shows that Naftogaz' position is entirely misconceived – the courts exercise considerable discretion in determining whether, and if so to what extent, an adjustment should be made.

(2612) This was also recognised in the Government Bill, see Prop. 1975/76:81:

Page 136:

"*With the suggested wording of the general clause, the courts are given relatively large discretion as regards deciding an appropriate remedy*."

Page 138:

"*The question of how far adjustment should be made upon the application of the general clause should, in my opinion, be left to the courts to decide.*"

VIII.11.5.11.3 Case law shows that adjustment is carried out restrictively by the courts

(2613) von Post has noted:

"*Adjustment of contract terms has been made in seven cases before the Supreme Court and none of these cases are of a pure commercial nature.*"

(2614) The most relevant cases have already been referred to above:

(i) NJA 1979 p 731 ("*Drottningtorp*")
(ii) NJA 1983 p 385 ("*Löddeköpinge*")
(iii)RH 1980:14 ("*Varbergs Renhållningsverk*")

(2615) In all these cases, the courts considered themselves free to determine an appropriate remedy, and in all these cases, the courts awarded a significantly smaller adjustment than had been requested by the claimant.

(2616) Moreover, in all these cases, the courts took account of what the parties themselves were able to agree upon, with the clear aim of providing a balance between the parties' respective interests.

VIII.11.5.11.4 The adjustment sought by Naftogaz should not be ordered

(2617) Naftogaz seeks to impose an adjustment which would be highly one-sided in favour of Naftogaz. This is not an attempt to balance the contract. On the contrary, Naftogaz' proposed adjustment would create a highly unbalanced contract.

(2618) Naftogaz does not seek to uphold the parties' original intentions as at the time when the contract was entered into. On the contrary, Naftogaz seeks to depart fundamentally from the parties' original intentions – by re-writing the price formula from an oil-index to a gas-hub index.

(2619) Naftogaz asks the Tribunal to engage in complex, technical issues. This is very far from the sort of simple adjustment that was envisaged in the preparatory works to the Swedish Contracts Act – such as reduction of the amount of a penalty or damages, increasing time limits, increasing the length of a contract's validity, or imposing a requirement of materiality in the event of a breach of contract. There are several complex, technical elements in Naftogaz' proposed adjustment, including:

(i) The choice of base price (P0);
(ii) The choice of hub;
(iii)The choice of hub price;

(iv) The choice of hub base price (H0);

(v) The detailed meaning of H; and

(vi) The choice of coefficient (k).

(2620) The Tribunal is in no position to re-write the Contract in this way. It is not possible for the Tribunal to make the various complex choices that would be required – only the parties, with their knowledge of the industry and of the particular commercial circumstances, would be in a position to do so.

VIII.11.5.11.5 There is no basis for imposing a retroactive adjustment

(2621) Naftogaz asks the Tribunal to impose an adjustment retroactively – from 20 May 2011, or 17 June 2011, or 27 April 2014. All these proposed adjustments would be retroactive. In particular, they would all be prior to the date of the Request for Arbitration, which was filed with the SCC Institute on 16 June 2014.

(2622) Naftogaz points out that Section 36 contains no limitations "*as to from what time an adjustment shall apply*". While it is correct that there are no limitations in the legislation in this respect, in practice the case law shows that – again – a restrictive view is taken by the courts.

(2623) Naftogaz refers to three cases in this regard, but in fact, in none of these cases was an adjustment imposed retroactively:

(i) NJA 1983 p 385 ("*Löddeköpinge*" / "*Höstvetefallet*") – In this case, the claim was originally submitted to the District Court in April 1977, and the Court of Appeal and the Supreme Court increased the rent starting from the rental year following the date on which the legal proceedings were commenced – i.e. from 1 July 1977, considerably after the date on which the case was filed.

(ii) NJA 1994 p 359 ("*Dalsjöfors*") – Here, the local authority sought to impose water charges from around the time when the legal proceedings were commenced (March/April 1988), but the lower courts ordered payment from a much later date (1 January 1995) and the Supreme Court decided that the respondent should be freed from paying water charges for as long as he lived at his property – i.e. it was held that there would be no adjustment until some unspecified time in the future.

(iii) RH 1980:14 ("*Varbergs Renhållningsverk*") – There was, in fact, no adjustment to the contract terms in this case, and no element of retroactivity. The claimant sued for payment of outstanding fees, and the Court of Appeal for Western Sweden awarded half of the payment claimed by the claimant.

(2624) As Naftogaz itself points out, one "*particularly relevant circumstance*" is when the claimant first made the other party aware of its claim for an adjustment. As noted above, Naftogaz' initial letters of 20 May 2011 and 17 June 2011 did not set out any claim but merely suggested that the parties should proceed to negotiations. It was only in its letter of 27 April 2014 that Naftogaz, for the first time, made any claim against Gazprom. Moreover, the actual adjustment claimed by Naftogaz was not put forward until 31 January 2015, when Naftogaz filed its Statement of Claim.

(2625) In any event, the aim of any adjustment under Section 36 is to restore the balance between the parties. As has been shown by Dr Moselle, the adjustment proposed by Naftogaz would have the effect of making the contract heavily one-sided in favour of Naftogaz.

VIII.11.5.12 In any event, there is no basis for a repayment to be made

(2626) There is no basis for Naftogaz to order a repayment by Gazprom by reason of an adjustment pursuant to Section 36. Reference is made to the arguments set out above.

(2627) Gazprom also refers in this respect to what has been stated above and invokes the same circumstances and arguments in relation to Naftogaz' repayment claim based on Section 36.

VIII.11.5.13 The doctrine of assumptions (Sw. *förutsättningsläran*) does not apply

(2628) Finally, Naftogaz apparently also relies upon the doctrine of assumptions (Sw. *förutsättningsläran*), but that doctrine is not applicable in the circumstances of the present case.

(2629) First, it is questionable whether the doctrine of assumptions applies at all nowadays, following the enactment of Section 36 of the Swedish Contracts Act. See Ramberg & Ramberg , and in particular page 213: "*Förutsättningsläran har numera begränsad praktisk betydelse*" (Eng. "*The doctrine of assumptions has nowadays limited practical importance*").

(2630) Second, Naftogaz does not even begin to satisfy the exacting requirements of the doctrine of assumptions. In particular, Naftogaz would have to show:

(i) that it had an assumption;

(ii) that Naftogaz' assumption was clear to Gazprom at the time when the Contract was entered into;

(iii) that Naftogaz' assumption was of such importance as to be crucial for Naftogaz in entering into the Contract; and

(iv) that it would be reasonable to put the risk of the assumption being incorrect upon Gazprom.

(2631) Third, and in any event, the doctrine of assumptions would not give Naftogaz the relief that it seeks. Naftogaz seeks an adjustment (Sw. *jämkning*), but Swedish law does not permit an adjustment of a contract pursuant to the doctrine of assumptions. The only remedy permitted is to set aside the contract in its entirety. See Ramberg & Ramberg, in particular page 212:

"*Under the doctrine of assumptions the only remedy is setting aside. A contract cannot be adjusted pursuant to the doctrine of assumptions. The doctrine of assumptions is thereby a "shield" against provisions that create hardship, but not a "sword" with the help of which a party could obtain additional advantages for itself (e.g. a party cannot obtain damages).has nowadays limited practical importance).*"

VIII.11.6 Objections to Naftogaz' alternative claim for a revised price leading to a favourable economic result for Naftogaz

(2632) Naftogaz relies, *inter alia,* on the alleged "*entitlement to economically market the supplied Natural Gas*" for its requests to revise the price provisions in Article 4.1 of the Contract.

(2633) What Naftogaz requests is not "*contractual interpretation*" in accordance with paragraph 1(2) of the Swedish Arbitration Act, but is gap filling.

(2634) The Tribunal cannot have been given jurisdiction pursuant to Section 1(2) of the Swedish Arbitration Act on the ground of usages.

(2635) The Tribunal does not have jurisdiction in relation to Naftogaz' requests to revise or replace Article 4.1 of the Contract based on the alleged "*entitlement to economically market the supplied Natural Gas*". The related relief sought should therefore be dismissed in this respect. If not dismissed, these claims should be rejected to the same extent and on the same basis.

(2636) Gazprom denies Naftogaz' claim that "*the buyer's entitlement to market the gas with a reasonable profit is inherent in the risk division under gas sales agreements based on the Groningen model*".

(2637) Gazprom denies that the Contract is "*based on the Groningen model*" as suggested by Naftogaz.

VIII.11.7 Defences to Naftogaz' claims for determination of the price

VIII.11.7.1 Introduction

(2638) Gazprom denies Naftogaz' claims for determination of the price, for the following reasons:

as to Addendum [redacted]

(i) [redacted] and

(ii) section 36 of the Swedish Contracts Act is not applicable and in any event [redacted] does not contain any unconscionable term; and

as to Addendum [redacted]

(i) [redacted]

(ii) in any event Gazprom is not benefitting from an "*illegal act*";

(iii) Gazprom is not estopped from asserting that the price reduction no longer applies; and

(iv) section 36 of the Swedish Contracts Act is not applicable and in any event [redacted] does not contain an unconscionable term.

VIII.11.7.3 The price referred to [redacted] is no longer applicable

VIII.11.7.3.1 Addendum [redacted] means what it says

(2639) Addendum [redacted] provides as follows:

[redacted]

[redacted]

[redacted]

[redacted]

(Emphasis added.)

(2640) Accordingly, in [redacted] Naftogaz and Gazprom agreed, in summary:

(i) [redacted]

(ii) [redacted]

(iii) [redacted]

(2641) The parties subsequently signed [redacted], which, in accordance with the parties' agreement in [redacted] with respect to the [redacted], provided that [redacted] resulting in an actual price for that quarter of USD [redacted] However, after Naftogaz' failure to pay for gas supplied in November and December 2013, Gazprom decided not to extend the discount provided for under Addendum No. [redacted] beyond the first quarter of 2014.

(2642) The wording of clause 1 of Addendum No. [redacted] expressly contemplates a situation where no supplementary agreement is signed "[redacted] and provides the default in those circumstances i.e. that the [redacted] (Emphasis added). This clearly envisages the possibility that supplementary agreements may not be signed. Therefore, it is entirely contrary to the wording of Addendum No [redacted] to suggest, as Naftogaz does, that the parties must enter into a supplemental agreement irrespective of its terms.

(2643) Naftogaz claims that the words [redacted]" in [redacted] (with reference to signing further supplementary agreements) cannot be construed to imply a discretionary right of Gazprom to refuse to sign [redacted].

(2644) However, the words simply mean exactly what they say. The wording of [redacted]

VIII.11.7.3.2 [redacted] *should be interpreted in accordance with its actual wording*

VIII.11.7.3.2.1 The wording of the contract is critical when interpreting contracts under CISG

(2645) As set out above, the written wording of a contract is of fundamental importance in determining the intentions of the parties pursuant to Article 8 of CISG. This is particularly the case here, for the reasons set out below.

(2646) First, it is evident from articles 9.2 and 9.3 of the Contract that the parties intended the written wording of the Contract to determine their contractual rights and obligations. Any amendments needed to be in writing, "*properly signed*" by the parties, and transmitted by fax and by hard copy original in accordance with the notice provisions under the Contract.

(2647) Second, both Naftogaz and Gazprom are large commercial parties, advised by experienced legal counsel, who can be expected fully to understand the importance and effect of formal written documents.

(2648) Third, both Naftogaz and Gazprom are based in countries that have a legal tradition of relying on formal legal documents and the history of the relationship between the parties is based on written documents.

(2649) Fourth, there is an obvious and important need for both parties to be able to rely upon the specific written wording agreed to, given the number of different people involved in each organisation and the high profile nature of the transaction.

(2650) Fifth, as will be further discussed below, the wording of [redacted] is clear and straightforward with respect to the possibility that the parties will [redacted] Given the clear and unambiguous wording of [redacted] in this respect, there must be a strong assumption that the wording of the agreement ([redacted]) also reflects the parties' common intentions and that the agreement should be interpreted in accordance with its wording.

(2651) Naftogaz' suggestion that, because Addendum No.[redacted] was entered into "*to mitigate a Contract Price which had moved out of step with the market*", [redacted] cannot be interpreted to give Gazprom "*a unilateral right to increase the factual price above the level of market prices*", is fallacious. As explained below, [redacted] was not entered into to "*prescribe*" a "*market reflective price*". Indeed, Naftogaz' own interpretation of [redacted] contradicts this suggestion since it would be impossible to know whether an actual price of USD [redacted] would continue to be "*market reflective*" for the next five years. Naftogaz seeks to escape this obviously nonsensical effect of its argument by asserting that the parties could refuse to sign a supplementary agreement setting the price at USD [redacted] if it was "*not market reflective*", without giving any basis or explanation as to why this is the case. In addition, as explained further below it is misleading to suggest that [redacted] gives "*Gazprom a unilateral right*" not to [redacted] the right is given to both parties equally.

VIII.11.7.3.2.2 There is no basis for departing from the actual wording of Addendum [redacted]

(2652) Naftogaz asserts that Swedish contract law "*places greater emphasis on finding the reasonable contractual solution rather than the solution that best adheres to a lexical reading of the Contract*" and argues for the limitation of the express wording of [redacted] on various bases, including that there is a requirement under Swedish law for a unilateral decision making right to be exercised consistently, loyally and reasonably. However, Naftogaz' arguments are wrong, as explained below.

(2653) First, Swedish law rules and case law on contract interpretation are not applicable, since (as agreed by both parties) the Contract is subject to CISG. Accordingly, the CISG rules on contract interpretation apply, with the effects set out above. In any event, as explained above, the written contract is also the starting point for determining the mutual intention of the parties under Swedish law rules of contractual interpretation. Naftogaz itself appears to agree that "[redacted]

(2654) Second, Naftogaz' assertion that Swedish contract law "*places greater emphasis on finding the reasonable contractual solution rather than the solution that best adheres to a lexical reading of the Contract*" is incorrect. As explained above, the written contract is the starting point in determining the mutual intention of the parties under Swedish law rules of contractual interpretation. Further, a court or arbitral tribunal does not under Swedish law have a freedom to depart from the parties' mutual intention to find "*the reasonable contractual solution*". It is not for the tribunal to renegotiate the parties' agreement, but to establish the mutual intent of the parties at the time the contract was entered into. In this respect, the wording of the contract is particularly important.

(2655) Third, Naftogaz' suggestion that a "*court or tribunal would seek to establish an interpretation that is consistent with the other parts of the parties' contract*" is beside the point. It is Naftogaz' interpretation that is inconsistent with the other parts of the parties' contract, inter alia, because:

(i) the Contract does not provide for a fixed price;

(ii) the wording of the Contract makes it clear that the price would be calculated on a quarterly basis; and (iii)the wording of Addendum No. 29 itself expressly contemplates a situation where no supplementary agreement is signed.

(2656) Fourth, it is unclear what Naftogaz means by its statement that the "*scope of a clause which ostensibly covers a certain situation may be reduced if the application of the clause on a particular set of facts would defeat the purpose of the clause*". It is unclear which provision in [redacted] that Naftogaz asserts "*ostensibly covers*" the present situation but that Naftogaz considers needs to be reduced. If Naftogaz refers to [redacted] It is unclear how Naftogaz suggests that the application of this provision in the exact situation contemplated by the parties when drafting the provision would defeat the purpose of the clause. Given that the wording of [redacted] explicitly regulates [redacted], Naftogaz cannot claim that it was Naftogaz' intention that such a situation would never occur. Further, it is not clear that the interpretative principle that Naftogaz refers to even exists under Swedish case law. The scholar referred to by Naftogaz in turn only refers to a case from the Swedish labour court (Sw. *Arbetsdomstolen*), a court that does not interpret commercial contracts.

(2657) Fifth, Naftogaz' interpretation of the case referred to, NJA 2005 p. 142, is incorrect. In any event, this case is not relevant in the context of this arbitration. First, the dispute concerned a financing contract. Lessors and lenders almost always reserve the right to change a specific contract term, e.g. the leasing fee, in the event the lessor's or lender's refinancing costs increase. The present situation is not comparable to such a situation. Second, the case concerned a unilateral decision-making right and this is not a situation in which Gazprom has a unilateral decision-making right. By definition, a unilateral decision-making right is a contractual term whereby one party has a choice of whether or not to apply or amend a contract term (e.g. a leasing fee), whereas the other party is bound by the term. [redacted]

(2658) Further, if (which is denied) the Tribunal considers NJA 2005 p. 142 to be relevant, Gazprom has taken no actions that are disloyal or inconsistent.

(2659) Moreover, by contrast with NJA 2005 p. 142, [redacted]

(2660) Accordingly, it is not possible to draw any conclusions relevant to this case from the Supreme Court's ruling in NJA 2005 p. 142.

(2661) In [redacted]

(2662) Therefore, on the clear wording of [redacted] well as on the evidence of the parties' intentions, there was no binding obligation in [redacted] on Naftogaz and Gazprom to enter into quarterly supplementary agreements to calculate [redacted] (i.e. the term set out in [redacted]) and is no longer applicable.

(2663) There is also no basis whatsoever for Naftogaz' suggestion that the parties could only refuse to enter into supplementary agreements if the price was not market reflective or for the implication of any requirement at all for Gazprom to have a particular reason for not doing so. There is no provision in the Contract for a "*right to a price which reflects the level of market prices*" and no basis for the assertion that Naftogaz has an "*inherent right to be able to market the gas at a reasonable profit*".

(2664) As stated above, both parties were free to [redacted] Nevertheless, Gazprom in fact had good reason not to sign a further supplemental agreement under [redacted]. As explained above, Gazprom entered into [redacted] in the context of rising outstanding debts owed by Naftogaz to Gazprom and the extension of a wider economic assistance package by the Russian government to the Ukrainian government. [redacted] explains:

"*The commercial rationale for Gazprom discounting the price under* [redacted] *was to incentivise payment of its outstanding invoices*".

(2665) Therefore, Gazprom agreed to [redacted] in the expectation that Naftogaz would settle all outstanding debts owed to Gazprom up to the end of the first quarter of 2014. However, Naftogaz continued to default in its payment obligations, specifically by failing to pay its debts in respect of November and December 2013.

(2666) [redacted] states:

> "*It was always clear to everyone involved in the negotiations that the price reduction in* [redacted] *was granted on a temporary basis,* [redacted] *and that any agreement to extend the price reduction for subsequent quarters was based upon Naftogaz making timely payments to Gazprom for gas already supplied.*
>
> *In the course of the first three months of 2014, Naftogaz made payment for gas supplied in August 2013, October 2013, January 2014 and February 2014, but it failed to pay for gas supplied in November and December 2014. Gazprom consequently decided not to extend the discount provided for under* [redacted] *beyond* [redacted]."

(2667) In these circumstances, Gazprom had a valid reason not to agree that Naftogaz could continue to benefit from further discounts to the contract price after [redacted]

VIII.11.7.3.2.3 [redacted] is not en enforceable agreement to agree

(2668) Naftogaz asserts that "*in essence*" [redacted] is an agreement to agree, which can be directly enforceable under Swedish law, "*if the subject the parties are to agree on is evident and the agreement to agree is sufficiently complete*". Naftogaz therefore implies that [redacted] constitutes a binding preparatory contract (Sw. *föravtal*). Naftogaz' argument is misconceived and incorrect.

(2669) It is common ground between the parties that [redacted] as such constitutes a binding agreement. Therefore, this is not even a question of whether there is a binding preparatory contract (Sw. *föravtal*). [redacted] should be applied in accordance with its wording. As set out above, the clear and straightforward wording of [redacted]

(2670) [redacted] does not impose any enforceable obligation on the parties to agree. [redacted]

Further, [redacted]

(2671) [redacted] The parties thereby agreed that any further supplemental agreement would be in writing.

(2672) Under Swedish law, where parties have agreed that the definitive or main contract will be in writing, it is presumed that the parties have also agreed that they will not be bound by the contract prior to confirming it in the written contract. Therefore, an agreement to use writing effectively has the same effect as a statutory requirement to use writing.

(2673) This means in this case there is a presumption that the parties agreed that they would not be bound until a further written contract was executed.

VIII.11.7.3.3 The Parties did not intend for the price referred to in [redacted] *to apply for the term for the Contract*

(2674) Naftogaz effectively argues, through a strained and convoluted interpretation and analysis of individual words and phrases [redacted] that the actual price of USD [redacted] per TCM would apply until the end of the term of the Contract i.e. 31 December 2019. This misconceived interpretation is not only contrary to the simple and straightforward wording of [redacted], but also defies commercial sense and was demonstrably not the parties' intention at the time the Contract was entered into, as explained below.

(2675) [redacted] and the parties' statements and conduct in connection with it, should be interpreted in accordance with Article 8 of CISG. This requires that [redacted] be interpreted in accordance with the intention of the parties, specifically that the statements and conduct of a party are to be interpreted according to that party's intentions where the other party knew or could not have been unaware what that intention was (Article 8(1) CISG). If that is not applicable, statements and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances (Article 8(2) CISG). In determining the parties' intentions or a reasonable person's understanding, consideration must be given to all relevant circumstances, including the negotiations, any standard practices between the parties, usages and any subsequent conduct of the parties (Article 8(3) CISG).

(2676) Applying Article 8(1) CISG, to the extent that Naftogaz claims that it intended, through [redacted] to enter into a binding, fixed price agreement that the actual price would be USD [redacted] per TCM from 1 January 2014 until the end of the term of the Contract on 31 December 2019, (which Gazprom doubts, for the reasons set out in paragraphs 360 and 361 below) Gazprom was not aware of it. This is clear from, inter alia:

(2677) [redacted] evidence:

"*It was always clear to everyone involved in the negotiations that the price reduction in* [redacted] *was granted on a temporary basis, was to be reviewed* [redacted] *and that any agreement to extend the price reduction for subsequent quarters was based upon Naftogaz making timely payments to Gazprom for gas already supplied.*";

(2678) The contemporaneous comments made in a press conference that took place on 19 December 2013 (two days after [redacted] was signed) by President Putin, who expressly confirmed that [redacted] was "*a temporary measure*";

(2679) Reports from various press sources, for example:

(i) the Kyiv Post: "*Putin, however, said that the new deal is a temporary solution*"; and

(ii) the Financial Times blog: "*Yanukovich and Putin did, however, confirm that the gas price discounts for Ukraine were - as Putin put it - "temporary" and would be reviewed each quarter*"; and

(iii) subsequent comments made in a press conference on 4 March 2014 by President Putin in response to a query as to whether Gazprom was "*reverting to its old gas prices*" from April 2014, which confirm this position:

"*Gazprom could not have said that; you were not listening carefully or it did not express itself clearly. Gazprom is not reverting to the old prices. It simply does not want to extend the current discounts, which it had agreed to apply or not apply on a quarterly basis. Even before all these events, even before they hit the crisis point. I know about the negotiations between Gazprom and its partners. Gazprom and the Government of the Russian Federation* *agreed that Gazprom would introduce a discount by reducing gas prices to $268.50 per 1,000 cubic metres. The Government of Russia provides the first tranche of the loan, which is formally not a loan but a bond purchase – a quasi-loan, $3 billion dollars in the first stage. And the Ukrainian side undertakes to fully repay its debt that arose in the second half of last year and to make regular payments for what they are consuming – for the gas. The debt has not been repaid, regular payments are not being made in full.*

Moreover, if the Ukrainian partners fail to make the February payment, the debt will grow even bigger. Today it is around $1.5–1.6 billion. And if they do not fully pay for February, it will be nearly $2 billion. Naturally, in these circumstances, Gazprom says, "Listen guys, since you don't pay us anyway, and we are only seeing an increase in your debt, let's lock into the regular price, which is still reduced". This is a purely commercial component of Gazprom's activities, which plans for revenues and expenditures in its investment plans like any other major company. If they do not receive the money from their Ukrainian partners on time, then they are undercutting their own investment programmes; this is a real problem for them. And incidentally, this does not have to do with the events in Ukraine or any politics. There was an agreement: "We give you money and reduced gas rates, and you give us regular payments". They gave them money and reduced gas rates, but the payments are not being made. So naturally, Gazprom says, Guys, that won't work."

(2680) Against this background, Gazprom had absolutely no reason to suppose that it was Naftogaz' intention that the price referred to [redacted] would be permanent. Therefore, the test that Gazprom "*could not have been unaware*" that such was Naftogaz' intention is not fulfilled and Article 8(1) of CISG does not support Naftogaz' case.

(2681) On the contrary, the various contemporary and subsequent statements demonstrate that Naftogaz knew or could not have been unaware that it was Gazprom's intention that [redacted] should be a temporary arrangement.

(2682) Further, if Article 8(1) of CISG is not applicable, pursuant to Article 8(2) of CISG, statements made by Naftogaz, and other conduct of Naftogaz, are to be interpreted according to the understanding that a reasonable person of the same kind as Gazprom would have had in the same circumstances.

(2683) There is no reason why a reasonable person of the same kind as Gazprom would have understood that Naftogaz intended to enter into a binding, fixed price agreement until the end of the Contract term. Indeed, it is highly implausible that such was in actual fact Naftogaz' intention at the time. In particular:

(i) the various contemporary statements made it abundantly clear that [redacted] was intended to be a temporary arrangement, with the actual price of USD [redacted] applicable for the first quarter of 2014 only (see paragraph 356 above);

(ii) the wording of [redacted] itself expressly contemplates a situation [redacted] (i.e. an actual price of USD [redacted] would likely not apply);

(iii) the wording of the Contract makes it clear that the price would be calculated [redacted]

(iv) Naftogaz' subsequent correspondence demonstrated that it considered that the price referred to in [redacted] was temporary and applied only to [redacted]

in its letter dated [redacted], Naftogaz stated:

"*In light of the foregoing, we are urging you, Mr Miller, to review the price of natural gas being delivered from April 2014 under Contract No. KP and sign the Supplement setting the relevant coefficient provided by the formula for calculating the price under Contract No. KP, which will make it possible to preserve the price of the gas being delivered at the level of* [redacted] *US dollars per 1,000 cubic metres, as set previously from 1 January of the current year.*"; and

in its letter dated [redacted] Naftogaz indicated that payment for past supplies was conditional upon Gazprom agreeing that the price for future supplies would be USD [redacted] per TCM, thereby acknowledging that a continuation of a price of USD [redacted] per TCM required an agreement between the parties to that effect:

"*..we are ready to immediately pay in full the accumulated debt for the natural gas delivered under [the Contract] on condition that the gas price under [the Contract] will remain at the level of the price set in* [redacted]*, i.e. in the amount of* [redacted] *US dollars per [TCM].*"

If Naftogaz really believed that the parties already had concluded such an agreement, Naftogaz would of course have referred to an already existing agreement in its letter; and

as [redacted] points out, it would have been commercially nonsensical for the parties to agree to a fixed price of USD [redacted] until the end of the term of the Contract:

"*I understand from Gazprom's legal counsel that Naftogaz has argued that the price of USD* [redacted] *should be applied for the remaining life of the Contract, until 2019. I consider that to be a commercially nonsensical proposition given the extent to which prices in the energy market can fluctuate and that the Contract at the time of* [redacted] *still had* [redacted] *left to run*".

(2684) Such alleged intention is also contradicted by Naftogaz' suggestion that [redacted] was entered into "*to mitigate a Contract Price which had moved out of step with the market and prescribes the calculation of a market reflective price*". Not only is this suggestion incorrect (as explained by [redacted] was agreed in view of political turmoil and imminent economic collapse in Ukraine, in the context of an extensive aid package offered to Ukraine by the Russian government and in order to incentivise payment by Naftogaz of outstanding invoices), but it would have been impossible to say, in 2013, whether the price of USD [redacted] that Naftogaz now alleges should be fixed, would be "*market reflective*" for the rest of the term of the Contract up to 2019.

VIII.11.7.3.4 Section 36 of the Swedish Contracts Act is not applicable in relation to [redacted]

VIII.11.7.3.4.1 Introduction

(2685) Naftogaz asserts an alternative case on the basis of section 36 of the Swedish Contracts Act. This alternative claim is based on the misconceived premise that the Tribunal may find that [redacted] "*entitles Gazprom to unilaterally increase the agreed factual price of USD 268.50 per [TCM] for reasons not related to the market or simply without reason at all*".

(2686) As set out above, the correct position is that the price stated in [redacted] applied (via an adjustment to the [redacted] Gazprom's position in relation to Naftogaz' alternative claim on the basis of section 36 is set out below.

VIII.11.7.3.4.2 The CISG approach to questions of invalidity and hardship

(2687) As explained, it is not appropriate under CISG to apply a national law approach under Section 36 of the Swedish Contracts Act in cases of hardship. Section 36 of the Swedish Contracts Act covers issues of whole or partial invalidity from the inception of the contract and issues of impediment or hardship due to changed circumstances. Whereas, pursuant to Article 4(a) of CISG, issues of invalidity fall outside the scope of CISG, issues of impediment or hardship fall within the scope of CISG – in particular Article 79. Therefore, questions of the potential modification of a contract by reason of changed circumstances should not be dealt with under national law.

(2688) It follows that, where CISG is applicable, Section 36 of the Swedish Contracts Act should not be applied in cases of changed circumstances.

(2689) However, in this case there is, in any event, no issue of hardship or impediment outside Naftogaz' control.

VIII.11.7.3.4.3 There is no term in [redacted] that is unconscionable under Section 36 of the Swedish Contracts Act

(2690) Even if, contrary to the above, the Tribunal finds that section 36 of the Swedish Contracts Act is applicable, Naftogaz has failed to prove that any term in [redacted] is unconscionable and should be set aside or amended in the manner argued for by Naftogaz.

(2691) Naftogaz' argument is apparently that, if the Tribunal finds against its primary position that the price of [redacted] is still applicable:

(i) such finding requires the implication of a term that Gazprom has a unilateral right to cancel the parties' alleged pricing arrangement; and
(ii) such an implied term is unconscionable and should therefore be set aside.

(2692) As set out above, the premise of this argument is fundamentally misconceived given that there is no need for the Tribunal to imply such a term in order to defeat Naftogaz' arguments in relation to [redacted] In summary:

(i) Gazprom has not unilaterally cancelled any pricing arrangement;
(ii) there is no contractual obligation upon Gazprom to sign further supplemental agreements;
(iii) there is nothing otherwise in Swedish law that would require Gazprom to sign such further supplemental agreements; and
(iv) the parties have already agreed on the consequences if no further supplementary agreements were signed.

(2693) Naftogaz' argument regarding an implied term ignores the express term that refers to either party (including Naftogaz itself) deciding [redacted]" not to sign a supplemental agreement in future. This is not a situation where any sole discretion has been given to Gazprom or where the final decision in relation to amendments on price has been given to one party. It is a situation where (in accordance with normal contractual principles) both parties must agree on any future change to the price and (consistent with the rights of both parties to adopt such a position) the parties did not reach such agreement [redacted] That this is the correct position is even more clear given that the parties expressly agreed on the consequences that would follow in the event of their failure to make future agreements (i.e. that [redacted] Gazprom has not unilaterally determined the price. Rather, the parties agreed beforehand on what price would apply [redacted] Naftogaz entirely fails to address the consequences of its agreement to that provision.

(2694) Finally, Naftogaz makes various unsupported assertions regarding the parties' respective bargaining power, the circumstances surrounding the agreement of [redacted] and the reasons underlying Gazprom's decision not to agree further supplementary agreements resulting in an actual price of [redacted] per TCM. While these points are irrelevant given the flaws in Naftogaz' arguments identified above, Naftogaz' assertions are a misrepresentation of the actual position and, in some instances, are nothing more than unjustified conjecture. As Gazprom's evidence shows:

(2695) Naftogaz' repeated assertions as to its "*inferior bargaining position*" and its claim that Gazprom was, and is, "*allowed to dictate the terms of sale*" for gas are untrue and ignore, inter alia:

(i) Naftogaz' position as the dominant transporter of Russian gas, which gives it significant bargaining power with Gazprom of which it took full advantage during the 2009 Contract negotiations; in particular given Naftogaz' precipitation of the 2009 gas crisis through its deliberate and premeditated disruption of transit supplies to Europe (see further paragraphs 121 to 149 above); and

(ii) the statements of Naftogaz' own employees and [redacted] including:

- [redacted] statement that the Contract was "*a victory of Ukraine in general and [Naftogaz] in particular*"; and

- [redacted] statement that "*we were confident that we had achieved a reasonably balanced contract based on the Groningen model….[i]n particular we were confident that the Contract Price was market reflective.*";

(2696) that [redacted] was entered into in the context of an extensive aid package given by Russia to Ukraine at a time of Ukrainian political turmoil and economic collapse, when Ukraine was at risk of defaulting on its international debt obligations, and in circumstances where Naftogaz owed over USD 2 billion to Gazprom, rather than in the context of agreement on "*market reflective*" pricing; and

(2697) Gazprom's reason for not agreeing to further supplementary agreements continuing the temporary discounted price after the end of the first quarter of 2014 is clear; it had expected that Naftogaz would make payment of its outstanding debts and Naftogaz failed to do so.

VIII.11.7.4 [redacted] does not entitle Naftogaz to a price reduction

VIII.11.7.4.1 [redacted] *means what it says*

(2698) [redacted] provides for the addition of the following wording to article 4.2 of the Contract:

[redacted] (Emphasis added.)

(2699) The wording of this provision is clear; [redacted] he word [redacted] means what it says.

(2700) Further, there is no need for any implied term as argued for by Naftogaz. The conditional wording of [redacted] presupposes that the relevant Russian resolutions might not apply and, in such circumstances, automatically means that there would be no discount to apply.

(2701) There is nothing in [redacted] to suggest that the parties agreed that the discount would last for the remainder of the Contract term, or even for a particular length of time. Importantly, [redacted] is silent about its future application.

(2702) Accordingly, upon the cancellation by the Russian Federation of the applicable customs duties resolutions, [redacted], ceased to require an adjustment to the actual Contract Price.

VIII.11.7.4.2 Gazprom is not benefitting from an illegal act

(2703) Naftogaz makes various arguments as to the legality of the Russian Federation's actions with respect to the Kharkiv Treaty, which it relies on to support its interpretation of [redacted] contrary to the clear wording of the text.

(2704) As explained above, the Russian Government provided a customs discount to Naftogaz by virtue of Resolution 291. That discount was later revoked by Resolution 260. Governments are entitled to make their own sovereign decisions regarding customs regulations and customs discounts. In any event, any complaints regarding the Russian Government's actions in this regard should be directed to the Russian Government, not to Gazprom, and lie entirely outside the Tribunal's jurisdiction and powers in this Arbitration.

(2705) The question of whether or not the incorporation of Crimea into Russia was in compliance with international law is irrelevant in this context. It is not a matter for this Tribunal to decide, nor would it be appropriate for the Tribunal to attempt to do so.

(2706) It is sufficient for the Tribunal to note that Gazprom is not benefitting from the incorporation of Crimea into Russia. Since Gazprom merely passed on the customs discount to Naftogaz pursuant to the terms of [redacted], neither the fact of the customs discount nor the revocation of that discount provided any benefit (or detriment) to Gazprom. [redacted] confirms:

"*.. the price reduction had no impact whatsoever on the revenues to Gazprom from the sale of gas. The reduction in customs duties* [redacted] *was not the result of a commercial negotiation between Gazprom and Naftogaz.*"

VIII.11.7.4.3 Gazprom is not etopped from asserting that the price reduction no longer applies

VIII.11.7.4.3.1 Section 33 of the Swedish Contracts Act is not applicable

(2707) Naftogaz further asserts that Gazprom is "e*stopped from reversing the price reduction*" and, in particular, by reason of Section 33 of the Swedish Contracts Act, Gazprom's reliance on its "*notice to Naftogaz that the price reduction should be reversed*" is against "*faith and honour*". Consequently, Naftogaz argues the price reduction remains in force.

(2708) In asserting that Gazprom is "*estopped from reversing the price reduction*", Naftogaz appears to ignore the fact that it is not Gazprom that "*reversed*" the price reduction; the only decision maker in that regard was the Russian Federation, which, self-evidently, is not synonymous with Gazprom or a party to this arbitration. Gazprom's only action was to notify Naftogaz of the factual position that the relevant customs duty resolution was no longer in place and therefore, according to the express wording of [redacted] [redacted] provided for in that resolution was no longer applicable.

(2709) In addition, Naftogaz' argument completely misunderstands the purpose and application of Section 33 of the Swedish Contracts Act, which is a provision on invalidity that has not been applied by the Supreme Court in modern times.

(2710) Section 33 of the Swedish Contracts Act provides:

"*A legal act which would otherwise be deemed valid may not be relied upon where the circumstances in which it arose were such that, having knowledge of such circumstances, it would be inequitable to enforce the legal act, and where the party in respect of whom such legal act was performed must be presumed to have had such knowledge.*"

(2711) Section 33 of the Swedish Contracts Act is a provision that relates to the invalidity of certain legal acts. Naftogaz argues that "*Gazprom's notice to Naftogaz that the price reduction should be reversed is a legal act.*" However, it is unclear what the effect is that Naftogaz contends the invalidation of Gazprom's "*notice*" would have. The fact that [redacted] does not entitle Naftogaz to a price reduction follows from the wording of [redacted] Gazprom's notice does not have any relevance in this regard.

(2712) Further, Section 33 of the Swedish Contracts Act is simply not applicable in this situation. The preparatory works refer to two principal situations in which Section 33 may apply, as follows:

(i) where the person performing the legal act (A) is influenced by circumstances making him incapable of understanding the content and consequences of the legal act, since it would be inequitable for someone to enforce that legal act, having knowledge of those circumstances; and

(ii) where the counterparty (B), without actually enforcing A's legal act, otherwise uses A's ignorance of the factual circumstances in a dishonest way.

(2713) Naftogaz' argument is that Gazprom's notice to Naftogaz that the price reduction was no longer in force is a legal act to which Section 33 should apply. However, as explained above, Section 33 is not directed at the person performing the legal act (A), but at the counterparty (B) who attempts to enforce and take the benefit of an undertaking or other legal act performed by (A) and is therefore inapplicable.

(2714) Axel Adlercreutz and Lars Gorton explain that what Section 33 addresses is B relying on A's legal act (knowing how that legal act originated):

"*An important difference in comparison with the invalidity rules in Sections 28-31 is that for Section 33 to apply it is not required – but it may well be the case – that inappropriate behaviour on the part of the other party B or a third party has evoked (caused) As legal act with the content in question. The inappropriate or dishonest behaviour lies in B invoking the legal act, despite the fact that he, at the above-mentioned relevant point in time, had knowledge of the circumstances that gave rise to the legal act.*"

(2715) In summary, therefore, Section 33 is not applicable to these circumstances.

VIII.11.7.4.3.2 The principle of *pactum turpe* is not applicable

(2716) As an alternative to applying Section 33, Naftogaz also refers to the principle of *pactum turpe* (contracts contrary to good morals). The basis for this principle is that certain contracts do not deserve the protection of judicial system, for example where the performance of the contract involves a criminal act.

(2717) Swedish legislators chose not to include the principle of *pactum turpe* in the Contracts Act and the Supreme Court has on the legislators' recommendation taken a liberal view in relation to such contracts. Ramberg and Ramberg confirm that judges should only in exceptional cases refuse to uphold a contract on grounds of *pactum turpe*.

(2718) It is unclear whether Naftogaz asserts that the Contract, [redacted] or Gazprom's "*notice*" is a contract contrary to good morals. However, the *pactum turpe* principle only applies to contracts (cf. Latin pactum,-a) and not legal acts in general. Therefore, insofar as Gazprom's "*notice*" is referred to, this principle cannot apply (even where the "*notice*" would be considered to constitute a legal act).

VIII.11.7.4.3.3 The general principle preventing a party from benefitting from its own wrongdoing is not applicable

(2719) Further in the alternative, Naftogaz relies on a general principle, which it claims was applied in the Supreme Court cases NJA 1971 p. 474 and NJA 2014 p. 332, by which a party is not allowed to benefit from its own wrongdoing.

(2720) However, as explained above, Gazprom is not benefitting from its own wrongdoing and therefore the cases relied upon by Naftogaz are irrelevant.

VIII.11.7.4.4 Section 36 of the Swedish Contracts Act is not applicable

(2721) As with [redacted], Naftogaz asserts an alternative case on the basis of Section 36 of the Swedish Contracts Act, as to which Gazprom's response is set out below.

VIII.11.7.4.4.1 The CISG approach to questions of invalidity and hardship

(2722) As explained, it is not appropriate under CISG to apply a national law approach under Section 36 of the Swedish Contracts Act in cases of hardship. Thus, questions of potential modification of a contract by reason of changed circumstances should not be dealt with under national law.

Again, there is no issue of hardship or an impediment beyond Naftogaz' control.

VIII.11.7.4.4.2 There is no term of [redacted] that is unconscionable under Section 36 of the Swedish Contracts Act

(2723) Further, even if Section 36 of the Swedish Contracts Act was applicable, Naftogaz has failed to prove that any term in [redacted] is unconscionable and should be set aside or amended in the manner argued for by Naftogaz.

(2724) As is clear from the word [redacted]" in [redacted] the parties took account of the fact that the Russian Federation might amend or cancel its customs resolutions and that such changes might be made for a variety of reasons. Therefore, the parties foresaw that the customs regulations might change and that the discount might cease to apply.

(2725) It is not unconscionable for a seller to pass on a customs discount to the buyer, and for the seller to cease to apply this arrangement pursuant to agreed contract terms in the event that the customs discount ceases to apply. Further it is not unconscionable that a customs discount (which was not expressly provided for in the terms of the Contract, but only by reference to any applicable government resolution) was revoked, particularly where that customs discount was not originally applicable.

(2726) Given the clear wording of [redacted], Naftogaz must be taken to have accepted the risk that the customs discount might cease to apply and that [redacted] would in such circumstances be applied by Gazprom in accordance with its specific terms.

(2727) In any event, as explained in above, the USD 100 reduction in export duties has since been re-implemented by means of other resolutions of the Russian government in respect of the period 1 November 2014 to 30 June 2015 and is reflected in [redacted]

(2728) Further, Naftogaz refers to "*the Russian side of the legal arrangement*", which must be understood to include Gazprom and the Russian Federation. However, again, the Russian Federation is not synonymous with Gazprom, or a party to this arbitration.

VIII.11.7.5 Naftogaz has no right to repayment in respect of the price determination claims

(2729) Naftogaz also brings claims against Gazprom for repayment (Naftogaz' Claim 4) "*that equates to the part of all monthly payments made for Natural Gas delivered under the Contract from 1 April 2014 to the date of the award exceeding the applicable factual price*" as determined according to Naftogaz' Claim 1.1 (relating to [redacted]) or [redacted] Gazprom denies these claims in their entirety.

(2730) First, it is unclear what repayment Naftogaz actually seeks under its Claim 4. It is, inter alia, unclear how this claim relates to [redacted] (in which it is recognised that [redacted]). Gazprom assumes that, should Naftogaz succeed with its Claim 1.2, Naftogaz does not at least claim that any repayment should be made for the period 1 November 2014 to 30 June 2015 (i.e. the contract term of Addendum [redacted]

(2731) Second, as set out above, Naftogaz has no right to price revision under the Contract. Therefore, since Naftogaz' price determination Claim is intertwined with the price revision claims, Naftogaz has no right to repayment based on that price determination claim.

(2732) Third, as explained above, Naftogaz' price determination claims themselves should be rejected. Therefore, it follows that Naftogaz has no right to repayment based on the price determination claims.

(2733) Fourth, although it is unclear what time periods Naftogaz' Claim 4 in fact covers, Naftogaz can never be entitled to price determination with retroactive effect based on the application of Section 36 of the Swedish Contracts Act.

VIII.11.7.6 Conclusion on Naftogaz' price determination claims

(2734) In summary, for the reasons set out above, Gazprom denies that Naftogaz is entitled to pay a [redacted] from the [redacted] of USD [redacted] per TCM on the basis of [redacted] and Swedish contract law or, alternatively, that it is entitled to a [redacted] payable from [redacted] reduced by [redacted] Naftogaz is not entitled to any repayment from Gazprom on the basis of the factual prices asserted by Naftogaz.

VIII.11.7.7 Gazprom's further submissions regarding [redacted]

VIII.11.7.7.1 Gazprom's interpretation of [redacted] *is consistent with the language used in* [redacted] *Naftogaz' interpretation of* [redacted] *cannot be sustained*

(2735) Gazprom's principal argument is that the use of the term [redacted] It should be noted that there is a comma before the [redacted] This comma appears in the Russian original text, and in Gazprom's English translation. However, the comma is noticeably missing from Naftogaz' English translation. This is a significant omission – the comma further emphasises that [redacted]

(2736) Naftogaz' contrary position is that a price reduction should remain in effect even where the relevant resolutions of the Government of the Russian Federation are no longer in effect (i.e., that the factual price can go down but cannot go back up again). However, Naftogaz' position is unsupported by the wording of [redacted] and is plainly wrong.

(2737) The only textual argument that [redacted]

(2738) A further point in Gazprom's favour is the fact that the word [redacted] (as well as [redacted]) refer to [redacted] of the Russian Federation. The use of the plural form implies that more than one [redacted] can be relevant to pricing. This feature of the text also provides a strong indication that Naftogaz' interpretation is erroneous.

(2739) Naftogaz makes a further argument to the effect that Gazprom's apparent failure "*to disclose to Naftogaz (and the State of Ukraine) that Gazprom interpreted [*[redacted] *in this manner … would be a decisive argument against construing* [redacted] *as Gazprom argues…*". It could just as easily be said that Naftogaz' failure to disclose its current interpretation to Gazprom makes Naftogaz' interpretation invalid. It is apparent that this argument is of no assistance to the Tribunal. Moreover, there is no evidence which indicates that, at the time of conclusion of [redacted] Naftogaz informed Gazprom that Naftogaz interpreted [redacted] in a particular way. As [redacted] notes he does not believe that "*anyone at Gazprom was made aware of Naftogaz having such an understanding*".

(2740) These points regarding the plain language of [redacted] are sufficient for the Tribunal to reject Naftogaz' interpretation. Accordingly, Naftogaz' price determination claim based on [redacted] should be rejected on the merits.

VIII.11.7.7.2 Naftogaz has no evidence to support its interpretation of [redacted]

(2741) Naftogaz refers to no witness evidence in support of its interpretation of [redacted] In fact, the only witness evidence in relation to [redacted] is that of Gazprom's witness, [redacted] Nothing in [redacted] evidence supports Naftogaz' strained interpretation of [redacted]

VIII.11.7.7.3 Naftogaz' assertions regarding the conduct of the Russin Federation are incapable of altering the interpretation of [redacted]

(2742) Naftogaz makes a number of assertions to the effect that the conduct of the Russian Federation with respect to the former Ukrainian province of Crimea supports its preferred interpretation of [redacted] The interpretation of [redacted] is a matter that must be resolved by reference the intentions of the parties to the Contract and the understanding that a reasonable person would derive from the text of [redacted] No explanation is provided for why the conduct of the Russian Federation (or for that matter, Gazprom if the actions of the Russian Federation are – erroneously – attributed to Gazprom) after the conclusion of the relevant contractual documentation, has any bearing on the interpretation of [redacted] Naftogaz' assertion that post-contractual events involving the international relations of the Russian Federation and Ukraine and, at best, only one of the two contracting parties (Gazprom) "*justifies a restrictive interpretation of* [redacted] is bereft of any legal basis in the applicable principles of contractual interpretation. However, nothing about the Russian Federation's conduct in March 2014 regarding the former Ukrainian province of Crimea sheds any light on the original intentions of Naftogaz and Gazprom when they entered into [redacted] in [redacted] For this reason alone, Naftogaz' assertions must be rejected.

(2743) Furthermore, Naftogaz' arguments ultimately involve an attempt to use arbitration under a commercial contract as a means of obtaining a remedy for conduct in the sphere of inter-state relations. However, the Contract is a contract between two private entities which is governed by Swedish law: it should not be treated as if it is a bilateral treaty between the Russian

Federation and Ukraine that is governed by public international law. In the context of a bilateral treaty between two sovereign States, questions of breach of separate public international law rules may well be relevant to State responsibility. But in a purely contractual arbitration these matters are legally irrelevant. The Russian and Ukrainian Governments accepted in their 2 October 2008 memorandum that gas supply to Ukraine from 1 January 2009 would be handled under a commercial contract between Gazprom and Naftogaz. That choice should be respected and political considerations should not be allowed to alter the balance of the rights and obligations under the Contract. As Gazprom has previously noted, complaints regarding the conduct of the Russian Federation in Crimea are entirely outside this Tribunal's powers.

(2744) In any event, Gazprom does not accept Naftogaz' assertions that the actions of the Russian Federation can be attributed to Gazprom nor does it accept Naftogaz' assertions that the interpretation of [redacted] put forward by Gazprom involves bad faith, a breach of a duty of loyalty and/or an abuse of rights. Naftogaz' arguments on these points are not supported by any of the authorities it cites. The Swedish Supreme Court Case referred to by Naftogaz, NJA 1993 p.188, dealt with a situation where a contractual restriction on business activities was held to apply to a related company: it says nothing about how subsequent events should affect the interpretation of a contract. Naftogaz also refers to writings of Professor Jori Munukka. However, Professor Munukka's comments have no relevance at all to matters of interpretation under the CISG. Moreover, Naftogaz does not specify how the occurrence of certain "*actions*" by the Russian Federation in 2014, or the purported inconsistency of these actions with rules of public international law relating to the use of force, provide any indication about the intentions of the parties when they concluded [redacted]

Naftogaz cannot rely on Section 33 of the Swedish Contracts Act to invalidate [redacted]

VIII.11.7.7.4 Naftogaz' claim for an adjustment of [redacted] *pursuant to Section 3 of the Swedish Contracts Act cannot be sustained*

(2745) Gazprom refers to its various arguments, as stated above, that Section 36 should, in any event, be applied restrictively in commercial contracts and in an international context.

(2746) Moreover, even if Section 36 could be applied, there is no basis for doing so in this situation. Quite simply, [redacted] was not unconscionable when it was entered into, nor has it become unconscionable by reason of subsequent circumstances. In particular, Naftogaz has not shown that the balance of the contract has been disturbed fundamentally.

(2747) In short, Naftogaz was given the benefit of [redacted] and that [redacted] ceased to be applied in 2014. However, the non-availability of [redacted] is, in itself, no grounds for claiming that the Contract is unconscionable; the question is whether the price is unconscionable. This argument in unsustainable.

(2748) Naftogaz also claims that it was unforeseeable that the discount would cease to be applied. However, this argument is this very clearly contradicted by the text of [redacted] itself which makes it abundantly clear that any discount was conditional on contemporaneous resolutions providing for customs duty reductions.

VIII.11.7.7.5 Repayment / damages

(2749) Gazprom understands that Naftogaz has no repayment or damages claim directly based on [redacted].

(2750) However, as far as Gazprom understands, Naftogaz appears to have a repayment claim connected to [redacted] in conjunction with its claims 1.1, 1.2, 1.3.1, 1.3.2, 1.4.1 and 1.4.2. This appears to follow from Appendix 1. Gazprom denies any repayment claim connected to [redacted]

VIII.11.7.7.6 Conclusion

(2751) In conclusion, Naftogaz' price determination claim based on [redacted] must be rejected on the merits. [redacted] does not entitle Naftogaz to a price reduction for the period following 2 April 2014.

<u>VIII.11.7.8 The price referred to in [redacted] is no longer applicable</u>

VIII.11.7.8.1 Introduction

(2752) Gazprom's position under [redacted] is that the parties were free to decide whether or not to enter into a supplementary agreement each quarter: [redacted]

VIII.11.7.8.2 Gazprom's interpretation of [redacted]

(2753) [redacted] directly contradicts Naftogaz' attempt to derive a binding obligation to enter into a supplemental agreement. The second sentence of [redacted] This sentence contains no indication at all that the parties have a binding obligation to reach agreement, or that a failure to reach agreement amounts to a breach of contract, or that damages will be payable as a consequence. Nothing in Naftogaz' Reply explains how this particular sentence can be reconciled with its position.

(2754) The evidence about the negotiating history of [redacted] is impossible to reconcile with Naftogaz' interpretation. Gazprom's evidence is that it was clear to all participants in the negotiations that [redacted] *was granted on a temporary basis…*". Gazprom also refers to press reports as well as subsequent correspondence between the parties which supports the inference that the parties understood that the commercial solution reached in [redacted] was temporary. No specific response has been provided to this material. Instead, [redacted] makes a broad and unsupported assertion that she is "*surprised*" by [redacted] statement that the price in [redacted] was temporary.

(2755) Naftogaz suggests that the price of [redacted] per TCM will not apply if it ceases to be "*market reflective*". Gazprom denies that any such term can or should be implied into [redacted] as: (1) there is no trace of any textual basis for this term; and (2) the term "*market reflective*" is impossible to apply in the absence of any definition of the market in question, the benchmarks to be used and the degree of difference permitted.

(2756) Naftogaz' interpretation of [redacted] must be rejected: a price of US [redacted] per TCM cannot be imposed on Gazprom [redacted]

VIII.11.7.8.3 To the extent it is relevant, Gazprom has acted in good faith in deciding [redacted] *and the price of USD* [redacted] *per TCM was lower than relevant benchmarks*

(2757) Gazprom does not accept that [redacted] allows for the Tribunal to scrutinise either party's refusal to enter into any particular supplementary agreement about the level [redacted] Instead, [redacted] is clear that either party can [redacted]

(2758) Nevertheless, if the Tribunal rejects this argument and assumes a jurisdiction to enquire into Gazprom's refusal to enter into supplementary agreements from [redacted] is Gazprom's position that its decision has been taken in good faith and for entirely legitimate reasons. Gazprom has explained that it refused to enter into further supplementary agreements because Naftogaz defaulted on payment obligations. That explanation has not been impugned in any way by Naftogaz.

(2759) Furthermore, even if the Tribunal accepts Naftogaz' contention that the only permissible reason for Gazprom refusing to agree to a price of USD [redacted] per TCM is that such price is lower than the market price (and therefore is not market reflective) - a premise that Gazprom rejects - Naftogaz would still be entitled to refuse to agree to such a price. As Dr Moselle shows, the price of USD [redacted] per TCM was lower than comparable benchmarks.

VIII.11.7.8.4 To the extent it is maintained, [redacted] pursuant to Section 36 of the Swedish Contracts Act cannot be sustained

(2760) First, NJA 2005 p 142 ("*Hoist Kredit*") does not provide relevant guidance. Section 36 was not referred to by any of the courts in that case. Moreover, in contrast to NJA 2005 p. 142, the current case does not involve a situation in which there is a one-sided right (Sw. ensidig rätt), nor does the current case involve a situation in which only one party has insight into the relevant factual circumstances. On Gazprom's interpretation both parties have the right to refuse to sign any supplementary agreement. Indeed, Naftogaz also accepts that both parties may, in certain circumstances, refuse to sign a supplementary agreement. There is nothing disloyal or inconsistent about either party exercising such a right.

(2761) Second, Naftogaz' argument appears to be that the price of USD [redacted] per TCM was higher than the market price in [redacted]. Gazprom does not accept that, and the evidence supports Gazprom in this respect. In any event, Gazprom had no obligation to accept Naftogaz' view of what constituted market prices. In short, the most that Naftogaz can claim is that Gazprom had a duty not to act disloyally (NJA 2005 p. 142), but it would not be disloyal for Gazprom to form its own view that USD [redacted] per TCM was too low, provided that view was honestly held. In the present case, there is nothing to suggest that Gazprom has acted dishonestly, in bad faith, or "*arbitrarily, capriciously or unreasonably*" in not signing a supplementary agreement. As stated in the its Defence and Counterclaim, and discussed above, Gazprom had very good reasons for not doing so.

VIII.11.7.8.5 Conclusion

(2762) In conclusion, Naftogaz' price determination claim based on [redacted] must be rejected on the merits.

VIII.11.7.8.6 Naftogaz has no right to repayment or damages

(2763) If the Tribunal, contrary to Gazprom's position would accept Naftogaz' Claim 3.1, Naftogaz is not entititled to any repayment under its Claim 4.1. Naftogaz is further not entitled to any damages based on an alleged breach of [redacted] No such breach has been committed and Naftogaz has in any event not suffered any compensatable damage. In addition, Naftogaz has not presented any underlying calculations for its claim.

<u>VIII.11.7.9 Objections to Naftogaz' claims for invalidity/ineffectiveness and replacement of provisions of the Contract pursuant to European Competition Law</u>

VIII.11.7.9.1 Introduction

(2764) In summary, and as explained in detail below, Gazprom's position in respect of Naftogaz' competition law claims is that:

i. there is no legal basis for the application of competition law to the Contract as argued by Naftogaz, and Naftogaz' competition law claims should therefore be rejected;

ii. in the event that the Tribunal were to find that there is a legal basis for the application of competition law to the Contract, the Contract does not breach competition law and Naftogaz' claims for a declaration of invalidity should therefore be rejected;

iii. alternatively, in the event that the Tribunal were to find that the Contract does breach competition law, there is no legal basis for invalidating the contractual provisions referred to, and Naftogaz' claims for a declaration of invalidity should therefore be rejected;

iv. in the event that the Tribunal were to find, in respect of any provision of the Contract:

- that such provision of the Contract is in breach of competition law; and
- that, as asserted by Naftogaz, such provision of the Contract is therefore invalid.

Gazprom has further developed its position in its Submissions of 17 March 2017 and of 17 May 2017.

(2765) Naftogaz' claims for replacement should be rejected, and consequently - since the claims for replacement and invalidity are intertwined - Naftogaz' claims for invalidity should also be rejected;

i. in the event that the Tribunal were to find, in respect of any provision of the Contract, that such provision should be declared invalid and/or that such provision should be replaced, the Contract should be adjusted so as to maintain and/or restore its equilibrium; and

ii. Naftogaz' claim for refund of excessive payments and interest should in any event be rejected.

VIII.11.7.10 No basis for the application of competition law in the matter argued by Naftogaz

VIII.11.7.10.1 Naftogaz' case on applicable competition laws

(2766) The basis for Naftogaz' claims that the Contract is in breach of competition law as explained in its Statement of Claim, both in respect of the price and in respect of the other four categories of contractual provisions referred to, is inconsistent and confused. Naftogaz refers *inter alia*, to the direct application of EU competition law, the application of the EnCT, mandatory Ukrainian law and Swedish law, but without providing a clear and particularised explanation of how each of these separate and distinct legal regimes results in the application of EU competition law to the Contract as pleaded. This confusion in Naftogaz' pleading should not obfuscate the reality that it has not demonstrated a proper legal basis for the application to the Contract of the competition law principles it pleads.

(2767) Gazprom has sought to understand the grounds on which Naftogaz asserts competition law applies. In Parts IX and X of its Statement of Claim, which are the sections of its Statement of Claim in which it sets out its case based on competition law, Naftogaz appears to rely on the following, equally misconceived, bases:

(2768) As regards its claim for invalidity and replacement of the price provisions, Naftogaz argues that the "*applicable competition laws*" are Articles 18(1) and 18(2) of the EnCT on the following bases:

(i) Ukraine has acceded to the EnCT and, as a member of the European Energy Community, is obliged to implement the EU *acquis* on competition in the field of energy;

(ii) the EnCT is applicable to the territory of Ukraine under Swedish law by virtue of Sweden's status as a member state of the EU;

(iii) the EnCT is applicable to the territory of Ukraine when applied under Swedish substantive law;

(iv) under Articles 18(1) and 18(2) of the EnCT, agreements between undertakings that are restrictive of competition and/or abuse of a dominant position are incompatible with the EnCT;

(v) such practices are assessed on the basis of Articles 101 and 102 TFEU; and

(vi) for the sake of simplicity, Naftogaz refers to Articles 101 and 102 TFEU, as it is the law and practice under those provisions that are also relevant under Articles 18(1) and 18(2) of the EnCT, but such references are to the relevant provisions of the EnCT.

(2769) As regards its other claims based on competition law, Naftogaz also argues that the "*applicable competition laws*" are Articles 18(1) and 18(2) of the EnCT on essentially the same bases.

(2770) Each of these arguments is flawed, for the reasons set out below.

VIII.11.7.10.2 The application of the EnCT

VIII.11.7.10.2.1 Introduction

(2771) The European Energy Community is an international organisation dealing with energy policy. The organisation was established by the EnCT, which was signed on 25 October 2005 between the European Community (now the EU) and nine "*Contracting Parties*", being Albania, Bulgaria, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Romania, Serbia and the United Nations Interim Administration Mission in Kosovo, and which entered into force in July 2006. On 24 September 2010, Ukraine signed a Protocol concerning the accession of Ukraine to the EnCT (the "Accession Protocol") and

Ukraine subsequently acceded to the EnCT on 1 February 2011. The Russian Federation is not a member of the European Energy Community and has not signed the EnCT.

(2772) The key aim of the European Energy Community was to extend the EU internal energy market to South East Europe and beyond on the basis of a framework that is legally binding on states.

(2773) Article 18 of the EnCT provides as follows:

"*1. The following shall be incompatible with the proper functioning of the Treaty, insofar as they may affect trade of Network Energy between the Contracting Parties:*

(a) all agreements between undertakings, decisions by associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition,

(b) abuse by one or more undertakings of a dominant position in the market between the Contracting Parties as a whole or in a substantial part thereof,

(c) any public aid which distorts or threatens to distort competition by favouring certain undertakings or certain energy resources.

2. Any practices contrary to this Article shall be assessed on the basis of criteria arising from the application of the rules of Articles 81, 82 and 87 of the Treaty establishing the European Community [now Articles 101, 102 and 107 of the TFEU]."

(2774) This provision reflects, but does <u>not</u> specifically incorporate the provisions of Articles 101 and 102 of the TFEU. It simply provides that any practices contrary to Article 18 "*shall be assessed on the basis of criteria arising from the application of*" those provisions.

(2775) Article 101(1) TFEU provides as follows:

"*The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:*

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

(2776) Article 101(2) TFEU provides that:

"*Any agreements or decisions prohibited pursuant to this Article shall be automatically void.*"

(2777) No equivalent provision is found in Article 18 of the EnCT.

(2778) Article 102 TFEU provides as follows:

"*Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.*

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

(2779) In its Statement of Claim, Naftogaz makes the ambitious assertion that: "*As a Contracting Party to the [EnCT], Ukraine has implemented the European Union acquis on competition in the field of energy as well as the acquis on energy*". Naftogaz also asserts: "*As it follows, both the EC/EU acquis on competition and the Ukrainian competition legislation referred to above, require that the terms and conditions of the Contract be adapted to conform with protection of competition requirements as well as render a number of its provisions invalid*". Against that background, Naftogaz relies on the application of the EU *acquis* by virtue of the EnCT and Article 18 of the EnCT as the basis for its competition claims against Gazprom.

(2780) Naftogaz' competition law claims are premised on the assumption that the EnCT and, in particular, Article 18 of the EnCT, has "*direct effect*" and is "*directly applicable*" to the Contract pursuant to Swedish law. Naftogaz refers to this expressly in its Statement of Claim, stating:

"*…a treaty concluded by the European Union as such or by an instrumentality of the European Union has direct effect in each of the member states if the standard requirements for direct effect are fulfilled….[The EnCT] ... is therefore directly applicable under Swedish law*".

(2781) However, Naftogaz' position in this regard is fundamentally misconceived. The actual position in relation to the EnCT is that:

(i) the Contracting Parties' obligations under the EnCT are aspirational in nature; the clear terms of the EnCT and the Accession Protocol provide for the <u>future</u> transposition and implementation of particular aspects of the EU *acquis* (and, in relation to the energy *acquis* specifically, provide a "*timetable for implementation of the acquis communautaire*");

(ii) it is widely accepted (including by the Energy Community Secretariat itself) that the general implementation of the EU *acquis* under the EnCT has not been achieved as originally anticipated[89], and Ukraine specifically, while acknowledged to be "*gathering momentum*", is deficient in numerous respects;[90] and

(iii) the EnCT is a political treaty, approximating the laws of the Contracting Parties, but it is not directly applicable to the Contract pursuant to Swedish law and, critically, does not afford private parties (such as Naftogaz) enforceable rights that would form the basis of claims against another private party (Gazprom).

VIII.11.7.10.2.2 The EnCT and implementation of the acquis

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[89] See, e.g. Leal-Arcas, Rafael, Andrew Filias and Ehab S. Abu Gosh. *International Energy Governance Selected Legal Issues*, 2014, pp. 354: "*Despite the Energy Community being lauded as a success story by the European Commission, numerous challenges have been identified. The most significant of these relate to the failure of many Contracting Parties to fully implement the acquis and ensure the enforcement of the rules thereof. Another concern has been the lack of sufficient investment to foster the infrastructure modernization required for the proper implementation of a number of EU directives and policies.*"

[90] See Energy Community Secretariat Annual Implementation Report dated 1 August 2014, pages 10 and 175 to 178 and paragraphs (2787) to (2789) below.

(2782) It is evident from its terms that the nature of the EnCT is aspirational, providing for the Contracting Parties to move towards harmonisation with the EU and adoption of relevant parts of the *acquis* in the energy sector in the future, rather than the direct application (or even implementation of) the entire EU *acquis* from the outset. The Preamble of the EnCT[91] contains the following statements, all phrased as future obligations:

(i) "*determined to create a stable regulatory and market framework*";

(ii) "*determined to develop gas and electricity market competition on a broader scale*";

(iii) "*a broad ranging and integrated market regulatory structure needs to be put in place supported by strong institutions and effective supervision*"; and

(iv) "*resolved to establish among the Parties an integrated market in natural gas and electricity*". (Emphasis added.)

(2783) Similarly, Article 2(1) of the EnCT provides:

"*The task of the Energy Community shall be to organise the relations between the parties and create a legal and economic framework in relation to Network Energy…in order to:*

(a) create a stable regulatory and market framework capable of attracting investment in gas networks, power generation, and transmission and distribution networks…

(e) develop Network Energy market competition on a broader geographic scale and exploit economies of scale." (Emphasis added.)

(2784) Article 3(a) of the EnCT refers to the activities of the Energy Community including: "*the implementation by the Contracting Parties of the acquis communautaire on energy, environment, competition and renewables….adapted to both the institutional framework of the Energy Community and the specific situation of each of the Contracting Parties…*". This provision not only envisages future implementation of the *acquis*, but also that it will need adapting for both the Energy Community and the particular circumstances of each country. This means that the relevant parts of the *acquis* will not necessarily even be implemented in the same way in the EnCT Contracting Parties as in EU law. The obligation imposed upon a Contracting Party is not a "*copy and paste*" one of straightforward direct transposition into

[91] Pursuant to Article 31(2) of the Vienna Convention on the Law of Treaties 1969, the text of a treaty includes, in the context of its interpretation, its Preamble and Annexes.

domestic law of the EU *acquis* but a fundamentally different one whereby adaptation of the *acquis* - potentially to a very significant degree - is involved. It is obvious from this that the EU *acquis* does not and cannot have immediate and direct applicability.

(2785) Likewise, Article 5 of the EnCT provides that "*the Energy Community shall follow the acquis communautaire … adapted to both the institutional framework of this Treaty and the specific situation of each of the Contracting Parties, with a view to ensuring high levels of investment security and optimal investments*".

(2786) The Energy Community Secretariat's Annual Implementation Report 2014 (the "EnCS Report") makes clear that there are at least two stages in the Contracting Parties' adoption of the relevant parts of the EU *acquis* pursuant to the EnCT: (i) the transposition of relevant EU legislation by each Contracting Party; and (ii) its actual implementation.[92] Only specific parts of the *acquis* are adopted by the Energy Community,[93] rather than the wholesale implementation that Naftogaz wrongly suggests. Further, the Accession Protocol provides a specific timetable for Ukraine's implementation of relevant parts of the *acquis* on energy, containing dates ranging from January 2012 to January 2018.[94]

(2787) The lengthy EnCS Report is dedicated to assessing the state of the Contracting Parties' transposition and implementation of the *acquis*. It is clear from this that, contrary to Naftogaz' assertion, Ukraine has not implemented fully the EU *acquis* on competition in the energy sector or the *acquis* on energy. The EnCS Report notes, *inter alia*, the following in relation to Ukraine's implementation, reflecting significant shortcomings:

(i) "*[i]n terms of legislation, the Law on the Principles of Functioning of the Natural Gas Market of 2010 reflects the main provisions of the acquis. However, it apparently does not supersede previous legislative acts and is contradicted by preceding laws…These laws typically repeat themselves and impede effective regulation rather than adding value for the independence or competences of the regulator*";[95]

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92 See EnCS Report, with reference to the Second Energy Package: "*The Implementation Reports of the last years essentially documented how most Contracting Parties managed to yield results quickly in the transposition of the Second Energy Package but failed to implement it in terms of creating truly open markets.*" (page 10).

93 See, e.g. page 25 of the EnCS Report, which refers to EU Regulation 994/2010 on measures to safeguard security of gas supply not yet having been adopted and page 16, which lists the specific parts of the EU *acquis* on gas that have been adopted.

94 Article 2, Accession Protocol.

95 EnCS Report, page 176.

(ii) "*the currently applicable Law on the Principles of Functioning of the Natural Gas Market (the Gas Law) is still not fully in line with the Second Energy Package*";[96]

(iii) *"[f]or transposition of the Third Package, the Secretariat submitted a draft Gas Law to the Ministry of Energy and Coal in April 2014 as the basis for an upgrade of the existing legal framework. It is currently being discussed in Ukraine*";[97]

(iv) "*[t]he gas market in Ukraine is currently not an open market*";[98]

(v) "*Ukraine is paying the price for postponing its gas market reforms beyond the deadlines of the [EnCT]*";[99] and

(vi) "*Ukraine should adopt a gas law compliant with the Third Package as soon as possible in cooperation with the Secretariat and start reforming its institutions in the gas sector. The agenda remains the same as last year: fully implementing the acquis with regard to unbundling, third party access, tariff principles, competences of NERC and price regulation*".[100]

(2788) It is the case that the Ukrainian Parliament has recently adopted a new Law on Natural Gas Market, which came into force on 9 May 2015. It would appear that this law seeks to reflect the requirements of the Third Energy Package.[101] However, the opening of the Ukrainian gas market in compliance with the *acquis* is clearly still at an early (and incomplete) stage.

(2789) The matters set out above as regards Ukraine's compliance with its obligations under the EnCT make it clear that there are significant continuing failings in Ukraine's implementation of the relevant parts of the *acquis* and that there is much work for it still to do. It is simply not the case that Ukrainian law can be taken as giving effect to the EU *acquis*.

VIII.11.7.10.2.3 The EnCT does not have direct effect or give Naftogaz enforceable rights

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96 EnCS Report, page 176.
97 EnCS Report, page 176.
98 EnCS Report, page 176.
99 EnCS Report, page 178.
100 EnCS Report, page 178.
101 The new Law provides for free access to the Ukrainian gas transportation system by any eligible party, secures non-discriminatory access to the gas market by all gas producers including biogas and gas from biomass, gives freedom of choice of gas suppliers to the gas consumers as well as separates activities of vertically integrated gas companies (unbundling). However, small distribution system operators which have less than 100,000 consumers will be exempt from the unbundling requirements. The Ukrainian Energy Commission (NERC) as a national energy regulator will get more powers.

(2790) As stated above, Naftogaz asserts that "*a treaty concluded by the European Union as such or by an instrumentality of the European Union has direct effect in each of the member states if the standard requirements for direct effect are fulfilled*" and that the EnCT "*is therefore directly applicable under Swedish law*". However, Naftogaz fails to state: (i) what it asserts the "*standard requirements*" for direct effect are; and (ii) how they are fulfilled in the case of the EnCT. Accordingly, Naftogaz has failed to make out its case that the EnCT has direct effect. It does not have such effect.

(2791) As a matter of EU law pursuant to the TFEU, an agreement concluded by the EU is binding on member states. This means that, as a matter of EU law, the EnCT is binding on Sweden as a member state of the EU. However, EU member states are not bound under international law by agreements concluded by the EU, unless those agreements are mixed and have the member states as contracting parties together with the EU Further, the legal consequences and effect of the binding nature of agreements concluded by the EU is not stated in the TFEU. In asserting that the EnCT has "*direct effect*" or is "*directly applicable*" in Sweden, Naftogaz seeks to apply the EU principle of horizontal direct effect to an international treaty between states, arguing that it, as a private party, can rely on the EnCT as the basis for its private claims against Gazprom. Such a position is misconceived, for the reasons set out below.

(2792) It is first relevant to note that Sweden has a dualistic approach to international treaties. Sweden is not a "*Contracting Party*" to the EnCT and has no obligation to incorporate it into Swedish law. The EnCT has not been incorporated into Swedish law.

(2793) The EnCT is not an EU agreement and it does not establish any EU institutions or give effect directly to EU law in the Contracting Parties.[102] The starting point is that the EnCT is an international treaty entered into by the EU and the Contracting Parties, which gives rise to international legal obligations between the states that are parties. On its clear terms, the EnCT does not give direct rights to private parties as against other private parties. Rather, it establishes inter-state obligations as a matter of public international law.

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[102] See, e.g. Leal-Arcas, Rafael, Andrew Filias and Ehab S. Abu Gosh. *International Energy Governance Selected Legal Issues*, 2014, pp. 354: "*The Energy Community (EnC) is a treaty-based regime set up under the Energy Community Treaty (EnCT) whose signatories include the EU and several third-party States. It is not an EU institution, despite the fact that it inducts various parts of the EU's acquis communautaire into the EnC's legal order.*"

(2794) The obligations in the EnCT, including to implement relevant parts of the *acquis* and Article 18 concerning competition, are, self-evidently, obligations on the Contracting Parties. The only relevant entity in terms of these proceedings to have any obligations under the EnCT is the state of Ukraine (which is not a party to this arbitration). The EU (and, to the extent relevant by extension, Sweden) is not a "*Contracting Party*" to the EnCT and has no obligations under the EnCT (save insofar as member states may become "*Participants*" in the Energy Community pursuant to Article 95).

(2795) That the EnCT contains inter-state obligations is reflected by Title VII of the EnCT ("*Implementation of Decisions and Dispute Settlement*"), which contains, *inter alia*, the following provisions reflecting, by their treatment of breaches of such obligations, the inter-state character of the obligations in the EnCT:

(i) "*[f]ailure by a Party to comply with a Treaty obligation or to implement a Decisions addressed to it may be brought to the attention of the Ministerial Council by a reasoned request of any Party, the Secretariat or the Regulatory Board*" (Article 90(1);

(ii) "*[t]he Ministerial Council may determine the existence of a breach by a Party of its obligations*" (Article 91); and

(iii) "*[A]t the request of a Party, the Secretariat or the Regulatory Board, the Ministerial Council, acting by unanimity, may determine the existence of a serious and persistent breach by a Party of its obligations under this Treaty and may suspend certain of the rights deriving from the application of this Treaty to the Party concerned, including the suspension of voting rights and exclusion from meetings or mechanisms provided for in this Treaty*" (Article 92).

(2796) As illustrated by the above, the dispute settlement provisions of the EnCT provide only for the jurisdiction of the Ministerial Council to consider breaches of EnCT obligations by the Parties and to take decisions in that respect, including with the potential consequences of the suspension of a state's voting rights and its exclusion from meetings or EnCT mechanisms. Notably, the dispute settlement provisions do not contain any mechanisms that might make the provisions of the EnCT directly enforceable by private parties, such as the setting up of a court or arbitration provisions.[103]

(2797) The only dispute settlement provision that addresses the right of private parties is Article 90(1), which provides that "*[p]rivate bodies may approach the Secretariat with complaints*". This does not suggest that the EnCT gives directly enforceable rights to private parties and in fact, by indicating that the correct avenue for private parties is a complaint to the Secretariat, contradicts Naftogaz' position that such rights are enforceable in contract-based international arbitration proceedings.

(2798) Further, as explained in detail above, the obligations under the EnCT are aspirational in nature and purpose, providing for the future implementation and application of parts of the EU *acquis* in the energy sector (as stipulated in the EnCT) and not for those provisions to be directly applicable. The language of the EnCT is demonstrably incompatible with its provisions having direct effect. Pursuant to Article 31(1) of the Vienna Convention on the Law of Treaties 1969, a treaty "*shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*". The ordinary meaning of the terms of the EnCT, in light of its object and purpose, as set out in, *inter alia*, the Preamble is that the Contracting Parties (i.e. non EU member states) were to take steps towards the implementation of certain aspects of the EU *acquis* on energy and competition. Their meaning is not the immediate and direct enforceability of EU competition law principles by a private party from a EnCT Contracting State against a third party (not from a Party state) and that was not the object and purpose of the EnCT.

(2799) In addition, the necessary conditions for a treaty provision to have direct effect in the EU legal order, i.e. that the provision in question is clear, precise and unconditional and leaves the relevant member state with no discretion as to how it should be implemented,[104] are not satisfied by the EnCT and in particular, by Article 18 of the EnCT. The case law of the European Court

[103] The lack of functioning enforcement mechanisms with regard to the EnCT's provisions was recognised by the Energy Community Secretariat as a major shortcoming and recommendations have been made to change the position in a new treaty. See EnCS Report, pp. 10 and 12, which state that the EnCT provides "*no functioning enforcement mechanisms*" and "*the Secretariat supports the High Level Reflection Group's call for a court as the only dispute resolution forum worthy of the European tradition*".

[104] Case 26/62 *Van Gend en Loos v Nederlandse Belastingadministratie* ECR 13.

of Justice shows its reluctance to find that international agreements fulfill the requirements for direct effect.[105]

(2800) Article 18 is not sufficiently clear and precise to have direct effect. Article 18 simply provides that certain circumstances (including, in summary, anti-competitive agreements, state aid and abuse of a dominant position) are "*incompatible with the proper functioning*" of the EnCT. Such a provision is not sufficiently clear to have direct effect and give direct rights as between private parties. It is entirely unclear what action any court (or in this case, arbitration tribunal) should take in the event that it determines that the circumstances listed in Articles 18(a) to (c) (anti-competitive agreements, abuse of a dominant position and state aid) exist.

(2801) There is a notable difference in this regard between the provisions of Article 18 of the EnCT, which merely provides that particular circumstances are "*incompatible with the proper functioning*" of the EnCT, and Articles 101 and 102 of the TFEU, which provide:

(i) in the case of anti-competitive agreements (Article 101 of the TFEU):

- "*The following <u>shall be prohibited</u> as incompatible with the internal market*"; and

- "*Any agreements or decisions prohibited pursuant to this Article <u>shall be automatically void</u>*"; and

(ii) in the case of abuse of a dominant position (Article 102 of the TFEU): "*Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it <u>shall be prohibited</u> as incompatible with the internal market in so far as it may affect trade between Member States*" (Emphasis added.)

(2802) Article 18 of the EnCT does not contain the "*shall be prohibited*" language found in Articles 101 and 102 of the TFEU and does not contain the clear statement in Article 101 of the TFEU that relevant agreements shall be "*automatically void*". This deliberate omission from Article 18 of the EnCT is telling and reinforces (by expressly not adopting the same language as in the TFEU (then Articles 81 and 82 of the EC Treaty)) that there is no clear intention in the treaty language as to the legal consequences arising from the circumstances listed.

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[105] See *inter alia*, Case 21-24/72 *International Fruit Company v Produktschap voor Groenten en Fruit* [1972] ECR 1219. Case 270/80 *Polydor and RSO Records Inc v Harlequin Record Shops and Simons Records Ltd* [1982] ECR 329. Case C-149/96 *Portugal v Council* [1999] ECR I-8395.

(2803) The difference between the EU competition legal order and that set out in the EnCT is also evident from the lack of any process in the EnCT for addressing competition infringements, when contrasted with Article 105 of the TFEU, which gives the Commission powers to investigate infringements (in addition to member state authorities). Such lack of any treaty provisions addressing the consequences of infringement (other than the dispute settlement provisions described above), further supports the position that Article 18 cannot have direct effect or be directly applicable under relevant national laws.

(2804) Further, Article 3(a) of the EnCT envisages adaptation of the *acquis* by the Contracting Parties to take account of both "*the institutional framework of the Energy Community and the specific situation of each of the Contracting Parties….*". Since the *acquis* is to be adapted to take account of local conditions in each Contracting Party, the EnCT could not give rise to directly enforceable rights since there could not be sufficient certainty as to what the legal rights to be given effect to directly would be. There is clear Contracting Party discretion as to how the *acquis* should be implemented, contrary to the conditions required for direct effect.

(2805) In summary, the requirements for the EnCT to have direct effect are not fulfilled. The EnCT therefore does not have direct effect in the Member States of the European Union, including Sweden, and has not been otherwise incorporated into Swedish law. Gazprom consequently denies that the EnCT forms part of Swedish substantive law and that it can be considered by the Tribunal.

VIII.11.7.10.2.4 The EnCT does not apply to the Contract in any event

(2806) Article 18 of the EnCT provides that agreements that restrict competition and abuse of dominance are "*incompatible with the proper functioning of the Treaty, insofar as they may affect trade of Network Energy between the Contracting Parties*". Therefore, in order for Article 18 to be relevant, the agreements or practices concerned must affect trade of "*Network Energy*" between "*Contracting Parties*".

(2807) The "*Contracting Parties*" are defined in the preamble to the EnCT as Albania, Bulgaria, Bosnia and Herzegovina, the Republic of Croatia, Macedonia, Montenegro, Romania, Serbia, Kosovo, and, by Article 1.1 of the Accession Protocol, Ukraine.

(2808) Russia is not a Contracting Party to the EnCT. The EU is not a Contracting Party either; the preamble to the EnCT makes clear that the EU is a "*Party*", but not a "*Contracting Party*" to the EnCT. Neither are the individual Member States of the EU; Articles 1.2 and 95 of the EnCT provide that a Member State may become a "*Participant*" in the EnCT, but this is not the same as a Contracting Party.[106]

(2809) Naftogaz has failed to establish in its Statement of Claim that the Contract affects "*trade of Network Energy [i.e. gas] between the Contracting Parties*". Given that the Contract relates to the supply of gas from Russia to the Ukraine, it will be unable to do so.

VIII.11.7.10.3 Ordre public

(2810) Although Naftogaz' position is unclear, it appears to argue that the prohibitions in Article 18 of the EnCT on anti-competitive agreements and abuse of dominance constitute a mandatory requirement of public law and/or public policy (having an "*ordre public character*") and that accordingly, contracts subject to the laws of a member of the Energy Community should be applied and interpreted by arbitrators in a manner consistent with those requirements. However, this argument fails, for the following reasons.

(2811) As indicated above, the EnCT is a political treaty, approximating the laws of the Contracting Parties, but it does not have direct effect and does not give any directly enforceable rights to Naftogaz against Gazprom.

(2812) Further, Naftogaz seeks to rely upon *Eco Swiss v Benetton International*.[107] However, that case relates to Article 101 of the TFEU, not to Article 18 of the EnCT, and no authority or explanation is given for Naftogaz' arguments that rely upon Article 18 of the EnCT. Arbitral awards that infringe on competition legislation outside of the EU do not fall within the scope of Swedish *ordre public*.[108] As the EnCT is not part of EU competition legislation, a breach of the EnCT is not a matter of *ordre public*.

(2813) As the above shows, neither Articles 101 and 102 of the TFEU nor Article 18 of the EnCT apply to the Contract in the present case and Naftogaz' claims based on alleged breaches of competition law should be rejected on the basis of this preliminary point. However, without

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106 See Articles 48, 54 and 59 EnCT.

107 Case C-126/97 *Eco Swiss v Benetton International* [1999] ECR I-3055.

108 Government Bill 1998/99:35, p.58: "*Det bör också uppmärksammas att skiljedomar som kränker konkurrensrätten utanför EG inte omfattas av den svenska lagstiftningens ordre public-begrepp.*" (In-house English translation: "*It should also be pointed out that arbitral awards which breach competition law outside the EU are not covered by the Swedish legislature's term ordre public.*").

prejudice to its arguments in this regard, Gazprom sets out its substantive case on Naftogaz' competition law claims below.

VIII.11.7.11 The assessment of the Energy Community Secretariat

(2814) Naftogaz places considerable emphasis in its Statement of Claim on the Preliminary Assessment of the Energy Community Secretariat, in which it sets out its view on the Contract's compliance with the competition law provisions of the EnCT, and on the evidence given in support of Naftogaz' claim by [redacted]

(2815) Articles 67 to 72 of the EnCT make provision for the creation of the Energy Community Secretariat. Article 67 of the EnCT sets out the role of the Secretariat. This includes to:

"*(a) provide administrative support to the Ministerial Council, the Permanent High Level Group, the Regulatory Board and the Fora; (b) review the proper implementation by the Parties of their obligations under this Treaty, and submit yearly progress reports to the Ministerial Council; …*".

(2816) By Article 90(1) of the EnCT, the Secretariat may bring to the attention of the Ministerial Council by a reasoned request any failure by a Party (i.e. a party to the EnCT) to comply with an EnCT obligation. This may be at the Secretariat's own initiative or as a result of a complaint by a private body. The Party concerned has a right to make observations in response to the request or complaint.[109] Such a failure would include a failure to comply with the *acquis* on competition contained in Article 18 of the EnCT.

(2817) It is the Ministerial Council which then determines the existence of a breach by a Party of its obligations, not the Secretariat (Article 91 of the EnCT).

(2818) The procedure for dealing with such matters is set out in Procedural Act No 2008/01/MC-EnC of 27 June 2008 on the Rules of Procedure for Dispute Settlement under the EnCT (the "Rules of Procedure"). The procedure is initiated by the Secretariat by way of an opening letter to the Party concerned.[110] The Party concerned is requested to submit its observations within, usually,

[109] Article 90(2) EnCT.
[110] Article 10(1), Rules of Procedure.

two months. It is requested to adopt a position on the points of fact and law raised in the opening letter.[111]

(2819) In the light of that reply, the Secretariat may address a reasoned opinion to the Party concerned which must contain a coherent and detailed statement of the reasons which led the Secretariat to conclude that the Party concerned failed to fulfil its obligations under the EnCT.[112] In the light of the reply, or absence of a reply, from the Party concerned, the Secretariat may bring the matter to the attention of the Ministerial Council by way of a reasoned request.[113] The reasoned request must set out the case against the Party concerned.[114] The Party concerned has a right to reply to the reasoned request in writing.[115]

(2820) Before making a decision on the reasoned request, the Presidency and the Vice-Presidency are required to ask an Advisory Committee for its opinion on the reasoned request, and the Party's reply.[116] Although the Ministerial Council is not bound to follow the opinion of the Advisory Committee, it frequently does so.

(2821) The Advisory Committee is comprised of three members, appointed by the Ministerial Council, who "*shall be chosen from persons whose independence is beyond doubt and who possess the qualifications required for appointment to the highest judicial offices in the respective Party*".[117]

(2822) Having received the opinion of the Advisory Committee, the Ministerial Council makes its decision in accordance with Article 91(1) of the EnCT on whether or not there has been a breach by a Party of its obligations arising from Energy Community law.[118]

(2823) The Secretariat is therefore an administrative body, whose role is comparable to that of the European Commission. However, the powers of the Secretariat are much more limited than those of the European Commission. Although it can make reasoned requests to the Ministerial Council, unlike the European Commission, the Secretariat cannot make decisions on whether there have been breaches, for example, of the relevant competition rules. That decision rests

111 Article 12, Rules of Procedure.
112 Article 13(1), Rules of Procedure.
113 Article 14, Rules of Procedure.
114 Article 28, Rules of Procedure.
115 Article 30, Rules of Procedure.
116 Article 32(1), Rules of Procedure.
117 Article 32(2), Rules of Procedure.
118 Articles 29(2) and 34, Rules of Procedure.

with the Ministerial Council, following the opinion of the Advisory Committee. The Ministerial Council (and the Advisory Committee) can accept or reject the case set out in the Secretariat's reasoned request and prefer that put forward by the Party concerned. On numerous occasions, the Secretariat's case has been rejected.

(2824) Therefore, the submission presented by Naftogaz from the Legal Counsel of the Energy Secretariat should be afforded no greater weight than that provided by any other competition lawyer.

(2825) Naftogaz also claims that the Preliminary Assessment of the Energy Community Secretariat "*provides an impartial and independent assessment of the Contract and its compatibility with the EU acquis on competition in the energy field*". However, the Energy Community Secretariat is not independent in these proceedings; to the contrary, as the only permanent institution of the Energy Community, its stated aim is to "*monitor... and assist... the Contracting Parties in the implementation of their obligations under the [EnCT]*".[119] The EnCT itself provides that the "*Director and staff*" shall "*promote the interests of the Energy Community*"[120] and the EnCS Report explicitly states that: "*the Secretariat assists the Parties and institutions of the [EnCT]*".[121]

(2826) Therefore, far from being independent and impartial, the Energy Community Secretariat's key function is to support Ukraine as a Contracting Party to the EnCT and to further its implementation of the *acquis*. It is entirely partial in these proceedings, given that they are between a company wholly owned by a Contracting Party state and a company from a non-party state. All of the Secretariat's produced material and conclusions must therefore be read in light of that function and objective, rather than as those of an independent observer.

(2827) Further, Article 70 of the EnCT provides that:

"*In the performance of their duties the Director and the staff shall not seek or receive instructions from any Party to this Treaty. They shall act impartially and promote the interests of the Energy Community.*"

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119 "Facts in Brief", *Energy Community*.

120 Article 70 EnCT.

121 EnCS Report, page 15.

(2828) The submission in these proceedings of a witness statement by [redacted] during the preparation of which he "*consulted Naftogaz' counsel*" is a clear violation of the prohibition in Article 70 of the EnCT against Secretariat staff seeking and receiving instructions from a Party.

(2829) In any event, the Secretariat's Preliminary Assessment is just that, "preliminary". It is no more than an interim view expressed by a body whose entire function is to "*support*" Ukraine's implementation of the relevant parts of the EU *acquis*. It is notable that there has been no determination made in relation to the Contract by any body that is legally placed to do so, for example, the courts or regulatory authorities in Ukraine.

VIII.11.7.12 No breach of competition law

VIII.11.7.12.1 Abuse of a dominant position – Article 102 TFEU

VIII.11.7.12.1.1 Introduction

(2830) In order to establish a breach of Article 102 of the TFEU, Naftogaz has to establish that (a) an undertaking has a dominant position in the relevant market, and (b) the undertaking has abused that dominant position.

(2831) Article 102 does not prohibit dominance as such. There is no infringement of Article 102 of the TFEU by virtue solely of being dominant.[122]

(2832) Similarly, there is no infringement by virtue solely of being 'abusive': conduct which would be abusive had an undertaking held a dominant position does not infringe Article 102 in the absence of such a position. As the Court of Justice stated in *Alsatel*, which concerned certain onerous contractual provisions, "*contractual practices, even if abusive ones, on the part of an undertaking … do not fall within the prohibition in Article [102] where that undertaking does not occupy a dominant position on the relevant market*".[123]

VIII.11.7.12.1.2 Dominance

(2833) The Court of Justice has defined a dominant position under Article 102 of the TFEU as:

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[122] Case 322/81 *Michelin v Commission* [1983] ECR 3461, para 57.
[123] Case 247/86 *Alsatel v Novasam* [1988] ECR 5987, para 23.

(2834) "*… a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers*".[124]

(2835) There are two stages to determining whether an undertaking holds a dominant position:

(i) defining the relevant product and geographic market; and

(ii) assessing the degree of market power (or economic strength) enjoyed by the undertaking on the relevant market. This assessment involves consideration of various factors: not just market share, but also barriers to entry and competitive constraints, such as countervailing buyer power.

VIII.11.7.12.1.3 Abuse

(2836) In *Hoffmann-La Roche v Commission*, the Court of Justice defined the concept of abuse as follows:

"*The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition*".[125]

(2837) First, this definition emphasises that an abuse involves "*recourse to methods different from those which condition normal competition*". In particular, a dominant undertaking can still (despite its position of dominance) take action to protect "*its own commercial interests if they are attacked, and … take such reasonable steps as it deems appropriate to protect its said interests*".[126]

(2838) Further, the definition of abuse emphasises the need for an analysis of the allegedly abusive conduct's effect on competition before an infringement can be established. It is the adverse

[124] *Michelin*, para 30.
[125] Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, para 91.
[126] Case 27/76 *United Brands v Commission* [1978] ECR 207, para 189.

effect on competition and the structure of the market which is relevant. The effect of the allegedly abusive conduct must be considered by reference to the particular factual context of this case.

(2839) Naftogaz argues that Gazprom has engaged in abuses of an exclusionary and/or an exploitative character.

VIII.11.7.12.1.4 Objective justification

(2840) Even if a dominant undertaking engages in conduct which is *prima facie* an abuse, if that undertaking can demonstrate that there is an objective justification for that conduct, then there is no breach of Article 102 TFEU.[127]

VIII.11.7.12.2 Anti-competitive agreements - Article 101 TFEU

(2841) Article 101(1) of the TFEU prohibits agreements which have as their object or effect the prevention, restriction or distortion of competition. It is agreed that the prohibition contained in Article 101(1) covers both horizontal and vertical agreements.

(2842) The object or effect of an agreement cannot be ascertained 'using an abstract formula'.[128] In assessing whether the agreement restricts competition, account should be taken of the economic and legal context in which the agreement is to be applied.[129]

(2843) The EU Courts have repeatedly affirmed that Articles 101 and 102 share the same basic objective of protecting competition.[130] An agreement between undertakings which restricts the freedom of action of the parties or one of them does not necessarily fall within the prohibition laid down in Article 101(1): almost every commercial contract can be said to 'restrict' the freedom of the parties to it.[131] The purpose of Article 101(1) is <u>not</u> to provide a general escape route for those wishing to avoid complying with contractual obligations which turn out to be more onerous than expected.[132]

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[127] See *inter alia* Case C-95/04 P *British Airways v Commission* [2007] ECR I-2331 at paras 68-69. Case C-52/09 *TeliaSonera Sverige* [2011] ECR I-527 at paras 75-76.

[128] See para 26 of the Opinion of AG Mazak in Case C-439/09 *Pierre Fabre Dermo-Cosmetique* [2011] ECR I-9419.

[129] Case C-209/07 *Beef Industry Development Society* [2008] ECR I-8637, para 16. Case T-461/07 *Visa Europe* [2011] ECR 0000, paras 67-68.

[130] See, for example, in Case T-51/89 *Tetra Pak Commission* [1990] ECR II-309, para 22.

[131] Case C-519/04P *Meca-Medina* [2006] ECR I-6991, para 42.

[132] See, for example, the judgment of the English Court of Appeal in *Chemidus Wavin v TERI* [1978] 3 CMLR 514.

(2844) In *AC-Treuhand v Commission*, the EU General Court explained that:

"*the Court has made it clear that it was not necessary to hold, wholly abstractly and without drawing any distinctions, that an agreement restricting the freedom of action of one or more of the parties is necessarily caught by the prohibition laid down in Article [101(1) TFEU] but that, in assessing the applicability of [Article 101(1) TFEU] to an agreement, account must be taken of the conditions in which it functioned, in particular the economic and legal context in which the undertakings operated, the products or services covered by the agreement and the actual structure and operating conditions of the market concerned*".[133]

(2845) A freely negotiated commercial agreement restricting the parties' freedom of action is not therefore automatically prohibited by Article 101(1); rather such an agreement must be shown on the basis of clear and compelling evidence to have as its object or effect the prevention, restriction or distortion of competition.

(2846) In order to assess whether the 'object' of an agreement is anti-competitive, regard must be had to the content of its provisions, the objectives it seeks to attain and the economic and legal context of which it forms part. [134] While the intention of the parties is not a requirement for finding that an agreement has an anti-competitive object, it can be relevant and may be taken into account. [135] There is no need to take account of the effects of an agreement if it has as its object the prevention, restriction or distortion of competition. [136]

(2847) Where an agreement does not have the object of restricting competition, there is no presumption that it has any actual or potential anti-competitive effect under Article 101(1) TFEU. Such effect must be proven. The test for establishing that an agreement has an anti-competitive effect is that it must be demonstrated, with a reasonable degree of probability, that the agreement in question has an appreciable effect on competition within the EU.[137] The competition in question should be assessed within the actual context in which it would occur in the absence of the agreement in question. [138]

VIII.11.7.12.3 Relevant background

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[133] Case T-99/04 *AC-Treuehand v Commission* [2008] ECR II-1501, paragraph 126.
[134] See, for example, Case 56/65 *Societe Technique Miniere* [1966] ECR 235 at 249.
[135] See, for example, Case C-8/08 *T-Mobile Netherlands* [2009] ECR I-4529 at para 27.
[136] See, for example, Case C-199/92P *Huls v Commission* [1999] ECR I-4287 at paras 158-166.
[137] See, Case 56/65 *Societe Technique Miniere* [1966] ECR 235 at 249.
[138] Case C-7/95P *John Deere v Commission* [1998] ECR I-3111 at para 76.

(2848) Naftogaz' arguments on competition law must be considered and assessed against the specific factual background to the parties' negotiation of and entry into the Contract. In particular, several unique circumstances distinguished the relationship between Gazprom and Naftogaz from Gazprom's relationships with its other customers. These include:

(i) the huge volumes of gas consumed by Ukraine annually: Ukraine has historically been one of the largest consumers of natural gas worldwide and also one of the least efficient;[139]

(ii) Ukraine's reliance for the majority of its energy supplies on imports of natural gas;

(iii) the location of over one third of Europe's natural gas storage capacity in the west of Ukraine (which is one of the main reasons for the construction of major transit pipelines through Ukrainian territory during the Soviet period);

(iv) Ukraine's consequent role as a transit corridor for gas supplies from Russia to Europe: around 70% of Gazprom's exports to European suppliers transit through the Ukrainian pipeline system;

(v) the legacy of the Soviet era gas supply and transit arrangements, which were not commercially or market driven;

(vi) Naftogaz' persistent financial difficulties, which are largely the result of:

- the failure of the Ukrainian government to implement domestic price reform, and the sale by Naftogaz of gas for domestic consumption (in particular to residential customers and district heating companies) at below cost-recovery levels; and

- non-payment by Naftogaz' customers for gas supplied, leading to a situation where, to sustain its own liquidity, Naftogaz is reliant on cash injections from the Ukrainian government (which is in turn, in periods of economic distress, reliant on loans from international financial institutions such as the IMF or foreign governments such as

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[139] See Pirani, S, Jonathan Stern and Katja Yafimava. "The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment", *Oxford Institute for Energy Studies*. February 2009, page 58, which states: "*These immediate and medium term concerns often obscure a more obvious, but salient, issue: that Ukraine's dependence on imported Russian gas is, strictly in energy terms, a consequence of its very high gas demand. This is turn results from it having the most energy-inefficient economy in the world. Gas is used in unusually large quantities: for example the heavily subsidized Ukrainian district heating system uses more gas than the entire Czech Republic.*"

Russia) and where Naftogaz has been consistently unable to pay for imports of gas at agreed prices (even when such prices have been well below market levels).

(2849) Of particular relevance to Naftogaz' competition law arguments is Ukraine's role as a transit corridor for Russian gas bound for Europe, which means that Naftogaz is able to exercise considerable leverage over Gazprom in relation to payments for supplies. If Gazprom reduces supplies to Ukraine on account of a failure by Naftogaz to pay - as would be normal practice in any purely commercial supply arrangement - it is within Naftogaz' physical control to off-take from the pipeline volumes of natural gas bound for Europe. This has happened in several instances over the past several years and was an important factor in negotiations of the provisions of the Contract in January 2009.

(2850) The Contract was negotiated and entered into against the background of the January 2009 Russo-Ukrainian gas crisis. From 7 to 20 January 2009, gas was cut off completely to countries in south-eastern Europe which were 100% dependent on Russian imports, and partially cut off to other countries. This situation was unprecedented. Supplies in Europe had never been halted since the gas transit system was built in Soviet times. Moreover, once the Ukrainian transport system was closed to deliveries of Russian gas, Naftogaz reversed the flow in the system, in order to transport gas from Ukraine's storage facilities, which are mostly in the west of the country, to major consuming areas in the south and east. The network was therefore unable to accept Russian gas for transit to Europe.[140]

VIII.11.7.12.4 Application of Article 102 TFEU

VIII.11.7.12.4.1 Naftogaz' insufficient market definition

(2851) The Energy Community Secretariat defines the relevant market as "*the market in natural gas procured to satisfy the demand of Naftogaz in performing [its public utility] functions*".[141] Naftogaz' expert, Carlos Lapuerta, defines the relevant market differently so to also include independent importers into Ukraine.[142] Naftogaz' pleaded position is that it agrees with the assessment of the Energy Community Secretariat, but that the "*precise market definition, both*

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140 See Pirani, Simon, Jonathan Stern and Katja Yafimava. "The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment". *Oxford Institute for Energy Studies*. February 2009, pages 23-24.

141 Energy Community Secretariat Preliminary Assessment dated 29 July 2014at page 10.

142 Lapuerta Report at paragraph 33.

as regards the product and the geographic dimension, can however be left open, as Gazprom has clearly a dominant position in any case".[143]

(2852) The European Court has held that market definition is of "*essential significance*" in any case; as an assessment of dominance and of abuse can only be carried out by reference to such market definition.[144] Naftogaz' approach to market definition is insufficient and inadequate. In effect, it has failed even to define the relevant market.

(2853) Moreover, market definition is not an abstract, theoretical exercise. The relevant product and geographic market must be defined by applying the relevant EU law principles and must be based on actual empirical evidence.[145] In order to define a relevant market, regard should be had to demand substitutability, supply substitutability and potential competition. Demand substitution is particularly important, especially when considering the pricing behaviour of firms.[146] In considering demand substitutability, the normal methodology to be used will be a hypothetical monopolist test or the SSNIP (small but significant non-transitory increase in price) test.[147]

(2854) Naftogaz has failed to engage in any, or any adequate, process in order to define the relevant market. It has failed to carry out a hypothetical monopolist test or the SSNIP test. Most importantly, it has failed to define the relevant market by reference to any actual empirical evidence.[148]

(2855) The definitions of the market contained in the Energy Community Secretariat's preliminary assessment and in the Lapuerta Report are not supported by any of the empirical evidence that would be required to perform any of the necessary tests. There is no suggestion in either of these reports that such tests have even been carried out.

VIII.11.7.12.4.2 Naftogaz fails to establish Gazprom's dominance

(2856) Naftogaz argues that Gazprom has a dominant position in the relevant market because of its high market shares. A "*pivotal supplier*" test is also carried out in the Lapuerta Report. These

143 Naftogaz' Statement of Claim, paragraph 1064.
144 Case 6/72 *Europemballage v Commission* [1973] ECR 215.
145 See the Commission's Notice on the definition of the relevant market for the purposes of Community competition law (97/C372/03).
146 *Ibid*., paragraph 13.
147 *Ibid*., paragraph 17.
148 Compare the process described in paragraphs 25 to 52 of the Commission's Notice on the definition of the relevant market for the purposes of Community competition law (97/C372/03).

matters are, however, insufficient to establish Gazprom's dominance on the relevant market (even if the relevant market has been defined adequately by Naftogaz, which, for the reasons set out above, is denied).

(2857) As explained above, dominance is defined in EU law as "*… a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent* <u>*independently of its*</u> *competitors and* <u>*customers*</u> *and ultimately of consumers*".[149] (Emphasis added.)

(2858) Dominance can only be established following consideration of a number of factors, including countervailing buyer power, i.e. the power of buyers to constrain an allegedly dominant undertaking's behaviour on the relevant market. The very definition of dominance requires that an allegedly dominant undertaking must be able to act independently of its customers.

(2859) As the European Commission explains:

"*It is important to stress that the existence of a dominant position cannot be established on the sole basis of large market shares. As mentioned above, the existence of high market shares simply means that the operator in question might be in a dominant position. Therefore, NRAs [national regulatory authorities] should undertake a thorough and overall analysis of the economic characteristics of the relevant market before coming to a conclusion as to existence of significant market power. In that regard, the following criteria can also be used to measure the power of an undertaking to behave to an appreciable extent independently of its competitors, customers and consumers. These criteria include amongst others: …*

– absence of or low countervailing buyer power …".[150]

(2860) However, Naftogaz has wholly ignored the countervailing buyer power which it exercised during negotiations with Gazprom that led to the conclusion of the Contract in January 2009. Naftogaz' position as the dominant transporter of Russian gas to Europe can be, and was in this instance, used by Naftogaz as a powerful weapon in its negotiations with Gazprom.

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149 *Michelin* (see above), para 30.

150 *Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services* Official Journal C 165, 11/07/2002 P. 0006 – 0031, at paragraph 78. See also paragraph 91 of the English Court of Appeal’s judgment in *H3G v Ofcom* [2009] EWCA Civ 683.

(2861) Those negotiations took place against the background of the January 2009 gas crisis where supplies to Europe were disrupted for a period of 13 days. On 7 January 2009, deliveries to European off-takers were stopped altogether, and Naftogaz turned the Ukrainian system into reverse flow. This appears to have been a premeditated action by Naftogaz, and it prevented any transit gas from reaching European off-takers.

(2862) The disruption to transit supplies meant that Gazprom was sustaining huge monetary losses on a daily basis. Gazprom has estimated that its losses from direct revenues and fines paid to European off-takers for failure to supply during this short period amounts to about USD 3 billion.[151] There was also great damage done to Gazprom's reputation as a reliable supplier of gas to Europe.[152] Gazprom was therefore under great pressure to conclude an agreement with Naftogaz and to resolve the crisis.

(2863) As a result, Gazprom was in no position to impose abusive Contract terms on Naftogaz and, as a matter of fact, it did not do so. This was also the clear and contemporaneous view of Naftogaz itself. On 21 January 2009, Naftogaz held a press conference at which Mr Didenko made the following public comments[153]:

"*...having gone through such hard rounds of negotiations, probably none of the parties is 100% satisfied. Neither [Naftogaz] nor [Gazprom] have reached their primary economic aims. However, based on extensive global civilized business experience, only those agreements and negotiations are to be considered objective, when none of the parties was 100% satisfied. However, I think that in spite of all political reasons we may consider that it is a victory of Ukraine in general and [Naftogaz] in particular. ...*".

(2864) Therefore, Naftogaz has failed to prove that Gazprom was in a dominant position. On the contrary, at the time that the Contract was entered into, Gazprom clearly was not dominant.

VIII.11.7.12.4.3 Relevant time for assessing abuse

(2865) Naftogaz' case is that a number of provisions contained in the Contract constitute abuses of dominance by Gazprom in breach of Article 102 TFEU. For the reasons set out above, it is Gazprom's case that Naftogaz has failed to establish dominance on the part of Gazprom.

151 [redacted] paragraph 21.
152 [redacted], paragraph 22; [redacted] paragraph 62.
153 Press Conference given by First Vice Chairman of Board of NJSC "Naftogaz of Ukraine" Igor Didenko on 21 January 2009. (See also [redacted] paragraph 68.)

However, if (contrary to those submissions) the Tribunal considers it necessary to address the question of abuse, it is Gazprom's case that the relevant time for assessing the allegations of abuse is at the time the Contract was entered into in January 2009.

(2866) The only point in time at which an abuse, such as an excessive price abuse, can take place is at the time that the price is negotiated. This is because this is the point in time when the dominant seller can exercise its market power, and thus can impose an abusive term on its customer.

(2867) If external circumstances change, this has nothing to do with any dominance on the part of the seller. The price to be charged in these changed circumstances does not depend on the buyer's or seller's market power or dominance, but rather on the contractual provisions. At that point in time, whether the seller is dominant or not is irrelevant to the determination of the price to be charged. The price to be charged is determined solely by the contractual terms, and thus the seller cannot exploit or abuse a (potential) dominant position. It must therefore follow that a price, which is determined under conditions set out in a contract, cannot become an abuse of a dominant position as a result of a change in external circumstances which have nothing to do with the seller's market power.[154]

VIII.11.7.12.5 The impugned provisions of the Contract

VIII.11.7.12.5.1 Introduction

(2868) Naftogaz argues that the following provisions in the Contract constitute abuses of a dominant position by Gazprom in breach of Article 102 of the TFEU:

(i) the oil price indexation clause in article 4.1 of the Contract;

(ii) the volume and Take or Pay provisions in articles 2.2 and 2.2.5 of the Contract;

(iii) the destination clause in article 3.10 of the Contract;

(iv) the unilateral suspension right in article 5.3 of the Contract; and

(v) the mandatory sales clause in article 9.7 of the Contract.

[154] See Coppi Report, paragraphs 2.9 to 2.24.

(2869) Naftogaz also argues that the volume and Take or Pay provisions in articles 2.2 and 2.2.5 of the Contract, the destination clause in article 3.10 of the Contract and the mandatory sales clause in article 9.7 of the Contract are in breach of Article 101(1) of the TFEU.

(2870) In summary, it is Gazprom's case that

(i) Naftogaz has failed to establish any breach of Article 102 TFEU:

- Naftogaz has carried out an insufficient market definition and has failed to establish dominance on the part of Gazprom;

- further or alternatively, none of the impugned terms constituted abuses of a dominant position for the purposes of Article 102 TFEU;

(ii) alternatively, the impugned terms were objectively justified in the particular circumstances, and therefore do not breach Article 102 TFEU.

(2871) Naftogaz has failed to establish any breach of Article 101(1) TFEU. The impugned provisions formed part of a freely-negotiated commercial agreement, and Naftogaz has failed to show that they had as their object or effect the prevention, restriction or distortion of competition.

VIII.11.7.12.5.2 The oil price indexation clause in Article 4.1. of the Contract

(2872) Naftogaz argues that the oil price indexation clause in article 4.1 of the Contract is based on a calculation mechanism which is unreasonable and thus unfair. It would appear that Naftogaz makes this assertion upon two bases: first, the Contract Price is excessive because, since at least 2011, it has no longer reflected market prices; and, second, the particular oil price indexation in the Contract discriminates against Ukrainian customers**.**

(2873) As regards Naftogaz' excessive pricing argument, the European Court has defined an abusively excessive price as being a price which "*has no reasonable relation to the economic value of the product supplied*".[155] The Court has set out a two-stage test for determining whether a price is "excessive" and thus "unfair" under Article 102(a) TFEU, as follows:

(i) it must be examined "*whether the difference between the costs actually incurred and the price actually charged is excessive*"; and

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155 Case 27/76 *United Brands v Commission* [1978] ECR 207, paragraph 250.

(ii) if the answer to the first question is in the affirmative, then it must be determined whether a price has been imposed which is either unfair in itself or when compared to competing products.

(2874) The standard of proof for establishing excessive pricing is very high. The leading English-language textbook on EU competition law states that "*decisions by the Commission and national courts demonstrate the considerable difficulties of establishing this abuse*".[156] There have only been a handful of cases establishing excessive pricing at the EU level since the early 1970s.[157]

(2875) None of the Lapuerta Report or the Preliminary Assessment of the Energy Community Secretariat or [redacted] statement contain any of the economic analysis which would be required to establish excessive pricing. There can be no assumption that an oil-indexed price will be excessive: depending on whether oil prices are high or low, oil indexation may result in prices which could be above or below those prevailing on "global gas markets".[158] In order to establish excessive pricing, Naftogaz would have to prove, by reference to empirical evidence, that the two-stage test is fulfilled. It has failed to do so.

(2876) As for the first stage of the test, Naftogaz would at a minimum have had to carry out a detailed analysis of the prices charged by Gazprom and the relative costs incurred by Gazprom in supplying Naftogaz so as to show that "*the difference between the costs actually incurred and the price actually charged is excessive*".[159] As for the second stage (which is only considered if the first stage of the test is fulfilled), Naftogaz would have to have compared the price charged by Gazprom to Naftogaz to prices of competing products.[160] Moreover, it would not have been enough for Naftogaz to establish that Gazprom had priced above cost: the threshold at which a high price is typically considered excessive is very high, in some cases, 100% higher than in comparable markets.[161]

(2877) Therefore, Naftogaz has clearly failed to establish excessive pricing on the part of Gazprom.

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156 John, Laura Elizabeth and Jon Turner QC. *Bellamy & Child: European Union Law of Competition*, 7th edn., 2013, at para 10.106.

157 Coppi Report, paragraph 2.45.

158 Coppi Report, paragraph 2.5.

159 Coppi Report, paragraphs 2.32 to 2.39.

160 Coppi Report, paragraphs 2.41 to 2.43.

161 Coppi Report, paragraph 2.50.

(2878) In any event, Naftogaz itself acceptsthat the Contract Price was not excessive or abusive when the contract was entered into in January 2009 (which, for the reasons set out above, is the relevant time for the competition analysis). [redacted] who was involved in the 2009 Contract negotiations with Gazprom clearly states:

"*we were confident that the Contract Price was market-reflective and could be revised if necessary by negotiations or arbitration*".

(2879) As regards Naftogaz' case on discriminatory pricing, Article 102(c) TFEU specifically prohibits a dominant firm from "*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*". Therefore, the person alleging abusive discrimination, first, has to identify equivalent transactions which have been treated differently by the dominant firm. Second, it has to demonstrate an effect on competition in the form of a "*competitive disadvantage*" in the related market of the customer.

(2880) The Lapuerta Report fails to establish abusive discriminatory pricing in breach of Article 102(c) TFEU. First, Mr Lapuerta seeks to establish that the Contract price is discriminatory against Ukrainian customers in two ways:[162]

(i) the inclusion of two different oil products (gas oil and fuel oil) in the contract formula would "force" Naftogaz to implement price discrimination; and

(ii) the specific contract formula would force Naftogaz to pay a premium for natural gas compared to buyers in Western Europe.

(2881) For the reasons set out in the Coppi Report, this argument is misconceived. The argument that the Contract formula's reliance on two different types of oil products forces Naftogaz to discriminate between customers so as to constitute an abuse under Article 102 is wrong and/or unproven, for the following reasons:[163]

(i) having more than one oil product in the price formula was normal in European long term gas contracts;[164]

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[162] Coppi Report, paragraph 3.2.
[163] Coppi Report, paragraphs 3.8 to 3.27.
[164] Witschen Report, paragraph 151.

(ii) the assumption that the oil products set the price level in the contract is incorrect, as the oil products determine the future trajectory of prices, not their level;

(iii) there is no evidence or analysis to demonstrate that the contract formula forced Naftogaz to charge different prices to different consumers. The prices in the Ukrainian retail market are still highly regulated, and regulation is the main driver of any price discrimination; and

(iv) even if it were demonstrated that Naftogaz is charging different prices to different consumers as a result of the Contract, this is not sufficient to prove an abuse of dominance. Price differences between customer segments exist in liberalised markets.

(2882) Further, Mr Lapuerta's argument that *de facto* the Contract formula results in discrimination against Naftogaz compared to buyers in Western Europe is also not borne out.[165] In particular, and contrary to the requirements of Article 102(c) TFEU, he has failed to show that Gazprom charges significantly different prices to other buyers competing with Naftogaz (he has failed to identify equivalent transactions which have been treated differently), and he has failed to show that Naftogaz is put at any disadvantage vis-à-vis its competitors (he has failed to demonstrate an effect on competition in the form of a "*competitive disadvantage*" in the related market of the customer).

(2883) Moreover, in this regard, Mr Lapuerta himself accepts that:

"*[w]hen initially adopted in January 2009, the price formula did not in practice discriminate between Ukraine and other countries. The report of Ms Hesmondhalgh and Mr Way explains that the price matched average German import prices netted back to the Russian border at the time*".[166]

(2884) Naftogaz has therefore failed to establish that the Contract price and/or price formula contained in the Contract constitute an abuse for the purposes of Article 102 TFEU.

VIII.11.7.12.5.3 The volume and Take or Pay provisions in Article 2.2 and 2.2.5 of the Contract

165 Coppi Report, paragraphs 3.28 to 3.33.
166 Lapuerta Report, paragraph 91.

(2885) Naftogaz argues that the long duration of the Contract together with the ACQ and the Take or Pay provisions foreclose a significant part of the Ukrainian gas market to the entry of any other potential suppliers of natural gas (apart from Gazprom) and prevent new market entry as they discourage Naftogaz from sourcing gas from any other suppliers. They are therefore incompatible with Article 101 TFEU. Naftogaz also argues that the duration, volume and Take or Pay provisions are an abuse of Gazprom's dominant position pursuant to Article 102 TFEU because they lead to market foreclosure and exclude new market entry.

(2886) In this regard, Naftogaz relies on the assessment of the Energy Community Secretariat. Naftogaz also relies upon the Lapuerta Report. Naftogaz has failed to prove its case in this regard.

(2887) First, the duration of the Contract was in line with normal commercial practice. In fact, its duration of eleven years can be described as "*comparatively short*" in comparison with other relevant contracts.[167]

(2888) Moreover, Take or Pay clauses are a completely normal feature of long-term European gas supply contracts. Mr Witschen comments that: "*[Take or Pay] clauses are very common in [long term import contracts]*".[168]

(2889) A paper by the Oxford Institute for Energy Studies published recently in October 2014 also noted this point and underlined that it is EU policy to hold Gazprom to its commitment to deliver the contracted for volumes:

"*The vast majority of Russian gas exports to Europe are sold on long-term contracts varying from 10 to 35 years in length. These contracts, which are legally binding and subject to international arbitration, contain take-or-pay clauses which require buyers to pay for a minimum annual quantity of gas, irrespective of whether they take that quantity. In the post-2008 period, the take-or-pay level in many of these contracts was reduced from 85 to 70 %. … There are significant limitations on the options to reduce the volumes in these contracts, or to terminate contracts before expiry. Thus far, despite difficult renegotiations and a large number of arbitration proceedings, no such actions have been reported. Indeed, we are aware of only*

167 Witschen Report, paragraph 137.
168 Witschen Report, paragraph 141.

two European contracts for Russian gas which have not been extended at expiry, one of which involved Russian gas being sold to other buyers in the same country.

Long-*term contractual commitments are, therefore, an important starting point for any discussion of reducing – or of making any significant change in – the volumes of Russian gas deliveries to European countries. In the exchange of letters between Russia's President Putin and the EU's President Barroso in April 2014, the latter reminded the Russian president that:*

The *contractual reliability of the Russian Federation as a supplier of gas is at stake in this matter…I would like to recall that supply contracts are between European companies and Gazprom. It therefore continues to be Gazprom's responsibility to ensure the deliveries of the required volumes as agreed in the supply contracts. The European Union has repeatedly stated that we expect commercial operators on all sides to continue respecting their contractual obligations and commitments.*

The final sentence provides clear confirmation at the highest EU level that the obligations in Russian long-term gas contracts with European companies are expected to be fulfilled by both sides, irrespective of any political crisis in Ukraine or between the latter and the Russian Federation. Therefore, even if it were possible to replace Russian gas supplies with other sources of energy and gas (which will be the main subject of this paper), aside from force majeure there are no circumstances including sanctions which would allow either European companies or Gazprom to renounce the overall volume offtake obligations in their long-term contracts."[169]

(2890) The EU has made it very clear that it expects Gazprom to meet its supply commitments in long-term gas contracts. It would be inconsistent not to expect the counterparties to such contracts not to meet their reciprocal Take or Pay obligations.

(2891) As regards Naftogaz' specific arguments under Article 101 TFEU, it is Gazprom's case that the duration, volume and Take or Pay requirements in the Contract formed part of a freely-negotiated commercial agreement, and Naftogaz has failed to establish that they had as their object or effect the prevention, restriction or distortion of competition.

169 Dickel, Ralf, Elham Hssanzadeh, James Henderson, Anouk Honoré, Laura El-Katiri, Simon Pirani, Howard Rogers, Jonathan Stern & Katja Yafimava. "Reducing European Dependence on Russian Gas: distinguishing natural gas security from geopolitics." *Oxford Institute for Energy Studies*, October 2014: p 5. http://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/10/NG-92.pdf

(2892) Naftogaz has failed to establish that the duration, volume and Take or Pay requirements had as their *object* the prevention, restriction or distortion of competition. On the contrary[170]:

(i) the volume requirements, i.e. an ACV of 52 BCM, were included in the Contract at the insistence of Naftogaz;[171]

(ii) Naftogaz did not object to a Take or Pay requirement (MAV) of 80% of the ACV and such a percentage is in line with normal industry practice;

(iii) an ACV of 52 BCM was in line with Naftogaz'/ Ukraine's historic demand for gas;

(iv) Naftogaz never expected that such a volume commitment would exceed its demand; and

(v) there is provision in the Contract (article 2.3) for the ACV to be reduced by agreement of the Parties, and such reductions have been agreed upon and made where justified.[172]

(2893) Naftogaz has also failed to establish that the volume and Take or Pay requirements had as their *effect* the prevention, restriction or distortion of competition.

(2894) Naftogaz has failed to demonstrate, with a reasonable degree of probability, on the basis of any actual empirical evidence that the volume and Take or Pay provisions in the Contract have an actual or potential appreciable effect on competition. Naftogaz has failed to carry out any empirical assessment of what competition would occur in the absence of the provisions in question.

(2895) Moreover, Naftogaz' own evidence[173] indicates that the volume and Take or Pay requirements under the Contract covered 55-60% of Naftogaz' total gas demand in 2012-2013. The remainder of its gas demand (35-40%) is fulfilled by domestic Ukrainian production. It would be within the power of Naftogaz/Ukraine to reduce this domestic production and/or for that gas to be sold outside Ukraine. If this was done, then the volume and Take or Pay requirements under the Contract would only cover 55-60% of Naftogaz' total gas demand. The remainder of Naftogaz' gas demand could be obtained from and therefore would be contestable by other suppliers.

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170 See [redacted], paragraphs 79 to 85.

171 [redacted], paragraphs 51 to 52.

172 Witschen Report, paragraph 140.

173 Energy Community Secretariat Preliminary Assessment, page 23.

(2896) In these circumstances, Naftogaz has failed to show that the volume and Take or Pay requirements under the Contract foreclose a significant part of the Ukrainian gas market to the entry of any other potential suppliers of natural gas and prevent new market entry.

(2897) Naftogaz also complains about the absence of "*make up*" provisions in the Take or Pay provisions of the Contract. Such complaints are misconceived. Ukraine is in a unique position in Europe in that, unlike other European off-takers, it is able to inject any excess volumes it has committed to take under the Contract into its underground storage facilities for use at a later date. Naftogaz did not therefore need "*make up*" provisions[174]. By contrast, the volume and Take or Pay requirements in the Contract were crucial to ensuring the security of transit supplies to European off-takers. Without such provisions, Gazprom had justified concerns about the security of its transit supplies.[175]

(2898) For the reasons set out above, Naftogaz has also failed to establish that the volume and Take or Pay requirements under the Contract constitute an abuse for the purposes of Article 102 TFEU. On the contrary, those provisions formed part of a freely-negotiated commercial agreement.

(2899) In any event, the volume and Take or Pay requirements under the Contract are objectively justified. Naftogaz' own expert, Mr Lapuerta, recognises that long-term purchase commitments in gas supply agreements have been common-place and may be justified where suppliers need to make investments to supply the gas in order to avoid "*hold up*" by purchasers. [176] In the present case, in order to make the supplies of gas required by Naftogaz, Gazprom must invest billions of dollars in exploration for reserves, the construction and operation of production facilities and construction and maintenance of pipeline infrastructure.[177] This investment provides an objective justification for the volume and Take or Pay requirements in the Contract. Moreover, the lack of "*make up*" provisions is objectively justified for the reasons set out above.

(2900) In conclusion, therefore, Naftogaz has failed to establish that the volume and Take or Pay provisions in the Contract are in breach of Article 101 TFEU and/or Article 102 TFEU.

VIII.11.7.12.6 The Destination Clause in Article 3.10 of the Contract (Naftogaz' Claim 6.2)

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174 Witschen Report, paragraph 142.
175 [redacted], paragraphs 50 to 58.
176 Lapuerta Report, paragraphs 58 to 61.
177 [redacted] paragraphs 53 and 54.

(2901) Naftogaz' case is that the destination clause contained in article 3.10 of the Contract is in breach of Article 101 TFEU and/or Article 102 TFEU because, by preventing Naftogaz from selling the gas supplied under the Contract outside Ukraine, it artificially partitions the energy market and potentially enables price discrimination.

(2902) However, Naftogaz has failed to establish by reference to actual empirical evidence that the destination clause has as its object and/or effect the prevention, restriction or distortion of competition pursuant to Article 101 TFEU, or that it is abusive pursuant to Article 102 TFEU. Again, Naftogaz' case in this regard is purely theoretical and pays no regard to the factual and economic context.

(2903) First, Naftogaz has failed to establish that the actual or potential effect of the destination clause is to artificially separate national markets and undermine integration of the energy market. As explained above, there is a large Ukrainian domestic production of natural gas (about 35-40% of Ukraine's gas demand in 2012/2013). Naftogaz could export such gas outside Ukraine, thus contributing to the integration of the energy market. There is no empirical evidence put forward by Naftogaz which proves that the destination clause has an appreciable effect on competition in these circumstances.

(2904) In any event, the destination clause reflects and was objectively justified by the special, preferential trading and pricing arrangements that have characterised the contractual supply, transit and storage relationships between Naftogaz and Gazprom since the 1990s. Naftogaz never objected to the clause during negotiation of the Contract.[178]

(2905) In conclusion, therefore, Naftogaz has failed to establish that the destination clause in the Contract is in breach of Article 101 TFEU and/or Article 102 TFEU.

VIII.11.7.12.7 The unilateral suspension right in Article 5.3 of the Contract (Naftogaz' Claim 6.3)

(2906) Naftogaz argues that the unilateral suspension right in article 5.3 of the Contract is an abuse pursuant to Article 102 TFEU on the basis that it is "*one-sided*", "*unusual*" and "*unfair*". The clause is not mentioned in the Energy Community Secretariat's Preliminary Assessment. [redacted] statement, he states that the unilateral suspension right is "*unusual and unreasonable,*

[178] [redacted] paragraphs 86 to 94.

and gives a presumption of abuse of dominance".[179] However, absolutely no basis is given by [redacted] for this assertion.

(2907) Mr Lapuerta addresses article 5.3 in the light of what Naftogaz "*might*" want to do.[180] However, Naftogaz has failed to show by reference to actual empirical evidence that the unilateral suspension right has any detrimental effect on competition or that it constitutes an abuse pursuant to Article 102 TFEU. Again, Naftogaz' case in this regard is purely theoretical and pays no regard to the factual and economic context.

(2908) In the event, article 5.3 is wholly reasonable and objectively justified by Naftogaz' long history of failing to pay for gas deliveries and accumulating huge debts to Gazprom, Naftogaz making unauthorised withdrawals of gas from the pipeline system, and the tactics employed by Naftogaz in attempting to renegotiate commercial arrangements with Gazprom (for example, in January 2009, reversing the flow of the pipeline system, and in 2014, withholding payment for supplies already delivered).[181] In these circumstances, the inclusion of article 5.3 was not only reasonable, but fundamental to Gazprom being in a position to secure payment of debts from Naftogaz.[182]

(2909) In any event, Swedish law (by way of CISG) provides Naftogaz with a corresponding right to suspend performance in certain circumstances, even without a specific clause to that effect in the Contract.[183]

(2910) In conclusion, therefore, Naftogaz has failed to establish that the unilateral suspension right in article 5.3 of the Contract is in breach of Article 102 TFEU.

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179 [redacted] page 3.

180 Lapuerta Report, paragraphs 97 to 100.

181 Witschen Report, paragraph 164.

182 [redacted] paragraphs 95 to 100.

183 Article 71 CISG, which provides:

"*(1) A party may suspend the performance of his obligations if, after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations as a result of:*
(a) a serious deficiency in his ability to perform or in his creditworthiness; or
(b) his conduct in preparing to perform or in performing the contract.
(2) If the seller has already dispatched the goods before the grounds described in the preceding paragraph become evident, he may prevent the handing over of the goods to the buyer even though the buyer holds a document which entitles him to obtain them. The present paragraph relates only to the rights in the goods as between the buyer and the seller.
(3) A party suspending performance, whether before or after dispatch of the goods, must immediately give notice of the suspension to the other party and must continue with performance if the other party provides adequate assurance of his performance."

VIII.11.7.12.8 The Mandatory Sales Clause in Article 9.7 of the Contract (Naftogaz' Claim 6.4)

(2911) Naftogaz argues that article 9.7 is in breach of Article 101 TFEU on the basis that it strengthens "*Gazprom's hold on the Ukrainian gas market*" and limits the amount of gas available on the market contrary to the on-going liberalisation process in Ukraine. However, Naftogaz has failed to articulate any basis upon which it is said that article 9.7 has the object and/or effect of preventing, restricting or distorting competition. Naftogaz has not even formulated an argument in this regard, let alone put forward any empirical evidence to support it.

(2912) On the contrary, the Energy Secretariat notes in its Preliminary Assessment that it had "*no information as to whether such contract was indeed concluded and which amounts of gas are supplied (and at what price). Given the absence of this information, it is not possible to conduct a valid competition assessment of this particular juncture*".[184]

(2913) Naftogaz' alternative case is that the article 9.7 constitutes an abuse of dominance on the basis that it allows Gazprom to use its dominant position on the "*wholesale*" market to strengthen its position the on the "*retail*" downstream market and thus limit competition on the "*retail*" market. Despite the lack of information available to them, both Mr Lapuerta and [redacted] appear to feel able to opine on this alleged abuse of a dominant position. Their opinions are based on absolutely no empirical evidence and are wholly theoretical.

(2914) As a matter of fact, although Naftogaz did enter into an agreement with Gazprom Sbyt pursuant to article 9.7 of the Contract in 2008, Gazprom Sybt never actually took the volumes provided for under the Contract, nor did it ever cover the 25% market share provided for in article 9.7 (its maximum sales between 2008 and 2013 were 16%).[185]

(2915) Moreover, contrary to Mr Lapuerta's unsupported assertion that had Naftogaz not agreed to article 9.7, it would have agreed to a lower ACQ,[186] the correct position as a matter of fact is that, even if Gazprom Sbyt had not existed and there had been no mandatory sales provision in the Contract, Naftogaz' sales (and the annual contract volume) would not have been different. Article 9.7 made no difference to Naftogaz' sales (or the annual contract volume) since Naftogaz was the sole gas importer and consumers who were supplied by Gazprom Sbyt would otherwise

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184 Energy Community Secretariat Preliminary Assessment, page 7. See also [redacted] statement, page 3.

185 [redacted] paragraphs 28 and 29.

186 Lapuerta Report, paragraph 108.

have had to acquire gas from Naftogaz (or other suppliers who acquired gas from Naftogaz).[187] There is therefore absolutely no basis for Mr Lapuerta's theoretical argument about "*raising rivals' costs*".

(2916) Most importantly, however, Naftogaz has failed to draw to the Tribunal's attention the fact that it took action to exclude Gazprom Sbyt from the market in Ukraine and, as from 1 March 2013, has refused altogether to sell gas to Gazprom Sbyt.[188] Article 9.7 is not therefore having any effect in the relevant markets at all, let alone any effect on competition. Nor can it be said, given Naftogaz' actions, that article 9.7 is a "*forced sale*" provision (Naftogaz is not being forced to make any sales to Gazprom Sybt) or that the clause constitutes any form of abuse by Gazprom.

(2917) There is therefore absolutely no basis for Naftogaz' case on article 9.7 of the Contract either under Article 102 TFEU or Article 101 TFEU. As a result, and in the light of its failure to disclose essential relevant information to the Tribunal, Naftogaz should withdraw its case against Gazprom in this regard.

VIII.11.7.13 Invalidity and its consequences

VIII.11.7.13.1 No invalidity under Article 18 EnCT

(2918) As explained above, whilst Article 101(2) of the TFEU explicitly provides that "*[a]ny agreements or decisions prohibited pursuant to this Article shall be automatically void*", no such provision is found in the EnCT.

(2919) Therefore, as Naftogaz' case is based on Article 18 of the EnCT, Naftogaz has failed to explain its case that any provisions of an agreement that fall within the ambit of Article 18(1)(a) EnCT or that are an abuse under Article 18(1)(b) EnCT are automatically void.

(2920) In the event that the Tribunal finds that any of the provisions of the Contract are in breach of Article 18 EnCT in that they are anti-competitive or an abuse of dominance (which is denied for the reasons set out above), Gazprom's primary position is that none of the provisions of the Contract are in any event automatically void or invalid, and Naftogaz' claims for invalidity should therefore be rejected.

187 [redacted], paragraph 31.
188 [redacted] paragraphs 32 to 36.

(2921) However, in the event that the Tribunal were to find, in respect of any provision of the Contract, that:

(i) such provision of the Contract is in breach of competition law; and

(ii) as asserted by Naftogaz, such provision of the Contract is therefore invalid and/or that such provision of the Contract should be replaced,

Gazprom claims that the Contract should be adjusted in such a manner as to maintain and/or restore its equilibrium, as set out further below.

VIII.11.7.13.2 The effects of invalidity

VIII.11.7.13.2.1 Introduction

(2922) In the event that the Tribunal holds that any provisions that are in breach of Article 18 EnCT are automatically void and invalid, the Tribunal must consider the implications of such a breach and consequent invalidity.

(2923) If this Tribunal was to find that any of the provisions referred to by Naftogaz are invalid, they are severable from the Contract and it falls to Swedish law to determine the consequences for the remaining parts of the Contract.

VIII.11.7.13.2.2 Application of Swedisch law

(2924) Under Swedish law, the question of the consequences of invalidity for the remainder of a contract is determined by the application of the general rules of contract law; in particular, by applying Section 36 of the Swedish Contracts Act by which contractual provisions may be modified or set aside, or alternatively by means of the doctrine of assumptions (Sw. *förutsättningsläran*).

(2925) In this case, reference should also be made to the international character of the Contract, having particular regard to the fact that the Contract is to be interpreted pursuant to CISG.[189] Reference can also be made to Article 6.2.3(4) of the UNIDROIT Principles, which states:

"*(4)* *If the court* finds *hardship it may, if reasonable,*

[189] See above.

(a) *terminate the contract at a date and on terms to be fixed, or*

(b) *adapt the contract with a view to restoring its equilibrium*".[190]

(2926) Therefore, since neither Naftogaz nor Gazprom is seeking to terminate the Contract, the appropriate remedy is to adapt the Contract with a view to restoring its equilibrium.

(2927) The preparatory works in respect of Section 36 of the Swedish Contracts Act provide that agreements that limit competition should be treated in accordance with the same principles as any other agreements that breach mandatory provisions.[191]

(2928) Section 36 of the Swedish Contracts Act generally applies to particular clauses in an agreement and not to agreements as a whole. However, section 36(1) of the Swedish Contracts Act provides:

"*[…] Where a term is of such significance for the agreement that it would be unreasonable to demand the continued enforceability of the remainder of the agreement with its terms unchanged, the agreement may be modified in other respects, or may be set aside in its entirety*."

(2929) Axel Adlercreutz and Johann Mulder state the following regarding the fact that an agreement should be considered in its entirety when applying Section 36 of the Swedish Contracts Act:

"*The first thing to be considered is adjustment or removal of the unconscionable provision in question. This can be modified (a period of notice may be prolonged, a contractual penalty may be reduced, etc.) or completely disregarded, in which case a legal right to cancel the contract may perhaps become applicable instead, or the agreement may perhaps be considered workable without the invalid provision, for example if the invalid provision is an unfair secondary obligation. But the relationship with other parts of the agreement can also mean that other parts need to be adjusted, for example the price, or that the entire agreement is declared invalid […]*".[192]

(2930) Ulf Bernitz summarises the position as follows:

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190 Article 6.2.3(4) of the UNIDROIT Principles.

191 Government Bill 1975/76:81, p. 122-123.

192 Adlercreutz, Axel and Bernard Johann Mulder. *Avtal, Lärobok i allmän avtalsrätt*, 2013, p. 99-100.

"*If the invalid clause only applies to a certain matter that has somewhat limited significance for the agreement as a whole, the remainder of the agreement should normally stay in force as it stands. If, on the other hand, the invalid clause has been of central importance for the intended purpose of the agreement, then the entire agreement will most likely become invalid according to the doctrine of assumptions or section 36 of the Swedish Contracts Act. If the invalid clause is somewhere in between, i.e. the removal of the clause twists the balance between the parties of the agreement without changing the foundation for the continued application of the agreement, then both the clause as well as other provisions of the agreement can be modified in accordance with section 36 of the Swedish Contracts Act.*".[193]

(2931) In the present case, there is no basis for Naftogaz' claims for invalidity and/or replacement. However, if there were, since neither Naftogaz nor Gazprom is seeking to terminate the Contract, and since the clauses that Naftogaz claims should be declared invalid are of central importance for the intended purpose of the Contract as a whole, the appropriate remedy would be to adapt the Contract with a view to restoring its equilibrium.

VIII.11.7.13.2.3 Article 9.5. of the Contract

(2932) Article 9.5 of the Contract provides:

"If *any of the provisions hereof becomes legally invalid or ineffective, it shall not affect the validity of the other provisions of this Contract. If any of the provisions hereof becomes invalid or ineffective, the Parties shall endeavour to reach an agreement to replace such invalid or ineffective provisions with a new one that would have the economic effect as close as possible to that of the invalid or ineffective provision.*"

(2933) Article 9.5 of the Contract confirms that it is not the parties' intention that the entire Contract would be declared invalid in such circumstances. Instead, any invalidated provision is to be considered severable, and the parties are to endeavour to agree to replace the invalidated provision "*with a new one that would have the economic effect as close as possible to that of the invalid or ineffective provision.*" This shows the parties' intention that invalidated provisions should not affect the equilibrium of the Contract.

VIII.11.7.13.3 The appropriate adjustment

193 Bernitz, Ulf. *Svensk och europeisk marknadsrätt 1*, 4 uppl, p. 224.

(2934) Unless and until Naftogaz sets out the basis of its case in more detail, it is not possible for Gazprom to state in specific terms what adjustment would be appropriate to restore the equilibrium between the parties in the event that the Tribunal finds any of the provisions referred to by Naftogaz to be invalid and/or that any of the provisions should be replaced. However, and in any event, it is clear that Naftogaz' suggested adjustments do not restore the equilibrium between the parties and should be rejected.

(2935) Gazprom hopes to be able to specify its claims in this regard in its Statement of Rejoinder, once Naftogaz has submitted its Statement of Reply and therefore reserves its position in this regard.

VIII.11.7.13.4 Refund of excess payments

(2936) In the event that the Tribunal was to hold that article 4.1 of the Contract is invalid and should be replaced, then the question arises as to whether Naftogaz is entitled to a refund of excess payments in such circumstances.

(2937) Gazprom relies on the arguments above, in which Naftogaz' other claims for repayment as regards its price revision claims are addressed.

(2938) The question of whether or not excess payments should be refunded is a matter of the applicable national law.[194]

(2939) Under Swedish law, the fact that an agreement is, or parts of an agreement are, declared invalid does not necessarily mean that previous performances in accordance with the agreement should be returned. The Supreme Court has stated as follows on this point:

"*The fact that an agreement is invalid does not necessarily mean that it lacks all legal consequence. Generally, observance of the agreement cannot be legally enforced. If, however, performance has been made in accordance with an agreement that is in breach of law or generally accepted practices, the performing party sometimes lacks the legal right to reclaim what he has handed over, whereas in other cases a settlement between the parties can be allowed and can also be examined by a court.*".[195]

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194 Case 319/82, *Société de Vente de Ciments et Bétons de l'Est SA v. Kerpen & Kerpen GmbH & Co KG* [1983] ECR 4173.

195 NJA 1997 p. 93, p. 96.

(2940) The Supreme Court set out two alternatives: in some cases it is not possible to reclaim what has been performed, whereas in other cases this issue may be settled by the parties and examined by the court if necessary. The Supreme Court did not give any guidance regarding the situations in which each alternative should apply.

(2941) Torbjörn Andersson has commented on this issue as follows:

"The general starting point is that performances that have already been made shall be reversed, but this does not seem to be strictly applied to invalid legal relationships when a reversion in practice is difficult or where the invalidity is a consequence of the fact that a certain business operation is in breach of law or generally accepted practice. In light hereof, it is impossible to say what, in principle, applies in Sweden when agreements are invalid in accordance with European Union competition rules. Insofar as an agreement has been in force for a long time and has encompassed use of good will, know how, intellectual property, trademarks or goods that long ago were consumed or written off, a reversion in kind is of course in practice impossible. Further, the competition legislation of the European Union should be characterized as a legal prohibition; but it is not certain that agreements in breach of the competition legislation are to be equated with "pactum turpe" or criminal activities."[196]

(2942) In this case, the Contract is a long term contract and performances by both parties in accordance with the Contract and its addenda have been made for more than half of the term of the Contract. It would be impossible in practice for the parties' respective performances to be reversed now.

(2943) Naftogaz does not specify what particular payments under the Contract should be reversed. Tellingly, Naftogaz also does not offer to return any gas supplied under the Contract.

(2944) It is also notable that the Contract, when it was signed, was not in breach of any competition law. If the Tribunal was to find that the Contract was in breach of competition law, this would solely be due to circumstances that occurred in Ukraine after the Contract was signed – in particular, Ukraine's voluntary accession to the EnCT. It is relevant to note that Naftogaz is a Ukrainian wholly state owned company and that the Contract is considered "*the most important contract in the Ukrainian economy*".

196 Andersson, Torbjörn. *Dispositionsprincipen och EG:s konkurrensregler*, 1999, p. 117.

(2945) In conclusion, Naftogaz is not entitled to a refund in respect of excess payments in the event that the Tribunal finds that article 4.1 of the Contract is invalid under competition law and should be replaced. Naftogaz' Claim 5, as regards competition law, should therefore be rejected.

<u>VIII.11.7.14 Gazprom has further developed its defences to Naftogaz' claims for invalidity / ineffectiveness and replacement of provisions of the Contract pursuant to European competition law</u>

VIII.11.7.14.1 Dismissal of the claims (Sw. "avvisning")

i) The competition laws relied upon by Naftogaz are not applicable to the Contract

(2946) The Contract is implemented outside the EU between two parties established outside the EU. As a matter of public international law, EU competition law is in such circumstances *only* applicable if the agreement (or the abuse) has an immediate, substantial and foreseeable negative effect on competition within the European Union: this is known as the *qualified effects test*. Naftogaz has failed to establish that the Contract has such an effect on competition within the EU. Accordingly, EU competition law is not applicable to the Contract or to the claims put forward by Naftogaz. (See further section XII.B below).

(2947) In addition, as a matter of EU law, Naftogaz has failed to establish that the Contract has the necessary effect on trade between EU Member States in accordance with the requirements of Articles 101 and/or 102 TFEU. Such an effect on trade between Member States must be established *in addition to* the aforementioned qualified effects test. Accordingly, EU competition law is not applicable to the Contract or to the claims put forward by Naftogaz. (See further section XII.D below).

(2948) The principle of territoriality in public international law prevents Naftogaz from relying on the EnCT. In any event, the EnCT does not set out any obligations on the EU or the Member States of the EU that could create any rights for Naftogaz (or for Gazprom). Therefore, the EnCT cannot be applied to the Contract or to the claims put forward by Naftogaz. (See further section XII.B below).

(2949) The parties have agreed in Clause 9.4 that the Contract shall be exclusively governed by the substantive laws of Sweden. Therefore, Ukrainian law cannot be applied to the Contract or to the claims put forward by Naftogaz. (See further section XII.D.5 below.)

ii)

iii) T

VIII.11.7.15 Nivå 4 EU Commission investigation into Gazprom

(2950) Naftogaz refers to a press release published by the European Commission on 22 April 2015[197] to the effect that the Commission has sent a Statement of Objections to Gazprom for alleged abuse of dominance on Central and Eastern European gas supply markets in breach of Article 102 TFEU. Naftogaz asserts that this Statement of Objections is "*also indirectly relevant to* this arbitration".198

(2951) However, the Commission's Statement of Objections only relates to Gazprom / Gazprom Export contracts and alleged conduct in EU Member States (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia). It does *not* relate to Gazprom contracts and/or conduct which occurs wholly *outside* the EU (as does the conduct at issue in this arbitration). The Commission makes no reference *at all* to the gas supply market in Ukraine. Nor is there any support in the Commission's Statement of Objections for Naftogaz' assertion that "[t]*he sale of gas from Russia to the Ukraine affects trade between EU Member States, including five of the Member States addressed in the Statement of Objections, as Ukraine is part of the internal gas market of the EU by virtue of the* [EnCT]".[199] Such an assertion is clearly misconceived.

(2952) Moreover, it should be noted that the Commission's Statement of Objections is produced at an early stage in its investigation, and sets out only the Commission's *preliminary* views.

(2953) Even after the Commission has reached a final decision, addressees still have the right to appeal that decision to the General Court and then to the Court of Justice of the European Union.

(2954) On 28 September 2015, Gazprom submitted its formal response to the Commission's Statement of Objections, arguing that the Commission's case against it (particularly its allegation of excessive pricing) was economically and legally unfounded. In parallel, Gazprom has also entered into settlement negotiations with the EU Commission.

(2955) In these circumstances, there is absolutely no basis for Naftogaz' assertions that the Commission's Statement of Objections is "*evidence of systematic abuse of dominance and*

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[197] European Commission Press Release 22 April 2015.
[198] Naftogaz' Reply, paragraph 1157.
[199] Exhibit CL-155 and Naftogaz' Reply, paragraph 1117.

restrictive practices in Europe, in order to divide markets and maintain Gazprom's dominant position", nor that the Contract is an integral part of such a strategy on the part of Gazprom.[200]

VIII.11.7.16 The basis for the application of competition law

VIII.11.7.16.1 The direct application of EU Competition Law

VIII.11.7.16.1.1 Introduction

(2956) Naftogaz alleges that EU competition law applies to its claims on the basis that the Contract affects trade between EU Member States contrary to Articles 101 and 102 TFEU.[201] Naftogaz revised its claims and it has now presented two separate grounds for its claims based on EU competition law:

(i) Naftogaz' primary legal basis for its competition law claims is the direct application of Articles 101 and 102 TFEU to the Contract due to the Contract's effects on trade between Member States of the EU.[202]

(ii) Naftogaz also argues that Articles 101 and 102 TFEU are directly applicable to the Contract as part of Swedish law.[203]

(2957) Sweden is a Member State of the EU and EU law must therefore be enforced in Swedish law. It follows that the two grounds put forward by Naftogaz are effectively one and the same ground.

VIII.11.7.16.1.2 Effect on trade within the European Union according to Naftogaz

(2958) Naftogaz states that a condition for the applicability of the prohibitions in Articles 101 and 102 TFEU is that trade between EU Member States is affected. According to Naftogaz, this is true also for restrictive agreements or practices covering non-EU countries which are entered into or conducted by undertakings established outside the EU.

(2959) Naftogaz asserts that the General Court extended the scope of EU jurisdiction in *Gencor*[204] so as to include the *qualified effects doctrine*. According to Naftogaz, the *qualified effects doctrine* provides that, if it is foreseeable that an agreement or a practice will have substantial effect

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200 Naftogaz' Reply, paragraph 1159.
201 Naftogaz' Reply, paragraph 1166
202 Naftogaz' Reply, paragraph 1164.
203 Naftogaz' Reply, paragraphs 1164 and 1191 to 1192.
204 Case T-102/96 *Gencor Ltd v Commission* [1999] ECR II-753.

within the EU, then EU law applies by virtue of the territoriality principle as recognised by public international law.

i) The territorial restriction on EU competition law under public international law: the qualified effects doctrine

A) Introduction

(2960) The qualified effects doctrine referred to by Naftogaz is controversial. There has been no definitive statement from the CJEU on whether such a doctrine exists in EU law. It is therefore not definitively established as a matter of EU law.

(2961) Moreover, there are several reasons why an extraterritorial application of EU competition law should be interpreted restrictively.

(2962) First, the territoriality principle, under which the EU has the power to make laws affecting conduct within its own territory only, is a fundamental principle in public international law. The CJEU has on several occasions stressed that the EU must respect international law in the exercise of its powers, including the principle of territoriality.[205]

(2963) Second, Article 101 TFEU (or indeed Article 102 TFEU) raises no issue of territorial jurisdiction from the point of view of public international law precisely because, given the way in which it is worded, it is quite simply *not* intended to be applied in any extra-territorial manner.

(2964) Too broad an interpretation of the territorial scope of EU competition law would encroach on the territoriality principle as recognised in public international law, sit uneasily with the wording of Articles 101 and 102 TFEU, and entail the risk of conflicts of jurisdiction with foreign competition authorities.

B) Limited extraterritorial application of EU competition law through the qualified effects doctrine

(2965) Naftogaz argues that EU competition law applies where an agreement or practice is either *implemented in* or *produces effects* within the EU. Naftogaz further argues that, if *either*

[205] Case C-286/90 *Poulsen and Diva Navigation* [1992] ECR I-6019 at paragraph 9 (concerning international law in general), Case C-89/85 *A Ahlstrom Osakeyhtio v Commission (Wood Pulp)* [1988] ECR 5193 at paragraph 18 (concerning the territoriality principle as universally recognised in public international law).

criterion is fulfilled, the jurisdiction of EU law is compatible with the requirements of public international law.

(2966) However, despite several possibilities to do so, the CJEU has never applied Article 101 or 102 TFEU based on qualified effects in a situation where the agreement or conduct in question was not *implemented* in the EU. For the reasons stated above, it is appropriate for this Tribunal also to adopt such a restrictive approach to such an application.

(2967) Moreover, the General Court has held that, in order to justify the application of EU competition law "*according to the rules of public international law*" based on the potential *effects* of the conduct where an abuse was implemented outside the EU between two parties established outside the EU, the criteria of "*immediate, substantial and foreseeable effect in the European Union*" must be satisfied.[206] This is also referred to as the *qualified effects test*.[207]

(2968) The test adopted by the General Court is a stringent one. The Court made clear that a detailed and thorough analysis of the potential effects of the agreement or practice in the EU is required in order to establish that these are "*substantial*".[208] Also, in order for an agreement or practice to have "*immediate*" effect in the EU, the effects must be direct, rather than merely indirect or having a knock-on effect.[209] In addition, the effect generated by the agreement or practice in the EU must have been *foreseeable* for the parties involved.[210]

(2969) The General Court has also clarified that the "*effect in the European Union*" refers to a *negative effect on competition* within the EU.[211] An extraterritorial effect of EU competition law in accordance with a qualified effects test could according to the General Court *only* be justified if there was a "*threat to the effective competition structure in the common market*".[212]

(2970) Application of EU competition law according to the rules of public international law is therefore quite different to the regular "*effect on trade*" test used for the application of Articles 101 and 102 TFEU. While the public international law test refers to a *negative effect on competition in*

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[206] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraph 243, Exhibit CL-179. See also Case T-102/96 *Gencor* [1999] ECR II-753 at paragraph 89-100.

[207] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraphs 233 and 244. The *Intel* judgment by the General Court is currently under appeal to the CJEU.

[208] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraphs 259-276.

[209] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraph 278.

[210] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraphs. 281-282.

[211] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraphs 251-252, 274-275 and 280.

[212] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraphs 251 to 252.

the EU, the application of Articles 101 and 102 TFEU refers to an effect, positive or negative, on "*trade between Member States*" of the EU.

(2971) Whether EU competition law, as a matter of public international law, can be applied to an agreement (or an abuse) which is implemented outside the EU between two parties established outside the European Union, is thus "*a question separate from*" that of the criteria laid down in Articles 101 and 102 TFEU.[213]

(2972) Both tests must be satisfied in order for EU competition law to be applied in circumstances such as those in this case. The question of an effect on trade between Member States is considered separately in paragraphs below.

C) Naftogaz has failed to establish jurisdiction in accordance with public international law under the qualified effects test

(2973) Naftogaz argues that the Contract and the practices of Gazprom produce economic effects within the EU as both the object and effect thereof is to foreclose the Ukrainian market from the EU market by hindering exports into the EU from Ukraine and by hindering suppliers located within the EU from marketing their gas on the Ukrainian market.

(2974) Naftogaz also argues that the Contract prevents flows between Ukraine and Slovakia, Poland and Hungary respectively. According to Naftogaz, each of these EU Member States can conduct trade with the other two by using Ukraine as a bridge, even in the absence of direct pipeline connections. Therefore, "*trade flows between EU Member States are also affected by the Contract and related practices. The territoriality principle is therefore satisfied, and EU competition law applies to the Contract and the practices connected to it*".

(2975) These arguments are misconceived as a matter of fact: seebelow. But, in any event, Naftogaz has confused the test for whether there is an effect on trade between EU Member States with the qualified effects test under public international law. As explained above, the two tests are distinct. It has failed to make a case under the qualified effects test.

(2976) As established above, the Contract will not fall within EU competition law under the qualified effects test unless it has "*immediate, substantial and foreseeable effect in the European Union*". There must be an effect *on competition in the EU* and this effect must be *negative*.

[213] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraph 248.

(2977) According to Article 2.1 of the Contract, the subject matter of the Contract is the sale and purchase of gas. Gazprom has undertaken to sell and Naftogaz to purchase a certain volume of gas from 1 January 2009 to 31 December 2019. It follows from Articles 2.3 and 2.4 of the Contract that Gazprom will deliver the gas to Naftogaz and that the delivery and acceptance point will be at the border of the Russian Federation and Ukraine and/or the border of the Republic of Belarus and Ukraine. The disputed Article 3.10 of the Contract further clarifies that the gas delivered is intended for consumers in Ukraine.

(2978) The Contract thus regulates the sale and purchase of gas in Ukraine between two undertakings established *outside* the EU and the gas is also intended for use on the market in Ukraine. The only *direct* effect on competition generated by the Contract would occur on the Ukrainian market. Competition in the EU can only be *indirectly* affected by the Contract.

(2979) Moreover, even if Naftogaz were able to establish that the object of the Contract is to foreclose the Ukrainian gas market from the EU, which is denied, there is no evidence that this alleged object would have a *negative* effect on competition in the EU which is *immediate, substantial and foreseeable* in nature.

(2980) Naftogaz itself argues that the oil price indexation clause, Article 4.1 of the Contract, may reduce natural gas demand *in Ukraine* and make higher volumes available to Gazprom for sale in EU countries and that this in turn would increase trade and have a *positive effect* on competition *in the European Union*. Such an effect is not detrimental to competition *in the* EU.

(2981) In addition, a higher gas volume sold by Gazprom to the EU and a potential consequential effect on prices in the EU could only constitute an *indirect* effect of the Contract price in Ukraine.

(2982) The indirect effect of Article 4.1 of the Contract is further underlined by Naftogaz' own assertions concerning this provision.[214] For example, Naftogaz asserts that "[t]*he inclusion of different oil products in the Price Formula discriminates between different customers <u>within Ukraine</u> based on their alternatives to consuming natural gas. Thus, the prices under the Contract not only discriminate against Naftogaz compared to other buyers, but also involve discrimination between gas users <u>within Ukraine</u>*."

(2983) Similarly, if the volume and take or pay provisions in the disputed Articles 2.2 and 2.2.5 of the Contract have any effect on the competition in the EU at all, this effect can only be *positive*.

[214] Naftogaz' Reply at paragraphs 1352 to 1419.

Naftogaz argues that these provisions prevent it from importing alternative gas supplies from Poland, Hungary and Slovakia that could otherwise compete effectively in Ukraine. This would accordingly generate an exclusionary effect on suppliers in the EU. However, such an effect would therefore also generate an *intensified competition amongst these suppliers on the internal EU gas market* since they are, according to Naftogaz, prevented from exporting gas to Ukraine.

(2984) Further, the purpose of Articles 2.2 and 2.2.5 of the Contract is to ensure that a certain amount of gas is sold and delivered in Ukraine and there is only a potential knock-on effect on competition in the EU. The mere *indirect* effect on competition in the EU of these provisions is apparent in Naftogaz' arguments concerning the purportedly abusive and restrictive nature of the volume and take or pay provisions, which is concentrated on alleged foreclosure effects *in Ukraine* and on Naftogaz' position on the *Ukrainian market*.

(2985) Concerning the disputed Article 3.10 of the Contract, Naftogaz asserts that this provision prevents Ukraine from exporting unwanted gas to Slovakia, Hungary and Poland in competition from Russia and elsewhere. According to Naftogaz, the alleged effect on exports to EU Member States also affect price levels and trade in the European Union.

(2986) However, Article 3.10 of the Contract is not concerned with any territory *within* the European Union; it deals with gas *before it is delivered to EU*. The provision prevents export from Ukraine, which is not a Member State of the EU, to destinations *outside* Ukraine.[215]

(2987) Naftogaz also challenges the unilateral suspension right in Article 5.3 of the Contract and argues that this provision puts Naftogaz at a competitive disadvantage with respect to potential sales to EU countries and will place suppliers in those countries at an advantage in competing with Naftogaz to supply customers in Ukraine.[216] However, as admitted by Naftogaz, the only consequence of the unilateral suspension right in Article 5.3 of the Contract is to place *suppliers*

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215 Cases in which destination clauses have been held to be contrary to EU competition law may be distinguished from the present case on the basis that they relate to restrictions on trade within the EU and therefore undermine the EU single market objective Further, cases such as *Case C-306/96 Javico International and Javico AG v Yves Saint Laurent Parfums SA (YSLP)* [1998] ECR I-01983 established that a restriction imposed on an undertaking to not sell outside a designated territory situated outside the borders of the EU, thus affecting export to the European Union, may have an objectionable restrictive effect on competition within the EU but only in certain circumstances Such circumstances are not present in this case The agreement in Javico concerned the contractual relationship between a supplier established in an EU Member State and a distributor in another Member State to which the supplier had entrusted the distribution of his products in a territory outside the EU and in doing so had imposed on the distributor an obligation to ensure that the products exported to the territory outside the EU was not sold outside that territory, for example by re-export back to the EU This firm link to the EU is missing in this case where the Contract concerns a contractual relationship situated entirely outside the EU Further, the CJEU did not find that the restriction is contrary to EU law per se; it was necessary to evaluate the effects of the restriction Such an evaluation has not been carried out in the present case

216 Naftogaz' Reply at paragraph 1495. See also paragraph 1491. See further the Lapuerta Report 2 at paragraph 137(e).

in EU Member States at an advantage in competing with Naftogaz to supply customers in Ukraine.

(2988) It is doubtful if *competition in the EU* may be affected at all by the unilateral suspension right. Considering that the only effect of this provision is a potential detrimental effect on Naftogaz, situated outside the EU. There could only at best be an *indirect positive* effect on competition in the EU.

(2989) In addition, Naftogaz argues that the mandatory sales clause in Article 9.7 of the Contract generates an advantage to Gazprom in the sale of gas to customers in Ukraine. Naftogaz asserts that this "*clause contributes to the strengthening of Gazprom's dominant position in the upstream market* […] *through forced sales by Naftogaz to a Gazprom subsidiary*". According to Naftogaz, potential suppliers from EU countries such as Slovakia, Poland and Hungary would thereby be put at a disadvantage in Ukraine, which in turn would affect trade patterns between EU countries.[217]

(2990) Accordingly, if the mandatory sales clause has any effect on competition in the EU at all, it is merely a consequential effect of the disadvantage allegedly suffered by suppliers established in the EU in Ukraine. If there is any foreclosing effect generated from Article 9.7 of the Contract at all, which is denied, this can only be an *indirect* consequence of this provision.

(2991) It follows from the analysis conducted above that *none* of the disputed provisions has a negative effect on competition in the EU. On the contrary, these provisions may well have a *positive* effect on competition in the EU when they are considered individually. In addition, the effect on competition in the EU generated by the disputed provisions is only *indirect*. Naftogaz has accordingly also failed to establish that these provisions have an *immediate* effect on competition in the European Union.

(2992) In addition to relying on the disputed provisions separately, Naftogaz also argues that the overall effect of the Contract has a detrimental effect on competition in the EU. However, Naftogaz has not provided a proper analysis of how this overall negative effect on competition in the EU is generated. Based on the review of the disputed provisions above, it is not possible for the overall effect of these provisions to generate a negative effect on competition in the EU.

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217 See the Lapuerta Report 2 at paragraph 137(f).

(2993) Further, Naftogaz has not argued that the effect on competition in the EU of individual provisions of the Contract or the Contract as a whole is "*substantial*" in accordance with the criteria for jurisdiction under public international law as set out above. Based on the discussion concerning the potential effect of the individual provisions as well as the overall effect of the Contract, it is denied that the Contract has such an effect.

(2994) In any event, Naftogaz has failed to provide the detailed and thorough analysis of the potential effects of the disputed provisions in the EU, which is required in order to establish that the negative effects on competition in the EU are "*substantial*". Naftogaz has therefore failed to establish that the Contract has substantial effect in the EU.

(2995) Finally, Naftogaz provides no analysis concerning the *foreseeability* of the effects of the Contract in accordance with the criteria for jurisdiction under public international law as set out above. It is denied that the disputed provisions considered individually or the Contract as a whole have a foreseeable effect on competition in the EU.

(2996) In conclusion, in order to determine whether EU competition law, as a matter of public international law, can be applied to conduct that takes place *outside* the EU, there must be a negative direct effect on competition in the EU that is both immediate, substantial and foreseeable to the parties. This effect has not been established by Naftogaz in this case.

ii) Effect on trade between EU Member States

A) Introduction

(2997) Even if Naftogaz is able to demonstrate that it can fulfil the requirements of the qualified effects test as a matter of public international law (which is denied), it is further denied that Naftogaz is able to establish the requisite effect on trade between EU Member States as a matter of EU competition law.

(2998) Whether EU competition law, as a matter of public international law, can be applied to conduct that takes place outside the EU, is "*a question separate from*" that of the criteria laid down in Articles 101 and 102 TFEU as regards effect on trade between EU Member States.[218]

B) Effect on trade – whole agreement or individual provisions?

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[218] Case T-286/09, *Intel Corp v. Commission*, 12 June 2014, at paragraph 248.

(2999) Naftogaz considers the question of whether it is able to prove that the whole agreement has an effect on trade between EU Member States, or whether it will have to prove that each of its individual provisions has such an effect. Naftogaz argues that if an agreement as a whole is capable of affecting trade between EU Member States, then EU law has jurisdiction over the entire agreement, "*including any parts of the agreement that individually do not affect trade between EU Member States*". Further, where a dominant undertaking engages in conduct in pursuit of the same aim, "*it is sufficient that at least one of those practices is capable of affecting trade between EU Member States*". Naftogaz relies upon paragraphs 14 to 17 of the EU Commission's Effect on Trade Guidelines in this regard.

(3000) However, paragraph 17 of the Effect on Trade Guidelines makes it clear that, in order to take advantage of this approach, Naftogaz needs to establish that the allegedly abusive conduct "*forms part of an overall strategy*" pursued by Gazprom. If Naftogaz cannot do that, then each individual element of the impugned conduct must be assessed separately and proven by Naftogaz to affect trade between EU Member States.

(3001) Naftogaz asserts that the various parts of the Contract are part of an "*overall strategy*" or "*common exclusionary strategy*" engaged in by Gazprom against Naftogaz. The only evidence cited in support of this assertion of a "*common exclusionary strategy*" is the Commission's Statement of Objections. However, for the reasons set out above, the Commission's Statement of Objections is not evidence of such an assertion.

(3002) Therefore, Naftogaz has failed to establish an "*overall strategy*". It thus needs to establish that each element of the alleged abuse (i.e. each impugned provision of the Contract) affects trade between EU Member States.

C) Naftogaz is unable to establish an effect on trade between EU Member States

(3003) In any event, Naftogaz is unable to establish an effect on trade between EU Member States whether it focuses on the Contract as a whole or on its individual provisions.

(3004) It is well established that EU law applies to EU Member States. It is, of course, the case that neither Russia nor Ukraine are EU Member States. It is also the case that Ukraine will not become a Member State of the EU in the near future. Articles 101 and 102 TFEU *only* apply to agreements and/or conduct "*which may affect trade between Member States*" of the EU. [219]

(3005) In the present case, the Contract involves two parties neither of which are located in EU Member States, and it regulates activities in a non-Member State. It sets out the terms and conditions for the supply of natural gas from Russia to Ukraine.

(3006) As regards producing effects on trade between EU Member States, in its Guidelines on the Effect on Trade, the European Commission states that:

"*In the case of agreements and practices whose object is not to restrict competition inside the Community, it is normally necessary to proceed with a more detailed analysis of whether or not cross-border economic activity inside the Community, and thus patterns of trade between Member States, are capable of being affected.*" [220]

(3007) The object of the Contract is not to restrict competition *within the EU*, it is to set out the terms and conditions for the supply of natural gas from Russia to Ukraine. However, Naftogaz has failed to provide any detailed analysis or evidence of how "*cross-border economic activity inside the Community, and thus patterns of trade between Member States*" are affected by the Contract, which, as stated above, is entered into between two parties located *outside* the EU and which relates to supplies of gas *outside* the EU.

(3008) Moreover, the CJEU has consistently held that, in order for an agreement or conduct to affect trade between EU Member States,

"[…] *it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or fact that it may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States, such as might prejudice the aim of a single market in all the Member States*."[221]

(3009) A speculative or contrived possibility is not enough. In its Guidelines on the Effect on Trade, the European Commission clarifies that:

[219] Article 101(1) TFEU and Article 102(1) TFEU.

[220] Paragraph 106, Effect on Trade Guidelines.

[221] Case 42/84 *Remia v Commission* [1985] ECR 2545, paragraph 22.

"The inclusion of indirect or potential effects in the analysis of effects on trade between Member States does not mean that the analysis can be based on remote or hypothetical effects. The likelihood of a particular agreement to produce indirect or potential effects must be explained by the [...] *party claiming that trade between Member States is capable of being appreciably affected. Hypothetical or speculative effects are not sufficient for establishing Community law jurisdiction."*[222]

(3010) Naftogaz has failed to discharge its burden in this regard, and thus has failed to establish that EU competition law could apply. The alleged effects on trade between EU Member States upon which Naftogaz seeks to rely are remote, hypothetical and speculative.

(3011) As regards the Contract as a whole, Naftogaz argues that the Contract and the practices of Gazprom may affect trade between EU Member States in two ways:

(i) they foreclose the Ukrainian market from the EU market by hindering exports into the EU from Ukraine; and

(ii) by hindering suppliers located within the EU from marketing their gas on the Ukrainian market.

(3012) Naftogaz argues that this not only affects trade between Ukraine and individual EU Member States, but also between EU Member States.

(3013) However, these arguments are misconceived:

(i) Historically, Ukraine has not exported any volumes of gas to other countries.[223] Naftogaz is a heavy importer of gas from Russia, and independent Ukrainian producers have been required under Ukrainian law to sell all domestic production to Naftogaz.[224] Moreover, there is no evidence that Ukrainian suppliers would have any incentives to export gas to the EU in the future.[225] Naftogaz' argument on effect on exports from Ukraine is wholly speculative and hypothetical.

(ii) There is nothing in the Contract which explicitly prohibits suppliers located in the EU from marketing their gas in Ukraine. Naftogaz' argument on effect on imports into Ukraine is wholly speculative and hypothetical.

222 [redacted].
223 [redacted]
[redacted]
224 [redacted] paragraph 78.
[redacted] TRANS ARB Moselle Report, paragraph 3.19.

(3014) Naftogaz also argues that the Contract prevents flows between Ukraine and Slovakia, Poland and Hungary respectively. According to Naftogaz, each of these EU Member States can conduct trade with the other two by using Ukraine as a bridge, even in the absence of direct pipeline connections. Therefore, "*trade flows between EU Member States are also affected by the Contract and related practices. The territoriality principle is therefore satisfied, and EU competition law applies to the Contract and the practices connected to it*".

(3015) These submissions are based on the Lapuerta Report 2, but the statements made by Mr Lapuerta in this regard are highly theoretical and speculative. They do not appear to be based on any factual evidence as regards the situation in Ukraine, Slovakia, Poland and Hungary.

(3016) [redacted] Gazprom Export LLC, and who is familiar with the structure and operation of the European and Ukrainian gas transmission systems, and with Gazprom's and Gazprom Export's arrangements for delivery of gas at and/or further transportation of gas from the exit points of the Ukrainian GTS, has given evidence in this regard in these proceedings.[226] He makes it clear that Gazprom has not "*blocked*" virtual reverse flow or that Gazprom has "*refused to permit efficient cross-border flows*" from Ukraine to these other countries.[227]

(3017) Further, as regards physical reverse flow, he explains that Mr Lapuerta's suggestion that Ukraine could act as a "*bridge*" between Poland, Hungary and Slovakia is impractical and unrealistic for a number of reasons.[228]

(i) First, there is limited or no physical reverse flow capacity from the countries adjoining Ukraine (i.e. Poland, Slovakia, Hungary and Romania) to Ukraine. The majority of the pipelines in Ukraine transport gas westwards from Russia and Belarus towards Europe. Moreover, the existing reverse flow pipelines from Slovakia, Poland and Hungary to Ukraine are not being utilised to their full capacity, suggesting that there is insufficient supply or demand to warrant any expansion of the existing infrastructure. Even if fully utilised, the volumes of gas that the existing reverse flow pipelines are capable of transporting, whilst not negligible, are insufficient for Ukraine to be able to position itself as a major transit route for trade between the countries adjoining Ukraine.[229]

226 [redacted]

227 [redacted] paragraphs 12 to 24.

228 [redacted], paragraphs 25 to 34.

229 [redacted] paragraphs 26 to 29.

(ii) Second, the existing infrastructure either already facilitates *direct* trading between Poland, Slovakia, Hungary and Romania, or there are plans in place to construct infrastructure that would facilitate it. There is consequently little reason for the countries adjoining Ukraine to use Ukraine as a "bridge" for supplies between them. In fact, the countries adjoining Ukraine appear to be seeking to expand available pipeline routes so as to be able to circumvent, or avoid, Ukraine in the event of another disruption of the transit of gas through Ukraine. Further, Mr Lapuerta's suggestion that Ukraine act as a "bridge" between neighbouring countries does not take into account the commercial interests and motivations of the national transmission system operators, or "TSOs", whose revenues are made up in large measure by entry and exit tariffs (or transit tariffs) for gas transported through their GTSs.[230]

(iii) Third, Ukraine does not currently have the infrastructure that would be required for it to establish itself as a gas trading hub between its adjoining countries.[231]

(3018) As a result, Naftogaz has failed to establish to the requisite standard as a matter of EU law that the Contract as a whole and/or the practices of Gazprom may affect trade between EU Member States.

(3019) Overall, Naftogaz has failed to establish that Articles 101 and 102 TFEU are directly applicable to the Contract due to its effects on trade between EU Member States (either as a whole or by reference to its individual provisions). There is therefore no basis in EU law for Naftogaz' claim under Articles 101 and 102 TFEU, and EU competition law cannot be applied to the claims put forward by Naftogaz.

VIII.11.7.16.1.3 Article 18 EnCT applicable as Swedish law

(3020) The CJEU has clarified when a provision in an international agreement concluded by the EU with a third country is regarded as capable of being relied on by an individual before a national court or tribunal of an EU Member State. Both Naftogaz and [redacted] have failed to engage with the criteria set out by the CJEU and therefore have entirely ignored the significance of the EU Treaties, the structure of the European Union and the case law of the CJEU.

(3021) A provision in an international agreement is subject to two conditions in order to be capable of being relied on by an individual in a court or tribunal in the EU.

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230 [redacted], paragrahs 30 to 44.
231 [redacted], paragraphs 45 to 48.

(3022) First, the EU is only responsible for the execution of an international agreement, to which it is a party, to the extent it has assumed obligations under the agreement. Accordingly, an individual cannot rely on a specific provision of an international agreement before a court or tribunal of a Member State of the European Union unless that provision contains a commitment undertaken by the EU.232

(3023) Second, the specific provision must be directly effective as a matter of EU law.[233] Direct effect of a provision in an international agreement depends on a two-tier test:

(i) first, the agreement as a whole must be capable of conferring enforceable rights;

(ii) second, the specific provision of the agreement relied upon by the individual must be sufficiently clear, precise and not subject to further implementing measures.

(iii) If either of these conditions is not met, the agreement cannot be relied upon by an individual before a court or tribunal within the EU.[234]

ii) First condition - Article 18 EnCT does not contain a commitment undertaken by the EU

(3024) The EnCT does not contain similar obligations for all Parties (in contrast to for example the free trade agreement with Portugal which the CJEU had to interpret in *Kupferberg*)[235]. There is a clear division between the commitments of the EU as a Party to the EnCT on the one hand and the Contracting Parties on the other. This division of obligations is in accordance with the purpose of the EnCT to create a *new legal and economic framework* amongst the Parties *based on the EU acquis communautaire* related to energy. By exporting EU rules to the Contracting Parties, the Parties intended to create a regulatory and market framework amongst themselves so as to ensure a stable and continuous energy supply.

(3025) It follows from Article 3(a) EnCT and the definition therein of "*the extension of the acquis communautaire*" that the obligation existing in Article 18 EnCT, under Title II of the EnCT, is

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232 See to this effect Joined Cases 21/72 to 24/72 *International Fruit Company and Others* [1972] ECR 1219 at paragraph 7.

233 Case C-308/06 *The Queen, on the application of International Association of Independent Tanker Owners (Intertanko) and Others v Secretary of State for Transport* [2008] ECR I-4057 at para. 45.

234 Case C-363/12 *Z. v A Government department and The Board of management of a community school* of 18 March 2014, not yet published, at paragraph 85.

235 Case 104/*81 Hauptzollamt Mainz v CA Kupferberg & Cie KG aA* [1982] ECR 3641.

addressed to the Contracting Parties only, including Ukraine, and *not* to the EU as a "Party" to the EnCT.

(3026) The wording of Article 18 EnCT itself further underlines the obligations *of the Contracting Parties* under this provision. Article 18(1) EnCT provides for certain anti-competitive measures to be incompatible with the proper functioning of the EnCT, insofar as they may affect trade of Network Energy "*between the Contracting Parties*". The wording of Article 18(1) EnCT does not refer to trade between the Parties to the EnCT, or between the Contracting Parties and the European Community, or between the Contracting Parties and the Member States of the Community.[236]

(3027) Article 18(1) EnCT, read in light of Article 3(a) EnCT, therefore confirms that the obligation in Article 18 EnCT is addressed to the Contracting Parties and not to the EU as a "Party" to the EnCT. Whether *Ukraine as a Contracting Party to the EnCT* is under an obligation to implement and apply the EnCT is simply irrelevant to an alleged right *in EU law* to rely on the EnCT and [redacted] is wrong to suggest otherwise.[237]

(3028) It follows that Article 18 EnCT does not contain any commitment for which the EU is responsible. Since Article 18 EnCT does not generate an obligation on the EU, there cannot be a corresponding duty to enforce the content of this provision in EU law. With no duty to enforce Article 18 EnCT by the EU, a private party cannot rely on this provision as a matter of EU law directly against another private party before a court or tribunal.

iii) Second condition - Article 18 EnCT does not have direct effect in EU law and Naftogaz is therefore not able to rely on this provision before the Tribunal

A) First tier of the test

(3029) The test for direct effect will only be relevant if Article 18 EnCT is found to contain an obligation for the performance of which the EU is responsible (contrary to Gazprom's submissions in the previous section).

(3030) In order to determine the first tier of the test for direct effect, i.e. whether the agreement as a whole is capable of conferring enforceable rights to individuals, regard must be had to the nature

[236] Article 18(1) EnCT.
[237] [redacted], paragraphs 18 and 22.

and purpose of the agreement.[238] In this regard, the CJEU has also held that "*the nature and the broad logic* [of the international agreement]*, as disclosed in particular by its aim, preamble and terms*" must be considered in order to determine whether the international agreement as a whole is capable of conferring enforceable rights on individuals as a matter of EU law. [239]

(3031) There are several reasons why the EnCT is not capable of conferring rights on individuals in EU law.

(3032) The purpose of the EnCT, according to both the recitals of the agreement and Article 2(1) EnCT, is to organise relations between the Parties and to create a legal and economic framework built on EU energy related Directives in areas of electricity, gas and oil.[240] The terms of the EnCT states specifically that the agreement "*shall follow the* acquis communautaire *on energy, environment, competition and renewables, adapted to both the institutional framework of the Energy Community and the specific situation of each of the Contracting Parties*".[241] Accordingly, in order to create this *new legal and economic framework* amongst the Parties, the EnCT seeks to export parts of the EU *acquis communautaire* related to energy *to the Contracting Parties*.

(3033) The nature and the broad logic of the EnCT as an instrument for the export of EU legal rules to the Contracting Parties for the purpose of creating a new legal and economic framework in areas of electricity, gas and oil, rather than as an agreement meant in itself to establish rights for individuals, is further evidenced by the specific provisions of the EnCT.

(3034) First, the EnCT explicitly specifies that the substantive obligations of the EnCT are directed towards *the Contracting Parties* and not to the EU.

(3035) Article 3(a) EnCT clarifies that the activities of the Energy Community shall include "*the implementation <u>by the Contracting Parties</u> of the* acquis communautaire *on energy, environment, competition and renewables, as described in Title II* [of the EnCT]*, adapted to*

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[238] Case C-162/96 *A. Racke GmbH & Co. v Hauptzollamt Mainz* [1998] ECR I-3655 at paragraph 31. See also Case 12/86 *Meryem Demirel v Stadt Schwäbisch Gmünd* [1987] ECR 3719 at paragraph 14. See also Case 104/81 *Hauptzollamt Mainz v CA Kupferberg & Cie KG aA* [1982] ECR 1183 3641 at paragraph 23, underlining the need to analyse the provision concerned in the light of both the object and purpose of the Agreement and of its context.

[239] Case C-308/06 *The Queen, on the application of International Association of Independent Tanker Owners (Intertanko) and Others v Secretary of State for Transport* [2008] ECR I-4057 at paragraph 54, 64 and 65.

[240] Article 2(1) EnCT referred originally only to Community Directives 2003/54/EC and 2003/55/EC. This has been extended to European Community Directive 2006/67/EC concerning crude oil and petroleum related products. Exhibit RLA-65.

[241] Article 5 EnCT.

both the institutional framework of the Energy Community and the specific situation of each of the Contracting *Parties*" (emphasis added).

(3036) The obligation *for the Contracting Parties* to implement the *acquis communautaire* on energy, environment, competition and renewables is in Article 3(a) EnCT referred to as "*the extension of the* acquis communautaire". This term is subsequently used as the heading to Title II of the EnCT, under which the substantive obligations of the agreement are found.[242]

(3037) Thus, while ignored by Naftogaz as well as by [redacted] [243] the implementation of the *acquis communautaire* on energy, environment, competition and renewables, as set out under Title II of the EnCT in Articles 10, 16, 18 and 20 EnCT respectively, contain obligations for *the* Contracting *Parties* only, including Ukraine, and not for the EU as a "Party" to the EnCT.[244]

(3038) Similarly, the requirement to comply with "*generally applicable standards of the European Community*", as set out in Chapter VI EnCT under "Title II – The Extension of the Acquis Communautaire" is addressed *to the Contracting Parties.* Article 22 EnCT provides that *the Contracting Parties* "*shall* […] *adopt development plans*" to bring their electricity and gas sectors falling within the scope of the designated EU energy related directives into line with the "Generally Applicable Standards of the European Community".[245]

(3039) Accordingly, in order to achieve the new legal and economic framework modelled upon the EU *acquis communautaire* and provided for by the EnCT, it is for the *Contracting Parties, including Ukraine*, to adopt the substantive EnCT commitments.

(3040) The EU, which is *not* a "Contracting Party" to the EnCT, is consequently *not* subject to the requirement set out in the EnCT to adopt the *acquis communautaire* on energy, environment, competition and renewables.

(3041) This view is confirmed by Council Decision 2006/500/EC of 29 May 2006[246] on the conclusion by the European Community of the Energy Community Treaty.

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[242] Article 3(a) EnCT.

[243] Paragraph 1 of the Preample of the EnCT. See further [redacted] at paragraphs 21, 24 and 35.

[244] Whether Article 18 EnCT must be enforced by the Contracting Parties, as emphasised by [redacted] is thus entirely irrelevant to the *obligations of the EU* under the EnCT (see further [redacted] at paragraphs 22 and 35).

[245] Article 23 EnCT clarifies that "Generally Applicable Standards of the European Community" shall refer to any relevant technical system that is applied within the European Community.

[246] Council Decision 2006/500/EC of 29 May 2006.

(3042) Since the EU is *not* required to implement any of the obligations under Title II of the EnCT, there is no corresponding duty upon the EU to enforce these provisions as a matter of EU law and inevitably the EnCT is *not* capable of conferring rights on individuals in EU law.

(3043) Second, as set out in Article 3(a) EnCT and referred to in the preceding paragraphs, the EnCT requires the Contracting Parties *to implement substantive obligations into their own national legal orders* and the EnCT is not meant to in itself generate rights for individuals that can be directly relied on before a court or tribunal.

(3044) Similarly, Articles 10, 16 and 20 EnCT provide that "[e]*ach Contracting Party shall* ***implement***"(emphasis added) EU legislation concerning energy, environment and renewables respectively.

(3045) Article 18 EnCT is worded differently. Article 18(1) EnCT provides that certain anti-competitive measures "shall be incompatible" with the EnCT insofar as they may affect trade of electricity and gas that fall within the scope of designated EU energy related directives. Accordingly, there is no reference to implementation of this provision by the Contracting Parties.

(3046) However, in light of Article 3(a) EnCT, which specifically provides for "*the implementation by the Contracting Parties of the* acquis communautaire *on* […] *competition* [..] *as described in Title II below*" (emphasis added), it is clear that Article 18 EnCT is meant to confer an obligation upon the Contracting Parties to provide for the *acquis communautaire* on competition in their national legal systems in the same way as Articles 10, 16 and 20 EnCT.

(3047) Article 24 EnCT further clarifies the need to *implement* Article 18 EnCT into the national legal orders of the Contracting Parties. This provision refers to measures to be adopted that adapt the *acquis communautaire* , taking into account both the institutional framework of the EnCT and the specific situation of each of the Contracting Parties, for the purposes of the "implementation" of Titles II of the EnCT, under which Article 18 EnCT is found.

(3048) The extent to which Ukraine has implemented the competition law rules in Article 18 EnCT, as emphasised by [redacted] in his second witness statement,[247] *has no relevance* to whether the EnCT itself is aspirational in character or not. Even if Ukraine had implemented all of its EnCT

[247] [redacted] paragraph 22.

obligations on the same day that the EnCT entered into force (which it did not), an individual would still not have been able to directly rely upon the EnCT itself against another individual.

(3049) Accordingly, it also follows from the specific provisions of the EnCT that this agreement is aspirational in nature. The EnCT does not set out obligations on the Contracting Parties that could generate any immediate rights on individuals that could be relied upon in a court or tribunal as a matter of EU law.

(3050) Third, only *a Party* to the EnCT can be considered to be in breach of a provision of this agreement.

(3051) According to Article 90(1) EnCT, a private body may approach the Energy Community Secretariat with complaints concerning the failure *of a Party* to comply with a Treaty obligation. The Secretariat may then, as set out in Article 92(1) EnCT, bring forward this complaint to the Ministerial Council that in turn may determine whether there has been a *failure by a Party* to comply with the particular obligation of the EnCT.

(3052) It follows that an individual may only approach the Energy Community Secretariat if it considers that *a Party* has failed to comply with an obligation of the EnCT. The individual cannot rely upon the EnCT and put forward a complaint to the Secretariat regarding an alleged breach of the EnCT by *another individual*.

(3053) Accordingly, the terms of the EnCT specifically foresee the breach of the agreement by Parties *only*. The risk of a breach of the EnCT by individuals has deliberately *not* been considered in the agreement since the EnCT was *not* meant to confer rights upon individuals directly. This further underlines the EnCT as an international agreement incapable of generating direct effect in EU law of its provisions.

(3054) The nature and broad logic of the EnCT, demonstrated by its object and purpose as well as its terms, as an international agreement not meant to generate direct effect as a matter of EU law can be contrasted with the EEA agreement, to which Naftogaz refers.

(3055) The EEA agreement, which is considered capable of generating direct effect, is very different to the EnCT in its objective, structure and character. According to Article 1(1) of the EEA agreement, which exemplifies this difference, the aim of that agreement is to promote "*a continuous and balanced strengthening of trade and economic relations between the*

Contracting Parties with equal conditions of competition, and the respect of the same rules, with a view *to creating a homogeneous European Economic Area*" (emphasis added).[248]

(3056) The fourth recital in the preamble to the EEA agreement further emphasises this difference between the EnCT and the EEA agreement; the objective of the Contracting Parties of the EEA agreement, of which the EU is one, is "[to establish] *a dynamic and homogeneous European Economic Area, based on common rules and equal conditions of competition and providing for the adequate means of enforcement including at the judicial level, and achieved on the basis of equality and reciprocity and of an overall balance of benefits, rights and obligations for the Contracting Parties*" (emphasis added).[249]

(3057) The EEA agreement has accordingly achieved something which is far more advanced than the EnCT. As explained by the General Court, "[t]*he* [EEA] *Agreement further provides that the EFTA States are to set up a surveillance authority, the EFTA Surveillance Authority, with equivalent powers and similar functions to those of the Commission, and a court of justice, the EFTA Court.*"[250] (emphasis added)

(3058) Further, "*by establishing an EFTA Surveillance Authority and an EFTA Court with powers and jurisdiction similar to those of the Commission and the Court of Justice, a two-pillar system has been created in which the EFTA Surveillance Authority and the EFTA Court monitor the application of the Agreement on the part of the EFTA States, while the Commission, the Court of Justice and the Court of First Instance do so on the part of the Community. That system is reinforced by a large number of factors intended to make sure that it is homogeneous.*"[251] (emphasis added)

(3059) The purpose of the EnCT is far removed from that of the EEA agreement. The EnCT is not meant to establish a homogeneous area based on the same rules with the necessary means to enforce those rules at a judicial level. Indeed, the Energy Community Secretariat far from enjoys comparable powers to those of the Commission and there is no Court established by the EnCT or by the Contracting Parties. The discretionary powers of the Ministerial Council, which is a political body,[252] are not a substitute for a court.

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248 See further T-115/94 *Opel Austria GmbH v Council* [1997] ECR II-00039 at paragraph 106.
249 See further T-115/94 *Opel Austria GmbH v Council* [1997] ECR II-00039 at paragraph 108.
250 T-115/94 *Opel Austria GmbH v Council* [1997] ECR II-00039 at paragraph 107.
251 T-115/94 *Opel Austria GmbH v Council* [1997] ECR II-00039 at paragraph 108.
252 Article 48 EnCT.

(3060) The aim of the EnCT is to create a *new legal and economic framework* amongst the Parties, which is *based on the EU acquis communautaire* related to energy and achieved by exporting EU rules to the Contracting Parties. The exported EU rules are meant to be *implemented* in the national legal orders of the Contracting Parties and *adapted* to both the institutional framework of the Energy Community and the specific situation of each of the Contracting Parties. Accordingly, the European Union as a "Party" to the EnCT will continue to be governed by its own rules and the Contracting Parties will adopt new rules based on the *acquis communautaire*, but adapted to their own specific situations as well as to the institutional framework of the EnCT. No adapted *acquis communautaire* is, or will be, applicable to the EU or the EU Member States.

(3061) In conclusion, it follows from the foregoing that the EnCT was not meant to establish substantive obligations for the EU that could generate rights to individuals that in turn could be directly relied upon before a court or tribunal as a matter of EU law. An examination of the nature and logic of the EnCT, as disclosed in particular by its aim, preamble and terms, clearly demonstrates that the EnCT as a whole is not capable of conferring enforceable rights on individuals as a matter of EU law.

B) Second tier of the test

(3062) The question whether Article 18 EnCT is directly effective in EU law only arises if the Tribunal finds, first, that this provision contains a commitment for the EU and, second, that the nature and broad logic of the EnCT, despite the circumstances outlined above, is deemed to not preclude the direct effect of its provisions in EU law.

(3063) The CJEU has decided when in such circumstances a provision in an international agreement is directly effective and can be relied upon by an individual before a court or tribunal within the EU:

(3064) "*… a provision in an agreement concluded by the Communities with a non-member country must be regarded as being directly applicable* <u>*when*</u>*, regard being had to its wording and to the purpose and nature of the agreement,* <u>*the provision contains a clear and precise obligation*</u>

which is not subject, in its implementation *or effects, to the adoption of any subsequent measure* …".[253] (emphasis added.)

(3065) There are several reasons, as set out below, why Article 18 EnCT (concerning anti-competitive measures) does not satisfy these requirements and therefore cannot be relied on by Naftogaz before the Tribunal.

C) Article 18 EnCT does not contain a clear and precise obligation

(3066) Article 18 of the EnCT does not contain a clear and precise obligation that could generate a private right in EU law which could be invoked by Naftogaz before a court or tribunal within the EU.

(3067) Article 3(a) EnCT states that the implementation by the Contracting Parties of the *acquis communautaire* on energy and competition must be adapted to "*both the institutional framework of the Energy Community and the specific situation of each of the Contracting Parties*".[254]

(3068) The EnCT does not specify to what extent and how Article 18 EnCT must be adapted to the institutional framework of the Energy Community and the specific situation of the Contracting Parties, nor does the EnCT specify what the consequences of such an adaptation are. It follows that the requirement set out in Article 3(a) EnCT generates uncertainty as to the implementation and effects of the obligations contained in Article 18 EnCT. This provision does therefore not contain a clear and precise obligation that could confer a right on Naftogaz that could be invoked before the Tribunal.

(3069) Article 94 EnCT does not provide a remedy to the scope for adaptation found in Article 18 EnCT. First, Article 94 EnCT states that the institutions of the EnCT, and not the Parties, the Contracting Parties or their authorities and courts, shall interpret any term or other concept used in the EnCT that is derived from European Community law (now EU law) in conformity with the case law of the CJEU and the General Court. Second, Article 94 EnCT holds that where no interpretation from the EU Courts is available, the Ministerial Council shall give guidance in interpreting the EnCT.

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[253] Case C-265/03, *Igor Simutenkov v. Ministerio de Educatión y Cultura and Real Federación Española de Fútbol*, [2005] ECR I-02579, at paragraph 21.

[254] Article 3(a) EnCT. Exhibit RLA-65.

(3070) Although Article 94 EnCT also states that the guidance given by the Ministerial Council shall not prejudge any interpretation of the *acquis communautaire* by the CJEU or the General Court at a later stage, there is thus still a risk that the Ministerial Council will adapt Article 18 EnCT to the institutional framework of the Energy Community and the specific situation of the Contracting Parties in a situation where EU law appears uncertain or when the particular issue has not been dealt with by the EU courts.

(3071) It is also unclear whether Article 94 EnCT would require the Ministerial Council *to change* its interpretation in a situation where the CJEU has delivered a judgment which is contrary to an earlier interpretation by the Ministerial Council of a term or concept which would be relevant to both Article 18 EnCT and Articles 101 and 102 TFEU.

D) Article 18 EnCT does not in any event contain an obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure

(3072) In any event, Article 18 EnCT does not contain an obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure.

(3073) Article 18 EnCT read in conjunction with Article 3(a) EnCT confers an obligation on the Contracting Parties *to implement* the *acquis* on competition in their national legal systems. Since Article 18 EnCT contains an obligation which is subject to the adoption of a subsequent decision by Ukraine to implement it, this provision is not capable of conferring a right in EU law on Naftogaz that it could rely on before a court or tribunal.

(3074) Further, and in any event, contrary to the requirements of the second tier of the test for direct effect, the consequences of a breach of Article 18 EnCT are not regulated by this provision and its effects must be provided for separately by the Contracting Parties.

(3075) Article 18(2) EnCT and its reference to Annex III of the EnCT do not undermine this interpretation. As explained below, it is contrary to the wording and purpose of Article 18(2) EnCT to infer that this provision would provide for the legal effects of a practice that has been found to be contrary to Article 18(1) EnCT.

(3076) The similarity in the wording of Article 18 EnCT and Articles 101 and 102 TFEU, referred to by both Naftogaz and [redacted] [255] does not undermine this reasoning. When analyzing

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[255] [redacted] at paragraphs 10 and 14 to 16.

whether a provision of an international agreement contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure, regard must be had not only to the wording of the provision, but also to the purpose and the nature of the agreement. The wording is thus only one element of the analysis.[256]

(3077) The purpose of the EnCT is very different to that of the EU Treaties. While the former aims to create a *new legal and economic framework* amongst the Parties by exporting parts of the EU *acquis communautaire* related to energy *to the Contracting Parties*, the EU Treaties have wide ranging aims that provide for a far more advanced integration than that of the relationship between the Parties to the EnCT.[257]

(3078) It follows that Article 18 EnCT does not contain an obligation which is not subject to the adoption of any subsequent measure in relation to its effects since the consequences of a breach of Article 18 EnCT must be provided for by the Contracting Parties in their national legal orders. It follows that Article 18 EnCT does not satisfy the second tier of the test for direct effect.

VIII.11.7.16.1.4 The assessment of the Energy Community Secretariat, the expert reports and [redacted] second witness statement

(3079) Naftogaz makes a number of criticisms of the expert reports by Dr Coppi and Mr Witschen that were submitted by Gazprom with its Defence and Counterclaim. Those criticisms are rejected in their entirety, and Gazprom stands by the content of those exert reports. With this Rejoinder, Gazprom submits a further expert report by Dr Coppi (the "Coppi Report 2") which addresses some of these criticisms and which responds to points made by Mr Lapuerta in the Lapuerta Report 1 submitted by Naftogaz with its Reply.

(3080) In this section of its Rejoinder, Gazprom also responds to points made by Naftogaz on the evidence submitted by [redacted]

i) The assessment of the Energy Community Secretariat and [redacted] second witness statement

[256] See e.g. Case C-162/96 *A. Racke GmbH & Co. v Hauptzollamt Mainz* [1998] ECR 1183 I-3655 at paragraph 31. See also Case 12/86 *Meryem Demirel v Stadt Schwäbisch Gmünd* [1987] ECR 3719 at paragraph 14.

[257] Article 3 TEU.

(3081) Naftogaz addresses the preliminary assessment of the Energy Community Secretariat and [redacted]

(3082) Gazprom rejects the assertion made by Naftogaz to the effect that the account given by Gazprom of the procedure under the EnCT is "*based on a gross misunderstanding and misrepresentation of the role of the Energy Community Secretariat*". Naftogaz is wrong to seek to equate the role of the Secretariat to that of the EU Commission. The powers of the Secretariat are substantially more limited than those of the EU Commission. In particular, Gazprom clearly made the point that it is not the Secretariat who decides whether to pursue cases under the EnCT. Nor does the Secretariat make decisions as to whether or not there has been a breach of the provisions of the EnCT. That point is accepted by [redacted] [258] This situation may be contrasted with the substantially more developed role of the EU Commission in prosecuting cases involving breaches of Articles 101 and/or 102 TFEU.

(3083) Another important distinction to be drawn between the process under the EnCT and that under the TFEU is that, under the EnCT, cases may only be brought against Parties to the EnCT, i.e. Contracting Parties. Again, [redacted] appears to accept that point.[259] The obligations in the EnCT do not apply to private persons, such as Gazprom.

(3084) Gazprom specifically maintains its submission that the Secretariat's assessment (as contained in the Preliminary Assessment and in [redacted] evidence) is no more than a preliminary view expressed by a body whose entire function is to "*support*" Ukraine's implementation of the relevant parts of the EU *acquis*.

ii) The Coppi Report 2

(3085) As indicated above, Dr Coppi responds in detail in the Coppi Report 2 to criticisms made by Naftogaz and by Mr Lapuerta. Gazprom refers to and relies upon the Coppi Report 2 in this regard. Naftogaz asserts that Dr Coppi should have considered the non-price terms of the Contract and how they interact with the price provisions so as to render the oil-indexed price abusive. This point is addressed in paragraphs 1.26 to 1.31 and Section 3 of the Coppi Report 2. In summary, however, it is the case that to show that a package of contractual terms (both price and non-price) is abusive would require quantification of the additional costs that the non-

[258] [redacted], paragraph 42.
[259] [redacted] paragraphs 41 to 43, cited at para 1238 of Naftogaz' Reply, where [redacted] refers to "*compliance by <u>a Party</u> to the Treaty*" and "*a breach <u>by a Party</u> of its obligations*".

price terms impose on the buyer, and those additional costs would have to be shown to be significant in order to satisfy the burden required to prove excessive pricing. Mr Lapuerta has failed to engage in either of these necessary tasks. Naftogaz has therefore failed to make out any case to the effect that the package of contractual terms is abusive.

(3086) Naftogaz refers opaquely to Gazprom having "*entered the Ukrainian market in direct competition with Naftogaz*" and that it is now seeking to "*raise rivals' costs*" by "*exploiting the advantage that its lower costs confer compared to the high costs that the Contract Price imposes on Naftogaz*". Although the point is not explained clearly (or at all), it is assumed that Naftogaz is referring here to the activities of Gazprom Sbyt.

(3087) Gazprom repeats the fact that Naftogaz has taken action to exclude Gazprom Sbyt from the Ukrainian market and, as from 1 March 2013, has refused to sell gas to Gazprom Sbyt. In those circumstances, there is nothing in the assertion that Gazprom has entered the Ukrainian market in direct competition with Naftogaz and that it is seeking to "*raise rivals' costs*" by "*exploiting the advantage that its lower costs confer compared to the high costs that the Contract Price imposes on Naftogaz*". Gazprom Sbyt is not even operating in the Ukrainian market (and has not been for over three years).[260]

(3088) In any event, in order to prove that Gazprom Sbyt was engaging in such exclusionary conduct and that such conduct was "*rais*[ing] *rivals' costs*" with an anti-competitive effect, Naftogaz and/or Mr Lapuerta would have had to carry out a detailed analysis of (a) the price at which Gazprom Sbyt sells gas in Ukraine; (b) the price at which Gazprom Sbyt buys gas from Naftogaz; and (c) Gazprom Sbyt's costs of selling and marketing the gas downstream. No such analysis has been carried out. Therefore, there is nothing in Naftogaz's vague and unparticularised allegations of anti-competitive conduct "*rais*[ing] *rivals' costs*".

(3089) For the avoidance of doubt, it is Gazprom's case that, as a matter of competition law and economics, the relevant time for assessing Naftogaz' allegations of abuse is the time that the Contract was entered into in January 2009.

(3090) The alleged evidence of excessive pricing contained in the Hesmondalgh and Way Report 1 is addressed in paragraphs 1.21 to 1.23 and 2.42 to 2.56 of the Coppi Report 2. In summary, the German hub prices for natural gas are not a suitable competitive benchmark for the prices under

260 See [redacted], paragraph 20.

the Contract, and the evidence contained in the Hesmondalgh and Way Report 2 does not show excessive pricing even when such a comparison is made.

(3091) The alleged evidence of discriminatory pricing contained in [redacted] statement is addressed in paragraphs 1.32 to 1.40 and Section 4 of the Coppi Reply Report and below. In summary, a comparison between the price which Naftogaz pays Gazprom for gas and the price which European importers pay Gazprom for gas is uninformative and irrelevant. In order to establish that there is price discrimination in breach of Article 102(c) TFEU, it is necessary to establish that a dominant undertaking is "*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*". Naftogaz does not compete with other European importers and thus cannot be placed at a competitive disadvantage vis-à-vis those importers, even if it is being charged a different price by Gazprom.

iii) The Lapuerta Report 2

(3092) The Lapuerta Report 2 is addressed in the Coppi Report 2. In summary, Dr Coppi's position is as follows.

(3093) Naftogaz' excessive pricing claim is invalid. Excessive pricing can only be assessed when an agreement is entered into, as this is the time when dominance can be exercised to force a buyer to accept onerous terms. Naftogaz accepts that the contract price was not excessive when the Contract was entered into in 2009. Nothing that Naftogaz says on the alleged "non-passivity" of Gazprom changes this. In any event, Naftogaz fails to prove that the contract price has become excessive within the meaning of Article 102 TFEU at some point during the life of the Contract.

(3094) There is no evidence that the "*complex package of contractual terms*" results in excessive pricing for the purposes of Article 102 TFEU. It is common ground that the contract price was not excessive when the Contract was entered into in 2009. There is no evidence that the economic cost of the non-price terms was so high that the package of contractual terms breached Article 102 TFEU.

(3095) Naftogaz' discriminatory pricing claim is invalid.

(i) Even if the prices charged by Gazprom to Naftogaz are higher than those charged by Gazprom to other European importers, this does not render the prices charged by Gazprom to Naftogaz discriminatory as such pricing does not involve "*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*" as required by Article 102(c) TFEU.

(ii) There is no evidence that the Contract Price was set by reference to the "*market value principle*". In any event, there is no discrimination where Gazprom charges one, single Contract Price to Naftogaz. The contract price does not make Naftogaz price-discriminate between *its* customers and, in fact, it would appear that Naftogaz actually does not do so in any event.

(3096) Dr Coppi concludes that there is no reason for him to change any of the conclusions in his First Report and he maintains the view that there is no evidence that the contract price (alone or in combination with the non-price terms) constitutes excessive pricing and/or discriminatory pricing within the meaning of Article 102 TFEU.

VIII.11.7.17 Background, market definition and dominance

VIII.11.7.17.1 Relevant background

(3097) Naftogaz sets out a summary of its position on the history of the negotiation of the Contract. Gazprom takes issue with Naftogaz's characterisation of the facts and, in particular, its assertion that the Russo-Ukraininan gas crisis of late 2008 and early 2009, which formed the background to negotiation of the Contract, "*arose due to Gazprom's own actions and violations of the established practices between the parties*".

(3098) Naftogaz's factual evidence in this regard is addressed in paragraphs 5 to 120 and 128 to 151 of [redacted] and in further detail in [redacted]

(3099) As is clear from that evidence, it is Naftogaz/ Ukrtransgaz (not Gazprom) that in January 2009 failed to comply with the nomination process which had long been in effect between the companies. Further, it was Naftogaz/ Ukrtransgaz that made unauthorised withdrawals of Gazprom's transit gas from the pipeline which should have been delivered to Gazprom's / Gazprom Export's European off-takers. The reasons that Naftogaz/ Ukrtransgaz sought to give for such unauthorised withdrawals (i.e. the need for fuel gas and the lack of a [redacted] were simply artificial excuses used by Naftogaz/ Ukrtransgaz to refuse to transit Gazprom's gas to its European off-takers. Those unauthorised withdrawals increased over the first few days of January 2009 until Naftogaz/ Ukrtransgaz put the Ukrainian pipeline system into reverse mode. This risky process must have been pre-planned by Naftogaz/ Ukrtransgaz.

(3100) Even after the appointment of EU monitors on 12 January 2009, Naftogaz repeatedly refused all requests by Gazprom to resume supplies through the main transit pipeline, insisting that supplies could not resume until such time as a new set of agreements had been entered into. Naftogaz/ Ukrtransgaz refused to reopen the pipeline to allow resumption of transit supplies until new supply and transit contracts were signed on 19 January 2009.

VIII.11.7.17.2 Market definition

(3101) In particular, Gazprom criticises the fact that Naftogaz had failed to base its case on any empirical evidence or to carry out any analysis of the relevant market, such as a hypothetical monopolist test or the SSNIP test.

(3102) Naftogaz appears to have accepted that criticism as, in the Lapuerta Report 2, Mr Lapuerta has now carried out a form of SSNIP test analysis.[261] As a result of having carried out that analysis, Naftogaz appears to have changed its case on the relevant geographic market, now asserting that "*the relevant geographic market includes Poland, Hungary and the Slovak Republic, in addition to Ukraine*".

(3103) However, the status of Naftogaz' earlier pleading as regards the relevant geographic market is unclear. Naftogaz asserts that "*the relevant geographic* [sic] *includes Ukraine, Slovakia, Poland and Hungary*". However, Naftogaz has not withdrawn its previously pleaded case, which was to the effect that the relevant geographic market is *only* Ukraine. Naftogaz appears to seek to keep open the possibility of arguing this as an alternative market definition on the basis that "*Gazprom's position is, however, clearly dominant whether we apply a national or* regional market *definition*".

(3104) As regards the relevant product market and market definition more generally, Naftogaz has also failed to withdraw its previous pleadings and evidence in this regard, and its position is therefore also confused and unclear. In particular, Naftogaz appears to continue to rely upon the assessment of the relevant market by the Energy Community Secretariat and in the Lapuerta Report 1, both of which accompanied its Statement of Claim.

(3105) In its Preliminary Assessment, the Energy Community Secretariat defined the relevant market as "*the market in natural gas procured to satisfy the demand of Naftogaz in performing* [its

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[261] Gazprom does not accept the assertions made by Mr Lapuerta as regards virtual reverse flows: see paragraphs 11 to 24, [redacted]

public utility] *functions*".[262] In the Lapuerta Report 1, Mr. Lapuerta, defined the relevant market differently so to also include independent importers into Ukraine.[263] Naftogaz' pleaded position is that it agrees with the assessment of the Energy Community Secretariat, but that the "*precise market definition, both as regards the product and the geographic dimension, can* […] *be left open, as Gazprom clearly has a dominant position in any case*".

(3106) This approach is unacceptable. The European Court has held that market definition is of "*essential significance*" in any case; as an assessment of dominance and of abuse can only be carried out by reference to such market definition.[264] Naftogaz' approach to market definition remains inadequate and confused.

VIII.11.7.17.3 Dominance

VIII.11.7.17.3.1 Market shares

(3107) Naftogaz asserts that Gazprom has a market share exceeding 50% whether one takes a relevant geographic market consisting of Ukraine alone, or consisting of Ukraine, Slovakia, Poland and Hungary. In this regard, Naftogaz relies upon Appendix A and Table 4 of the Lapuerta Report 2.

(3108) However, the figures upon which Naftogaz relies in Table 4 of the Lapuerta Report 2 are inaccurate and do not correspond to the data published by Naftogaz and Ukrainian governmental authorities. Mr Lapuerta explains that, in calculating these market share figures, he has used figures for consumption in Ukraine which exclude any imports that were injected into storage or used to operate the compressors of the pipeline system itself.[265] Such an approach is flawed. There is no reason to exclude fuel gas from the consumption figures: such gas is used to supply the natural gas to users in Ukraine and thus is part of the consumption of natural gas in Ukraine.[266] In statistical data published in Ukraine, fuel gas is included in the total consumption figures.[267]

VIII.11.7.17.3.2 Countervailing buyer power

262 Energy Community Secretariat Preliminary Assessment dated 25 July 2014.
263 Lapuerta Report 1 dated 30 January 2015.
264 Case 6/72 *Europemballage v Commission* [1973] ECR 215.
265 Lapuerta Report 2, paragraph 168.
266 [redacted] paragraphs 41 to 43.
267 [redacted] paragraphs 42 to 43.

(3109) Naftogaz now accepts that countervailing buyer power is a relevant factor in assessing whether a firm holds a dominant market position. This is a welcome concession: Naftogaz had previously ignored the issue of countervailing buyer power.

(3110) However, Naftogaz seeks to argue that Gazprom's arguments on countervailing buyer power cannot succeed for three reasons. Each must be rejected.

(3111) First, as a matter of fact, Naftogaz argues that it did not exercise buyer power during negotiation of the Contract in 2009.[268] Gazprom rejects that assertion and repeats and relies upon paragraphs 829 to 832 of its Defence and Counterclaim in this regard. Gazprom also refers to the evidence of [redacted] and [redacted] in response to Naftogaz' reply evidence on the events of January 2009.

(3112) It is clear that Gazprom was effectively held hostage by Naftogaz by what was essentially a blockade of the main transit pipelines by Naftogaz/ Ukrtransgaz. Gazprom was under huge pressure from the international community to resume transit supplies to Europe. In all the circumstances, it cannot reasonably be suggested that Gazprom was in a position to force Naftogaz to agree to anything, and it did not do so.

(3113) Second, as a matter of law, Naftogaz argues that where a supplier is an unavoidable trading partner, its buyers cannot have relevant buyer power that could prevent the supplier from being dominant.[269] Naftogaz argues that Gazprom was an unavoidable trading partner for Naftogaz when the Contract was entered into in 2009.

(3114) The two cases upon which Naftogaz relies, *Tomra*[270] and *Telekomm Polska*[271], do not establish such a proposition of EU law.

(3115) First, these are both merely decisions of the EU Commission and their jurisprudential status is therefore minimal. There is no authority from the European Courts which supports Naftogaz' argument that where a supplier is an unavoidable trading partner, its buyers cannot have relevant buyer power that could prevent the supplier from being dominant.

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268 Naftogaz' Reply, paragraphs 1314 and 1319.
269 Naftogaz' Reply, paragraphs 1315 to 1318.
270 Commission decision of 29 March 2006 in case COMP/E-1/38.113 *Tomra*.
271 Commission decision of 22 June 2011 in case COMP 39.525 *Telekomunikacja Polska*.

(3116) The European Courts' position on countervailing buyer power is clear: it is a relevant question of fact which must be considered in cases where dominance is in issue. In *Italian Flat Glass*,[272] the General Court was critical of the fact that the Commission "*has not even attempted to gather the information necessary to weigh up the economic power of the three producers* [alleged to be collectively dominant] *against that of Fiat, which could cancel each other out*". The European Courts have not held that where a supplier is an unavoidable trading partner, its buyers *cannot* have relevant buyer power that could prevent the supplier from being dominant.

(3117) In fact, upon closer examination, it is clear that neither of the two Commission decisions cited by Naftogaz establish such a proposition either. In *Tomra*, for example, the availability of alternative sources of supply was just one of a number of facts considered by the Commission in assessing the issue of buyer power. These included that "*a comparison of the demand and the supply structure in the individual countries does not suggest that customers are able to outweigh Tomra's strong position on the supply side. Besides the generally three or four retail groups in many countries there are a number of smaller retail groups with low market shares, including groups which are active only in particular regions*"[273] and that "*procurement of reverse vending equipment is not part of the core activities of retail groups. The circumstances of the case do not suggest that they were likely to act in a strategic manner in order to subsidise and actively build up competing suppliers to which large parts of the demand could be diverted*".[274] It was only after having considered all of these factors that the Commission concluded that there was no countervailing buyer power.

(3118) Even on Naftogaz' own case, Gazprom only had a market share of between 52% and 72%.[275] Therefore, Naftogaz *does* have alternative sources of supply for natural gas.

(3119) However, even if it did not and (as Naftogaz argues) Gazprom was an unavoidable trading partner, Naftogaz could still have countervailing buyer power which could reduce or negate any market power on the part of Gazprom.

(3120) As a matter of law, the Tribunal is not precluded from considering the issue of countervailing buyer power even if (which is denied) Gazprom is an unavoidable trading partner for Naftogaz.

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272 Cases T-68/89, etc. *SIV v Commission* [1992] ECR II-1403, paragraph 366.

273 Paragraph 88 of the Commission's decision in *Tomra*.

274 Paragraph 89 of the Commission's decision in *Tomra*.

275 Depending on whether the relevant market is Ukraine alone or Ukraine together with Hungary, Poland and Slovakia: see Table 4 of the Lapuerta Report 2.

The role of the Tribunal to consider what degree of countervailing buyer power exists and what effect it has.

(3121) It is Gazprom's case that, in the circumstances prevailing in late 2008 and early 2009, Naftogaz had such a substantial degree of countervailing buyer power that Gazprom was in no position to impose any abusive Contract terms on Naftogaz and, as a matter of fact, it did not do so.

(3122) Third, Naftogaz argues that it is for Gazprom to demonstrate that Naftogaz had countervailing buyer power sufficient to outweigh Gazprom's market power. On the facts, Gazprom has demonstrated that, in the circumstances pertaining in late 2008 and early 2009, Gazprom was in no position to impose abusive Contract terms on Naftogaz, and it did not do so. This was also the clear and contemporaneous view of Naftogaz itself.[276]

(3123) In conclusion, Naftogaz has failed to prove that Gazprom was dominant. On the contrary, at the time that the Contract was entered into, Naftogaz' countervailing buyer power (arising from its ability effectively to blockade Gazprom's transit supplies to Europe) cancelled out any market power or dominance which Gazprom may otherwise have had.

VIII.11.7.17.3.3 A dominant position within the internal market or a substantial part of it

(3124) The territory of the Netherlands may be sufficient to constitute a "*substantial part*" of the internal market: see *Michelin I*. However, it is obviously the case that Ukraine is *not* a part of the internal market (substantial or otherwise) as it is not an EU Member State. Therefore, Naftogaz cannot rely upon establishing a dominant position within Ukraine *alone* in order to fulfil the requirements of Article 102 TFEU (that there is "*a dominant position within the internal market or in a substantial part of it*").

(3125) Gazprom argues that it is able to fulfil the Article 102 TFEU criterion (that there is "*a dominant position within the internal market or in a substantial part of it*") if it is able to establish that Gazprom has a dominant position in a regional market defined as Ukraine, Slovakia, Poland and Hungary (or in a substantial part of that market). However, Naftogaz also appears to argue that it can fulfil this criterion even if it is only able to establish dominance on the basis of a national market, i.e. Ukraine *alone*.

276 See statement of [redacted] reproduced at para 832 of Gazprom's Defence and Counterclaim.

(3126) That argument is clearly wrong. Ukraine is *not* a Member State of the EU. A dominant position in Ukraine can*not* be "*a dominant position within the internal market or in a substantial part of it*" as required by Article 102 TFEU.[277]

(3127) This remains the case even if (which is denied) "*Gazprom has isolated Ukraine through the* [Contract TKGU]*, erecting barriers to trade with other countries*". Such an argument cannot override the clear requirements of Article 102 TFEU that there be "*a dominant position within the internal market or in a substantial part of it*".

(3128) Naftogaz argues that the criterion of "*a dominant position within the internal market or in a substantial part of it*" is in any event fulfilled for the EnCT, since the Energy Community includes Ukraine. That argument does not follow. The EnCT does not make Ukraine part of the EU, i.e. part of the "*internal market*". Nor does it change the meaning of the Article 102 TFEU. In any event, for the reasons set out above, Naftogaz cannot rely upon Article 18 EnCT at all in the present case.

VIII.11.7.17.4 Anti-competitive conduct under articles 101 TFEU and 102 TFEU

VIII.11.7.17.4.1 The territorial scope of Articles 101 TFEU and 102 TFEU

(3129) The wording of Articles 101 TFEU and 102 TFEU clearly states that those articles exclusively relate to practices which restrict competition within the EU, rather than outside it. Article 101 TFEU prohibits, expressly, "*all agreements between undertakings … and concerted practices which <u>may affect trade between Member States</u> and which have as their object or effect the prevention, restriction or distortion of competition <u>within the internal market</u>*" (emphasis added).[278] Article 102 TFEU contains the same rule, *mutatis mutandis*: it prohibits, expressly, "*abuse of a dominant position <u>within the internal market</u>*" (emphasis added).[279]

(3130) In other words, Articles 101 TFEU and 102 TFEU regulate anti-competitive behaviour within the EU ("*within the internal market*"). They do *not* seek to regulate anti-competitive behaviour *outside* the EU.

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[277] Article 102 TFEU.
[278] Article 101 TFEU.
[279] See the Opinion of AG Wahl in Case C-231/14, *InnoLux Corp. v Commission* [2015] of 9 July 2015, at paragraphs 35 and 38.

(3131) This geographical limitation is at the heart of Articles 101 TFEU and 102 TFEU. It goes not only to the question of jurisdiction, but *also* to the substantive application of Articles 101 TFEU and 102 TFEU.

(3132) Even if Naftogaz is able to establish jurisdiction in this case (under international law as a result of the application of the qualified effects doctrine or under the EU law effects on trade between Member States test), which Gazprom denies, it still has to establish as a matter of substance that the impugned provisions of the Contract involve anti-competitive behaviour within the EU ("*within the internal market*"). It cannot otherwise prove that the provisions of this Contract are in breach of the substantive requirements of Articles 101 TFEU and/or 102 TFEU.

(3133) However, the Contract is between two undertakings established *outside* the EU. It concerns the sale and purchase of gas *outside* the EU. The provisions of the Contract which Naftogaz seeks to challenge under EU competition law all concern behavior which takes place *outside* the EU.

(3134) Naftogaz' case does not and cannot fall within the scope of Articles 102 TFEU and 102 TFEU as a matter of substance. As regards each of the impugned provisions:

(3135) First, Naftogaz argues that the oil price indexation clause in Article 4.1 of the Contract constitutes a breach of Article 102 TFEU. In order to establish such a breach, Naftogaz has to prove that the price clause in the Contract is an "*abuse of a dominant position <u>within the internal market</u>*". As explained above, Naftogaz has to establish that Gazprom has "*a dominant position within the internal market or in a substantial part of it*" for the purposes of Article 102 TFEU. Moreover, Naftogaz has to establish that the charging of the contract price by Gazprom to Naftogaz in Ukraine (i.e. *outside* the EU) is an abuse of *that* dominant position. But there is no link between the alleged dominant position in the EU and the abuse which takes place outside the EU. Naftogaz fails to explain how the charging of the contract price by Gazprom to Naftogaz in Ukraine (i.e. *outside* the EU) can be an abuse of a dominant position *within* the EU.

(3136) It is certainly the case that the European Courts have *never* held that the charging of unfair prices *outside* the EU can be an abuse for the purposes of Article 102 TFEU. In an analogous situation involving a cartel under Article 101 TFEU, the CJEU held that an infringement of EU competition law *only* arose where the cartelised goods were sold in the EU and therefore the anti-competitive prices were charged in the EU: it is only "*where those producers concert on the prices to be charged to their customers <u>in the Community</u> and put that concertation into effect by selling at prices which are actually coordinated* [that] *they are taking part in* *concertation which has the object and effect of restricting competition within the common market within the meaning of Article* [101] *of the Treaty*" (emphasis added).[280]

(3137) Second, Naftogaz argues that the volume and take or pay provisions in Articles 2.2 and 2.2.5 of the Contract constitute a breach of Article 102 TFEU and/or are in breach of Article 101(1) TFEU. Again, however, Naftogaz has failed to explain how volume and take or pay provisions which impose requirements on Naftogaz as to its purchases of gas in Ukraine (i.e. *outside* the EU) constitute the abuse of a dominant position *within* the EU for the purposes of Article 102 TFEU. Nor has Naftogaz explained how these provisions have the object and effect of restricting competition *within* the internal market for the purposes of Article 101 TFEU.

(3138) Third, Naftogaz argues that the destination clause in Article 3.10 of the Contract is in breach of Article 101 TFEU and/or Article 102 TFEU. However, Naftogaz has failed to explain how it is said that this provision, which restricts sales to Ukraine only, i.e. *outside* the EU, has the object and/or effect of restricting competition *within* the internal market for the purposes of Article 101 TFEU or how it is said to be an abuse of a dominant position *within* the internal market for the purposes of Article 102 TFEU.

(3139) In the context of Article 101 TFEU, the CJEU has made it clear that "*an agreement in which the reseller gives to the producer an undertaking that he will sell the contractual products on a market outside the Community cannot be regarded as having the <u>object</u> of appreciably restricting competition within the common market … Consequently, the agreements at issue, in that they prohibit the reseller Javico from selling the contractual product outside the contractual territory assigned to it, do not constitute agreements which, by their very nature, are prohibited by Article [101] of the Treaty*" (emphasis added).[281]

(3140) In order to establish that such a clause has the *effect* of restricting competition within the EU, Naftogaz would have had to have carried out an extensive analysis of its effects of within the EU.[282]

(3141) Naftogaz has carried out no such assessment, and is therefore unable to establish that the destination clause has the effect of restricting competition *within* the internal market for the

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280 Case C-89/85 *A Ahlstrom Osakeyhtio v Commission (Wood Pulp)* [1988] ECR 5193, paragraph 13. See also the Opinion of AG Wahl in Case C-231/14, *InnoLux Corp. v Commission* [2015] of 9 July 2015, and the judgment of the CJEU of 9 July at paragraph 72.

281 Case C-306/96 *Javico*, paragraphs 20 to 21.

282 Case C-306/96 *Javico*, paragaphs 22 to 25.

purposes of Article 101 TFEU. Naftogaz has similarly failed to explain how that clause could be said to be an abuse of a dominant position *within* the internal market for the purposes of Article 102 TFEU.

(3142) Fourth, Naftogaz argues that the unilateral suspension right inArticle 5.3 of the Contract is in breach of Article 102 TFEU. The clause concerns the right of one of the parties (Gazprom) to suspend performance of the Contract in certain circumstances. Given that the right of suspension relates to a Contract between two parties established *outside* the EU as regards the supply of gas *outside* the EU, it is difficult to see (and Naftogaz fails to explain) how such a clause could constitute the abuse of a dominant position *within* the EU for the purposes of Article 102 TFEU.

(3143) Finally, Naftogaz argues that the mandatory sales clause in Article 9.7 of the Contract is in breach of Article 101 TFEU and/or Article 102 TFEU. That clause relates to sales by Naftogaz to Gazprom Sbyt in Ukraine. Even if the clause were having any effect whatsoever (which is denied as Gazprom Sbyt has been excluded from Ukraine by Naftogaz), it is extremely difficult to see how such a clause (which relates solely to sales in Ukraine) could be said to have the object and/or effect of restricting competition *within* the EU internal market for the purposes of Article 101 TFEU.

(3144) Further, as regards Article 102 TFEU, Naftogaz' argument is that the clause allows Gazprom to use its dominant position on the "wholesale" market to strengthen its position on the "retail" downstream market and thus limit competition on the "retail" market. The retail market to which Naftogaz refers in this instance is the retail market for the supply of gas *in Ukraine*. It is extremely difficult to see how this "abuse" which is alleged to have taken place on a market in Ukraine is said to be an abuse of a dominant position *within* the EU for the purposes of Article 102 TFEU. Naftogaz fails to explain its case in this regard.

(3145) In conclusion, there is a fundamental substantive problem at the heart of this case. EU competition law regulates anti-competitive behaviour in the EU which restricts competition within the EU. EU competition law is principally concerned with establishing a single market in the EU. However, this Contract has (at best) only tenuous links with the EU. It is a Contract between two parties located *outside* the EU which concerns the supply of gas *outside* the EU. Naftogaz ignores this problem and thereby fails to establish the required substantive link between the impugned provisions of the Contract and the restriction of competition *within* the EU.

VIII.11.7.17.4.2 Relevant time for assessing abuse

(3146) Naftogaz addresses the issue of the relevant point in time for assessing abuse under Article 102 TFEU.

(3147) It remains Gazprom's case that the only point in time at which an abuse, such as an excessive pricing abuse, can take place is at the time when that price is negotiated. This is because this is the only point in time when the dominant seller can exercise its market power (and thus engage in abusive conduct).

(3148) Naftogaz accepts that "[i]*n 2009 the price was reasonable in the sense that it was in line with market conditions*". But Naftogaz criticises Gazprom's argument on the basis that the consequence of that argument would be that, if the Contract was not abusive when entered into in January 2009, then "*Gazprom would be free to exercise its rights under the Contract to their full extent* and *refuse any renegotiations that are not required by the Contract*".

(3149) That is correct. But such a consequence is neither surprising nor unlawful. Any party that has entered into a contract is able to exercise its rights under that contract to their full extent and to refuse any renegotiations that are not required by the contract. That is the position whether or not the party has market power. This consequence has nothing to do with the exercise of market power; it is simply the consequence of having entered into a contractual arrangement. Such actions cannot, therefore, be abusive.

(3150) Naftogaz' case is not entirely clear in this regard, but it would appear that Naftogaz'argument in essence is that Gazprom acted abusively by refusing to enter into negotiations in May 2011 and/or proposed an unreasonable price. That assertion is denied by Gazprom as a matter of fact. Gazprom did not refuse to enter into negotiations; Naftogaz failed to provide proper and reasonable proposals for renegotiation.

(3151) In any event, a refusal to enter into negotiations and/or a refusal/ failure to amend the price terms of the Contract (which were not abusive when the Contract was entered into) cannot be an abuse for the purposes of Article 102 TFEU. Such conduct does not rely upon an exercise of market power. It is simply a reliance on the terms of the Contract itself. See further paragraphs 1.13 to 1.17 and 2.4 to 2.27 of the Coppi Report 2.

(3152) Naftogaz' argument in this regard is not improved by its assertion that Gazprom has not been a "*passive counterparty*". Naftogaz' case is not entirely clear, but, in any event, its position is undermined by its own pleading whereby it asserts that Gazprom has made proposals "*which if accepted*" would result in excessive pricing and abuse. Self-evidently, such proposals do not have to be accepted and Naftogaz has not accepted them. Naftogaz can rely on the terms of the existing Contract and, where there is a dispute between the parties, refer it to arbitration (as it has done in the present case). Naftogaz criticises Gazprom's case on the relevant time for assessing abuse on the basis that "[n]*o case-law or other legal sources are offered in support of* [its] *position*". However, Gazprom's position is the only coherent position as a matter of logic and economic analysis. Naftogaz' position that contractual terms can somehow become abusive as a result of external circumstances (i.e. changes in the price of oil), even though they were not abusive when entered into, is not supported by the case-law upon which Naftogaz seeks to rely. It is specifically denied that "*the position invoked by Gazprom has been rejected by the EU Courts*".

(3153) First, the case-law on the "*special responsibility*" of dominant undertakings says nothing about the relevant time for assessing abuse. It simply makes clear that conduct which is unobjectionable when engaged in by a non-dominant undertaking (such as a refusal to supply, for example) can be an abuse when engaged in by a dominant undertaking. That is uncontroversial.

(3154) Second, Naftogaz relies upon the judgments of the General Court and the CJEU in *Compagnie Maritime Belge*. However, Naftogaz has mischaracterised the Courts' judgments in that case. Contrary to what Naftogaz asserts, the Courts did not find that the implementation of an agreement may be an abuse of a dominant position "*even if the conclusion of that agreement did not in itself constitute an abuse*".

(3155) The General Court made it clear that no action was being taken against the conclusion of the agreement in issue simply because it had been entered into *before* the relevant legislation came into force.[283] Therefore, action could only be taken against the continued implementation of the agreement *after* the date the relevant legislation came into force. The Court did not consider

[283] Paragraph 99 of the General Court's judgment in joined cases T-24, 25, 26 and 28/93 *Compagnie Maritime Belge Transports SA and others v Commission*, ECR 1996 II-01201.

whether or not the conclusion of the agreement in issue itself constituted an abuse as a matter of substance.

(3156) Further, the CJEU held that:

"*It is established, in the present case, that Cewal sought to rely on the contractual exclusivity provided for in the Ogefrem Agreement in order to remove its only competitor from the market. Such conduct was in no way required by that agreement, since, under the second paragraph of Article 1 thereof, express provision is made for possible derogations, so that the requirements of Article 86 of the Treaty could be met.*"[284] (Emphasis added.)

(3157) The CJEU therefore held that the conduct at issue in the case, which was held to be abusive, was not simply implementation of contractual terms. On the contrary, it was conduct which was *not* required by the agreement.

(3158) Finally, contrary to Naftogaz' case, the judgment of the General Court in *ITT Promedia* does not support Naftogaz' assertion that "*the implementation of a contract and the exercise of contractual rights by a* dominant *player may constitute an abuse, irrespective of whether the* conclusion *of the contract constituted an abuse*".

(3159) In this regard, the statements in paragraph 140 of the General Court's judgment cannot be read in isolation. In the very next paragraph of its judgment, the General Court held that no abuse had been established in that case.[285]

(3160) As regards the first condition set out in paragraph 140, i.e. whether Belgacom's claim exceeded what the parties could expect under the contract, the Court held that the claim fell within the ambit of the contract and so was not an abuse for the purposes of Article 102 TFEU.

(3161) As regards the second condition, the Court made it clear that the mere conclusion of an agreement (and the defending of Belgacom's rights under that agreement) cannot in itself be an abuse for the purposes of Article 102 TFEU. Nivå 5 Breaches of competition law: the impugned provisions of the Contract

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[284] Paragraph 86 of the CJEU's judgment in joined cases C-395/96 P and C-396/96 P *Compagnie Maritime Belge Transports SA and others v Commission*, ECR 2000 I-01365.

[285] Para 141 of the Court's judgment in Case T-111/96 *ITT Promedia v Commission*, ECR 1998 II-02937.

VIII.11.7.17.4.3 The oil-price indexation clause

i) Excessive pricing

A) The legal test

(3162) The United Brands test entails a two –stage approach:

(i) first, it must be examined "whether the difference between the costs actually incurred and the price actually charged is excessive"; and

(ii) if the answer to the first question is in the affirmative, then it must be determined whether a price has been imposed which is either unfair in itself or when compared to competing products.

(3163) However, despite accepting that the *United Brands* test is the appropriate legal test for establishing excessive pricing, Naftogaz then seeks to resile from its concession and to argue that the *United Brands* test is "*not an exhaustive, "one-size-fits-all" legal test for every type of product and in all scenarios*". Naftogaz argues that a purchaser which complains about a dominant company's prices does not have to provide evidence of that company's costs and profit margins; the assessment of whether a price is unfair may simply be based on a comparison with the prices charged elsewhere.

(3164) Effectively, Naftogaz appears to be arguing that one may ignore the first stage of the *United Brands* test (an examination of "*whether the difference between the costs actually incurred and the price actually charged is excessive*") and jump straight to the second stage of the *United Brands* test (whether a price has been imposed which is either unfair in itself or when compared to competing products). Mr Lapuerta also appears to be advocating such an approach in paragraphs 117 and 120 of the Expert Competition Reply where he dismisses the *United Brands* test on the basis that it is an "*old bananas case*".

(3165) It is the case that in *United Brands*, the Court indicated that "*other ways may be devised*" in order to determine whether prices are unfair.[286] However, the two-stage *United Brands* test has been applied in numerous subsequent and more recent cases.[287] It has been applied in various industries including shipping, music licensing and postal services.[288] There is no reason why it

[286] *United Brands*, paragraphs 252 to 253.

[287] See cases cited at paras 10-107 to 10-109 of *Bellamy and Child: European Union Law of Competition*, 7th edition.

[288] See paragraphs 1.20 and 2.41 of the Coppi Report 2.

should not be applied in the present case. This is particularly the case where Naftogaz has failed to identify an appropriate comparator in order to support its assertion that the contract price is excessive and unfair in breach of Article 102 TFEU. Further, as Dr Coppi points out in the Coppi Report 2, in its current investigation of upstream gas supplies in Central and Eastern Europe, the European Commission conducted a comparison of Gazprom's prices with its costs.[289]

(3166) Naftogaz also argues that its approach is supported by two "*more recent*" judgments of the CJEU, *Bodson* and *SACEM*. But neither of those two cases undermine the approach taken in *United Brands* (and numerous subsequent cases) to establishing excessive pricing.

(3167) Both of these cases date back to the late 1980s. In those cases, the European Court was able to make a straight comparison between the prices charged by undertakings in the same or similar positions in other EU Member States.

(3168) In SACEM¸ in response to a question from a French court, the Court simply held that "*Article [102] of the Treaty must be interpreted as meaning that a national copyright-management society holding a dominant position in a substantial part of the common market imposes unfair trading conditions where the royalties which it charges to discotheques are appreciably higher than those charged in other Member States, the rates being made on a consistent basis*", unless such difference in charges can be objectively justified. The Court did not identify whether this breach of Article 102 TFEU involved excessive or discriminatory pricing. It certainly did not reject the test set out in *United Brands*.

(3169) In Bodson, the questions referred to the Court concerned what is now Article 106 TFEU which relates to measures put in place as regards public undertakings. Such measures must not be contrary to *inter alia* Articles 101 TFEU and/or 102 TFEU. In considering such questions, the Court indicated that it had been contended by Mrs Bodson that the public undertakings which operated the funeral services at issue charged excessive prices. The French Government denied that the prices were excessive. The Court held that "[t]*he documents before the Court do not contain any information enabling that problem to be resolved*". It therefore clearly did not make a finding on excessive pricing. In passing, the Court indicated that a comparison between the prices charged by undertakings which held public concessions and prices charged elsewhere "*<u>could</u> provide a basis for assessing whether or not the prices charged by the concession*

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[289] See Coppi Report 2, paragrphs 1.20 and 2.41.

holders are fair" (emphasis added), but it did not consider that issue further. The Court certainly did not reject the test set out in *United Brands*.

B) Evidence on Gazprom's costs and margins

(3170) Naftogaz asserts that it does not have access to data on Gazprom's costs, but that it can compare the prices charged under the Contract with German hub prices in order to establish excessive pricing. Such an approach is misconceived.

(3171) First, as explained above, a comparison with other prices charged by Gazprom only goes to the second stage of the *United Brands* test and one does not get to the second stage unless one has established, under the first stage, that "*the difference between the costs actually incurred and the price actually charged is excessive*".

(3172) In any event, German hub prices are not an appropriate competitive benchmark for the prices charged under the Contract: see paragraphs 1.21 to 1.23 and 2.42 to 2.56 of the Coppi Report 2.

C) High threshold for excessive pricing

(3173) Naftogaz asserts that "*there is no basis in case-law that a dominant player is free to overcharge as long as the overcharge is less than 100%*". Insofar as that is meant to be a reflection of Gazprom's case, it clearly misstates Gazprom's case.

(3174) Gazprom has simply stated that the "*standard of proof for establishing excessive pricing is very high*", and that "*the threshold at which a high price is typically considered excessive is very high, in some cases, 100% higher than in comparable markets*". Those statements are clearly borne out by the case-law.

D) Contract prices exceed market prices

(3175) Naftogaz seeks to compare the prices charged under the Contract with German hub prices in order to establish excessive pricing. Such an approach is misconceived.

(3176) First, the relevant time for assessing whether the contract price was abusive is in 2009 when the Contract was entered into: see above. At that point in time, Naftogaz agrees that it was not excessive and accepts that it was reasonable and in line with market prices.

(3177) Second, as explained above, a comparison with other prices charged by Gazprom only goes to the second stage of the *United Brands* test and one does not get to the second stage unless one has established, under the first stage, that "*the difference between the costs actually incurred and the price actually charged is excessive*".

(3178) In any event, German hub prices are not an appropriate competitive benchmark for the prices charged under the Contract. Hub contracts have completely different characteristics from long-term contracts (such as the Contract).

(3179) Moreover, even on Naftogaz' own figures, it is unable to establish that "*at least since 2011, the Contract Price has been significantly higher than market prices for natural gas*". The Lapuerta Report 2 includes two additional price comparisons: (i) a comparison of the Contract Price with the average German import price as reported by BAFA;[290] and (ii) a comparison of the Contract Price with the average price charged by Gazprom to European buyers.[291] A close look at these comparisons reveals that they fail to prove that Gazprom charged excessive prices, and actually prove the opposite, i.e. that Gazprom's price was in line with the price of comparable products: see paragraphs 1.24 to 1.25 and 2.57 to 2.64 of the Coppi Report 2.

(3180) Third, and importantly, if (contrary to Gazprom's arguments above) the Tribunal is to look at the situation after 2009, the price formula under the Contract should be considered over the entire Contract period. The contract price is oil-indexed. The oil-indexation works both ways: when the price of oil goes up the contract price increases to Gazprom's advantage, but when the price of oil goes down the contract price decreases to Naftogaz' advantage.

ii) Discriminatory pricing

A) Legal test

(3181) Article 102(c) TFEU specifically prohibits a dominant firm from "*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*".[292] This requires the person alleging abusive discrimination to demonstrate an effect on competition, in the form of a "competitive disadvantage", in the related market of the customer.

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290 Lapuerta Report 2, Figure 3.
291 Lapuerta Report 2, Appendix B.
292 Article 102 TFEU.

(3182) The relevant case-law is clear that a party alleging abusive discriminatory pricing under Article 102 TFEU has the burden of establishing that the different pricing places it at a competitive disadvantage vis-à-vis its competitors. Two recent decisions of the Stockholm District Court (the specialist Swedish competition court) clearly demonstrate this proposition of law.

(3183) In T 5995-09, *Preem mot Gävle Hamn*, judgment of 31 May 2012,[293] the Court stated that the practice of a dominant undertaking to charge different customers different prices for goods or services does not of itself suggest that there exists an exclusionary abuse for the purposes of Article 102 TFEU: Case C-209/10 *Post Danmark A/S v Konkurrencerådet* [2012] ECR I-0000 at paragraph 30.[294] The Court held that it is necessary to show that Preem's competitive position has been distorted, on an upstream or a downstream market, in relation to Hamnbolaget's other contracting parties: Case C-95/04 *British Airways plc v Commission* [2007] ECR I-2331 at paragraphs 143-145 and C-52/07 *Kanal 5 Ltd and TV 4 AB v Föreningen Svenska Tonsättares* Internationella *Musikbyrå (STIM) upa.* [2008] ECR I-09275 at paragraphs 42 to 48.[295]

(3184) Whether Preem's competitive position had been hindered had to be determined by considering if Preem, Afab and other contracting parties to Hamnbolaget on the market of the relevant port services were competing on the same upstream or downstream market. The Court found that Preem had either not put forward or not established that its competitive position had been distorted, on an upstream or a downstream market, in relation to Hamnbolaget's other contracting parties in any other way. It had therefore failed to establish a case of abusive discriminatory pricing under Article 102 TFEU.

(3185) In T 20621-10, *Verizon Sweden AB mot Tele2 Sverige AB*, 7 February 2014, the Court again held that price differentiation by a dominant undertaking does not necessarily constitute a price discriminatory abuse.[296] The fact that the practice of a dominant undertaking may be described as "price discrimination", that is to say, charging different customers or different classes of customers different prices for goods or services whose costs are the same or, conversely, charging a single price to customers for whom supply costs differ, cannot of itself suggest that

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293 Stockholm District Court (Sw. tingsrätt) judgment T 5995-09, *Preem mot Gävle Hamn.*

294 Case C-209/10 *Post Danmark A/S v Konkurrencerådet*, [2012] ECR page 00000.

295 Case C-52/07 *Kanal 5 Ltd and TV 4 AB v Föreningen Svenska Tonsättares Internationella Musikbyrå (STIM) upa* [2008] ECR I-09275.

296 Stockholm District Court (Sw. tingsrätt) judgment T 20621-10 *Verizon Sweden AB mot Tele2 Sverige AB.*

there exists an abuse (C-209/10 *Post Danmark A/S v Konkurrencerådet* [2012] ECR I-0000 at paragraph 30).[297]

(3186) The Court further held that the relevant question is whether the competitive position of the undertaking affected by the price differentiation has been distorted, on an upstream or a downstream market, in relation to the dominant undertaking's other contracting parties: Case C-95/04 *British Airways plc v Commission* [2007] ECR I-2331 at paragraphs 143 to 145 and C-52/07 *Kanal 5 Ltd and TV 4 AB v Föreningen Svenska Tonsättares Internationella Musikbyrå (STIM) upa.* [2008] ECR I-09275 at paragraphs 42 to 48.[298] The evaluation of whether the competitive position has been hindered is typically determined by considering whether the dominant undertaking's contracting parties compete on an upstream or downstream market.

(3187) The Court emphasised that the complainant, Verizon, bore the burden of proof in this regard. However, Verizon had not shown that the prices charged to its competitor, TeliaSonera, put it at a competitive disadvantage. It had therefore failed to establish a case of abusive discriminatory pricing under Article 102 TFEU.

(3188) These cases (and the EU case-law cited in them) establish that, in order to prove a case of discriminatory pricing under Article 102(c) TFEU, it is not sufficient simply to establish that Gazprom has charged different prices to different customers. Naftogaz must prove the following:

(i) It is comparing prices charged for "*equivalent transactions*". In other words it is comparing like with like.

(ii) That the prices charged for such "*equivalent transactions*" are different, without there being any objective justification for such difference.

(iii) That the "*other trading parties*" in such "*equivalent transactions*" are competing on an upstream or a downstream market and, if so, which one.

(iv) That the different prices being charged to those "*other trading parties*" are "*placing them at a competitive disadvantage*" vis-à-vis their competitors on that upstream or downstream market.

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297 Case C-209/10 *Post Danmark*,

298 Case C-52/07 *Kanal 5*.

(3189) Naftogaz has failed to fulfil any of these elements necessary to prove discriminatory pricing in breach of Article 102(c) TFEU.

(3190) Further, Naftogaz asserts that the specific prohibition in Art 102 (c) TFEU, which prohibits a dominant firm from "*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*" does not apply to "*where transactions with a single trading party (Naftogaz) leads to discrimination between that trading party's customers*".[299] No authority is cited by Naftogaz in support of this assertion, and this concept of "*secondary*" or "*downstream*" discrimination is unknown to EU competition law. Naftogaz's assertion in this regard should be rejected.

B) Discrimination between different types of consumers

(3191) Naftogaz argues that "*the inclusion of different oil products in the price formula discriminates between different customers within the Ukraine based on their alternatives to consuming natural gas*". This would appear to be a reference to what Mr Lapuerta has variously described as the indifference principle or "market value principle" or downstream price discrimination.

(3192) Naftogaz' case in this regard is misconceived and should be rejected.

(3193) First, as explained above, abusive price discrimination is clearly defined as "*applying dissimilar conditions to equivalent transactions with other trading parties*",[300] that is, charging different prices to customers in equivalent situations. Gazprom only charges one price under the Contract to Naftogaz. Gazprom cannot price discriminate by charging a single contract price. See paragraphs 1.32 to 1.34 and 4.5 to 4.14 of the Coppi Report 2.

(3194) Second, the indifference principle or "market value principle" has not been recognised in EU case-law as constituting abusive price discrimination for the purposes of Article 102 TFEU. Gazprom notes that no references are given for the assertions made by Mr Lapuerta in paragraph 132 of the Lapuerta Report 2 to the effect that "[c]*ompetition authorities and other organisations like the International Energy Agency … have clearly associated the "*market value principle*" with abusive price discrimination*". Gazprom denies that this is the case.

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299 Naftogaz's Reply, in paragraph 1400.

300 Article 102 TFEU.

(3195) Third, there is no evidence to demonstrate that the contract formula forced Naftogaz to charge different prices to different consumers: see paragraphs 1.35 to 1.40 and 4.15 to 4.32 of the Coppi Report 2.

(3196) In any event, Mr Lapuerta states that "*Dr Coppi cites Ukrainian regulations as preventing price discrimination in practice. I agree that Naftogaz does not discriminate against Ukrainian customers in the manner suggested by the market value principle*" (emphasis added).[301] Mr Lapuerta therefore agrees that, as a matter of fact, there is not any discriminatory pricing between Ukrainian consumers. Therefore, there cannot be any abusive price discrimination for the purposes of Article 102 TFEU. Naftogaz' case in this regard is hopeless.

(3197) However, Mr Lapuerta then goes on to assert that "*the Contract Price would compel Naftogaz to discriminate in order to earn a reasonable margin. By refraining from discrimination, Naftogaz has not been able to earn a reasonable margin*".[302] This is pure speculation, which is unsupported by any evidence from Naftogaz. See further paragraphs 1.35 to 1.40 and 4.15 to 4.32 of the Coppi Report 2.

C) Discrimination between Naftogaz and other purchasers from Gazprom

(3198) EU competition law does not mandate that every buyer should receive the same price. The practice of charging different prices to different customers is common.[303] Mr Lapuerta appears to agree with this.[304]

(3199) That a gas supplier is allowed to charge different prices in different countries without raising concerns under Article 102(c) TFEU is also confirmed by the European Commission.

(3200) It is established as a matter of EU competition law that, in order to establish abusive discriminatory pricing for the purposes of Article 102(c) TFEU, a party alleging the abusive discriminatory pricing has the burden of establishing that the differential pricing places it at a competitive disadvantage vis-à-vis its competitors.

(3201) In the Swedish cases cited above, the court held (on the basis of EU case-law) that the complainant customer had to establish that its competitive position had been distorted, on an

301 Lapuerta Report 2, paragraph 135.
302 Lapuerta Report 2, paragraph 135.
303 Coppi Report 1, paragraph 1.24. See also Coppi Report 2 at paragraphs 4.11 to 4.14.
304 Lapuerta Report 2, paragraph 132.

upstream or a downstream market, in relation to the seller's other contracting parties. In both cases, on the facts, the complainants were unable to establish that this was the case and their complaints were rejected.

(3202) In the present case, Naftogaz' claim is that "[s]*ince it is Gazprom's illegal and abusive restrictions which prevent Naftogaz from reselling gas in competition with Gazprom's customers in Western Europe, charging higher prices from Naftogaz than from customers in Western Europe involves placing Naftogaz at a competitive disadvantage within the meaning of Article 102(c)*".

(3203) Naftogaz has failed to discharge the burden of establishing that its competitive position has been distorted, on the downstream market, in relation to Gazprom's other (Western European) contracting parties:

(i) First, Mr Lapuerta's own analysis shows that the actual price that Gazprom charges to Naftogaz is lower than the average price that Gazprom charges to other European importers (see Figure 4 on page 33 of the Lapuerta Report 2). The most appropriate comparison is with the actual price (rather than the contract price). This means that Mr Lapuerta's claim that Naftogaz is being charged a higher price than other European importers is factually incorrect: see paragraph 4.8 of the Coppi Report 2

(ii) Second, even on Naftogaz' case, the contract price only became higher than the average Russian price in 2010 and, at its highest, in 2014, the contract price was only roughly about 20% higher than the average Russian price.[305] Naftogaz has put forward no evidence to establish that such a price differential puts it at a "*competitive disadvantage*" in the downstream market vis-à-vis other Gazprom customers.

(iii) Third, and in any event, there is no evidence that Naftogaz would export gas for sale to consumers outside Ukraine in competition with Gazprom's Western European customers, even in the absence of such a price differential: see above. Historically, Ukraine has not exported any volumes of gas to other countries.[306] Naftogaz is a heavy importer of gas from Russia, and independent Ukrainian producers have been required

305 Appendix B and Figure 5 of the Lapuerta Report 2.

306 See TRANS ARB [redacted], paragraphs 73 and 78 and TRANS ARB [redacted] paragraphs 14 to 15 in the Transit Arbitration.

under Ukrainian law to sell all domestic production to Naftogaz.[307] Moreover, there is no evidence that Ukrainian suppliers would have any incentives to export gas to the EU in the future.[308]

(iv) Finally, as explained above, the relevant time for assessing a pricing abuse is 2009 when the Contract was entered into. At that time, Naftogaz accepts that the price formula in the Contract did not discriminate between Ukraine and other countries.

iii) Effect on trade

(3204) First, Naftogaz argues that the various provisions of the Contract form part of an "*overall strategy*" and that, therefore, it need only establish that one of Gazprom's practices is capable of having an effect on trade between EU Member States. Article 102 TFEU will then apply to all provisions of the Contract and practices of Gazprom which result from the Contract (including, presumably, the price provisions). In this regard, Naftogaz relies upon the EU Commission's Statement of Objections.

(3205) For the reasons set out above, however, it is Gazprom's case that the Commission's Statement of Objections is not evidence of an "*overall strategy*". Naftogaz therefore needs to establish that each element of the alleged abuse (including the price provisions) affects trade between EU Member States.

(3206) Naftogaz' alternative case is that the "*oil indexation clause in itself affects trade between EU countries*". This assertion is made on the basis of Mr Lapuerta's evidence that higher prices in Ukraine lead to reduced demand and "[r]*educed natural gas demand in Ukraine makes higher volumes available to Gazprom for sale in EU countries*".[309]

VIII.11.7.17.4.4 The volume and take or pay provisions

i) The legal tests under Articles 101 and 102

(3207) First, Naftogaz addresses the legal test under Article 102 TFEU. That test is uncontroversial: when a dominant firm enters into an agreement whereby its customer agrees to obtain "*all or most*" of its requirements exclusively from that dominant firm, then this is an abuse of a

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307 TRANS ARB [redacted] paragraph 78.
308 TRANS ARB Moselle Report, paragraph 3.19.
309 Lapuerta Report 2, paragraph 137(a).

dominant position for the purposes of Article 102 TFEU. The case-law indicates that "*all or most*" of a customer's requirements equates to about 75 to 80 per cent.

(3208) As for the legal test under Article 101 TFEU, it is also uncontroversial that a non-dominant firm may enter into an exclusive agreement with its customers. It is only where a network of exclusive agreements with a cumulative effect forecloses the relevant market that such agreements might be in breach of Article 101 TFEU.

(3209) The present case is concerned only with a single agreement: the Contract . Therefore, the legal test to be applied is that under Article 102 TFEU, rather than Article 101 TFEU (there being no network of exclusive agreements).

ii) The abusive and restrictive nature of the volume and take or pay provisions

(3210) As indicated above, in order to establish a breach of Article 102 TFEU, Naftogaz must establish that the Contract requires Naftogaz to obtain "*all or most*" of its requirements exclusively from Gazprom. The case-law has indicated that this equates to about 75 to 80 per cent.

(3211) The factual and evidential basis for Naftogaz' case on the volume and take or pay provisions was found in the Preliminary Assessment of the Energy Community Secretariat of 25 July 2014 ("the Secretariat's Assessment"), which Naftogaz cites in support of its argument that the volume and take or pay provisions cover Naftogaz' "*entire demand for imported natural gas and a majority of the total gas demand of Naftogaz for a duration of 11 years*". The Lapuetra Report 1 refers to and comments on the Secretariat's Assessment, but adds no further empirical evidence in support of Naftogaz' case.

(3212) In the Secretariat's Assessment, it is stated that:

(i) "*By the Gas Contract, ACA is set at 52 bcm, which proceeding from the declining trend in natural gas imports lies above the level of actual foreign gas demand of Naftogaz (29-35 bcm in 2012-2013). … In addition, 80% of ACA (i.e. MAA) is also likely to exceed the actual demand of Naftogaz*";

(ii) "*… the Gas Contract almost fully covering the demand for imported natural gas and the majority part of the total gas demand of Naftogaz (i.e. 55-60% of its total gas demand in 2012-2013), as entered for a period of 10 years* [sic]*, creates significant restrictions of competition*"; and

(iii) "*… the take-or-pay clause by which Naftogaz is obliged to purchase the predominant part of the needed gas from Gazprom (i.e. 55-60% of its total gas demand in 2012-2013) amounts to an exclusionary form of abuse of dominance*."

(3213) In response to that case, Gazprom argues that the volume requirements only cover 55 to 60 per cent. of Naftogaz' requirements and thus Naftogaz is unable to establish that it is required to obtain "*all or most*" of its requirements exclusively from Gazprom. It is therefore unable to establish a breach of Article 102 TFEU.

(3214) Naftogaz' requirements constitute all consumption in Ukraine (i.e. what the Secretariat describes as its total gas requirements, rather than its foreign gas demand). It is this volume of gas which Naftogaz has to procure in order to supply its customers, i.e. industrial and domestic users in Ukraine. It is a matter for Naftogaz as to whether it procures its requirements of gas from domestic producers or foreign imports, but, Naftogaz' requirements constitute all the gas which it needs to procure in order to supply *its* customers in the Ukraine.

(3215) Naftogaz argues that "*Ukrainian law prohibits Naftogaz from exporting domestic production, which is not even large enough to avoid take-or-pay liabilities*".[310] However, there are no provisions of Ukrainian law of which Gazprom is aware which prohibit Naftogaz from exporting such gas. It may be exported if an export quota is obtained (and it has been in the past).[311] Therefore, domestic production should not be deducted from a calculation of Naftogaz' natural gas requirements.

(3216) Naftogaz now argues that "*Gazprom contracts cover on average 87-88% of total demand in the two broader market definitions and 82% of demand in the Ukraine*".[312]

(3217) However, the figures upon which Naftogaz rely in making this assertion (as contained in Table 5 of the Lapuerta Report 2) are incorrect.

(i) First, the figure for consumption in the Ukraine does not include fuel gas.[313] This approach is flawed. There is no reason to exclude fuel gas from the consumption

310 Paragraph 94 of the Lapuerta Report 2.
311 See [redacted], paragraphs 37 to 39.
312 See paragraph 1450 of Naftogaz's Reply and paragraph 169 (and Table 5) of the Lapuerta Report 2.
313 Lapuerta Report 2, paragraph 168.

figures: such gas is used to supply the natural gas to users in Ukraine and thus is part of the consumption of natural gas in Ukraine.[314]

(ii) Second, the Gazprom annual contract quantities (the Minimum Annual Volume or MAV) are also incorrect.

(3218) Once fuel gas is included and the MAV figures have been corrected, the figure of 82% of total demand in the Ukraine drops to 68.2%.

(3219) The figure 68.2% is arrived at by calculating the average MAV as a percentage of total gas consumption in Ukraine (as reported by the Ministry of Energy and Coal of Ukraine) in the years 2009, 2010, 2011, 2012 and 2013 (the same period cited by Mr Lapuerta[315]), as reflected in the table below.[316]

Year	2009	2010	2011	2012	2013
Total gas consumption in Ukraine (in BCM), as published in Ukraine[317]	51.9	57.7	59.3	54.8	50.3
Total gas consumption in Ukraine (in BCM) as reported by Mr Lapuerta[318]	*46.77*	*52.17*	*53.75*	*49.54*	*44.99*
MAV under Contract KP (as amended)	[redacted]	[redacted]	40	41.6	41.6
MAV as % of total consumption (as reflected in lines 1 and 3 above)	[redacted]	[redacted]	67.5%	75.9%	82.1%

(3220) However, this is an average figure for the period 2009 to 2013. For the reasons set out above, the relevant point in time for assessing an abuse is when the Contract was entered into.

(3221) In that regard, as [redacted] explains:

"*In January 2009, Naftogaz insisted that Gazprom undertake a supply commitment of 40 BCM for 2009, and 52 BCM annually thereafter, in exchange for which Gazprom insisted that Naftogaz undertake a take or pay obligation of 80%, i.e. 32 BCM in 2009 and 41.6 BCM thereafter. Viewed against consumption in 2008 (the most recent consumption data available*

314 See [redacted] paragraphs 41 to 43.

315 Lapuerta 2, Tables 4 and 5, pages 46 to 47.

316 Compare to Lapuerta 2, paragraph 169: "*Gazprom contracts cover on average…82% of demand in Ukraine.*"

317 [redacted] Table of data reflecting the Ukrainian "gas balance" over the years 2009 to 2015, which was prepared on the basis of statistics published in Ukraine.

318 Lapuerta 2, Table 4, page 46.

at the time Contract KP was signed), this take or pay commitment represented, relative to 2008 consumption figures, 48% and 62.7%, respectively, of total Ukrainian consumption."[319]

(3222) As a result, Naftogaz has failed to establish that it is required to obtain "*all or most*" of its requirements exclusively from Gazprom. It is therefore unable to establish a breach of Article 102 TFEU.

iii) Objective justification

(3223) In any event, the volume and take or pay provisions were objectively justified. In the regard, Gazprom makes the further additional submissions:

(i) The volume and take or pay provisions were a *quid pro quo* for the significant supply commitment that Gazprom entered into for the first time vis-à-vis Naftogaz in the Contract .[320]

(ii) Gazprom did not pressure Naftogaz to agree to the volume commitments. The high supply commitment undertaken by Gazprom was entered into at Naftogaz' insistence. [321]

(iii) Gazprom had to make substantial investment in order to sustain production at a level sufficient to supply Ukraine with the ACV of 52 BCM in Contract KP. One example of this is Gazprom's investment into the Bovanenko gas field. [322] Another is the contract which Gazprom entered into to purchase gas from Central Asia.[323] Gazprom therefore rejects Naftogaz' assertions that the take or pay commitments do not reflect investments made by Gazprom in order to supply Naftogaz under the Contract.

(iv) Finally, the take or pay obligations are a reasonable measure to ensure security of supply to Europe by encouraging Naftogaz to maintain adequate levels of gas in storage in winter. Mr Lapuerta argues that "*the take-or-pay commitment is actually superfluous to the goal of incentivising summer gas storage. As long as Gazprom limits the maximum consumption of gas in winter, Naftogaz will have efficient incentives to respond by taking more gas under the Contract than it needs in the summer, and storing*

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319 [redacted] paragraph 64.
320 [redacted] paragraphs 61 to 63.
321 [redacted] paragraphs 63 to 65.
322 [redacted] paragraphs 73 to 76.
323 [redacted] paragraphs 77 to 82.

the excess in for use in the winter".[324] However, as [redacted] explains, "*a simple cap on winter consumption*" as suggested by Naftogaz is not a realistic proposition:

- First, Gazprom has no control over gas consumption in Ukraine.[325]

- Second, Gazprom has tried to limit supplies to Ukraine in the past, usually as a result of Naftogaz' failure to pay for past supplies, but this has resulted in shortfalls in deliveries to Gazprom's European off-takers and/or a commercial renegotiation being forced upon Gazprom.[326] It has not imposed the incentives on Naftogaz which they now argue would result from limiting deliveries.

- Third, the whole Ukrainian GTS is structured as a form of internal virtual reverse flow. In peak consumption periods and years, there is insufficient capacity at the entrance points of the Ukrainian GTS to meet combined domestic Ukrainian and European off-taker demand. The system relies upon Naftogaz replacing the volumes of gas that it offtakes for domestic consumption in the east of Ukraine (where consumption is highest as a result of population density and industry) by withdrawing gas from storage in the west to send on to Gazprom's off-takers. If Gazprom were to reduce supplies in the winter period, then the result would be that Naftogaz, in order to deliver the required transit volumes, would have to increase withdrawal from storage. If there was insufficient gas in storage, Naftogaz would deplete its storage reserves more quickly, and the result would not be shortfalls in deliveries to the Ukrainian domestic market, but instead shortfalls in deliveries to Gazprom's European off-takers. Limiting supplies in the winter would therefore be an unacceptable risk for Gazprom to take.[327]

- Finally, as for the argument that Gazprom itself could inject more gas into Ukrainian storage facilities,[328] Gazprom does not have a storage contract with Naftogaz. [redacted] explains why this is the case: in all the circumstances, Gazprom cannot trust Naftogaz / Ukrtransgaz to hold gas on its behalf and to

324 Lapuerta Report 2, paragraph 91.
325 [redacted] paragraph 108.
326 paras 109 to 111.
327 paragraphs 112 to 114.
328 Lapuerta Report 2, paragraph 93.

withdraw that gas and send it to Gazprom's European off-takers as and when needed.[329]

iv) Make up provisions

(3224) Naftogaz argues that the concept of "make-up" gas only applies once a company like Naftogaz has filled its storage capacity to the maximum, can no longer take more gas, and has no alternative but to pay the penalty. However, in the present case, Naftogaz has not reduced the impact of the take or pay provisions by taking gas under the Contract and injecting that gas into its storage facilities. On the contrary, over the relevant period, Naftogaz has made net withdrawals from its storage capacity.[330]

(3225) Gazprom maintains that Naftogaz did not need "make up" provisions in the Contract as it is able to inject any excess volumes it has committed to take under the Contract into its storage facilities for use at a later date. The absence of a make-up provision is also necessary to ensure that Naftogaz maintains sufficient gas in storage in the summer.

(3226) It is further the case that the reason that the Contract does not include any such provisions is not because Gazprom would not have been prepared to agree to them, but more because Naftogaz did not request one. Had Naftogaz made such a proposal, Gazprom would have given it due and serious consideration.[331]

(3227) In any event, over the course of the Contract, there have been amicable negotiations between Naftogaz and Gazprom in which Gazprom has shown significant flexibility and as a result of which it has agreed to discount the price of gas under the Contract , to make advance payments for transit services, to defer Naftogaz' payment obligations, and most significantly, to give up its take or pay rights in respect of [redacted] In effect, Gazprom has given up its right to enforce the take or pay obligations without having received anything in return from Naftogaz.[332]

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329 [redacted] paragraphs 115 to 120.

330 See Gas balance of Ukraine over the period 2009 to 2015 (Exhibit [redacted] to [redacted] and in particular the lines "Offtake from underground gas storage facilities (UGSFs) and GTS" and "Injection into UGSFs and GTS".

331 [redacted], paragraphs 83 to 86.

332 [redacted] paragraphs 86 to 87.

v) Effect on trade

(3228) Naftogaz addresses the question of effect on trade of the volume and take or pay provisions under the Contract.

(3229) First, , it is Gazprom's case that Naftogaz is unable to establish that there is an "*overall strategy*" on the part of Gazprom or that Gazprom's practices form part of the "*same overall infringement*". Naftogaz therefore needs to establish that each element of the alleged abuse (including the volume and take or pay provisions) affects trade between EU Member States.

(3230) Naftogaz' alternative case is that the volume and take or pay provisions in themselves affect the flow of trade within the EU. This is based on the assertion that "*the extended duration and ToP commitment together foreclose competition to supply gas to consumers in Ukraine, impeding Naftogaz from importing alternative gas supplies from Poland, Hungary and Slovakia that could otherwise compete effectively in Ukraine. Impeding exports from EU countries affects their price levels and trade*".[333]

(3231) Naftogaz' argument that impeding exports affects price levels and trade is pure speculation, which the EU Commission has clarified in its Guidelines on the Effect on Trade[334] is not sufficient to establish the requisite effect on trade between Member States so as to establish the jurisdiction of EU competition law: see above.

(3232) As regards the lack of make-up provisions in the Contract, Mr Lapuerta asserts that "[t]he absence of make-up gas provisions allows Gazprom to sell the same gas twice, making *more gas immediately available for export to EU countries if Naftogaz does not take it*".[335] Such an assertion is mistaken. The presence or absence of make-up provisions in the Contract does not affect trade between EU Member States. Make-up provisions concern payment for gas not used. They are not about making more gas available on the market.

VIII.11.7.7.4.5 The destination clause

i) Naftogaz has not established that Article 3.10 of the Contract is a restriction on competition under Article 101 TFEU and/or Article 102 TFEU

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333 Lapuerta Report 2, paragraph 137(c).
334 Exhibit CL-61, paragraph 1182.
335 Lapuerta Report 2, paragraph 137(d).

(3233) Naftogaz argues that Article 3.10 is a "*hard-core*" restriction of competition. However, in making this submission, Naftogaz ignores the fact that each Article 101 TFEU and Article 102 TFEU require that there be a restriction of competition and/or an abuse in the internal market, i.e. within the EU. Clause 3.10 simply restricts the use of the gas sold under the Contract to use within Ukraine.

(3234) In those circumstances, the European Courts have held that such clauses cannot have the object of restricting competition: "*an agreement in which the reseller gives to the producer an undertaking that he will sell the contractual products on a market outside the Community cannot be regarded as having the* <u>*object*</u> *of appreciably restricting competition within the common market … Consequently, the agreements at issue, in that they prohibit the reseller Javico from selling the contractual product outside the contractual territory assigned to it, do not constitute agreements which, by their very nature, are prohibited by Article* [101] *of the Treaty*" (emphasis added).[336]

(3235) As regards the effect of such a clause, it is not enough for Naftogaz simply to assert that "*in the absence of the destination clause, Naftogaz would have been able to sell the unwanted gas elsewhere, competing with Gazprom supplies, and reducing the competitive price of natural gas*".

(3236) In order to establish that such a clause has the *effect* of restricting competition within the EU, Naftogaz would have had to have carried out an extensive analysis of its effects of within the EU. As the CJEU said in *Javico*:

"*In that regard, it is first necessary to determine whether the structure of the Community market in the relevant products is oligopolistic, allowing only limited competition within the Community network for the distribution of those products.*

It must then be established whether there is an appreciable difference between the prices of the contractual products charged in the Community and those charged outside the Community. Such a difference is not, however, liable to affect competition if it is eroded by the level of customs duties and transport costs resulting from the export of the product to a non-member country followed by its re-import into the Community.

[336] Case C-306/96 *Javico*, paragraphs 20 to 21.

If that examination were to disclose that the contested provisions of the agreements concerned had the effect of undermining competition within the meaning of Article [101] of the Treaty, it would also be necessary to determine whether, having regard to YSLP's position on the Community market and the extent of its production and its sales in the Member States, the contested provisions designed to prevent direct sales of the contractual products in the Community and re-exports of them to the Community entail any risk of an appreciable effect on the pattern of trade between the Member States such as to undermine attainment of the objectives of the common market."[337]

(3237) Naftogaz has carried out no such assessment, and is therefore unable to establish that the destination clause has the effect of restricting competition *within* the internal market for the purposes of Article 101 TFEU. Naftogaz has similarly failed to explain how that clause could be said to be an abuse of a dominant position *within* the internal market for the purposes of Article 102 TFEU.

ii) Effect on trade

(3238) Naftogaz addresses the question of effect on trade of Article3.10 the Contract.

(3239) First, for the reasons set out above, it is Gazprom's case that Naftogaz is unable to establish that there is an "*overall strategy*" on the part of Gazprom or that Gazprom's practices form part of the "*same overall infringement*". Naftogaz therefore needs to establish that each element of the alleged abuse (including Article 3.10) affects trade between EU Member States.

(3240) Alternatively, it is not sufficient for Naftogaz simply to assert that the destination clause alone will affect trade between EU countries on the basis that it prevents Ukraine from exporting unwanted gas.[338] There is nothing to support the assertion that, in the absence of the destination clause, Ukraine would export gas to EU countries such as Slovakia, Hungary and Poland.

(3241) This is no more than a speculative or contrived possibility, which the EU Commission has clarified in its Guidelines on the Effect on Trade[339] is not sufficient to establish the requisite effect on trade between Member States so as to establish the jurisdiction of EU competition law: see above.

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337 Case C-306/96 *Javico*, paragaphs 23 to 25.
338 Naftogaz's Reply, paragraph 1487 and Lapuerta Report 2, paragraph 137(b).
339 Exhibit CL-61, paragraph 1182.

VIII.11.7.17.4.6 The unilateral suspension right

i) Naftogaz cannot establish that Article 5.3 of the Contract is in breach of Article 102 TFEU

(3242) Naftogaz argues that Article 5.3 of the Contract is abusive under Article 102 TFEU on the basis that, as a result of this "*unusual*" clause "*Naftogaz faces a handicap that other importers of natural gas do not face*", i.e. "[i]*f Naftogaz cannot suspend the Contract then it cannot offer the same security to its customers as other suppliers*".[340]

(3243) However, Naftogaz explicitly accepts that Swedish law provides it with a right to suspend performance of the Contract "*even without a specific clause to that effect in the Contract*".

(3244) As a result of that concession, Naftogaz' case on Article 5.3 collapses. This admission wholly undermines the arguments made in the Lapuerta Report 2 as regards "*asymmetric risks*". There is no asymmetry where both parties have the right to suspend the Contract.

(3245) In any event, Article 5.3 is justified by Naftogaz's record of non-payment.

ii) Effect on trade

(3246) First, for the reasons set out above (and contrary to the submission made by Naftogaz), it is Gazprom's case that Naftogaz is unable to establish that there is an "*overall strategy*" on the part of Gazprom or that Gazprom's practices form part of the "*same overall infringement*". Naftogaz therefore needs to establish that each element of the alleged abuse (including Article 5.3) affects trade between EU Member States.

(3247) Alternatively, it is not sufficient for Naftogaz simply to assert that Article 5.3 will affect trade between EU countries on the basis that it puts Naftogaz at a disadvantage in competing with suppliers in EU Member States.[341] For the reasons set out above, Naftogaz' argument on "*asymmetric risks*" is wholly misconceived. Naftogaz is not therefore put in a different position from suppliers in EU Member States.

(3248) Even if Naftogaz were put in a different position from suppliers in EU Member States, however, there is nothing to support the assertion that this might affect trade between Member States.

[340] Lapuerta Report 2, paragraph 104.
[341] Naftogaz' Reply, paragraph 1495 and Lapuerta Report 2, paragraph 137(e).

Such an effect is no more than a speculative or contrived possibility, which the EU Commission has clarified in its Guidelines on the Effect on Trade[342] is not sufficient to establish the requisite effect on trade between Member States so as to establish the jurisdiction of EU competition law.

VIII.11.7.17.4.7 The mandatory sales clause

i) Naftogaz cannot establish that Article 9.7 of the Contract is in breach of Article 101 and/or 102 TFEU

(3249) Naftogaz argues that that Article 9.7 is abusive and restrictive of competition in breach of Articles 101 and/or 102 TFEU. Naftogaz argues that "[t]*he clause contributes to the strengthening of Gazprom's dominant position in the upstream market by providing it with direct influence on the downstream market in Ukraine through forced sales by Naftogaz to a Gazprom subsidiary*".

(3250) This argument is wholly misconceived.

(i) First, there are no sales ("*forced*" or otherwise) on the "*downstream market in Ukraine ... by Naftogaz to a Gazprom subsidiary*". Naftogaz has taken action to exclude Gazprom Sbyt from the Ukrainian market and, as from 1 March 2013, has refused to sell gas to Gazprom Sbyt. Gazprom Sbyt is not operating in the Ukrainian market (and has not been for over three years). Article 9.7 is not having *any* effect on the downstream market in Ukraine.

(ii) Gazprom rejects the assertions made by Naftogaz to the effect that it took no action to exclude Gazprom Sbyt from the Ukrainian market.

(iii) The evidence produced for Naftogaz by [redacted] and [redacted] (neither of whom were working for Naftogaz during the relevant period) is addressed in the second statement of [redacted].[343] Her evidence makes it clear that, from 2012 onwards, Naftogaz started making unjustified exclusions from its nominations of Gazprom Sbyt's off-takers.[344] By its letter of 26 February 2013, Naftogaz indicated that it was stopping

342 Exhibit CL-61, cited by Naftogaz in its Reply, paragraph 1182.
343 [redacted] paragraphs 6 to 25.
344 [redacted], paragraphs 10 to 18.

deliveries to all of Gazprom Sbyt's off-takers.[345] Naftogaz made no further deliveries after 1 March 2013. This was not due to a lack of supplies from Gazprom to Naftogaz under the Contract .[346] Nor was the reduction in volumes of supplies by Naftogaz to Gazprom Sbyt due to an overall decrease in demand by Ukrainian customers. Contrary to what is said by Naftogaz' Reply, Gazprom and Gazprom Sbyt did complain to Naftogaz about its actions, but nothing was done.[347]

(iv) Second, even if Article 9.7 were having an effect on the downstream market in Ukraine, this would not amount to such a clause (which relates solely to sales in Ukraine) having as its object and/or effect of the restriction of competition *within* the EU internal market for the purposes of Article 101 TFEU. Further, as regards Article 102 TFEU, any "abuse" is alleged to have taken place on a market in Ukraine. It cannot therefore be said to be an abuse of a dominant position *within* the EU for the purposes of Article 102 TFEU.

(v) Third, and in any event, Naftogaz effectively admits that Article 9.7 had no effect on its sales volumes because Gazprom Sbyt had to obtain the gas it sold in Ukraine between 2010 and 2013 from Naftogaz. Instead, Naftogaz seeks to argue that its profits were reduced because it sold that gas to Gazprom Sbyt at a discount from the price which it would have sold directly to industrial customers. However, this complaint does not establish an adverse effect on competition in breach of Article 101 and/or Article 102 TFEU. On the contrary, if there was any effect on competition, it was a positive effect and increased competition as industrial customers could choose to obtain their supplies from Gazprom Sbyt or Naftogaz.

ii) Effect on trade

(3251) First, for the reasons set out above, it is Gazprom's case that Naftogaz is unable to establish that there is an "*overall strategy*" on the part of Gazprom or that Gazprom's practices form part of the "*same overall infringement*". Naftogaz therefore needs to establish that each element of the alleged abuse (including Article 9.7) affects trade between EU Member States.

345 [redacted], paragraph 17.
346 [redacted] paragraph 19.
347 [redacted] paragraphs 13 to 15.

(3252) Alternatively, it is not sufficient for Naftogaz simply to assert thatArticle 9.7 will affect trade between EU countries on the basis that it gives Gazprom an advantage in the sale of gas to Ukraine and, as a result, potential suppliers from EU countries such as Slovakia, Poland and Hungary are put at a disadvantage, which, in turn, affects trade patterns within the EU.[348] Such arguments are no more than speculative or contrived, which the EU Commission has clarified in its Guidelines on the Effect on Trade[349] is not sufficient to establish the requisite effect on trade between Member States so as to establish the jurisdiction of EU competition law.

VIII.11.7.17.5 No breach of the EnCT, and no right in EU law against Gazprom

(3253) Naftogaz alleges that the direct effect of the EnCT confers a right on Naftogaz in EU competition law that could be directly relied upon against Gazprom before the Tribunal.

(3254) If the Tribunal were to find that Article 18 EnCT could confer a right on Naftogaz that it can invoke and rely on before a court or tribunal within the European Union (which is denied), such a right does not confer a right on Naftogaz that could be directly relied upon against Gazprom before the Tribunal. The direct effect of Article 18 EnCT could only confer a right to Naftogaz *against the state of Ukraine* for a failure to implement the EnCT.

(3255) Direct effect in EU law does not automatically mean that an individual may rely on a particular act, including a specific provision in an international agreement which has been deemed capable of generating direct effect as a matter of EU law, against another individual. As clarified by the CJEU, "[i]*n conformity with the principles of public international law Community institutions which have power to negotiate and conclude an agreement with a non-member country are free to agree with that country what effect the provisions of the agreement are to have in the internal legal order of the contracting parties*."[350]

(3256) Accordingly, the consequence of a breach of Article 18 EnCT is dependent on the context of the agreement and the intention of the Parties. It follows from the purpose and wording of the EnCT that it was not intended to generate direct effect between two individuals.

(3257) First, as set out above, Article 18(1) EnCT, read in light of Article 3(a) EnCT, confirms that the obligation in Article 18 EnCT is addressed to the Contracting Parties and not to the European

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348 Lapuerta Report 2, para 137(f).

349 Exhibit CL-61, paragraph 1182.

350 Case 104/81 *Hauptzollamt Mainz v CA Kupferberg & Cie KG aA* [1982] ECR 3641 at paragraph 17.

Union as a "Party" to the EnCT. The consequences of the direct effect of Article 18 EnCT could accordingly only confer a right to Naftogaz *against the state of Ukraine* to have certain anti-competitive measures assessed.

(3258) Second, and in any event, the consequences of a breach of the EnCT are regulated in the EnCT and such consequences can only be dealt with by the Ministerial Council in accordance with the EnCT.

(3259) The consequences of a breach of Article 18 EnCT are regulated in Articles 90 to 93 EnCT. According to Article 90(1) EnCT, a private body may approach the Secretariat constructed by the EnCT with complaints. As set out in Article 92(1) EnCT, the Secretariat may then request the Ministerial Council to determine the existence of a serious and persistent breach *by a Party to the EnCT* of its obligations under the agreement, but the Secretariat is under no legal obligation to do so.

(3260) The Ministerial Council may then, as a consequence, suspend certain of the rights deriving from the application of the EnCT *to the Party concerned*. The Ministerial Council is, however, under no legal obligation to determine a breach or to suspend rights deriving from the application of the EnCT.

(3261) It follows that any breach of the EnCT must be dealt with by the Ministerial Council and a breach of the agreement may amount to suspension of certain aspects of the EnCT to *the Party* concerned, but it can never directly affect a contract in private law between two undertakings.

VIII.11.7.17.6 No breach of Ukrainian law

(3262) To the extent that Naftogaz purports to rely upon Ukrainian law, Gazprom's position is as follows.

VIII.11.7.7.6.1 Naftogaz accepts that Naftogaz is still in this process of implementing the EnCT into its national legislation

(3263) Naftogaz alleges that Ukraine as a Contracting Party to the EnCT is obliged to implement EU competition law and EU energy law in accordance with the EnCT and that these rules therefore apply to its claims as part of Ukrainian law.

(3264) While Naftogaz states that Ukraine was given until 1 January 2015 to implement energy related EU legislation specified in the EnCT[351] into its national legislation, Naftogaz also accepts that Ukraine is still in the process of implementing this legislation.

(3265) Naftogaz further states that the Ukrainian Parliament adopted a new Ukrainian Natural Gas Market Law on 9 April 2015 in order to implement the Third Energy Package, but that the aim is to develop and finalise relevant secondary legislation in the course of spring/summer 2015 in order for this secondary legislation to enter into force together with the New Ukrainian Natural Gas Market Law by 1 October 2015.

(3266) In addition, Naftogaz has also admitted that existing Ukrainian legislation is contrary to EU law, but that the new Natural Gas Market Law, supplemented by secondary legislation that is currently being prepared, is meant to address this inconsistency.

VIII.11.7.17.6.2 Naftogaz has failed to clarify what Ukrainian law it relies upon in the Supply Arbitration

(3267) Naftogaz has failed to clarify what Ukrainian law it relies upon in the Supply Arbitration, and to what extent any such Ukrainian law might have an effect upon the Contract and the claims put forward by Naftogaz.

(3268) It is accordingly unclear to what extent, if any, Naftogaz relies upon Ukrainian law in the Supply Arbitration.

VIII.11.7.17.6.3 Article 18 EnCT cannot be relied on by Naftogaz as part of Ukrainian law

(3269) Naftogaz argues that Article 18 EnCT constitutes mandatory Ukrainian law. Although Naftogaz admits that Ukrainian law is not applicable to the Contract *per se*, Naftogaz asserts that Ukrainian law constitutes facts that render the provisions of the Contract in breach of Article 18 EnCT and therefore ineffective in accordance with Article 9.5 of the Contract.

(3270) Naftogaz states that, pursuant to Article 9 of the Constitution of Ukraine, the EnCT became an integral part of the national legislation of Ukraine on 1 February 2011. Naftogaz underlines that the Ukrainian legal system acknowledges the precedence of an international treaty, which has been ratified by the Parliament of Ukraine, over national laws and regulations in accordance

[351] See further Article 11 of the EnCT and the legislation listed in Annex I of the EnCT.

with Article 19(2) of the Law of Ukraine on International Treaties of Ukraine, No. N 1906-IV, dated 29 June 2004.

(3271) It is denied that Article 18 EnCT as part of Ukrainian law can be relied on by Naftogaz against Gazprom.

(3272) Regardless of the status of an international treaty in Ukrainian law, Naftogaz has failed to clarify how an international treaty may be relied on by a private party against another private party and also what is required of an international treaty in order to have such direct effect between private parties according to Ukrainian law.

(3273) Further, in any event, any breach of the EnCT must be dealt with by the Ministerial Council and a breach of the agreement may amount to suspension of certain aspects of the EnCT to *the Party* concerned, but it can never directly affect a contract in private law between two undertakings.

VIII.11.7.17.6.4 In any event, Ukrainian law is not applicable to the Contract

(3274) Article 9.4 of the Contract expressly states that: "*This Contract shall be exclusively governed by the substantive laws of Sweden*".

(3275) It follows that, in principle, the Tribunal is found to apply exclusively Swedish law in determining the parties' claims pursuant to the Contract .

(3276) The only exception to this principle could be if there are found to be mandatory laws of a third country that nevertheless must be applied as international mandatory law, notwithstanding the fact that the parties have expressly chosen exclusively Swedish substantive law to regulate and determine their respective right and obligations under the Contract.[352]

(3277) Thus, it would not be sufficient that Naftogaz might refer to provisions of Ukrainian law that were considered to be mandatory in Ukraine. In order to be applicable in this Arbitration, by an international arbitral tribunal sitting in Stockholm that is required to apply exclusively

[352] See, e.g. Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), Article 9(1): "*Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.*"

Swedish substantive law, Naftogaz would have to show that the provisions of Ukrainian law relied upon constitute provisions of international mandatory law.

(3278) Naftogaz has failed to show that any provisions of Ukrainian law could constitute international mandatory law.

VIII.11.7.17.7 Invalidity and ineffectiveness and their consequences

VIII.11.7.17.7.1 There is no basis in competition law for a finding that any provision of the Contract is invalid or ineffective

(3279) In the event that the Tribunal were to find that any of the clauses of the Contract are in breach of EU competition law or the EnCT or Ukrainian law, the Tribunal must then consider the implications of such a breach, if any.

(3280) Naftogaz relies on a direct application of Articles 101 and 102 TFEU as well as Article 18 EnCT and argues that a breach of any of these provisions must result in the invalidity of that provision. In addition, Naftogaz asserts that Article 18 EnCT applies to the Contract as mandatory Ukrainian law and a breach of Article 18 EnCT as part of Ukrainian law would also result in invalidity and/or ineffectiveness.[353]

(3281) Further, Naftogaz also states that the consequences of invalidity pursuant to Articles 101 and 102 TFEU as well as Article 18 EnCT should be determined in accordance with Swedish law.

(3282) Naftogaz has changed the alleged date of invalidity of its competition law claims. Naftogaz had put forward 1 February 2011, the date of accession of Ukraine to the EnCT, but has now adjusted this date.

(3283) The principal date of invalidity/ineffectiveness for Naftogaz' claim concerning Article 4.1 of the Contract (the price revision claim) has now been changed to 20 May 2011.

(3284) As regards Articles 2.2 and 2.2.5 and 3.10, 5.3 and 9.7 of the Contract (the non-price provision claims), the alleged date of invalidity is 19 January 2009, corresponding to the date the Contract was concluded.

[353] Naftogaz seems to suggest that a provision of the Contract in breach of Article18 EnCT as part of Ukrainian law is invalid. However, Naftogaz also seems to suggest that such a provision is ineffective.

(3285) Article 101(2) TFEU states that "[a]*ny agreements or decisions prohibited pursuant to this Article shall be automatically void*".

(3286) EU competition law only takes effect on the Contract insofar as clauses are actually in breach of EU competition law. For the reasons set out above, Gazprom does not accept that any of the impugned provisions of the Contract are in breach of EU competition law. Whether or not clauses are "ineffective" is of no relevance. The Arbitral Tribunal should therefore disregard Naftogaz' competition law claims insofar as they concern "ineffective clauses".

VIII.11.7.17.7.2 Invalidity based on the EnCT

(3287) Naftogaz also argues that a breach of Article 18 EnCT results in the same consequences as a breach of Articles 101 and 102 TFEU, i.e. invalidity.

(3288) Naftogaz does not deal specifically with the consequences of a breach of Article 18 EnCT. However, Naftogaz does provide arguments to this effect when it considers the conditions for direct effect.

(3289) As underlined by Naftogaz, Article 18(2) EnCT states that "*any practice to this Article shall be assessed on the basis of criteria arising from the application of the rules of Articles 81, 82 and 87 of the Treaty establishing the European Community*" (current Articles 101, 102 and 107 TFEU).

(3290) Naftogaz argues that the wording of Article 18(2) EnCT only deals with a situation when a practice has already been found to be contrary to Article 18(1) EnCT and that it is the consequences of such a breach that shall be assessed in light of the full *acquis communautaire* on competition. Thus, according to Naftogaz, the consequences of violating Article 18 EnCT are the same as under the EU rules on competition.

(3291) This reading of Article 18(2) EnCT is impossible to sustain in light of the wording and purpose of this provision and it is denied that any provision of the Contract is invalid or ineffective by reason of the EnCT.

(3292) The wording of Article 18(2) EnCT refers to "*practices contrary to this Article*". The wording used indicates that it is these practices that are meant to be assessed on the basis of criteria arising from the application of the rules of Articles 101, 102 and 107 TFEU. The literary meaning of the terms "*any practices contrary to this Article*" in Article 18(2) EnCT does not in any way imply that the Parties intended for this provision to refer to the *consequences* of a practice that has been found to be contrary to Article 18(1) EnCT. If the Parties intended for the consequences of a practice contrary to Article 18(1) EnCT to be assessed on the basis of criteria arising from the application of the rules of Articles 101, 102 and 107 TFEU, they would have used clear terms to that effect.

(3293) Moreover, the consequences of a breach of the EnCT are regulated in the EnCT itself. Such consequences may amount to a suspension of aspects of the EnCT, but they can never directly affect a contract in private law between two undertakings.

VIII.11.7.17.7.3 No ineffectiveness based on breach of Article 18 EnCT as part of Ukrainian law

(3294) It should initially be noted that it appears as if Naftogaz is using the terms "invalidity" and "ineffectiveness" interchangeably in its submissions concerning the consequences of a breach of Article 18 EnCT as part of Ukrainian law. It seems as if the intention is for these two terms to mean the same thing.

(3295) Naftogaz asserts that Article 18 EnCT constitutes mandatory Ukrainian law. Naftogaz puts forward that, although Ukrainian law "as such" is not applicable to the Contract pursuant to Swedish law, Ukrainian law "*nevertheless affects the performance of the obligations under the Contract*." Ukrainian law is, according to Naftogaz, "*facts that render provisions of the Contract ineffective*."

(3296) Naftogaz seems to suggest that the consequences of a breach of Article 18 EnCT as part of Ukrainian law should be interpreted in the same way as the consequences of Articles 101 and 102 TFEU. Based on this assertion, it seems as if Naftogaz puts forward that a provision of the Contract is invalid if it is found by the Tribunal to be in breach of Article 18 EnCT as part of Ukrainian law.

(3297) Gazprom denies that any of the provisions of the Contract are invalid or ineffective by reason of Article 18 EnCT as part of Ukrainian law.

(3298) The consequences of a breach of the EnCT are regulated in the EnCT itself. Such consequences may amount to a suspension of aspects of the EnCT, but they can never directly affect a contract in private law between two undertakings.

VIII.11.7.17.8 A finding of invalidity in respect of a provision of the Contract will not affect the validity of other clauses of the Contract or give the Tribunal a right to re-write the Contract

(3299) A breach of a specific provision of the Contract does not affect the validity of other clauses of the Contract.

VIII.11.7.17.8.1 A breach of a specific provision does not affect the validity of other provisions pursuant to EU Competition law and Swedish law

(3300) It is established under EU law that nullity applies only to those individual elements of an agreement which fall within the EU competition law prohibition.

(3301) Article 101(2) TFEU provides: "[a]*ny agreements or decisions prohibited pursuant to this Article shall be automatically void*."

(3302) Neither of the Parties requests the Tribunal to find that the Contract should be declared invalid in its entirety. Rather, the Parties agree that nullity applies only to those individual elements of an agreement which would fall within an EU competition law prohibition.

VIII.11.7.17.9 Replacement

(3303) It should be noted that Naftogaz does not seek replacement of all those Articles of the Contract that they claim to be invalid. Naftogaz states that the destination clause at Article 3.10 of the Contract cannot be replaced since any destination clause would be strictly prohibited under EU law. Also, Naftogaz states that the mandatory sales clause at Clause 9.7 of the Contract cannot be replaced since the very obligation to enter into a long term contract with "OOO Gazprom Sbyt Ukraine" is abusive.

(3304) Naftogaz seeks invalidity *and replacement* of the following clauses of the Contract : Article 4.1 (the price provisions), Articles 2.2 and 2.2.5 (the volume and take or pay provisions) and Article 5.3 of the Contract.

VIII.11.7.17.9.1 The Tribunal lacks jurisdiction and substantive power to determine Naftogaz' claims based on competition law and Clause 9.5 of the Contract, since the Tribunal has not been given jurisdiction or substantive power to revise or replace the Contract

(3305) Naftogaz relies on Article 9.5 of the Contract for its request to revise or replace Articles, 4.1, 2.2, 2.2.5 and 5.3 of the Contract due to competition law (Naftogaz' Claims 1.1 – 1.5, 6.1 and

6.3). It follows from paragraph 1(2) of the Swedish Arbitration Act that an arbitral tribunal lacks jurisdiction to fill in gaps in a contract (Sw. *komplettera*) beyond contractual interpretation without having been given mandate to do so.

(3306) A typical arbitration clause – including the SCC's standard arbitration clause and the arbitration clause in Article 8.2 of the Contract – does not give the Tribunal additional jurisdiction pursuant to Section 1(2) of the Swedish Arbitration Act. Such additional power must be given either directly in the arbitration clause, or indirectly in the contract.

(3307) What Naftogaz requests is not "*contractual interpretation*" in accordance with paragraph 1(2) of the Swedish Arbitration Act, but is gap filling. It is undisputed that an arbitral tribunal needs a specific mandate according to paragraph 1(2) of the Swedish Arbitration Act to settle a dispute which refers to gap filling where there is no basis for how the tribunal's discretion should be exercised.

(3308) In this case, the Tribunal has not – directly or indirectly by Articles 8.2, 9.5 or elsewhere – been given the jurisdiction to revise or replace the Contract in case of invalidity and/or ineffectiveness. In fact, Article 9.5 explicitly states that: "*If any of the provisions hereof becomes invalid or ineffective, <u>the Parties</u> shall endeavor to reach an agreement to replace such invalid or ineffective provision with a new one that would have the economic effect as close as possible to that of the invalid or ineffective provision.*" (emphasis added). Accordingly, the Contract expressly confers the task of replacing invalid or ineffective provisions to the parties, and not to a tribunal (or any other third party), and there is no legal basis for the replacement of invalid or ineffective provisions by the Tribunal.

(3309) It should in this context also be emphasized that, Article 8 of the Contract does not give the Tribunal power to revise the price formula.

(3310) Consequently, under no circumstances does Article 9.5 of the Contract give the Tribunal the authority to fill in gaps in the Contract pursuant to Section 1(2) of the Swedish Arbitration Act that would be necessary for the Tribunal to try Naftogaz' Claims 1.1 – 1.5, 6.1 and 6.3pursuant to competition law and Article 9.5.

(3311) For the reasons set out above, the Tribunal does not have jurisdiction in relation to Naftogaz' requests to revise Articles 4.1, 2.2, 2.2.5 and 5.3 of the Contract based on competition law and

Article 9.5. Claims 1.1 – 1.5, 6.1 and 6.3 should therefore be dismissed in this respect. If not dismissed, these claims should be rejected to the same extent and on the same basis.

VIII.11.7.17.9.2 The replacement clauses proposed by Naftogaz are not required by EU competition law

(3312) Moreover, even if the Tribunal finds that it can replace a provision of the Contract that it has found to be invalid or ineffective, it must do so in accordance with the agreement of the Parties as set out in Article 9.5 of the Contract.

(3313) Naftogaz argues that replacement provisions under Article 9.5 of the Contract should have "*the same economic effect as close as possible to that of the invalid or ineffective provision*", but that a new provision cannot be included in the Contract unless the new provision is "*compliant with applicable competition law and hence valid itself*". Naftogaz further argues that any new provisions must be "*as close as possible to the invalidated provisions (taking into consideration that the new provisions shall be valid under competition law*".

(3314) However, for the reasons set out below, even if Naftogaz would succeed in its competition law case (i.e. Naftogaz' case for invalidity/ineffectiveness) and the Tribunal would have jurisdiction and the substantive power to try Naftogaz' replacement claims, the replacement provisions set out by Naftogaz are not required by EU competition law. Accordingly, the economic effects of the requested provisions are not as close as possible to that of the invalid or ineffective provisions.

i.) The contract price: Article 4.1

(3315) The replacement price formula which Naftogaz proposes is a formula which is indexed entirely to German hub gas prices.[354] For the reasons set out above, German hub prices are *not* an appropriate comparator for the purposes of EU competition law, nor are they an appropriate index for the setting of gas prices in a long-term supply contract such as the Contract .

(3316) Moreover, there is nothing in applicable competition law which requires that gas prices in a long-term supply contract, such as the Contract , should be indexed to gas hub prices rather than (for instance) being indexed to oil prices. The EU Commission itself has recognised that there is nothing objectionable as a matter of EU competition law in oil-indexation of gas prices.

354 See Lapuerta Report 1, Section IV.D and Naftogaz' Statement of Claim, paragraph 1094.

In its press release commenting on its recent investigation into Gazprom, the Commission stated:

"*The Commission does not consider that indexing a product's price to oil products or any other product is in itself illegal.*"[355]

ii.) The volume and take or pay provisions: Articles 2.2 and 2.2.5

(3317) As regards the volume and take or pay provisions, Naftogaz' case is that it should be awarded:

(i) [redacted]

(ii) [redacted]

(3318) Naftogaz argues that "*the new volume and take or pay provisions shall apply only as from the date of the award (as revised take or pay provisions cannot reasonably be applied retroactively)*". However, there is no basis in Swedish law or EU competition law for such a restriction.

(3319) The ACV of [redacted] is calculated as 50% of [redacted] on the basis that, in the *E.ON* case, the German competition authorities prohibited contracts between a dominant gas importer and its customers with a term of more than four years if the contract covered more than 50% of a customer's actual demand. Naftogaz therefore accepts that a contract which covers 50% of a customer's actual demand is compatible with EU competition law.

(3320) The figure of [redacted] is itself derived from the lower of the figures cited by the Energy Community Secretariat for Naftogaz' foreign gas demand in 2012 to 2013.[356] However, Naftogaz' foreign gas demand is only a part of its actual demand. Naftogaz' actual demand constitutes all consumption in Ukraine (i.e. what the Secretariat describes as its total gas requirements, rather than its foreign gas demand). It is this volume of gas which Naftogaz has to procure in order to supply its customers, i.e. industrial and domestic users in Ukraine. It is a

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[355] European Commission, MEMO/15/4829, "*Antitrust: Commission sends Statement of Objections to Gazprom – Factsheet*", 22 April 2015.

[356] Page 15 of the Energy Community Secretariat's Preliminary Assessment of 25 July 2014 at Exhibit C-80.

matter for Naftogaz as to whether it procures its requirements of gas from domestic producers or foreign imports, but, Naftogaz' requirements constitute all the gas which it needs to procure in order to supply *its* customers in the Ukraine.

(3321) Moreover, it is the MAV (rather than the ACV) which constitutes the obligation on Naftogaz to take a certain volume of gas, as it is the MAV which obliges Naftogaz to off-take annually and pay for, or pay for if the volume of gas is made available by Gazprom but not off-taken by Naftogaz. The ACV does <u>not</u> constitute a purchasing obligation (it effectively gives Naftogaz an option to take a guaranteed volume). It is the MAV which constitutes the purchasing obligation. Therefore, it is the MAV (rather than the ACV) to which the 50% figure should apply.

(3322) When one considers Naftogaz' proposed MAV of [redacted] as against actual Ukrainian consumption over the relevant period (2009 to 2015), the proposed MAV accounts for between [redacted] of Naftogaz' actual demand.[357] This is well below the level even Naftogaz considers compatible with EU competition law. Therefore, Naftogaz' proposed replacement for Articles 2.2 and 2.2.5 of the Contract is not required by EU competition law even on Naftogaz' own case.

iii.) The unilateral suspension clause: Article 5.3

(3323) Naftogaz argues that Clause 5.3 should be replaced with a new provision whereby it "*effectively is given the same rights as Gazprom enjoys under the Contract*". Given that, as a matter of Swedish law, Naftogaz already has an equivalent right to suspend performance of the Contract, it is wholly unclear how such a replacement provision is said to be required by EU competition law.

VIII.11.7.17.9.3 Conclusion

(3324) The Tribunal lacks jurisdiction and the substantive power to determine Naftogaz' claims based on competition law and Article 9.5 of the Contract, since Article 9.5 does not give the Tribunal jurisdiction or substantive power to replace clauses in the Contract. These claims should therefore be dismissed or rejected. Moreover, even if Naftogaz was to succeed in its competition law case (i.e. Naftogaz' case for invalidity/ineffectiveness) and the Tribunal had jurisdiction and the substantive power to try Naftogaz' replacement claims, the economic effects

357 [redacted], paragraph 70.

of the requested provisions are not as close as possible to that of the invalid or ineffective provisions. The claims put forward in relation to invalidity and replacement should therefore, in any event, be rejected on this basis.

VIII.11.7.17.10 Repayment/ damages claim following invalidity of Article 4.1 of the Contract under competition law

(3325) Naftogaz claims repayment of alleged overpayments as from 20 May 2011, based on an alleged breach of competition law allegedly leading to invalidity of Clause 4.1, and a subsequent replacement based on Article 9.5 of the Contract.

(3326) As an alternative to repayment, Naftogaz now claims damages based on Chapter 3, Section 25 of the Swedish Competition Act.

VIII.11.7.17.10.1 Naftogaz's repayment claim

(3327) As set out above, Gazprom has not breached EU competition law and there is no basis for declaring Article 4.1 invalid or ineffective. Further, , Naftogaz' claim for replacement should be dismissed since Article 9.5 does not give the Tribunal authority to make such replacement. Naftogaz' claim for replacement based on Article 9.5 should in any event be rejected.

(3328) If the Tribunal, contrary to Gazprom's position, would conclude that Article 4.1 should be declared invalid/ineffective, and that it has the authority to replace Article 4.1 based on Article 9.5 of the Contract , with the price formula claimed by Naftogaz, then Gazprom denies that such replacement can take effect *retroactively*.

(3329) Naftogaz' claim for retroactive replacement is based on Article 9.5. However, this provision does not provide for any retroactive replacement in case of invalid contract provisions, and there is no other basis for retroactive replacement in the Contract or under Swedish law. Since no replacement can be made with retroactive effect, Naftogaz has no right to any repayment.

(3330) Should the Tribunal, contrary to Gazprom's position, conclude that a replacement based on Article 9.5 can take effect retroactively, then Naftogaz is still not entitled to any repayment of payments made before 27 April 2014. Gazprom invokes the same circumstances and arguments in defence of Naftogaz' repayment claim based on replacement by virtue ofArticle 9.5.

VIII.11.7.17.10.2 Naftogaz's damages claim

(3331) As an alternative to its claim for repayment, Naftogaz claims damages "*for any loss suffered by Naftogaz as a consequence of Gazprom's breach of applicable competition law*". Naftogaz refers to Chapter 3, Section 25 of the Swedish Competition Act as a basis for such damages claim.

(3332) Chapter 3, Section 25 of the Swedish Competition Act provides:

"*If an undertaking intentionally or negligently infringes any of the prohibitions contained in Chapter 2, Article 1 or 7, or in Article 101 or 102 in the Treaty, the undertaking shall compensate the damage that is caused thereby. The right to such damages shall lapse if no action is brought within ten years from the date when the damage was caused*."

(3333) Naftogaz asserts that: "*[a]s a dominant undertaking on the market for natural gas, Gazprom has been obliged to have knowledge of market prices on the gas market. Hence, Gazprom has at least been negligent when imposing an excessive price on Naftogaz*".

(3334) Gazprom denies Naftogaz' claim for damages in its entirety. As set out above, Gazprom has not committed any breach of EU competition law. In any event, Gazprom has not acted intentionally or negligently, which is a requirement for damages under Chapter 3, Section 25 of the Swedish Competition Act.

(3335) Such intentional or negligent acting must be attributable to a person having a leading position (Sw. *ledande ställning*) in the company. Naftogaz has not even suggested who at Gazprom would have acted intentionally or negligently in relation to the alleged breach of EU competition law.

(3336) Gazprom also notes that Naftogaz does not state at what point in time Gazprom allegedly acted negligently or what actual actions by relevant persons at Gazprom would constitute negligence. In any event, Gazprom including any relevant person at Gazprom has at no time acted negligently and Gazprom has not "*imposed an excessive price*" on Naftogaz. The price formula in Article 4.1 was the result of negotiations between the parties. Gazprom could not know how the contract price would develop based on the agreed formula and can consequently not have been negligent in that respect.

(3337) Further, Gazprom was never presented with the price formula claimed by Naftogaz in this Arbitration during the parties' negotiations and can therefore not have acted negligently by not accepting such price formula.

(3338) Gazprom also denies Naftogaz' statement that Gazprom "*has been obliged to have knowledge of market prices on the gas market*". Gazprom was under no such obligation. Moreover, Naftogaz does not clarify what prices or what market Gazprom should have known about. In any event, Gazprom has not been aware of the prices that Naftogaz now claims constitute the relevant market prices (i.e. German hub prices), even less so was Gazprom aware that such prices would be relevant for the Contract .

(3339) If the Tribunal would, contrary to Gazprom's position come to the conclusion that Gazprom has breached EU competition law intentionally or by negligence, then Naftogaz is still not entitled to damages. Naftogaz has not suffered any compensable damage and/or its right to damages is forfeited.

(3340) Gazprom also denies that there would be any causal link between Gazprom's alleged actions and Naftogaz' alleged damage. Gazprom further denies Naftogaz' calculation of damages. Naftogaz has not presented any underlying calculation for its damages claims.

(3341) Gazprom reserves the right to invoke further and other defences against Naftogaz'damages claim, should Naftogaz develop its claim.

VIII.11.7.18 Conclusion on Naftogaz' competition law claims

(3342) In summary, for the reasons set out above, Gazprom denies that Naftogaz is entitled to any of the reliefs it seeks on the basis of competition law.

VIII.11.8 Gazprom's position regarding Naftogaz' claims for relief

VIII.11.8.1 Gazprom's position in general regarding Naftogaz' claims for relief

VIII.11.8.1.1 Introduction

(3343) Gazprom's position in general regarding Naftogaz' claims for relief is as follows:

(i) Gazprom requests that the Tribunal dismisses *(Sw. avvisar)* Naftogaz' Claims 1.5, 3.1, 4.2, 5.1.1-5.2 and 6.1-6.4 for lack of specificity.

(ii) In addition, and as a consequence thereof, Gazprom requests that the Tribunal dismisses Naftogaz' Claims 2.1 and 2.2, 4.1, 4.2 and 5.1.1-5.2 to the extent that such claims depend on claims that lack specificity.

(iii)Gazprom requests that the Tribunal dismisses Naftogaz' action (Sw. *talan*) (including its Claims 1.1-1.5, 2.1, 2.2, 4.1- 4.2, 5.1.1-5.2, 6.1 and 6.3) for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to:

- Articles 4.4-4.4.2 of the Contract;
- Article 9.5 of the Contract;
- the alleged "*entitlement to economically market the supplied Natural Gas*", and/or
- any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3344) In any event, Gazprom denies all of Naftogaz' claims. Accordingly, if not dismissed, or to the extent that they are not dismissed, Gazprom requests that the Tribunal rejects on the merits (Sw. *ogillar*) all the claims for relief sought by Naftogaz.

VIII.11.8.1.2 Lack of specificity

(3345) If a request for relief is not specified in an arbitration under the SCC Rules, the Tribunal has a duty to dismiss such a claim. Gazprom refers to what has been stated in its Defence and Counterclaim and adds the following.

(3346) The requirement that the claimant should state the specific relief sought also protects the respondent, since the respondent needs to know the precise claim that is made against it in order to be able to safeguard its interests in the proceedings. The specific relief is also of key importance for a court's or a tribunal's assessment of the scope of its mandate, and also for the operation of the doctrine of *res judicata*.

VIII.11.8.1.2 Dismissal or rejection of Naftogaz' claims for lack of specificity

VIII.11.8.1.2.1 [redacted]

(3347) In relation to Naftogaz' Claim 1.5, this claim is unspecific because Naftogaz does not state explicitly what Naftogaz wishes the Tribunal to declare.

(3348) Naftogaz' alternative price revision claim in Claim 1.5 seeks a declaration by which the Tribunal is asked to re-write the terms of Article 4.1 of the Contract. However, Naftogaz fails to specify a) the effective date of any such requested declaration, b) the requested base price, P_0, c) the requested values of the gas price, H and H_0, and d) the requested weights of the prices of gas oil and fuel oil, G/G_0 and M/M_0. Accordingly, Naftogaz fails to state explicitly how the Contract price formula set out in Article 4.1 should be amended. Hence, Claim 1.5 is not specific enough in order to avoid doubts as to the content of the award claimed by Naftogaz. This is particularly the case since the various different parameters are interdependent. For example, the contract price, at any given time, is dependent on both the level of P_0 and the weight of the various fuel indices. Consequently, Naftogaz has failed to state explicitly what Naftogaz wishes the Tribunal to declare.

(3349) Further, since Naftogaz fails to state the effective date from which it seeks price revision, it is not possible to establish what *res judicata* effect an award would have if the claim for relief would be granted.

(3350) Naftogaz tries to justify its claim by referring to the principle *major includit minor*. However, a reference to the principle *major includit minor* does not make an unspecific claim acceptable. However, for the following reasons, the principle *major includit minor* – which implies that a court or a tribunal in some cases may give an award for something less than the amount requested by the claimant – has no relevance in relation to Naftogaz' price revision case. Naftogaz is not asking for payment of a lesser monetary amount (which is the usual situation in which the principle *major includit minor* operates). Instead, Naftogaz is asking the Tribunal to re-write Article 4.1 of the Contract in a different way. This is not something "less", but something "other", which would need to be specified. The Tribunal is not allowed to give an award for something "other" or "more" than what has properly been demanded by a party.

(3351) In particular:

(i) First, the principle *major includit minor* is not applicable in relation to the effective date from which Naftogaz seeks amendment of the price formula, since an award on a different effective date would be given for something "*other*" and not something "*less*" (as alleged by Naftogaz).

(ii) Second, the principle cannot be applied in relation to the requested values of [redacted] the requested weights of the prices of gas oil and fuel oil (G/G_0 and M/M_0), since a replacement of the fuel indices would mean that an award would be given for something "*other*", and not something "*less*", than that requested by Naftogaz. It goes without saying that a change of the weight of the fuel indices would lead to a price that would fluctuate, and accordingly the price would sometimes rise (i.e. the price would be "*more*" at certain times) and at other times the price would go down.

(iii)Third, as stated above, all parameters of the price revision claims are interdependent, meaning that it is impossible to anticipate the result of any such award.

(3352) In addition, it should be emphasised that Claim 1.5 means that Gazprom does not know the claim that is made against it in Claim 1.5. Thus, Gazprom is not sufficiently informed in order to be able to safeguard its interests in the proceedings. Gazprom is clearly not able to respond to the various possible changes of a) the effective date, b) the requested level of the base price, P_0, c) the requested amounts of the gas prices, H and H_0, and d) the requested weights of the fuel oil indices. Every single adjustment of these various different parameters would require expansion of the material circumstances and the evidence invoked by Naftogaz (in particular in relation to the expert witnesses). In this context, it should be noted that Naftogaz has not stated any material circumstances on which it relies in relation to the alleged alterations according to Claim 1.5. Accordingly, Gazprom has not been informed of what it should respond to.

(3353) In summary, therefore, Claim 1.5 does not fulfill the requirement in Article 24(1)(i) of the SCC Rules to state the specific relief sought and should therefore be dismissed. If not dismissed, Claim 1.5 should be rejected on the same basis

VIII.11.8.1.2.2 Claims 2.1 and 2.2

(3354) Naftogaz' Claims 2.1 and 2.2 relate to, and are conditional upon, *inter alia* the "*major includit minor*" claim (Claim 1.5). Consequently, since Claim 1.5 does not fulfill the requirement to state the specific relief sought, it also follows that Claims 2.1 and 2.2 are not sufficiently specified. Claims 2.1 and 2.2 should therefore be dismissed to the extent that they depend on Claim 1.5.

(3355) If not dismissed, or to the extent they are not dismissed, Claims 2.1 and 2.2 should be rejected on the same basis.

VIII.11.8.1.2.3 Claim 3.1

(3356) Naftogaz' Claim 3.1 is vague because Naftogaz fails to state explicitly and unequivocally what Naftogaz wishes the Tribunal to decide. Naftogaz merely states that the Tribunal shall declare that the factual price shall be USD [redacted] per 1,000 m^3 of Gas "*for as long as this price is* *market reflective*". The wording "*for as long as this price is market reflective*" makes Naftogaz' claim utterly unclear. Therefore, Claim 3.1 is not sufficiently specific to avoid any doubts as to the content of the award claimed by the claimant. Claim 3.1 does not fulfill the requirement in Article 24(1)(i) of the SCC Rules to state the specific relief sought and should therefore be dismissed.

(3357) If not dismissed, or to the extent it is not dismissed, Claim 3.1 should be rejected on the same basis.

VIII.11.8.1.2.4 Claim 4.1

(3358) Naftogaz' Claim 4.1 relates to, and is conditional upon, *inter alia*, the *major includit minor* claim (Claim 1.5) and Naftogaz' alternative claim based on [redacted] (Claim 3.1) which are unspecific. Consequently, since Claims 1.5 and 3.1 do not fulfill the requirement to state the specific relief sought, it also follows that Claim 4.1 is not sufficiently specified. Claim 4.1 should therefore be dismissed for lack of specification to the extent that it depends on Claim 1.5 or Claim 3.1.

(3359) If not dismissed, or to the extent it is not dismissed, Claims 2.1 and 2.2 should be rejected on the same basis.

VIII.11.8.1.2.5 Claim 4.2

(3360) In relation to Naftogaz' Claim 4.2, Naftogaz seeks monetary compensation from Gazprom without particularising the amount. As described at paragraph 49 of Gazprom's Defence and Counterclaim, if a claim for relief seeks monetary payment, a specific amount must be stated by the claimant. Furthermore, the wording of the claim is too unclear to be understood; it is, *inter alia*, unclear how this claim relates to Naftogaz' other claims.

(3361) Consequently, Claim 4.2 does not fulfill the requirement in Article 24(1)(i) of the SCC Rules to state the specific relief sought, and the claim should therefore be dismissed.

(3362) In any event, Naftogaz' Claim 4.2 relates to, and is conditional upon, *inter alia*, the *major includit minor* claim (Claim 1.5) and Naftogaz' alternative claim based on [redacted] (Claim 3.1) which are unspecific. Consequently, since Claims 1.5 and 3.1 do not fulfill the requirement to state the specific relief sought, it also follows that Claim 4.2 is not sufficiently specified. Claims 4.2 should therefore, in any event, be dismissed for lack of specification to the extent that it depends on Claim 1.5 or Claim 3.1.

(3363) If not dismissed, or to the extent it is not dismissed, Claim 4.2 should be rejected on the same basis.

VIII.11.8.1.2.6 Claims 5.1.1, 5.1.2, 5.1.3, 5.1.4 and 5.2

(3364) Following Naftogaz' adjustment to its interest claims (Claims 5.1 and 5.2), Gazprom does not maintain its objections that these claims lack specificity, with one exception. Gazprom maintains that, to the extent these claims relate to Claims 1.5 (*major includit minor*), 3.1 and/or 4.2, Claims 5.1 and 5.2 should be dismissed for lack of specificity. Gazprom refers to paragraph 1279 of its Rejoinder. This means that the objections set out in paragraphs 1271-1278 of the Rejoinder are not maintained.

(3365) Naftogaz' Claims 5.1.1-5.2 relate to, and are conditional upon, *inter alia*, the *major includit minor* claim (Claim 1.5), Naftogaz' alternative claim based on Addendum No. 29 (Claim 3.1) and the monetary claim for the period "*from and including 1 September 2015*" (Claim 4.2) which are unspecific. Consequently, since Claims 1.5, 3.1 and 4.2 do not fulfill the requirement to state the specific relief sought, it also follows that Claims 5.1.1-5.2 are not sufficiently specified. Claims 5.1.1-5.2 should therefore, in any event, be dismissed for lack of specification to the extent that they depend on Claim 1.5, 3.1 or 4.2.

(3366) If not dismissed, or to the extent they are not dismissed, Claims 5.1.1-5.2 should be rejected on the same basis.

VIII.11.8.1.2.7 Claims 6.1, 6.2, 6.3 and 6.4

(3367) In relation to Claims 6.1, 6.2, 6.3 and 6.4, Naftogaz fails to state each specific alternative effective date at which Articles 2.2, 2.2.5, 3.10, 5.3, and 9.7 of the Contract respectively are to be declared "*invalid or ineffective*". Naftogaz merely states that these articles should be declared invalid or ineffective "*with effect from 19 January 2009, <u>or alternatively the earliest following date as determined by the Tribunal</u>*" (emphasis added).

(3368) The lack of specificity in Claims 6.1, 6.2, 6.3 and 6.4 means that Gazprom is not sufficiently informed in order to be able to safeguard its interests in the proceedings. In this context it should be noted that Naftogaz does not state any material circumstances on which it relies in relation to its alternative requests for declarations with effect as of "*the earliest following date as determined by the Tribunal*".

(3369) In addition, since Naftogaz fails to state the effective date from which it seeks price revision, it is not possible to establish what *res judicata* effect an award would have if the claims were to be granted.

(3370) Consequently, Claims 6.1, 6.2, 6.3 and 6.4 do not fulfill the requirement in Article 24(1)(i) of the SCC Rules to state the specific relief sought, and should therefore be dismissed. If not dismissed, these claims should be rejected on the same basis.

VIII.11.8.1.3 Lack of jurisdiction or substantive power

VIII.11.8.1.3.1 Dismissal or rejection of Naftogaz' price revision claims

a) Claims 1.1-1.5

(3371) Naftogaz' Claims 1.1 – 1.5 are all claims for price revision. All such claims should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to:

(i) Articles 4.4.-4.4.2 of the Contract

(ii) Competition law and Article 9.5 of the contract

(iii)The alleged "*entitlement to economically market the supplied Natural Gas*", and/or

(iv)Any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3372) If not dismissed, or to the extent that they are not dismissed, Claims 1.1-1.5 should be rejected by the Tribunal on the same basis.

b) Claims 4.1, 4.2 and 5.1.1-5.2

(3373) Further, Claims 4.1, 4.2 and 5.1.1- 5.2 are all claims for repayment, damages or interest related to the price revision claims set out in Claims 1.1-1.5. Since the Tribunal lacks jurisdiction to determine Naftogaz' Claims 1.1-1.5 to the extent stated above, the Tribunal accordingly also lacks jurisdiction in relation to Claims 4.1, 4.2 and 5.1.1-5.2, and those Claims should therefore be dismissed, to the same extent. If not dismissed, or to the extent that they are not dismissed, Claims 4.1, 4.2 and 5.1.1-5.2 should be rejected by the Tribunal on the same basis.

c) Claims 2.1 and 2.2

(3374) Further, Naftogaz' Claims 2.1 and 2.2 also relate to, and are conditional upon, the price revision claims. Since the Tribunal lacks jurisdiction to determine Naftogaz' price revision claims to the extent stated above, the Tribunal accordingly also lacks jurisdiction in relation to Claims 2.1 and 2.2, and those Claims should therefore be dismissed, to the same extent. If not dismissed, or to the extent that they are not dismissed, Claims 2.1 and 2.2 should be rejected by the Tribunal on the same basis.

VIII.11.8.1.3.2 Dismissal or rejection of Naftogaz' invalidity/ineffectiveness and replacement claims in relation to the non-pricing provisions

(3375) Naftogaz' Claims 6.1 and 6.3 are invalidity/ineffectiveness and replacement claims based on competition law and Article 9.5 of the Contract, or alternatively Section 36 of the Swedish Contracts Act. The Tribunal has no jurisdiction or substantive power to determine Naftogaz' invalidity/ineffectiveness and replacement claims on this basis, since neither competition law nor Article 9.5 of the Contract gives the Tribunal jurisdiction or substantive power to re-write the Contract.

(3376) Consequently, Claims 6.1 and 6.3 should be dismissed to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace or in any other way amend the Contract pursuant to any other legal ground, other than Section 36 of the Swedish Contracts Act. If not dismissed, or to the extent that they are not dismissed, Claims 6.1 and 6.3 should be rejected on the same basis

IX. RELIEF SOUGHT BY THE PARTIES

IX.1 Relief Sought by Naftogaz[358]

IX.1.1 Request 1

(3377) In relation to the price revision claims based principally on Article 4.4 of the Contract, alternatively on Naftogaz' inherent entitlement to economically market the supplied Natural Gas, Section 36 of the Contracts Act, or on the entitlement to economically market the supplied Natural Gas in conjunction with Section 36, and further in the alternative based on competition law and Article 9.5 of the Contract.

IX.1.2 Request 1.1

(3378) Principally, with reference to Naftogaz' 20 May 2011 request for price revision and the end of period approach.

(3379) Declaring that with effect as of 20 May 2011, Article 4.1 shall read as follows:

"The Contract Price for the Natural Gas having the basic net calorific value of [redacted]*/m³ and delivered hereunder shall be calculated on a* [redacted] *basis according to the following formula:*

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[358] See (349) above.

[redacted]

[redacted]

[redacted]

[redacted]	
[redacted]	[redacted]
[redacted]	
[redacted]	[redacted]
[redacted]	
	[redacted]
[redacted]	
[redacted]	[redacted]

[redacted]

[redacted]

[redacted]

Rounding shall be carried out by discarding the digit next to the digit being rounded, if the discarded digit is a number from 0 through 4 inclusive, or by adding one to the digit being rounded, if the discarded digit is a number from 5 through 9."

IX.1.3 Request 1.2

(3380) In the alternative to request 1.1 above, with reference to Naftogaz' 20 May 2011 request for price revision and the delta of deltas approach.

(3381) Declaring that with effect as of 20 May 2011, Article 4.1 shall read as under 1.1) above, except that the [redacted] shall read:

[redacted]

IX.1.4 Request 1.3.1

(3382) In the alternative to requests 1.1 and 1.2 above, with reference to Naftogaz' 17 June 2011 letter to Gazprom and the end of period approach.

(3383) Declaring that with effect as of 17 June 2011, Article 4.1 shall read as under 1.1) above.

IX.1.5 Request 1.3.2

(3384) In the alternative to request 1.3.1 above, with reference to Naftogaz' 17 June 2011 letter to Gazprom and the delta of deltas approach.

(3385) Declaring that with effect as of 17 June 2011, Article 4.1 shall read as under 1.1) above, except that the [redacted] shall read:

[redacted]

IX.1.6 Request 1.4.1

(3386) In the alternative to requests 1.1 to 1.3.2 above, with reference to Naftogaz' 27 April 2014 Notification of dispute and request for negotiations and consultations and also notification of arbitration, and the end of period approach.

(3387) Declaring that with effect as of 27 April 2014, Article 4.1 shall read as under 1.1) above, except that the [redacted] shall read:

[redacted]

[redacted]

[redacted]

IX.1.7 Request 1.4.2

(3388) In the alternative to request 1.4.1 above, with reference to Naftogaz' 27 April 2014 Notification of dispute and request for negotiations and consultations and also notification of arbitration, and the delta of deltas approach

(3389) Declaring that with effect as of 27 April 2014, Article 4.1 shall read as under 1.4.1 above, except that the definition of P_0 shall read:

[redacted]

IX.1.8 Request 1.5

(3390) In relation to requests 1.1) to 1.4.2) above, based on major includit minor

(3391) Declaring that with effect as of 20 May 2011 (or a later date as the Tribunal shall determine), P_0 is reduced as the Tribunal shall determine, and/or the price of natural gas as defined under 1.1) above (H/H_0) is introduced as an index in the escalation supplement with a lower weight than one (1) as the Tribunal shall determine, and the weights of the prices of gas oil and fuel oil in the escalation supplement (G/G_0 and M/M_0) are pro-rata reduced correspondingly to give the indices in the escalation supplement a total weight of one (1).

IX.1.9 Request 2

(3392) In relation to the price revision and price determination claims.

IX.1.10 Request 2.1

(3393) Principally, and in addition to the requests 1 above, based on [redacted] to the Contract.

(3394) Declaring that as from [redacted]

IX.1.11 Request 2.2

(3395) In the alternative to the requests 1-2.1 above.

(3396) As under requests 1.1-1.5 above alone, [redacted]

IX.1.12 Request 3

(3397) In relation to the [redacted]

IX.1.13 Request 3.1

(3398) In the alternative to claims 1.1-2.2) above, based on [redacted] to the Contract.

(3399) [redacted]

IX.1.14 Request 3.2

(3400) In the alternative to claims under requests 1.1-3.1 above, based on [redacted] the Contract.

(3401) [redacted]

IX.1.15 Request 4

(3402) Naftogaz' monetary claim (see also Appendices 1, 2 and 3).

IX.1.16 Request 4.1

(3403) For the period from 20 May 2011 to and including 30 April 2016.

(3404) Naftogaz requests the Tribunal to [redacted] as the case may be, the factual price, as determined by the Tribunal's award, principally USD 14,289,418,005.43.

IX.1.17 Request 4.2

(3405) For the period from and including 1 May 2016.

(3406) Naftogaz requests the Tribunal to declare that Gazprom is obliged to pay to Naftogaz the amount of money that equates to the part of all monthly payments made for Natural Gas delivered under the Contract from and including 1 May 2016 to the date of the award exceeding the applicable factual price calculated pursuant to the price provisions of the Contract based on the Contract Price and/or, as the case may be, the factual price, as determined by the Tribunal's award.

IX.1.18 Request 5

(3407) Naftogaz' interest claims (see also Appendix 3).

IX.1.19 Request 5.1

(3408) In relation to overpaid amounts.

IX.1.20 Request 5.1.1

(3409) Naftogaz requests the Tribunal to order Gazprom to pay interest on each partial capital amount described in Appendix 3 (each a "**Capital Amount**") and where the date of payment (as specified in Appendix 3 ("**Date of Payment**") falls *before 17 June 2014*:

(i) in accordance with Section 2 and 5 of the Swedish Interest Act (1975:635) ("**Yield Interest**") from and including the day after the Date of Payment of such amount up to and including 17 June 2014 (if later) and pursuant to Section 6 of the Swedish Interest Act (1975:635) ("**Delay Interest**") from and including 18 June 2014 until full payment is made; or alternatively

(ii) Yield Interest from and including the day after the Date of Payment of such amount up to and including 31 January 2015 and Delay Interest from and including 1 February 2015 until full payment is made; or alternatively

(iii) Yield Interest from and including the day after the Date of Payment of such amount up to and including 8 October 2015 and Delay Interest from and including 9 October 2015 until full payment is made; or alternatively

(iv) Yield Interest from and including the day after the Date of Payment of such amount up to and including the date of the award and Delay Interest from the date of the award until full payment is made; or alternatively

(v) Delay Interest from the date of the award until full payment is made.

IX.1.21 Request 5.1.2

(3410) Naftogaz requests the Tribunal to order Gazprom to pay interest on each Capital Amount where the Date of Payment falls on or after 17 June 2014 but *before 31 January 2015*:

(3411) Delay Interest from and including the day after the Date of Payment of such amount until full payment is made; or alternatively

(i) Yield Interest from and including the day after the Date of Payment of such amount up to and including 31 January 2015 and Delay Interest from and including 1 February 2015 until full payment is made; or alternatively.

(ii) Yield Interest from and including the day after the Date of Payment of such amount up to and including 8 October 2015 and Delay Interest from and including 9 October 2015 until full payment is made; or alternatively

(iii)Yield Interest from and including the day after the Date of Payment of such amount up to and including the date of the award and Delay Interest from and including the date of the award until full payment is made; or alternatively

(iv)Delay Interest from the date of the award until full payment is made.

IX.1.22 Request 5.1.3

(3412) Naftogaz requests the Tribunal to order Gazprom to pay interest on each Capital Amount where the Date of Payment falls on or after 31 January 2015 but *before 8 October 2015*:

(i) Delay Interest from and including the day after the Date of Payment of such amount until full payment is made; or alternatively

(ii) Yield Interest from and including the day after the Date of Payment of such amount up to and including 8 October 2015 and Delay Interest from and including 9 October 2015 until full payment is made; or alternatively

(iii) Yield Interest from and including the day after the Date of Payment of such amount up to and including the date of the award and Delay Interest from and including the date of the award until full payment is made; or alternatively

(iv) Delay Interest from the date of the award until full payment is made.

IX.1.23 Request 5.1.4

(3413) Naftogaz requests the Tribunal to order Gazprom to pay interest on each Capital Amount where the Date of Payment falls on or after 8 October 2015 but *before the date of the award*:

(i) Delay Interest from and including the day after the Date of Payment of such amount until full payment is made; or alternatively

(ii) Yield Interest from and including the day after the Date of Payment of such amount up to and including the date of the award and Delay Interest from and including the date of the award until full payment is made; or alternatively

(iii) Delay Interest from the date of the award until full payment is made.

IX.1.24 Request 5.2

(3414) In relation to damages for the loss of opportunity.

(3415) In addition, Naftogaz requests the Tribunal to order Gazprom to pay interest on each Capital Amount awarded under 4) but on which no interest is awarded under request 5.1) according to the following:

(i) on Capital Amounts where the Date of Payment is before 18 June 2014, Delay Interest on each such Capital Amount from and including 18 June 2014 until full payment is made; and

(ii) on Capital Amounts where the Date of Payment is before 1 February 2015 and where interest has not been awarded under (a) above, Delay Interest on each such Capital Amount from and including (i) the day after the Date of Payment of such amount until full payment is made; or alternatively (ii) 1 February 2015 until full payment is made; and

(iii) on Capital Amounts where the Date of Payment is before 8 October 2015 and where interest has not been awarded under (a) or (b) above, Delay Interest on each such Capital Amount from and including (i) the day after the Date of Payment of such amount until full payment is made; or alternatively (ii) 9 October 2015 until full payment is made; and

(iv) on Capital Amounts where the Date of Payment is before the date of the award and where interest has not been awarded under (a) – (c) above, Delay Interest on each such Capital Amount from and including the day after the Date of Payment of such amount until full payment is made;

(v) on any Capital Amount where interest has not been awarded under (a) – (d) above, Delay Interest on each such Capital Amount from and including the date of the award until full payment is made; and

(vi) on each Capital Amount, Yield interest from and including the day after the Date of Payment of such amount up to and including the day before Delay Interest is awarded on such Capital Amount.

IX.1.25 Request 6

(3416) In relation to the claims for declaratory relief concerning non-price provisions.

IX.1.26 Request 6.1

(3417) In relation to Articles 2.2 and 2.2.5, based on competition law or contract law.

(3418) Declaring that with effect from 19 January 2009, or alternatively the earliest following date as determined by the Tribunal, Article 2.2 is invalid or ineffective;

(3419) Declaring that with effect from the date of the award, Article 2.2 is replaced with a new provision which reads

[redacted]

(3420) Declaring that with effect from 19 January 2009, or alternatively the earliest following date as determined by the Tribunal, Article 2.2.5 is invalid or ineffective; and

(3421) Subject to the Tribunal awarding any of the reliefs in 1.1) to and including 1.4.2), declaring that with effect from the date of the award, Article 2.2.5 is replaced with a new provision which reads:

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

IX.1.27 Request 6.2

(3422) In relation to Article 3.10, based on competition law or contract law.

(3423) Declaring that with effect from 19 January 2009, or alternatively the earliest following date as determined by the Tribunal, Article 3.10 is invalid or ineffective.

IX.1.28 Request 6.3

(3424) In relation to Article 5.3, based on competition law or contract law.

(3425) Declaring that with effect from 19 January 2009, or alternatively the earliest following date as determined by the Tribunal, Article 5.3 is invalid or ineffective; and

(3426) Declaring that with effect from the date of the award, Article 5.3 is replaced with a new provision which reads:

[redacted]

[redacted]

IX.1.29 Request 6.4

(3427) In relation to Article 9.7, based on competition law or contract law.

(3428) Declaring that with effect from 19 January 2009, or alternatively the earliest following date as determined by the Tribunal, Article 9.7 is invalid or ineffective.

IX.1.30 Request 7

(3429) In relation to Gazprom's counterclaims.

(3430) Rejecting Gazprom's counterclaims in their entirety.

IX.1.31 Request 8

(3431) In relation to requests 1.1 to 7 above.

(3432) Ordering Gazprom to compensate Naftogaz for its costs of arbitration in an amount to be specified later together with interest pursuant to Section 6 of the Swedish Interest Act (Swedish *räntelagen (1975:635)*) as from the date following the final award until full payment is made and, as between the Parties, alone to bear the arbitrators' fees and expenses and the SCC administrative expenses, and to compensate Naftogaz for any amounts that Naftogaz has paid or will pay to the SCC in relation to the arbitration including, but not limited to, Naftogaz' part of the advance on costs.

(3433) Naftogaz' monetary claims, capital amounts, are specified in Appendices to Annex 1 – Relief Sought to Naftogaz' Post-Hearing Brief.

IX.2 Relief Sought by Gazprom[359]

IX.2.1 Gazprom's specific claims for relief

IX.2.1.1 Monetary Claims

(3434) Gazprom seeks the following monetary claims.

(3435) An ORDER that Naftogaz makes payment to Gazprom, in respect of its Supply Claims concerning gas delivered in December 2013, of the outstanding amount of USD 1,527,971.32

[359] See (349) above.

(3436) An ORDER that Naftogaz makes payment to Gazprom, in respect of its Supply Claims concerning gas delivered in May and June 2014, of the outstanding amount of USD 2,195,069,643.37.

(3437) An ORDER that Naftogaz makes payment to Gazprom in respect of its Take or Pay Claim for 2012 in the amount of USD 7,087,648,811.36.

(3438) An ORDER that Naftogaz makes payment to Gazprom in respect of its Take or Pay Claim for 2013 in the amount of USD 11,387,961,390.02.

(3439) An ORDER that Naftogaz makes payment to Gazprom in respect of its Take or Pay Claim for 2014 in the amount of USD 8,196,987,377.26.

(3440) An ORDER that Naftogaz makes payment to Gazprom in respect of its Take or Pay Claim for 2015 in the amount of $2,549,796,811.06.

XI.2.1.2 Interest Claims

(3441) Gazprom seeks the following Interest Claims:

(3442) In respect of **gas delivered in February and March 2014,** an ORDER that Naftogaz makes payment to Gazprom of late payment interest (accrued pursuant to Article 6.2 of the Contract on the overdue amounts at the rate of 0.03% on the overdue amounts for each day of delay in payment) in the amount of USD 13,076,056.27.

(3443) In addition and in respect of gas delivered in April, May and June 2014, an ORDER that Naftogaz makes payment to Gazprom of late payment interest (accrued pursuant to Article 6.2 of the Contract on the overdue amounts at the rate of 0.03% on the overdue amounts for each day of delay in payment over the period from 8 May 2014 to 30 May 2015) in the amount of USD 326,635,833.75.

(3444) In addition and in respect of **gas delivered in May and June 2014** an ORDER that Naftogaz makes payment to Gazprom of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 2,195,069,643.37 for each day of delay in payment from 31 May 2015 until full payment has been made.

(3445) In addition and in respect of **gas delivered in July 2015** an ORDER that Naftogaz makes payment to Gazprom of late payment interest (accrued pursuant to Article 6.2 of the Contract on the overdue amount at the rate of 0.03% on the overdue amount for each day of delay in payment) over the period from 8 August 2015 to 10 August 2015 in the amount of USD 920.688.27.

(3446) In addition and in respect of its **Take or Pay Claim for 2012**, an ORDER that Naftogaz makes payment to Gazprom of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 7,087,648,811.36 for each day of delay in payment from 1 February 2013 until full payment has been made; or alternatively an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 7,087,648,811.36 from and including 16 February 2013 until full payment has been made.

(3447) In addition and in respect of the **Take or Pay Claim for 2013**, an ORDER that Naftogaz makes payment to Gazprom of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 11,387,961,390.02 for each day of delay in payment from 4 May 2014 until full payment has been made; or alternatively an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 11,387,961,390.02 from and including 24 May 2014 until full payment has been made.

(3448) In addition and in respect of the **Take or Pay Claim for 2014**, an ORDER that Naftogaz makes payment to Gazprom of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 8,196,987,377.26 for each day of delay in payment from 8 June 2015 until full payment has been made; or alternatively an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 8,196,987,377.26 from and including 27 June 2015 until full payment has been made.

(3449) In addition and in respect of the **Take or Pay Claim for 2015**, an ORDER that Naftogaz makes payment to Gazprom of late payment interest accruing pursuant to Article 6.2 of the Contract at the rate of 0.03% on the overdue amount of USD 2,549,796,811.06 for each day of delay in payment from 30 January 2016 until full payment has been made; or alternatively an ORDER that Naftogaz makes payment to Gazprom of delay interest pursuant to Section 6 of the Swedish Interest Act on the overdue amount of USD 2,549,796,811.06 from and including 20 February 2016 until full payment has been made.

IX.2.1.3 Claim for dismissal of Naftogaz' defence

(3450) Gazprom also makes a claim for dismissal of Naftogaz' defence, as follows:

(3451) Gazprom requests that the Tribunal dismisses Naftogaz' action (Sw. *talan*) in relation to Naftogaz' defence to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act. Alternatively, Gazprom requests that the Tribunal limits the effects of any invalidity so far as possible.

IX.2.1.4 Alternative claim to limit the effects of any alleged invalidity

(3452) Further, to the extent that Naftogaz were to succeed in any of its claims to invalidate any of the provisions of The Contract, Gazprom also makes a claim to limit the effects of any such invalidity, as follows:

Gazprom requests that the Tribunal limits the effects of any invalidity so far as possible.

IX.2.2 Gazprom's position as regards Naftogaz' claim for relief

IX.2.2.1 Naftogaz' principal price revision claim (Claim 1.1)

(3453) Naftogaz' principal "*price revision*" claim for a declaration (Claim 1.1) should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) competition law and Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3454) If not dismissed, or to the extent that it is not dismissed, Claim 1.1 should be rejected on the merits by the Tribunal.

IX.2.2.2 Naftogaz' alternative price revision claims (Claims 1.2, 1.3.1, 1.3.2, 1.4.1 and 1.4.2)

(3455) Naftogaz' alternative "*price revision*" claims for declaration (Claims 1.2, 1.3.1, 1.3.2, 1.4.1 and 1.4.2) should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) Articles 4.4-4.4.2 of the Contract, (ii) competition law and Article 9.5

of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3456) If not dismissed, or to the extent that they are not dismissed, Claims 1.2, 1.3.1, 1.3.2, 1.4.1 and 1.4.2 should be rejected on the merits by the Tribunal.

IX.2.2.3 Naftogaz' price revision claim based on the principle "*major includit minor*" (Claim 1.5)

(3457) Naftogaz' "*price revision*" claim for a declaration based on the principle *major includit minor* (Claim 1.5) should be dismissed for lack of specificity.

(3458) In any event, Claim 1.5 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) competition law and Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3459) If not dismissed, or to the extent that it is not dismissed, Claim 1.5 should be rejected on the merits by the Tribunal.

IX.2.2.4 Naftogaz' claims dependent on the price revision claims (Claims 2.1 and 2.2)

(3460) Naftogaz' Claims 2.1 and 2.2 should be dismissed to the extent that they depend on Claim 1.5, since Claim 1.5 is unspecific (see item 3) above).

(3461) In any event, Claims 2.1 and 2.2 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) competition law and Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3462) If not dismissed, or to the extent that they are not dismissed, Claims 2.1 and 2.2 should be rejected on the merits by the Tribunal.

IX.2.2.5 Naftogaz' alternative price determination claim [redacted] (Claim 3.1)

(3463) Naftogaz' [redacted]

(3464) If not dismissed, or to the extent that it is not dismissed, Claim 3.1 should be rejected on the merits by the Tribunal.

IX.2.2.6 Naftogaz' [redacted]

(3465) Naftogaz' alternative claim based [redacted]

IX.2.2.7 Naftogaz' monetary claim for the period "*from 20 May 2011 to and including 31 August 2015*" (Claim 4.1)

(3466) Naftogaz' monetary claim for the period "*from 20 May 2011 to and including 31 August 2015*" (Claim 4.1) should be dismissed to the extent that it depends on the *major includit minor* claim (Claim 1.5) and Naftogaz' alternative claim based on [redacted] (Claim 3.1) which are unspecific (see items 3) and 5) above).

(3467) In any event, Claim 4.1 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) competition law and Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3468) If not dismissed, or to the extent that it is not dismissed, Claim 4.1 should be rejected on the merits by the Tribunal.

IX.2.2.8 Naftogaz' monetary claim for the period "*from and including 1 September 2015*" (Claim 4.2)

(3469) Naftogaz' monetary claim for the period "*from and including 1 September 2015*" (Claim 4.2) should be dismissed since it is unspecified.

(3470) Further, Naftogaz' Claim 4.2 should be dismissed to the extent that it depends on the *major includit minor* claim (Claim 1.5) and Naftogaz' alternative claim based on [redacted] (Claim 3.1) which are unspecific (see items 3) and 5) above).

(3471) In any event, Claim 4.2 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) competition law and Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3472) If not dismissed, or to the extent that it is not dismissed, Claim 4.2 should be rejected on the merits by the Tribunal.

IX.2.2.9 Naftogaz' interest claims (Claims 5.1.1, 5.1.2, 5.1.3, 5.1.4 and 5.2)

(3473) Naftogaz' Claims 5.1.1-5.2 should be dismissed to the extent that they depend on the *major includit minor* claim (Claim 1.5), Naftogaz' alternative claim based on Addendum No. 29 (Claim 3.1) and the monetary claim for the period "*from and including 1 September 2015*" (Claim 4.2) which are unspecific.

(3474) Moreover, Claims 5.1.1-5.2 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace or in any other way amend the Contract pursuant to (i) Articles 4.4 to 4.4.2 of the Contract, (ii) competition law and Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3475) If not dismissed, or to the extent that they are not dismissed, Claims 5.1.1, 5.1.2, 5.1.3, 5.1.4 and 5.2 should be rejected on the merits by the Tribunal.

IX.2.2.10 Naftogaz' claim in relation to competition law or contract law regarding Articles 2.2 and 2.2.5 of the Contract (Claim 6.1)

(3476) Naftogaz' claim in relation to competition law or contract law for a declaration regarding the invalidity/ineffectiveness and replacement of Articles 2.2 and 2.2.5 of the Contract (the Annual

Contract Volume and the Minimum Annual Volume) (Claim 6.1) should be dismissed since it is unspecified.

(3477) In any event, Claim 6.1 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) competition law and Article 9.5 of the Contract, (ii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iii) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3478) If not dismissed, or to the extent that it is not dismissed, Claim 6.1 should be rejected on the merits by the Tribunal.

IX.2.2.11 Naftogaz' claim in relation to competition law regarding Article 3.10 of the Contract (Claim 6.2)

(3479) Naftogaz' claim in relation to competition law for a declaration regarding the invalidity / ineffectiveness of Article 3.10 of the Contract (the destination clause) (Claim 6.2) should be dismissed since it is unspecified.

(3480) If not dismissed, or to the extent that it is not dismissed, Claim 6.2 should be rejected on the merits by the Tribunal.

IX.2.2.12 Naftogaz' claim in relation to competition law regarding Article 5.3 of the Contract (Claim 6.3)

(3481) Naftogaz' claim in relation to competition law for a declaration regarding the invalidity and replacement of Article 5.3 of the Contract (the unilateral suspension clause) (Claim 6.3) should be dismissed since it is unspecified.

(3482) In any event, Claim 6.3 should be dismissed for lack of jurisdiction to the extent that Naftogaz' action relies on the alleged power of the Tribunal to revise, replace, adjust, or in any other way amend the Contract pursuant to (i) competition law and Article 9.5 of the Contract, (ii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iii) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3483) If not dismissed, or to the extent that it is not dismissed, Claim 6.3 should be rejected on the merits by the Tribunal.

IX.2.2.13 Naftogaz' claim in relation to competition law regarding Article 9.7 of the Contract (Claim 6.4)

(3484) Naftogaz' claim in relation to competition law for a declaration regarding the invalidity/ineffectiveness of Article 9.7 of the Contract (the undertaking with respect to gas delivery) (Claim 6.4) should be dismissed since it is unspecified.

(3485) If not dismissed, or to the extent that it is not dismissed, Claim 6.4 should be rejected on the merits by the Tribunal.

IX.2.2.14 Naftogaz' claim in respect of Gazprom's counterclaims (Claim 7)

(3486) In respect of Naftogaz' defence to Gazprom's counterclaim (Sw. *genkäromål*), Gazprom maintains its counterclaim, subject to the adjustments and additions set out below.

(3487) Gazprom requests that the Tribunal dismisses Naftogaz' defence to Gazprom's counterclaim for lack of jurisdiction to the extent that Naftogaz' action relies on and/or relates to the alleged power of the Tribunal to revise, replace, adjust or in any other way amend the Contract pursuant to (i) Competition Law and Articles 4.4 to 4.4.2 of the Contract, (ii) Article 9.5 of the Contract, (iii) the alleged "*entitlement to economically market the supplied Natural Gas*", and/or (iv) any other legal ground, other than Section 36 of the Swedish Contracts Act.

(3488) If not dismissed, or to such extent that it is not dismissed, Claim 7 should be rejected on the merits by the Tribunal.

IX.2.2.15 Naftogaz' claim in respect of costs (Claim 8)

(3489) Naftogaz' claim in respect of costs (Claim 8) should be rejected on the merits by the Tribunal.

X. THE TRIBUNAL’S REASONS

X.1 Introduction

(3490) In deciding the Parties’ claims, as set out in this Award, the Tribunal has carefully considered all of the submissions made and evidence adduced by the Parties, including allegations, witness/expert statements, legal authorities, and arguments not mentioned in the discussion below or otherwise in this Award. The reasoning given below summarizes what the Tribunal considers relevant for its decisions. If and to the extent that facts, witness/expert statements, legal authorities, or arguments advanced by the Parties are not addressed in the reasoning, they would not have changed the Tribunal’s conclusions.

(3491) The Tribunal has taken into account the cross-references to the Transit Arbitration made by the Parties regarding some factual matters and related evidence as to the calculation of netback costs as well as to legal arguments relating to competition law.

(3492) On the basis of its decision to render a Separate Award in accordance with Article 38 of the SCC Rules (cf. Section 29 of the Swedish Arbitration Act) disposing of the issues of fact and law required to decide:

(i) Whether there is a right to price revision;
(ii) Whether there is a right to price determination;
(iii) Whether Gazprom has a right to take or pay payments;
(iv) What the price will be for off-taken gas but not paid for; and
(v) Whether one or more contractual provisions shall be declared void or ineffective,

and, thus, leaving all resulting outstanding issues, including quantum and claims for set-off or “*netting*”, to be determined by agreement of the Parties or decided by the Tribunal in its Final Award after further proceedings in the Arbitration, here the Tribunal limits its Reasons to the following.

X.1.1 Jura novit curia

(3493) The Tribunal has concluded, and made it clear to the Parties, that it will not apply the doctrine of “*jura novit curia*” in this Arbitration being an international arbitration between non-Swedish Parties. Needless to say, this does not apply as far as applicable mandatory law is concerned.

X.1.2 Issues of interpretation of the Contract

(3494) The answer to many of the issues in the Arbitration requires an interpretation of the Contract and the Parties' intentions.

(3495) The relationship between Gazprom and Naftogaz is not merely a normal commercial relationship. With the two states controlling the Parties, and the importance to the economy of Russia and of Ukraine of the Contract, in combination with the Transit Contract, the relationship has also been political. Russia and Ukraine, and Gazprom and Naftogaz, have had longstanding relations where considerations other than merely commercial considerations have often been decisive.

(3496) Although the intention has been to move into a new, more "*European*" relationship when the two Contracts were entered into in 2009, the special circumstances of the relationship continued also after 2009. Also after the entering into the Contracts in 2009, the political leaders of the two states have intervened.[360]

(3497) These circumstances have to be considered in the interpretation of the Contract. Needless to say, the case has, however, been examined by the Tribunal from a strictly legal point of view.

(3498) Further, the interpretation is complicated by the Contract in some decisive aspects being unprecise and simplistic, and its provisions not also being very well formulated. The Contract text may well reflect mutual intentions, but not necessarily exhaustively.

(3499) In many instances, there is little or no evidence regarding which intentions the Parties had, and sometimes it seems as if the Parties have not given any thought to what the Contract terms should mean.

(3500) The Parties often rely on their experts' findings and conclusions regarding factual matters, and the Parties sometimes base their conclusions on the experts' interpretation of the Contract. However, the expert reports are in many respects based on approximations, and on uncertain or incomplete data, which leads to uncertainties or doubts regarding their conclusions.[361]

[360] This is the case notwithstanding the declarations in the Memorandum of Understanding [redacted] is a clear example of a confounding of political and commercial interests.
[361] For example, Dr. Moselle uses import prices as a proxy for prices of long term gas supply contracts which makes it necessary for him to make corrections for that purpose, Dr. Moselle Expert report, §§ 2.54, 4.20, 98, and Appendix 6. Another example is the calculations made by Dr. Hesmondhalgh and Mr. Way of Naftogaz' price revision claims (net-back calculations, wholesale margins, bid-versus-mid prices, etc.).

(3501) Further, conclusions of the experts do not always strictly follow from their factual findings, and sometimes they tend to be legal rather than factual. These circumstances entail complications, when assessing the expert reports and in determining the disputed issues.

(3502) Absent any clear basis for attributing a particular meaning to a provision of the Contract, the Tribunal will have to interpret such provision in accordance with Swedish law regarding interpretation of contracts, which essentially means interpreting the provisions in accordance with the plain and ordinary meaning of the words used.

X.1.3 The "*Groningen Model*"

(3503) Naftogaz asserts that the Parties agreed that the Contract was based on the same principles as those of the "*Groningen model*", including the principles for the division of risk between the Parties, the netback approach, price revision, and take or pay, and other terms. Naftogaz asserts that these principles underlie the principles for the continental European long-term gas sales agreements, which must be considered usage to which the Parties agreed, and are bound by, in accordance with Article 9 (1) of CISG[362], and, alternatively, that the "*Groningen model*" is relevant to the interpretation of the Contract pursuant to Article 8 CISG. Further, also alternatively, Naftogaz claims that the Tribunal should seek to find a solution to the interpretation by implying a term into the Contract, with the "*Groningen model*" as an important source, if CISG does not give an answer.

(3504) Gazprom does not agree. Gazprom denies that the Parties should have explicitly agreed that the Contract should be based on the "*Groningen model*" pursuant to Article 9(1) of CISG. Gazprom notes that Naftogaz does not claim that the "*Groningen model*" is a "*practice which the parties have established between themselves*" pursuant to Article 9(1) of CISG. Gazprom denies that Naftogaz' vague reference to the "*Groningen model*" meets the CISG-standard of "*sufficient clarity*" according to Article 8 of CISG.

(3505) Naftogaz refers to evidence in support of its assertion that the Parties agreed that the Contract is based on the principles of the "*Groningen model*" as usage, or that the "*Groningen model*" is relevant to the interpretation of the Contract according to Article 8 CISG [363]. However, the

[362] Naftogaz does not assert that the "*Groningen model*" is "*usage*", which the parties should impliedly have made applicable to the Contract pursuant to Article 9(2) of CISG.
[363] For example, exhibits C-17, C-19, C-121, C-126, and C-164, and statements by [redacted] and [redacted] during their witness examinations (day 5).

Tribunal does not find that it has been presented with evidence sufficient to convince the Tribunal that the Parties, expressly or impliedly, had agreed to apply the principles of the "*Groningen model*" as usage, or, even if there were references to the "*Groningen model*" and to principles for the continental European long-term gas sales agreements, that these references are sufficient for the purpose of Article 8 CISG.

(3506) Thus, the Tribunal will not consider the principles of the "*Groningen model*" as binding on the Parties as agreed usage, or apply the "*Groningen model*" in its interpretation of the Contract according to Article 8, or use it as a basis for implying terms into the Contract.

X.2 The structure of the Tribunal's Reasons

(3507) In the following, as regards Naftogaz' claims, the Tribunal follows generally the structure as indicated above with the logic indicated as concerns the order in which it is necessary to consider the various claims.

Gazprom has two counterclaims: payment for volumes off-taken but not paid for, and payment for gas not off-taken pursuant to the Take or Pay obligation in Article 2.2.5. The differences between the Parties regarding the claim for volumes offtaken but not paid for relates to the price that should apply. The claim regarding payment for gas not off-taken pursuant to Article 2.2.5 is more complex. Naftogaz has advanced a set of defences which go to the duty to pay for historically not off-taken volumes, and two main defences which relates to the validity of the Take or Pay provision (and other provisions), Competition law and Section 36 of the Swedish Contracts Act. The latter defences may also have the effect of a invalidation of the claim for payment. If the Competition law defence succeeds, there is no reason to consider the Section 36 defence or the defence to the Take or Pay payment claim. Should the Competition law defence fail but the Section 36 defence succeed, there is no reason to consider the Take or Pay payment claim. Should the Section 36 defence fail, the Take or Pay payment claim must be tried. The Tribunal will address the Take or Pay claims in that order.

(3508) Further, Gazprom has raised a number of objections as to the jurisdiction of the Tribunal and also requested dismissals in relation to a number of claims. However, the Tribunal sees no reason to consider in this Award any such objections other than those which are relevant to the claims addressed by the Tribunal in its Reasons.

X.3 Price Revision

X.3.1 Article 4.4

(3509) Primarily, Naftogaz relies on Article 4.4. in support of its claim for price revision. According to Gazprom, Article 4.4. is merely a re-negotiations clause, and that therefore the Tribunal does not have jurisdiction to revise, replace, adjust or in any other way amend the Contract based on Article 4.4.

(3510) It is convenient to reiterate the text of 4.4 here. The Parties have different views on how to correctly translate the text into English. The text below is the translation of Naftogaz with some text from Gazprom's translation inserted reflecting differences that are discussed below.

"*4.4. If either Party declares that the fuel and energy market conditions have changed significantly compared to what the Parties had reason to expect at the conclusion of this Contract, and if the Contract Price provided in Article 4.1 of this Contract does not reflect the level of market prices, then the Parties shall enter into negotiations regarding an adjustment of* [Gazprom: *proceed to negotiations to reconsider*] *the Contract Price in accordance with the provisions of this Contract.*

*4.4.1. A request for price revision [*Gazprom*: to reconsider the price] shall be submitted in writing and shall be properly substantiated* [Gazprom*: duly justified]by the requesting Party*]. *Upon receipt of the above-mentioned request by the Party concerned, the Parties shall enter into negotiations within 20 days and, if an agreement is reached, sign the respective addendum to this Contract.*

4.4.2. If a written agreement on the revision of the Contract Price [Gazprom: *to reconsider the contract price*] *cannot be reached within 3 (three) months from the date of the beginning of negotiations, each of the Parties has a right to dispute the other Party's performance of the present Contract* [Gazprom**:** *has a right to challenge the actions of the other Party to perform this Contract*] *and to submit the matter to arbitration in accordance with Article 8 of the Contract for the passing of a final decision* [Gazprom: *for the adoption of a final resolution*]."

(3511) The Tribunal does not find that the differences in translations into English are decisive to the question whether Article 4.4. is a price revision clause or a re-negotiation clause, or regarding what jurisdiction the Tribunal has. For the reason of simplification, here the Tribunal mostly uses the text of Gazprom. The words "*revision*", "*revise*", etc. are used in the following without thereby prejudicing the possibility of other meanings such as "*adjustment*", "*adjust*", etc.

X.3.1.1 Price revision or re-negotiation

(3512) The differences of opinion between the Parties regarding the interpretation of Article 4.4. are the result of a number of ambiguities in the text of Article 4.4. These ambiguities are also found in the Russian original text.

(3513) Key words are: "*each of the Parties has a right to challenge the actions of the other Party to perform this Contract*" [364]. In spite of the words "*perform this Contract*", the "*actions … to perform this Contract*", that can be challenged, cannot sensibly be any action in the performance of any of the provisions of the Contract. As used in the present context, "*actions*" must in any reasonable sense [redacted] the provision empowers a party to "*challenge*" the "*actions*", "*actions*" must mean [redacted]

(3514) Apart from the right of challenge itself, which are the rights or obligations that can be found in Article 4.4., 4.4.1. and 4.4.2. inclusive, and that could be a basis for a referral to arbitration?

(3515) Although not expressly stated, the "*chapeau*" of Article 4.4 must be understood to provide a Party with the right to have the Contract Price revised, or, at least to require negotiation of a revision of, the Contract Price, such that the Contract Price pursuant to Article 4.1. "*reflects the level of market prices*", if the conditions set forth in the "*chapeau*" of Article 4.4. are met. That there is a right to price revision as such has not been challenged by Gazprom; Gazprom's objection is that such right is a right to proceed to negotiations for a reconsideration of the Contract Price, but not an enforceable right to have the price revised through arbitration.

(3516) Even if Gazprom were right that the Tribunal is not empowered to revise the price formula, this would not mean that the Tribunal lacks the power to try and determine if the conditions for a price revision of the "*chapeau*" are met, or, if Naftogaz has fulfilled the conditions according

[364] The text allows "*each of the Parties*" to bring a challenge. This is strange because in the situation when Article 4.4.2 comes into play is one where the parties have failed to agree in accordance with 4.4.1; it is not applicable to failures of "*actions*" pursuant to the "*chapeau*" of Article 4.4 or Article 4.4.1. In that situation, it is hard to envisage that the party, to whom a request of a revision has been made would have an interest to challenge the "*actions*" of the requesting party. Clearly, however, the requesting party can have an interest in bringing a dispute to arbitration.

to Article 4.4.1., or if a right pursuant to Article 4.4. can apply with retroactivity, or if circumstances would bar Naftogaz from requiring negotiations. That the Tribunal has powers in these respects follows from the general dispute resolution agreement in Article 8 providing for all disputes, controversies or claims to be arbitrated; Article 4.4.2. has the limited application regarding a "*challenge of the actions*" of the other Party.

(3517) During the oral hearing, Gazprom admitted that the possible remedies in case of a failure of Gazprom to proceed to negotiations could be that the Tribunal could order Gazprom to enter into negotiations in accordance with Article 4.4.1.[365] Such order would require that the Tribunal has the power to determine, and had found, that the conditions for negotiations according to the "*chapeau*" had been met. Gazprom also admitted that, where it is found in arbitration that Gazprom would have failed in its performance, i.e. in negotiations, liability in damages for Gazprom could arise. These admissions confirm that also Gazprom believes that the arbitration agreement in Article 8 entails the possibility to arbitrate some elements of Article 4.4. even if, as is the position of Gazprom, a tribunal is not empowered to revise the Contract Price. It is also implied by the submission of Gazprom of 1 September 2016, in response to the Tribunal's request for a specification of its objections to the jurisdiction of the Tribunal, where Gazprom's objects to the Tribunal's jurisdiction to revise, replace, adjust or in any other manner amend the Contract based on Article 4.4. but not to the Tribunal's general powers under Article 8.

(3518) In conclusion, even if Gazprom were right that Article 4.4. does not empower the Tribunal to revise Article 4.1., the Tribunal nevertheless finds that it has jurisdiction to try and resolve a number of important issues in relation to Naftogaz' possible entitlement to a revision of Article 4.1., and to order Gazprom to negotiate in good faith an agreement with Naftogaz regarding a revision of the Contract Price in Article 4.1, if the pre-conditions for such negotiations have been met, and possibly order payments of damages.

(3519) To this analysis and to this conclusion can be added the following.

(3520) The words of Article 4.4.2., that "*the right to challenge the actions of the other Party to perform this Contract and to submit the matter to arbitration in accordance with Article 8 of the Contract for the adoption of a final resolution*", do not conclusively preclude an interpretation

[365] Transcripts, day 13 57:21 – 22 and 58:14-19

that the intent was to provide a Party with a right to submit for a final decision by an arbitral tribunal a revision of the formula in Article 4.1.

(3521) These words make sense, if they are understood to mean that it is an alleged breach of contract that could be submitted to arbitration. The right to submit to arbitration "*the actions of the other party*" arises in case of a failure to agree. To provide for a right to arbitrate actions, which are compliant with the Contract, would not make sense. The breach could be a refusal to accept a revision, which would follow from the application of the "*chapeau*".[366] But to provide in Article 4.4.2. for a right to arbitrate a breach would not add anything to the right under Article 8, except that the negotiation period is prolonged from 30 days to three months, and, if that would be the whole meaning of Article 4.4.2., it could have been achieved in a simpler fashion. The words "*for the adoption of a final resolution*" do not match well with the idea that the only thing that Article 4.4.2. does is to extend the "*freezing period*" before a party could go to arbitration. The words "*for a final resolution*" would be an unnecessary addition as Article 8 already says generally that any dispute arbitrated under that Article shall be finally resolved. In the context of a price revision clause in a gas supply contract, a more obvious meaning would be that the matter to be finally resolved is the price revision itself.

(3522) The Contract was negotiated just before the Transit Contract was finished. The two Contracts have many parallel clauses, one of which relates to price revision. However, the clause in the Transit Contract regarding the right to submit a dispute to arbitration, after negotiations of a price revision request, is different. It is contained in Article 8.7.2:

"*8.7.2. If a written agreement on the revision of the price for the transit services cannot be reached within 3 (three) months from the date of the beginning of the negotiations, then each Party has the right to refer the matter to arbitration in accordance with Article 12 of the Contract for the passing of a final decision.*"

(3523) The Parties are in agreement that this Article is a price revision provision, and that the Tribunal is empowered to revise the price (the tariff) under that clause.

[366] The words "*written agreement to reconsider the Contract Price*" as per the Gazprom translation do not make sense, if they do not mean a revised Contract Price. It would have been circular if the meaning would literally be an agreement to reconsider, i.e. to agree to reconsider, the Contract Price as a result of negotiations to reconsider the Contract Price!

(3524) There has not been presented any evidence as to why the price revision Articles of the two Contracts are different in this respect.

(3525) It is difficult to find any sensible reason for an intent that the Transit Contract should be different in respect to price revision from the Contract.

(3526) Maybe the negotiators of Naftogaz at a late stage of the negotiations realized that the text of Article 4.4.2. in the drafts that had been exchanged [redacted][67], which they then sought to [redacted] by the addition of the words "*for a final resolution*", and that, when the Transit Contract was finalized, the corresponding clause was given a more precise language. At least, it is clear that those words have been added at the very end of the negotiations of the Contract; they do not appear in drafts of 18 or 19 January 2009[368]. Considering the history of the negotiations, it seems as if it was in the interest of Naftogaz both in the case of the Transit Contract and the Contract to have a right to a price revision. This is speculative in the sense that there is no evidence regarding the negotiations on this particular point, but on the other hand there is no evidence presented to negate the reasonable conclusion that the adding of the words "*for a final resolution*" was intended to mean something, and, there is, in the view of the Tribunal, only one meaning that makes sense, namely that the Parties wished to provide for a right to price revision, that could be submitted to arbitration for a final resolution on how to revise Article 4.1.

(3527) However, there is evidence regarding the issue whether or not Article 4.4 was a price revision clause: In support thereof, [redacted] [redacted], and [redacted], and in denial thereof [redacted] and [redacted][369].

(3528) These witness statements follow closely the views of the Party who has introduced them, and they are in some instances ambiguous. It is doubtful if any weight could be given to them. In any event, assessed in their totality, they do not negate the analyses above.

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[367] In none of the drafts of the Contract of 26, 27, 28, and 29 December 2008 and the drafts of the Contract of 13, 18, and 19 January 2019 presented to the Tribunal, those words can be found, C-143, C-148, C-149, C-150, C-151, R-121, R-LK-15, C-160, C-161 and C-205. [Note that the translation in [redacted] witness statement 1, para 70 where he quotes C-143 is not correct – he includes the words "*for the adoption of a final resolution*". They are not found in C-143. Nor does the contract draft attached to R-77 or to R-79, to which he refers ambiguously, include those words.]

[368] C-160 , C-161 and C-205.

[369] [redacted] WS 1 (page ¾), WS 2 (paragraphs 12 - 14); [redacted] WS 1 (page 4/5), WS 2 (paragraph 34), WS 3 (paragraph 44); and [redacted] WS 1 (page 3/5), WS 2 (paragraphs 24 - 25), and in denial thereof [redacted] WS [redacted] 50).

(3529) In conclusion, the Tribunal finds that Article 4.4. is a price revision clause, and, where the Parties fail to reach an agreement in accordance with Article 4.4.1., that a Party has the right to submit the determination of a revised Article 4.1 to arbitration in accordance with Article 4.4.2. From this follows that the Tribunal considers itself to have jurisdiction also in this respect.

(3530) This conclusion leads to the need to consider a number of other issues for determining, if, in the circumstances, there is a right of Naftogaz to a price revision. Some are factually more complex than others. They can be dealt with in different orders. The Tribunal has chosen to commence with those which are less complex and which could lead to a rejection, and those which could reduce alternatives in the possible further determinations.

X.3.1.2 Are the pre-requisites for a submittal to arbitration under Article 4.4.2 met?

(3531) Naftogaz relies on three letters of alleged requests for price revision, the letters of 20 Maj 2011, 17 June 2011 and of 27 April 2014[370], which Naftogaz claims were sufficiently substantiated. Naftogaz argues that the requests from 2011 still are open as no agreement was reached after negotiations.

(3532) Gazprom has a number of objections which will be dealt with here.

(3533) The objections of Gazprom regarding the requirement of substantiation of Article 4.4.1. can be summarised as follows:

(3534) The Tribunal lacks jurisdiction and/or substantive power to consider Naftogaz'

(3535) revision claims as presented in this arbitration because:

(i) The letters from Naftogaz of 20 Maj 2011, 17 June 2011 and of 27 April 2014 do not contain sufficient substantiation to oblige Gazprom to enter into negotiations; and

(ii) The grounds for revision stated by Naftogaz in these letters are not the same as those advanced in this Arbitration.

(3536) The findings of the Tribunal are as follows.

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370 C-12, C14 and C-16.

(3537) The claim that the Tribunal should lack jurisdiction to consider Naftogaz' price revision claims does not of course prevent the Tribunal from trying whether the alleged reasons for such lack of jurisdiction are valid.

(3538) As regards the letters of 20 May and 17 June of 2011, it is not in dispute that the Parties' subsequently, within 20 days, entered into negotiations on 5 July 2011. The entry into negotiations on 5 July 2011 relating to pricing is confirmed by Gazprom in its 27 July 2011[371] response to Naftogaz 17 June 2011 letter, in which Naftogaz expressly requested negotiations with reference to Article 4.4., and also during the Arbitration. In the 27 July 2011 letter, Gazprom did not repeat or refer to its reservations regarding substantiation in its 8 June 2011 letter[372]. This must be understood to mean [redacted]

(3539) As regards the letter of 27 April 2014, on which Naftogaz also relies for its price revision claim, the Tribunal makes the following observation. A close look at the 27 April 2014 letter, shows that in reality the letter is not a request for price revision; it only states that according to Naftogaz the negotiation period of Article 4.4.1. regarding price revision has since long expired, and that therefore Naftogaz intends to submit to arbitration the revision of the Contract Price. Therefore, the Tribunal considers the 27 April 2014 [redacted] In this respect, Naftogaz has argued that its request for price revision of June 2011 is still open as the negotiations subsequently in 2011 did not result in any agreement.

(3540) The Tribunal will come back to the question of what significance, if any, the Tribunal attaches to the fact that Naftogaz did not request the resolution of a revised price formula until in April 2014.

(3541) Nevertheless, as both Parties have argued as if the 27 April 2014 letter were a request for revision of the Contract Price, the Tribunal makes the following further observations.

(3542) It is not clear from the wording of Article 4.4.1. – "*properly substantiated*" or "*duly justified*" - how much and what kind of information that is required. Gazprom is obviously right when

[371] C-166.
[372] C-164/R-90.

contending that the contractual prerequisite that any request be duly substantiated is not meant to be merely a formalistic requirement.

(3543) Article 4.4.1. establishes the conditions required to oblige a Party, to whom a request is made, to enter into negotiations regarding a price revision. The context and the function of the requirement of substantiation, as a trigger for negotiations, give that requirement the meaning that the request should include information on the circumstances, which according to the "*chapeau*" of Article 4.4. could justify a revision, and which are sufficient to justify negotiations. In addition, the purpose of the substantiation requirement is reasonably to ensure that informed negotiations can take place. The parties do not disagree on these principle findings. Still, Gazprom has added to this that the terms of the price revision sought should also be included in the request. However, [redacted]

(3544) Gazprom, as an important actor on the European market, was no doubt fully aware of the developments on the European market to which Naftogaz referred, but it does not follow from the letters more precisely, which of the energy market conditions that Naftogaz considered justified a revision of the price. As the letters from 2011 and 2013 referred to in Naftogaz' letter of 27 April 2014 show, the concerns that Naftogaz expressed were that the Contract Price did not meet expectations from the time of entering into the Contract and that the Contract Price had been unreasonable in comparison with the prices that other customers of Gazprom paid, resulting in reduced volumes sold by Naftogaz in Ukraine. Otherwise, the letters reiterate the abstract words of the "*chapeau": "The circumstances in the fuel and energy market have changed significantly compared to what the Parties reasonably expected when the Contract was entered into, and the contract price in Article 4.1 does not reflect the level of market prices."* Moreover, the 27 April 2014 letter does not invoke any new circumstances having occurred after 2011.

(3545) All this considered, if the 27 April 2014 letter were to be considered a request for price revision, the Tribunal does not find that the 27 April 2014 letter contains substantiation enough pursuant to Article 4.4.1.

(3546) It follows that the circumstances for its claims for price revision put forward by Naftogaz in the Arbitration are different from the circumstances relied on in its earlier requests, the circumstances invoked in the Arbitration being regulatory developments, the rise in hub pricing, and factors causing the gas glut, which according to Naftogaz all led to the decoupling of the gas price from oil products prices, ultimately changing the way in which gas prices were formed.

(3547) Before addressing the issue of whether it is permissible to pursue in the Arbitration different grounds from those presented in the requests for price revision, and an adjustment other than the one claimed in the request for price revision or during the Parties' negotiations that preceded the referral to Arbitration, the Tribunal will consider the objections of Gazprom that Naftogaz price revision claims "*are barred*":

(i) by reasons of Naftogaz' conduct or passivity; and

(ii) because the Parties have reached subsequent agreements on pricing.

(3548) Gazprom points out that approximately two and half years have expired after the three months' negotiation period ended on October 5, 2011, and that evidence of references to price revision in these years is scarce, three letters[373] and three press releases from political meetings[374].

(3549) Gazprom correctly states that none of these letters or the press releases refer to the requests of the 20th May 2011 or the 17th June 2011 letters.

(3550) According to Gazprom, the *ad hoc* discussions, which took place in the period between October 2011 and April 2014, had nothing to do with a continuation of negotiations in accordance with the 2011 price review requests, for which there is no evidence.

(3551) Gazprom alleges that these circumstances made Gazprom believe that Naftogaz had relinquished its request for price revision.

(3552) The Tribunal agrees with Naftogaz, in summary, that absent any express statutory support, or contractual duty to the effect that a claim must be raised within a specific period of time, which

[373] A letter of 7 September 2011 (R-96), a letter of 2 August 2013 (R-104 C-206), a letter of 4 (or 1) October 2013 (R-107, C-207), and a letter of 30 October 2013 (C-215), but actually four: also a letter of 11 September 2012 (Annex 2 to C-231).
[374] A press release of 17 March 2012 (C-208), of 22 October 2012 (C-209), and of 19 March 2013 (C-210).

there is not for claims of the nature dealt with here, the regular period of ten years for prescription will apply[375]. This is qualified by general principles of Swedish law that a party may lose its rights through passivity, where the party knows that the other party has been influenced to behave in a certain manner in reliance on a legal assessment that is incorrect, or when a party has given the other party the impression that the first party has relinquished its right, or when a party for a very long period omits to assert its right, ref. for example NJA 2002 p 630 and references therein[376].

(3553) The relevant question here is then, if there is support for the view of Gazprom that Gazprom had reasons to believe that Naftogaz had relinquished its claim for price revision. And further, if that belief, if it existed, had in any way impacted on Gazprom business activities.

(3554) The historical relationship between the two states, and between the parties to the Contract, and how various issues have been handled in the past, must be taken into account when assessing [redacted] The evidence shows that the relationship has not been formalistic but rather pragmatic in line with [redacted]

(3555) Even if Naftogaz has not [redacted] it can be seen from the correspondence and the press releases that [redacted] during the period from July 2011 until April 2014: [redacted] a letter of 7 September 2011, a letter of 11 September 2012, a letter of 2 August 2013, a letter of 4 (or 1) October 2013, and a letter of 30 October 2013, and press releases, one of 29 December 2011, one of 17 March 2012, one of 22 October 2012, and one of 19 March 2013,[377] and, [redacted] a letter of 23 December 2011, a letter of 28 May 2012, and a letter of 4 April 2014[378].

(3556) Gazprom has referred to the testimony of [redacted] and of [redacted][379], who claim that the understanding of Gazprom was that the payment arrangements of a number of supplemental

[375] NJA 2002 p. 630, Cl-119.
[376] Cl-119.
[377] R-97 [add the rest]
[378] A letter of 23 December 2011 (R-97), a letter of 11 September 2012 (C-231) a letter of 28 May 2012 (R-98), and a letter of 4 April 2014 (R-112).
[379] [redacted] paragraphs 122 and 123 and [redacted] paragraphs 84 – 86.

agreements entered into in 2011, 2012 and 2013 had dealt with Naftogaz' request for price revision. Gazprom refers in particular to [redacted] regarding a reduction of the [redacted] This is not credible. Nor are [redacted]

(3557) These [redacted] have nothing to do with, and do not reflect, Naftogaz' request for price revision; they are the result of payment difficulties of Naftogaz, and record [redacted], which, however, does relate to price, was part of a Russian aid package to Ukraine[381]. The price fixed by [redacted] is by its express words contingent on [redacted] Moreover, if [redacted] and of [redacted] were right, it would have meant that the issue of price revision was "*alive*" as late as on 17 December 2013 [redacted] was entered into.

(3558) Has Naftogaz' conduct in accepting deliveries of gas and of having paid invoices[382] without notifying Gazprom that it might seek refunds of amounts paid, had the effect that Gazprom had reasons to believe that Naftogaz had abandoned it price revision claim? The Tribunal does [redacted]

(3559) There are two aspects to the question. First, these circumstances could not reasonably [redacted] Second, Naftogaz [redacted] y negotiations or by an arbitral award.

(3560) Thus, the Tribunal finds [redacted] The question, whether

[380] In its Post-Hearing Submission (paragraph 162.3), Gazprom also refers for the first time to Addendum 27 of 28 August 2013, which is about price under the Transit Contract. However, the observations regarding Addendum 29 are also valid in regard to Addendum 27.

[381] The Statement of Claim Part IV section 4.4 and Naftogaz 'Sur-Reply and Rejoinder to Counterclaim paragraph 40.

[382] According to Gazprom, Naftogaz made 180 payments during the relevant period.

Gazprom had in any way been influenced in its business activities on the basis of a belief that Naftogaz had relinquished it request for price revision, is then not necessary to consider.

(3561) Gazprom has also alleged as a separate ground that the Parties have reached subsequent agreements on pricing, with the effect that the price revision request has been resolved. It is true [redacted] an agreement on pricing, but, as follows from the above, [redacted] had nothing to do with the request for price revision.

(3562) Gazprom has also advanced the argument that the Tribunal should have no jurisdiction to "*reconsider*" the price provisions, because the Contract is not the same as it was when Naftogaz requested price revision in 2011. Again, the Tribunal [redacted]

(3563) The changes to which Gazprom refers are those that resulted [redacted]. However, as follows from the above, they are not of the kind that they have any relevance to the request for a price revision or more generally Article 4.4., and therefore, as concerns the application of Article 4.4., the [redacted] could possibly have had such an effect, because it would have had a decisive effect on the price to be paid for the gas, but it did not survive the crises in April 2014.

(3564) Thus, the Tribunal rejects the objections of Gazprom as to the Tribunal's jurisdiction as discussed above.

(3565) Now to the question of the objection of Gazprom that the Tribunal does not have jurisdiction to consider in this Arbitration grounds for revision other than those stated by Naftogaz in the letters from 2011, or any adjustment other than an adjustment claimed in the letters from 2011, or during the parties' negotiations that preceded the referral to arbitration. The basis for these contentions is, according to Gazprom, that the grounds relied on in support of Naftogaz' requests as per its letters from 2011 are different from the circumstances invoked in the Arbitration, and that Naftogaz now in this Arbitration claims adjustments, which were not identified in the letters from 2011 or during the negotiations that took place in 2011.

(3566) In its letters of 20 May 2011 and 17 June 2011, Naftogaz refers to substantial changes in the fuel and energy market affecting the price formation of energy carriers, and, in the letter of 17 June 2011, to the netback principle as concerns a comparison with the prices of deliveries of gas by Gazprom to its other customers, and states that "*the Contract Price neither reflects the price level anticipated as of the signing date of the Contract, nor corresponds to the prevailing market prices, with regard to the delivery points for gas.*"[383] In its letter of 17 June 2011, Naftogaz suggested that the negotiations to revise the Contract Price should use "*a formula-based approach to regulate the Contract Price, including the application of additional coefficients reflecting the actual conditions for gas deliveries to Ukraine (the wholesale nature of gas purchases and non-uniform seasonal volumes of gas deliveries …") "so that the anticipated long-term Contract Prices be reasonable and consistent with the market conditions* … ".

(3567) There is no evidence showing what happened in the negotiations as a result of Naftogaz' 17 June 2011 letter.[384] The statements made by [redacted] and [redacted] in their witness statements do not contain any information regarding which claims for price revision that were negotiated or any other information that could have shed light on which claims and which objections or counter proposals were made, nor any information regarding the grounds relied on by Naftogaz.

(3568) In this Arbitration, Naftogaz invokes as a basis for the revision it claims, regulatory developments, the rise in hub pricing, and factors causing the gas glut, which according to Naftogaz all led to the decoupling of the gas price from oil products prices, ultimately changing the way in which gas prices were formed. One could read into the 17 June 2011 letter that [redacted]

(3569) Article 4.4. does not contain any restriction that, [redacted] The fact that Article 4.4. requires that the Party seeking price revision shall substantiate its request [redacted]. The underlying intent being that the price should be kept in line with market developments, [redacted].

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[383] C-14.

[384] Except as follows from the letter of 7 September 2011, where it is stated that a meeting was held and that discussions on long term future relations took place .

(3570) Naftogaz argues that the matter which may be referred to arbitration is whether and how the Contract Price can be revised, and that the matter concerns the Parties' rights and obligations concerning the Contract Price, and that it is not limited to specific negotiations. According to Naftogaz, if the latter should be the case, each Party would have an unreasonable, arbitrary power to tailor in advance its own future jurisdictional objections in arbitration, simply by refusing to discuss whatever issues it sees (un)fit.

(3571) As stated above, the wording of Article 4.4.1. does not support [redacted]. Nor does the wording of Article 4.4.2. support the view that in the [redacted]. Article 4.4.2., in a neutral manner, only states that, if the parties have failed to agree, with the interpretation of the Tribunal of Article 4.4. being a price revision clause, there is a right to proceed to arbitration in accordance with Article 8.

Also, Article 8 prescribes negotiations as a pre-condition for arbitration, and, similarly to Article 4.4.2., it says that, in case of failure to agree, the dispute shall be finally resolved by arbitration. Nor is here [redacted] what the parties may have proposed in the preceding negotiations referred to in Article 8.

(3572) Gazprom refers to the argument of Naftogaz (with which it does not agree) that there is an implied contractual obligation to reach agreement on a revised price, and claims that, in such case, for the Tribunal to conclude that Gazprom has failed to comply with this implied obligation, Gazprom must have known the revised formula presented to it and which Gazprom should have accepted.[385]

(3573) In the Tribunal's view, [redacted] he words *"challenge the actions of the other Party to perform this Contract"* refer to that [redacted]

[385] Naftogaz argument regarding an obligation to reach a final result is made in the context of its arguments that Article 4.4. is a price revision clause and not merely a re-negotiation clause.

(3574) However, as has emerged from the evidence, Gazprom never accepted to negotiate a revised formula. Consequently, there is no issue of a proposal having been made that according to Gazprom would have limited the scope of jurisdiction of the Tribunal.

(3575) Further, it does not follow that, where the Tribunal in the hypothetical case were to find that Gazprom had failed to agree, the Tribunal, after having heard the arguments of the Parties and considered the evidence, in determining whether or not and how to revise the Contract price, would be restricted to consider only a proposal that Gazprom should have accepted in the negotiations.

(3576) The issues before a tribunal, in a case like this, are first whether there have been good faith negotiations, in which case what actually had taken place is relevant, and second, if the matter goes to arbitration, which possible limitations would there be for the tribunal in its jurisdiction.

(3577) In the Tribunal's view, limitations as to what a tribunal may consider, other than those limitations that follow from the parties' pleadings and mandatory law, must have clear contractual support. It would be an unusual solution that a tribunal's jurisdiction should be circumscribed by [redacted] Obviously, dynamics of negotiations can lead the parties to make a number of different proposals, which would be unsuitable for a tribunal to know. [redacted]

(3578) In conclusion, the Tribunal finds that it has jurisdiction to consider the revised formula claimed by Naftogaz.

(3579) With this conclusion, there is no need to consider the argument by Naftogaz that Gazprom should have waived its right to raise the issue of non-compliance with Article 4.4.1.

(3580) Finally, as regards jurisdiction, Gazprom alleges that the Tribunal is not empowered to *"re-write"* the price formula, because the Tribunal has not, directly or indirectly, been given the additional jurisdiction that is required pursuant to Article 1 (2) of the Swedish Arbitration Act.

(3581) Both Parties have in this connection argued that the words "*in accordance with the provisions of this Contract"* in the *chapeau* of Article 4.4. support their case regarding the powers of the Tribunal to adjust the formula in Article 4.1.. However, the Tribunal does not find that those words provide an answer to the question.

(3582) The Tribunal has concluded that Article 4.4. is a price revision clause, which thus does empower the Tribunal to consider a claim for price revision. The "*chapeau"* of Article 4.4. sets the parameters for how a possible revised price formula shall be determined, where the conditions for a price revision are met, "*this Contract does not reflect the level of prices in the market",* which the Tribunal understands to mean [redacted] which have been addressed by the financial experts and to which the Tribunal will come back below. Naftogaz has the same understanding, and Gazprom argues on the basis of that understanding.

(3583) Gazprom has also invoked that the Tribunal should not have the substantive power to revise the price provisions, based on the same grounds, which it has invoked in relation to the alleged lack of jurisdiction. The Tribunal rejects this additional claim on the same grounds that have been set forth above regarding the question of alleged lack of jurisdiction.

X.3.2 The merits

(3584) This brings the Tribunal to the merits of Naftogaz' claim for price revision.

X.3.2.1 The conditions for price revision

(3585) The *"chapeau"* says (Gazprom's translation)

"If either Party declares that the fuel and energy market conditions have materially changed in comparison with the conditions reasonably anticipated by the Parties when concluding this Contract, and the contract price specified in Clause 4.1 of this Contract does not reflect the level of prices in the market, the parties shall proceed to negotiations to reconsider the contract price ….."

(3586) First, for the present purposes, the Tribunal does not give any weight to the differences in the translations.

(3587) The trigger in the "*chapeau*" of Article 4.4. has three elements that require a determination, namely the "*fuel and energy market*", *"the circumstances have (…) materially changed"* or *[*"*significantly changed*"], and "*in comparison with the conditions reasonably anticipated by the Parties when concluding this Contract"*.

X.3.2.2 The fuel and energy market

(3588) Article 4.4. does not indicate what should be meant by "*fuel and energy market"*.

(3589) However, the words "*fuel and energy market"* in "*fuel and energy market conditions*" do not need to be given an exact meaning in the context of whether market conditions have changed, as the experts (see below), agree that market conditions have changed, and that these conditions are the occurrence of decoupling of oil-linked prices and hub prices, resulting in hub prices becoming a prominent or important price formation mechanism in Western European markets. Gazprom makes a point that decoupling could not be characterised as a change in market conditions, but the parties, and the experts, largely agree on the underlying causes for decoupling occurring.

(3590) The question, whether the changes were significant or material, has been intermingled with the issue of foreseeability, which is the next issue to consider.

X.3.2.3 Foreseeability

(3591) Article 4.4. requires that the changes are significant or material compared to what the parties had reason to expect, or reasonably anticipated, at the time of the entering into the Contract, here "*foreseeable"* or "*foresee"*.

(3592) The Tribunal finds that this requirement must be considered [redacted] The right to re-negotiation/price revision must reasonably be based on this assumption, as the right can be triggered, if the price does not reflect the level of market prices as a result of a significant change in the market conditions. [redacted]

[redacted] [387] The question here then becomes, with the information available at the time of entering into the Contract, would it have been reasonable for the parties to agree on a price formula that reflected hub prices rather than the formula that was included in the Contract linking the Contract Price to oil-indices?

(3593) Article 4.1. is clear, it links the Contract Price to oil prices. At that time, neither party seems to have suggested or considered anything else.[388]

(3594) In January 2009, there were several indications of changes[389]. At that time, there were also indications that oil-linked prices could be lower than hub prices over 2009.[390]

(3595) The Parties have presented expert reports on the matter by Dr. Hesmondhalgh and Mr. Way, and by Dr. Moselle. They experts agree that decoupling of oil-linked prices and hub prices would occur, and that, as a result, hub prices would become a prominent or important price formation mechanism in Western European markets, and largely on the factors that lead to this development. The only disagreement of importance here is whether the developments and their significance were foreseeable in January 2009.[391]

(3596) Dr. Hesmondhalgh and Mr. Way opine that *"it is not reasonable to conclude that the parties were in a position to take into account the possibility of decoupling when they finalised the contract terms*" and that "*[*T*]hey had neither a well-founded reason to expect the development…*".[392]

[386] The Parties were in agreement that the Ukrainian market was not a relevant market.
[387] The Tribunal of course realizes that it is possible that parties may agree not to reflect [redacted]
[388] Except perhaps Naftogaz at a time in October 2008 as indicated by its letter to Gazprom of 31 October 2008 (C-147).
[389] For example, Dr. Hesmondhalgh and Mr. Way Expert Report 1 §§ 54 – 74 (C-176), and Dr. Moselle Second Expert Report §§ 4.15 – 4.45.
[390] For example, Dr. Hesmondhalgh and Mr. Way Expert Report 1 §§ 40 – 41, and Figures 2 and 3 (C-176) and Dr. Hesmondhalgh and Mr. Way Reply Expert Report § 61, transcripts day 8 pp.2 -10, and a press release of the Government of Ukraine, C-194.
[391] Dr. Hesmondhalgh and Mr. Way third Expert Report § 154, and Moselle 2 § 4.16.
[392] Dr. Hesmondhalgh and Mr. Way Expert Price Reply § 62.

(3597) Dr. Moselle, when commenting on the issue of foreseeability, expressed his opinion that: [O]*verall, I consider that it was clearly foreseeable as at January 2009 that hub prices would become a prominent, if not dominant price formation mechanism in Western Europe markets such as Germany and the Netherlands* <u>*during the life of the Contract KP*</u>*, although the exact pace of the transition would have been difficult to predict"*[393] (underlying added). His opinion is in response to the instruction given to him by Gazprom to look at the issue from that time perspective, or rather if "*as at January 2009 [*that*] hub prices would become an important price formation mechanism in Europe during the life of Contract KP*".[394]

(3598) This instruction creates problems, and has affected the conclusions arrived at by Dr. Moselle. Further, it is not clear what the intention is with the instruction to Dr. Moselle.

(3599) If the interpretation of Gazprom's instruction should be [redacted] then this is not very helpful in relation to the application of Article 4.4. in the present case.

(3600) For example, if it was foreseeable at the time of the entering into the Contract that [redacted].[395]

(3601) Gazprom's argument that, if the [redacted] it cannot be treated as an [redacted] and that the parties should make provision to deal with such change in the Contract, fails because, contrary to what Gazprom asserts, [redacted].. Otherwise, it would be difficult to make a provision for the change. Many things can be foreseen over a long period of time, but, in the view of the Tribunal, to be relevant in the context of Article 4.4., a change must be foreseeable [redacted]

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[393] Moselle First Expert report § 1.21 (2), Moselle second Expert report § 4.2 and Moselle third Expert report pages 20 – 26.
[394] Dr. Moselle the first expert report § 1.21 (2), repeated in the two subsequent reports. Also Dr. Hesmondhalgh and Mr. Way Expert Report 3 § 153.
[395] Similar analysis by Dr. Hesmondhalgh and Mr. Way Expert Price Reply § 58.

[redacted][396] This does not mean, as argued by Gazprom, [redacted]. Also, to assess with a certain precision does not mean an exact assessment. Exactly what "[redacted] means has to be determined based on the specific circumstances of the individual case.

(3602) The example of Gazprom regarding a foreseen increase in taxes, which were anticipated to occur at a precise point in time (2015) and the occurrence of which "*accelerated*" to an earlier point in time [redacted] It also presumes that [redacted] the Contract would have meant that the Contract [redacted]

(3603) If the introduction [redacted]. In the present case, if Gazprom were right about [redacted]. Because, in the beginning of 2009, when oil indexation was the then dominant price-setting mechanism for long term gas supply contracts, which was anticipated to continue for an unknown future, [redacted] Even if it could have been foreseen that, [redacted] it was not clear more precisely [redacted] determining what should be considered *"the level of prices in the market"*. These uncertainties would of course have made

[396] Dr. Hesmondhalgh and Mr. Way Expert Reply report §60.
[397] See above and for example Dr. Moselle Expert Report §§ 6.32 – 6.43 and Dr. Hesmondhalgh and Mr. Way First expert report §53.

it difficult to transform [redacted] The answer to what the parties should have done, and did, [redacted]

(3604) In other words, in the opinion of the Tribunal, the concept of foreseeability, as expressed in Article 4.4., has the meaning that only circumstances that [redacted]

(3605) With this understanding of Article 4.4., the opinion of Dr. Moselle is not precise enough on which to base a conclusion that Naftogaz (or "*the Parties")* in January 2009 should have [redacted]

(3606) On this basis, the Tribunal also finds it difficult to conclude that [redacted]

(3607) To the Tribunal, the above means that, in terms of Article 4.4., the [redacted]

X.3.2.4 The level of market prices

(3608) The next question is whether "*the Contract Price*" in 2011, or 2014, reflected the level of market prices, which requires an answer to the questions, which market or markets, and which prices?

(3609) The Parties rely heavily on the reports of the experts.

(3610) However, the reports of the experts are not very helpful because of the instructions imposed by the Parties, and the different approaches of the experts.

(3611) Naftogaz instructed Dr. Hesmondhalgh and Mr. Way that "'*market prices' should be taken to mean gas prices at both the wholesale and retail level*" and that "*the relevant markets to*

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[398]Dr. Moselle the third expert report, pages 23 and his Second Expert Report § 4.27.

consider are Germany, the Czech Republic and Slovakia".[399] According to Dr. Moselle, he was instructed by Gazprom "*to compare the Actual Price with prices in other large-scale long term import contracts in markets which* [he deems] *relevant, and determine the amount by which Naftogaz has overpaid or underpaid Gazprom relative to those prices…"*.[400]

(3612) Dr. Hesmondhalgh and Mr. Way also takes the view that "*level of market prices*" shall "*mean the price that Gazprom could obtain for the Contract volumes if it did not sell the gas to Naftogaz"*.[401]

(3613) Dr. Hesmondhalgh and Mr. Way base their analyses on the prices that a hypothetical German wholesale buyer of gas from Gazprom would be willing to pay for gas it would re-sell at prices for gas traded at the [redacted] hub. From the hub prices, they deduct a gross margin for certain costs, risks and a profit. Then they further deduct costs of transit from the Russian/Ukraine border to the German border (netback). For the comparison, they use market prices as per either May 2011 or June 2011, or the 2nd quarter of 2014.

(3614) Dr. Moselle uses import prices as proxy for large scale long term import contracts for imports into a number of countries, and looks at how the Factual Price has developed compared to import prices from May 2011 and onwards until April 2014.

(3615) In addition, there are a number of subsidiary issues on which they disagree: (i) "*netback price*"; (ii) "*delta-of-deltas*" or "*end-of-period*" (in Gazprom's translation of the Contract, "*absolute*") approach; (iii) should the coefficient "*k*" equalling .8 in 2009 be excluded from the Contract Price in 2009; (iv) should a wholesale margin be applied; and (v) "*bid prices*" or "*mid prices*".

(3616) These issues are largely decisive[402]. It is clear that none of these issues were considered when the Parties agreed the terms of the Contract.

(3617) Notwithstanding the differences between the experts, the reports are anyway helpful in some respects.

X.3.2.5 Reference markets

[399]Dr. Hesmondhalgh and Mr. Way First expert report § 3.
[400] Dr. Moselle Expert report § 1.21 (4)
[401] Dr. Hesmondhalgh and Mr. Way First expert report § 99.
[402] Dr. Moselle's Opening Statement pp. 9 – 10.

(3618) The parties agree that the Ukrainian market as reference market is irrelevant.[403]

(3619) Naftogaz claims that, for the purposes of Article 4.4., Germany, Slovakia and the Czech Republic are relevant, of which Germany is the by far the largest market and then the most important, whereas Gazprom includes Germany, France, Italy, Slovakia, the Czech Republic, Poland and Hungary.

(3620) The witness, or other, evidence does not give any clear answer to what shall be understood to be the "*market*".

(3621) The respective witnesses of the Parties give contradictory evidence. Their evidence does not support an assertion that there was a common understanding of what should be a reference market.[404]

(3622) In their expert reports on the matter, Dr. Hesmondhalgh and Mr. Way, and Dr. Moselle, analyse the issue from a non-legal, economical perspective, and do not therefore bring clarity to the question of which intention that Parties may have had, or otherwise what legally should be the interpretation.

(3623) Dr. Hesmondhalgh and Mr. Way discuss the matter based on the instructions they have been given, namely that the relevant markets are [redacted][405] Dr. Moselle has been instructed to [redacted]

(3624) However, the Parties use three markets which they have in common, Germany, Slovakia and the Czech Republic. Gazprom's additional markets are France, Italy, and Poland and Hungary.

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403 Naftogaz Reply § 183 and Gazprom's Rejoinder § 281.
404 [redacted] P. 3 [redacted] 2. § 11, [redacted] section 3, [redacted] § 21 Section 3, [redacted], §§ 21 and 25, [redacted] § 36
405 They have this notwithstanding also made calculations including France and the Netherlands in 2011 and also Italy in 2014, Dr. Hesmondhalgh and Mr. Way Expert Price Reply report §§ 47, 48 and 122.
406 Moselle Second expert report § 1.2 (4).
407 These criteria refer to the size of volume of gas imported from Russia and history of importing large volumes of gas from Russia, Moselle first Expert Report §§ 2.18 and 8.9.

(3625) As regards Poland and Hungary, Dr. Hesmondhalgh and Mr. Way have objected to the inclusion of these markets because they are dominated by Russian gas[408], and as inclusion of these markets would be "*circular*". They have added that these markets, and Slovakia and the Czech Republic, are among the countries cited by the European Commission in its competition case against Gazprom for Gazprom's strategy to partition of Central and Eastern Europe with negative effect on prices.[409] Dr. Moselle does not agree with the exclusion of these markets. His argument is that benchmarking against the price of Russian gas to these markets tells you if the Contract Price is comparable to the prices at which Gazprom sells gas to other countries.[410]

(3626) The Tribunal agrees with [redacted] that [redacted][411], or [redacted] Further, the question here in this Arbitration is not whether or not [redacted][412].

(3627) As regards Italy[413], in summary Dr. Hesmondhalgh and Mr. Way, based *inter alia* on findings of the European Commission and the Italian energy regulator, state that that the Italian prices in the second quarter of 2011 were distorted and should not be included in an analysis of market prices, but that by the second quarter in 2014 Italian prices were broadly in line with Northwest European prices on a net-back basis, and that Italian prices then could be taken into consideration.[414] Dr. Moselle does not directly negate these arguments; his arguments are different.[415] In summary, his arguments for including Italy are based on calculations he has made, showing that the spread of the Italian import prices over German import prices in 2011, is generally consistent with the spread observed since then, the point seemingly being that this shows that the argument that Italian prices were distorted is wrong. The Tribunal [redacted]

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[408] Dr. Hesmondhalgh and Mr. Way Expert Price Reply report § 107, and Lapuerta 2 Figure 1 and § 36, and Lapuerta 3 Table 3.
[409] Dr. Hesmondhalgh and Mr. Way Expert Price Reply report §§ 105 – 110, European Commission – Fact Sheet EPR_9.8. They also concluded that market prices in the Czech Republic and Slovakia were predominantly set by reference to German hub prices, Dr. Hesmondhalgh and Mr. Way Expert Price Reply report § 110.
[410] Dr. Moselle Second expert report § 6.7.
[411] The German market is not dominated by gas from Gazprom, Lapuerta 2 Figure 1.
[412] This approach does, however, connect to Naftogaz' reasons for price revision relied upon by Naftogaz in 2011, but this is not relevant here.
[413] The reference to [redacted]
[414] Dr. Hesmondhalgh and Mr. Way Expert Price Reply report §§ 113 – 122.
[415] Moselle Second expert report §§ 6.24 – 6.29.

(3628) As to France, Dr. Hesmondhalgh and Mr. Way state, with approval of Dr. Moselle, that the French hub prices are generally very similar to the German hub prices.[416]

(3629) On the basis of the above, the Tribunal concludes, absent any better basis, that for the purposes of Article 4.4., the "[redacted] in the [redacted] should mean the [redacted]

X.3.2.6 The comparator

(3630) The Parties disagree which prices should represent the market prices in the comparison with "*the Contract Price*" pursuant to the "*chapeau*" of Article 4.4..

(3631) The principle differences between the Parties concern: (i) if it is appropriate to deduct transport costs, i.e. applying a "netback" approach; (ii) whether the Contract Price Po or the Factual Price shall be used as the price of the Contract; and (ii) whether it is appropriate to use [redacted] prices for the benchmark in 2011 and onwards, or large scale long term gas supply contracts.

X.3.2.7 [redacted]

(3632) The Tribunal [redacted]

Naftogaz' and Dr. Hesmondhalgh's and Mr. Way's use of a netback approach is based on the concept of "*opportunity cost*", which in the present case would mean that the Parties, when referring to "*market prices*", should have meant the next best possible <u>outcome</u> (not "*price*" or "*Netback market price*" as Dr. Hesmondhalgh and Mr. Way sometimes chose to call it[417]) that Gazprom (or Naftogaz) could have achieved, if the gas was not sold to Naftogaz (or if Naftogaz bought the gas elsewhere). The wording of Article 4.4. [redacted] The words chosen refer to [redacted].[418] The prices

[416] Dr. Hesmondhalgh and Mr. Way Expert Price Reply report § 112, and Moselle Second expert report § 6.22.
[417] Dr. Hesmondhalgh and Mr. Way First expert report § 99 and Figure 34.
[418] Dr. Moselle has raised some objections of a more practical nature in his Expert Report § 8.17. [redacted]

[redacted]

(3633) There is no disagreement that, as a concept in general, "*netback pricing*" just means that a price for gas shall be competitive at the market where the gas is sold, and, if there are costs to bring the gas to the delivery point at the market, they will have to be for the account of the seller at the delivery point in the market.

(3634) For Gazprom, with its intention to reach a financial return on its export operations to former Soviet states and other East European countries on an equal level to its exports to EU countries, it was [redacted] However, from that intention[421] [redacted]

(3635) Naftogaz has referred to evidence that it considers showing that the Contract Price was reflecting a German netback price.[422] It may well be true that the [redacted] A reasonable, but not decisive, conclusion from that evidence is that [redacted]

(3636) Naftogaz' argument that the word [redacted]. Naftogaz

[419] Putting a Price on Energy, Energy Charter Secretariat, p 167 CL- 120.
[420] Putting a Price on Energy, Energy Charter Secretariat, p174 CL- 120.
[421] [redacted]
[422] For example, footnotes 147, 149 and 150 of Naftogaz' Post-hearing Brief
[423] Footnote 150 of Naftogaz' Post-hearing Brief.
[424] *Putting a Price on Energy*, Energy Charter Secretariat, p 167 CL- 120, and [redacted] Day 6 34:18-21.

[redacted][25] The *"chapeau"* of Article 4.4. says that, if the Contract Price does not reflect the level of market prices, the parties shall negotiate. [redacted]

(3637) Simply put, the intent seems to be that [redacted]

X.3.2.8 The Contract Price Po or the Factual Price

(3638) The Tribunal then considers whether it is appropriate to use the Factual Price or the Contract Price.

(3639) Article 4.4. refers to the Contract Price provided in Article 4.1, *i.e.* (Pn), and not to the Factual Price (Px), which is set forth in Article 4.2. According to Article 4.2. as per the Contract at 19 January 2009, the Factual Price is the Contract Price Pn corrected for a calorific value different from the calorific value as provided in Article 4.1..[426] [redacted]

(3640) However, the Tribunal makes the following observations.

(3641) The Factual Price is the price actually paid by Naftogaz. [redacted] In reality, as a result of [redacted]

(3642) With respect to [redacted] there [redacted]

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[425] Statement of Claim § 896, and Naftogaz' Post-hearing Brief § 125.
[426] According to Article 4.7 the factual price shall be corrected for variations in the water dew point.
[427] Moselle expert report § 8.36.

[redacted]

(3643) The logic behind the approach applied by [redacted]

(3644) The obvious intent underlying Article 4.4. is that, [redacted]

(3645) When the Parties entered into the Contract, [redacted] In this regard, the [redacted] One could say that the reference to [redacted]

(3646) There is no support for giving the words "*the Contract Price provided in Article 4.1*" in Article 4.4 [redacted]

[428] This is reflected in the Russian Government Resolution N0. 291 wherein it is stated "*…a) where the level of contract price of the natural gas…, taking into account the low heating value (Px), is less than 100/Tp…*".

(3647) The Tribunal does not find any reason to treat the reductions under the other [redacted] differently.

(3648) Thus, the Tribunal concludes that for the purposes of Article 4.4., [redacted]

(3649) The next issue is whether it is appropriate to use [redacted] hub prices for the benchmark in 2011 and onwards, or large scale long term gas import Contracts.

X.3.2.9 [redacted]

(3650) In order to decide the scope of analyses required, the Tribunal starts with considering whether the appropriate method is the "*delta-of-deltas*" method or the "*end-of-period*" or "*end point*" method (or "*absolute approach*" with the terminology of Dr. Moselle).

(3651) Absent any evidence giving the answer, the Tribunal turns to the text of Article 4.4.

(3652) The text of the "*chapeau*" of Article 4.4. simply says that the Parties shall enter into negotiations, if the Contract Price [redacted]) does "*not reflect the level of prices in the market*". That is, a comparison shall be made between the Contract Price ([redacted]) and the level of market prices at the time of the application of Article 4.4.1.. The *chapeau*" of Article 4.4.. does not, as is the case in other contracts, state [redacted]

(3653) Thus, the Tribunal concludes that it is [redacted]. This means that [redacted]

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[429] Dr. Moselle Expert report, paragraph 8.39.
[430] Putting a Price on Energy International Pricing Mechanisms for Oil and Gas page 155

(3654) The next question is whether the [redacted] in 2011 or in 2014 did or *"did not reflect the level of prices in the market*"?

(3655) Naftogaz alleges that also prices for fuels other than gas may be relevant as the words "*the level of market prices*" should be read in conjunction with "*fuel and energy market* ".[431] The Tribunal [redacted] The words "*fuel and energy market conditions*" in the "*chapeau*" [redacted] However, [redacted]

(3656) [redacted] in the Arbitration, both Parties only use prices of gas, although different prices, and not prices of any other fuels.

(3657) Literally, "*the level of prices in the market*" or "*the level of market prices*" is a very general reference [redacted]

(3658) As stated above, the Tribunal's opinion is that word "*reflect*", properly interpreted, [redacted]

(3659) Also with respect to this issue, there is no indication of what the Parties intended when entering into the Contract.

(3660) There is no evidence from the negotiations regarding Article 4.4. showing [redacted] The plain and ordinary meaning of the words used does not give any guidance. Thus, it is an open question which

[431] For example Naftogaz' Statement of Reply and Defence to Counterclaim §§ 729 and 730.

[redacted]

(3661) Dr. Moselle considers import prices as valid a measure of market prices as wholesale prices and hub-prices, whereas he notes an important difference in that hub products do not offer flexibility as they are for "*flat*" deliveries of gas.[432] His preference for import prices is based on his view that many import prices are more similar to the long-term nature and flexibility of the Contract, and that they reflect the average price that is paid for all gas that is imported, including at hub prices or hub-linked prices, under long-term contracts and short term contracts. [433]

(3662) Dr. Hesmondhalgh and Mr. Way have explained their rejection of import prices by having been informed by Counsel for Naftogaz that, from a legal perspective, the fact that the Contract does not refer to import prices, makes import prices of little relevance to the comparison. Further, they have raised objections as to the reliability of import prices as indicator of market prices, and as to import prices having become increasingly linked to hub prices. [434]

(3663) The Tribunal [redacted]

(3664) [redacted]

[432] Dr. Moselle Expert report § 8.22 (2) and (3)
[433] Dr. Moselle Expert report § 8.28 and Second expert report § 7.3 and Third expert report § 2.1.
[434] Dr. Hesmondhalgh and Mr. Way Expert Reply report §§84 – 89.
[435] Dr. Moselle Second expert report §§ Section 5.

(3665) These analyses[436], [redacted]

[redacted]

436 [redacted]
437 [redacted]

[redacted]

[redacted]

[redacted]

(3666) The question whether or not the [redacted]. As is shown below, the Tribunal's conclusion on this issue is, [redacted]

Similar analyses[438], using [redacted] [439]

(3667) These analyses have not been refuted by Dr. Hesmondhalgh and Mr. Way, who stick to their views [redacted]

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438 [redacted]

439 See the previous footnote.

(3668) The Tribunal has noted that, for the comparison, Dr. Hesmondhalgh and Mr. Way have chosen [redacted][40]

(3669) The Tribunal has also noted that Dr. Moselle accepts [redacted] [redacted]

(3670) The Tribunal therefore concludes that for the purpose of the comparison, [redacted]

(3671) [redacted] the Tribunal finds that, [redacted] *"the contract price specified in Clause 4.1 of this Contract does not reflect the level of prices in the market"* [redacted] As can be seen [redacted]

(3672) However, on the basis of the Tribunal's conclusion [redacted], in April [redacted].

(3673) This brings the Tribunal back to the letter of 27 April 2014.

X.3.2.10 The letter of 27 April 2014

(3674) As has been stated, this letter is not in itself an Article 4.4. request. It refers to Naftogaz' earlier request in 2011, and, in it, Naftogaz claims that it is entitled to price revision.

(3675) By its 27 April 2014 letter, after the Russian Government's and Gazprom's termination [redacted] Naftogaz revived the requests from 2011.

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[440] Dr. Hesmondhalgh and Mr. Way First expert report §§ 75 – 83 and 108, and Third expert report § 11.
[441] Dr. Moselle Expert report § 8.22 (3) and Second expert report §§ 7.10 – 7.12.
[442] Dr. Moselle Second expert report §§ 5.20 – 5.22 and Figure 5-8, 5-9 and 5.10.

(3676) As the Tribunal has concluded above, Naftogaz has not by passivity, or for any other reason invoked by Gazprom, lost its right to rely on the requests in 2011.

(3677) In the letter, Naftogaz refers to changes in the fuel and energy markets since 2009, and, in addition to the letters of 20 May and 17 June of 2011 and some other letters, to a letter of 2 August 2013, in which Naftogaz develops its views on the circumstances in the market that lead to the price not reflecting the then current market situation.

(3678) In the second quarter of 2011, the Contract Price was higher, and the Factual Price was lower, and in April 2014 the Contract Price (and the Factual Price), was higher than [redacted] hub prices (and the average import prices)[443]. In terms of the comparison whether the Contract Price reflected the level of market prices, [redacted] because that was the actual price paid.

(3679) There is then an issue in that, at [redacted] was below market prices, and thus, at that time there was no right to a price revision.

(3680) What does this mean under Article 4.4. in relation to the 27 April 2014 letter?

(3681) Article 4.4. simply says, without any further precision or guidance, that, if there are significant unforeseeable changes in market conditions and the Contract Price no longer reflects the level of market prices, there is a right to negotiations and arbitration.

Article 4.4. is a corrective and protection of a party, in case market conditions change, and the result is that the Contract Price has lost touch with the level of market prices ("*to re-establish the balance between the parties*").

(3682) In the absence of any guidance from what the Parties may have intended, on the basis of the mandate to arbitrators under Article 4.4.2. and more generally under Article 8, where the plain and ordinary meaning of the words used does not given an answer, Tribunal has to interpret Article 4.4. in light of its rational and function, against the relationship of the Parties and their controlling owners, and in view of the particular circumstances that existed.

443 Dr. Moselle Second expert report §§ - 5.15 – 5.25 with the Figures.

(3683) As can be seen below, the reductions of the Contract Price [redacted], have had no relationship with Article 4.4., or the balancing of the rights and obligations of the parties under the Contract.

(3684) It was because of the exceptional and controversial acts of Russia, that the termination of the Kharkiv Treaty and the abolishment of the reduction of the export customs duty, and the unilateral effective termination of [redacted] came about. It is true that [redacted]

(3685) It was undoubtedly these sudden unilateral interventions by Russia in the contractual relationship between Gazprom and Naftogaz that caused Naftogaz to send the 27 April 2014 letter demanding price revision and putting Gazprom on notice that Naftogaz intended to initiate arbitration regarding the price for the gas.

(3686) In the circumstances, the Tribunal finds that it would be [redacted]

(3687) At that time, there was a total break between Russia and Ukraine. Promptly after Russia's unilateral termination of the Kharkiv Treaty and the revocation of Decree No. 291 on 2 April 2014, Naftogaz had a meeting with Gazprom already on 3 April 2014, at which the Contract Price was discussed.[446] According to a letter of 4 April 2014, at that meeting Naftogaz claimed that the price offered by Gazprom was not in line with gas prices in Europe, and Naftogaz declared that it could guarantee payment of its debts.[447] In a letter of 15 April 2014, Naftogaz

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444 [redacted] § 114.
445 [redacted] § 110 – 111.
446 A letter from Naftogaz to Gazprom, R-112.
447 The letter as per R-112.

repeated its concerns about the price and its willingness to pay outstanding debts.[448] [redacted]

(3688) Based on the above, the [redacted]

X.3.2.11 Retroactivity

(3689) From when shall a revised Contract Price take effect? The Parties disagree.

(3690) As evidence in support of its assertion that the Parties agreed that retroactivity should not be applied, Gazprom has referred to draft contracts from October 2008, in which there was a clause providing for retroactivity from the date of the request, and which clause was deleted in subsequent drafts, and which clause apparently is not found in the Contract. However, from what the witnesses have stated, it is clear that [redacted].[449] Further, there is no other relevant evidence from the time that the Contract was entered into.

(3691) Against this background, the Tribunal does not consider that the [redacted]

[448] C-22.
[449] [redacted] § 77, [redacted] §§ 43 - 46, [redacted] §§ 15 – 16, [redacted] § 3, [redacted] § 26.

(3692) Gazprom has also argued that that the Parties subsequent conduct should confirm that neither Party intended that a price revision should take effect retroactively.[450] [redacted]

(3693) Looking at the question from a principle point of view, one will find that there is a connection between the point in time of the request for price revision, the changed market conditions, the point in time to be used to determine whether the Contract Price reflects the level of market prices, the relevant market prices being the "*comparator*", and the effective date of a new Contract Price determined in the process of the price revision.

(3694) Article 4.4. must be understood to mean that [redacted]

(3695) It is simple commercial logic that, [redacted]

[450] Gazprom's Post-Hearing Submissions, §§ 119 – 123.

(3696) What about the time for the request for arbitration or the Statement of Claim as has been advanced by Gazprom? [redacted]

(3697) Then, there may be practical considerations, such as that [redacted] ursuant to Article 4.4 of the Contract. However, Naftogaz has claimed that the effective date shall be 27 April 2014.

(3698) As a result of the conclusion that the Tribunal has arrived at regarding the 27 April 2014 letter, the effective date for the price revision shall be 27 April 2014.*"bid prices or mid prices"*

(3699) There is an issue regarding which hub prices to use as market price. The price formulas that Naftogaz claims are based on "*bid prices*". Gazprom considers "*mid prices*" more appropriate.

(3700) In the selection of price there are three possibilities: "*bid prices*", "*mid prices*" and "*ask prices*".

(3701) The Tribunal [redacted]

(3702) To the Tribunal, it seems reasonable to choose [redacted] transactions are made. In any event, which to choose has very little impact.[452]

X.3.2.12 [redacted]

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[451]Dr. Hesmondhalgh and Mr. Way Expert Price Reply report § §17 2- 173.

[452] Dr. Hesmondhalgh and Mr. Way Expert Price Reply report § 174. and 108, ant

(3703) Even if the claims for price determination based on [redacted] are in the alternative to price revision, it follows from the Tribunal's discussions above, that the Tribunal has to try Naftogaz claims regarding [redacted]

(3704) An initial observation is that the price reduction according to [redacted] required [redacted] and that [redacted] Is there then support for Naftogaz' claim that the Parties were obliged to [redacted] for the remainder of the Contract term?

(3705) The price reductions according to [redacted] and, essentially, [redacted] were not the result of commercial considerations between Gazprom and Naftogaz. [redacted] was part of a rent under the Kharkiv Treaty for the presence of the Russian Federation Black Sea Fleet on Ukrainian territory. [redacted] was part of an extensive assistance package to Ukraine, which at the time was in a serious political and economic crisis.[453]

(3706) According to [redacted], the price reduction under [redacted] was for Gazprom "*to incentivise payment*" by Naftogaz of its outstanding invoices for gas supplied in August, October and November 2013. Further, according to [redacted], it was clear that any agreement to extend the quarterly price reduction was based upon Naftogaz making timely payments to Gazprom for gas supplied. During the first quarter of 2014, Naftogaz made payments for gas supplied in August and October 2013 and January and February 2014, but failed to pay for gas supplied in November and December 2013. According to [redacted] for this reason, Gazprom decided not to extend the discount provided by [redacted] [454]

(3707) There is [redacted]' assertion that [redacted] was entered into to mitigate market developments and their impact on the Contract Price[455], or that the price reduction should apply for the remainder of the Contract term (subject to Article 4.4.), in case the price no longer was market reflective[456].

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[453] Press release of 19 December 2013 and press release of 4 March 2014, pages 15 – 16, and [redacted] §§ 109 – 110.

[454] [redacted] §§ 109 - 114. See also the letter from Naftogaz of 4 April 2014 in which Naftogaz states that after consultations with the Ukrainian Government it could guarantee to pay its debts to Gazprom. This was repeated in a letter of 15 April 2014, C-22.

[455] The press release invoked by Naftogaz (C-168) [redacted]

[456] Naftogaz' Statement of Reply and Defence to Counterclaim §1120 – 1122.

(3708) Without making any determination as to the applicability of these Sections as such, the Tribunal does not find that Section 36 or Section 33 of the Swedish Contracts Act, or any other legal rule or doctrine, is applicable to the circumstances regarding [redacted] and its asserted continued applicability beyond April 2014. The circumstances do not justify their application. As mentioned, as between the commercial parties, [redacted] was motivated by payment difficulties of Naftogaz, and Naftogaz failed to fulfil to pay outstanding invoices (which is not in dispute). The Tribunal can, however, agree that the situation in 2014 was politically driven, and that, in different circumstances, it would seem likely that the Russian leadership and Gazprom would have acted differently in the spirit of earlier times, which existed as late as in December 2013.

(3709) In conclusion, the Tribunal [redacted]

(3710) Before addressing [redacted] and the assertions made by the Parties in relation to it, the Tribunal wishes to emphasise that the Parties have presented no information as to why the rent to be paid by the Russian Federation to Ukraine [redacted]. Naftogaz simply notes that the purpose was not to align the Contract Price with the market[457]. Gazprom states simply that it was not involved in the discussions between the leaders of the two states, and that the discussions leading to the Kharkiv Treaty and to the reduction of the customs duty related to many issues but not to gas supplies[458]. Based on some information introduced in the Arbitration, one can, however, speculate about the motives. According to an IMF Country Report on Ukraine from 2012,[459] Naftogaz "*carries out large quasi-fiscal activities*" and Naftogaz "*suffered deficits of 1.7 and 1.5 percent of GDP in 2010 and 2011*". Maybe, [redacted] was a means to [redacted] This is mere speculation, and does not help in finding an answer to the issues regarding [redacted]

(3711) As to the factual background and legally, from what has emerged, [redacted] differs from [redacted] Whereas [redacted] had a background involving not only the two states but

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[457] Naftogaz' Statement of Claim § 443.
[458] Gazprom's Statement of Defence and Counterclaim § 177.
[459] R-25

also contractual matters between Gazprom and Naftogaz, [redacted] has no explanation, which relates to the contractual relationship between Gazprom and Naftogaz.

(3712) However, there is evidence indicating that the intent was that [redacted] should apply for the entire term of the Contract.

(3713) The Kharkiv Treaty, on which Addendum 3 is based, has a validity of twenty-five years from 28 May 2017. Article 2 of the Treaty provides that the rent shall consist of an annual amount of MUSD 100, and a price reduction in amounts of up to USD 100 per 1000 m3 from the price under the Contract. It states expressly that the price reduction shall start from the effective date of the Treaty, but without any provision for an end date or term. Article 2 also states that these funds shall be recorded for every calendar year without specifying any end date or term.

(3714) [redacted] states that the [redacted] neither the Kharkiv Treaty nor Decree No. 291, providing for the reduced customs duty, was yet in force. The Kharkiv Treaty was ratified on 29 April 2010, and the entering into force of the Decree occurred on 30 April 2010, i.e. in both cases after the entering into force of [redacted] which occurred on 21 April 2010, when [redacted] was signed.

(3715) Considering the above, it seems clear that, at the time of the entering into the Kharkiv Treaty, the intent was that the rent should be paid for the entire term of the Kharkiv Treaty, and that the intent was that the reduction in customs duty should continue for the entire term of the Contract. There is no evidence that points in another direction. The Parties only base their assertions on interpretations of the wording of [redacted] and on different legal theories. Further, from the inconsistency between the longer duration of the Kharkiv Treaty and the shorter term of the Contract, one cannot draw any conclusions regarding [redacted] and the asserted continued application after the revocation by the Russian Government of Decree No. 291.

(3716) By the revocation of Decree No. 291 on 2 April 2014, after the unilateral termination of the Kharkiv Treaty the same day, the reduction of the export customs duty terminated [redacted]

(3717) There is no evidence that Gazprom had any involvement in the revocation of the export customs duty reduction, nor that Gazprom would have any benefit from it. Gazprom was like Naftogaz only an "*innocent*" bystander in this regard. The termination of the Kharkiv Treaty and the revocation of Decree 291 were "*merely*" logical consequences of the annexation of Crimea.

(3718) Even if [redacted] is a separate agreement between Naftogaz and Gazprom, [redacted] t is not independent of the decreed reduction of the export customs duty; rather [redacted] the decreed reduction of the export customs duty. By the mechanism that [redacted] If [redacted] were to be interpreted to mean that, [redacted] that would [redacted]

(3719) Naftogaz has argued that the actions of the Russian Federation should be attributed to Gazprom as if they were Gazprom's own. That argument [redacted]

(3720) Naftogaz has also relied on Sections 33 and 36 of the Swedish Contracts Act.

(3721) Without making any determination as to the applicability of these Sections as such, the Tribunal does not find that Section 33 or 36 of the Swedish Contracts Act, nor any other legal rule or doctrine, are applicable to [redacted] While the Tribunal agrees that exceptional events in 2014 were very unfortunate and for which Russia can be criticized, the circumstances do not justify their application. As mentioned above, [redacted] Differently put, Gazprom did not benefit from the acts of the Russian Government. Also, as stated above, there is no evidence in support of an assertion that Gazprom acted in concert with the Russian

Government, nor did Gazprom, obviously, by its [redacted]

(3722) Thus, the Tribunal concludes [redacted]

X.3.2.13 A new formula

(3723) As stated above, the Tribunal has rejected Gazprom's objections that the Tribunal should not have jurisdiction to consider grounds for revision other than those stated by Naftogaz in its letters from 2011, nor any adjustment other than an adjustment claimed in those letters.

(3724) Further, the Tribunal has concluded that Article 4.4. empowers the Tribunal to revise the Contract Price formula in Article 4.1., as long as it does so within the parameters of Article 4.4., [redacted] To this latter question could be added that Gazprom's argument that the Tribunal is only allowed to adjust the "*contract price*" and not the "*price provisions*" is misconceived, as Article 4.4. says the "*contract price specified in Clause 4.1.*", and, in Article 4.1., the "*contract price*" is defined as Pn, being the result of the formula.

(3725) With the Tribunal's conclusion regarding the effective date of a price revision, the variables are Po and the formula determining the Contract Price.

(3726) From the above conclusions regarding price revision follows that a new formula [redacted] HUB prices. As to the question of the use of "*bid prices*" or "*mid*" prices, as set forth above, the Tribunal has found for [redacted]". Further, based on the conclusions that the effective date for the price revision shall be 27 April 2014, [redacted]

(3727) The remaining formula with its remaining elements, [redacted] may be determined by the Parties in agreement, or, failing such agreement will be determined by the Tribunal after further proceedings in the Arbitration.

X.3.3 Naftogaz' other price revision claims

(3728) As the Tribunal has found that Naftogaz is entitled to price revision based on Article 4.4., there is no reason for the Tribunal to consider the other price revision claims of Naftogaz.

X.3.4 Gazprom's claim for gas taken but not paid for

(3729) [redacted]

X.3.5 Naftogaz' claims for repayment and damages

(3730) [redacted].

(3731) For the period from and including 1 May 2016, Naftogaz claims the amount of money that equates to the part of all monthly payments under the Contract from and including 1 May 2016 to the date of the Award exceeding the applicable Factual Price calculated pursuant to the price provisions of the Contract based on the Contract Price and/or, as the case may be, the Factual Price, as determined by the Tribunal.

(3732) In the alternative, Naftogaz claims damages relying on Article 4.4.2. and Article 6.1. The claim is the same as the claim for repayment, except that the loss claimed arises only on 8 September 2011.

(3733) [redacted]

(3734) Gazprom's defences are the same as those regarding jurisdiction, retroactivity, conduct or passivity and supplementary agreements, as have been raised by Gazprom against Naftogaz' claim for the right to price revision. The Tribunal has [redacted] Gazprom's defences regarding the right to repayment are based on the same set of facts and the same legal arguments as those regarding the right to price revision. The Tribunal notes in this connection that [redacted] Therefore, the Tribunal does not find any reason to treat these defences differently in this context.

(3735) Thus, the Tribunal [redacted] also as regards the right to repayment. Further, the Tribunal [redacted].

(3736) There is then no reason to consider the alternative damages claim.

(3737) Naftogaz' resulting monetary claims may be determined by the Parties in agreement, or, failing such agreement, will be determined by the Tribunal after further proceedings in the Arbitration.

X.4 Naftogaz' claims for invalidity/ineffectiveness and replacement of Contract provisions based on competition law

(3738) Naftogaz alleges that a number of clauses in the Contract are in violation of fundamental competition law principles.

(3739) In section X.4.1 below, the clauses of the Contract which Naftogaz alleges are in violation of competition law principles, are listed. In section X.4.2 below, Naftogaz' allegations are considered and decided on.

X.4.1 Clauses of the Contract, which Naftogaz alleges are in violation of competition law principles

X.4.1.1 The Contract Price (Article 4.1)

(3740) Naftogaz alleges that the application of the oil price indexation clause in Article 4.1 of the Contract amounts to an abuse of a dominant position by Gazprom, cf. article 102 TFEU, cf. article 18(1)(b) ECT.

(3741) Naftogaz alleges that the Contract Price constitutes exploitative pricing since the oil indexation of the prices of gas results in an excessive contract price compared to the current and normal market levels.

(3742) Further, it is alleged that the Contract Price is discriminatory due to the prices paid by other customers of Gazprom in the European gas market.

(3743) In consequence hereof, Naftogaz alleges that the Contract Price is invalid and should be replaced by a contract price which is not excessive and which does not include oil indexation. A new price formular should reflect current notions of what constitutes a reasonable market related price formular.

(3744) Gazprom, on the other hand, argues that Naftogaz has failed to establish excessive pricing on the part of Gazprom. In this respect Naftogaz should as a minimum have carried out a detailed analysis of the prices charged by Gazprom and the relative costs incurred by Gazprom in supplying Naftogaz so as to show that "*the difference between the costs actually incurred and the price actually charged is excessive*", cf. Coppi Report, paragraphs 2.32-2.39.

(3745) Further, Gazprom alleges that Naftogaz has failed to establish that the oil-indexed price contained in the Contract is unfair within the meaning of article 102 TFEU, as Naftogaz has failed to prove that the price bears "*no reasonable relation to the economic value of the product supplied*", cf. United Brands, paragraph 210[460]. Gazprom therefore alleges that Naftogaz has not established that the price provisions of the Contract constitute an abuse for the purpose of article 102 TFEU.

X.4.1.2 The volume and Take-or-Pay obligations (Articles 2.2 and 2.2.5)

(3746) Naftogaz alleges that the volume obligations and take-or-pay provisions in Articles 2.2 and 2.2.5 of the Contract lead to market foreclosure by effectively requiring Naftogaz to obtain all of the majority of its demand for gas from Gazprom.

(3747) Naftogaz further alleges that the provisions also allow Gazprom to impose unfair trading practices having regard to Naftogaz' demand for import of natural gas and the minimum annual quantity Naftogaz has to take or pay for under the Contract.

(3748) In conclusion, Naftogaz alleges that Articles 2.2 and 2.2.5 should be declared invalid, cf. Article 102 TFEU, Article 18 ECT and Article 13 of the Ukrainian Law on Competition and replaced by provisions which are in conformity with the EU competition laws.

(3749) Gazprom, on the other hand, alleges that the volume and take-or-pay obligations contained in clauses 2.2 and 2.2.5 of the Contract are not such as to foreclose the market in breach of Article 101 and/or 102 TFEU. And even if Naftogaz was able to establish that the volume and take-or-pay obligations foreclose the relevant market to Gazprom's competitors, it is Gazprom's position that such obligations are objectively justifiable and, therefore, there is no breach of Articles 101 and/or 102 TFEU.

[460] Case 27/76 United Brands v. Commission [1978]

X.4.1.3 The destination clause (Article 3.10)

(3750) Naftogaz argues that the destination clause in Article 3.10 of the Contract is a violation of EU competition rules, as it prevents Naftogaz from re-selling the excess gas fuel it is required to buy. It is Naftogaz' position that Article 3.10 should be declared invalid in its entirety.

(3751) Gazprom, on the other hand, alleges destination clauses are hard-core restrictions under EU law, if they have an effect on trade within the European Union.[461] Naftogaz has failed to establish by reference to actual empirical evidence that the destination clause has as its object and/or effect the prevention, restriction, or distortion of competition in the EU pursuant to article 101 TFEU or that it is abusive pursuant to article 102 TFEU.

X.4.1.4 Gazprom's unilateral suspension rights (Article 5.3)

(3752) Gazprom's unilateral right to suspend and fulfil its contractual obligations pursuant to Article 5.3 of the Contract is, in Naftogaz' opinion , a direct consequence of Gazprom's dominant position and allows Gazprom to impose unfair trading conditions on Naftogaz. It is thus in violation of Article 102 TFEU.

(3753) Naftogaz claims that Article 5.3 should be declared invalid and replaced by a provision with a corresponding suspension right for Naftogaz.

(3754) Gazprom, on the other hand, argues that Article 5.3 is unsurprising, given Naftogaz' long history of non-payment. Gazprom further argues that according to Swedish law, Naftogaz can suspend performance of the Contract. There is therefore no asymmetry. And no effect on competition.

X.4.1.5 Mandatory sales clause (Article 9.7)

(3755) Naftogaz alleges that the mandatory sales clause in Article 9.7 of the Contract gives Gazprom an advantage in the Ukrainian market over other potential suppliers in that it contributes to the strengthening of Gazprom's dominant position in the upstream market by providing it with direct influence on the downstream market in Ukraine through forced sales by Naftogaz to a Gazprom subsidiary.

(3756) Naftogaz claims that the provision should be declared invalid in its entirety.

[461] Cf. Statement of Dr. Coppi, T10, 158:20-21.

(3757) Gazprom, on the other hand, argues that Naftogaz has failed to prove that the clause has any actual or potential effect on the downstream market in Ukraine. Naftogaz has further failed to prove that the clause has any actual or potential effect on competition in breach of Articles 101 and/or 102 TFEU.

X.4.2 Application of competition law

(3758) The dispute concerns delivery of natural gas from the Russian Federation to Ukraine – both outside the EU – according to a contract entered into between a Russian company, Open Joint Stock Company "Gazprom", and an Ukrainian company, National Joint Stock Company "Naftogaz of Ukraine".

(3759) According to Article 9.4 of the Contract, "*(t)he present Contract is regulated exclusively by the material laws of Sweden*".

(3760) Before assessing whether the impugned clauses in question are in breach of competition law rules as alleged by Naftogaz, the Tribunal must determine whether EU law, and more specifically EU competition law, applies to the dispute either as a result of the direct applicability of articles 101 and 102 TFEU (see section X.4.2.1 below), as a result of the Contract's reference to the laws of Sweden (see section X.4.2.2 below), or indirectly by way of clause 18 of the Energy Community ("EnCT") (se section X.4.2.3 below). Only if the Tribunal concludes that EU competition law applies directly or indirectly, will it be necessary to assess whether one or more of the mentioned clauses are contrary to EU competition law.

(3761) Naftogaz has also taken a secondary position that Ukrainian competition law applies (see section X.4.2.4 below).

<u>X.4.2.1 Are articles 101-102 TFEU directly applicable in this matter?</u>

X.4.2.1.1 Naftogaz' position

(3762) Whether TFEU, articles 101-102, should be applied to this case, is an issue of the private international laws of Sweden, more particularly those in the Rome I and Rome II Regulations.

(3763) It is Naftogaz' position that these rules point inescapably to EU law and/or Ukrainian law.

(3764) In Naftogaz' opinion, the effect of the Rome I and Rome II Regulations is that:

(i) by way of the articles 3(1) of Rome I, the applicable law of the Contract is *prime facie* Swedish law, which includes EU law,

(ii) articles 101 and 102 TFEU have the status of mandatory public policy within the EU and must be given effect by courts and tribunals sitting in an EU member state,

(iii) the Tribunal may give effect to Ukrainian competition law.

(3765) In relation to EU competition law, it is Naftogaz' position that the territoriality principle is not relevant. If, however, the Tribunal was to hold that the territoriality principle was relevant, the qualified effects doctrine is satisfied; the Contract affects trade between member states within the meaning of articles 101 and 102 TFEU, and article 18 ECT has direct effect.

(3766) Finally, it is the position of Naftogaz that the Contract affects trade between contracting parties.

X.4.2.1.2 Gazprom's position

(3767) Gazprom alleges that public international law prevents the application of articles 101 and 102 TFEU to the Contract. It is Gazprom's position that in order to justify the application of EU competition law, the criteria of immediate, substantial and foreseeable effect in the EU must be satisfied (also known as the Qualified Effects Doctrine test).

(3768) It is Gazprom's position that Naftogaz has failed to establish jurisdiction under the Qualified Effects Doctrine test as a matter of fact. Gazprom further alleges that articles 101 and 102 TFEU require that trade between EU member states must be affected which has not been proven by Naftogaz.

X.4.2.1.3 The Tribunal's findings

(3769) Articles 101 and 102 TFEU do not contain any legislative jurisdiction outside the territory of the EU. This is also known as the principle of territoriality. As neither the Russian Federation nor Ukraine are members of the EU, the Tribunal concludes that as a starting point the EU has no legislative power in Russia or Ukraine.

(3770) The principle of territoriality is a fundamental international law principle and entails that a state – or the EU – only has powers to make laws that affect its own territory.

(3771) In *Woodpulp*,[462] paragraph 18, the CJEU confirmed that

"*…the Community's jurisdiction to apply its competition rules to such conduct is covered by the territoriality principle as universally recognized in public international law*".

(3772) Thus, the principle of territoriality is not limited to criminal law, as seems to be alleged by Naftogaz.[463]

(3773) Nor is the principle of territoriality confined to the public law enforcement of articles 101 and 102 TFEU, as further alleged by Naftogaz. This is apparent from *Gencor*[464], where the Court considered whether the application of the EU merger regulation was contrary to the principle of territoriality, thus extending the territoriality principle beyond public law enforcement.

(3774) The Tribunal finds that it is Naftogaz' burden of proof to establish that the qualified effects doctrine sets aside the principle of territoriality and to establish that purchase and sale of natural gas between two non-EU private parties according to the Contract has an effect on trade between EU member states.

(3775) Naftogaz' expert, Sir Francis Jacobs, and Gazprom's expert, Professor Henriksson, agree that regardless of the territoriality principle, the Contract is subject to EU competition rules, provided the Contract is capable of having immediate, substantial, and foreseeable effects in the EU, also known as the "*Qualified Effects Doctrine*".[465]

(3776) Both experts agree that the "*Qualified Effects Doctrine*" has only been used by the General Court twice. *Gencor,*[466] dealt with the application of merger regulation and *Intel,*[467] dealt with public enforcement of EU law.

(3777) Both experts further agree that the "*Qualified Effects Doctrine*" has never been applied by the European Courts in a dispute between two private parties.

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[462] Exhibit CL-113
[463] Ref. T1 110: 12-17: From Naftogaz' Opening Statement: "The qualified effects test is a test that the EU courts have developed in response to the principle of public international law known as the territoriality principle. That principle means that states should not seek to enforce their own criminal laws outside their own territory."
[464] Exhibit CL-114
[465] Both Sir Francis Jacobs and Professor Henriksson agree that neither the "Single economic entity" doctrine nor "the implementation" doctrine are relevant to this matter.
[466] Exhibit CL-114
[467] Exhibit CL-113

(3778) Finally, the experts agree that the CJEU has never considered whether to recognize the "*Qualified Effects Doctrine*"[468], and there is therefore no established case law by the CJEU in this respect.

(3779) The "Qualified Effects Doctrine" has been considered by Advocate General Nils Wahl in his opinion in the above mentioned Intel-case, delivered on 20 October 2016.[469] The case concerns possible enforcement of EU-law. In his opinion the Advocate General i.a. writes as follows:

"*295. In fact, several Advocates General have already advised the court to adopt an effects-based approach to In fact, several Advocates General have already advised the Court to adopt an effects-based approach to jurisdiction in the field of competition law. The Court has not, to date, either endorsed or expressly rejected that approach.*

296. Against that background, I believe that the Court should explicitly address that issue here and, in line with what has been suggested by the Advocates General mentioned in the previous point, adopt an effects-based approach to the application of Articles 101 and 102 TFEU.

297. Whether such an approach is anchored in a (broad) concept of territoriality, or instead involves some extra territorial application of the EU rules is not determinative. What is crucial is that, under certain conditions, effects is a jurisdictional criterion which, as concerns this kind of legislation, is generally acceptable under the rules of public international law and has been embraced by many jurisdictions worldwide. Indeed, many legal scholars take the view that any controversy regarding its acceptability is something that, by now, belongs to the past.

298. In that context, it is worth noting that several other provisions of EU law regulate the foreign conduct of entities which are neither nationals of an EU Member State nor physically or legally present in the Union, because of the effect produced by that conduct in the internal market. That is the case, for example, of a number of provisions governing transactions in financial instruments or other types of economic conduct. (188)

[468] Professor Henriksen writes in his opinion 1, paragraph 33: "…the ECJ is yet to rule on the existence of a qualified effects doctrine…" which is slightly twisted by Sir Francis Jacobs as he writes in his opinion, paragraph 14: "As Professor Henriksen correctly points out, the effects doctrine has not yet been endorsed by the CJEU"
[469] Case C-413/14

299. That does not mean, however, that any effect, no matter how weak or indirect, could trigger the application of EU competition rules. In a globalised economy, conduct that takes place anywhere in the world, for example in China, will almost inevitably have some sort of effect in the European Union. Yet, the application of Articles 101 and 102 TFEU cannot be based on a link or effect that is too remote or purely hypothetical.

300. I consider it to be particularly important that jurisdiction is asserted with restraint in relation to behaviour that has not, strictly speaking, taken place within the territory of the European Union. Indeed, to comply with a certain form of comity and, by the same token, to ensure that undertakings can operate in a foreseeable legal environment, it is only with a great deal of caution that the effect of the conduct complained of can be used as the yardstick for asserting jurisdiction. That is all the more important today. There are over 100 national or supranational authorities worldwide that claim jurisdiction over anticompetitive practices."

(3780) The Tribunal notes that while Advocate General Wahl in paragraph 296 of his opinion urges the ECJ to "*adopt an effects-based approach to the application of Article 101 and for TFEU*", he also states in paragraph 300 that jurisdiction should be "*asserted with restriction in relation to behaviour that has not, strictly speaking, taken place within the territory of the European Union.*"

(3781) The Tribunal further notes that in footnote 176 of his opinion the Advocate General specifically states:

"*176 – In this Opinion, I shall not consider the jurisdiction of Courts of the European Union to hear cases of private enforcement of EU competition rules, or the power of the EU legislature to legislate on competition matters."*

(3782) Against this background and in view of the fact that the Court is in no way bound by the opinion of the Advocate General the Tribunal finds that it does not have sufficient legal basis for applying the qualified effects doctrine in this matter. Consequently, articles 101 and 102 TFEU cannot apply directly to the Contract.

(3783) As the Tribunal does not find that the qualified effects doctrine test applies in the present matter, the Tribunal does not have to decide whether the Contract has immediate, substantial, and foreseeable effect on the competition in the EU. Furthermore, the Tribunal does furthermore not have to determine whether there is an effect on trade between EU member states within the meaning of articles 101 and 102 TFEU.

X.4.2.2 Do articles 101 and 102 TFEU apply due to the Contract being governed by Swedish law?

X.4.2.2.1 Naftogaz' position

(3784) Naftogaz argues that since the parties have chosen the law of an EU member state to govern the Contract, there can be no objection in principle to applying EU competition law to the claim, and there is no need to have recourse to principles of public international laws whether EU law can properly be applied.

X.4.2.2.2 Gazprom's position

(3785) Gazprom has argued that Naftogaz' argument was not introduced until Naftogaz' Opening Statement, but is, however, not claiming that the argument should be dismissed for this reason.

(3786) Materially, Gazprom has argued that the parties chose Swedish law and not EU law, and that EU law should only be applied if and when it is applicable to the factual situation.

X.4.2.2.3 The Tribunal's findings

(3787) Article 9.4 of the Contract states:

"*The present contract is regulated exclusively by the material laws of Sweden.*"

(3788) The Tribunal finds that Swedish law and EU law are distinguishable and that the Contract's reference to the material laws of Sweden is not in itself a reference to EU law as well. As a member state of the EU Sweden is under an obligation to respect the primacy of EU law and apply EU law when it is applicable. The Tribunal finds that EU law should be applied if and when it is applicable to the factual situation in issue.

(3789) Naftogaz' expert, Sir Francis Jacobs, has in his opinion in the Transit-case stated as follows:

"However, a question which has not to my knowledge been specifically considered by the EU Courts is whether the qualified effects doctrine, which has been developed in the context of regulation and enforcement, is equally applicable in a dispute between private parties who have chosen the law of an EU Member State to govern their contract. In my view there is a

strong case for applying the EU competition rules to conduct which has taken place outside the EU in those circumstances, as the policy considerations that dictate a restrictive approach to the extraterritorial enforcement of EU law are much less compelling. In particular, there is no question of any quasicriminal penalties being imposed where the court is concerned only with a private contractual dispute. Indeed it is not obvious why the application of EU law should be limited, in those circumstances, to cases where the effects on competition in the EU are immediate, substantial, and foreseeable. On the contrary, it seems reasonable and appropriate to apply EU law to any agreement of conduct that effects competition in the EU where the parties to a contract, though located outside the EU, have freely accepted this."

(3790) In cross-examination, Sir Francis Jacobs confirmed, that "*…there is no authority for it in the case-law of the European Courts."*

(3791) On this background the Tribunal finds that as Naftogaz has not proven that the Contract affects competition in the EU, articles 101 and 102 TFEU do not apply. The mere reference to the laws of Sweden in the Contract does, in the opinion of the Tribunal, not alter this fact.

<u>X.4.2.3 Article 18 EnCT</u>

X.4.2.3.1 Naftogaz' position

(3792) In addition to articles 101-102 TFEU, EU law also includes the EnCT article 18, which essentially replicates articles 101 and 102 TFEU and applies them to agreements and conduct which effect trade between Contracting Parties. It is Naftogaz' position that article 18 EnTC has direct effect as a matter of EU law with the consequence that Naftogaz is entitled to rely on a breach of competition rules in article 18(a) and (b) directly in proceedings before the court or tribunal where EU law applies.

(3793) It is Naftogaz' position that the provision of an international agreement concluded by the EU such as the EnCT has direct horizontal effect and may be relied on by private parties when it is "operational".

X.4.2.3.2 Gazprom's position

(3794) It is Gazprom's position that a provision in an international treaty can only be invoked by a private party before national court in the EU, if the following four conditions are met:

(i) the disputable provision must contain a commitment undertaken by the EU,

(ii) the grant of direct rights to a private parties is consistent with the "nature and broad logic" of the treaty in question,

(iii) the treaty provision contains a sufficiently clear and precise obligation,

(iv) the treaty provision is unconditional in that it is not subject to further implementing measures.

(3795) It is Gazprom's submission that Naftogaz is not entitled to invoke article 18 EnCT in this Arbitration because none of the four conditions are meet.

X.4.2.3.3 The Tribunal's findings

(3796) The EnCT is an international organisation dealing with energy policy. The organisation was established by an international treaty in October 2005. The treaty entered into force in July 2006. The treaty establishing the EnCT brings together the EU on the one hand and the following contracting parties on the other hand: Albania, Bulgaria, Bosnia, Herzegovina, Croatia, Yugoslav Republic of Macedonia, Montenegro, Romania, Serbia and the United Nations Interim Administration Mission in Kosovo.

(3797) On 24 September 2010, Ukraine signed a protocol concerning the accession of Ukraine to the EnCT, and Ukraine subsequently exceeded to the EnCT on 1 October 2011. The Russian Federation has not signed the EnCT.

(3798) The key goal of EnCT is to extend the EU internal energy market to South East Europe and beyond on the basis of a legally binding framework.

(3799) Article 18 of EnCT provides as follows:

"1. *The following shall be incompatible with the proper functioning of the Treaty, insofar as they may affect trade of Network Energy between the Contracting Parties:*

(a) all agreements between undertakings, decisions by associations of undertaking and concerted practices which have as their object or effect the prevention, restriction or distortion of competition,

(b) abuse by one or more undertakings of the dominant position in the market between the Contracting Parties as a whole or in a substantial part thereof,

(c) any public aid which distorts or threatens to distort competition by favouring certain undertakings or certain energy resources.

2. Any practices contrary to this Article shall be assessed on the basis of criteria arising from the application of the rules of Articles 81, 82 and 87 of the Treaty establishing the European Community (attached in Annex III)."

(3800) The question for the Tribunal to decide is whether the EnCT creates rights and obligations for individuals, or in other words whether article 18 of EnCT has direct effect as a matter of EU law. The consequence of this would be that EU competition law would be indirectly applicable.

(3801) The issue has not been decided by the CJEU. There is therefore no relevant case law which addresses the question of the direct effect of the EnCT or the interpretation of article 18 EnCT.

(3802) Naftogaz' expert, Sir Francis Jacobs, has stated that other treaties have been held by the CJEU to have direct effect. Four treaties have been mentioned in this respect.

(3803) Firstly, the European Economic Area Treaty, from which, however, Professor Jacobs stated there could not be drawn any conclusions.[470]

(3804) Secondly, Sir Francis Jacobs has referred to three agreements – the EU-Poland Agreement, the EU-Slovakia Agreement and EU-Russia Agreement. These treaties all contain provisions which explicitly grant rights to individuals and which explicitly impose commitments of the EU. 18 EnCT does not do this, and there is therefore no relevant competition between the three agreement and the EnCT.

(3805) As a starting point, the Tribunal notes that addressee of article 18 EnCT is the Contracting Parties, not the EU.

(3806) The Tribunal finds that Naftogaz' reliance on Article 18 EnCT as a way of indirectly applying EU competition law requires Naftogaz to prove that Article 18 EnCT has direct effect as a matter of EU law.

[470] Ref. T9 123:21-23.

(3807) With reference to Article 3 (a)[471], the heading of Title II, "THE EXTENSION OF THE ACQUIS COMMUNAUTAIRE" and all of the provisions of Title II, the Tribunal finds that the EnCT only imposes obligations on the Contracting Parties to implement the acquis communautaire into their own national law The Contracting Parties are under a similar obligation with regard to each of the categories of acquis communautaire listed under Title II.

(3808) This interpretation of the EnCT is supported by the EU Commission[472] and the EU Council[473] as well as the EnCT itself, whose website reads as follows:

"*By the entry into force of the Energy Community Treaty on 1 Jul 2006, the Contracting Parties are under an obligation to introduce, to the extent the trade of network energy between the Contracting Parties may be affected, rules prohibiting cartels (agreements between undertakings, decisions by associations of undertakings and concerted practices), abuses of a dominant position, and rules prohibiting State aid. Moldova and Ukraine are under the same obligation from May 2010 and Feb 2011 respectively.*

…..

While the Contracting Parties, pursuant to Article 6 of the Treaty, are obliged to ensure efficient implementation of their obligations under the Treaty, of which efficient enforcement of the rules in substance is an important aspect, specific Energy Community acquis on competition and State aid law enforcement (procedures, institutions, sanctions, remedies etc.) are currently lacking."[474]

(3809) The Tribunal notes that Article 4 of the EnCT Rules of Procedure for Dispute Settlement under the Treaty specifically states:

"*Dispute settlement procedures must relate to a violation by a Party of Energy Community law and may not concern disputes between private parties.*"

[471] Article 3 (a) states that for the purpose of Article 2, the activities of the Energy Community shall include the implementation by the Contracting Parties of the acquis communautaire on energy, environment, competition and renewables.
[472] Exhibit RLA-110
[473] Exhibit RLA-183
[474] Gazprom Closing-Bundle pages 379-380

(3810) The fact that pursuant to article 216 (2) TFEU, the EnCT is binding on the EU and thereby its member states, including Sweden, does, however, not mean that article 18 in EnCT confers rights and obligations to a private party as a matter of EU law.

(3811) In *International Fruit*[475] as reflected in *Intertumbo*[476] and *Kupferberg*[477] and a number of other cases[478] the ECJ has held that the following conditions must be met in order for an individual to invoke a provision in an international treaty concluded by the EU:

1. Article 18 EnCT must contain a commitment undertaken by the EU

The Tribunal finds that Article 18 EnCT is addressed to the Contracting Parties only and does not impose any commitments or obligations of the EU[479] and there therefore cannot be a corresponding duty to enforce the content of this provision in the EU law. As there is no duty by the EU to enforce article 18 EnCT, a private party cannot rely on this provision as a matter of EU law directly against another private party before a court or tribunal.

2. The grant of direct rights to private parties and/or the imposition of direct obligations on private parties is consistent with the "*nature and broad logic*" of the treaty in question

In order to determine whether the agreement as a whole is capable of conferring enforceable rights to individuals, regard must be had to the nature and purpose of the agreement.

The nature and purpose of the EnCT is to create a legal and economic framework based on the EU acquis communautaire, related to energy. By exporting the EU rules to the Contracting Parties, the parties intended to create a regulatory market framework. This export of rules is to be achieved by the Contracting Parties implementing the acquis communautaire into their national laws. The grant of the direct request is not consistent herewith.

3. The treaty provision contains a sufficient and clear precise obligation

The Tribunal notes that the parties to the treaty have not chosen the same wording as in articles 101 and 102 TFEU. The drafters of the EnCT thus chose not to impose a clear and direct prohibition on the entire competitive conduct, as – contrary to Article 101 and 102

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[475] Joined cases 21/72 to 24/72 International Fruit Company and Others.
[476] Case C-308/06
[477] Case 104/81
[478] Cases C-12/06, C-121/06, C-366/10 and C-363/12
[479] This was accepted by Sir Francis Jacobs, T9 131:25 – 132:16, and [redacted], T4 169.8-23 and 170:25-171:5

TFEU - they did not include a provision setting out that prohibited conduct shall be automatically void. The Tribunal finds that Article 18 EnCT is not sufficiently clear and precise, since it is for the Contracting Parties to decide what the civil consequences anti-competitive conduct contrary to article 18 EnCT should be.

4. Treaty provision is unconditional in that it is not subject to further implementing measures

The Tribunal notes – as it appears from article 3 a) – that the Contracting Parties are to implement the acquis communautaire into their national laws as adapted to the specific situation of each of the Contracting Parties. Therefore, article 18 is not unconditional, since it is subject to further implementing measures.

In conclusion the Tribunal finds that Article 18 EnCT has no direct effect as a matter of EU law and that consequently Naftogaz is not by way of Article 18 EnCT entitled to rely on a breach of Article 101 and 102 TFEU.

X.4.2.4 Ukrainian competition law

X.4.2.4.1 Naftogaz' position

(3812) It is Naftogaz' position that the Ukrainian competition law applies as super-mandatory law under article 9 (3) ROME I. It is Naftogaz' position that Articles 2, 2.2.5, 3.10, 4.1, 5.3 and 9.7 of the Contract are unlawful and invalid under the Ukrainian law, as they breach Ukrainian mandatory competition law.

X.4.2.4.2 Gazprom's position

(3813) It is Gazprom's position that Ukrainian competition law is not applicable to the current dispute, whether pursuant to the ROME I regulations or as a matter of Swedish law.

X.4.2.43 The Tribunal's findings

(3814) The Tribunal finds that Ukrainian competition law is not applicable to the present dispute, whether according to the Rome I regulation or national Swedish law.

(3815) With regard to Rome I, it is only in clear cases of "*overriding mandatory provisions*" that a party may be able to impose its own legislation on the other party despite the governing law of the contract that was agreed between the parties. The Tribunal notes in this respect that Naftogaz is owned by the Ukrainian government.

(3816) The Tribunal finds that Naftogaz has not satisfied the burden of proving that overriding mandatory provisions of the Ukrainian law could be applied in respect of the Swedish law contract. The Tribunal notes in this respect that as a general rule, foreign states' public law may not be applied by Swedish courts or arbitration tribunals apart from cases where the opposite follows from Sweden's international obligations.[480]

X.4.3 Conclusions

(3817) On the above bases, the Tribunal concludes that the competition defence of Naftogaz to Gazprom's Take or Pay claims, and that also the claim for invalidation of the other provisions, fail.

X.5 Gazprom's Counterclaims

(3818) As mentioned, Gazprom has two counterclaims: payment for volumes off-taken but not paid for, and payment for gas not off-taken pursuant to Article 2.2.5.

X.5.1 Payment for volumes off-taken but not paid for

(3819) There is no dispute as to the volumes of gas delivered.

(3820) Naftogaz' defence is based on Naftogaz succeeding in its claims for price revision or price determination.

(3821) As the Tribunal has concluded that Naftogaz is entitled to price revision from 27 April 2014 and has rejected the right to price determination, the amount to be paid by Naftogaz shall be calculated on the basis [redacted] subject to the formula to be applied from 27 April 2014, and based on the unpaid volumes as they are agreed by the Parties.

X.5.2 Gazprom's take-or-pay claim

[480] Bogdan, Svensk Internationell privat- och procesrätt, 8th edition, p. 74 et seq. with references.

(3822) Apart from Naftogaz’ defences based on competition law, which has failed, and Section 36 of the Swedish Contracts Act, Naftogaz claims:

(i) That Gazprom has relinquished its Take or Pay claim;

(ii) That Gazprom has not proven that it made available the gas not taken;

(iii) That Gazprom caused Naftogaz not to off-take the gas;

(iv) That the Take or Pay provision is not workable; and

(v) That in any event the Take or Pay claims are much smaller than claimed by Gazprom.

(3823) In addition, The Take or Pay claim should be set off against Naftogaz' damages claim for breach by Gazprom of competition law.

(3824) These defences relate to the monetary claims by Gazprom. The defence relying on Section 36 of the Swedish Contracts Act is, however, for invalidity or adjustment of the Take or Pay and volume provisions.

(3825) Further, Naftogaz has late in the proceedings in its Post Hearing Brief, as part of its defence based on Section 36 of the Swedish Contracts Act against Gazprom’s Take or Pay claim, alleged that representatives of Gazprom have made misrepresentations in connection with the entering into the Contract. Gazprom has denied this allegation. Gazprom has also objected to the late introduction of this allegation, claiming that it was not permitted under Article 25 of the SCC Rules, and has requested that the Tribunal should decide to disregard it. The Tribunal has not made such decision on the basis that the Tribunal has found that this allegation anyhow is without merits.

(3826) Although not strictly necessary to address as the Tribunal, as set forth below, has found the Take or Pay provision invalid.

X.5.3 Gazprom has relinquished its Take or Pay claim

(3827) Naftogaz relies heavily on statements made by Mr. Putin and Ms. Tymoshenko at two press conferences in 2009, at which Mr. Putin stated that Gazprom would not impose “*the penalties*” or “*fines*” for failure by Naftogaz to purchase agreed volumes.[481]Mr. Putin also answered categorically no to the question whether penalties would be applied in the future. He also said

[481] C-213 and C-214.

that "*Gazprom has been ordered not to collect any fines from the Ukrainian partners*". However, from the context it is reasonable to conclude [redacted] At the press conferences, [redacted] and, at the press conference in November 2009, answering a question Mr. Putin said "*What do we have to do to avoid a similar situation next year? We decided today that despite the earlier agreements on purchase of volumes Gazprom and Naftogaz will adjust the amount for the next year. No extra gas in the contracts, no sanctions. This is a very simple decision which suits everyone and do not violate existing contracts.*"

(3828) Further, [redacted], regarding a very important element of the Contract, were understood and meant [redacted]

(3829) In any event, and in spite of what [redacted] and [redacted] have stated[482], the written evidence shows that Naftogaz [redacted] Gazprom to have [redacted] under the Take or Pay provision in Article 2.2.5, [redacted] the MAQ for the years 2009 and 2010. This follows from letters from Naftogaz and from Gazprom.[483] Nor is there in subsequent documents or correspondence in the records of this Arbitration, [redacted] Article 2.2.5.

(3830) The fact that the first invoice regarding Take or Pay was not issued until in the beginning of 2013 [redacted]

X.5.4 Gazprom has not proven that it made available the gas not taken

(3831) The text of Article 2.2.5. – "*if the quantity was delivered by the Seller but not offtaken by the Buyer*" -is not accurate in the sense that a situation cannot arise, where gas is delivered but not

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[482] [redacted] § 23, [redacted], § 35, and [redacted] § 31, and [redacted], § 55.

[483] For example, a letter of 7 September 2011 from Naftogaz to Gazprom in which Naftogaz expressly referred to its Take or Pay obligation, R-96, and letters from Gazprom, for example a letter of 10 October 2012 in which Gazprom expressly referrers to Article 2.2.5., R-159.

off-taken. What must in all probability have been meant is that, [redacted]

(3832) Naftogaz simply asserts that it is for Gazprom to prove that it had gas available.

(3833) In support of an allegation that Gazprom has periodically been unable to make gas available, Naftogaz has presented a letter from Naftogaz to Gazprom indicating a deficit of gas supplied for transit and to Naftogaz during 21 days in February 2012[484], copies of fax messages[485] indicating delivery problems in 2009, for a day (it seems), and for two days in November 2015, Further, Dr. Hesmondhalg and Mr. Way has supported the claim of Naftogaz by referring to reports that allege to show that in February 2012 and in September 2014, Gazprom had difficulties to meet its delivery obligations to customers in Europe.[486]

(3834) This evidence [redacted] at singular instances there had been some problem of some kind, and that, in regard to what Dr. Hesmondhalg and Mr. Way have stated, that there were problems of deliveries in February 2012 and in September 2014, which affected other European customers; what that meant to Naftogaz is unclear. However, the witness statement of [redacted] indicates [redacted] to be supplied to Ukraine during the 21 days in February 2012 which coincides with the problems for the same period that Dr. Hesmondhalg and Mr. Way presented.

(3835) Gazprom relies on witness evidence to support its claim that it had permanently gas available for delivery to Naftogaz,[487] and Gazprom simply states that it has a perfect record of fulfilling nominations under the Contract available for delivery the gas had Naftogaz made the necessary nominations. [redacted] 2012, 2013 and the period in 2014, when Article 2.2.5. applied.

(3836) Even if it is true that as a matter of principle, Gazprom has the burden of proof for the availability of gas to be delivered to Naftogaz, [redacted]

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484 Annex 5 to [redacted] C-186.
485 Annexes 21, 26 and 27 to [redacted] in the Transit Arbitration, C-167.
486 Dr. Hesmondhalg and Mr. Way Third expert report, §§ 174 – 177.
487 [redacted] §§ 71 – 75, and [redacted] §7, C-185, [redacted] §§ 56 – 60, and [redacted] §§ 27 – 37,

[redacted] that Gazprom could not satisfy nominations made by Naftogaz in the relevant periods. In this respect, the evidence invoked by [redacted]

(3837) Further, the Tribunal notes that Naftogaz could have presented evidence of nominations of gas that were not confirmed by Gazprom, and that it chose not to do so, but chose to present only a few faxes indicating that at some problems had occurred for a day (it seems) in 2009 and for two days in November 2015.

(3838) [redacted] Gazprom could have presented evidence showing the nominations that Naftogaz had made and that Gazprom had confirmed for delivery, but it chose not to do so. Even if one could have expected Gazprom to present better evidence regarding the gas it had available, [redacted]

(3839) In sum, the [redacted]

X.5.5 Gazprom caused Naftogaz not to off-take the gas

(3840) Naftogaz has invoked this defence as a separate defence from the Section 36 defence, although it essentially relies on the same facts, and legal and other arguments, as those relied on in its Section 36 defence. Also, many arguments are the same as those invoked for its competition defence.

(3841) As those arguments have been dealt with previously in the Award and as the Tribunal has found that the Take or Pay provision is invalid, there is no reason to further consider this defence.

X.5.6 The Take or Pay provision is not workable

(3842) In the opinion of the Tribunal, the Take or Pay provision is simplistic, which leaves open issues in its implementation. However, the Tribunal does not consider this to be such that the deficiency or deficiencies of the provision should defeat its validity under some legal theory.

The issue is rather an issue of interpretation or of complementation, or perhaps of gap filling, which is not the subject matter of Naftogaz' claim in respect of the Take or Pay provision.

X.5.7 In any event the Take or Pay claims are much smaller than claimed by Gazprom

(3843) This defence does not have the potential to defeat the validity of the Take or Pay provision. As a result of the Tribunal's conclusion based on Section 36 below, this defence has no relevance any more.

(3844) In conclusion, also these defences fail. Remains then Naftogaz' defence based on Section 36 of the Swedish Contracts Act,

X.6 Section 36 of the Swedish Contracts Act

X.6.1 Section 36 of the Swedish Contracts Act and Articles 2.2 and 2.2.5

(3845) Naftogaz second primary defence against Gazprom's Take or Pay claims is based on Section 36 of the Swedish Contracts Act.

(3846) Competition law questions has been dealt with above. Since these questions have significance when considering the Section 36 defense, the Tribunal will however come back to them in this connection.

(3847) Section 36 is of general application and allows courts to set aside or modify contractual terms or contracts in their entirety on the basis of unconscionability. Section 36 provides that:

"A contract term or condition may be modified or set aside if such term or condition is unconscionable having regard to the contents of the agreement, the circumstances prevailing at the time the agreement was entered into, subsequent circumstances, and circumstances in general. Where a term is of such significance for the agreement that it would be unreasonable to demand the continued enforceability of the remainder of the agreement with its terms unchanged, the agreement may be modified in other respects, or may be set aside in its entirety.

Upon determination of the applicability of the provisions of the first paragraph, particular attention shall be paid to the need to protect those parties who, in their capacity as consumers or otherwise, hold an

inferior bargaining position in the contractual relationship."

(3848) The provisions of the first and second paragraphs shall apply mutatis mutandis to questions relating to the terms of legal acts other than contracts.

(3849) The provisions of Section 11 of the Consumer Contracts Act (SFS 1994:1512) shall also apply to the modification of contractual terms relating to consumers, (SFS 1994:1513).

(3850) Section 36 is primarily applied in disputes between consumers and commercial parties. The second paragraph of Section 36 expressly provides that when assessing whether or not a contract term or condition is unconscionable, it is especially important whether one of the parties, due to being a consumer or otherwise, is in an inferior position in the contractual relationship. Though the principle of unconscionability is technically applicable in relationships between commercial parties, the principles *pacta sunt servanda* ("agreements must be kept") and *rigor commercialis* (freedom of contract) are fundamental in Swedish Contract Law, and Section 36 is therefore seldom applied. (*See, e.g.*, Jan and Christina Ramberg, Allmän avtalsrätt, 8 edition p. 175 et sec with references). The Supreme Court has expressly stated that particular restrictiveness shall be observed in application of Section 36 to commercial relationships (see e.g. NJA 1984 p. 229 and NJA 1992 p- 782).

(3851) As mentioned above, Section 36 is however of general application. It has in practice been applied by courts to set aside or to modify commercial contracts, albeit not at all as frequently as in relation to business-to-consumer contracts. As follows from the second paragraph of Section 36, in determining whether to apply the provision, courts shall pay particular attention to the need to those parties who, in their capacity as consumers or otherwise, hold an inferior bargaining position.

(3852) The use of Section 36 is dependent on various considerations (such as events in connection with the making of the contract and the use of the parties' own contract practice), and the overall purpose is to achieve better balance between the parties than follows from the original contract. It has been repeatedly emphasized that the rule gives a wide discretion to courts, which they have used cautiously particularly in business-to-business contracts. A court may also consider events occurring after the making of the contract, In NJA 1989 p. 346, the Supreme Court applied Section 36 in a business-to-business situation to set aside a contractual provision. NJA 1994 p. 359, is another example of the Supreme Court applying Section 36 in a business-to-business context.

(3853) In legal literature, Section 36 has been considered to be of particular importance in connection with long term contracts. One decision is NJA 1979 p. 731, in which the Supreme Court used Section 36 to create a better balance in the contractual relation between the parties. If a contracting party has managed to impose certain conditions in order to circumvent the mandatory rules or achieve benefits at the expense of the other contracting party, Section 36 may no doubt be used also to set aside or to modify commercial contracts.

(3854) Naftogaz has asserted that the Parties have agreed that the Take or Pay provisions are unreasonable. In this respect Naftogaz relies again on statements made by Mr. Putin and Ms. Tymoshenko at two press conferences in 2009, at which Mr. Putin stated that Gazprom would not impose "*the penalties*" or "*fines*" for failure by Naftogaz to purchase agreed volumes. The Tribunal has found, as stated below, that the written evidence shows that [redacted] The Tribunal holds that [redacted]

(3855) Naftogaz has however invoked a number of other reasons why the application of the Take or Pay provisions and the volume provision are in Naftogaz' opinion unconscionable and have been so ever since the signing of the Contract. Naftogaz submits that the Take or Pay regulation is exceptional and unreasonable, that the volume and Take or Pay provisions were based on failed assumptions regarding future developments. Naftogaz also invoked Gazprom's delay in pursuing its claim. These [and the other arguments must of course be considered but are not sufficient to allow the Tribunal to apply Section 36 in the present case, especially since it cannot be sufficiently concluded from the evidence that Naftogaz has been in an inferior position as compared to Gazprom during the negotiations.

(3856) According to Naftogaz, the Take or Pay clause in this case operates as a penalty clause and the penalty is far higher than Gazprom's loss, if any at all. The Tribunal [redacted] he Tribunal notes that in NJA 2012 p. 597 the Supreme Court pointed out that the total compensation under a penalty clause could be so great that this can be a reason for modifying such condition in a commercial contract.

(3857) [redacted] are the arguments by Naftogaz that the provisions now discussed exceed what is market practice and allowed under competition law. The destination clause is according to Naftogaz a hard-core restriction on competition, prohibited in every conceivable market. Thus, the three interacting clauses – volume, destination and Take or Pay – were, already at the date of the Contract, exceptional and clearly deviated from industry practice. Naftogaz has pointed out that Section 36 allows courts and tribunals to adjust and align a contract and its application with commercial administrative law (such as competition law) and its underlying rationale. even if these rules do not in themselves invalidate a clause or do not formally apply.

(3858) As follows from the above, the Tribunal has already dealt with the competition law questions and [redacted]

(3859) However, the Take or Pay provision together with the destination clause and the volume clause [redacted], as it gives Gazprom an [redacted] to customers in Ukraine. As a result, not only [redacted]. If the Tribunal were to apply EU competition law or the EnCT competition provisions these provisions [redacted]. The [redacted] should be the case if the Ukrainian competition law were to be used.

(3860) Hence, the situation is that the Take or Pay provisions rules [redacted] The Tribunal considers [redacted]. The Tribunal holds that Articles 2.2 and 2.2.5 as these articles are now formulated [redacted]. Even taking into account [redacted] the Tribunal holds that [redacted]

(3861) Consequently, [redacted]

(3862) With respect to [redacted], there is no [redacted]. For the [redacted] however, the Contract [redacted]. This is also what Naftogaz has requested.

(3863) Article 9.5 of the Contract states that in case of invalidity or termination of any provision of the Contract, the Parties shall endeavour to reach an agreement to replace such invalid or ineffective provision with a new provision that would have the economic effect as close as possible to that of the invalid or ineffective provision. In absence of any such agreement this provision cannot be applied in this Award.

(3864) Section 36 itself, however, gives the Tribunal a wide discretion to partly rewrite an agreement when needed (see e.g. Grönfors, Avtalslagen – en kommentar). Naftogaz has requested a modified wording of Articles 2.2 and 2.2.5. For the eventuality that the Tribunal were to find for Naftogaz, Gazprom has pleaded that the Tribunal should limit the effects of invalidity so far as possible, and has also suggested different modifications of these Articles. The Tribunal finds that new Articles 2.2 and 2.2.5 shall be based on a modified wording of Article 2.2, where the ACQ [redacted] for each year of the remaining term of the Contract from the date of the Final Award, [redacted] rticle 2.2.5 (MAQ) shall be based on [redacted]; Article 2.2.5 shall include [redacted]. The details of the Volume and Take or Pay provisions to be determined by the Parties in agreement, or, failing such agreement, will be decided by the Tribunal after further proceedings in the Arbitration.

X.6.2 Section 36 of the Swedish Contracts Act and Articles 3.10, 5.3 and 9.7

(3865) As has already been indicated some of the other provisions in the Contract are closely linked to the Take or Pay provisions. According to Article 3.10 the natural gas delivered under the Contract is intended for consumers in Ukraine, and the Naftogaz is not entitled to sell it outside Ukraine. In Article 9.7 Naftogaz undertakes to enter into a long-term contract with a subsidiary of Gazprom concerning 25% of the whole volume of the Gas being imported for sale to industrial consumers of Ukraine. Those two provisions clearly interact with the Take or Pay provisions and must be [redacted]

(3866) Naftogaz also claims invalidity of Article 5.3, which gives Gazprom the right unilaterally to cease or suspend the performance of its obligations, should the Naftogaz fail to perform or have performed its obligations.

(3867) This provision may be certainly be discussed on the basis of competition law, but as has been stated before there is no competition law to be used by the Tribunal. As has been admitted by Naftogaz, Swedish law by CISG provides Naftogaz with a right to suspend performance in certain circumstances even without a specific clause to that effect in the Contract. This means that the right that the Contract gives Gazprom is in reality not unilateral. In any case, the arguments by Naftogaz are not strong enough to give the Tribunal right to apply Section 36 as far as tis Article is concerned.

X.7 Section 33 of the Swedish Contracts Act

(3868) Having applied Section 36 of the Swedish Contracts Act, the Tribunal does not find it necessary to consider Section 33 of the Swedish Contracts Act,

X.8 Naftogaz' Interest Claim

(3869) As a result of the conclusions that the Tribunal has arrived at, there are two categories of payments on which interest will accrue and which the Tribunal has to consider:

(i) Payments by Naftogaz for off-taken gas delivered in November - December 2013 and in April, May and June 2014, but not paid for, which shall be made on the basis of the Contract Price that was applicable at the relevant periods;
(ii) Repayment by Gazprom of amounts paid by Naftogaz for gas at a price that is in excess of the Contract Price, as revised in accordance with this Award and any subsequent agreement by the Parties, or by the Tribunal in the Final Award, up to the date the Final Award,

(3870) Regarding (1) above, the Tribunal notes that Gazprom has chosen to allocate Naftogaz' 5 November 2014 and 24 December 2014, respectively, payments to the oldest invoices first.

(3871) There is no dispute that the applicable interest for payments for gas off-taken, but not paid for,, as per (1) above shall be the interest pursuant Article 6.2 of the Contract.

(3872) Regarding (2) above, first, there is [redacted] and, as [redacted] the Tribunal has foun [redacted]

(3873) Second, the Tribunal finds that Naftogaz already in the Request for Arbitration presented a claim for refund of payments exceeding the applicable Contract Price based on a claim for price revision.

(3874) On that basis, the Tribunal concludes that Naftogaz is entitled to interest according to the Swedish Interest Act from the date of payment until

(i) For payments made on or after 24 April 2014 and before 17 June 2014, yield interest according to Sections 2 and 5 of the Swedish Interest Act up to and including 17 June 2014 and thereafter delay interest according to Sections 4 and 6 of the Swedish Interest Act until payment is made;

(ii) For payments made on or after 17 June 2014, delay interest according to Sections 4 and 6 of the Swedish Interest Act until payment is made.

THE TRIBUNAL'S DECISION

For the Reasons set out above in this Award,

the Tribunal decides as follows:

TO DECLARE

(1) That National Joint Stock Company Naftogaz of Ukraine has the right to price revision in accordance Article 4.4. of the Contract, and on no other basis claimed in the Arbitration;

(2) That a new formula in accordance with Article 4.1. of the Contract shall be applicable, based [redacted] HUB prices and "[redacted] prices, which shall take effect from and including 27 April 2014; such formula with its remaining constituent elements to be determined by agreement of the Parties, or, failing such agreement, by the Tribunal after further proceedings in the Arbitration;

(3) That National Joint Stock Company Naftogaz of Ukraine does not have the right to price determination based on [redacted] and on no other basis in the Arbitration;

(4) That Articles 2.2. ("Volumes") and 2.2.5. ("Take or Pay") of the [redacted]

(5) That from the [redacted] in Article 2.2. ("Volumes") of the Contract the Annual Contract Quantity ("ACQ") shall be based on [redacted] for each year of the remaining term of the Contract from the date of the Final Award, [redacted] where Article 2.2.5. (MAQ) shall be based [redacted] of ACQ and where Article 2.2.5. shall include [redacted]; the details of the Volume and the Take or Pay provisions to be determined by the Parties in agreement, or, failing such agreement, decided by the Tribunal after further proceedings in the Arbitration;

(6) That Article 3.10. ("Destination") of the Contract is [redacted]

(7) That Article 9.7. ("Mandatory sales") of the Contract [redacted];

(8) That the price for outstanding amounts off-taken gas delivered in November - December 2013 and in April, May and June 2014, but not paid for, shall be the Contract Price applicable at the relevant periods;

(9) That National Joint Stock Company Naftogaz of Ukraine is entitled to repayment of amounts paid for gas at a price that is in excess of the Contract Price, as revised in accordance with this Award and any subsequent agreement by the Parties, or, failing such agreement, as decided by the Tribunal in further proceedings in the Arbitration;

(10) That National Joint Stock Company Naftogaz of Ukraine is not entitled to damages as claimed in the Arbitration;

(11) That interest on amounts to be paid in accordance with (8) above shall be pursuant to Article 6.2. of the Contract;

(12) That interest on amounts to be paid in accordance with (9) above shall be (i) for payments made on or after 24 April 2014 and before 17 June 2014, yield interest according to Sections 2 and 5 of the Swedish Interest Act up to and including 17 June 2014, and thereafter delay interest according to Sections 4 and 6 of the Swedish Interest Act until payment is made; and (ii) for payments made on or after 17 June 2014, delay interest according to Sections 4 and 6 of the Swedish Interest Act until payment is made; and

(13) That all Gazprom's objections as to the jurisdiction of the Tribunal relevant to the declarations under (1), (2), (4), (5), (6), (7), (9), (11) and (12) are rejected.

This Separate Award has been executed in six (6) copies.

Place of Arbitration: Stockholm, Sweden

Date: 31 May 2017

The Tribunal

Johan Munck

Jens Rostock-Jensen

Tore Wiwen-Nilsson

Chairman

APPENDIX 1.

DEFINITIONS AND EXPLANATIONS

This list of Definitions and Explanations is made up from the Parties' submissions and from the expert reports which means that it shows the Parties'/experts' version of the particular word/abbreviation which is not always the same as the lexical definition of the word in question.

1999 award	The final award in ICC case 9812 rendered in August 1999 and partly published in ICC International Court of Arbitration Bulletin, Volume 20/2 – 2009;
2007 award	The final award in ICC case 13504 rendered in January 2007 and partly published in ICC International Court of Arbitration Bulletin, Volume 20/2 – 2009
Actual Price	[redacted]
ACQ	Annual Contract Quantity of Natural Gas defined in Article 2.2 of the Contract
ACV	Annual Contract Volume
Addendum	An Addendum to the Contract as so described;
AEEG or AEEGSI	Autorita per L'Energia Elletrica il Gas e il Sistema Idirico – the Italian gas regulator
AMCU	Antimonopoly Committee of Ukraine
Average Daily Delivery Rate	[redacted]
BAFA	Bundesamt für Wirtschaft und Ausfuhrkontrolle – the Federal Office for Economic Affairs and Export Control
Base date	[redacted] January 2009;
BBL	Balgzand Bacton Line

BCM	Billion cubic metres of Natural Gas (a unit of measurement of volumes of gas delivered or transited)
BGC	British Gas Corporation
Binding Protocol / Interim Agreement	Binding Protocol regarding the conditions for gas delivery from the Russian Federation to Ukraine for the period from 1 November 2014 until 31 March 2015, entered into by Ukraine, the Russian Federation and the European Commission, dated 30 October 2014
Brattle 1	First expert report [redacted] prepared by Serena Hesmondhalgh and Anthony Way, dated 31 January 2015 (the "Expert Price Report") (Exhibit C-176)
Brattle 2	Second expert report [redacted] prepared by Serena Hesmondhalgh and Anthony Way, dated 8 October 2015 (Exhibit C-182)
Brattle 3	Third expert report concerning [redacted] prepared by Serena Hesmondhalgh and Anthony Way, dated 31 May 2016 (Exhibit C-226)
Brattle 4	Fourth expert report [redacted] prepared by Serena Hesmondhalgh, dated 6 February 2017, revised on March 10, 2017 (Exhibit C-228)
Brattle 5	Naftogaz' updated [redacted] A fifth report prepared by Dr Serena Hesmondhalgh, dated 10 March 2017 (Exhibit C-229)
Brattle 6	Sixth Brattle Report in SCC Arbitration V2014/078/080, prepared by Dr Serena Hesmondhalgh, dated 21 April 2017 (Exhibit C-230)
British Gas	British Gas Plc.
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
CEGH	Central European Gas Hub, the traded gas market in Austria;
CESL	Common European Sales Law;
CIS	Commonwealth of Independent States;
CISG	United Nations Convention on Contracts for the International Sale of Goods;

Claimant	NJSC Naftogaz of Ukraine, or "Naftogaz";
COMECON	The Council for Mutual Economic Assistance, also called the Organization for International Economic Cooperation, an organisation established in 1949 to facilitate and coordinate the economic development of the eastern European countries belonging to the Soviet bloc;
Compass Lexecon	Part of the FTI Consulting, Inc. group
Contract / Gas Sales Contract	Contract No. KP dated 19 January 2009 between the Open Joint Stock Company "Gazprom" of Moscow, Russian Federation and the National Joint Stock Company "Naftogaz of Ukraine" Kiev, Ukraine on the purchase and sale of Natural Gas in 2009-2019, being the agreement underlying the dispute in this arbitration;
Contract 198	Contract of 14 March 2008 between Naftogaz and RosUkrEnergo which provided for the supply of [redacted] of Central Asian gas at the price of USD [redacted] per TMC over the period from 1 January 2008 to 31 December 2008
Contract KP	Contract No. KP between Gazprom and Naftogaz, dated 19 January 2009, for the sale and purchase of natural gas in 2009-2019
Contract TKGU	Contract No. TKGU between Gazprom and Naftogaz, dated 19 January 2009, on the volumes and terms of transit of naturl gas through the territory of Ukraine for the period 2009-2019
Contract Act	The Swedish Act of 1915 pertaining to conclusion of agreements etc.;
Contract Price	[redacted]
Coppi 1	Expert report of Dr Lorenzo Coppi dated 12 June 2015
Coppi 2	Second expert report of Dr Lorenzo Coppi dated 14 March 2016
Coppi 3	Third expert report of Dr Lorenzo Coppi dated 26 August 2016
Cubic meter / cub. m. / m^3	The amount of dry gas which occupies the volume of one cubic meter at a temperature of 20 degrees Celsius and at an absolute pressure of 0.101325 MPa, cf. Article 1.3 of the Contract;

Day	A period of 24 hours beginning at 10:00 a m. Moscow time and ending at 10:00 a.m. Moscow time on the following calendar day. The Day shall be 23 hours long when switching to daylight saving time and shall be 25 hours long when switching to winter time, cf. Article 1.4 of the Contract;
DCFR	The Draft Common Frame of Reference;
Decree No. 291	The Russian Government's decree of 30 April 2010 No. 291 "On the export duty rate of delivery of gas from the territory of the Russian Federation to the territory of Ukraine" whereby the Russian Government implemented the Kharkiv Treaty (also called Resolution No. 291)
Decree No. 1137	The Russian Government`s Decree of 1 November 2014 No. 1137 "On the export duty rate of delivery of gas from the territory of the Russian Federation to the territory of Ukraine";
Defence	Gazprom's Statement of Defence and Counterclaim in this arbitration proceedings, SCC case No. V 2014/078, dated 12 June 2015
Delay Interest	Interest accruing pursuant to Section 6 of the Swedish Interest Act (1975:635);
Delivery Point	The point where the gas pipeline crosses the border of the Russian Federation/Ukraine and/or the border of the Republic of Belarus/Ukraine within the area of the respective Gas Metering Station or Gas Flow Metering Point, cf. the "Point of Delivery" in Article 1.10 of the Contract;
Delivery Quarter	Means any of the below mentioned periods of three consecutive months beginning at 10:00 a m. Moscow time on the first day of any Quarter and ending at 10:00 a m. Moscow time on the first day of the following Quarter: I – January to March; II – April to June; III – July to September; IV – October to December, cf. Article 1.6 of the Contract;
Delivery Year	A 12-month time interval beginning at 10:00 a.m. Moscow time on 1 January and ending at 10:00 a m. Moscow time on 1 January of the year following the reporting year, cf. Article 1.7 of the Contract
Destatis	German Federal Statistical Office
Depreciated replacement cost	Cost to replace items, less depreciation
Distrigas	Distrigas NV
[redacted]	[redacted]

[redacted]	[redacted]
[redacted]	[redacted]
Dr Coppi	Dr Lorenzo Coppi of Compass Lexecon
Dr Hesmondhalgh	Dr Serena Helmondhalgh of the Brattle Group
EC	The European Commission
ECJ	Court of Justice of the European Union
ECT or EnCT	Energy Community Treaty
Econgas	Econgas GmbH
EEX	European Energy Exchange – an exchange on which natural gas can be traded
EFET	The European Federation of Energy Traders
EIA	The US Energy Information Administration
EnCS Report	The Energy Community Secretariat's Annual Implementation Report 2014
Energy Community Treaty / ECT	The Treaty establishing the Energy Community, dated 25 October 2005, between the European Union and the then nine Contracting Parties, Albania, Bulgaria, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Romania, Serbia and the United Nations Interim Administration Mission in Kosovo, providing inter alia for the establishment of an integrated energy market among the Parties from the entry into force of the Energy Treaty on 1 July 2006
ENTSOG	European Network of Transmission System Operators of Gas
E.On	E.On Ruhrgas AG
European Competition Law	In Naftogaz' submissions this includes the competition rules of the EU and the Energy Community Treaty, "ETC", see Naftogaz' Statement of Reply and Defence to Counterclaim, Binder 1, dated 8 October 2015, paragraph 71
Eurostat	European Statistics Agency
Expert Competition Report	(Lapuerta 1) The first Expert Report by Mr Carlos Lapuerta concerning Naftogaz's Competition law claims and defence against counterclaims related to the Contract, dated 30 January 2015

Expert Competition Reply	The second Expert Report by Mr Carlos Lapuerta concerning Naftogaz's Competition law claims and defence against counterclaims related to the Contract, dated 8 October 2015
Expert Competition Sur-Reply	(Lapuerta 3) The third Expert Report on Competition Issues prepared by Mr Carlos Lapuerta dated May 2016
Expert Price Report	The first Expert Report concerning price revision and determination in respect of Contract No. KP, prepared by Serena Hesmondhalgh and Anthony Way, dated 31 January 2015
Expert Price Reply	The second Expert Report concerning price revision and determination in respect of Contract No. KP, prepared by Serena Hesmondhalgh and Anthony Way, dated 8 October 2015
Expert Price Sur-Reply	Third Expert Report concerning price revision and determination in respect of Contract No. KP, prepared by Serena Hesmondhalgh and Anthony Way, dated 31 May 2016
E&Y	Ernst & Young LLP
Factual Price	The price of gas actually paid by Naftogaz, taking into account several Supplementary Agreements between the Parties
FERC	Federal Energy Regulatory Commission - the current US energy regulator
Force Majeure	Has the meaning given to that term in Article 7.1 of the Contract
FPC	Federal Power Commission – the US energy regulator prior to the establishment of FERC
Friendship Treaty	The Treaty on Friendship, Cooperation and Partnership between the Russian Federation and Ukraine, dated 31 May 1997
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
FSU	The Former Soviet Union;
FTI Consulting	The FTI Consulting, Inc. group
Fuel gas	The gas required to run the compressor stations. (also called “technical gas”)
G	Gasoil;
Gas Flow Metering Point	A station where the quantity of gas is measured on a gas pipeline during gas delivery and acceptance. The Gas Flow Metering Points shall be as follows: GFMP to Volchansk and GFMP Loznaya, cf. Article 1.12 and Article 1.14 of the Contract

Gas Terra	Gasa Terra B.V.
Gasunie	N.V. Nederlandse Gasunie
Gazprom	The Public Joint Stock Company (OJSC, or "OAO" in Russian) Gazprom – Respondent in these arbitral proceedings;
Gazprom Export	Gazprom Export LLC, a 100 per cent subsidiary of Gazprom, responsible for the majority of Gazprom's sales to European customers
Gazprom Factual Price	Gazprom's interpretation of the Factual price
Gazprom's RfA	Gazprom's Request for Arbitration dated 16 June 2014
GDP	Gross Domestic Product
GECF	Gas Exporting Countries Forum – an association of leading gas producing countries
GFU	Gas Negotiation Committee – responsible for marketing Norwegian gas
GMS	A Gas Metering Station where Gas quantity and quality parameters are measured. The Gas Metering Stations shall be as follows: GMS Sudzha, GMS Sokhranovka, GMS Serebrianka, GMS Pisarevka, GMS Valuiki, GMS Platovo, GMS Mozyr, GMS Kobrin, GMS Prokhorovka, and GMS Belgorod, cf. Article 1.11 and Article 1.13 Contract
[redacted]	[redacted]
GPL	Gaspool, a virtual trading spot for natural gas in Germany, established in 2009, and operated by Gaspool Balancing Services GmbH
GSU	Gazprom Sbyt Ukraina
GTC	Gas Transit Contract
GTS	Gas Transmission System
Henriksson Report	Expert report of Professor Lars Henriksson dated 14 March 2016
Hesmondhalgh and Way Report	First expert report concerning price revision and determination in respect of Contract No. KP by Serena Hesmondhalgh and Antony Way dated 31 January 2015 ("The Expert Price Report"), "Brattle 1".
ICIS Heren	ICIS Heren, a provider of independent pricing information for global energy markets, covering key energy markets including gas, liquefied natural gas (LNG), electricity, carbon-emissions, coal and oil, cf. also www.icis.com;

IEA	The International Energy Agency, an intergovernmental organisation which acts as an energy policy advisor to its 28 member countries
IGU	International Gas Union – an international industry body
IMF	International Monetary Fund
Interim Agreement	Agreement between the Parties and the Ministers of Energy of Ukraine and the Russian federation, with the assistance of the European Commisssion, on natural gas delivieries by Gazprom to Naftogaz in the winter of 2014/2015
Istat	Italian National Institute of Statistics
June 2014 Claim	Gazprom's additional claim for payment from Naftogaz for gas delivered by Gazprom and off-taken by Naftogaz in June 2014, submitted on 19 November 2014
[redacted]	[redacted]
[redacted]	[redacted]
Kcal/m^3	Kilocalories per cubic metre
[redacted]	[redacted]
[redacted]	[redacted]
Kharkiv Treaty	Treaty of 21 April 2010 between the Russian Federation and Ukraine regarding the extension of the presence of the Russian Federation's Black Sea fleet on the territory of Ukraine
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]

[redacted]

Lapuerta Report (Also called "Expert Competition Report") Expert report prepared by Mr Carlos Lapuerta concerning Naftogaz's Competition Law Claims and defence against counterclaims related to Contract No. KP dated 30 January 2015

Lapuerta 2 Second Expert Report on Competition Issues prepared by Mr Carlos Lapuerta dated 8 October 2015

Lapuerta 3 Third Expert Report on Competition Issues prepared by Mr Carlos Lapuerta dated 31 May 2016

LNG Liquefied Natural Gas. Natural Gas that has been cooled to approximately -162°C, forming a liquid. LNG occupies around 1/600th of the volume of Natural Gas in its gaseous state, and is transported commercially by ship;

LTC Long-term gas supply contract

M Fuel oil

[redacted]

MAV The Minimum Annual Volume specified by Contract KP – the minimum amount of gas that Naftogaz must pay for each year, whether or not the gas is actually taken

MAQ The Minimum Annual Quantity of the Natural Gas, calculated as 0.8 x ACQ, cf. the prevailing version of Article 2.2.5 of the Contract

MECI Ministry of Energy and Coal Industry of Ukraine

[redacted]

Memorandum The Memorandum on Security Assurances in Connection with Ukraine's Accession to the Treaty on the Non-Proliferation of Nuclear Weapons, dated 7 December 1994;

Monthly Delivery Volume	The Gas delivery volume to be determined by the Parties in the manner set out in Article 3.2. hereof, cf. Article 1.8 of the Contract;
Moselle Report	Expert report prepared by Dr Boaz Moselle dated 12 June 2015, submitted by Gazprom with its Statement of Defence and Counterclaim
Moselle 2	Second expert report of Dr Boaz Moselle dated 14 March 2016
Moselle 3	Third expert report of Dr Boaz Moselle dated 26 August 2016
Moselle 4	Fourth expert report by Dr Boaz Moselle dated 29 March 2017
Mr Way	Mr Anthony Way of the Energy Contract Company
Naftogaz	National Joint Stock Company "Naftogaz of Ukraine" – Claimant in these arbitral proceedings;
Naftogaz Factual Price	Naftogaz's interpretation of the Factual Price
NBP	National Balancing Point – the UK gas trading hub
[redacted]	[redacted]
NCSEPUR	National Commission for State Energy and Public Utilities Regulation – the Ukrainian Energy Regulator
NERC	The Ukrainian Energy Commission
Notice	Naftogaz's 28 April 2014 Notice of dispute and request for negotiations and consultation, and notice of arbitration
NTS	National Transmission System
NYMEX	New York Metals Exchange
Ofgem	Office of Gas and Electricity Markets, the British energy regulator
OIES	Oxford Institute for Energy Studies
Opex	Operating expense
OTC	Over the Counter – a form of trading using brokers as intermediaries
[redacted]	[redacted]

[redacted]	[redacted]
Party and Parties	Buyer and/or Seller as well as Claimant and/or Respondent individually or jointly;
Payment Claims	Gazprom's claims for payment for deliveries of Natural Gas in the period from November 2013 to December 2014, in the period from April 2014 to May 2014, and in June 2014;
PECL	Principles of European Contract Law
PGNiG	Polskie Gornictwo Naftowe i Gazownictwo
Platts NWE index	The index of prices for energy products in North West Europe produced by Platts, a provider of energy and metals information and a source of benchmark price assessments in the physical energy markets
Price review period	The period from 19 January 2009 to the Effective Date of this price review, i.e. principally 20 May 2011;
Protocol	The Protocol concerning the Accession of Ukraine to the Energy Treaty of 24 September 2010
PSV	Punto di Scambio Virtuale – the Italian natural gas hub
QED	The qualified effects doctrine
RAB	Regulatory Asset Base
Reply	Claimant's Statement of Reply and Defence to Counterclaim of 8 October 2015;
Resolution No. 260	The Russian Government's Resolution of 2 April 2014 "On declaring Resolution No. 291 of the Government of the Russian Federation of 30 April 2010 to be no longer in force" with effect from 2 April 2014
Resolution No. 291	See Decree No. 291
Respondent	OJSC Gazprom / Gazprom
RUE	RosUkrEnergo AG, an intermediary supplier of natural gas to Ukraine (from the beginning of 2005 to the end of 2008), a Swiss based company co-owned (50/50 joint venture) by Gazprom and the group of companies owned and/or controlled by the Ukrainian businessman Mr Dmytro Firtash
[redacted]	[redacted]

[redacted]	[redacted]
SCA	The Swedish Contracts Act
SO	Statement of Objections issued by the European Commisssion to Gazprom
SoC	Claimant's Statement of Claim of 31 January 2015
Sonatrach	Sonatrach Spa
Statoil	Statoil ASA
Take or Pay Claims	Gazprom's claims for payment of Natural Gas made available by Gazprom, but not off-taken or paid for by Naftogaz in 2012, 2013 and in the period from 1 January 2014 to 31 October 2014
TANAP	Trans-Anatolian Natural Gas Pipeline
TBG	Dr Hesmondhalgh and Mr Carlos Lapuerta
TCM	Thousand cubic metres
Technical gas	The gas required to run the compressor stations (also called "fuel gas")
TFEU	The Treaty on the Functioning of the European Union
ToP	Take-or-pay
TRANS ARB	Refers to documents submitted in the Transit Arbitration
Transit Arbitration	SCC Arbitration V 2014/129
Treaty	The Treaty between Ukraine and the Russian Federation on the presence of the Russian Federation's Black Sea Fleet on the territory of Ukraine, dated 21 April 2010;
Tribunal	The arbitral tribunal in this case, SCC Case V 2014/078. Also referred to as the "Arbitral Tribunal";

TTF	Title Transfer Facility – the Dutch natural gas trading hub. (A virtual trading point for natural gas in the Netherlands and the first of its kind in North Western Europe. It was set up by Gasunie in 2003 and is operated by an independent subsidiary of Gasunie, Gasunie Transport Services B.V., and allows gas to be traded within the Dutch Gas Network.)
UGSF	Under ground storage facilities
Ukrtransgaz	Naftogaz' wholly owned affiliate, operator of the Ukrainian GTS
UNIDROIT Principles	Means the UNIDROIT Principles of International Commercial Law;
USD	Means United States dollar or US dollar, the currency of the United States of America
WACC	Weighted Average Cost of Capital
Vienna Convention	The Vienna Convention on the Law of Treaties
Wingas	Wingas GmbH
Witschen Report	Expert report prepared by Mr Bernhard Witschen dated 12 June 2015, submitted by Gazprom with its Statement of Defence and Counterclaim
Witschen 2	Second expert report of Mr Bernhard Witschen dated 14 March 2016
Witschen 3	Third expert report of Mr Bernhard Witschen dated 26 August 2016
Yield Interest	Interest accruing in accordance with Section 2 and 5 of the Swedish Interest Act (1975:635)
ZTP	Zeebrugge Trading Point – a Belgian natural gas trading hub