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Transit of Russian gas across Ukraine: conditions for post-2024 continuation

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Katja Yafimava, Senior Research Fellow, OIES

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Contents

Figures and Tables

1. Introduction

On 1 January 2025 the package of commercial, legal and technical agreements between the Ukrainian (state-owned) gas company (Naftogaz), the Ukrainian (state-owned) gas TSO (GTSOU), and the Russian (majority state-owned) company Gazprom, underpinned by a trilateral political agreement between the European Commission (EC), the Ukrainian government, and the Russian government – thereafter all together referred to as the Transit Agreement – will expire. This Agreement, signed on 30 December 2019, has provided political, commercial, technical and legal grounds for the transit of Russian gas across Ukraine during 2020-24. Although the Agreement provides for a possibility of extension, the Ukrainian government has repeatedly stated that it will not extend the Agreement because of its unwillingness to have a direct relationship with the Russian government and Gazprom as long as the armed conflict between two countries continues.[1] Once the Agreement expires – and if no extension or alternative transit arrangement are agreed – the transit of Russian gas across Ukraine will stop. The EC has asserted that the EU is 'ready to live' without Russian pipeline gas that is still transiting Ukraine – 14 bcm in 2023 – and that it will not put pressure on Ukraine to renew the Agreement.[2] The Russian government has stated that it will provide the gas for delivery across Ukraine if a legal framework for transit will be put in place.[3] While at the time of this paper going to print in early December 2024 no such framework has been agreed – and neither the EC nor the Ukraine government statements bode well for this to happen – nonetheless, transit cessation is not yet a foregone conclusion.

A plethora of studies have been published to date, analysing 'the post-2024 transit question', assessing whether the transit will continue, analysing the impact of potential stoppage, assessing its probability,[4] exploring access to alternative supplies,[5] and making various policy recommendations.[6] Few – if any – have analysed the incentives (both short- and longer-term) for the EU, and especially its Member States most affected by potential stoppage, such as Slovakia and Austria, to step up and find an agreement that would enable transit to continue. Even fewer studies have analysed conditions under which such an agreement could be politically feasible, including a possibility of it to be (one part of) a process, eventually leading towards negotiated settlement of the ongoing military conflict.

This Paper aims to fill this gap by:

- estimating the impact of transit cessation on the EU as a whole and the potentially most affected Member States;
- reviewing the existing Transit Agreement and its signatories' positions on its (non-)extension;
- analysing the incentives (and barriers) for finding an alternative transit arrangement, which would enable continued transit, and exploring the form(s) it could take (particularly analysing the possibility of European companies taking delivery of Russian gas at the Russian – Ukrainian border and booking capacity in the Ukrainian transmission system for shipping it across Ukraine);
- outlining <u>the minimal conditions</u> – political, legal/regulatory and commercial – that would have to be met for transit to continue after 31 December 2024.

[1] 'Ukraine's Naftogaz in talks with Azerbaijan's SOCAR on transit, storage: CEO', *S&P*, 7 August 2024.
[2] EC (2024b).
[3] 'Novak listed conditions for continued transit of Gazprom's gas across Ukraine', *Interfax*, 9 October 2024.
[4] Vakulenko (2024); Corbeau and Mitrova (2023).
[5] Pinto (2024a), Pinto (2024b), Halser and Skaug (2024).
[6] Keliauskaitė and Zachmann (2024), Łoskot-Strachota, Matuszak and Rudnik *(2024).*

2. Changing dynamics of Russian gas exports to Europe and the EU position on post-2024 transit across Ukraine

In the immediate aftermath of the start of the armed conflict between Russia and Ukraine on 24 February 2022, the EU made a political choice to phase out Russian gas from its energy balance. This was reflected in the Versailles Declaration, whereby all EU Member States agreed to "phase out' dependence on Russian gas imports 'as soon as possible'. Member States have invited the EC to propose a REPowerEU Plan to this effect.[7] While no specific phase-out deadline has been enshrined in the EU *acquis* so far, a document accompanying the REPowerEU Plan, presented in May 2022 by the EU Directorate for Energy, DG ENER, headed by Commissioner Kadri Simson, contained a list of measures which would have to be implemented for the phase-out to be completed by 2027.[8] The year 2027 was also earmarked by the EC President, Ursula von der Leyen, as the intended year that the phase out would be completed.[9] An EC spokesperson has since referred to the 2027 'deadline' as 'indicative'.[10] Notably, while the REPowerEU Plan aims for the phase-out of Russian fossil fuels (including gas), it also pledges that the EU must ensure that such phase-out is 'both achievable and affordable for all Member States'.[11] There is no easy way of balancing these aims, as an overly fast phase-out of Russian gas could result in increased gas prices in Europe. This was acknowledged by the (then) Commissioner-Designate for Energy, Dan Jørgensen, during his confirmation hearings at the European Parliament on 5 November 2024.[12]

EU imports of Russian pipeline gas

According to the EC, EU imports of Russian pipeline gas have already fallen sharply from 150 bcm in 2021 to just 25 bcm in 2023.[13] This decrease was due to a combination of several factors, including:

- non-availability of pipeline export capacity affecting Russian gas exports to several EU Member States, e.g.
  - mutual sanctioning in May 2022 by Polish and Russian governments of the Yamal-Europe pipeline operator, EuroPolGaz, which made Gazprom unable to book capacity in the Yamal-Europe pipeline;[14]
  - an interrupted turbine repair and maintenance cycle and subsequent explosions on the Nord Stream pipelines in September 2022 rendering them physically inoperable, thus making supplies to Germany, France, Italy, Austria and Czechia via Nord Stream impossible;[15]
- refusal of several EU Member States' gas buyers (Poland being the largest market) to switch to the 'gas-for-rouble' payment scheme, introduced by the Russian government in May 2022, which led Gazprom to cut their supplies off;[16]
- national prohibition on imports of Russian gas in several Member States (adopted by Estonia, Lithuania, and Latvia).[17]

All of these factors have contributed to sharp price increases. Average monthly TTF prices at which alternative supplies had to be sought were in the €80-235/MWh range throughout 2022 – with EU gas

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[7] Council (2022), *Versailles Declaration*.
[8] EC (2022), REPowerEU Plan, p. 2.
[9] President Ursula von der Leyen opening remarks, 11 March 2022.
[10] 'Austrian energy minister targets 2027/27 Russian gas exit', *Energy Intelligence*, 19 April 2024.
[11] EC (2022), REPowerEU Plan, p. 2.
[12] Confirmation hearing of Dan Jørgensen, Commissioner-designate, Energy and Housing, European Parliament, 5 November 2024.
[13] EC (2024e). OIES in-house research suggests that imports of Russian gas by EU27 and the UK (which introduced policy to exclude all imports of Russian fuels) were 142 bcm in 2021, based on ENTSOG data.
[14] Notably, Russian gas flows to Germany via Yamal-Europe pipeline had stopped in 2021, even before mutual sanctions were introduced in May 2022, as by that time all Russian gas supplies to Germany were delivered via Nord Stream.
[15] Fulwood, Stern, Sharples and Yafimava (2022).
[16] Ason (2022), Yafimava (2022).
[17] Similar ban is currently under consideration in Finland, see Yafimava, Ason and Stern (2024b).

demand falling dramatically by 18% between August 2022 to July 2024, according to the EC,[18] partly in response to very high prices, relatively warm winters, and EU and Member State policy measures aimed at reduced gas consumption (including the REPowerEU policy of phasing out Russian gas).

EU imports of Russian LNG

While reduced gas consumption and sharpy increased imports of US LNG were the main factors alleviating Europe's gas balance during the 2021-23 crisis, imports of Russian LNG into the EU-27 plus UK (without subtracting re-exports) rose only slightly from 18.2 bcm in 2021 to 20.7 bcm in 2023.[19] It is worth nothing that unlike Russian pipeline gas – all of which is now sold under Gazprom's LTSCs – most Russian LNG coming to Europe originates from Novatek's Yamal LNG project and is sold under Novatek contracts.[20] Of these volumes ~25% was transhipped in EU ports for onward delivery outside the EU, mostly to Asia.[21] Among other measures, the EU's 14th sanctions package, adopted unanimously in July 2024, introduced a ban on the transshipment of Russian LNG through EU ports to non-EU countries. Transshipment of Russian LNG through EU ports to EU counties has not been banned but derogations would have to be sought for this activity.[22] The package has also banned imports of Russian LNG into EU 'off-grid' import terminals – terminals not connected to the EU gas grid – from 26 September 2024, resulting in cessation of imports into four terminals (two in Sweden, and two in Finland). Imports of Russian LNG into the EU terminals connected to the grid – constituting an overwhelming majority of EU LNG import capacity – have not been prohibited.

In 2023 overall EU imports of Russian gas – pipeline and LNG – stood at ~40 bcm, a much lower level of EU dependence on imports of Russian gas compared to pre-crisis levels. While EU imports of Russian pipeline gas and LNG increased in the first half of 2024 – which according to the EC *could* result in an additional 6 bcm of pipeline gas and 2 bcm of LNG in 2024 compared to 2023[23] – the overall level of dependence on Russian gas in the EU remains low, with the exception of several central and east European EU Member States. Some of these receive their Russian gas imports exclusively through the Ukrainian corridor, under the Transit Agreement, expiring on 1 January 2025.

The EC position on the Russian gas phase-out and continued (or discontinued) transit across Ukraine

Having achieved a very significant reduction of dependence on Russian gas over 2021-23 (from 45% to 18%), the EU remains committed to the complete phase-out of Russian and therefore views any increase in Russian gas imports with concern. In October 2024, the outgoing EU Commissioner for Energy, Kadri Simson, expressed 'deep concern' about an increase in Russian gas imports in the first half of 2024, which *could* result in higher imports in 2024.[24] While acknowledging that such an increase was 'partly due to temporary circumstances',[25] she warned against 'the risk of backtracking on the REPowerEU agenda' and called upon the EU to be 'vigilant' that the increase 'does not become a structural trend'. Thus the EU Member States' gas buyers remain under significant political pressure to reduce imports of Russian gas – both pipeline and LNG – which is reflected *inter alia* by renewed calls for more sanctions against Russian LNG.[26] The political will for phasing out Russian gas is also evident

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[18] EC (2024e), Report on the state of the Energy Union and follow up on the implementation of the REPowerEU Plan – presentation by the Commission, Brussels, 4 October 2024.
[19] OIES in-house research based on Kpler data. The UK government imposed a ban on Russian LNG imports which came into force in December 2022.
[20] LNG from Vysotsk is sold under Gazprom Export contracts despite also being a Novatek's project as Novatek does not have an export license in respect of this project. It was mostly delivered to Finland and Sweden but as imports of Russian LNG to off-grid LNG terminals have been banned from 26 July 2024, these imports have stopped.
[21] Yafimava, Ason and Stern (2024b).
[22] Ibid.
[23] EC (2024c).
[24] Ibid.
[25] Ibid.
[26] EC (2024c), Remarks by Commissioner Simson at the press conference of the Energy Council, 15 October 2024; 'EU energy ministers discuss Ukraine energy crisis, Russian LNG', *Reuters*, 15 October 2024; 'More transparency on Russian gas imports sought by EU countries, document shows', *Reuters*, 14 October 2024; 'France calls for tighter monitoring of Russian gas

from the statement of the Commissioner-Designate for Energy, Dan Jørgensen, pledging to present an Action Plan for phasing out Russian gas even before the 2027 'deadline' in the first quarter of 2025.[27]

However, given that the 2027 phase-out 'deadline' has not been formally endorsed by the Council and is not legally-binding, and also given the EC pledge that such a phase-out must be 'achievable and affordable for all Member States' – a premise that would be severely tested, particularly in respect of Slovakia and Austria, should gas transit via Ukraine stop on 1 January 2025 – its speed and date by which it will be achieved are uncertain. In her October 2024 remarks, Commissioner Simson did not mention 2027 (or any other phase-out 'deadline') while noting that the EU had 'the tools for a gradual, full phase out of Russian imports', referring to the provisions of EU's Decarbonised Gas and Hydrogen Package[28] as well as to its 14th sanctions package which provide legal instruments for Member States to limit imports of Russian gas. Jørgensen's promised roadmap for the pre-2027 phase out would also have to be balanced against the EC's earlier pledge for it to be 'achievable and affordable'.

This suggests that while the EU is still politically committed to phasing out Russian gas from its energy balance, there appears to be little certainty about the date by which it would be completed. This could be explained by the EU understanding that an overly fast phase-out would inevitably lead to price increases in Europe, still reeling from the 2022 price shocks, as well as by the fact that not all of its Member States are equally enthusiastic about the phase-out due to uncertainty about alternative supplies and their cost. This is especially true of the new 'wave' of LNG, which is still expected to start in late 2025.[29] Estimated year-on-year growth of the new LNG has changed compared to original estimates, pushing more projects later, so that the 'wave' will only ramp up over the years (with particularly strong growth in 2027).[30] Significant uncertainty remains about the availability of global LNG in the 2030s due to uncertain post-2030 growth, which is subject to many factors, few of which would be under EU control. Finally, uncertainty about EU gas demand in light of its far-reaching decarbonisation policies blurs the picture further.

Nonetheless, Commissioner Simson stated that the EU was 'ready' for the end of the Transit Agreement between Gazprom and Naftogaz. The EU Agency for the Cooperation of Energy Regulators (ACER) warned that if the Transit Agreement is not extended, it could potentially lead to a loss of 13.6 bcm of gas supply to the EU compared to 2023.[31] Simson said the EU 'can live' without this gas should transit stop on 1 January 2025.[32] She added that the EC has been 'working closely with the most impacted Member States to prepare for a zero-transit scenario', asserting that there are 'diversified options to fully replace the 14 bcm of Russian gas' currently transiting via Ukraine.[33] It is understood that the EU has conducted a modelling exercise to understand the impact of transit stoppage, and Simson's statement appears to have been based on this exercise. (However, the results of this exercise have not been published.) In November 2024, the EC announced that it had run another exercise 'to test the resilience of the EU security of supply framework' […] 'under extremely severe conditions, also in view of the end of the transit of gas', which 'confirmed that the EU is well prepared and well-equipped in terms of security of gas supply to face the most severe and unlikely scenarios'.[34] (The results of this exercise are expected to be published before the end of 2024).

At the same time, Simson acknowledged that some Member States might 'prefer to continue importing Russian gas' and do so 'even beyond contracted capacity'. While saying that such a political choice was

exports to EU', *Financial Times*, 15 October 2024; 'Belgium calls for EU ban on Russian gas as imports rise', *Financial Times*, 26 September 2024; 'Belgium calls for tracking system for Russian LNG', *Belga news agency*, 15 October 2024; 'No time to give up on Russia sanctions', *Financial Times*, 1 August 2024; 'EU Member States propose tracking Russian LNG imports', *Energy Intelligence*, 15 October 2024.

[27] European Parliament Dan Jørgensen hearings, 5 November 2024.

[28] The Package enables Member States to take measures to 'temporarily restrict natural gas supplies from the Russian Federation and Belarus, for a fixed term […] by limiting up-front bidding for capacity by any single network user at entry points from the Russian Federation or Belarus, where that is necessary to protect their essential security interests and those of the Union', see Regulation (EU) 2024/1789 on the internal markets for renewable gas, natural gas and hydrogen, 13 June 2024, Art. 6.

[29] Farren-Price, Sharples and Honoré (2024).

[30] 'Next wave of LNG supply delayed to 2027 due to project hold-ups, TotalEnergies says', *Reuters*, 22 October 202

[31] ACER (2024a), 'Analysis of the European LNG market developments: 2024 market monitoring report', 19 April 2024.

[32] EC (2024c).

[33] Ibid.

[34] EC (2024d).

‘dangerous’, she stopped short of stating that the EC would intervene to prevent Member States from doing so. Furthermore, in December 2024, Simson confirmed that European companies are still allowed to “negotiate with the Ukrainians and continue their purchase” of gas from Russia and ‘it is possible for them to buy Russian gas at the Ukrainian border.[35] It could be argued that having significantly reduced its dependence on Russian gas imports during 2022-24 and having introduced various safeguards in the EU *acquis* aimed at curtailing Russia’s ability to manipulate supplies in the future (e.g. mandatory certification of storage operators, exclusion of Russian pipeline gas & LNG from the EU Energy Platform, and the possibility to restrict import capacity for Russian gas by individual Member States), the EU *as a whole* might no longer consider <u>some</u> Russian gas in its energy balance as a security threat, thus reducing the perceived urgency of accelerated phase-out. It is in this context that the question of post-2024 Russian gas transit – and the EC attitude towards European gas buyers achieving an agreement enabling transit to continue post-2024 – needs to be analysed.

3. Impact on EU Member States if no post-2024 transit agreement is reached

European imports of Russian gas and alternative supplies: routes and border crossings

At present, Russian pipeline gas is – and can only be – imported by several EU Member States and non-EU Balkan countries via two routes – the Ukrainian corridor and TurkStream.[36] The Ukrainian corridor has four interconnection points (IPs) via which Russian gas can flow to the EU – with Poland (Drozdovichi), Slovakia (Veľké Kapušany),[37] Hungary (Bereg) and Romania (Isaccea) – and several smaller IPs enabling this gas to flow to Moldova (Figure 1). As of 2023, Slovakia’s Veľké Kapušany has effectively become the only IP for imports of Russian gas into the EU via Ukraine, as imports via Hungary’s Bereg and Romania’s Isaccea had stopped. While there are gas flows across the border from Ukraine into Poland at Drozdovichi, these are the result of traders buying gas on the Ukrainian market and re-selling it into Poland.[38] Gazprom cut gas deliveries to Poland under its contract with PGNiG in April 2022, when PGNiG refused to pay under new ‘gas for roubles’ procedure,[39] and the contract expired at the end of 2022.

Figure 1: Entry points of Russian pipeline gas to the EU, Ukraine and Moldova

Source: ENTSOG (adapted by the author)

[35] ‘EU’s outgoing energy chief warns against masking Russian gas imports’, *Financial Times*, 1 December 2024.
[36] Two other corridors – Nord Stream / Nord Stream 2 and Yamal-Europe – have remained inoperable for political, physical, and regulatory reasons. Both strings of Nord Stream and one string of Nord Stream 2 are damaged whereas another string of Nord Stream 2 is physically intact, but its certification was put on hold by the German regulator in February 2022).
[37] There is also another IP – Budince – used for imports of gas from the EU to Ukraine.
[38] While this gas is non-Russian contractually, the physical molecules are likely Russian. These volumes constitute around 4% of consumption, see Pinto (2024a).
[39] Introduced by the Russian government in March 2022, see Yafimava (2022).

In 2023 and 2024 the following EU Member States, whose buyers have long term supply contracts (LTSCs) with Gazprom Export, were receiving their Russian gas imports **via Ukraine**: Slovakia, Austria (via Slovakia), Hungary (via Slovakia and Austria),[40] Italy (via Slovakia and Austria), and Czechia (via Slovakia).[41] Hungary's MVM has a 15-year long term contract with Gazprom Export for 4.5 bcma, signed in 2021. Whereas the majority of deliveries were to be made via TurkStream (see below), a smaller share would arrive via Nord Stream (across Germany, Czechia, Slovakia, and Austria, thus arriving at the Austria – Hungary border.)[42] As Nord Stream became inoperable in 2022, this volume was instead delivered via Ukraine, Slovakia and Austria, still arriving at the Austria – Hungary border. Notably, since July 2023, Hungary's imports via Austria have fallen to much lower levels, and since September 2023 have fallen to almost zero, with Hungary receiving nearly all of its Russian gas imports via TurkStream. Slovenia's Geoplin, which was previously importing Russian gas via Ukraine (across Slovakia and Austria), has terminated its long-term contract with Gazprom Export (which was set to expire in 2028) at the end of 2022, and deliveries stopped in 2023.[43] (Moldova (non-EU) is still receiving all its Russian gas imports via Ukraine; this gas is consumed by the breakaway region of Transdniestria whereas the rest of Moldova is supplied by imports from Romania.)

During the same period, two Member States, whose buyers have long term supply contracts with Gazprom Export, were receiving their Russian gas imports **via TurkStream**: Hungary (via Bulgaria and Serbia) and Greece (via Bulgaria). Romania was importing Russian gas via TurkStream (via Bulgaria) under supply contract with Gazprom's subsidiary WIEE Romania,[44] but these deliveries stopped once the Russian government imposed sanctions on WIEE Romania in May 2022.[45] Bulgaria was also receiving Russian gas via TurkStream under a Bulgargaz contract with Gazprom Export but deliveries were cut off in April 2022, following Bulgargaz's refusal to pay in line with the new 'gas for rubles' procedure.[46] The contract expired at the end of 2022. Croatia's PPD was receiving Russian gas via TurkStream as of late 2021 under a supply contract with Gazprom (valid until 2027) but there were no flows in 2024.[47] TurkStream has also been used for exports of Russian gas to several non-EU European countries: Serbia (via Bulgaria), Bosnia & Herzegovina (via Bulgaria and Serbia), and North Macedonia (via Bulgaria).

The table below provides an overview of various routes and border crossings via which Russian gas is currently delivered to Europe as well as potential routes via which alternative supplies could be delivered if gas transit via Ukraine stops (Table 1).[48]

Should the Transit Agreement lapse on 1 January 2025 without replacement, most of ~14 bcma of Russian gas volumes transited across Ukraine would disappear from the European market. While this volume is not very significant to Europe as a whole, it is certainly important for several individual EU Member States. Its loss would complicate the next two winters, although to a significantly lower degree compared with the potential problems of the past two winters.

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[40] Historically, Hungary received its Russian gas via Ukraine directly at Beregovo IP but switched to receiving it via TurkStream in October 2021. In late 2021, Hungary's MVM signed a new supply contract with Gazprom, with the majority of deliveries (~3/4) to be made via TurkStream and a smaller share (~1/4) via Nord Stream (across Germany, Czechia, Slovakia, and Austria, thus arriving at the Austria-Hungary border, see Losz (2023). As Nord Stream became inoperable in 2022, this share was instead delivered via Ukraine, Slovakia and Austria, still arriving at the Austria-Hungary border. However, since July 2023, Hungary's imports via Austria have fallen to much lower levels, and since September 2023 has fallen to almost zero, with Hungary since receiving nearly all of its Russian gas imports via TurkStream.

[41] While deliveries to Slovakia, Austria and Hungary were direct purchases under LTSCs, it is unclear whether deliveries to Italy and Czechia were under LTSCs or represent gas bought at the European exchanges.

[42] 'Hungary signs new gas deal with Gazprom', *Politico*, 31 August 2022. Also see Losz (2023).

[43] Geoplin, 'Slovenia no longer relies on Russian gas', 20 May 2024. To compensate for lost volumes of Russian gas, Geoplin has increased purchases of Algerian gas and has also been buying gas at the Austrian exchange (some of which is likely to be of Russian origin).

[44] 'Romania becomes net gas exporter', *Argus*, 1 December 2022.

[45] In total 31 Gazprom's subsidiaries have been sanctioned, see Russian Government Declaration N 851, 11 May 2022.

[46] Yafimava (2022).

[47] See Pinto (2024b). Prior to TurkStream start of operation, Croatia's PDD was receiving Russian gas imports via Ukraine (across Hungary).

[48] For gas flows analysis, see OIES Quarterly Gas Reviews.

Table 1: Import routes for Russian gas supplies to Europe (Ukraine corridor and TurkStream) and routes for alternative supplies

European countries importing Russian gas through Ukraine and/or TurkStream, 2022-24	Delivery points	Ukraine corridor: routes and borders		TurkStream: routes and borders		Alternative supplies routes and borders if no post-2024 transit across Ukraine is agreed (examples)
		Route	IPs	Route	IPs	
EU countries						
Austria	Baumgarten	RU-UA-SK-AT	3			NL-DE-AT, DE-AT; IT-AT
Slovakia	Veľké Kapušany	RU-UA-SK	2			PL-SK; DE-CZ-SK; HU-SK
Hungary	Kiskundoroszma	RU-UA-SK-AT-HU	4	TR-BG-RS-HU	3	HR-HU; AT-HU
Czechia		RU-UA-SK-CZ	3			DE-CZ
Italy	Baumgarten	RU-UA-SK-AT-IT	4			LNG; AG-TS-IT; AZ-TR (TANAP)-GR-AB-IT (TAP)
Slovenia	Ceršak	RU-UA-SK-AT-SL	4			AT-SL
Croatia	Rogatec	RU-UA-SK-AT-SL-HR	5			LNG
Poland	Drozdovichi	RU-UA-PL; RU-BL-PL	2			
Greece	Sidirokastron			RU-TR-BG-GR	3	LNG
Bulgaria	Strandzha-2			RU-TR-BG		
Romania	Negru Voda			RU-TR-BG-RO	3	RO
Non-EU countries						
Moldova	Grebenyky	RU-UA-MD	2			RO-MD; TR (TurkStream)-BG-RO (TransBalkan)
Serbia	Zaychar			RU-TR-BG-RS	3	
Bosnia & Herzegovina	Zvornik			RU-TR-BG-RS-BH	4	
North Macedonia	Zidilovo			RU-TR-BG-NM	3	
Turkey	Kiyikoy*			RU-TR	1	

Source: ENTSOG, author's compilation

*Turkey also imports Russian gas via Blue Stream delivered at Samsun

Slovakia and Austria would appear to be most significantly affected. In 2023 Slovakia relied on Russian gas via Ukraine for ~60% of its gas supplies.[49] It shares a border with the countries which would also be affected by transit cessation (such as Czechia and Austria), it is landlocked and is far away from the LNG import terminals.[50] Austria's average dependence on Russian gas has been ~70% during 2022-24.[51] Austria also imports alternative supplies from Germany but these imports declined in 2024 as the German 'storage levy' made them significantly more expensive than Russian gas (Section 3). As a result, Austria's reliance on Russian gas has increased in 2024.

Hungary, although also landlocked, would be in a less difficult position. Having diversified its import routes for Russian gas it is able to receive Russian gas both via TurkStream and Ukraine. In fact, as of September 2023 Hungary has been receiving nearly all its Russian gas imports via TurkStream at the Hungarian – Serbian border, with flows via Ukraine (across Slovakia and Austria) dropping to near zero. This suggests that as long as the TurkStream corridor remains operational, Russian gas imports into Hungary would be assured.

Italy, which has already reduced its imports of Russian gas to very low levels, would be least impacted. By virtue of being a coastal country with several LNG terminals it could procure replacement volumes from the global LNG market. (It also has access to Algerian pipeline gas (via Tunisia and the Enrico Mattei offshore pipeline), Libyan gas (via the Green Stream offshore pipeline) and Azeri gas (via TAP), but additional supplies through these pipelines are unlikely in the short term and uncertain in the longer term. While there are gas flows across the border from Austria to Italy – albeit significantly reduced compared to pre-2022 – it is not clear whether these are imports under Italian Eni's long-term contract with Gazprom or cross-border trading, whereby Italian buyers purchase volumes from counterparties on the Austrian VTP.

Czechia (which prior to the crisis received Russian gas via Nord Stream and Germany, switching afterwards to importing non-Russian alternatives via Germany) has again been importing Russian gas via Ukraine since October 2023. This is understood (as was also the case with Austria) to be due to the German 'storage levy' making imports of alternatives via Germany more expensive. According to Kpler, capacity constraints at the German – Czech border could mean that Russian gas flows could not be compensated fully by imports from Germany.[52]

Finally, Poland and Slovenia would be the least affected as their direct purchases of gas from Gazprom have already ceased. Nevertheless, their ability to purchase volumes on the regional spot market – such as Polish imports from Ukraine and Slovenian imports from Austria – will be affected by the increased tightness of the regional market.

Ultimately, given that LNG from global market will be the only alternative source of supply to compensate for Russian gas volumes if transit across Ukraine stops on 1 January 2025 – with European domestic production in decline and with no meaningful increase in non-Russian pipeline gas imports foreseen from anywhere – **LNG availability and the cost of transporting it to the affected Member States** will be the two metrics by which the impact of gas transit cessation on their economies would be measured. Given that several other coastal Member States with LNG import capacity – particularly Germany, with its three (currently underutilized) LNG terminals – would become the "gate-keepers" for this LNG, it is important to ensure there are no undue barriers (commercial, technical or regulatory[53]), obstructing flows to the affected countries.

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[49] 'Central Europe makes progress towards energy independence', *EIU*, 8 October 2023.
[50] Although it does have an IP with Poland from where some LNG could arrive.
[51] 'Austria urgently seeks to cut ties with Russian gas amid "massive risk"', *RBC-Ukraine*, 13 August 2024,
[52] Pinto (2024a).
[53] Such as, for example, the German 'storage levy' analysed below.

Availability of LNG on the global market

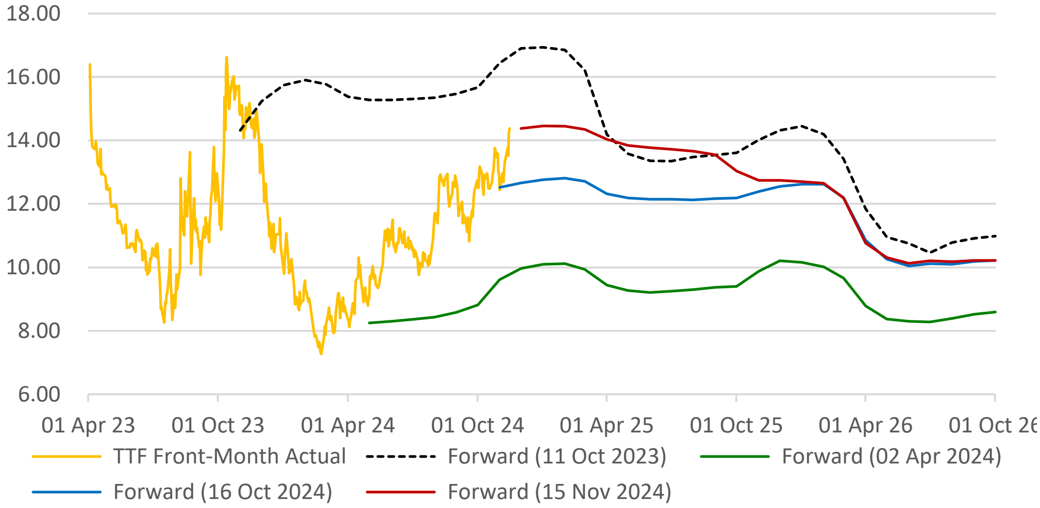
Various studies e.g. by Kpler[54] and Rystad[55] as well as OIES in-house modelling[56] indicate sufficient availability of LNG for the European market during winter 2024-25, albeit acknowledging ongoing market tightening, reflected in gas price increases as of Q2 2024 (Figure 2). There is also sufficient capacity available for bringing such supplies in, although some bottlenecks could not be ruled out.

Transportation cost for alternative supplies: additional levies and their impact

Austria, Slovakia, Hungary and Czechia gas buyers have sought to prepare for potential cessation of Russian gas transit across Ukraine – by concluding new contracts for alternative supplies or preparing to procure spot volumes, as well as by booking capacity in relevant LNG import terminals and transmission networks (Section 5). As noted earlier, these supplies would have to travel over long distances and cross several borders (see Table 1) thus making the cost of transportation an important factor impacting wholesale gas prices in these countries. In this context, an avalanche of various levies, either adopted (Germany) or under consideration (previously – in Italy and Austria, currently – in the Netherlands) – aimed at recouping heavy losses incurred by purchasing gas to fill their respective gas storages during the 2021-23 energy crisis might have a negative impact on prices and affordability for the next two years.

ACER's overview of the costs of cross-border gas transportation capacity (booked on annual basis) shows entry and exit tariffs as well as additional levies, charged at selected border points across the EU (Figure 3). Notably, Germany applied a levy of 1.84 euros/MWh (often referred to as the gas 'storage levy') on natural gas exiting the German gas grid on all of its borders with other countries – with the Netherlands, Belgium, Denmark, Poland, Switzerland, Austria and Czechia. This increases the total cost of transport per border by 2 to 5 times (e.g. by ~5 times at the borders with Austria, France, Switzerland, ~2 times at the borders with Poland, Switzerland and Denmark) thus bringing it in within a range of 2.5 – 4 euros/MWh. Considering that alternative supplies would need to cross two or three borders before reaching potentially affected Member States, additional transportation costs would be considerable. Meanwhile, the levy has been increased to 2.5 euros/MWh for the second half of 2024.[57]

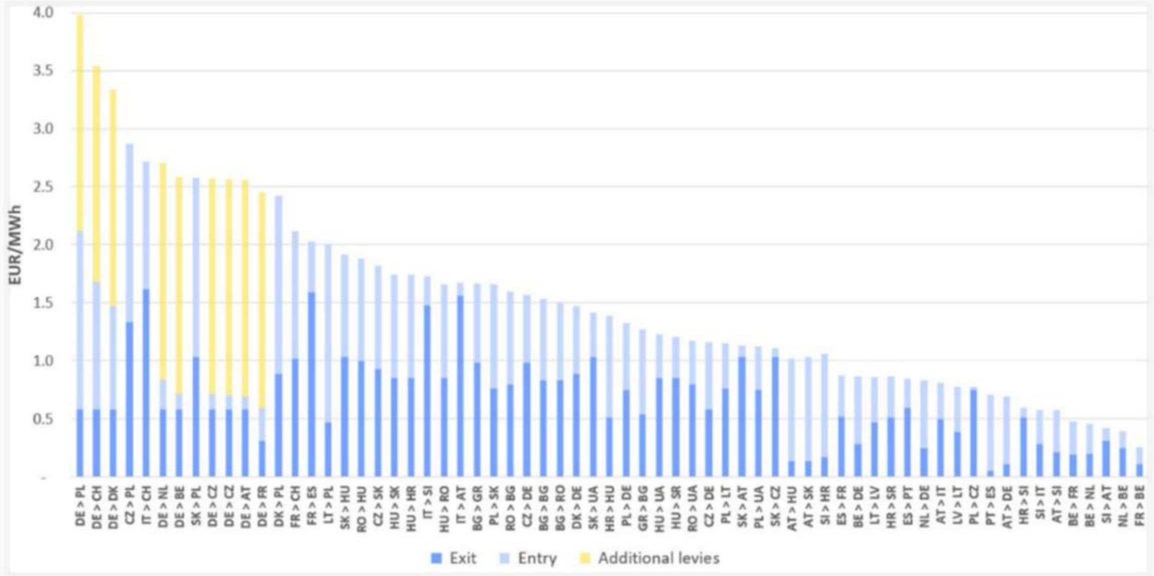
Figure 2: Historic front-month and forward prices for TTF ($/mmbtu)



Source: OIES/Sharples. Data from EIKON Refinitiv (S&P Global). This graph was previously published in the OIES European Gas Market Winter Outlook on 18 November 2024

[54] E.g. Pinto (2024a) and Pinto (2024b).
[55] Halser and Skaug (2024).
[56] Farren-Pirce, Sharples and Honoré (2024).
[57] 'German THE sets gas storage levy at €2.50/MWh', *Argus*, 21 May 2024.

Figure 3: Overview of cross-border gas transport costs at selected countries (yearly product), April 2024, euros/MWh



Source: ACER (2024b)

The German `Storage Levy'

Germany introduced the levy in 2022 (since extended to 2027[58]) to recover at least some of the vast amount of money it spent on purchasing ~50 TWh of non-Russian gas, to compensate for lost Russian gas volumes delivered via Nord Stream before it was sabotaged in September 2022. Average monthly TTF prices at which this alternative gas had to be bought were in the €80-235/MWh range throughout 2022. This gas was needed to fill storage ahead of winter and meet legally-binding storage targets/trajectories – both EU-set and Germany's (even more ambitious) own – hence it has become known as the gas 'storage levy' (or 'storage neutrality charge'). According to Argus, as these purchases were not hedged forward in summer 2022, only ~1/3 (~3.15 bn euros) of the money spent could be recovered leaving the remaining ~6.3 bn euros to be levied on all gas exiting the German grid (including at cross-border IPs).[59] Notably, when Germany first introduced its 'storage levy', Italy also considered introducing a similar levy, but decided against it.[60] However, a similar levy is understood to be currently under consideration in the Netherlands.[61]

Germany, by virtue of its geographic position and being a host to several (currently underutilized) LNG import terminals, would be the key "gate-keeper" for flowing global LNG into the affected region. The presence of any undue barriers for cross-border gas transportation across its territory – such as are currently presented by its 'storage levy' – would undermine this role. In May 2024 the German government agreed for the levy applied to cross-border IPs to be cancelled from 1 January 2025 [62] after the EC criticised the measure and several Member States (Austria, Hungary, Czechia and Slovakia) complained to the EC, questioning the levy's conformity with the *acquis* and pointing out its disproportional impact on the CEE region.[63] Clearly, the levy's cancellation would reduce the costs of transporting imported LNG into the region and hence the wholesale price of gas. However, cancellation was intended to be introduced by means of the government submitting a new law to the German

[58] 'Germany to stop gas storage levy on transit from 2025', *Argus*, 30 May 2024; 'Germany's gas storage levy negatively impacts markets, four EU countries say', *MLex*, 29 May 2024.
[59] Ibid.
[60] 'Italy's Arera proposes gas storage levy', *Argus*, 15 December 2023.
[61] Dutch government eyes gas storage levy from 2026, *Argus*, 18 September 2024.
[62] Levy in respect of gas exiting the grid to domestic consumers would remain in place.
[63] 'Germany to stop gas storage levy on transit from 2025', Argus, 30 May 2024; 'Germany's gas storage levy negatively impacts markets, four EU countries say', *MLex*, 29 May 2024.

parliament. The breakdown of the German governing coalition on 6 November 2024[64] meant that while it would still be possible to pass the law in time for it to take effect by 1 January 2025, it was by no means guaranteed. Until the law is passed, the 'storage levy' would remain in force. On 8 November 2024, the Austrian regulatory authority, E-Control, stated that it will "take all necessary steps" at an EU level if the law abolishing the levy from 1 January 2025 is not passed in time.[65] As this paper goes to print, the levy remains in place.

In its criticism of the German 'storage levy', the EC stopped short of saying whether it violates the EU *acquis*. In March 2024 Commissioner Simson said "[u]nilateral national measures in the form of export restrictions or levies at cross-border exit points put energy solidarity at risk", adding that the levy works 'against efforts to diversify away from Russian gas'. It is worth noting that Regulation 2022/1032, which introduced mandatory storage targets and filling trajectories states that Member States are obliged to take 'all necessary measures' to meet the [storage] filling targets, including compensation to market participants, which 'may, in particular, include […] financial incentives for market participants, including for storage system operators, such as […] providing compensation […] for the shortfall in revenues or for costs incurred by them as a result of obligations on market participants, including storage system operators which cannot be covered by revenue' (Art. 6b.1(f)). This would suggest that the levy could be seen as such compensation. However, the Regulation further states that such measures may include 'collecting the revenues needed to recover the capital and operational expenditures related to regulated storage facilities as storage tariffs and as a dedicated charge incorporated into transmission tariffs collected only from exit points to final customers located within the same Member States' (Art. 6b.1(k)). This suggests that such compensation (levy) could only apply to domestic exits within the German territory, and that imposing the levy in respect of Interconnection Points would violate this requirement. More generally, the TFEU (Art. 28) prohibits 'customs duties on imports and exports and of all charges having equivalent effect'.

The German 'storage levy' – unless abolished from 1 January 2025 – would make replacement of Russian gas supplies more expensive for Member States potentially affected by cessation of Russian gas transit across Ukraine, as they would have pay for transportation of non-Russian gas supplies across multiple countries/borders, including Germany which is the key "gate-keeper" for LNG flow into the affected region. Following the forced exit of FDP from the government coalition there is uncertainty about the ability of what has become a minority government to pass the law rescinding the levy in time. This provides a strong additional incentive to affected Member States to contribute towards finding an agreement enabling post-2024 transit. It also provides justification for the EC not to impede such efforts given that it might be beyond its power to secure a timely cancellation of the levy.

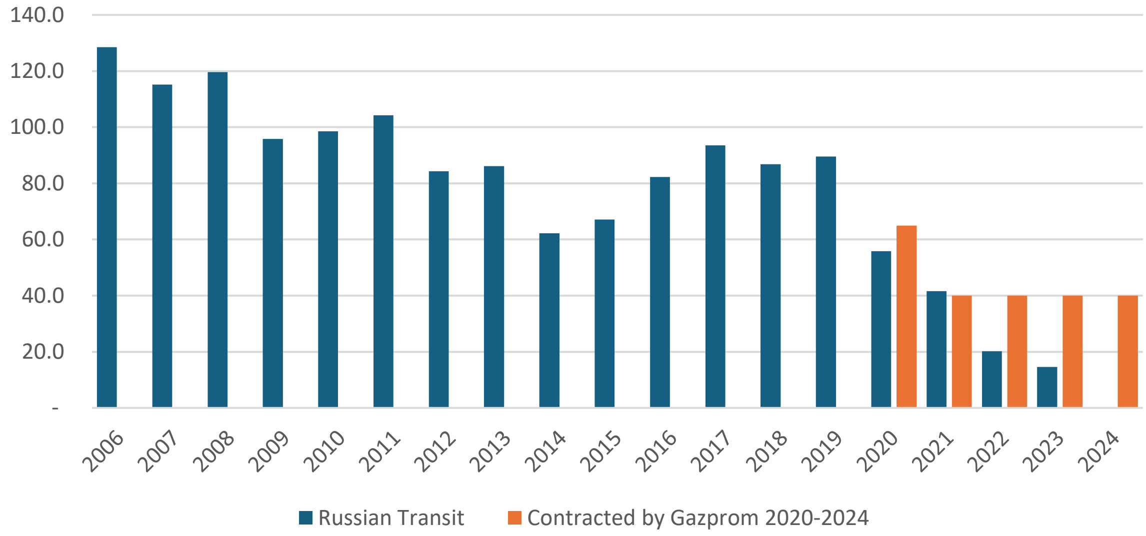
4. The 2020-24 Ukraine gas transit agreement: key points

Ukrainian gas corridor: evolution of transit volumes

The Ukrainian gas transmission system is one of the largest in the world. It was still transiting close to 120 bcma during 2006-2008, before the 2008 crisis lowered the range to 80-100 bcma, before decreasing further to 60 bcma by 2013 as Gazprom started to re-route flows through Nord Stream (Figure 4). Yet the Ukrainian corridor still maintained substantial volume of transit, in the range of 80-95 bcma during 2016-2019, reflecting growing demand for Russian gas in Europe. Transit has fallen sharply since 2020. The Transit Agreement, which underpinned the transit relationship throughout 2020-24, provided for 65 bcm to be transited in 2020 and 40 bcma – during 2021-24. While transit volumes largely held at the agreed levels in 2020 and 2021, they fell to just ~20 bcm in 2022 and ~14 bcm in 2023, less than half the agreed levels.

[64] 'Germany can only change gas levy once law is passed', *Argus*, 12 November 2024.
[65] 'Austria to ask EU to act if German gas levy not removed', *Argus*, 08 November 2024.

Figure 4: Gas transit via Ukraine: actual transit and contracted volumes, bcma



Source: OIES/Sharples, data for gas transit 2006-2021 from Naftogaz Annual Reports 2021 (p. 56) and 2015 (pp. 100-101), and data for 2022 and 2023 from ENTSOG

The Transit Agreement – analysed in the next section – was seen at the time of its signature in December 2019 as the means for guaranteeing transit – and transit revenue – for Ukraine in anticipation of the start of Nord Stream 2 operations, which had been planned for 2021 but were delayed by US sanctions and EU/German regulatory requirements. Although the Agreement was seen as the quid pro quo, allowing Nord Stream 2 to clear the remaining hurdles, the project continued to be plagued by delays after the Agreement was signed. Finally, on 22 February 2024, the German regulatory authority, BNETZA, imposed an indefinite freeze on certification of Nord Stream 2 – which was already filled with gas[66] – in response to Russia's formal recognition of two breakaway regions in eastern Ukraine.[67] In September 2022, one of the Nord Stream 2 pipelines (together with two Nord Stream pipelines) was damaged in a sabotage attack, rendering them inoperable.[68] The EU policy of phasing out Russian gas, adopted in the aftermath of the start of the Russian-Ukrainian armed conflict on 24 February 2024, resulted in exports of Russian gas to Europe falling to levels no longer sufficient to guarantee transit across Ukraine even at the level of 40 bcma, stipulated by the Agreement – even though Nord Stream, Nord Stream 2 and Yamal-Europe pipelines were out of operation. Effectively, reduced European gas demand – coupled with EU determination to reduce imports of Russian gas – has translated into reduced demand for Ukraine's transit services. (Furthermore, the usefulness for Ukraine – and for the EU – of preserving Russian gas transit across Ukraine at any level has become a subject of heated debate.)

The Ukrainian pipeline **gas transmission system** transports domestically produced and imported gas for Ukraine's own consumption as well as transiting Russian gas further onward to Europe. It consists of three main corridors, of which only the central corridor – which includes the Urengoi-Pomary-Uzhgorod pipeline, running from the Urengoi field in Russia, entering Ukraine at Sudzha IP, and going into Uzhgorod on Ukraine's border with Slovakia – is currently used for imports of Russian gas into Europe. The Ukraine-Russia gas supply relationship ended in 2015, when Ukraine decided to stop importing Russian gas. At present, gas is imported to Ukraine from several European countries (both as physical and virtual reverse flow).

[66] 'Nord Stream 2 starts filling second pipe with natural gas', *Reuters*, 17 December 2021.
[67] 'Germany freezes Nord Stream 2 gas project as Ukraine crisis deepens', *Reuters*, 22 February 2022.
[68] 'Gas from Russia's Nord Stream 2 pipeline leaks into Baltic Sea', *Reuters*, 26 September 2022; 'Nord Stream gas 'sabotage': who's being blamed and why?', *Reuters*, 6 October 2022; 'Nord Stream: Denmark closes investigation into pipeline blast', *BBC*, 26 February 2024; Swedish Prosecution Authority, 'The prosecutor closes the Swedish investigation concerning gross sabotage against Nord Stream', 7 February 2024; 'Has the mystery of the Baltic Sea attack been solved?', *Zeit Online*, 14 August 2024.

The Ukrainian gas transmission system is operated by the (state-owned) Ukrainian TSO, Gas Transmission System of Ukraine (GTSOU), in respect of which in December 2019 the Energy Community Secretariat issued an opinion supporting its certification as Ukraine's new gas TSO, unbundled in line with the EU *acquis* (adjusted for EnCT Contracting Parties).[69] Nonetheless, questions remained in the early 2020s about governance and independence of the Supervisory Board of the 'Main Gas Pipelines of Ukraine' (MGU) – a company which held corporate rights in GTSOU and oversaw its activities – and therefore compliance with certification conditions.[70] MGU has since been dissolved and its rights transferred to the Ukrainian Ministry of Energy; the Supervisory Board of GTSOU itself was established in late 2023.[71] This step was made under the law on optimisation of the GTSOU ownership structure, adopted in 2023 and welcomed by the EnCT Secretariat as demonstrating 'Ukraine's dedication towards reassuring the independence and unbundling of its gas transmission operator'.[72]

In addition to transmission, the gas **storage system** is another integral part of the Ukrainian gas system. It is operated by Ukrtransgaz, a subsidiary of (stated-owned) Naftogaz. In April 2023 Ukrtransgaz was certified as an EU *acquis* compliant Storage Operator (SO) under Gas Regulation 715, which was amended during the 2021-23 energy crisis to require mandatory certification of SOs.[73] The Bilche-Volytsko-Uherske storage facility (which has ~32.1 bcm of total capacity, of which 15.7 bcm is active) together with four other (smaller) facilities are located in western Ukraine, close to the border with Slovakia, and constitute more than ½ of Ukraine's total storage capacity.[74] While being one of the key components for ensuring availability of gas for Ukrainian domestic consumption over winter periods, historically Ukrainian storage (particularly western Ukrainian facilities) was used for providing flexibility to European buyers of Russian gas, contracted by Gazprom to be stored by Naftogaz. This Ukrainian-Russian storage relationship ended in 2005, when Gazprom refused to store gas in Ukraine.[75] Since 2020 the Ukrainian storage has been used by European traders, encouraged by Ukrtransgaz and GTSOU through discounted transport tariffs and a "customs warehouse" regime under which stored gas was exempt from customs duties.[76] While initially popular with European traders and profitable for Ukraine, this storage relationship started to diminish in the wake of the February 2022 crisis, although in 2023 European traders were still storing ~2.5 bcm of gas). It, effectively came to an end in 2024 after storage facilities were hit by Russian missiles, changing risk/reward calculations for private traders. Attempts to secure European Bank of Reconstruction and Development (EBRD) and European Investment Bank (EIB) financial guarantees to bridge the gap proved unsuccessful.[77]

At present, the only surviving relationship between Ukraine and Russia in the gas sector is the transit relationship underpinned by the Transit Agreement. If the Agreement is not extended or replaced from 1 January 2025, this relationship will also come to an end.[78]

The GTSOU press service, as quoted by Ukrainian media, stated that the gas transmission system successfully passed 'independent international stress tests' in 2023 and 2024, where a zero-transit scenario was simulated, which 'proved its ability to supply gas to consumers in reverse mode'.[79] However, the end of the transit relationship would pose important questions for the future of the Ukrainian gas system, which was built as part of the integrated Soviet gas system and was designed to

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[69] GTSOU (2019), 'Energy Community Secretariat supports certification of GTSOU, Ukraine's new gas transmission system operator', 17 December 2019.
[70] 'Ukraine gas transit in question after removal of GTSOU CEO by supervisory board', *ICIS*, 22 September 2022.
[71] GTSOU (2023), 'The Supervisory Board of the GTS Operator of Ukraine has been established', 1 November 2023.
[72] Energy Community Secretariat (2023b), 'Secretariat welcomes President Zelenskyy's signing of gas governance reform law', 2023.
[73] Energy Community Secretariat (2023a), 'Ukrainian regulator adopts final certification for gas storage system operator following the Secretariat's opinion', 17 April 2023. Also see Energy Community Secretariat (2019), Opinion 4/19, 17 December 2019.
[74] Pirani (ed), *Russian and CIS gas markets and their impact on Europe*, OIES/OUP, 2009.
[75] Following 'the missing gas' incident when Gazprom accused Naftogaz of its gas being stolen.
[76] Pirani and Sharples (2020a).
[77] 'Brussels woos banks to provide guarantees for gas stored in Ukraine', *Financial Times*, 2 June 2023.
[78] For history and analysis of the Ukraine-Russia gas transit relationship in the 2010s, see Yafimava (2011), *The Transit Dimension of EU Energy Security*, OUP/OIES. For analysis of specific transit disputes, see Stern, Pirani and Yafimava (2009) and Stern (2006).
[79] 'Ukraine's gas transmission system passes two independent stress tests – operator, *Ukrinform,* 9 August 2024.

handle significantly higher domestic and transit gas flows. How and to what extent could the system be decommissioned without negatively affecting domestic security of supply, while also preserving its ongoing integration with the EU market? Questions of cost and financing this process would also have to be addressed.

Under the Transit Agreement, Naftogaz receives a payment of ~1 bn euros per year from Gazprom, most of which is subsequently paid to GTSOU, with Naftogaz retaining the agency fee. It is understood that most of the amount received by GTSOU is spent on system repair and maintenance. Once the Agreement expires and a transit payment stops, this source of financing will disappear thus necessitating an increase in tariffs to pay for future de-commissioning and maintenance of the scaled down system. In October 2020, the (then) CEO of GTSOU, Sergiy Makogon, was open to signing another long-term transit agreement with Gazprom once the Transit Agreement expires, while noting that otherwise system capacity would have to be cut down to decrease costs and provide 'socially acceptable' tariffs for remaining network users.[80] The draft tariff methodology published by the Ukrainian regulatory authority NEURC in November 2024 – which was built on the assumption of zero transit post-2024 – stipulates a two-fold increase in tariffs for the regulatory period 2025-29.

The expiry of the Transit Agreement and the end of the transit relationship pose not only financial/technical questions for Ukraine but also questions related to safety. Despite the ongoing combat, in the process of which many energy (particularly, power) infrastructure sites have been damaged, the Ukrainian gas transmission system has remained largely intact. This suggests that its continued utilisation was seen as useful by both Ukraine and Russia. However, if the Transit Agreement is not replaced by another arrangement and transit stops on 1 January 2025, the system would no longer be useful for Russia, while still being critical for Ukraine's domestic gas supply security, as it is also used for domestic transportation and imports of gas from Europe. This could make the gas transmission system just as vulnerable to potential attacks as gas storage infrastructure already is.[81] This consideration may play a role in Ukraine's willingness to guarantee continued transit as the transmission system is crucial for domestic security of gas supply. According to media reports, Ukraine has asked for guarantees of physical security of its gas infrastructure to be part of any prospective post-2024 transit agreement.[82]

The Transit Agreement (2020-24)

The Transit Agreement, which has underpinned the transit of Russian gas across Ukraine during 2020-24, is a 'package' agreement, which consists of:

- trilateral protocol between the EC, Ukraine and Russia (19-20 December 2019);
- three bilateral agreements (30 December 2019):
    - Naftogaz-Gazprom transportation agreement;
    - GTSOU-Naftogaz transportation agreement (transit contract);
    - Gazprom-GTSOU interconnection agreement.

The trilateral protocol was signed by representatives of the Ukrainian government (Andriy Ermak, Dmytro Kuleba, Oleksiy Orzhel), the Russian government (Dmitriy Kozak, Alexander Novak), and the EC (Maroš Šefčovič), in the presence of representatives of Naftogaz (Yiriy Vitrenko), GTSOU (Sergiy Makogon), and Gazprom (Alexei Miller).[83] It is worth noting that the majority of the government representatives signing the protocol are still in office with broad responsibilities encompassing the energy sector – Ermak in Ukraine, Novak in Russia, and Šefčovič[84] in the EU. As far as representatives

[80] 'Insight Conversation: Sergiy Makogon, Gas TSO of Ukraine', *Platts*, 7 October 2020.
[81] See e.g. Keliauskaitė and Zachmann (2024).
[82] 'Rejection of transit: Ukraine proposed a new scheme of gas supplies to Europe', *RBC-Ukraine*, 17 October 2024.
[83] Trilateral Protocol, 19 – 20 December 2019.
[84] Šefčovič has been confirmed as a Commissioner for Trade and Economic Security in the von der Leyen 2.0 Commission.

of the companies were concerned, both Vitrenko and Makogon have since been replaced.[85] At present, Naftogaz's CEO is Oleksiy Chernyshov (since November 2022) and GTSOU's CEO is Dmytro Lyppa (since March 2023).

The trilateral protocol – leaked to the press shortly after being signed – stipulated the following:

- payment by Gazprom of a $2.9 bn arbitration award from its dispute with Naftogaz and withdrawal by both companies of all other mutual claims;
- signature of a Gazprom-Naftogaz transportation agreement, signature of a Naftogaz-GTSOU transportation agreement and signature of a Gazprom-GTSOU interconnection agreement;
- acquisition of transmission capacity by Naftogaz from GTSOU for shipping Gazprom gas (fixed volumes of 65 bcm in 2020, 40 bcma in 2021–24) at 'a competitive tariff' set by the Ukrainian regulatory authority (NEURC);
- certification of GTSOU as the new EU *acquis*-compliant TSO by the NEURC;
- guarantee and confirmation in writing by the EC of;
    - certification of GTSOU as the new TSO, and
    - compliance of Ukraine's gas transport legislation with the *acquis*.
- intention to consider the possibility of extending cooperation under the same conditions during 2025-2034;
- possibility of considering direct supplies of Russian gas to Ukraine at hub prices with a discount dependent on contracted volumes.

Signature of the trilateral protocol paved the way for signing the following **three bilateral agreements** underpinning commercial and technical aspects of the Ukraine – Russia gas transit relationship in 2020-24:

- **Gazprom – Naftogaz gas transportation agreement** – parts of which were also leaked to the press shortly after its signature – an agency agreement under which Gazprom has contracted Naftogaz to ship its gas across Ukraine without having to book capacity directly from GTSOU:
    - for transiting 225 bcma over 2020-24, Naftogaz was to receive ~$7.2 bn from Gazprom, most of which Naftogaz would pay to GTSOU – with a tariff set at ~$31.72/mcm (2.66/mcm/100 km, 1192 km) – while retaining an agency fee;
    - payment by Gazprom to Naftogaz was to be made monthly, 2 weeks in advance of shipment;
    - annual capacities were to be calculated on a daily basis, enabling a shipment of 178 mcm/day in 2020 and 110 mcm/day in 2021-24 – the fixed volume with no monthly variation. If no shipment was made Gazprom would still have to pay as if the fixed volume was shipped ('ship-or-pay' clause);
    - it is understood that Gazprom could also book capacity in excess of fixed annual capacities directly with GTSOU but a multiplying coefficient would be applied (1.1 for quarterly capacity, 1.2 for monthly capacity, and 1.45 for daily capacity);
    - the agreement contains an international arbitration clause with any dispute to be referred to the International Court of Arbitration of the International Chamber of Commerce (ICC), with Zurich, Switzerland as the location and Swedish law as applicable law;

[85] Vitrenko, who was a CFO of Naftogaz when the protocol was signed, became its CEO in April 2021, when the Ukrainian government had dismissed the company's Supervisory Board and fired its previous CEO, Andriy Kobolev, in a move criticised by the EU and the US as undermining corporate governance standards; Vitrenko resigned in November 2022, see 'Ukraine faces sharp criticism from U.S., EU after sacking management at state energy company', *NBC News*, 30 April 2021. Makogon was fired in 2022 by the Supervisory Board of MGU, which itself has since been liquidated, see 'Ukraine gas transit in question after removal of GTSOU CEO by supervisory board', *ICIS*, 22 September 2022.

- **GTSOU – Naftogaz gas transportation contract** – a shipper agreement under which Naftogaz has booked capacity in the transmission system from GTSOU and acted as a shipper of Gazprom gas across Ukraine;
- **Gazprom – GTSOU interconnection agreement** – an inter-TSO technical agreement specifying various technical conditions for gas flows between two adjacent operators (GTSOU and Gazprom).

Implementation of the 2020-24 Transit Agreement: transit flow continues albeit marred by disputes

GTSOU's declaration of *force majeure* in respect of the Ukrainian GMS Sokhranovka (May 2022): sharp decline in transit

The Transit Agreement has been severely tested from the start of the February 2022 crisis. As noted earlier, while the transit volumes remained close to (but slightly below) the capacity of 178 mcm/day in 2020 and 110 mcm/day in 2021 stipulated by the Agreement, transit fluctuated widely in 2022 (occasionally reaching booked capacity) before falling to just under 40 mcm/day in May 2022.

This decline occurred following the GTSOU decision to declare a *force majeure* in respect of gas metering station (GMS) Sokhranovka (one of the two remaining operational Interconnection Points on the Ukraine-Russia border) and the compressor station (CS) Novopskov, from 11 May 2022. GTSOU stated that *force majeure* 'makes it impossible to further transport gas' through Sokhranovka and Novopskov,[86] because of GTSOU's inability to 'carry out operational and technological control' over these assets. GTSOU has further asserted 'the interference of the occupying forces in technical processes and changes in the modes of operation of GTS facilities, including unauthorized gas offtakes from the gas transit flows', noting that such actions 'constitute *force majeure* circumstances' under the existing contract. The (then) GTSOU CEO, Makogon, stated that the Sokhranovka IP will not be reopened until full control over the Ukrainian gas transmission system is restored.[87] Gazprom 'categorically rejected' GTSOU's claims, saying it saw no proof of *force majeure* or obstacles to continuing as before.[88] It has further stated that Naftogaz 'has refused to fulfill its transit obligations through Sohranovka GMS without suitable grounds' whereas 'services not rendered […] should not and will not be paid for' irrespective of *force majeure* declaration.[89] Having stopped the offtake of gas at Sokhranovka, GTSOU offered to 'temporarily transfer' capacity from Sokhranovka to Sudzha – the sole remaining entry point for Russian gas on the Ukraine-Russia border. Gazprom has not made use of this offer, saying it was not technologically possible to reroute all its supply via Sudzha – an assertion denied by GTSOU[90] – while continuing to flow gas through Sudzha. It is understood that while Gazprom has continued to pay for capacity at Sudzha, it stopped paying for capacity at Sokhranovka. In September 2022, Naftogaz – as a party to the agency agreement with Gazprom – started arbitration proceedings against Gazprom at the ICC International Arbitration Court to make it pay for what its (then) CEO, Yuryy Vitrenko, alleged was "the rendered service of organising natural gas transportation through the territory of Ukraine", adding that payment made by Gazprom was "neither on time nor in full".[91] Gazprom notified the Secretariat of the Court of its rejection of Naftogaz's claims, while adding that it had been 'deprived' of 'the fundamental right to fair and unbiased arbitration in both arbitration itself and the government courts where it is held", as Sweden and Switzerland 'have joined the ranks of countries unfriendly to the Russian Federation thanks to the introduction of an enormous amount of sanctions'. Gazprom has

[86] GTSOU (2022). According to GTSOU, Novopskov is the transit route for ~32.6 mcm/day (1/3 of the Russian gas to Europe via Ukraine). Also see 'Ukraine to halt key Russian gas transit to Europe, blames Moscow', *Reuters*, 10 May 2022.
[87] 'Exclusive: Ukraine will not reopen gas route until it controls pipeline system', *Reuters*, 12 May 2022.
[88] 'Ukraine to halt key Russian gas transit to Europe, blames Moscow', *Reuters*, 10 May 2022.
[89] 'Gazprom warns Naftogaz lawsuit could result in sanctions ban on transactions on part of Russia', *Interfax*, 27 September 2022.
[90] 'Exclusive: Ukraine will not reopen gas route until it controls pipeline system', *Reuters*, 12 May 2022.
[91] 'Ukraine's Naftogaz initiates new arbitration proceeding against Gazprom', *Reuters*, 9 September 2022.

subsequently been granted an injunction in the Russian court.[92] Gazprom has also stated that the Russian government may introduce sanctions against Naftogaz if it pursues its arbitration proceedings further, in which case it would be prohibited from making any transit payment to Naftogaz.[93]

Russian GMS Sudzha falling under control of Russian troops (7 – 9 August 2024): transit unaffected

Transit flows came into focus again on in August 2022 when the Ukrainian troops seized control of GMS Sudzha on the Russian territory during an armed incursion into the Kursk region on the 6th of August.[94] However, transit of gas via Sudzha continued uninterrupted[95] with Gazprom feeding the gas despite the station – and its metering equipment – falling under control of Ukrainian troops. Notably, the relevant compressor station – and hence the ability to turn the valve and cut the gas off – is located further away from GMS Sudzha and remains under Russian control. Gazprom made no comment on the situation, except pointing out sharp gas price increases caused by events around Sudzha.[96] As this paper goes into print, transit through Sudzha continues at the maximum technical level of ~42 mcm flows.

5. Ukraine, European buyers and Russia's attitudes towards continued transit and impact of potential cessation on Gazprom's LTSCs

Is Ukraine open to transit of Russian gas?

As noted in Section 3, the Transit Agreement contains a clause envisaging a possibility of its extension for another ten-year period. The Ukrainian government has repeatedly stated that the Agreement will not be extended once it expires on 1 January 2025. In January 2024, Ukraine's prime minister, Denys Shmyhal, affirmed that neither the existing Agreement will be extended nor a new transit agreement will be signed with Gazprom'.[97] This echoes a statement in October 2023 by the CEO of Naftogaz, Oleksiy Chernyshov – Gazprom's counterparty to the agency transportation contract under the Transit Agreement – who said that the company could not renew the contract 'during the war' and would not initiate its extension.[98] In March 2024, Ukraine's Energy Minister, German Galushchenko, confirmed that the Agreement will not be extended or amended.[99]

At the same time, Ukraine did not rule out the possibility of continuing transit if asked to do so by European gas buyers – as confirmed by Ukraine's President Volodymyr Zelenskyy, its energy minister, Galushchenko, and its prime minister Shmyhal. Yet there has been a persistent lack of clarity as to whether Ukraine would be open to the transit of Russian gas, or whether only to the transit of non-Russian (other suppliers') gas. For example, in March 2024, Galushchenko ruled out any commercial agreements to allow Russian natural gas to continue flowing through Ukraine after the current Transit Agreement expires.[100] In July 2024 President Zelenskiy affirmed that Ukraine would only be open to transiting non-Russian gas – thus not letting Russia earn money on sales of gas transiting though

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[92] 'Russian court injuncts Naftogaz's ICC claim', *Global Arbitration Review*, 12 January 2024.
[93] Such sanctions have already been introduced by the Russian government in respect of EuroPolGaz, the owner of the Polish section of the Yamal-Europe gas pipeline, in response to Polish sanctions in respect of Gazprom, resulting in cessation of transit through Poland. To date no sanctions have been introduced by Russia in respect of Naftogaz. See 'Russia's Gazprom rejects Ukraine's Naftogaz claims in arbitration', *Reuters*, 27 September 2022.
[94] 'Ukraine claims capture of key gas transit point in largest Russia incursion', *Financial Times*, 9 August 2024
[95] 'Gazprom's gas transit via Ukraine to continue Thursday amid reported clashes near Russia's Sudzha town', *Reuters*, 7 August 2024.
[96] Gazprom, spokesperson's statement, *Telegram*, 9 August 2024.
[97] 'Ukraine's cabinet of ministers denies an extension of contract to transport gas from Russia', *Kommersant*, 25 January 2024.
[98] 'Ukraine's Naftogaz in talks with Azerbaijan's SOCAR on transit, storage: CEO', *S&P*, 7 August 2024; 'Naftogaz: Ukraine will not extend the contract for transiting Russian gas to Europe', *Kommersant*, 29 October 2023; 'Kremlin points to alternative routes if no Ukrainian gas transit after 2024', *ICIS*, 26 January 2024; 'Most likely no Russian gas transit via Ukraine from 2025: industry chief', *S&P*, 9 November 2023; 'We want to export gas' (interview with Naftogaz CEO, Oleksiy Chernishov)' (in Ukrainian), *Biz-NV*, 6 August 2024.
[99] 'Ukraine will not extend a contract with Gazprom: Galushchenko', *Ukrainska Pravda*, 17 March 2024.
[100] 'Ukraine slams the door on bringing Russian gas to Europe', *Bloomberg*, 5 March 2024; 'Zelenskiy: Ukraine in talks for Azeri gas transit to EU', *Bloomberg*, 3 July 2024.

Ukraine[101] while referring to ongoing negotiations about transiting Azeri gas. In August 2024, he added that should there be a request from the European buyers for Ukraine to transit other suppliers' gas, then Ukraine – together with the EC – would consider it [102]

Interestingly, while both Ukraine's President and its Energy Minister appear to have rejected the possibility of transiting Russian gas, its Prime Minister, Shmyhal, did not rule it out. In March 2024 he stated that the country was ready to continue transit of Russian gas after the Transit Agreement expires, but would not negotiate with Russia directly, while echoing Zelenskiy's statement that transit could only be possible if there were to be a request from European buyers.[103] On his part, the CEO of GTSOU, Dmytro Lyppa, has said that Ukraine would be ready to transit Russian gas until 2027, if the European buyers needed it.[104]

Notably, Azerbaijan's President, Ilham Aliyev, has never confirmed negotiations concerning Azeri gas. In July 2024 he said that Azerbaijan has been 'approached by the Ukrainian authorities and the EU to facilitate the prolongation of this contract' [the Transit Agreement], thus implying that the gas in question would be Russian.[105] At the time, Aliyev expressed a certain optimism, stating that he thought it was 'possible to prolong this deal', adding that Azerbaijan was 'in the process of negotiations with Russia on this matter'. In October 2024, Russian deputy prime minister, Alexander Novak, noted that no proposal had been presented to Russia for swapping Russian gas with Azeri gas for transport across Ukraine and no such talks were underway.[106] In early November 2024, when media reports appeared that European gas buyers were close to signing a contract with Azerbaijan for Azeri gas to be delivered to the Russia-Ukraine border point of Sudzha, GTSOU denied the reports stating that it was "not aware of any negotiations" about SPP and MVM receiving Azeri gas at Sudzha.[107] All of this seems to confirm that the negotiations were not in respect of Azeri gas, thus suggesting that the role of Azerbaijan was more likely that of a mediator rather than a potential gas supplier.

Slovakia (as most vulnerable) is most active in finding an agreement for continued transit

The Slovak (state-owned) gas company, SPP supplies about 2/3 of national gas consumption of about 5 bcma and has been buying ~3 bcm of Russian gas under a 'take-or-pay' long-term supply contract LTSC for 6.5 bcma with Gazprom Export (signed in 2008 and effective until 2028[108]).The Slovak (state-owned) TSO, Eustream, has a long-term gas transmission contract with Gazprom, signed in 2017 and valid until 2050.[109] If the Transit Agreement expires on 1 January 2025 without replacement, Slovakia stands to lose not only Russian gas deliveries but also payment for transit of gas across Slovakia *en route* to Austria.

SPP has also been preparing for potential cessation of transit by investing it pipeline interconnections with Hungary (Veľké Zlievce/Balassagyarmat)[110] and Poland (Výrava) and increasing reverse flow capacity on its borders with Czechia (Lanžhot) and Austria (Baumgarten).[111] In September 2024, SPP's CEO, Vojtech Ferencz, said that the company had "14 TWh (~1.4 bcm) in storage and an additional 3 TWh in reserve, as well as five alternative gas supply contracts, and two others under negotiation". He has not provided further details but asserted these supplies were sufficient to cover the heating season

[101] 'Zelenskiy: Ukraine in talks for Azeri gas transit to EU', *Bloomberg*, 3 July 2024.
[102] Ibid. Also see 'Zelensky: Ukraine will not extend a contract with Russia to transit gas', *Kommersant*, 27 August 2024.
[103] 'Ukraine's Ministry of Energy: the contract with Gazprom to transit gas will not be extended', *Kommersant*, 18 March 2023.
[104] 'Operator of the Ukrainian Gas Transmission System: the country may continue to transit Russian gas until 2027', *Kommersant*, 5 March 2024. In contrast, an ex-CEO of GTSOU, Sergiy Makogon, who signed the Transit Agreement in December 2019 is opposed to (any) transit, see 'Former head of GTS Operator on why Ukraine must halt Russian gas and oil transit', *Liga-Net*, 8 August 2024, also see Makogon and Sabadus (2024).
[105] 'Azerbaijan in talks with Russia on Ukraine gas transit', *S&P*, 22 July 2024.
[106] 'Russia not discussing gas swap supply from Azerbaijan, Turkey to EU involving Ukrainian pipelines, no infrastructure anyway – Novak', *Interfax*, 9 October 2024.
[107] 'Slovakia's SPP says no imminent Azeri gas transit deal', *Argus*, 1 November 2024.
[108] SPP (2008).
[109] Previous contract was valid until 2028, see 'Gazprom Export signs 5.3 bln euro contract with EUSTREAM on gas transportation to 2050', *Interfax*, 11 April 2017.
[110] 'Hungary – Slovakia gas capacity to rise by 33pc', *Argus*, 1 October 2024.
[111] 'Slovakia's SPP dismisses report of imminent deal for gas supply via Ukraine', *S&P*, 1 November 2024.

(2024-25) for its customers.[112] Prior to 2024, SPP signed several new contracts with various companies (including BP, ExxonMobil,[113] Shell Energy Europe, ENI[114] and RWE) for 2023 and 2024 – confirmed by SPP to be 'flexible both in terms of volume and time'[115] – enabling it to cover ~70% of its customers' consumption with non-Russian suppliers.[116] SPP has also secured transportation capacity from LNG terminals in Italy and Croatia.[117] Another Slovak importer, ZSE Group, which is the second largest supplier in Slovakia, signed a contract with Polish Orlen to supply LNG (covering 1/3 of the ZSE customers) from January 2025 until the end of the year. It would be brought in through the Lithuanian Klaipeda LNG terminal and further transported by the Gas Interconnector Poland – Lithuania (GIPL) across Lithuania and Poland to the Polish – Slovakian border.[118]

However, Slovakia is still vulnerable being landlocked, located further away from LNG import terminals, likely to incur the highest transportation cost for bringing in alternative supplies, and sharing a border with countries that would not be in a strong position to help in the event of transit stoppage. Therefore, Slovakia has the strongest incentive to ensure that transit will continue uninterrupted. Indeed, Slovakia's SPP has been pro-active and made repeated attempts to secure a post-2024 transit agreement. In May it said that it considered the creation of a European consortium to take delivery of gas at the Russia-Ukraine border as "feasible" to ensure continued supplies of Russian gas via Ukraine post-2024.[119]

In September 2024, SPP's CEO, Ferencz, said that the company 'is continuing negotiations to secure an extension of gas transit through Ukraine', adding that 'several options are on the table'[120] and "transit should be and must be maintained in order to avoid artificial costs in central Europe."[121] According to Fenencz, one potential option included the possibility of involving the Azeri gas company, SOCAR, which could transport gas across Ukraine (thus becoming a shipper), thus getting around Ukraine's unwillingness to have a direct commercial relationship with Gazprom, and return it to Gazprom at the Ukraine-Slovakia border (see Section 6). Another option included transit under the ownership of another intermediary, such as a consortium including SPP (see Section 6).[122] Ferencz also said that discussions with Ukraine to preserve the status quo – i.e. extending the expiring Transit Agreement – have continued, despite earlier rejection of this option by Ukraine.[123] He has also commented on potential transit volumes, saying that the volume of Russian gas transit flow through Ukraine should be maintained under any new transit agreement (thus implying continued deliveries not only to Slovakia but also to other European buyers, including Austria, Italy and Czechia) because transiting gas only for supplying Slovakia would significantly increase transit costs.[124] Notably, Ferencz stated his intention to travel to Brussels to discuss the EC's 'support' for a new transit agreement. So far, such support appears to have been missing. The EC, including the outgoing Energy Commissioner, Simson, has repeatedly stated that it will not put pressure on Ukraine to negotiate a new transit agreement.[125] However, as explained earlier, Ukraine has its own reasons for preserving transit and in fact no pressure from the EC might be needed for Ukraine to agree, but rather the lack of the EC's objection to the agreement.

Unlike the Austrian government (see next Section), the Slovakian government has maintained the 'hands on' approach to the transit problem and made no suggestion that it wanted SPP's supply (or transit) contract with Gazprom to be terminated. The Slovak prime minister, Robert Fico, has been

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[112] 'Slovak gas buyer SPP continues to talk about extending Ukraine transit', *World Energy News*, 26 September 2024.
[113] 'Slovak gas importer SPP signs LNG supply deal with Exxon', *Reuters*, 8 September 2024.
[114] Agreement with Eni appears to be a memorandum of understanding rather than a contract, see Eni (2023).
[115] 'Slovakia to raise pressure on Ukraine over maintaining Russian gas flows', *Upstream Online*, 7 October 2024,
[116] SPP (2023).
[117] 'Slovak gas importer SPP signs LNG supply deal with Exxon', *Reuters*, 8 September 2024.
[118] Orlen (2024); 'Poland to supply natural gas to Slovakia via Lithuania LNG terminal', *Upstream Online*, 8 July 2024.
[119] 'Slovakia's SPP dismisses report of imminent deal for gas supply via Ukraine', *S&P*, 1 November 2024.
[120] 'Slovak gas buyer SPP says talks continue to extend Ukraine transit', *Reuters*, 3 October 2024.
[121] Ibid.
[122] 'Slovak gas buyer SPP continues to talk about extending Ukraine transit', *World Energy News*, 26 September 2024.
[123] Ibid.
[124] Ibid.
[125] 'EU will not require Ukraine to extend the contract for transit of Russian gas', *Kommersant*, 21 May 2024; EC (2024a), Midday press briefing, 21 May 2024.

personally involved in negotiations with his Ukrainian counterpart, Denis Shmyhal, and the Slovakian government has been unequivocally supportive of SPP's attempts to broker an agreement enabling transit across Ukraine to continue.

On 24 January 2024, Fico, following a meeting with Shmyhal, symbolically held in Uzhgorod, the Ukrainian border-town where the transit pipelines cross the Slovakian border, said that "an agreement arose that the transit of Russian gas through Ukraine will probably continue", adding this was "great news".[126] However, no understanding was reached about the framework within which this could happen. Fico's statement was swiftly followed by a Ukrainian government statement, saying that "the position of the Ukrainian side was clear: the transportation contract ends at the end of this year, we are not going to negotiate with the Russians and extend the contract, and the Prime Minister of Ukraine informed his Slovak counterpart on this".[127] However, it is understood that the Ukrainian government would be prepared to discuss continued use of its gas transmission system with European countries.[128] An unnamed source in the Ukrainian government was quoted by the media saying 'an option is possible where a Slovak company independently leases capacities' of the Ukrainian transmission system.[129] Following the meeting, the Ukraine and Slovakia governments issued a joint statement, which called inter alia for "maintaining the physical capacity and legal framework for gas transmission from Ukraine to the EU".[130]

At another meeting between Fico and Shmyhal, held in early October 2024, again in Uzhgorod, Fico again raised the issue of enabling post-2024 Russian gas transit through Ukraine.[131] Shmyhal stated that Ukraine "once again says it will not continue the transit agreement with Russia after it expires".[132] Although no agreement has been reached, Fico said both Ukraine and Slovakia had 'an interest in the transit system […] on Ukrainian territory continuing to be used, when it comes to both oil and gas'.[133] Interestingly, Fico said that there was 'huge pressure' from the EC that 'nothing comes from east to west' in terms of gas flows, thus implying the EC's opposition to continued transit.[134]

Austria is interested in continued transit but keeps low profile

Austria's average dependence on Russian gas has been ~70% during 2022-24 (Figure 5).[135] Its reliance on Russian gas increased in2024 , as the German 'storage levy' made imports of alternatives via Germany significantly more expensive (see Section 3) thus increasing Austria's financial exposure to transit stoppage.[136] Austria's OMV – the company, which supplies ~30% of the Austrian market[137] and in which the Austrian government is the biggest shareholder (31.5%) – imports Russian gas via Ukraine under a long-term supply contract (LTSC) with Gazprom Export ("Austrian Contract"). The contract was signed in 2006[138] and was set to expire in 2028; in 2018 it was extended until 2040.[139] The contract's annual contractual quantity (ACQ) is reported to be 6 bcma,[140] and, similarly to many other Gazprom European LTSCs, it is understood to contain a 'take-or-pay' (TOP) clause. Essentially, TOP clauses provide that a buyer must pay for specified quantities of gas from a seller, even if the buyer is unwilling

[126] 'Slovakia says Ukraine open to Russian gas transit beyond 2024 - Bloomberg', *Bloomberg*, 25 January 2024; 'Fico announced an agreement on transit of Russian gas across Ukraine', *RBC*, 25 January 2024.
[127] 'Kremlin points to alternative routes if no Ukrainian gas transit after 2024', *ICIS*, 26 January 2024; 'Kyiv will not extend gas transit deal, Ukraine tells Slovakia', *Reuters*, 7 October 2024.
[128] 'Novak announced Russia's readiness to discuss gas supplies to the EU not only via Ukraine', *Kommersant*, 27 January 2024.
[129] 'Contract for Russian gas transit through Ukraine not to be extended, nuances remain', *RBC-Ukraine*, 25 January 2024.
[130] CMU (2024a) and CMU (2024b).
[131] 'Slovakia to raise pressure on Ukraine over maintaining Russian gas flows', *Upstream Online*, 7 October 2024.
[132] 'Kyiv will not extend gas transit deal, Ukraine tells Slovakia', *Reuters*, 7 October 2024.
[133] Ibid.
[134] 'Kyiv will not extend gas transit deal, Ukraine tells Slovakia', *Reuters*, 7 October 2024; 'Slovakia says it has strong interest in maintaining transit of Russian oil, gas via Ukraine', Reuters, 3 October 2024.
[135] 'Austria urgently seeks to cut ties with Russian gas amid "massive risk"', *RBC-Ukraine*, 13 August 2024.
[136] Pinto (2024a).
[137] 'Austria's OMV to continue to import Russian gas, chief says', *Financial Times*, 9 July 2023.
[138] It was signed by OMV subsidiary Econgas, fully consolidated by OMV in 2015.
[139] OMV (2018).
[140] 'Russia's Gazprom Export begins gas supply to OMV in Germany under long-term deal', *S&P*, 2 December 2020.

or unable to take such quantities.[141] OMV also has another contract with Gazprom Export for deliveries to Germany via Nord Stream, signed in 2020 ("German Contract").[142] In January 2023 OMV initiated arbitration proceedings against Gazprom in respect of this contract, as gas deliveries dwindled and eventually stopped in September 2022 when Nord Stream became inoperable. On 13 of November 2024 OMV announced that the arbitration tribunal awarded it 230 mn euros (plus interest and costs) in damages in relation to these supplies.[143] As OMV announced that it will enforce the award, issued in respect of its Germany contract, by setting it off "with immediate effect" against payments to be made by OMV to Gazprom under its Austrian contract,[144] Gazprom suspended gas deliveries to OMV on 16 November 2024 – although flows to Austria continued.[145] As this paper goes to print in early December 2024, the OMV's Austrian contract remains in force, but no gas is flowing under it. Conclusion of post-2024 agreement for transiting Russian gas across Ukraine will determine whether Russian gas flows to Austria will continue.

Figure 5: Austria's natural gas demand: shares of Russian and non-Russian supplies, %

Source: Bloomberg based on Austrian government data[146]

Mindful of the EU pledge to phase out Russian gas and in the view of the expiry of the Transit Agreement, OMV sought to prepare for a potential loss of Russian supplies by signing several contracts with other suppliers in 2023. In July it signed a 10-year contract with BP for up to 1 mtpa of LNG, with supplies to start from 2026.[147] In September it signed a 5-year supply contract with Equinor for 12 TWh (1.16 bcma) of gas, with supplies to start in October 2023. This was followed by signature of a contract with Cheniere in November 2023 for 0.85 mtpa of LNG, with supplies to start in 2029 via the Netherlands Gate LNG terminal.[148] According to OMV CEO, Alfred Stern, the company would be 'prepared 100%' to deliver non-Russian gas to all its direct customers (i.e. entities which have supply contracts with OMV) should Russian gas not arrive at the contractual delivery point Baumgarten at the Austrian-Slovakian border on 1 January 2025. A resulting shortfall is expected to be met by pipeline gas from OMV's own production portfolio and by gas contracted from third parties, as well as by imported LNG, contracted by OMV under long term contracts. This LNG would arrive at the Gate LNG terminal for onward transportation to Austria via the Netherlands and Germany.[149] Stern confirmed that all the necessary pipeline and LNG import capacity has been booked.

[141] Polkinghorne (2014), 'Take-or-pay conditions in gas supply agreements', *OGEL*, vol. 12, issue 14, October 2014.
[142] 'Russia's Gazprom Export begins gas supply to OMV in Germany under long-term deal', *S&P*, 2 December 2020.
[143] OMV (2024b).
[144] Ibid. Also see 'Exclusive: Austria's half-century bond with Gazprom ended by gas seizure, sources say', *Reuters*, 25 November 2024.
[145] 'Russia is keeping up gas flows to Europe despite OMV cut-off', *Bloomberg*, 16 November 2024.
[146] 'Austria urgently seeks to cut ties with Russian gas amid 'massive risk', *RBC-Ukraine*, 13 August 2024.
[147] BP (2023).
[148] OMV (2023).
[149] 'OMV is prepared to deliver gas to all customers: CEO', *Bloomberg*, 13 June 2024. Also see OMV (2024a).

While OMV secured back-up contracts to cover its import needs from alternative sources, it also confirmed that it would continue to buy gas under its LTSC with Gazprom, as long as Russian gas is (a) 'legally acceptable' and (b) delivered to the contractual delivery point at the Austrian – Slovakian border.[150] As far as legal acceptability is concerned, to date there are no legal prohibitions on importing Russian pipeline gas into the EU, but delivery of Russian gas to the Austrian-Slovakian border on 1 January 2025 will depend on whether the Transit Agreement is renewed or replaced with an alternative arrangement. So far, there has been no indication that OMV is involved in any way in negotiations with Gazprom to change its delivery point to the Ukrainian – Russian border, or with the GTSOU to book capacity in the Ukrainian system for transporting the gas to the Austrian – Slovakian border. As far as the financial impact of transit cancellation is concerned, the OMV CEO said that if supplies of Russian gas stop, then the company would have to purchase missing volumes on the spot market. He accepted that in the event of transit cancellation European hub prices could increase thus presenting a 'certain risk' but argued that such risk would be limited to 'at most one month', thus suggesting 'limited' financial impact.[151]

While OMV adopted a neutral attitude towards its supply relationship with Gazprom, stating that it will continue to import Russian gas as long as it is delivered in line with the contract, the attitude of the Austrian coalition government – with the conservative party (ÖVP) as senior, and the Green party as junior partner – has been more complex, with ÖVP adopting a neutral approach and the Greens seeking to terminate the contract. In February 2023, the Austrian (ÖVP) Chancellor, Karl Neuhammer, said 'if the Russians continue to deliver', he 'cannot prohibit OMV from fulfilling its contractual obligations'.[152] However, in February 2024, the Greens' Energy Minister, Leonore Gewessler, stated that 'all options for terminating the [OMV's Gazprom] contract must be examined and implemented'.[153] In July 2024 she set up a commission to review the contract 'to check if there were possibilities to cancel it' and 'review the political circumstances in which the contract was signed'.[154] Notably, she cited a potential cessation of transit across Ukraine on 1 January 2025 as the grounds for contract termination.[155] The commission was expected to present its final report by the end of 2024.[156] In parallel, in April 2024, Gewessler sent draft legislation to the government to oblige all gas importers to diversify their imports and phase out Russian gas by the start of the 2027 gas year, thus coinciding with EU's indicative phase-out 'deadline'.[157] The roadmap for implementing this legislation was expected to be presented before the national elections in September 2024 but does not appear to have happened.[158] This legislation could only be sent for a vote in the Austrian parliament – where a majority would be required for it to enter into force – if it were to secure coalition government approval. It is understood that this has not happened.

It is not clear whether any of these initiatives, largely driven by the Greens, will be developed further or shelved by the new Austrian government (which at the time of this paper going to print in early December 2024 is not in place yet). It was confirmed in November that the Greens (only coming fifth with 8.2% of the vote) will not be part of the new coalition government and that three parties – ÖVP (26.3%), SPÖ (21%) and NEOS (9.1%) – have agreed to enter into the collation agreement talks.[159] Should these talks fail ÖVP could form a two-party collation with SPÖ but it would only have a majority of one seat which, while possible for forming a government, might be unworkable in practice.[160] With the Greens likely to be out, it is reasonable to expect that the new government coalition will be less enthusiastic about the termination of OMV's Gazprom contract but will continue to support diversification of gas supplies and reduced dependence on Russian gas. However, it is uncertain whether the new government as well as OMV will take any steps towards negotiating a new transit agreement.

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[150] 'Austria's OMV to continue to import Russian gas, chief says', *Financial Times*, 9 July 2023.
[151] 'OMV expects 'rather small' impact if Russian gas stops', *Argus*, 29 October 2024
[152] 'Austria hesitates on measures against Russian gas imports', *Euractiv*, 13 February 2023.
[153] 'Austria seeks to cancel Gazprom gas contract', *Energy Intelligence*, 12 February 2024.
[154] 'Austria forms commission to review OMV's Russian gas contract', *Montel News*, 9 July 2024; 'Austria appoints commission to try to ditch Russian gas contract', *Reuters*, 9 July 2024.
[155] 'Austria seeks to cancel Gazprom gas contract', *Energy Intelligence*, 12 February 2024.
[156] 'Austria appoints commission to try to ditch Russian gas contract', *Reuters*, 9 July 2024.
[157] 'Austrian energy minister targets 2027/27 Russian gas exit', *Energy Intelligence*, 19 April 2024.
[158] 'Austria urgently seeks to cut ties with Russian gas amid "massive risk"', *RBC-Ukraine*, 13 August 2024.
[159] 'Austria's three-party collation is taking shape', *Tagesschau*, 13 November 2024.
[160] 'Austria far right shunned for coalition despite winning election', *BBC*, 22 October 2024.

Hungary is also supportive of continued transit but less vulnerable if it stops

Hungary sought to reduce its reliance on the Ukrainian transit corridor long before the Ukraine-Russian armed conflict broke out, by building connections with TurkStream, through which Russian gas started to be delivered to Hungary in late 2021. In summer 2021 Hungary signed a 15-year supply contract with Gazprom Export to receive 3.5 bcma of gas from Russia via the TurkStream pipeline and a further 1 bcma via a pipeline from Austria.[161] However, as of September 2023, flows from Austria fell to almost zero and nearly all of Hungary's Russian gas imports have been delivered via TurkStream. As a result, Hungary's physical flows of Russian gas would not be impacted by potential cessation of transit across Ukraine. Correspondingly, the Hungarian government's position in respect of the upcoming expiry of the Transit Agreement is that it would not have 'any kind of impact' on Hungary.[162] In August 2022 Hungary contracted an additional 5.8 mcm/day (2 bcma) under its existing contract with Gazprom (to be delivered via TurkStream).[163] In November 2024, Hungary's Foreign Minister, Péter Szijjártó, said that Hungary is discussing contracting additional supplies from Gazprom for 2025 via TurkStream.[164] In parallel, Hungary also sought to diversify its supplies by signing a contract with Türkiye's Botas.[165] Although Hungary will continue receiving Russian gas via TurkStream if transit across Ukraine stops, it would still be vulnerable in the sense that it would become overwhelmingly dependent on TurkStream. Therefore, continued transit across Ukraine is in Hungary's interest.

Other affected Member States' positions (Italy, Czechia)

Other Member States potentially affected by transit cessation, such as Italy and Czechia, as well as their gas companies – Eni and CEZ – have largely maintained a low profile and had no apparent involvement in any initiatives to secure continued post-2024 transit. This could be explained by their lower exposure to transit risk.

Continued uncertainty keeps European gas market on its toes

As this paper goes to print in early December 2024 there is no agreement in place to replace the expiring Transit Agreement. However, several media reports alleging that the agreement has been 'close' or even reached already kept the European gas market on its toes. On 19 September 2024 a Ukrainian news outlet, *Ukrainska Pravda*, citing an unnamed source in the Ukrainian government, reported that the country had agreed to transit Azeri gas to Europe as a temporary measure after the Transit Agreement expires.[166] The report, reprinted by Reuters, gained wider traction, with the European front-month TTF gas price benchmark falling by 9% to 32.04 euros/MWh on the news.[167] Shortly after, *Ukrainska Pravda* effectively refuted the report by stating that its source emphasised that there was currently neither a signed transit agreement between Ukraine and Azerbaijan nor any relevant negotiations.[168] Both the Azeri energy ministry and the Azeri state-owned energy company, SOCAR, also dismissed the report, while the Ukrainian energy ministry declined to comment, after which[169] TTF prices briefly went up again.

Similarly, on 31 October 2024, Bloomberg, citing unnamed sources, reported that 'European buyers are nearing a commercial agreement with Azerbaijan to keep natural gas flowing' after the Transit Agreement expires on 1 January 2025, with 'companies from Hungary and Slovakia' being 'close to signing a contract for as much as 12-14 billion cubic meters of gas a year from Azerbaijan' to be transited through the Ukrainian network.[170] According to Bloomberg, SOCAR would deliver gas to Sudzha IP at the Ukrainian – Russian border, from where Slovakia's SPP and Hungary's MVM would take it over for

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[161] 'Hungary agrees 15-year gas deal with Gazprom -foreign minister', *Reuters*, 3 June 2021.
[162] 'As Ukraine gas transit halt looms, Hungary at ease thanks to TurkStream pipeline', *Anadolu Agency,* 24 November 2024.
[163] 'Hungary signs new gas deal with Gazprom', *Politico*, 31 August 2022.
[164] 'Hungary's Foreign Minister did not rule out an increase in Russian gas supplies', *Kommersant*, 15 October 2024; 'Hungary FM teases more Gazprom contracts after huge blowup with EU ministers', *Politico*, 30 August 2024. Also see 'Hungary and Gazprom in talks for extra Russian gas for Budapest in 2025', *Euractiv*, 15 October 2024.
[165] 'Hungary's new gas deal fuels Russia fears', *Politico*, 2 April 2024.
[166] 'News outlet backs away from report on Azerbaijan-Ukraine gas transit deal', *Reuters*, 20 September 2024.
[167] 'Erroneous report sends gas prices into tailspin', *Montel News*, 20 September 2024.
[168] Ibid.
[169] Ibid.
[170] 'Europe Gas Buyers Near Azeri Deal to Maintain Ukraine Flows', *Bloomberg*, 31 October 2024.

onward transport across Ukraine to Europe, thus suggesting that they would need to book transportation capacity in the Ukrainian network from the Ukrainian TSO, GTSOU. The contract would have to include a swap agreement, whereby Russian gas would be swapped for Azeri gas. On these reports, the European front-month TTF benchmark fell by ~3% to 39.85 euros/MWh.[171] It climbed up again as the report was swiftly denied by SPP, which stated that although it 'regularly discuss[es] the topic' with its partners, 'the information about the upcoming conclusion of a gas supply contract with the participation of SPP is not true'.[172] MVM also denied that the agreement was 'close', adding that it 'does not conduct the mentioned negotiations about the Ukrainian transit".

Russia/Gazprom position: ready to provide gas if there is a legal framework for transit

The Russian government and (majority state-owned) Gazprom's publicly expressed position in respect of Transit Agreement expiry is that Gazprom will continue to use the Ukrainian corridor to deliver gas to its existing European buyers if there were to be a legal framework for transit in place.

In January 2024 the Russian President's spokesperson, Dmitry Peskov, noted that there are other routes apart from Ukraine through which to deliver gas to Europe – via Turkey, noting the development of the Turkish hub, or as LNG – but those were 'already booked in many ways, and […] this will lead to a change in all logistics chains'.[173] Russian deputy prime minister, Alexander Novak, added that while Russia was 'ready to discuss' supplies via other routes it saw no interest expressed by 'the other side'.[174] In September 2024, Russian President Vladimir Putin, stated that Russia was prepared to continue gas supplies though Ukraine, while also noting the existence of other export corridors that could be used (also mentioning the undamaged string of Nord Stream 2).[175] More recently, in October 2024, he observed that Ukraine neither had an intention to extend the expiring Transit Agreement nor had its TSO (GTSOU) held a capacity auction in July 2024 – as required under EU rules for booking annual capacity – during which transportation capacity in the Ukrainian system could be booked by potential shippers for 2025 and beyond.[176]

In October 2024, Novak confirmed Russia's willingness to supply gas via Ukraine, noting its 'repeatedly expressed' position that 'the ball is on the side of' buying partners and Ukraine'. He stressed that the European buyers would have to provide corresponding legal documentation, including their agreements with the Ukrainian GTSOU. While he acknowledged European buyers' interest in continued imports via Ukraine, he noted that no such documentation has been presented yet.[177] Novak also confirmed that there were no discussions on "swap" deals with Azerbaijan for transit.[178] This statement came shortly after the Ukrainian prime minister, Shmyhal, speaking after his meeting with his Slovak counterpart, Fico said that Ukraine will not extend the Transit Agreement.

The impact of discontinued Russian gas transit across Ukraine on future deliveries under Gazprom's European LTSCs

Having ceased selling gas on the European hubs (via trading subsidiaries) and on the St Petersburg Electronic Platform over 2021-22, Gazprom Export currently only sells gas to EU buyers under long-term supply contracts (LTSCs). Of the estimated 140 bcma of these LTSCs in the gas year 2021/22, ~55 bcm have either expired without renewal (Poland, Bulgaria, the Netherlands, Czechia) or have been terminated (Finland, Germany's Uniper, Latvia, Slovenia). Around half of this lost volume is attributed to Germany's (state-owned) company Uniper (nationalised in 2022), which terminated its 25 bcma LTSC with Gazprom, following an arbitration tribunal's ruling.[179]

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[171] 'Slovakia's SPP dismisses report of imminent deal for gas supply via Ukraine', *S&P*, 1 November 2024.
[172] Ibid.
[173] 'Kremlin points to alternative routes if no Ukrainian gas transit after 2024', *ICIS*, 26 January 2024.
[174] 'Novak announced Russia's readiness to discuss gas supplies to the EU not only via Ukraine', *Kommersant*, 27 January 2024.
[175] 'Slovakia's SPP dismisses report of imminent deal for gas supply via Ukraine', *S&P*, 1 November 2024.
[176] 'Putin talked about future gas supplies to Europe', *RBC*, 25 October 2024. Also see 'President Vladimir Putin press conference after BRICS summit', 24 October 2024.
[177] 'Novak listed conditions for continued transit of Gazprom's gas across Ukraine', *Interfax*, 9 October 2024.
[178] 'Russia's Novak says ball is in Ukraine's and EU's court on gas transit deal', *Reuters*, 9 October 2024.
[179] Stern, Yafimava and Ason (2024a).

Gazprom's LTSCs for the remainder volumes (~85 bcma) are still in force although many of them (covering ~65-70 bcma), including with Germany's RWE, France's Engie, Italy's Eni, are in different stages of international arbitration launched by these buyers on the grounds of reduced/stopped flows via Nord Stream over summer/autumn 2022; the Austria's OMV arbitration concluded in November 2024. Deliveries to some of these buyers – such as RWE and Engie – have stopped, as they were served exclusively via Nord Stream and Yamal Europe, both of which became inoperable. However, deliveries to other buyers – such as Eni and OMV[180] – continued via the Ukrainian corridor during arbitration proceedings. Slovakia's SPP and Hungary's MVM are understood to be the only two European gas buyers that are importing Russian gas via Ukraine and whose LTSCs with Gazprom are not in international arbitration.

While the arbitration tribunal in its Uniper – Gazprom ruling did not recognise the Nord Stream attack as a *force majeure* event and awarded Uniper 13 bn euros in damages while also enabling it to terminate its LTSCs with Gazprom, it is not automatic that other arbitration tribunals will rule in a similar way. It is also not known whether any other European gas buyers will want to terminate their LTSCs. It could be argued that following the arrest warrant issued by the German court for a suspected perpetrator of Nord Stream attack in August 2024[181] – which happened after the Uniper – Gazprom tribunal delivered its judgment on 7 June 2024 – it would be difficult for any tribunal not to accept the attack as a *force majeure* event.

In its ruling of 13 November 2024, the OMV – Gazprom arbitration tribunal awarded OMV 230 mn euros (plus interest and costs) in respect of 'irregular' supplies under what is understood to be a 1 bcma contract for deliveries to Germany via Nord Stream.[182] According to the OMV press release, the award was granted in relation to supplies which 'had eventually ended in September 2022'. This suggests that, unlike the Uniper tribunal, the OMV tribunal did recognise the September 2022 Nord Stream attack being a *force majeure* event, as otherwise the award would have been much bigger.

If other tribunals follow suit in recognising the Nord Stream attack as a *force majeure* event, it might be more difficult for European buyers to terminate their LTSCs. However, as the EU pledged to phase out Russian gas 'as soon as possible', some buyers may come under significant pressure from their governments to terminate LTSCs. But if buyers do not want to terminate and their governments do not pressurize them into doing so, those LTSCs under which no gas is currently flowing could remain suspended until export capacity enabling deliveries becomes available in the future.

Just as Nord Stream unavailability hampered Gazprom's ability to deliver on LTSCs with its European buyers either fully (Uniper, RWE, Engie) or partly (Eni, OMV), potential unavailability of the Ukrainian corridor due to possible failure to conclude a new transit agreement would hamper its ability to deliver on its LTSCs with SPP, OMV, MVM, and Eni. Thus, if no capacity is offered at the Ukraine-Russia border interconnection point(s) – either via a bilateral agreement ("Transit Agreement 2.0") or an auction ("CAM NC Model") (see Section 6) – Gazprom would probably declare *force majeure* in respect of relevant LTSCs served via Ukraine on the grounds of obstruction of (gas transportation) service. If European gas buyers were to reject this *force majeure* declaration, another wave of arbitrations could follow (or new claims could be added to ongoing arbitrations). Ultimately, if the tribunals were to accept Gazprom's *force majeure* declaration in respect of the Ukrainian corridor, these LTSCs could also be suspended until capacity becomes accessible again.

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[180] While OMV's German contract was in arbitration, flows continued under its Austrian contract.
[181] 'Has the mystery of the Baltic Sea attack been solved?', *Zeit Online*, 14 August 2024.
[182] OMV (2024b).

6. Post-2024 transit scenarios and potential legal frameworks for continued transit

Post-2024 transit scenarios: "Stop", "Continuation", and "Delayed Re-Start"

There are three possible scenarios – "Stop", "Continuation", and "Delayed Re-start" – any of which could happen once the Transit Agreement expires on 1 January 2025:

- **"Stop":** gas transit will stop and will never re-start, thus necessitating decommissioning of large parts of the Ukrainian gas transmission network and ending Ukraine's role as a gas transit country;
- **"Continuation":** transit will continue uninterrupted;
- **"Delayed Re-start":** transit will stop and re-start with a delay (which could last months or years).

Under a "Stop" scenario gas transit will stop and not resume in the foreseeable future thus necessitating significant de-commissioning of the Ukrainian transmission system, ending Ukraine's role as a gas transit country. This scenario will come to pass if the Transit Agreement expires without renewal or replacement by another arrangement by 1 January 2025. This would have an impact on several EU Member States presently receiving their gas via Ukraine (as well as Moldova and Ukraine itself), forcing their gas buyers to purchase alternative supplies on the spot market and arrange for its transportation to national borders (Section 3).

Under a "Continuation" scenario transit will continue with no interruption on 1 January 2025. This scenario will come to pass if the Transit Agreement is extended (repeatedly ruled out by Ukraine) or replaced by another arrangement enabling transit to continue but without Gazprom as Naftogaz's counterparty. This could be accomplished within different legal frameworks – negotiated ("Transit Agreement 2.0") or regulated ("CAM NC Model") – both of which are analysed in the next sub-section.

Should it prove impossible to extend the Transit Agreement or agree on its replacement by 1 January 2025, transit will stop but resume in the foreseeable future – within the same negotiated or regulated legal frameworks as under a "Continuation" scenario – once pre-defined conditions are met, such as the end of military hostilities between Russia and Ukraine ("Delayed Re-Start" scenario), and provided that commercial rationale still holds. It is argued here that the longer transit interruption lasts once transit has stopped, the more difficult it will be to agree on transit re-start.

Possible legal frameworks for continued transit: "Transit Agreement 2.0" and "CAM NC Model"

To construct possible legal frameworks within which both "Continuation" and "Delayed Re-Start" scenarios could be accomplished, it is necessary to understand the parties' 'red lines' – non-negotiable conditions that will not be accepted under any circumstances.

The most important 'red line' concerns Ukraine and is political. It is Ukraine's refusal – repeatedly stated by all relevant Ukrainian officials (Section 5) to extend, either in its original or amended form, the Transit Agreement under which Gazprom would remain a party to a commercial contractual relationship with Naftogaz, as long as the armed conflict continues.

Another 'red line' concerns the EC and is also political. It is the EC's apparent unwillingness to broker an agreement between European gas buyers, Ukraine, and Gazprom to find an arrangement enabling transit to continue. The EC, having thrown its financial and military weight behind Ukraine and having imposed unprecedented sanctions on Russia aimed at crippling its economy, is unwilling and unable to present itself as a mediator to the Russian side (as this would indirectly acknowledge Europe's continued reliance on Russian gas) nor would it be accepted as such by Russia.

Having acknowledged these 'red lines', it is equally important to understand what the parties <u>may be</u> prepared to accept. As far as Ukraine is concerned, the key question is whether its government is open to transiting Russian gas (under any arrangement)? Answering this question is not straightforward as while all the Ukrainian officials, including the country's President, confirmed Ukraine's readiness to transit gas to Europe, their responses as to whether it is prepared to transit <u>Russian</u> gas – or only that of other suppliers – have differed. Both President Zelenskiy and the Ukrainian energy minister, Galushchenko, have rejected the possibility of transiting Russian gas, with Zelenskiy referring to ongoing negotiations with Azerbaijan/SOCAR in respect of transiting Azeri gas.[183] However, the Ukrainian prime minister, Denys Shmyhal, has said that Ukraine would be prepared to transit Russian gas, subject to the request from the European buyers (see Section 5).

Interestingly, Azerbaijan president, Ilham Aliyev, interviewed in September 2024, stated that he was 'approached by Ukrainian authorities and the EU to facilitate a prolongation' of the Transit Agreement. This implies that the gas in question would be Russian, since the existing Agreement underpins transit of Russian, rather than Azeri gas.[184] He said he thought it was 'possible to prolong this deal', adding that Azerbaijan is 'in the process of negotiations with Russia on this matter'. Overall, there appears to be serious confusion about the role of Azerbaijan in the transit of gas across Ukraine, with its role being either that of a mediator or a supplier, or both.

Ukraine's willingness to transit Russian gas is indispensable for continued transit because no other supplier – be it Azeri SOCAR or any other non-Russian company – has the necessary volume of gas, available for substituting the14 bcma of Russian gas currently transiting through Ukraine. If, for example, SOCAR had such a volume, it could have reached a "swap" agreement with Gazprom Export, so that the gas handed over at the Ukraine-Russia border for shipment would still be physically Russian, but contractually Azeri, and therefore potentially more politically acceptable to the Ukrainian leadership.

As Azerbaijan does not have the volume necessary for a full 'swap', the only way for transited gas to be seen as 'Azeri' is for Gazprom to sell to SOCAR on the Ukraine-Russia border and for SOCAR either to (a) arrange sale to European buyers at the Ukraine-Russia border leaving it for them to book capacity across Ukraine, or (b) book transport capacity across Ukraine and hand the gas over to SPP at the Ukrainian-Slovakian border. Under this arrangement SOCAR would have to be paid a service fee for being an intermediary. Also, if Gazprom were to agree to it, it would probably require a deposit to be paid so that if its gas is not handed over to European buyers, it would be compensated. Overall, any such arrangement – effectively introducing an intermediary for no other benefit than pretending the gas in question is not Russian – appears to be too complex and an unnecessarily cumbersome way of enabling the "Continuation" scenario. In December 2024, the outgoing EU Commissioner Simson warned against this arrangement, adding it was 'totally unnecessary' as it was possible for European companies to buy Russian gas at the Ukrainian border themselves.[185] Yet, depending on Ukraine's position, it may be the only way to preserve supplies.

It is worth noting though that Azerbaijan may have some small volume of gas available, that it could potentially "swap" with Gazprom at the Ukraine-Russia border, thus enabling a very limited transit flow across Ukraine in January 2025 as the Transit Agreement expires. This volume could be complemented with Russian gas volumes in the future, when or if the relationship between Ukraine and Russia improves. This situation would resemble the "Delayed Re-start" scenario. However, timing is important as the longer the interruption in flows lasts then the less likely it is that flows will restart, at least for substantial volumes. (Interestingly, on 13 November SPP issued a press release, stating that SPP has signed 'a short-term, pilot contract, for the supply of natural gas from SOCAR' and '[a]fter a successful evaluation of the cooperation […] will consider concluding a gas supply contract for a longer period'.[186] The press release did not provide information on volume, duration or route via which this gas would be delivered.[187])

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[183] 'Zelenskiy: Ukraine in talks for Azeri gas transit to EU', *Bloomberg*, 3 July 2024.
[184] 'Azerbaijan in talks with Russia on Ukraine gas transit', *S&P*, 22 July 2024.
[185] 'EU's outgoing energy chief warns against masking Russian gas imports', *Financial Times*, 1 December 2024.
[186] SPP (2024).
[187] According to *Reuters*, supply under the pilot agreement will be purchased in December 2024, with delivery to come to Austria and 'small volumes of Azerbaijani gas will be shipped via the Trans Balkan pipeline in Bulgaria, see 'Slovakia's SPP signs pilot deal for Azerbaijani gas', *Reuters*, 13 November 2024.

European buyers taking delivery of Gazprom gas at the Ukrainian – Russian border and arranging further transportation across Ukraine themselves would appear to be a far more straightforward and transparent arrangement for enabling the "Continuation" scenario. If Ukraine is open to transit of Russian gas – without re-branding it as 'Azeri' – albeit without a direct commercial relationship with Gazprom Export, then post-2024 transit agreement could be based on:

- either the existing Transit Agreement, whereby Gazprom would be replaced by a European gas buyer (or a consortium of buyers) as the holder of a transportation contract with Naftogaz ("Transit Agreement 2.0");
- or a Capacity Allocation Mechanism Network Code (CAM NC) model, whereby a European gas buyer (or a consortium of buyers) would book capacity directly from the GTSOU, with no involvement of Naftogaz ("CAM NC Model").

Slovakian SPP and Hungarian MVM, which have repeatedly expressed their interest in continued transit of Russian gas across Ukraine, would be the most obvious candidates for participating in such an arrangement. Unlike many other European buyers – including OMV[188] and Eni – SPP and MVM have not been in international arbitration with Gazprom.

The **"Transit Agreement 2.0"** would necessitate replacing the agency transportation agreement between Naftogaz and Gazprom – one of three bilateral agreements underpinning commercial, legal and technical aspects of the Transit Agreement (see Section 4) – with another transportation agreement between Naftogaz and a European gas buyer. Thus, a European gas buyer (or a consortium of buyers) would replace Gazprom as Naftogaz's counterparty. On its part, Naftogaz would continue booking capacity from the GTSOU and retain its role as a shipper, but it would be shipping the gas owned by the European gas buyer instead of shipping Gazprom's gas. Should the European buyers be able to agree an agency transportation contract with Naftogaz, this could be seen by Gazprom as a sufficient legal framework for agreeing to change the delivery points in its LTSCs to the Russia-Ukraine border, with the European buyer (or a consortium of European buyers) taking ownership of the gas prior to its transit across Ukraine. Volumes and durations would also have to be amended – both could prove to be contentious issues, given the EU commitment to phase out Russian gas as soon as possible.

The main benefit of the Transit Agreement 2.0 is that it should be relatively quick to draft as it would involve only a few changes in the already existing framework. This is important, given the 1 January 2025 expiry date of the Transit Agreement. Also important is that it would not cross the Ukraine's 'red line' of not having a commercial relationship with Gazprom. It would also not cross the EU's 'red line' of not having to be involved in negotiations.

The **"CAM NC model"** would be different from the Transit Agreement 2.0 in that it would be a European gas buyer (or a consortium of European buyers) rather than Naftogaz that would become GTSOU's counterparty under a transportation capacity contract. In other words, a European gas buyer could book capacity in the Ukrainian network at the Russia-Ukraine border directly from the GTSOU under the EU CAM NC and assume responsibility for shipping this gas across Ukraine. For this option to be workable, the GTSOU would have to hold capacity auctions, where such capacity would be offered and where it could be booked. Under the "CAM NC model", there would be no need to involve Naftogaz as capacity would be booked by the European company directly from the GTSOU.

Unlike the Transit Agreement 2.0 – which would be a bespoke agreement tailored to the needs of the parties – the "CAM NC model" would be based on the existing legal framework for capacity booking, provided by the CAM NC, as adjusted for Energy Community Treaty (EnCT) Contracting Parties, including Ukraine.[189]

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[188] On 13 November 2024 OMV announced that it won $243mn in its arbitration with Gazprom, 'OMV gets over $243 mln in arbitral award for Gazprom's irregular German gas supplies', *Reuters*, 13 November 2024.
[189] The CAM NC implementation deadline was 28 February 2020.

The CAM NC stipulates that the national TSO must hold the following capacity auctions:

- annual auctions for yearly capacity once a gas year[190] on the first Monday of July, offering capacity at least for the next 5 gas years and for no longer than the next 15 gas years;
- annual auctions for quarterly capacity four times during a gas year, on the first Monday of August, November, February, and May
    - e.g. capacity for quarters two (January – March) through four (July – September) has to be auctioned on the first Monday of November);
- rolling monthly capacity auctions on the third Monday of each month;
- rolling daily capacity auctions.

However, while the CAM NC scope is such that it applies to interconnection points *between Contracting Parties,* whereas its application to entry points from and exit points to third [non-EnCT] countries is subject to the decision of the relevant national regulatory authority. GTSOU has been auctioning capacity in line with the CAM NC at the Ukraine borders with EU countries despite them not being EnCT Contracting Parties. GTSOU did not hold auctions at Sudzha on the Ukraine – Russia border, where yearly or quarterly capacity for 2025 (and beyond) could have been booked. It did not hold an annual auction on the first Monday of July 2024 when yearly capacity could have been booked. It also did not hold an annual auction on the first Monday of November 2024 where quarterly capacity from January through September 2025 could have been booked.[191] Unless a monthly auction will be held on the third Monday of December where capacity could be booked for January 2025 or a daily auction is held on 31 December 2024 for 1 January 2025, the CAM NC model would exhaust its potential to become a potential legal framework for transit to continue on 1 January 2025. However, it could be used in the future, as part of a “Delayed Re-start” scenario.

On 7 November the Ukrainian regulatory authority (NEURC) published for consultation its draft tariff methodology for the 2025-29 regulatory period on the assumption of zero transit across Ukraine. Thus, while the draft methodology has provided tariffs for all IPs between Ukraine and other countries (with tariffs more than doubling compared to the previous regulatory period), it did not provide an entry tariff either for Sudzha or Sokhranovka IPs on the Ukraine-Russia border,[192] due to ‘absence of information on booked capacity for these entry points into the gas transmission system from the GTSOU and Naftogaz’.[193] According to an unnamed market source, cited by ICIS, tariffs could be adjusted should an agreement on post-2024 be agreed at a later date.[194] Given that neither the GTSOU nor Naftogaz have provided NEURC with information on booked capacity, this confirms that no capacity has been offered (and booked) at either of these points for 2025-29. (Reportedly under the existing Transit Agreement Gazprom was able to book capacity in excess of fixed annual capacities (which were booked for it by Naftogaz) directly with GTSOU (although the mechanism for doing so is not known).[195]

Given that no auctions for annual or quarterly capacity have been held in respect of Sudzha (or Sokhranovka) on the days prescribed by the CAM NC, thus only leaving an option of booking capacity there on a monthly or daily basis, the Transit Agreement 2.0 appears to be a more likely arrangement for continued transit.

It is worth noting that for either model – “Transit Agreement 2.0” or “CAM NC model” – to be possible, <u>an interconnection agreement between the GTSOU and Gazprom must be in place</u>. Such an agreement would need to specify one (or more) Interconnection Points, where the gas leaves the Russian gas transmission system and enters the Ukrainian gas transmission system – e.g. Sudzha and (possibly Sokhranovka) – whose subsequent shipment across the Ukrainian territory becomes the responsibility

[190] Gas year starts on 1 October.
[191] ‘Putin talked about future gas supplies to Europe’, *RBC*, 25 October 2024.
[192] Previously entry tariffs for Sudzha and Sokhranovka were 14.7 euros/MWh, see ‘Ukraine gas transmission tariffs expected to double on no Russian transit scenario’, *ICIS*, 8 November 2024. Also see NERC, Draft Tariff Methodology, 13 November 2024.
[193] Ibid.
[194] ‘Ukraine gas transmission tariffs expected to double on no Russian transit scenario’, *ICIS*, 8 November 2024.
[195] Pirani and Sharples (2020b).

of Naftogaz (if it has a transit contract with GTSOU) or a European gas buyer (if it has a transit contract with GTSOU or booked capacity from the GTSOU under the CAM NC). The need for interconnection agreements has often been referred to as one of the barriers to agreeing on continued transit, as it suggests a relationship between Naftogaz and Gazprom, which Ukraine wants to avoid. This Insight argues that this concern is overplayed as an interconnection agreement is merely a technical document, not a political or commercial agreement. (Moreover, continued transit of Russian oil across Ukraine to Slovakia and Hungary would not have been possible without an interconnection agreement between Ukrainian and Russian oil system operators, suggesting that such an agreement could also be possible for gas operators).

If Ukraine were to refuse to sign an interconnection agreement which is required for booking transit capacity in the Ukrainian system, no continued transit would be possible and the 'Stop" scenario would result. In turn, this could enable Gazprom Export to declare a *force majeure* on its LTSCs with SPP, OMV, ENI and MVM, served via Ukraine (see Section 5).

7. Conclusions

The main conclusion of this paper is that an agreement enabling continued transit of Russian gas across Ukraine after expiry of the Transit Agreement on 1 January 2025 <u>could</u> still be reached. But at a minimum the following conditions would have to be met for this outcome to be possible:

- political support from EU Member States which would be most affected by potential transit cessation (particularly Slovakia and Austria) for their buyers' efforts to reach an agreement on continued transit enabling them to book capacity in the Ukrainian gas transmission system at the Ukraine-Russia border;
- clearly communicated lack of objection on the part of the EC for these Member States and their gas buyers to do so;
- most importantly, Ukraine's willingness to transit Russian gas as confirmed by signature (or renewal) of the technical interconnection agreement between the Ukrainian TSO (GTSOU) and Gazprom.

None of these conditions can be taken for granted. It is understood that preparatory work, exploring whether any of these conditions could possibly be met within the existing political and security constraints, has been ongoing for some time – both at government and company levels. Sporadic media reports to this effect first started to appear in summer 2024 and became more frequent in the second half of the year. Meanwhile, a dispute concerning Russian oil transit across Ukraine to Slovakia and Hungary has been resolved thus suggesting a resolution could also be reached in respect of gas.[196]

Strong support from Slovakia for continued transit, manifested in its Prime Minister's meetings with Ukrainian officials and SPP's efforts to reach an agreement, is evident. Hungary is also supportive although keeping a lower profile as it is potentially less affected by transit cessation (since its Russian gas imports arrive mostly through TurkStream). Austria's coalition government has been divided in respect of Russian gas imports per se, with its (ÖVP-affiliated) Chancellor confirming the country's willingness to receive Russian gas, provided it is delivered in line with OMV's Gazprom contract but its (Green party-affiliated) Energy Minister seeking to terminate the contract and viewing transit cessation as means for doing so. As the new coalition government (which may or may not be in power before 1 January 2025) is not expected to include the Green party, it is unlikely to seek early termination of the contract. However, it is uncertain whether it will lend its support to OMV to participate in negotiating the new transit arrangement.

It is difficult to decipher the EC's attitude towards continued transit. On one hand, it views it as an obstacle to the EU's declared goal of phasing Russian gas out as soon as possible, and as such might be hostile towards any agreement enabling transit to continue. It has also publicly stated that it will not

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[196] 'Russia's Lukoil set to resume supplies via southern Druzhba in October, sources say', *Reuters*, 10 September 2024; 'Supplies of LUKOIL's oil to Hungary and Slovakia have stabilised', *Kommersant*, 2 December 2024.

push Ukraine to negotiate any such agreement. On the other hand, the energy crisis is not fully over yet, and the European gas market remains tight. Given limited upside flexibility from European domestic production and pipeline imports, global LNG would remain the main source of alternative supplies. But as the arrival of the 'new wave' of additional LNG has been pushed back – possibly until 2027 – in the interim Europe will have to compete for existing LNG with Asia. While a physical shortage in winter 2024/25 is understood not to be a risk, the recent OIES Winter Outlook 2024-25 – which assumes cessation of gas transit across Ukraine on 1 January 2025 – warns that 'the need to call upon additional LNG supply in a currently tight market will place upward pressure on prices, while a greater call on storage will imply greater need for storage replenishment in summer 2025 in what promises to remain a tight market, which will also push prices higher than they would otherwise have been'.[197] This may suggest that while the EC will not endorse a post-2024 transit agreement, it may abstain from raising objections if it is reached.

This paper argues that the fact that transit has continued to date (albeit at lower levels than envisaged by the Transit Agreement) despite ongoing military hostilities suggests that both countries attach certain value (both commercial and possibly strategic) to continued transit relationship.(There was no interruption even after the Russia – Ukraine border interconnection point, Sudzha, fell under control of Ukrainian troops in August 2024.) For Ukraine, the value is the ability to earn transit revenue of ~1 bn euros per year, to have access to (less expensive) virtual reverse flow, and to maintain its gas transmission system, which is crucial for domestic transport and imports from Europe). For Russia, the value is Gazprom's ability to meet its LTSCs with its few remaining European buyers, earning ~6.5 bn euros per year for gas that could not be redirected to other markets, and having access to the only remaining export corridor to European countries that cannot be served via TurkStream. It is also beneficial for European gas buyers in Slovakia and Austria, as transit cessation would have a negative financial impact for them.

This suggests that should a politically acceptable legal framework be proposed, that would respect parties' 'red lines', particularly Ukraine's refusal to have any commercial relationship with Gazprom (as is the case under the existing Transit Agreement), neither party would be likely to turn it down. As Ukraine and the EC are unwilling – and Russia is unable – to advance such a framework themselves, there is no one else but the European gas buyers to do so.

European buyers taking delivery of Gazprom's gas at the Ukrainian – Russian border interconnection point(s) and arranging further transportation across Ukraine would be the most straightforward and transparent arrangement for enabling continued transit. Such an arrangement could be based on either:

- the existing Transit Agreement, whereby Gazprom would be replaced by a European gas buyer (or a consortium of buyers) as the holder of a transportation contract with Naftogaz ("Transit Agreement 2.0"), or
- the Capacity Allocation Mechanism Network Code (CAM NC) model, whereby a European gas buyer (or a consortium of buyers) would book capacity directly from the GTSOU, with no Naftogaz involvement ("CAM NC Model").

This arrangement would not cross either the Ukraine's 'red line' of having a direct commercial relationship with Gazprom, or the EC's 'red line' of having to be involved in negotiations. The main benefit of the Transit Agreement 2.0 is that it would be relatively easy to develop, necessitating only a few changes in the expiring Transit Agreement. The likelihood of the "CAM NC Model" is receding as no auctions were held by GTSOU under the CAM NC in respect of the Ukraine – Russia border interconnection point(s), where annual or quarterly capacity could be booked for 2025 and beyond.

Given that neither Slovak SPP nor Hungarian MVM have been in international arbitrations against Gazprom, they are better placed to participate in such an arrangement. It would be significantly more difficult for those European buyers which are in arbitration proceedings with Gazprom, such as Italian Eni or Austrian OMV. As far as OMV is concerned, its participation will depend on the reactions of both parties post-the arbitral award.

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[197] Farren-Price, Sharples and Honoré (2024).

Ukraine's willingness to transit Russian gas is indispensable for continued transit because it is well known to all parties that no other supplier – be it Azeri SOCAR or any other non-Russian company – has sufficient volume of gas to replace 14 bcma of transited Russian gas with its own gas. Therefore, any such company could only be part of the new transit arrangement as a mediator and/or an intermediary, which would still be supplying mostly Russian gas. Its presence would make the arrangement more cumbersome and less transparent for no other benefit than pretending the gas in question is not Russian. However, depending on Ukraine's position, it may be the only way to preserve supplies. As SOCAR may have some (much smaller) volumes of gas available, which could be potentially "swapped" with Russian gas at the Ukraine – Russia border, its inclusion as a supplier would enable a very limited transit flow in January 2025, even if the new transit agreement in respect of Russian gas is not signed.

Finally, no transit arrangement will be possible until and unless GTSOU and Gazprom sign a new interconnection agreement or extend the expiring agreement. From a legal point of view, in the absence of such agreement, there are no interconnection point(s), at which capacity could be booked by any party, including a European buyer (or a consortium of buyers). While signature of such agreement is often referred to as one of the key barriers to continued transit due to Ukraine's objection to have any relationship with Gazprom, this concern appears to be overplayed as it would be merely a technical document, not a political or commercial agreement. If an interconnection agreement is not signed and no capacity is offered at the Ukraine-Russia border interconnection point(s) – either via a bilateral agreement ("Transit Agreement 2.0") or an auction ("CAM NC Model") – Gazprom would be likely to declare a *force majeure* in respect of relevant LTSCs on the grounds of obstruction of service. If the arbitration tribunals were to accept *force majeure*, these LTSCs could be suspended until capacity potentially becomes accessible in the future, thus providing Europe with a cushion against future market tightness. Alternatively, tribunals – as in the case of Uniper – could allow buyers to terminate contracts. If they did not, some buyers – particularly if pressed by their governments – may decide to terminate these LTSCs unilaterally.

Continued transit of Russian gas across Ukraine implies the presence of a relatively small volume (14 bcma) and share (~7%) of Russian pipeline gas in the European gas balance. For many European politicians and civil society commentators, any volume of Russian gas – no matter how small – is considered unacceptable, as it is believed to provide funds to support Russia's armed conflict in Ukraine and leave European countries open to energy blackmail. However, it could be argued that having sharply reduced its dependence on Russian gas since 2021 and having introduced various safeguards in the *acquis*, aimed at curtailing Russia's ability to manipulate supplies in the future, the EU *as a whole* might no longer consider some volume of Russian gas in its energy balance as a security threat. With the EU dependence on Russian pipeline gas being down to ~7%, it is difficult to argue that Europe is exposed to blackmail, as the corresponding volume of Russian gas could be replaced by non-Russian alternative supplies at a much lower cost than during the 2021-23 crisis.

Ultimately, reaching an agreement on post-2024 gas transit across Ukraine will depend not only on (undoubtedly positive) commercial considerations but also on whether the continued transit can be seen as a step towards preserving the Ukrainian gas system (crucial for domestic supply security) and becoming one of the first steps towards a negotiated end of the armed conflict (perhaps as part of a broader agreement not to target each other's energy infrastructure)[198] – and whether the EC itself will see these reasons sufficiently convincing as not to block it.

[198] Talks on non-targeting energy infrastructure reportedly took place in August 2024 before being derailed by Ukraine's incursion in the Kursk region, which could re-start at a later point, see 'Ukraine and Russia in talks about halting strikes on energy plants', *Financial Times*, 29 October 2024.

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