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The June 2010 Russian-Belarusian Gas Transit Dispute:
a surprise that was to be expected

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Abstract

This paper analyses the June 2010 Russia-Belarus gas transit dispute and argues that the dispute was triggered by the following combination of factors:

- existence of several 'fault-lines' in the January 2007 supply and transit contract, such as the lack of clarity and transparency on price methodology and the lack of clarity on the relationship between a price and a transit fee;
- the lack of transparency in the protocol which set up the Gazprom-Belarus JV 'Beltransgaz', in particular on the relationship between the Beltransgaz wholesale mark-up and a transit fee;
- Belarus' desire to improve its economic conditions – negatively affected by the financial and economic crisis of 2008 and by the January 2010 changes in Russian oil export regime – by means of postponing its transition to European 'netback' gas prices until 2014-2015, before its bargaining power vis-à-vis Gazprom declines further as a result of the Nord Stream pipeline completion in 2012;
- the decreasing degree of 'allowable' Belarus deviation from the January 2007 contract, possibly resulting from decreasing Russian government tolerance of Belarus.

1. Introduction

In June 2010 Belarus - the former Soviet country that does not feature too often in European media - attracted many headlines because of its transit dispute with Russia's Gazprom. Presented with an ultimatum to repay its gas debt it five days or face supplies cuts, Belarus confronted Gazprom with a counter-demand to pay the debt for transit at an increased rate, threatening to reduce and potentially halt transit of gas and oil to Europe. This was not the first transit dispute between Belarus and Russia: the two countries went through several such incidents in the past, including in February 2004, January 2007 and January 2010. Only two past disputes – the 2004 gas dispute and the 2007 oil dispute – actually resulted in transit interruptions. All of these disputes were milestones marking the Russia's quest to commercialise its gas and oil relationship with Belarus. The Russian government set this course in the early 2000s, once it had become clear that the project of political integration with Belarus had failed. Thus Russia decided to end various subsidies to Belarus - most significantly, the subsidy to Belarusian oil refineries provided by the sale of crude oil without export duty, and the subsidy included in cheap gas prices. The loss of \$2bn in oil subsidies and an anticipated rise of gas bill created significant pressure on the Belarus' finances, which were already under severe strain as a result of the financial and economic crisis of 2008. Aware of its decreasing negotiating power vis-à-vis Gazprom, because of the Nord Stream pipeline completion in 2012, Belarus attempted to use its (still important) gas and oil transit position to secure better commercial terms and thus improve its overall economic position. The worsening political relationship between the two countries may have made the achievement of this aim even more difficult.

All of these developments are important for European energy security. Belarus' total gas transit capacity is 48 bcm which is 22 percent of total Russian export capacity to Europe in 2010.[1] The amount of actual transit varies from year to year. The EU Commission estimates that Belarus transits around 6.25 percent of total EU gas consumption, but for Poland and Lithuania the figures would be much larger.[2] Belarus also transits around 68 mn tons of Russian oil exports.[3]

2. The Origins of the Dispute: February 2004

The June 2010 dispute is not the first time Gazprom has cut gas supplies to Belarus. On January 1, 2004, following the failure to conclude a new supply contract because of Belarus's refusal to agree to a price increase from \$30 to \$50/mcm, Gazprom stopped shipping gas to Belarus via Beltransgaz's Northern Lights pipeline, letting the Russian 'independents' to take up the business and supply gas to Belarus at \$46.68/mcm. On February 18, 2004 when the last short-term contract expired, Belarus was left without gas supply – except the gas that was still travelling via the Yamal-Europe pipeline in transit to Europe. Given its near total dependence on imported gas, 90 percent of its power generation is gas-fired, and with no storage capacity capable of withstanding a stoppage, Belarus was in a critical situation. However, its government continued to refuse to sign a new contract at \$50/mcm. Instead, Beltransgaz took gas out of the Yamal-Europe pipeline (which is intended solely for delivery

[1] S. Pirani, J. Stern and K. Yafimava, *The April 2010 Russo-Ukrainian gas agreement and its implications for Europe*, OIES working paper NG 42, published online June 2010 <http://www.oxfordenergy.org/pdfs/NG42.pdf>, p. 26.

[2] M. Holzner, Gas supply disruption in Belarus: extracts from the EC midday press briefing follow-up 21/06/10, 22 June 2010 <http://ec.europa.eu/avservices/services/showShotlist.do?filmRef=70962>

[3] GomelTransNeft Druzhba website, http://www.transoil.by/about/general/

to Europe[4]) to which Gazprom responded by cutting flows off via this route as well.[5] In less than a day, Beltransgaz signed new short-term supply contracts with 'independent producers' until mid-2004 and it was only in mid-June that Beltransgaz and Gazprom signed a 2004 contract at a price of $46.68/mcm, and at a transit tariff of $0.75/mcm/100km via the Northern Lights (up from $0.53/mcm/100km) and $0.46/mcm/100 km via Yamal-Europe. The price and the tariffs remained unchanged in 2005 and 2006. [6]

3. The January 2007 Supply and Transit Contract

In 2006, the Russian government announced its new policy of achieving 'equal profitability' from domestic, CIS and European gas sales by 2011. In line with this policy, Gazprom announced that Belarus should expect to pay $200/mcm in 2007. At the same time, it continued to push for acquisition of a stake in Beltransgaz. The Dutch bank ABN Amro was contracted to do an independent valuation of Beltransgaz, and Gazprom accepted the highest valuation suggested by ABN Amro, and agreed to pay $2.5 bn for a 50 percent stake. However, the Belarus president stated that if the gas price were to be $200/mcm, the 'fair' price of Beltransgaz would be $17 bn, irrespective of ABN Amro valuation. Gazprom and Belarus continued their bargaining up until the New Year Eve, when Belarus was forced to accept a $100/mcm price as well as agreed to sell 50 percent of Beltransgaz at $2.5 bn in four equal tranches over the 4-year period.

As of January 1, 2007 Russian-Belarusian gas relations were formalised by means of a 5-year supply and transit contract.[7] Accordingly to the Gazprom press-release, this contract set the gas price for Belarus in 2007 at $100/mcm and stipulated that the price would correspond to a percentage of the price at which Gazprom exports its gas to Europe – 67, 80 and 90 percent in 2008, 2009 and 2010 respectively. Starting from 2011 Belarus would have to pay the full European gas price. The transit fee via the Northern Lights pipeline network was increased from $0.75 to $1.45/mcm.

As we argued elsewhere, the January 2007 contract should have been considered more of a 'work in progress' rather than a finished contract.[8] Although the contract introduced welcome commercialisation of Russia-Belarus gas relationship, making it less susceptible to changes in political relations, the contract contained significant 'fault-lines', which could potentially lead to a dispute[9]:

- the lack of clarity about the point in time and the location in Europe at which Gazprom was going to calculate its European price, to which a discount was to be applied;

[4] In 2004 23-24 bcm of gas was transited to Europe via Yamal-Europe and 7-9 bcm via the Belarus-owned Northern Lights.
[5] K. Yafimava, *Post-Soviet Russian-Belarussian relationships: the role of gas transit pipelines* (Stutgart: Ibidem Verlag, 2007).
[6] It is important to stress that the strains in Russia-Belarus gas relations had appeared long before the February 2004 dispute, for history of these relations see C. Bruce, *Fraternal friction or fraternal fiction? The gas factor in Russian-Belarusian relations*, OIES working paper NG 8, published online March 2005 <http://www.oxfordenergy.org/pdfs/NG8.pdf>
[7] For details see K. Yafimava and J. Stern, *The 2007 Russia-Belarus gas agreement*, Oxford Energy Comment, published online January 2007 <http://www.oxfordenergy.org/pdfs/comment_0107-3.pdf>
[8] Yafimava and Stern, op.cit.
[9] The contract is not available in public domain.

- the lack of common understanding of the relationship between prices and transit fees: Gazprom press-release did not mention any mechanism relating gas price and transit tariff increases, whereas immediately after the signature the Belarusian deputy prime minister Vladimir Semashko stated that the transit fee would increase in line with gas price increases.

Apart from the contract, Gazprom and Belarus signed a protocol setting up the Russian-Belarusian JV 'Beltransgaz', which stipulated the sale of 50 percent of Beltransgaz shares to Gazprom at $2.5 bn. The protocol envisaged signature by June 2007 of a purchase and sale agreement setting out the conditions of the sale. In May 2007 Belarus and Gazprom signed the agreement, albeit after lengthy negotiations on the Beltransgaz wholesale mark-up (see Box 1) and transit volumes through the Northern Lights pipeline.[10]

Box 1: Beltransgaz wholesale mark-up

The Beltransgaz wholesale mark-up is the difference between the import price and the sales price, at which Beltransgaz sells gas to the state-owned company, Beltopgaz, for distribution and sales to end users. (Beltransgaz also sells gas to a limited number of end users directly, at a price identical to that of Beltopgaz.) Reportedly, in 2007 Beltransgaz wanted to cancel its wholesale mark-up in order to cushion sharp price increases resulting from the January 2007 Russian-Belarusian supply and transit contract, but Gazprom objected. As stipulated by the protocol setting up the Beltransgaz JV, in May 2007 Beltransgaz and Gazprom signed a purchase and sale agreement for a 50% stake in Beltransgaz, envisaging a step-by-step increase of Beltransgaz wholesale mark-up, to reach $10.45 and $11.07/mcm in 2009 and 2010 respectively. According to Gazprom, the protocol made an increase of transit fee conditional on the increase of mark-up . During the June 2010 dispute Gazprom claimed that Beltransgaz had not increased its mark-up in line with the agreement, and hence Belarus' demand to pay a transit fee of $1.74 and $1.88/mcm/00km in 2009 and 2010 respectively, was unjustified. It is impossible to know whether or not Belarus raised the Beltransgaz mark-up to pre-agreed levels as beginning from January 1, 2007, the Belarusian government stopped publishing Beltransgaz sales prices thus making it impossible to ascertain the size of its wholesale mark-up. The composition of the mark-up is not clear: it could include a number of elements, such as profit, maintenance cost (including investment) and taxes; we think it does not include transportation cost. Given the centrality of the mark-up in this dispute, the lack of transparency about what it reflects is a major problem.

A detailed table on the dynamics of Belarusian gas price structure during 1999-2010 is available in Appendix A.

In line with the protocol, the sale of 50 percent of Beltransgaz was finalized in February 2010. Shortly afterwards, Gazprom board member and CFO, Andrei Kruglov, stated that Gazprom was interested in acquiring control in the JV. The Russian ambassador in Belarus, Alexander Surikov, also stated that Gazprom might be interested in further increasing its

[10] Neither the protocol nor the sale and purchase agreement is publicly available.

share. As the JV's half-owner, Gazprom has now four representatives on the board of directors, and four representatives on the management board, equalling Belarusian representation. Gazprom deputy CEO Valerii Golubev is head of the board – the position previously held by Belarusian deputy prime minister Vladimir Semashko.[11] However, parity ownership suggests that any corporate management decision can only be taken if both owners agree; if there is no unanimity decision-making could be deadlocked. This became evident during the June 2010 transit dispute, when the inability to agree on a wholesale mark-up appeared to have contributed to the conflict.

4. Testing the January 2007 Contract: the August 2007 incident and subsequent developments

The first test for the 2007 contract came in August 2007 - only half a year after it was signed – when it transpired that during the first half of 2007, Belarus was effectively paying only 55 percent of the new price. Belarus claimed that the December 2007 contract and protocol provided for it to pay \$55/mcm until June 2007, and to pay \$100/mcm from July as well as *begin repayment* of the debt accumulated during the first half of 2007. Another source, later indirectly confirmed by Gazprom, said that the contract envisaged that *accumulated debt was to be paid off in its entirety by 23 July*.[12] An increasingly vociferous public dispute ensued. Meanwhile Belarus' debt to Gazprom for 2007 imports rose rapidly. On 1 August it stood at \$456.16 million[13], and Gazprom announced that it would reduce supplies by 45 percent on August 3.[14] The threat proved effective, and Belarus paid off all its 2007 debt within four days – albeit after much harsh anti-Gazprom rhetoric on national television.[15]

As 2007 drew to a close, negotiations over the 2008 gas terms began. Given the aforementioned uncertainty about Gazprom's methodology for calculating a European price (of which Belarusian price was to constitute 67 percent minus transportation cost), estimates varied from \$108 to \$165/mcm. Eventually, the parties agreed on \$119.6/mcm in the first quarter, and \$127.9/mcm in the three subsequent quarters.[16] The average price for 2008 was \$125/mcm and that year was relatively uneventful.

The dynamics of oil prices in 2008, when oil prices hit \$147 in July and then crashed to \$30, meant that price for Belarus increased sharply to reach \$210/mcm in the first quarter of 2009 but then fell to \$158/mcm in the second quarter and declined further to \$115/mcm in the second half of the year. In March 2009 Russian and Belarusian presidents reportedly agreed that at least during the first half of 2009, Belarus would be paying Gazprom an *average* annual price, rather than a quarterly contractual price, allowing Belarus to avoid a sharp increase in the beginning of the year and smooth price fluctuations. This was a verbal agreement, which was never formalized. The absence of a formal document enabled Gazprom to request Belarus to pay a quarterly price in line with the contract. As Belarus

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[11] Beltransgaz official website, http://www.btg.by/btgtoday/nabsovet/

[12] I. Krilovich, 'Not everybody is able to pay for gas', *Belorusy i rinok,* 2 Apr. 2007, '*BR* note', *Belorusy i rinok,* 6 Aug. 2007.

[13] *'BR note', Belorusy i rinok,* 6 Aug. 2007.

[14] 'Gazprom to cut Belarus supplies', *BBC News*, 1 Aug. 2007.

[15] T. Manenok, 'With the sense of accomplished duty' (in Russian), *Belorusy i rinok*, 13 Aug. 2007, 'Belarus has paid' (in Russian), *Vzgliad*, 8 Aug. 2007.

[16] 'Belarus envies Armenia. The government demands revision of gas pricing agreement with Gazprom' (in Russian), *Vzgliad*, 1 Aug. 2008.

continued to pay an average annual price of $150/mcm, by August 2009 the country accumulated a $280 mn debt, but paid some of this by November, and the rest in December. The debt would have been higher, had Gazprom chosen to apply penalties for lower off-take in 2009 when Belarus took only 17.6 bcm against a contractual 21.5 bcm.[17] Although Gazprom did not amend the contract with Belarus (as it did with Ukraine) to formalize non-enforcement of penalties, it did not enforce the penalties (although occasionally threatened that it would). Moreover, Gazprom agreed to increase a discount to European 'netback' prices in 2009 from the contractual 20 to 30 percent.

In January 2010 Belarus again asked Gazprom to increase the discount to European prices from the contractual 10 percent to 25-30 percent to maintain an average annual price at $150/mcm.[18] Evidently, Gazprom refused, as in late March Andrei Kruglov stated that an average price for Belarus - with a 10 percent discount - would constitute $171.5/mcm, while also stressing that Belarus had already accumulated a $94.5 mn debt which had climbed to $137.49 mn by the end of the first quarter.[19] In April 2010, Belarus sent to Gazprom a draft agreement, which Belarus wanted to serve as a framework for their gas relations, once the January 2007 contract expired at the end of 2011. The main Belarus demand was that the agreement should stipulate Russia and Belarus simultaneously reaching European 'netback' price equivalence by 2014-2015. Belarus argued that when the January 2007 contract was signed, the Russian government envisaged that Russian domestic consumers would be paying European 'netback' prices by 2011, i.e. the same year by which Belarus committed under the contract to pay the full 'netback' price. However, in the wake of the 2008 financial and economic crisis the Russian government postponed reaching 'netback' prices for domestic consumers until 2014-2015. Belarus argued that since the initial timetable for reaching European 'netback' price had changed since January 2007 (when the contract based on this assumption was signed) and the 'grace period' was extended for Russia, it should also be extended to Belarus. As this line of reasoning did not seem to convince either the Russian government or Gazprom, Belarusian president Alexander Lukashenko offered to sell a controlling stake in Beltransgaz if Belarus were to receive gas at domestic Russian prices.[20] Gazprom's spokesman Kuprianov said that Gazprom would only discuss this offer once the existing debt was paid[21], whereas Russian deputy prime minister Igor Sechin was more dismissive, as saying that Gazprom had already bought - and 'overpaid' for - a 50 percent share of Beltransgaz, this investment having no 'great commercial rationale'.[22] This was important because for the first time, a leading Russian policy maker had cast doubt on the desirability of owning CIS pipeline networks.

In early June, Belarusian deputy prime minister Semashko reiterated that Russia should extend a grace period for Belarus reaching equal profitability with European sales until 2014-2015, to synchronize gas prices with domestic Russian consumers. He claimed that the January 2007 contract was based on understanding that in 2011 domestic Russian consumers will themselves be paying European gas prices. In early June, Belarusian president went to

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[17] 'Sechin – the issue of Belarusian gas debt could only be solved by payment' (in Russian), www.tut.by, 11 June 2008.
[18] Ibid.
[19] 'Gazprom: gas price for Belarus will constitute $171.5' (in Russian), *Vzgliad*, 26 Mar. 2010, 'Without looking at the contract' (in Russian), *Vzgliad*, 20 May 2010.
[20] 'Lukashenko announced the condition of selling a controlling stake in Beltransgaz' (in Russian), *Vzgliad*, 27 May 2010.
[21] 'It is possible to cooperate with Belarus once the debt is cleared' (in Russian), *RIA Novosti*, 28 May 2010.
[22] 'Igor Sechin did not support the idea of buying a controlling stake in Beltransgaz' (in Russian), *Kommersant*, 28 May 2010. 'Cooled off Beltransgaz?' (in Russian), *Interfax*, 28 May 2010.

Moscow to discuss gas issues with both Russian president and prime minister, but the absence of any official, let alone joint, statement suggested that no progress had been made. Several days later a televised Medvedev-Miller meeting followed, when Belarus was confronted with a 5-day ultimatum to repay its debt.

5. The June 2010 Dispute

Despite the fact that the existing supply and transit contract stipulated that Belarus had to pay $169.22/mcm in the first quarter, and $184.79/mcm in the second quarter of 2010, the country unilaterally decided to pay Gazprom only $150/mcm,[23] and as a result, accumulated debt. Contractual price for Belarus in the third and fourth quarters of 2010 is set to increase further. On June 8, Gazprom spokesman Sergei Kuprianov estimated the average annual price for Belarus in 2010 at $187/mcm.[24] If Belarus were to continue to pay just $150/mcm, its debt would grow, potentially reaching $500-600 mn by the end of 2010. Although Belarus began to accumulate debt from January 2010, it was only in late March that Gazprom first expressed its concern, and again in April. Yet Belarus continued to pay $150/mcm, and by June its debt reached $192 mn.

On June 15, a televised meeting took place between Russian president Dmitri Medvedev and Gazprom CEO Alexei Miller. Medvedev addressed the issue of Belarus gas debt: he said that the explanation provided by Belarusian president, Alexander Lukashenko, citing difficult financial circumstances, was 'insufficient' and gave Belarus five days to clear its debt of around $200 mn,[25] otherwise 'other measures will have to be applied'. On June 18 Belarusian deputy energy minister, Edouard Tovpenets, stated that while Gazprom requested Belarus to pay $192 mn debt for gas supplies, Gazprom itself owed Belarus more than $200 mn for transit.[26] First deputy prime minister and Chairman of the Gazprom board, Viktor Zubkov, stated Belarus had not provided Gazprom with a document proving the existence of debt.[27] Meanwhile, the talks between Gazprom and Belarus held on June 19 in St Petersburg failed to result in payment, although Belarus offered to repay its debt in goods and equipment.

On June 21, Medvedev and Miller reconvened in the same televised setting, with Medvedev agreeing with Miller's proposal to gradually reduce supplies to Belarus by amount proportional to accumulated debt.[28] Responding to Belarus' offer to repay debt by barter, Medvedev said that Gazprom would only accept monetary payment, noting that 'pies, butter, cheese or pancakes' are not acceptable means of payment. Medvedev also ordered to communicate this decision to Gazprom's counter-parties within the European cooperation framework.[29]

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[23] Belarus was also paying $150/mcm in 2009.
[24] 'Average annual price for Belarus in 2010 will constitute $187/mcm' (in Russian), http://www.echo.msk.ru/news/686084-echo.html
[25] Gazprom stated that the debt was $192 mn whereas Belarus said it was only $187 mn.
[26] Meeting with Gazprom CEO Alexei Miller, http://end.news.kremlin.ru/transcripts/445, 15 June 2010, 'Belarus did not present Russia with the documents proving the existence of debt for transit' (in Russian), *Interfax*, 19 June 2010.
[27] 'Belarus did not provide Russia with documents proving the existence of debt' (in Russian), 19 June 2010, http://www.interfax.by/news/belarus/74614
[28] Meeting with Chairman of Gazprom's Management Committee Alexei Miller, 21 June 2010, http://end.news.kremlin.ru/468
[29] Presumably president Medvedev referred to the Early Warning Mechanism (EWM) memorandum, which was signed by the then EU Energy Commissioner, Andris Piebalgs, and Russian energy minister, Sergei Shmatko, in November 2009. In line with the memorandum, Russia and the EU 'notify any likely oil, gas or electricity

Shortly after the meeting, Miller announced a 15 percent reduction of supplies, stating that supplies could ultimately be cut by up to 85 percent.[30] In line with this announcement, Gazprom reduced supplies to Belarus by 15 percent at 10:00 am on June 21. Belarus offered to repay the debt within the two weeks, claiming that it needed time to borrow this money, as it did not have the necessary funds available.[31] Gazprom responded that it would not wait for two weeks, and indicated that further reductions will come through unless the payment was made.[32] On its part, Belarus demanded Gazprom to pay off a $217 mn debt for transit, saying that the supply debt would then be paid. Gazprom spokesman Kuprianov confirmed the existence of debt for transit, but claimed this had accumulated due to Belarus' refusal to sign the acts of acceptance thus making it difficult for Gazprom to pay.[33] Belarusian deputy energy minister, Edouard Tovpenets, denied this; he claimed that the acts were signed by Beltransgaz deputy CEO, Dmitri Anjuk, as well as Gazprom's representative in Belarus, but not by Gazprom itself.[34] He also stressed that according to the contract Gazprom cannot reduce supplies by 85 percent as Belarus non-payment constituted only around 15 percent and therefore supplies could not be reduced by more than 15 percent.[35] At this point, the Belarusian energy ministry sent a letter to the European Commission, warning about the possibility of technical reduction of transit in the event of further supply reductions.[36] EU Energy Commissioner Günther Oettinger also received a letter from Russian deputy prime minister Igor Sechin in the late morning of June 21, saying that there will be an interruption as well as providing a risk assessment.[37]

On June 22 Gazprom reduced pressure by another 15 percent. On the same day Belarus paid $260 mn for May supplies (thus paying a contractual quarterly price of $169/mcm), and sent Gazprom a letter signed by Belarusian first deputy prime minister, Vladimir Semashko, threatening to divert gas in transit in order to meet domestic demand.[38] On the same day, during his meeting with Russian foreign minister, Sergei Lavrov, Belarusian president Alexander Lukashenko stated that Belarus would halt gas transit to Europe until Gazprom paid Belarus $260 mn for transit services rendered by Belarus from November 2009 to May 2010. He stressed specifically that Gazprom had not paid for transit during this period and that its debt was higher than Belarus' debt, while also noting that Gazprom rejected an offset payment offer.

Gazprom appeared to have been caught off guard. Gazprom spokesman stressed that Belarus' threat was illegal, and went on to stress that Gazprom would make every effort to avoid supply reductions to European customers.[39] Gazprom stated that higher volumes could be transported across Ukraine, with Ukraine's energy minister, Yuri Boiko, confirming that

supply interruption, including an exchange of the assessments of the situation' which would allow 'the holding of consultations or, if needed, to have a common assessment of the situation and a joint plan for a solution', http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1718&language=en

30 'Gazprom cuts gas supplies to Belarus as debt talks fail to reach agreement', *Bloomberg*, 21 June 2010.
31 'Belarus intends to pay its gas debt within two weeks' (in Russian), *Belta*, 21 June 2010.
32 'Gazprom says will not wait 2 weeks for Minsk to pay off gas debt' (in Russian), *RIA Novosti*, 21 June 2010.
33 By signing these acts of acceptance, Gazprom and Beltransgaz confirm that a transit service had indeed been rendered in accordance with the supply and transit contract. 'Belarus does not permit to pay Gazprom's debt for transit' (in Russian), *RIA Novosti*, 21 June 2010.
34 'The size of supplies reduction introduced by Gazprom is unfounded' (in Russian), *Belta*, 21 June 2010.
35 Ibid.
36 'Belarus warns Europe about possible transit disruptions' (in Russian), *RIA Novosti*, 21 June 2010.
37 M. Holzner, spokesperson for energy on the Belarus gas situation, 'Gas supply disruption in Belarus: extracts from the EC midday press briefing', 21 June 2010, http://ec.europa.eu/avservices/services/showShotlist.do?out=PDF&lg=En&filmRef=71203
38 'Russia-Belarus gas dispute', Russia and CIS oil and gas weekly, *Interfax*, June 17-23
39 Belarus 'to suspend Russian gas transit to Europe', *BBC News*, 22 June 2010.

Naftogaz had the necessary capacity for doing so, but noted that Gazprom had not yet asked Ukraine to increase transit. Throughout the day, Belarusian energy ministry spokeswoman, Ludmila Zen'kovich, repeated that transit via both Northern Lights and Yamal pipelines continued in full. In the late afternoon of June 22, Belarusian deputy energy minister, Mikhail Mikhadjuk, stated that the ministry was working on practical implementation of the Belarusian president's order to stop transit. Later that evening an unnamed Belarusian official was quoted by Interfax as saying that transit across Belarus had been reduced proportionally to the reduction in supply, but no official confirmation from Belarus followed.[40] Still later that evening, RIA Novosti quoted the head of European Parliament, Jerzy Buzek, as saying that Poland, Germany and Lithuania experienced reductions but this was denied by Russian energy minister, Sergei Shmatko.[41] Buzek's statement was also disavowed by the Commission spokeswoman, Nicole Bockstaller. Buzek also offered to send a monitoring group to observe transit flows, to which Shmatko responded that he discussed the possibility of deploying a monitoring group with EU energy commissioner, Günther Oettinger, and that an agreement had been reached for a group to be sent in the event of unauthorized gas off-takes. On the same day, the Energy Charter Secretariat (ECT) Secretary General André Mernier issued a statement expressing concern over the dispute, calling it a commercial matter while drawing attention to the ECT principle of uninterrupted transit. [42]

Announcing a further 30 percent reduction of supplies to Belarus on June 23 at 10:00 am (bringing total reduction to 60 percent), Gazprom CEO Miller stated that transit across Belarus had remained unaffected. The European Energy Commissioner spokeswoman, Marlene Holzner, stated in her mid-day briefing (14:30) that Poland and Lithuania were receiving the same volumes as usual (thus implying that Germany was also not experiencing interruptions). However, the Lithuanian national gas company, Lietuvos Dujos, reported that it began experiencing 'variations' in its supply from 12:00, and that a reduction in volumes required by both Lithuania and the Russian city of Kaliningrad constituted around 30 percent.[43] Lietuvos Dujos CEO, Viktoras Valentukevicius, stated that if volumes became insufficient to serve Lithuanian consumers the company would first reduce supplies to the Russian city of Kaliningrad proportionally to undelivered volumes.[44]

On June 23, at 16:00, Belarus paid its debt of $187 mn to Gazprom. Gazprom only confirmed the receipt of payment on June 24, and fully restored supplies at 10:00 am that day. Having made its payment, Belarusian deputy prime minister Semashko demanded Gazprom to pay Belarus $260 mn for transit by June 24, 11:00 Moscow time, otherwise threatening to halt transit.[45] The next day, Semashko extended the deadline until 14:00 Moscow time, and added that otherwise transit will be reduced proportionally to outstanding debt (thus qualifying his

[40] 'Belarus reduced gas transit to Europe proportionally to reduced supplies from Russia' (in Russian), *Interfax*, 22 June 2010.
[41] 'Supplies of Russian gas to Lithuania and east Germany have decreased' (in Russian), *RIA Novosti*, 22 June 2010.
[42] Statement by the Energy Charter Secretary General concerning the current Russia-Belarus gas dispute, http://www.encharter.org/index.php?id=21&id_article=209&L=0
[43] Lietuvos Dujos press-release, 23 June 2010, available online at http://www.dujos.lt/index.php/media-service/press-releases/gas-supply-to-lithuania-via-territory-of-belarus-has-been-reduced/38264
[44] 'Lithuania will reduce supplies to Kaliningrad in case of gas shortages', *Interfax*, 23 June 2010. This statement raises interesting questions about the applicability of the Energy Charter Treaty (ECT) to EU member states: under the ECT Lithuania is a transit territory for Russian gas en route to Kaliningrad, and hence should provide an uninterrupted transit. Anecdotal evidence suggested that Gazprom had told the Lithuanians that in the event of shortages through Belarus they would receive compensatory volumes via Latvia.
[45] 'Belarusian deputy prime minister announced that Belarus paid off its debt for Russian gas' (in Russian), *Vzgliad*, 23 June 2010.

earlier statement that transit would be cut completely), whereas Belarusian president stated in his interview to Euronews that European consumers affected by any resulting reductions should address all their grievances to Gazprom.[46] Meanwhile, Gazprom paid Belarus $228 mn for transit (at $1.45/mcm/00km transit tariff), in line with the contract. However, Semashko noted that a debt of $32 mn remained outstanding, as the transit fee in 2009 was $1.74/mcm/00km, and in 2010 - $1.88/mcm/00 km – not $1.45/mcm/00km. He added that Belarus would only consider $228 mn as the first tranche of the required $260 mn payment. Gazprom spokesman Kuprianov conceded that there existed a protocol, which envisaged the possibility of an increase of transit fee to $1.74 and $1.88 in 2009 and 2010 respectively, but this was dependent on an introduction of a wholesale mark-up for domestic Belarusian consumers ($10.45/mcm and $11.07/mcm in 2009 and 2010 respectively), to ensure agreed profitability of the Beltransgaz JV (see Box 1). According to Kuprianov, this mark-up was not introduced, and therefore a contractual addendum for 2010 stipulating a transit fee increase was not signed.[47]

Meanwhile, Gazprom CEO Miller reported to Russian prime minister Putin that Belarus had demanded a higher transit payment than envisaged by the contract. Putin responded by saying that Gazprom should pay in line with the contract and if either side wanted to change the contract, this should be subject to negotiations. On June 25, Belarusian president added a new dynamic to the process, stating that Gazprom had two more days to pay the remaining $32 mn, before the transit of gas *and* oil (see Appendix B) was halted. Throughout the dispute, the Belarus government appeared to have been trying to soften the president's fiery rhetoric. Semashko asked the president for a maximum of two weeks for settling the dispute, adding that Gazprom delegation would be arriving in Minsk on June 28 and the negotiations over transit payment would continue until June 30, when Gazprom deputy CEO Golubev, was expected to arrive and sign the addendum to the contract.[48] On his part, Gazprom CEO Miller confirmed that the parties no longer had principled disagreements, and that the expectation was that the addendum will be signed quickly.[49] On June 28, Beltransgaz CEO Majorov reported that there was no need for Gazprom delegation to come to Minsk as the negotiations would continue at long-distance.[50] On June 30, Semashko said that the addendum was likely to be signed on July 1, noting that Russia had acknowledged the transit fee of $1.88/mcm/00 km in 2010.

On the morning of July 2 Beltransgaz CEO Majorov announced that the addendum, stipulating a transit fee of $1.88/mcm/00km in 2010, was finally signed.[51] That afternoon Gazprom issued a press-release confirming this, while stressing that a transit fee increase was due to Belarus, increasing the Beltransgaz 2010 wholesale mark-up to $11.09/mcm.[52]

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[46] Belarusian president Alexander Lukashenko' interview to *Euronews*, http://www.euronews.net/2010/06/25/lukashenko-russia-is-casting-covetous-eyes-on-our-public-sector/

[47] Transcript of Gazprom spokesman S. Kuprianov meeting with journalists, 24 June 2010 <http://www.gazprom.ru/press/russia-belarus/> According to Russian daily newspaper *Vedomosti*, Gazprom and Beltransgaz signed an addendum for 2009 stipulating a transit fee of $1.74/mcm/00km in 2009, and Gazprom was paying Belarus for transit at this rate until November 2009. See 'What Gazprom and Belorussia argued about' in E. Mazneva and E. Chechel, 'An insurance against 'batka', *Vedomosti*, 5 July 2010.

[48] 'Russian delegation is expected in Minsk' (in Russian), *Vzgliad*, 26 June 2010.

[49] N. Grib and O. Mordushenko, 'Price and piece' (in Russian), *Kommersant*, 26 June 2010.

[50] 'Beltransgaz and Gazprom will sign an addendum on transit to the contract very soon' (in Russian), *Belta*, 28 June 2010.

[51] 'Beltransgaz and Gazprom have signed a transit addendum to the contract' (in Russian), *Belta*, 3 July 2010.

[52] Gazprom, 'Protocol on contributions by Beltransgaz to Belarusian Innovation Fund and Addendum to gas supply and transit contract signed', press-release published online 2 July 2010 <http://www.gazprom.ru/press/news/2010/july/article100645/>

Gazprom also stated the parties signed a protocol obliging Belarus to set the Beltransgaz levy towards the Belarusian energy ministry's innovation fund at a level not exceeding the minimum levy applied in Belarus.[53] These funds are planned to be invested in the construction of storage facilities in Belarus. The press-release is silent on the transit fee to be applied in 2011. However, it mentions that the protocol setting up the Beltransgaz JV provides that the 'rate for Russian gas transit via the company's pipeline system in 2009-2011 can be increased in case the Belarusian party introduces wholesale markups…'[54] As we noted earlier, Belarus demanded Gazprom pay extra $32 mn for transit – based on a transit fee of $1.74/mcm/00km in November-December 2009 and $1.88/mcm/00km in January-May 2010. Since the addendum was signed, there have been no reports on whether Gazprom made any payment towards this amount.

The June 2010 gas transit dispute should be viewed against the background of worsening economic conditions in Belarus. The country is struggling to cope with the consequences of the 2008 financial and economic crisis, and also suffered a serious financial blow as a result of Russia's introduction of a 100 percent oil and oil products export duty in January 2010 (see Appendix B). The rising 2010 gas bill created additional pressure on the country's finances. Furthermore, Belarus' apparent failure to get Gazprom's consent to postpone the introduction of European 'netback' prices, suggests that Belarus might have to pay this price in 2011.

Aware of this unfavorable outlook, Belarus tried to improve its financial position by attempting to secure abolition of the oil and oil products export duty within the Russia-Belarus-Kazakhstan Customs Union (CU), which was to be created by July 1, 2010. Belarusian deputy prime minister Semashko, echoing the position of Belarusian president, stated that it would be 'nonsense' to have such duty inside the CU.[55] Yet in March Russian prime minister Putin had stated that the duties would only be abolished once Russia, Belarus and Kazakhstan had created a Common Economic Space (to become operational in 2012), thus implying that the CU does not provide a form of integration close enough to justify the abolition of oil export duties.[56] In response, Belarus made its participation in the CU conditional on abolition of the duty and boycotted the signature of the CU agreement. It was reported that on June 30 – the last day before summer holidays - the Belarusian parliament ratified the Custom Union code; however, no official confirmation followed on that day.[57] Curiously, just a day before, Semashko was saying that it would not be before July 5 - when Russian, Kazakh and Belarusian presidents were expected to meet in Kazakh capital Astana to announce Customs Union coming in force – that Belarus would decide whether to join the

[53] The money accumulated in the energy ministry's innovation fund is used for financing the state programme of modernisation of energy sector's assets during 2005-2010; this levy increases the cost and hence decreases the profit of any enterprise paying the levy. A December 2010 directive stipulated an upper level of this levy at 19% - the highest figure compared to other ministries (and equal only to that of the transport ministry's innovation fund), as others ministries' levies vary between 2 and 13.5 % (presidential directive *On some questions of creation and usage of innovation funds*, 7 Dec. 2009, N 597) whereas for those not listed in the directive, the size of levy does not exceed 0.25%.
[54] Gazprom press-release, 2 July 2010. The reason why Gazprom refers to 'introduction' rather than to 'increase' of wholesale mark-ups might be explained by the fact that in 2007 Belarus wanted to cancel these mark-ups altogether but then agreed to increase them gradually so that they would reach $11.07/mcm/00km in 2010. There is no information in public domain on the size of these mark-ups during 2007-2010 (see Box 1).
[55] 'Belarus and Russia have signed a package of documents on oil supplies' (in Russian), www.tut.by, 27 Jan. 2010.
[56] 'The fuel of friendship' (in Russian), *Vzgliad*, 16 Mar. 2010.
[57] 'Belarusian parliament has ratified the Customs Union code' (in Russian), *RIA Novosti*, 30 June 2010.

CU, adding that its decision would depend on the Russian position on oil export duties.[58] However, on July 3 (the Independence Day in Belarus), Belarusian president announced that Belarus has ratified the Customs Union code.[59]

6. Conclusion

The 2010 June Russia-Belarus transit dispute was not entirely unexpected. There had been several indications that, while the January 2007 gas contract was working, Russia-Belarus supply and transit relations did not reflect some of its terms. Sometimes the contract was amended to take into account the changing 2008 crisis and post-crisis commercial environment; sometimes it remained unchanged but its parties were ‘allowed’ to deviate from certain contractual clauses. Although the contract stipulates payment of quarterly prices, Belarus was allowed to pay an average annual price in 2009 and accumulate debt. Gazprom made no threats to reduce supplies, as the average annual price was apparently agreed between Russian and Belarusian presidents, although informally. Belarus was also forgiven its ‘take-or-pay’ penalties for lower off-take in 2009, although such penalties were envisaged in the contract. Belarus also succeeded in getting a 30 percent price discount to the European netback price in 2009 (instead of 20 percent envisaged in the original contract). But when in 2010 Belarus continued to pay $150/mcm (while asking for a 30 percent discount so that $150/mcm would constitute an annual average price), its request was not granted and supplies were reduced.

Notably, Gazprom not only allowed Belarus to deviate from the 2007 contract, but also deviated itself. Indeed, it transpired that Gazprom was not paying Belarus for transit during November 2009-May 2010 because it wanted to pay $1.45/mcm/00km (as stipulated by the contract) whereas Belarus wanted it to pay $1.74/mcm/00km and $1.88/mcm/00km (also as envisaged by the contract but conditional on an increase in the wholesale mark-up). However, since the Belarusian government is a 50 percent owner of the Beltransgaz JV, its agreement is necessary to resolve the mark-up issue.

Any contract should be adhered to until and unless it is amended to take into account the changing commercial environment. If the contract is not amended but is selectively enforced, the parties’ adherence to its terms will inevitably be influenced by their broader commercial and political considerations. In our view, Belarusian position was influenced first and foremost by commercial considerations.

As Belarus revenues from oil products exports dropped sharply, its gas bill increased thus creating further pressure on country’s finances. In an attempt to relieve the pressure, Belarus tried to secure concessions on gas prices and transit tariffs, including through synchronisation of gas prices with domestic Russian consumers, but with no success. This was manifested by the uncompromising position taken by the Russian government and Gazprom. The June 2010 dispute demonstrated that for Belarus the issue at stake was not as much about unpaid debt and more about attempting to improve the commercial terms within the current contract and its post-2010 replacement. Belarus knows that having sold 50 percent of its transit network to Gazprom, it has few bargaining cards left, and that its negotiating power (which stems mostly from its ability to disrupt transit) will be reduced dramatically once the first Nord Stream pipeline is built by 2012. Therefore, if Belarus is to succeed in obtaining any price/tariff concessions, its best chance for doing so will be before 2012. Therefore, it should not have

[58] ‘Customs Union code from July 1: for two or for three?’ (in Russian), *RIA Novosti*, 30 June 2010.
[59] ‘Belarus has ratified the Customs Union code – Lukashenko’ (in Russian), *Belta*, 3 July 2010.

come as a complete surprise both to Gazprom and to Europe that Belarus might be tempted to use this ‘window of opportunity’.

It is more difficult to explain the Russian position. The June 2010 dispute demonstrated that Russia decided to make Belarus adhere strictly to the terms of the contract. This suggests that the dispute was a commercial matter. However, the fact that Belarus was allowed to deviate from the contract in 2009, but not in 2010, indicates a decreasing degree of Russian government tolerance towards Belarus, possibly resulting from the latter not recognizing Abkhazia and South Ossetia, granting asylum to the ousted Kyrgiz president, and boycotting the Russia-led CU. This does not mean that the June 2010 episode should be regarded purely as a political dispute, but it does suggest that political reasons might have been one of the factors which decreased the degree of ‘allowable’ Belarus deviation from the commercial contractual terms.

At the same time, Gazprom’s commercial rationale for being embroiled in the dispute is not strong. With both parties back to square one in negotiations over an increase of a transit fee and a wholesale mark-up, after paying each other roughly equal amounts of debt, it is not obvious what Gazprom gained from the dispute. However, it could be argued that the dispute might have brought longer-term commercial benefits by preventing Belarus from accumulating larger debts of $500-600 by the end of 2010, when the problem would have to be dealt with. But if Gazprom decided to risk a transit crisis in order to make Belarus pay in accordance with the contract, it should have had an impeccable payment record itself. It was reckless of Gazprom to start a dispute, owing Belarus a comparable sum for transit (irrespective of the reasons), as it was predictable that once it became known that Gazprom risked its reputation for no apparent financial gain, there would be no shortage of political commentators saying that Gazprom had used gas as an instrument of political pressure.

Appendix A

Gas price dynamics and price structure for industrial enterprises

Table 1: Gas price dynamics, and price structure for industrial enterprises, $/mcm

Resolution of the Ministry of Economy	25.05. 1999 no. 52	25.01. 2000 no.14	29.03. 2001 no. 67	13.06. 2002 no. 124	25.11. 2002 no. 251	24.01. 2003 no. 25	25.09. 2003 no. 6194	28.01. 2004 no. 21	02.02 2005 no. 20	24.02. 2006 no. 32	25.01. 2007 no. 20	12.01. 2008 no. 12	14.01. 2009 no. 7	18.02. 2010 no. 39
Import price	n/d	30.00	30.00	24.52	33.59	34.37	37.59	46.68	55.08	55.08	118	125	150	187
Beltransgaz mark-up	n/a	11.38	11.38	10.03	9.14	6.99	6.92	8.14	8.07*	7.9*	n/a	n/a	n/a	n/a
Beltransgaz sale prirce	40.50	41.38	41.38	34.55	42.73	41.36	44.51	54.82	59.54	58.87	n/d	n/d	n/d	n/d
Beltopgas mark-up	16.30	17.42	15.38	13.38	9.17	9.53	9.43	12.18	12.76	16.28	n/a	n/a	n/a	n/a
Beltopgas sale price	56.8	58.8	56.67	47.93	51.90	50.89	53.94	67.00	72.3	75.16	141.7	171.3	205.5	261.3

* In 2005 and 2006, a state budget subsidy of $3.61 and $4.11 respectively was paid to Beltransgaz, so that it would be able to sell gas to Beltopgaz at $59.54 and $58.57, instead of $63.15 and $62.98 respectively.
* * The price at which Beltransgaz sells to Beltopgaz has not been published from January 2007; only the price at which Beltransgaz sells gas to a limited number of enterprises, which is identical to the price at which Beltopgaz sells to consumers, is published.

Note: All prices include VAT. Although the price of imported gas in 2005-2006 remained the same as in 2004, there was a domestic price increase of 18% due to the changes in VAT regime from January 2005, when Belarus and Russia switched to a regime of indirect tax payments based on the country of destination, hence $55.08 instead of $46.68.

Source: adapted from K. Yafimava 'Belarus: the domestic gas market and relations with Russia' in S. Pirani (ed.) Russian and CIS gas markets and their impact on Europe (Oxford: OUP/Oxford Institute for Energy Studies, 2009), Table 4.11; 1999-2004 data: E. Rakova, F. Pavel and I. Pelipas, 'Gas sector restructuring in Belarus: necessity and directions', IPM/GET, PP/15/04, 2004 citing Beltransgaz and Beltopgaz sources, 2005-2010 data - author's calculations based on *Postanovleniya Ministerstava Ekonomiki Respubliki Belarus* 2 Feb. 2005, no. 20; 24 Feb. 2006, no. 32; 25 Jan. 2007, no. 20; 12 Jan. 2008, no. 12; 14 Jan. 2009, no. 7; 18 Feb. 2010, no. 39.

Appendix B

Belarus-Russia oil disputes, 2007-2010

Russia-Belarus transit disputes have not been restricted to gas, and there have been several oil transit disputes. The first incident came in January 2007, when Belarus imposed an additional \$45/tonne transit tariff on Russian oil in transit to Poland and Germany through the Druzhba pipeline; this was followed by alleged illegal siphoning of oil from that pipeline by Belarus, causing the Russian pipeline company Transneft to cut supplies for two days, until a telephone call between the Russian and Belarusian presidents resolved the dispute. The additional oil transit tariff appears to have been imposed as retaliation against the imposition of a \$180/tonne export duty on Russian oil sold to Belarus.

Another oil transit incident happened in January 2010. As the January 2007 Russia-Belarus intergovernmental agreement, which was concluded in the aftermath of the 2007 oil transit incident, expired in the end of 2009, Russia requested Belarus to pay 100 percent duty on all Russian oil exports to Belarus, except for Belarusian domestic consumption. Belarus refused to sign a new agreement on these terms, arguing that any export duty would be unlawful since Russia and Belarus are members of the single Customs Union (CU) created in 1995. The negotiations continued throughout December without success. On January 1, 2010, the agreement still not signed, the Russian government stated that a 100 percent duty would be applied,[60] but confirmed Russia's willingness to continue duty-free exports for domestic consumption, provided that the necessary documents are signed.

On January 3, Reuters, citing unnamed Russian oil traders, reported that Russia had stopped oil supplies to Belarusian refineries.[61] On January 4, Belarus stated that oil transit via the 'Druzhba' pipeline system operates normally.[62] Reportedly, Belarusian refineries had enough oil to last for at least one week.[63] The Russian state oil transport company Transneft never confirmed whether cuts took place, but its deputy CEO Mikhail Barkov stated that 'under no circumstances' would the company reduce transit volumes across Belarus.[64] There was much hype in the European media amidst worries that the 2007 transit cuts could be repeated, but in the event no reduction in transit volumes was reported.

On January 27, Belarus and Russia signed a protocol to the 2007 intergovernmental agreement stipulating that Belarus will be buying 6.3 mn tons of oil for domestic consumption duty free in 2010, and export duty would be applied to any extra volumes; it also included an 11 percent increase in oil transit tariff in 2010., The agreement resulted in significant financial losses for Belarus, estimated by the IMF at \$2 bn.

[60] 'Belarus hopes to get duty free Russian oil in January and February' (in Russian), *Interfax*, 1 Jan. 2010.
[61] D. Zhdannikov, 'Russia halts oil flow to Belarus refineries, *Reuters*, 3 Jan. 2010.
[62] 'Russian oil is transported via the Belarusian section of the 'Druzhba' pipeline normally' (in Russian), Belta, 4 Jan. 2010.
[63] *Reuters*, 3 Jan. 2010.
[64] 'Transit of oil across Belarus will not be reduced – Transneft' (in Russian), *RIA Novosti*, 3 Jan. 2010.

Glossary of Units:

Bcm = billion cubic metres
$/mcm = dollars per thousand cubic metres

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