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Ukraine: the beginning of Naftogaz's restructuring

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On 1 July, the Ukrainian government approved the restructuring plan for the state-owned company Naftogaz. It envisages removing it from the structure of transit gas pipelines and underground gas storage facilities, which will provide the base for establishing two joint-stock companies: Gas Mains of Ukraine and Underground Gas Storage of Ukraine. The ownership unbundling of Naftogaz will take place after the Arbitration Court in Stockholm has passed its verdict concerning the suit brought by Naftogaz against Gazprom. The two new companies are expected to be turned into modern corporations and will be controlled by the Ministry for Energy. The largest production company, *UkrGasVydobuvannya* (with an output of 14.5 billion m3 of gas) will remain part of Naftogaz.

Commentary

- The approved but still unpublished plan for Naftogaz's restructuring is an important step on the way towards unbundling the company's ownership and Kyiv's compliance with the obligations it has made to the EU and the International Monetary Fund to make the Ukrainian gas sector meet the requirements of the so-called EU's Third Energy Package. The plan, which has been adopted after months of negotiations and disputes, is a compromise between two competitive models lobbied for by the Ministry for Energy and Naftogaz and approved by the Energy Community as meeting the unbundling criteria. However, the split of Naftogaz – including the transfer of assets to the new companies – will not take place in 2016. In Kyiv's opinion, a date will be set when the verdict of the Arbitration Court in Stockholm will be passed (in 2017 at the earliest). The court is considering the mutual claims of Naftogaz and Gazprom.
- The main goal of Naftogaz's unbundling is to create a competitive domestic market and to improve the transparency of the gas sector, as well as to attract a Western investor to the Gas Mains of Ukraine company. Kyiv hopes that the participation of a large Western firm will give Ukraine a better chance of maintaining its status of an important transit state after the expiry of the contract with Gazprom in 2019. In turn, the Underground Gas Storage of Ukraine company (twelve gas storage facilities, with a total capacity of 31 billion m3) is expected to become a pillar of a gas hub which Ukraine plans to be located in western Ukraine and to be linked via an interconnector with Poland and Slovakia. However, the profitability of this project is questionable, and it is still unclear which of the storage facilities will be transferred to the new company or privatised.

- The decision to split Naftogaz has been accompanied by a rapidly falling consumption of natural gas in Ukraine (it fell 12.5% in the first half of 2016, year-on-year) in effect of the liberalisation of gas prices for residents and the municipal sector, declining industrial production and a curb on corruption in the gas sector. The likely continuation of this trend, along with efforts to improve energy efficiency and the planned increase in the domestic production of natural gas (by 8 billion m3 from 19 billion m3 last year), all mean that Ukraine will be able to significantly decrease gas imports from both the EU and Russia within the next five years.