IN THE MATTER OF AN ARBITRATION UNDER THE RULES OF ARBITRATION OF THE ARBITRATION INSTITUTE OF THE STOCKHOLM CHAMBER OF COMMERCE

SCC CASE NO. 2015/092

LITTOP ENTERPRISES LIMITED

BRIDGEMONT VENTURES LIMITED

BORDO MANAGEMENT LIMITED

Claimants

AND

UKRAINE

Respondent

CLAIMANTS' STATEMENT OF CLAIM

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27 May 2016

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I. INTRODUCTION

1. Pursuant to item 1 of the Procedural Timetable which is the Annex to Procedural Order No. 1 of 27 January 2016, as amended by direction of the President of the Tribunal on 2 May 2016, the Claimants file this Statement of Claim in *Littop Enterprises Limited, Bridgemont Ventures Limited and Bordo Management Limited v Ukraine*, SCC Case No. 2015/092.

2. In March 2007, three Cypriot companies – Littop Enterprises Limited, Bridgemont Ventures Limited and Bordo Management Limited (the "**Claimants**") – acquired a significant minority shareholding in PJSC Ukrnafta ("**Ukrnafta**"). Ukrnafta was one of the largest extractors of oil and natural gas in Ukraine, and a strong enterprise at that time. In the previous year, for example, it produced almost three billion cubic metres of gas – the commodity with which this dispute is concerned. It had an infrastructure network that spread throughout Ukraine. It comprised many hundred oil and gas wells, numerous extraction permits and hundreds of filling stations. It was, unsurprisingly, a profitable undertaking.

3. The other major shareholder in Ukrnafta was NJSC Naftogaz Ukrainy ("**Naftogaz**"). Naftogaz held at the time, and still holds, a bare majority of the shares in Ukrnafta. It is wholly owned by the State of Ukraine (the "**Respondent**"). It was established in 1998 pursuant to a Decree of the President of Ukraine and a Decree of the Cabinet of Ministers of Ukraine, and was managed by the Ministry of Energy and Coal Industry of Ukraine until 2015, at which point management was assumed by the Ministry of Economic Development and Trade of Ukraine.

4. The constitutive documents of Ukrnafta established the rights of its shareholders in the corporate governance of the company. To this end, the Articles of Association of the company and various agreements signed by the shareholders (one of which was also signed by the State) set out how the shareholders were to be represented in the managements bodies of Ukrnafta, and how they were to cooperate to achieve certain goals. Among other things, these goals included the attainment of economically justified market prices for Ukrnafta's production.

5. Over the years following the Claimants' acquisition of the shareholdings in Ukrnafta, however, the Respondent took a series of measures that injured both Ukrnafta, and the value the Claimants derived from it, and the rights of the Claimants to participate in the corporate governance of the company. These are set out in detail in Section II of this Statement of Claim. In summary:

a) Naftogaz and its wholly owned subsidiary company, PJSC Ukrtransgaz ("**Ukrtransgaz**"), used their physical control of Ukraine's gas transportation and storage system to prevent Ukrnafta from exercising its ownership rights in respect of the gas it pumped into that system (for instance, by selling its gas to third parties in accordance with Ukrainian law).

b) After Ukrtransgaz had already acknowledged that certain gas from Ukrnafta had been received into Ukraine's gas transportation and storage system, Naftogaz claimed that the gas had then been appropriated, without Ukrnafta's consent, and used to satisfy the needs of the Ukrainian population (as the Cabinet of Ministers also noted).

c) In relation to gas which Ukrnafta had no choice but to pump into the gas transportation and storage system, Ukrtransgaz refused to acknowledge receipt unless and until Ukrnafta yielded to its various demands (such as agreeing that the gas had been transferred to it to satisfy the needs of the Ukrainian population).

d) The Respondent refused to comply with orders of its courts that were adverse to it. This misconduct was repeated. Its courts would serially issue decisions against the Respondent, consistently affirming Ukrnafta's right of ownership over gas stored by Ukrtransgaz and right to sell its own gas, and consistently rejecting the Respondent's efforts to force Ukrnafta to sell gas at an undervalue (i.e., below its cost of production). Despite this, the Respondent often refused to comply with those court orders.

e) The Respondent repeatedly changed its legal and regulatory regime in an effort to manufacture a legal basis which, in light of recent decisions of its own courts finding that Naftogaz and Ukrtransgaz had acted unlawfully in their treatment of Ukrnafta and its gas, would avoid any equivalent rulings in the future.

f) The Respondent attempted to compel Ukrnafta to enter into contracts for the sale of gas to Naftogaz below value, in some instances having first promulgated through its energy regulator resolutions which purported to establish the price payable.

g) The Respondent imposed enormous financial burdens on the sector in which Ukrnafta operated, and ultimately structured that law and the penal consequences of not complying with it in a way that had significantly detrimental effects for Ukrnafta.

h) The Respondent exercised its legislative powers to interfere in a targeted fashion to subvert the Claimants' rights in the corporate governance of Ukrnafta.

6. As Sections III and IV of this Statement of Claim explain, the dispute between the Claimants and the Respondent falls within the jurisdiction of this Tribunal, and the foregoing conduct of the Respondent constitutes a breach of the Energy Charter Treaty ("**ECT**"). On the issue of breach, the Respondent has violated several of the treatment obligations contained in Article 10(1) of the ECT. This is because it: failed to accord at all times fair and equitable treatment to the Claimants' investments; impaired by unreasonable measures the management, maintenance, use, enjoyment or disposal of the Claimants' investments; failed to provide the Claimants' investments most constant protection and security; and failed to observe obligations it had entered into with the Claimants. The Respondent's conduct also breached other provisions of the ECT. Thus the Respondent failed to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to the Claimants' investments, in breach of Article 10(12) of the ECT. It

also violated Article 11(2) of the ECT by failing to permit the Claimants to employ any key person of their choice regardless of nationality and citizenship. Finally, it has also expropriated, or subjected to measures with equivalent effect, the Claimants' investments, and thereby breached Article 13 of the ECT.

7. As a result of these breaches of the ECT, the Respondent must make full reparation to the Claimants. The principles underlying this requirement under public international law, and the explanation as to what full reparation by way of compensation entails in this case, are set out in Section V of this Statement of Claim. In particular, the compensation payable to the Claimants is made up of five parts. First, the Respondent must pay to the Claimants a sum equal to the additional dividends which, but for the Respondent's breaches of the ECT, the Claimants would have received from Ukrnafta in respect of their 40.1009% shareholding in the company in the period between the date of their investment and the date of the Award. Secondly, the Respondent must pay to the Claimants a sum equal to the diminution in the value of their 40.1009% shareholding in Ukrnafta which occurred as a result of the Respondent's breaches of the ECT. Thirdly, the Respondent must pay to the Claimants pre-Award interest. Fourthly, the Respondent must pay to the Claimants post-Award interest. Finally, the Respondent must pay to the Claimants their costs associated with this arbitration. The total sum payable to the Claimants by the Respondent is US$4.674 billion, exclusive of post-Award interest and costs.

8. The Claimants submit documents alongside and as part of their Statement of Claim in this case. In addition to their factual exhibits and legal authorities, the Claimants also submit witness statements from the following individuals:

   a) Mr Igor Palytsia, member of the Supervisory Board of Ukrnafta and former Chairman of the Executive Board of Ukrnafta;

   b) Mr Uri Laber, member of the Supervisory Board of Ukrnafta.

   c) Mr Michael Bakunenko, Chief Executive Officer of PJSC Ukrnaftoburinnya and former Deputy Chairman of the Executive Board of Ukrnafta;

d) Mr Vyacheslav Kartashov, Director of the Legal Procurement Department of Ukrnafta;

e) Mr Vladimir Pustovarov, Deputy Director General for Finance and Chairman of the Investment Project Protection Committee of Ukrnafta, and former Deputy Chairman of the Executive Board of Ukrnafta; and

f) Mr Andriy Mas'ko, a Senior Manager at Primecap Cyprus Ltd, a corporate services firm.

9. Further, the Claimants also submit the following expert reports:

a) Expert Report of Dr Armen Khachaturyan of the law firm Asters, an expert in Ukrainian law;

b) Expert Report of Mr Philip Haberman of Haberman Ilett, an accounting expert specialising in the valuation of loss;

c) Expert Report of Mr Stephen Rogers of Arthur D Little, an expert in technical and commercial aspects of the oil and gas industry; and

d) Expert Report of Dr Jeffrey Leitzinger of EconOne, an expert in market economics and market pricing.

10. Finally, the Claimants note that attached as Annexes to this Statement of Claim are:

a) as Annex 1, a detailed Chronology of events over the relevant period, with cross-references to factual exhibits filed with this Statement of Claim, which the Claimants intend to be: (i) in a form and tone that will allow the document to be successively augmented by, and ultimately agreed between, the Parties; and (ii) a substitute for an extended (but relevant) narrative within the body of the Statement of Claim, and in particular in relation to the critically relevant but detailed history of the litigation in Ukrainian courts between Ukrnafta and the Respondent;

b) as Annex 2, a *dramatis personae* of various individuals and entities named in this Statement of Claim, and a brief identification of their role; and

c) as Annex 3, a schedule titled "Own Gas Schedule" showing the volumes of Own Gas and JIA Gas (both defined in Section V below) which were actually produced and (in some instances) sold between 2002 and 2015.

II. STATEMENT OF FACTS

A. The Parties and other relevant entities and individuals

1. The Claimants

11. The Claimants in this arbitration are three Cypriot companies. They were each incorporated in Cyprus on 8 September 2005 in accordance with Cypriot law, and their respective certificates of incorporation were duly issued under section 15(1) of The Companies Law of Cyprus.[1] Their addresses are set out in the Request for Arbitration.[2]

12. The Claimants collectively hold a 40.1009% shareholding in Ukrnafta. Ukrnafta's history, purpose, ownership and core constitutive provisions are discussed in detail in Section II.B below. In short, Ukrnafta was established in 1994, as the successor entity to State Enterprise Producing Association Ukrnafta, a State-owned organisation that had operated in Ukraine or the Ukrainian region of the Union of Soviet Socialist Republics since 1945. It is one of the largest extractors of oil and natural gas in Ukraine, with significant upstream and downstream businesses. The Claimants form a large majority of the minority shareholders in Ukrnafta, and, since 1998, the 100% State-owned Naftogaz has owned a bare majority of the shareholding in Ukrnafta. By its constitutive documents, Ukrnafta establishes its corporate governance rules, which extends to the minority shareholders, and in particular the Claimants, rights of representation on and appointment to the management bodies of the company.

2. The Respondent

13. The Respondent is Ukraine. The conduct of several of Ukrainian authorities is relevant to this case. While these include the President of Ukraine, the Cabinet of

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1 Certificate of Incorporation of Littop Enterprises Limited, 8 September 2005, **Exhibit {C-842 Original}**; Certificate of Incorporation of Bridgemont Ventures Limited, 8 September 2005, **Exhibit {C-843 Original}**; Certificate of Incorporation of Bordo Management Limited, 8 September 2005, **Exhibit {C-844 Original}**.

2 SCC Request for Arbitration, 30 June 2015, paragraph 7, **Exhibit {C-1391 Original}.**

Ministers of Ukraine and the Ministry of Energy and Coal Mining Industry of Ukraine, there are three that are of particular note: Naftogaz; the National Commission for Regulation of the Electricity Sector of Ukraine, the National Commission for State Regulation of Energy and the Energy and Public Utilities Regulatory Commission (all being different designations given to this regulatory body over the past decade or so); and Ukrtransgaz.

(i) Naftogaz

14. Naftogaz is a public joint stock company that is the national oil and gas company of Ukraine. It is 100% owned by the State, with the Cabinet of Ministers of Ukraine as the representative organ of the State in this regard.[3] It was established in 1998 pursuant to a Decree of the President of Ukraine and a Decree of the Cabinet of Ministers of Ukraine. While Naftogaz's sole shareholder was the Cabinet of Ministers, it was to be managed by the Ministry of Energy and Coal Industry of Ukraine (which management extended to directing Naftogaz how to conduct its affairs, including in respect of its participation in Ukrnafta), albeit as of late 2015 it has been managed by the Ministry of Economic Development and Trade of Ukraine.[4]

15. On 25 February 1998, the President of Ukraine issued Decree No. 151/98 "On reforming the oil and gas sector of Ukraine".[5] This Decree instructed the Cabinet of Ministers to establish Naftogaz. The President's purpose in issuing the Decree was stated to be:

> "contributing to the structural transformation of the oil, gas and oil refining industries of Ukraine, increasing the level of energy security of the state, ensuring effective functioning and

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3 "Detailed information about a legal entity: Naftogaz of Ukraine: National Joint-Stock Company", Ukraine Ministry of Justice website, accessed 27 May 2016, at http://ursinfo.irc.gov.ua/edr.html, **Exhibit {C-1404}**.

4 Decree No. 1002 of the Cabinet of Minister s of Ukraine "On some issues of improving the corporate governance of the public joint-stock company Naftogaz of Ukraine", 5 December 2015, **Exhibit {C-576}**.

5 Decree No. 151/98 of the President of Ukraine "On reforming the oil and gas sector of Ukraine", 25 February 1998, **Exhibit {C-302}**.

> development of the oil and gas sector, greater satisfaction of the needs of industrial and domestic consumers for raw materials and fuel and energy resources."[6]

16. Having noted the State's purpose in establishing Naftogaz, the Presidential Decree continued as follows:

> "[…] I hereby order as follows:
>
> 1. To support the initiative of the Cabinet of Ministers of Ukraine and the State Property Fund of Ukraine about the creation by the Cabinet of Ministers of Ukraine of the state National Joint-Stock Company Naftogaz of Ukraine (hereinafter to be referred to as the Company) on the basis of 100 percent of shares of state joint-stock companies created by transformation of enterprises of the oil and gas sector which are not subject to privatisation and also packages of shares of open joint-stock companies of the oil and gas sector which according to the existing legislation are left in state ownership.
>
> 2. As regards the Cabinet of Ministers of Ukraine:
>
> to take steps within two months regarding the creation of the Company, in particular, to approve its Articles of Association and the composition of the Supervisory Board, to appoint the Chairman, Deputy Chairmen and members of the Board of the Company […]".[7]

17. The Cabinet of Ministers acted on this Presidential Decree. On 25 May 1998, the Cabinet of Ministers issued Decree No. 747 "On establishing the National Joint Stock Company Naftogaz of Ukraine". That Decree, *inter alia*, established Naftogaz, confirmed that Naftogaz's authorised capital would be formed from other State-owned companies, and approved Naftogaz's Articles of Association.[8] Attached to

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6 Decree No. 151/98 of the President of Ukraine, "On reforming the oil and gas sector of Ukraine", 25 February 1998, preamble, **Exhibit {C-302}**.

7 Decree No. 151/98 of the President of Ukraine "On reforming the oil and gas sector of Ukraine", 25 February 1998, paragraphs 1-2, **Exhibit {C-302}**. The Claimants note that the Ukrainian word "Голова" can be translated either as "Chairman" or "Head", and as such this Statement of Claim and the Chronology use those words in English interchangeably.

8 See Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, paragraphs 1, 2 and 5, **Exhibit {C-563}**. It also decreed that the various Board Members of Naftogaz would be equated

the Decree of the Cabinet of Ministers was a copy of the Articles of Association of Naftogaz, which the Cabinet of Ministers had approved in the Decree, as the Presidential Decree required.[9]

18. Provisions of note in Naftogaz's Articles of Association (as stated in the versions of the Articles in force from time to time during the period material to this dispute) include:

a) Naftogaz was founded by the State pursuant to Presidential Decree No. 151/98,[10] and its purpose was "contributing to the structural transformation of the oil, gas and oil refining industries of Ukraine, increasing the level of energy security of the state, ensuring effective functioning and development of the oil and gas sector, greater satisfaction of the needs of industrial and domestic consumers for raw materials and fuel and energy resources and making profit";[11]

b) while Naftogaz was to act with "economic independence" and its shareholders would not be liable for its obligations, the Cabinet of Ministers

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to various senior officials in the Ukrainian government for the purpose of medical and public services: Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, paragraph 12, **Exhibit {C-563}**.

9 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}**. It was also the Cabinet of Ministers that promulgated amendments to the Articles of Association of Naftogaz: see, e.g., Decree No. 362 of the Cabinet of Ministers of Ukraine "On amendments to the Charter of NJSC Naftogaz of Ukraine", 4 June 2015, **Exhibit {C-562}.**

10 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 1, 5 and 21, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

11 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 5, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563**}.

and the Ministry of Energy and Coal Mining Industry of Ukraine would guide the activities of Naftogaz (which activities were to comply with the Constitution of Ukraine, the laws of Ukraine and the Articles of Association themselves);[12]

c) Naftogaz's business was to manage "state-owned facilities, in particular, equity rights which are owned by the state in the authorised (registered) capital of business entities and which are transferred to the authorised capital of the Company", and its corporate seal was to bear the State Emblem of Ukraine;[13]

d) Naftogaz's profits were to be "distributed in accordance with the financial plan approved by the Cabinet of Ministers of Ukraine";[14] and

e) Naftogaz's company organs were a General Meeting of Shareholders, Supervisory Board, Board of Directors, and Audit Committee,[15] in respect of which:

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12 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 13, 15 and 17, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}**.

13 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 12 and 14, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

14 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 45, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

15 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 49, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

- Naftogaz's only shareholder, and thus the only entity voting in the General Meeting of Shareholders, is the Respondent (which is represented in this regard by the Ministry of Energy and Coal Mining Industry);[16]

- through the General Meeting of Shareholders, the Ministry of Energy and Coal Mining Industry elects and terminates the Chairman and Members of the Supervisory Board and Audit Committee,[17] "by agreement with the Cabinet of Ministers of Ukraine";[18]

- through the General Meeting of Shareholders, the Cabinet of Ministers of Ukraine was vested with powers to amend the Articles of Association, to re-organise capital and shares, to elect and terminate the employment of the Chairman and Members of the Board of Directors, and to engage in matters relating to the liquidation of Naftogaz and its subsidiaries;[19]

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16 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 22 and 39, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

17 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 51(9), (10) and (12), attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

18 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 51(21) and 67, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

19 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 51(21), attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

- members of the Supervisory Board (which "carries out the protection of the rights of shareholders of the Company and within its competence determined by the law and these Articles of Association controls and regulates the activities of the Board"[20]) were to exercise powers based on an order of the Ministry of Energy and Coal Mining Industry or the approval of the Supervisory Board;[21] and

- the employment contract of the Chairman of the Board of Directors was to be signed by the Ministry of Energy and Coal Mining Industry,

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[20] See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 61, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}.**

[21] See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 67, attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}**. Throughout the relevant period covered in this Statement of Claim, the Ministry of Energy and Coal Mining Industry of Ukraine appointed only government officials to the posts of Chairman and Members of the Supervisory Board of Naftogaz. For instance, as at 1 August 2013, the composition of the Supervisory Board was government-centric: Andriy Bondarenko (Deputy Minister of Energy and Coal Mining Industry, Head of Administration); Oleksandr Shchukin (Director of the Department for Organizational Support of Activity of the Minister and Documentary of the Ministry of Energy and Coal Mining Industry); Oleksandr Atroshchenko (Director of the Department for Provision of Activity of the Minister of the Ministry of Economic Development and Trade); Andriy Bilousov (Deputy Minister of Regional Development, Construction and Housing and Utilities Infrastructure – Head of Administration); Evgen Ivanov (First Deputy Head of the State Property Fund); Andriy Ignatov (Deputy Minister of Revenue and Duties); Sergiy Melnychenko (Director of the Department for Finances of Production Sphere and Property Relations of the Ministry of Finances); Oleg Myrgorodskyy (Director of the Legal Department of the Ministry of Energy and Coal Mining Industry); Oleksiy Perevezentsev (Director of the Legal Department of the Ministry of Economic Development and Trade); Oleksandr Sushko (Deputy Minister for Ecology and Natural Resources – Head of Administration); and Olena Ferens (Director of the Department of Civil and Financial Legislation and Legislation in Matters of Land Relations of the Ministry of Justice): Decree No. 615-r of the Cabinet of Ministers of Ukraine "On approval of the Supervisory Board of the National Joint Stock Company Naftogaz of Ukraine", 1 August 2013, **Exhibit {C-1289**}.

> the agreement of which Ministry the Chairman needed in order to approve the structure and number of Naftogaz's employees.[22]

19. The original Articles of Association were amended by the Cabinet of Ministers of Ukraine a number of times over the years,[23] albeit the substance of the above provisions did not materially change in the course of those amendments. Of note, however, is that, as part of an amendment in December 2009, the Cabinet of Ministers clarified the relationship it had with Naftogaz in respect of the latter's exercise of voting rights in the company bodies of Ukrnafta. Thus the Cabinet of Ministers decreed that Naftogaz:

> "shall, with the approval of the Cabinet of Ministers of Ukraine: approve assignments for its proxies in voting at general shareholders meetings and meetings of the supervisory board of Ukrnafta … on matters of changing the amount of authorised capital, an additional share issue, distribution of profit, election of the chairman of the management board, restructuring of the companies and the founding by those

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22 See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraphs 84 and 90(8), attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}**. The Chairman of the Board of Directors also needed the agreement of the Ukrainian Prime Minister and approval of the Ministry of Energy and Coal Mining Industry in order to "appoint to a position by agreement with the Prime Minister of Ukraine on condition of prior agreement with the Ministry of Energy and Coal Mining and dismiss from a position heads of branches, representative offices, other stand-alone business units and subsidiaries and also within his/her competence conclude labour contracts with heads of business entities in the authorised (registered) capital of which the Company owns 100 percent of shares": See Articles of Association of National Joint Stock Company Naftogaz of Ukraine, paragraph 90(11), attached to and approved by Decree No. 747 of the Cabinet of Ministers of Ukraine "On establishing NJSC Naftogaz of Ukraine" Decree of the Cabinet of Ministers of Ukraine, "On establishing the National Joint Stock Company Naftogaz of Ukraine" dated 25.05.1998, last amended on 4.06.2015, 25 May 1998, **Exhibit {C-563}**.

23 The most significant of these amendments are evident in: Articles of Association of National Joint Stock Company Naftogaz of Ukraine, as amended by Decree No. 1354 of the Cabinet of Ministers "On certain matters of the activities of National joint-stock company Naftogaz of Ukraine" dated 2.12.2009, last amended on 15.06.2015, 2 December 2009, **Exhibit {C-564**}; Articles of Association of National Joint Stock Company Naftogaz of Ukraine, as amended by Decree of the Cabinet of Ministers of Ukraine No. 724, "On establishing the National Joint Stock Company Naftogaz of Ukraine", 2 October 2013, **Exhibit {C-1295}**.

> companies of other legal entities, the acquisition of shares (equity, interests) in the authorised (reserve) capital of business entities".[24]

20. Naftogaz was, therefore, required to vote in respect of wide and fundamental matters in its participation in the corporate governance of Ukrnafta only as permitted by the Cabinet of Ministers.

21. Also of note is that, on 16 October 2013, shortly after another amendment to the Articles of Association of Naftogaz on 2 October 2013, the Respondent's Ministry of Energy and Coal Mining Industry issued regulations that prescribed in detail the activities that could be undertaken by two of Naftogaz's company bodies, namely, the Supervisory Board and the Audit Commission.[25]

22. Eventually, on 5 December 2015, the Cabinet of Ministers of Ukraine approved by its Resolution No 1002 new Articles of Association of Naftogaz.[26] While these new Articles of Association were introduced after most of the events material to this case had taken place, the context in which they were introduced is informative. On 1 January 2015, for instance, Naftogaz created a chart depicting and describing its corporate governance systems as they stood at that time (and had stood for many years). It stated in this respect that its:

> "Decision-making process is complicated and politicized [due to]:

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[24] See: Decree No. 1354 of the Cabinet of Ministers "On certain matters of the activities of National joint-stock company Naftogaz of Ukraine" dated 2.12.2009, last amended on 15.06.2015, 2 December 2009, **Exhibit {C-564}**. See also the discussion by Mr Kartashov of this Decree, as well as how Naftogaz's representatives in the corporate bodies of Ukrnafta, were instructed as to how to vote in those bodies by the Ministry of Energy and Coal Industry of Ukraine: Witness Statement of Mr Kartashov, paragraphs 92-99.

[25] See: Provisions on the Supervisory Board of Naftogaz of Ukraine (new edition), as approved by Order No 742 of the Ministry of Energy and Coal Industry, 16 October 2013, Exhibit {C-**1298**}; Provision on the Audit Committee of the National Joint Stock Company Naftogaz of Ukraine, approved by Order No. 741 of the Ministry of Energy and Coal Mining Industry, Article 1.6, 16 October 2013, **Exhibit {C-1299}**.

[26] Naftogaz Charter amended Decree No. 1002 of the Cabinet of Ministers of Ukraine "On some issues of improving the corporate governance of the public joint-stock company Naftogaz of Ukraine", 5 December 2015, **Exhibit {C-1412** Original}.

- Unclear separation of authority between governing agencies
- Conflicting roles of the founder and the shareholder
- Potential conflict of the economic goals for Naftogaz with social and regulatory function of the government
- High risk of political meddling and graft".[27]

23. This concern about the degree of political control of corporate governance at Naftogaz was also ventilated later in 2015. In or around August 2015, Naftogaz released a "Corporate Governance Action Plan" identifying steps to be taken in reorganising its corporate governance structure. These included:[28]

a) "abolish requirement to issue voting instructions for Naftogaz to vote at the GSMs of its subsidiaries";

b) "abolish the applicability of restrictions on expenditures to Naftogaz and its subsidiaries (to enter into force when the internal control framework of Naftogaz is fully operational)";

c) "abolish the requirement to have financial plans approved by the Ministry of Finance for wholly owned subsidiaries of Naftogaz so as to allow them to act as commercial companies. (to enter into force when the internal control framework of Naftogaz is fully operational)";

d) "initial insulation from political meddling and graft";

e) "develop and submit for approval by the Parliament draft laws ensuring initial insulation from political meddling and graft in line with international standards"

f) "replace inefficient State controls by new controls"; and

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27 Naftogaz Corporate Governance Status 2015, 2015, **Exhibit {C-1357 Original}.**

28 Naftogaz Corporate governance action plan August 2015, August 2015, **Exhibit {C-1396 Original}.**

g) "set up internal control procedures which are used in standard corporate practice to allow Naftogaz to act as a commercial company".

24. As Naftogaz currently explains on its website, these steps were intended to change the *status quo*, which it described as having "significant flaws", such as *inter alia*:[29]

a) "The people of Ukraine, as the ultimate owners of Naftogaz, were represented by government agencies that had a direct influence on daily operations of the group. This structure did not guarantee that the group was governed in the interests of the ultimate owners. Instead, it could be influenced by political interests. Any change of the government meant a de facto change of Naftogaz shareholder."

b) "Some functions that should be performed independently were in fact performed by the same body. In particular, the Energy Ministry acted as a shareholder at the GM and also controlled the supervisory board (which must be independent and accountable to the GM)."

c) "There was no transparent procedure for nomination and election of the supervisory board members. There were no mechanisms and instruments in place that would enable engaging highly qualified professionals with an impeccable reputation to the board. The professional requirements for supervisory board members were minimal, and so was the level of remuneration. The previous procedure did not allow for the establishment of a qualified and independent supervisory board."

d) "There was no procedure for approval and revision of Naftogaz strategy focused on the business goals of the company and the interests of its ultimate owners (the people of Ukraine). Decisions on appointing, dismissing and remunerating management of Naftogaz and its subsidiaries were executed by

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[29] Naftogaz Corporate Governance Website accessed on 2.03.2016, 2 March 2016, **Exhibit {C-1435 Original}.**

the government agencies and not by independent boards, which resulted in a conflict of interest and could affect management decisions."

25. The revisions to Naftogaz's Articles of Association in December 2015 thus took place in this context. Naftogaz remains a wholly owned company of the Respondent, albeit now with an apparent intention to alter the above issues that existed in respect of its operations in previous years and decades.

(ii) NERC/NESR/NEPURC

26. The National Commission for Regulation of the Electricity Sector of Ukraine ("**NERC**"), the National Commission for State Regulation in the Sphere of Energy ("**NESR**") and the National Commission Responsible for State Regulation in the Area of Energy and Utility Services ("**NEPURC**") are the successive forms of the Respondent's regulatory authority that oversees its energy sector, including pricing in the natural gas sector.[30]

27. NERC was established pursuant to Presidential Decree No. 738/94 on 8 December 1994,[31] following which Presidential Decree No. 213/95, "On measures for provision of activity of the National Commission for Regulation of the Electricity Sector of Ukraine" was issued on 14 March 1995.[32] By that latter Decree, as amended from time to time, the President approved and attached the Regulation on the National Commission for Regulation of the Electricity Sector of Ukraine (the "**NERC Regulation**").

28. The NERC Regulation, as amended from time to time, established the basic tenets of NERC's constitutive status and the scope of its powers. It confirmed that the NERC

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30 The involvement of NERC/NESR/NEPURC in the natural gas sector insofar as is relevant to this arbitration is discussed in Section II.E below and the Chronology at Annex 1.

31 Decree No. 738/94 of the President of Ukraine "On the National Commission for Regulation of Electronic Power Utilities", 8 December 1994, **Exhibit {C-1883}.**

32 Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}.**

"is an independent non-departmental permanently working state body." It stated that it would be "governed in its activity by the Constitution of Ukraine […] and laws of Ukraine, resolutions of the Verkhovna Rada of Ukraine, decrees and resolutions of the President of Ukraine, acts of the Cabinet of Ministers of Ukraine, as well as this Regulation."[33] The NERC Regulation confirmed that the Head of the NERC was to be appointed by the President of Ukraine.[34]

29. The NERC Regulation also identified the tasks of the NERC. These included, *inter alia* and *sic*: "Participation in the formation and ensuring the realization of the unified state policy as to the development and functioning of the wholesale market of electricity, markets of gas, oil and oil products"; "State regulation of activity of the natural monopolies subjects in the spheres of electric energy and oil-and-gas complex"; "ensuring the carrying out of the price and rate policy in the spheres of electric energy and oil-and-gas complex"; "protection of the rights of consumers of electric and thermal energy, gas, oil and oil products"; "development and adoption of the rules for use of electricity and gas"; and "coordination of the activity of the state bodies in the issues of the regulation of the energy carriers markets".[35]

30. The NERC, in the performance of these tasks, was deeply embedded in the apparatus of the Respondent's government. Thus the NERC Regulation prescribed that the NERC, "during the performance of the functions laid on it, interacts on the issues

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33 See Regulation on the National Commission for Regulation of the Electricity Sector of Ukraine, Article 2, attached to and approved by Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}.**

34 See Regulation on the National Commission for Regulation of the Electricity Sector of Ukraine, Article 8, attached to and approved by Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}.**

35 See Regulation on the National Commission for Regulation of the Electricity Sector of Ukraine, Article 3, attached to and approved by Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}.**

within its competence with the ministries and other central bodies of executive power, bodies of executive power of the Autonomous Republic of Crimea, local bodies of executive power and local governments, as well as relevant bodies of foreign countries and international organizations."[36] In completing its duties, the NERC was empowered to issue resolutions and directives. The NERC Resolution was explicit that the "decisions of [NERC] adopted within its scope of authority are mandatory for the performance by the companies, institutions and organizations of all forms of property performing activity on the wholesale market of electric energy, gas, oil and oil products."[37]

31. On 23 November 2011, the NERC was liquidated by Presidential Decree No. 1057/2011, "On Liquidation of the National Electric Power Regulatory Commission of Ukraine".[38] On the same day, the NESR, which was in effect the NERC's successor authority (with a very similar remit), was established by virtue of Presidential Decree No. 1059/2011, "On the National Commission for state regulation in the area of energy".[39] By that Decree, the President established the NESR, and approved and

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36 See Regulation on the National Commission for Regulation of the Electricity Sector of Ukraine, Article 6, attached to and approved by Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}.**

37 See Regulation on the National Commission for Regulation of the Electricity Sector of Ukraine, Article 13, attached to and approved by Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}.**

38 See Decree No. 1057/2011 of the President of Ukraine "On liquidation of the National Electric Power Regulatory Commission of Ukraine", 23 November 2011, **Exhibit {C-453**}. This Order also formally rendered "null and void" Decree No. 213/95 of the President of Ukraine, "On activities aimed at supporting the operation of the National Commission for Regulation of the Electricity Sector of Ukraine", 14 March 1995, as amended on 21 April 1998, 1 February 1999 and 5 March 2004, **Exhibit {C-294}** and **Exhibit {C-295}**.

39 See Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452**}.

attached the Regulation on the National Commission for state regulation in the sphere of energy (the "**NESR Regulation**").[40]

32. Like the NERC Regulation before it, the NESR Regulation set out basic tenets of the NESR's constitutive status and the scope of its powers. It stated that "The National Commission responsible for state regulation in the area of energy (NESR) is a state collegial body subordinated to the President of Ukraine and accountable to the Verkhovna Rada of Ukraine. The NESR is the body of state regulation of activity in the sphere of energy."[41] As with the NERC, the President of Ukraine appointed the Head of the NESR, but he also appointed its Members.[42]

33. Article 3 of the NESR Regulation identified the "main tasks" of the NESR as follows:

> "State regulation of the activity of subjects of natural monopolies and business entities that conduct activity on adjacent markets, in the sphere of utilities, heat supply as a part of activity related to heat production on combined heat and power stations, thermal power plants, nuclear power plants, cogeneration plants and plants using non-traditional or renewable energy sources (hereinafter to be referred to as the sphere of heat supply), on natural gas markets, oil (associated) gas, gas (methane) of coal deposits and gas in shale formations (hereinafter to be referred to as the natural gas), oil and oil products;
>
> Promoting competition in the sphere of electrical power production and supply, on the natural gas market, and

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40 See Regulation on the National Commission for state regulation in the sphere of energy, attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}**.

41 See Regulation on the National Commission for state regulation in the sphere of energy, Article 1, attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}.**

42 See Regulation on the National Commission for state regulation in the sphere of energy, Article 9, attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}**.

creation of a competitive environment in the sphere of heat supply;

Ensuring the pricing and rate policy in the sphere of energy, oil and gas industry;

Promoting the efficient functioning of commodities markets on the basis of balancing the interest of state, natural monopoly entities and consumers of goods (services) produced (rendered) by the natural monopoly entities;

Protecting the rights of consumers of goods (services) on the market that is in the condition of a natural monopoly, and on adjacent markets in the sphere of electrical power, heat supply and oil and gas industry."[43]

34. The NESR was embedded in Ukrainian government no less than the NERC. It reported directly to the President of Ukraine,[44] and was required, *inter alia*, to "interact[] with the executive authorities, local governments, NGOs, and also cooperate[] with relevant agencies of foreign states and international organizations on the issues within its competence and participate[] in drafting of international contracts with Ukraine".[45] Its activities included "management of the state property

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[43] See Regulation on the National Commission for state regulation in the sphere of energy, Article 3, attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}.**

[44] See Regulation on the National Commission for state regulation in the sphere of energy, Article 4(3), attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}.**

[45] See Regulation on the National Commission for state regulation in the sphere of energy, Article 4(25), attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452**}. Further, "[d]uring fulfilment of its tasks assigned within the due procedure the NESR interacts with other state bodies, auxiliary bodies and services created by the President of Ukraine, as well as local authorities, relevant bodies of foreign states and international organizations, enterprises, establishments and organizations within the prescribed manner": See Regulation on the National Commission for state regulation in the sphere of energy, Article 7, attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}.**

belonging to the scope of its management in accordance with legislation".[46] In completing its duties, "[d]ecisions taken by the NESR are formulated by resolutions and orders", and "[d]ecisions of the NESR adopted within its powers are binding on the subjects of natural monopolies".[47]

35. On 27 August 2014, the NESR was liquidated by Presidential Decree No. 693/2014.[48] On the same day, the NEPURC, which was the NERC's successor authority (as well as being the successor authority to the National Commission for State Regulation of Utilities), was created by Presidential Decree 694/2014, "On the National Commission that is to Exercise State Regulation of the Electric Power Generation and Utilities Sectors".[49] That Presidential Decree appointed the Chairman of the NEPURC and required that he submit a draft regulation of the NEPURC's activities in the "exercise [of] state regulation in the electric power generation and utilities sectors".[50] Subsequently, Presidential Decree No. 715/2014, entitled "On Approval of Regulation on National Commission Responsible for State Regulation in the Area of Energy and Utility Services",[51] approved and attached the Regulation on the National

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46 See Regulation on the National Commission for state regulation in the sphere of energy, Article 4(27), attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}.**

47 See Regulation on the National Commission for state regulation in the sphere of energy, Article 13, attached to and approved by Decree No. 1059/2011 of the President of Ukraine, "On the National Commission for State Regulation in the area of energy", 23 November 2011, **Exhibit {C-452}.**

48 See Decree No. 693/2014 of the President of Ukraine "On the liquidation of National Commission for State Regulation in the Sphere of Energy" dated 27.08.2014, last amended on 13.10.2014, 27 August 2014, **Exhibit {C-520}.**

49 See Decree No. 694/2014 of the President of Ukraine, "On the National Commission that is to Exercise State Regulation of the Electric Power Generation and Utilities Sectors", 27 August 2014, **Exhibit {C-516}**.

50 Decree No. 694/2014 of the President of Ukraine, "On the National Commission that is to Exercise State Regulation of the Electric Power Generation and Utilities Sectors", 27 August 2014, **Exhibit {C-516**}.

51 See Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}**.

Commission responsible for state regulation in the area of energy and utility services (the "**NEPURC Regulation**").[52] The NEPURC is thus the current manifestation of the Respondent's regulatory authority in the energy sector.

36. As in the NERC Regulation and NESR Regulation, the NEPURC Regulation set out basic tenets of the NEPURC's constitutive status and the scope of its powers. It stated that "The National Commission responsible for state regulation in the area of energy and utility services (NEPURC) is a state collegial body, subordinated to the President of Ukraine and accountable to Verkhovna Rada of Ukraine. The NEPURC is a state regulation body in the spheres of the energy industry and utility services."[53] As with the NESR, the President of Ukraine appointed the Head and Members of the NEPURC.[54]

37. Article 3 of the NEPURC Regulation identified the "primary objectives" of the NEPURC, which reflected those in the NERC Regulation and NESR Regulation, but expanded upon them as well.[55] Much like its predecessor instruments, however, the first of the objectives the NEPURC was to pursue was:

> "State regulation of natural monopoly entities and business entities carrying out activity on adjacent markets, in the spheres of electric power, heating, central water supply and

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52 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}**.

53 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 1, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}.**

54 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 9, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}.**

55 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 3, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517**}.

> discharge, on natural gas markets, associated (casing-head) gas, gas (methane) from coal deposits and gas from shale deposits (hereinafter – natural gas) oil and petroleum products markets, as well as domestic waste recycling and disposal".[56]

38. No less than the NERC and NESR, the NEPURC is embedded in Ukrainian government. It reports directly to the President of Ukraine,[57] and must "interact[] with the executive authorities, local government authorities, public organizations and cooperates with relevant authorities of foreign states and international organizations on matters within its competence, and takes part in the preparation of international treaties drafts of Ukraine".[58] Its activities include "perform[s] the state property objects management being under its control in accordance with legislation",[59] while "[d]ecisions taken by [the NEPURC] are documented by decrees

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56 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 3, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}**.

57 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 4(3), attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}**.

58 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 4(29), attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}**. Further, NEPURC was to cooperate "with the other state power bodies, subsidiary bodies and services, formed by the President of Ukraine, and also with the local authorities, relevant authorities of foreign states and international organizations, companies, institutions and organizations": See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 9, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517**}.

59 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 4(31), attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}.**

and orders" and when made "within its competence is binding for natural monopolies entities".[60]

(iii) Ukrtransgaz

39. Ukrtransgaz is the main operator of the gas transportation system in Ukraine, which comprises natural gas pipelines and underground natural gas depots. On its website, Ukrtransgaz describes itself as "the leading company engaged in transmission and storage of natural gas in Ukraine", having "transported 132 billion cubic meters (bcm) in 2013", and owning "Europe's largest underground gas storage network, with total capacity of 31 bcm".[61]

40. Ukrtransgaz is 100% owned by Naftogaz, and therefore is 100% indirectly owned by the State[62] (as the latter, through its Cabinet of Ministers of Ukraine, is Naftogaz's founder and only shareholder[63]). It was established in 1998 pursuant to Decree 1173/1998 of the Cabinet of Ministers of Ukraine,[64] which was promulgated "in fulfilment" of the same Presidential Decree that contributed to the constitution of Naftogaz.[65]

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60 See Regulation on the National Commission responsible for state regulation in the area of energy and utility services, Article 13, attached to and approved by Decree No.715/2014 of the President of Ukraine "On the adoption of Regulation on the National Commission for State Energy and Public Utilities Regulation", 10 September 2014, **Exhibit {C-517}.**

61 Screenshot of Ukrtransgaz Website 'Ukrtransgaz Today', Ukrtransgaz website, accessed 27 May 2016, at http://utg.ua/en/utg/company/ukrtransgaz-today.html, **Exhibit {C-1456 Original}.**

62 "Detailed information about a legal entity: Ukrtransgaz Public Joint-Stock Company", Ukraine Ministry of Justice website, accessed 6 October 2015, at http://usrinfo.irc.gov.ua/edr.html, **Exhibit {C-1404**}. See also Charter of PJSC Ukrtransgaz, 25 December 2012, (as amended on 17 October 2014), Article 4.1, **Exhibit {C-1882}** ("**Articles of Association of Ukrtransgaz**").

63 Information from the Ministry of Justice website on Naftogaz, accessed 6 October 2015 , at http://usrinfo.irc.gov.ua/edr.html, **Exhibit {C-1403**}.

64 Decree No. 1173 of the Cabinet of Ministers of Ukraine "On separation of the functions of natural gas production, transport, storage and sale" dated 24.07.1998, last amended on 18.01.2003, 24 July 1998, **Exhibit {C-313}**.

65 See Presidential Order 151/98, "On reforming the oil and gas sector of Ukraine", 25 February 1998, **Exhibit {C-302}** (discussed above in relation to Naftogaz). Ukrtransgaz was originally a subsidiary company of Naftogaz, but became a public joint stock company by virtue of a

41. Ukrtransgaz has a monopoly in transporting natural gas by main pipelines in Ukraine.[66] It is licensed to conduct natural gas storage business in underground gas storage facilities pursuant to NERC Resolution 9/2010, "On Approval of Licensing Conditions for the Exercise of the Natural and Petroleum Gas Main Gas Pipeline Transportation Business".[67]

42. Ukrtransgaz controls and operates the Unified Gas Transmission System ("**GTS**") in Ukraine. The GTS was formerly a part of the Unified Gas Supply System in the Soviet Union, which was built as a mechanism for the synchronised operation of gas production, transmission, storage and distribution (and eventually export). The modern GTS is a sophisticated gas storage and transportation system, which is now independent of its previous interconnections with the Unified Gas Supply System.

43. Ukrtransgaz is constituted by Articles of Association. Provisions of note therein include:

Decree of the Cabinet of Ministers in 2012: Decree No. 360-r of the Cabinet of Ministers of Ukraine "On restructuring of subsidiaries of Naftogaz of Ukraine National joint-stock company", 13 June 2012, **Exhibit {C-465}**; Case No. 6/521 Decision of the Supreme Commercial Court of Ukraine, 19 May 2014, page 2, **Exhibit {C-125}**. It appears this was done at least in part to satisfy European Union standards, given that the Decree of the Cabinet of Ministers refers to Article 7 of the Law of Ukraine "On Pipeline Transport", 15 May 1996 (as amended 23 December 2015), which in turn refers to the ability of the Cabinet of Ministers to reorganise State enterprises to meet Ukraine's obligations arising out of accession process to the European Union: Law of Ukraine 192/96-VR "On Pipeline Transport" dated 15.05.1996, last amended 23.12.2015, 15 May 1996 (as amended), **Exhibit {C-298}**. In any event, references to "Ukrtransgaz" are references to both the original and successor companies, as applicable in the context.

66 That Ukrtransgaz has this monopoly is confirmed by the Antimonopoly Committee of Ukraine, which publishes a consolidated list of the companies which have recognised natural monopolies: "Consolidated list of natural monopolies", Antimonopoly Committee of Ukraine website, accessed, Ukrtransgaz AMC Natural Monopoly List (extract), 22 January 2016, at http://www.amc.gov.ua/amku/control/main/uk/publish/article/94020, **Exhibit {C-1427}**. See also Law of Ukraine No. 1682-III "On natural monopolies" dated 20.04.2000, last amended on 31.05.2005, 20 April 2000, Article 5(1), **Exhibit {C-325}**; Reuters Article 'Ukraine has stopped receiving gas from Russia – Ukrtransgaz', 1 July 2015, **Exhibit {C-1392 Original}**.

67 NERC Resolution No. 9 "On approval of licencing terms for business in the transport of natural, petroleum and coal bed gas (methane) by pipeline" dated 13.01.2010, last amended on 31.03.2011, 13 January 2010, **Exhibit {C-436}**.

a) Ukrtransgaz has only one founder and shareholder, which is Naftogaz.[68]

b) Naftogaz, through the general meeting of shareholders of Ukrtransgaz, controls its decision-making "unilaterally"[69] in relation to changes to the Articles of Association,[70] the election of the Chair and members of Ukrtransgaz's supervisory and management boards,[71] "significant transactions" by the company;[72] and

c) Ukrtransgaz was entitled to use State property, which would be listed as its assets, in accordance with law.[73]

44. The integration between Naftogaz and Ukrtransgaz is very high. Not only does Naftogaz unilaterally control all major aspects of Ukrtransgaz's activities and the composition of its supervisory and management boards, but it also staffs those boards with individuals who have held senior position within its own company bodies.[74] Thus, for example, as at the date of this Statement of Claim: Sergiy Pereloma is the Head of the Supervisory Board of Ukrtransgaz, while also being the First Deputy Chairman of the Executive Board of Naftogaz; Yaroslav Tekliuk is a Member of the Supervisory Board of Ukrtransgaz, while also being the Director for Legal Affairs and Government Relations of Naftogaz; Polina Zagnitko is a Member of the Supervisory Board of Ukrtransgaz, while also being the Director of Property and

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68 Articles of Association of Ukrtransgaz, 25 December 2012, Articles 1.5 and 4.1, **Exhibit {C-1405}**.

69 Articles of Association of Ukrtransgaz, 25 December 2012, Articles 5.7 and 11.36, **Exhibit {C-1405}**.

70 Articles of Association of Ukrtransgaz, 25 December 2012, Articles 5.7 and 11.33.2, **Exhibit {C-1405}**.

71 Articles of Association of Ukrtransgaz, 25 December 2012, Articles 5.7, 11.33.16 and 11.33.18, **Exhibit {C-1405}**.

72 Articles of Association of Ukrtransgaz, 25 December 2012, Articles 5.7 and 11.33.22, **Exhibit {C-1405**}.

73 Articles of Association of Ukrtransgaz, 25 December 2012, Article 5.9, **Exhibit {C-1405**}.

74 Screenshot of Ukrtransgaz Website 'Supervisory Board Members' Accessed 15 April 2016, 15 April 2016, **Exhibit {C-1466**}; Screenshot of Ukrtransgaz Website 'Executive Board Members', 15 April 2016, **Exhibit {C-1465}.**

Corporate Relations of Naftogaz; and Ihor Prokopiv is President of the Executive Board of Ukrtransgaz, having immediately previously been the First Deputy Chairman of the Executive Board of Naftogaz.

45. Ukrtransgaz is thus in reality an extension of the State, through Naftogaz. The State controls the activities of Ukrtransgaz, both by way of formal provisions in the Articles of Association and the rights they give to Naftogaz as the sole shareholder, but also by way of informal means resulting from the appointment of Naftogaz personnel to senior management positions in Ukrtransgaz.

3. Other relevant individuals and entities: *dramatis personae*

46. As noted in Section I above, a *dramatis personae* of various individuals and entities named in this Statement of Claim, and a brief identification of their role, is attached at Annex 2.

B. Ukrnafta: its history, its purpose, its ownership and its core constitutive provisions

47. The entity at the heart of this arbitration, and at the heart of the Claimants' investment, is Ukrnafta. Although it is a major figure in the gas and oil sector in the region, and as such may already be familiar to the Tribunal, this Section II.B outlines Ukrnafta's history, purpose, ownership and core constitutive provisions.

48. Ukrnafta, in its current and predecessor incarnations, has operated in the oil and gas sector of Ukraine for 70 years.[75] From 1945 to 1994, Ukrnafta in its predecessor form was 100% State-owned, initially by the Soviet Union and then by Ukraine after its independence. However, in 1994, Ukraine started the process of privatising Ukrnafta. This began by converting Ukrnafta into its current incarnation as a joint

[75] Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/history, **Exhibit {C-1422 Original}.**

stock company in 1994.[76] Then, in subsequent years, the State divested itself of almost half the shares in Ukrnafta. In 1998, Ukraine transferred its remaining shares in Ukrnafta, amounting to 50% plus 1 share, to Naftogaz – which, as stated in Section II.A above, was and remains a 100% State-owned company.[77]

49. The purpose of Ukrnafta is, at its most fundamental level, to exploit oil and gas reserves in Ukraine, both upstream and downstream. Its own company profile records as part of its upstream business no less than six oil production divisions, three drilling operations which encompass 58 drilling rigs (constituting the largest onshore drilling operations in Ukraine), three gas processing plants, two cementing divisions and significant operational support facilities.[78] At the end of 2014, Ukrnafta had 1,949 oil wells and 185 gas wells in operation, which in 2014 generated more than 1.7 billion cubic metres of gas and more than 1.8 million tonnes of oil and condensate.[79] For downstream activities, Ukrnafta records that it has 28 regional clusters of filling stations and hundreds of filling stations across Ukraine.[80] In 2014, Ukrnafta had a 14.9% share of national sales of gasoline and diesel fuel, and an 8.5% share of LPG retail sales, through filling stations. It held 82 permits for the extraction

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76 Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/history, **Exhibit {C-1422 Original}**.

77 Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/history, **Exhibit {C-1422 Original}**.

78 See: Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/structure, **Exhibit {C-1422 Original}**; Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/profile, **Exhibit {C-1422 Original}**.

79 See: Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/business/production, **Exhibit {C-1422 Original}.**

80 Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/structure, **Exhibit {C-1422 Original}.**

of hydrocarbons and commercial development of reserves,[81] and maintained research and development facilities.[82]

50. This profile situates Ukrnafta as one of the largest oil and gas companies in Ukraine, as part of a market that has well over a dozen significant operators. As Ukrnafta itself advertises, its share in Ukraine's 2014 oil and gas condensate production was 69.2%, while its share in Ukraine's total gas production was 8.6%.[83]

51. As the above indicates, Ukrnafta is currently partly owned by the State, through Naftogaz, and partly owned by private companies and individuals. The States still owns though Naftogaz 50% plus 1 share of Ukrnafta. The Claimants constitute the majority of the private ownership, and have done for several years. They currently collectively own 40.1009% of Ukrnafta.

52. The Claimants originally acquired a total of 40.05% of Ukrnafta on 16 March 2007.[84] They held those shares without interruption until 30 October 2008. From 30 October

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81 Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/profile, **Exhibit {C-1422 Original}**

82 See: Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/structure, **Exhibit {C-1422 Original}**; and Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production' accessed 5 January 2016, at http://www.ukrnafta.com/en/about/profile, **Exhibit {C-1422 Original}.**

83 Screenshot of Ukrnafta Website 'History', 'Corporate Structure', 'Company Profile' and 'Production', accessed 5 January 2016, at http://www.ukrnafta.com/en/about/profile, **Exhibit {C-1422 Original}.**

84 They did so by way of subscription applications, whereby each Claimant's parent company acquired newly issued and allotted shares in each respective Claimant in return for "in kind contribution" in the form of the shareholdings in Ukrnafta.

In December 2006, Littop Enterprises Limited issued and allotted 3,199,000 shares in itself to Fresno Capital Corp. (a Belizean company) in return for 7,238,613 shares in Ukrnafta (which constituted a 13.3483% shareholding in Ukrnafta). Fresno Capital Corp. had in turn purchased this shareholding in Ukrnafta for value from Ravenscroft Holdings Limited pursuant to an Agreement on Securities Purchase and Sale of 23 January 2007. See Littop Notice of Issue and Allotment of shares, 11 December 2007, **Exhibit {C-929}** (note that this document erroneously refers to 11 December 2007, instead of 11 December 2006); Littop Enterprises Ltd Notice of Waiver of right to subscribe for new shares by Katia Parpi, 11 December 2006, **Exhibit {C-857}**; Littop Enterprises Ltd Resolution of Directors issue and

allotment of new ordinary shares, 11 December 2006, **Exhibit {C-858}**; Littop Enterprises Ltd Resolution of Shareholder re issue and allotment of shares, 11 December 2006, **Exhibit {C-860 Original}**; Littop Enterprises Ltd Resolution of Directors to increase share capital, 11 December 2006, **Exhibit {C-859}**; Littop Enterprises Ltd Resolution of Shareholders to increase share capital, 11 December 2006, **Exhibit {C-861}**; Littop Enterprises Ltd Subscription Application by Fresno Capital Corp., 11 December 2006, **Exhibit {C-862}**; Ukrnafta Agreement on Securities Purchases and Sale No. K-48 between Ravenscroft Holdings Limited as Seller and Fresno Capital Corp. as Buyer, 23 January 2007, **Exhibit {C-871}**; Payment Order between Fresno and Ravenscroft 27 March 2007, **Exhibit {C-1493 Original}**. The full history of the ownership of a shareholding in Ukrnafta by Littop Enterprises Limited is set out in the combination of the following two share custodian registry documents: Statement of securities transactions - Littop Enterprises Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1439}**; Statement of securities transactions - Littop Enterprises Limited for the period from 15.01.2007- 15.03.2016, 22 March 2016, **Exhibit {C-1444}**.

In December 2006, Bridgemont Ventures Limited issued and allotted 3,199,000 shares in itself to Edmore Equities Ltd (a Belizean company) in return for 7,238,613 shares in Ukrnafta (which constituted a 13.3483% shareholding in Ukrnafta). Edmore Equities Ltd had in turn purchased this shareholding in Ukrnafta for value from Brotstone Ltd pursuant to an Agreement on Securities Purchase and Sale of 23 January 2007, with the share transfer taking place on 1 March 2007. See Bridgemont Notice of Issue and Allotment of shares, 11 December 2007, **Exhibit {C-927}** (note that this document erroneously refers to 11 December 2007, instead of 11 December 2006); Bridgemont Ventures Ltd Notice of Waiver of right to subscribe for new shares by A. Hadjipapa, 11 December 2006, **Exhibit {C-852}**; Bridgemont Resolution of Shareholder re issue and allot new ordinary shares, 11 December 2007, **Exhibit {C-928 Original}** (note that this document erroneously refers to 11 December 2007, instead of 11 December 2006); Bridgemont Ventures Ltd Resolution of Shareholders to increase share capital, 11 December 2006, **Exhibit {C-855 Original}**; Bridgemont Ventures Ltd Written Resolution of Directors to increase share capital, 11 December 2006, **Exhibit {C-853}**; Bridgemont Ventures Ltd Resolution of Directors to issue and allot new ordinary shares, 11 December 2006, **Exhibit {C-854}**; Bridgemont Ventures Ltd Subscription Application by Edmore Equities, 11 December 2006, **Exhibit {C-856}**; Ukrnafta Agreement on Securities Purchases and Sale No. K-50 between Brotstone Ltd as Seller and Edmore Equities Ltd as Buyer, 23 January 2007, **Exhibit {C-872}**; Payment Order between Edmore and Brotstone, 27 March 2007, **Exhibit {C-1492 Original}**. The full history of the ownership of a shareholding in Ukrnafta by Bridgemont Ventures Ltd is set out in the combination of the following two share custodian registry documents: Statement of securities transactions - Bridgemont Ventures Limited for the period from 15.01.2007- 15.03.2016, 22 March 2016, **Exhibit {C-1443}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1437}**.

In December 2006, Bordo Management Limited issued and allotted 3,199,000 shares in itself to Croydon Trading Group Ltd (a British Virgin Islands company) in return for 7,238,614 shares in Ukrnafta (which constituted a 13.3483% shareholding in Ukrnafta). Croydon Trading Group Ltd had in turn purchased this shareholding in Ukrnafta for value from Gleslon Commercial Ltd pursuant to an Agreement on Securities Purchase and Sale of 23 January 2007, with the share transfer taking place on 1 March 2007. See Bordo Management Ltd Notice of Issue and Allotment of Shares by Croydon Trading Group Limited, 27 December 2006, **Exhibit {C-863 Original}**; Bordo Management Ltd Notice of Waiver of right to subscribe for new shares by Anna Korelidou, 27 December 2006, **Exhibit {C-864 Original}**; Bordo Management Ltd Resolution of Directors re increase of share capital, 27 December 2006, **Exhibit {C-865 Original}**; Bordo

2008, for a period of some four and a half months, until 20 March 2009, the Claimants did not directly hold legal title in the shareholdings in Ukrnafta.[85] The reason for this temporary transfer of the shareholdings away from the Claimants was a commercial one unrelated to this dispute – namely, because the Claimants had become aware of a risk that a third party was considering targeting their assets.[86] During this period, however, under the Trust Deeds implementing this arrangement, the Claimants retained the beneficial interest in the shareholdings, and were entitled to direct that the shareholdings be returned to them[87] – which is ultimately what happened.[88] The

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Management Ltd Resolution of Directors re issue and allotment of ordinary shares, 27 December 2006, **Exhibit {C-866 Original}**; Bordo Management Ltd Resolution of Shareholders to increase share capital, 27 December 2006, **Exhibit {C-868 Original}**; Bordo Management Ltd Resolution of Shareholder re issue and allotment of shares, 27 December 2006, **Exhibit {C-867 Original}**; Bordo Management Ltd Subscription Application by Croydon Trading, 27 December 2006, **Exhibit {C-869 Original}**; Ukrnafta Agreement on Securities Purchases and Sale No. K-52 between Gleslon Commercial Ltd as Seller and Croydon Trading Group Ltd as Buyer, 23 January 2007, **Exhibit {C-873}**; Payment Order between Croydon and Gleslon 27 March 2007, **Exhibit {C-1491 Original}**. The full history of the ownership of a shareholding in Ukrnafta by Bordo Management Ltd is set out in the combination of the following two share custodian registry documents: Statement of securities transactions - Bordo Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1442}**; Statement of securities transactions - Bordo Management Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1438}**.

85 Minutes of the Extraordinary General Meeting of the Shareholders of Bridgemont Ventures Limited, 1 October 2008, **Exhibit {C-1916}**; Minutes of the Extraordinary General Meeting of the Shareholders of Bordo Management Limited, 1 October 2008, **Exhibit {C-1917}**; Minutes of the Extraordinary General Meeting of the Shareholders of Littop Enterprises Limited, 1 October 2008, **Exhibit {C-1918}**; Statement of securities transactions - Littop Enterprises Limited for the period from 21.04.2005 - 12.10.2013, 16 March 2016, **Exhibit {C-1439**}; Statement of securities transactions - Littop Enterprises Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1444**}; Statement of securities transactions - Bridgemont Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1443**}; Statement of securities transactions - Bridgemont Ventures Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1437}**; Statement of securities transactions - Bordo Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1442**}; Statement of securities transactions - Bordo Management Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1438**}.

86 Witness statement of Mr Masko, paragraph 21(a).

87 See Deed of Trust between the Claimants and Ballioti Enterprises Ltd, Karino Trading Limited and Marktol Management Ltd, 30 October 2008, **Exhibit {C-1898**}.

88 Resolution of Karino Trading Limited to transfer shares of Ukrnafta back to the company, 16 February 2009, **Exhibit {C-1896};** Resolution of Marktol Management Limited to transfer shares of Ukrnafta back to the company, 16 February 2009, **Exhibit {C-1896**}; Resolution of Ballioti Enterprises Limited to transfer shares of Ukrnafta back to the company, 16 February 2009,

Claimants then supplemented this shareholding by acquiring on 24 February 2011 a total of 0.78% of Ukrnafta, bringing their total shareholding to 40.82%.[89] After one of the Claimants, Bordo Management Limited, disposed of and acquired a small percentage of shares on 12 May 2011 and 23 December 2011 respectively, the Claimants' collective shareholding in Ukrnafta settled at 40.1009%.[90] It has remained

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Exhibit {C-1895}; Statement of securities transactions - Littop Enterprises Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1439}**; Statement of securities transactions - Littop Enterprises Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1444}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1443}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1437}**; , Statement of securities transactions - Bordo Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1442}**; Statement of securities transactions - Bordo Management Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1438}**.

[89] Littop Enterprises Limited purchased 139,171 shares in Ukrnafta for value (which constituted a 0.26% shareholding in Ukrnafta) from Investment Company "Business-Invest" Ltd pursuant to an Agreement on Securities Purchase and Sale of 18 February 2011. Bridgemont Ventures Limited purchased 139,171 shares in Ukrnafta for value (which constituted a 0.26% shareholding in Ukrnafta) from Investment Company "Business-Invest" Ltd pursuant to an Agreement on Securities Purchase and Sale of 18 February 2011. Bordo Management Limited purchased 139,171 shares in Ukrnafta for value (which constituted a 0.26% shareholding in Ukrnafta) from Investment Company "Business-Invest" Ltd pursuant to an Agreement on Securities Purchase and Sale of 18 February 2011. See Ukrnafta Share Purchase Agreement No. 99-D between Investment Company "Business-Invest" Ltd as Seller and Littop Enterprises Limited as Buyer, 18 February 2011, **Exhibit {C-1168 Original)**; Ukrnafta Agreement on Securities Purchase and Sale No. 100-D between Investment Company "Business-Invest" Ltd as Seller and Bridgemont Ventures Limited as Buyer, 18 February 2011, **Exhibit {C-1167 Original}**; Ukrnafta Share Purchase Agreement No. 98–D between Investment Company "Business- Invest" Ltd as Seller and Bordo Management Limited as Buyer, 18 February 2011, **Exhibit {C-1166 Original}.** As noted, the full history of the ownership of a shareholding in Ukrnafta by the Claimants is set out in the combination of these six share custodian registry documents: Statement of securities transactions - Littop Enterprises Limited for the period from 21.04.2005 - 12.10.2013, 16 March 2016, **Exhibit {C-1439}**; Statement of securities transactions - Littop Enterprises Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1444}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1443}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1437}**; Statement of securities transactions - Bordo Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1442}**; Statement of securities transactions - Bordo Management Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1438}**.

[90] Agreement on Securities Purchase and Sale No.485-B between Bordo Management Limited and Navaro Development Limited, 10 May 2011, **Exhibit {C-1919 Original}**; Agreement on Securities Purchase and Sale No.482-B between Bordo Management Limited and Duxton Holdings

at that level without change since 23 December 2011. Each of the Claimants is 100% owned by a parent company, the shares in each of which parent company are beneficially owned by a number of natural persons. Of those natural persons (who are of a variety of nationalities), the two individuals with the largest portion of such beneficial ownership are Mr Igor Kolomoisky, a Cypriot-Israeli-Ukrainian national, and Mr Genady Bogoliubov, also a Cypriot-Israeli-Ukrainian national.

53. The core constitutive provisions of Ukrnafta are articulated in its Articles of Association. The applicable version of the Articles at the time the Claimants made their investment was the Articles of Association of Open Joint Stock Company "Ukrnafta", as ratified by the General Meeting of Shareholders on 20 December 2005 ("**2005 Articles**"). The 2005 Articles remained unaltered until 22 March 2011 (the content of which amended Articles is discussed below).

54. The core provisions in the 2005 Articles were Articles 3, 5 and 9.

55. Article 3 set out the objective and scope of the activities of Ukrnafta. It provided that the objective of Ukrnafta's activities was as follows:

> "The aim of the Company's activities is … [t]o provide the economy of Ukraine with oil, gas and products of their refining, to satisfy the demand of the population, enterprises and organisations for other products, to introduce interventions and other innovations into the national economy, to develop oil and gas fields, to seek and explore new oil and gas fields, to refine oil and gas, to carry out any types of production and commercial activities not forbidden by the

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Limited, 10 May 2011, **Exhibit {C-1920 Original}**; Agreement on Securities Purchase and Sale No.901-B between Bordo Management Limited and Navaro Development Limited, 25 November 2011, **Exhibit {C-1921 Original}**; Statement of securities transactions - Littop Enterprises Limited for the period from 21.04.2005 - 12.10.2013, 16 March 2016, **Exhibit {C-1439}**; Statement of securities transactions - Littop Enterprises Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1444}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1443}**; Statement of securities transactions - Bridgemont Ventures Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1437}**; Statement of securities transactions - Bordo Ventures Limited for the period from 15.01.2007-15.03.2016, 22 March 2016, **Exhibit {C-1442**}; Statement of securities transactions - Bordo Management Limited for the period from 21.04.2005 - 12.10.2013, 17 March 2016, **Exhibit {C-1438}**.

> legislation of Ukraine in force, with the aim of obtaining profit."[91]

56. Article 5 of the 2005 Articles set out what entities could be shareholders and what rights and duties they would have as shareholders. It confirmed that Ukrainian and foreign legal and natural persons may be shareholders of Ukrnafta, that is, "Legal entities and natural persons of Ukraine and other countries, which/who have acquired the right of ownership of Shares on the grounds of the legislation of Ukraine in force".[92] It gave shareholders rights: to take part in Ukrnafta's general meetings; to elect and be elected to the management bodies of Ukrnafta; to receive dividends; to receive information about Ukrnafta's activities; to a share of Ukrnafta's equity if it is liquidated; and to dispose of shares and acquire preferentially any additionally-issued shares.[93]

57. Article 9 of the 2005 Articles set out how and by whom the management of Ukrnafta was conducted. It prescribed that the management bodies of Ukrnafta were the General Meeting of Shareholders, the Supervisory Board and the Executive Board.[94] It also stated that the Audit Commission would oversee the financial and business activities of the Executive Board.[95]

58. Article 9.5 of the 2005 Articles set out in detail the role and the procedures for the activities of the General Meeting of Shareholders. While the provision was detailed, several of its clauses are worth highlighting for present purposes. Voting was to

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91 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 3.1, **Exhibit {C-846}**. The Articles then set out 50 types of activities that were to be the content of Ukrnafta's activities: Articles of Association of Ukrnafta 2005, 20 December 2005, Article 3.2, **Exhibit {C-846}.**

92 Articles of Association of Ukrnafta 2005, 20.12.2005, Article 5.2, **Exhibit {C-846}.**

93 Articles of Association of Ukrnafta 2005, 20.12.2005, Article 5.3, **Exhibit {C-846}**. Shareholders also have a duty: to observe Ukrnafta's constitutive documents and to fulfil decisions of the general meetings; not to disclose confidential information about Ukrnafta; and to bear other obligations imposed by the Articles or Ukrainian legislation: Articles of Association of Ukrnafta 2005, 20.12.2005, Article 5.4, **Exhibit {C-846}**.

94 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.1, **Exhibit {C-846}.**

95 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.2, **Exhibit {C-846}.**

"take[] place by the principle 'one share – one vote'."[96] The General Meeting of Shareholders was quorate only "if Shareholders having in aggregate over 60% of the votes take part in it."[97] Decisions were to be by "simple majority of the votes of the Shareholders taking part in the Meeting", other than where a special majority of 75% was required for decisions relating "[m]aking amendments to the Company's Articles of Association; [t]aking the decision to cease the Company's activities; [and] [t]aking decisions on the creation and cessation of the activities of subsidiary enterprises, affiliates and representative offices".[98] A decision that could only be taken by the General Meeting of Shareholders was the election and removal of the Chairman of the Executive Board, the Chairman and Members of the Supervisory Board and the Chairman and Members of the Audit Commission. Thus the 2005 Articles empowered the General Meeting of Shareholders in respect of:

> "Making amendments to the Company's Articles of Association, including change in the size of its Charter Capital; election and revocation of the Chairman of the Company's Executive Board, the Chairman and members of the Company's Supervisory Board, the Chairman and members of the Audit Commission; … the procedure for the distribution of profit, the time and procedure of payment of shares in profit (dividends) … are in the exclusive competence of the Company's supreme body and may not be delegated to the Company's other bodies."[99]

59. Article 9.6 of the 2005 Articles set out in detail the role and the procedures for the activities of the Supervisory Board. Again, the provision was lengthy, but key points are noteworthy. The Supervisory Board was elected by the General Meeting of Shareholders, and comprised 11 individuals,[100] each of whom had one vote.[101] It analysed the actions of the Executive Board and, if necessary, initiated extraordinary

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96 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.5.3, **Exhibit {C-846}.**

97 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.5.7, **Exhibit {C-846}.**

98 Articles of Association of Ukrnafta 2005, 20 December 2005, Articles 9.5.9-10, **Exhibit {C-846}**.

99 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.5.16, **Exhibit {C-846}.**

100 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.6.2, **Exhibit {C-846}.**

101 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.6.14, **Exhibit {C-846}.**

internal or independent audits of Ukrnafta's financial and business activities.[102] It had the right to obtain information about Ukrnafta's activities, and to receive reports from the Executive Board on those activities.[103] A meeting of the Supervisory Board was quorate only "if no fewer than 60% of its members are present at it".[104] Decisions were by simple majority, other than where a special majority of 75% was required for decisions relating to the disposal of a certain amount of Ukrnafta's real property, acquisition by Ukrnafta of its own shares, or distribution by Ukrnafta of additional shares.[105] Further, the Supervisory Board, "[a]t the request of the Chairman of the Executive Board, elect[ed] members of the Executive Board".[106]

60. Article 9.7 of the 2005 Articles set out in detail the role and the procedures for the activities of the Executive Board. The provision was again detailed, but contained some key items for current purposes. The term of the Chairman and a Member of the Executive Board was five years.[107] The Supervisory Board could terminate before the end of five years the powers of a Member of the Executive Board in accordance with Ukrainian legislation, and could suspend the Chairman "in circumstances of the incompetence … abuse of his/her office, disclosure of a commercial secret or in cases of the performance of actions or of failure to act which caused or could have caused detriment to the interests of the Company as a whole or of certain Shareholders", provided that any such decision is done with "no fewer than 60% of the votes of the total membership of the Company's Supervisory Board".[108]

61. Article 9.8 of the 2005 Articles set out the role of the Audit Commission. While the provision had some detail, the essence of the role was that the Audit Commission conducted internal audits of Ukrnafta's financial and business activities. Such an

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102 Articles of Association of Ukrnafta 2005, 20 December 2005, Articles 9.6.6.3-4, **Exhibit {C-846}**.

103 Articles of Association of Ukrnafta 2005, 20 December 2005, Articles 9.6.7.1-2, **Exhibit {C-846}.**

104 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.6.12, **Exhibit {C-846}.**

105 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.6.13, **Exhibit {C-846}.**

106 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.6.6.10, **Exhibit {C-846}.**

107 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.7.3, **Exhibit {C-846}.**

108 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.7.4, **Exhibit {C-846}**

audit could be "carried out by the Audit Commission on the instructions of the General Meeting, the Supervisory Board, the Executive Board or on its own initiative, or at the request of Shareholders having in aggregate more than 10% of the votes."[109]

62. The 2005 Articles subsisted from the date of their ratification on 20 December 2005 until promulgation of the Articles of Association of Public Joint Stock Company "Ukrnafta", as ratified by the General Meeting of Shareholders on 2 March 2011 ("**2011 Articles**").[110] While the advent and relevant content of the 2011 Articles is discussed below, it is presently noteworthy that the substance of the provisions in the 2005 Articles noted above was broadly maintained in the 2011 Articles, albeit with refinements particularly in relation to which shareholders had rights to nominate the individuals elected to the management bodies of Ukrnafta.

C. The 2010 Shareholders Agreement and 2010 Cooperation Agreement: their purposes and contents

63. In 2010, the Claimants concluded two agreements that became a fundamental part of their investment in Ukrnafta. They were:

a) the Agreement on mutual understanding and cooperation between OJSC "Ukrnafta", the minority shareholders and the owner of the controlling shareholding in OJSC "Ukrnafta", done in Kyiv, dated 25 January 2010 ("**2010 Shareholders Agreement**"); and

b) the Agreement on mutual understanding and cooperation between the Ministry of Energy and Coal Industry of Ukraine, OJSC "Ukrnafta", the minority shareholders and the owner of the controlling shareholding in OJSC

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109 Articles of Association of Ukrnafta 2005, 20 December 2005, Article 9.8.4, **Exhibit {C-846}.**

110 The 2005 Articles were amended once on 26 January 2010. The primary purpose of these amendments was to bring the 2005 Articles into conformity with a shareholders agreement signed by Naftogaz, the Claimants, and another minority shareholder, Ballioti Enterprises Limited (discussed immediately below), and in particular the allocation of rights to nominate individuals to positions in the management of Ukrnafta. See Amendments and Supplements to the Articles of Association", as ratified by the General Meeting of Shareholders on 26 January 2010, **Exhibit {C-1072}.**

"Ukrnafta", done in Kyiv, dated 23 December 2010 ("**2010 Cooperation Agreement**").

64. The 2010 Shareholders Agreement was concluded between Naftogaz, the Claimants, and another minority shareholder, Ballioti Enterprises Limited ("**Ballioti**"). Ukrnafta was also a party to it.[111] The objectives of the 2010 Shareholders Agreement are stated in its recitals. Among others, the objectives included "ensuring the rights of majority and minority shareholders for the Company's governance, the creation of an efficient mechanism for the execution of shareholders' rights and ensuring a balance of their interests" and "avoiding circumstances leading to corporate conflicts between shareholders".[112]

65. This objective arose in a particular context. As Mr Palytsia explains:

> "In January 2010, Yuliya Tymoshenko was Prime Minister of Ukraine and her government was receptive to ideas for attracting investment into Ukraine. For instance, her government had overseen the sale of the Kryvorizstal steel company and it also decided that new investors should have an opportunity to invest in Ukrnafta. The idea which was common to the government and the minority shareholders was to float the business on an international stock exchange and offer shares in it to international investors. The funds raised would be used to acquire oil refineries which would turn Ukrnafta into a vertically integrated business."[113]

66. The Respondent through Naftogaz thus entered into the 2010 Shareholders Agreement at least in part to facilitate the payment of dividends by Ukrnafta to Naftogaz,[114] but also at least in part as a prelude to significant international investment being injected into Ukrnafta, consistent with the government's efforts to attract investment into Ukraine generally.[115] However, if the injection of such

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111 2010 Shareholders Agreement, 25 January 2010, **Exhibit {C-1068}.**

112 2010 Shareholders Agreement, 25 January 2010, recitals 2 and 4, **Exhibit {C-1068}.**

113 Witness Statement of Mr Palytsia, paragraph 13.

114 Witness Statement of Mr Palytsia, paragraph 13.

115 Witness Statement of Mr Palytsia, paragraph 13.

investment into Ukrnafta was to be achieved, it could not be at the cost of the Claimants' (and other minority shareholders') position in the management of the company. As a result, the core provisions in the 2010 Shareholders Agreement contain numerous prescriptions as to how Ukrnafta's shareholders would participate in its management. These included the rights they would have in the election and removal of the Members of Ukrnafta's Supervisory Board, Executive Board and Audit Commission. These provisions were set out in a context of broader duties to act in concert, rather than contest, with one another.

67. To this end, the 2010 Shareholders Agreement begins by recording foundational points of agreement between the parties to it, namely, that they are:

a) "to act jointly, as mutually agreed to ensure the development of the Company, its attractiveness as an investment throughout the whole period of its activity";[116]

b) "to act in such a way that its [a Party's] execution of corporate rights does no harm and creates no threat of harm to the rights of the other Parties, according to the principles of reliability, reasonability, fairness and equality, without abuse of its rights and not creating any obstacles to the execution and protection of their corporate rights by the other Parties" and "not to create obstacles to the other Parties in the execution of their shareholders rights, in particular, by means of non-attendance of shareholders' meetings";[117]

c) "not to take any direct or indirect measures aimed at having priority in the exercise of their corporate rights over the rights both of other Parties thereof and the Company's [Ukrnafta's] shareholders, not to take measures aimed at

116 2010 Shareholders Agreement, 25 January 2010, Article 1, **Exhibit {C-1068}.**

117 2010 Shareholders Agreement, 25 January 2010, Article 2, **Exhibit {C-1068}.**

the violation of rights, discrimination of the Company, other Parties to this Agreement and Company's shareholders.";[118]

d) "to take all necessary measures … to ensure sale of the Company's products at economically reasonable market prices";[119] and

e) "to act in good faith, fairly and reasonably".[120]

68. With these basic protections, obligations and minimum standards of cooperation established, the parties also undertook, at the first General Meeting of Shareholders following the execution of the 2010 Shareholders Agreement, to approve Articles "in a version compliant with the nature of the understandings under" the 2010 Shareholders Agreement.[121] This agreement anticipated the ratification of the 2011 Articles, noted above and discussed further below. It also prompted immediately an amendment to the 2005 Articles, on 26 January 2010. The primary purpose of these amendments was to bring the 2005 Articles into conformity with the 2010 Shareholders Agreement, and in particular the allocation of rights among the shareholders to nominate individuals to positions in the management of Ukrnafta.[122]

69. The 2010 Shareholders Agreement also set out the rights of the minority shareholders in the management of Ukrnafta. This was, as Mr Palytsia explains, consistent with:

> "[o]ne of the key purposes of the 2010 Shareholders Agreement[, which] was to ensure that the position of the minority shareholders would be protected. The crucial provision in this regard (and probably the most important provision of all from the minority shareholders' point of view) was Article 9, which set out the powers of appointment that

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118 2010 Shareholders Agreement, 25 January2010, Article 3, **Exhibit {C-1068}.**

119 2010 Shareholders Agreement, 25 January 2010, Article 4, **Exhibit {C-1068}.**

120 2010 Shareholders Agreement, 25 January 2010, Article 12, **Exhibit {C-1068}.**

121 2010 Shareholders Agreement, 25 January 2010, Article 6, **Exhibit {C-1068}.**

122 See Amendments and Supplements to the Articles of Association", as ratified by the General Meeting of Shareholders on 26 January 2010, **Exhibit {C-1072}.**

each of Naftogaz and the minority shareholders had in respect of the management bodies of Ukrnafta."[123]

70. The core of the 2010 Shareholders Agreement was thus Article 9. For the purpose of "balancing the interests of all the Shareholders and safeguarding their rights to take part in the Company's management", Article 9 records the parties' agreement on issues relating to the constitution of Ukrnafta's Supervisory Board, Executive Board and Audit Commission. Article 9 thus stipulates that:

a) "the election and revocation as well as termination of the powers of the members, including the chairman, of the Company's Supervisory Board and Audit Commission, and also the Chairman of the Company's Executive Board, is in the exclusive competence of the General Meeting of Shareholders";

b) "a simple majority (6 members) of the number of members of the Company's Supervisory Board and Audit Commission (a simple majority of the number of members of the Audit Commission to be set by the General Meeting of the Company's Shareholders), including those bodies' Chairmen, will be elected from candidates proposed by [Naftogaz], and the Chairman of the Company's Executive Board and the other members (5 members) of the number of members of the Company's Supervisory Board and Audit Commission (the difference between the total number of members and the simply majority) from candidates proposed by majority vote of Shareholders of the Company other than [Naftogaz – that is, the minority shareholders of which the Claimants were the majority]";

c) "[t]he Parties agree to keep the currently existing number of members of the Company's Supervisory Board, Audit Commission and Executive Board, the procedure for taking decisions and the criteria for setting a quorum for the

123 Witness Statement of Mr Palytsia, paragraph 15.

work of the Company's management bodies" (which for the Supervisory Board was eight of its 11 members); and

d) if the parties decided to amend the 2005 Articles vis-à-vis the number of members of the Supervisory Board, Executive Board and/or Audit Commission, or the procedure by which those bodies took decisions, they would "maintain the proportions of membership of their representatives and the scope of their powers provided by" Article 9.

71. The 2010 Shareholders Agreement was a key first step towards making possible a flotation of Ukrnafta, though various changes would first have had to be made to Ukrainian law in order to allow such a flotation to happen.[124] Nonetheless, as the foregoing demonstrates, the Claimants and Naftogaz bound themselves in the 2010 Shareholders Agreement to abide by particular conduct in relation to the management of Ukrnafta, including in respect of the election and removal of Members of Ukrnafta's Supervisory Board, Executive Board and Audit Commission.

72. Following the 2010 Shareholders Agreement, Naftogaz, the Claimants, and two other minority shareholders, Ballioti and Renalda Investments Limited ("**Renalda**"), concluded the 2010 Cooperation Agreement. The Ministry of Energy and Coal Industry of Ukraine and Ukrnafta were also parties to it.[125] In concluding the 2010 Cooperation Agreement, the parties expressly stated they were "guided by" the 2005 Articles and the 2010 Shareholders Agreement.[126]

73. Mr Palytsia explains the context in which the 2010 Cooperation Agreement was signed:

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124 As Mr Palytsia explains: "There was no direct reference in the 2010 Shareholders Agreement to the intention to float Ukrnafta. This was because changes would have to be made to Ukrainian law to enable the float to take place and those changes had not yet been assessed. It would therefore have been inappropriate to refer to this intention in the agreement. This intention was however known to all signatories of the 2010 Shareholders Agreement and to the Ukrainian government at the time": Witness Statement of Mr Palytsia, paragraph 14.

125 2010 Cooperation Agreement, 23 December 2010, **Exhibit {C-1144}**.

126 2010 Cooperation Agreement, 23 December 2010, preamble, **Exhibit {C-1144}.**

> "When Mr Yanukovich won the Presidency of Ukraine in February 2010 (and Mr Azarov took up the post of Prime Minister), the new government continued, for a time, the policy of seeking investment for Ukrnafta through a stock market flotation. The 2010 Cooperation Agreement, which was executed on 23 December 2010, represented a further step along the road to achieving this. It was intended to increase the confidence of prospective investors by improving protections for existing minority shareholders and to pave the way for changes to Ukrnafta's Articles of Association. By this time the necessary legal changes to permit Ukrnafta to be floated had been identified. Consequently the 2010 Cooperation Agreement referred directly, in Article 7, to the intention to list Ukrnafta's shares on the London stock exchange."[127]

74. The objectives of the 2010 Cooperation Agreement, which are stated in its recitals, reflect Mr Palytsia's explanation. Among others, the objectives included creating a vertically integrated Ukrnafta in "observance of the norms of the legislation of Ukraine in force, of the understandings between the Parties existing on the date of execution of the present Agreement and also of the understandings enshrined in the present Agreement", and achieving "such a level of interaction between the shareholders of OJSC 'Ukrnafta', that a public vertically integrated company created on the basis of OJSC 'Ukrnafta' would operate with maximum effectiveness".[128]

75. As with the 2010 Shareholders Agreement, provisions in the 2010 Cooperation Agreement establish minimum standards of cooperation between the parties. They thus agreed "to act jointly and in a mutually agreed way" and in observance of 2005 Articles,[129] and to undertake the "necessary joint decisions according to the procedure set by the legislation in force, the Charter of OJSC 'Ukrnafta', and the joint understandings of the Parties set out in the present Agreement in order to achieve the aim set by the present Agreement".[130] The parties also agreed to perform the 2010

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127 Witness Statement of Mr Palytsia, paragraph 19.

128 2010 Cooperation Agreement, 23 December 2010, recitals 1 and 2, **Exhibit {C-1144}.**

129 2010 Cooperation Agreement, 23 December 2010, Article 1, **Exhibit {C-1144}.**

130 2010 Cooperation Agreement, 23 December 2010, Article 4, **Exhibit {C-1144}.**

Cooperation Agreement "in full with respect for the interests of other shareholders", and each undertook "to act in good faith, fairly and reasonably" in that performance.[131]

76. With these minimum standards of cooperation agreed, the parties to the 2010 Cooperation Agreement also undertook to bring the 2005 Articles into accordance with the requirements of the Law of Ukraine "On Joint Stock Companies" of 2008.[132] This undertaking continued the movement recorded in Article 6 of the 2010 Shareholders Agreement towards the ratification of the 2011 Articles, noted above and discussed further below.

77. The 2010 Cooperation Agreement also specified steps that the parties would take in respect of the election of a Chairman of the Executive Board of Ukrnafta. After recording that such an election would occur,[133] the Claimants (along with Ballioti and Renalda) undertook "to propose a nominee for the position of Chairman of the Company's Board selected in a competitive process, who will, by his/her professional qualities, reputation acquired and experience of work, be capable of ensuring the achievement of the aims of the present Agreement".[134] Naftogaz undertook "to approve the nominee proposed" in this way.[135] The minority shareholders undertook work to this end in early 2011, with Ballioti leading the search for potential candidates.[136] Ultimately, Mr Peter Vanhecke, an individual with experience in and

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131 2010 Cooperation Agreement, 23 December 2010, Article 14, **Exhibit {C-1144}.**

132 2010 Cooperation Agreement, 23 December 2010, Article 5, **Exhibit {C-1144}.**

133 2010 Cooperation Agreement, 23.12.2010, Article 9, **Exhibit {C-1144}**.

134 2010 Cooperation Agreement, 23 December2010, Article 10, **Exhibit {C-114}4**. The parties also agreed that all the relevant decisions to be taken by the General Meeting of Shareholders pursuant to the 2010 Cooperation Agreement would take place in a single meeting of that body: 2010 Cooperation Agreement, 23 December 2010, Article 11, **Exhibit {C-1144}.**

135 2010 Cooperation Agreement, 23 December 2010, Article 10, **Exhibit {C-1144**}.The parties also agreed that all the relevant decisions to be taken by the General Meeting of Shareholders pursuant to the 2010 Cooperation Agreement would take place in a single meeting of that body: 2010 Cooperation Agreement, 23 December 2010, Article 11, **Exhibit {C-1144**}.

136 Agreement No. REP-01/11 between Ballioti and Zao Razrabotka Osnov Sistemy Expert-Personal, 18.01.2011, **Exhibit {C-1155}**; Additional Agreement No. 1 to Agreement No. REP-

knowledge of investment banking and the floating of companies, was identified and appointed to the position.

78. As with the 2010 Shareholders Agreement, the foregoing demonstrates that the 2010 Cooperation Agreement bound the parties to it to abide by particular conduct in relation to the management of Ukrnafta, and especially the election and removal of the Chairman of the Executive Board.

D. The 2011 Articles: their purpose and content

79. As anticipated in the 2010 Shareholders Agreement and the 2010 Cooperation Agreement, the 2005 Articles were replaced by the 2011 Articles.

80. The purpose of ratifying the 2011 Articles was manifold. As noted above, it was done in order to ensure the applicable Articles of Ukrnafta were consistent with the content of the agreement of the shareholders of Ukrnafta set out in the 2010 Shareholders Agreement,[137] and to ensure the applicable Articles of Ukrnafta were consistent with the content of the Law of Ukraine "On Joint Stock Companies" of 2008.[138] As set out further below, a key aspect of achieving this consistency in the 2011 Articles was the refinement of the rules relating to how the management bodies of Ukrnafta were to be constituted, and the role that the minority shareholders (of whom the Claimants were the majority) had in that process of constituting them.

81. The core provisions in the 2011 Articles are Articles 2, 3 and 9.

01/11 between Ballioti and Zao Razrabotka Osnov Sistemy Expert-Personal, dated 18.01.2011, 18 January 2011, **Exhibit {C-1156}**; Acceptance Act to Additional Agreement No. 1 to Agreement No. REP-01/11 18 January 2011 between Ballioti and Zao Razrabotka Osnov Sistemy Expert-Personal, 25 January 2011, **Exhibit {C-1158 Original}.**

137 See 2010 Shareholders Agreement, 25 January 2010, Article 6, **Exhibit {C-1068}**. The same can be said of the amendments to the 2005 Articles done immediately after the conclusion of the 2010 Shareholders Agreement: See Amendments and Supplements to the Articles of Association", as ratified by the General Meeting of Shareholders on 26 January 2010, **Exhibit {C-1072}.**

138 2010 Cooperation Agreement, Article 5, 23 December 2010, **Exhibit {C-1144}.**

82. Like Article 3 in the 2005 Articles, Article 2 of the 2011 Articles sets out the objective and scope of the activities of Ukrnafta. The objective of Ukrnafta stated in the 2011 Articles is similar to that stated in the 2005 Articles:

> "The aim of the Company's activities is to produce oil and gas, provide consumers with products of oil and gas refining, produce other goods in order to satisfy the needs of the energy market, to introduce inventions and other innovations into various areas of commercial activity and international business, to conduct prospecting and exploration for new oil and gas fields, to develop oil and gas fields, to carry out any type of production and commercial activities not prohibited by the legislation of Ukraine in force, with the aim of obtaining profit."[139]

83. Article 3 of the 2011 Articles set out what entities could be shareholders and what rights and duties they would have as shareholders. It states that shareholders may be "legal entities and individuals which/who acquired the right to share ownership based on provisions of these Articles of Association and requirements of current Ukrainian legislation".[140] Article 3 continues by articulating typical rights for shareholders, namely, rights to "Participat[e] in Company management, personally or through a representative; Receiv[e] dividends; Receiv[e] a share of Company property or value in the event of Company liquidation; [and] Receipt of information about Company's economic activity …".[141]

84. Article 9 of the 2011 Articles, like Article 9 of the 2005 Articles, sets out how and by whom the management of Ukrnafta is conducted. It maintains the same management bodies as those set out in the 2005 Articles, namely, the General

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139 Ukrnafta Articles of Association 2011, 22 March2011, Article 2.1, **Exhibit {C-1175}**. The 2011 Articles then set out 56 types of activities that were to be the content of Ukrnafta's activities: 2005 Articles, Article 2.2, **Exhibit {C-1175}**.

140 Ukrnafta Articles of Association 2011, 22 March 2011, Article 3.1, **Exhibit {C-1175}**

141 2011 Articles, Article 5.3, **Exhibit {C-1175}**. Shareholders also have a duty: to comply with Ukrnafta's constitutive documents and to fulfil decisions of the general meetings; to perform their obligations to Ukrnafta, including those related to participation deriving from property ownership; not to disclose any commercial secretor confidential information about Ukrnafta's activities; and to carry out responsibilities provided for by Ukrainian legislation: 2011 Articles, Article 3.4, **Exhibit {C-1175**}.

Meeting of Shareholders, the Supervisory Board, the Executive Board and the Audit Commission.[142]

85. Article 9.1 of the 2011 Articles sets out in detail the role and the procedures for the activities of the General Meeting of Shareholders. Many of the core features from the equivalent provisions in the 2005 Articles are retained in the 2011 Articles. Thus, "[o]ne voting share gives a shareholder one vote to decide on every item during the General Meetings, except for cumulative voting",[143] while the "General Meeting has a quorum if shareholders having in aggregate not less than 60% of the votes register to participate in it".[144] Decisions of the General Meeting of Shareholders were "made by simple majority of votes of shareholders registered to participate in the General Meeting",[145] other than where a special majority of 75% was required for specified decisions including, relevantly for present purposes, "[i]ntroducing amendments to the Company's Articles of Association".[146] In addition, and consistent with the position under the 2005 Articles, a decision that had to be taken by the General Meeting of Shareholders was the election and removal of the Chairman of the Executive Board, the Chairman and Members of the Supervisory Board and the Chairman and Members of the Audit Commission.[147] This competence of the General Meeting of Shareholders is, however, articulated in the context of the 2010 Shareholders Agreement and the prescriptions therein about which shareholders are entitled to nominate individuals to fill such management positions within Ukrnafta.

86. Article 9.2 of the 2011 Articles sets out in detail the role and the procedures for the activities of the Supervisory Board. Again, many of the core features from the equivalent provisions in the 2005 Articles remain in the 2011 Articles. "The

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142 Ukrnafta Articles of Association 2011, 22 March 2011, chapeau to Article 9, **Exhibit {C-1175}**.

143 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.1.8, **Exhibit {C-1175}.**

144 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.1.7, **Exhibit {C-1175}.**

145 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.1.9, **Exhibit {C-1175}.**

146 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.1.10, **Exhibit {C-1175}.**

147 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.1.6.(16)-(20), **Exhibit {C-1175}.**

Supervisory Board consists of 11 (eleven) members elected by the General Meeting according to the procedure provided by the Articles of Association",[148] each "member of the Supervisory Board has one vote",[149] the Supervisory Board is quorate "if there are at least 8 members of the active Supervisory Board present",[150] and "[d]ecisions of the Supervisory Board are by simple majority of votes cast by members present at the meeting".[151] The Supervisory Board has competence over "[e]lecting and terminating powers of Executive Board members according to the conditions of the Articles of Association. Members of the Executive Board … are elected on the application of the Chairman of the Company Executive Board".[152] Further, consistent with the 2010 Shareholders Agreement:

> "If among Company shareholders there is a shareholder … that owns … more than 50 percent of Company shares, simple majority (6 members, including the Chairman) of the quantitative representation of the Company's Supervisory Board shall be elected from the candidates proposed by the shareholder … that owns … more than 50 percent of Company shares, and other members (5 members) from the quantitative representation of the Company Supervisory Board shall be elected from candidates proposed by other Company shareholders."[153]

87. In effect, this means that six of the individuals on the Supervisory Board (including its Chair) are to be elected from Naftogaz's nominees, and the other five from the nominees of the minority shareholders (of whom the Claimants were the majority).

88. Article 9.3 of the 2011 Articles sets out in detail the role and the procedures for the activities of the Executive Board, once more with similarities to the equivalent provisions in the 2005 Articles. The Executive Board "is the executive body of the

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148 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.2.2, **Exhibit {C-1175}.**

149 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.2.10, **Exhibit {C-1175}**.

150 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.2.9, **Exhibit {C-1175}**.

151 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.2.10, **Exhibit {C-1175}.**

152 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.2.3.(8), **Exhibit {C-1175}**.

153 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.2.2, **Exhibit {C-1175}**.

Company which manages Company's ongoing activities".[154] It "consists of 7 members (including the Chairman of the Executive Board)", and "Members of the Executive Board (apart from the Chairman) are elected by the Supervisory Board for a period of five years".[155] The Supervisory Board could terminate the powers of the Chairman or a Member of the Executive Board in limited circumstances: "Powers of Executive Board members may be prematurely terminated by the Supervisory Board of the Company. Termination of powers of the Chairman and/or members of the Executive Board may be carried out on grounds established by law, these Articles of Association, as well as by contract".[156] Further, consistent with the 2010 Shareholders Agreement:

> "If among Company shareholders there is a shareholder … that owns … more than 50 percent of Company shares, the Chairman of the Executive Board shall be elected among the candidates proposed by the majority of the votes of shareholders other than the shareholder … that owns … more than 50 percent of Company shares."[157]

89. In effect, this means that the Chairman of Executive Board is to be someone the Claimants nominate for the position. Given the nature of the powers exercised by the Chairman of Executive Board, this right of the Claimants is an important one, and a crucial part of their investment in Ukrnafta.

90. Article 9.4 of the 2011 Articles sets out in detail the role and the procedures for the activities of the Audit Commission. As in the equivalent provision in the 2005 Articles, the essence of Article 9.4 is that the Audit Commission conducts internal audits of Ukrnafta's financial and business activities. An audit is "carried out at the initiative of the Audit Commission, by the decision adopted by the General Meeting, Supervisory Board, Executive Board or at the request of shareholders … who jointly own … more than 10 percent of ordinary shares of the Company on the date of

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154 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.3.1, **Exhibit {C-1175}**.

155 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.3.2, **Exhibit {C-1175}**.

156 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.3.2, **Exhibit {C-1175**}.

157 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.3.2, **Exhibit {C-1175}**.

submission of such a request."[158] Further, consistent with the 2010 Shareholders Agreement:

> "If among Company shareholders there is a shareholder … that owns … more than 50 percent of Company shares, simple majority (3 members including the Chairman) of the Audit Commission shall be elected among the candidates proposed by the shareholder … that owns … more than 50 percent of Company shares, and the other members (2 members) of the Audit Commission shall be elected among candidates proposed by other shareholders of the Company."[159]

91. In effect, this means that three of the individuals on the Audit Commission (including its Chair) are to be elected from Naftogaz's nominees, and the other two from the Claimants' nominees.

92. As the foregoing demonstrates, the arrangement of the corporate governance of Ukrnafta in the 2011 Articles, and consistent with the 2010 Shareholders Agreement and the 2010 Cooperation Agreement, was carefully set up so as to afford both the Respondent and the Claimants balanced rights of participation in the management of the company. The rights of the Claimants in this regard were thus a key part of their investment in Ukraine. They had in the 2011 Articles a set of rights that allowed them to manage their investment in Ukraine in an effective and sensible manner. Moreover, they were rights to the possession of which the Respondent fully consented, both acting through Naftogaz signing the 2011 Articles, the 2010 Shareholders Agreement and the 2010 Cooperation Agreement, and through the Ministry of Energy signing the 2010 Cooperation Agreement.

E. The Respondent has, over many years and contrary to its own laws, sought to acquire gas produced by Ukrnafta at prices well below cost of production, or simply to take that gas without paying for it

93. In the context of the foregoing operations and constitutive basis of Ukrnafta, a primary objective of the Respondent for most of the past decade has been to acquire

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158 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.4.9, **Exhibit {C-1175}**.

159 Ukrnafta Articles of Association 2011, 22 March 2011, Article 9.4.2, **Exhibit {C-1175}**.

gas produced by Ukrnafta, whether on its own or through joint ventures, at prices well below a level that would allow Ukrnafta to recover its economically justified costs of producing that gas, let alone permit it to earn a profit, as Ukrainian law at all material times required, or simply to take that gas without paying for it.

94. The Respondent has pursued this objective through a series of related strategies over the course of the past decade. As this Section II.E explains, the Respondent has engaged in such conduct in the following forms.

a) Ukrtransgaz and Naftogaz used their physical control of the GTS to prevent Ukrnafta from exercising its ownership rights in respect of the gas it pumped into that system (for instance, by selling its gas to third parties in accordance with Ukrainian law).

b) After Ukrtransgaz had already acknowledged receipt of certain gas from Ukrnafta, Naftogaz claimed that the gas had then been appropriated, without Ukrnafta's consent, and used to satisfy the needs of the Ukrainian population.

c) In relation to gas which Ukrnafta had no choice but to pump into the GTS, Ukrtransgaz refused to acknowledge receipt unless and until Ukrnafta yielded to its various demands (such as agreeing that the gas had been transferred to it to satisfy the needs of the Ukrainian population).

d) It repeatedly changed its legal and regulatory regime in an effort to manufacture a legal basis on which it would not have to comply with the decisions of its own courts which held that Naftogaz and Ukrtransgaz had acted unlawfully in their treatment of Ukrnafta and its gas.

e) It attempted to compel Ukrnafta to enter into contracts for the sale of gas to Naftogaz below value, in some instances having first promulgated a NERC / NESR Resolution purporting to establish the price payable.

95. The Respondent's misconduct gave rise to many disputes in the Ukrainian Commercial and Administrative Courts between Ukrnafta on the one hand and

Naftogaz, Ukrtransgaz, the NERC / NESR / NEPURC on the other. In virtually every case that has been decided, Ukrnafta prevailed, and the Respondent's conduct was held to be unlawful. Despite this, the Respondent has regularly not complied with its own courts' rulings. Rather, it has repeated time and again arguments concerning the effect of Ukrainian legislation that have been rejected by the courts on numerous occasions. Moreover, in the enforcement proceedings which followed the Respondent's non-compliance with its courts' judgments, it has challenged the courts' orders on spurious grounds.

96. The starting point for the explanation of this misconduct is the legal and regulatory regime the Respondent had in place prior to 2007 (Section II.E.1 below). Thereafter, the Respondent's misconduct is best set out in broadly chronological terms (Sections II.E.2 onwards below). For the sake of brevity, this Section II.E does not summarise all of the content of the many proceedings before the Ukrainian courts that the Respondent has lost. The full detail of those proceedings is set out in the Chronology at Annex 1, knowledge of which is assumed in the presentation of this Section II.E.

1. <u>The Respondent's legal and regulatory regime prior to 2007</u>

97. The legal and regulatory regime the Respondent had in place at 2006 can be taken in two parts: that which is broadly relevant to the events in issue, and that which was focused on the gas sector in which Ukrnafta and the Claimants operated and invested.

98. As to the former, numerous basic precepts of Ukrainian law provided protection of rights that any business operation would expect to see in a developed legal system. These basic principles included:

a) protection of ownership and property rights, including the principle that one could not be deprived of those rights otherwise than in accordance with law and receipt of full redemption or compensation;[160]

b) enshrinement of the principle of freedom of contract or agreement, within the limitations of the law;[161]

c) prohibition of retroactively-applicable laws;[162]

d) prescription that budgetary laws of Ukraine are to be annually approved, and are to apply only to the specified calendar year;[163] and

e) confirmation that price is an essential condition of a business contract, whether that price be freely negotiated or fixed by the State.[164]

99. The Respondent also created a legal and regulatory regime specifically relating to natural gas. For present purposes, three instruments are noteworthy.

100. First, on 18 March 1999, the NERC issued Resolution No 337 ("**1999 NERC Resolution**") setting the "threshold level of bulk prices" (that is, the maximum allowable wholesale price) "for natural gas of domestic use", meaning "domestic use by population and individual heating of houses".[165] That price was UAH 185,[166]

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160 See Civil code of Ukraine No. 435−IV (Unofficial Copy), 16 January 2003, Articles 3(2), 319(7), 321(1)-(3) and 353(1)-(2), **Exhibit {C-312}**.

161 See: Civil code of Ukraine No. 435−IV (Unofficial Copy), 16 January 2003, Articles 3(3) and 627, **Exhibit {C-312}**; Commercial Code of Ukraine dated 16.01.2003, last amended on 9.01.2007, 16 January 2003, Article 179(4), **Exhibit {C-342}**.

162 See Constitution of Ukraine dated 19.03.1996, last amended on 19.09.2013, 19 March 1996, Article 58, **Exhibit {C-493}**.

163 See Budget Code of Ukraine (No. 2542-III), 21 June 2001, Article 3, **Exhibit {C-40}8** (which law remained in force until it was replaced by the Budget Code of Ukraine (No. 2456-VI), **Exhibit {C-407}.**

164 See Commercial Code of Ukraine dated 16.01.2003, last amended on 9.01.2007, 16 January 2003, Articles 189-191, **Exhibit {C-342}**.

165 NERC Resolution No. 337 "On the establishment of the threshold level of bulk prices for natural gas of domestic use and tariff rates for services associated with gas transportation and distribution to consumers in Ukraine", 18 March 1999, **Exhibit {C-305**}.

inclusive of tariffs for transportation and distribution. It applied regardless of whether the gas was "of domestic production or imported". The 1999 NERC Resolution also fixed the tariffs for transportation and distribution which were included within the maximum allowable wholesale price. The NERC subsequently stated (as was confirmed by the Ukrainian courts in Case No 18/228, discussed below) that the 1999 NERC Resolution did not apply to transactions between Naftogaz and Ukrnafta.[167]

101. On 3 December 1999, the NERC issued Resolution No 1453. It approved the licensing terms for gas storage operations (and hence Ukrtransgaz's operations). Key provisions in it included that: Clause 2.7, which provided that the licensee must provide equal rights of access to the GTS to all gas suppliers; Clause 2.8, which provides that the licensee cannot (either directly or indirectly) obstruct, complicate or counteract the operations of other businesses with gas; Clause 3.3.1, which provides that the licensee will store gas on a contractual basis, with standard contracts and any amendments thereto to be approved by the Ministry of Energy and the NERC; and Clause 3.3.6, which provides that injection and withdrawal of gas is to be made on a non-discriminatory basis, and that the licensee cannot reject a request for injection.[168]

102. On 21 June 2001, the Verkhovna Rada passed the Budget Code of Ukraine.[169] Article 3 provides, in relevant part: "The budget period for all budgets that comprise the

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166 References to the price of gas in this Statement of Claim are to the price for 1,000m^3 of gas.

167 The NERC also confirmed later in time that this price did not allow sufficiently for capital investment in Ukrnafta's business. Thus, on 21 March 2001, the NERC issued a letter detailing the extent to which the price of UAH 185 set by the 1999 NERC Resolution for sales to the population (and the price charged to municipal heat-generating companies of UAH 231) had, for reasons of social policy, been set at levels substantially below the "economically reasonable price". After noting that this led to insufficient capital investment being made by gas-producing companies and the deleterious effect of insufficient investment, the NERC then proposed to increase the prices towards the economically reasonable level Letter from the NERC No. 05-11-09/681 'Matters related to the formulation of electricity rates and natural gas prices for the public', 21 March 2001, **Exhibit {C-827}.**

168 NERC Resolution No. 1453 "On approval of the Conditions and Rules (Licensing Conditions) of activity for the storage of natural gas", 3 December 1999, **Exhibit {C-1770**}.

169 Budget Code of Ukraine (No. 2542-III), 21 June 2001, **Exhibit {C-408**}.

budget system shall be one calendar year that begins on the 1st of January of a relevant year and ends on the 31st of December of the same year."[170]

103. On 27 December 2001 the Cabinet of Ministers issued Decree No 1729 ("**2001 Cabinet Decree**").[171] This provided, *inter alia*, that: the public's needs were to be satisfied with gas extracted by gas production enterprises subordinated to Naftogaz, such as Ukrnafta; and the Cabinet of Ministers was to approve on an annual basis an expected balance of inflow and distribution of gas, taking into account the need for such gas of the national economy, budget-financed institutions and organisations and the public, as well as the capabilities of the gas transportation system. The 2001 Cabinet Decree was limited in its purpose. It did not: state to whom the affected entities were to sell their gas; stipulate the price at which the affected entities were to sell their gas; provide that the price at which the affected entities were to sell their gas was a regulated price; establish an upper limit on the price at which the affected entities were to sell their gas; establish any principle by reference to which price was to be determined or approved (e.g., that the price had to allow the seller to recover its economically justified costs of production plus a profit); or make any provision concerning the process by which the price was to be determined or approved.[172]

104. On 2 April 2002, Ukrtransgaz entered into Agreement No 29/11-462/100a-H with Ukrnafta ("**2002 Ukrtransgaz Agreement**"). Pursuant to this agreement, Ukrtransgaz agreed, *inter alia*, to receive gas from Ukrnafta at gas metering stations and transport the gas in its transmission systems, to transport it to consumers, and to conclude Deeds of Transfer and Acceptance – documents that recorded the receipt of a

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170 Budget Code of Ukraine (No. 2542-III), Article 3, 21 June 2001, **Exhibit {C-408}**.

171 See full version Decree No. 1729 of the Cabinet of Ministers of Ukraine "On providing consumers with natural gas" dated 27.12.2001, last amended 28.02.2015, 28 February 2015, **Exhibit {C-545}**; Cabinet of Ministers Decree No. 1729 (original version), 27 December 2011, **Exhibit {C-311}.**

172 The 2001 Cabinet Decree was subsequently amended, as set out in the Chronology attached as Annex 1 to this Statement of Claim.

specified volume of gas by Ukrtransgaz from Ukrnafta – shortly after the end of each reporting month.[173]

105. On 1 January 2004, the Verkhovna Rada enacted a new Civil Code, and on the same day it enacted the Commercial Code.[174] On 6 July 2005, the Verkhovna Rada enacted the Code of Administrative Procedure.[175] The relevant provisions of these laws are set out in the Chronology attached as Annex 1 to this Statement of Claim.

106. Pursuant to its power to issue annual budgetary laws, the Verkhovna Rada passed Law No 3235-IV "On the State Budget of Ukraine for 2006" on 20 December 2005 ("**2006 Budget Law**").[176] The key provision in the 2006 Budget Law was Article 4, which applied both to entities (such as Naftogaz) in which the State owned more than 50% of the shares directly, and to entities (such as Ukrnafta) where more than 50% of the shares were owned by another entity (such as Naftogaz) in which the State held a controlling interest. With this scope of applicability, Article 4 states that "sales of equity natural gas", being gas which such entities had produced themselves, "for household use" were to be made by the entities in "the manner prescribed by the Ukrainian Cabinet of Ministers".[177]

107. As confirmed by the Respondent's own courts, the 2006 Budget Law only applied to sales of Ukrnafta's 2006 gas,[178] and even then only to sales of 2006 gas effected during the 2006 calendar year. Moreover, the price at which that gas could be sold was not regulated by the Respondent. It was a free price. If Ukrnafta did not agree the price,

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173 Agreement No. 29/11-462/100 a-G between Ukrtransgaz and Ukrnafta, 2 April 2002, **Exhibit {C-831}**.

174 Civil code of Ukraine No. 435–IV (Unofficial Copy), 16 January 2003, **Exhibit {C-312}**; Commercial Code of Ukraine dated 16.01.2003, last amended on 9.01.2007, 9 January 2007, **Exhibit {C-342}**.

175 Code of Administrative Procedure of Ukraine No. 2747-IV, dated 6 July 2005, last amended 2 March 2016, 2 March 2016, **Exhibit {AK-8}**.

176 Law of Ukraine "On state budget for year 2006", 20 December 2005, **Exhibit {C-332}**.

177 Law of Ukraine "On state budget for year 2006", 20 December 2005, **Exhibit {C-332}.**

178 Where reference is made to, for example, "2006 gas", this is a reference to gas produced during the 2006 calendar year.

it could not be compelled to enter into a contract to sell its 2006 gas to Naftogaz (or anyone else).

108. Commensurate with this position, the 2006 Budget Law did not regulate certain aspects of the gas market. Like the 2001 Cabinet Decree, the 2006 Budget Law did not: state to whom the affected entities were to sell their gas; stipulate the price at which the affected entities were to sell their gas; provide that the price at which the affected entities were to sell their gas was a regulated price; establish an upper limit on the price at which the affected entities were to sell their gas; establish any principle by reference to which price was to be determined or approved (e.g., that the price had to allow the seller to recover its economically justified costs of production plus a profit); or make any provision concerning the process by which the price was to be determined or approved.

109. In this legal and regulatory context, Ukrnafta was a successful operation in 2006/2007. The volume of gas it produced was rising at and in the period immediately before this time.[179] In the course of 2006 Ukrnafta, produced a total of 2,841,245,700m^3 of 2006 Own Gas (as defined in Section V below), had a total of 2,362,180,012m^3 of 2006 Own Gas available for sale and passed 2,061,805,134m^3 of this 2006 Own Gas into the GTS.[180]

110. This strength of performance by Ukrnafta was met with a twofold strategy on the part of the Respondent in pursuit of an objective of acquiring Ukrnafta's gas at a price substantially below its cost of production, or for no compensation at all.

111. First, Naftogaz sought to compel Ukrnafta to enter into contracts to sell gas to it at a price which would have allowed Ukrnafta to recover only a fraction of its costs of production. When Ukrnafta did not do so, the matter was dealt with in the Ukrainian courts in a number of cases between Naftogaz, Ukrtransgaz and Ukrnafta. The ultimate resolution of those cases was that Ukrnafta was not obliged to enter into

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179 Witness Statement of Mr Palytsia, paragraph 10.

180 See Own Gas Schedule, Annex 3.

the contracts proposed by Naftogaz, and was not obliged to agree a price proposed by Naftogaz as the correct price was the free price. Secondly, Ukrtransgaz refused to acknowledge receipt of Ukrnafta's 2006 gas into the underground storage facilities ("**UGS**") that was part of the GTS unless and until Ukrnafta recorded its agreement that the gas was being provided for onward transmission to the public. This matter was also referred to the Ukrainian courts. Ukrnafta again prevailed in the courts, and Ukrtransgaz began to sign Deeds of Transfer and Acceptance in respect of the gas pumped into the UGS.

112. From Ukrnafta's perspective, these difficulties that arose in 2006 were resolved at that time, as the litigation which ultimately all favoured Ukrnafta's position was largely completed in 2006 (with the exception of a small number of appeals that were resolved in the first part of 2007). Ukrnafta's operations thus continued through the period in a productive manner, and were to be expected to continue into the future in light of how the litigation had been resolved. Regrettably for Ukrnafta and the Claimants, however, the Respondent in the years that followed began to implement, and then vigorously pursued, a strategy to acquire Ukrnafta's gas at an undervalue – that is, for a value below Ukrnafta's costs of production – or for no value at all.

2. The Respondent's 2007 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

113. In 2007, the Respondent's strategy to obtain Ukrnafta's gas at an undervalue, or for no compensation at all, started to become perceptible.

114. On 19 December 2006, the Verkhovna Rada passed Law No 489-V "On the State Budget of Ukraine for 2007" ("**2007 Budget Law**").[181] There were a number of differences between Article 3 of the 2007 Budget Law and Article 4 of the 2006 Budget Law. Thus, Article 3 of the 2007 Budget Law stated that it applied not only to the entities to which the 2006 Law had applied, but also to, *inter alia*, the subsidiaries of such entities and to parties to joint venture agreements involving such entities –

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[181] Law of Ukraine "On state budget for year 2007", Article 3 (extract), 19 December 2006, **Exhibit {C-340}.**

with the result that gas produced by joint ventures to which Ukrnafta was a party was covered by the 2007 Budget Law. The 2007 Budget Law also provided that the gas produced by the affected entities "shall be used for the building of, and drawing on … the pool of natural gas for household use" in a "manner prescribed by the Ukrainian Cabinet of Ministers". It also stipulated that the entities were to sell "all" gas towards the building of this pool, and that such sales were to be "at a price" which was "not to exceed the maximum wholesale price for the natural gas for household use, as determined in the prescribed manner, less the transportation, distribution tariffs, and the special purpose increment to the natural gas tariff applicable to consumers of all forms of ownership".[182]

115. Insofar as the 2007 Budget Law did apply, its effect was that the price of Ukrnafta's gas had become a State-regulated price, and it established a principle by reference to which price was to be determined or approved. However, there were points the 2007 Budget law did not address. It did not stipulate what the State-regulated price was to be, or by whom the State-regulated price was to be determined or approved.[183] And it did not stipulate to whom the affected entities were to sell their gas – although it did contemplate that the Cabinet of Ministers would make such a stipulation, which it ultimately did in the form of Decree No 31 ("**2007 Cabinet Decree**").

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182 As is evident from reviews of cases later in this Section II.E, the 2007 Budget Law only applied to sales of 2007 gas, and then only to sales which were effected during the 2007 calendar year.

183 As set out below, the NERC would be given responsibility in this regard when, on 16 January 2007, the Cabinet of Ministers issued Decree No 31 See Law of Ukraine "On state budget for year 2007", Article 3 (extract), 19 December 2006, **Exhibit {C-340}**; See Decree No. 31 of the Cabinet of Ministers of Ukraine "On amendments to Cabinet of Ministers of Ukraine Decree No. 1729 of 27 December 2001" dated 16.01.2007, last amended on 26.03.2008, 26 March 2008, **Exhibit {C-357**}. The 2007 Budget law also did not establish the procedure by which price was to be determined or approved. Instead, it contemplated that such a procedure would be established – which, in the event, did not happen until 22 January 2009 when the NERC issued the 2009 NERC Resolution, thereby approving the 2009 NERC Gas Pricing Procedure.

116. The 2007 Cabinet Decree, issued on 16 January 2007, amended the 2001 Cabinet Decree.[184] Article 2(1) of the 2007 Cabinet Decree applied both to the same entities as the 2007 Budget Law applied to, and also to those entities' subsidiaries and joint venture counterparties. It provided that Naftogaz was authorised to build and dispose of the pool of gas for household use, and that household demand for gas was to be satisfied from sales by the affected entities of all of the gas that they produced (less gas which they needed to satisfy their own needs or intended to use in a technological process). It also provided that such sales were to be made to Naftogaz, "at the price approved by [the NERC]". The State-regulated price set by the NERC was not to "exceed the wholesale threshold price for natural gas which is utilised for the domestic consumer excluding tariffs for transportation and supply, and a specific mark-up to the applicable tariff for natural gas". Despite stating that the NERC was to set a State-regulated price, the 2007 Cabinet Decree did not make any provision concerning the procedure by which that price was to be determined or approved.[185]

117. While no relevant Ukrainian legal proceedings were initiated by Ukrnafta, Naftogaz or Ukrtransgaz in 2007, litigation arose in 2008. As set out below, Naftogaz in 2008 attempted to compel Ukrnafta to enter into a contract concerning its 2007 gas, as a result of which conduct further litigation arose.

118. However, 2007 was not entirely free of the Respondent's misconduct, notwithstanding the earlier litigation in 2006 that had sought to address the difficulties. For instance, while Ukrtransgaz had started to sign Deeds of Transfer and Acceptance in respect of the gas pumped into the UGS, it ultimately refused to sign such documents in respect of the majority of the gas. Ukrnafta raised this issue with the Respondent in late 2007. Thus, on 7 November 2007, it wrote to Naftogaz

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184 See Law of Ukraine "On state budget for year 2007", Article 3 (extract), 19 December 2006, **Exhibit {C-340}**. See Decree No. 31 of the Cabinet of Ministers of Ukraine "On amendments to Cabinet of Ministers of Ukraine Decree No. 1729 of 27 December 2001" dated 16.01.2007, last amended on 26.03.2008, 26 March 2008, **Exhibit {C-357}.**

185 Further detail is provided in respect of the 2007 Cabinet Decree in the Chronology attached as Annex 1 to this Statement of Claim.

and the Respondent's First Deputy Minister of Fuel and Energy,[186] complaining that, in breach of previous court orders from 2006, Ukrtransgaz was still not executing Deeds of Transfer and Acceptance in respect of gas pumped by Ukrnafta into the UGS. Ukrnafta added in the letter that it would conclude agreements for the sale of gas produced in May to October 2007 to Naftogaz at a price of UAH 458.51, which was its Zero Profit Price (as defined in Section V below) for the first half of 2007. While the terms of any contracts for the sale of gas by Ukrnafta to Naftogaz, and in particular the price for such a sale, were debated in 2007 both before and after Ukrnafta's letter, Ukrtransgaz persisted in its refusal to sign Deeds of Transfer and Acceptance.

119. This heralded an increase in the Respondent's efforts in 2008 to acquire Ukrnafta's gas at an undervalue, or for no value at all.

3. The Respondent's 2008 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

120. On 28 December 2007 the Verkhovna Rada passed Law No 107-IV "On the State Budget of Ukraine for 2008" ("**2008 Budget Law**").[187] As the effect of the changes to Ukrainian law brought about by the 2007 Budget Law and the 2007 Cabinet Decree had not been the subject of any dispute, the 2008 Budget Law did not depart significantly from the prescriptions in the 2007 Budget Law.

121. Insofar as the 2008 Budget Law did apply, Article 3 of the 2008 Budget Law (like Article 3 of the 2007 Budget Law) provided that the affected entities were to sell "all natural gas" directly to the entity authorised by the Cabinet of Ministers, namely, pursuant to the 2007 Cabinet Decree, Naftogaz. The 2008 Budget Law provided that these sales were to be made at a price "approved" by the NERC for each business entity (which tailored regulation was not part of the 2007 Budget Law). While the

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186 Letters No. yur-2413 and yur-2412 by Ukrnafta to the First Deputy Minister of Fuel and Energy and Naftogaz encl. Calculation of the Costs, 7 November 2007, **Exhibit {C-919}.**

187 Law of Ukraine "On state budget for year 2008", Article 3 (extract), 28 December 2007, **Exhibit {C-348}.**

2008 Budget Law did not contain the reference to a threshold price, the 2007 Cabinet Decree remained in force, including its above-quoted prescription that the price was not to "exceed the wholesale threshold price for natural gas which is utilised for the domestic consumer excluding tariffs for transportation and supply, and a specific mark-up to the applicable tariff for natural gas". However, it was still the case that the 2008 Budget Law made no provision as to how, subject to the threshold referred to in the 2007 Cabinet Decree, the State-regulated price was to be determined or approved.

122. The relative continuity provided by the 2008 Budget Law at the start of 2008 did not persist throughout the year. The Respondent's significant increase in efforts to acquire Ukrnafta's gas at an undervalue was achieved pursuant to a number of steps.

123. ***Cabinet of Ministers Instructions and Decree***. First, the Cabinet of Ministers issued two Instructions. It issued Instruction No 57-r on 9 January 2008, by which it approved a forecast balance of acquisition and distribution of gas for 2008.[188] That document in effect regulated the amount of gas that could be distributed from the GTS throughout Ukraine. On the same day the Cabinet of Ministers issued Instruction No 58-r, by which it approved a proposal by Naftogaz to purchase from Ukrnafta 3,460,000,000m^3 of 2006 and 2007 gas at a price of UAH 265 (not including VAT, tariffs for transportation, distribution and supply, the targeted mark-up or the costs of pumping and storing gas in underground facilities).[189] The Respondent's intention in relation to this second Instruction appears to have been to provide Naftogaz with a putative legal entitlement to purchase the stated volume of 2006 and 2007 gas at the stated price – albeit that intention was later thwarted by the Respondent's courts, as discussed below. In any event, before the courts' decisions on this issue, Naftogaz acted on the putative legal basis created by these two

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188 Decree No. 57-r of the Cabinet of Ministers of Ukraine "On approving the forecast balance of supply and demand of natural gas for 2008" dated 9.01.2008, last amended on 02.06.2008, 2 June 2008, **Exhibit {C-360}.**

189 Decree No. 58-r of the Cabinet of Ministers of Ukraine "On purchase of natural gas mined by OJSC Ukrnafta in 2006 – 2007", 9 January 2008, **Exhibit {C-350}.**

Instructions. As set out in more detail in the Chronology attached as Annex 1 to this Statement of Claim, Naftogaz sent to Ukrnafta draft contracts for the sale of 2006 to 2008 gas by Ukrnafta to Naftogaz at a price well below the Zero Profit Price Ukrnafta had previously stated. Naftogaz did so expressly on the basis that it was implementing the two Instructions of the Cabinet of Ministers,[190] and then sought to force through its agenda in this regard by calling a series of Extraordinary General Meetings of Ukrnafta.[191]

124. The Cabinet of Ministers also, during 2008, openly acknowledged that Naftogaz had obtained gas that had been pumped by Ukrnafta into the GTS, which Naftogaz then sold to the Ukrainian population. Thus, on 25 April 2008, the Cabinet of Ministers issued Decree No. 421, stating that Naftogaz was:

> "to ensure the registration of the natural gas volumes received in January 2007 and January-March 2008 from Open joint Stock Company 'Ukrnafta' into the gas transportation system and sold to the population …"[192]

125. ***NERC Resolutions.*** Secondly, the NERC and Naftogaz worked together in an effort to compel Ukrnafta to enter into contracts to sell its 2008 gas at a price far below its cost of production, including before the Ukrainian courts. The detail of these events is set out in the Chronology attached as Annex 1 to this Statement of Claim. The essential points are as follows.

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190 Letter No. 6/1-50-131 by Naftogaz to Ukrnafta with encl. and other documents, 17 January 2008, **Exhibit {C-943}.**

191 Letter No. 10/4-617-1707 by Naftogaz to Ukrnafta, 17 April 2008, **Exhibit {C-974};** Letter No. 6/1-677-1467 by Naftogaz to the Cabinet of Ministers concerning the settlement of contractual relations with Ukrnafta, 7 May 2008, **Exhibit {C-977};** Ukrnafta Executive Board Minutes No. 4, 5 February 2008, **Exhibit {C-952}**; Ukrnafta Executive Board Minutes No. 16 (extract), 25 April 2008, **Exhibit {C-975}**; Ukrnafta Executive Board Minutes No. 26 (extract), 11 July 2008, **Exhibit {C-990**}; Ukrnafta Executive Board Minutes No. 37 (extract), 2 October 2008, **Exhibit {C-995}**; Ukrnafta Executive Board Minutes No. 53 (extract), 19 December 2008, **Exhibit {C-1004};** Further detail is provided in respect of Naftogaz's attempts to convene an Extraordinary General Meetings of Ukrnafta in the Chronology attached as Annex 1 to this Statement of Claim.

192 Decree No. 421 by the Cabinet of Ministers of Ukraine "On certain questions of Ukrnafta activities", dated 25.04.2008, last amended on 3.12.2008, 3 December 2008, **Exhibit {C-366}**.

a) On 31 January 2008, the NERC issued Resolution No 155, by which it purported to approve a price of UAH 272.6 (excluding VAT) for Ukrnafta's 2008 gas, and to apply this price with retrospective effect from 1 January 2008.[193]

b) On 13 February 2008, Ukrnafta commenced Case No 8/137 against the NERC in the Kiev District Administrative Court, seeking the cancellation of Resolution No 155 and suspension of its force until such time as the court gave judgment.[194]

c) Not to be deterred by Ukrnafta's commencement of Case No 8/137, the NERC on 28 February 2008 issued Resolution No 315, by which it cancelled Resolution No 155 and purported to impose an even lower price of UAH 199.20 (excluding VAT) for Ukrnafta's 2008 gas, stating that this price was to apply from 1 March 2008.[195] It did so, the Ukrainian courts later held, by relying on the same information and calculation methods on which it relied when issuing Resolution No 155 (irrespective of the large difference in the prices it purported to set in each Resolution), which did not include Ukrnafta's actual costs.[196]

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193 NERC Resolution No. 155 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 31 January 2008, **Exhibit {C-351}**. The NERC stated that it was doing so "in compliance with" Article 3 of the 2008 Budget Law.

194 Case No. 8/137 Order of the District Administrative Court of Kiev, 14 February 2008, **Exhibit {C-28}.**

195 NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28 February 2008, at **Exhibit {C-353}.**

196 NERC Resolution No. 155 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 31 January 2008, **Exhibit {C-351}.**

d) On 12 March 2008 Ukrnafta amended its claim in Case No 8/137 to seek also the cancellation of NERC Resolution No 315 and suspension of its force until such time as the court gave judgment.[197]

126. The NERC would go on to lose Case No 8/137, and Resolutions No 155 and No 315 were cancelled as of the date of their issuance.[198] In the course of the courts' judgments, many aspects of the NERC's conduct was criticised.[199] The detail of this misconduct is set out in the Chronology at Annex 1, but includes, as stated by the Supreme Administrative Court: applying an incorrect procedure for determining the price of Ukrnafta's gas; setting a price below Ukrnafta's costs of production, contrary to Article 10 of the Commercial Code and Article 3 of the Law on Prices and Pricing; setting the price of Ukrnafta's gas by reference to the need to maintain a balance between that price and the price at which Naftogaz could sell to the public, which

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197 Case No. 8/137 Decision of the District Administrative Court of Kiev, 12 March 2008, **Exhibit {C-30}.**

198 Ukrnafta lost in the first instance, but won on appeal to the Kiev Administrative Court of Appeal and the Supreme Administrative Court: Case No. 8/137 Decision of the District Administrative Court of Kiev, 17 July 2008, **Exhibit {C-35}**; Case No. 22-a-31576/09 (Case 8/137) Decision of the Administrative Court of Appeal of Kiev, 13 July 2009. **Exhibit {C-41}**; Case No. K-32535/09 (Case No. 8/137) Decision of the Supreme Administrative Court of Ukraine, 9 March 2010, **Exhibit {C-42}.**

199 As if to justify in advance the courts' criticisms, the NERC had purported to extend the application of Resolution No 315, and thus the price of UAH 199.20 (excluding VAT) for Ukrnafta's gas, during the pendency of the litigation to January 2009 (by Resolution No 75 dated 29 January 2009 NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28 February 2008, **Exhibit {C-353}**; NERC Resolution No. 75 "On the extension of the NERC regulation dated 28 February 2008 N 315", 29 January 2009, **Exhibit {C-376**}, to February and March 2009 (by Resolution No 256 dated 27 February 2009 NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28 February 2008, **Exhibit {C-353}**; NERC Resolution No. 256 "On the extension of the NERC regulation dated 28 February 2008 N 315", 27 February 2009, **Exhibit {C-378}** to the period from April to December 2009 (by Resolution No 351 dated 26 March 2009 NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28 February 2008, **Exhibit {C-353};** NERC Resolution No. 256 "On the extension of the NERC regulation dated 28 February 2008 N 315", 27 February 2009. **Exhibit {C-378}** and to the entire 2010 year (by Resolution No 1489 dated 24 December 2009 (see NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28 February 2008, **Exhibit {C-353}**; NERC Resolution No. 1489 "On the extension of the NERC regulation dated 28 February 2008 No. 315", 24 December 2009, **Exhibit {C-391}**.

was not the correct consideration; going beyond its power to ratify a price proposed by Ukrnafta, and *ultra vires* purporting to set the price; and setting a price that would make it impossible for Ukrnafta to make a profit, while also not providing for payment of a subsidy to cover Ukrnafta's losses, contrary to Article 191(6) of the Commercial Code.[200]

127. ***Naftogaz contracts for 2008 gas.*** Thirdly, shortly after Ukrnafta amended its claim in Case No 8/137 to impugn both NERC Resolutions No 315 and 155, Naftogaz implemented a complementary part of the Respondent's strategy to try to force Ukrnafta to sell it gas at an undervalue. In March 2008, and purportedly on the basis of Resolutions No 315 and 155, Naftogaz sent[201] Ukrnafta draft contracts obliging Ukrnafta to supply to Naftogaz: (1) 432,011,555m^3 of 2008 gas which Ukrnafta had produced in January and February 2008 at the price of UAH 272.60 (excluding VAT); and (2) 2,183,500,000m^3 of 2008 gas which Ukrnafta had produced or would produce in the period from March to December 2008 at a price of UAH 199.20 (excluding VAT).

128. Ukrnafta refused to sign these draft contracts. Consequently, even while the validity of the NERC Resolutions No 155 and 315 was being challenged before the Ukrainian courts, Naftogaz commenced Case No 29/193 and Case No 29/195 seeking to compel Ukrnafta to enter into contracts in the terms it had proposed, and to transfer ownership of these significant volumes of gas to Naftogaz.[202] While the cases were initially stayed pending the outcome of Case No 8/137 (which, as noted further below and in the Chronology at Annex 1 of the Statement of Claim, was to declare the invalidity of the NERC Resolutions No 155 and 315 on which Naftogaz based the

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200 Case No. K-32535/09 (Case No.8/137) Decision of the Supreme Administrative Court of Ukraine, 9 March 2010, **Exhibit {C-42}.**

201 Letter No. 6/1-455-1198 by Naftogaz to Ukrnafta on natural gas delivery agreements, 20 March 2008, **Exhibit {C-969}.**

202 Case No. 29/193 Naftogaz Statement of Claim Letter No. 14/2-22, 21 April 2008, **Exhibit {C-56**}; See Case No. 29/195 - Naftogaz Statement of Claim Letter No. 14/2-23, 21 April 2008, **Exhibit {C-61}.**

prices in the contracts it wanted to compel Ukrnafta to sign),[203] Naftogaz lost Case No 29/193 and Case No 29/195 before every court in which it pursued the claims.[204]

129. ***Naftogaz contracts for 2006 gas.*** Fourthly, having already attempted unsuccessfully to compel Ukrnafta to enter into a contract to sell it 2,233,000,000m^3 of 2006 gas at a price of UAH 112.20, including VAT, Naftogaz renewed its attempts to obtain 2006 gas at an undervalue. On 20 March 2008, Naftogaz sent Ukrnafta a draft contract pursuant to which Ukrnafta would be obliged to supply it with 1,544,070,386m^3 of 2006 gas at a price of UAH 265.65, or UAH 360.18 including VAT and the cost which Ukrnafta had incurred in respect of pumping and storing the gas. Ukrnafta declined to sign the contract, and so Naftogaz again commenced litigation. On 24 April 2008, Naftogaz commenced Case No 29/194 against it in the Kiev Commercial Court, seeking orders compelling Ukrnafta to enter into a contract to sell 1,544,070,386m^3 of 2006 gas at the same prices, and to transfer that volume of gas to it from the gas which it had stored in the UGS.

130. Naftogaz contended that the effect of the 2006 Budget Law, the 2008 Budget Law, the 2001 Cabinet Decree (as amended by the 2008 Cabinet Decree) and the second Cabinet Instruction of 9 January 2008 was that Ukrnafta was obliged to sell all of its 2006 gas to Naftogaz at the price which it proposed. This claim was rejected by the courts at every level.[205] Reasons for rejection included that: the 2008 Budget Law only applied to 2008 gas, not 2006 gas; the 2006 Budget Law had applied to 2006 gas only while it was in force, that is, during the 2006 calendar year; no legislation had

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203 Case No. 29/193 Decision of the Commercial Court of Kiev, 22 May 2008, **Exhibit {C-57}.** See Case No. 29/195 Order of the Commercial Court of Kiev, 22 May 2008, **Exhibit {C-63}.**

204 Case No. 29/193 Decision of the Commercial Court of Kiev, 22 May 2008, **Exhibit {C-57};** Case No. 29/193 Decision of the Supreme Court of Ukraine, 8 April 2014, **Exhibit {C-60};** See Case No. 29/195 Order of the Commercial Court of Kiev, 22 May 2008, **Exhibit {C-63}**; See Case No. 29/195 Decision of the Commercial Court of Kiev, 14 May 2015, **Exhibit {C-66}.**

205 Case No. 29/194 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-44};** and Case No. 29/194 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, **Exhibit {C-45};** Case No. 29/194 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-46**}; Case No. 29/194 Decision of the Supreme Court of Ukraine, 12 November 2008, **Exhibit {C-47}.**

set the price of the 2006 gas; as the second Cabinet Instruction of 9 January 2008 was not a regulatory act, it only authorised Naftogaz to enter into a contract to purchase 2006 and 2007 gas, but did not oblige Ukrnafta to conclude a contract in respect of such gas; and, as a result, there was no State-regulated price for 2006 gas, such that it could be sold at a free price.

131. ***Naftogaz contracts for 2007 gas.*** Fifthly, Naftogaz also sought to force Ukrnafta to enter into a contract to sell 2007 gas at an unacceptable price. On 20 March 2008, Naftogaz sent Ukrnafta a draft contract pursuant to which Ukrnafta would be obliged to supply it with 1,566,790,908m^3 of 2007 gas at a price of UAH 265.65 excluding VAT and the cost which Ukrnafta had incurred in respect of pumping and storing the gas, or UAH 338.58 including VAT and the cost which Ukrnafta had incurred in respect of pumping and storing the gas. When Ukrnafta again refused to sign the contract, Naftogaz commenced Case No 29/192. Naftogaz's claims,[206] and the reasons of all three levels of the Respondent's courts that rejected the claims,[207] were the same as in Case No 29/194, *mutatis mutandis*.

132. ***Naftogaz's appropriation of gas.*** Sixthly, Naftogaz refused to respect the proceedings before or the consequences of the orders of the Respondent's courts in the above cases. Although the result of those cases in law were that Ukrnafta was free to sell its 2006 and 2007 gas to whomever it wished and at whatever price it could agree, Naftogaz took action that prevented Ukrnafta from doing so.

133. On 26 April 2008 there was a meeting of the Board of Naftogaz.[208] The minutes of that meeting record that Naftogaz constructed a plan that, in effect, purported to

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206 Case No. 29/192 – Naftogaz Statement of Claim Letter No. 14/2-21 encl. additional documents, 21 April 2008, **Exhibit {C-48}.**

207 Case No. 29/192 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-50};** Case No. 29/192 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, at **Exhibit {**C-**53}**; Case No. 29/192 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-54};** Case No. 29/192 Decision of the Supreme Commercial Court of Ukraine, 6 November 2008, **Exhibit {C-55}.**

208 Minutes of the Board of Directors of Naftogaz meeting No. 41, 26 April 2008, **Exhibit {C-976}.**

appropriate gas that was owned by, and had been stored in the UGS by, Ukrnafta. The Board began by noting that some of the gas produced by Ukrnafta in 2007 and not sold had been pumped into the UGS, but this was "not documented" and was to be treated as "gas of undeterminable owner". It observed that the Ukrainian population had in fact consumed particular volumes of gas during January 2007 and the first quarter of 2008, and that slightly more than 4 billion m^3 of gas that had "not been documented" had been used to meet the needs of the population in those periods. On this basis, Naftogaz's Board decided the following:

a) Naftogaz should create documents recording that gas of "undeterminable owner" had been selected from Ukrtransgaz's UGS and sold to the population in the relevant periods;

b) Naftogaz should also create documents which recorded that this gas was then transferred by Naftogaz to SC Gaz of Ukraine (its subsidiary);

c) these transactions should be recorded in Naftogaz's accounts at certain prices; and

d) the Deputy Board Director should "provide an accumulation of funds in order to pay for the natural gas after determining the owner of the gas selected" from the UGS.

134. Naftogaz acted on this remarkable series of decisions immediately.[209] On the same day as the Board meeting, 26 April 2008, Naftogaz and Ukrtransgaz executed a series

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209 See: Act No. 01/07-NGU-GVV-PSG/N-3 of Acceptance of Delivery of Gas from UGS SC Ukrtransgaz, 26 April 2008, **Exhibit {C-628};** Act No. 01/08 - NGU- GVV-PSG/N-2 of Acceptance of Delivery of Gas from UGS SC Ukrtransgaz, 26 April 2008, **Exhibit {C-629};** Act No. 01/08- NGU-GVV/N-1 of Acceptance of Delivery of Gas from SC Gaz of Ukraine, 26 April 2008, **Exhibit {C-630};** Act No. 02/08 - NGU-GVV- PSG/N 4 of Acceptance of Delivery of Gas from UGS SC Ukrtransgaz, 26 April 2008, **Exhibit {C-631};** Act No. 02/08 - NGU-GVV/N 3 of Acceptance of Delivery of Gas from UGS SC Ukrtransgaz, 26 April 2008, **Exhibit {C-632};** Act No. 03/08- NGU-GVV/N-3 of Acceptance of Delivery of Gas from SC Gaz of Ukraine, 26 April 2008, **Exhibit {C-633};** Act No. 421-41/1 of Acceptance of Delivery of Gas into Gas Transport System from SC Ukrtransgaz, 26 April 2008, **Exhibit {C-634}** ; Act No. 421-41/2 Withdrawal of Gas from UGS SC Ukrtransgaz 26 April 2008, **Exhibit {C-635};** Act No. 127(03/1) Withdrawal

of Acts of Acceptance of Delivery, each of which purported to show that Ukrtransgaz had delivered to Naftogaz gas of "undeterminable owner" for consumption by the population in January 2007 and the first quarter of 2008. Further, Naftogaz and SC Gaz of Ukraine (and, in some instances, Ukrtransgaz) executed a series of Acts of Acceptance of Delivery, each of which purported to show that in January 2007 and the first quarter of 2008 Naftogaz had transferred to SC Gaz, and SC Gaz had received for the purpose of onward sale to consumers, certain volumes of gas at stated prices.[210]

135. Although there was no doubt under the decisions of the Respondent's own courts that this gas remained Ukrnafta's, and that Ukrnafta was free to sell it to whomever it wished and at whatever price it could achieve, Naftogaz's conduct deprived Ukrnafta of that gas and of the rights to sell it. At no stage did Naftogaz tender any payment for the gas it acquired in this way.

136. ***Naftogaz's approach to contracts generally.*** Seventhly, despite all of the foregoing, Naftogaz continued to provide Ukrnafta with draft contracts that sought to obtain its gas at an undervalue, and to pressure by way of correspondence Ukrnafta and its

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and Replacement of Gas from UGS SC Ukrtransgaz, 26 April 2008, **Exhibit {C-636};** Act No. 421-41/3 Withdrawal and Replacement of Gas from UGS SC Ukrtransgaz, 26 April 2008, **Exhibit {C-637}**.

210 Additional documents of this nature and for this purpose were created on 30 November 2008 and 31 December 2008. See: Act No. 10/08 - NGU-GVV/N-2 of Acceptance of Delivery of Gas from SC Gaz of Ukraine, 30 November 2008, **Exhibit {C-652},** Act No. 11/07- NGU-GVV-PSG/N-1 of Acceptance of Delivery of Gas from UGS SC Ukrtransgaz, 30 November 2008, **Exhibit {C-653}**; Act No. 11-138 of Acceptance of Delivery of Gas in Gas Transport System from SC Ukrtransgaz, 30 November 2008, **Exhibit {C-654};** Act No. 12/08 -NGU-GVV/N-2 of Acceptance of Delivery of Gas from SC Gaz of Ukraine, 31 December 2008, **Exhibit {C-659};** Act No. 12/08- NGU-GVV-PSG/N-1 of Acceptance of Delivery of Gas from USG SC Ukrtransgaz, 31 December 2008, **Exhibit {C-660};** Act No. 12-1 of Acceptance of Delivery of Gas in Gas Transport System from SC Ukrtransgaz, 31 December 2008, **Exhibit {C-661};** Act No. 121(02) Withdrawal of Gas from UGS SC Ukrtransgaz, 30 November 2008, **Exhibit {C-655};** Act No. 141- (02) Withdrawal of Gas from UGS SC Ukrtransgaz, 31 December 2008, **Exhibit {C-662**}; Act No. 53(03/1) Withdrawal and Replacement of Gas from UGS SC Ukrtransgaz, 30 November 2008, **Exhibit {C-656}**.

joint investment partners to enter into the contracts.[211] Naftogaz maintained this pressure even though Ukrnafta had explained in clear terms to the Respondent why it would not sign the contracts – namely, that: Ukrtransgaz would not sign Deeds of Transfer and Acceptance; Naftogaz would not agree a price which would cover Ukrnafta's costs; and the NERC had set a price which was less than Ukrnafta's costs, and its Resolution was being challenged.[212]

4. The Respondent's 2009 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

137. After its flurry of activity during 2008, the Respondent continued its unlawful efforts to acquire Ukrnafta's gas at an undervalue, or for no value at all, in 2009 through the manipulation of its legal regime. At the forefront of this misconduct was the NERC.

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211 See: Letter No. 6/1-784-2385 by Naftogaz to Ukrnafta and UkrKarpatOil encl. Natural Gas supply Agreement, 29 May 2008, **Exhibit {C-986}**; Letter No. 6/1-785-2386 by Naftogaz to Ukrnafta and Momentum encl. Natural Gas supply Agreement, 29 May 2008, **Exhibit {C-985};** Letter No. 6/1-786-2387 by Naftogaz to Ukrnafta and Regal Petroleum encl. Natural Gas supply Agreement, 29 May 2008, **Exhibit {C-984};** Letter No. 6/1-787-2388 by Naftogaz to Ukrnafta and Nadra-Invest encl. Gas supply contract, 29 May 2008, **Exhibit {C-983};** Letter No. 6/1-788-2389 by Naftogaz to Ukrnafta and NDIKB Burovogo Instrumentu encl. Gas supply contract, 29 May 2008, **Exhibit {C-982};** Letter No. 6/1-789-2390 by Naftogaz to Ukrnafta and Carlton Trading Ukraine and Galls-K, 29 May 2008, **Exhibit {C-982};** Letter No. 6/1-790-2391 by Naftogaz to Ukrnafta and Nadra Ukraine encl. Gas supply contract, 29 May 2008, **Exhibit {C-980};** Letter No. 6/1-1223-3769 by Naftogaz to DP Chernigivnaftogazgeologiya, Ukrnaftogazinvest and Ukrnafta encl. Gas supply contract Naftogaz and Ukrnafta, 4 August 2008, **Exhibit {C-991};** Letter No. 6/1-2030-6419 by Naftogaz to Ukrnafta and Karpatsky Petroleum encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1010};** Letter No. 6/1-2029-6420 by Naftogaz to Ukrnafta and Momentum encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1009};** Letter No. 6/1-2028-6421 by Naftogaz to Ukrnafta and Nadra Ukraine encl. Natural Gas supply Agreement, 30 December 2008, **Exhibit {C-1008};** Letter No. 6/1-2027-6422 by Naftogaz to Ukrnafta and Joint Ukrainian-American Venture UkrKarpatOil encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1007};** Letter No. 6/1-2026-6423 by Naftogaz to Ukrnafta and Regal Petroleum Corporation encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1006};** Letter No. 6/1-2025-6424 by Naftogaz to Ukrnafta and Nadra-Invest encl. Gas supply agreement, 30 December 2008, **Exhibit {C-1005}.**

212 See: Letter No. yur-821 by Ukrnafta to the First Vice –Prime Minister of Ukraine Turchynov O.V, 3 June 2008, **Exhibit {C-987}.**

138. ***The NERC's misconduct.*** At the very end of 2008, the NERC issued Resolutions No 1534 to 1539 ("**2008 JIA NERC Resolutions**").[213] In them, the NERC purported to approve prices of gas (exclusive of VAT) produced pursuant to joint venture contracts between Ukrnafta and various third parties at levels between UAH 278 and UAH 292, stating that it did so pursuant to the 2008 Budget Law. The NERC chose these price levels notwithstanding the fact that Ukrnafta had submitted calculations and supporting materials that demonstrated that its Zero Profit Price (as defined in Section V below) was between UAH 507.35 and 1,385.80 (including VAT). It also chose the prices notwithstanding the fact that, the very next day, on 26 December 2008, the Verkhovna Rada passed Law No. 835-VI "On the State Budget of Ukraine for 2009" ("**2009 Budget Law**").[214] Article 3 of the 2009 Budget Law was in the same terms as Article 3 of the 2008 Budget Law, save that it provided that the price that was to be approved by NERC "shall assure coverage of economically reasonable production costs and a margin".

139. In order to entrench its attempt to acquire Ukrnafta's gas for a value below Ukrnafta's costs of production despite data provided by Ukrnafta and the direction of the Verkhovna Rada that any set price was to ensure Ukrnafta obtain a margin on its costs, the NERC in January 2009 formalised its approach. On 22 January 2009 the

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213 NERC Resolution No. 1534 "On approval of the price for natural gas (including oil (associated gas)) extracted under Contract on Joint Investment Activity of 14.09.95 N 410/95", 25 December 2008, **Exhibit {C-367}**; NERC Resolution No. 1535 "On approval of the price for natural gas (including oil (associated gas)) extracted under Contract on Joint Investment Activity of 24.12.97 N 999/97", 25 December 2008, **Exhibit {C-368}**; NERC Resolution No. 1536 "On approval of the price for natural gas (including oil (associated gas)) extracted under Contract on Joint Investment Activity of 20.07.2004 N 35/809-SD", 25 December 2008, **Exhibit {C-369}**; NERC Resolution No. 1537 "On approval of the price for natural gas (including oil (associated gas)) extracted under Contract on Joint Investment Activity of 21.12.2000 N 5/56", 25 December 2008, **Exhibit {C-370};** NERC Resolution No. 1538 "On approval of the price for natural gas (including oil (associated gas)) extracted under Contract on Joint Investment Activity of 24.02.2003 N 35/78", 25 December 2008, **Exhibit {C-371}**; NERC Resolution No. 1539 "On approval of the price for natural gas (including oil (associated gas)) extracted under Contract on Joint Investment Activity of 01.07.2007 N 35/71", 25 December 2008, **Exhibit {C-372**}.

214 Law of Ukraine "On State Budget for Year 2009", Article 3 (extract), 26 December 2008, **Exhibit {C-373}**.

NERC passed Resolution No 35 ("**2009 NERC Resolution**").[215] Hitherto, the Respondent had made no provision concerning the procedure by reference to which the NERC was to approve the price of Ukrnafta's gas. But by the 2009 NERC Resolution, the NERC approved a document entitled "Procedure of Natural Gas (including Oil (Associated) Gas) Prices Formation, Calculation and Approval for Gas-Producing Companies" which was attached thereto ("**2009 NERC Gas Pricing Procedure**").[216]

140. Paragraph 1.2 of the 2009 NERC Gas Pricing Procedure explained that it was a "statutory document specifying the mechanism of formation, approval and provision of unified principles and methodological bases of prices formation for natural gas". Paragraph 1.4 provided that:

> "Prices calculated pursuant to this Procedure shall provide the following to natural gas-producing companies:
>
> reimbursement of economically reasonable producing expenses for the planning period;
>
> earning the profit sufficient for fulfilment of the investment program (capital investment plan), separately for each natural gas field for the planning period;
>
> paying all the taxes, mandatory payments and budget charges pursuant to the current legislation of Ukraine."

141. The remainder of the 2009 NERC Gas Pricing Procedure defined terms, set out a pricing formula, and made detailed provision as to what is and is not to be included in each element of that formula.

142. In essence, therefore, a price calculated pursuant to the 2009 NERC Gas Pricing Procedure should have enabled Ukrnafta to recover at least its Zero Profit Price

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215 NERC Resolution No. 35 "On approval of the procedure of natural gas (including oil (associated) gas) prices formation, calculation and approval for gas-producing companies", 22 January 2009, **Exhibit {C-375}.**

216 NERC Resolution No. 35 "On approval of the procedure of natural gas (including oil (associated) gas) prices formation, calculation and approval for gas-producing companies", 22 January 2009, **Exhibit {C-375}.**

(defined in Section V below). Even on this basis, however, the 2009 NERC Gas Pricing Procedure was at odds with the 2009 Budget Law in not allowing Ukrnafta to earn a margin on its production costs, and stating the recoverable price or profit level at a level that would only cover production costs, reinvestment costs and the costs of taxes and other State charges. In any event, as discussed below, the NERC did not comply even with the more limited terms of its own 2009 NERC Resolution, and the 2009 NERC Gas Pricing Procedure was eventually held by the Ukrainian courts to have no legal effect vis-à-vis Ukrnafta.

143. In this context, Ukrnafta was forced again to resort to the Respondent's courts in order to establish what was obvious to the NERC.

144. In January 2009, Ukrnafta commenced proceedings against the NERC in the Kiev District Administrative Court seeking cancellation of the 2008 JIA NERC Resolutions. These proceedings were originally captioned Case No 2a-713/09/2670 (which is the designation used in this Statement of Claim and the Chronology attached as Annex 1) and later Case No 2a-8945/12/2670 and, in the Supreme Administrative Court, Case No K/800/5577/14. While the detail of this litigation is set out in the Chronology, the history in relation to the issuing of the 2008 JIA NERC Resolutions, the explanations given and arguments advanced by the NERC, and the reasons of the Court for rejecting those arguments,[217] were similar to those set out in Case No 8/137 concerning NERC Resolutions No 155 and 315.

145. Although there were several judgments issued in respect of this claim, the ultimate decision of the Supreme Administrative Court cancelled the 2008 JIA NERC Resolutions.[218] It held that there had been no procedure for determining the price to be paid pursuant to the 2008 Budget Law at the time of the 2008 JIA NERC Resolutions, and that the NERC had failed to comply with the foundations of the

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217 Case No. 2a-8945/12/2670 (formerly Case No. 2a-713/09/2670) Decision of the District Administrative Court of Kiev, 17 October 2013, **Exhibit {C-79}.**

218 Case No. K/800/5577/14 (formerly Case No. 2a-713/09/2670) Order of Supreme Administrative Court, 15 April 2014, **Exhibit {C-81}.**

State pricing policy.[219] As the prices set out in the 2008 JIA NERC Resolutions were lower than the prime cost of each joint investment activity and would not ensure that those ventures made sufficient profit to cover investment spending, and as the 2008 JIA NERC Resolutions did not provide for subsidies to cover those losses, they were therefore unlawful.

146. Ukrnafta also commenced a lawsuit against the NERC in relation to the 2009 NERC Gas Pricing Procedure (namely, Case No 2a-11259/11/2670). However, as that lawsuit commenced in 2011, it will be noted in Section II.E.6 below (and in the Chronology attached as Annex 1). In summary, Ukrnafta succeeded in that claim in that the 2009 NERC Gas Pricing Procedure was held to have no legal effect in relation to Ukrnafta.

147. The NERC's strategies to force Ukrnafta to sell its gas for a value below its costs of production were thus held to be unlawful under Ukrainian law by the Respondent's own courts. But the Respondent did not limit its pursuit of this strategy to the conduct pursued through the NERC.

148. ***Naftogaz's misconduct.*** In a continuation of its misconduct during 2008, Naftogaz sought to assert an entitlement to appropriate Ukrnafta's gas without its consent.

149. The origins of Naftogaz's assertion lie in Ukrnafta's transmission to Ukrtransgaz of draft Contract No 29/889-r concerning the storage of various volumes of gas.[220] Ukrtransgaz did not sign the contract or respond to Ukrnafta. In those circumstances, on 20 November 2008 Ukrnafta commenced Case No 6/489 against Ukrtransgaz in the Kiev Commercial Court, seeking an order that Ukrtransgaz enter into a contract on particular terms. As noted further below, and detailed in the Chronology at Annex 1 to this Statement of Claim, Ukrnafta won that lawsuit, and the Supreme Commercial Court validated the orders of the Kiev Appellate

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219 In particular, it had to comply with Article 10 of the Commercial Code, Article 3 of the Law on Prices and Pricing, and Article 191(6) of the Commercial Code.

220 Letter No yur-1844, 15 September 2008, **Exhibit {C-994}.**

Commercial Court as to content of the contract that Ukrtransgaz had to enter into with Ukrnafta.

150. However, even though this dispute was between Ukrnafta and Ukrtransgaz and could be resolved readily by the Respondent's courts on that basis, Naftogaz sought and was granted permission to be joined as a third party and made written submissions in the proceedings.[221] It then launched a remarkable series of claims against Ukrnafta in the context of the proceedings.

151. Naftogaz argued that the 2006 to 2009 Budget Laws, the 2001 Cabinet Decree and the Second 2008 Cabinet Instruction served as a basis for depriving Ukrnafta of its ownership of the gas without its consent. Naftogaz said that, after Ukrnafta had transferred gas produced in 2006 to 2009 into the UGS, it (Naftogaz) had received the gas and transferred it for consumer consumption. Therefore, the gas was no longer present in the UGS, and Ukrnafta's claim should be dismissed because it was seeking to compel Ukrtransgaz to enter into a storage contract in respect of non-existent gas.[222] Naftogaz also contended that, in any event, it was entitled to extract gas produced by Ukrnafta in the years 2006 to 2009 from the UGS whenever it wished to do so, making settlements at prices stipulated by the NERC at the time of extraction.

152. Unsurprisingly, the Supreme Commercial Court rejected those arguments on 8 June 2010.[223] The details of the case and the court's reasoning are set out in the Chronology at Annex 1. However, the obvious point was that Ukrnafta at no point alienated its property – that is, the gas that it had stored in the UGS. While Naftogaz sought to avoid this fundamental point in a variety of ways, the essential problem with its claims was that it had no basis in law for depriving Ukrnafta of its ownership of the gas. None of the instruments noted above that Naftogaz invoked as a basis for

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221 Case No. 6/489 Naftogaz Application No. 14/2-1291 to Enter the Proceedings, dated 13 July 2009, **Exhibit {C-87}**; Case No. 6/489 Naftogaz Explanatory Note - Letter No. 14/2-1362, dated 22 July 2009, **Exhibit {C-88}.**

222 See also Naftogaz's letter dated 16 October 2009 to the Kiev Commercial Court. Letter No. 14/2-1954 from Naftogaz to the Commercial Court, dated 16 October 2009, **Exhibit {C-1041}.**

223 Case No. 32/296 Decision of the Commercial Court of Kiev, 8 June 2010, **Exhibit {C-98}.**

taking Ukrnafta's gas without its consent in fact provided any such right of requisition on the part of Naftogaz, particularly when uncompensated.

153. This behaviour in Case No 6/489 was typical of Naftogaz's conduct at the time in relation to Ukrnafta. Two examples highlight Naftogaz's approach to the situation.

154. First, Naftogaz maintained its correspondence stream pressuring Ukrnafta to enter into contracts to sell 2008 gas to it at an undervalue and proposing contracts for the sale of 2008 gas or 2009 gas also at an undervalue.[224] It did so even though Ukrnafta explained that there was no basis on which Naftogaz could purchase the gas at that price, not least because it was below the cost of production.[225]

155. Secondly, Naftogaz acted in furtherance of the scheme conceived by its Board on 26 April 2008. Thus, on 16 March 2009, Naftogaz resolved to prepare Acts of Acceptance and Delivery that were backdated to 20, 26 and 28 February 2009. Naftogaz thus purported to record that up to 190,000,000m^3 of February 2009 gas had been produced by an "undeterminable owner" and had been received into the UGS by Ukrtransgaz and that, pursuant to, *inter alia*, the 2009 Budget Law, that gas was to be transferred directly to Naftogaz for supply to consumers. The Board then went on to decide that:[226]

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224 See Letter No. 6/1-242-868 by Naftogaz to Ukrnafta and Kashtan Petroleum encl. Gas supply Agreement, 23 February.2009, **Exhibit {C-1021}**; Letter No. 6/1-243-869 by Naftogaz to Ukrnafta, 23 February 2009, **Exhibit {C-1022}**. This correspondence relates to that noted above: Letter No. 6/1-2030-6419 by Naftogaz to Ukrnafta and Karpatsky Petroleum encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1010}**; Letter No. 6/1-2029-6420 by Naftogaz to Ukrnafta and Momentum encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1009}**; Letter No. 6/1-2028-6421 by Naftogaz to Ukrnafta and Nadra Ukraine encl. Natural Gas supply Agreement, 30 December 2008, **Exhibit {C-1008}**; Letter No. 6/1-2027-6422 by Naftogaz to Ukrnafta and Joint Ukrainian-American Venture UkrKarpatOil encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1007**}; Letter No. 6/1-2026-6423 by Naftogaz to Ukrnafta and Regal Petroleum Corporation encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1006}**; Letter No. 6/1-2026-6423 by Naftogaz to Ukrnafta and Regal Petroleum Corporation encl. Gas supply Agreement, 30 December 2008, **Exhibit {C-1005}.**

225 See Letter No. yur-139 by Ukrnafta to Naftogaz, 28 January 2009, **Exhibit {C-1015}.**

226 Minutes of the Board of Directors of Naftogaz meeting No. 37, 16 March 2009, **Exhibit {C-1025}**.

a) Naftogaz should prepare Acts of Acceptance of Delivery for execution by Naftogaz and Ukrtransgaz recording that in February 2009 Ukrtransgaz had delivered to Naftogaz up to 190,000,000m^3 of gas from the UGS for consumption by the population;

b) Naftogaz should prepare Acts of Acceptance of Delivery for execution by Naftogaz and SC Gaz that recorded that in February 2009 Naftogaz had transferred up to this volume of gas to SC Gaz, and SC Gaz had received it; and

c) a Member of the Board of Naftogaz should "identify the owner" of the gas and "conduct negotiations" with it.

156. This conduct was highly disingenuous. Naftogaz well knew that the gas in question was Ukrnafta's, and that its scheme for preparing Acts of Acceptance of Delivery in relation to gas that was of "undeterminable owner" was merely a ruse by which it could acquire Ukrnafta's gas without the latter's consent and without having to pay for it. This was perhaps an inevitable strategy on the part of Naftogaz, given that it had repeatedly stated in 2009 that it had already used Ukrnafta's 2006-2009 gas that had been stored in the UGS, even though it had not paid for that gas.[227]

5. <u>The Respondent's 2010 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all</u>

157. The Respondent's efforts to acquire Ukrnafta's gas at an undervalue, or for no value at all, continued into 2010.

158. The year began inauspiciously for the Respondent in this regard. On 27 April 2010, the Verkhovna Rada duly passed Law No. 2154-VI "On the State Budget of Ukraine

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227 Case No. 6/489 Naftogaz Explanatory Note - Letter No. 14/2-1362,22 July 2009, **Exhibit {C-88}**; Letter No. 14/2-1954 from Naftogaz to the Commercial Court, 16 October 2009, **Exhibit {C-1041**}.

for 2010" ("**2010 Budget Law**"),[228] Article 3 of which was relevantly in the same terms as Article 3 of the 2009 Budget Law.[229] Thereafter, in early 2010, the Respondent's highest courts issued three judgments adverse to the Respondent's strategy.

a) The first was the decision of the Supreme Commercial Court in Case No 6/489, discussed above.[230] The Court squarely defined the issue as whether Ukrnafta had been deprived of its ownership of gas in circumstances in which the law provided that it could be and, if it had been, whether this had taken place in accordance with the procedure specified by that law. On this central issue, and alongside other findings on related points,[231] the Court concluded that the 2006 to 2009 Budget Laws provided no right to any person unilaterally to undertake actions aimed at depriving Ukrnafta of its ownership of the gas. As a result of this and other findings, the Court held that if gas produced in a particular year is not sold in that year, Ukrnafta had the right to sell it in subsequent years "freely without restriction". Ukrtransgaz was thus ordered to enter into a gas storage contract with Ukrnafta (which it ultimately refused to do).

b) The second was the decision of the Supreme Administrative Court in Case No 8/137, also discussed above.[232] The Court confirmed, *inter alia*: that the

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228 Law of Ukraine No. 2154-VI "On State Budget for Year 2010", Articles 58 and 59 (extract), 27 April 2010, **Exhibit {C-400}**.

229 Further notably, Article 58 of the 2010 Budget law amended Article 30 of the Law on Joint Stock Companies so that the Executive Board of a joint stock company has the right independently to adopt a decision concerning the paying out of dividends in an amount not exceeding 30% of the net profit for the year in question (whereas a decision to pay out more than 30% can only be made by the General Meeting). Article 58 also required Ukrnafta to pay to the Respondent's State budget by 1 July 2010 the dividends which are due to Naftogaz for 2009. The 2010 Budget Law came into effect on 30 April 2010. See Law of Ukraine No. 2154-VI "On State Budget for Year 2010", Articles 58 and 59 (extract), 27 April 2010, **Exhibit {C-400}**.

230 Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}.**

231 These are set out in detail in the Chronology attached as Annex 1 to this Statement of Claim.

232 Case No. K-32535/09 (Case No. 8/137) Decision of the Supreme Administrative Court of Ukraine, 9 March 2010, **Exhibit {C-42}**.

relevant legislation only gave the NERC the power to ratify prices, not to correct prices or to set them of its own initiative; that the NERC failed to comply with Article 10 of the Commercial Code and Article 3 of the Law on Prices and Pricing when setting prices below Ukrnafta's costs of production (in other words, at an undervalue); and that it breached Article 191(6) of the Commercial Code by setting a price that made it impossible for Ukrnafta to make a profit (in the absence of any payment of a subsidy to cover Ukrnafta's losses). For these and other reasons,[233] the Court confirmed that NERC Resolutions No 155 and 315 were invalid from the time of their adoption.

c) The third was the decision of the Constitutional Court in Case No 13-rp/2010 on 11 May 2010.[234] In response to a challenge to the constitutionality of various provisions of the 2009 Budget Law, the Court held *inter alia* that it only has jurisdiction to consider the constitutionality of laws which were in force, that a Budget Law is only in force from 1 January to 31 December of the relevant year (and that the 2009 Budget Law therefore ceased to be in force on 31 December 2009).[235]

159. The Respondent's reaction to its latest failures to acquire Ukrnafta's gas at an undervalue, or for no value at all, was swift and multifaceted.

160. ***The Respondent altered its laws.*** First, the Respondent simply altered its law in an attempt to circumvent its courts' judgments. On 8 July 2010 the Verkhovna Rada passed Law No 2467-VI "On Principles of Natural Gas Market Operation" ("**July 2010 Gas Market Law**"), which came into effect on 24 July 2010.[236]

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233 These are set out in detail in the Chronology attached as Annex 1 to this Statement of Claim.

234 Summary to the Decision of the Constitutional Court of Ukraine No. 13-rp/2010 (obtained from official website on 24.03.2016), 11 May2010, **Exhibit {C-96 Original}**.

235 See further detail in the Chronology attached as Annex 1 to this Statement of Claim.

236 Law of Ukraine No. 2467-VI "On Principles of Natural Gas Market Operation", 8 July 2010, **Exhibit {C-409}.**

161. The July 2010 Gas Market Law effected a significant change in the law. That is because, whereas previous legislation had provided that the affected entities were to sell all of their gas to the authorised entity (Naftogaz) at a price to be approved or ratified by the NERC, Article 10(1) of the July 2010 Gas Market Law provided that they were to do so at a price to be "established" by the NERC for each entity on an annual basis and "according to the Procedure approved by [NERC] for establishment and calculation of natural gas prices for gas mining companies".[237] Further, the July 2010 Gas Market Law was not limited in time as the previous Budget Laws were – once it came into effect on 24 July 2010, it remained in effect until it was repealed in 2015. The Respondent thus sought to circumvent the need to promulgate a Budget Law each new calendar year.[238]

162. The timing of the July 2010 Gas Market Law was no coincidence. It was passed only a few months or weeks after: the Supreme Administrative Court in Case No 8/137 confirmed that the applicable legislation only gave the NERC the power to ratify, rather than correct or set, prices;[239] and the Constitutional Court in Case No 13-rp/2010 held that a Budget Law for a particular calendar year is no longer valid after the end of that year.[240]

163. Unsurprisingly in this context, the NERC moved immediately to entrench this new subversion of the existing law. Within three days of the July 2010 Gas Market Law coming into effect, the NERC passed Resolution No 889 on 27 July 2010 ("**July 2010**

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237 Law of Ukraine No. 2467-VI "On Principles of Natural Gas Market Operation", 8 July 2010, **Exhibit {C-409}.**

238 Indeed, the Respondent apparently hoped that the July 2010 Gas Market Law would have retrospective effect and hence apply to gas produced before it came into effect on 24 July 2010. However, as explained below, its own courts emphatically rejected that argument, and the July 2010 Gas Market Law thus only applied to gas produced after 24 July 2010.

239 Case No. K-32535/09 (Case No. 8/137) Decision of the Supreme Administrative Court of Ukraine, 9 March 2010, **Exhibit {C-42**}.

240 Summary to the Decision of the Constitutional Court of Ukraine No. 13-rp/2010 (obtained from official website on 24.03.2016), 11 May 2010, **Exhibit {C-96 Original}.**

NERC Resolution").[241] By this Resolution, the NERC purported to set a price of UAH 458 for Ukrnafta's gas with effect from 1 August 2010, stating that it was doing so pursuant to the July 2010 Gas Market Law and the 2009 NERC Gas Pricing Procedure. It set this price even though Ukrnafta provided the NERC with information and documents which show that its Zero Profit Price (as defined in Section V below) was UAH 815.08.[242] While the July 2010 NERC Resolution would ultimately be challenged by Ukrnafta in Case No 2a-899/11/2670, re-designated as Case No 2a-10541/12/2670 upon resubmission, and deemed invalid from the time of its adoption by the courts,[243] the attempt by the Respondent to reverse the effect of the clear decisions of its own courts by simply changing the law in force could hardly be more blatant.[244]

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241 NERC Resolution No. 889 "On approval of the price for commercial natural gas for OJSC Ukrnafta", 27 July2010, **Exhibit {C-413}.**

242 Letter No. 6pg-12/363 by Ukrnafta to Ukrtransgaz 16.07.2010 re gas delivery 06/2010, 16 July 2010, **Exhibit {C-703}.**

243 Regarding Case No 2a-899/11/2670, see Case No. 2a-899/11/2670 Decision of the Administrative Court of Kiev, 26 December 2011, **Exhibit {C-116}**; Case No. 2a-899/11/2670 Decision of the Administrative Court of Appeal of Kiev, 17 May2012, **Exhibit {C-117}**; Case No. K-34110/12 (Case No. 2a-899/11/2670) Order of the Supreme Administrative Court, 12 July 2012, **Exhibit {C-11}8**. Regarding Case No 2a-10541/12/2670, see Case No. 2a-10541/12/2670 Order of the Administrative Court of Kiev, 14 April 2014, **Exhibit {C-212}**; Case No. 2a-10541/12/2670 Decision of the Administrative Court of Appeal of Kiev, 22 July2014, **Exhibit {C-214}**; Case No. K/800/445320003/14 (2a-10541/12/2670) Decision of the Supreme Administrative Court, 15 August 2014, **Exhibit {C-215}**; Case No. K/800/45003/14 (2a-10541/12/2670) Decision of the Supreme Administrative Court, 22 August 2014, **Exhibit {C-216}**.

244 Notably, the NERC adopted a similarly restrictive approach to pricing in respect of joint investment activities. On 23 December 2010, NERC issued Resolutions No 1949 to 1952, which purported to approve prices of gas (exclusive of VAT) produced pursuant to joint investment activities at levels between UAH 394 and UAH 928 (excluding VAT) with effect from 1 January 2011, and to repeal the corresponding 2008 JIA NERC Resolutions. See Resolutions No 1949 to 1952: NERC Resolution No. 1949 "On approval of the price for commercial natural gas extracted under Contract on Joint Investment Activity of 14 September 1995 N 410/95", 23 December 2010, **Exhibit {C-423}**; 24 December 1997 N 999/97, **Exhibit {C-424}**; 20 July 2004 N 35/809-SD", **Exhibit {C-425}**; and 21 December 2000 N 5/56", **Exhibit {C-426} (**collectively, the "**December 2010 JIA NERC Resolutions**). Ukrnafta sought the cancellation of the **December 2010 JIA NERC Resolutions** in **Case No. 2a-8944/11/2670**, re-designated on submission for reconsideration as **Case No. 2a-15313/12/2670**. Ukrnafta ultimately succeeded in that case and the **December 2010 JIA NERC Resolutions** were declared invalid: Case No. 2a-8944/11/2670 Decision of the Kiev District Administrative

164. ***Naftogaz and Ukrtransgaz prevent Ukrnafta from extracting and selling 2009 gas.*** Secondly, Naftogaz and Ukrtransgaz openly frustrated Ukrnafta's desire to sell 2009 gas to industrial consumers during 2010.

165. On 11 March 2010, Ukrnafta entered into gas storage Contract No 110-99 with Ukrtransgaz for the storage of gas until 15 April 2010.[245] Pursuant to this contract, Ukrnafta transferred a total of 1,191,335,010m^3 to the UGS, of which 1,050,859,004m^3 was 2009 gas and the remaining 140,476,006m^3 was 2010 gas. Upon the expiry of that contract, Ukrnafta and Ukrtransgaz entered into gas storage Contract No 29/573-r.[246] Pursuant to this contract, Ukrtransgaz was obliged to store the gas until 15 April 2011 and, if Ukrnafta requested to extract the gas during that period, to comply with that request.

166. On 22 April 2010, Ukrnafta requested, pursuant to Contract No 29/573-r, that Ukrtransgaz extract the 1,050,859,004m^3 of 2009 gas from the UGS (in instalments), transfer this to Ukrnafta for onward supply to industrial consumers, and provide executed statements of transfer and acceptance.[247] On 6 May 2010, Ukrtransgaz informed Ukrnafta that it would not comply with its request because (it contended) the effect of the 2009 Budget Law, the 2010 Budget Law and the 2001 Cabinet Decree was that Ukrnafta was obliged to sell this 1,050,859,004m^3 of 2009 gas to Naftogaz for

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Court, 17 November 2011, **Exhibit {C-179}**; Case No. 2a-8944/11/2670 Decision of the Kiev Administrative Court of Appeal, 17 May 2012, **Exhibit {C-180}**; Case No. K-9991-34109-12 Decision of Supreme Administrative Court, 18 October 2012, **Exhibit {C-1636}**; Case No. 2a-15313/12/2670 Decision of Kiev District Administrative Court, 18 March 2013, **Exhibit {C-1660}**; Case No. 2a-15313/12/2670 Decision of Kiev Administrative Court of Appeal, 31 October 2013, **Exhibit {C-1685}**; Case No. K/800/59619/13 Decision of the Supreme Administrative Court, 17 April 2014, **Exhibit {C-1703}**; Case No. 2a-15313/12/2670 Decision of Kyiv District Administrative Court, 2 July 2014, **Exhibit {C-1710}**; Case No. 2a-15313/12/2670 Decision of Kyiv Administrative Court of Appeal, 20 November 2014, **Exhibit {C-1721}**; Case No. K/800/65643/14 Decision of Supreme Administrative Court, 26 May 2015, **Exhibit {C-1737**}.

245 Agreement No. 110-99 for storage of natural gas between Ukrtransgaz and Ukrnafta, 11 March2010, **Exhibit {C-1078}**.

246 Agreement No. 29/573-G for storage of natural gas between Ukrtransgaz and Ukrnafta, 15 April 2010, **Exhibit {C-1092}**.

247 Letter No. 6PG-12/194a from Ukrnafta to Ukrtransgaz for natural gas withdrawal from UGS, 22 April 2010, **Exhibit {C-1085**}.

onward supply to the population, and was therefore not permitted to sell it to industrial consumers.[248] In response to an enquiry by Ukrtransgaz,[249] Naftogaz instructed Ukrtransgaz that the volume of Ukrnafta's gas was not to be included in the balance of Ukrnafta's gas held in storage because Ukrnafta was obliged to supply it to Naftogaz.[250]

167. This arrangement of course involved an appropriation of Ukrnafta's gas and a disregard for the contracts Ukrnafta and Ukrtransgaz had signed only a couple of months earlier. As a result, in late May 2010, Ukrnafta commenced Case No 32/296 in the Kiev Commercial Court against Ukrtransgaz and Naftogaz. Ukrnafta sought an order that Ukrtransgaz and Naftogaz not obstruct its exercise of its ownership rights in relation to this gas, an order compelling Ukrtransgaz to comply with its contractual obligations in relation to the gas, and an order compelling Naftogaz to include the gas in the balance.

168. Further detail of Case No 32/296 is set out in the Chronology at Annex 1 to this Statement of Claim. In summary, Ukrtransgaz and Naftogaz lost at every stage of the litigation.[251] As the 2009 Budget Law only applied to sales of 2009 gas effected in 2009, and as the July 2010 Gas Market Law (that came into effect midway through the litigation) did not have retroactive effect, Ukrnafta had the right to dispose of its 2009 gas from 1 January 2010 freely and without limitation, including to industrial consumers.

169. ***Naftogaz and Ukrtransgaz prevent Ukrnafta from extracting and selling 2009 and 2010 gas.*** Thirdly, Ukrtransgaz and Naftogaz repeated their conduct regarding the

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248 Letter No. 5197/6-004 from Ukrtransgaz to Ukrnafta, 6 May 2010, **Exhibit {C-1089}**.

249 Letter No. 6009/6-004 from Ukrtransgaz to Naftogaz on collection of gas by Ukrnafta, 18 May 2010, **Exhibit {C-1091}**.

250 Letter No. 6/1-741-3215 from Naftogaz to Ukrtransgaz, 27 May 2010, **Exhibit {C-103}**.

251 Case No. 32/296 Decision of the Commercial Court of Kiev, 8 June 2010, **Exhibit {C-98**}; Case No. 32/296 Decision of the Supreme Court of Ukraine, 20 September 2010, **Exhibit {C-99}**. Note that the appeal by Ukrtransgaz and Naftogaz was directly from the Commercial Court of Kiev to the Supreme Commercial Court of Ukraine, which was permitted under the applicable law in force at the time.

frustration of Ukrnafta's desire to extract its gas from the UGS in relation to separate volumes of gas from those described above. They did so even though they had already lost Case No 32/296 by the time the litigation in relation to these additional volumes of gas began.

170. As noted above, pursuant to Contract No 110-99 between Ukrnafta and Ukrtransgaz,[252] Ukrnafta pumped a total of 1,191,335,010m^3 of gas into the UGS, consisting of 1,050,859,004m^3 of 2009 gas, and 140,476,006m^3 of January 2010 gas. When this contract expired on 15 April 2010, the parties entered into Contract No 29/573-r, pursuant to which Ukrtransgaz was obliged to store the gas until 15 April 2011 and, if Ukrnafta requested the extraction of the gas during that period, to comply with that request. Having won at all levels in Case No 32/296, on 25 September 2010, Ukrnafta requested that Ukrtransgaz extract approximately 156,000,000m^3 of gas, including the 140,476,006m^3 of January 2010 gas,[253] which Ukrtransgaz refused to do.

171. Again, Ukrnafta was required to commence litigation in respect of this appropriation of its gas, and again Ukrtransgaz and Naftogaz failed in that litigation at all levels. Thus Ukrnafta commenced Case No 46/480 on 18 October 2010, in which Ukrtransgaz was ultimately ordered not to prevent Ukrnafta from exercising its ownership rights in respect of the 140,476,006m^3 of January 2010 gas and to perform Ukrnafta's request, while Naftogaz was ordered to include this volume in the balance.[254]

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252 Agreement No. 110-99 for storage of natural gas between Ukrtransgaz and Ukrnafta, 11 March 2010, **Exhibit {C-1078}**.

253 See Letter No 6PG-12/501 from Ukrnafta to Ukrtransgaz, 25 September 2010, **Exhibit {C-1925}**; Letter No 6PG-7/500 from Ukrnafta to Naftogaz, 25 September 2010, **Exhibit {C-1926}.**

254 Case No. 46/480 Decision of the Commercial Court of Kiev, 18 October 2010, **Exhibit {C-100}**; Case No. 46/480 Decision of the Commercial Court of Appeal of Kiev, 9 November 2010, **Exhibit {C-101}**; Case No. 46/480 Decision of the Supreme Commercial Court of Ukraine, 9 November 2010, **Exhibit {C-101}**. Ukrnafta's claim in relation to the remaining gas failed, but only because it had not been stored pursuant to the particular contract which was the subject of this particular set of proceedings (Contract No 29/573-G).

172. ***Naftogaz and Ukrtransgaz prevent Ukrnafta from extracting and selling 2007-2009 gas.*** Fourthly, Ukrtransgaz and Naftogaz repeated their intransigence regarding the extraction of gas by Ukrnafta yet another time in 2010. This conduct culminated in Ukrnafta starting Case No 42/392. That case was concerned with a request by Ukrnafta to Ukrtransgaz on 25 October 2010 to extract from storage 157,538,509m^3 of gas, which was part of a total volume of 174,034,461m^3 of gas which had been pumped into storage in 2007 to 2009, so that Ukrnafta could sell it to manufacturers of nitrogen-based chemical fertilisers. Ukrtransgaz refused, and Ukrnafta initiated litigation. Ukrnafta's claims against Ukrtransgaz and Naftogaz were upheld at all levels by the Respondent's courts,[255] again on the basis that neither the 2010 Budget Law nor the July 2010 Gas Market Law had any application to such gas.

173. ***Naftogaz pressures Ukrnafta to contract to provide gas to it at an undervalue.*** Fifthly, despite all of the foregoing, Naftogaz continued to provide Ukrnafta with draft contracts that sought to obtain its gas at an undervalue, and to pressure Ukrnafta to enter into the contracts.[256] Naftogaz maintained this pressure even though it was well aware of the costs of production Ukrnafta was incurring in 2010.

174. These instances of the Respondent seeking to acquire Ukrnafta's gas at an undervalue, or for no value at all, prompted Naftogaz to seek instructions from the Cabinet of Ministers.[257] Thus, on 9 December 2010, Naftogaz:

a) asserted that, pursuant to the July 2010 Gas Market Law and the 2001 Cabinet Decree, all of the gas that Ukrnafta produced in 2010 and passed into the UGS and all of the gas that it was projected to produce in 2011 (including, in each

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255 Case No. 42/392 Decision of the Commercial Court of Kiev, 26 November 2010, **Exhibit {C-103}**; Case No. 42/392 Decision of the Supreme Commercial Court of Ukraine, 31 January 2011, **Exhibit {C-105}**.

256 See: Letter No. 6/1-766-3331 by Naftogaz to Ukrnafta encl. Natural Gas supply Agreement, 3 June 2010, **Exhibit {C-1097}**.

257 Letter No. 6-5065/1/KM-10 from Naftogaz to the Cabinet of Ministers, 9 December 2010, **Exhibit {C-1142}.**

case, gas produced pursuant to joint venture agreements) was to be used for consumer consumption;

b) noted that, despite being subject to these laws and despite the fact that the price of its gas had been set by the July 2010 NERC Resolution, Ukrnafta had refused to enter into agreements with Naftogaz concerning its 2010 and 2011 gas;

c) stated that, if it could not use Ukrnafta's gas to satisfy the needs of the population, it would be "forced" to use imported gas, in which case Naftogaz and the State would suffer "substantial losses";

d) noted that it did not have the documents which were required pursuant to Act No 2289-VI of 1 June 2010 "About State purchase implementation" to enable it to obtain the necessary consent of an authorised body either to participate in a gas purchase tender or to lodge a claim in the Ukrainian courts to seek to compel Ukrnafta to enter into contracts;

e) noted the decisions of the Respondent's courts in Case No 46/480 which ordered Ukrtransgaz not to prevent Ukrnafta from exercising its ownership rights in respect of the 140,476,006m^3 of January 2010 gas and to perform Ukrnafta's request, and ordered Naftogaz to include this volume in the balance; and

f) concluded that, "[t]aking into account the above, we request to ensure the decision is made concerning making the natural gas sale-purchase agreements between [Naftogaz] and [Ukrnafta]".

175. The content of this letter was revealing as to the motives Naftogaz had pursued in its dealings with Ukrnafta. They were directed squarely at seeking to force Ukrnafta to direct its gas towards consumer consumption at the behest of the Respondent. The letter is also revealing as to the level of coordination within the Respondent to achieve its overarching objective of procuring from Ukrnafta below-value gas. Naftogaz, Ukrtransgaz, the Cabinet of Ministers and the NERC are all participants in

the description given by Naftogaz as to how the Respondent had sought to achieve that objective.

6. The Respondent's 2011 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

176. The Respondent's efforts to achieve its objective of acquiring Ukrnafta's gas below or for no value continued in 2011.

177. ***The NERC moves to establish gas prices.*** The first movement in 2011 towards this goal was undertaken by the NERC. As explained above, on 22 January 2009, the NERC had passed the 2009 NERC Resolution, which approved the 2009 NERC Gas Pricing Procedure. On 10 February 2011, the NERC passed Resolution No 222 ("**2011 NERC Resolution**"),[258] which made a series of amendments to the 2009 NERC Gas Pricing Procedure. Of foremost relevance among those was how the 2011 NERC Resolution, after referring to the July 2010 Gas Market Law, provide that the NERC will be establishing prices, not merely approving them.

178. While the 2009 NERC Gas Pricing Procedure (as amended) would ultimately be declared to have no legal effect vis-à-vis Ukrnafta in Case No 2a-11259/11/2670, as discussed below, the intention of the NERC in making these amendments was clear. In light of the July 2010 Gas Market Law, and in a further step to circumvent the findings of the Respondent's own courts in Case No 8/137, the NERC was enshrining in its Gas Pricing Procedure a basis on which it could set, rather than simply ratify, prices for the sale of gas.

179. ***Naftogaz continues its scheme to acquire Ukrnafta's gas for no value.*** The strategy of the Respondent to acquire Ukrnafta's gas below or for no value, and in direct contravention of its courts' decisions on the issue, continued in the form of Naftogaz seeking to justify its appropriation of Ukrnafta's gas in 2011. On 20 April 2011, Naftogaz held a Board meeting that furthered this strategy, following on from the

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258 NERC Resolution No. 222 "On introduction of changes to the procedure of Natural gas (including oil (associated) gas) prices formation, calculation and approval for gas-producing companies", 10 February 2011, **Exhibit {C-433}.**

scheme devised at the Board meeting on 26 April 2008, discussed above. The minutes of the meeting on 20 April 2011 record the following.[259]

a) In February and March 2011, the Ukrainian population had consumed 5.329 billion m^3 of gas. But Naftogaz had only 3.159 billion m^3 of its own gas to supply for that period. It followed that the population had consumed 2.170 billion m^3 more gas in the period than Naftogaz owned.

b) However, as of 1 February 2011 there was in the UGS some 1.745 billion m^3 of gas produced by Ukrnafta in 2010, together with 0.596 billion m^3 of gas produced by Ukrnafta pursuant to joint ventures in 2008 to 2010 and January 2011 (a total of 2.341 billion m^3).

c) Based on Naftogaz's interpretation of Ukrainian law, all of that 2.341 billion m^3 of gas was to be used to satisfy the needs of the population. Accordingly, 2.170 billion m^3 of the 2.341 billion m^3 was to be treated as having been consumed by the population in February and March 2011. That 2.170 billion m^3 was to be treated as being made up of the 1.745 billion m^3 of Ukrnafta's 2010 gas and 0.425 billion m^3 out of the 0.596 billion m^3 of gas produced by Ukrnafta pursuant to joint ventures.

d) The 1.745 billion m^3 of Ukrnafta's 2010 gas was to be treated as having been acquired by Naftogaz at the price of UAH 458 (excluding VAT) stipulated in the July 2010 NERC Resolution. The gas produced pursuant to the joint ventures was to be treated as having been acquired at the prices stipulated in one of the 2008 JIA NERC Resolutions and the December 2010 NERC Resolutions.

e) It was decided that Naftogaz should prepare Acts of Acceptance of Delivery which recorded the receipt of this gas from Ukrnafta and the parties to the joint ventures, and send these to Ukrnafta.

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259 Minutes of the Board of Directors of Naftogaz meeting No. 77, 20 April 2011, **Exhibit {C-1183}.**

f) It was also decided that Naftogaz should prepare Acts which recorded the selection of the gas from the UGS.

180. Naftogaz also took actions consistent with the above position. In March 2011, Naftogaz commenced: Case No 31/101 against Ukrnafta in the Kiev Commercial Court, seeking an order compelling Ukrnafta to conclude a contract with it for the sale of 2010 gas at the price set by the July 2010 NERC Resolution (i.e. UAH 458);[260] and Case No 8/88 against Ukrnafta in the Kiev Commercial Court, seeking an order compelling Ukrnafta to conclude a contract with it for the sale of 2010 gas at the same price.[261] The details of these pieces of litigation are set out in the Chronology at Annex 1 to this Statement of Claim, although they were ultimately stayed by the Kiev Commercial Court on 24 January 2012 and 9 February 2012, respectively, pending the decision in Case No 2a-899/11/2670 (and remain stayed to this date).

181. However, Naftogaz was not content to pursue its attempt to appropriate the 2010 gas solely through litigation against Ukrnafta. In the month after starting Case No 31/101 and Case No 8/88, on 27 April 2011, Naftogaz wrote to Ukrnafta setting out the figures referred to in the minutes of the Board meeting on 20 April 2011, and noting that the 1.745 billion m^3 of Ukrnafta's own 2010 gas in the UGS consisted of 0.395 billion m^3 of January to March 2010 gas and 1.350 billion m^3 of April to December 2010 gas.[262] It asserted that the effect of the July 2010 Gas Market Law and the 2001 Cabinet Decree was that Ukrnafta was obliged to sell its gas to Naftogaz at the price set by the NERC, and that in February and March 2011 the Ukrainian population had consumed the 2.170 billion m^3 of Ukrnafta's gas, which pursuant to the July 2010 NERC Resolution was priced at UAH 458 (excluding VAT).[263] Naftogaz then attached Acts of Acceptance of Delivery in respect of the gas, and requested that

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260 Case No. 31/101 Naftogaz Explanatory Note Letter No. 14/2-530, 11 May 2011, **Exhibit {C-164}.**

261 Case 31/101 Naftogaz Statement of Claim Letter No. 14/2-15, 12 March 2011, **Exhibit {C-162}**.

262 Letter No. 6-2660/1.2-11 from Naftogaz to Ukrnafta with encl. Act of Acceptance of Delivery of Natural gas, 27 April 2011, **Exhibit {C-1186**}.

263 Letter No. 6-2660/1.2-11 from Naftogaz to Ukrnafta with encl. Act of Acceptance of Delivery of Natural gas, 27 April 2011, **Exhibit {C-1186}.**

Ukrnafta sign draft contracts that had previously been sent to it on 8 February 2011.[264] Ukrnafta replied to Naftogaz that: no contracts for the sale of 2010 and 2011 gas had been entered into; that the price offered by Naftogaz for 2010 gas would not allow Ukrnafta to recover its costs; that no price was set by the NERC for 2011 and that, in those circumstances, there are no legal grounds to sign the Deeds of Transfer and Acceptance.[265] This exchange followed similar earlier attempts by Naftogaz to procure Ukrnafta's entry into contracts for the sale of 2010 gas at prices that Ukrnafta explained were not economically justified and would not allow Ukrnafta to recover its costs.[266]

182. The attempt by Naftogaz to justify its appropriation of 2010 gas produced prior to 24 July 2010 by reference to the effect of the July 2010 Gas Market Law was, of course, directly contrary to the decisions of the Ukrainian courts in Case No 32/296 and Case No 46/480, in which it had been held that the July 2010 Gas Market Law did not enter into force until 24 July 2010 and could not affect the position in relation to gas produced prior to that date.

183. This did not, however, deter Naftogaz from seeking to pursue its agenda of acquiring Ukrnafta's gas below or for no value. Indeed, over the course of March to June 2011, significant items of correspondence flowed between Ukrnafta and Naftogaz in relation to the disputed 2006-2009 gas and 2010-2011 gas.

a) On 30 March 2011, the Respondent's Ministry for Fuel and Energy wrote to Ukrnafta. The Respondent explained that, because Ukrnafta and Naftogaz had not entered into contracts for the supply of 2010 and 2011 gas, there was a shortage of gas for the needs of the population (thus articulating a point

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264 Letter No. 6-692/1.2-11 by Naftogaz to Ukrnafta, 8 February 2011**, Exhibit {C-1163}.**

265 Letter No. yur-1038 by Ukrnafta to Naftogaz, 19 May 2011, **Exhibit {C-1189}.**

266 See Letter No. 6-362/1.2-11 from Naftogaz to Ukrnafta (first page), 25 January 2011, **Exhibit {C-1157}**; Letter No. 6-362/1.2-11 from Naftogaz to Ukrnafta (second and third pages), 25 January 2011, **Exhibit {C-1157}** (or Letter No. yur-198 by Ukrnafta to Naftogaz, 4 February 2011, **Exhibit {C-1161**}).

Naftogaz had repeatedly relied on unsuccessfully in the Ukrainian litigation).[267]

b) On 21 April 2011, Ukrnafta replied to the Respondent's Ministry for Fuel and Energy, stating *inter alia*: Ukrnafta is the owner of some 7 billion m^3 of gas in the UGS, only 2 billion m^3 of which had been properly documented by Ukrtransgaz; orders by the Respondent's courts in favour of Ukrnafta had not been implemented; and the NERC has been setting prices which are below Ukrnafta's costs of production.[268]

c) On 20 May 2011, Naftogaz replied to Ukrnafta and the Respondent's Ministry for Fuel and Energy, reiterating the position it had been placing before the Ukrainian courts without success, including *inter alia*: the effect of the July 2010 Gas Market Law and the 2001 Cabinet Decree is that Ukrnafta is to sell all of its gas to Naftogaz at the price set by the NERC; and the price of UAH 458 (excluding VAT) set by the July 2010 NERC Resolution is not valid only until 31 December 2010, but is applicable to sales of 2011 gas.[269]

d) While Ukrnafta sought to settle this dispute by compromise following meetings with Naftogaz and the Ministry for Fuel and Energy,[270] Naftogaz replied in terms that in effect enforced the NERC pricing on the 2010-2011 gas and, while acknowledging that Ukrnafta was entitled to the 2006-2009 gas, nonetheless insisted that Ukrnafta could not receive that older gas because it was no longer in the UGS (as it had been used by the population), because

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267 Letter No. 01/31-0380 by the Ministry of Energy and Coal to Ukrnafta, 30 March 2011, **Exhibit {C-1178}.**

268 Letter No. yur-851 by Ukrnafta to the Minister of Energy and Coal with encl. document, 21 April 2011, **Exhibit {C-1185}**.

269 Letter No. 14-1976/1/MPE from Naftogaz to the Minister of Energy and Coal of Ukraine, 20 May 2011, **Exhibit {C-1190**}.

270 Letter No. 2/01-16-444 by Ukrnafta to Naftogaz with encl. Information, 17 June 2011, **Exhibit {C-1195}** (sixth to eighth pages).

any gas provided to Ukrnafta would have to be replaced by more expensive imported gas.[271]

e) The difficulties with Naftogaz's proposal were highlighted by Ukrnafta in a responsive letter of 17 June 2011.[272]

184. The Respondent's refusal to act lawfully in relation to Ukrnafta's gas in 2011 did not, however, end with the passing of the 2011 NERC Resolution and Naftogaz's continuation of its strategy to acquire Ukrnafta's gas without its consent and regardless of the effort to reach a compromise in March to June 2011. To the contrary, on multiple fronts Naftogaz, Ukrtransgaz and the NERC (which became the NESR later in the year) refused to respect Ukrnafta's rights to such an extent that significant additional litigation occurred.

185. ***Naftogaz and Ukrtransgaz refuse to comply with court orders.*** First, Naftogaz and Ukrtransgaz disregarded orders issued by the Respondent's courts in relation to Ukrnafta's gas. In Case No 6/489, the courts held that Ukrnafta had transferred into the UGS volumes of gas (including 1,548,035,386m^3 produced in 2006/2007 and 528,813,008m^3 in April to June 2006), and ordered Ukrtransgaz to enter into a gas storage contract with Ukrnafta from the date of the court's decision (see Sections II.E.4-5 above). In defiance of these orders made, Ukrtransgaz refused to enter into the gas storage contract, and Naftogaz did not procure that it do so.

186. On 25 October 2010, Ukrnafta requested Ukrtransgaz to extract a total of 2,061,805,134m^3 of 2006 gas so it could sell it to industrial consumers, including fertiliser manufacturers. This consisted of volumes of 1,544,070,386m^3 (out of the 1,548,035,386m^3 referred to above) and 517,734,748m^3 (out of the 528,813,008m^3 referred to above). Ukrtransgaz did not comply with this request. This was in part because of the 2,061,805,134m^3 of 2006 gas which Ukrnafta passed into the UGS, the

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271 Letter No. 14-1976/1/MPE from Naftogaz to the Minister of Energy and Coal of Ukraine, 20 May 2011, **Exhibit {C-1190}**.

272 Letter No. 2/01-16-444 by Ukrnafta to Naftogaz with encl. Information, 17 June 2011, **Exhibit {C-1195}.**

517,736,748m³ which had been produced in April / May 2006 had not been pumped into the UGS because it had been sold to members of the population in those months, while the remaining 1,544,070,386m³ that had been pumped into the UGS was then withdrawn and sold to the population in early 2007 and early 2008.

187. In this context, Ukrnafta commenced Case No 6/521 against Ukrtransgaz and Naftogaz on 16 November 2010.[273] Naftogaz relied upon its by then traditional argument that Ukrnafta was obliged to sell the gas to it for onward sale to consumers, and was not entitled to sell it to industrial consumers.[274] Ukrtransgaz argued that the 1,544,070,386m³ had been sold to the population in January 2007 and the first quarter of 2008 pursuant to the decision of the Board of Naftogaz of 26 April 2008, that receipt of the 517,734,748m³ had not been recorded because Ukrnafta refused to comply with Protocol No 54, and that this gas had been sold to the population in April/May 2006.[275]

188. The details of Case No 6/521 are set out in the Chronology at Annex 1, but the ultimate result was that Ukrnafta succeeded in the claim in a series of judgments starting in early 2011.[276] The orders eventually endorsed by the Supreme Commercial Court directed that: Ukrtransgaz and Naftogaz were not to impede Ukrnafta's exercise of its rights of ownership in relation to the 2,061,805,134m³ of 2006 gas, including its rights to extract that gas from the GTS to sell to industrial consumers; Ukrtransgaz was to satisfy Ukrnafta's request of 25 October 2010 by

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273 Case No. 6/521 Ukrnafta Statement of Claim Letter No. yur-1920, 11 November 2010, **Exhibit {C-119}**.

274 Case No. 6/521 Naftogaz Response Letter No. 14/2-1558, 29 November 2010, **Exhibit {C-120}**.

275 Case No. 6/521 Ukrtransgaz Response Letter No. 13886/6, 29 November 2010**, Exhibit {C-121}**; Letter from Ukrtransgaz No. 64-2156/7, 24 November 2010**, Exhibit {C-1140}** (first page only). Letter No. 11998/64-004 by Ukrtransgaz to Ukrnafta regarding the providing of information, 30 October 2008, **Exhibit {C-999}.**

276 Case No. 6/521 Decision of the Commercial Court of Kiev, 20 January 2011, **Exhibit {C-123**}; Case No. 6/521 Decision of the Commercial Court of Appeal, 14 April 2011, **Exhibit {C-124**}; Case No. 6/521 Decision of the Supreme Commercial Court of Ukraine, 19 May 2014, **Exhibit {C-125}**.

extracting the gas and preparing a statement of acceptance and transfer; and Naftogaz was to include the gas in the annual balance.

189. Once again, therefore, Ukrtransgaz and Naftogaz's actions violated Ukrnafta's rights under Ukrainian law. Regardless of what the courts ordered, Ukrtransgaz and Naftogaz were implacable in their desire to acquire Ukrnafta's gas at an undervalue. As discussed further in Section II.E.9 below, this recalcitrance extended even so far as to ignore the orders of the courts in Case No 6/521, and to thus compel Ukrnafta to commence enforcement litigation (which Ukrtransgaz and Naftogaz also resisted).

190. ***The NERC maintains unlawful Resolutions.*** Secondly, in addition to Ukrtransgaz and Naftogaz's recalcitrance, the NERC also insisted on maintaining a plainly unlawful position. By 2011, the 2009 NERC Resolution and the 2009 NERC Gas Pricing Procedure had been in effect for some time, despite reasoning of the courts in relation to previous NERC Resolutions and Gas Pricing Procedures casting doubt on whether these newest iterations could possibly be valid. In August 2011, Ukrnafta started Case No 2a-11259/11/2670, later re-designated as Case No K/9991/37707/12, against the NERC in the Kiev District Administrative Court, seeking the cancellation of the 2009 NERC Resolution and the 2009 NERC Gas Pricing Procedure that it promulgated.

191. The NERC resisted this claim, the details of which are in the Chronology at Annex 1, but ultimately failed, once again, to show the lawfulness of its position. The first instance court held that the 2009 NERC Resolution had not been registered with the Ministry of Justice, such that it had not entered into force, had no legal effect vis-à-vis Ukrnafta, and could not be used by the NERC to establish a price for Ukrnafta's gas. While this meant that Ukrnafta's claim was formally to be dismissed (as its rights could not have been violated by an instrument not in effect), Ukrnafta had succeeded with the practical purpose of its claim and the 2009 NERC Resolution and the 2009

NERC Gas Pricing Procedure were deemed invalid.[277] This result was, over the course of appeals to the Kiev Appellate Administrative Court and the Supreme Administrative Court, upheld.[278]

192. ***The NERC maintains further unlawful Resolutions.*** Thirdly, the NERC's resistance to acting lawfully also manifested itself in other respects in 2011. As noted in Section II.E.5 above, the NERC passed the July 2010 NERC Resolution on 27 July 2010, by which it purported to establish a price of UAH 458 for Ukrnafta's gas with effect from 1 August 2010, allegedly pursuant to the July 2010 Gas Market Law and the 2009 NERC Gas Pricing Procedure. Ukrnafta had of course explained to the NERC that such a decision would be untenable (and indeed would be unlawful).[279] The reason for that position was that Ukrnafta's demonstrated Zero Profit Price (as defined in Section V below) was UAH 815.08, or UAH 679.24 excluding VAT, with the result that the NERC's decision to set the price at UAH 458, without providing for a subsidy to cover the shortfall, was contrary to numerous pieces of legislation.[280]

193. In light of the NERC's refusal properly to take into account the information Ukrnafta had provided to it and its decision to issue the unlawful July 2010 NERC Resolution, on 18 January 2011, Ukrnafta commenced Case No 2a-899/11/2670 against the NERC, seeking an order cancelling the July 2010 NERC Resolution. Again, the details of this litigation are set out in the Chronology at Annex 1. The NERC failed in this case. Findings of the courts that were core to their reasoning were that: Article 10 of the July 2010 Gas Market Law meant that Ukrnafta was obliged to sell all of its gas to Naftogaz at a price to be determined by the NERC on an annual basis in accordance

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277 Case No. 2a-11259/11/2670 Decision of Administrative Court, 26 September 2011, **Exhibit {C-173}.**

278 Case No. 2a-11259/11/2670 Decision of Administrative Court of Appeal, 16 May 2012, **Exhibit {C-174}**; Case No. K/9991/37707/12 (Case No. 2a-11259/11/2670) Decision by the Supreme Administrative Court of Ukraine, 3 April 2014, **Exhibit {C-175}.**

279 Letter No. 6pg-12/363 by Ukrnafta to Ukrtransgaz 16.07.2010 re gas delivery 06/2010, 16 July 2010, **Exhibit {C-703}.**

280 Case No. 2a-899/11/2670 Ukrnafta Statement of Claim Letter No. yur-65, 18 January 2011, **Exhibit {C-113}.**

with a procedure for forming, calculating and approving price approved by the NERC; Article 3 of the 2010 Budget Law meant that the price had to include economic costs incurred at production level and a profit margin; the NERC made no provision for a subsidy in light of the inability of Ukrnafta to make a profit on the NERC's State-regulated price; and the NERC had applied the 2009 NERC Gas Pricing Procedure, but had done so improperly (as its price did not cover all the relevant costs of Ukrnafta) and unlawfully (as it had not been registered with the Ministry of Justice, and thus had no legal force and could not be applied).[281]

194. ***The NESR issues Resolutions to subvert adverse court findings.*** Fourthly, the Respondent wasted no time in ignoring the decisions that invalidated the July 2010 NERC Resolution. On 29 December 2011, the NESR, which had succeeded the NERC the previous month, issued three Resolutions. This was only three days after the Kiev District Administrative Court had held in Case No 2a-899/11/2670 that the July 2010 NERC Resolution, which set a price of UAH 458 (excluding VAT) for Ukrnafta's gas, was invalid.

a) NESR Resolution No 255 purported to set a price of UAH 458 (excluding VAT) for gas produced by Ukrnafta, effective from 1 January 2012.[282] That was the very same price that the now invalid July 2010 NERC Resolution had purported to set. It was thus necessarily the case that the NESR had deliberately ignored the two substantive grounds on which the Kiev District Administrative Court had held the July 2010 NERC Resolution to be invalid, namely, that the NERC had improperly omitted elements of cost and made no allowance for capital expenditure, and that the NERC had set the price below

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281 Case No. 2a-899/11/2670 Decision of the Administrative Court of Kiev, 26 December 2011, **Exhibit {C-116}**; Case No. 2a-899/11/2670 Decision of the Administrative Court of Appeal of Kiev, 17 May 2012, **Exhibit {C-117}.** The courts also rejected the argument that the claim should be dismissed as it was commenced against the NERC, which has been liquidated and replaced with the NESR shortly before the Kiev District Administrative Court had issued its first instance judgment.

282 NERC Resolution No. 255 "On setting of price for equity commercial natural gas for PJSC Ukrnafta", 29 December 2011, **Exhibit {C-457**}.

Ukrnafta's cost of production without providing for a subsidy. NESR Resolution No 255 would ultimately be invalidated by the courts in Case No 2a-3293/12/2670 (see Section II.E.7 below).

b) NESR Resolution No 258 purported to set a price of UAH 412 (excluding VAT) for gas produced pursuant to a joint venture between Ukrnafta and Regal Petroleum Corporation Ltd, effective from 1 January 2012.[283] Again, the NESR ignored the grounds on which the Kiev District Administrative Court had held the July 2010 NERC Resolution to be invalid. NESR Resolution No 258 would ultimately be invalidated by the courts in Case No 2a-4029/12/2670 (see Section II.E.7 below).

c) NESR Resolution No 259 purported to set a price of UAH 928 (excluding VAT) for gas produced pursuant to a joint venture between Ukrnafta and Nadra-Invest, effective from 1 January 2012,[284] again ignoring the grounds on which the July 2010 NERC Resolution had been declared in valid. NESR Resolution No 259 would ultimately be invalidated by the courts in Case No 2a-4029/12/2670 (see Section II.E.7 below).

195. The attempt by the NESR to ride roughshod over the courts' decisions by way of these new Resolutions was blatant and, as further court decisions would ultimately conclude, unlawful.

7. The Respondent's 2012 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

196. In 2012, the Respondent maintained its objective of obtaining Ukrnafta' gas at an undervalue. The Respondent resisted Ukrnafta's claim that NESR Resolutions 255, 258 and 259, discussed immediately above, were invalid.

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283 NERC Resolution No. 258 "On approval of the price for commercial natural gas owned produced extracted under Contract of Joint Activity of 20.07.2004 N 35/809-SD", 29 December 2011, **Exhibit {C-455}.**

284 NERC Resolution No. 259 "On approval of the price for commercial natural gas owned produced extracted under Contract of Joint Activity of 21.12.2000 N 5/56", 29 December 2011, **Exhibit {C-456**}.

197. ***The NESR's misconduct.*** In March 2012, Ukrnafta commenced Case No 2a-3293/12/2670 against the NESR in the Kiev District Administrative Court, seeking the cancellation of NESR Resolution No 255.[285] It contended that this price would not allow it to recover its economically grounded expenses, let alone earn a profit, and would lead to cessation of gas extraction activities at some facilities and a reduction in the volume extracted at others. It said that its break-even price was UAH 1,208.47 (excluding VAT) or UAH 1,450.17 (including VAT). This was entirely consistent with the position Ukrnafta had explained to the NESR prior to starting the claim. In a letter of 13 February 2012, for instance, Ukrnafta sought from the NESR a revision of the price stated in NESR Resolution No 255.[286] It noted that the price of UAH 549.60 (including VAT) would not enable it to perform "the capital investments required for gas mining" or even permit it to recover all of the costs incurred in mining and preparing gas – which information it provided to the NESR on 26 October 2011 in order to substantiate its Zero Profit Price for 2012 of UAH 1,450.17 (including VAT).[287]

198. The course of litigation in this instance was long (and its details are set out in the Chronology at Annex 1). When the claim was initially considered, Ukrnafta did not succeed in its challenge to NESR Resolution No 255.[288] However, as noted in Section II.E.6 above, on 3 April 2014, the Supreme Administrative Court handed down its judgment in Case No 2a-11259/11/2670, re-designated as Case No K/9991/37707/12, cancelling the 2009 NERC Resolution and the 2009 NERC Gas Pricing Procedure. In

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285 Case 2a-3293/12/2670 Ukrnafta Statement of Claim Letter No. yur-446, 5 March 2015, **Exhibit {C-228}**; see also Case No. 2a-3293/12/2670 Order of the Administrative Court of Kiev, 12 March 2012, **Exhibit {C-229}.**

286 Letter No. 15PE-9 by Ukrnafta to the NERC with encl. documents, 13 February 2012, **Exhibit {C-1225}**. NESR replied in dismissive terms: Letter No. 1600/24/47-12 by the NESR of Ukraine to Ukrnafta, 16 March 2012, **Exhibit {C-1227}.**

287 Letter No.15PE-135 from Ukrnafta to NERC encl. from Price justification for gas produced in 2011 and Plan for 2012, 26 October 2011, **Exhibit {C-1203**}.

288 First instance decision: Case No. 2a-3293/12/2670 Decision of the Administrative Court of Kiev, 16 October 2013, **Exhibit {C-237**}; Case No. 2a-3293/12/2670 Decision of the Kiev Administrative Court of Appeal, 12 December 2013, **Exhibit {C-238}**; Case No. 2a-3293/12/2670 Decision of the Supreme Administrative Court of Ukraine, 23 January 2014, **Exhibit {C-239}**.

light of this development, Case No 2a-3293/12/2670 challenging NESR Resolution No 255 was resumed, and the Kiev District Administrative Court set aside its previous decision against Ukrnafta, and instead found in its favour on the basis that NESR Resolution No 255 had been adopted on the basis of the 2009 NERC Resolution and the 2009 NERC Gas Pricing Procedure, which in fact were invalid from their day of promulgation.[289] Ukrnafta also succeeded on NESR's appeals,[290] and as a result NESR Resolution No 255 was declared invalid.

199. A similar course of litigation occurred in respect of Ukrnafta's challenge to NESR Resolutions 258 and 259 in Case No 2a-4029/12/2670.[291] Again, Ukrnafta did not succeed in the first instance court,[292] but did succeed in the subsequent reopened litigation on the same issue that followed the Supreme Administrative Court's judgment in Case No 2a-11259/11/2670, re-designated as Case No K/9991/37707/12.[293] The detail is again set out in the Chronology at Annex 1, but the result was that NESR Resolutions 258 and 259 were invalidated.

200. NESR's insistence at engineering a purported legal basis on which the Respondent could further its attempts to acquire Ukrnafta's gas at an undervalue also manifested itself outside the context of litigation before Ukrainian courts. On 13 September 2012 the NESR passed Resolution No 1177 ("**September 2012 NESR Resolution**").[294] By this, the NESR adopted the "Procedure of Natural Gas Prices Formation, Calculation

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289 Case No. 2a-3293/12/2670 Decision of the District Administrative Court of Kiev, 14 May 2014, **Exhibit {C-240}**.

290 Case No. 2a-3293/12/2670 Decision of the Administrative Court of Appeal of Kiev, 4 September 2014, **Exhibit {C-241}**; Case Numbers K800/50026/14, K800/50049/14 and K800/50313/14 (Case No. 2a-3293/12/2670) Decision by the Supreme Administrative Court of Ukraine, 11 December 2014 **Exhibit {C-242}**.

291 Case No. 2a-4029/12/2670 Ukrnafta Statement of Claim Letter No. yur-520, 20 March 2012, **Exhibit {C-183}.**

292 Case No. 2a-4029/12/2670 Decision of the Administrative Court, 7 October 2013, **Exhibit {C-187}.**

293 Case No. K/800/45461/14 (Case No. 2a-4029/12/2670) Order of the Supreme Administrative Court of Ukraine, 7 October 2014, **Exhibit {C-196}**.

294 NESR Resolution No. 1177 "On approval of the procedure of natural gas prices formation, calculation and fixation for gas-producing companies", 13 September 2012, **Exhibit {C-475**}.

and Fixation for Gas-Producing Companies" ("**2012 NESR Gas Pricing Procedure**"), which stated that it was adopted pursuant to, *inter alia*, the July 2010 Gas Market Law.

201. The structure of the 2012 NESR Gas Pricing Procedure was very similar to that of the 2009 NERC Gas Pricing Procedure. Paragraph 1.5 of the former made very similar provision to paragraph 1.4 of the latter, stating that:

> "Prices calculated pursuant to this Procedure shall provide the following to natural gas-producing companies:
>
> > reimbursement of economically reasonable producing expenses for the planning period;
> >
> > earning the profit sufficient for fulfilment of the investment program, separately for each natural gas field for the planning period;
> >
> > payment of all taxes and charges pursuant to the current legislation of Ukraine."

202. Paragraph 1.3 defined terms, including "Economically reasonable expenses for the planning period", "Estimated profit" and "Natural gas price". Paragraph 2.16 stated a pricing formula. The rest of the 2012 NESR Gas Pricing Procedure made detailed provision as to what was and was not to be included in each element of that formula, and as to the procedure which was to be followed.

203. As discussed further below, however, the 2012 NESR Gas Pricing Procedure was unlawfully promulgated by the NESR. It would ultimately be declared invalid in Case No 826/6130/13-a. It thus stood as another attempt by the NESR to use whatever means it could conceive, regardless of their legality, to acquire Ukrnafta's gas at a below value price. It was a particularly unjustifiable approach in this instance, given that shortly before the NESR promulgated the September 2012 NESR Resolution and the 2012 NESR Gas Pricing Procedure, the Verkhovna Rada on 21 June 2012 passed Law No 5007-VI "On Prices and Pricing" ("**2012 Law on Prices and Pricing**") – Article 12(2) of which provided that State regulated prices "shall be economically justified" in that they were to ensure conformity between (on the one

hand) the price and (on the other hand) the costs of production, the costs of sale and profit from sale.[295]

204. In any event, the NESR then moved to use its purported, but illegitimate, basis in the September 2012 NESR Resolution and 2012 NESR Gas Pricing Procedure to impose a price on the gas it wished to acquire from Ukrnafta. On 27 December 2012, the NESR passed Resolution No 1832 ("**December 2012 NESR Resolution**"),[296] by which it purported to set a price of UAH 492.60 (excluding VAT) for Ukrnafta's gas with effect from 1 January 2013, stating that it did so pursuant to, *inter alia*, the July 2012 Gas Pricing Law, the September 2012 NESR Resolution and the 2012 NESR Gas Pricing Procedure.[297] As is obvious, the price of UAH 492.60 (excluding VAT) was, like with NESR Resolution 255, well below the break-even price Ukrnafta had notified to the NESR was UAH 1,208.47 (excluding VAT) in the context of Case No 2a-3293/12/2670, concerning the challenge to NESR Resolution 255. Once again, and as discussed in Section II.E.8 below, the December 2012 NESR Resolution was unlawfully issued by the NESR, would ultimately be declared invalid in Case No 826/4350/13-a, and was in reality yet another attempt by the NESR to further the Respondent's objective of acquiring Ukrnafta's gas at an undervalue.

205. ***Naftogaz's and Ukrtransgaz's misconduct.*** Although the NESR was apparently at the forefront of the Respondent's strategy in this regard in 2012, Naftogaz and Ukrtransgaz were not inactive. To the contrary, both initiated litigation against Ukrnafta in an attempt to obtain its gas for no value.

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295 Law of Ukraine No. 5007-VI "On Prices and Price Formation", 21 June 2012, **Exhibit {C-1767}.**

296 NESR Resolution No. 1832 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 27 December 2012, **Exhibit {C-481}.**

297 NESR Resolution No. 1832 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 27 December 2012, **Exhibit {C-481}.** The December 2012 NESR Resolution also invalidated NESR Resolution 255, albeit only prospectively from 27 December 2012 onwards. As such, Case No 2a-3293/12/2670, which was challenging the validity of NESR Resolution 255, continued after the date of this December 2012 NESR Resolution to establish that NESR Resolution 255 was invalid from the date of its adoption.

206. As noted in Sections II.E.3 and II.E.5 above, the Kiev Appellate Commercial Court upheld an appeal by Ukrtransgaz and Naftogaz in Case No 6/521, which raised an issue concerning the ownership of 2,061,805,134m^3 of 2006 gas that Ukrnafta had pumped into Ukrtransgaz's facilities – in particular, whether Ukrtransgaz and Naftogaz were correct that the effect of the July 2010 Gas Market Law was that Ukrnafta was obliged to sell all of its gas to Naftogaz, regardless of the year in which it was produced. While the Supreme Commercial Court would in due course uphold Ukrnafta's appeal on 19 May 2014, rejecting Ukrtransgaz and Naftogaz's argument and confirming Ukrnafta's ownership of the gas, Ukrtransgaz in the meantime commenced in March 2012 Case No 5011-35/4141-2012 against Ukrnafta in the Kiev Commercial Court.

207. In that case, Ukrtransgaz sought a declaration that Ukrnafta was not the owner of the 2,061,805,134m^3 of 2006 gas.[298] Naftogaz was joined as a third party, and it was again said that Naftogaz had already used the gas to satisfy the needs of the population, with the consequence that it was no longer present in the UGS. Notably, however, Ukrtransgaz and Naftogaz did not try to establish that Naftogaz had been entitled to use the gas by reference to the July 2010 Gas Market Law, but on, *inter alia*, the 2006 to 2008 Budget Laws and the Second 2008 Cabinet Instruction.

208. Once again, Ukrtransgaz and Naftogaz failed in their litigation. Indeed, the arguments they advanced had already been considered and rejected in previous cases, such as Case No 6/489, which involved all the same parties. As set out in the Chronology at Annex 1, the Kiev Commercial Court rejected the claim on this basis on 27 June 2012, as well as on the basis that Ukrtransgaz did not have standing to sue,[299] and its decision was upheld at both levels of appeal.[300]

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298 Case No. 5011-35/4141-2012 Statement of Claim Ukrtransgaz v Ukrnafta No.2908/6-007, 26 March 2012, **Exhibit {C-201}.**

299 Case No. 5011-35/4141-2012 Decision of Kiev Commercial Court, 27 June 2012, **Exhibit {C-202}.**

209. Naftogaz itself also sought to further the Respondent's overarching objective. Its acts in this regard started early in the year. By letter dated 3 January 2012, Naftogaz wrote to Ukrnafta, attaching a draft contract for the sale and purchase of 2012 gas.[301] Ukrnafta replied on 17 January 2012.[302] It noted that Ukrnafta had repeatedly informed Naftogaz that it stood ready to comply with Article 10 of the July 2010 Gas Market Law and, while that remained the position, it was also necessary that any sale of gas comply with the law by defining the price of the gas. In that regard, Ukrnafta referred to its earlier letter of 28 December 2011, by which it had replied to an earlier proposal by Naftogaz that the price at which it would recover its costs of producing 2012 gas but make no profit was UAH 1450.17 (including VAT), and the requirement under Article 191(6) of the Commercial Code for Ukrnafta for a subsidy.[303] Ukrnafta noted that the price set out in the July 2010 NERC Resolution which Naftogaz was offering (UAH 458 excluding VAT, or UAH 549.60 including VAT) was "knowingly loss-making" for Ukrnafta and that selling gas at that price would "inevitably" result in a reduction of the volume produced. Ukrnafta engaged in further correspondence with Naftogaz, but did not make any progress on this essential point.[304] To the contrary, Naftogaz in 2012 continued to pressure Ukrnafta to sign contracts for the supply of gas at prices set by the NESR that were well below economically justifiable

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300 Case No. 5011-35/4141-2012 Kiev Commercial Court of Appeal, 6 September 2012, **Exhibit {C-203}**; Case No. 5011-35/4141-2012 Supreme Commercial Court, 7 November 2012, **Exhibit {C-204}.**

301 Letter No. 6-2/1-12 by Naftogaz to Ukrnafta encl. Natural Gas supply agreement, 3 January 2012, **Exhibit {C-1219}.**

302 Letter No. yur-73 by Ukrnafta to Naftogaz with reference to draft contract relating to natural gas purchase, 17 January 2012, **Exhibit {C-1215}.**

303 Letter No. yur-2694 by Ukrnafta to Naftogaz, 28 December 2011, **Exhibit {C-1210}**; Letter No. 6-7341/1.2-11 by Naftogaz to Ukrnafta encl. Natural Gas supply Agreement, 13 December 2011, **Exhibit {C-1205}**. Ukrnafta supplied further data in this regard to the NESR later in 2012, and continued to state its position to Naftogaz as well: Letter No. 15PE-42 by Ukrnafta to the NESR with encl. document, 1 June 2012, **Exhibit {C-1235}**; Letter No. yur-1137 by Ukrnafta to Naftogaz re natural gas purchase Agreement for 2012 , 12 June 2012, **Exhibit {C-1236}.**

304 Letter No. yur-214 by Ukrnafta to Naftogaz with reference to draft contract on natural gas purchase in 2012, 3 February 2012, **Exhibit {C-1223}**; Letter No. 6-321/1-12 by Naftogaz to Ukrnafta encl. Natural Gas supply agreement, 24 January 2012, **Exhibit {C-1222}.**

prices, and pursuant to NESR Resolutions that would ultimately be deemed invalid by the Respondent's courts.[305]

210. Presumably in response to Ukrnafta insisting, as previous court decisions had insisted, that Naftogaz abide by the law in respect of any sale of gas from Ukrnafta to Naftogaz, in July 2012, Naftogaz started Case No 5011-69/9686-2012 against Ukrnafta in the Kiev Commercial Court, seeking an order compelling Ukrnafta to sell it 1,480,000,000m^3 of 2012 gas at the price established by NESR Resolution No 255 (UAH 458 excluding VAT). Ukrtransgaz was joined as a third party, and the proceedings were stayed pending the determination of Case No 2a-3293/12/2670 (and have not been reactivated to date).[306]

8. The Respondent's 2013 conduct in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

211. Much of the Respondent's misconduct in pursuit of acquiring Ukrnafta's gas below or at no value in 2013 focused on the (unsuccessful) conduct of litigation before its own courts. This did not prevent Naftogaz, however, from maintaining its persistent practice over many years of pressuring Ukrnafta to enter into contracts for the sale of gas to Naftogaz at a price well below its cost of production,[307] despite Ukrnafta resisting that pressure and explaining to the NESR how its Zero Profit Price was to be calculated during the relevant period.[308]

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305 See e.g., Letter No. 6-3053/1-12 by Naftogaz to Ukrnafta encl. Natural Gas supply agreement, 22 May 2012, **Exhibit {C-1233}**; Letter No. 6-6176/1.2-12 by Naftogaz to Ukrnafta, 2 November 2012, **Exhibit {C-1245}.**

306 Case No. 5011-69/9686-2012 Decision of the Commercial Court of Kiev, 23 October 2012, **Exhibit {C-200}**; Case No. 5011-69/9686-2012 Ukrnafta Response Letter No. yur-1495, 8 August 2012, **Exhibit {C-198}.**

307 See, e.g., Letter No. 6-126/1.2-13 by Naftogaz to Ukrnafta, 10 January 2013, **Exhibit {C-1649}**; Letter No. 6-218/1.2-13 by Naftogaz to Ukrnafta, 16 January 2013, **Exhibit {C-1650**}; Letter No. 6-669/1.2-13 by Naftogaz to Ukrnafta, 6 February 2013, **Exhibit {C-1653**}; Letter No. 6-3134/1.2-13 by Naftogaz to Ukrnafta encl. a copy, 18 June 2013, **Exhibit {C-1284}.**

308 See, e.g., Letter by No. yur-268 by Ukrnafta to Naftogaz, 5 February 2013, **Exhibit {C-1652}**; Letter No. yur-613 by Ukrnafta to Naftogaz re the natural gas balance for March 2013, 2 April 2013, **Exhibit {C-1271}.**

212. One instance of litigation arose out of Ukrnafta's challenge to the December 2012 NESR Resolution. In March 2013, Ukrnafta commenced Case No 826/4350/13-a against the NESR in the Kiev District Administrative Court, seeking the cancellation of the December 2012 NESR Resolution on the basis that the price of UAH 492.60 (excluding VAT) which it purported to set for Ukrnafta's gas was much lower than the economically reasonable price, would not permit it to recover its costs and receive a profit, and had been determined in violation of law. Ukrnafta had earlier submitted calculations and supporting materials that demonstrated that the break-even prices (i.e. allowing zero profit) were UAH 1,288.23 (excluding VAT) and UAH 1,545.88 (including VAT) for 2012, and were expected to be UAH 1,941.19 (excluding VAT) and UAH 2,329.43 UAH (including VAT) for 2013.[309]

213. NESR resisted this claim by Ukrnafta, on which the latter ultimately succeeded at both levels of appeal.[310] The reasoning in the judgment of the Kiev Administrative Court of Appeal on 15 January 2014 was detailed, made numerous points as to how the NESR had breached the law, and concluded that the NESR's calculation of price was not in compliance with the July 2010 Gas Market Law, the Law on Prices and Pricing, or even with the 2012 NESR Gas Pricing Procedure.[311] While the litigation is summarised in the Chronology at Annex 1, the result was that the Kiev Administrative Court held the December 2012 NESR Resolution invalid from the

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309 Justification for the Required Level of Prices for Marketable Combustible Natural Gas Produced In-house in 2012 and a draft plan for 2013, **Exhibit {C-1924}**.

310 Case No. 826/4350/13-a Decision of the Kiev Administrative Court of Appeal, 15 January 2014, **Exhibit {C-226}**; Case No. K/800/5575/14 (Case No. 826/4350/13-a) Decision of the Supreme Administrative Court, 14 May 2014, **Exhibit {C-227}**. Note that Ukrnafta lost at first instance, wrongly: Case No. 826/4350/13-a Decision of the Administrative Court of Kiev, 29 October 2013, **Exhibit {C-224}.**

311 Case No. 826/4350/13-a Decision of the Kiev Administrative Court of Appeal, 15 January 2014, **Exhibit {C-226}.**

moment of its adoption,[312] which conclusion the Supreme Administrative Court endorsed.[313]

214. A further claim the NESR resisted without legal basis was Ukrnafta's claim in Case No 826/6130/13-a. On 29 April 2013, Ukrnafta commenced the claim against the NESR to seek the cancellation of the September 2012 NESR Resolution and the 2012 NESR Gas Pricing Procedure. The detail is again set out in the Chronology at Annex 1, but once more Naftogaz resisted the claim wrongly, and Ukrnafta prevailed at the levels of first and final appeal.[314] The appellate courts explained the flaws in the NESR process for issuing and the substance of the September 2012 NESR Resolution and the 2012 NESR Gas Pricing Procedure, and held that they were promulgated inconsistent with numerous Ukrainian laws. As a result, they were deemed invalid from the moment of their adoption.[315]

215. However, the Respondent's pursuit of Ukrnafta's gas did not involve only maintaining indefensible positons regarding the legality of its purported regulation of gas pricing and distribution. In addition, in March 2013, Naftogaz commenced Case No 910/5082/13 against Ukrnafta in the Kiev Commercial Court, seeking an order compelling Ukrnafta to enter into a contract to supply gas in 2013 at the price of UAH 492.60 (excluding VAT) which had been established by the December 2012

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312 Case No. 826/4350/13-a Decision of the Kiev Administrative Court of Appeal, 15 January 2014, **Exhibit {C-226}**.

313 Notably, the judgments in Case No 826/4350/13-a proceeded on the assumption that the September 2012 NESR Resolution and the 2012 NESR Gas Pricing Procedure were valid. However, both those instruments would subsequently be declared invalid in Case No 826/6130/13-a: see Section II.E.9 below.

314 Case No. 826/6130/13-a Decision of the Kiev Administrative Court of Appeal, 26 November 2014, **Exhibit {C-251}**; Minutes No. 21 of the General Meeting of Ukrnafta Shareholders (extract), 22 March 2011, **Exhibit {C-1176**}. Note that Ukrnafta lost at first instance, wrongly: Case No. 826/6130/13-a Decision of the Administrative Court, 4 November 2013, **Exhibit {C-245**}.

315 Similar baseless resistance came from Ukrtransgaz and Naftogaz in the form of refusing to sign with Ukrnafta agreements for the storage of natural gas produced pursuant joint investment agreements in litigation from 2012 until present, such as in Case No 35/179, Case No 35/176, Case No 46/603, Case No 46/604 and Case No 46/606. The cases are detailed in the Chronology at Annex 1.

NESR Resolution. Upon Ukrnafta's application, on 5 November 2013 the Kiev Commercial Court stayed these proceedings pending the determination of Ukrnafta's claim in Case No 826/4350/13-a, discussed above. The proceedings were temporarily resumed, but were stayed again in November 2015, and remain so today.

216. Regardless of the ligation that was considering the validity of its December 2012 NESR Resolution,[316] the NESR continued its practice of setting gas prices in a manner proscribed by law. Thus, on 30 December 2013, the NESR passed Resolution No 1853 ("**December 2013 NESR Resolution**"),[317] by which it purported to set a price of UAH 562.50 (excluding VAT) for Ukrnafta's gas with effect from 1 January 2014,[318] stating that it did so pursuant to (*inter alia*) the July 2012 Gas Pricing Law and the 2012 NESR Gas Pricing Procedure.[319] As is obvious, the price of UAH 562.50 (excluding VAT) was, like with NESR Resolution 255, well below the break-even price Ukrnafta had notified to the NESR was UAH 1,288.23 (excluding VAT) for 2012 in the context of Case No 826/4350/13-a, concerning the challenge to the December 2012 NESR Resolution. Again, and as discussed in Section II.E.9 below, the December 2013 NESR Resolution was unlawfully issued by the NESR, would ultimately be declared

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316 NESR Resolution No. 1832 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 27 December 2012, **Exhibit {C-481}.**

317 NESR Resolution No. 1853 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 30 December 2013, **Exhibit {C-502}.**

318 The December 2013 NESR Resolution also invalidated the December 2012 NESR Resolution, albeit only prospectively from 30 December 2013 onwards. As such, Case No 826/4350/13-a, which was challenging the validity of the December 2012 NESR Resolution, continued after the date of this December 2013 NESR Resolution to establish that the December 2012 NESR Resolution was invalid from the date of its adoption.

319 In fact, the NESR went one step further, and the next day, on 31 December 2013, it issued NESR Resolution No 1910. That Resolution amended the 2012 NESR Gas Pricing Procedure such that it required that a gas producing entity was to approve an investment program by 1 September each year, and submit it for approval to the Respondent's authority responsible for the creation of the State's policy in the oil and gas sector. NESR Resolution No 1910 also provides that the NESR can set a lower price than that which the gas producing entity states if the NESR finds that the entity has, *inter alia*, allocated funds to costs in a way not envisaged, or failed to substantiate components of costs in the manner specified, or failed to submit additional documents as requested. See NESR Resolution No. 1910 "On approval of amendments to the procedure for formation, calculation and fixing of natural gas prices for business entities carrying out its production", 31 December 2013, **Exhibit {C-504}.**

invalid in Case No 826/9050/14, and was in reality yet another attempt by the NESR to further the Respondent's objective of acquiring Ukrnafta's gas at an undervalue.

9. The Respondent's conduct from 2014 onwards in pursuit of its objective to acquire Ukrnafta's gas at an undervalue, or for no value at all

217. The Respondent did not cease its efforts to obtain Ukrnafta's gas below or for no value in 2014. Instead, it continued to seek to appropriate Ukrnafta's gas on flawed legal bases and without paying any money to Ukrnafta. It also, of course, continued to press Ukrnafta to sign contracts for the supply of gas at prices set by the NESR that were well below economically justifiable prices, and pursuant to NESR Resolutions that would ultimately be deemed invalid by the Respondent's courts.[320] Naftogaz continued to pursue this position despite Ukrnafta explaining its position as to why such contracts were not viable, and how the prices involved would be "knowingly loss making".[321]

218. A key instance of the Respondent pursuing this strategy occurred in relation to Case No 6/521. As already noted, the Supreme Commercial Court held in this case on 19 May 2014 that: Ukrtransgaz and Naftogaz were not to impede Ukrnafta's exercise of its rights of ownership in relation to 2,061,805,134m^3 of 2006 gas, including its rights to extract that gas from the UGS to sell to industrial consumers; Ukrtransgaz was to satisfy Ukrnafta's request of 25 October 2010 by extracting the gas and preparing a statement of acceptance and transfer; and Naftogaz was to include the gas in the annual balance.

219. However, despite the Kiev Commercial Court duly issuing orders for the purpose of enforcing its original ruling of 20 January 2011 in this case, neither Ukrtransgaz nor Naftogaz complied with the court orders. Accordingly, on 28 July 2014, Ukrnafta applied to the enforcement authority (the State Bailiffs Service Department of the Shevchenko District Justice Administration ("**Bailiff**")), seeking to commence

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320 Letter No. 6-92/1-14 by Naftogaz to Ukrnafta, 14 January 2014, **Exhibit {C-1317}.**

321 See, e.g., Letter No. 10/209 by Ukrnafta to Naftogaz, 6 February 2014, **Exhibit {C-1320}**; Letter No. 10/772 by Ukrnafta to Naftogaz, 13 April 2014, **Exhibit {C-1705}.**

enforcement proceedings,[322] which the Bailiff duly opened.[323] Naftogaz was thereby ordered to carry out the court's ruling voluntarily and not to cause impediments to Ukrnafta's exercise of its rights, and to report to the Bailiff within three days that it had done so.

220. As the Chronology at Annex 1 sets out, Naftogaz sought to avoid this basic duty to comply with court orders in Case No 6/521 in numerous ways. It appealed to the Kiev Commercial Court, seeking orders that the Bailiff's actions were unlawful and that the enforcement proceedings were to be discontinued, but was unsuccessful.[324] The Bailiff thus issued demands and imposed fines on Naftogaz seeking its compliance with the pre-existing judgments.[325] Its appeal on this point to the Kiev Appellate Commercial Court, failed.[326] Naftogaz's attempts to avoid having to release 2,061,805,134m^3 of 2006 gas from the UGS to Ukrnafta in compliance with court orders in this case continued into 2015. It thus applied on 26 January 2015 to the Kiev Commercial Court for an order declaring that the orders of the Supreme Commercial Court in Case No 6/521 were unenforceable.[327] Naftogaz's application

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322 Case No. 6/521 Ukrnafta Application for enforcement proceedings against Ukrtransgaz Letter No.10/1403, 28 July 2014, **Exhibit {C-126}**; Case No. 6/521 Ukrnafta Application for enforcement proceedings against Ukrtransgaz Letter No.10/1404 , 28 July 2014, **Exhibit {C-127}**; Case No. 6/521 Ukrnafta Application for enforcement proceedings against Naftogaz Letter No.10/1407, 28 July 2014, **Exhibit {C-128}**; Case No. 6/521 Ukrnafta Application for enforcement proceedings against Naftogaz Letter No.10/1408 , 28 July 2014, **Exhibit {C-129}.**

323 See, for example, Enforcement Number 44193147 (Case No. 6/521) Decree on the Issuance of a Fine, 28 September 2014, **Exhibit {C-135}**; Enforcement Number 44193183 (Case No. 6/521) Decree on the Issuance of a Fine, 28 September 2014, **Exhibit {C-136}.**

324 Case No. 6/521 Order of the Commercial Court of Kiev (regarding Bailiff Decree No. 44193183), 2 September 2014, **Exhibit {C-133}**; Case No. 6/521 Order of Commercial Court (re Bailiff Decree No. 44193183), 2 September 2014, **Exhibit {C-1714**}.

325 Enforcement Number 44193147 (Case No. 6/521) Decree on the Issuance of a Fine, 28 September 2014, **Exhibit {C-135}**; Enforcement Number 44193183 (Case No. 6/521) Decree on the Issuance of a Fine, 28 September 2014, **Exhibit {C-136}**; Case No. 6/521 Bailiff Demand No. 1724/10 against Naftogaz, 28 September 2014, **Exhibit {C-138**}; Case No. 6/521 Bailiff Demand No. 1723/10 against Naftogaz, 28 September 2014, **Exhibit {C-137}** .

326 Case No. 6/521 Decision of the Commercial Court of Appeal (regarding Enforcement Number 44193147), 27 November 2014, **Exhibit {C-140}.**

327 Case No. 6/521 Decision of the Commercial Court of Kiev, 26 January 2015, **Exhibit {C-143}.**

was dismissed by two levels of the Respondent's appellate courts.[328] The Supreme Court of Ukraine then refused Naftogaz permission to appeal from the decision of the Supreme Commercial Court,[329] and the extent of Naftogaz's (and Ukrtransgaz's) refusal to comply with this court order prompted the Bailiff to submit a request to commence criminal proceedings against Ukrtransgaz for failure to comply with the rulings of the Kiev Commercial Court.[330] Naftogaz and Ukrtransgaz nonetheless continued not to comply with the court orders, sought (unsuccessfully) to obtain extensions to challenge some of those orders[331] and Ukrtransgaz even went so far as to submit an application to the Kiev Commercial Court requesting an explanation as to how it should execute the order to return the gas to Ukrnafta – which application was dismissed.[332]

221. Naftogaz did not, however, limit its attempts to appropriate Ukrnafta's gas to its refusal to comply with court orders stipulating that it and Ukrtransgaz should transfer that gas to Ukrnafta. In addition, it once again sought to force Ukrnafta to sign a contract transferring a significant volume of gas to it well below its value.[333]

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328 Case No. 6/521 Decision of the Commercial Court of Appeal of Kiev, 11 March 2015, **Exhibit {C-144}**; Case No. 6/521 Decision of the Supreme Commercial Court of Ukraine, 14 July 2015, **Exhibit {C-145}.**

329 Case No. 6/521 Decision of the Supreme Court of Ukraine, 15 September 2015, **Exhibit {C-146}.**

330 Enforcement Number 44213701 (Case No. 6/521) Bailiff Application No. 59/3, 2 December 2015, **Exhibit {C-149}**. The Kiev Commercial Court was also forced to dismiss an application by Ukrtransgaz to compel the Bailiff to withdraw its requests to commence criminal proceedings: Case No. 6/521 Decision of the Commercial Court of Kiev regarding Enforcement Number 44213701, 25 January 2016, **Exhibit {C-154}.**

331 Case No. 6/521 Decision of the Supreme Court of Ukraine, 22 December 2015, **Exhibit {C-150}**; Case No. 6/521 Order of the Supreme Court, 2 February 2016, **Exhibit {C-155}.**

332 Case No. 6/521 Ukrtransgaz Application No.15110/6 about Explanation of Court Order, 30 November 2015, **Exhibit {C-147}**; Case No. 6/521 Decision of the Commercial Court of Kiev, 19 January 2016, **Exhibit {C-152}**; Case No. 6/521 Order of the Commercial Court of Kiev (regarding Enforcement Number 44213701), 18 January 2016, **Exhibit {C-151}.** An appeal by Ukrtransgaz was rejected on 9 March 2016, and a further appeal is yet to be heard.

333 On the issue of transfer of gas to Naftogaz, it is notable that, on 26 November 2014, the Cabinet of Ministers issued Cabinet Decree 647 ("**November 2014 Cabinet Decree**"). That Decree provided, *inter alia*, that: all industrial, power-generating and heat-generating companies which are listed in the Appendix to the Decree (which did not include Ukrnafta),

222. Thus, on 16 April 2014, Naftogaz sent to Ukrnafta a draft contract pursuant to which Ukrnafta would be obliged to supply Naftogaz with 1,000,000,000m^3 of 2014 gas at the price of UAH 562.50 (excluding VAT) set by the December 2013 NESR Resolution, or UAH 675 (including VAT).[334] With Ukrnafta having declined to sign the contract due to the price being well below what it had explained several times to Naftogaz was the price that would allow it to break-even, in July 2014 Naftogaz commenced Case No 910/15003/14 against Ukrnafta in the Kiev Commercial Court, seeking an order compelling Ukrnafta to enter into a contract on those terms.[335] On 1 October 2014, the Court stayed those proceedings pending the determination of Case No 826/9050/14, in which that Resolution was being challenged (and the proceedings have not been reactivated to date).[336]

223. Amidst this pursuit by Naftogaz of Ukrnafta's gas for below or no value, the NESR also sought to defend the purported basis on which it stipulated the price at which Naftogaz was pressing to obtain the gas. This occurred in Case No 826/9050/14. That case was started by Ukrnafta against the NESR in the Kiev District Administrative Court, seeking the cancellation of the December 2013 NESR Resolution, by which

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and all State-owned companies which use gas for industrial purposes (which may include Ukrnafta, though it is not clearly stipulated), are required to purchase their gas exclusively from Naftogaz; and the affected companies are prohibited from using gas from any source other than Naftogaz, including their own gas. If this November 2014 Cabinet Decree does cover Ukrnafta, it is another measure of the Respondent that facilitates the transfer of gas from Ukrnafta to Naftogaz on terms to which the former had not consented. The November 2014 Cabinet Decree has, however, been challenged by numerous companies listed therein in cases consolidated as Case No 826/17772/14. The Kiev Administrative Court has upheld the claims and declared the provisions in the November 2014 Cabinet Decree null and void from the moment of their adoption, and the Kiev Administrative Court of Appeal dismissed an appeal: Case No. 826/17772/14 - Decision of the Kiev District Administrative Court, 16 December 2014, **Exhibit {C-285}**; Case No. 826/17772/14 - Decision of the Kiev Administrative Court of Appeal, 5 February 2015, **Exhibit {C-286**}. The Claimants understand that the decision of the Kiev Administrative Court of Appeal is itself presently being appealed, albeit no decision has yet been issued.

334 Letter No. 6-1545/1.4-14 by Naftogaz to Ukrnafta encl. Natural Gas supply agreement, 16 April 2014, **Exhibit {C-1324}.**

335 Case No. 910/15003/14 Statement of Claim, 18 July 2014, **Exhibit {C-283}.**

336 Decision by the Kiev Commercial Court (Case No. 910/15003/14), 1 October 2014, **Exhibit {C-284}.**

NESR purported to set a price of UAH 562.50 (excluding VAT) for Ukrnafta's gas with effect from 1 January 2014 (see Section II.E.8 above).[337]

224. While the Chronology at Annex 1 describes this litigation, on 10 April 2015, the Kiev District Administrative Court upheld Ukrnafta's claim and cancelled the December 2013 NESR Resolution from the date of its adoption,[338] which decision was upheld on an appeal by the NESR in both the Kiev Administrative Court of Appeal and the Supreme Administrative Court of Ukraine.[339] The courts' basis for the decision was that: in calculating the price and passing the December 2013 NESR Resolution, the NESR had applied the 2012 NESR Gas Pricing Procedure, which had since been declared invalid in Case No 826/6130/13-a (as noted above); and the NESR had allowed less than what Ukrnafta had claimed as the constituent elements of its prime-cost, without explanation, with arbitrary reductions (of between 3% and 79%), and with the result that the price of UAH 562.50 (excluding VAT) did not cover Ukrnafta's economically grounded costs, let alone allow it to earn a profit. As a result, the December 2013 NESR Resolution was declared invalid, and the NESR was again shown to have participated in the pursuit of the Respondent's objective of acquiring Ukrnafta's gas below value on grounds that were unlawful.

10. Conclusion

225. As the foregoing illustrates, the Respondent's conduct in relation to its attempts to acquire Ukrnafta's gas at an undervalue – that is, for a value below Ukrnafta's costs of production – or for no value at all escalated over the relevant time period. At first, the Respondent's focus was primarily to obtain Ukrnafta's gas at an undervalue. This took several forms. Naftogaz pushed Ukrnafta to sign contracts for the

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337 Case No. 826/9050/14 Ukrnafta Statement of Claim Letter No. 10/1191, 23 June 2014, **Exhibit {C-261}**; Case No. 826/9050/14 Ruling of the Kiev District Administrative Court, 27 June 2014, **Exhibit {C-262}.**

338 Case No. 826/9050/14 Decision of the Kiev District Administrative Court, 10 April 2015, **Exhibit {C-277}.**

339 Case No. 826/9050/14 Order of the Administrative Court of Appeal of Kiev, 26 May 2015, **Exhibit {C-278}**; Case No. K 800/25475/15 et al (appeal re case No. 826/9050/14) Decision of the Supreme Administrative Court, 15 March 2016, **Exhibit {C-1903}.**

acquisition of its gas at a price that was lower than Ukrnafta's costs of production. Ukrtransgaz also pressured Ukrnafta to sign such undervalue contracts by equivocating over whether it would sign Deeds of Transfer and Acceptance in respect of gas pumped by Ukrnafta into the UGS, or delaying the signature of such documents. The NERC for its part issued Resolutions that purported to approve prices for the sale of gas that did not cover the costs of production of Ukrnafta. All three of these entities of course also participated in litigation that tested whether they were entitled to acquire Ukrnafta's gas at such prices. Despite consistently failing in that litigation, Naftogaz, Ukrtransgaz and NERC / NESR repeated the same conduct, made the same decisions and advanced the same justifications as those which had previously been held unlawful by the Respondent's courts. Such conduct illustrates that the Respondent knew that the prices it was seeking to impose were below Ukrnafta's cost, and therefore also knew it was causing loss to Ukrnafta, and in doing so was deliberately and consciously damaging the Claimants.

226. During this first phase of the Respondent's conduct, the Respondent did take steps to acquire Ukrnafta's gas for no value – that is, simply to take the gas without Ukrnafta's consent and without paying Ukrnafta for it. However, that trait of the Respondent's conduct increased as the years passed and Naftogaz, Ukrtransgaz and NERC / NESR repeatedly lost the litigation before the Ukrainian courts on the issue of the price at which Ukrnafta was being asked to sell its gas. The Respondent maintained pressure on Ukrnafta to supply it with undervalued gas (not least when it passed the July 2010 Gas Market Law that subverted the rulings of the Respondent's courts on this issues), but by 2012 Naftogaz in particular was increasingly insisting that Ukrnafta's gas in the UGS should be treated as belonging to an "undeterminable owner" and that Ukrnafta could not be the owner of gas in the UGS because that gas had already been extracted and used by Naftogaz for sale to and consumption by the general population. Again, this position was advanced repeatedly by the Respondent to justify its position, even though the previous litigation had established that such a justification was unlawful. This conduct was, in

effect, a plain appropriation of Ukrnafta's gas by the Respondent, consciously done contrary to law and without compensation.

227. The foregoing submissions and supporting evidence establish these phases of conduct by the Respondent, whereby it sought to acquire Ukrnafta's gas at an undervalue and then, seeing that attempt repeatedly fail before the Respondent's courts, directed more efforts towards acquiring the gas for no value at all. However, this is not a point on which significant contest is to be expected between the Parties, in light of the public position taken by Naftogaz in relation to this arbitration. As Mr Kobolev has been quoted:

> "In Ukraine, there are court decisions that oblige Naftogaz of Ukraine and Urktransgaz to return the gas... We are unable to do that because the population consumed the gas and this gas is not something that Naftogaz took and hid somewhere or used otherwise. The gas was transferred to the population. There is no secret here."[340]

228. This is a clear acceptance that Naftogaz took Ukrnafta's gas and is refusing to return it, that Naftogaz's taking of the gas was a violation of Ukrainian law, and that Naftogaz and Ukrtransgaz have not complied with court orders. Further, the same article noted that Naftogaz's auditors believe it owes Ukrnafta a large sum of money for the gas it had taken from Ukrnafta: "According to Naftogaz of Ukraine's financial reports for the period of 2012-2013 audited by Deloitte & Touche, Naftogaz of Ukraine estimates its obligations to Ukrnafta for the 10.1 billion cubic meters of gas that was used to meet household needs in the period from 2006 to 2011 at UAH 3.753 billion."[341]

229. In this context, the final phase of the Respondent's misconduct in respect of Ukrnafta (and the Claimants investments in it) was predictable: it moved simply to take control of Ukrnafta in its entirety. This final phase of misconduct began when the

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340 Article 'Naftogaz Says Ukraine Has Good Chance Of Winning International Arbitration Dispute Over Price of Ukrnafta's Gas', 21 April 2016, **Exhibit {C-1879** Original}.

341 Article 'Naftogaz Says Ukraine Has Good Chance Of Winning International Arbitration Dispute Over Price of Ukrnafta's Gas', 21 April 2016, **Exhibit {C-1879 Original}.**

Respondent tried to impose enormous financial burdens on the sector in which Ukrnafta operated, but with significant detriment to and focus on Ukrnafta itself. It also included the alteration of by the Verkhovna Rada of Ukrainian law in order to allow Naftogaz to take full control of the corporate governance of Ukrnafta, regardless of the bargain it had struck in 2010 Shareholders Agreement, 2010 Cooperation Agreement and 2011 Articles.

F. The Respondent in late 2014 and 2015 sought to impose enormous financial burdens on the sector in which Ukrnafta operated, but with significant detriment to and focus on Ukrnafta itself

230. Although the foregoing explanation of how the Respondent sought to obtain Ukrnafta's gas below or for no value demonstrates the fixedness with which it pursued this strategy, it was not the only way in which the Respondent impaired Ukrnafta. In addition, it imposed enormous financial burdens on the sector in which Ukrnafta operated (see Section II.F.1 below), and ultimately structured that law and the penal consequences of not complying with it in a way that had significantly detrimental effects for Ukrnafta (see Section II.F.2 below).

1. The conception and introduction of a "temporary" rental fee increase

231. The earliest conception of the idea of imposing increased rental payments imposed on oil production operations appears to have been in early 2014, when the Cabinet of Ministers raised the initiative, including by placing draft laws to that effect before the Verkhovna Rada, albeit they were ultimately not put to the vote.[342]

232. In any event, despite initial setbacks in forcing through this increase in the rental fee,[343] the Cabinet of Ministers eventually achieved its purpose. On 31 July 2014, the Verkhovna Rada passed draft Law 4309A, which was then titled Law of Ukraine

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342 The Cabinet of Ministers thus reportedly sought to introduce draft Law No. 4647 to the Verkhovna Rada, but the Deputies did not permit a vote on that draft Law to be included on the agenda: Oil & Gas Eurasia Article "Ukrainian Government to increase severance tax for oil and condensate", 9 April 2014, Exhibit {C-1323 Original}; Verkhovna Rada of Ukraine News 'Plenary meeting of Verkhovna Rada', 9 April 2014, **Exhibit {C-1322 Original}.**

343 Article 'Cabinet of Ministers Initiative to increase rental fee for oil productions was not successful', 9 April 2014, **Exhibit {C-1880}.**

1621-VII, "Amending Ukrainian Tax Code".[344] The presently relevant provisions of Law 1621-VII were in Subsection 9:

> "1. Temporarily, until 1 January 2015, these features of the application of some norms of section XI "Payment for Use of Subsoils" of this [Tax] Code are established:
>
> 1.1 Fee rates for use of subsoils for extraction of oil, condensate, natural gas and iron area … are established for the period specified by the first paragraph of this item, in percentages of the value of the commodity products of the mining company – extraction of minerals (raw minerals) in the following amounts:

Name of the group of mineral resources that are provided to the mining company with the use of subsoil	Rate, percentage of the value of the commodity of the mining company
…	
Oil, condensate:	
From deposits that are fully or partially at a depth of 5000 meters	45.00
From deposits that are completely at a depth above 5000 meters	21.00
Natural gas (any origin):	
Natural gas that meets the conditions specified in subitem 263.11.5 of item 263.11 of Article 263 of this Code, extracted from deposits down to 5000 meters	20.00
Natural gas that meets the conditions specified in subitem 263.11.5 of item 263.11 of Article 263 of this Code, extracted from deposits above 5000 meters	14.00
…	
From deposits that are fully or partially at a depth of 5000 meters	55.00
From deposits that are fully at a depth above 5000 meters	28.00"

[344] Law of Ukraine No. 1621-VII "On changes to the Tax Code of Ukraine and some other legislative acts of Ukraine", 31 July 2014, last amended on 28 December 2014, **Exhibit {C-536}**.

233. The key components of Law 1621-VII were thus: it was temporary, with the increase only set to last until 1 January 2015; the fee for the extraction of oil and condensate up to a depth of 5,000 metres increased from 39% (oil) and 42% (condensate) up to 45%; the fee for the extraction of oil and condensate beyond a depth of 5,000 metres increased from a uniform 18% to 21%; the fee for the extraction of gas up to a depth of 5,000 metres increased from 28% to 55%; and the fee for the extraction of gas beyond a depth of 5,000 metres increased from 15% to 28%.[345]

234. The reaction of the industry was swift. As the President of the Association of Subsoil Users of Ukraine observed:

> "By increasing the rental rate, Ukraine will see a decline in production in 2015 and the outflow of investment capital instead of the anticipated revenues to the state budget. Almost all private oil and gas companies operating in Ukraine have already informed about the reduction in investments. Moreover, amendments to article 29 of the Budget Code of Ukraine will allocate 75% instead of 50% of rental payments to the central fund of the state budget, which will further reduce the funding for the geological industry. Such steps will lead Ukraine in the opposite direction to energy independence, and the country should be prepared for the reduction in volume of internal energy resources and the stagnation in private gas production in Ukraine."[346]

235. As several oil companies stated in an open letter to Prime Minister Yatsenyuk and others:

> "Oil and gas industry requires planning of the project economy and stable long-term investment. Any change in the tax burden (upwards) fundamentally undermines the investment attractiveness of further hydrocarbon deposits' development in Ukraine because of the unpredictability in economic

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345 Law of Ukraine No. 1621-VII "On changes to the Tax Code of Ukraine and some other legislative acts of Ukraine" 31 June 2014, last amended on 28 December 2014, **Exhibit {C-536}** See also Oil News Article 'Rada increased rentals payments on extraction', 31 July 2014, **Exhibit {C-1339**}.

346 Oilreview.Kiev.UA Article 'Yaresko: The rise of gas extraction rent to 70% to cover additional state subsidies in the amount of UAH 12.5 billion', 17 February 2015, **Exhibit {C-1366**}.

> justification of hydrocarbons' production and calculation of the investment payback time. In the absence of profit, private gas producing companies will not be able to finance the exploration and development of deposits, drilling of new wells and fulfilment of additional studies. This will unavoidably lead to suspension of the industry's development in general.
>
> …
>
> A challenge of increasing hydrocarbons' production requires that the government creates and supports attractive investment climate, which presupposes stable and flexible fiscal system, basic legislation and regulatory framework that would be clear for international investors. The royalty rates stipulated by the draft law are unprecedented even for the European perspective. Today, the international community is very focused on the new initiatives of the Ukrainian government as never before since they will be taken into account when decisions about the financing of the Ukrainian economy and projects are made. That is why, any change in the tax legislation and increase in the tax payments can lead to phasing out of such investment projects and flight of international investors from the Ukrainian market in favour of other, more attractive neighbouring jurisdictions (Poland, Romania, Turkey) that compete with Ukraine for development of their own oil and gas industries, if to compare their fiscal and tax conditions (the above countries provide favourable conditions for stimulation of domestic production development) and systems for stimulation of hydrocarbons' production with the Ukrainian ones."[347]

2. <u>The introduction of a permanent rental fee increase, and the targeting of Ukrnafta</u>

236. Despite the outcry of the industry confirming the drastic effect that such an increase in the rental fee would have on operations, the Respondent moved, three days before Law 1621-VII was due to expire, to place its content on a permanent footing under Ukrainian law. On 28 December 2014, the Respondent passed Law of Ukraine No.

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[347] Smart Holding Article "Open letter to Prime Minister of Ukraine A.P. Yatsenyuk regarding initiative to increase rent rate for subsoil use for private gas production companies", 30 July 2014, **Exhibit {C-1338** Original}.

71-VIII "On Amending the Tax Code of Ukraine and certain legislative acts of Ukraine concerning tax reform".[348] The core provisions of Law 71-VIII were thus:

> "1. The following amendments shall be made to the Tax Code of Ukraine (News of the Parliament of Ukraine, 2011, NN 13-17, art. 112):
>
> Section IX RENTAL FEE
>
> …
>
> 252.20 The rental rate for use of subsoil to extract minerals shall be set as a percentage of the value of the marketable product--the extracted mineral (mineral stock)--produced by the extraction enterprise using the following formula:

Name of groups of minerals granted to the extraction enterprise for use of subsoil	Rate, percentage of the value of the marketable product of the extraction enterprise
natural gas (of any origin)	
natural gas extracted during the performance of joint operating contracts	70.00
from deposits wholly or partially found at a depth up to 5000 meters	55.00
from deposits wholly or partially found at a depth beyond 5000 meters	28.00

> …
>
> Subsection 9-1. Features of the collection of the rental fee for subsoil use for mineral extraction.
>
> Temporarily, until 1 July 2015, the following features of the application of certain norms of section IX Rental Fee of this Code are established:
>
> 1.1. The rental fees for the use of subsoil for the extraction of natural gas, as defined by clause 252.20 in article 252 of this

[348] Law of Ukraine No. 71-VIII "On amending the Tax Code of Ukraine and certain legislative acts of Ukraine concerning tax reform", Article 252 (extract), 28 December 2014, **Exhibit {C-535}**.

> Code, for natural gas produced during the performance of joint operating contracts are set for the period defined by the first paragraph of this subsection as a percentage of the value of the marketable product--the extracted mineral (mineral stock)--produced by the extraction enterprise using the following formula:
>
> from 1 January to 31 March 2015 (inclusive) – 60 per cent;
>
> from 1 April to 30 June 2015 (inclusive) – 65 per cent;
>
> as of 1 July, the rate set by clause 252.20 in article 252 of this Code shall apply"

237. Law 71-VIII thus introduced permanently into Ukrainian law the same increased rental fees that Law 1621-VII had introduced temporarily.[349]

238. The Respondent did not cease its push for higher rental fees at that point, however. On 17 February 2015, the Minister of Finance of Ukraine, Ms Natalie Ann Jaresko, publicly announced that the Respondent intended to introduce an increased rate of rental fee which would apply exclusively to gas producing companies in which the Respondent was a majority shareholder, directly or indirectly.[350] By the next day, on 18 February 2015, the notion was being described as a proposal of the Cabinet of

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349 See also Unian Information agency Article 'MPs adopt amendments to the Tax Code of Ukraine in the second reading', 28 December 2014, **Exhibit {C-1353}.** Notably, however, the Respondent's courts declared Law 1621-VIII invalid on the basis of cases commenced by Ukrnafta. For example, in Case No. 826/18764/15, both the Kiev Administrative Court and the Kiev Administrative Court of Appeal held, *inter alia*, that the rental fee could not be changed less than six months before the start of a fiscal period (and certainly not in the middle of a fiscal period, as occurred in this instance). See: Case No. 826/18764/15 Decision of the Administrative Court of Kiev Decision in relation to Ukrnafta appeal of Rental Fee Amendment, 18 September 2015, **Exhibit {C-287}**; Case No. 826/18764/15 Decision of Kiev Administrative Court of Appeal, 23 December 2015, **Exhibit {C-288}**.To change a tax rate other than at least six months in advance of the relevant fiscal period would, the courts held, violate the principle of tax stability set out in Article 4 of the Tax Code of Ukraine. An appeal was lodged with the Supreme Administrative Court of Ukraine, but, as the applicable court fee was not paid, the matter was returned by that Court without any consideration of it. See Case No. 826/18764/15 Decision of Supreme Administrative Court, 2 March 2016, **Exhibit {C-289}**.

350 Oilreview.Kiev.UA Article 'Yaresko: The rise of gas extraction rent to 70% to cover additional state subsidies in the amount of UAH 12.5 billion', 17 February 2015, **Exhibit {C-1366**}.

Ministers of the Respondent.[351] The Respondent candidly acknowledged that the purpose of this new measure was not driven by any particular policy or industry consideration. Rather, as Ms Jaresko openly stated, it was implemented in order to "gain the required revenues to the budget",[352] and that point was reiterated during the drafting of the subsequent law enacting the Cabinet of Minister's proposal. Thus the explanatory memorandum to the subsequent law stated:

> "1. Rationale for the need to pass the Draft Law
>
> The economic situation in the country at this time calls for an increase in tariffs for natural gas, which is sold for the needs of the population, and for supporting internally displaced persons ...
>
> 2. The purpose and ways to achieve it
>
> ...
>
> In connection with the above, it is proposed to increase the royalty rate from 20% to 70%. This will bring in additional revenues for the state budget that will be used for direct support of low-income households, and increase the net income of gas producing companies that will be used for further development of the industry
>
> ...
>
> 4. Financial and economic justification
>
> The adoption and implementation of this Draft Law will bring about UAH 9 billion to the State Budget of Ukraine in 2015."[353]

239. The Respondent was also candid that this increase from 20% to 70% was intended to target only two companies, namely, Ukrnafta and PJSC Ukrgazvydobuvannya.[354]

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351 Interfax Ukraine Article 'Cabinet proposes Rada raises Ukrgazvydobuvannia, Ukrnafta royalties from 20% to 70%', 18 February 2015, **Exhibit {C-1368 Original}**.

352 Oilreview.Kiev.UA Article 'Yaresko: The rise of gas extraction rent to 70% to cover additional state subsidies in the amount of UAH 12.5 billion', 17 February 2015, **Exhibit {C-1366}.**

353 Explanatory Note of Ministry of Justice to the Draft Law of Ukraine on amendments to Articles 165 and 252 of the Tax Code of Ukraine", 23 February 2015, **Exhibit {C-542}.**

354 Interfax Ukraine Article 'Cabinet proposes Rada raises Ukrgazvydobuvannia, Ukrnafta royalties from 20% to 70%', 18 February 2015, **Exhibit {C-1368 Original}.**

However, the reality is that this measure would only affect one of these two companies (and in that sense was targeted at), Ukrnafta. This is because Ukrgazvydobuvannya is wholly owned by the Respondent. As a result, any monies paid in the form of increased rental fees pursuant to the new measure would simply effect a transfer from one part of the Respondent's budget to another. By contrast, as noted in Section II.A above, Ukrnafta is owned in the amount of 50% plus 1 share by Naftogaz, with the remaining shares being privately held (of which 40.1009% are held by the Claimants). Thus, the only budgetary gain to the Respondent by the rental fee increase would be at the expense of the element of Ukrnafta that was not State-owned – any monies paid over by Ukrnafta to the Respondent pursuant to the increased rental fee would cause loss directly to the minority shareholders, of whom the Claimants were the majority.

240. Doubtless aware of this reality, on 2 March 2015, Ukraine passed draft Law No. 2213 which gave effect to the proposal. The measure was signed into law by the President of Ukraine on 10 March 2015 as Law 211-VIII, which entered into force on 1 April 2015.[355] The rush to enact the legislation was great enough for the Respondent apparently to ignore entirely the criticisms of the Verkhovna Rada's own expert:

> "The Draft Law proposes to increase from 20 to 70% the rate of royalties for subsoil use for extraction of "natural gas that meets the conditions set out in section 252.24 of Article 252 of the Tax Code extracted from deposits at up to 5,000 metres." However, the explanatory note to the Draft Law contains no relevant justification as to the feasibility of setting the royalty rates proposed in the Draft Law, which does not meet the requirements of Article 91 of the Regulations of the Verkhovna Rada of Ukraine and Article 27 of the Budget Code of Ukraine, according to which a draft law should be accompanied by an appropriate financial feasibility study (including the relevant calculations)."[356]

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355 Law No. 211-VIII "On amending the tax Code of Ukraine", 2 March 2015, **Exhibit {C-548}.**

356 Conclusion No. 2213 of the Cabinet of Ministers of Ukraine "On the Draft Law of Ukraine on amendments to Articles 165 and 252 of the Tax Code of Ukraine", 23 February 2015, **Exhibit {C-541}.**

241. The reason for paying no heed to the expert's view was the same as it was before: the Respondent simply wanted the cash. As Ms Jaresko stated once again on the floor of the Verkhovna Rada when draft Law No. 2213 was being discussed:

> "there is a need to extract for the State Budget a portion of surplus income that will be received by gas producing companies as a result of reduced cross-subsidisation. To this end, for those gas producing companies in Ukraine, in which the state has a significant share (we are talking about Ukrgazvydobuvannya [and Ukrnafta] here), we propose to increase royalties from 20 to 70 percent. This will allow to bring in additional revenues of UAH 9 billion to the state budget in 2015".[357]

242. The core provision which achieved this in Law 211-VIII reads as follows:[358]

> "2) In Article 252:
>
> In section 252.20 of the table, the item
>
> 'Natural gas that meets the conditions set out in section 252.24 of this article extracted from deposits at depths of up to 5,000 metres: 20.00'
>
> shall be replaced with the following item:
>
> 'Natural gas that meets the conditions set out in section 252.24 of this article, extracted from deposits at depths of up to 5,000 metres: 70.00'".

243. The Respondent thus achieved its goal of establishing in law a basis on which it could extract money from Ukrnafta, to the direct harm of the Claimants, in order to offset its budgetary shortfall. This objective, it seems, was enough to make the Respondent impose an enormous increase in the rental fee payable by Ukrnafta, to ignore the criticisms of its own expert appointed by the Verkhovna Rada and amend its law with little apparent consideration as to its practical effects.

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357 Transcript of Verkhovna Rada Session re Draft Law No.2213 (extract), 2 March 2015, **Exhibit {C-1369}.**

358 Law No. 211-VIII "On amending the tax Code of Ukraine", 2 March 2015, **Exhibit {C-548}.**

244. The Respondent ultimately appeared to recognise that its position on the rental fee was unsustainable. In early 2016, the Respondent reduced the rental fee to levels that were approximately equivalent to those that were in place before the initial increase in 2014, by way of Law 1621-VII, had occurred.[359] However, unfortunately for Ukrnafta, and for the Claimants that held shareholdings in Ukrnafta, the effects of this increase in the rental fee over a period of some two years had a significant detrimental effect.

245. The detrimental effect on Ukrnafta was primarily that its inability to pay the far higher rental fee over the 2014 to 2016 period meant that its tax liability increased by a large amount in a short period of time. As Mr Kartashov states:

> "Ukrnafta did not have the resources to pay the Rental Fee at the increased rates and was soon in arrears. Ukrnafta first sought the agreement of the tax authorities to defer the payment, but they would not agree. Then in May 2015 Ukrnafta sought to pay the Rental Fee for the period from August to December 2014 on the basis of adjusted Rental Fee declarations in which it used the old rates. The tax authorities did not agree. They refused to apply the old rates and instead imposed the new rates and added a 50% penalty. This increased Ukrnafta's alleged tax liability to UAH 1.2 billion (including the Rental Fee in relation to oil and condensates as well as gas)."[360]

246. Other significant detrimental effects were that the imposing of the rental fee increased Ukrnafta's overall tax liability up to several billion hryvnias, and Ukrnafta's inability to pay the rental fee led to the Respondent refusing to extend Ukrnafta's exploration and industrial development and production licences.[361] In this way, the imposition of the rental fee impaired not only Ukrnafta's financial viability as a going concern, but also its operational viability as an oil and gas extractor. The Respondent may have imposed the enormous financial burdens on the sector in which Ukrnafta operated, but its conduct when Ukrnafta could not pay

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359 See, e.g., KMP.UA Article 'Rental fee. Amendments 2016', 29 January 2016, **Exhibit {C-1429}.**

360 Witness Statement of Mr Kartashov, paragraphs 102-104**.**

361 Witness Statement of Mr Kartashov, paragraph 118.

that suddenly increased rental fee meant that Ukrnafta felt an even greater burden that the simple increase in rental fee would otherwise have suggested.

G. The conduct of the Respondent, including Naftogaz, in relation to altering the corporate governance of Ukrnafta and emasculating the shareholders agreement

247. Once again, however, the Respondent did not limit its impairments of the Claimants' investments to strategies it had traditionally pursued. Instead, in 2015, it conceived and adopted a further strategy to this end. In this section II.G, the Claimants explain, first, how the Respondent exercised its legislative powers to interfere in a targeted fashion to subvert the Claimants' rights in the corporate governance of Ukrnafta, and, secondly, how Naftogaz implemented the objectives of those legislative changes to subvert the Claimants' rights. The substance of the rights of the Claimants in the corporate governance of Ukrnafta have already been set out in Sections II.B-II.D above.

1. The legislative interference in 2015 in the corporate governance of Ukrnafta

248. The corporate governance of Ukrnafta was structured fully in compliance with relevant Ukrainian legislation, and in particular the Law of Ukraine "On Joint Stock Companies" of 2008.[362] It also reflected the agreement of the shareholders as to how the company should be governed, as reflected in the 2005 Articles,[363] the 2010 Shareholders Agreement,[364] the 2010 Cooperation Agreement[365] and the 2011 Articles.[366]

249. However, from the early days of 2015, the Respondent exercised its legislative powers in numerous ways in order to interfere extensively in the corporate

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362 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, **Exhibit {C-361}**.

363 Ukrnafta Articles of Association 2005, 20 December 2005, **Exhibit {C-846}**.

364 Ukrnafta Shareholders Agreement, 25 January 2010, **Exhibit {C-1068**}.

365 Ukrnafta Cooperation Agreement, 23 December 2010, **Exhibit {C-1144**}.

366 Ukrnafta Articles of Association 2011, 22 March 2011, **Exhibit {C-1175}**.

governance of Ukrnafta, with the precise and targeted objective of establishing a legislative regime pursuant to which the Claimants' rights as Ukrnafta shareholders would be systematically undermined.

250. The first manoeuvre of the Respondent in this regard was in January 2015. On 13 January 2015, the Respondent passed Law No. 91-VIII, which its President signed into law on 28 January 2015.[367] Prior to January 2015 the minority shareholders of Ukrnafta had protection of their rights in general meeting by virtue of the law requiring a quorum of 60% of shareholders. Article 41(1)-(2) of the Law of Ukraine "On Joint Stock Companies" of 2008 stated in relevant part that:

> "1. Presence of a quorum of a general meeting shall be determined by a registration commission at the closing of registration of the shareholders for participation in the public company general meeting.
>
> 2. The general meeting shall have a quorum provided the shareholders owning jointly at least 60 percent of the voting shares have registered themselves for participation in the general meeting."[368]

251. However, the central prescription contained in Law No. 91-VIII was that a general meeting of the shareholders of a joint stock company in which the Respondent owned a shareholding of 50% or more would be quorate if shareholders owning more than 50% of the company's shares attended that meeting. Law No. 91-VIII altered the existing law in the following terms:

> "The Parliament of Ukraine **decrees**:
>
> 1. The following amendments are made to article 41 of the Law of Ukraine "On Joint-Stock Companies" (News of the Parliament of Ukraine, 2008, N 50 – 51, art. 384):
>
> 1) in part two:

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367 Law of Ukraine No.91-VIII "On amending Article 41 of the Law of Ukraine "On joint-stock companies", 13 January 2015, **Exhibit {C-537}**.

368 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, Article 41(1)-(2), **Exhibit {C-361**}.

in the first paragraph, replace the words and numbers "at least 60" with the words and numbers "more than 50";

in the second paragraph, replace the words and numbers "at least 60" with the words and numbers "more than 50";

2) add a part three as follows:

'3. A general shareholders meeting of a joint-stock company in the authorised capital of which includes equity rights of the state and in which the state owns 50 or more percent of the company's ordinary shares, has a quorum if shareholders that in aggregate are owners of more than 50 per cent of the voting shares register to participate in it.'"[369]

252. Law No. 91-VIII also provided that it "comes into force on the day after it is published, except section 1, subsection 1 of this Law, which comes into force on 1 January 2016".[370]

253. The Respondent's rationale in enacting Law No. 91-VIII was publicly affirmed by some of its most senior officials. Statements made by members of the Verkhovna Rada confirmed that the Respondent was enacting Law No. 91-VIII in order to undermine the rights that the Claimants had as shareholders in Ukrnafta under the company's constitutive documents, and to increase the control that the Respondent could exercise through Naftogaz over the company. Examples of such statements are:

a) A member of the Verkhovna Rada and the governing coalition, Mr Leshcenko, said during discussion of the proposed new law on 14 January 2015 that all members of Parliament "knew what [proposed Law No. 91-VIII] was about" and "understood … that we were talking about Ukrnafta".[371] He added that, "[f]or the first time in Ukraine's history there was made the

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369 Law of Ukraine No. 91-VIII "On amending Article 41 of the Law of Ukraine "On joint-stock companies", 13 January 2015, Article I, **Exhibit {C-537}**.

370 Law of Ukraine No. 91-VIII "On amending Article 41 of the Law of Ukraine "On joint-stock companies", 13 January 2015, Article II, **Exhibit {C-537**}.

371 Transcript of plenary session, the Thirteenth Meeting Sessional Hall of the Verkhovna Rada (extract), 14 January 2015, page 1, **Exhibit {C-1359**}.

decision which allows to hold shareholder meetings at one of the most powerful enterprises in the oil and gas industry 'Ukrnafta', enterprise, where the State owns a controlling stake, but for more than a decade could not hold a shareholders meeting and appoint executives, couldn't distribute dividends and receive them in the budget revenues, not without agreeing it first with one of the oligarchic clans".[372]

b) A further member of the Verkhovna Rada and the governing coalition, Ms Voytsitska, stated also during discussion of the proposed new law on 13 January 2015 that: "when we were reviewing and adopting the budget [sic] for 2015, we considered that around 2 billion hryvnias should be arrived [sic] from the state-controlled company. We are directly referring to "Naftogaz" and "Ukrnafta" which are totally owned by state [sic]."[373]

c) Another member of the Verkhovna Rada and the governing coalition, Mr Lyashko, stated also during discussion of the proposed new law on 13 January 2015 that: "We have many-many billions worth of state owned property. And today, the state, for example, having 50 per cent in [sic] the state-owned joint stock company, in fact cannot manage it, because to be able to make decisions, [sic] 60 per cent of votes plus one vote are required… Therefore, my draft law proposes [sic] to reduce the [sic] quorum required for decision-making where there is a state ownership in joint stock companies, down to 50 per cent plus one vote. This will enable the state to manage its property including the billions which are generated by this property, directing them to the state budget."[374]

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372 Transcript of plenary session, the Thirteenth Meeting Sessional Hall of the Verkhovna Rada (extract), 14 January 2015, page, **Exhibit {C-1359}**.

373 Transcript of plenary session, the Eleventh Session Meeting Room of the Parliament of Ukraine (Verkhovna Rada), 13 January 2015, page 4, **Exhibit {C-1358**}.

374 Transcript of plenary session, the Eleventh Session Meeting Room of the Parliament of Ukraine (Verkhovna Rada), 13 January 2015, page 3, **Exhibit {C-1358**}.

254. The pattern of these comments could hardly be mistaken. The Respondent was targeting Ukrnafta, and in particular the Claimants' rights as shareholders in the company, in order to undermine their rights and improve the State's position in respect of the management of the company. Desirous of obtaining cash from Ukrnafta quickly, the Respondent sought to use its legislative prerogatives simply to rewrite the law in a manner that would directly contravene and subvert the Claimants' rights of corporate governance in Ukrnafta, as set out in the 2011 Articles, 2010 Shareholders Agreement and 2010 Cooperation Agreement.

255. The purpose of Law No. 91-VIII was thus nothing to do with addressing an issue of general difficulty in the Ukrainian experience of corporate governance for all joint stock companies. It does not appear, and the Claimants are not aware, that the Respondent conducted any public or widespread consultation or research on the need for or effect of this change in the law. It does not appear, and the Claimants are not aware, that representatives of industry were asked to express a view to those preparing the law as to how corporate governance would be improved by the passage of Law No. 91-VIII. It does not appear, and the Claimants are not aware, that the Respondent deliberated for a significant period of time before passing Law No. 91-VIII. At the very minimum, none of this information, and no articulation of why the change in law was necessary for Ukrainian corporate governance principles as a general matter, was set out in the explanatory notes to Law No. 91-VIII, cited in speeches during its consideration by the Verkhovna Rada, or provided to shareholders in companies in which the Respondent owned a shareholding large enough to mean that the new legislation would apply to them in just over a fortnight's time. Rather, as the Respondent's own Prime Minister later described the enactment of Law No. 91-VIII, it was "passed in a hurry",[375] and with little attention to detail.

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375 Transcript of plenary session, the Sixteenth Meeting Session hall of the Verkhovna Rada, 16 January 2015, page 2, **Exhibit {C-1364**}.

256. This conclusion is endorsed by Dr Khachaturyan, the Ukrainian legal expert who has submitted an expert legal report in this case. In his report, Dr Khachaturyan explains the procedure by which legislation in Ukraine is to be adopted.[376] An important part of that procedure is the review of draft laws by the relevant Committees of the Verkhovna Rada of Ukraine.[377] As Dr Khachaturyan explains, Law No. 91-VIII was apparently not reviewed by several of the relevant Committees – including the Budget Committee, the Anti-Corruption Committee and the European Integration Committee – and on the evidence was clearly not reviewed by the Committee of Economy Policy.[378] As Dr Khachaturyan concludes, this failure to complete the proper procedure for the passage of Law No. 91-VIII "violates the requirements of the Rules of Procedure Law Article 93 (part 1), Article 96, Article 103 and Article 112".[379]

257. The Respondent's haste to enact Law No. 91-VIII thus resulted in its passage being completed in breach of Ukrainian law. However, the Respondent's precipitousness in seeking to land a legislative blow against the Claimants' participation in the corporate governance of Ukrnafta did not only involve a violation of its own laws – it also meant that Law No. 91-VIII in fact missed its target. After its enactment, it transpired that the terms of Law No. 91-VIII would not apply to Ukrnafta as quickly as the Respondent intended. This is because Law No. 91-VIII stated that it only applied immediately to joint stock companies in which 50% or more of shares are owned by the State, and that its changes would extend to joint stock companies generally from 1 January 2016. Given that the Respondent did not own a direct shareholding in Ukrnafta, but rather held its majority shareholding in Ukrnafta indirectly through its wholly-owned company Naftogaz, Law No. 91-VIII only altered the quorum of the General Meeting of Shareholders of Ukrnafta from 1 January 2016.

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376 Expert Report by Armen Khachaturyan, paragraph 29.

377 Expert Report by Armen Khachaturyan, paragraph 32(a).

378 Expert Report by Armen Khachaturyan, paragraph 32(a).

379 Expert Report by Armen Khachaturyan, paragraph 32(a).

258. The Respondent's reaction to its attempt to legislate against the Claimants' interests as shareholders in Ukrnafta both confirms that such subversion of the Claimants' rights was the abiding objective of this legislation, and that the Respondent would brook no delay or obstacle to the attainment of that objective.

259. The first reaction was an expression by senior officials of the Respondent that the failure to apply Law No. 91-VIII immediately to Ukrnafta and the Claimants meant that the law did not achieve its purpose, and that a change was necessary if the Claimants' rights were to be undermined as quickly as the Respondent intended. Examples of such statements are:

a) The Minister of Economic Development and Trade of Ukraine, Mr Abromavicius, stated in a press briefing on 14 January 2015 that the Prime Minster of Ukraine, Mr Yatsenyuk, both "asked the Parliament to make amendments that would allow this Law [No. 91-VIII] to apply to 'Ukrnafta'" and "publicly instructed the Minister of Energy of Ukraine to convene a general meeting of the shareholders of 'Ukrnafta', and among other things to put on the agenda of the meeting the issue of changing the management of the company".[380]

b) Mr Yatsenyuk made the point himself in the Verkhovna Rada on 16 January 2015, noting that: "First. I am publicly instructing the Minister of Energy of Ukraine to convene a general meeting of Ukrnafta shareholders (applause), including with the agenda on changes in the company's management. Second. It is unfortunate that the law on which the parliament has voted does not apply to Ukrnafta. That is why I am asking the members of parliament to amend this law accordingly. Because this bill was passed in a hurry and, unfortunately, this law has no relation to the management of Ukrnafta."[381] Mr

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380 Statement by the Minister of Economy of Ukraine, 14 January 2015, page 4, **Exhibit {C-1863}**.

381 Transcript of plenary session, the Sixteenth Meeting Session hall of the Verkhovna Rada, 16 January 2015, page 2, **Exhibit {C-1364**}.

Yatsenyuk added that "I have stated publicly and I am stating once again that the government will resume control of Ukrnafta".[382]

c) Mr Yatsenyuk reiterated the point in opening remarks to the Cabinet of Ministers of Ukraine on 21 January 2015, stating: "I recall that there was an attempt of the Verkhovna Rada [Upper Chamber] of Ukraine to help convene meetings in companies where the state has a stake. Unfortunately, the attempt was not successful, because the law does not cover the company 'Ukmafta'. In accordance with the law it does not apply to 'Ukmafta'. That is why the Government of Ukraine has prepared a draft law which would allow Ukrainian state to convene a meeting of shareholders in all companies where the state share is 50 plus 1, and not only to call a meeting of shareholders, but, and this draft law provides a mechanism for the declaration of dividends after the relevant shareholders' meeting has been convened."[383]

260. In the context of this recognition that Law No. 91-VIII did not deprive the Claimants of their rights, the Respondent tried a second time legislatively to subvert the Claimants' rights of management in Ukrnafta contained in the 2011 Articles, the 2010 Shareholders Agreement and the 2010 Cooperation Agreement. With the public backing of the Prime Minister, draft Law No. 1778 was introduced to the Verkhovna Rada on 16 January 2015 – just three days after Law No. 91-VIII had been introduced.[384] If draft Law No. 1778 had been adopted, it would have meant that the quorum requirement contained in Law No. 91-VIII would apply in respect of joint stock companies in which the majority of voting rights were held either directly by the State or indirectly by the State via its majority ownership of shares in a holding entity. As draft Law No. 1778 stated, after reiterating the prescription a general

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382 Transcript of plenary session, the Sixteenth Meeting Session hall of the Verkhovna Rada, 16 January 2015, page 2, **Exhibit {C-1364}**.

383 Opening speech of Prime Minister Arseniy Yatsenyuk at a meeting of the Cabinet of Ministers of Ukraine, 21 January 2015, page 1, **Exhibit {C-1365**}.

384 Draft Law No. 1778 "On amendments to article 41 of the Law of Ukraine "On joint stock companies", 16 January 2015, **Exhibit {C-538**}.

meeting of the shareholders of a joint stock company would be quorate if more than 50% (rather than more than 60%) of its shareholders attended:

> "The action of this law applies to joint stock companies in the authorised capital of which more than 50 percent of corporate rights belong to the State or a legal person in the authorised capital of which the stake of the State is more than 50 percent, from the day of enactment of this Law, and to other joint stock companies – from 1 January 2016."[385]

261. However, the Verkhovna Rada did not pass draft Law No. 1778 as it was unable to obtain enough supporting votes from its members.[386]

262. Despite its inability to achieve its desired impairment of the Claimants' rights in respect of the corporate governance of Ukrnafta, the Respondent sought once more to do so through a fresh exercise of its legislative powers. On 2 March 2015, draft Law No. 2273 was introduced to the Verkhovna Rada.[387] The Respondent passed that piece of legislation on 19 March 2015, and published it on 26 March 2015 as Law No. 272-VIII.[388]

263. Again, public statements by senior officials of the Respondent made it clear that the passage of Law No. 272-VIII was intended to strike at the Claimants' rights in respect of the corporate governance of Ukrnafta. Examples of such statements are:

a) A member of the Verkhovna Rada and the governing coalition, Mr Lyashko, stated in parliament on 19 March 2015 that Law No. 272-VIII: "pertains to the state's ability to manage its property, its assets, specifically Ukrnafta" and

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385 Draft Law No. 1778 "On amendments to article 41 of the Law of Ukraine "On joint stock companies", 16 January 2015, Article II.2, **Exhibit {C-538}**.

386 Transcript of plenary session, the Sixteenth Meeting Session hall of the Verkhovna Rada, 16 January 2015, pages 4-5, **Exhibit {C-1364}**.

387 Draft Law No. 2273 "On amending the Law of Ukraine "On joint stock companies", 2 March 2015, **Exhibit {C-546}**.

388 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, **Exhibit {C-552**}.

that it would "return to the state the right to influence its own property … Ukrnafta."[389]

b) A further member of the Verkhovna Rada, Mr Leshchenko, stated in parliament on 19 March 2015 when discussing Law No. 272-VIII that: "[t]oday might indeed be an historic day, because for the first time in 13 years we might have the opportunity to install state management at Ukrnafta."[390]

c) On 24 March 2015, an executive director and acting Chairman of the Board of Naftogaz, Mr Pasishnik, continued the theme, stating that "after signing of bill #2273 by the President we will announce open tender for filling the positions of management of 'Ukrnafta'".[391]

d) On 29 March 2015, the Prime Minister, Mr Yatsenyuk, stated that the respondent was "going to establish new high-quality foreign management" for Ukrnafta.[392]

264. Though it was introduced into the Verkhovna Rada only a handful of weeks after Law No. 91-VIII and draft Law No. 1778 failed to achieve the Respondent's purpose, Law No. 272-VIII was thorough in its dismantling of the Claimants' rights in a way that the Respondent's earlier attempts were not. Law No. 272-VIII repealed Law No. 91-VIII.[393] With that done, Law No. 272-VIII effected several key changes to Ukrainian companies law, each of which subverted rights of the Claimants contained

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389 Transcript of plenary session, the Nineteenth Meeting Session of the Parliament of Ukraine, 19 March 2015, page 18622, **Exhibit {C-1375}**.

390 Transcript of plenary session, the Twentieth Meeting Session of the Parliament of Ukraine, 19 March 2015, page 18580, **Exhibit {C-1374}**.

391 Facebook post by Andriy Pasishnik regarding the tender for the Chairman of Ukrnafta, 24 March 2015, **Exhibit {C-1376}**.

392 RBC.UA Article "'Ukrnafta' and 'Ukrtransnafta' will get new foreign management – Yatsenyuk", 29 March 2015, **Exhibit {C-1377**}.

393 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article II.2, **Exhibit {C-552**}.

in the 2011 Articles, the 2010 Shareholders Agreement and the 2010 Cooperation Agreement.

265. First, Article 41(1)-(2) of the Law of Ukraine "On Joint Stock Companies" of 2008, quoted above, had previously provided that quorum would be at least 60%.[394] Under this position, the Claimants' 40.1009% shareholding in Ukrnafta meant that a general meeting of the shareholders of the company could only be quorate if the Claimants participated in it. By contrast, Law No. 272-VIII provided that the quorum for a general meeting of shareholders for all joint stock companies was reduced from at least 60% to more than 50%. Clause 3(1) of Section I of Law No. 272-VIII provided that: "in the first and second paragraphs of [Article 41] the words and figures 'at least 60' and 'at least 60' shall be replaced with the words and figures 'more than 50'".[395]

266. The amendment effected by Law No. 272-VIII not only meant that the Claimants were no longer necessary participants in a quorate general meeting, but also that the Respondent, through Naftogaz, could supply a quorum by itself. Put another way, a quorum that previously could only exist through the participation of both the Respondent and the Claimants could now, by virtue of the Respondent's legislative interference in the matter, exist solely by virtue of the participation of the Respondent alone. The Respondent thus legislatively arrogated to itself control of the General Meeting of the Shareholders of Ukrnafta, contrary to the provisions regulating such control in the 2011 Articles and the 2010 Shareholders Agreement.

267. Secondly, previously under Law of Ukraine "On Joint Stock Companies" of 2008, the first sentence of Article 55(2) provided that the "meeting of the supervisory board shall be deemed competent if at least half of its members take part in it", but the second sentence of that provision stated that the "company's charter or by-law of the company supervisory board may establish a larger number of members of the

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394 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, Article 41(1)-(2), **Exhibit {C-361}**.

395 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article I.3.(1), **Exhibit {C-552}**.

supervisory board required for recognizing its meetings competent".[396] This meant that a joint stock company and its shareholders could deem a meeting of a supervisory board as quorate only if more than a simple majority of its members participated in the relevant meeting. As discussed above, Naftogaz and the Claimants availed themselves of this right, and established that eight of the 11 Members of Ukrnafta's Supervisory Board had to be present for a quorum to exist. Given that the Claimants supplied five of the 11 Members, a Supervisory Board meeting could only be quorate if at least two of the Claimants nominees attended.

268. Law No. 272-VIII altered this position by stipulating that the quorum for a meeting of a supervisory board for all joint stock companies would be at least 50%. It continued by stating that "In part two of Article 55 … the second sentence shall be deleted", meaning that 50% as the figure establishing a quorum could not be changed by the company or its shareholders.[397] This meant that, as a result of this change, only six of the 11 Members of Ukrnafta's Supervisory Board had to be present to supply a quorum to a meeting of that Board. The effect was that the Claimants were no longer necessary participants in a quorate Supervisory Board meeting, and that the Respondent, through Naftogaz, could supply a quorum by itself. Accordingly, like the quorum issues for the General Meeting of the Shareholders of Ukrnafta, the Respondent has legislatively arrogated to itself control of the Supervisory Board of Ukrnafta, contrary to the provisions regulating such control in the 2011 Articles and the 2010 Shareholders Agreement.

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396 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, Article 55(2), **Exhibit {C-361}**.

397 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article I.4.(1), **Exhibit {C-552}**. It continued by adding that Article 55 would be supplemented "with the following second paragraph: 'In the event of early termination of the powers of one or more members of the Supervisory Board and until the election of all members of the Supervisory Board, Supervisory Board meetings shall be quorate for resolving issues in accordance with its authority, provided that the powers of more than half of the Supervisory Board members are in effect'": Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article I.4.(2), **Exhibit {C-552**}.

269. Thirdly, Article 38(1) of the Law of Ukraine "On Joint Stock Companies" of 2008 stated in relevant part that: "Each shareholder shall have the right to make proposals regarding the issues included in the agenda of the public company general meeting and also regarding new candidates for the company bodies the number of which shall not exceed the membership of each of the bodies."[398] This position left open the possibility that a joint stock company and their shareholders could establish bespoke arrangements for the nomination and election of the members of the management bodies of the company. As discussed above, Ukrnafta, Naftogaz and the Claimants availed themselves of this ability. Most notably, the Claimants were entitled under the 2010 Shareholders Agreement and the 2011 Articles to nominate the Chair of the Executive Board (who in turn nominated the remaining Members of the Executive Board) and five of the Members of the Supervisory Board of Ukrnafta.

270. By contrast, Law No. 272-VIII provided that the rights of shareholders to add items to the agenda of a general meeting and to propose candidates to the management bodies of the company were rights that could not be limited by the Articles of a company. Clause 2 of Section I of Law No. 272-VIII further provided that Article 38 of the earlier law would be supplemented with: "shareholders' rights related to the making of these proposals and the procedure of their introduction under this article may not be changed by the joint-stock company's Articles of Association".[399] It eliminated the possibility that bespoke arrangements for the nomination and election of the members of the management bodies of a joint stock company could be established. In doing so, Law No. 272-VIII in effect destroyed the right of the Claimants to nominate the Chair of the Executive Board and five of the Members of the Supervisory Board of Ukrnafta.

271. Fourthly, under Article 30 of the Law of Ukraine "On Joint Stock Companies" of 2008, the general meeting of shareholders was to decide whether dividends were to

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398 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, Article 38(1), **Exhibit {C-361}**.

399 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article I.2, **Exhibit {C-552}**.

be paid by the company and, if so, in what amount.[400] It stipulated that any dividends were to be paid within two months of the date of that decision.[401] In a departure from this rule, Law No. 272-VIII provided that the time for payment of dividends by a joint stock company could be decreased by a decision of the general meeting of shareholders, and that, if dividends are not paid on time, a shareholder could enforce such payment without the need to start court proceedings. Clause 1 of Section I of Law No. 272-VIII stated that the general meeting of shareholders could require that dividends be paid in a shorter period, and could recover any dividends not paid within the required timeframe by way of a procedure involving a notary, rather than a court:

> "1. Part two of Article 30 after the second paragraph shall be supplemented by two new paragraphs as follows:
>
> 'If the general meeting decides to pay dividends within a period that is less than provided by the first paragraph in this section, dividends shall be paid within the period specified by the general meeting.
>
> If no dividends are paid in the period specified by the first and second paragraphs in this section, or in a period set by the general meeting in accordance with the third paragraph in this section to pay dividends if it is less than the period prescribed by the first and second paragraphs in this section, the shareholder shall have the right to apply to a notary with a request for the notary's writ of execution to be inscribed on documents under which a debt is collected on an uncontested basis, the list of which is set by the Cabinet of Ministers of Ukraine."[402]

272. The effect of Law No. 272-VIII was to allow a shareholder that controls the general meeting of shareholders to compel the company to pay dividends immediately and, if it does not, to recover the unpaid dividends through a procedure with no judicial

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400 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, Article 30, **Exhibit {C-361}**.

401 Law of Ukraine No. 514-VI "On joint stock companies" original version as signed on 17.09.2008, 17 September 2008, Article 30(2), **Exhibit {C-361}**.

402 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article I.1, **Exhibit {C-552**}.

oversight. In the context of the public statements by senior officials of the Respondent, this aspect of Law No. 272-VIII can only be a reflection of the Respondent's desire to hurry Ukrnafta into the payment of dividends to the Respondent, both at the time of Law No. 272-VIII and in the future, irrespective of whether the management of the company regarded such a payment to be in the company's best interests. In combination with the Respondent's legislative interference in the procedures for establishing quorum, this change in its corporate governance law allows the Respondent through Naftogaz to determine that Ukrnafta will pay dividends and pay them immediately, and to recover dividends compulsorily if Ukrnafta did not make or delayed making such a payment to the Respondent.

273. In addition to the foregoing aspects of Law No. 272-VIII altering the substance of the law on corporate governance in Ukraine, Law No. 272-VIII also ensured that those changes would take effect as quickly as possible. Two provisions achieved this.

a) Clause 1 of Section II of Law No. 272-VIII provided that "This Law shall come into force on the day following the day of its publication, except for sections 2 and 4 of Part I of this Law which shall take effect two months after the day of its publication."[403] This meant that the changes to the rules on quorum for a general meeting of shareholders and on the payment of dividends took effect on 27 March 2015, while the changes to the rules on quorum for a meeting of a supervisory board and on the nomination and election of the members of the management bodies of the company took effect on 26 May 2015.

b) Clause 3 of Section II of Law No. 272-VIII provided that "It shall be determined that, until brought into conformity with this Law, the Articles of Association of joint-stock companies shall be applied to the extent not

403 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article II.1, **Exhibit {C-552**}.

inconsistent with this Law."[404] This in effect meant that the 2011 Articles were amended by the Respondent's legislative intervention. This compulsory amendment of Ukrnafta's constitutive documents took effect at the same time the respective provisions in Law No. 272-VIII took effect, with the result that by 26 May 2015 provisions of the 2011 Articles that were inconsistent with Law No. 272-VIII were effectively struck out.

274. The speed with which the Respondent wished to ensure that the Claimants' rights in respect of the corporate governance of Ukrnafta were undermined also produced the same consequence as it did vis-à-vis its first attempt to do so in Law No. 91-VIII – that is, Law No. 272-VIII was enacted in violation of Ukrainian law. As Dr Khachaturyan explains, draft laws in Ukraine can only be adopted after three readings, or, if eligible, pursuant to a "simplified procedure" after the first or second reading.[405] In this instance, Law No. 272-VIII was passed after its first reading in circumstances where is plainly was not eligible to be enacted pursuant to the simplified procedure.

275. Dr Khachaturyan explains the position as follows:

> "Based on the transcript of the Verkhovna Rada's plenary session on 19 March 2015, the draft Second New Law was discussed and subsequently adopted by the Verkhovna Rada after the first reading based on the simplified procedure. However, pursuant to the conclusion of the Main Legal Expert Department of the Parliament, dated 3 March 2015, the draft Second New Law received a number of comments and proposals from the Verkhovna Rada's Legal Expert Division and, therefore, the draft Second New Law was not eligible for adoption under the simplified procedure. Consequently, such adoption violated the Rules of

404 Law of Ukraine No. 272-VIII "On amending the law of Ukraine on joint stock companies", 19 March 2015, Article II.3, **Exhibit {C-552}**.

405 Expert Report by Armen Khachaturyan, paragraph 32(b).

> Procedure Law Article 102 (part 4) and Article 114 (part 2)."[406]

276. As confirmed by the foregoing public expressions of the Respondent's intentions when exercising its legislative powers, the content of Law No. 91-VIII and Law No. 272-VIII, and the speed with which the Respondent enacted those laws in violation of its own legislative procedures, the Respondent through its enactment of new laws sought to destroy the rights the Claimants held in respect of the corporate governance of Ukrnafta. Indeed, Prime Minister Yatsenyuk was candid on this point, stating in the Verkhovna Rada earlier this year that "Regarding Ukrnafta – together, we got the control back."[407] The Prime Minister was correct. The new laws, and in particular Law No. 272-VIII, meant that the Respondent through Naftogaz could establish quorum in the General Meeting of Shareholders and Supervisory Board of Ukrnafta and could procure the immediate payment of dividends without any regard to the Claimants or indeed any of the minority shareholders.

2. <u>The implementation by Naftogaz of the objectives of the legislative changes in the corporate governance of Ukrnafta to the subversion of Ukrnafta's rights under the shareholders agreement</u>

277. The foregoing amendments to the Ukrainian law on corporate governance were proposed and promulgated with the express intention of enabling the Respondent through Naftogaz to force through changes in the composition and decision-taking of Ukrnafta's management, with no regard to the Claimants. Naftogaz soon acted on that intention. It moved unilaterally to establish and execute a recruitment process for a new Chairman of Ukrnafta's Executive Board, thereby effectively deciding that the incumbent Chairman was to be replaced with an individual of Naftogaz's choosing, irrespective of the Claimants' right under the 2011 Articles and 2010 Shareholders Agreement to nominate the individual who act as Chairman of the Executive Board.

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406 Expert Report by Armen Khachaturyan, paragraph 32(b) (citations omitted).

407 Finance.UA Article 'All property of Ukrnafta is seized', 5 February 2016, **Exhibit {C-1430}**.

278. In accordance with the Respondent's Prime Minister's public instruction to his Minister of Energy (quoted above), Naftogaz procured the publication of a notice on 18 June 2015 convening a General Meeting of Shareholders of Ukrnafta to be held on 22 July 2015 for the purpose of taking full control of Ukrnafta.[408] Echoing the statements by the Respondent's senior officials, the agenda included the following items for decision by the General Meeting of Shareholders:

> "9. Distribution of the Company's profits (procedure of loss covering) according to results of business activities in 2014. Approval of the amount, procedure and terms of payment of dividends.
>
> …
>
> 11. Changes of and amendments to the Statute of the Company by issuing its new version.
>
> 12. Termination of authority of Chairman of Company's Board of Directors.
>
> 13. Election of a new Chairman of Company's Board of Directors.
>
> 14. Approval of the Company's Board structure according to the Company's activities.
>
> 15. Termination of authority of Member of Company's Board of Directors.
>
> 16. Election of the Board Member of Company's Board of Directors – Deputy of Chairman of the Board of Directors – director of finances.
>
> 17. Termination of authority of the Chairman and members of the Supervisory Board.
>
> 18. Election of the Supervisory Board members, and establishing term of their authority.
>
> 19. Election of the Supervisory Board Chairman.

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408 Ukrnafta Public Joint Stock Company, Notice of the company general shareholders meeting on 22 July 2015, issued 18 June 2015, **Exhibit {C-1390}**.

20. Termination of authority of the Chairman and members of the Auditing committee of the Company.

21. Election of members of the Auditing committee.

22. Election of the Chairman of the Auditing committee."[409]

279. At that meeting, pursuant to the notice Naftogaz caused to be published and consistent with the directive of the Respondent's Prime Minister, numerous resolutions were put to a vote. One resolution, proposed by Naftogaz,[410] was to adopt a new set of Articles of Association for Ukrnafta. The draft new Articles of Association, prepared by Naftogaz,[411] would have reduced the quorum in the General Meeting of Shareholders from 60% to 50%,[412] reduced the quorum in the Supervisory Board from eight to six of its 11 Members,[413] transferred the right to elect and terminate the powers of the Chairman of the Executive Board from the General Meeting of Shareholders to the Supervisory Board,[414] and transferred the right to nominate the Members of the Executive Board from the Chairman of the Executive Board to the Supervisory Board.[415] Naftogaz voted in favour of that resolution, while the Claimants, naturally not in support of such an emasculation of their rights in the 2011 Articles, voted against it.[416] Because the 2011 Articles prescribed that it could

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409 Ukrnafta Public Joint Stock Company, Notice of the company general shareholders meeting on 22 July 2015, issued 18 June 2015, Column 1, **Exhibit {C-1390}**.

410 See Minutes No. 23 of the General Meeting of Ukrnafta Shareholders, 22 July 2015, resolution 11, page 23, **Exhibit {C-1395}**.

411 See Ukrnafta Public Joint Stock Company, Minutes general shareholders meeting on 22 July 2015, resolution 11, page 23, **Exhibit {C-1395}**; Letter from Naftogaz to Ukrnafta 'About submission of proposals', dated 2 July 2015.

412 See Letter from Naftogaz to Ukrnafta 'About submission of proposals', dated 2 July 2015, item 4 on page 3, **Exhibit {C-1393}**.

413 See Letter from Naftogaz to Ukrnafta 'About submission of proposals', dated 2 July 2015, item 7 on page 4, **Exhibit {C-1393}**.

414 See Letter from Naftogaz to Ukrnafta 'About submission of proposals', dated 2 July 2015, item 6 on page 4, **Exhibit {C-1393}**.

415 See Letter from Naftogaz to Ukrnafta 'About submission of proposals', dated 2 July 2015,item 8 on page 4, **Exhibit {C-1393}**.

416 See Ukrnafta Public Joint Stock Company, Minutes No. 23 of the General Meeting of Ukrnafta Shareholders on 22 July 2015, resolution 11, page 24, **Exhibit {C-1395}**.

only be amended if 75% of the General Meeting of Shareholders voted in favour of amendment, the resolution was not passed. To quote the minutes, as a "decision on this issue [can only be] adopted by more than three quarters of votes of shareholders who were registered to participate at the general meeting of shareholders and are owners of shares voting on the issue", the "decision is not adopted".[417]

280. At the meeting, other resolutions were passed which, in sum, replaced the Chairman of the Executive Board (Mr Vanhecke being replaced by Mr Rollins),[418] and replaced the Chairman and Members of the Supervisory Board.[419] In the process of such a wholesale replacement of the senior management of Ukrnafta, the Claimant's previous nominees for Chairman of the Executive Board (Mr Vanhecke) and for five Members of the Supervisory Board were dismissed.[420] The Claimants voted in favour of these points, but did so because they had no other options. Quite apart from the pressure being placed on them to vote in favour of the resolutions, it would have been futile for them to resist given that the Respondent had openly altered its law to render resistance meaningless. The new reality was that, the Respondent having passed Law No. 272-VIII, Naftogaz could by itself form a quorum at the General Meeting and force through the appointment of new management. In such a situation, participating in the General Meeting and doing what was possible to ensure that the new management was at least competent to perform the tasks required of them, was the best and only way that the Claimants had to exert some influence over the events that were transpiring and the future management of Ukrnafta.

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417 Ukrnafta Public Joint Stock Company, Minutes No. 23 of the General Meeting of Ukrnafta Shareholders on 22 July 2015, resolution 11, pages 24-25, **Exhibit {C-1395}**.

418 See Ukrnafta Public Joint Stock Company, Minutes No. 23 of the General Meeting of Ukrnafta Shareholders on 22 July 2015, resolutions 12 and 13, pages 25-26, **Exhibit {C-1395}**.

419 See Ukrnafta Public Joint Stock Company, Minutes No. 23 of the General Meeting of Ukrnafta Shareholders on 22 July 2015, resolutions 17-19, pages 30-35, **Exhibit {C-1395**}.

420 See Ukrnafta Public Joint Stock Company, Minutes No. 23 of the General Meeting of Ukrnafta Shareholders on 22 July 2015, resolution 12, page 25 (regarding the Chairman), and resolution 17, pages 30-31 (regarding Members of the Supervisory Board), **Exhibit {C-1395**}.

III. THE TRIBUNAL HAS JURISDICTION OVER THIS CLAIM

281. The jurisdictional conditions in the ECT are satisfied in this case. The Tribunal has jurisdiction both *ratione personae* (Section III.A below) and *ratione materiae* (Section III.B).

A. The Respondent is a "Contracting Party" to the ECT, and the Claimants are "Investor[s]" of another Contracting Party to the ECT

282. The Respondent is a "Contracting Party" to the ECT, and the Claimants are "Investor[s]" of another Contracting Party to the ECT. The Claimants elaborate on each of these aspects of the Tribunal's jurisdiction *ratione personae* in turn below.

283. The Respondent is a "Contracting Party" to the ECT. A "Contracting Party" is defined in Article 1(2) of the ECT to mean, in relevant part, "a state […] which has consented to be bound by this Treaty and for which the Treaty is in force".

284. The Respondent signed the ECT on 17 December 1994, ratified it on 6 February 1998 and was bound by it upon its entry into force on 27 January 1999.[421] The Respondent thus meets the conjunctive test to be a "Contracting Party" under Article 1(2) of the ECT, namely, that it has consented to be bound by the ECT and that the ECT is in force in respect of it.[422]

285. The Claimants are "Investor[s]" of another Contracting Party to the ECT other than the Respondent, namely, Cyprus. Cyprus is a "Contracting Party", having signed the ECT on 17 December 1994, ratified it on 2 January 1998 and being bound by it upon

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421 "Ukraine", Screenshot of Energy Charter website Ratification of the ECT, accessed on 25 April 2016, at http://www.energycharter.org/who-we-are/members-observers/countries/ukraine/, **Exhibit {C-1469 Original}**.

422 See: *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraph 123, **{CLA-3}**; *Ioannis Kardassopoulos v. Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction, 6 July 2007, paragraph 110, **{CLA-4}**; and *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228, **{CLA-5}**, *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227, **{CLA-6}**, and *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 226, Interim Award on Jurisdiction and Admissibility, 30 November 2009, paragraph 385, **{CLA-7}** (collectively, the "***Yukos* Jurisdiction Awards**").

its entry into force on 16 April 1998.[423] Cyprus thus meets the conjunctive test, noted above, to be a "Contracting Party" under Article 1(2) of the ECT.

286. Article 1(7)(a)(ii) of the ECT defines an "Investor" to mean "with respect to a Contracting Party: […] a company or other organization organized in accordance with the law applicable in that Contracting Party". Each Claimant is a company organised in accordance with the law applicable in Cyprus. This is conclusively established, in accordance with previous case law considering Article 1(7)(a)(ii),[424] by the Claimants' respective certificates of incorporation, which were duly issued under section 15(1) of The Companies Law of Cyprus.[425] Each of the Claimants is thus an "Investor" for the purposes of the ECT.

287. Accordingly, the Tribunal has jurisdiction *ratione personae* in this matter.

B. The Claimants had an "Investment" for the purposes of the ECT

288. The Claimants had an "Investment" in the "Area" of the Respondent. They elaborate on each of these aspects of the Tribunal's jurisdiction *ratione materiae* in turn below.

289. Article 1(6) of the ECT defines "Investment" for the purposes of the ECT. It begins by saying that an "Investment" means "every kind of asset, owned or controlled

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423 "Cyprus", Screenshot of Energy Charter website Ratification of the ECT, accessed on 25 April 2016, at http://www.energycharter.org/who-we-are/members-observers/countries/cyprus/, **Exhibit {C-1468 Original}**.

424 *Anatolie Stati, Gabriel Stati, Ascom Group S.A. and Terra Raf Trans Traiding Ltd v. Republic of Kazakhstan*, SCC Case No. V116/2010, Award, 19 December 2013, paragraph 745, **{CLA-8}**; *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraphs 124 and 128, {**CLA-3}**; *Yukos* Jurisdiction Awards, paragraphs 411 and 417, **{CLA-5} {CLA-6} {CLA-7}**. As His Excellency Judge Crawford S.C. expressed the point in relation to Article 1(7)(a)(ii): "Companies incorporated in Contracting Parties are embraced by the definition, regardless of the nationality of shareholders, the origin of investment capital or the nationality of directors or management": J. Crawford, "Energy Charter Treaty Arbitration: Jurisdiction Issues", 22 June 2006, submitted to and quoted by the tribunal in the *Yukos* Jurisdiction Awards, paragraph 411, {**CLA-5} {CLA-6} {CLA-7}**.

425 See: Certificate of Incorporation of Littop Enterprises Limited, dated 8 September 2005, **Exhibit {C-842 Original}**; Certificate of Incorporation of Bridgemont Ventures Limited, dated 8 September 2005, **Exhibit {C-843 Original}**; and Certificate of Incorporation of Bordo Management Limited, dated 8 September 2005, **Exhibit {C-844 Original}**.

directly or indirectly by an Investor". It continues by providing a non-exhaustive list of assets that fall within the definition. The assets it lists include "shares", "claims to performance pursuant to contract having an economic value and associated with an Investment", "[r]eturns" and "any right conferred by law or contract". Article 1(6) also states that "'Investment' refers to any investment associated with an Economic Activity in the Energy Sector […]".

290. The Claimants had an "Investment" within the meaning of Article 1(6) of the ECT. As a preliminary point, the Claimants' shareholdings and rights fall within the broadly-phrased chapeau to Article 1(6), which regards as an "Investment" "every kind of asset, owned or controlled directly or indirectly by an Investor". However, in addition, the Claimants' assets are also covered by several of the examples Article 1(6) expressly lists as assets.

a) First, the Claimants held a significant minority shareholding in Ukrnafta. In total, the Claimants held a 40.1009% shareholding in Ukrnafta.[426] This shareholding is an asset that Article 1(6)(b) expressly establishes is an "Investment" for the purposes of the ECT. Case law has been unequivocal in concluding that the possession of a shareholding is a form of "Investment" pursuant to this provision of the ECT.[427]

b) Secondly, the Claimants had claims to performance of contracts having an economic value, namely, the 2010 Shareholders Agreement and 2010 Cooperation Agreement which they signed with Naftogaz, Ukrnafta and the Ukrainian Ministry of Energy and Coal Industry, and the 2011 Articles.[428]

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426 See Section II.A above.

427 See, e.g.: *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, paragraph 5.49, **{CLA-9}**; *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraph 141, **{CLA-10}**; *Limited Liability Company Amto v. Ukraine*, Arbitration No. 080/2005, Final Award, 26 March 2008, paragraph 39, **{CLA-11}**; *Yukos* Jurisdiction Awards, paragraph 477, {**CLA-5} {CLA-6} {CLA-7}**.

428 See Sections II.C-D above.

These contracts had an economic value, and were intimately associated with the Claimants' Investments given they pertained to the management of Ukrnafta. Case law is clear that the possession of such claims to performance of contracts is an "Investment" pursuant to Article 1(6)(c) of the ECT.[429]

c) Thirdly, the Claimants had rights to returns on their Investment, including dividends. While case law on Article 1(6)(e) of the ECT is sparse, that which exists readily characterises assets falling under that provision as an "Investment",[430] consistently with broader investment treaty jurisprudence that regards references to "returns" in investment treaties as a category of investment.[431]

291. In addition to having assets expressly stated to be "Investments" under Article 1(6)(b), (c), (e) and (f) of the ECT, the Claimants' investment was also "associated with an Economic Activity in the Energy Sector" pursuant to the last paragraph of Article 1(6). The definition of "Economic Activity in the Energy Sector" is given in Article 1(5) of the ECT, quoted above. As "natural gas" is one of the "Energy Materials and Products" listed in Annex EM, the Claimants' shareholding in Ukrnafta, and its other rights discussed above, constitute an "investment associated with an Economic Activity in the Energy Sector".

292. Accordingly, there can be no doubt that the Claimants had assets that were an "Investment" under the generally-phrased chapeau to Article 1(6) of the ECT, the

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429 See, e.g.: *Anatolie Stati, Gabriel Stati, Ascom Group S.A. and Terra Raf Trans Traiding Ltd v. Republic of Kazakhstan*, SCC Case No. V116/2010, Award, 19 December 2013, paragraph 808, **{CLA-8}**; *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, paragraphs 5.52-5.53, **{CLA-9}**; *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraph 139, **{CLA-10}**.

430 *Anatolie Stati, Gabriel Stati, Ascom Group S.A. and Terra Raf Trans Traiding Ltd v. Republic of Kazakhstan*, SCC Case No. V116/2010, Award, 19 December 2013, paragraph 808, **{CLA-8}**.

431 *Daimler Financial Services AG v. Argentine Republic*, ICSID Case No. ARB/05/1, Award, 22 August 2012, paragraph 83, **{CLA-12}**; *Inmaris Perestroika Sailing Maritime Services GmbH and others v. Ukraine*, ICSID Case No. ARB/08/8, Decision on Jurisdiction, 8 March 2010, paragraphs 104-108, **{CLA-13}**.

specific examples of such assets given in Article 1(6)(b), (c), (e) and (f) of the ECT, and the last paragraph of Article 1(6) of the ECT.

293. In addition, the Claimants' investment was also in the "Area" of the Respondent. This is a jurisdictional requirement *ratione materiae* that is contained in Article 26(1) of the ECT. That provision provides that only "[d]isputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III" can be the subject of dispute settlement pursuant to Article 26.[432]

294. The "Area" of a Contracting Party is defined in Article 1(10)(a) of the ECT to include "territory under its sovereignty". The Claimants' "Investment" was in the "Area" of the Respondent. As set out above, the Claimant had a shareholding in, and rights in connection with the management of and activities undertaken by, Ukrnafta. Ukrnafta was organised in accordance with the law applicable in Ukraine, and conducted its natural gas production and distribution businesses in territory under the sovereignty of Ukraine. Having a shareholding in Ukrnafta meant that the Claimants had investments in the "Area" of the Respondent. Case law has

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[432] The Claimants note that no other aspect of Article 26 of the ECT impairs the Tribunal's jurisdiction in this case. Thus, before the Claimants elected to refer this dispute to arbitration under Articles 26(2)(c) and 26(4)(c) of the ECT, the Parties sought to resolve this dispute "amicably" for a period of more than "three months from the date on which either party to the dispute requested amicable settlement" pursuant to Articles 26(1) and 26(2): see e.g., Letter from the Claimants to Ukraine 'Notification of Dispute Under the Energy Charter Treaty', dated 31 December 2014, **Exhibit {C-1356}**; Letter from the Claimants to Ukraine 'Notification of Dispute Under the Energy Charter Treaty', dated 17 June 2015, **Exhibit {C-1389 Original}**.Amicable settlement was pursued even though engaging in such an attempt is not a jurisdictional prerequisite: see, e.g., *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction, 14 November 2005, paragraph 100, {**CLA-14**}; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Award on Jurisdiction, 6 August 2003, paragraph 184, {**CLA-15**}. Also, the Parties have consented to this dispute being referred to arbitration – in Article 26(3) of the ECT, Ukraine gave "its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article", which under Article 26(4)(c) includes arbitration under the SCC Rules, while the Claimants gave their consent in writing in the Request for Arbitration.

confirmed that a shareholding in a company incorporated and operating in a State is in the "Area" of that State for the purpose of Article 1(10)(a).[433] Further, having contractual rights in connection with the management of and activities undertaken by Ukrnafta also meant that the Claimants had investments in the "Area" of the Respondent. Again, case law confirms that contractual rights relating to activities within the territory of a State are within the "Area" of that State for the purpose of Article 1(10)(a).[434]

295. Accordingly, the Tribunal has jurisdiction *ratione materiae* in this matter.

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433 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraphs 125 and 131, **{CLA-3}**; *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraphs 141-145, **{CLA-10**}.

434 *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraph 140, **{CLA-10**}.

IV. THE RESPONDENT HAS BREACHED THE ECT

296. The Respondent has breached the ECT. The Claimants in this Section IV explain why this is so. The Claimants briefly explain the basis of the Respondent's liability, before explaining how the Respondent's conduct has breached Articles 10(1), 10(12), 11(2) and 13 of the ECT.

A. Introduction: Basis of liability

297. The Claimants set out below the various breaches of the ECT by the Respondent. The Claimants maintain that the liability of the Respondent for those breaches is established on the totality of its conduct over the full period of time discussed in Section II of this Statement of Claim. Further, given the way in which the Respondent deliberately renewed its attempts to procure Ukrnafta's gas at an undervalue year-on-year between 2006 and 2014, and since 2014 has sought to impose on Ukrnafta enormous fiscal burdens, the liability of the Respondent is also established on a year-on-year basis, in that the Respondent's conduct in each year from 2007 onwards separately constituted a breach of the ECT.

B. The Respondent has failed to accord at all times fair and equitable treatment to the Claimants' investments, in breach of Article 10(1) of the ECT

298. The Respondent has failed to accord at all times fair and equitable treatment to the Claimants' investments, in breach of Article 10(1) of the ECT, because its conduct was arbitrary, lacked transparency and consistency, and frustrated the Claimants' legitimate expectations.

1. The applicable standard

299. The relevant part of Article 10(1) of the ECT reads:

> "Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment."

300. While the obligation to afford the Claimants' investments "fair and equitable treatment" under Article 10(1) "must be appreciated *in concreto* taking into account the specific circumstances of each case",[435] it is generally accepted that the obligation contains a number of core duties. These include the duty not to act arbitrarily, the duty to act with transparency and consistency, and the duty not to frustrate an investor's legitimate expectations. Previous decisions under both the ECT and other investment treaties, and commentary on those aspects of the fair and equitable treatment obligation, explain the (broad) scope of these duties that the Respondent has taken on itself pursuant to Article 10(1).

301. First, the duty not to act arbitrarily is a core feature of the fair and equitable treatment obligation. The concept of arbitrariness is well-established in public international law. In *ELSI*, the International Court of Justice held:

> "Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the *Asylum* case, when it spoke of 'arbitrary action' being 'substituted for the rule of law' (*Asylum, Judgment, I.C.J. Reports 1950*, p.284)."[436]

302. Similarly, the Separate Opinion of Judge Trindade in the *Diallo* case before the Court more recently held that the term "arbitrary":

> "came thus to be used in order to characterize decisions grounded on simple preference or prejudice, defying any test of 'foresee-ability', ensuing from the entirely free will of the authority concerned, rather than based on reason, on the conception of the rule of law in a democratic society, on the criterion of reasonableness and the imperatives of justice, on

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435 *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Award, 6 November 2008, paragraph 185, **{CLA-2}**.

436 *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, 15, paragraph 128, **{CLA-16**}.

> achieve a legitimate policy objective, necessary for that objective, and not excessive considering the relative weight of each interest involved."[440]

305. While arbitrariness is often understood, as the above quotes indicate, as a characteristic of an intentional act by the State, it need not be the intent of the State to act arbitrarily for it still to do so and thus breach its duty to refrain from doing so. The tribunal in *Occidental v Ecuador*, for instance, held that confusion and lack of clarity in the local tax regime "resulted in some form of arbitrariness, even if not intended".[441]

306. Secondly, the duty to act with transparency and consistency is another key feature of the fair and equitable treatment obligation. This is especially so in Article 10(1) of the ECT, in which the fair and equitable treatment in the second sentence is linked with the duty of the State to "create stable, equitable, favourable and transparent conditions".[442]

307. As the case law establishes, this imposes a duty on the host State to legislate and regulate (i) consistently (ii) transparently (iii) in a manner which enables the investor adequately to plan its investment. The legal framework of legislation, decrees, licences and executive decision must be implemented and applied in a reasonably justifiable way. The duty is not such as to impose the equivalent of a stabilisation clause in respect of the investment.. But at a minimum, the State must not repeatedly alter the law in a manner that has a changing and unpredictable effect on the investment.

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440 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 179, **{CLA-20**}.

441 *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004, paragraphs 162-163 **{CLA-21}**.

442 The case law tends to read the two sentences together, albeit while also noting that the conditions in the first sentence extend to all of the pre-and post-investment protections contained in the later sentences of the provision. See: *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraph 172, **{CLA-3}**; and *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraph 179, **{CLA-10}**.

308. *Al-Bahloul v Tajikistan* set out the content of this duty that arises under Article 10(1) of the ECT in some detail, including by reference to previous case law considering the same concept (albeit outside the ECT context):

> "The notion of transparency as an element of fair and equitable treatment has been expounded upon in a number of investment treaty arbitration decisions. Interpreting transparency in the context of the NAFTA treaty, the tribunal in *Metalclad v. Mexico* considered it 'to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters.'
>
> The notion of consistency as an element of fair and equitable treatment has been found to stand for the proposition that the foreign investor should be entitled to expect the host State to act 'without arbitrarily revoking any pre-existing decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.' See *Tecmed v. Mexico*.
>
> Neither of these criteria is intended however to go so far as to require the State to freeze its legal framework, but rather to act in an open manner and consistent with commitments it has undertaken. As noted by the Tribunal in *CMS v Argentina*: 'It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made'."[443]

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443 *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraphs 183-185, **{CLA-10}**, citing *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of 30 August 2000, paragraph 76, **{CLA-22}**, *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of 29 May 2003, paragraph 154, **{CLA-23}**, and *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12 May 2005, paragraph 277, **{CLA-24**}.

309. *Mamidoil v Albania* expressed a similar view when construing Article 10(1) of the ECT. The tribunal there explained the need to balance stability with the State's right to alter its laws, but held "even when legislative changes seem legitimate, they must not have the character of a continuous oscillation and unpredictability".[444]

310. In *Electrabel v Hungary*, the effect of the express reference to transparency in the first sentence of Article 10(1) of the ECT was explained as follows:

> "The reference to transparency can be read to indicate an obligation to be forthcoming with information about intended changes in policy and regulations that may significantly affect investments, so that the investor can adequately plan its investment and, if needed, engage the host State in dialogue about protecting its legitimate expectations."[445]

311. As two scholars have summarised the duty of transparency:

> "fair and equitable treatment most certainly imposes an obligation with respect to the impartial administration of state regulation. … [T]ribunals have cited haphazard, opaque, contradictory and inconsistent decisions and decision-making as not being transparent."[446]

312. Thirdly, the duty not to frustrate an investor's legitimate expectations is another core tenet of the fair and equitable treatment obligation. A classic explanation of the content of this duty is in *Saluka v Czech Republic*:

> "An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as

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444 *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award, 30 March 2015, paragraph 621, **{CLA-63}**.

445 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 7.79, {**CLA-20}**.

446 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer, 2009) page 293, **{CLA-25}**.

> on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable."[447]

313. Like this passage, case law has tended to focus on whether the source and the timing of the legitimate expectations are such that their frustration by the State is a breach of the fair and equitable treatment obligation. When interpreting Article 10(1) of the BIT, the tribunal in *Kardassopoulos v Georgia* held:

> "The Tribunal finds the following passage in *Saluka* to be particularly helpful in understanding the potential sources of expectations, and the time at which they arise for the purpose of asserting the breach of a treaty standard:
>
> > 'A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies bona fide by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. …'.
>
> In the present case, although the specific assurances of compensation alleged to have been given to [the claimant] came years after his initial investment in Georgia, the Tribunal considers the Respondent's interpretation of the legitimate expectations element of the FET standard to presuppose limitations upon the notion of fair and equitable treatment that are not established as a matter of law and that are inconsistent with the terms of the BIT read in their proper context."[448]

314. The source of the expectations of the investor therefore need not be specific assurances received from the State. An investor's expectations that a State will implement its laws and policies in a "reasonably justifiable" way can be legitimate for present purposes. This is confirmed by other case law considering Article 10(1) of

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447 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 301, **{CLA-26}**.

448 *Ioannis Kardassopoulos and Ron Fuchs v. Georgia*, ICSID Case No. ARB/07/15, Award, 3 March 2010, paragraphs 438-439, **{CLA-27}**.

the ECT.[449] It is also confirmed by leading scholarship. After noting that an investor's legitimate expectations may be based on both "the host state's legal framework and on any undertakings and representations made explicitly or implicitly by the host state", Dolzer and Schreuer confirm that the "legal framework on which the investor is entitled to rely consists of legislation and treaties, assurances contained in decrees, licenses, and similar executive statements, as well as contractual undertakings."[450]

315. Further, the timing of the expectation is often said to be "at the time the investment is made", albeit "the interpretation of 'time of the investment' has been quite broad" in the case law, encompassing at least the time when "the investment was decided and made".[451]

316. For example, in *Mamidoil v Albania*, after noting jurisprudence that generally tended to note that the timing of the expectation should be at the time the investment is made, one arbitrator observed:

> "the time at which legitimate expectations should be measured depends on how Claimant formulates its reliance case, and Schreuer and Kriebaum correctly suggest that a tribunal should differentiate those moments at which Claimant claims it relied on new state action to its detriment in order to test the legitimacy of that reliance based on the circumstances that existed at such time(s)."[452]

2. <u>The Respondent has breached that standard</u>

317. The conduct of the Respondent set out in Section II above breached the fair and equitable treatment obligation in numerous ways.

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449 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 7.78, {**CLA-20}**.

450 Dolzer and Schreuer, *Principles of International Investment Law* (CUP, 2nd ed. 2012), page 145, **{CLA-28}**.

451 *AES Summit Generation Limited and AES-Tisza Erömu Kft. v. Republic of Hungary*, ICSID Case No. ARB-07-22, Award, 23 September 2010, paragraph 9.3.12, **{CLA-29**}.

452 *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Dissenting Opinion, 30 March 2015, paragraph 89, **{CLA-63}**.

318. First, the Respondent breached the obligation by violating its own laws in its treatment of the Claimants' investment, and then seeking to change its law to subvert the decisions of its own courts that held it had acted unlawfully.

a) The Respondent's conduct is arbitrary because it involves the manipulation of its domestic legal system in order to benefit it (and harm the Claimants). To use the language of the International Court of Justice, simply altering your law to subvert local court decisions adverse to the State's wishes is "opposed to the rule of law",[453] and, as one Judge of the Court expressed it, "ensu[es] entirely from the free will of the authority concerned".[454] In this sense, the Respondent's amendment of its laws in order to undo the decisions of its domestic courts "depend[s] on individual discretion; … founded on prejudice or preference rather than on reason or fact"[455] and on a "willful disregard of the law" as it stood at the time of the courts' decisions.[456]

b) This conduct also lacked transparency and consistency. The repeated alteration by the Respondent of its laws in order to undo its courts decisions represents "haphazard, opaque, contradictory and inconsistent decisions and decision-making".[457] These actions by the Respondent had "the character of a

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453 *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, 15, paragraph 128, {**CLA-16}**.

454 *Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo)*, Separate Opinion of Judge Cançado Trindade, 30 November 2010, ICJ Reports 2010, 729, paragraph 108, {**CLA-17}**.

455 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, 3 September 2001, paragraphs 221 and 232, **{CLA-18**}.

456 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 17 January 2007, paragraphs 318-319, **{CLA-19}**.

457 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer, 2009) page 293, **{CLA-25}**.

continuous oscillation and unpredictability" that violates this tenet of the fair and equitable treatment obligation.[458]

c) The Respondent's manipulation of its laws also undermined the legitimate expectations of the Claimants. The "totality of the business environment" in March 2007 did not indicate that the Respondent would serially change its laws in order to subvert the decisions of its own courts vindicating the Claimants' rights in relation to the investment.[459] Certainly such behaviour subverts a belief that "the conduct of the host State subsequent to the investment will be fair and equitable" from March 2007 onwards.[460] The "legal framework" at March 2007 was one in which the Respondent would be expected to comply with domestic court decisions rather than pursue in legislative and regulatory acts that subvert those decisions.[461] That is not "reasonably justifiable" implementation of laws and policies by the Respondent.[462]

319. While the evidence of this breach of the fair and equitable treatment obligation is set out in Section II above and the Chronology at Annex 1, key examples are as follows.

a) After the Respondent's courts held that the NERC did not have the power to establish prices and only had the power to approve them (such that, to take Case No 8/137 for instance, NERC Resolutions No 155 and 315 were held invalid[463]), the Verkhovna Rada passed the July 2010 Gas Market Law on 24

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458 *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award, 30 March 2015, paragraph 621, {**CLA-63}**.

459 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 301, **{CLA-26}**.

460 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 301, **{CLA-26}**.

461 Dolzer and Schreuer, *Principles of International Investment Law* (CUP, 2nd ed. 2012), page 145, **{CLA-28}**.

462 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 7.78, **{CLA-20**}.

463 See Section II.E.3 above.

July 2010. That legislation provided that entities to which it applied were to sell gas to Naftogaz at a price "established" by the NERC for each entity on an annual basis and "according to the Procedure approved by [NERC] for establishment and calculation of natural gas prices for gas mining companies".[464] The NERC then entrenched this attempt to reverse the courts' rulings by issuing the July 2010 NERC Resolution on 27 July 2010, which purported to set a price for Ukrnafta's gas from 1 August 2010.[465]

b) After the Respondent's courts held that the NERC did not have the power to establish prices, and citing the lead of the Verkhovna Rada when it passed the July 2010 Gas Market Law, the NERC passed the 2011 NERC Resolution. That Resolution amended the 2009 NERC Gas Pricing Procedure, including so that the NERC would be able to establish prices, not merely approve them.[466]

c) Within days of one of the Respondent's courts' decisions which held that the July 2010 NERC Resolution was invalid, the NESR passed NESR Resolution No 255. This Resolution set the price for Ukrnafta's gas at the very same price that the recently invalidated July 2010 NERC Resolution had purported to set, necessarily meaning that the NESR deliberately sought to overwrite the two substantive bases on which the court had held the July 2010 NERC Resolution to be invalid (namely, that the NERC had improperly omitted elements of cost and made no allowance for capital expenditure, and that the NERC had set the price below Ukrnafta's cost of production without providing for a subsidy).[467]

320. Secondly, the Respondent violated the fair and equitable treatment obligation by setting prices for the sale of gas by Ukrnafta to Naftogaz at a level that, contrary to

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464 See Section II.E.5 above.

465 See Section II.E.5 above.

466 See Section II.E.4 above.

467 See Section II.E.6-7 above.

the law, did not allow Ukrnafta to recover its production costs (let alone reinvest in the business or earn a margin).

a) This conduct of the Respondent is arbitrary because it neither arises out of a rational policy nor is a reasonable execution of such a policy (were one to exist). The Respondent's approach to gas pricing cannot be regarded as "rational" – in that it was adopted "following a logical (good sense) explanation and with the aim of addressing a public interest matter"[468] – or as a "reasonable" application of policy – in that "an appropriate correlation between the state's public policy objective and the measure adopted to achieve it" existed[469] – because it sought to compel Ukrnafta to sell its gas at a price that would not cover production costs, and would thus render the company's operations commercially unviable.

b) The Respondent's approach to gas pricing lacked transparency and consistency. It is "haphazard, opaque, contradictory and inconsistent"[470] for the Respondent to enact legislation in the Verkhovna Rada promising that such prices will allow for gas producers to cover production costs and a margin, but then for the NERC repeatedly to pass Resolutions that refused to Ukrnafta to cover production costs and a margin.

c) The Respondent's conduct also undermined the legitimate expectations of the Claimants. At the time of the Claimants' investment in March 2007, "[t]he legal framework on which the investor is entitled to rely"[471] contained no requirement that Ukrnafta sell at a certain price. It is a frustration of

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468 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 179, {**CLA-20}**.

469 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 179, {**CLA-20}**.

470 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer, 2009) page 293, **{CLA-25}**.

471 Dolzer and Schreuer, *Principles of International Investment Law* (CUP, 2nd ed. 2012), page 145, **{CLA-28**}.

expectations legitimately arising out of that framework for the Respondent to empower the NERC to set sale prices, and for the NERC to set such prices at a level that meant Ukrnafta could not cover production costs and a margin. This frustration of expectations is particularly acute where the Respondent's courts had effectively confirmed the basis of the expectation, but the Respondent in any event and despite the courts' rulings proceeded to reformulate and at times re-legislate in order to achieve an objective on gas pricing which had already been established to be illegitimate.

321. Section II above and the Chronology at Annex 1 are replete with evidence of this breach of the fair and equitable treatment obligation. Select examples are as follows.

a) In early 2008, the NERC issued Resolution No 155, by which it purported to approve a price of UAH 272.6 (excluding VAT) for Ukrnafta's 2008 gas, with retrospective effect from 1 January 2008, and Resolution No 315, by which it purported to approve an even lower price of UAH 199.20 (excluding VAT) for Ukrnafta's 2008 gas, with effect from 1 March 2008. The two Resolutions were held to be invalid on several bases, including that they purported to set a price below Ukrnafta's costs of production (which was contrary to the law in force at the time).[472]

b) At the end of 2008, the NERC issued the 2008 JIA NERC Resolutions, by which it purported to approve prices of gas (exclusive of VAT) produced pursuant to joint venture contracts between Ukrnafta and various third parties at levels between UAH 278 and UAH 292. The Resolutions were held to be invalid on similar grounds to those applicable to Resolutions No 155 and No 315, including that the price set was below Ukrnafta's costs of production.[473] The issue of these two Resolutions by the NERC only one day before the 2009 Budget Law was enacted was especially cynical, given the

472 See Section II.E.3 above.

473 See Section II.E.4 above.

latter stated that any NERC-approved price had to allow recovery of economically reasonable production costs and a margin.

c) In mid-2010, the NERC passed Resolution No. 889, by which it purported to approve a price of UAH 458 (excluding VAT) for Ukrnafta's 2008 gas, with effect from 1 August 2010. The Resolution was held to be invalid on several bases, such as that it did not cover economically reasonable costs of production and provide a profit (which was contrary to the 2010 Budget Law in effect at the time).[474]

d) At the end of 2012, the NERC passed the December 2012 NESR Resolution, by which it purported to set a price of UAH 492.60 (excluding VAT) for Ukrnafta's 2008 gas, with effect from 1 January 2013. The Resolution was held to be invalid on several bases, such as that it did not cover economically justified costs of production and provide a profit (which was contrary to the July 2010 Gas Market Law, the 2012 Law on Prices and Pricing and the Commercial Code in effect at the time).[475]

e) At the end of 2013, the NERC passed the December 2013 NESR Resolution, by which it purported to set a price of UAH 562.50 (excluding VAT) for Ukrnafta's 2008 gas, with effect from 1 January 2014. The Resolution was held to be invalid on several bases, such as that it did not cover economically justified costs of production and provide a profit (which was contrary to the 2012 Law on Prices and Pricing).[476]

f) Finally, in addition to the above examples of where the Respondent sought to impose specific prices for the sale of gas by Ukrnafta to Naftogaz at a level that was unlawful, Naftogaz repeatedly pressured Ukrnafta to enter into contracts at the unlawfully low prices set by the NERC, and commenced

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474 See Section II.E.5 above.

475 See Section II.E.8 above.

476 See Section II.E.9 above.

litigation against Ukrnafta on numerous occasions seeking an order that Ukrnafta enter into such contracts (which litigation never succeeded).[477]

322. Thirdly, the Respondent violated the fair and equitable treatment obligation by refusing to comply with decisions of its own courts in cases commenced by Ukrnafta that were adverse to the Respondent.

a) The Respondent's conduct is arbitrary because it involves a deliberate disregard for the orders of its own courts. This, to quote again the International Court of Justice, is "oppos[ition] to a rule of law",[478] and, as one investment treaty tribunal phrased it, constitutes a "willful disregard of the law" in the form of the courts' decisions.[479]

b) This conduct also undermined the legitimate expectations of the Claimants. The "totality of the business environment" in March 2007 did not indicate that the Respondent would ignore the orders of its own courts in relation to disputes with Ukrnafta.[480] This behaviour again subverts a belief that "the conduct of the host State subsequent to the investment will be fair and equitable" from March 2007 onwards.[481] Certainly the "legal framework" mandated compliance with those court decisions.[482] This is especially so where, as Dr Khachaturyan confirms, in Ukraine:

> "courts' decisions entered into force are mandatory for their fulfilment by all entities, including public bodies,

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477 See Section II.E generally above.

478 *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, 15, paragraph 128, {**CLA-16}**.

479 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 17 January 2007, paragraphs 318-319, **{CLA-19}**.

480 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 301, **{CLA-26}**.

481 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 301, **{CLA-26}**.

482 Dolzer and Schreuer, *Principles of International Investment Law* (CUP, 2nd ed. 2012), page 145, **{CLA-28**}.

> without any exceptions. Consequently, there is no basis on which any entity (including Naftogaz, Ukrtransgaz or the NERC) is exempted from being bound by decisions of the administrative and commercial courts against them."[483]

323. Section II above and the Chronology at Annex 1 evidence this breach of the fair and equitable treatment, such as in the following conduct.

a) After losing cases in 2006 regarding Ukrnafta's 2006 gas and being ordered to acknowledge receipt of that gas as having been pumped into the UGS, Ukrtransgaz simply refused to sign Deeds of Transfer and Acceptance in respect of the majority of the gas.[484]

b) After losing cases in 2008 which concluded that Naftogaz's attempts to compel Ukrnafta to sign contracts by which Naftogaz would purchase Ukrnafta's gas already in the UGS at an undervalue (Case No 29/192, Case No 29/193, Case No 29/194 and Case No 29/195), Naftogaz held a Board meeting at which it decided to create documents recording that the same gas was of "undeterminable owner", had already been sold and had already been sold at prices to be stated.[485] This plan of action, which Naftogaz acted upon, plainly circumvented the prior orders of the Respondent's courts.

c) After Ukrtransgaz and Naftogaz lost more cases that had been commenced in 2011 which ordered it to release gas to Ukrnafta (Case No 6/489 and Case No 6/521), Ukrtransgaz and Naftogaz refused to release the relevant gas to Ukrnafta, stating *inter alia* that it had already been sold to the population.[486]

d) In respect of one of the cases they lost in 2011 (Case No 6/521), Ukrtransgaz and Naftogaz continued to refuse to release the relevant gas even though

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483 Expert Report by Armen Khachaturyan, paragraph 27.

484 See Section II.E.2 above.

485 See Section II.E.3 above.

486 See Sections II.E.6-7 above.

Ukrnafta commenced enforcement proceedings through the Bailiff against Ukrtransgaz and Naftogaz (Demand No 1724/10), in which the Respondent's courts again found in Ukrnafta's favour.[487] The behaviour of Ukrtransgaz and Naftogaz in the enforcement proceedings was particularly cynical. In addition to refusing to meet the Bailiff's demand, they also unsuccessfully challenged each of: the legality of the Bailiff's actions; the enforceability of the orders of the Supreme Commercial Court in the original Case No 6/521; and the orders of the courts during the enforcement proceedings.[488] Ukrtransgaz even took its desire not to comply with the court's orders so far as to submit an application to the initial Kiev Commercial Court requesting an explanation as to how it should execute the order to return the gas to Ukrnafta.[489]

324. Fourthly, the Respondent violated the fair and equitable treatment obligation by altering the corporate governance arrangements of Ukrnafta, and depriving the Claimants in a targeted fashion of their rights in that corporate governance.

a) The Respondent's alteration of its laws in relation to the corporate governance of Ukrnafta in order to remove the Claimants' rights in that regard was arbitrary. This is because senior officials of the Respondent explicitly recognised that the purpose of the new laws was to gain control over the management of Ukrnafta, as those officials believed that the State should have such control and elicit the financial benefits from it. In this way, the Respondent's alteration of its laws was "founded on prejudice or preference rather than on reason or fact".[490]

b) The Respondent's conduct also undermined the legitimate expectations of the Claimants. At the time of their investment in March 2007, "[t]he legal

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487 See Section II.E.9 above.

488 See Section II.E.9 above.

489 See Section II.E.9 above.

490 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, 3 September 2001, paragraphs 221 and 232, **{CLA-18}**.

framework on which the investor is entitled to rely"[491] was clear that quorum for a general meeting of shareholders in a joint stock company was 60%. This meant that the minority shareholders' shareholding of just over 40% of Ukrnafta ensured that no general meeting would be quorate without them. The centrality of their role in Ukrnafta's corporate governance was confirmed by the 2010 Shareholders Agreement, 2010 Cooperation Agreement and 2011 Articles. The Claimants' legitimate expectations were thus engendered at the time of the investment[492] and from further "specific assurances … years after [the] initial investment".[493]

325. Although full evidence of this breach of the fair and equitable treatment obligation is in Section II above and the Chronology at Annex 1, core examples of it are as follows.

a) The purpose of the laws changing the corporate governance arrangements of Ukrnafta were unrelated to a general concern about how joint stock companies are managed, or even a concern about a specific aspect of the management of Ukrnafta itself. Rather, the purpose was to gain control of Ukrnafta, to obtain cash from it in the order of "around 2 billion hryvnias" to contribute to the State budget, and to achieve this "in a hurry".[494]

b) The Respondent does not appear to have: conducted any consultation or research on the need for or effect of this change in the law; asked representatives of industry as to how corporate governance would be

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491 Dolzer and Schreuer, *Principles of International Investment Law* (CUP, 2nd ed. 2012), page 145, **{CLA-28}**.

492 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 301, **{CLA-26}**.

493 *Ioannis Kardassopoulos and Ron Fuchs v. Georgia*, ICSID Case No. ARB/07/15, Award, 3 March 2010, paragraphs 438-439, **{CLA-27**}.

494 See Section II.G.1 above.

improved by the new laws; or even to have deliberated for a significant period of time before passing the new laws.[495]

c) When the Respondent's first effort to target Ukrnafta by way of a law to improve its own rights (and diminish the Claimants' rights) in the corporate governance of the company failed, senior officials of the Respondent did not discuss policy consequences of that failure, but instead explicitly insisted that the second effort ensure that Ukrnafta was properly targeted so that "this Law [would] apply to 'Ukrnafta'" and so that "the government will resume control of Ukrnafta".[496]

d) The Respondent enacted the laws altering the corporate governance of Ukrnafta in breach of Ukrainian legal procedures for the adoption of legislation by the Verkhovna Rada.[497]

e) When passing the law which ultimately did strip the Claimants of rights in the corporate governance of Ukrnafta as the Respondent intended, senior officials of the Respondent were explicit that this allowed it to appoint new management at the company and issue dividends. Those were rights that previously could be exercised only with the participation of the minority shareholders, not least the Claimants due to the 2010 Shareholders Agreement and the 2011 Articles.[498]

326. Fifthly, the Respondent violated the fair and equitable treatment obligation by imposing enormous financial burdens on the sector in which Ukrnafta operated, with a particular focus on Ukrnafta itself.

a) The Respondent's alteration of its laws in relation to the rental fee payable by Ukrnafta was arbitrary. This is because the size of the increase in the rental

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495 See Section II.G.1 above.

496 See Section II.G.1 above.

497 See Section II.G.1 above.

498 See Section II.G.2 above.

fee, the lack of meaningful forewarning of the increase, and the manner in which the increase targeted Ukrnafta evinced that this alteration in the Respondent's laws was "founded on prejudice or preference rather than on reason or fact".[499] It was also arbitrary because, even if it was a rational policy measure, it was not done reasonably, with the result that there was no "appropriate correlation between the state's public policy objective and the measure adopted to achieve it."[500]

b) This conduct also lacked transparency and consistency. The uncertainty relating to the duration and magnitude of the rental fee, and its introduction in a manner that did not comply with basic Ukrainian taxation law principles, meant that the measure reflected "haphazard, opaque, contradictory and inconsistent decisions and decision-making".[501] The uncertainty reflected "continuous oscillation and unpredictability" in breach of the fair and equitable treatment obligation.[502]

c) The Respondent's conduct also undermined the legitimate expectations of the Claimants. At the time of their investment in March 2007, "the legal framework on which the investor is entitled to rely"[503] not only did not have a rental fee of such magnitude, but also proscribed alterations to tax rates less than six months in advance of the application of the new rates.

327. Section II above and the Chronology at Annex 1 evidence this breach of the fair and equitable treatment, such as in the following conduct.

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499 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, 3 September 2001, paragraphs 221 and 232, **{CLA-18}**.

500 *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, paragraph 179, **{CLA-20**}.

501 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer, 2009) page 293, **{CLA-25**}.

502 *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award, 30 March 2015, paragraph 621, {**CLA-63}**.

503 Dolzer and Schreuer, *Principles of International Investment Law* (CUP, 2nd ed. 2012), page 145, **{CLA-28**}.

a) The change in the law was implemented in an unpredictable manner. While the possibility of a rental fee increase had been floated and then not pursued in early 2014, it was ultimately introduced without meaningful notice on 31 July 2104. It was described as being only a temporary measure for the remainder of 2014, but became, again without meaningful notice, a permanent measure.[504]

b) The Respondent provided no justification for the magnitude of the increase in the rental fee payable. Even if one might regard an increase in the rental fee as a rational policy, the magnitude of the increase in the fee had no correlation with that policy. The expert engaged by the Respondent's Verkhovna Rada endorsed this view, noting the absence of a "relevant justification as to the feasibility of setting the royalty rates" at the new levels.[505]

c) The purpose of the increase in the fee was recognised by senior officials of the Respondent. The Minister of Finance confirmed that the measure was designed to raise cash to contribute to the State budget. To this end, two companies were the focus of the Respondent's revenue raising, but only Ukrnafta was owned in part by private shareholders (including the Claimants) who would be financially affected by the new measure. There was no general policy being implemented by virtue of this increase in the rental fee.[506]

d) The Respondent altered the rental fee in violation of principles of tax stability in Ukrainian tax law. The Respondent's own courts held that an increase in the rental fee could not be implemented less than six months in advance of the fiscal period in which the increased rate would apply.[507]

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504 See Section II.F above.

505 See Section II.F above.

506 See Section II.F above.

507 See Section II.F above.

328. For these reasons, the Respondent breached the fair and equitable treatment obligation in Article 10(1) of the ECT.

C. The Respondent has impaired by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of the Claimants' investments, in breach of Article 10(1) of the ECT

329. The Respondent has impaired by unreasonable measures the management, maintenance, use, enjoyment or disposal of the Claimants' investments, in breach of Article 10(1) of the ECT, because it has unreasonably impaired the management, maintenance, use, enjoyment and disposal of the Claimants' investments.

1. The applicable standard

330. The relevant part of Article 10(1) of the ECT reads:

> "no Contracting Party shall in any way impair by unreasonable or discriminatory measures [the Investments'] management, maintenance, use, enjoyment or disposal."

331. Case law notes that the unreasonableness portion of this obligation overlaps with the protection afforded by the fair and equitable treatment obligation.[508] This is shown by the way in which *Plama v Bulgaria* linked, when discussing this aspect of Article 10(1), the concepts of unreasonableness and arbitrariness, describing them jointly as measures "not founded in reason or fact but on caprice, prejudice or personal preference".[509] A breach of the two obligations is thus likely to be established by the same conduct.

332. Nonetheless, the unreasonableness obligation contains its own standard for breach. The tribunal in *AES v Hungary* stated in respect of Article 10(1):

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508 See, in the context of the ECT alone: *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraph 183, **{CLA-3}**; *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraph 248, **{CLA-10}**; *Anatolie Stati, Gabriel Stati, Ascom Group S.A. and Terra Raf Trans Traiding Ltd v. Republic of Kazakhstan*, SCC Case No. V116/2010, Award, 19 December 2013, paragraphs 1281-1282, **{CLA-8}.**

509 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, paragraph 184, **{CLA-3**}.

> "There are two elements that require to be analyzed to determine whether a state's act was unreasonable: the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy.
>
> A rational policy is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter.
>
> Nevertheless, a rational policy is not enough to justify all the measures taken by a state in its name. A challenged measure must also be reasonable. That is, there needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented."[510]

333. The approach of defining the "reasonableness" of a measure by reference to its link with a rational policy, reasonably pursued, is also supported by case law outside the context of the ECT. *Saluka v Czech Republic*, for instance, held that reasonableness requires that the State's conduct "bear[] a reasonable relationship to some rational policy", in a finding relied upon in *Biwater Gauff v Tanzania* and *Rumeli Telekom v Kazakhstan*.[511]

2. <u>The Respondent has breached that standard</u>

334. Given the overlap between the unreasonableness obligation and the fair and equitable treatment obligation (and especially its prohibition of arbitrary conduct), the Claimants rely on the breaches of the latter obligation, set out in Section IV.B immediately above, as breaches of the former obligation, *mutatis mutandis*.

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510 *AES Summit Generation Limited and AES-Tisza Erömu Kft. v. Republic of Hungary*, ICSID Case No. ARB-07-22, Award, 23 September 2010, paragraphs 10.3.7-10.3.9, **{CLA-29}**.

511 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraph 460, **{CLA-26}**; *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID Case No. ARB/05/08, Award, 24 July 2008, paragraph 729, **{CLA-34}**; and *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award, 29 July 2008, paragraph 679, **{CLA-38**}.

335. Accordingly, on the basis of the evidence noted in Section IV.B above and set out fully in Section II above and in the Chronology at Annex 1, the Respondent breached the unreasonableness obligation in Article 10(1) of the ECT:

a) by violating its own laws in its treatment of the Claimants' investment, and then seeking to change its law to subvert the decisions of its own courts that held it had acted unlawfully;

b) by setting prices for the sale of gas by Ukrnafta to Naftogaz at a level that, contrary to the law, did not allow Ukrnafta to recover its production costs (let alone reinvest in the business or earn a margin);

c) by refusing to comply with decisions of its own courts in cases commenced by Ukrnafta that were adverse to the Respondent;

d) by altering the corporate governance arrangements of Ukrnafta, and depriving the Claimants in a targeted fashion of their rights in that corporate governance; and

e) by imposing enormous financial burdens on the sector in which Ukrnafta operated.

336. In addition to the foregoing, the Respondent breached this obligation by refusing to permit capital investment each year by Ukrnafta in relation to the equipment and infrastructure which it uses to extract and process oil and gas. It cannot be regarded as a "rational policy", let alone a "reasonable" implementation of a policy,[512] to refuse to allow Ukrnafta to engage in proper capital investment, and instead to insist on the withdrawal of dividends to such an extent that the Ukrnafta's infrastructure falls or risks falling into disrepair. Indeed, some capital investment was required each year for production even to be maintained at an existing level, such that no capital investment resulted inevitably in production capacity being reduced each year by a

512 *AES Summit Generation Limited and AES-Tisza Erőmu Kft. v. Republic of Hungary*, ICSID Case No. ARB-07-22, Award, 23 September 2010, paragraphs 10.3.7-10.3.9, **{CLA-29**}.

significant amount thereby perpetuating the loss of income. The Respondent's insistence through Naftogaz that the maximum withdrawals from Ukrnafta take place to such an extent that the operations of Ukrnafta were compromised was a decision based on "preference" rather than "reason or fact".[513]

337. Section II above and the Chronology at Annex 1 evidence this breach of the unreasonableness obligation, such as in the following conduct.

a) At a General Meeting of Shareholders on 22 July 2015, one of the Claimants proposed that only 50.04% of Ukrnafta's 2014 net profit of UAH 1,264,626,000 be distributed as dividends and that the remaining 49.96% be retained for capital investment (given that there had been no significant investment for the several years prior), but Naftogaz ensured an alternative resolution was passed which requires at least 99.9% of the net profit to be distributed as dividends.[514]

b) On 23 September 2014, approved instructions to its representatives in the General Meeting of Shareholders of Ukrnafta that, subject to further approval of the Ministry of Energy and Coal Industry and the Cabinet of Ministers, 99.99% of Ukrnafta's net profit for 2011, 99.98% of its net profit for 2012 and 99.95% of its net profit for 2013 be distributed as dividends, thus leaving only 0.01%, 0.02% and 0.05% of that sum for capital investment in each of those years. The Ministry of Energy and Coal Industry approved those instructions on 9 October 2014. Naftogaz ensures that a resolution at the General Meeting to this effect was passed.[515]

c) On 25 January 2010, Naftogaz instructed its representatives in the General Meeting of Shareholders of Ukrnafta that 99.99% of Ukrnafta's net profit for

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513 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraph 184, {**CLA-3}**.

514 See Chronology at Annex 1.

515 See Chronology at Annex 1.

2006, 2007 and 2008 are to be distributed as dividends, thus leaving only 0.01% of that sum for capital investment.[516]

d) On 10 February 2009, Naftogaz instructed its representatives in the General Meeting of Shareholders of Ukrnafta that 100% of Ukrnafta's net profit for 2006 and 2007 is to be distributed as dividends, thus leaving no portion of that sum for capital investment.[517]

e) The NERC over many years issued Resolutions that did not, as Ukrnafta itself explained, enable Ukrnafta to perform "the capital investments required for gas mining".[518]

f) The NERC issued those Resolutions even though the Respondent's courts held that failing to set prices that allowed Ukrnafta to engage in capital investment was unlawful and rendered successive Resolutions invalid.[519]

g) The NERC refused to alter its stance even when the Chairman of the Executive Board explained that the prices the NERC was setting meant that no capital investment would be possible.[520]

338. For these reasons, the Respondent breached the obligation in Article 10(1) of the ECT not to impair by unreasonable measures the management, maintenance, use, enjoyment or disposal of the Claimants' investments.

D. The Respondent has failed to provide the Claimants' investments most constant protection and security, in breach of Article 10(1) of the ECT

516 See Chronology at Annex 1.

517 See Chronology at Annex 1.

518 See Chronology at Annex 1.

519 See Chronology at Annex 1.

520 See Chronology at Annex 1.

339. The Respondent has failed to provide the Claimants' investments most constant protection and security, in breach of Article 10(1) of the ECT, because its conduct has undermined the legal protection of those investments.

1. <u>The applicable standard</u>

340. The relevant part of Article 10(1) of the ECT reads:

> "Such Investments shall also enjoy the most constant protection and security …"

341. It is uncontentious that this obligation imposes a due diligence duty on States to take steps to protect and secure investments from damage.[521] The obligation traditionally applied to situations where the State was required to take steps to forestall the infliction of physical damage on an investment, usually by third parties but also by State actors.[522] However, investment treaty arbitration tribunals have in the last decade recognised that the obligation can also apply to a failure to take duly diligent steps to create a framework that grants administrative and legal security. While that interpretation of the standard of conduct required by the obligation is not unanimously held, it has been endorsed with greater regularity over recent years, and the majority of tribunals that have considered the position adopt this understanding of the standard

342. For instance, in the context of Article 10(1) itself, *Plama v Bulgaria* noted the "standard includes, in this manner, an obligation actively to create a framework that grants security."[523] Other tribunals have reached the same conclusion, sometimes with fuller explanation. Thus the tribunal in *Azurix v Argentina* held that the obligation "go[es] beyond protection and security ensured by the police ... [and] the stability

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521 See, e.g., *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraph 123, {**CLA-3}**.

522 See, e.g., *AAPL v Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990, **{CLA-30}**, and *American Manufacturing and Trading Inc v Zaire*, ICSID Case No. ARB/93/1, Award, 21 February 1997, **{CLA-31}**.

523 See, e.g., *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, paragraph 180, **{CLA-3**}.

afforded by a secure investment environment is as important from an investor's point of view."[524] The tribunal in *Siemens v Argentina* agreed with applying the obligation beyond the context of physical security, and noted in respect of intangible investments such as a shareholding that it wold be "difficult to understand how the physical security of an intangible asset would be achieved".[525] *Aguas/Vivendi v Argentina* also commented on the scope of the obligation:

> "the scope of the [obligation] should be interpreted to apply to reach any act or measure which deprives an investor's investment of protection and full security, providing, in accordance with the Treaty's specific wording, the act or measure also constitutes unfair and inequitable treatment. Such actions or measures need not threaten physical possession or the legally protected terms of operation of the investment."[526]

343. Similarly, the tribunal in *Biwater Gauff v Tanzania* held that the obligation "may extend to matters other than physical security", that it "implies a State's guarantee of stability in a secure environment, both physical, commercial and legal", and that confining it to physical security, especially as the treaty was "directed at the protection of commercial and financial investments", would be "unduly artificial" [527]

344. The tribunal in *National Grid v Argentina* also endorsed such a conclusion:

> "the phrase 'protection and constant security' as related to the subject matter of the Treaty does not carry with it the implication that this protection is inherently limited to protection and security of physical assets."[528]

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524 *Azurix Corporat{ion v The Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paragraph 408, **{CLA-32}**.

525 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 17 January 2007, paragraph 303, {**CLA-19}**.

526 *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentina*, ICSID Case No. ARB/97/3, Award, 20 August 2007, paragraph 7.4.15, **{CLA-30**}.

527 *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID Case No. ARB/05/08, Award, 24 July 2008, paragraph 729, **{CLA-34**}.

528 *National Grid plc v Argentina*, UNCITRAL, Award, 3 November 2008, paragraph 189, **{CLA-35}**.

345. Even modern cases that still invoke an older conception of the obligation by arguing that it should relate primarily to protection from physical harm acknowledge that such an approach to the obligation is not wholly appropriate. Thus, in *AES v Hungary*, the tribunal held that the obligation required host States to "take reasonable steps to protect its investors (or to enable its investors to protect themselves) against harassment by third parties and/or state actors", but added that the obligation:

> "can, in appropriate circumstances, extend beyond a protection of physical security, it certainly does not protect against a state's right (as was the case here) to legislate or regulate in a manner which may negatively affect a claimant's investment, provided that the state acts reasonably in the circumstances and with a view to achieving objectively rational public policy goals."[529]

346. There are more cases that endorse the conclusion that the obligation to provide "most constant protection and security" requires not only physical protection, but also legal protection as well.[530]

347. Finally, this conclusion is particularly apposite in this case, where the wording of the obligation is in a very broad form, and is not limited to "physical security". The qualifier "most constant" in Article 10(1) of the ECT, like the common qualifier "full" in other treaties, is to be read as extending the protection offered beyond mere physical protection. Case law supports this interpretive approach,[531] primarily on the basis that, as the tribunal in *Biwater Gauff v Tanzania* observed, when the word "full"

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529 *AES Summit Generation Limited and AES-Tisza Erömü Kft. v Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010, paragraph 13.3.2, {**CLA-29}**.

530 See, e.g., *Marion Unglaube and Reinhard Unglaube v Costa Rica*, ICSID Case No. ARB/08/1 and ICSID Case No. ARB/09/20, Award, 16 May 2012, paragraph 287, {**CLA-36}**; *CME Czech Republic B.V. v Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, paragraph 613, **{CLA-37**}.

531 See, e.g., *Azurix Corporation v The Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paragraph 408, {**CLA-32**}; *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID Case No. ARB/05/08, Award, 24 July 2008, paragraph 729, **{CLA-34**}.

is included in the obligation, it "would ... be unduly artificial to confine the notion of 'full security' only to one aspect of security".[532]

2. The Respondent has breached that standard

348. Unless one adopts the restrictive traditional approach to the scope of the most constant protection and security obligation, a breach of that obligation can be established by way of the same conduct that breaches the fair and equitable treatment obligation. This is particularly so where the State fails to take duly diligent steps to create a framework that grants administrative and legal security,[533] or to act reasonably in the circumstances and with a view to achieving objectively rational public policy goals.[534] The result of this for the purpose of this case is that conduct which is arbitrary, which is lacking in transparency or consistency, or which frustrates an investor's legitimate expectations breaches the most constant protection and security obligation.

349. Accordingly, on the basis of the evidence noted in Section IV.B above and set out fully in Section II above and in the Chronology at Annex 1, the Respondent breached the most constant protection and security obligation in Article 10(1) of the ECT:

a) by violating its own laws in its treatment of the Claimants' investment, and then seeking to change its law to subvert the decisions of its own courts that held it had acted unlawfully;

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532 *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID Case No. ARB/05/08, Award, 24 July 2008, paragraph 729, **{CLA-34}**.

533 See, *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, paragraph 180, **{CLA-3}**; *Azurix Corporation v The Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paragraph 408, **{CLA-32}**; *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID Case No. ARB/05/08, Award, 24 July 2008, paragraph 729, **{CLA-34}**.

534 *AES Summit Generation Limited and AES-Tisza Erömü Kft. v Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010, paragraph 13.3.2, **{CLA-29}**.

b) by setting prices for the sale of gas by Ukrnafta to Naftogaz at a level that, contrary to the law, did not allow Ukrnafta to recover its production costs (let alone reinvest in the business or earn a margin);

c) by refusing to comply with decisions of its own courts in cases commenced by Ukrnafta that were adverse to the Respondent;

d) by altering the corporate governance arrangements of Ukrnafta, and depriving the Claimants in a targeted fashion of their rights in that corporate governance; and

e) by imposing enormous financial burdens on the sector in which Ukrnafta operated.

350. For these reasons, the Respondent breached the obligation in Article 10(1) of the ECT to provide the Claimants' investments most constant protection and security.

E. The Respondent has failed to observe any obligations it has entered into with the Claimants, in breach of Article 10(1) of the ECT

351. The Respondent has failed to observe any obligations it has entered into with the Claimants, in breach of Article 10(1) of the ECT, because it breached both the 2010 Shareholders Agreement and the 2010 Cooperation Agreement (into which it had entered with the Claimants).

1. The applicable standard

352. The relevant part of Article 10(1) of the ECT (often called an "umbrella clause") reads:

> "Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."

353. Case law considering this particular provision has highlighted two points. The first is the breadth of the provision. The second is that it undoubtedly applies to contractual undertakings entered into by the State with the claimant investor(s), failure to abide by which on the part of the State constitutes a breach of the provision.

354. *Plama v Bulgaria* is clear on this:

> "Arbitral Tribunal can limit itself to noting that the wording of this clause in Article 10(1) of the ECT is wide in scope since it refers to "any obligation". An analysis of the ordinary meaning of the term suggests that it refers to any obligation regardless of its nature, i.e., whether it be contractual or statutory. However, the ad hoc Committee that decided the annulment in the case, *CMS v. Argentina*, commented that the use of the expression "entered into" should be interpreted as concerning only consensual obligations. In any case, these obligations must be assumed by the host State with an Investor.
>
> Following either the wide interpretation of the clause or the more restricted one proposed by the ad hoc Committee, contractual obligations are covered by the last sentence of Article 10(1) ECT."[535]

355. Similar points were made by the tribunal in *Amto v Ukraine*:

> "The so-called 'umbrella clause' of the ECT is of a wide character in that it imposes a duty on the Contracting Parties to 'observe any obligations it has entered into with an Investor or an Investment of an Investor of the other Contracting Party'. This means that the ECT imposes a duty not only in respect of the investor which is otherwise customary in an investment treaty context, but also vis-a-vis a subsidiary company, established in the host state."[536]

356. *Al-Bahloul v Tajikistan* also notes the breadth of the provision, and confirms it imposes a duty on State to observe contracts into which they enter with investors covered by the ECT.[537]

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535 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, paragraphs 186-187, {**CLA-3}**.

536 *Limited Liability Company Amto v. Ukraine*, SCC Case No. 080/2005, Final Award, 26 March 2008, paragraph 110, **{CLA-11**}.

537 *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, paragraph 257, **{CLA-10**}.

357. On the basis of the case law considering the present "umbrella clause", therefore, there is little doubt that a failure by a State to observe contractual obligations into which it has entered with an investor breaches Article 10(1).

358. When consulting case law considering treaties other than the ECT, the usual contest between *SGS v Pakistan* and *SGS v Paraguay* is notable.[538] To the extent it is necessary to consult jurisprudence outside the ECT context, the Claimants note:

a) the language of the "umbrella clause" in this case is both simpler and broader than the language of the "umbrella clause" at issue in either *SGS v Pakistan* and *SGS v Paraguay* (if only because it relates to "any obligations [the State] has entered into with an Investor or an Investment of an Investor"),[539] thus rendering any narrow interpretation of "umbrella clauses" in that case law inapposite;

b) a significantly greater number of cases have adopted the approach of *SGS v Paraguay* (in which, in broad terms, the tribunal regarded a failure to observe an obligation that the State assumed in a contract with the investor also constituted a breach of the relevant "umbrella clause")[540] rather than *SGS v*

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538 *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of Tribunal on Objections to Jurisdiction, 6 August 2003, **{CLA-15}**; *SGS Société Générale de Surveillance S.A. v. The Republic of Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, 12 February 2010, **{CLA-39}**.

539 By contrast, the language in both the *SGS* cases was limited to specific investments. In *SGS v Pakistan*, the "umbrella clause" read: "Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party": *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of Tribunal on Objections to Jurisdiction, 6 August 2003, paragraph 53, **{CLA-15**}. In *SGS v Paraguay*, the "umbrella clause" read: "Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party": *SGS Société Générale de Surveillance S.A. v. The Republic of Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, 12 February 2010, paragraph 115, **{CLA-39}**.

540 See, e.g., *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 17 January 2007, paragraph 204, **{CLA-19**}; *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay*, ICSID Case No. ARB/07/9, Decision on Jurisdiction, 29 May 2009, paragraphs 141-142, **{CLA-41}**; *Joseph C. Lemire v. Ukraine*, ICSID Case No.

Pakistan (in which, also in broad terms, the tribunal held that a State's breach of its contractual obligation could only breach the relevant "umbrella clause" where the parties to the contract had expressed an intent that a breach thereof would also be a breach of the treaty obligation); and

c) any hesitation to treat breach of any and all contractual obligations as a breach of the treaty appears to derive from the concern that such an approach risks undermining the division between domestic and international obligations between States, albeit that risk reduces where the particular domestic obligation in issue binds the State directly and is breached by way of an exercise of sovereign powers.[541]

2. <u>The Respondent has breached that standard</u>

359. The Respondent has breached its contractual duties in the 2010 Shareholders Agreement, and thus the observance of obligations provision in Article 10(1) of the ECT, as follows.

a) It breached its duty in Article 1 of the 2010 Shareholders Agreement "to act jointly, as mutually agreed to ensure the development of the Company, its attractiveness throughout the whole period of activities".[542] It did so when Naftogaz pressured Ukrnafta to sell it gas at a price that, contrary to the law, did not allow Ukrnafta to recover its production costs, and refused to comply with decisions of Ukrainian courts in cases commenced by Ukrnafta that were adverse to Naftogaz.

ARB/06/18, Decision on Jurisdiction and Liability, 21 January 2010, paragraph 498, **{CLA-42}**; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, paragraph 174, **{CLA-43}**; *Eureko B.V. v. Republic of Poland*, Ad Hoc, Partial Award, 19 August 2005, paragraph 257, **{CLA-44**}.

541 See, e.g. *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, paragraphs 348-349, **{CLA-40**}.

542 2010 Shareholders Agreement, Article 1, 25 January 2010, **Exhibit {C-1068}**.

b) It breached the same duty in Article 1 of the 2010 Shareholders Agreement by refusing to allow reinvestment which was necessary even to maintain, let alone improve, production capacity.

c) It breached its duty in Article 4 of the 2010 Shareholders Agreement "to take all the necessary measures … to ensure sale of the Company's products at economically reasonable market prices".[543] It did so when Naftogaz pressured Ukrnafta to sell it gas at a price that, contrary to the law, did not allow Ukrnafta to recover its production costs (let alone reinvest in the business or earn a margin).

d) It breached its duty in Article 12 of the 2010 Shareholders Agreement "to act in good faith, fairly and reasonably".[544] It did so when Naftogaz pressured Ukrnafta to sell it gas at a price that, contrary to the law, did not allow Ukrnafta to recover its production costs (let alone reinvest in the business or earn a margin), and refused to comply with decisions of Ukrainian courts in cases commenced by Ukrnafta that were adverse to Naftogaz.

360. Section II above and the Chronology at Annex 1 evidence these breaches of Articles 1, 4 and 12 of the 2010 Shareholders Agreement and thus the observance of obligations provision in Article 10(1) of the ECT, such as in the following conduct.

a) Naftogaz repeatedly pressured Ukrnafta to enter into contracts for the sale to it by Ukrnafta of gas at prices that had been set by the NERC unlawfully low, and commenced litigation against Ukrnafta on numerous occasions seeking an order that Ukrnafta enter into such contracts (which litigation never succeeded).[545]

b) After losing cases in 2006 regarding Ukrnafta's 2006 gas and being ordered to acknowledge receipt of that gas as having been pumped into the UGS,

543 2010 Shareholders Agreement, Article 4, 25 January 2010, **Exhibit {C-1068}**.

544 2010 Shareholders Agreement, Article 12, 25 January 2010, **Exhibit {C-1068}**.

545 See Section II.E generally above.

Ukrtransgaz simply refused to sign Deeds of Transfer and Acceptance in respect of the majority of the gas, and Naftogaz did not procure that Ukrtransgaz do so.[546]

c) After losing cases in 2008 which concluded that Naftogaz's attempts to compel Ukrnafta to sign contracts by which Naftogaz would purchase Ukrnafta's gas already in the UGS at an undervalue (Case No 29/192, Case No 29/193, Case No 29/194 and Case No 29/195), Naftogaz held a Board meeting at which it decided to create documents recording that the same gas was of "undeterminable owner", had already been sold and had already been sold at prices to be stated.[547] This plan of action, which Naftogaz acted upon, plainly circumvented the prior orders of the Respondent's courts.

d) After Naftogaz and Ukrtransgaz lost more cases that had been commenced in 2011 which ordered it to release gas to Ukrnafta (Case No 6/489 and Case No 6/521), they refused to release the relevant gas to Ukrnafta, stating *inter alia* that it had already been sold to the population.[548]

e) In respect of one of the cases they lost in 2011 (Case No 6/521), Naftogaz and Ukrtransgaz continued to refuse to release the relevant gas even though Ukrnafta commenced enforcement proceedings through the Bailiff against Naftogaz and Ukrtransgaz, in which the Respondent's courts again found in Ukrnafta's favour.[549] The behaviour of Naftogaz and Ukrtransgaz in the enforcement proceedings was particularly cynical. In addition to refusing to meet the Bailiff's demand, they also unsuccessfully challenged each of: the legality of the Bailiff's actions; the enforceability of the orders of the Supreme

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546 See Section II.E.2 above.

547 See Section II.E.3 above.

548 See Section II.E.6-7 above.

549 See Section II.E.9 above.

Commercial Court in the original Case No 6/521; and the orders of the courts during the enforcement proceedings.[550]

361. The Respondent has breached its contractual duties in the 2010 Cooperation Agreement, and thus the observance of obligations provision in Article 10(1) of the ECT, as follows.

a) It breached its duties in Articles 1 and 4 of the 2010 Cooperation Agreement "to act jointly and in a mutually agreed way" and in observance of 2005 Articles,[551] and to undertake the "necessary joint decisions according to the procedure set by the legislation in force, the Charter of OJSC "Ukrnafta", and the joint understandings of the Parties set out in the present Agreement in order to achieve the aim set by the present Agreement".[552] It did so when it altered the corporate governance arrangements of Ukrnafta, and deprived the Claimants in a targeted fashion of their rights in that corporate governance.

b) It breached its duty in Article 14 of the 2010 Cooperation Agreement to perform that contract "in full with respect for the interests of other shareholders", and each undertook "to act in good faith, fairly and reasonably" in that performance.[553] As when it breached the unreasonableness obligation in Article 10(1) of the ECT, the Respondent breached Article 14 of the 2010 Cooperation Agreement: by violating its own laws in its treatment of the Claimants' investment, and then seeking to change its law to subvert the decisions of its own courts that held it had acted unlawfully; by setting prices for the sale of gas by Ukrnafta to Naftogaz at a level that, contrary to the law, did not allow Ukrnafta to recover its production costs (let alone reinvest in the business or earn a margin); by refusing to comply with decisions of its own courts in cases commenced by Ukrnafta that were adverse to the

550 See Section II.E.9 above.

551 2010 Cooperation Agreement, Article 1, 23 December 2010, **Exhibit {C-1144}**.

552 2010 Cooperation Agreement, Article 4, 23.12.12010, **Exhibit {C-1144**}.

553 2010 Cooperation Agreement, Article 14, 23.12.2010, **Exhibit {C-1144}.**

Respondent; by altering the corporate governance arrangements of Ukrnafta, and depriving the Claimants in a targeted fashion of their rights in that corporate governance; and by imposing enormous financial burdens on the sector in which Ukrnafta operated.

362. Section II above and the Chronology at Annex 1 evidence these breaches of Articles 1, 4 and 14 of the 2010 Cooperation Agreement and thus the observance of obligations provision in Article 10(1) of the ECT. As these breaches of Articles 1, 4 and 14 of the 2010 Cooperation Agreement were occasioned by the same conduct that breached the fair and equitable treatment obligation, the evidence supporting the existence of a breach of the latter (set out in Section IV.B.2 above) is the same evidence that supports a breach of the former.

363. For these reasons, the Respondent breached the obligation in Article 10(1) of the ECT to observe any obligations it has entered into with the Claimants.

F. The Respondent has failed to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to the Claimants' investments, in breach of Article 10(12) of the ECT

364. The Respondent has failed to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to the Claimants' investments, in breach of Article 10(12) of the ECT, because it repeatedly refused to abide by the decisions of its own courts and thereby frustrated the enforcement of rights on the part of Ukrnafta.

1. The applicable standard

365. Article 10(12) of the ECT reads:

> "Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations."

366. This provision was considered in *Amto v Ukraine*, in which the tribunal described it as "a specific obligation to ensure that domestic law provides an effective means for the

assertion of claims and the enforcement of rights".[554] The tribunal held the provision requires host States to promulgate "legislation for the recognition and enforcement of property and contractual rights" and "secondary rules of procedure so that the principles and objectives of the legislation can be translated by the investor into effective action in the domestic tribunals".[555] Tribunals interpreting identical or similar provisions in other treaties have confirmed this point.[556]

367. However, while there was some early uncertainty, recent cases have confirmed that, while the duty of the State is to administer its judicial bodies "effectively", tribunals are to examine the individual case to ascertain whether, in that case, the judicial system did not provide an effective means by which the investor could assert claims and enforce rights. Thus, when applying Article 10(12), the existence of a breach is not dependent on a tribunal finding that there is a systemic failing in the State's administration of its judicial bodies regardless of the facts of the case in issue. Rather, the facts of the case will determine whether the inability of the investor to assert claims or enforce rights was due to the ineffectiveness of that overall system of administration, and thus a breach the treaty.[557]

368. In this context, recent case law considering such "effective means" provisions has focused on whether a significant delay in the resolution of a claim before the host

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554 *Limited Liability Company Amto v. Ukraine*, SCC Case No. 080/2005, Final Award, 26 March 2008, paragraph 75, **{CLA-11}**.

555 *Limited Liability Company Amto v. Ukraine*, SCC Case No. 080/2005, Final Award, 26 March 2008, paragraph 87, **{CLA-11}**.

556 See: *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador*, PCA Case No. AA 277, Partial Award on the Merits, 30 March 2010, paragraph 247, **{CLA-54}**; *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Final Award, 30 November 2011, paragraph 11.3.2(b), **{CLA-55}**.

557 See: *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador*, PCA Case No. AA 277, Partial Award on the Merits, 30 March 2010, paragraph 247, **{CLA-54}**; *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Final Award, 30 November 2011, paragraph 11.3.2(e)-(i), **{CLA-55}**.

State's courts constituted a breach.[558] The Claimants accept that this is the usual situation in which this type of provision is invoked by claimants and applied by tribunals. However, this is not the only situation in which such provisions, and in this case Article 10(12) of the ECT, provides an investor with protection. Thus, in *Petrobart v Kyrgyz Republic*, the tribunal held that the State had breached the obligation when its Prime Minister wrote to a domestic court to support a stay of execution of a judgment given by the court which had ordered a State-owned joint stock company to pay the claimant a large sum of money for receipt of gas condensate. The interference of the State in order to prevent the decision of the court from being enforced by the claimant against a State-owned entity was held to be in breach of the duty to provide an effective means of asserting claims and enforcing rights.[559]

369. Article 10(12) thus also protects an investor in a situation where claims in relation to its investment are asserted against the State or its organs or entities in the local courts, those claims are decided by the courts timeously, but then the rights vindicated by those courts cannot be enforced because the State or its organs or entities interferes or refuses to comply with the courts' judgments.

370. This is a correct application of Article 10(12). The ordinary meaning of the provision does not limit its application to the duty of the State to legislate for the recognition and enforcement of rights through a properly administered judicial system. The provision is not a form of "denial of justice light". Rather, as tribunals have confirmed, it is *lex specialis* and thus distinct from any concept of denial of justice, and requires that the State take all action necessary to establish laws and institutions that

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558 See: *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador*, PCA Case No. AA 277, Partial Award on the Merits, 30 March 2010, paragraph 206, **{CLA-54}**; *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Final Award, 30 November 2011, paragraph 11.4.1, **{CLA-55**}.

559 *Petrobart Limited v. The Kyrgyz Republic, SCC Case No. 126/2003*, Arbitral Award, 29 March 2005, paragraph VIII.8.21, **{CLA-45}**.

work effectively to allow the assertion of claims and enforcement of rights.[560] To read the provision as only requiring a State to administer a judicial system that decides matters timeously would be to read it unduly narrowly, and to give it no application beyond the denial of justice element contained in the fair and equitable treatment obligation.

371. Rather, Article 10(12) of the ECT prohibits the State from acting so as to subvert the rights of an investor that have been vindicated by the local courts in cases started by the investor against the State or its organs or entities. The ordinary meaning of the provision, its established status as *lex specialis*, and its focus on individual cases in the context of the facts regarding the State's administration of justice as a whole all militate in favour of such a conclusion.

2. <u>The Respondent has breached that standard</u>

372. The conduct of the Respondent set out in Section II above breached the effective means obligation in Article 10(12) of the ECT. It did so when, despite Ukrnafta successfully asserting claims in relation to the Claimants investment before its courts against its own organs and entities, it did not comply with the courts' judgments against it. While the Claimants accept that the Respondent has established a judicial system that affords them an effective means for asserting claims and having them decided, the breach of this provisions exists in the State's subsequent conduct of non-compliance with those decisions. What is not effective is the enforcement of rights as established against State organs by State organs, which enforcement the State has the power to ensure through the moderation of its own conduct, but in this case has instead frustrated. This is enforcement denied rather than enforcement delayed. This is a more egregious breach than delay in the resolution of a claim by a State's domestic courts.

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560 See: *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador*, PCA Case No. AA 277, Partial Award on the Merits, 30 March 2010, paragraph 242-244, **{CLA-54}**; *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Final Award, 30 November 2011, paragraph 11.3.2(a)-(b), **{CLA-55}**.

373. Section II above and the Chronology at Annex 1 evidence this breach of Article 10(12) of the ECT. The particular examples of the evidence of the Respondent's refusal to comply with its courts' decisions in breach of this obligation is the same evidence that established the Respondent breach of the fair and equitable treatment obligation by way of its refusal to comply with its courts' decisions, as set out in Section IV.B.2.

G. The Respondent has failed to permit the Claimants to employ any key person of their choice regardless of nationality and citizenship provided that such key person has been permitted to enter, stay and work in Ukraine, in breach of Article 11(2) of the ECT

374. The Respondent has failed to permit the Claimants to employ any key person of their choice regardless of nationality and citizenship provided that such key person has been permitted to enter, stay and work in Ukraine, in breach of Article 11(2) of the ECT, because the Claimants were not permitted to employ key people of their choice in an exercise of their right to do so.

1. The applicable standard

375. Article 11(2) of the ECT reads:

> "A Contracting Party shall permit Investors of another Contracting Party which have Investments in its Area, and Investments of Investors, to employ any key person of the Investor's or the Investment's choice regardless of nationality and citizenship provided that such key person has been permitted to enter, stay and work in the Area of the former Contracting Party and that the employment concerned conforms to the term, conditions and time limits of the permission granted to such key person."

376. It appears that the only occasion on which a breach of this provision was pleaded in an arbitration, the tribunal declined to make a finding in relation to that breach.[561] Further, it appears that alleged breaches of equivalent "choice of personnel"

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561 *Anatolie Stati, Gabriel Stati, Ascom Group S.A. and Terra Raf Trans Traiding Ltd v. Republic of Kazakhstan*, SCC Case No. V116/2010, Award, 19 December 2013, paragraphs 1322-1324, {**CLA-8**}.

provisions in other treaties before other tribunal have also not generated jurisprudence.[562]

377. According to the ordinary meaning of the provision, however, the scope of the State's obligation is clear. Provided that the relevant individual has been permitted to enter, stay and work in the State, and that his or her work conforms to the term, conditions and time limits of the permission granted, then the State must permit the investor or the investment to employ that individual regardless of nationality and citizenship.

2. The Respondent has breached that standard

378. The conduct of the Respondent set out in Section II above breached the effective means obligation in Article 11(2) of the ECT.

379. The breach arose when Naftogaz removed from management positions in Ukrnafta individuals the Claimants had nominated to those positions in accordance with their right to do so under the 2010 Shareholders Agreement and the 2011 Articles.[563] The removal of those individuals, in circumstances where the Claimants through their vote in the General Meeting of Shareholders had no choice but to consent to it due to the Respondent's recent legislative intervention to allow Naftogaz to form a quorum of its own accord in that General Meeting,[564] prevented the Claimants from "employ[ing] any key person[s] of the Investor's or the Investment's choice".

H. The Respondent has expropriated, or subjected to measures with equivalent effect, the Claimants' investments, in breach of Article 13 of the ECT

380. The Respondent has expropriated, or subjected to measures with equivalent effect, the Claimants' investments, in breach of Article 13 of the ECT, because it has incidentally interfered with the Claimants' use of their shareholdings in Ukrnafta in a

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562 One contribution notes that the protection is not a common one in investment treaties, which may explain why it has been so rarely invoked: Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer, 2009) p. 144-145, {**CLA-25}**.

563 See Sections II.C-D.

564 See Section II.G.

way that has the effect of depriving them in significant part of the use and reasonably-to-be-expected economic benefit of those shareholdings.

1. The applicable standard

381. The relevant part of Article 13(1) of the ECT reads:

> "Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:
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> (a) for a purpose which is in the public interest;
>
> (b) not discriminatory;
>
> (c) carried out under due process of law; and
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> (d) accompanied by the payment of prompt, adequate and effective compensation."

382. This provision provides protection against both direct and indirect expropriation. As the tribunal in *Petrobart v Kyrgyz Republic* stated:

> "As to Article 13(1) of the Treaty, which deals with expropriation, the Arbitral Tribunal notes that this provision gives protection not only in respect of expropriation but also in regard to measures having effect equivalent to expropriation. Such measures are sometimes referred to as "indirect", "creeping" or "de facto" expropriation and are frequently assimilated to formal expropriation as regards their legal consequences."[565]

383. An indirect expropriation may arise from a wide variety of measures for which a State is responsible under international law and which substantially deprive the

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565 *Petrobart Limited v. The Kyrgyz Republic, SCC Case No. 126/2003*, Arbitral Award, 29 March 2005, paragraph VIII.8.23, **{CLA-45**}. See also A. Reinisch, "Expropriation" in P. Muchlinksi, F. Ortino and C. Schreuer, "The Oxford Handbook of International Investment Law" (OUP, 2008) 407 at 420-421, **{CLA-46}**; and G. Christie, "What Constitutes a Taking of Property under International Law?" (1962) 38 *British Yearbook of International Law* 307 at 309, **{CLA-47**}.

investor of the economic benefit, use, enjoyment or value of its investment.[566] In *Metalclad v Mexico* the tribunal explained that expropriation includes:

> "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."[567]

384. A consistent body of jurisprudence confirms that it is not necessary to show that title to the investment has been taken to establish that it has been indirectly expropriated.[568] Indeed, the taking by a State of title to an investment is the distinguishing feature of a direct expropriation; by definition, this is not necessary for an indirect expropriation.[569]

385. In the context of Article 13 of the ECT, *AES v Hungary* observed:

> "It is evident that many state's acts or measures can affect investments and a modification to an existing law or regulation is probably one of the most common of such acts or measures. Nevertheless, a state's act that has a negative effect on an investment cannot automatically be considered an expropriation. For an expropriation to occur, it is necessary for the investor to be deprived, in whole or significant part, of the property in or effective control of its investment: or for its

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566 See, e.g, A. Reinisch, "Expropriation" in P. Muchlinksi, F. Ortino and C. Schreuer, "The Oxford Handbook of International Investment Law" (OUP, 2008) 407 at 421-423, **{CLA-46}**; and *Compañía del Desarrollo de Santa Elena SA v Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award, 17 February 2000, paragraph 76, **{CLA-48}**.

567 *Metalclad Corp v United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, paragraph 103, **{CLA-22}**.

568 See, e.g., *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No. ARB07/16, Award, 8 November 2010, paragraph 408, **{CLA-49**}; *Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran, Government of the Islamic Republic of Iran and others* (1984) 6 Iran-US CTR 219 at p. 225, **{CLA-50}**; *Metalclad Corp v United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, paragraph 103, **{CLA-22**}.

569 R. Dolzer and C. Schreuer, *Principles of International Investment Law* (OUP, 2012) 101, **{CLA-28**}.

> investment to be deprived, in whole or significant part, of its value."[570]

386. The main characteristics of indirect expropriation, including creeping expropriation, have been described as follows:

> "A substantial body of jurisprudence and scholarly opinion also recognizes that formal appropriation or extinguishment of title to property is not the only way an investor can be deprived of property in contravention of an applicable BIT. Instead, the host State can take actions and enact measures that are tantamount to expropriation, and constitute 'indirect' expropriation, which becomes 'creeping' expropriation when the expropriatory measures take effect over a period of time. In such cases, the analysis must focus not on the form of the alleged expropriatory measures, but on their actual substance and corresponding cumulative impact."[571]

387. A "creeping expropriation" is a type of indirect expropriation.[572] Creeping expropriation is an incremental process made up of a series of damaging acts or omissions, which may or may not constitute unlawful acts independently, and which, cumulatively, are expropriatory in their nature and effect. In *Siemens v Argentina* the Tribunal described creeping expropriation as a step-by-step process:

> "By definition, creeping expropriation refers to a process, to steps that eventually have the effect of an expropriation. … Obviously, each step must have an adverse effect but by itself may not be significant or considered an illegal act. The last step in a creeping expropriation that tilts the balance is similar to the straw that breaks the camel's back. The preceding straws

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570 *AES Summit Generation Limited and AES-Tisza Erömu Kft. v. Republic of Hungary*, ICSID Case No. ARB-07-22, Award, 23 September 2010, paragraph 14.3.1, **{CLA-29}**. See also *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011, paragraph 327, **{CLA-51}**; *CME Czech Republic BV (The Netherlands) v Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, paragraphs 604-605, **{CLA-37}**.

571 *Impregilo SpA v Argentine Republic*, ICSID Case No, ARB/07/17, Concurring and Dissenting Opinion of Judge Charles Brower, 21 June 2011, paragraph 21, **{CLA-52**}.

572 See, e.g., *Técnicas Medioambientales Tecmed SA v United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, paragraph 114, **{CLA-23**}; G. Christie, "What Constitutes a Taking of Property under International Law?"(1962) 38 *British Yearbook of International Law* 307, **{CLA-47}**.

> may not have had a perceptible effect but are part of the process that led to the break."[573]

388. One commentary on indirect expropriations has described creeping expropriations as a:

> "process which, notwithstanding that it may be aimed at other entirely legitimate regulatory objectives and does not involve a single instance of an outright taking, nonetheless has the effect, often degree-by-degree, of depriving an owner of fundamental rights of property."[574]

389. Like a direct expropriation, an indirect or creeping expropriation will be unlawful if it does not comply with the criteria for a lawful expropriation in Article 13 of the ECT.

2. <u>The Respondent has breached that standard</u>

390. The Claimants shareholdings in Ukrnafta have been subjected to measures on the part of the Respondent having effect equivalent to their expropriation – that is, they have been indirectly expropriated. This is because the Respondent conduct has had "the effect of depriving the [Claimants], in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property",[575] i.e., their shareholdings. It does not matter that there has been no "formal appropriation or extinguishment of title to [that] property";[576] indeed, the fact that the Respondent has not acquired the shareholdings for itself is no impediment to its conduct amounting to an indirect expropriation. Moreover, even if the Respondent's conduct "may be aimed at other

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573 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 17 January 2007, paragraph 263, {**CLA-19**}.

574 Y. Fortier and S. Drymer, "Indirect Expropriation in the Law of International Investment: I know It When I See It, or Caveat Investor" (2004) 19 *ICSID Review – Foreign Investment Law Journal* 293 at 294, {**CLA-53}**.

575 *Metalclad Corp v United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, paragraph 103, **{CLA-22}**.

576 *Impregilo SpA v Argentine Republic*, ICSID Case No, ARB/07/17, Concurring and Dissenting Opinion of Judge Charles Brower, 21 June 2011, paragraph 21, **{CLA-52**}.

entirely legitimate regulatory objectives"[577] (which the Claimants do not accept), that is again no barrier to an indirect expropriation occurring.

391. Further, the requirements of a lawful expropriation set out in Article 13 of the ECT are not satisfied in this case. As this is a question of indirect expropriation, the taking has necessarily not been carried out under due process of law, and necessarily not been accompanied by the payment of prompt, adequate and effective compensation. In addition, the indirect expropriation targeted the Claimants' shareholdings in Ukrnafta, and was therefore discriminatory. Finally, the Respondent articulated no purpose which is in the public interest related to the indirect expropriation of the Claimants' investments. In this context, each of the conditions for a lawful expropriation under Article 13 of the ECT are unfulfilled in this case.

392. Section II above, the Chronology at Annex 1 and the expert reports attached to this Statement of Claim evidence this breach of Article 13 of the ECT.

393. First, they evidence that the impact of the Respondent's conduct has been to deprive the Claimants in significant part of the use and economic benefit of their shareholdings in Ukrnafta and their rights of participation and representation in the corporate governance of Ukrnafta.

a) The Claimants have been deprived in significant part of the value of their shareholdings in Ukrnafta, as discussed in detail in Section V below.

b) The Respondent has destroyed the Claimants' rights of participation and representation in the corporate governance of Ukrnafta.

i. The purpose of the laws changing the corporate governance arrangements of Ukrnafta was to gain control of Ukrnafta, to obtain cash from it in the order of "around 2 billion hryvnias" to contribute to

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577 Y. Fortier and S. Drymer, "Indirect Expropriation in the Law of International Investment: I know It When I See It, or Caveat Investor" (2004) 19 *ICSID Review – Foreign Investment Law Journal* 293 at 294, **{CLA-53}**.

the State budget, and to achieve this "in a hurry".[578] The Respondent's Prime Minister publicly confirmed that the Respondent "we got the control back" over Ukrnafta.[579]

ii. When passing the law which ultimately did strip the Claimants of rights in the corporate governance of Ukrnafta as the Respondent intended, senior officials of the Respondent were explicit that this allowed it to appoint new management at the company and issue dividends. Those were rights that previously could be exercised only with the participation of the minority shareholders, not least the Claimants due to the 2010 Shareholders Agreement and the 2011 Articles.[580]

394. Secondly, the evidence demonstrates that the Respondent's conduct has interfered with the Claimants' expectations in respect of their investments, such that they will not receive the reasonably-to-be-expected economic benefit of those investments. The evidence that establishes this is the same as the evidence that establishes a breach of the fair and equitable treatment obligation in Article 10(1) of the ECT by virtue of the Respondent's frustration of the Claimants' legitimate expectations. This evidence is set out in Section IV.B above, and the Claimants rely on it as also proving that the Respondent's conduct has interfered with the Claimants' expectations in respect of their investments to a degree that constitutes an indirect expropriation.

395. Thirdly, the evidence demonstrates that the nature or character of the Respondent's conduct is not conduct aimed at legitimate regulatory objectives – even though, if it had been, that in itself would not preclude that conduct from amounting to an indirect expropriation. In any event, the evidence establishing that the Respondent's conduct is not of such a legitimate category is the same as the evidence that establishes: a breach of the fair and equitable treatment obligation in Article 10(1) of

578 See Section II.G above.

579 See Section II.G above.

580 See Section II.G above.

the ECT by virtue of the Respondent's conduct being arbitrary and non-transparent and inconsistent; a breach of the unreasonableness obligation in Article 10(1) of the ECT by virtue of the Respondent's conduct being unreasonable; and a breach of the most constant protection and security obligation in Article 10(1) of the ECT by virtue of the Respondent failing to take duly diligent steps to create a framework that grants administrative and legal security or to act reasonably in the circumstances and with a view to achieving objectively rational public policy goals. This evidence is set out in Sections IV.B-D above, and the Claimants rely on it as also proving that the Respondent's conduct was not conduct aimed at legitimate regulatory objectives.

396. For these reasons, the Respondent breached the obligation in Article 13 of the ECT not to subject the Claimants' investments to measures having an effect equivalent to their expropriation.

V. THE RESPONDENT MUST MAKE FULL REPARATION TO THE CLAIMANTS

397. As a result of the breaches of the ECT set out in Section IV above, the Respondent must make full reparation to the Claimants. This Section V states the principles underlying this requirement (Sections V.A-D), and explains what full reparation by way of compensation entails in this case (the remainder of Section V).

398. On the latter, the compensation payable to the Claimants is made up of five parts. First, the Respondent must pay to the Claimants a sum equal to the additional dividends which, but for the Respondent's breaches of the ECT, the Claimants would have received from Ukrnafta in respect of their 40.1009% shareholding in the company in the period between the date of their investment and the date of the Award. Secondly, the Respondent must pay to the Claimants a sum equal to the diminution in the value of their 40.1009% shareholding in Ukrnafta which occurred as a result of the Respondent's breaches of the ECT. Thirdly, the Respondent must pay to the Claimants pre-Award interest. Fourthly, the Respondent must pay to the Claimants post-Award interest. Finally, the Respondent must pay to the Claimants their costs associated with this arbitration.

A. Relevant Legal Principles

399. The Claimants do not propose to make lengthy submissions concerning the legal principles which apply in relation to the assessment of compensation, because those principles should be largely, if not wholly, uncontroversial. At this stage, they simply note that their claims are predicated on the following basic principles.

400. The ECT does not make provision concerning the compensation which is payable by a Contracting Party in the event that it commits a non-expropriatory breach of its ECT obligations. Also, while Article 13 of the ECT addresses the measure of compensation which must be paid in order to render an expropriation lawful, the ECT does not make provision concerning the compensation which is payable by a Contracting Party in the event that its expropriation does not comply with Article 13 and is unlawful.

401. In those circumstances, the amount of compensation which the Respondent is obliged to pay in respect of its breaches of the ECT (the "**Respondent's Breaches**") is to be assessed by reference to the principles of customary international law, as established by the Permanent Court of International Justice in the *Chorzów Factory* case and subsequently reflected in the ILC Articles.

402. In that case, the Permanent Court stated that the "essential principle" is that "reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed".[581]

403. This statement of customary international law has subsequently been endorsed by the ILC Articles.[582] Relevantly:

a) Article 31(1) provides that "The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act".

b) Article 36(1) provides that "The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as damage is not made good by restitution".

c) Article 36(2) provides that "The compensation shall cover any financially assessable damage including loss of profits insofar as it is established".

d) Having set out the passage from the *Chorzów Factory* case cited above, the Commentary concerning the draft ILC Articles explains that "The obligation placed on the responsible State by article 31 is to make 'full reparation' in the *Factory at Chorzów* sense".[583]

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581 *Factory at Chorzów (Germany v Poland) (Merits)*, PCIJ Rep. Ser. A. (No. 17) (13 September 1928), page 47, **{CLA-56}**.

582 International Law Commission in its ILC Articles on State Responsibility (2001), **{CLA-57}**.

583 International Law Commission in its ILC Articles on State Responsibility (2001), **{CLA-57}**.

404. Full reparation in this sense requires the Respondent to pay the difference between:[584]

a) the financial position which the Claimants would have been in but for the Respondent's unlawful conduct; and

b) the financial position which the Claimants are actually in.

405. In relation to non-expropriatory breaches of international law:

a) The object of compensation is to make good the damage suffered as a result of the particular State measure(s) by putting the Claimant in the financial position which it would have been in had the breach(es) not occurred.[585]

b) The starting point for compensation is the Fair Market Value of the lost investment at the relevant date, but compensation is not limited to this.[586] The Claimant may claim both diminution in the value of its investment and loss of dividends.[587]

c) The diminution in the value of a shareholding is the difference between (1) the value of the shareholding with the impact of the State measures, and (2) the value of the shareholding without such impact.[588]

406. In relation to an unlawful expropriation:

a) The measure of compensation for a non-expropriatory breach does not differ from the measure of compensation for an expropriatory breach.[589]

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584 Ripinsky and Williams, *Damages in International Investment Law* **("Ripinsky")**, page 112, **{CLA-58}**.

585 Ripinsky, pages 13-14, 89, {**CLA-58}**; *Petrobart v Kyrgyz Republic*, Award of 29 March 2005 at 78, **{CLA-45}**.

586 Ripinsky, pages 13 and 85-86, **{CLA-58}**.

587 Ripinsky, pages 91-92, **{CLA-58**}; *Walter Bau v Thailand*, UNCITRAL Award, 1 July 2009, paragraphs 14.28 to 14.30, **{CLA-64}**.

588 *Sempra Energy v Argentina*, Award of 28 September 2007, paragraphs 411-412, **{CLA-59**}; *BG Group v Argentina*, Final Award of 24 December 2007, paragraphs 438-444, **{CLA-59**}.

b) Thus, as with a non-expropriatory breach, the starting point for compensation is the Fair Market Value of the lost investment at the relevant date, but compensation is not limited to this.[590] The Claimant may recover both the value of the investment which has been lost and lost dividends.[591]

c) The Claimant is entitled to choose between valuation as at the date of the expropriation and valuation as at the date of the Award.[592]

407. For the purpose of determining what position the Claimant would have been in had the Respondent's Breaches not occurred (i.e. considering what would have happened in the **"But For World"**), one does not engage in conjecture as to whether the Respondent would have been able to act in a lawful manner and, if so, how. The international law of damages is based on the fundamental notion that, once a State has committed an unlawful act, it must bear the full consequences of this conduct, rather than the difference between the unlawful and the otherwise-possible lawful conduct. Put differently, the State had a chance to act lawfully but did not use it and must be held responsible for the damage resulting from its failure to act lawfully.[593]

408. In relation to pre-Award interest:

a) ILC Article 38(1) provides that "Interest on any principal sum payable under this chapter shall be payable when necessary in order to ensure full

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589 See, e.g., *Sempra Energy v Argentina*, Award of 28 September 2007, paragraph 403, **{CLA-59}**.

590 Ripinsky, pages 13 and 85-86, **{CLA-58}**.

591 *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228, {**CLA-65}**, *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227, {**CLA-66}**, and *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 226, Final Award, 18 July 2014, paragraphs 1777-1812, {**CLA-67}** (collectively, the "***Yukos* Final Awards**").

592 *Ioannis Kardassopoulos v Georgia* and *Ron Fuchs v Georgia*, ICSID Case Nos ARB/05/18 and ARB/07/15, Award, 3 March 2010, paragraphs 514, {**CLA-27}**; *Yukos* Final Awards, paragraphs 1766-1769, {CLA-65} {CLA-66} {CLA-67}.

593 Ripinsky, pages 117-119, {**CLA-58}**; *Amco v Indonesia II*, Award on the Merits of 31 May 1990, 89 ILR 368, paragraph 174, {**CLA-61}**.

reparation. The interest rate and mode of calculation shall be set so as to achieve that result".[594]

b) The Claimant may claim the rate of interest which it would have been in a position to have earned if it had been paid in time and thus had the funds available to invest in a form of commercial investment in its own country.[595]

c) The modern practice of Tribunals in investor-State arbitrations is to award compound interest so as to ensure full reparation.[596]

B. The Heads of Damages Claimed

409. The Claimants' claim is for a total of **US$4.674 billion**. This sum is comprised of:

a) a sum equal to the additional dividends which, but for the Respondent's Breaches, the Claimants would have received from Ukrnafta in respect of their shareholding in the company in the period between the date of their investment (16 March 2007) and the assumed date of the Award (30 June 2018) ("**Loss of Dividends Claim**"), which has been quantified at **US$2.063 billion**; and

b) pre-award interest on the sum payable in respect of the Loss of Dividends Claim up to the assumed date of the Award ("**Pre-Award Interest Claim**"), which is presently quantified at **US$932.3 million**; and

c) a sum equal to the diminution in the value of the Claimants' shareholding in Ukrnafta which will have occurred as a result of the Respondent's Breaches at

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594 International Law Commission in its ILC Articles on State Responsibility (2001), **{CLA-57}**. Further, to the extent that the standard of interest on compensation payable in respect of a lawful expropriation under the ECT is relevant, Article 13(1) of the ECT provides that "Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment": **{CLA-1}**

595 *Sylvania Technical Systems v Iran*, Award of 27 June 1985, 8 Iran-US CTR 298, 320, **{CLA-62**}.

596 Ripinsky, pages 384-387, **{CLA-58}**.

the assumed date of the Award ("**Loss of Value Claim**"), which is presently quantified at **US$1.679 billion**.

410. The Claimants also claim:

a) post-award interest, calculated at the same rate and on the same basis as in the Pre-Award Interest Claim; and

b) costs.

411. The figures claimed above may require correction for the reasons explained at paragraph 449 below.

C. The "But For World"

412. In order to identify the sums which the Respondent is obliged to pay to the Claimants, the Tribunal will need to form a view as to what is likely to have happened in the But For World.

413. The Claimants' case as to what is likely to have happened, as to the basis upon which their claims should be quantified, and as to the sums which they contend are payable on that basis, is set out below.

414. Insofar as the Respondent advances a different case in its Defence, the Claimants reserve the right to identify the sums which they contend would be payable if the Tribunal were to accede to such a case.

415. If the Tribunal were to find that the claims should be quantified on a basis which is different to that pleaded by either of the parties, the Claimants' experts have developed models which should enable them to identify in short order the sums which would be payable on any such basis.

D. Some relevant concepts

416. At all material times, Ukrnafta has had two types of wells:[597]

a) Some wells ("**Associated Wells**") primarily produce crude oil, but also produce some gas ("**Associated Gas**").

b) Other wells ("**Non-Associated Wells**") primarily produce gas, but also produce some liquids ("**Condensates**").

417. When crude oil and gas are produced from wells, there is a mixture of oil, water, sediment and dissolved gases (which include methane, propane and butane). The gases are separated from the mixture and undergo processing. During processing, the mixture of propane and butane segregates into sediment from which Ukrnafta produces technical propane and butane mixture ("**TPBM**"). The price of TPBM is higher than the price of methane, which is known as "**Natural Gas**".[598]

418. The volume of TPBM which Ukrnafta has historically produced is relatively small. The focus of the claims is on Natural Gas:

a) As will be explained below, the Claimants contend that, in the But For World, Ukrnafta would have produced substantial additional volumes of gases (as well as crude oil and condensates).

b) The Claimants recognise, and their experts have taken account of the fact, that some of these additional gases would have been TPBM.

c) At one time, Ukrnafta intended to construct an additional TPBM processing plant and produce more TPBM. It went so far as to put the project out to tender. In the event, the project did not proceed due to lack of funds for capital investment. It is strongly arguable that, in the But For World, the

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597 Witness statement of Mr Pustovarov, paragraph 32.

598 Witness statement of Mr Pustovarov, paragraphs 33-34.

project would have proceeded and produced additional cash flows for Ukrnafta.[599]

d) However, in the interests of simplicity, the Claimants have chosen not to advance a case to that effect. Their case is focused on the Natural Gas which was actually produced, and the additional Natural Gas (as well as crude oil and condensates) which they contend would have been produced in the But For World. References hereinafter to "gas" are to Natural Gas unless the contrary is indicated.

419. For the purposes of the claims, it is appropriate to distinguish between:

a) gases which Ukrnafta produces itself ("**Own Gas**");

b) gases which are produced pursuant to a joint investment activity ("**JIA**") in which Ukrnafta participates with a third party pursuant to a JIA agreement (which sets out, *inter alia*, each party's percentage participating interest and percentage profit share),[600] without the creation of a separate legal entity ("**JIA Gas**"); and

c) gases which are produced pursuant to a joint venture ("**JV**") between Ukrnafta and a third party which, in contrast to a JIA, is carried on through a separate legal entity ("**JV Gas**").

420. Likewise, reference will be made herein to "**Own Oil**" and "**JIA Oil**".

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599 Minutes of a Supervisory Board Meeting on 9 February 2006, **Exhibit {C-1847}**; Letter from Propak Systems Ltd to Ukrnafta re Engineering services, 22.12.2011, **Exhibit {C-1890 Original};** Propak Project Execution Plan for Pre-Feed Engineering issued for Ukrnafta, 22.12.2011, **Exhibit {C-1891}**; Propak Systems Ltd Draft Professional Service Agreement, 2011, **Exhibit {C-1892}**; Propak Systems Ltd Rate Schedule, 14.06.2011, **Exhibit {C-1893}**; Technical Specifications (Propak) for Glinsko- Rozbyshevsky GPP and Pasichniansky GPP, **Exhibit {C-1894}**.

600 A party's percentage participating interest can differ from its percentage profit share: see witness statement of Mr Kartashov, paragraph 40.

421. The volumes of Own Gas and JIA Gas which were actually produced and (in some instances) sold between 2002 and 2015 are identified in the "**Own Gas Schedule**", which is at Annex 8.[601]

422. In relation to gas prices, it is appropriate to distinguish between:

a) the different maximum (i.e. ceiling) prices which were set by the Cabinet of Ministers or the NERC (or its successor) for sales of gas to different groups of Ukrainian consumers, such as:

- members of the Ukrainian population;
- district heating companies;
- organisations which are financed from State or local budgets;
- chemical companies; and
- other industrial consumers and business entities;

b) the price which would be negotiated and agreed between a willing seller and a willing buyer of its choosing, subject to any relevant maximum price for that category of buyer which was established by Ukrainian law at the relevant time ("**Free Price**");

c) a price which would enable a gas-producing seller to recover (a) its costs of production, (b) the amounts which it was obliged to pay to the State budget (i.e. VAT and the Rental Fee), and (c) a sum sufficient to enable it to implement its capital investment program ("**Zero Profit Price**");

d) the prices which the NERC (or its successor) purported to set from time to time for sales of Ukrnafta's Own Gas and for sales of the JIA Gas produced by each relevant JIA; and

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601 See also at **Exhibit {C-829}.**

e) the prices at which Naftogaz has offered to sell gas since the Ukrainian gas market was liberalised when the 2015 Gas Market Law came into force on 1 October 2015.

423. As has been explained in the Chronology:

a) At the beginning of the period which is relevant to the present dispute, the position under Ukrainian law was that Ukrnafta was free to sell its Own Gas and JIA Gas at Free Prices.

b) Subsequently, the NERC (or its successor) was empowered to approve, and later to set, prices for Ukrnafta's Own Gas, as well as for the JIA Gas which was produced pursuant to JIAs in which Ukrnafta had a participating interest of more than 50%, on the basis that Ukrnafta or the JIA should receive at least its Zero Profit Price.

c) In those circumstances, from time to time Ukrnafta made submissions to the NERC (or its successor) which contained detailed calculations of Ukrnafta's forecast of Zero Profit Prices for its Own Gas or JIA Gas for the period for which the price was to be approved or set, together with supporting documents and information.

d) In each such instance the NERC (or its successor) issued a Resolution by which it purported to set a price for Ukrnafta's Own Gas or JIA Gas which was substantially lower than the forecast Zero Profit Price provided by Ukrnafta – and even more substantially lower than the Free Prices at which Ukrnafta could have sold to industrial consumers.

e) However, with limited exceptions which are not relevant for present purposes, each such Resolution was eventually held by the Ukrainian Courts to be invalid or of no effect because, in essence, the NERC (or its successor) neither set a proper Zero Profit Price nor provided for Ukrnafta's losses to be covered by a subsidy, which Ukrainian law required in the event that a State regulated price was less than the Zero Profit Price. With those exceptions, at

no stage did the NERC (or its successor) ever manage to set a Zero Profit Price for Ukrnafta's Own Gas or JIA Gas which was lawful as a matter of Ukrainian law.[602]

424. The disparity between (on the one hand) the prices which the NERC (or its successor) purported to set and (on the other hand) Ukrnafta's Zero Profit Prices and the Free Prices at which Ukrnafta could have sold to industrial consumers is striking. The position in relation to Own Gas was as follows (where all prices are in UAH and include VAT):

602 The first set of exceptions related to the price produced pursuant to JIA No 5/56 and arose only because Ukrnafta decided that the sums at stake were so insignificant that it was not worth the expense of pursuing challenges to the Resolutions through the Courts: see Witness statement of Mr Kartashov, paragraphs 44(d) and (e). NERC Resolution No 526 of 6 May 2010 was only briefly in force before the passage of the July 2010 Gas Market Law, and was not tested in litigation.

Year	*Price Purportedly Set By The NERC (or its Successor)*[603]	*Ukrnafta's Final Zero Profit Price*[604]	*Estimated Free Price for Sale To Industrial Consumers*[605]
2008	327.12[606]	521.22	1,135
	239.04[607]	521.22	1,135
2009	239.04	536.65	2,404
2010	239.04	818.33	2,480
	252.00[608]	818.33	2,480
	549.60[609]	818.33	2,480
2011	549.60	1,275.26	3,356
2012	549.60	1,589.20	4,190
2013	591.12[610]	2,896.37	4,160
2014	675.00[611]	4,606.67	5,289

603 See the Chronology.

604 See the Chronology. The final Zero Profit Price for the year in question sometimes differed slightly from the forecast Zero Profit Price which was submitted to the NERC (or its successor) in advance of the year beginning, but this is immaterial for the purpose of this illustration.

605 Expert report of Mr Leitzinger, Table 4 (beneath paragraph 76).

606 NERC Resolution No. 155 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 31.01.2008, **Exhibit {C-351}**.

607 NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28.02.2008, **Exhibit {C-353**}.

608 NERC Resolution No. 526 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta", 6.05.2010, **Exhibit {C-402}**.

609 NERC Resolution No. 889 "On approval of the price for commercial natural gas for OJSC Ukrnafta", 27.07.2010, **Exhibit {C-413**}.

610 NESR Resolution No. 1832 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 27.12.2012, **Exhibit {C-481}**.

611 NESR Resolution No. 1853 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 30.12.2012, **Exhibit {C-502**}.

E. Overview of the Claimants' case in relation to their Loss of Dividends Claim

425. In this section, the Claimants provide an overview of the essential elements of their Loss of Dividends Claim. Further detail in relation to particular points is set out in the passages of the witness statements to which cross-references are provided, and in the reports of the Claimants' experts.

1. Sale of gas at Free Prices in the year after production

426. The first element of the Claimants' case is that, for the reasons given in Section V.H below, their claims are to be quantified on the basis that, in relation to the relevant volumes of Own Gas, JIA Gas and JV Gas which were produced in a particular year, Ukrnafta was entitled as of 1 January of the following year to sell the gas to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer. This is so even in relation to gas which was produced in years in which the NERC (or its successor) was empowered to approve or set prices for such gas, but failed to do so in a lawful manner. Hence, for example, the Claimants' case is that, as of 1 January 2009, Ukrnafta was entitled to sell gas which was produced in 2008 at Free Prices.[612]

2. Additional Net Income from the sale of relevant Own Gas, JIA Gas and JV Gas which was actually produced

427. In the But For World, Ukrnafta would have sold certain volumes of Own Gas, JIA Gas and JV Gas which were actually produced at Free Prices (in the manner pleaded at paragraph 428 below) and thereby generated more net income than it actually generated ("**Additional Net Income**").[613] The relevant volumes are as follows:

a) **2006 to 2015 Own Gas which has not been sold**. The volumes recorded in the row entitled "Unsold gas total (as of 01.01.2016)" in the Own Gas Schedule are volumes of Own Gas which Ukrnafta produced in the period

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612 There is one qualification to this. Gas produced after the 2015 Gas Market Law came into force on 1 October 2015 could be sold at Free Prices without delay.

613 In relation to the Own Gas, JIA Gas and JV Gas which was actually produced, all of the costs of production have already been incurred.

from 2006 to 2015 and pumped into the GTS but which, as a result of the Respondent's Breaches, it has not been permitted to sell. In the But For World, it would have been entitled to sell this gas at Free Prices and would have done so. In total, there is more than 10 billion m^3 of unsold Own Gas. This consists of:

- 2,061,805,134m^3 of 2006 Own Gas;
- 1,382,345,985m^3 of 2007 Own Gas;
- 2,326,600,151m^3 of 2008 Own Gas;
- 1,187,504,403m3 of 2009 Own Gas;
- 1,349,671,696m3 of 2010 Own Gas;
- 1,375,656,470m3 of 2011 Own Gas;
- 700,777,440m3 of 2012 Own Gas;
- 130,053,481m3 of 2013 Own Gas; and
- 15,201,233m3 of 2015 Own Gas.

b) **2006 Own Gas which was sold at an undervalue**. As the Own Gas Schedule records, the sales of 2006 Own Gas which Ukrnafta made in 2006 included sales of 50,000,000m^3 to OJSC Ivano-Frankivsgaz, 50,000,000m^3 to PJSC Lvivgaz, 50,000,000m^3 to PJSC Chernigivgaz and 30,000,000m^3 to PJSC Volyngaz. All of those companies were State suppliers of gas into particular regions. The sales were made at prices ranging from UAH 290.93 to 293.86, which were well below the Free Price that year (UAH 616).[614] Ukrnafta sold other 2006 Own Gas that year at Free Prices. In the But For World, Ukrnafta

[614] Expert report of Mr Leitzinger, Table 4 beneath paragraph 76.

would not have sold this 180,000,000m³ of gas at these prices. It would have been entitled to sell it at Free Prices and would have done so.[615]

c) **2007 Own Gas which was sold at an undervalue**. As the Own Gas Schedule records, in 2007 Ukrnafta sold a total of 780,303,798m³ of 2007 Own Gas to Naftogaz. These sales were made at a price of UAH 318.78. This price was well below the Free Price that year (UAH 844). Indeed, it was well below Ukrnafta's Zero Profit Price (UAH 461.36). In the But For World, Ukrnafta would not have sold this gas at this price. It would have been entitled to sell it at Free Prices and would have done so.[616]

d) **Other Own Gas which was sold at an undervalue**. In the period from 2009 to 2013 the State and Naftogaz permitted Ukrnafta to sell a total of approximately 3 billion m³ of Own Gas to chemical companies, particularly those which use gas as a raw material to produce fertilisers. These sales are recorded in the Own Gas Schedule as sales to OJSC DniproAZOT, OJSC AZOT Cherkasy, LLC Energoalliance Company, LLC Ukroptgroup and LLC Groningen (the latter three being third party intermediaries). They were made at prices which were at or just below the special maximum prices for sales to chemical companies which were set by the NERC (when applicable), and substantially below the Free Prices from time to time. In the But For World, Ukrnafta would not have sold this gas at these prices. It would have been entitled to sell it at Free Prices and would have done so.[617]

e) **Own Gas which was used to produce ammonia**. In July 2010 Ukrnafta rented some ammonia production facilities from OJSC DniproAZOT. Beginning in 2011, it then transferred substantial volumes of its Own Gas to

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615 Witness statement of Mr Pustovarov, paragraphs 44-47; Witness statement of Mr Laber, paragraphs 14(a), 16.

616 Witness statement of Mr Pustovarov, paragraphs 48-74; Witness statement of Mr Laber, paragraphs 14(b), 16.

617 Witness statement of Mr Pustovarov, paragraphs 75-92; Witness statement of Mr Laber, paragraphs 14(c), 16.

these facilities; used the gas to produce ammonia; entered into transactions with OJSC DniproAZOT pursuant to which it sold the ammonia to, and purchased urea from, OJSC DniproAZOT; and exported the urea and sold it. The Own Gas Schedule records that the volumes of gas which Ukrnafta used in this way were 444,110,694m^3 in 2011, 533,819,606m^3 in 2012, 538,859,952m^3 in 2013, 559,175,600m^3 in 2014 and 544,880,420m^3 in 2015 – i.e. around 2.6 billion m^3 in total. The net revenue which was generated by this exercise was substantially less than the revenue which would have been generated by selling the 2.6 billion m^3 of Own Gas at Free Prices. In the But For World, Ukrnafta would not have used the gas in this way. It would have been entitled to sell the gas at Free Prices and would have done so.[618]

f) **JIA Gas which has not been sold**. Since 2006 Ukrnafta has pumped approximately 1 billion m^3 of JIA Gas (including the partners' shares) into the GTS. As a result of the Respondent's Breaches, the JIAs have not been permitted to sell this gas. In the But For World, the JIAs would have been entitled to sell it at Free Prices and would have done so, with Ukrnafta receiving its share of the proceeds of sale. The relevant JIAs are JIA No 35/78, JIA No 410/95, JIA No 35/809, JIA No 999/97, JIA No 35/71 and JIA No 35/21.[619]

g) **JIA No 999/97**. In June 2011, Ukrnafta reduced its participating interest in JIA No 999/97 below 50%, principally for the purpose of avoiding State pricing regulation. Thereafter, it transferred into the JIA a series of wells which had previously produced Own Gas, and substantially increased the volume of gas which was produced by the JIA. In the But For World, this would not have happened. Ukrnafta would have retained the participating interest which it had prior to June 2011 and the relevant wells would have continued to

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618 Witness statement of Mr Pustovarov, paragraphs 93-97; Witness statement of Mr Laber, paragraphs 15-16

619 Witness statement of Mr Kartashov, paragraphs 38-82.

produce Own Gas which Ukrnafta would have been entitled to sell, and would have sold, at Free Prices.[620]

h) **JV Gas which has not been sold**. Finally, there is a volume of 77,525,808m^3 of JV Gas which was produced pursuant to Ukrnafta's JV with UkrKarpatoil and pumped into the GTS. As a result of the Respondent's Breaches, this gas has not been sold either. In the But For World, it would have been sold at Free Prices, with Ukrnafta receiving its share of the proceeds of sale.[621]

3. The timing and volume of sales, and storage fees

428. As to the manner in which, in the But For World, the relevant volumes of Own Gas, JIA Gas and JV Gas would have been sold at Free Prices, it is necessary to make assumptions as to when sales would have been made and in what volumes. In that regard:

a) It is distinctly possible that Ukrnafta would have sought to stockpile some gas for the purpose of selling it at higher prices a considerable period of time after its production. In particular, by about March 2008 relations between Russia and Ukraine were such that a reasonable businessman would have considered that it was probable that Russia would restrict supply and/or substantially increase import prices, that domestic prices would therefore rise substantially, and that a higher price could be obtained by stockpiling gas for later sale. Indeed, it is possible that Ukrnafta would have stockpiled some gas until the market peaked in early 2012.

b) However, the Claimants do not calculate their claims on that basis. Instead, the Claimants invite the Tribunal to quantify their claims on the more conservative assumption that Ukrnafta would have sold the gas in the year after its production and would have spread the sales evenly over the twelve

620 Witness statement of Mr Kartashov, paragraphs 48, 65-71; Witness statement of Mr Laber, paragraphs 17-19.

621 Witness statement of Mr Kartashov, paragraphs 83-89.

months of the year. Hence, for example, the assumption is made that Ukrnafta would have sold its 2007 gas in twelve equal tranches throughout 2008.

c) It necessarily follows from the Claimants' case that, in the But For World, particular volumes of gas would have been stored in the UGS for particular periods of time. The Claimants' experts have accordingly taken account of the fees which would have been payable by Ukrnafta to Ukrtransgaz in respect of the injection, storage and withdrawal of gas.

4. Free Prices

429. The Free Prices which could and would have been obtained in each relevant month are those set out in Table 4 beneath paragraph 76 of the expert report of Dr Leitzinger. These prices were slightly below the maximum (ceiling) prices for sales to industrial consumers which were set by the Cabinet of Ministers or the NERC (or its successor).[622]

5. Actual Capital Investment and Dividends, and the substantial decline in the volume of oil and gas which was actually produced

430. As mentioned above, the Claimants' case is concerned not only with the Own Gas, JIA Gas and JV Gas which was actually produced, but with the additional Own Gas, JIA Gas, Own Oil and JIA Oil which would have been produced in the But For World.

431. As Mr Rogers explains in his expert report, it is axiomatic in the oil and gas industry that, in order for a company simply to maintain the volume of its annual production, it is necessary for it to make substantial investment each year in relation to the infrastructure and equipment which it uses to extract and process oil and gas ("**Capital Investment**").

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622 Expert report of Dr Leitzinger, paragraphs 72-76.

432. In 2004 Ukrnafta took a US$240 million, five year loan facility from Deutsche Bank AG London.[623]

433. Otherwise, Ukrnafta funded Capital Investment by retaining for company development some of the net profit which it had generated from the previous years' operations.

434. The table below summarises the manner in which the net profit which Ukrnafta actually achieved in the period from 2000 to 2015 was either distributed to Ukrnafta's shareholders as dividends ("**Dividends**") or retained so that it could be spent on the future development of the company:

Year	*Net Profit (Uah)*	*Distributed As Dividends (UAH and %)*	*Retained For Company Development (Uah And %)*	*Date Of Decision / Decision-Maker*	*Refs*
2000	991,704,000	-	991,704,000 (100%)	21 March 2003 (General Meeting)	Exhibit C-1843
2001	975,204,000	-	975,204,000 (100%)	21 March 2003 (General Meeting)	Exhibit C-1843
2002	446,014,000	-	446,014,000 (100%)	21 March 2003 (General Meeting)	Exhibit C-1843
2003	890,006,000	100,322,743 (11.3%)	789,683,256 (88.7%)	5 November 2004 (General Meeting)	Exhibit C-1846
2004	1,347,207,000	1,347,036,188 (99.99%)	170,811 (0.0001%)	20 June 2005 (General Meeting)	Exhibit C-7
2005	1,870,201,000	1,869,799,024 (99.99%)	401,975 (0.0002%)	11 May 2006 (General	Exhibit C-1850

623 Witness statement of Mr Laber, paragraph 21(c).

				Meeting)	
2006	2,412,560,000	2,412,084,124 (99.99%)	475,875 (0.0001%)	26 January 2010 (General Meeting)	Exhibit C-1074
2007	1,237,946,000	1,237,494,598 (99.99%)	451,401 (0.0003%)	26 January 2010 (General Meeting)	Exhibit C-1074
2008	1,438,030,000	1,437,597,800 (99.99%)	432,199 (0.0003%)	26 January 2010 (General Meeting)	Exhibit C-1074
2009	378,783,000	113,337,585 (30%)	265,445,414 (70%)	30 April 2010 (Executive Board)	Exhibit C-1088
2010	2,646,287,000	793,905,386 (30%)	1,852,381,613 (70%)	25 February 2011 (General Meeting)	Exhibit C-1169
2011	2,182,892,000	2,181,612,957 (99.99%)	279,043 (0.0001%)	10 October 2014 (General Meeting)	Exhibit C-1346
2012	1,428,110,724	1,427,836,668 (99.99%)	274,056 (0.0002%)	10 October 2014 (General Meeting)	Exhibit C-1346
2013	189,886,355	189,799,785 (99.99%)	86,570 (0.0004%)	10 October 2014 (General Meeting)	Exhibit C-1346
2014	1,264,626,000	(99.99%)	(0.01%)	22 July 2015 (General Meeting)	Exhibit C-1395

435. Accordingly, in the period between the decision taken at the General Meeting on 5 November 2004 and the decision taken by the Executive Board on 30 April 2010 only a tiny proportion of Ukrnafta's net profit was retained for company development.

436. In those circumstances, Ukrnafta was only able to spend the following sums (which are rounded to the nearest million UAH) on Capital Investment:[624]

Year	*Total (UAH)*	*Drilling*	*Equipment*	*Construction*	*Other*
2007	1,079,000,000	651,000,000	281,000,000	103,000,000	44,000,000
2008	959,000,000	651,000,000	177,000,000	103,000,000	28,000,000
2009	744,000,000	470,000,000	91,000,000	94,000,000	89,000,000
2010	839,000,000	507,000,000	224,000,000	0	108,000,000
2011	959,000,000	485,000,000	225,000,000	143,000,000	106,000,000
2012	784,000,000	404,000,000	169,000,000	122,000,000	89,000,000
2013	846,000,000	376,000,000	250,000,000	163,000,000	57,000,000
2014	766,000,000	496,000,000	80,000,000	141,000,000	49,000,000
2015	550,000,000				

437. The consequence of Ukrnafta's spending on Capital Investment being limited in this manner was that the total volume of gas and oil (not including condensates) which Ukrnafta actually produced declined very substantially between 2007 and 2015:

Year	*Own Gas (billion m^3)*	*JIA Gas (billion m^3)*	***Total Gas (billion m^3)***	*Own Oil (million tonne)*	*JIA Oil (million tonne)*	***Total Oil (million tonne)***
2007	2.830	0.407	**3.237**	2.700	0.161	**2.861**
2008	2.768	0.397	**3.165**	2.586	0.158	**2.744**
2009	2.690	0.256	**2.947**	2.384	0.138	**2.523**
2010	2.245	0.223	**2.637**	2.131	0.083	**2.215**

624 Ukrnafta Annual Report 2014, page 142, **Exhibit {C-1316}**; Ukrnafta Annual Report 2008, page 27, **Exhibit {C-936}**; Expert report of Mr Rogers, Table 8 beneath paragraph 4.4.6.

2011	2.093	0.053	**2.146**	2.024	0.054	**2.078**
2012	1.650	0.361	**2.011**	1.875	0.059	**1.934**
2013	1.150	0.753	**1.903**	1.780	0.070	**1.850**
2014	0.907	0.830	**1.737**	1.676	0.086	**1.762**
2015	0.810			1.488	0.088	**1.577**

438. The insufficiency of the Capital Investment and consequences thereof were regularly noted, both within and outside the company. For example:

a) By 2008 Ukrnafta's management considered that, without Capital Investment, the volume of production from existing wells could be expected to decline by 10% each year. It accordingly considered that Capital Investment was urgently needed so that new wells could be drilled in existing deposits, exploratory wells could be drilled in relation to potential new deposits, necessary construction works could be undertaken at the gas fields, and new equipment could be purchased to replace worn-out equipment and for use in new wells.[625]

b) On 10 April 2008 the Acting Head of Ukrnafta's Executive Board proposed that all of the company's net profit for 2006 and 2007 should be allocated to Capital Investment.[626] However, that did not happen, and in fact 99.99% of the net profit for those years was subsequently distributed as Dividends.

c) By Article 8 of the 2010 Shareholders Agreement,[627] the parties agreed that "In making decisions on the distribution of profits, the Parties shall take into

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625 Justification of required level of price for gas of own production for Price justification for Ukrnafta produced gas in 2007 - 2008 and Plan for 2009, 2007-2009, **Exhibit {C-825}**.

626 Letter No. yur-534 from Ukrnafta to Naftogaz, 10 April 2008, **Exhibit {C-973**}.

627 Ukrnafta Shareholders Agreement 2010, 25 January 2010, **Exhibit {C-1068}.**

account whether it is necessary and reasonable to distribute a part of the profit (dividends) to Company's development."

d) As noted above, when the decisions concerning the allocation of net profit for the 2009 and 2010 financial years were taken (in 2010 and 2011 respectively), 70% of the net profit was retained for Capital Investment. However, this was insufficient to arrest the slide in Ukrnafta's production volumes, and on 1 March 2011 Ukrnafta informed Naftogaz that "vast investments" would be required if the Minister's objective of increasing production volumes was to be achieved.[628]

e) In a presentation which was prepared in March 2011 in connection with a proposed IPO of Ukrnafta shares, Renaissance Capital observed that the "extremely low" level of "investments in exploration and drilling" in recent years "created threats to the company's longer-term viability".[629]

f) In a further such presentation, UBS observed that the consequence of "historical underinvestment in exploration and drilling" had been "continuing production decline in both liquids and gas", and that it was "Key to develop a credible realistic production plan aimed at tackling output decline via application of efficient development technologies, as well as further appraisal / exploration".[630]

g) In a letter dated 21 April 2011 to the Minister, which he wrote within weeks of taking up his post as the new Head of Ukrnafta's Executive Board, Mr Vanhecke stated that there was a "really big problem", including because the

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628 Letter No. 6-1530/1.2-11 by Naftogaz to Ukrnafta encl. Natural Gas supply contract Agreement, 16 March 2011, **Exhibit {C-1174}**.

629 Renaissance Capital "Discussion materials" March 2011, March 2011, **Exhibit {C-1171}**

630 UBS "Ukrnafta Discussion materials", 1 July 2011, **Exhibit {C-1198}**

state of the company's production equipment was "extremely unsatisfactory", while its production facilities required "urgent and global modernisation".[631]

h) By June 2011, Ukrnafta's Executive Board had received advice from Mr David Sturt, a renowned expert, to the effect that production volumes could not be increased (from the levels to which they had by that stage fallen) without both an upgrade in the company's infrastructure and significant additional drilling operations, including exploratory drilling. On 24 June 2011, Mr Vanhecke informed the NERC that, to that end, the Board wished to double Capital Investment in the following year.[632]

i) The position by 2012 was that more than 70% of Ukrnafta's 300 operating units needed replacing (particularly the equipment which was used for pumping and cementing wells, and the mobile compressor units which were used for well development). So too did 80-85% of the drilling equipment, 60-70% of oil field equipment, 65-75% of GPZ operational equipment, and 85% of gas engine compressors.[633]

j) In a letter to the Ministry dated 28 October 2013, Ukrnafta noted that the fixed assets which it was using to extract and process gas were mostly commissioned in the second half of the previous century and were 75-80% depreciated, and that it was simply not possible to maintain production volumes with this equipment.[634]

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631 Letter No. yur-851 by Ukrnafta to the Minister of Energy and Coal with encl. document, 21 April 2011, **Exhibit {C-1185}**.

632 Letter No. yur-1321 by Ukrnafta to NERC, 24 June 2011, **Exhibit {C-1197}**.

633 Price justification for Ukrnafta produced natural gas in 2010 - 2011 and Plan for 2012, 2010, **Exhibit {C-1056}**.

634 Letter No. yur-1987 by Ukrnafta to the Deputy Minister of Energy and Coal of Ukraine, 21 October 2013, **Exhibit {C-1301**}.

6. Additional Capital Investment, the Maintained Production Condition, and the production of additional oil and gas in the But For World

439. Without basic levels of maintenance and Capital Investment, production capacity declines year on year. Had Ukrnafta been able to, it would obviously have made at least the minimum Capital Investment necessary to ensure that production capacity was maintained at existing levels. (As explained below, the Ministry in fact wanted Ukrnafta to increase production levels.) In the But For World, Ukrnafta would have had greater financial resources from the generation of Additional Net Profit and would have been able to and would have retained for company development, and subsequently spent on Capital Investment, much more than it actually did. In particular – and subject to the requirements of Ukrainian law concerning the minimum percentage of net profit which had to be distributed as dividends[635] – Ukrnafta would have retained and spent on Capital Investment whatever proportion of its actual net income and its Additional Net Income it needed to retain and spend in order to enable it to maintain the total volume of production of gas and the total volume of production of oil slightly above their respective 2006 levels ("**Maintained Production Condition**").

440. Naftogaz and Ukrtransgaz have repeatedly asserted that Naftogaz has in fact used Ukrnafta's gas to supply members of the population, notwithstanding that Ukrnafta had not entered into any contract to sell the relevant gas to Naftogaz.[636]

441. However, the effect of the decisions of the Courts is that, if this expropriation of Ukrnafta's gas did occur, it was unlawful. In the But For World, it would not have occurred.

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635 There was no minimum percentage in relation to the 2006 to 2007 financial years. Thereafter, the minimum percentages were 15% in relation to the 2008 financial year, 30% in relation to the 2009 to 2012 financial years, 50% in relation to the 2013 and 2014 financial years, and 75% in relation to the 2015 financial year: see the witness statement of Mr Kartashov, paragraphs 90-91. Ukrnafta's experts have been instructed to assume that the minimum percentage from 2016 onwards will be a more commercially realistic 50%.

636 See Chronology at Annex 1.

442. If Naftogaz was not able lawfully to procure from Ukrnafta the volumes of gas which it needed to fulfil its obligations and to satisfy its needs, it would have had to procure that gas from another source. In that regard, Naftogaz has repeatedly stated that, if Ukrnafta would not sell to it, there would be a shortage which Naftogaz would have to make up by purchasing much more expensive imported gas.[637]

443. Moreover, if Ukrnafta's volume of production had been allowed to fall as a result of insufficient Capital Investment, Naftogaz would have had to purchase more and more of this much more expensive imported gas.

444. In the But For World, it would therefore have been very much in the interests of Naftogaz and the Respondent to ensure that Ukrnafta at least achieved the Maintained Production Condition.

445. In fact, the Ministry set Ukrnafta the task of increasing its production volumes,[638] albeit that this was an impossible task in circumstances in which Ukrnafta was incurring all of the cost of producing gas but not receiving the revenue which it ought to have received, and in which, in many years, 99.99% of any net profit which the company achieved was being distributed as Dividends.

446. Accordingly, in the But For World, Naftogaz would have acted in such a way as to ensure that a sufficient proportion of Ukrnafta's annual net profit (which, in the But For World, would have included Additional Net Income) was allocated to Capital Investment to permit the achievement of the Maintained Production Condition, either by consenting to proposals by the Claimants or, if necessary, by exercising its rights in relation to General Meetings of Ukrnafta's shareholders and meetings of the

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637 See, for example: Letter No. 6-5065/1/KM-10 from Naftogaz to the Cabinet of Ministers, 9 December 2010, **Exhibit {C-1142}**; Letter No. 2/01-16-444 by Ukrnafta to Naftogaz with encl. Information, 17 June 2011, **Exhibit {C-1195}**.

638 Letter No. yur-379 by Ukrnafta to Naftogaz, 1 March 2011, **Exhibit {C-1172}**; Letter No. yur-851 by Ukrnafta to the Minister of Energy and Coal with encl. document, 21 April 2011, **Exhibit {C-1185}**; Letter No. yur-1321 by Ukrnafta to NERC, 24 June 2011, **Exhibit {C-1197}**.

Supervisory Board in such a way as to bring about this result. If necessary, the Respondent would have procured that Naftogaz act in this way.

447. The expert calculations in this respect are developed as follows. Having been informed by Mr Haberman what the maximum sum available for additional Capital Investment would have been in each year, Mr Rogers has identified:

a) the combination of incremental investment activities (in terms of drilling further development and exploration wells,[639] undertaking workovers in relation to existing wells, and upgrading surface facilities) that he considers that an economically rational Ukrnafta management team could have pursued so as to achieve the Maintained Production Condition; and

b) the sums which would have been required for those activities.

448. Shortly before this Statement of Claim was due to be filed, it came to the attention of the Claimants' legal team and experts that a change to one assumption underlying the experts' calculations is required. This is as a result of a late clarification of the facts concerning the minimum percentage of Ukrnafta's net profit for each financial year which would have been required by Ukrainian law to be distributed to shareholders as dividends in the But For World. The experts' calculations assumed that there was no minimum percentage in relation to the 2006 to 2008 financial years (i.e. all net profit could be retained for investment) and that, thereafter, the minimum percentages were 30% in relation to the 2009 to 2012 financial years, 50% in relation to the 2013 and 2014 financial years, and 75% in relation to the 2015 financial year. On that basis, Mr Haberman informed Mr Rogers that the sum which was available for investment in 2008 was UAH 2,496,051,930, when in fact it should have been only UAH 2,220,120,515. The activities which Mr Rogers identified would have cost UAH 2,282,710,404. This overspend of UAH 62,589,889 equates to around US$12 million or less than 3% of that year's spend. In fact, Ukrainian law would have

639 The terms of Ukrnafta's licences were such that, within the designated areas, Ukrnafta was permitted to drill as many wells as it wished, of whichever type it wished to drill: see witness statement of Mr Kartashov, paragraph 115.

required a minimum of 15% of the net profit for the 2008 financial year to be distributed as dividends if a decision had been made by the General Meeting to distribute dividends for that year (which the Claimants contend would have happened in the But For World). It is possible that this change of assumption will have a consequential effect on cash flows in subsequent years, in which case the overall claim figures will need to be corrected. Rather than delay the filing of the Statement of Claim, this will be addressed on the basis that the Claimants' experts will investigate this issue, and any necessary correction will be made, within a short period of time.

449. In consequence of the achievement of the Maintained Production Condition, Ukrnafta would, in the But For World, have produced more Own Gas, JIA Gas, Own Oil and JIA Oil in each year than it actually produced.

450. The Claimants recognise, and their experts have taken account of the fact that:

a) additional variable costs would have been incurred in respect of the production of the additional Own Gas, JIA Gas, Own Oil and JIA Oil; and

b) not all of the additional Own Gas and JIA Gas which would have been extracted would ultimately have been available for sale, because some would have been lost or consumed during processing, some would have been used to produce TPBM, and some would have been non-compliant gas which would have been sold to the Galychyna refinery. Likewise, a fraction of the additional Own Oil and JIA Oil would have been lost or consumed.[640]

640 Witness statement of Mr Pustovarov, paragraphs 35-41; Expert report of Mr Rogers, paragraphs 4.2.35 to 4.2.46.

7. Sale of the remaining additional gas and the additional oil and condensates, and generation of more Additional Net Income

451. In relation to the additional Own Gas and JIA Gas which was available for sale, Ukrnafta would have been entitled to sell this at Free Prices and would have done so, in the manner pleaded above.

452. Ukrnafta would also have been entitled to sell the additional Own Oil and JIA Oil and would have done so at auction, in accordance with Ukrainian law.

453. By effecting those sales, Ukrnafta would have generated more Additional Net Income.

8. Debt financing

454. Reference has been made above to the US$240 million, five year loan facility from Deutsche Bank AG London which Ukrnafta took in 2004.

455. In the But For World, Ukrnafta would have taken US$500 million of debt financing by way of a Eurobond issue on or about 30 June 2011. In that regard, the Claimants rely upon the following matters:

a) It is normal for companies in the oil and gas industry to have substantial debt financing. Typically, this is structured so that the ratio of EBITDA to the cost of borrowing is around 2 to 2.5 times.[641]

b) When Mr Vanhecke and Mr Bakunenko had discussions with the banks in 2011, the banks were enthusiastic about a US$500 million Eurobond issue.[642]

c) There is no reason why, in principle, the Respondent or Naftogaz would have been opposed to debt financing. Whereas an IPO of Ukrnafta's shares would

641 Witness statement of Mr Bakunenko, paragraph 17; Witness statement of Mr Laber, paragraph 21(a).

642 Witness statement of Mr Bakunenko, paragraphs 15-16, 19; Witness statement of Mr Laber, paragraph 21(d).

have diluted Naftogaz and deprived it of its majority shareholding, there was no such issue in relation to debt. Furthermore, because the borrowing could have been used to finance Capital Investment, the shareholders would have been able to allocate more of the company's net profit to Dividends.[643]

d) The Respondent and Naftogaz had previously approved of Ukrnafta taking out the loan facility with Deutsche Bank AG London.

e) When Mr Vanhecke and Mr Bakunenko had discussions with the banks in 2011, the Respondent and Naftogaz were supportive of the proposed US$500 million Eurobond issue. The only reason why this initiative did not ultimately proceed was that there was a stalemate between the shareholders arising out the disputes concerning the treatment of Ukrnafta's unsold gas and the price of its gas going forward.[644]

456. In the discussions in 2011, various maturities were discussed and the prospective rates indicated to Ukrnafta by the banks were slightly above Ukrainian sovereign rates.[645] Mr Haberman considers that it is appropriate to assume a 7 year maturity and an interest rate of 8%.[646]

457. By virtue of having obtained such debt financing, Ukrnafta would not have needed to retain as much of its actual net income or its Additional Net Income in order to fund the Capital Investment which was needed to achieve the Maintained Production Condition as would otherwise have been the case.

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643 Witness statement of Mr Laber, paragraph 21(b).

644 Witness statement of Mr Bakunenko, paragraphs 17-18; Witness statement of Mr Laber, paragraph 21(d).

645 Witness statement of Mr Bakunenko, paragraph 16.

646 Expert report of Mr Haberman, paragraphs 4.47 to 4.50.

9. Fiscal terms

458. It is necessary to take account of any additional liability which Ukrnafta would have incurred in relation to the payment of Corporation Tax, Rental Fees and the Geological Exploration Levy. The Claimants' experts have done so.[647]

10. Fines and interest on tax debts

459. As a result of the Respondent's Breaches, Ukrnafta has suffered severe cashflow difficulties. By late 2014 it found itself in the position of being unable to discharge its liability to pay Corporation Tax, VAT and Rental Fees. Consequently, it has incurred liabilities to pay fines and interest which, in the But For World, it would not have incurred. In its accounts for the 2015 financial year, it has made a provision in respect of such fines and interest in the amount of UAH 4,419,728,519.[648]

11. Dividends

460. The final elements of the Claimants' case in relation to their Loss of Dividends Claim are as follows:

a) Insofar as there was any actual net income or Additional Net Income which was left after (1) retention for Capital Investment of whatever sum was needed to ensure achievement of the Maintained Production Condition in future years, and (2) the discharge of any additional fiscal liability, Ukrnafta would, in the But For World, have distributed this to its shareholders as Dividends.

b) The Dividends (if any) in respect of a particular financial year would have been distributed to the Claimants on 30 June of the following year.

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647 Expert report of Mr Haberman, paragraph 4.51; Expert report of Mr Rogers, section 4.6; Witness statement of Mr Kartashov, paragraphs 123-125.

648 Witness statement of Mr Kartashov, paragraphs 108-112.

c) The claims should be quantified on the basis of the USD value of the Dividends on the date of receipt. In circumstances in which the UAH has depreciated very significantly during the period over which the Dividends would have been paid, this is necessary so as to "wipe out all the consequences" of the Respondent's unlawful acts, as required by the *Chorzów Factory* case. To the extent that it is relevant, Ukrnafta did in fact pay substantial amounts of Dividends to the Claimants in USD.[649]

461. On that basis, the total sum which the Claimants claim in respect of the Loss of Dividends Claim is **US$2.063 billion**.

462. The relevant calculations, and further detail concerning the instructions, assumptions and matters of expert opinion upon the basis of which those calculations have been made, are set out in the expert reports of Messrs Haberman, Rogers and Leitzinger.

F. The Pre-Award Interest Claim

463. The Claimants claim the sum of **US$932.3 million** by way of pre-Award interest on the sum payable in respect of their Loss of Dividends Claim. They do so on the following basis:

a) As pleaded in Section V.A above, the Claimants are entitled to claim interest at the rate which they would have been in a position to have earned if they had received their Dividends when they ought to have received them and thus had the funds available to invest in a form of commercial investment in their own country.

b) The Claimants' own country is Cyprus.

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649 Witness statement of Mr Masko, paragraph 23.

c) The Claimants' could have invested their Dividends in USD accounts at PrivatBank (Cyprus) at the interest rate which was payable from time to time to strategic customers of that bank.[650]

d) To the extent that it is relevant, each of the Claimants did in fact maintain a bank account with PrivatBank (Cyprus) and received Dividends into that account.[651]

e) Interest is payable from the time at which the Dividends in respect of each financial year would have been paid in the But For World (i.e. 30 June of the following year).

f) Pre-Award interest has also been calculated through to the assumed date of the Award (30 June 2018), and it has been assumed for this purpose that the current PrivatBank (Cyprus) interest rate will remain unchanged during this period. Updated calculations will be provided as the proceedings progress.

g) For the reason given in Section V.A above, interest should be compounded.

h) Interest should be compounded monthly because, at all material times, that is how interest on deposits in the relevant PrivatBank (Cyprus) accounts was compounded.[652]

464. The relevant calculations are set out in Mr Haberman's report.[653]

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650 Letter from PrivatBank to Littop Enterprises Limited, 25 May 2016, **Exhibit {C-1887}**; Letter from PrivatBank to Bordo Management Limited, 25 May 2016, **Exhibit {C-1888}**; Letter from PrivatBank to Bridgemont Ventures Limited, 25 May 2016, **Exhibit {C-1889}**.

651 Witness statement of Mr Masko, paragraph 24.

652 Letter from PrivatBank to Littop Enterprises Limited, 25 May 2016, **Exhibit {C-1887}**; Letter from PrivatBank to Bordo Management Limited, 25 May 2016, **Exhibit {C-1888}**; Letter from PrivatBank to Bridgemont Ventures Limited, 25 May 2016, **Exhibit {C-1889}**.

653 Expert report of Mr Haberman, paragraphs 4.67 to 4.69 and Appendix 3.

G. Overview of the Claimants' case in relation to the Loss of Value Claim

465. The sum of **US$1.679 billion** which the Claimants claim in respect of their Loss of Value Claim represents the difference, at the assumed date of the Award (30 June 2018), between:

a) the value which the Claimants' shareholding in Ukrnafta would have had in the But For World, in circumstances in which, in particular:

- Ukrnafta's infrastructure had benefited from the additional Capital Investment referred to above and the Maintained Production Condition had been achieved; and
- the Claimants' rights under the 2010 Shareholders Agreement and the 2010 Cooperation Agreement had been fully respected; and

b) the value which the Claimants' shareholding in Ukrnafta actually has today, in circumstances in which:

- that additional Capital Investment has not been made, the volume of oil and gas produced by Ukrnafta has declined very substantially, and Ukrnafta's infrastructure is in a very poor state indeed; and
- the Claimants' rights under the 2010 Shareholders Agreement and the 2010 Cooperation Agreement have not been respected.

466. The calculation of that sum, and further detail concerning the instructions, assumptions and matters of expert opinion upon the basis of which it has been made (including in relation to matters such as the appropriate discount rate and discount for partial control), are set out in Mr Haberman's report.[654]

H. Ukrnafta's Rights as a matter of Ukrainian Law concerning the Sale of its Gas

467. In the text below:

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654 Expert report of Mr Haberman, section 5.

a) All prices are per 1,000m^3 of gas.

b) All prices include VAT unless the contrary is stated.

468. The subsections below set out the position under Ukrainian law concerning the sale of gas in each relevant year, having regard to the relevant legislation, decrees and resolutions ("**Laws**") and the interpretation thereof by the Courts. The Laws and the judgments of the Courts are analysed in detail in the Chronology and elsewhere in this Statement of Claim.[655] Capitalised terms bear the meanings ascribed to them in the Chronology.

1. <u>The position in relation to 2006 gas, and the basis upon which the Claimants advance their case concerning this gas</u>

469. There were two Laws which were of principal relevance to the sale of Ukrnafta's 2006 gas. These were the 2006 Budget Law and the 2001 Cabinet Decree (as amended). The 1999 NERC Resolution, by which the NERC set the "threshold level of bulk prices" for "natural gas of domestic use" at UAH 185, did not apply to transactions between Ukrnafta and Naftogaz.[656]

470. Article 4 of the 2006 Budget Law applied both to entities (such as Naftogaz) in which the State owned more than 50% of the shares directly, and to entities (such as Ukrnafta) where more than 50% of the shares were owned by another entity (such as Naftogaz) in which the State held a controlling interest. Its effect was that sales of gas which was to be used to satisfy the needs of members of the Ukrainian

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655 The analysis in this Section V.H is principally directed to the positon concerning Own Gas. The position in relation to JIA Gas is not relevantly different. Detail concerning the JIA Gas litigation is primarily contained in the Chronology, in addition to being covered in a less detailed fashion in Section II.E above. See witness statement of Mr Kartashov, paragraphs 38-50.

656 NERC Resolution No. 01-30-09/466, 10 February 2004, **Exhibit {C-321}**; NERC Resolution No. 01-39-14/5131, 23 November 2004, **Exhibit {C-323}**; Letter from the NERC No. 05-39-14/1393 'Re: Providing clarifications', 29 March 2005, **Exhibit {C-839};** Case No. 18/228 Decision of Kiev Commercial Court, 30 May 2006, **Exhibit {C-18}**; Case No. 18/228 Decision of Kiev Court of Appeal, 26 June 2006, **Exhibit {C-19**}; Case No. 18/228 Decision of Supreme Court of Ukraine, 3 October 2006, **Exhibit {C-20}**.

population were to be made by the affected entities in "the manner prescribed by the Ukrainian Cabinet of Ministers".[657]

471. In that regard, Article 2 of the 2001 Cabinet Decree (as amended) provided that the needs of the population were to be satisfied with (*inter alia*) gas produced domestically by Ukrnafta.[658]

472. Neither the 2001 Cabinet Decree nor the 2006 Budget Law:

a) stipulated to whom the affected entities were to sell their gas;

b) stipulated the price at which the affected entities were to sell their gas;

c) provided that the price at which the affected entities were to sell their gas was a State regulated price;

d) established a maximum price at which the sales were to be made;

e) established any principle by reference to which price was to be determined or approved (e.g. that the price should be a Zero Profit Price); or

f) made any provision concerning the procedure by which the price was to be determined or approved.

473. On 9 January 2008 the Cabinet of Ministers issued the Second 2008 Cabinet Instruction.[659] The Cabinet thereby approved a proposal by Naftogaz to purchase certain volumes of 2006 gas and 2007 gas at a certain price.

474. The Courts have held that:

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657 Law of Ukraine "On state budget for year 2006", Article 4 (extract), 20 December 2005, **Exhibit {C-332}.**

658 Law of Ukraine "On state budget for year 2007", Articles 2 and 63 (extract), 19 December 2006, last amended 17 November 2011, **Exhibit {C-341**}.

659 Decree No. 58-r of the Cabinet of Ministers of Ukraine "On purchase of natural gas mined by OJSC Ukrnafta in 2006 – 2007", 9 January 2008, **Exhibit {C-350**}.

a) The Budget Law for a particular year only applied while it was in force, from 1 January to 31 December of the year in question. It therefore only applied to gas produced during that calendar year, and only to sales of such gas which were effected during that calendar year. It did not apply to gas produced in a previous year. Hence, for example:[660]

- The 2006 Budget Law only applied to sales of Ukrnafta's 2006 gas, and it only applied to sales of 2006 gas which were effected during the 2006 calendar year. It did not oblige Ukrnafta to sell 2006 gas to Naftogaz in 2007 or any subsequent year.

- The 2007 Budget Law had no application to sales of 2006 gas.

b) The Second 2008 Cabinet Instruction was not a regulatory act. It merely confirmed that Naftogaz was authorised to enter into a contract to purchase 2006 and 2007 gas at the stated price. It did not oblige Ukrnafta to conclude a contract in respect of such gas if it did not wish to do so.[661]

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660 Case No. 29/194 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-44}**; Case No. 29/194 Decision of the Commercial Court of Appeal of Kiev 7 July 2008, **Exhibit {C-45}**; Case No. 29/194 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-46}**; Case No. 1-28/2008 Decision No. 10-rp/2008 of the Constitutional Court of Ukraine, 22 May 2008, **Exhibit {C-67}**; Case No. 6/489 Decision by the Kiev Commercial Court, 29 October 2009, **Exhibit {C-89}**; Case No. 6/489 Decision of the Commercial Court of Appeal of Kiev, 10 December 2009, **Exhibit {C-90}**; Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}**; Case No 10-rp/2008 of the Constitutional Court, 22 May 2008, **Exhibit {C-67}**; Case No. 32/296 Decision of the Commercial Court of Kiev, 8 June 2010, **Exhibit {C-98}**; Case No. 5011-35/4141-2012 Decision of Kiev Commercial Court, 27 June 2012, **Exhibit {C-202}**; Case No. 5011-35/4141-2012 Kiev Commercial Court of Appeal, 6 September 2012, **Exhibit {C-203**}; Case No. 5011-35/4141-2012 Supreme Commercial Court, 7 November 2012, **Exhibit {C-204}.**

661 Case No. 29/194 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-44}**; Case No. 29/194 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, **Exhibit {C-45**}; Case No. 29/194 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-46}**; Case No. 29/194 Decision of the Supreme Court of Ukraine, 12 November 2008, **Exhibit {C-47}**; Case No. 6/489 Decision by the Kiev Commercial Court, 29 October 2009, **Exhibit {C-89**}; Case No. 6/489 Decision of the Commercial Court of Appeal of Kiev 10 December 2009, **Exhibit {C-90}**; Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}**; Case No. 5011-35/4141-2012 Decision of Kiev

c) The effect of a Law begins when it enters into force and ceases when it is no longer in force. It cannot have retroactive effect. It can therefore only apply to relations which appeared after the Law entered into force.[662] Hence, for example, a Law which entered into force after 2006 does not have retroactive effect in relation to 2006 gas or any other gas produced prior to the date upon which it entered into force.[663]

d) In particular, the July 2010 Gas Market Law only applied to gas produced after it came into force on 24 July 2010. It had no application to 2006 gas or any other gas produced prior to that date.[664]

e) Neither the 2001 Cabinet Decree, nor the 2006 Budget Law (nor, for that matter, the 2007 to 2009 Budget Laws), nor the Second 2008 Cabinet Instruction served as a basis for depriving Ukrnafta of its ownership of the gas without its consent.[665]

Commercial Court, 27 June 2012, **Exhibit {C-202}**; Case No. 5011-35/4141-2012 Kiev Commercial Court of Appeal, 6 September 2012, **Exhibit {C-203}**; Case No. 5011-35/4141-2012 Supreme Commercial Court, 7 November 2012, **Exhibit {C-204}**.

662 Case No. 03/29-97 Decision of Constitutional Court of Ukraine, 13 May 1997, **Exhibit {C-1}**; Case No. 1-7/99 Decision of Constitutional Court of Ukraine, 9 February 1999, **Exhibit {C-2}**; Case No. 1-16/2001 Decision of Constitutional Court of Ukraine, 5 April 2001, **Exhibit {C-3}**.

663 Case No. 8/137 Decision of the District Administrative Court of Kiev, 17 July 2008, **Exhibit {C-35}**; Case No. 22-a-31576/09 (Case 8/137) Decision of the Administrative Court of Appeal of Kiev, 13 July 2009, **Exhibit {C-41}**; Case No. K-32535/09 (Case No. 8/137) Decision of the Supreme Administrative Court of Ukraine, 9 March 2010, **Exhibit {C-42}**.

664 Case No. 32/296 Decision of the Supreme Court of Ukraine, 20 September 2010, **Exhibit {C-99}**; Case No. 46/480 Decision of the Commercial Court of Kiev, 18 October 2010, **Exhibit {C-100}**; Case No. 46/480 Decision of the Commercial Court of Appeal of Kiev, 9 November 2010, **Exhibit {C-101**}; Case No. 46/480 Decision of the Supreme Commercial Court of Ukraine, 20 December 2010, **Exhibit {C-102}**; Case No. 42/392 Decision of the Commercial Court of Kiev, 26 November 2010, **Exhibit {C-103}**; Case No. 42/392 Decision of the Commercial Court of Appeal, 9 December 2010, **Exhibit {C-104**}; Case No. 42/392 Decision of the Supreme Commercial Court of Ukraine, 31 January 2011, **Exhibit {C-105**}; Case No. 42/392 Decision of the Supreme Commercial Court of Ukraine.

665 Case No. 6/489 Decision by the Kiev Commercial Court, 29 October 2009, **Exhibit {C-89**}; Case No. 6/489 Decision of the Commercial Court of Appeal of Kiev, 10 December 2009, **Exhibit {C-90**}; Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}**; Case No. 32/296 Decision of the Commercial Court of Kiev, 6 June 2010, **Exhibit**

f) Neither the 2001 Cabinet Decree nor the 2006 Budget Law (while it was in force) had the effect that it was mandatory for Ukrnafta to enter into a contract with Naftogaz for the sale of 2006 gas, still less that it was mandatory for Ukrnafta to do so at a price proposed by Naftogaz. Neither of those Laws determined the price of 2006 gas. That price was not regulated by the State. It was a Free Price. If Ukrnafta did not agree the price, it could not be compelled to enter into a contract to sell its 2006 gas to Naftogaz (or anyone else).[666]

g) Even if the NERC had the power to set the price of gas which was produced in a particular year, it could only exercise that right in the year in question. It did not have the right, in a particular year, to establish the price of gas that had been produced in a previous year.[667]

{C-98}; Case No. 5011-35/4141-2012 Decision of Kiev Commercial Court, 27 June 2012, **Exhibit {C-202}**; Case No. 5011-35/4141-2012 Kiev Commercial Court of Appeal 6 September 2012, **Exhibit {C-203}**; Case No. 5011-35/4141-2012 Supreme Commercial Court, 7 November 2012, **Exhibit {C-204}**.

666 Case No. 18/228 Decision of Kiev Commercial Court, 30 May 2006, **Exhibit {C-18}**; Case No. 18/228 Decision of Kiev Court of Appeal, 26 June 2006, **Exhibit {C-19}**; Case No. 18/228 Decision of Supreme Court of Ukraine, 3 October 2006, **Exhibit {C-20}**; Case No. 29/194 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-44}**; Case No. 29/194 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, **Exhibit {C-45}**; Case No. 29/194 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-46}**; Case No. 29/194 Decision of the Supreme Court of Ukraine 12 November 2008, **Exhibit {C-47}**; Case No. 6/489 Decision by the Kiev Commercial Court, 29 October 2009, **Exhibit {C-89}**; Case No. 6/489 Decision of the Commercial Court of Appeal of Kiev, 20 December 2009, **Exhibit {C-90**}; Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}.**

667 Case No. 6/489 Decision by the Kiev Commercial Court, 29 October 2009, **Exhibit {C-89**}; Case No. 6/489 Decision of the Commercial Court of Appeal of Kiev, 20 December 2009, **Exhibit {C-90**}; Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}.**

h) So far as concerns 2006 to 2009 gas, if gas produced in a particular year was not sold in that year, the owner had the right to sell it in subsequent years "freely without restriction".[668]

475. Naftogaz attempted on two occasions (in 2006 and then in 2008) to compel Ukrnafta to enter into contracts to sell 2006 Own Gas to Naftogaz at a price of Naftogaz's choosing, which was well below Ukrnafta's Zero Profit Price. However, it was held by the Courts that Naftogaz was not entitled to do so.[669] Ultimately no contract for the sale of 2006 Own Gas by Ukrnafta to Naftogaz was ever concluded, either during the 2006 calendar year or thereafter.

476. The Claimants' advance their case on the basis that, as of 1 January 2007, Ukrnafta was free to sell its 2006 gas to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer.

2. <u>The position in relation to 2007 gas</u>

477. There were two Laws which were of principal relevance to the sale of Ukrnafta's 2007 gas: the 2007 Budget Law and the 2007 Cabinet Decree.

478. Article 3 of the 2007 Budget Law applied not only to the entities to which the 2006 Budget Law had applied, but also to (*inter alia*) the subsidiaries of such entities and to parties to joint activities involving such entities. It further provided that:[670]

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668 Case No. 6/489 Decision by the Kiev Commercial Court, 29 October 2009, **Exhibit {C-89}**; Case No. 6/489 Decision of the Commercial Court of Appeal of Kiev, 20 December 2009, **Exhibit {C-90}**; Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}**.

669 Case No. 18/228 Decision of Kiev Commercial Court, 30 May 2006, **Exhibit {C-18}**; Case No. 18/228 Decision of Kiev Court of Appeal, 26 June 2006, **Exhibit {C-19}**; Case No. 18/228 Decision of Supreme Court of Ukraine, 3 October 2006, **Exhibit {C-20}** and Case No. 29/194 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-44**}; Case No. 29/194 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, **Exhibit {C-45**}; Case No. 29/194 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-46**}; Case No. 29/194 Decision of the Supreme Court of Ukraine, 12 November 2008, **Exhibit {C-47**}.

670 Law of Ukraine "On state budget for year 2007", Article 3 (extract), 19 December 2006, **Exhibit {C-340}.**

a) The affected entities "shall, on a monthly basis, sell" certain products.

b) The gas produced by the affected entities "shall be used for the building of, and drawing on … the pool of natural gas for household use". The affected entities were to sell "all" gas towards the building of this pool.

c) This was to be done in "the manner prescribed by the Ukrainian Cabinet of Ministers".

d) Sales were to be made "directly to the entity authorised by the Ukrainian Cabinet of Ministers to build such pool".

e) Such sales were to be made "at a price" which was "not to exceed the maximum wholesale price for the natural gas for household use, as determined in the prescribed manner, less the transportation, distribution tariffs, and the special purpose increment to the natural gas tariff applicable to consumers of all forms of ownership".

479. The 2007 Cabinet Decree amended the 2001 Cabinet Decree. Article 2 of the 2007 Cabinet Decree applied to the same entities as the 2007 Budget Law. It provided that:[671]

a) Naftogaz was the entity which was authorised to build and dispose of the pool of gas for household use.

b) Household demand for gas was to be satisfied from sales by the affected entities of all of the gas which they produced, less gas which they needed to satisfy their own needs or intended to use in a technological process.

c) Ukrnafta, joint activities in which Ukrnafta was involved and certain other entities were to sell gas "exclusively" to Naftogaz.

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671 Decree No. 31 of the Cabinet of Ministers of Ukraine "On amendments to Cabinet of Ministers of Ukraine Decree No. 1729 of 27 December 2001" dated 16.01.2007, last amended on 26.03.2008, 26 March 2008, **Exhibit {C-357}**.

d) Such sales to Naftogaz were to be made "at the price approved by [the NERC]".

e) This price was not to "exceed the wholesale threshold price for natural gas which it utilised for the domestic consumer excluding tariffs for transportation and supply, and a specific mark-up to the applicable tariff for natural gas".

480. As explained above, the 2007 Budget Law only applied to sales of 2007 gas, and then only to sales which were effected during the 2007 calendar year.

481. Insofar as the 2007 Budget Law did apply, its effect was that the price of Ukrnafta's 2007 gas was now a State regulated price, and it established a principle by reference to which price was to be determined or approved. However, it did not stipulate what the price was to be. Nor did it establish the procedure by which price was to be determined or approved. Instead, it contemplated that such a procedure would be established.

482. In the event, this did not happen until 22 January 2009 when the NERC issued the 2009 NERC Resolution, thereby approving the 2009 NERC Gas Pricing Procedure. They did not have retrospective effect.

483. In the meantime, the NERC did not purport to approve or itself set a price for Ukrnafta's 2007 gas. Hence there was no attempt during the 2007 calendar year to set a State regulated price for 2007 gas.

484. As pleaded above, in 2007 Ukrnafta entered into contracts pursuant to which it sold a total of 780,303,798m^3 of 2007 Own Gas to Naftogaz at a price of UAH 318.78, which was well below its Zero Profit Price.

485. In 2008, Naftogaz attempted to compel Ukrnafta to enter into a contract for the sale of further 2007 Own Gas at a price of Naftogaz's choosing, which was well below Ukrnafta's Zero Profit Price, but it was held by the Courts that Naftogaz was not

entitled to do so.[672] Ultimately no contract for the sale of further 2007 Own Gas by Ukrnafta to Naftogaz was ever concluded.

486. The basis upon which the Claimants advance their case concerning 2007 gas is set out below.

3. <u>The position in relation to 2008 gas</u>

487. Like Article 3 of the 2007 Budget Law, Article 3 of the 2008 Budget Law provided that the affected entities were to sell "all natural gas" directly to the entity authorised by the Cabinet of Ministers (i.e. Naftogaz). It further provided that these sales were to be made "at a price approved by [the NERC] for each business entity".[673] It did not contain the reference to the threshold price which Article 3 of the 2007 Budget Law had contained. However, the 2001 Cabinet Decree (as amended by the 2007 Cabinet Decree), which provided that the price was not to "exceed the wholesale threshold price for natural gas which it utilised for the domestic consumer excluding tariffs for transportation and supply, and a specific mark-up to the applicable tariff for natural gas", remained in force.

488. It was still the case that no provision had been made as to how, subject to the principle referred to in 2001 Cabinet Decree (as amended by the 2007 Cabinet Decree), the price was to be approved.

489. By NERC Resolution No 155 dated 31 January 2008[674] and NERC Resolution No 315 dated 28 February 2008,[675] the NERC purported to set prices for Ukrnafta's 2008 Own

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672 Case No. 29/192 Decision of the Commercial Court of Kiev, 3 June 2008, **Exhibit {C-50}**; Case No. 29/192 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, **Exhibit {C-53**}; Case No. 29/192 Decision of the Supreme Commercial Court of Ukraine, 11 September 2008, **Exhibit {C-54}**; Case No. 29/192 Decision of the Supreme Commercial Court of Ukraine, 6 November 2008, **Exhibit {C-55}**.

673 Law of Ukraine "On state budget for year 2008", Article 3 (extract), 28 December 2007, **Exhibit {C-348}.**

674 NERC Resolution No. 155 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 31 January 2008, **Exhibit {C-351}**.

Gas which were to apply from 1 January 2008 and 1 March 2008 respectively, stating that it was doing so in compliance with Article 3 of the 2008 Budget Law. However, the Courts first suspended those Resolutions[676] and then held them to be invalid, cancelling them from the date of their adoption. Notably, the Courts held (*inter alia*) that the applicable legislation only gave the NERC the power to *approve* prices proposed by Ukrnafta, not to *correct* them or to *set them* of its own initiative. If the NERC considered Ukrnafta's proposal to be unsatisfactory, it only had the power to refuse to approve the price, not to proceed to set a different price.[677]

490. The Courts consequently held that Naftogaz was not entitled to compel Ukrnafta to enter into contracts to sell its 2008 Own Gas to Naftogaz at the prices stipulated in NERC Resolution No 155 or NERC Resolution No 315.[678]

491. By the 2008 JIA NERC Resolutions (i.e. NERC Resolutions No 1534 to 1539) dated 25 December 2008, the NERC purported to set prices of JIA Gas produced pursuant to JIA No 410/95, JIA No 999/97, JIA No 35/809, JIA No 5/56, JIA No 35/78 and JIA No

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675 NERC Resolution No. 315 "On approval of natural gas (including petroleum (associated) gas) price for OJSC Ukrnafta for 2008", 28 February 2008, **Exhibit {C-353}**.

676 Case No. 8/137 Order of the District Administrative Court of Kiev, 14 February 2008, **Exhibit {C-28}**; Case No. 8/137 Decision of the District Administrative Court of Kiev, 12 March 2008, **Exhibit {C-30}**.

677 Case No. 8/137 of the District Administrative Court of Kiev - Ukrnafta Statement of Claim Letter No. yur-179, 8 February 2008, **Exhibit {C-27}**; Case No. 8/137 Order of the District Administrative Court of Kiev, 14 February 2008, **Exhibit {C-28}.**

678 Case No. 29/193 Naftogaz Statement of Claim Letter No. 14/2-22, 21 April 2008, **Exhibit {C-56}**; Case No. 29/193 Decision of the Commercial Court of Kiev, 22 May 2008, **Exhibit {C-57}**; Case No. 29/193 Decision of the Commercial Court of Kiev, 11 December 2013, **Exhibit {C-59};** Case No. 29/193 Decision of the Commercial Court of Appeal of Kiev, 5 March 2014, **Exhibit {C-60};** Case No. 29/193 Decision of the Supreme Court of Ukraine, 8 April 2014, **Exhibit {C-61};** Case No. 29/195 - Naftogaz Statement of Claim Letter No. 14/2-23, 21 April 2008, **Exhibit {C-61}**; Case No. 29/195 – Ukrnafta Statement of Defence Letter No. yur-683, 12 May 2008, **Exhibit {C-62**}; Case No. 29/195 Order of the Commercial Court of Kiev, 22 May 2008, **Exhibit {C-63}**; Case No. 29/195 Order of the Commercial Court of Kiev, 26 May 2014, **Exhibit {C-64}**; Case No. 29/195 Order of the Commercial Court of Kiev, 24 April 2015, **Exhibit {C-65**}; Case No. 29/195 Decision of the Commercial Court of Kiev, 14 May 2015, **Exhibit {C-66}**.

35/71, stating that it did so pursuant to the 2008 Budget Law.[679] These NERC Resolutions were likewise held by the Courts to be invalid and cancelled from the date of their adoption.[680]

492. Accordingly, no State regulated price for either Ukrnafta's 2008 Own Gas or the 2008 JIA Gas which it produced pursuant to these JIAs was validly set while the 2008 Budget Law remained in force.

493. No contracts for the sale of 2008 Own Gas were ever concluded between Ukrnafta and Naftogaz.

494. In the course of striking down NERC Resolution No 155, NERC Resolution No 315[681] and the 2008 JIA NERC Resolutions[682] the Courts held that:

a) The NERC was obliged to comply with the conditions set out in Article 10 of the Commercial Code, Article 3 of the Law on Prices and Pricing, and Article 191(6) of the Commercial Code.

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679 Case No. 6/489 Decision of the Supreme Commercial Court of Ukraine, 24 February 2010, **Exhibit {C-91}**; Case No. 6/489 Naftogaz Appeal to the Supreme Court of Ukraine - Letter No. 14/2-27, 22 March 2010, **Exhibit {C-92}**; Case No. 6/489 Ukrtransgaz Appeal to the Supreme Court, 24 March 2010, **Exhibit {C-93}**; Case No. 6/489 Ukrnafta Response to Appeal - Letter No. yur-365, 23 December 2010, **Exhibit {C-94}**; Case No. 6/489 Ukrnafta Application No. yur-1040 to the Commercial Court of Kiev, 19 May 2011, **Exhibit {C-95}**; Summary to the Decision of the Constitutional Court of Ukraine No. 13-rp/2010 (obtained from official website on 24.03.2016), 11 May 2010, **Exhibit {C-96 Original}.**

680 Case No. 2a-713/09/2670 Order of the District Administrative Court of Kiev on initiation of administrative case proceedings, 6 February 2009, **Exhibit {C-68}**; Case No. 2a-713/09/2670 Order of the District Administrative Court of Kiev, 15 May 2009, **Exhibit {C-72}**; Case No. 2a-713/09/2670 Decision of the District Administrative Court of Kiev, 14 April 2010, **Exhibit {C-74}**; Case No. 2a-713/09/2670 Decision of the Court of Appeal of Kiev, 22 February 2011, **Exhibit {C-75}**.

681 Case No. 8/137 of the District Administrative Court of Kiev - Ukrnafta Statement of Claim Letter No. yur-179, 8 February 2008, **Exhibit {C-27}**; Case No. 8/137 Order of the District Administrative Court of Kiev, 14 February 2008, **Exhibit {C-28}.**

682 Case No. 2a-713/09/2670 Order of the District Administrative Court of Kiev on initiation of administrative case proceedings, 6 February 2009, **Exhibit {C-68}**; Case No. 2a-713/09/2670 Order of the District Administrative Court of Kiev, 15 May 2009, **Exhibit {C-72}**; Case No. 2a-713/09/2670 Decision of the District Administrative Court of Kiev, 14 April 2010, **Exhibit {C-74}**; Case No. 2a-713/09/2670 Decision of the Court of Appeal of Kiev, 22 February 2011, **Exhibit {C-75}**.

b) Article 10 of the Commercial Code obliged the NERC to seek to "secure equivalence in the process of selling the national product, observing due parity of prices among branches and types of economic activity, as well as ensuring stability of wholesale and retail prices".

c) Article 3 of the Law on Prices and Pricing obliged the NERC to seek to ensure equal economic conditions and incentives for the development of all forms of ownership, and a balanced market of means of production, goods and services; the creation of the necessary economic guarantees for producers; and orientation of the prices of the domestic market on the level of the world market.

d) Those provisions would not be complied with if the price was lower than the cost of production, because this would provide Ukrnafta with no incentive to develop its gas producing activities.

e) Article 191(6) of the Commercial Code provided that "When the set fixed prices make it impossible for the business entities to make profit, the executive authorities and local governments shall provide such business entities with grants in accordance with law". If the price set by the NERC would make it impossible for Ukrnafta to cover its costs and make a sufficient profit to cover capital investment spending, in order to be valid a Resolution would have to provide for a subsidy to cover the difference.

495. The basis upon which the Claimants advance their case concerning 2008 gas is set out below.

4. <u>The position in relation to 2009 gas</u>

496. Article 3 of the 2009 Budget Law was in the same terms as Article 3 of the 2008 Budget Law, save that it provided that the price that was to be approved by the

NERC "shall assure coverage of economically reasonable production costs and a margin".[683]

497. On 22 January 2009 the NERC passed the 2009 NERC Resolution, by which it approved the 2009 NERC Gas Pricing Procedure:[684]

a) Paragraph 1.2 of the 2009 NERC Gas Pricing Procedure explained that it was a "statutory document specifying the mechanism of formation, approval and provision of unified principles and methodological bases of price formation for natural gas".

b) Paragraph 1.4 provided that:

> "Prices calculated pursuant to this Procedure shall provide the following to natural gas-producing companies:
>
> > reimbursement of economically reasonable producing expenses for the planning period;
> >
> > earning the profit sufficient for fulfilment of the investment program (capital investment plan), separately for each natural gas field for the planning period;
> >
> > paying all the taxes, mandatory payments and budget charges pursuant to the current legislation of Ukraine."

c) Paragraph 1.5 defined a number of terms, including "Economically reasonable producing expenses for the planning period", "Estimated profit" and "Natural gas price". Paragraph 2.16 stated a pricing formula. The rest of the document made detailed provision as to what was and was not to be

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683 Law of Ukraine "On State Budget for Year 2009", Article 3 (extract), 26 December 2008, **Exhibit {C-373}.**

684 NERC Resolution No. 35 "On approval of the procedure of natural gas (including oil (associated) gas) prices formation, calculation and approval for gas-producing companies", 22 January 2009, **Exhibit {C-375}.**

included in each element of that formula, and as to the procedure which was to be followed.

498. However, the Courts held that the 2009 NERC Gas Pricing Procedure was of no legal effect vis-à-vis Ukrnafta. Consequently, various NERC Resolutions which purported to set a price for Ukrnafta's Own Gas or JIA Gas by reference to the 2009 NERC Gas Pricing Procedure were held to be invalid and cancelled from the date of their adoption.

499. The NERC did not, however, purport to issue any such Resolution in 2009.

5. The Claimants' case concerning 2007, 2008 and 2009 gas

500. The Claimants' case in relation to 2007, 2008 and 2009 gas is that the effect of the decisions of the Courts is that:[685]

a) by 1 January 2008 Ukrnafta was free to sell its 2007 gas to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer;

b) by 1 January 2009 Ukrnafta was free to sell its 2008 gas to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer; and

c) by 1 January 2010 Ukrnafta was free to sell its 2009 gas to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer.

6. The position in relation to 2010 gas produced between 1 January and 23 July 2010

501. Article 3 of the 2010 Budget Law was (relevantly) in the same terms as Article 3 of the 2009 Budget Law.[686] The 2010 Budget Law did not enter into force until 30 April 2010

685 See paragraph 475(h) above.

686 Law of Ukraine No. 2154-VI "On State Budget for Year 2010", Article 3 (extract), 27 April 2010, **Exhibit {C-399}**.

and the Courts have held that it therefore had no application to gas produced before that date.[687]

502. As noted above, the Courts have held that the July 2010 Gas Market Law only applied to gas produced after it came into force on 24 July 2010. It had no application to 2006 gas or any other gas which was produced prior to that date.[688]

503. Accordingly, the Claimants' case in relation to 2010 gas which was produced in the period from 1 January to 23 July 2010 is the same as in relation to 2007 gas, 2008 gas and 2009 gas. By 1 January 2011 Ukrnafta was free to sell this 2010 gas to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer.

504. No contracts for the sale of Own Gas produced during the period from 1 January to 24 July 2010 were concluded between Ukrnafta and Naftogaz.

7. The position in relation to 2010 gas produced between 24 July 2010 and 1 October 2015

505. On 24 July 2010, the July 2010 Gas Market Law came into effect.[689] The definition of "commercial gas" was subsequently amended on 17 June 2011.[690]

506. The July 2010 Gas Market Law was significant for two reasons:

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687 Case No. 46/480 Decision of the Commercial Court of Kiev, 18 October 2010, **Exhibit {C-100}**; Case No. 46/480 Decision of the Commercial Court of Appeal of Kiev, 9 November 2010, **Exhibit {C-101}**; Case No. 46/480 Decision of the Supreme Commercial Court of Ukraine, 20 December 2010, **Exhibit {C-102}**; Case No 42/392; Case No. 42/392 Decision of the Commercial Court of Kiev, 26 November 2010, **Exhibit {C-103}**; Case No. 42/392 Decision of the Supreme Commercial Court of Ukraine, 31 January 2011, **Exhibit {C-105}**.

688 Case No. 32/296 Decision of the Supreme Court of Ukraine, 20 September 2010, **Exhibit {C-99}**; Case No. 6/521 Decision of the Commercial Court of Kiev, 20 January 2011, **Exhibit {C-123}**; Case No. 6/521 Decision of the Commercial Court of Appeal, 14 April 2011, **Exhibit {C-124}**; Case No. 6/521 Decision of the Supreme Commercial Court of Ukraine, 19 May 2014, **Exhibit {C-125}**; Case No. 29/193 Decision of the Commercial Court of Kiev, 11 December 2013, **Exhibit {C-58}**; Case No. 29/193 Decision of the Supreme Court of Ukraine, 8 April 2014, **Exhibit {C-60**}.

689 Law of Ukraine No. 2467-VI "On Principles of Natural Gas Market Operation", 8 July 2010, **Exhibit {C-409**}.

690 Law of Ukraine No. 3550-VI "On amendments to the Law of Ukraine 'On the formation of the functioning of the natural gas market'", 17 June 2011, **Exhibit {C-446}.**

a) First, whereas annual Budget Laws only had effect from 1 January to 31 December of the year in question (see above), the July 2010 Gas Market Law was not a Budget Law, and was therefore capable of affecting the position in relation to the sale of Ukrnafta's gas from the moment at which it came into force until the moment at which it ceased to be in force.

b) Secondly, whereas previous legislation had provided that the affected entities were to sell all of their gas to the authorised entity (Naftogaz) at a price to be approved by the NERC, Article 10(1) of the July 2010 Gas Market Law provided that they were to do so at a price to be "established" by the NERC for each entity, on an annual basis, and "in accordance with the Procedure for constituting, calculating and setting natural gas prices … approved by" the NERC.

507. The July 2010 Gas Market Law ceased to have effect on 1 October 2015, when the 2015 Gas Market Law came into effect (see below).

508. On 21 June 2012 the 2012 Law on Prices and Price Formation was passed:[691]

a) Article 12(2) provided that State regulated prices "shall be economically justified" in the sense that they shall ensure conformity between (on the one hand) the price and (on the other hand) the costs of production, the costs of sale and profit from sale.

b) Article 15(1) provided that the Cabinet, executive bodies and local authorities which established State regulated prices at a level which was lower than the "economically viable rate" were to reimburse the seller in respect of the difference between the price and the economically viable rate. Article 15(2) provided that establishment by those bodies of a State regulated price which was lower than the economically viable rate without the source for the

691 Law of Ukraine No. 5007-VI "On prices and pricing" dated 21.06.2012, last amended on 2.06.2015, 2 June 2015, **Exhibit {C-561**}.

reimbursement being identified was prohibited and could be challenged in court.

509. Relevantly, the Courts have held that:

a) The effect of Article 10 of the July 2010 Gas Market Law was that Ukrnafta was obliged to sell all of its gas to Naftogaz at a price to be determined by the NERC, on an annual basis (i.e. the NERC would set a price for 2010 gas, and then a price for 2011 gas and so on), and in accordance with a procedure, approved by the NERC, for forming, calculating and approving price. The effect of Article 3 of the 2010 Budget Law was that the price had to include economic costs incurred at production level and a profit margin. By virtue of those pieces of legislation, the price of gas was a State regulated price. In particular, it was a fixed price. Article 191(6) of the Commercial Code was therefore applicable: if the State regulated price made it impossible for Ukrnafta to make a profit, it had to be paid a subsidy.[692]

b) The effect of Article 10 of the July 2010 Gas Market Law was that the purchase price of gas produced by the affected entities was a State regulated price. The effect of Article 191 of the Commercial Code was that State regulation of prices was to be carried out pursuant to the 2012 Law On Prices and Price Formation. The effect of Article 12 of that Law was that State regulated prices had to be set at an economically justified level. This meant that the price had to allow the seller to recover its costs of production and sale, and earn a profit. The effect of Article 15(2) of that Law was that it was not permissible to set State regulated prices at a level that was lower than the economically justified amount without providing for reimbursement of the difference between the

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692 Case No. 2a-899/11/2670 Decision of the Administrative Court of Kiev, 26 December 2011, **Exhibit {C-116}**; Case No. 2a-899/11/2670 Decision of the Administrative Court of Appeal of Kiev, 17 May 2012, **Exhibit {C-117**}; Case No. K-34110/12 (Case No. 2a-899/11/2670) Order of the Supreme Administrative Court, 12 July 2012, **Exhibit {C-118**}.

price and the economically justified amount and indicating the budgetary source of the funds from which the reimbursement was to be made.[693]

c) The 2012 NESR Gas Pricing Procedure provided that price must cover economically justified production costs, a profit sufficient to support an investment programme, and payment of all taxes and fees payable under current Ukrainian law. It further provided that the calculation was to be based on the full net cost of gas, profit tax, VAT and a profit margin. Although the 2012 NESR Gas Pricing Procedure was invalid for other reasons, in that respect at least it was consistent with the 2012 Law on Prices and Price Formation.[694]

510. On 26 November 2014 the Cabinet of Ministers issued the November 2014 Cabinet Decree.[695] It is unnecessary to consider its effect because it was subsequently declared by the Courts to be null and void from the moment of its adoption.[696]

511. Between 24 July 2010 and 1 October 2015, the NERC and its successor entities (the NESR and the NEPURC) issued a series of Resolutions which purported to establish the price for Ukrnafta's Own Gas. However, each such Resolution was held by the

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693 Case No. K/800/45461/14 (Case No. 2a-4029/12/2670) Order of the Supreme Administrative Court of Ukraine, 7 October 2014, **Exhibit {C-196}** (second series); Case No. 826/4350/13-a Decision of the Administrative Court of Kiev, 29 October 2013, **Exhibit {C-224}**; Case No. 826/4350/13-a Decision of the Kiev Administrative Court of Appeal, 15 January 2014, **Exhibit {C-226}**; Case No. K/800/5575/14 (Case No. 826/4350/13-a) Decision of the Supreme Administrative Court, 14 May 2014, **Exhibit {C-227}**; Case No. 826/6130/13-a Decision of the Kiev Administrative Court of Appeal, 26 November 2014, **Exhibit {C-251}**; Case No. 826/6130/13-a (K/800/63990/14) Decision of Supreme Administrative Court, 5 March 2015, **Exhibit {C-251}**; Case No. 826/9050/14 Decision of the Kiev District Administrative Court, 10 April 2015, **Exhibit {C-277}**.

694 Case No. 826/6130/13-a Decision of the Kiev Administrative Court of Appeal, 26 November 2014, **Exhibit {C-251**}; Case No. 826/6130/13-a (K/800/63990/14) Decision of Supreme Administrative Court, 5 March 2015, **Exhibit {C-251**}.

695 Decree No. 647 of the Cabinet of Ministers of Ukraine "On natural gas purchasing procedures for industrial, power generating and thermal generating facilities", 26 November 2014, **Exhibit {C-525}**.

696 Case No. 826/17772/14 - Decision of the Kiev District Administrative Court, 16 December 2014, **Exhibit {C-285**}; Case No. 826/17772/14 - Decision of the Kiev Administrative Court of Appeal, 5 February 2015, **Exhibit {C-286}.**

Courts to be invalid and cancelled from the date of its adoption. Accordingly, at no stage during this period of more than 5 years was a State regulated price for Ukrnafta's Own Gas validly set.

512. Each such Resolution was purportedly adopted pursuant to the original 2009 NERC Gas Pricing Procedure (approved by the 2009 NERC Resolution), the amended 2009 NERC Gas Pricing Procedure (as amended by the 2011 NERC Resolution on 10 February 2011),[697] or the 2012 NESR Gas Pricing Procedure (approved by the September 2012 NESR Resolution).[698] However, these were all struck down by the Courts or held to be of no legal effect vis-à-vis Ukrnafta.[699]

513. The relevant Resolutions concerning Own Gas and the cases in which they were held to be invalid or ineffective were as follows:

a) July 2010 NERC Resolution:[700] 27 July 2010.[701]

b) NESR Resolution 255:[702] 29 December 2011.

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697 Case No. 35/63 Naftogaz Response Letter No. 14/2-393, 31 March 2011, **Exhibit {C-159}**.

698 NESR Resolution No. 1177 "On approval of the procedure of natural gas prices formation, calculation and fixation for gas-producing companies", 13 September 2012, **Exhibit {C-475}**.

699 Case No. K/9991/37707/12 (Case No. 2a-11259/11/2670) Decision by the Supreme Administrative Court of Ukraine, 3 April 2014, **Exhibit {C-175}**; Case No. 826/6130/13-a Decision of the Kiev Administrative Court of Appeal, 26 November 2014, **Exhibit {C-251}**; Case No. 826/6130/13-a (K/800/63990/14) Decision of Supreme Administrative Court, 5 March 2015, **Exhibit {C-252}**.

700 NERC Resolution No. 889 "On approval of the price for commercial natural gas for OJSC Ukrnafta", 27 July 2010, **Exhibit {C-413**}.

701 Case No. 2a-899/11/2670 Decision of the Administrative Court of Kiev, 26 December 2011, **Exhibit {C-116}**; Case No. 2a-899/11/2670 Decision of the Administrative Court of Appeal of Kiev, 17 May 2012, **Exhibit {C-117};** Case No. K-34110/12 (Case No. 2a-899/11/2670) Order of the Supreme Administrative Court, 12 July 2012, **Exhibit {C-118**}; Case No. 2a-10541/12/2670 Decision of the Administrative Court of Kiev, 29 April 2014, **Exhibit {C-213**}; Case No. 2a-10541/12/2670 Decision of the Administrative Court of Appeal of Kiev, 22 July 2014, **Exhibit {C-214**}; Case No. K/800/445320003/14 (2a-10541/12/2670) Decision of the Supreme Administrative Court, 15 August 2014, **Exhibit {C-215**}; Case No. K/800/45003/14 (2a-10541/12/2670) Decision of the Supreme Administrative Court, 22 August 2014, **Exhibit {C-216}**.

c) December 2012 NESR Resolution:[703] 27 December 2012.[704]

d) December 2013 NESR Resolution:[705] 30 December 2013.[706]

514. No contracts for the sale of Own Gas produced during the period from 1 July 2010 to 1 October 2015 were concluded between Ukrnafta and Naftogaz. In relation to the relevant volumes of gas which were produced (or would, in the But For World, have been produced) between 24 July 2010 and 1 October 2015, the Claimants' case is that, because (1) a State regulated price was not validly set for this gas during the period when the July 2010 Gas Market Law was in force, and (2) the Courts have held that, even if the NERC had the power to set the price of gas which was produced in a particular year, it could only exercise that right in the year in question (see paragraph 474.g) above), their claims should be quantified on the basis that Ukrnafta was free to sell gas produced in a particular year to any third party to whom it wished to sell, at a Free Price to be agreed with the buyer, as of 1 January of the following year.

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702 NESR Resolution No. 255 "On setting of price for equity commercial natural gas for PJSC Ukrnafta", 29 December 2011, **Exhibit {C-457}**. See: Case No. 2a-3293/12/2670 Decision of the Kiev Administrative Court of Appeal, 12 December 2013, **Exhibit {C-238}**; Case No. 2a-3293/12/2670 Decision of the Supreme Administrative Court of Ukraine, 23 January 2014, **Exhibit {C-239}**; Case No. 2a-3293/12/2670 Decision of the District Administrative Court of Kiev, 14 May 2014, **Exhibit {C-2014}**; Case No. 2a-3293/12/2670 Decision of the Administrative Court of Appeal of Kiev, 4 September 2014, **Exhibit {C-241}**; Case Numbers K800/50026/14, K800/50049/14 and K800/50313/14 (Case No. 2a-3293/12/2670) Decision by the Supreme Administrative Court of Ukraine, 11 December 2014, **Exhibit {C-242}**.

703 NESR Resolution No. 1832 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 27 December 2012, **Exhibit {C-481}**.

704 Case No. 826/4350/13-a Decision of the Administrative Court of Kiev, 29 October 2013, **Exhibit {C-224}**; Case No. 826/4350/13-a Decision of the Kiev Administrative Court of Appeal, 15 January 2014, **Exhibit {C-226}**; Case No. K/800/5575/14 (Case No. 826/4350/13-a) Decision of the Supreme Administrative Court, 14 May 2014, **Exhibit {C-227**}.

705 NESR Resolution No. 1853 "On price fixation for saleable natural gas of equity production for PJSC Ukrnafta", 30 December 2013, **Exhibit {C-502**}.

706 Case No. 826/9050/14 Decision of the Kiev District Administrative Court, 10 April 2015, **Exhibit {C-277**}.

8. The position in relation to 2015 gas produced after 1 October 2015

515. The 2015 Gas Market Law was passed on 9 April 2015 and, has been mentioned, came into effect on 1 October 2015, whereupon the July 2010 Gas Market Law ceased to have effect.[707]

516. The effect of the 2015 Gas Market Law is that Ukrnafta is entitled to sell its gas to any third party to whom it wishes to sell, at a Free Price to be agreed with the buyer, whenever it wishes to do so. That is the basis upon which the Claimants advance their case in respect of this gas.

[707] Case No. 29/192 Decision of the Commercial Court of Appeal of Kiev, 7 July 2008, **Exhibit {C-53}**.

VI. PRAYER FOR RELIEF

517. The Claimants request that the Tribunal:

a) declare it has jurisdiction to determine this dispute;

b) declare the Respondent has breached Articles 10(1), 10(12), 11(2) and 13 of the ECT; and

c) order the Respondent pay the Claimants US$4.674 billion in reparation for its breach of the ECT, that sum comprising:

- US$2.063 billion in respect of the Loss of Dividends Claim;
- US$932.3 million in respect of the Pre-Award Interest Claim; and
- US$1.679 billion in respect of the Loss of Value Claim;

d) order the Respondent pay the Claimants post-award interest on the sum awarded pursuant to prayer (c), calculated at the same rate and on the same basis as in the Pre-Award Interest Claim; and

e) order the Respondent pay the Claimants' costs associated with this arbitration.