Plans to create a Europe that is wholly free from Russian oil and gas

Remarks by Yuriy Vitrenko, CEO, Naftogaz Ukraine
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Dear Mr. Chairman and Honorable Members of the Commission:

Thank you very much for inviting me to share my views on this important and timely topic. Before I turn to the subject, I would like to thank President Joe Biden and the bi-partisan support in the US Congress for America's unwavering commitment to Ukrainian independence and its territorial integrity. As well, the Ukrainian people are very thankful for the political, military, economic and humanitarian support given to us during Russia's unlawful invasions of Ukraine in 2014 and in 2021.

The European Union has developed a rather comprehensive plan to eliminate its critical dependance on Russian oil and gas – titled REPowerEU. It stops short of making Europe wholly free from the Russian Federation, but from the Ukrainian perspective, it is not the biggest problem with this plan.

The biggest problem is that this plan allows Russia to continue enjoying enormous profits from exports of oil and gas to Europe, at least in the short run. Even though volumes of exports are falling because of the EU's actions, record high global prices more than compensate for the volume decreases, and thereby Putin's regime is now receiving more money than it did, for example, last year.

Naftogaz of Ukraine together with the Gas Transmission System Operator of Ukraine submitted to the European Commission our detailed proposal addressing this and other problems. Some our suggestions were considered, but not all.

We continue a constructive dialog with the European Commission, and hope that it will soon consider the following suggestions from our side:

- Implementing sanctions against Nord Stream 1;
- fighting abuse of market dominance by Gazprom, in particular making Gazprom unblock flows of natural gas from Central Asia and transfer the gas entry points to the Ukrainian-Russian border;
- specific storage obligations for European importers of Russian gas.

I would also mention that this plan could benefit from a stimulus to increase supplies from the Middle East in the short-term in return for a long-term security of demand of carbon-neutral oil and gas; endorsement and even EU funding of new upstream projects outside Russia subject to "net zero" conditions; measures to decrease demand in the spot market through regulation of pricing structures for households.

A plan to create a Europe that is wholly free from Russian oil and gas should be indeed a very comprehensive set of measures to increase energy efficiency; to promote radical electrification of heating and mobility sectors; to facilitate transition to hydrogen as a universal carrier of decarbonized energy from competing sources, including decarbonized oil and gas (through Carbon Capture).

Importance of a robust energy embargo for starving the Russian war machine.

I am a member of the international working group on sanctions on Russia headed by Andriy Yermak, Head of the Office of the President of Ukraine, and Ambassador Michael McFaul, Director of the Freeman Spogli Institute for International Studies (FSI). We recently presented The Energy Sanctions Roadmap: Recommendations on Sanctions on the Russian Federation (https://drive.google.com/file/d/1FP3R-jMvO5zw5Jin8L8LTWqRLAQIhbgJ/view).

Following the presentation of the Action Plan on tightening sanctions on Russia, we continued our work and prepared a document detailing energy sanctions, helping governments and companies around the world formulate proposals for sanctions on Russia. The application of energy sanctions should increase the cost of invading Ukraine for Russia and help the Ukrainian state protect its territorial integrity, freedom and democratic values.

We point out that Russia's budget is based on revenues from the sale of energy, primarily to European countries. Since February 24, the European Union has paid about US$800 million daily for Russian oil and gas imports.

The document contains recommendations for political action that will help deprive Russia of this income while minimizing disruptions in markets and the world economy. The expert group supports the decision of the European Commission to impose a total ban on imports of all Russian oil, and substantiates the gradual embargo on gas imports from Russia. In addition, experts provide suggestions, including specific mechanisms, on how to ensure the managed phased implementation of such a ban, while minimizing profits from Russian oil exports during the transition period. Such mechanisms may be considered a priority by individual countries. The case is about a regulated import tax (or tariff) and keeping funds for energy in a special escrow account.

Particular attention has been paid to additional sanctions to prevent circumvention of restrictions imposed on the energy sector. In particular, these are targeted sanctions against maritime export service providers bypassing the controlled sales regime.

In addition, the roadmap proposes the strategy to prevent the consequences, which makes Europe independent of Russian energy and counters the use of energy resources as weapons.

The document also emphasizes the importance of disconnecting Russia from financial flows from gas exports, as Europe pays Russia much more for gas than it does for oil during the war.

The expert group emphasizes that the European embargo on Russian energy should be part of a coordinated strategy between the EU and the United States, which will include synchronous diplomatic steps and cooperation with stakeholders in the private sector.

Unfortunately, so far not all recommendations of the expert group have been implemented. Further to the developing debates about risks and benefits of different options for the sanctions, I would suggest considering a new, or slightly modified, option of a “transfer cap,” whereby: financial sanctions that would allow transfers of payments from European off-takers (of oil and gas sold by Russian companies) to Russia only within a defined cap (per barrel of oil, per Megawatt hour of natural gas, etc). The difference between the full amount paid by off-takers (presumably they will pay according to prices specified in their contracts for purchases of Russian oil and gas) and money transferred to Russia (within the “transfer cap”) will be frozen until Russia withdraws from Ukraine and pays reparations. The “transfer cap” should be set at a level that covers opportunity costs for Russian producers, and this level is expected to be times lower than contract (market) prices. As a result of the transfer cap, Putin’s war machine will be starved, Russia will have a clear motivation to stop the war and compensate damages, while market disruptions will be prevented. In fact, we might see market trends opposite to current trends yet positive for Ukraine and the Free World as a whole: Russia will have to supply more to global markets while getting times less money than now because of the “transfer cap”; besides market prices will decrease due to increased supply.

Options to ensure that Ukraine’s energy needs are met

Natural gas is an energy source for heating about 90% of Ukrainian households. Winters in Ukraine are rather cold and long, thus security of supply of natural gas is critical. I would also add that natural gas is now being used as a backup source for coal fired power plants because coal supply logistics have been broken due to the war.

Ukraine plans to import up to 6 bcm of natural gas for the next heating season (starts in mid-October 2022 through April 2023). Based on current market prices that import is worth up to US$8 billion. Due to the war, Ukraine will need assistance from its international partners to finance these natural gas purchases. Basically, similar to food, water and medicines, gas and heating is a humanitarian need for Ukrainian households that will require international assistance and Naftogaz has started consultations with the US government on potential options. In particular, we are discussing export financing and political insurance for supplies of the US LNG to Ukraine, as well as making supplies of US LNG a part of the land-lease program.

What would also enhance energy security of Ukraine, as well as our Eastern European partners such as Slovakia and Poland? EU implemtation of sanctions against the Nord Stream 1 (NS1) pipeline.

If we look at beyond the next heating season, options to ensure that Ukraine’s energy needs are met include investments into domestic production of gas and oil, where Ukraine has a great potential; investments into transition from natural gas to bio/geothermal energy in heating; investments into electrification; investments into energy efficiency across the value chain; market reforms to drive efficiency and fight corruption.

Alternative sources of energy for Europe

In addition to sources of energy mentioned by me when discussing plans to create a Europe that is wholly free from Russian oil and gas, I would also mention the following potential alternative sources of energy for Europe:

- US LNG; there is still a potential to increase exports of the US LNG;
- Canadian LNG, in particular, from Quebec;
- Natural gas from Kurdistan;
- Exports of electricity from Ukraine; we are still waiting for the EU to allow Ukraine to start electricity exports from our nuclear power plants; it could save up to 10 bcma of natural gas consumed in the EU for power generation;
- Exports of natural gas and hydrogen from Ukraine (in 2-5 years perspective subject to investments and technology partners).