

TO: Mr Volodymyr Vasylyovych Demchyshyn
Minister of Energy and Coal Industry of Ukraine
30, Khreshchatyk str., Kyiv, Ukraine 01601

31 December 2014

Dear Sirs

Re: Notification of Dispute Under the Energy Charter Treaty

We write to notify you pursuant to Article 26(2) of the Energy Charter Treaty (the *ECT*) of a dispute between Littop Enterprises Limited, Bridgemont Ventures Limited and Bordo Management Limited (together, the *Investors*) and the State of Ukraine and its instrumentalities (*Ukraine*). The Investors are each a company incorporated in Cyprus. OJSC Ukrnafta (*UKN*) is a company incorporated under the laws of Ukraine. The Investors each own shares in UKN (the *Investments*).

UKN is one of the largest producers of natural gas in Ukraine.

The dispute arises out of actions by Ukraine in breach of its obligations under the ECT, including but not limited to its commitments under Part III of the ECT. We set out below a brief summary of Ukraine's actions, the applicable provisions of the ECT, and propose a way forward to resolve these disputes amicably.

1. Actions by Ukraine

Since 2006, UKN has been the subject of persistent and damaging interference in its operations by Ukraine. UKN has been subjected to repeated unlawful and unjustifiable attempts to force it to sell its natural gas at a significantly depressed price, which is below the cost of production, and has been impeded in its ability to sell its natural gas on the open market. Moreover, instrumentalities of Ukraine have misappropriated or expropriated substantial amounts of natural gas belonging to UKN.

1.1 2006 – 2014 - Repeated attempts to force the sale of gas at a price below UKN's production costs

Under Ukrainian law the sale price of natural gas by UKN cannot be fixed below UKN's production costs. Despite this, the Ukrainian National Commission for State Energy and Public Utilities Regulation Regulating Energy (*NKRE*) and NJSC Naftogaz Ukrainy (*NAK*), a company wholly owned by the Ukrainian State, have persistently sought to fix the sale price of natural gas below this threshold.

This has been the subject of a number of court proceedings between NAK and NKRE on one hand, and UKN on the other hand, including but not limited to:

- (i) Case No 18/228 in relation to gas produced in 2006;
- (ii) Case No 29/192 in relation to gas produced in 2007;

- (iii) Case No 29/193 in relation to gas produced in 2008;
- (iv) Case No 31/101 in relation to gas produced in 2010;
- (v) Case No 8/88 in relation to gas produced in 2011;
- (vi) Case No 2a – 899/11/2670 in relation to NKRE Regulations purporting to govern the price of gas produced in 2010 and 2011;
- (vii) Case No 5011-69/9686-2012 in relation to gas produced in 2012;
- (viii) Case No 2a – 3293/12/2670 in relation to NKRE Regulations purporting to govern the price of gas produced in 2012;
- (ix) Case No 910/5082/13 in relation to gas produced in 2013;
- (x) Case No 826/4350/13-a in relation to NKRE Regulations purporting to govern the price of gas produced in 2013;
- (xi) Case No 910/15003/14 in relation to gas produced in 2014.

As regards cases (i) – (iii) above, they were brought by NAK and in each of these cases the Ukrainian Courts have invalidated the pricing structure imposed on UKN.

As regards cases (iv) and (v), those cases were again brought by NAK, but they were stayed pending the outcome of case (vi) which was an Ukrainian Administrative Court challenge to the NKRE Regulations setting prices. Similarly, cases (vii) and (ix) were brought by NAK but they were stayed pending the outcome of cases (viii) and (x) which were Ukrainian Administrative Court challenges to the NKRE Regulations setting prices. In essence, cases (vi), (viii) and (x) determined that the relevant NKRE Regulations setting prices were invalid, inter alia, because the price set was below UKN's production costs for natural gas.

Nevertheless, NKRE and NAK have failed to comply with these decisions and have continued to try to impose natural gas prices below production costs in each subsequent period, requiring UKN to incur significant legal and other costs to challenge these attempts every year and causing serious disruption to UKN's ability to operate its business.

In addition, NKRE has produced successive regulations dealing with information gathering procedures via which NKRE arrives at the prices it sets for natural gas. Those regulations have also been successfully challenged by UKN (case No 2a-11259/11/2670 and case No 826/6130/13-a).

1.2 2006 – July 2010 – UKN has been Unlawfully Prevented from Selling Surplus Natural Gas on the Open Market

In the period 2006 – 2007, pursuant to annual Laws on State Budget promulgated by the Ukrainian Parliament, UKN was obliged to sell gas it produced during the relevant 12 month period to an entity authorised by the Ukrainian Cabinet of Ministers (which was NAK). In both 2006 and 2007 there remained gas that was produced in that relevant year that had not been sold to NAK ("surplus" gas).

On 19 May 2014, the Ukrainian Supreme Commercial Court in Case No 6/521 confirmed that:

- UKN was entitled to sell surplus gas produced in 2006 on the open market.
- Subsequent legislation in 2008 and 2010 did not apply to this gas.

This decision is applicable by analogy to surplus gas produced in the period 2007 – July 2010 (in addition to the 2006 year with which it was concerned), albeit that Laws on State Budget from 2008 onwards differ as explained in the next paragraph.

In 2008 the Law on State Budget applicable to gas produced in 2008 provided that NKRE would approve the price of gas sold that year to an entity authorised by the Ukrainian Cabinet of Ministers (which was NAK). There remains surplus gas produced, but not sold, in 2008. The Regulations issued by NKRE which purported to approve the gas price in 2008 have been the subject of proceedings brought by UKN in the Ukrainian Administrative Court which seek an order that those Regulations are void because they are contrary to Ukrainian law (case 8/137). On 9 March 2010 the Ukrainian Supreme Administrative Court confirmed that those Regulations were indeed unlawful and invalid from the date that they were adopted.

A consistent approach has been taken for subsequent years by the Ukrainian Administrative Courts in cases listed at (vi), (viii) and (x) above.

The effect of these decisions in short is that the Ukrainian Courts have established that UKN was free to sell on the open market surplus gas produced in the period 2006 – July 2010, and that the NKRE Regulations purporting to govern prices of gas each year are unlawful and void.

However, UKN has been prevented from exercising its rights as confirmed by court decisions described above by NAK and NKRE, without legal basis and despite the final and binding nature of those court decisions in favour of UKN. Instead, NAK and NKRE have either expropriated UKN's gas (on which see below) or have attempted to force UKN to sell its surplus natural gas at a price below the open market price.

1.3 2006-2010 – Misappropriation/Expropriation of Gas Belonging to UKN

For each year from 2006 to July 2010, any surplus of natural gas produced by UKN and not sold that year has been stored by Ukrtransgas (UTZ), a Ukrainian company which is a wholly owned subsidiary of NAK. The surplus gas was stored in the Single Gas Transportation System of Ukraine (the SGTS) or in underground gas storage facilities, both of which are operated by UTZ. Under Ukrainian law, the stored surplus gas is the property of UKN, which is allowed to sell this surplus gas on the open market.

Despite this, with the exception of certain gas produced in 2009 and 2010 as to which NAK/UTZ have complied with the effect of court decisions permitting gas to be sold, NAK and UTZ have prevented UKN from selling its surplus natural gas on the open market and have refused to release it to UKN, alleging that:

- (i) the surplus gas does not exist;
- (ii) because UKN had not entered into a formal contract with UTZ, UKN has no proprietary interest in any natural gas held by UTZ;
- (iii) even if surplus natural gas belonging to UKN was held by UTZ, UKN cannot sell it on the open market, and must instead sell it to NAK at a price imposed by the NKRE.

Each of these arguments finds no basis in Ukrainian law and is in breach of specific decisions by the Ukrainian courts confirming UKN's entitlement to the natural gas. For example, in Case 6/521, the Ukrainian court confirmed that the surplus natural gas existed, and validated UKN's proprietary interest in the stored natural gas for 2006. The same Ukrainian court also concluded that UKN could sell the natural gas on the open market. NAK and UTZ have to date failed and refused to comply with the court decision.

Enforcement proceedings following case 6/521 (cases number 44193183 and 44193147) have been unsuccessfully challenged by NAK on spurious grounds both at first instance and in the Kiev Commercial Court of Appeal. For example, NAK sought to argue that the enforcement proceedings requested enforcement where NAK was registered and not where the gas itself was located in underground storage (the location of the underground storage facilities is not known to UKN or the state enforcement office). NAK's argument in this regard was dismissed. However, notwithstanding its unsuccessful challenge, NAK has launched fresh proceedings in Kiev Commercial Court on 4 November 2014 again seeking to avoid enforcement of the decision of the Supreme Court of Ukraine in case 6/521 on yet further grounds. NAK's stance as to this enforcement particularly inexplicable given that it did not obstruct the sale of certain gas produced in 2009 and 2010 in compliance with court orders. NAK's actions appear to lack any reasonable basis.

Further, we highlight that after the Court of Appeal decision in case 6/521 UTZ issued its own claim against UKN seeking a declaration that UKN had no title in precisely the same gas at issue in case 6/521. UKN won that case, the Supreme Commercial Court of Ukraine making a final order rejecting UTZ's claim on 7 November 2012 (case 5011-35/4141-2012).

2. Breaches of the ECT

The ECT applies to the Investors and their Investments in Ukraine because:

- (i) The Investors are nationals of Cyprus.
- (ii) Both Ukraine and Cyprus have ratified the ECT.¹
- (iii) The ECT protects every kind of asset, owned or controlled directly or indirectly by an investor in, inter alia, "tangible and intangible, and movable and immovable property", "shares, stock, or other forms of equity participation in a company or business enterprise", and "claims to money and claims to performance pursuant to contract having an economic value".²
- (iv) The Investors' shares in UKN (inter alia) are Investments for the purposes of the ECT.

As a consequence, Ukraine is under an obligation to provide the Investors with the protections set out in Part III of the ECT, including but not limited to Ukraine's commitment:

- (i) to accord at all time fair and equitable treatment to foreign investments (Art 10(1));
- (ii) to provide foreign investments most constant protection and security (Art 10(1));
- (iii) not to impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments (Art 10(1));
- (iv) to observe any obligations it has entered into with foreign investors (Art 10(1));
- (v) to accord foreign investments "most favoured treatment" (Art 10(3));
- (vi) to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to foreign investments (Art 10(12)); and

¹ Ukraine ratified the ECT on 29 October 1998, and it entered into force on 27 January 1999. Cyprus ratified the ECT on 16 January 1998, and it entered into force on 16 April 1998.

² ECT, Article 1(6).

- (vii) not to expropriate, or subject to measures with equivalent effect, foreign investments (Art 13).

In addition, under Art 22 of the ECT Ukraine is under an obligation to ensure that its State enterprises shall conduct their activities in relation to the sale or provision of goods and services, and any entity entrusted with regulatory, administrative or governmental authority shall exercise its authority, in a manner consistent with Ukraine's obligations under Part III of the ECT.

All the described steps taken by NAK and its subsidiaries are reflective of the stance taken by Ukraine on this matter and clearly demonstrate numerous breaches by Ukraine and its instrumentalities of the above mentioned obligations.

NAK is a 100% state-owned entity. According to the Regulation N.747 of 25 May 1998 "On the creation of the National Joint Stock Company "Naftogaz Ukrainy", the sole shareholder of NAK is the Cabinet of Ministers of Ukraine. The function of the highest governing body of NAK rests with the Ministry of Energy and Coal Industry of Ukraine which is again determinative of the stance taken by NAK (and by extension Ukraine) in relation to the gas belonging to UKN.

We have sufficient grounds to believe that all acts and decisions by the representatives of NAK in connection with the gas belonging to UKN are dictated and controlled directly by the members of the Cabinet of Ministers of Ukraine through written instructions and through direct contact (including by telephone through the so-called "telephone justice") with the management of NAK. This is further reconfirmed by the ongoing failure to enforce the decision of the Ukrainian Supreme Commercial Court in Case No 6/521, notwithstanding the fact that the enforcement proceedings and all necessary actions had been initiated back in July 2014. It is exactly this type of obedience to the direct instructions from the government of Ukraine that guarantees "immunity" to the top management of NAK against any investigation by the law enforcement agencies of Ukraine. The law enforcement agencies are not even attempting to hold the top management of NAK to account for the wilful contempt of the court's decision in case No 6/521.

Furthermore, through its efforts to frustrate the enforcement of the court order in case No 6/521, Ukraine (acting through NAK) is causing further loss to UKN and its shareholders. UKN's inability to obtain and sell its gas (notwithstanding direct confirmation by Ukrainian courts of UKN's right to do so) resulted in cash flow deficit which in turn led to UKN being unable to fully comply with its tax payment obligations. This in turn led to substantial financial penalties being imposed on UKN by the tax authorities from August 2014. The amount of imposed penalties is so significant that it puts under question the ongoing viability of UKN as a going concern. UKN however would have been able to fully meet its tax obligations had it been allowed to sell even as little as 20 percent of the gas that it was entitled to obtain and sell.

We are therefore convinced that the government of Ukraine consciously blocks the ability of UKN to use UKN's own assets and at the same time (through its control of the tax authorities) imposes further financial sanctions on UKN.

By its actions in relation to the investments as outlined above, Ukraine has breached each of the commitments set out above, and has caused the Investors and UKN substantial losses which exceed 5 billion US dollars. The Investors seek compensation for those losses as well as guarantees that Ukraine will comply with its obligations under Ukrainian law and the ECT henceforth.

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3. Amicable Settlement


Under Article 26(1) of the ECT, disputes between investors and contracting parties should be settled amicably so far as possible. For this purpose representatives of the Investors are available to meet with representatives of Ukraine whenever convenient to Ukraine. If this dispute cannot be settled within three (3) months of the date of this letter, the Investors intend to submit this dispute to international arbitration as provided by Article 26(2) of the ECT.

The Investors continue to analyse their treatment by Ukraine with their advisors and reserve the right to supplement or amend the details provided above in any future Request for Arbitration, should this become necessary.

Yours faithfully,


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