

Title of meeting: Cabinet

Date of meeting: 21st June 2022

Subject: Corporate Gas Contract

Report by: James Hill - Director for Housing, Neighbourhood and Building Services

Author: Andrew Waggott, Head of Energy Services

Wards affected: All

Key decision: No

Full Council decision: No

1. Purpose of report

- 1.1 To update Cabinet as to the changes in structure of Gazprom Marketing and Trading Limited ("Gazprom M&T") trading as Gazprom Energy and the control of their parent company, Gazprom Germania, since the Cabinet decision in March 2022.
- 1.2 To provide context, evidence and reassurance that conditions have significantly changed since March 2022, and that further, positive developments are likely in the coming weeks and months.
- 1.3 To provide evidence that Gazprom M&T, nor its parent company Gazprom Germania, are directly buying Russian gas.
- 1.4 To show that many of the risks associated with terminating the existing corporate gas contract ("the Contract") highlighted in the report to Cabinet in March 2022 (Appendix A of this report), remain.
- 1.5 In light of these changes to approve recommendations which amends the decision made by Cabinet in March 2022, which instructed officers to terminate the contract with Gazprom M&T.

2. Recommendations

It is recommended that the Cabinet:



- 2.1 Consider the content of this report, particularly the breakage of the link between Gazprom M&T with the Russian state, which was made by the change in ownership of the single shareholder; from the Russian Federation to Gazprom Germania on the 4th April 2022.
- 2.2 Notes the change in control of Gazprom Germania, the parent company and single shareholder of Gazprom M&T, enacted by the German Government resulting in Gazprom Germania being under the control of the German Federal Network Agency 4th April 2022.
- 2.3 Cabinet notes that Gazprom M&T are not placing direct orders for Russian gas.
- 2.4 Cabinet notes that Gazprom Germania is not directly placing orders for Russian gas and is prevented from doing so, should it wish to, by Russian sanctions.
- 2.5 Cabinet notes the financial and legal risk, detailed within this paper and the paper of March 2022, associated with terminating the Contract in June 2022.
- 2.6 Cabinet instructs officers in light of the changed circumstances not to terminate the Contract with Gazprom M&T on or before the 30th June 2022, in line with the contract conditions.

3. Background

3.2 Previous Cabinet Decision - 22nd March

- 3.2.1 On 22nd March 2022, the Cabinet agreed the recommendation that the Council's gas contract with Gazprom M&T should be terminated before the 30th June 2022, in line with the contract conditions. The 30th June being the latest annual date that the Council could serve notice in order to terminate (on none default positions) upon the contract's anniversary on 30th September 2022.
- 3.2.2 This decision was reached in the immediate aftermath of the invasion of Ukraine, and was made with a desire to break any connection in the supply with the Russian state, the Russian state being the single shareholder of Gazprom M&T and its parent companies, with the strong likelihood that revenue and profits made on the Contract, that were finding their way back to Russia.
- 3.2.3 On 22nd March many local authorities and other organisations were similarly looking for an opportunity to end their respective contracts with Gazprom M&T. In particular, the Council was engaged in discussions with the Local Government Association (LGA), who had organised meetings with peer authorities, with their own Gazprom M&T contracts, and central government departments.
- 3.2.4 The Cabinet were asked to note in the recommendations that events remained fluid and that, should matters materially change, that powers could be executed by the Chief Executive during the pre-election period and the immediately after the election.

3.2.5 The Cabinet also requested that a paper be brought to the next Cabinet of the new municipal year, in order to reflect market conditions.

3.2.6 The full text of the March 22nd Cabinet paper is in Appendix A of this report.

3.3 Developments Since 22nd March

3.3.1 A number of significant developments have occurred since the Cabinet decision on the 22nd March. The key developments are the change in ownership of Gazprom M&T and the change in control of Gazprom Germania.

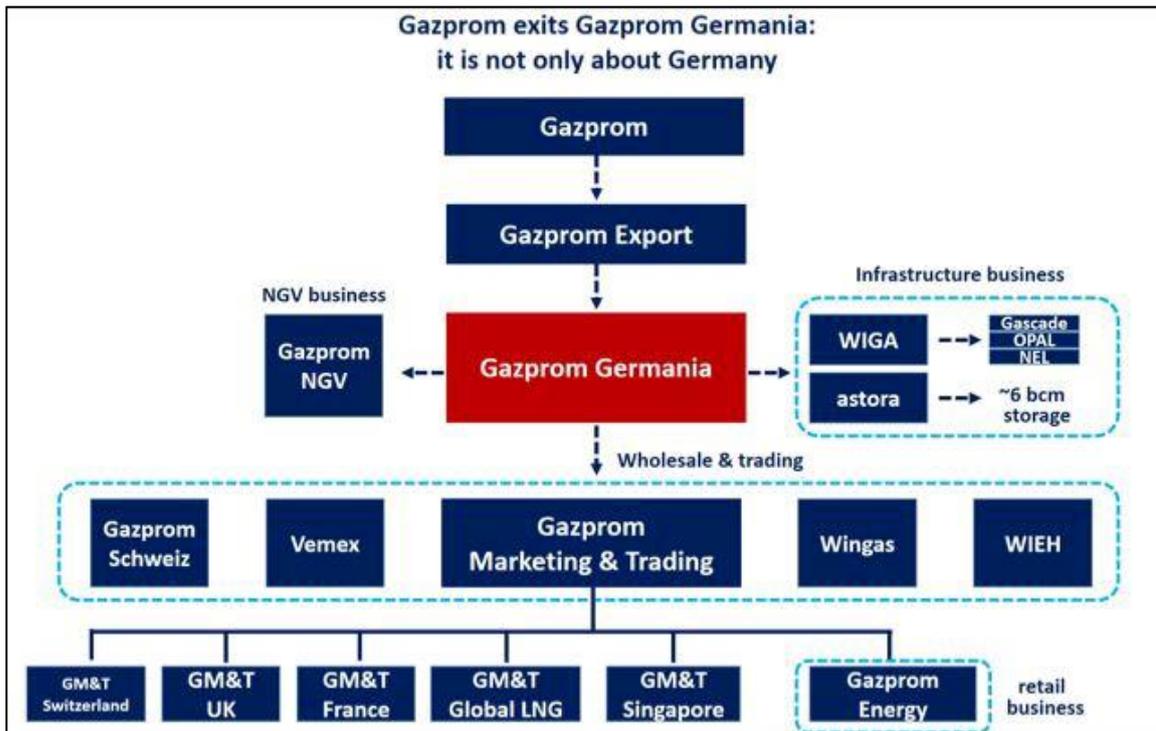
3.3.2 A timeline of the key developments over recent months is included within the table below:

Date	Development
24/02/2022	Russia invades Ukraine
26/02/2022	The USA sanctions the Gazprom company group including Gazprom Germania and its subsidiary company Gazprom M&T
04/04/2022	The German government hands control of Gazprom Germania to the German Federal Network Agency
04/04/2022	Gazprom Germania replaces the Russian Federation as the single shareholder of Gazprom M&T
02/05/2022	The US Department of the Treasury removes sanctions on Gazprom Germania and its subsidiary, Gazprom M&T
03/05/2022	Russia imposes sanctions on Gazprom Germania and its subsidiaries, including Gazprom M&T

3.3.3 One of the key developments is the change of shareholding within Gazprom M&T. Until the 4th April, 100% of the shares were held by the Russian Federation. On that date, Gazprom Germania became the single shareholder¹.

3.3.4 The control of the parent company, Gazprom Germania to the German Federal Network Agency was made on 4th April. The diagram below shows the position of Gazprom Germania within the company structure:

¹ [GAZPROM MARKETING & TRADING LIMITED persons with significant control - Find and update company information - GOV.UK \(company-information.service.gov.uk\)](https://www.gov.uk/company-information/service.gov.uk)



- 3.3.4 German law has a 6-month limitation on the period that it can seize control over Gazprom Germania. This can be extended indefinitely, with the current period set to end on the 30th September 2022. Despite this, it is considered extremely unlikely that control would be ceded back to Russia.
- 3.3.5 At time of writing (the 10th June), the German government does not have a legal mechanism by which it can expropriate the shares from Gazprom Germania, however they have taken control of the company and its subsidiaries. The German government has also laid legislation in the Bundestag (yet to be enacted) which will enable this².
- 3.3.6 Russian sanctions means that Gazprom Germania is unable to buy Russian gas from Russia³.
- 3.3.7 It can be reasonably inferred from the US removal of sanctions on Gazprom Germania, that they are satisfied that the link with the Russian state has been severed.
- 3.3.8 It is widely believed that Gazprom Energy will rebrand in early July⁴.

² [Reform of the Energy Security Act: New Options for Action to Secure Energy Supply in the Event of Crisis | Hogan Lovells - JDSupra](#)

³ [Germany faces 5 billion euros a year hit from Russian gas sanctions, Welt am Sonntag reports | Reuters](#)

⁴ [I can't believe it's not Gazprom! Gas giant's UK division seeks rebrand as it severs ties with Putin \(cityam.com\)](#)

- 3.3.9 In the period since the March cabinet paper was made, a number of peer authorities have publicly stated that they cannot end their supply contracts with Gazprom⁵, some of which had initially announced their intention to do so⁶.
- 3.3.10 Eden District Council have specifically cited the ultimate German control as the reason for staying in their Gazprom supply contracts⁷.

4. Reasons for recommendations

- 4.1 The imperative that existed to end the contract in March no longer exists, as in so far as can be reasonably ascertained, no money from the Contract is flowing back to the Russian state. The change of shareholder of Gazprom M&T and the control of Gazprom Germania by the German Federal Network Agency breaks the link between the Contract and Russia.
- 4.2 Gazprom M&T has no direct contracts in place for Russian gas. Gazprom Germania is unable to buy Russian gas, if it wanted to, because of the Russian sanctions placed on the company⁸.
- 4.3 Terminating the Contract with Gazprom M&T will have an inevitable cost increase to the Council which cannot be quantified in full noting the termination cost provision is linked to costs incurred by Gazprom M&T, but it will result in a negative effect from Best Value perspective. These likely cost implications are articulated in detail in the 22nd March Cabinet paper in Appendix A.
- 4.4 Terminating the Contract in line existing Contract conditions is in the Council's gift provided this is done within the annual deadline timeframe. However, the provision and calculation of termination costs is not clear and would result in a negotiation with Gazprom M&T and potential litigation costs.

5. Integrated impact assessment

- 5.1 See Appendix A of this report.

6. Legal implications

- 6.1 The Council entered into the Contract with Gazprom M&T for the supply of gas on 1 October 2021 with an expiry date of 30 September 2024. The Contract was awarded via the Council's broker through a competitive tender process.

⁵ [Sanctioning Gazprom would legally protect councils, Salford mayor says - BBC News](#)

⁶ [Merton Council urges law change to exit Gazprom contract \(swlondoner.co.uk\)](#)

⁷ [Eden District Council to continue Gazprom contract - BBC News](#)

⁸ [Russia puts sanctions on Gazprom units in Europe and U.S., part owner of pipeline | Reuters](#)



- 6.2 The Council can exit the Contract on the 12-month anniversary (30 September 2022), subject to providing written confirmation before 30 June 2022. This is a continuing annual right
- 6.3 If the Council elects to terminate early, in accordance with the contract terms, then the Council will have to pay a "*termination payment*", outlined in 4.3 of this report. Legal cannot quantify the costs of *termination payment* at this stage due to the basis of the reality of the unknown factors such as Gazprom's loss of costs. . Negotiations as to such costs would begin with the contractor via legal upon issuing of the notice.
- 6.4 Any decision to terminate the contract outside the annual anniversary notice date would be deemed wrongful termination resulting in liability for damages allowing Gazprom M&T and entitlement to damages for breach of contract based on common law principles. This would not be regulated or limited by the Contract. Legal cannot comment or assess the potential quantum at this stage (due to this being based on common law statute) but it is highly likely to exceed the termination payment liability under the break clause.
- 6.5 As noted in the previous March report Section 17 of the Local Government Act 1988 (LGA 1988) relates to exclusion of non-commercial consideration. Section 17(4)(c)(ii) covers the termination of contracts in such instances.
- 6.6 Section 17(5)(e) of the LGA 1988 states that one of the non-commercial matter(s) that cannot be considered by local authorities is "*the country or territory of origin of supplies to, or the location in any country or territory of the business activities or interests of, contractors*". It seems apparent that the contract with Gazprom M&T and their relationship with Russia would fall within this category of non-commercial matters'.
- 6.7 As a result of section 17 there are limited ways to legally terminate the existing Contract (outside the above issuing of termination notice with termination costs) without risk of challenge.
- 6.8 The Council has a duty of Best Value under section 3 of the Local Government Act 1999, which states the Council must "*make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.*" Cabinet is reminded that consideration must be given to this duty when reaching a decision on the recommendations in the report.
- 6.9 The Russia (Sanctions) (EU Exit) (Amendment) Regulations 2022 do not reflect commercial relationships already entered into by Authorities and there is currently no specific trade restriction on purchasing gas from a Russian source. Continued investigation should be undertaken to monitor any further amendments and sanctions that could be of relevance.

7. Director of Finance's comments

- 7.1 The invasion of the Ukraine happened 10 days after the Council's budget was agreed on the 14th February 2022 and as a consequence there is no contingency built into the current budget to cover the financial impact of terminating the agreement with Gazprom.
- 7.2 The Council would need to identify a funding source should they choose to terminate this contract. The exact scale of the financial impact of this decision as stated in the report is as yet unknown and neither is the remedial action to cover the financial impact.
- 7.3 The major concern if the contract was cancelled is the Council would need to seek an alternative provider and purchase gas at today's prices. It's unlikely that we would be able to hedge our gas price without a substantial uplift to the current contract.

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Signed by: James Hill - Director of Housing, Neighbourhood and Building Services

Appendices:

Appendix A - Portsmouth City Council - Gas Contract - Cabinet Paper of the 22nd March 2022

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Title of document	Location
N/A	

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by on

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Signed by: