



JEWEL IN HOSE CROWN?

June 2009

No sooner had the Ukrainian-Polish Commission for Trade and Economic Cooperation reached agreements on oil and gas [supplies] (June 3, Rzeszów, Poland) than striking news arrived from St Petersburg, Russia on Sunday. On June 9, Leonid Kuchma and Vladimir Putin signed a statement on strategic partnership in the gas industry.

Similar statements have been made before, and the "strategic partnership" is already documented, so it's no big deal. What is really special about this political statement which was immediately approved by German Federal Chancellor Gerhard Schroeder is *the intention to set up, on a parity principle, a consortium for the management and development of Ukraine's gas transportation system (GTS).*

Although Ukraine's and Russia's governments (as well as the enterprises involved from both countries) are only waiting for instructions to draft a bilateral agreement "in the short term", the Presidents already said in their statement that the participants in the consortium(?) will "jointly decide on the terms of participation of the European gas companies and invite them to joint activity".

No sooner had the ink of the signatures dried on the statement than European companies announced their intention to participate. Notably, the first companies to do so were Ruhrgas (Germany), Gas de France (France) and Eni (Italy). Notably because firstly, they all are traditional partners of Russia's Gazprom and buyers of Russian natural gas. Secondly, almost two years ago these companies signed a memorandum with Gazprom on participation in another international consortium - for construction of a pipeline via Poland and Slovakia (in other words, bypassing Ukraine). For various reasons, the project didn't survive. By expert estimates, it would have taken almost ten years and several billion dollars. A good reason.

Instead, the Russians agreed, so far verbally, to sign a ten-year agreement with Ukraine (on June 21 in Kharkiv) on the guaranteed transit of 110 billion cu m of natural gas annually by Ukraine's GTS (last year the amount barely reached 105 billion cu m). They then told everyone not to bother any longer about any "bypass" pipelines.

The idea of the consortium and the ten-year agreement was put forward by Russia after it became clear that if Gazprom accepted \$1.4 billion worth of bonds issued by Naftogaz Ukrainy [state oil and gas company] as payment for outstanding debts, it would have to immediately pay \$700M in taxes to Russia's federal budget. But didn't the two countries' experts (let alone top leaders) know about the tax liabilities when they drafted and signed the agreement? And do Russia's and Germany's leaderships know that Ukraine has no legislation allowing it to set up such a consortium? Moreover, that it is prohibited to cede or hand over the GTS to anyone?

Hence, a question: was it in exchange for the bonds or something else that prompted the Russians offer to Kuchma of using the Ukrainian GTS together? A kind of barter: we keep your pipelines filled and working for ten years, and you give us a part of the profit from the cost of the transit of our gas. Why did the Social Democrats and even the Communists who had bargained so vehemently for chairs in parliamentary committees immediately support the idea of the consortium? And why did three dozen people's representatives rush to join the committee for fuel and energy matters?..

Such questions worried last week not only politicians, specialists in the oil and gas industry, journalists, but also the experts, particularly those with the Razumkov Center of Economic and Political Studies. Volodymyr Saprykin, the Center's manager of fuel and energy research projects, shared our apprehensions and told many of interesting facts.

Ukraine inherited a great wealth from the USSR - a powerful oil and gas infrastructure. The "jewel" of this wealth is the gas transportation system. It's the nation's property. So before doing anything with this property, the authorities should first of all explain openly to the citizens of this country what good this or that step would do. They should explain to the lawmakers who make decisions, explain to the experts who are supposed to help make the best decisions. Now we see once again that the Ukrainian people have no power to decide how to use their own property. But they have the right to know the possible consequences of the decisions and steps that are being made.

So far, things remain as they are. So it's logical to ask: was this decision well-reasoned or rushed? Was it an offer that Kuchma had to accept for some reasons?..

The preliminary decision on joint management of the Ukrainian gas transportation system, in our opinion, was extemporized and unexplainable - even the experts don't know now what to expect. It could be called an improvisation. But improvisations in the oil and gas complex take two, three or five years of preparation. Nobody knows if this decision had been worked out long beforehand.

But something was done about it, wasn't it?

By the end of June, an international group of experts (five Ukrainian and five EU experts) within the framework of the INOGATE program were supposed to come to a decision which would be preferable to Ukraine: privatization, concession, hand-over of management or other ways to make the use of the Ukrainian GTS more efficient. The results of this haven't been announced. Of course, expert recommendations are not infallible, but they have not even been published.

It's very difficult to invent something new in the oil and gas complex, particularly in the management of and use of the infrastructure. We know that Poland and Slovakia, as candidates for EU membership, took this road. They privatized their gas transportation systems. But the process was transparent and clear to their citizens. There were clear-cut requirements and terms for participants in tenders, international consortiums in particular (one of them involved Gazprom), that contended for managing the gas pipelines of those countries. Every detail was transparent and clear both to the public and the investors. In Slovakia, for instance, the consortium where the Russians participated won a tender - quite openly and intelligibly.

Since Ukraine has declared its intention to join the EU, a similar approach would be appropriate and logical, because privatization of the oil and gas enterprises is one of the requirements of all candidates for EU membership.

Are you positive that the use of the Ukrainian GTS by a consortium is an advantageous option? And how realistic is Putin's promise to invest \$2.5 billion in Ukraine's gas transportation system?

In my view, privatization of the GTS would be the best option for Ukraine: there would be investors, first of all Russia's Gazprom, and bypass pipelines wouldn't be needed, Western companies would bring in their level of management and investment.

As for investment... just now Gazprom is catastrophically short of funds - it borrows from the West. So we can't expect any big investment from it... Schroeder doesn't have money, either - the money for such projects are given by banks and companies - Germany's economy is not administrated by the government...

Still, Gazprom and the Russian Federation are Ukraine's strategic partners, no matter how anyone looks at it. But wasn't there any other reason for making such a decision?

In my opinion, there were objective reasons, both external and internal. In recent years, largely thanks to Putin, the Russian Federation has made a great breakthrough in its relations with the EU and the USA in the field of energy resources. There are concrete plans that demand both money and political will. But without involving the Ukrainian GTS in these projects, the Russians and the EU are unable to implement them efficiently.

It's an encouraging fact that several rounds of talks on constructing a pipeline through Poland's territory have brought no result, for a number of subjective and objective reasons. The objective reason is that Poland doesn't need large additional amounts of natural gas. Neither does Germany. So it's inexpedient to build a new branch of the Yamal-Europe-2 pipeline.

One more reason is that Russia has also failed to agree with Poland on extending the Yamal-Europe-1 pipeline. The stumbling block was the question: who would fund the project, who and to what extent would own it?

Besides, there are political problems connected with Kaliningrad [former Prussian town of Königsberg]. I don't want to mix these issues, but this factor is also important.

And, finally, one of the most decisive reasons: Ukraine has trumpeted from the rooftops that the problem of its debts for consumed Russian natural gas has been settled. Yes, Ukraine has fulfilled all the terms of the intergovernmental agreement: it has issued bonds and placed them with a Western bank; we spent the money, but Gazprom didn't take the bonds. It means that the debt problem hasn't been solved. So we ask ourselves: was the statement on joint management of the Ukrainian GTS instead of or a continuation of "the debt matter"? It would be logical to solve the first task first - to clear the debt - before moving further on.

We are talking of tentative plans for the GTS, but it's appropriate to mention the legislative limitations as well.

So far, the state is unprepared legislatively to either privatize or lease its gas mains. Firstly, Parliament hasn't annulled its categorical ban on the privatization of basic oil and gas facilities, including the GTS. Secondly, management transfer is an element of concession. Ukraine's legislation lists objects that may be subject to concession. The gas transportation system is not on that list. So even if an agreement on the joint management of the Ukrainian GTS is prepared by this fall, it has to be considered by Parliament. A new law will have to be adopted. And even if it is adopted, it will take at least a year.

There's no point in trying to analyze vague prospects. Yet, we have only tried to remind again all those who are empowered to make vital decisions that before making them, it is sensible to explain openly: why and what for, what it will give the country and every citizen in it.



Let me just remind you that several years ago there was a precedent: passions ran high over Shell's offer of a concession. Shell promised Ukraine some 2 billion...
in depends the Ukrainian authorities didn't bother to timely and publicly explain what it would have led to. It looks like today history may repeat...
in a different cast of guest stars...

I tried to get firsthand information from Yuriy Boiko, the board chairman of Naftogaz Ukrainy, but he was away on business. However, as we were...
the company's staffers, they haven't received as yet any official instructions to draft an agreement on the management of Ukraine's gas transportation system...
jointly with Russia's Gazprom and other foreign companies.

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