

Ukrainian gas transportation system: market and bureaucracy

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Consortium (from Latin consort-, consors - fellowship) is an agreement, combination, or group (as enterprises, organizations or industrial companies) formed to undertake an enterprise beyond the resources any one member, including implementation of capital-intensive projects or joint placement of loan. Obligations of the members, their shares in expenses and profits as well as forms of participation in the project are determined by agreement of the founders. Members of a consortium bear joint responsibility to its client. After achieving its goal, a consortium ceases to exist or is transformed into another legal entity.

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General Context

The Kishinev's summit of the heads of the CIS states brought some surprises. As it had been planned, on October 7, 2002, Ukrainian and Russian Premiers Anatoliy Kinakh and Mikhail Kasyanov signed the declaration on strategic partnership in the gas sphere. Presidents of the Russian Gazprom and the Ukrainian Naftogaz Ukraine, Olexiy Miller and Yuri Boiko signed the agreement on setting up the international gas consortium. President of the Russian Federation Vladimir Putin unexpectedly proposed to consider, by March 2003, the issue of election of the Ukrainian President Leonid Kuchma as chairman of the CIS Council of Heads of State. Actually that proposal runs counter to the CIS Statute. The document approved in January 1993 reads that Presidents and Prime Ministers of the CIS states shall chair sessions of the CIS Council of Heads of State in Russian alphabetical order of names of the countries-members of the CIS. However, the Statute does not provide for the office of «chairman of the CIS Council» at all.

As for Ukrainian President, such support and respect demonstrated by Russia are very important today. Moreover, manifestation of friendship on the part of Russia leaves no alternative for Ukraine, especially with regard to long-lasting deterioration of relations between the Ukrainian President and Western countries determined by the tape-gate and Iraq-gate scandals. Recently, the President of Ukraine has resolutely rejected Polish proposal to help organize a roundtable session with the opposition, which would undoubtedly entail tangible worsening of the Ukrainian-Polish relations. Problems in Ukraine's relations with other countries are also aggravated by growing tension in domestic politics related to failure to establish a dialogue between the power and the opposition. Hence, given the situation, general prospects of Ukraine's President are quite uncertain.

It should also be mentioned that improvement of Ukraine's relations with Russia took place at the height of the tape-gate. Russia took advantage of internal political crisis in Ukraine and isolation of the Ukrainian President

on the part of Western states. And the same is true about the current situation. It turns out that except for political dividends, Russia's support will give the country an opportunity to derive financial benefits as well.

So, the June 2002 declaration on foundation of the international consortium managing the Ukrainian gas transportation system (GTS) signed by Presidents of Ukraine and Russia Leonid Kuchma and Vladimir Putin and German Chancellor Gerhard Schroeder can be interpreted in the above context. Under the above documents governments of Ukraine and Russia were ordered to work out and present for endorsement, within a short period, a joint agreement on strategic partnership in the gas sphere providing for foundation of the international consortium or joint venture dealing with management and development of the Ukrainian GTS.

In the opinion of experts, initiatives of the EU countries, especially Germany, to upgrade the Ukrainian GTS could be explained, first and foremost, by «rapprochement of the Russian Federation with the United States of America and the NATO, which formed preconditions for closer strategic cooperation between the EU countries and Russia in the fuel and energy field.» Meanwhile, it was noted that «issues to be solved by Russian and German diplomats who initiated the agreement on foundation of the international consortium were not limited to enhancement of effectiveness of the Ukrainian GTS» but were caused by economic problems in the energy field existing in both the Russian Federation and the EU countries. Those problems emerged because of slow pace of reforms in the Russian gas industry and possible decrease of gas output, which «adversely influences the ability of the Russian Gazprom to meet long-term obligations relating to supply of the EU states with natural gas» (the *Kompanion*, No. 38, 2002). It is necessary to remind that at present, Ukraine's GTS carries up to 90% of Russian natural gas exported to 19 European countries. The overall length of the Ukrainian pipeline network defined by the Kuchma-Gohr Commission as a valuable national asset is 36.7 thousand kilometers, of which pipelines with a diameter of 1,000-1,400 mm constitute 35%. Along this network, 72 compressor stations with 112 compressor houses equipped with 710 gas-pumping units and a powerful system of 13 underground gas storage facilities ensure transportation of gas. Gas pipeline capacity of the Ukrainian GTS is 290 billion cubic meters per annum at the point of inflow and equals 170 billion cubic meters per annum at the point of outflow, of which 140 billion cubic meters are supplied to European countries. Volumes of transit of Russian natural gas increased from 92 billion cubic meters in 1992 up to nearly 120 billion cubic meters in 1999. Growing volume of transit gas can serve as a confirmation of the Ukraine's status of the world's leader in gas transportation services.

Provisions of the Declaration

The declaration on strategic partnership in the gas sphere between the Cabinet of Ministers of Ukraine and the government of the Russian Federation was signed in Kishinev. Meanwhile, for the time being, the German and other parties potentially interested in the foundation of the international consortium made no strenuous efforts to join the project but took a wait-and-see position instead. On the day following the date of signing of the agreement, press-secretary of the Ruhrgas Heiner Garbe stated that before his company specifies forms of its participation in the consortium, politicians would have to settle all legal and technical issues related to implementation of the above project.

Under Article 3, «Parties have agreed to found the international consortium in the form of joint stock company (hereinafter referred to as the Consortium) that shall transport natural gas and ensure effective, secure and stable functioning of the Ukrainian gas transportation system and increase of volumes of natural gas carried in transit via the territory of Ukraine; build new competitive gas transportation capacities in Ukraine: rationally utilize trunk gas pipelines and underground gas storage facilities; and attract investment necessary for modernization

and development of the Ukrainian GTS.» According to the agreement, organizations responsible for foundation of the Consortium shall be the Naftogaz Ukrainy representing the Ukrainian Party and the Gazprom representing Russia. The authorized organizations were ordered, «to conclude an agreement on actions to be taken for foundation of the Consortium on a parity basis.» Participants in the Consortium shall jointly and on the consensus basis regulate requirements for participation of European gas companies in the Consortium. The declaration shall be valid within 30 years and shall be automatically prolonged for another five-year term. Another provision reads, «The Consortium shall be established, registered and operate in compliance with the Ukrainian legislation. The Consortium's headquarters and management bodies shall be located in Kyiv (Ukraine).»

Positive Aspects

Positive implications of the project include revival of cooperation between Ukraine and Russia in the gas sphere and attraction of potential foreign partners, especially those from the USA and the EU countries. However, mechanisms for attraction of foreign partners are yet to be worked out. In June, 2002, commenting on the trilateral initiative to establish the international gas consortium, experts believed that rejection of the idea of building the gas pipeline Byelorussia-Poland-Slovakia by-passing Ukraine could be viewed as another positive aspect. Although, news agencies inform that according to sources in the Russian government, the above is not true, since nobody was going to stake everything on one project. Hence, signing of the Russian-Ukrainian declaration on setting up the international gas consortium does not mean that Russia will turn down alternative routes of supplies of natural gas to European countries. Solution to the above issue will mostly depend upon implementation of available Russian-Ukrainian agreements, especially on the fact, «whether the above project will be clear and efficient and whether legal acts will guarantee against risks related to participation in the consortium.» Such requirements can be interpreted as a kind of pressure on those responsible for elaboration of the agreements on the one hand and confirm a natural desire to diversify gas transportation flows and minimize economic risks on the other.

Privatization of the Ukrainian GTS is inevitable though privatization mechanisms used cannot but surprise.

Issues to Be Solved

There are numerous issues to be solved, such as, for instance, shares of the Parties in the Consortium; the essence of the term «parity basis», on which the Consortium will function; attraction of partners to the Consortium; the value of the Ukrainian GTS; methods for regulation and distribution of financial flows of the project etc. The afore-mentioned issues represent just a brief list of problems to be settled. It is necessary to mention that notwithstanding general non-transparency in approval of public decisions, signing of the above agreement exceeded all examples of the past. Until recently, even experts from key Ukrainian energy companies did not have complete information on elaboration and text of the agreement. There is no feasibility report describing advantages of a certain form of cooperation for our state. It seems to be more logical to make necessary analysis and calculations prior to taking a conceptual decision.

One of the provisions of the agreement, i.e. the provision on location of management bodies of the Consortium in Kyiv (Ukraine) and registration of the Consortium according to the Ukrainian legislation, is positive for Ukraine. Though, the provision is not essential as it is unclear what advantages our country will have. It is like that mechanisms for setting up and functioning of the Consortium will be specified in the future. However, such details often proved to be very important. Declaration of intentions does not answer questions arising from

establishment of the consortium. What the agreement emphasizes is the issue of management and development of the Ukrainian GTS on the part of Russia. The Consortium shall not be a structure where one Party supplies natural gas and another successfully transports it. Earlier on, experts pointed out that should Russia manage Ukraine's GTS, it will be able to minimize its financial expenses for modernization of the gas transportation system. «Right to manage property enables the managing Party to make no investments in the Consortium... The share of funds received from utilization of the Ukrainian property of the GTS should be transferred to the manager, i.e. the Russian Gazprom» (the *Kompanion*, No. 38, 2002). And, should the above be realized, proceeds of the national budget of Ukraine will substantially decrease. So, critics of the idea to establish the international consortium are justified. According to expert calculations published in the Ukrainian press and cited by Ukrainian politicians, after establishment of the consortium, direct national budget receipts, inclusive of the profit tax, the value added tax and the rent for transit of natural gas, will decline by nearly UAH 6 billion. It should also be mentioned that those revenues are mostly allocated for funding of various social security programs. Furthermore, Ukraine will need additional UAH 2 billion to compensate price for natural gas supplied to population (today, transit natural gas is sold to population at the fixed price of UAH 170 per 1 thousand cubic meters, whereas the market price amounts to around UAH 350 per 1 thousand cubic meters).

According to some Ukrainian officials, should the budget incur such losses, the form of cooperation will have to be changed. Head of the Parliamentary Committee on Fuel and Energy Complex Andriy Kluiev and Prime Minister of Ukraine Anatoliy Kinakh share the above viewpoint. The Premier believes that the Russian-Ukrainian agreement on strategic partnership in the gas sphere and establishment of the gas transportation consortium may be denounced if the project proves unacceptable to Ukraine for technical or economic reasons.

Determination of shares of the Parties in the international consortium managing Ukrainian GTS is one of the major issues as well. Earlier, Ukrainian officials insisted on 50% plus one share. In August, Minister of Fuel and Energy of Ukraine Vitaliy Haiduk stated, «We set our conditions, first of all, so that to protect national interests». Before negotiations between the Naftogaz Ukrainy and Russian Gazprom in September, President of the Ukrainian company Yuri Boiko asserted, «It is envisaged in our project that Ukraine should have 50% plus one share though this issue is subject to negotiations between the leaders of our countries» (the *Vremya Novostey*, September 11, 2002).

However, it is questionable, whether Ukraine will be able to retain a controlling stockholding in the future. At present, the Russian Party insists that the founders of the consortium should own 50% of shares each. According to the information provided by «a high-ranking official in the Russian government» to the Russian news agency Novosti, the Parties should participate in the project on a parity basis. Should western companies join the consortium, the shares will be subject to change. According to the Russian party, in this case Ukraine and Russia should maintain control over the company and their shares should remain equal.

Meanwhile, Prime Minister of Ukraine Anatoliy Kinakh announced that Ukraine would insist on getting the controlling stockholding of the Consortium. However, according to information of the Russian News Agency Novosti, Russia referred to tough requirements of Ukraine as rhetoric that should be stopped so that to make consultations more fruitful.

The question relating to the value of the Ukrainian GTS still remains open. It should be reminded that earlier on, the Innogate Company appraised Ukraine's gas transportation network as worth USD 13.8 billion. However, it does not mean that the Ukrainian Party agrees with the above amount.

Response of the Parliament

At present, most of the Ukrainian MPs are skeptical and negative about either foundation of the consortium or advantages the Ukrainian Party can gain. They emphasized «betrayal of the national interests of Ukraine and the need to institute legal proceedings against the President of Ukraine Leonid Kuchma for the committed violation...» (Yulia Tymoshenko, Yulia Tymoshenko's bloc), for «government of Ukraine made the Russian President a gift worth actually 10% of the national budget or UAH 6 billion (Borys Kostyniuk, the «Our Ukraine» Party).» In this respect, members of Ukrainian opposition mention deputy State Secretary of the Ministry of Finance Serhiy Baulin who was allegedly dismissed from his office after promulgation of information that subsequent to establishment of the international consortium, direct receipts to the national budget will decrease by about UAH 6 billion. Severe critics of the consortium initiatives in the Ukrainian parliament cast doubt on the possibility of ratification of respective international treaties. However, some MP guess that the Ukrainian-Russian agreement on foundation of the international gas transportation consortium does not require ratification by the parliament. Permanent Representative of the Ukrainian President in the Verkhovna Rada of Ukraine Olexandr Zadorozhnyi shares the above opinion. According to Mr. Zadorozhnyi, far as the legal aspect is concerned, the agreement to be signed by the Russian Gazprom and the Naftogaz Ukrainy represents a contract between two economic entities and thereby is not liable to ratification. He said that the Ukrainian-Russian framework agreement should not be ratified because of the subject of the agreement and the same was true about the agreement between the Russian Gazprom and the Naftogaz Ukrainy, as it represents a contract between two companies. Hence, some political forces will view such a situation as an additional argument in their fight against the existent regime.

Experience of many European countries proves that privatization of Ukraine's GTS is inevitable. Although, method of privatization and possible implications for the Ukrainian economy caused by activities of the international gas transportation consortium in the absence of adequate legal basis leave more questions than answers and outline more drawbacks than advantages of implementation of the project ranging from budget proceeds to the ability of our country to adhere to transparent economic policy. The above once again casts doubt on the ability of Ukraine to follow the so-called pro-Ukrainian policy repeatedly announced by high officials.