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With this issue the Working Group 3 Coordinator Office continues the monthly publication of information-analytic bulletin for sectoral review of situation in EaP countries. By means of the publication it is intended to enlighten the energy and ecology sectors in EaP countries. This issue of the bulletin is devoted to most important sectoral events of EaP countries within March 2010.

Special thanks to our correspondents who made written contributions and for assistants who organized it for this issue: Gayane Sargsyan (Armenia), Murman Margelashvili (Georgia), Ion Preascu (Moldova), Tatyana Manionok (Belarus).

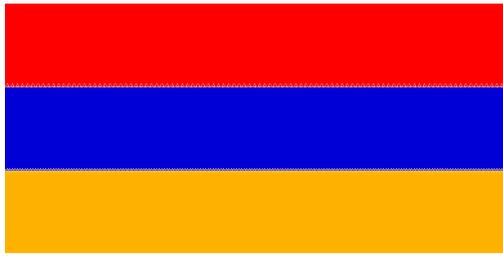
Kyiv 2010

EU allocates 13 million euro to Eastern Partnership countries to develop new environmental project

The European Union made around €13 million investments in new environmental flagship project under the Eastern Partnership policy. The project aims to strengthen environmental governance and to develop a regional **Shared Environmental Information System**.

According to Štefan Füle, European Commissioner for Enlargement and European Neighbourhood policy: “It is in our common interest to work together with our Eastern partner countries so that our neighbourhood becomes greener”.

The first phase of the flagship initiative focuses on increasing the availability of reliable information in EaP countries. The Flagship project will also focus on involving relevant stakeholders in environmental decision-making, reporting and on conducting Environmental Impact Assessments and Strategic Environmental Assessments for projects in line with EU legislation.



Armenia

1. Armenia ready to implement energy projects with Turkey

Armenia is ready to participate in pipeline construction projects, said RA Deputy Minister of Energy and Natural Resources Areg Galstyan at the 73rd NATO PA Rose-Roth seminar in Yerevan.

According to him, if the mains will go through Armenia, tax payers of EU states will save several hundred million dollars. "Armenian side has repeatedly stated this during the energy projects implementation back in 1990s, but no positive response followed, as the decision was made by politicians, who displayed no economic reasonableness," Deputy Minister declared.

He outlined that Armenia implements joint energy projects with Iran and intends to deepen that cooperation. Some projects are carried out also with Georgia, and joint one is scheduled to launch shortly with Iran and Georgia. In particular, for energy supply to Georgia a power line of 400kWt and 2 hydropower plants with Iran on Arax river will be built.

Armenia is ready to implement similar projects with Turkey, Galstyan said adding that functioning in soviet times power supply line of 220 kilowatt in Turkey is already restored.

2. Poland interested in Armenia's experience of nuclear energy

The Prime Minister of Armenia, Tigran Sargsyan, received on March 12 the delegation headed by his Polish counterpart Donald Tusk.

Henceforth the Armenian-Polish relations will develop in a new direction. The two countries have signed an economic cooperation agreement. The parties agreed to create an intergovernmental commission that will discuss the economic, political, financial and cultural issues on bilateral agenda. Donald Tusk noted, in turn, that Poland might adopt Armenia's experience in the field of nuclear energy.

3. Armenia, Syria to cooperate in energy field

Armenian Government has given consent to assist initiative on signing the agreement on electric and renewable energy cooperation between Armenian and Syrian governments. Under the contract, construction of new power plants and electric equipment producing factories is encouraged, Armenian Government's press office said.

4. Managing energy and environment for sustainable development

During the year of 2010-2011 UNDP Armenia will continue to work on increasing access to sustainable energy services. UNDP Armenia will help to: (i) improve legislative frameworks to increase energy efficiency; (ii) facilitate to introduction of new technologies for renewable energy; (iii) assist rehabilitation of municipal heat and water supply systems in selected places. In doing so UNDP Armenia will seek for wider donor assistance and partnership with local stakeholder communities and private sector. The activities will be implemented according the project document signed between UNDP and Armenian Government. The AWP will be the instrument referred to as the Project Document in Article 1 of the SBAA between the Government of Armenia and UNDP, signed on March 8, 1995 and ratified on February 9, 2000.



Azerbaijan

1. Russian Gazprom has doubled its gas imports from Azerbaijan to 3 bcm a day as of March 5. Once again Gazprom confirmed it was ready to further receive all the gas Azerbaijan would supply. President Ilham Aliyev said earlier that Azerbaijan will sell more gas to the Russian gas monopoly if the implementation of the Western-backed Nabucco pipeline project stalls.

Earlier this year, Gazprom agreed to buy 1 bcm from Azerbaijan in 2010. The company has said it will double import in 2011 and buy 2 bcm of gas from Azerbaijan. Azerbaijan has proven reserves of 1,5 trillion cubic meters of gas. Azerbaijan's domestic gas consumption totals 14 bcm.

At present, Azerbaijan exports gas to Georgia, Turkey, and Russia. In the coming months it will export gas to Iran. Starting this year end Syria may get 1bcm of Azerbaijani gas annually. This decision was reached during the visit of Azerbaijani Industry and Energy Minister Natig Aliyev, senior representatives of the State Oil Company of Azerbaijan Republic and the leadership of the Azerbaijan State Oil Academy to Syria. According to Natig Aliyev, gas will be transited via Turkey. The two sides also considered the establishment of joint Azerbaijani-Syrian companies to sell not only gas but also oil to Syria.

Aliyev further said Turkey and Syria were already in cooperation to unite their natural gas networks which would provide the opportunity for Azerbaijan to realize this gas project.

2. On March, 10, the State Oil Company of the Republic of Azerbaijan (SOCAR) and the RWE Group, which is one of the six shareholders in the planned Nabucco pipeline, have signed a memorandum of understanding to draw up an agreement for the hydrocarbon exploration and development for the Nakhichevan perspective structure in the Azerbaijan sector of the Caspian Sea.

According to preliminary government estimates, the Nakhichevan deposit may contain up to 300 bcm of gas and 40 mln tons of gas condensate. "During a year operations on the preparation of the PSA contract will be held. Exploration operations will be carried out on the field after contract is signed," Abdullayev said.

The contract for the development of Nakhchivan perspective offshore field was already signed between ExxonMobil and SOCAR (50% each) in 1997. But the contract was closed due to discovery of commercially unattractive volumes of hydrocarbons.

Thomas Rappuhn, Chairman of the management board of RWE Dea, believes that signing of this memorandum will not be single RWE activity in Azerbaijan. "The signing of the memorandum of understanding is a first step towards RWE initiating upstream activities in Azerbaijan, and we look forward to constructive collaboration with SOCAR," says Thomas Rappuhn. "Our intention is to gradually step up our activities in this country in the course of time," he adds. "The company aims at ensuring Europe's energy security. Hydrocarbons from Azerbaijan and Turkmenistan could contribute to gas supplies for the countries of Eastern and Western Europe," he stressed.

3. On March 11, 2010 the meeting of the Joint Working Group (JWG) between SOCAR, Bulgartransgas and Shah Deniz co-venturers (BP-Statoil) on the project for the transportation of compressed natural gas from Azerbaijan to Bulgaria and to the EU markets was held in Baku. During the meeting issues related to technical possibilities and commercial profitability of supplies of compressed natural gas from Azerbaijan across the Black Sea to Bulgaria, and, potentially, to other European countries were discussed. The mentioned JWG was established in accordance with the Memorandum on Understanding and Co-operation on

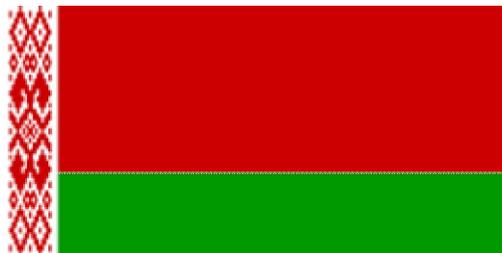
transportation of natural gas signed between SOCAR and Bulgartransgas in November 2009. Next meeting of the Joint Working Group will be held in Sofia at the end of April.

4. Azerbaijani Industry and Energy Minister Natig Aliyev informed that Azerbaijan had received a proposal from Romania to supply gas to the country in transit through Georgia.

According to him, Azerbaijan has already considered the possibility of delivery of Azeri gas to Romania across the Black Sea. The most optimal way is the construction of a branch of the Baku - Tbilisi-Erzurum gas pipeline on the territory of Georgia in the direction of one of the Black Sea ports, where LNG-terminal should be built. Then it is possible to organize a tanker delivery to the Romanian port of Constanta, where regasification terminal for receiving compressed natural gas should be built. The project, according to the Azerbaijani Minister, must be supported by the governments of three countries, and after that the private companies should be involved, which could solve business issues.

In late 2009, the President of SOCAR Rovnag Abdullayev assumed the possibility of building LNG-terminal in the Georgian port of Kulevi, the owner of which SOCAR is. According to him, there is enough space for the construction of a gas liquefaction plant and LNG-terminals.

A project may get an extra boost in case of implementation by Ukraine of a similar to Romania project of construction of the regasification terminal on the Black Sea (potentially, a Yuzhniy port near Odessa). On actualization of the project the Ministry of Fuel and Energy of Ukraine expressed in March. The appearance of Ukrainian consumers, in addition to the Romanians, will help increase the commercial attractiveness of the project of transporting Azerbaijani gas to Europe. Also, the project would be strengthened if Bulgaria joins it.



Belarus

1. Venezuelan vector of energy policy in Belarus

Announcement of large-scale shipments of Venezuelan oil to Belarus by President A.Lukashenko during his official visit to Caracas on March, 15 is only backed by an agreement to supply an experimental party of 80 thousand tons with an opportunity to increase exports during the year up to 4 mln tons.

But it was not officially reported at what price Venezuela sells oil to Belarus. According to information from anonymous sources, Venezuela will provide Belarus raw materials free of charge. Belarus will pay only for shipment of oil to its refineries in Mozyr and Novopolotsk. Instead, Belarus is obliged to supply a certain amount of air defense systems and sets of “surface-to-air” missiles to them. Sales of petroleum products, produced from Venezuelan oil, will be carried out by the joint venture, with 75% owned by PDVSA and only 25% of the Belarusian Oil Company.

At a meeting in Minsk on March, 30 Alexander Lukashenko instructed the government to work out to July, 1 2010 proposals for supply of Venezuelan oil to Belarus by pipelines. He stressed that in this year Belarus should get the maximum amount of Venezuelan oil - 4 mln tons, and in next year to increase supplies up to 10 mln tons. ***“10 million tons of oil - this is the first step of our state independence. We must achieve this, whatever it would cost us. Any deviation from these figures must be reported to me with giving reasonable grounds”***, Alexander Lukashenko said. At the same time Alexander Lukashenko also set a task to prepare Belarusian companies for processing Venezuelan oil. The Mozyr oil refinery is more technologically prepared for processing Venezuelan oil from “Santa Barbara” fields.

Logistics of Venezuelan oil supply to Belarus is costly. Oil will be shipped by tankers to the Ukrainian port of Odessa, and then by railroad to the Mozyr oil refinery. The trial 80000-tonne batch of oil will consist of about 25 trains. The cost of delivery, according to preliminary estimates, could reach \$65/t that is more than the cost of shipping oil from Venezuela to the Ukrainian port. A.Lukashenko demanded the government to examine all the possible options for the supply of oil through the pipeline system (*see schematic map 1*). As he stated, “By this year end we must find the way to deliver oil to Belarus by pipelines.”

Belarus also intends to continue negotiations with the Baltic countries in order to use ports of Klaipeda (Lithuania), Butinge (Lithuania) and Ventspils (Latvia) for providing oil to Novopolotsk oil refinery. “If it is decided on ports of Klaipeda and Ventspils for oil supplies from Venezuela to Belarus, the further transportation of oil to the refinery is possible only by railroad. If Butinge terminal is chosen, which is owned by a Polish company ORLEN, it is possible to use a combined method - railroad and northern branch of the Druzhba oil pipeline”, - the representative of the port of Klaipeda said.

The “Belarusian Oil Company” (BOC) will own the trial batch of Venezuelan oil. The BOC is instructed to work out the logistics of supply of first batch of Venezuelan oil from Odessa to the Mozyr refinery. Belarusian oil refineries have experience of processing oil similar to “Santa Barbara” sort. According to specialists, after processing of such oil it is possible to get 70% of petroleum derivatives, and their pricing conjuncture on the world markets is now quite favorable. The BOC noted that the company would sell oil products, produced from the Venezuelan oil, on those markets, where the price is the highest. Those are probably the nearest markets - Polish, Ukrainian, Baltic countries. In March of this year, the BOC has opened its subsidiary in Ukraine – “BOC-Ukraine”. The company previously engaged in exports of petroleum products to the northern regions of Ukraine. “The task of the subsidiary company “BOC-Ukraine” is to establish a more

efficient export of oil products to the nearest to Belarus and a capacious Ukrainian market”, - the BOC noted.

The ability to optimize the delivery of Venezuelan oil to Belarus exists - through the pipelines “Odessa – Brody” and “Druzhba”. To do this, it is necessary to change operation of the “Odessa – Brody” pipeline from reverse to normal mode, and reserve for one of the two “Druzhba” pipelines on the distance Brody – Mozyr (*see schematic map 1*). This corresponds to the pattern of supply of Caspian oil to the countries of Central and Eastern Europe, including Belarus, where the official Minsk is still a bystander (*see schematic map 1*). The developer of the Caspian project is a joint venture “Sarmatia”, co-owned by oil companies of Ukraine, Poland, Azerbaijan, Georgia and Lithuania. It is doubtful also that Belarus will soon join the project “Sarmatia” to bring Caspian oil because this step would deprive Belarus of preferential supply of Russian oil in the amount of 6,3 million. Russian President Dmitry Medvedev warned Alexander Lukashenko about it during the January correspondence. “We expect that the Belarusian side will not take action to compete with Russian supplies of oil ... and possibly to participate of Belarus in the project “Sarmatia””, the Russian President wrote in a letter addressed to Alexander Lukashenko.

Proceeding from this, there is a high probability that supply of Venezuelan oil through the Ukrainian port of Odessa to the Mozyr refinery will stop after supply of the trial batch.

Schematic map 1



2. Chinese vector of Minsk nuclear policy. On March, 25 during a visit of a Chinese official delegation, the President of Belarus Alexander Lukashenko has invited China to participate in the construction of the first Belarusian nuclear power plant. “Currently from Chinese means we are implementing projects in Belarus on about a billion dollars. I think that this vector needs to be increased significantly,”- Alexander Lukashenko said. He praised a high level of economic and trade cooperation between the two countries: “I remember the times when we were dreaming to achieve turnover of \$500 mln, but today we have already almost \$2.5 bln turnover a year.” Belarusian president thanked China for its "great help" in field of economics and finance, and support in the international arena.

On March, 31 Russia reacted to the “Chinese hint” of Minsk. The Russian Ambassador to Belarus Alexander Surikov announced that Russia did not intend to build nuclear power plant in Belarus

together with China. “If the Belarusian side proposed that the Chinese co-financed the project, then I think Russia will withdraw from the project” – Surikov said.

Chinese vector in the Minsk nuclear policy plays the same role as the Venezuelan vector plays in the oil sector. The reluctance of Russia to build nuclear plant in Belarus, (as Russia prefers Belarusian project its own - Baltic nuclear power plant near Kaliningrad (Königsberg)) - stimulates Minsk to look for alternative partners. It is possible that Japanese and Korean, but unlikely European, companies will appear on the list of alternative partners.



Georgia

1. On February 25, 2010, the U.S. and Georgia signed the agreement on Partnership for Energy Infrastructure Expansion, which envisages up to US\$124 million of investment, through USAID, in energy infrastructure development in Georgia.

In addition to the funds committed by the United States, the Georgian side committed additional US\$115 million of its own funding for the co-financing.

The agreement is pursuing three objectives:

- It will facilitate HPP investments through the implementation of technical, economical, and environmental studies, investment promotion and marketing activities.
- A new gas pipeline will be constructed connecting the Black Sea port of Poti and its free industrial zone to the existing pipeline network, and rehabilitate critical segments of the East-West gas pipeline.
- Critical power transmission infrastructure will be rehabilitated, increasing electricity reliability and improving Georgia's capability to route and export power to Turkey and beyond.

2. In 2010 the oil terminal at the Georgian port of Kulevi owned by SOCAR plans to increase shipments of oil and oil products in 1,5-1,75 times compared to 2009 - from 2 mln tons to 3-3,5 mln tons. Growth will be achieved through the handling of oil from the Tengiz field in Kazakhstan via the route Tengiz - the Caspian Sea - Baku (tankers) - Azerbaijan - Georgia (railway) - Kulevi. An appropriate contract was concluded between the Tengizchevroil and the Cross Caspian company. For the transport of oil to Kulevi Tengizchevroil required enabling the reception and loading of Aframax class tankers with DWT min. 80 thous. tons. Kulevi complied with these requirements. In addition, the possibility of Turkmen oil transportation via Kulevi is considering, in particular, for Irish Dragon Oil working in Turkmenistan.

For reference. SOCAR has become the sole owner of Kulevi terminal in January 2007, has invested in its construction about \$350 million and commissioned it in May 2008. Initial capacity is 10 mln tons per year, later it will be increased to over 20 mln tons.

3. Georgia welcomes Kazakhstan's initiative to build a new pipeline through the Caucasus corridor, where oil can be shipped by tankers across the Black Sea to the Constanta - Trieste oil pipeline, said the spokesman for Prime Minister Nikoloz Mchedlishvili.

The President of Kazakhstan Nursultan Nazarbayev at the beginning of March has taken the initiative to establish a new pipeline between the Caspian and Black Seas at a meeting with the President of Romania Traian Basescu. In particular, Kazakhstan plans to ship oil across the Caspian Sea to Baku. Passing Azerbaijan and Georgia, the oil will go to the Black Sea coast. Further it will be transported by tankers to Romania, where the "black gold" will be delivered to Western Europe through the Constanta-Trieste oil pipeline (Italy).

For reference. Declaration on the construction of the Constanta - Trieste pipeline was signed by energy ministers from Romania, Serbia, Slovenia, Italy and Croatia, as well as the representative of the European Commission in 2007. Construction of the 1,319 km

long pipeline is to be completed by 2011, but the lack of progress since the signing of the Declaration moves the project implementation period away.

4. On March 19, 2010, the Turkish Kolin Construction Company is declared as the winner of the tender for the construction of 4 hydroelectric power stations cascade on the Tekhuri river in western Georgia. It was announced by the Minister of Energy of Georgia Alexander Khetaguri. The tender was attended by four foreign companies. Alexander Khetaguri said that the overall capacity of the cascade stations will be 104 MW and investments in the project are estimated at \$ 150 mln. The project will take 3 years and 9 months to be realised since the signing of the agreement. The Kolin Company has already submitted all the necessary bank guarantees both on preconstruction works, and on the construction itself.

The Minister noted that the Government had also decided to hold an international tender for a project to build a cascade of 4 hydroelectric stations on the Acharistskali river. Power stations of the cascade will have capacity of 115 MW and investments in the project will make approximately \$ 180 mln.

5. Negotiations between RAO UES of Russia and the Government of Georgia on joint management of the Inguri hydroelectric power plant were terminated due to inconsistency with the Abkhaz side – the Deputy Energy Minister of Georgia Marika Valishvili said. “The talks were terminated because the already agreed provisions are not implemented by the Russian side. This is due to the fact that there were some problems with the Abkhaz side”- she said.

For reference. In December 2008 Georgia and Russia signed a memorandum, which foresaw that in 2010 Georgia's largest hydroelectric Inguri HPP passed under joint management. The Russian side assumed liability to pay for the electricity consumed by Abkhazia - about 15 mln lari per year (\$ 8.6 million). In summer the Russian company Inter RAO could export electricity to Turkey – that would be additional 25 mln lari (\$ 14.4 million) in the budget of Georgia. Inter RAO has been working in Georgia since 2003, owns the power distribution company Telasi in Tbilisi, 2 blocks of TbilGRES (Tbilisi hydroelectric power station) and 2 hydropower plants on the Khrami river.



Moldova

1. Republic of Moldova is expected to become a full member of the Energy Community as of 1 May 2010. On March, 17 Deputy Prime Minister and Minister of Economy of the Republic of Moldova Valeriu Lazăr and Fatmir Besimi, in his function as the Energy Community Presidency in Office, signed a protocol on the accession of Moldova to the Energy Community in Vienna. He said that by joining the Energy Community, Moldova is taking a decisive step towards aligning its market rules to European Union standards.

2. The European Union will continue backing Moldova in terms of diversifying the energy resources. This was stated on 24 March by the EU Commissioner for Energy Günther Oettinger at a meeting in Brussels with the Prime Minister of Moldova Vladimir Filat. In turn, Filat said during the meeting with Mr. Oettinger that recent accession to the Energy Community Treaty is very important for Moldova. The prime minister said that this step will contribute to diversifying energy resources, liberalizing the energy market in Moldova, will optimize the capacity of their stocking, will diminish their negative impact on the environment, as well as will facilitate the enforcement of the EU acquis in the energy field, as reflected in the Treaty. EU Commissioner showed interest in the latest reforms implemented by the Moldovan government.

3. The court suspended increase of tariffs for energy resources. On March 18, the judge of the Appeals Chamber has suspended the decision of the National Agency for Energy Regulations (ANRE) to increase the tariffs for energy resources. It is the first time in Moldova that such a judicial decision was adopted.

The General director of ANRE Victor Parlicov said that the agency filed a lawsuit to cancel decision rendered by the Appeals Chamber, on the grounds that it was unduly and that a preliminary investigation was not properly followed. The ANRE leadership noted that if the Supreme Court of Justice upheld the decision of the Appeals Chamber on the proposition of recalculation of tariffs for energy resources, the agency will obey. The ANRE has increased since January 19 of this year at 13.9% average tariff for the supply of natural gas, at 20,9% tariff on electricity and at 29,2% - on the heat.

4. Gazprom will increase by 9% the price of natural gas supplied to Moldova

From April, 1 the price of natural gas supplied to Moldova by Gazprom, will increase from \$233 up to \$253 per thous.cm, which would entail a rise in price of natural gas for household consumers. Due to the 9% growth in purchase price for gas and the difference of the exchange rate that was embedded by the ANRE in the tariff, the ultimate price for the "blue fuel" for consumers in Moldova could rise in April by more than 10%, explained CEO of the National Agency for Energy Regulations Victor Parlicov.

According to SC "Moldovagaz" projections, in 2010 the purchasing price of the Russian gas for Moldova will not exceed \$ 242.

5. "Paper investments" of the Russian shareholder. Inter RAO UES intends to invest \$87 million in the largest power plant of the country Moldavskaya GRES. In the explanatory note to the financial statements for 2009, the Russian company Inter RAO UES informed that in December 2009 it acquired 62.55% ordinary shares of CJSC Moldavskaya GRES for about \$87 million as

result of increase of company's authorized capital up to \$139 million in the separate region of Moldova.

According to the INTER RAO UES, these funds are intended for implementation of investment commitments made during the privatization of the CJSC Moldavskaya GRES, and will be used for station modernization. But informed sources suggest that all these investments are actually made mostly on paper, and that Russian shareholders have used the CJSC Moldavskaya GRES for money laundering. As an argument, they cite a number of deals with various offshore companies, whereafter Inter RAO UES has become a shareholder.



Ukraine

1. Key appointments in the Ukrainian energy sector. Appointments in the Government and public companies, made in March, indicate that a number of key positions in the Cabinet of the Ministers, the Presidential Administration and the energy sector are occupied by the representatives of the “Gas Syndicate” (*see Annex 1*), controlled by oligarch Dmitry Firtash:

- Head of the Presidential Administration of Ukraine - Sergey Levochkin,
 - Head of the Security Service of Ukraine - Valery Khoroshkovsky,
 - Minister of Fuel and Energy - Yuri Boyko,
 - Chairman of the Board of the National Joint-Stock Company “Naftogaz of Ukraine” – Yevhen Bakulin,
 - Director General of the gas transportation company “UkrTransGaz” - Sergey Vinokurov,
 - Director General of the gas producing company “UkrGazVydobuvannia” - Yuri Borisov.
- The latter two until recently were managers in Firtash’s “OstShem Holding AG” (*see Annex 1*).

The concept of “Gas Syndicate” can be obtained from an interview with the notorious since 90-ies Ukrainian gas oligarch Igor Bakay, hiding in Russia from criminal prosecution. The interview was given during the presidency of Viktor Yushchenko in January 2009, at the height of the gas crisis, but some retrospective assessments are very noticeable. Below are some fragments that characterize the current key government officials belonging to the “Gas Syndicate”:

“In addition to odious Firtash’s figure, the brightest and most well-known figures of the “syndicate” are Misters Levochkin and Boyko. And now they have very high level lobbyists. Unfortunately, they are not only drawn Yushchenko into their company, but also engaged Yanukovych as a lobbyist of their interests. At the same time, misleading them both, they hope to preserve their criminal business ...”.

“Just with their appointments the level of corruption in Ukraine has become one of the highest in the world, and hurt all the echelons of authority. As you can see, today they don’t hesitate to represent the interests of the “RosUkrEnergo” as public interest.”

“If a gas war with Russia ends for Ukraine with gas price 450 dollars, which today is simply deadly for the economy, the Ukrainian people must know that it is done “thanks” to Mrs. Boyko, Firtash, and Levochkin efforts.”

(Ihor Bakay: Firtash, Boyko, “Lace” Levochkin and President Viktor Yushchenko devastate Ukraine, 16.01.2009, http://www.cripo.com.ua/?sect_id=2&aid=65436)

It should be noted that the price of gas at 450 dollars has become the base price in the proposed on Jan. 19, 2009 by Gazprom “European price formula” for gas for Ukraine.

In addition, we should draw attention to “RosUkrEnergo, which was launched in Yalta in 2004, as a large-scale transnational business scheme of nontransparent gas trading in Ukraine and the EU that was materialized, not least, thanks to “Gas Syndicate” efforts.

The Center “NOMOS” with the support of the International Renaissance Foundation in the framework of the project “Oil and Gas Sector of Ukraine: the transparency of operations and revenues” in 2007-2008 performed an assessment of scale of the installed in 2004 system of the “RosUkrEnergo” gas business. Below are snippets of the report of NGO’s project results, published in 2008.

“Yalta-2004, where the meeting between the Presidents of Ukraine and Russia took place, meant for Ukraine the loss of direct gas relations with Turkmenistan. From the intergovernmental level these relations passed to the commercial level with participation of a new opaque mediator – the company “RosUkrEnergo” (RUE), which signed the contracts with Gazprom and “Naftogaz of Ukraine”.

Gazprom clarified: *“the documents are signed to develop agreements of two states chairmen in Yalta about forming of single gas balance of Russia and Ukraine. Gazprom unveiled only a part of documents so far, but they also can be considered as a sensation.”* (“Kommersant” № 138 (2977), 30.07.2004)

The signing of a package of agreements between RUE and “Naftogaz of Ukraine” reformatted direct gas relations between Ukraine and Turkmenistan in trade through an intermediary. There is a high probability to assume that the approval of an opaque scheme by the leadership of Ukraine and the state company “Naftogaz of Ukraine” is a result of several factors, including corruption.

In particular, the name of the then head of “Naftogaz of Ukraine” and the First Deputy of Fuel and Energy Minister Yuri Boyko was marked in the minutes of the Coordinating Board of the RUE as a private person representing the Austrian company “CentraGas AG”, owned by D. Firtash. (*See Annex I*). His signature is also under the basic contract between the RUE and “Naftogaz of Ukraine”. This is incompatible with the status of public person, which the deputy minister is.

The Annex gives an idea about the parameters of a signed contract. The total volume of the contracted gas by the RUE corresponds to the volumes of the contract signed between “Gazprom” and “Turkmenneftegaz” in 2003 and makes **1337 bcm** during the validity of the contract. **Costs of these gas volumes in the prices of 2007 make ~\$210,4 billions.** Annual generated **financial flow makes ~\$9,6 billions** in the prices of 2007. **Gross revenue of RUE** can make on the average **not less ~\$1,3 billions.** Thus, generated income is, due to the use of potential of Ukrainian state GTS and UGS, redistributed in behalf of private individuals and does not work in behalf of society. The scheme of specific “black box” of transnational scale’s gas business is formed. And not in the Russian-Ukrainian format, as it is usually considered. Actually, this format is trilateral - Russia – Ukraine – the EU. The co-coordinating advisory council of RUE consists of 8 persons including 2 citizens of EU-countries, having very serious connections. At entrance in the scheme is Central Asian gas resources, at exit, in Swiss Canton Zug, is a money flow, redistributed nontransparently between private shareholders, which use capabilities of the state gas transporting system and underground gas storage facilities.

Financial resources, circulating out of control, represent serious potential, including corruption. Company registration in the canton of Zug means that its activities are out of control by any competent authorities of Ukraine, Russia or the EU. On the governing body decision money may be transferred to the accounts of various individuals and entities, as well as in order to solve any problems and maintain the opaque gas-trading scheme. For example, the RUE shares (there are one thousand such shares) can be transformed from nominal into bearer shares, and vice versa. This opens up opportunities for the real owners for their opaque turnover. This is one of the reasons that in 2005-2006 this scheme was not been eliminated, but on the contrary, could even be strengthened through the creation of a joint venture “Ukrغازenergo” (UGE) by the RUE and “Naftogaz of Ukraine”. In 2007, the scheme “RUE – UGE” practically took away the biggest share of the domestic gas market from the state company “Naftogaz of Ukraine” that led to a sharp drop in financial performance of the company. Practically, this “coupled scheme” became a tool of gas market usurpation in Ukraine by the Russian gas monopoly.

Analysis of the Yalta-2004 indicates that there was not only upgrade of the gas trading scheme with having respect to the business interests of political figures, but the simultaneous correction of the strategic priorities of Ukraine. Perhaps it was a Russian package approach with long-term objectives (until 2028). Financial potential of the RUE schemes and extensive network of corrupt lobbyist communications enable the Russian side to actively influence on Ukraine, seeking strategic concessions. Here is a media illustration of events of July 26th, 2004:

“From the military doctrine of Ukraine positions concerning entry in NATO and European Union as ultimate goals of policy of Euro-Atlantic and European integration of country are excluded. It is mentioned in the decree of the President of Ukraine Leonid Kuchma, signed on

July 15th. It was published only on July 26th – before the meeting of the presidents of Russia and Ukraine in Yalta.”

Andrey Miseluk, Kiev, www.bbcussian.com, 2004/07/26 17:19:09 GMT

From the above mentioned we can presume that with the return of the “Gas Syndicate” personalities to power gas business in Ukraine will not become more transparent. On the contrary, opaque schemes of the gas business will be reanimated or newly created according to the algorithm worked out before. Therefore, reappearance of the idea of the gas transportation consortium to manage Ukraine's gas transport system is explicable. The “syndicate” is not inspired to reform the energy sector in general and the gas sector in particular. But, its interests come into conflict with the interests of the government, which wants to resume cooperation with the IMF and international banks. The condition of restoration of crediting of Ukraine by international financial institutions is to reform the gas sector. Terms of reform were set out in the relevant memorandum (*see Annex 2*), adopted in summer 2009. Azarov’s government comes from the fact that these conditions were adopted for Yulia Tymoshenko’s government and for the old program of cooperation with the IMF, so a new program should be adopted for the new government. In such way the “Gas Syndicate” will try to soften the conditions for the reform of the gas sector.

Some steps of Yanukovich’s team show that they try to use “Yalta scenario” - political concessions in exchange for cheaper gas. In particular, the presidential decree abolished the National Center for Euro-Atlantic integration - the main institution responsible for the preparation of Ukraine's joining the NATO, as well as the two leading think tanks in the system of the National Security and Defense Council of Ukraine - National Institute of International Security Problems and the Institute of National Security Problems. Abolished Institutions worked on, in particular, themes of European and Euro-Atlantic integration of Ukraine and energy security.

2. On March, 25 the Prime Minister of Ukraine Mykola Azarov held talks in Moscow with the Russian Prime Minister Vladimir Putin about the lowering the price for gas supplied by Gazprom to Ukraine. Kiev expected to secure the price of \$168 for 1 thous.cm (that Belarus pays) instead of the current price of \$305 for 1 thous. cm. Ukrainian negotiators proposed a maximum set of possible concessions, including the establishment of a consortium to manage Ukraine's gas transportation system and the possibility of direct access of the Russian gas monopoly to Ukrainian industrial gas consumers. The Russian side has defiantly ignored these proposals. The Russian Premier Minister invited Ukraine to join the Customs Union of Russia, Belarus and Kazakhstan in order to be able to get gas for Belarusian price. However, this Russian proposal is unacceptable for Ukraine, because Ukraine is a member of the WTO. Negotiations have stalled and have been conducting in “backstage mode”. It is possible that in exchange for lowering gas prices Ukraine will agree on long-term deal with Russia to supply nuclear fuel for its 4 nuclear power plants and will reject to cooperate with the U.S. Westinghouse. It will jeopardize relations with the United States.

The Cabinet of Ministers of Ukraine is preparing the budget bill with the gas price of \$334 per 1 thous. cm. The President of Ukraine Viktor Yanukovich instructed M.Azarov to prepare and convey to the Russian side Ukrainian offers for lowering gas prices. Simultaneously, the government is trying to launch projects that might have some effect of pressure on the Russian side and to encourage it to softer price policy.

3. On March, 18 the Ministry of Fuel and Energy issued a draft order of the Cabinet of Ministers of Ukraine “On approval of the plan to initiate an investment project “Delivery to Ukraine of liquefied natural gas and the construction of regasification terminal”.

Elaboration of a draft order is dictated by:

- the need to ensure country’s demand in natural gas of alternative (non-Russian) origin;
- the need to diversify routes and sources of supply;
- the increase of the reliability and stability of gas supply;
- the increase of competition on the domestic gas market in Ukraine;

- the possibility to load the shipbuilding industry of Ukraine (construction of tankers in cooperation with foreign companies).

Liquefied natural gas (LNG), according to the Ministry, is practically the only way to provide real diversification of imports of this source, which transportation is not associated with transit through the territory of third countries. This policy fully meets the trends of the natural gas market in the European Union, where capacities to receive LNG have been increasing every year.

The cost of LNG terminal with capacity of 10 bcm per year is estimated over \$1 billion. The final choice of regasification terminal location should be made during the preparation of a feasibility study and business plan. In the analysis, in which almost all major ports of Ukraine were examined, it was concluded to consider further three possible locations of the LNG terminal: Feodosia (Crimea), Ochakov (Kherson region), Yuzhniy (Odessa region).

In case of adoption this order by the Cabinet of Ministers of Ukraine, it is expected to hold talks with potential investors until June.

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