



## Gas Deal Signed With Russia Gas Supplies to Resume to Europe

Prime Minister Yulia Tymoshenko and her Russian counterpart Vladimir Putin, were present in Moscow to witness Gazprom and Naftohaz sign a ten year contract that brings an end to the gas dispute. Following signature of the contracts, instructions were given to resume gas flows to Europe.



▲ Prime Minister Yulia Tymoshenko and Russian Prime Minister Vladimir Putin agreed a deal to get the gas flowing again in the early hours of Sunday morning.

The basis of the deal, agreed over the weekend, involves Ukraine paying 20 percent less than the European market price for gas in 2009. In return, the existing discounted tariff Gazprom pays for its gas to be transported through Ukraine's pipeline system to Europe will remain in place until the end of the year. On 1 January 2010, both countries will then pay European market prices for gas supply and transit respectively.

Ms Tymoshenko described the agreement as "historic" and said that Europe would receive supplies "as soon as the gas passes through our pipelines. There won't be any delay."

She also took time to call José Manuel Barroso, the President of the European Commission, whom she thanked for the EU's assistance in helping to resolve the dispute.

In 2008, Ukraine paid \$179.50 per thousand cubic metres of gas, which is slightly less than half the current market price for European countries. Under the new contract Ukraine is likely to pay less than \$250 per thousand cubic metres. A higher rate will be paid in the first quarter but this will decrease as the price of gas catches up with the price of oil. The latter has plummeted from about \$147 in July to as low as \$35 a barrel today.

Supply contracts for natural gas tend to be lengthier than oil contracts and, typically, gas prices lag behind oil prices by six to seven months. According to Ronald Smith, a strategist at Alfa Bank, by midsummer Ukraine could be paying as little as \$150 per thousand cubic metres.

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EU officials welcomed the contract signature, sounding a cautiously optimistic tone. "The proof of the pudding is in the eating and the proof of the gas is in the flowing," remarked Johannes Laitenberger, a European Commission spokesperson.





▲ Hammering out a deal. The gas talks in Moscow began last Saturday.

The new deal also removes intermediaries from the supply of natural gas to Ukraine; something Prime Minister Tymoshenko has long campaigned for (see article below). The agreement also maintains Ukraine's sovereignty over its gas transit system, which is a prized national asset that has long been coveted by Gazprom. Ukraine transports about one-fifth of the EU's gas supplies.

The eventual move to European market prices should benefit both countries. A major benefit for Ukraine is that Russia will no longer be able to use its energy card to exert influence over Kyiv.

"We seek to develop closer energy ties to Europe," said Hryhoriy Nemyria, Deputy Prime Minister responsible European integration, "energy security, transparency and stability of supply are fundamental tenets underpinning future energy cooperation."

Securing a deal to end the dispute was a coup for Ms Tymoshenko. "Ukraine's prime minister has again affirmed her pragmatic approach in terms of dealing with Russia," said Tim Ash, a senior emerging markets banker for the Royal Bank of Scotland.



## Intermediaries Removed From New Gas Deal

**The shady intermediary RosUkrEnergy (RUE) has been eliminated from the newly brokered deal to supply natural gas to Ukraine, heralding a new era of transparent contractual relations between Naftohaz and Gazprom.**

The seismic shift in the Kremlin's policy towards RUE is not surprising and comes after years of patient lobbying by Prime Minister Yulia Tymoshenko whilst in the opposition and in government.



At the height of the gas dispute, when claims and counter claims were being traded thick and fast between Moscow and Kyiv, Russia's Prime Minister Vladimir Putin lambasted Ukraine's leaders and RUE. Mr Putin even suggested that some political leaders were profiting from the presence of the Swiss-registered company in supplying gas to Ukraine.

"What (they) are fighting for today is not the gas price, but a chance to keep their middlemen in order to use the dividends obtained for personal ends and personal enrichment and in order to receive financial resources needed for their future political campaigns," said Mr Putin.

On the eve of the gas talks in Moscow, Ms Tymoshenko also made this linkage. She claimed



that the terms for a gas deal were agreed on 30 December 2008, "But during the last two days of the year, those political forces within Ukraine that have corruption links to the shadowy middleman, RosUkrEnergo, took the opportunity to ruin the signing of the contract, and sabotage the entire painstakingly constructed process of negotiation."

## Dubious Role Acknowledged

Russian acknowledgement that RUE had a dubious role in the gas trade indicates a welcome about-turn in Kremlin policy. It is a far cry from February 2007, when, at the Munich Conference, Mr Putin said that he considered President Yushchenko's signing of the gas deal with RUE was "a responsible, absolutely correct and market-oriented decision."

Ms Tymoshenko, and the leaders of her eponymous bloc, made it a condition of the talks that the scandal plagued intermediary play no further part in future gas contracts between the two countries.

But some of Ms Tymoshenko's critics suggested that Ukraine's premier was only interested in replacing RUE with another intermediary that would benefit her alleged associates. Party of

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"This hardly merits comment," said a Bloc of Yulia Tymoshenko (BYuT) spokesperson,

"Ms Tymoshenko has been consistent over the years and emphatic about the removal of *all* intermediaries. This latest contract confirms that."

Mr Boyko's assertion was even dismissed by those in his own party. Zik reported that the prominent Party of Regions lawmaker Nestor Shufrych "called Boyko's statement an irresponsible provocation."

## Removal of Intermediaries

Ms Tymoshenko, has for years steadfastly campaigned for the removal of RUE from the supply of natural gas to Ukraine. Having famously described it as a "corrupt cancer," she has advocated, and has now succeeded in securing, a transparent and direct contractual relationship between Naftohaz and Gazprom. In July 2006, in the Wall Street Journal, Ms Tymoshenko attacked RUE's role saying, "Such arrangements diminish investor confidence and heavily burden countries such as Ukraine that are attempting to break away from past corruption and inefficiency."

## Chequered History

Headquartered in Zug, Switzerland, RUE, which is owned 50:50 by Gazprom and Centragas AG, has had a chequered history. It has been plagued by alleged links to organised crime, an investigation by the US Justice Department, and an opaque ownership structure that hid the identities of its Ukrainian beneficiaries. Its auditor, KPMG International, resigned over concerns that its association with the company could damage its reputation.



▲ Russian Prime Minister Vladimir Putin agreed to remove RUE.



After persistent allegations of shady dealing and intense media speculation, the identities of its Ukrainian beneficiaries were finally revealed in April 2006. The story was broken by Izvestia (the Gazprom owned daily newspaper) in what was regarded as a move to halt damaging rumours. The owners proved to be Ukrainian businessman Dmitry Firtash, whose company Group DF owns 90 percent of Centragas AG, and Ivan Fursin a close business associate, who owns the remaining 10 percent.

## Welcome Shift by the Kremlin

The shift in Kremlin policy regarding RUE took place long before the gas dispute. Last October, Prime Minister Putin met with Ms Tymoshenko and signed a memorandum that agreed, amongst other things, the removal of intermediaries from future gas contracts. At the time, BYuT hailed this as a huge step in the right direction.

More recently, Naftohaz CEO Oleh Dubyna indicated he would prefer to resign if the intermediary stayed.

Writing in the Financial Times (15 January), Diarmid O'Sullivan and Tom Mayne, of the British anti-corruption watchdog Global Witness, called upon the EU to use its regulatory powers to ensure that companies trading in its energy markets operated with full disclosure and transparency. They wrote: "As Europeans, we need to know who supplies our oil and gas. We need to know who owns the companies and what qualifies them to play the role that they do. We need to know how they price their energy and how much revenue they pay. We need to be assured that they came by their contracts in an open and transparent manner."



The removal of RUE is an important first step.

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## Yushchenko Loses Control Over His Faction

**Mykola Martynenko has been elected to head the Our Ukraine-People's Self Defence (OU-PSD) faction. His deputies are: Oleksandr Tretiakov, Ruslan Kniazevych, Taras Stetskiv and Borys Tarasiuk. All five are members of the new enlarged democratic coalition that comprises the Bloc of Yulia Tymoshenko (BYuT), OU-PSD and the Lytvyn bloc.**



▲ Presiding over the decline of OU-PSD. Many lawmakers remain deeply concerned about the degree of control exerted over the president by Mr Baloha.

The new OU-PSD leadership indicated that the president has completely lost control over his faction. Mr Martynenko said, on 16 January, that the "faction would no longer be the property of the president." Then, in what was clearly a reference to past attempts by the Presidential Secretariat to dictate OU-PSD policy and voting behaviour, Mr Martynenko said, "The decisions of the faction would be decided directly by lawmakers."

It is possible that as many as 20 out of the 30 lawmakers outside the democratic coalition may now cross over and align behind the pro-Tymoshenko government coalition. The Chief of Staff of the President's Secretariat is Viktor Baloha. His United Centre party is opposed to the new coalition but now controls only 10 out of OU-PSD's 72 lawmakers.



## Hottest Seat In Parliament

If you thought the prime minister or speaker had the "hottest seat" in the 450-seat Verkhovna Rada you would be very wrong. That accolade goes to Bloc of Yulia Tymoshenko (BYuT) lawmaker Valentyn Zubov, whose electronic voting system caught fire during a break in Friday's plenary session. According to *Interfax*, Mr Zubov said that he saw smoke coming from the equipment after inserting his voting card into the system. It must have been a heated debate!



Messrs. Martynenko and Tretiakov, are businessmen who were once loyal to President Yushchenko and funded Our Ukraine from its launch as Yushchenko's party in 2001. Their defection to the Tymoshenko-led coalition ranks is a sign of their frustration with Mr Baloha's control over the president and the resultant strategic mistakes made by him that have reduced the president's popularity to low single digit figures. The defection of OU-PSD businessmen to the pro-Tymoshenko coalition also reflects how small Mr Yushchenko's support base has become.

OU-PSD deputy Davyd Zhvannia lobbied for Mr Martynenko to be elected head of OU-PSD. Mr Zhvannia fell foul of the president last year when there was a politically inspired attempt to strip him of his Ukrainian citizenship after he refused to toe the presidential

line in the May 2008 Kyiv city council pre-term elections. Mr Zhvannia became a Ukrainian citizen in 1999 after renouncing his Georgian citizenship.

Mr Yushchenko will enter the presidential elections with a very low popularity of 2.4 percent (according to a January Democratic Initiatives poll) and a tiny political support base composed of Our Ukraine (one of the 9 parties in OU-PSD) and United Centre. There is no unity among these two remaining pro-Yushchenko parties as Our Ukraine refuses to cooperate with United Centre.



The two pro-presidential parties are divided over two important issues. Firstly, Our Ukraine, headed until recently by Vyacheslav Kyrilenko, is opposed to a grand coalition with the Party of Regions, while United Centre supports a grand coalition. Secondly, Mr Kyrilenko's group in parliament does not support a vote of no confidence in Ms Tymoshenko's government, while United Centre is aligned with the Party of Regions in supporting the government's removal.

With a fractured bloc and dwindling political support, the ability of President Yushchenko to muster orange voters must now be questioned. As it stands, this latest development is likely to make the presidential election a two-horse race between BYuT and the Party of Regions.

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