

## **NEW COMPLICATIONS IN UKRAINE'S ENERGY SITUATION**

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by Vladimir Socor

Indications are multiplying that the Ukrainian government is abandoning a project to extend the Odessa-Brody pipeline into Poland as a route for Kazakhstani oil outside Russian control. Instead, the Ukrainian government now intends to connect the Odessa-Brody pipeline with the Druzhba pipeline that carries Russian oil westward via Ukraine and Slovakia.

On December 12 in Kyiv, Fuel and Energy Minister Yuriy Boyko discussed these intentions with the visiting Slovak Economy Minister Lubomir Jahneček. At Kyiv's initiative, the ministers decided to set up a joint working group for drafting an agreement on oil transit. Under the new concept, oil volumes pumped through the Odessa-Brody line into Druzhba, and onward through Slovakia would reach the Kralupy and Litvinov refineries in the Czech Republic.

Boyko obliquely admitted in his public remarks that Kazakhstan has some reservations about this proposal. Indeed, Kazakhstan may be reluctant to have its high-quality oil mixed with lower-grade Russian oil in the Druzhba pipeline. As a further drawback to this shift, Russian state companies are eyeing Slovakia's oil transit pipeline for takeover, whereas an extension of Odessa-Brody into Poland would have been immune to a Russian takeover. Integrating the Odessa-Brody project with Druzhba would defeat the project's basic purpose of avoiding any form of Russian control. However, the Ukrainian government's main consideration at this stage is apparently to come up with an alternative to the Polish route. "We see Europe represented by Slovakia," Boyko declared, signaling the shift away from Poland (UNIAN, December 12).

Ukrainian President Viktor Yushchenko first proposed switching from the Polish to the Slovak route in late October, and Prime Minister Viktor Yanukovich informed Polish Prime Minister Jaroslaw Kaczynski about Kyiv's change of plans in mid-November. Moreover, on November 28 at the CIS summit in Minsk, Yushchenko suggested to President Alyaksandr Lukashenka that the Odessa-Brody pipeline could be used for supplying refineries in Belarus as well (see EDM, November 16, December 12).

However, the Odessa-Brody pipeline's capacity is insufficient for supporting two extensions on commercially attractive terms. Thus, the now-proposed Slovak route is alternative, not complementary, to the initially proposed Polish route. Boyko is also being identified as obstructing contractual arrangements with U.S. companies to explore for oil and gas on Ukraine's continental shelf in the Black Sea. Earlier this year, the Houston-based Vanco Energy company won a competitive tender and contract for offshore exploration in a 12,000-square-kilometer deep-water exploration area. After the change of government in Kyiv, however, Boyko's ministry declined to move forward with a production-sharing agreement, which would normally have been the next step after the award of contract to Vanco. Instead, the minister invited Russia's Gazprom to participate (RFE/RL, December 4, 7).

Another Houston-based company, Cardinal Resources, complains about being squeezed out of a contractual commitment with the government-controlled Ukrnafta to develop gas deposits in Ukraine. Cardinal blames the situation on an unnamed Ukrainian oligarch who opposes Western investment and seemingly exerts undue influence on Ukrnafta's policy. The Vanco and Cardinal situations came up in the run-up and during Yanukovich's recent visit to Washington (Washington Post, December 2; Washington Times, November 21).

When Yanukovich first visited Washington as Ukrainian prime minister in 2003, U.S. Vice-President Richard Cheney persuaded him to postpone a decision on allowing Russian companies to use the Odessa-Brody pipeline southward for Russian oil, instead of Caspian oil going northward. By 2004, however, Russia conclusively thwarted oil deliveries from Kazakhstan to Odessa-Brody, thus facilitating Kyiv's decision to allow Russian "reverse-use" of the pipeline.

That year, Boyko in his then-capacity as head of Naftohaz Ukrainy was instrumental in bringing Gazprom's shadowy offshoot RosUkrEnergo for the first time into Ukraine. At present, RosUkrEnergo and its offshoot, UkrGazEnergo, are using their monopolistic positions as transit operator and industrial distributor, respectively, of Russian gas in attempting to take over Ukrainian companies. Thus, the managements of gas supplying and distributing companies in seven Ukrainian oblasts, including six western oblasts, complain that RosUkrEnergo is pressuring owners (in some cases through law-enforcement bodies) to hand over controlling stakes in the companies (Interfax-Ukraine, December 8).

For its part, UkrGazEnergo has discontinued gas deliveries to 16 energy and manufacturing companies, many of them associated with the Pryvat conglomerate, apparently attempting to force a transfer of shares. UkrGazEnergo has failed to answer repeated inquiries from Ukraine's Anti-Monopoly Committee regarding this situation (Interfax-Ukraine, December 12).

UkrGazEnergo's near-monopoly on selling gas to industrial users is a major contributory factor to the financial crisis of the national oil and gas company Naftohaz Ukrainy. Confined since February of this year to the non-lucrative, tightly regulated market for municipal and household consumers, Naftohaz has fallen precipitously into debt and a crippling cycle of taking out new loans to repay previous loans against its own assets. According to the deputy prime minister responsible for energy, Andriy Kluyev, the cabinet of ministers plans to restructure a portion of Naftohaz' debts. The company's total borrowings are reported at \$2.17 billion (some 90% of these in the form of foreign bank loans) and its tax arrears at 3.7 billion hryvnias (some \$740 million) -- staggering sums for a company with relatively modest revenues (Interfax-Ukraine, December 13).

Naftohaz last showed a profit at just 8 million hryvnias in 2004, then losses of 1.84 billion hryvnias (some \$360 million) in 2005; and it expects bigger losses in 2006. Pushing Naftohaz into insolvency, preparatory to some form of Russian takeover, was

Moscow's goal behind the RosUkrEnergo and UkrGazEnergo deals signed in January-February of this year with the pro-Yushchenko government in Kyiv. The current government now conveniently blames the Naftohaz situation on their predecessors.

--Vladimir Socor