

# ASIAN CULTURES AND MODERNITY

Research Report No. 15, November 2008

Natural-Gas Trade  
between Russia, Turkmenistan,  
and Ukraine

*Agreements and Disputes*

Michael Fredholm



*Department of Oriental Languages*

*Department of Political Science*

# Asian Cultures and Modernity

## Research Reports

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Department of Oriental Languages

Stockholm University

SE-106 91 Stockholm

E-mail: [asiancultures@orient.su.se](mailto:asiancultures@orient.su.se)

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Asian Cultures and Modernity  
Research Report No. 15

**Natural-Gas Trade between Russia,  
Turkmenistan, and Ukraine**  
**Agreements and Disputes**

by

Michael Fredholm  
Department of South and Central Asian Studies  
Stockholm University

***Editorial Note***

The author has written extensively on the history, defence and security policies, and energy sector developments of Eurasia. He also heads the business research company Team Ippeki. The views presented in this article are those of the author alone and do not represent those of the Swedish government or any other group.

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# Natural-Gas Trade between Russia, Turkmenistan, and Ukraine

## Agreements and Disputes

### *Abstract*

1. Since independence, Ukraine's dependence on cheap natural gas, either from Russia or at least transited through Russia, in combination with Russia's need to export natural gas to western Europe, has consistently caused disturbances in the relations between the two countries.
2. Russia depends on Ukraine, for the transiting of natural gas primarily aimed for Europe but also to some extent for moving natural gas into southern Russia and the Caucasus.
3. Turkmenistan remains a major supplier of gas to both Russia and Ukraine, regardless of its deals with China.
4. The trade in natural gas between the three countries has been characterised by opaque relationships, secret contracts, and hidden beneficiaries, which, most observers conclude, has engendered substantial corruption, with serious losses to both the Russian and Ukrainian states as well as consumers and shareholders there and elsewhere in Europe.
5. Contrary to the view common in western media, it is Russia's gas export monopoly Gazprom that since about 2002 has aimed at introducing businesslike practices in the trade relationship, while various Ukrainian interests have striven to retain opacity and procedures not open to scrutiny.
6. Russia and Turkmenistan have agreed on a new, market-based pricing mechanism for export gas from 2009 onwards.
7. The introduction of export prices aligned to those being paid elsewhere in Europe will not immediately help Ukraine solve its chief problem: an obsolete, energy-inefficient heavy industry sector that depends on imports of cheap natural gas.

## ***Introduction***

The three countries Russia, Turkmenistan, and Ukraine are for historical reasons, dating back to Soviet times and the infrastructure then in place, closely tied to each other in the natural gas trade. All three countries produce natural gas, but while Turkmenistan exports far more than it consumes, and Russia despite a high level of consumption also manages to export very substantial amounts of gas, Ukraine consumes significantly more than it produces (see Table 1). The three countries thus have quite different needs when it comes to gas. Because of the available gas transportation infrastructure, they still need each other, so a considerable trade in gas among the three has emerged. This work aims to describe how this trilateral relationship has developed since the dissolution of the Soviet Union in 1991, and to analyse how it is faring at present and what can be expected to come out of it in the near future.

To achieve this, it will be necessary briefly to assess the available gas transportation infrastructure.

Then one must go on to investigate the gas trade relationships between first Russia and Turkmenistan, then Russia, Turkmenistan, and Ukraine. The gas trade cannot always easily be separated into bilateral relationships. Indeed, the three countries form a natural troika in gas production, transit, and consumption. Even so, the emphasis will be on Russia and Ukraine, since Turkmenistan for geographical reasons usually was forced to be a fairly passive actor in the trade relationship.

Since the gas trade relationship between the three countries to a large extent seems to have been shaped by the interests of the individuals involved, rather than state interests or pure commercial motives, a large number of individual actors - politicians, traders, and businessmen - will be introduced. The key actors of the drama are further described in the appendix.

***Table 1. Natural Gas Production / Consumption (billion cubic metres)***

Year	Turkmenistan	Russian Federation	Ukraine
1990	81.9 / 9.8	597.9 / 420.1	26.2 / 127.8
1991	78.6 / 9.6	599.8 / 431.1	22.8 / 121.5
1992	56.1 / 9.3	597.4 / 417.3	19.6 / 103.5
1993	60.9 / 9.3	576.5 / 416.0	17.9 / 92.9
1994	33.3 / 10.2	566.4 / 390.9	17.0 / 81.3
1995	30.1 / 8.0	555.4 / 377.8	17.0 / 76.2
1996	32.8 / 10.0	561.1 / 379.9	17.2 / 82.5
1997	16.1 / 10.1	532.6 / 350.4	17.4 / 74.3
1998	12.4 / 10.3	551.3 / 364.7	16.8 / 68.7
1999	21.3 / 11.3	551.0 / 363.6	16.9 / 73.0
2000	43.8 / 12.6	545.0 / 377.2	16.7 / 73.1
2001	47.9 / 12.9	542.4 / 372.7	17.1 / 70.9
2002	49.9 / 13.2	555.4 / 388.9	17.4 / 69.8
2003	55.1 / 14.6	578.6 / 392.9	18.0 / 67.8
2004	54.4 / 15.5	591.0 / 401.9	19.1 / 73.2
2005	58.8 / 16.6	598.0 / 405.1	19.4 / 73.0
2006	62.2 / 18.9	612.1 / 432.1	19.1 / 67.1
2007	67.4 / 21.9	607.4 / 438.8	19.0 / 64.6

Source: *BP Statistical Review of World Energy June 2008* (www.bp.com)

## ***Available Gas Transportation Infrastructure***

When it comes to available infrastructure, there is no denying that so far, both Turkmenistan and Ukraine depend on Russia. Even though Turkmenistan has been working on various other solutions for its natural gas exports, including ongoing work on a pipeline to China, Turkmenistan can at present only export gas through Russia, except for limited swaps with Iran, the latter a trade that in any case was suspended on 1 January 2008.<sup>1</sup>

Ukraine, on the other hand, at present receives all its gas via Russia, whether it comes from Russian or Central Asian fields. But Russia depends on the use of the Ukrainian pipeline system for much of its transit needs for exports to western Europe.<sup>2</sup> Prior to the completion of the Yamal-Europe natural gas pipeline, inaugurated in 1999 with a total capacity of 32.3 billion cubic metres (bcm), which passes through Belarus, around 90 per cent of the Russian gas exports to Europe had to pass through Ukraine.<sup>3</sup> Some 84 per cent of Russian gas exports, and 14 per cent of Russian oil exports, still transit through Ukraine on its way to Europe.<sup>4</sup> Due to its virtual transit monopoly, Ukraine gained considerable leverage over Russia, which allowed Ukraine to build up a major debt to Russia. Ukraine, as will be shown, also siphoned off significant amounts of Russian gas from the pipeline.

There are three major routes for transportation of gas through Russia. The Northern route, which has the highest load, delivers gas from the Nadym-Pur-Taz gas production area (where 80 per cent of Russian gas is produced, and which is expected to remain the main resource base until at least 2010) to consumers of north-western Russia as well as facilitates exports to the Baltic countries, Belarus, and western Europe. The Central route provides gas (again from the Nadym-Pur-Taz area) to consumers in central Russia and facilitates export to Europe by way of Ukraine. The Southern route, which is the least loaded, delivers gas from the same area but also from Turkmenistan, Kazakstan, and Uzbekistan to consumers in southern Russia and adjacent countries including Ukraine and Turkey (through Blue Stream, a gas pipeline across the Black Sea).<sup>5</sup> Most Russian gas exports to Central Europe transits through an export network often known from the old Soviet name of one of its components as Bratstvo (“Brotherhood”), which consists of several routes through Ukraine, namely: through Ukraine and Poland; through Belarus and Ukraine to Slovakia and Hungary; and through Ukraine and Moldova to Romania, with an extension to Bulgaria and Turkey (known as the Russia-Turkey pipeline), and with another extension from Bulgaria to Macedonia and Greece.<sup>6</sup>

The Russian gas transported to Europe through Ukraine moves along three main pipeline corridors:<sup>7</sup>

1. The central corridor, which includes (1) the Urengoy-Pomari-Uzhhorod pipeline and (2) the parallel, Progress pipeline (which originates in the Yamburg gas field).
2. The pipelines from Bryansk and Tula (the Bratstvo lines) that bring gas to Kiev and then join the main westward system.
3. The Soyuz pipeline from the Orenburg gas field, and other lines from Aleksandrov Gai, that enter Ukraine east of Novopskov and run westward to Uzhhorod.

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<sup>1</sup> Yigal Schleifer, “The Iranian-Turkmen Gas Row: And the Winner is...Russia,” *Business & Economics* (www.eurasianet.org), 28 January 2008.

<sup>2</sup> See, e.g., Michael Fredholm, *The Russian Energy Strategy & Energy Policy: Pipeline Diplomacy or Mutual Dependence?* (Conflict Studies Research Centre, UK Defence Academy, Russian Series 05/41, September 2005).

<sup>3</sup> Matthew Sagers (Cambridge Energy Research Associates), in Bill Lahneman and Timothy R. Gulden, *Conference on the Geopolitics of Energy in 2015: Russia* (College Park, Maryland: National Intelligence Council Project, University of Maryland, 10 May 2002); Andreas Heinrich, “Gazprom: A Reliable Partner for Europe’s Energy Supply,” *Russian Analytical Digest* 1, 2006 (www.res.ethz.ch, www.russlandanalysen.de), 2-6, on 3. On the Yamal-Europe pipeline, see the EuRoPol Gaz s.a. web site, www.europolgaz.com.pl.

<sup>4</sup> International Energy Agency (IEA), *Ukraine: Energy Policy Review 2006* (Paris: OECD/IEA, 2006), 204.

<sup>5</sup> Interview with Rudolf Ter-Sarkisov, *Oil & Gas Eurasia* 6, 2005, pp. 54-8.

<sup>6</sup> See, e.g., IEA, *Russia Energy Survey 2002*.

<sup>7</sup> Simon Pirani, *Ukraine’s Gas Sector* (Oxford: Oxford Institute for Energy Studies, June 2007), 76.

There is also a major gas pipeline corridor that runs from central Russia into eastern Ukraine, through Novopskov and Luhansk, then out of Ukraine again and via Rostov-na-Donu to southern Russia.<sup>8</sup> The significance of this is that Russia until November 2007 was forced to transit considerable amounts of gas through Ukraine, and pay transit fees for this, merely to supply the southern parts of its own territory. This pipeline was also used for the supply of Russian gas to the southern Caucasus countries of Armenia, Georgia, and Azerbaijan (but not for the supply of gas from Turkmenistan, Uzbekistan, and Kazakstan to these countries, since such gas arrived through a different pipeline). In November 2007, a new bypass pipeline on Russian territory, from Sokhranovka to Oktyabrskaya, was completed to avoid this dependence, but this substitute may lack the capacity fully to compensate for the transit through Ukraine of gas aimed for southern Russia.<sup>9</sup> This was one of many side-effects of the fact that the old Soviet gas transportation system, like all other Soviet infrastructure and for that matter, the entire Soviet economy, disregarded the union state borders. In Soviet times it did not matter, but since 1991 these lines on the map have become international borders.

This means that to diversify either imports or exports, Russia, Turkmenistan, and Ukraine will have to build new gas transportation infrastructure. This is costly and not always feasible. In the gas trade, the three countries remain tied to one another.

Under these circumstances, it is hardly surprising that Ukraine also has expressed an interest in importing liquefied natural gas (LNG). In January 2006, the Ukrainian state oil and gas company Naftogaz Ukrainy announced that it had finished a feasibility study for an LNG terminal on the Black Sea coast with an initial capacity of 10 bcm. LNG would be imported from Libya, Egypt, and other countries, Naftogaz Ukrainy stated.<sup>10</sup> However, even so, this volume would not last long when it comes to satisfying Ukraine's need for natural gas (see Table 1).

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<sup>8</sup> Pirani, *Ukraine's Gas Sector*, 76.

<sup>9</sup> Gazprom press release, 21 November 2007.

<sup>10</sup> IEA, *Ukraine*, 176. Naftogaz Ukrainy may have been considering the AEGas Terminal (Aziatsko-Yevropeyskiy Gazovyy Terminal), in Kerch on the Black Sea, operated by the Kazakstani firm AEGas (Asian-European Gas) and established in 2005. The firm's plan was to ship liquefied petroleum gas (LPG) in the form of propane or butane from Kazakstan for onward sale to the European and Turkish markets. AEGas approached the European Bank for Reconstruction and Development (EBRD) for financing, but it declined, considering the business plan not viable. *Nefterynek* (Oil Market) 11, 2005; INOGATE (Interstate Oil and Gas Transport to Europe) Round Table presentation, Brussels, 24-25 June 2008.

## ***Russia and Turkmenistan in the Natural Gas Trade***

### ***Volumes***

Both Russia and Turkmenistan are important producers of natural gas, but Russia has since Soviet times also consumed significant amounts of natural gas from Turkmenistan. For obvious reasons, Russia was always a key market, for consumption or transit elsewhere, for Turkmenistani natural gas.

Russia has tied up the Turkmenistani natural gas production for several years through a series of contracts, even though these contracts do allow Turkmenistan higher gains from the sale than what was previously earned. On 10 April 2003, the governments of Russia and Turkmenistan signed a 25-year intergovernmental agreement on gas co-operation that stipulated a gradual increase formula for the purchase of Turkmenistani gas. The agreement envisaged Turkmenistani exports as follows:

2004	5-6 bcm
2005	6-7 bcm
2006	10 bcm
2007	60-70 bcm
2008	63-73 bcm
2009-2028	70-80 bcm

Delivery volumes would thus significantly increase from 2007 (when coincidentally, the 14 May 2001 Turkmenistani-Ukrainian commercial contract had expired; Ukraine being a major market for Turkmenistani gas). By 2009, Russia would in effect be buying virtually all of Turkmenistan's gas. Moreover, Russia would retain the exclusive right to re-export the gas elsewhere.<sup>11</sup>

In late 2005, Russia's gas export monopoly Gazprom in fact went on to negotiate a purchase of no less than 30 bcm of Turkmenistani gas in 2006, with half of this volume to be delivered in the first quarter of the year.<sup>12</sup> However, it soon became clear that the huge volumes contracted were unattainable, at least for transportation purposes, within the time-frame in question. Present infrastructure, the Central Asia-Centre (CAC) pipeline system could then no longer cope with such volumes. On 5 August 2006, Gazprom agreed to buy 12 bcm of gas in 2006 and only 50 bcm per year between 2007 and 2009.<sup>13</sup> Even so, the agreement has been rightly assessed as a negotiation success by Gazprom in its quest to control the Caspian gas resources. However, the deal also meant that Gazprom would need a new pipeline from Turkmenistan to Russia, most likely via Kazakstan.<sup>14</sup> If this pipeline is built, and if the Turkmenistani gas reserves are as large as claimed, Russia will have succeeded in gaining a monopoly of Turkmenistani gas for the foreseeable future.

### ***Pricing***

Despite the successfully concluded agreements between Gazprom and Turkmenistan, Turkmenistani-Russian natural gas relations have not been as smooth as envisaged. From 2003 to 2004, Turkmenistan sold gas to Russia for a price of \$44 per thousand cubic metres, with 50 per cent paid in barter.<sup>15</sup> However, in early December 2004, Turkmenistan requested a price

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<sup>11</sup> Soglashenie mezhdru Rossiey i Turkmenistanom o sotrudnichestve v gazovoy otrasli, Moskva, Kreml', 10 aprelya 2003 goda (at the Ministry of Foreign Affairs web site, [www.in.mid.ru](http://www.in.mid.ru)). See also Veniamin Ginsburg and Manuella Troshke, "The Export of Turkmenistan's Energy Resources," *Central Asia and the Caucasus* 24 (2003), 108-17.

<sup>12</sup> Gazprom press release, 29 December 2005.

<sup>13</sup> Sergey Tolstov, "Energy Security in the Interrelations among the EU, RF, Ukraine, and Central Asia," *Central Asia and the Caucasus* 6 (42), 2006, 7-18, on 13; Igor Tomberg, "Energy Policy and Energy Projects in Central Eurasia," *Central Asia and the Caucasus* 6 (48), 2007, 38-50, on 47.

<sup>14</sup> See, e.g., James Purcell Smith, "Turkmenbashi's Gas Games: Gas for Power?" *Central Asia Caucasus Analyst* ([www.cacianalyst.org](http://www.cacianalyst.org)), 4 June 2003. See also Michael Fredholm, *The World of Central Asian Oil and Gas: Power Politics, Market Forces, and Stealth Pipelines* (forthcoming, 2008).

<sup>15</sup> Global Witness, *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade* (Washington, DC: Global Witness Publishing, April 2006), 26.

increase from Russia and Ukraine for 2005 from \$44 to \$58. Since at first neither buyer agreed, Turkmenistan stopped pumping gas, thus ceasing gas deliveries to both Russia and Ukraine, on 31 December 2004, at 10:00 Moscow time. This cut was motivated by the need to carry out repairs and restoration on the CAC pipeline. Ukraine had to negotiate, and on 1 January 2005 accepted deliveries at a price of \$58.<sup>16</sup> Presumably, the Turkmenistani leaders thought that the same tactics would be just as effective against Russia as against Ukraine. They were wrong, and eventually Turkmenistan had to give in. On 10 January 2005, Turkmenistan resumed gas supplies to Russia.<sup>17</sup> On 15 April 2005, the head of Gazprom, Aleksei Miller, met Turkmenistan's President Saparmurat Niyazov, who agreed to reinstate the existing structure of contracts and agreements, including those on pricing.<sup>18</sup> Niyazov and Miller agreed that the price of \$44 would remain for 2005-2006 but would be paid in cash instead of half barter, half cash. Gas deliveries to Russia under the new agreement began in May 2005.<sup>19</sup>

In December 2005, Gazprom negotiated a price of \$65 for 2006.<sup>20</sup> By January 2006, Gazprom's export arm OOO Gazexport (since 1 November 2006 renamed OOO Gazprom Export) indeed bought gas from Turkmenistan for \$65 as had been agreed.<sup>21</sup> However, news reports by then claimed that Turkmenistan already wished to raise the price to \$85.<sup>22</sup>

On 5 August 2006, Gazprom agreed to a price for 2007 set at \$100. This price would remain until 2009, according to the agreement. Despite this, Turkmenistan in November 2007 persuaded Gazprom to accept a new price of \$130 for the first half of 2008, to be increased again to \$150 in the second half of 2008. Gazprom would also work on a gas pricing formula for supplies starting in 2009 under a long-term contract valid through 2028.<sup>23</sup> Gazprom, which earlier had taken advantage of its monopolistic position by buying gas cheaply in Turkmenistan and selling it at a considerably marked-up price in Europe, was clearly in the process of changing its modus operandi into a more market-oriented formula. Some might argue that Gazprom's move towards market forces was nothing but a virtue made out of necessity due to the increasing clout of the Central Asian producers and the potential of them eventually to export their gas to other markets. Even so, the move was genuine and should be welcomed.

On 11 March 2008, the heads of the gas monopolies of Russia, Kazakstan, Uzbekistan, and Turkmenistan jointly declared that from 2009, they would all sell gas at European market prices.<sup>24</sup> Then, on 25 July 2008, Miller visited Turkmenistan's President Gurbanguly Berdimuhammedov in Ashgabat. Gazprom signed the agreement on the pricing mechanisms for the Turkmenistani gas exports to Russia up to 2028 that Gazprom had been working on since autumn the previous year. From 2009, Russia will pay a base gas purchasing price based on the average wholesale price in Europe and Ukraine. At present estimates, the 2009 price for Turkmenistani gas will be in the range of \$225-295, as compared to Gazprom's present purchasing price of \$150 (for the second half of 2008) and China's present purchasing price of \$195 plus a transport fee of \$50.<sup>25</sup>

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<sup>16</sup> *Nefteryok* (Oil Market) 1, 2005. See also Jonathan Stern, *The Russian-Ukrainian Gas Crisis of January 2006* (Oxford: Oxford Institute for Energy Studies, January 2006), 3-4; Vladimir Saprykin, "Iran as an Exporter of Natural Gas to the South Caucasian Countries," *Central Asia and the Caucasus* 33 (2005), 108-20, on 113.

<sup>17</sup> *Nefteryok* (Oil Market) 1, 2005.

<sup>18</sup> *Nefteryok* (Oil Market) 4, 2005.

<sup>19</sup> Stern, *Russian-Ukrainian Gas Crisis*, 4.

<sup>20</sup> Gazprom press release, 29 December 2005.

<sup>21</sup> Global Witness, *It's a Gas*, 58.

<sup>22</sup> *Vedomosti*, 13 January 2006.

<sup>23</sup> *International Oil Daily*, 28 November 2007, 21 December 2007; Tolstov, "Energy Security," 13; Tomberg, "Energy Policy," 47; Aisha Berdyeva, "Turkmenistan: Can Ashgabat Keep All of Its Energy Export Promises?" *Business & Economics* (www.eurasianet.org), 4 December 2007; *Financial Times*, 20 December 2007.

<sup>24</sup> Gazprom press release, 11 March 2008.

<sup>25</sup> Gazprom press release, 25 July 2008; *Asia Times*, 30 July 2008 (www.atimes.com).

## ***Russia, Turkmenistan, and Ukraine in the Natural Gas Trade***

### ***Ukraine's Energy Policy***

Ukraine is a significant gas producer in its own right but also a major consumer of gas. Moreover, Ukraine has made but little effort to reduce the dependence on gas that it developed in the late Soviet period. Ukraine consumes about 75 bcm per year but produces only about 20 bcm. The remaining 55 bcm the country hopes to get from Russia or Central Asia.<sup>26</sup> The reasons for Ukraine's need of subsidised imports go beyond the scope of this work; however, it should be noted that since independence, Ukraine has retained a high level of energy consumption merely to maintain its very obsolete heavy industry sector, especially in ferrous metallurgy, as a backbone of the economy, regardless of the sector's unsatisfactory economic performance.<sup>27</sup> In addition, retail natural gas prices in Ukraine remain several times lower than prices in western Europe as well as in Russia. This is because of internal Ukrainian policy decisions, not conditions imposed from others. In comparison, Ukrainian oil and oil product prices are at international levels, while Ukrainian coal prices do not cover production costs.<sup>28</sup> As if this was not enough, Ukraine remains one of the most energy-intensive countries in the region, with the energy intensity of Ukraine's GDP (energy use per unit of GDP) being higher than that of both Russia and Belarus and more than three times higher than the average energy intensity of the EU, despite the fact that industrial gas consumption has fallen since independence.<sup>29</sup> A significant omission in the currently valid Ukrainian Energy Strategy to 2030 is that it is supply-oriented and fails to analyse demand. The strategy has formulated projections, but these are politically driven goals, not realistic forecasts, and would seem to be mainly aimed at a domestic audience to mollify concerns over present policies.<sup>30</sup>

The Ukrainian natural gas sector is often poorly understood. One important reason for this is that there are wide disparities between information from different sources with regard to natural gas imports into Ukraine, which makes research difficult.<sup>31</sup>

### ***The Early Years***

During the early 1990s, Ukraine was often unable to pay for the gas imported from or through Russia. This led to very high levels of debt and unpaid bills, which led to a reduction of Russian and Turkmenistani gas supplies to Ukraine for short periods (in 1992, 1993, and 1994<sup>32</sup>) in an attempt to restore payment discipline, which in turn caused unauthorised diversions of the volumes of gas in transit to western Europe. The level of debt was often disputed, as were the unauthorised diversions of gas.<sup>33</sup> Illicit diversions of gas from transit pipelines by Ukrainian business firms and institutions certainly took place in September 1993 and November 1994, two occasions for which Ukraine eventually acknowledged diversions. Russia during these years accused Ukraine of other diversions as well.<sup>34</sup> Such diversions would indeed continue; from 1998 to 2000 Gazprom claimed that substantial volumes had been diverted and in 2001 Ukraine's then deputy prime minister Oleh Dubyna acknowledged that in 2000 alone, 8.7 bcm

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<sup>26</sup> See, e.g., Pirani, *Ukraine's Gas Sector; Vedomosti* (www.vedomosti.ru), 27 February 2008.

<sup>27</sup> Oppenheimer Technical Assistance Consultants, *Kazakhstan's Energy Sector Overview*, Working Paper, 27 January 2005.

<sup>28</sup> See, e.g., IEA, *Ukraine*, 18.

<sup>29</sup> IEA, *Ukraine*, 80, 117.

<sup>30</sup> Cabinet of Ministers, *Energetychna strategiya Ukrayiny na period do 2030 roku* (Kiev: Cabinet of Ministers, Decree No. 145, 15 March 2006), available (also in English translation) from the Ministry of Fuel and Energy web site, <http://mpe.kmu.gov.ua>. See in particular section 2.4 on Ukraine's natural gas balance which although referred to as a forecast is no more than wishful thinking. See also IEA, *Ukraine*, 85-6, 91.

<sup>31</sup> See, e.g., Pirani, *Ukraine's Gas Sector*, 109. As an example, statistics as published respectively by the Ukrainian government and British Petroleum (in *BP Statistical Review of World Energy June 2008*; at the firm's web site, [www.bp.com](http://www.bp.com)) tend to differ considerably in details, even though they typically show the same trends.

<sup>32</sup> Pirani, *Ukraine's Gas Sector*, 19.

<sup>33</sup> See, e.g., Stern, *Russian-Ukrainian Gas Crisis*, 2.

<sup>34</sup> Pirani, *Ukraine's Gas Sector*, 19.

of Russian gas had been siphoned off from transit pipelines.<sup>35</sup> During these turbulent years, there were also attempts when Russian President Boris Yeltsin introduced linkages between the repayment of Ukrainian debts for gas and other issues, for instance in September 1993 when Yeltsin offered the Ukrainian President Leonid Kravchuk (the country's first president) cancellation of debt in exchange for control of the Black Sea fleet and Ukraine's nuclear warheads. Likewise, there were in these years Russian attempts to take control of assets in the Ukrainian gas sector in exchange for debt cancellation. Eventually, in March 1994, a Ukrainian deputy prime minister agreed with Russian negotiators that Gazprom could take a 51 per cent stake in the Ukrainian pipeline system, but the Ukrainian government and parliament later decided against it. In early 1995, the Russian and Ukrainian governments agreed to form a new, joint company named Gaztransit. Transit assets would be concentrated within this firm in exchange for the cancellation of much of Ukraine's gas debts. However, the Ukrainian parliament blocked this agreement as well and in November 1995 adopted a law that prohibited any privatisation of Ukrainian oil and gas assets. This policy would remain for the gas sector but some privatisation was later allowed within the oil sector.<sup>36</sup>

### ***The Intergovernmental Agreement of 18 February 1994***

As long as Ukraine bought most of its natural gas from Turkmenistan, the gas at least at some point had to transit through Gazprom's pipelines. Thus, the Ukrainian gas purchases to some extent always consisted of a three-party negotiation.

The various problems made the Russian and Ukrainian governments realise that a framework agreement was necessary to regulate the export to and transit through Ukraine of gas from Russia. An intergovernmental agreement between Russia and Ukraine, the *Agreement between the Governments of Ukraine and Russian Federation on Export of Russian Natural Gas to Ukraine and its Transit through the Territory of Ukraine to European Countries*, was signed on 18 February 1994. This agreement established a policy framework that in all fundamentals seems to have remained in force until 2005. The Russian government allowed Gazprom to export gas to Ukraine and to transit gas through Ukraine, while the Ukrainian government agreed to expand transit capacity through its territory. The agreement also prohibited the re-export of Russian gas supplied to Ukraine, kept the price of gas at an artificially low level, and limited the export of gas produced in Ukraine.<sup>37</sup> Ukraine is, as noted, crucial to Russia and Europe as a transit country.

The agreement did not solve the question of Ukrainian debt, and the period of the agreement began inauspiciously. On the very same day that the Russo-Ukrainian intergovernmental agreement was signed, Turkmenistan sent an ultimatum to the Ukrainian government, threatening to cut off supplies of gas from Turkmenistan, unless the Ukrainians at least began to pay off their energy debt. The Ukrainians did nothing, however, so on 21 February 1994, Turkmenistan's Minister for Foreign Affairs announced that Turkmenistan had decided to halt gas deliveries to Ukraine. The announcement came while he was in Almaty, then the capital of Kazakstan, through which the Turkmenistani gas exports would have to transit.<sup>38</sup>

An ultimatum was clearly what was needed to jerk Ukraine into action. On 26 February 1994, Ukraine stated that Turkmenistan was ready to resume supplying gas.<sup>39</sup> The two countries had reached an agreement.

However, on 3 March 1994, Gazprom began to reduce deliveries of gas to Ukraine, claiming that it would halt all supplies by 5 March if payment for the debt to Russia was not received.<sup>40</sup>

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<sup>35</sup> Jonathan P. Stern, *The Future of Russian Gas and Gazprom* (Oxford: Oxford University Press/Oxford Institute for Energy Studies, 2005), 88-89; Pirani, *Ukraine's Gas Sector*, 22. On this and the subsequent debt issue, see also IEA, *Ukraine*, 220.

<sup>36</sup> Pirani, *Ukraine's Gas Sector*, 19-20.

<sup>37</sup> IEA, *Ukraine*, 218-19.

<sup>38</sup> *Europe Energy*, March 1994.

<sup>39</sup> RFE/RL *News Briefs*, 28 February 1994.

<sup>40</sup> RFE/RL *News Briefs*, 4 March 1994.

### ***The First Phase in the Ukrainian Gas Trade: Respublika***

Something would have to be done about the gas debt, the Ukrainian government realised. However, the government's solution was not quite what most would have expected. It selected a private business company to control the Turkmenistani-Ukrainian gas trade. This was a Ukrainian firm called Respublika. It swapped Ukrainian goods for Turkmenistani gas in barter deals. This can be called the first phase in the Ukrainian gas trade: Ukrainian firms importing Turkmenistani gas and paying, if at all, in barter. Respublika was headed by one Ihor Bakai, whose name henceforth would appear frequently in the history of the Ukrainian gas trade. In what appears to be the first of many opaque deals in the Ukrainian gas business, the Ukrainian government in April 1994 therefore designated Respublika (a company established only a few months previously by Bakai) to pay off the state's gas debt (around \$800 million in total;<sup>41</sup> in 1993 alone, the Ukrainian government owed \$671.9 million to Turkmenistan for gas) through barter transactions. The Ukrainian state in return gave Respublika a license to import natural gas from Turkmenistan. In addition, the state guaranteed both the repayment programme and the gas imports, so that Respublika would not need to accept any financial risk or responsibility for either operation. Respublika thus imported 9.2 bcm of gas from Turkmenistan at the price of \$50 at the Turkmenistan-Uzbekistan border. However, Respublika did not fulfill its obligations, so Prime Minister Vitaliy Masol on 13 October 1994 ordered the state bank to cover Respublika's debt – the whole scheme thus in fact worsened the situation of the state budget instead of solving anything. President Kuchma, who succeeded Kravchuk, in early 1995 dismissed Masol from the cabinet, and Respublika was cut out from the gas market.<sup>42</sup> The activities of Respublika neither led to the payment of the gas debt, nor were its activities ever fully investigated. Its office and all its records were reportedly destroyed in a fire in 1995. Bakai instead formed a new company, Interhaz, which following the introduction in May 1996 of the gas trading concession system in Ukraine (see below) supplied Russian gas to Ukraine.<sup>43</sup>

Interhaz eventually went bankrupt, however, so Bakai was in September 1997 appointed first deputy chairman of the State Committee for Oil, Gas, and Refining.<sup>44</sup>

Interhaz was not a minor actor in the Ukrainian gas trade, and Bakai was not the only one who made a career through this company. A certain Oleksiy Ivchenko in 1995-1997 worked for Interhaz, first as the firm's general representative in western Ukraine in 1995-1996, then as deputy director of the department for realisation of gas in 1996-1997, and finally as first vice president of Interhaz, with responsibility for gas supply to industrial enterprises, from 1997. Ivchenko was another of those entrepreneurs who in the Soviet period had worked, by his own testimony often illegally, as private contractors, in his case in the construction business. However, from these humble beginnings Ivchenko from 1996 embarked upon what would become a quite successful political career that led straight into the Ukrainian government and eventually gave him responsibility for the nation's oil and gas.<sup>45</sup>

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<sup>41</sup> Global Witness, *It's a Gas*, 33; citing *BBC Summary of World Broadcasts*, 18 March 1994.

<sup>42</sup> Shinkichi Fujimori, "Ukrainian Gas Traders, Domestic Clans and Russian Factors: A Test Case for Meso-Mega Area Dynamics," in Kimitaka Matsuzato (ed), *Emerging Meso-Areas in the Former Socialist Countries: Histories Revived or Improvised?* (Sapporo: Slavic Research Center, Hokkaido University, 2005), 113-36, on 121. Vitaliy Masol, appointed by President Kravchuk, was prime minister from 16 June 1994 to 1 March 1995. Respublika's gas imports totalled 9.2092 bcm.

<sup>43</sup> Global Witness, *It's a Gas*, 7, 33.

<sup>44</sup> *Ukraine Intelligence*, 16 March 2006 ([www.ukraine-intelligence.fr](http://www.ukraine-intelligence.fr)); Fujimori, "Ukrainian Gas Traders," 129.

<sup>45</sup> In 1997, Ivchenko became an advisor to prime minister Pavlo Lazarenko. Following more political activities, often in conjunction with the oil and gas business, in which he allied himself to Viktor Yushchenko, he on 3 February 2005 was appointed first deputy minister of fuel and energy. On 3 March 2005, President Yushchenko appointed Ivchenko chairman of Naftogaz Ukrainy, a position he kept until 11 March 2006 (although he was relieved of the position of first deputy minister of fuel and energy already on 9 December 2005). The prosecutor-general of Ukraine subsequently accused Ivchenko of embezzlement of state funds during the time when he was chairman of Naftogaz Ukrainy; however, the charges, which included his acquisition of a new Mercedes paid for with state funds, seemed petty in comparison to other corruption cases. *Ukrayinska Pravda*, 14 November 2007 ([www.pravda.com.ua](http://www.pravda.com.ua)); the web site, [www.anticompromat.ru](http://www.anticompromat.ru); citing Maksim Balutenko and Vladimir Pribylovskiy, *Kto est' kto v politike na Ukraine* (Moscow: Panorama, January 2006).

### ***The Second Phase: Omrania and Itera***

Bakai's Respublika had neither solved Ukraine's debt crisis nor pleased the gas suppliers. The Gazprom management realised that something would have to be done. And preferably something that quite possibly might bring some personal profit as well.

Following the Respublika debacle, in late 1994 Gazprom assisted the company Itera in taking charge of the selling of Turkmenistani gas to other CIS (Commonwealth of Independent States) countries. In the case of Ukraine, Itera acted through certain Ukrainian gas traders. Among them was a firm named Omrania.<sup>46</sup> Thus began the second phase of Ukraine's gas imports: Ukraine bought its gas not directly from Russia but with the help of an intermediary appointed by Gazprom. The first such intermediary was Itera. The gas itself often but not always derived from Turkmenistan. Ukrainian firms paid Itera for the gas. Itera in turn paid Turkmenistan for the gas and Gazprom for transit. A part was no doubt paid in barter.

Both Omrania and Itera had been founded in 1992 by Igor Makarov, a Russian born in Turkmenistan. He was a cycling champion before he entered business. Makarov began trading food for Turkmenistani oil in the early 1990s before he founded Itera. In October 1992, Makarov registered a company called Omrania Trading Company in Cyprus. In February 1994, Makarov registered a new company in Jacksonville, Florida, called Itera International Energy LLC.<sup>47</sup> Itera may have opened an office in Jacksonville in an ultimately failed attempt to secure guarantees from United States officials. However, even so the company from 1994/1995 supplied gas to Ukraine and since at least 1998 to Armenia, Azerbaijan, Georgia, Belarus, and Moldova as well, a group of countries known as the problem clients of Gazprom since they paid seldom if at all for gas deliveries. The rapid rise of Itera came amid suspicions that the firm was nothing but a front for Gazprom executives in what many believed was a scheme for some of them to siphon off Gazprom profits.<sup>48</sup> In 2000, documents reportedly show that Gazprom bought Turkmenistani gas from Itera that it could have bought more cheaply from Turkmenistan itself. Indeed, Itera bought gas from Turkmenistan, used Gazprom's pipeline to move it, and then sold the gas to Gazprom at a substantial mark-up. Itera paid Turkmenistan \$35.37, then allegedly resold a third of this gas to Gazprom for \$45 or perhaps even \$50; Gazprom even paid Itera to move the gas - through its own pipelines. It has been estimated that Itera may have made more than \$100 million by selling gas to Gazprom that the Russian company could have bought directly from Turkmenistan.<sup>49</sup>

Makarov acknowledged that there was a special relationship between Itera and Gazprom. "Our company does not intend to compete with Gazprom," he concluded, adding: "Knowing we cannot play otherwise, we set down mutually beneficial playing rules with Gazprom, and we take all of our decisions in compliance with Gazprom's policies."<sup>50</sup>

Whatever these mutually beneficial rules might have been, in 2001 Russia's President Vladimir Putin appointed Aleksei Miller as new head of Gazprom. Itera and the Gazprom group then suddenly became fierce competitors. Miller, whom President Putin knew personally since at least 1991, was after a career in various government and commercial enterprises in 2000 appointed deputy minister of energy of the Russian Federation. On 30 May 2001, he became

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<sup>46</sup> Fujimori, "Ukrainian Gas Traders," 123.

<sup>47</sup> Global Witness, *It's a Gas*, 34; Itera's web site, [www.iteragroup.com](http://www.iteragroup.com). Although Itera International Energy LLC kept its Florida address for legal purposes, the actual seat of the company was in Limassol, Cyprus. See, e.g., the Audit Chamber of the Russian Federation (Schetnaya palata RF) report No. 11 (71), 2003.

<sup>48</sup> Itera's web site, [www.iteragroup.com](http://www.iteragroup.com); David Hoffman, "Itera: Mystery Player in Russia's Natural Gas Market," *Washington Post*, 21 May 2000, p. H1; R. Hrair Dekmejian and Hovann H. Simonian, *Troubled Waters: The Geopolitics of the Caspian Region* (London: I. B. Tauris, 2001), 158-9; International Energy Agency (IEA), *Russia Energy Survey 2002* (Paris: OECD/IEA, 2002), 116-17; Caroline McGregor, *Gazprom and Itera: A Case Study in Russian Corporate Misgovernance* (Washington, DC: Carnegie Endowment for International Peace, 18 March 2002); Audit Chamber of the Russian Federation (Schetnaya palata RF) report No. 11 (71), 2003; Stern, *Future*, 22-5.

<sup>49</sup> Global Witness, *It's a Gas*, 7, 35.

<sup>50</sup> Interview with Igor Makarov in *Russia Journal*, 27 September-3 October 1999, p. 17. His comments could be interpreted as suggesting that a gas cartel then was in operation.

chairman of Gazprom's management committee in a move widely believed to have been an effort to regain control of the firm from Rem Vyakhirev and his associates.<sup>51</sup>

Itera was, as noted, involved in the supply of gas from Turkmenistan to Ukraine from 1994/1995 to 2002.<sup>52</sup> In 1995, Itera's Ukrainian partner Omrania Trading Company became an actor to be reckoned with. The firm acted as agent for exports of 11 bcm of the total of 20 bcm that Ukraine received, at a price of \$57 per thousand cubic metres. The gas was sold to the Ukrainian-Russian joint venture OLhaz (or Olgaz) which in turn sold it to wholesale consumers.<sup>53</sup>

Already in this period, in the early 1990s, among the group of people who worked with Makarov appeared Dmytro Firtash, a Ukrainian trader. He had as early as the late 1980s been involved in commodity trading in the Ukrainian and Russian parts of the Soviet Union.<sup>54</sup> His name would henceforth turn up again and again in the history of the Ukrainian gas trade.

### ***Other Ukrainian Gas Importers***

However, these were not the only gas importers in Ukraine. In May 1996, a gas trading concession system was introduced in Ukraine which allowed selected gas traders to accumulate quick profits, control over industrial assets, and political influence.<sup>55</sup> The system was the creation of Pavlo Lazarenko, the presidential representative in Dnipropetrovsk Oblast and powerful supporter of President Kuchma in the 1994 presidential elections who on 28 May 1996 was appointed prime minister.<sup>56</sup>

Among the selected gas traders was, coincidentally, Lazarenko's associate since 1992, the future prime minister Yulia Tymoshenko. She had a background in the energy sector, having already in 1991 been the managing director of the business enterprise Korporatsiya Ukrayins'kiy Benzin (KUB; known in English as the Ukrainian Oil Corporation), but this had not been a great success. With the support of Lazarenko, however, Tymoshenko rose to power as the head of the firm United Energy Systems of Ukraine (Edyni Enerhetychni Systemy Ukrayiny, UESU), the most powerful of the traders in the gas trading concession system. UESU not only won the coveted mandate for wholesale gas sales in Donetsk, the country's largest industrial region, but also played a regulatory role through a related firm, the Ukrainian Gas Resources Consortium (UGC; Ukrayins'kiy Hazoresurniy Konsortsium). When Lazarenko fell from power in July 1997, UESU lost its powerful position to Interhaz, Itera, IUD (see below), and others and went bankrupt. Tymoshenko had then already embarked upon a political career.<sup>57</sup>

Other gas traders within the system were the already mentioned Interhaz of Ihor Bakai, which in 1996 received the mandate to distribute 7.8 bcm of gas acquired from Gazprom, and Itera-Energy, which acquired the right to distribute 16.8 bcm from Central Asia, as well as OLhaz,

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<sup>51</sup> Vyakhirev was the first head of Gazprom, a position he had attained after a long career within the Soviet gas industry and government. When President Putin in 2001 replaced him with Miller as head of Gazprom, Vyakhirev still had a son, Yuriy, as head of the firm's export arm Gazexport and a daughter, Tatiana, among the owners of the Gazprom group's pipeline construction firm Stroytransgaz. On 31 May 2001, he was chosen as head of the newly created Russian Gas Society, a position he kept until 20 December 2002. See, e.g. Vyakhirev's biography in the web sites, [www.temadnya.ru](http://www.temadnya.ru); [www.viperson.ru](http://www.viperson.ru). The Russian Gas Society maintains a web site, [www.gazo.ru](http://www.gazo.ru). For Miller's biography, see Gazprom's web site, [www.gazprom.ru](http://www.gazprom.ru); the web site, [www.anticompromat.ru](http://www.anticompromat.ru).

<sup>52</sup> Global Witness, *It's a Gas*, 33.

<sup>53</sup> David Preyger and Vladimir Omelchenko, "Problems of Turkmen Gas Export: View from Ukraine," *Central Asia and the Caucasus* 43 (2007), 120-33, on 123.

<sup>54</sup> Firtash's biography in his enterprise's web site, [www.groupdf.com](http://www.groupdf.com).

<sup>55</sup> Pirani, *Ukraine's Gas Sector*, 20-21.

<sup>56</sup> Fujimori, "Ukrainian Gas Traders," 125-9. After Lazarenko's resignation, he in March 1998 came back, and was elected to parliament. However, in December 1998 Lazarenko was detained on the border to Switzerland on money-laundering charges. He was again detained upon attempting to enter the United States on 20 February 1999. In August 2006, Lazarenko was convicted and sentenced to prison in the United States for money laundering and extortion, having stolen approximately \$114 during 1996-1997 from the government of Ukraine. See, e.g., *New York Times*, 15 February 1999, 23 February 1999, 2 June 2000, 26 August 2006.

<sup>57</sup> Fujimori, "Ukrainian Gas Traders," 127-8; Pirani, *Ukraine's Gas Sector*, 20; Tymoshenko's web site, [www.tymoshenko.com.ua](http://www.tymoshenko.com.ua).

with 3.5 bcm from Gazprom, not to mention others. In comparison, UESU distributed as much as 25.2 bcm, almost all of it from Gazprom.<sup>58</sup> In 1997, the gas traders included Interhaz, which received the right to distribute 8.3 bcm acquired from Gazprom, Itera-Ukraine, with 11.1 bcm from Central Asia, and UESU, with 15.5 bcm from Gazprom.<sup>59</sup>

Not all gas came from Turkmenistan or Russia. Gas was also imported from Uzbekistan. From 1996 to 2003, one of Ukraine's largest industrial corporations, the Industrial Union of Donbass (IUD; in Ukraine referred to as Industrial'nyy Soyuz Donbassa, ISD<sup>60</sup>), formed in December 1995, imported gas along the lines of 3-3.5 bcm per year from Uzbekneftegaz. And in 2003-2004 an offshore IUD subsidiary, Eastern Distribution Ltd, supplied about 3 bcm of Uzbekistani gas to state-owned Naftogaz Ukrainy (see below) in a deal arranged to avoid the payments of Ukrainian value-added tax. In January 2007, the IUD agreed to recommence its purchases of Uzbekistani gas.<sup>61</sup>

### ***TurkmenRosGaz***

In October 1995, Russia's Gazprom and Turkmenistan's GTK Turkmenneftegaz founded the joint venture TurkmenRosGaz for the purpose of selling Turkmenistani gas to Ukraine. The firm was a joint venture between Turkmenneftegaz with a 51 per cent stake, Gazprom with 45 per cent, and Itera with 4 per cent.<sup>62</sup> TurkmenRosGaz exported gas to Ukraine from at least August 1996 until the spring of 1997, when Turkmenistan cut gas supplies to Ukraine.<sup>63</sup>

However, problems soon developed. One of the Turkmenistani officials who was responsible for setting up TurkmenRosGaz was Valery Otchertsov, the vice-president of the Supreme Soviet (parliament) of Turkmenistan from 1989 to 1991, and the minister of economics and finance as well as deputy chairman of the cabinet of ministers of Turkmenistan from 1991 to 1996. By early 1997, he had moved to Moscow and accepted an offer to become vice-president of Itera, a competitor to TurkmenRosGaz. He has since held several high posts at Itera.<sup>64</sup>

Turkmenistan unilaterally disbanded TurkmenRosGaz on 19 June 1997, due to debts which had not been paid by Itera with respect to gas deliveries to Ukraine. As a result, possibly unintended, Itera came to assume control over the gas supplies to Ukraine.<sup>65</sup>

### ***The Third Phase: Naftogaz Ukrainy***

In February 1998, the gas trading concession system used in Ukraine since May 1996 was dismantled.<sup>66</sup> Several of the companies that had profited most from the system, among them Tymoshenko's UESU and Bakai's Interhaz, immediately went bankrupt, leaving the state to pay the remaining debt, which usually was considerable.<sup>67</sup>

In its stead, a vertically integrated, fully state-owned firm, known as NAK Naftogaz Ukrainy [Naftohaz Ukrayiny], was created in February 1998. Naftogaz Ukrainy is a holding company that consists of several subsidiaries, including DK Ukrtranshaz, which operates the main gas pipelines and 12 underground gas storage facilities; DAT Chornomornaftohaz, which operates gas pipelines and the Hlibivsk underground gas storage facility in Crimea and is involved in offshore exploration and production; VAT Ukrtransnafta, which operates all main oil pipelines; DK Haz Ukrayiny (Gas of Ukraine), a wholesale gas trading and distribution firm that sells gas to the partially privatised regional distribution companies; and several others. The firm has since played a dominant role in many aspects of the oil and gas business in Ukraine, including oil and gas production, management of trunk pipelines, oil and gas transit, natural gas processing and

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<sup>58</sup> Fujimori, "Ukrainian Gas Traders," 125.

<sup>59</sup> Fujimori, "Ukrainian Gas Traders," 128.

<sup>60</sup> The firm's web site, [www.isd.com.ua](http://www.isd.com.ua).

<sup>61</sup> Pirani, *Ukraine's Gas Sector*, 45; Ukrainian news web site, [www.from-ua.com](http://www.from-ua.com).

<sup>62</sup> Fujimori, "Ukrainian Gas Traders," 123; *APS Review Gas Market Trends*, 4 October 2004.

<sup>63</sup> Preyger and Omelchenko, "Problems of Turkmen Gas Export," 124.

<sup>64</sup> Itera's web site, [www.iteragroup.com](http://www.iteragroup.com).

<sup>65</sup> RFE/RL *Newsline*, 25 June 1997; Global Witness, *It's a Gas*, 34; Stern, *Future*, 73.

<sup>66</sup> Pirani, *Ukraine's Gas Sector*, 20-21.

<sup>67</sup> Fujimori, "Ukrainian Gas Traders," 130.

distribution in Ukraine, and, until early 2006, all gas imports into the country. It should be noted that the Ukrainian gas transport network is owned by the Ukrainian state and managed by two of the already mentioned Naftogaz Ukrainy subsidiaries: (1) Ukrtransgaz, the national gas transport company (which in turn functions through six regional subsidiaries), and (2) Chornomornaftohaz, which manages the network in Crimea (less than 5 per cent of the network).<sup>68</sup>

The people put in charge of the new Ukrainian state-owned firm were a colourful lot. Ukraine's President Kuchma picked Ihor Bakai, previously head of Respublika and Interhaz, as the new firm's first chairman. That Bakai had twice bankrupted his companies, and in the process of doing so, caused great damage to the state budget by letting the state pick up the resulting debt, apparently did not matter. Kuchma knew what he wanted and whom he could trust.<sup>69</sup> Bakai remained chairman of Naftogaz Ukrainy from 1998 until he resigned on 24 March 2000. From October 2003 to December 2004, he also served Kuchma as director of State Property Management within the presidential administration. Bakai was eventually accused of having operated a multi-million-dollar slush fund for his president and moved to Russia, from where the post-Kuchma Ukrainian government wanted him extradited. However, Bakai had been granted Russian citizenship and could not be extradited.<sup>70</sup> Bakai's immediate successor as chairman of Naftogaz Ukrainy, Ihor Didenko, who was acting chairman from 7 April 2000 until 7 June 2000, was arrested in Germany on 14 June 2001, accused of the embezzlement in the 1990s of 4 million Deutschmarks intended for pay-outs to compensate the victims of Nazi concentration camps and forced labour still living in Ukraine.<sup>71</sup>

In 1999, Ukraine agreed to pay for gas (20 bcm per year) directly to Turkmenistan. Itera remained delivery operator, and Gazprom offered its transportation network for a set fee. Thus began the third phase of Ukrainian gas imports. Naftogaz Ukrainy bought the gas from Turkmenistan at the Turkmenistani border, paying half cash, half barter; Itera then through unknown means paid Gazprom for transportation, and itself received a transportation fee taken in gas from the supplies to Ukraine; while Gazprom moved the gas to Ukraine. However, Ukraine neither repaid its debts to Turkmenistan nor paid for new deliveries on time. Until mid-May 1999, Turkmenistan sent Ukraine some 5 bcm of fundamentally unpaid gas and then halted supplies.<sup>72</sup>

At the very end of 1999, the involved parties - Naftogaz Ukrainy, Gazprom, Itera, and Turkmenneftegaz - at last agreed to a delivery in 2000 of 20 bcm for a price of \$36 at the border of Turkmenistan and Uzbekistan (other documents indicate that Itera purchased gas from Turkmenistan in 2000 for a price of \$35.37<sup>73</sup>). Itera received a transportation fee paid in gas, taken from the supplies to Ukraine (equivalent to half the supplies, Ukraine claimed), which in effect meant that the gas price paid by Ukraine was substantially higher than \$36. Ukraine's debt grew, and supplies were again halted from time to time.<sup>74</sup>

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<sup>68</sup> See, e.g., IEA, *Ukraine*, 42, 160-2, 207, 210; Pirani, *Ukraine's Gas Sector*, 76. See also the firm's web site, [www.naftogaz.com](http://www.naftogaz.com). For the subsidiaries, see their respective web sites, [www.ukrtransgas.naftogaz.com](http://www.ukrtransgas.naftogaz.com); [www.gas.crimea.ua](http://www.gas.crimea.ua); [www.ukrtransnafta.com](http://www.ukrtransnafta.com); and [www.gasukraine.com.ua](http://www.gasukraine.com.ua). Ukraine's total gas storage capacity is 36 bcm of working gas. Incidentally, the name of the company should strictly speaking be transliterated as Naftohaz Ukrayiny, but the form employed here appears to be in far more common use.

<sup>69</sup> Fujimori, "Ukrainian Gas Traders," 131. See also Roman Kupchinsky, "Naftohaz Ukrainy: A Study in State-Sponsored Corruption," *RFE/RL Organized Crime and Terrorism Watch* 3: 25 (18 July 2003); 3: 26 (5 August 2003); 3: 28 (15 August 2003); 3: 29 (21 August 2003); 3: 30 (28 August 2003).

<sup>70</sup> *Eesti Elu*, 9 September 2005 ([www.eesti.ca](http://www.eesti.ca)).

<sup>71</sup> Following a livelihood in Komsomol and several industrial enterprises including Ukrnafta, Didenko had in 1998 attempted a political career. On 10 June 1999, however, he joined the management of Naftogaz Ukrainy, where he on 18 July 1999 became Bakai's first deputy. In June 2004, Didenko was sentenced to imprisonment in Germany on these charges. However, he was subsequently acquitted in another court in December 2004. On 25 May 2006, Didenko was reinstated at Naftogaz Ukrainy. And in January 2008, Didenko was again appointed first deputy chairman of Naftogaz Ukrainy. News web sites, UkrInformByuro, 25 May 2006 (<http://ukrinform.info>); Prima News, 19 June 2003 ([www.prima-news.ru](http://www.prima-news.ru)); Unian News Agency, 6 February 2008, 28 February 2008 ([www.unian.net](http://www.unian.net)).

<sup>72</sup> Preyger and Omelchenko, "Problems of Turkmen Gas Export," 124.

<sup>73</sup> Global Witness, *It's a Gas*, 35.

<sup>74</sup> Preyger and Omelchenko, "Problems of Turkmen Gas Export," 125.

In 2000, Turkmenistan insisted on a price of \$42, which in 2001 rose to \$44.<sup>75</sup>

According to a contract (No. 14/404) between Naftogaz Ukrainy and Turkmenneftegaz signed on 14 May 2001, 50 per cent of the contracted payments, from the years 2002 to 2006, were to be paid in cash to the value of \$840 million, with the remaining 50 per cent to be supplied in barter goods worth the same amount.<sup>76</sup>

On 4 October 2001, Russia and Ukraine signed an intergovernmental agreement on Additional Measures for the Russian Natural Gas Transit through Ukraine (known as the 2001 Transit Agreement) that sanctioned the import of Russian gas to Ukraine in lieu of transit fees. According to this agreement, Russia and Ukraine were required to sign, every year, an intergovernmental protocol that specified, among others, the volume of gas to be transited and the payment for this service. The agreement also provided a framework for the balance of Ukrainian gas imports from Turkmenistan.<sup>77</sup>

In 2002-2004, Ukraine thus paid for gas imported from Russia mainly with the provision of transit services for Russian gas destined to Europe, except for a small volume (1-3 bcm) paid for in cash. Turkmenistani gas, however, was bought by Naftogaz Ukrainy from Turkmenneftegaz at the Turkmenistani border, with a large proportion paid for by barter, and then shipped to Ukraine by an independent trader (Itera until the end of 2002 and Eural Trans Gas, on which more below, in 2003-2004). Naftogaz Ukrainy, at the Turkmenistani border, immediately resold the gas to the shipper, only to purchase it back at the Russo-Ukrainian border. Any gas that Naftogaz Ukrainy did not purchase back at once was left in Ukrainian storage facilities. These facilities were owned by Naftogaz Ukrainy, which retained a first-priority right to purchase at times of peak demand, and with the shipper bearing the risk of loss and leakage. The shipper would be paid for its services in kind, that is, with gas (the approximately 13.5 bcm per year of Russian gas that Naftogaz Ukrainy received in lieu of payment of transit fees for Russian gas destined for Europe), some of which was sold in Ukraine and some of which was re-sold to the European market. Each contract had confidentiality clauses so that prices and key terms would not be disclosed.<sup>78</sup> It goes without saying that under these conditions, opportunity was ripe for the siphoning-off not only of gas but of revenues as well. In addition, it was often difficult for the parties involved in the trade to correctly assess how debt was growing, so the potential for misunderstandings was substantial.

### ***The International Consortium for the Control and Development of the Gas Transportation System of Ukraine***

Everybody realised that something would have to be done about the Ukrainian gas transportation system, vital as it was not only to the Ukrainian gas sector but to the transit of gas to western Europe as well. Already in June 2002, Ukrainian President Leonid Kuchma and Russian President Vladimir Putin agreed on the joint management of the Ukrainian gas transportation system, and later German chancellor Gerhard Schroeder, who had participated in the talks, also stated his desire to take part.<sup>79</sup> The governments of Ukraine, Russia, and Germany in June 2002 for this reason signed a trilateral agreement on a consortium. On 7 October 2002, the Russian and Ukrainian presidents founded the International Consortium for the Control and Development of the Gas Transportation System of Ukraine<sup>80</sup> at the CIS summit held in Chisinau, Moldova. Ukrainian President Leonid Kuchma at first insisted on a 51-per

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<sup>75</sup> Preyger and Omelchenko, "Problems of Turkmen Gas Export," 125.

<sup>76</sup> Global Witness, *It's a Gas*, 15. The contract also reveals that the Central Bank of Turkmenistan held a state account at Deutsche Bank in Frankfurt-am-Main (account number 949924500), which it used as its main account for receiving gas revenues.

<sup>77</sup> IEA, *Ukraine*, 220-21; Pirani, *Ukraine's Gas Sector*, 22, 31.

<sup>78</sup> Audit Chamber of the Russian Federation (Schetnaya palata RF) report No. 11 (71), 2003; Pirani, *Ukraine's Gas Sector*, 31-2.

<sup>79</sup> See, e.g., "Ukraine Looks to EBRD for Gas Consortium Project," *BlackSea Trend Review* 2: 4 (Summer 2003), 64.

<sup>80</sup> Known in Russian as OOO Mezhdunarodnyy konsortsiy po upravleniyu i razvitiyu gazotransportnoy sistemy Ukrainy. In Gazprom English-language press releases, the consortium tends to be referred to as the International Consortium for Ukraine's Gas Transmission System Management and Development, or some variant on this name. See, e.g., Gazprom press releases, 16 June 2004, 31 August 2004.

cent controlling stake in the inter-state gas consortium, but had to agree to the Russian demands for parity ownership.<sup>81</sup> At first, the idea was that the Consortium would refurbish and operate some of Ukraine's main transit gas pipelines and build at least one new pipeline. There were also plans to allow foreign investment in the system to ensure its long-term sustainability, and Ruhrgas and Gaz de France were invited to participate. INOGATE, an EU-funded programme, financed a major study, which was completed in June 2003 (and for curious reasons remain confidential).<sup>82</sup> Following a number of disputes about capital investments, Gazprom and Naftogaz Ukrainy in 2004-2005 agreed not to operate the main pipeline system after all, but only to build and operate a small additional gas pipeline, from Bohorodchani (known in Russian as Bogorodchany) to Uzhhorod, to raise transit capacity by 19 bcm. The new pipeline would engage and ensure loading the Ivatsevichi-Dolyna and Torzhok-Dolyna gas pipelines, which by then were idle. However, yet further disputes delayed construction of the new pipeline. In April 2006, the Consortium finally announced that a Ukrainian company, Naftohazbud, had won the tender to construct the new pipeline.<sup>83</sup> In other words, the grandly-named International Consortium for the Control and Development of the Gas Transportation System of Ukraine resulted in no more than plans for a single pipeline. There is no reason to expect any further activities along the lines of the original plans.

### ***Eural Trans Gas***

In late 2002, either Gazprom alone (then under a new management that no longer included Rem Vyakhirev), or perhaps in a joint action with Naftogaz Ukrainy, forced Itera out of the business of delivering gas to Ukraine.<sup>84</sup> In November 2002, Gazprom reduced the amount of gas that Itera was allowed to deliver to Ukraine. At the end of the month, Gazprom announced that it would take over the gas export from Turkmenistan to Ukraine. Gazprom then terminated Itera's contract. Naftogaz Ukrainy was not unhappy about this, since Itera had been taking business away by selling gas directly to customers within Ukraine.<sup>85</sup> On 20 January 2003, Gazprom even announced a full halt to gas supplies to Itera, for reasons of non-payment.<sup>86</sup>

Much the same then happened in the other countries in which Gazprom previously had allowed Itera to dominate the gas trade. Itera had worked for many years in Armenia, but in June 2003 Gazprom took over this niche.<sup>87</sup> By January 2004, Itera was almost completely out of the Armenian market.<sup>88</sup> Gazprom then reappeared on the Georgian market, forcing Itera out. Itera had to stop gas deliveries to Georgia in October 2003. Instead Gazprom's export arm Gazexport began deliveries on 1 October 2003, at the same price that Itera had used.<sup>89</sup> In late 2003, Gazprom also forced Itera out of Azerbaijan.<sup>90</sup> Unable to compete with Gazprom, Itera in 2003 had to close its office in Uzbekistan's capital Tashkent as well.<sup>91</sup> The firm survived, but its power was severely diminished.

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<sup>81</sup> Taras Kuzio, "Moscow's Energy Strategy," *Jane's Intelligence Digest*, 20 December 2002.

<sup>82</sup> Energy Charter Secretariat, *Gas Transit Tariffs in Selected Energy Charter Treaty Countries* (Brussels: Energy Charter Secretariat, January 2006), 61. On INOGATE (Interstate Oil and Gas Transport to Europe), see its web site, [www.inogate.org](http://www.inogate.org).

<sup>83</sup> IEA, *Ukraine*, 216-17. See also David Preyger and Vladimir Omelchenko, "Caspian Dilemma: How to Deliver Blue Fuel to the European Market," *Central Asia and the Caucasus* 33 (2005), 120-28, on 123.

<sup>84</sup> Some claim that it was Naftogaz Ukrainy which forced out Itera. Pirani, *Ukraine's Gas Sector*, 22. However, it seems more likely that it was Gazprom alone since this is what Gazprom then, or soon afterwards, did with regard to Itera in several other CIS countries.

<sup>85</sup> Global Witness, *It's a Gas*, 36.

<sup>86</sup> Fujimori, "Ukrainian Gas Traders," 133; citing Itera's press release, 24 January 2003.

<sup>87</sup> Saprykin, "Iran as an Exporter," 117.

<sup>88</sup> Samvel Martirosyan, "Will Gas Be a Lethal Weapon in the South Caucasus?" *Alexander's Gas & Oil Connections* 9: 6 (25 March 2004; [www.gasandoil.com](http://www.gasandoil.com)); Stern, *Future*, 85.

<sup>89</sup> Saprykin, "Iran as an Exporter," 115-16; Stern, *Future*, 25, 83-4.

<sup>90</sup> Martirosyan, "Will Gas Be a Lethal Weapon?"; Stern, *Future*, 25, 83.

<sup>91</sup> Murat Laumulin, "Gazprom as a Transnational Corporation and Central Asia," *Central Asia and the Caucasus* 41 (2006), 34-46, on 46.

Then Naftogaz Ukrainy and Gazprom on 5 December 2002 signed an agreement to participate, on a parity basis, in a joint venture company for the exports of Central Asian gas to Ukraine. Although the name of the joint venture was not mentioned in this particular contract, Gazprom on the same day signed a contract on gas deliveries to Ukraine with a firm named Eural Trans Gas. This company would henceforth take over Itera's role in handling the supply of gas from Turkmenistan to Ukraine and Europe.<sup>92</sup> Eural Trans Gas was in the media closely linked to the already mentioned Dmytro Firtash, a Ukrainian businessman, who claims to have founded Eural Trans Gas.<sup>93</sup>

Eural Trans Gas was a new company, indeed it was only registered on the following day. Eural Trans Gas Kft was registered in Hungary on 6 December 2002 at an address in the city of Csabdi (Szabadság u. 24), with an account at Raiffeisenbank, and a capital listed as the equivalent of \$12,000. The company started operations a month later (in January 2003) with a work-force of about thirty people.<sup>94</sup>

Firtash was a key executive of Eural Trans Gas. Another was Oleg Palchikov. There was no apparent Gazprom involvement in the ownership structure.<sup>95</sup> In the early 1990s, as noted, Firtash had worked with Igor Makarov, the head of Itera, on the Turkmenistani gas exports.<sup>96</sup> Since Gazprom had terminated its use of Itera as middleman, it may simply have wanted to continue working with the established Ukrainian side, that is, Firtash. Because, as will be shown, Firtash would remain a key Ukrainian actor in the Ukrainian gas trade also after Eural Trans Gas.

Palchikov too had links with Itera, through his wife, Lyubov, who reportedly used to work for Itera-Rus' and Gazprom. Palchikov's history was no less colourful than Firtash's although arguably not quite as successful. In 2000-2001, Palchikov worked in the Moscow-based firm General Company Resource, in which capacity he maintained links with Elmstad Trading Limited, tied to the Ukraine-born businessman and alleged organised crime leader Semyon Mogilevich, and Highrock Properties Ltd, linked to Dmytro Firtash. In 2001, Palchikov started the firm Geopromtrans, of which he owned a 70-per cent stake, which became licensed to carry out geological surveys for the gas and oil industry. From April 2001 to 2004, Palchikov was the

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<sup>92</sup> Global Witness, *It's a Gas*, 37.

<sup>93</sup> Firtash, a Ukrainian businessman, by then had interests in Moldova and Turkmenistan and an Israel-registered company, Highrock Properties Ltd. Others suggest that Highrock Properties instead was registered in Limassol, Cyprus, on 15 January 2001 with a capital of \$10,000. Firtash allegedly ran this company together with a Ukraine-born associate named Igor L'vovich Fisherman, who in turn has been alleged to have been a one-time associate of Semyon Mogilevich, a Ukraine-born alleged leader in organised crime (both Fisherman and Mogilevich are wanted by the FBI for racketeering and other crimes; see the Federal Bureau of Investigation (FBI) web site, [www.fbi.gov](http://www.fbi.gov)), who in turn has been linked to former Ukrainian Prime Minister Pavlo Lazarenko, eventually condemned for money laundering. Robert I. Friedman, *Red Mafiya: How the Russian Mob Has Invaded America* (Boston: Little, Brown and Company, 2000), 249; *Alexander's Gas & Oil Connections* 8: 3 (6 February 2003); citing *RFE/RL Crime and Corruption Watch* 3: 2; *Kommersant*, 5 July 2001. Yet another company within his business group was Highrock Holdings, registered in Nicosia. Global Witness, *It's a Gas*, 7, 37-8, 40. According to Firtash, this firm, formed in 2001, was at first controlled by Igor Makarov of Itera, and Firtash only became a shareholder in 2001. He then acquired control of Highrock Holdings in 2003 (which makes sense, since Itera suffered severe losses this year, having been forced out of several important markets by Gazprom). Firtash at present owns the Group DF enterprise, also known as GDF and the Firtash Group of Companies (with a web site, [www.groupdf.com](http://www.groupdf.com), which also includes his biography and a chronology of his business interests), founded in early (reportedly June) 2007. See, e.g., Interfax-Ukraine, 1 February 2008; Pirani, *Ukraine's Gas Sector*, 41.

<sup>94</sup> Eural Trans Gas maintains a web site, [www.etg.hu](http://www.etg.hu), which gives its present address as 1054 Budapest Bank Center, Szabadság tér 7. According to a statement by Firtash, he had founded Eural Trans Gas in October 2001 (a slip of the tongue, it was 2002) and signed a contract with Gazprom in November 2002. Pirani, *Ukraine's Gas Sector*, 40. This presumably means that Firtash launched his then not-yet registered company in October 2002 and then negotiated the contract with Gazprom in November 2002, even though the contract was not signed until 5 December 2002. *RFE/RL Organized Crime and Terrorism Watch* 3: 21 (19 June 2003). See also *Upstream*, 7 March 2003 ([www.upstreamonline.com](http://www.upstreamonline.com)); Kupchinsky, "Naftohaz Ukrainy," *RFE/RL Organized Crime and Terrorism Watch* 3: 25 (18 July 2003); 3: 26 (5 August 2003); 3: 28 (15 August 2003); 3: 29 (21 August 2003); 3: 30 (28 August 2003); Global Witness, *It's a Gas*, 37.

<sup>95</sup> Pirani, *Ukraine's Gas Sector*, 40.

<sup>96</sup> Pirani, *Ukraine's Gas Sector*, 39.

head of Elmstad Trading Limited's Moscow office. From December 2002 to 2004, he also was the Moscow representative of Eural Trans Gas.<sup>97</sup>

Eural Trans Gas paid Gazprom for transportation services but was itself paid by Ukraine in gas, 13.4 bcm out of the total of 35.4 bcm that it delivered to Ukraine according to the contract signed on 5 December 2002 by Gazprom and Eural Trans Gas. The gas was then resold in Ukraine and elsewhere, among other customers reportedly to Gazexport's German subsidiary ZMB GmbH, the UK-based Gazprom Marketing & Trading Ltd, Poland's state gas company PGNiG, and state companies in Hungary and Slovakia.<sup>98</sup> In 2004, Eural Trans Gas reportedly sold even larger volumes of gas in European markets.<sup>99</sup>

### ***The 2004 Agreements between Russia and Ukraine***

On 29 July 2004, the heads of Gazprom and Naftogaz Ukrainy, Aleksei Miller and Yuriy Boiko, signed a set of documents that would regulate the mechanism up to 2028 for supplies of Turkmenistani gas to Ukraine and the transit through Ukraine of gas destined for western Europe. The agreement entailed the establishment of a new entity, RosUkrEnergo, that would launch its activities starting 1 January 2005 based on Turkmenistani gas procurement agreements adopted with Naftogaz Ukrainy for the period 2005-2006 and Gazexport for 2005 onwards.<sup>100</sup>

On 9 August 2004, Gazprom and Naftogaz Ukrainy also signed Annex 4 to the Contract on the Volumes and Terms of Russian Natural Gas Transit through Ukraine between 2003 and 2013 (a long-term contract, signed already on 21 June 2002, which in turn referred to a previous intergovernmental agreement, the 4 October 2001 Agreement between the Government of the Russian Federation and the Cabinet of Ministers of Ukraine on Additional Measures for the Russian Natural Gas Transit through Ukraine, as well as annually signed Intergovernmental Protocols that fixed the rate of Russia's gas transit through Ukraine over a year and regulated transit services).<sup>101</sup>

On 10-11 August 2004, Gazprom, Vnesheconombank (as agent for the Russian government), and Naftogaz Ukrainy signed a set of documents on the full, if discounted, repayment of the Ukrainian debt for Russian natural gas for the period 1997-2000.<sup>102</sup>

The repayment agreement as well as the new Annex 4 agreement foresaw deliveries of Russian gas to Ukraine of 21-25 bcm per year for the period 2005-2009 as a barter payment for the transit of gas to Gazprom's customers in western Europe. Under this barter agreement, the notional price of Russian gas delivered to Ukraine under these terms was \$50 and the notional tariff for transit of Russian gas across Ukraine was set at \$1.09375 for 1,000 cubic metres per 100 km (as this was barter, mostly no actual money changed hands) up to 2009.<sup>103</sup> The barter deliveries of gas was no mean addition to Ukraine's gas balance, since they constituted about a third of Ukraine's total consumption.<sup>104</sup>

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<sup>97</sup> There does not seem to be any official biography of Palchikov. This information derives from a large number of news media reports but primarily *Novaya gazeta*, 6 February 2006 and the web site, [www.anticomproamat.ru](http://www.anticomproamat.ru). From July 2004 to April 2007, Palchikov was a managing director of RosUkrEnergo, more on which below. On Mogilevich, see, e.g., the FBI web site, [www.fbi.gov](http://www.fbi.gov); the web site, [www.anticomproamat.ru](http://www.anticomproamat.ru).

<sup>98</sup> Global Witness, *It's a Gas*, 47. ZMB GmbH is a wholly-owned Gazprom subsidiary founded on 28 June 1993 to market Russian gas in Germany and western Europe. The firm maintains a web site, [www.zmb.de](http://www.zmb.de). The Eural Trans Gas web site confirms a contract with ZMB, valid up to 2008. Gazprom Marketing & Trading Ltd in October 2006 became the first Gazprom retail brand in Britain and France and maintains an expensive-looking but not very informative web site, [www.gazprom-mt.com](http://www.gazprom-mt.com).

<sup>99</sup> Global Witness, *It's a Gas*, 48.

<sup>100</sup> Gazprom press release, 29 July 2004; *Nefterynek* (Oil Market) 6-7, 2004.

<sup>101</sup> IEA, *Ukraine*, 221-2; Gazprom press release, 7 December 2005. Excerpts from the contract were reprinted in *Ukrayinska Pravda*, 22 December 2005 ([www.pravda.com.ua](http://www.pravda.com.ua)).

<sup>102</sup> Gazprom press release, 11 August 2004. On Vnesheconombank, see the firm's web site, [www.veb.ru](http://www.veb.ru).

<sup>103</sup> Gazprom press release, 11 August 2004; David Preiger; Irina Maliarchuk; and Taisia Grinkevich, "Ukraine, Russia, and the Central Asian States: Cooperation Problems in the Gas Sector," *Central Asia and the Caucasus* 25 (2004), 101-10, on 104; Stern, *Russian-Ukrainian Gas Crisis*, 2. See also excerpts from the contract reprinted in *Ukrayinska Pravda*, 22 December 2005 ([www.pravda.com.ua](http://www.pravda.com.ua)).

<sup>104</sup> Preiger; Maliarchuk; and Grinkevich, "Ukraine, Russia, and the Central Asian States," 102.

For once, things seemed to run smoothly in the Russo-Ukrainian gas trade relationship. Presidents Putin and Kuchma met in Sochi on 18 August 2004 and gave a press conference in which they gave positive assessments of relations between their two countries. Putin signed a decree that transferred the right to collect value-added tax on Russian fuel exported through Ukraine, Kazakstan, and Belarus to the governments of these countries, in effect handing over money to them.<sup>105</sup> On the same day, 18 August 2004, the prime ministers of Russia and Ukraine signed an agreement on strategic co-operation in the gas industry.<sup>106</sup>

#### ***The Fourth Phase: RosUkrEnergo***

Eural Trans Gas was, as noted, often accused in the media of connections with organised crime, so on 29 July 2004 was made superfluous by the signing of documents by the heads of the two state monopolies regulating the mechanism for the transport and delivery of natural gas up to 2028. This, the fourth phase of Ukraine's gas imports, entailed the establishment of yet a new entity, Switzerland-registered SP RosUkrEnergo, which would buy Turkmenistani gas for the Ukrainian market, and operate as a transit operator as well as investor in the gas-transportation infrastructure needed for subsequent deliveries. RosUkrEnergo was owned, on a parity basis, by OAO Gazprombank, the authorised bank of Gazprom, and Austria's Raiffeisenbank. The Ukrainian firm NAK Naftogaz Ukrainy would henceforth serve only as the ultimate gas consumer.<sup>107</sup> (In August 2005, Eural Trans Gas announced that its office in Ukraine had closed.<sup>108</sup> The firm retains its web site, however.)

Although the creation of RosUkrEnergo marked a new phase in the Ukrainian gas trade – with Gazprom ownership and planned investments in transportation infrastructure – in many ways the firm was no more than a continuation of Eural Trans Gas. Both entities were run by Firtash and his associates. Firtash later indeed claimed that Gazprom at first had considered buying 50 per cent of Eural Trans Gas, but since the firm had been the subject of scandal, a new company, RosUkrEnergo, had been founded instead, with 50 per cent Gazprom ownership.<sup>109</sup>

RosUkrEnergo, registered in Zug, Switzerland, on 22 July 2004, commenced operations on 1 January 2005. In exchange for its services as operator for the supply of gas from Turkmenistan to Ukraine, RosUkrEnergo would reportedly receive 13 bcm of gas - roughly the same amount per year that Ukraine reportedly had to pay first Itera and then Eural Trans Gas. There have been claims that Ukraine and Gazprom each lost \$478 million in annual revenues due to the arrangement.<sup>110</sup>

The initial holdings in RosUkrEnergo were held on a parity basis by two Austrian firms, ARosGas Holding AG, owned by or at least linked to Gazprombank (Gazprom eventually acquired this share and was most likely the real owner all along), and Raiffeisen Investment AG, on behalf of CentraGas Holding AG. The latter was believed at the time to have been a wholly-owned subsidiary of Raiffeisen Investment AG.<sup>111</sup> However, it has since become clear that CentraGas Holding was incorporated in Vienna in July 2004, until April 2006 was held in trust by Raiffeisen Investment, and is 90 per cent owned by GDF, the financial group of Dmytro

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<sup>105</sup> RFE/RL *Newsline*, 19 August 2004. The decree turned out not to be immediately applicable to Belarus. RFE/RL *Newsline*, 20 August 2004.

<sup>106</sup> *Nefterynok* (Oil Market) 6-7, 2004.

<sup>107</sup> RFE/RL *Central Asia Report* 4: 30 (10 August 2004); referring to Prime-TASS Energy Service, 29 July. Gazprombank, in which Gazprom claims to have a stake of 50 per cent or less, maintains a web site, [www.gazprombank.ru](http://www.gazprombank.ru). It should be noted that Gazprombank is hardly an independent bank; the chairman of the bank's council, Aleksei Miller, is also the chairman of Gazprom's management committee, and several other key Gazprom executives also sit on the council of Gazprombank, including Aleksandr Ananenko and Aleksandr Medvedev. For further information on these individuals, see Gazprom's web site, [www.gazprom.ru](http://www.gazprom.ru).

<sup>108</sup> IEA, *Ukraine*, 223 n. 44.

<sup>109</sup> Pirani, *Ukraine's Gas Sector*, 40.

<sup>110</sup> Roman Kupchinsky, "Ukraine: Criminal Cases Filed over Gas Schemes," RFE/RL *Organized Crime and Terrorism Watch* 5: 6 (14 July 2005; [www.rferl.org](http://www.rferl.org)). RosUkrEnergo maintains a web site, [www.rosukrenerg.ch](http://www.rosukrenerg.ch).

<sup>111</sup> Global Witness, *It's a Gas*, 49; IEA, *Ukraine*, 224. For yet more information on the convoluted ownership of these firms, see Hans-Martin Tillack, "Die Gazoviki, das Geld und die Gier," *Stern* 38, 2007. Tillack adds details but his investigation produces the same overall conclusion, i.e., the ARosGas stake belonged to Gazprom.

Firtash.<sup>112</sup> The equity in RosUkrEnergo has since been transferred so that the firm is now directly owned by respectively Gazprom and CentraGas Holding.

Although Gazprom was thus directly involved in RosUkrEnergo, the ownership of the firm's Ukrainian side remained opaque for a considerable time and cannot be said to be known for certain even now. To make things more complicated, ARosGas Holding AG and Raiffeisen Investment AG on paper reportedly shared the same Vienna address, and definitely the same telephone number, although ARosGas was, through Gazprom, connected to the Russian state, while Raiffeisen acted on behalf of certain private Ukrainian businessmen.<sup>113</sup> Among the latter was allegedly the controversial Ukrainian businessman Semyon Mogilevich (in 2008 arrested in Moscow<sup>114</sup>), but this cannot be verified.<sup>115</sup> From the inaugural meeting of RosUkrEnergo in 2004 until perhaps June 2005, the Ukrainian side of the firm was represented on the board by Yuriy Boiko and Ihor Voronin, the chairman and deputy chairman respectively of the state oil and gas company Naftogaz Ukrainy. The latter, oddly enough, had no acknowledged link to the private company Raiffeisen Investment AG which actually held the equity and no apparent investment in RosUkrEnergo. Nor did the Ukrainian state have any acknowledged link to RosUkrEnergo. Yet both Boiko and Voronin held strategic positions on the coordination committee of RosUkrEnergo.<sup>116</sup> Later it became clear that of the 50 per cent controlled by Ukrainian interests, 45 per cent of RosUkrEnergo was owned by the already mentioned Ukrainian businessman, Dmytro Firtash, and the remaining 5 per cent by another Ukrainian, Ivan Fursin. Firtash was then reported to be the owner of the Kiev basketball club and two Ukrainian television channels, K-1 and K-2, while Fursin owned several enterprises including a film studio and a small Ukrainian bank, Misto-Bank in Odessa.<sup>117</sup>

If Firtash and Fursin actually owned half of RosUkrEnergo, who was then Boiko who sat on the board? From 1981, Boiko worked in various industrial enterprises. His career took a decisive turn only with his 31 January 2002 appointment as chairman of the Ukrainian state oil and gas company Naftogaz Ukrainy. This also brought with it a position in the ministry of fuel and energy. In August 2003, Boiko was appointed first deputy minister of fuel and energy, while retaining his post at Naftogaz Ukrainy. And then, as it turned out, Boiko was on the board of RosUkrEnergo from its inaugural meeting in July 2004. The following month he was decorated Hero of Ukraine for his work within the energy sector.<sup>118</sup>

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<sup>112</sup> Group DF, the Firtash group of companies, with the web site, [www.groupdf.com](http://www.groupdf.com).

<sup>113</sup> *RFE/RL Organized Crime and Terrorism Watch 5*: 6 (14 July 2005); IEA, *Ukraine*, 224. The question of addresses is intriguing. Raiffeisen Investment's present address in Vienna is Krugerstrasse 13 (see the firm's web site, [www.raiffeisen-investment.com](http://www.raiffeisen-investment.com)), while ARosGas Holding is registered at Tegetthoffstrasse 1 (see, e.g., the web site [www.hotfrog.at](http://www.hotfrog.at) and several other corporate web services). However, the telephone number given for ARosGas Holding (+43 1 710 54000) is the same as the number to the switchboard of Raiffeisen Investment. One is therefore inclined to agree with Raiffeisen Investment's claim, on the firm's web site, that it is "the leading Corporate Finance Advisory firm in Emerging Europe" and that its one guiding principle is "to act in the best interests of our clients at all times." Raiffeisen Investment AG was in turn part of the Austrian firm Raiffeisen Zentralbank Österreich AG (RZB), the third-largest bank in Austria. The bank maintains a web site, [www.rzb.at](http://www.rzb.at).

<sup>114</sup> ITAR-TASS, 29 January 2008, 11 February 2008.

<sup>115</sup> Claims of his involvement have been made in various news reports, e.g., *Saar-Echo*, 14 December 2005 ([www.saar-echo.de](http://www.saar-echo.de)). See also Global Witness, *It's a Gas*, 57. Mogilevich reportedly knows Dmytro Firtash, and Zeev Gordon, the Israeli lawyer who had registered Eural Trans Gas, was apparently also Mogilevich's lawyer. In 2006, a Ukrainian newspaper reported that the beneficiaries of Raiffeisen Investment AG were the two Ukrainians Dmytro Firtash (90 per cent of the equity) and Ivan Fursin (10 per cent). *Ukrayinska Pravda*, 26 April 2006 ([www.pravda.com.ua](http://www.pravda.com.ua)). RosUkrEnergo's public relations manager/press secretary was a Russian, Andrei Knutov, who explained that 35 persons worked in RosUkrEnergo but only nine in Switzerland. *Ukrayinska Pravda*, 5 February 2007 ([www.pravda.com.ua](http://www.pravda.com.ua)).

<sup>116</sup> Global Witness, *It's a Gas*, 6, 51-2, 54.

<sup>117</sup> *UkrainianJournal.com*, 26 April 2005 ([www.ukrainianjournal.com](http://www.ukrainianjournal.com)); the web sites, [www.anticompromat.ru](http://www.anticompromat.ru); <http://ukrinform.info>. Both K-1 and K-2 were launched in 2005.

<sup>118</sup> Oddly enough, there seems not to be any available official biography of Boiko, despite his prominent official posts. This section is based on information from various news media including the web site, [www.anticompromat.ru](http://www.anticompromat.ru). On 4 March 2005, Boiko was dismissed from both his ministerial post and the job for Naftogaz Ukrainy in a move initiated by Yulia Tymoshenko. However, from August 2006 until 20 December 2007, Boiko was minister of fuel and energy. Boiko's successor as chairman of Naftogaz Ukrainy, Oleksiy Ivchenko, subsequently admitted that Boiko had simply sold no less than 8 bcm of Gazprom-owned, Russian gas kept in storage in Ukraine – a major cause

As for Voronin, he was another Ukrainian businessman. Deputy chairman of the Ukrainian state oil and gas company Naftogaz Ukrainy since April 2002, Voronin had in 2001-2002 worked as assistant to the then first deputy prime minister of Ukraine, Oleh Dubyna.<sup>119</sup>

When RosUkrEnergo replaced Eural Trans Gas as operator of the gas export from Turkmenistan to Ukraine, RosUkrEnergo contracted (what was then clearly unrealistic) purchases of Turkmenistani gas of 60-70 bcm per year beginning in 2007, rising to 70-80 bcm per year in 2009.<sup>120</sup> Such volumes were never delivered.

### ***Turkmenistan Raises Prices, Ukraine Searches for Loopholes***

When things finally seemed to have been settled in the gas trade between Ukraine and Russia, Turkmenistan suddenly again made its presence felt.

In early December 2004, Turkmenistan requested a price increase from Russia and Ukraine for 2005 from \$44 to \$58. However, the parties could not agree. On 31 December 2004, Turkmenistan abruptly ceased delivering gas to Ukraine, reportedly due to the high price of barter goods from Ukraine. This forced Ukraine to accept a price hike. The price of gas was raised from \$44 to \$58, but the barter portion remained. On 3 January 2005, Turkmenistan thus allowed the flow of gas to Ukraine to resume, at the agreed price of \$58 (half barter, half cash).<sup>121</sup> From 1 July 2005, Ukraine followed Russia's lead in opting to pay a cash price of \$44 for Turkmenistani gas, instead of the higher but in part barter price.<sup>122</sup> The new contract with Ukraine was supposed to end barter transactions.<sup>123</sup>

During the first half of 2005, a number of confusing statements from Ukrainian and Turkmenistani sources were made on how the gas deliveries would be handled. It was, for instance, announced that Turkmenneftegaz had signed a contract with Naftogaz Ukrainy for 50-60 bcm per year for the period 2006-2026, with the Ukrainian side to select operator of the gas transportation.<sup>124</sup> Then, on 25 July 2005, Ukraine suddenly signed a memorandum with Iran on the construction of a new pipeline that would export Iranian gas to Europe, bringing 20-30 bcm of Iranian gas to Ukraine via Armenia, Georgia, and Russia. The three latter countries were invited into a pentapartite commission to project and construct the Iran-Ukraine gas pipeline that Ukraine proposed. If Russia was not interested, the Ukrainian side suggested, then the new pipeline could run across the Black Sea, bypassing Russia. Meanwhile, Ukraine's deputy fuel and energy minister, Sergei Titenko, seemingly announced that the pipeline in any case would be built bypassing Russia, crossing the Black Sea from the Georgian port of Supsa to the Crimea in Ukraine.<sup>125</sup> But in October 2005 Turkmenistan's President Niyazov announced that any long-term gas supply arrangement with Ukraine would need also to involve Russia.<sup>126</sup>

In December 2005, the presidents of Ukraine and Turkmenistan announced that Ukraine would buy 40 bcm of gas at \$50, beginning in January 2006.<sup>127</sup> From the second half of 2006, the price was set to rise to \$60. However, in the end no gas was delivered under this agreement, and on 29 June 2006 Turkmenistan's Ministry of Foreign Affairs announced that the contract was no longer valid, in effect a unilateral breach of the agreement. While Turkmenistan blamed

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of contention between Gazprom and Naftogaz Ukrainy, since the latter at first did not admit that the gas had gone missing. *Ukrayinska Pravda*, 14 November 2007 ([www.pravda.com.ua](http://www.pravda.com.ua)).

<sup>119</sup> Web site of UkrGaz-Energo, [www.ukrgazenergo.ua](http://www.ukrgazenergo.ua). The web site's biography mentions Voronin's position as assistant to the then first deputy prime minister but interestingly fails to mention that this was Dubyna. Voronin continued to enjoy a successful career. On 2 February 2006, he was nominated chairman of the management board of UkrGaz-Energo.

<sup>120</sup> Preyger and Omelchenko, "Problems of Turkmen Gas Export," 125.

<sup>121</sup> *Nefterynok* (Oil Market) 1, 2005.

<sup>122</sup> Stern, *Russian-Ukrainian Gas Crisis*, 4.

<sup>123</sup> Global Witness, *It's a Gas*, 27.

<sup>124</sup> Stern, *Russian-Ukrainian Gas Crisis*, 4.

<sup>125</sup> Interstate Oil and Gas Transport to Europe (INOGATE) web site, [www.inogate.org](http://www.inogate.org), July 2005, citing *AZG Armenian Daily*, 27 July 2005; August 2005, citing RIA Novosti, 1 August 2005; *Kommersant*, 26 July 2005.

<sup>126</sup> Stern, *Russian-Ukrainian Gas Crisis*, 4.

<sup>127</sup> G. P. Armstrong, *Russian Federation/CIS Weekly Sitrep*, 15 December 2005; Stephen Blank, "The Energy Wars: Turkmenistan Strikes Back," *Central Asia-Caucasus Analyst*, 22 February 2006.

Ukrainian debt, the fact that Russia, as noted above, was ready to pay a higher price (\$65) for the same gas no doubt influenced the decision. Then, in the summer of 2006, Turkmenistan's President Niyazov announced that he aimed at raising the price of gas at the Turkmenistani border for both Russia and Ukraine, to somewhere between \$100 and \$125.<sup>128</sup>

### ***The January 2006 Russia-Ukraine Natural Gas Dispute***

In late December 2005, Gazprom made it clear to its Ukrainian counterpart, Naftogaz Ukrainy, that it no longer would supply Ukraine with natural gas at subsidised prices well below those on the European market. Gazprom demanded that Ukraine from the beginning of 2006 pay non-subsidised prices for its gas. The price under discussion ranged from \$160 to 230, unless Ukraine accepted allowing Gazprom an equity stake in the transit pipeline network. Ukraine, on the other hand, demanded that market prices would only be phased in over a period of time, and stated that it was not prepared to pay more than \$80 in 2006.<sup>129</sup>

When Naftogaz Ukrainy refused to sign a contract on the purchase of natural gas at the higher price demanded by Gazprom's head Miller, Gazprom threatened to discontinue gas supplies on 1 January 2006 - in the middle of a very cold winter. The ostensibly commercial dispute then turned political as Russian President Putin, on national television, on 31 December 2005, ordered Gazprom to continue selling subsidised gas to Ukraine until the end of March as long as Ukraine agreed to pay market prices from April onwards, a compromise first suggested by one of the Ukrainian negotiators (this would have protected Yushchenko from any domestic effects of the planned price increase until after the 26 March 2006 Ukrainian parliamentary election and the coldest period of the winter). Putin gave Ukraine until midnight to accept his terms. However, Ukraine's President, Viktor Yushchenko, declined to go along with Putin's compromise offer, calling the proposal "economic pressure" - so on 1 January 2006, Gazprom cut the natural gas supplies intended for Ukraine, reducing the flow of gas into Ukraine by 20 per cent. Naftogaz Ukrainy on 1 January stated that it had faxed a draft contract to Russia shortly after 11 pm on the previous day, agreeing to the terms laid out by Putin. Nonetheless, Gazprom on the same day indicated that the faxed reply had fallen short of demands. On 2 January 2006, the loss in pressure due to the disruption in supplies caused shortages further downstream in the European pipeline system. Hungary, Austria, and Slovakia reported a drop in pressure at a time of peak winter demand for natural gas. Aleksandr Medvedev, the director of Gazexport, the export arm of Gazprom, explained the drop in pressure by saying that Ukraine already on the first day of disruption had siphoned off 100 million cubic metres intended for export to Western Europe. Yet on the same day (2 January) Gazprom agreed to restore gas deliveries close to normal levels to compensate for the gas that Ukraine was siphoning, and on the following day, full gas deliveries were resumed.<sup>130</sup>

That first Miller's and then Putin's demands consisted of "economic pressure" cannot be disputed. Gas exports to most European countries, including Ukraine, certainly take place in a seller's market. Analysts are divided, however, on whether these demands also should be termed political pressure. The key issue was after all quite simple: should Ukraine pay market prices or continue to enjoy subsidised prices - for no other reason except that Ukraine had done so in the past? Those who prefer a slightly more sinister - but still economic - explanation might suggest that Gazprom's underlying strategic objective to acquire infrastructural assets in Ukraine no doubt also influenced the dispute, although in the end Ukraine did not give up any. In spite of this, many observers attempted to portray the Russia-Ukraine gas dispute as a political struggle between Presidents Putin and Yushchenko. While political antipathies almost certainly aggravated the crisis, and unresolved political issues surely influenced it, the dispute had far more to do with economics than with foreign policy. Putin himself later (on 6 July 2006) concluded that the "hysteria" created in the European and North American media about Russia's

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<sup>128</sup> Pirani, *Ukraine's Gas Sector*, 36.

<sup>129</sup> Stern, *Russian-Ukrainian Gas Crisis*, 6.

<sup>130</sup> See, e.g., *International Herald Tribune*, 30 December 2005, 31 December 2005, 2 January 2006, 3 January 2006; *New York Times*, 1 January 2006, 2 January 2006; *Dow Jones Energy Service*, 2 January 2006; Reuters News, 3 January 2006. See also Robert L. Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier* (Stockholm: FOI, 2006), 204-221.

energy policy was "an attempt to pressurise Russia. ... Someone wanted to force us to continue selling gas at knockdown prices. [This practice] is over and done with."<sup>131</sup> And for sure, it was not only with regard to Ukraine that Gazprom had insisted on a move to market prices for Russian gas. Most gas-importing former Soviet republics were already paying market prices, or prices close to market prices, for Russian gas deliveries. Even Belarus, a country formally united to Russia in a two-state union, was long under heavy pressure to accept market prices for its Russian gas imports and in March 2006 had to face a Gazprom ultimatum to accept market prices in 2007, or sell Gazprom a fifty per cent stake in AO Beltransgaz, the state-owned operator of Belarus' gas pipelines.<sup>132</sup> In the case of Belarus, there was no reason for Russia to resort to political pressures. But there were sound economic reasons to demand market prices for the natural gas deliveries - because increased gas revenues have become a necessity for Gazprom, which is engaged in a substantial investment programme to maintain its production and distribution capacity.<sup>133</sup>

On 4 January 2006, Gazprom and Naftogaz Ukrainy signed a 5-year contract to mark an end to the dispute. Like all previous agreements of this type, the terms were at first considered commercial secrets. However, since the political career of Yulia Tymoshenko took off, gas contracts have regularly been leaked to the Ukrainian press for domestic political reasons, so the contents of this contract are currently well known.<sup>134</sup> The terms included the following:<sup>135</sup>

1. Gazprom and RosUkrEnergo would until 1 January 2011 pay Naftogaz Ukrainy a tariff of \$1.60 per thousand cubic metres per 100 km for transit of natural gas to Europe.
2. RosUkrEnergo would be the sole company that delivered natural gas to Ukraine. From 1 January 2006, Gazprom would not export Russian natural gas to Ukraine, and Naftogaz Ukrainy would not re-export any natural gas that it had received from Russia.
3. RosUkrEnergo and Naftogaz Ukrainy would form a joint venture not later than 1 February 2006 to market natural gas in Ukraine which had been received through the territory of the Russian Federation,
4. RosUkrEnergo's annual natural gas balance would from 1 January 2006 consist of:
  - 41 bcm of Turkmenistani natural gas purchased from Gazexport and Naftogaz Ukrainy;
  - Up to 7 bcm of Uzbekistani natural gas purchased from Gazexport, some of which with the specific aim of swaps with deliveries to countries in the South Caucasus;
  - up to 8 bcm of Kazakstani natural gas purchased from Gazexport, some of which with the specific aim of swaps with deliveries to countries in the South Caucasus;
  - up to 17 bcm of Russian natural gas purchased from Gazprom with a base price of \$230.

In terms of sales:

- 34 bcm of natural gas would be sold by the joint venture (between RosUkrEnergo and Naftogaz Ukrainy) at a price of \$95 during the first half of 2006 for the Ukrainian market without the right to re-export (until the creation of the joint venture by 1 February 2006, Naftogaz Ukrainy would serve as seller);
- in 2007, up to 58 bcm of natural gas would be sold by the joint venture (between RosUkrEnergo and Naftogaz Ukrainy) to the Ukrainian market without the right to re-export;

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<sup>131</sup> *Platts Oilgram News* 84: 128 (7 July 2006).

<sup>132</sup> *Kommersant*, 31 March 2006.

<sup>133</sup> See, e.g., Michael Fredholm, *Gazprom in Crisis: Putin's Quest for State Planning and Russia's Growing Natural Gas Deficit* (Conflict Studies Research Centre, UK Defence Academy, Russian Series 06/48, October 2006).

<sup>134</sup> IEA, *Ukraine*, 219.

<sup>135</sup> The contract was reprinted in *Ukrainskaya Pravda*, 5 January 2006 ([www.pravda.com.ua](http://www.pravda.com.ua)).

- 15 bcm of natural gas may be exported in a joint programme with Gazexport (the contract gives no details, but this might possibly refer to the 15 bcm of Uzbekistani and Kazakstani gas some of which would be swapped; this volume roughly corresponds to the then needs of the South Caucasus and the throughput capacity of the Trans-Caucasus pipeline that at the time still supplied Georgia, Armenia, and Azerbaijan with natural gas).

The agreement thus confirmed the rights of RosUkrEnergo as exclusive gas supplier to Ukraine. Ukraine would buy gas from Turkmenistan for \$95 - most of which Gazprom then acquired from Turkmenistan for at first \$65 plus transportation costs (and RosUkrEnergo acquired at an undisclosed price), but which would cost \$100 from 2007 and, it soon became clear, even more later. On the other hand, the transit price payable by Gazprom was raised to \$1.60 but was agreed to remain unchanged for the next five years and remain unrelated to the gas price. In addition, Ukraine lost its contracts with Turkmenistan, since all previous gas agreements were annulled by the new agreement.<sup>136</sup> But this meant little or nothing since Turkmenistan in any case did not honour the December 2005 agreement to supply gas. Most importantly, the January 2006 deal also allowed RosUkrEnergo to take a share in Ukraine's domestic market. Furthermore, the contract appeared to allow for negotiations on the price of Ukraine's gas imports to be reopened after six months, although Naftogaz Ukrainy claimed that the price was set for five years.<sup>137</sup> In fact, the terms of the contract seem to be quite clear on the intention that it was only the transit tariff that was fixed for five years; it has been pointed out that gas prices are market-related, while transit tariffs are, or should be, cost-related.<sup>138</sup> The contract was signed by the chairmen of Gazprom and Naftogaz Ukrainy (Aleksei Miller and Oleksiy Ivchenko, who had then as will be recalled risen high above his humble beginnings) and the managing directors of RosUkrEnergo (Oleg Palchikov and Konstantin Chuychenko).<sup>139</sup>

In Ukraine, this agreement was the first within the gas trade to be concluded outside the framework of a broader, intergovernmental agreement since 1994.<sup>140</sup>

As for the transit of Russian gas to Europe, the new agreement meant that henceforth Gazprom would pay in cash, not with gas. The transit payment, about \$2.2 billion per year, comprises a significant part of the revenues of Naftogaz Ukrainy.<sup>141</sup> The revenues, whatever they are used for, are not, apparently, released to allow Ukrtransgaz, the operator of Ukraine's main gas pipelines, necessary infrastructure investments (the same anomaly applies to the revenues from the oil transit with regard to Ukrtransnafta which operates the main oil pipelines).<sup>142</sup> In comparison with transit tariffs elsewhere in Europe, it has been observed that the Ukrainian transit fee is higher than the transit fees of Russia, Belarus, and (depending on the manner of calculation) Poland, but lower than those of Bulgaria and the west European countries.<sup>143</sup> However, the storage services provided to RosUkrEnergo and UkrGaz-Energo (see below) remain a fraction of European market rates. Since July-August 2004, RosUkrEnergo has been charged \$2.25 per thousand cubic metres for storage and this fee, according to the agreement of 29 July 2004, remains fixed until 2028 (in comparison, the storage fees in the Czech republic and Germany would range from \$87 to 110 per thousand cubic metres).<sup>144</sup> Gazprom, which in the period 1993-2005 reportedly was charged more for storage (on average \$4.95 per thousand cubic metres), has indicated an interest in acquiring equity in the Ukrainian underground gas storage facilities, but Naftogaz Ukrainy has declined to sell.<sup>145</sup>

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<sup>136</sup> Tolstov, "Energy Security," 12.

<sup>137</sup> Global Witness, *It's a Gas*, 6, 58.

<sup>138</sup> Stern, *Russian-Ukrainian Gas Crisis*, 12 n. 52.

<sup>139</sup> The contract was reprinted in *Ukrainskaya Pravda*, 5 January 2006 ([www.pravda.com.ua](http://www.pravda.com.ua)).

<sup>140</sup> Pirani, *Ukraine's Gas Sector*, 18.

<sup>141</sup> Pirani, *Ukraine's Gas Sector*, 74, 84.

<sup>142</sup> IEA, *Ukraine*, 26.

<sup>143</sup> Pirani, *Ukraine's Gas Sector*, 85; Energy Charter Secretariat, *Gas Transit Tariffs*, 65.

<sup>144</sup> Pirani, *Ukraine's Gas Sector*, 74, 85-6.

<sup>145</sup> IEA, *Ukraine*, 210, 213.

The RosUkrEnergo director Palchikov, as noted, has appeared several times in the history of the Ukrainian gas trade, and it seems very likely that he represented the Ukrainian side of RosUkrEnergo. But who was Chuychenko, the other managing director of the company? Chuychenko, although having had an intriguing career, seemed considerably more straightforward than his new colleague. He only became active in the Ukrainian gas trade in his capacity as a Gazprom employee. This does not, of course, mean that he lacked connections. In 1987, Chuychenko graduated from the Law Faculty of Leningrad State University, where he studied at the same time as Dmitry Medvedev, Russia's current president. In 1989-1992, he served in the intelligence service KGB (some claim that he in 1992 spent a short period of time on KGB duties in Germany<sup>146</sup>). Since March 2001, Chuychenko was the head of the Legal Department of Gazprom, and since April 2002, a member of the management committee of Gazprom. Since July 2004, he was also a managing director of RosUkrEnergo.<sup>147</sup>

Despite the various problems, there is a close working relationship between Gazprom and its Ukrainian counterparts. Gazprom has representatives stationed at the entry and exit points and the central gas dispatch centre in Kiev, so as to be able to monitor the volumes of gas transited through Ukraine. In addition, gas used by compressors as fuel is metered.<sup>148</sup>

### ***The Creation of UkrGaz-Energo***

It only remained to clarify the nature and specifics of the joint venture between RosUkrEnergo and Naftogaz Ukrainy. Already on 2 February 2006, the very day when Gazprom agreed to restore gas deliveries, Naftogaz Ukrainy announced that a joint venture named UkrGaz-Energo had been created. The joint venture, owned on a parity basis by Naftogaz Ukrainy and RosUkrEnergo, would supply gas to the Ukrainian domestic market. The deputy chairman of Naftogaz Ukrainy, Ihor Voronin, was appointed chairman of the management board of UkrGaz-Energo.<sup>149</sup> From March 2006, most of the gas that RosUkrEnergo imported was sold no longer to Naftogaz Ukrainy but, as per the 4 January 2006 agreement, through UkrGaz-Energo, which then began operations. In April 2006, RosUkrEnergo switched to selling gas only to UkrGaz-Energo.<sup>150</sup>

The price of gas to Ukraine remained at \$95 for the rest of 2006, even after the creation of UkrGaz-Energo.<sup>151</sup>

It was not only Ukraine that bought gas from RosUkrEnergo. The company reportedly resold gas not only to Ukraine but also - like its predecessor Eural Trans Gas - to Poland, Slovakia, and Hungary.<sup>152</sup>

In December 2006, Poland's gas monopoly PGNiG agreed to import 2.5 bcm of gas per year for three years from 2007 onwards from RosUkrEnergo. Poland imports around 6.20 bcm per year from Russia out of its total demand of about 13.7 bcm per year.<sup>153</sup>

Other customers were Wintershall in Romania and Emfesz Kft in Hungary (a gas trader in fact wholly owned by Dmytro Firtash).<sup>154</sup>

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<sup>146</sup> The web site, [www.anticompromat.ru](http://www.anticompromat.ru).

<sup>147</sup> President of Russia web site, [www.kremlin.ru](http://www.kremlin.ru); Gazprom web site, [www.gazprom.ru](http://www.gazprom.ru); UkrGaz-Energo web site, [www.ukrgazenergo.ua](http://www.ukrgazenergo.ua). Chuychenko's later career is more intriguing still, since he on 13 May 2008 became an aide to his old friend Dmitry Medvedev, the new President of the Russian Federation. Chuychenko then also became the Head of the Presidential Control Directorate. On 25 June 2008, Chuychenko left Gazprom's management committee.

<sup>148</sup> IEA, *Ukraine*, 213-14.

<sup>149</sup> The web site of UkrGaz-Energo, [www.ukrgazenergo.ua](http://www.ukrgazenergo.ua).

<sup>150</sup> Pirani, *Ukraine's Gas Sector*, 55, 61.

<sup>151</sup> Pirani, *Ukraine's Gas Sector*, 38.

<sup>152</sup> Global Witness, *It's a Gas*, 50.

<sup>153</sup> *Platts International Gas Report* 566 (29 January 2007), 19; *BP Statistical Review of World Energy June 2008* ([www.bp.com](http://www.bp.com)). In October 2003, Naftogaz Ukrainy and PGNiG had entered into an agreement to export gas to Poland, with 2.67 bcm of gas being received in Poland in 2004. Pirani, *Ukraine's Gas Sector*, 71.

<sup>154</sup> *Vedomosti*, 13 February 2008 ([www.vedomosti.ru](http://www.vedomosti.ru)). Emfesz Kft, which sells gas in Poland and Hungary, in October 2006 also moved into electricity trading. Pirani, *Ukraine's Gas Sector*, 41. On Emfesz, see also the group's web site, [www.groupdf.com](http://www.groupdf.com). Wintershall had entered into a gas purchase agreement with Naftogaz Ukrainy in March 2004, for deliveries between 2004 and 2007. Pirani, *Ukraine's Gas Sector*, 71.

### ***Rising Costs and Increased Opacity***

Ukraine's fuel and energy minister, Yuriy Boiko, in October 2006 announced that Ukraine had signed contracts for 58 bcm of gas with Uzbekistan, Kazakhstan, and Turkmenistan, and for this reason would not buy any gas from Russia in 2007.<sup>155</sup> This no doubt sounded reassuring to his domestic audience, but the gas he referred to was the 58 bcm that UkrGaz-Energo would supply to the Ukrainian market according to the 4 January 2006 contract. One could of course argue that since UkrGaz-Energo was a Ukrainian firm, Ukraine would not buy any gas from Russia, although the gas originated there. Even so, under a deal signed with RosUkrEnergo in late October 2006 Ukraine from January 2007 had to pay a price of \$130 for gas.<sup>156</sup> As before, the deal was subject to renegotiation annually in October.<sup>157</sup> This price for gas was still the lowest in Europe with the exception of Belarus.<sup>158</sup> It has been observed that with transit costs of gas from Central Asia of about \$30 per thousand cubic metres, it was hard to see where RosUkrEnergo would earn its profit margin.<sup>159</sup>

In March 2007, Valeriy Golubev, since November the previous year the deputy chairman of Gazprom's management committee, publicly described the transit arrangement with RosUkrEnergo as "not the optimal one" and said that a new scheme could be introduced.<sup>160</sup> He should know, since in addition to his Gazprom job he was, and is, the chairman of the supervisory board of UkrGaz-Energo.<sup>161</sup>

On 15 October 2007, Dmitry Medvedev, then chairman of Gazprom's board of directors (now president of the Russian Federation), suggested that Gazprom in 2008 probably would abandon any intermediate structures, that is, RosUkrEnergo, and instead begin direct supplies of gas to Ukraine. He concluded: "We will probably revise the scheme of our relations and give up any intermediary structures that are not clearly understandable, at least those structures whose existence is not quite clear to us and which were proposed by our partners in a certain historical context."<sup>162</sup>

That Medvedev suggested this may be significant. Following a political career in St. Petersburg, Medvedev had in 1999 been brought to Moscow by soon-to-be President Putin, whom he had known since at least 1991. In 2000, Putin appointed Medvedev chairman of the board of directors of Gazprom. On 30 October 2003, Medvedev replaced Aleksandr Voloshin as Putin's chief of staff, a position held by Voloshin ever since Yeltsin's time as Russia's president. This move may have marked Putin's final break with the Yeltsin team. And Medvedev was elected president of the Russian Federation on 2 March 2008.<sup>163</sup> Being close to his friend and present aide Chuychenko, then a managing director of RosUkrEnergo, Medvedev can be expected to know the inner workings of RosUkrEnergo. His comment on structures that were proposed by Russia's partners would indeed seem to suggest that these were structures introduced by the Ukrainian side.<sup>164</sup>

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<sup>155</sup> RFE/RL *Newsline*, 10 October 2006; Tolstov, "Energy Security," 17.

<sup>156</sup> BBC *Monitoring Newsfile*, 24 October 2006; citing Ukrainian news agency UNIAN, which in turn quoted a RosUkrEnergo and UkrGaz-Energo joint report.

<sup>157</sup> Energy Information Administration (EIA), *Ukraine*, August 2007 ([www.eia.doe.gov](http://www.eia.doe.gov)).

<sup>158</sup> Pirani, *Ukraine's Gas Sector*, 27.

<sup>159</sup> Pirani, *Ukraine's Gas Sector*, 38.

<sup>160</sup> Pirani, *Ukraine's Gas Sector*, 42; the firm's web site, [www.gazprom.ru](http://www.gazprom.ru).

<sup>161</sup> The firm's web site, [www.ukrgazenergo.ua](http://www.ukrgazenergo.ua).

<sup>162</sup> *Interfax Oil & Gas Report*, 11-17 October 2007; *Platts Oilgram News* 85: 205 (17 October 2007).

<sup>163</sup> For biographies of Medvedev, see the web site of the President of Russia, [www.kremlin.ru](http://www.kremlin.ru); the web site, [www.anticromat.ru](http://www.anticromat.ru).

<sup>164</sup> A similar statement was made three years earlier, in an interview with Aleksandr Medvedev, head of Gazexport, on 24 June 2004 ([www.gazprom.ru](http://www.gazprom.ru)). Medvedev then noted that "Eural Trans Gas is the authorised agent for the transit of Turkmen gas to Ukraine and it is authorised not by Naftogaz Ukrainy but by the government of Ukraine. The reasons why the Ukrainian government chose Eural Trans Gas as agent are outside our competence, as is its system of mutual payments with Ukraine."

On 4 December 2007, Gazprom's chairman, Miller, and Ukraine's fuel and energy minister, Boiko, agreed that Ukraine had accepted a new gas import price for 2008 of \$179.5 on the Russia-Ukraine border.<sup>165</sup>

In January 2008, it was reported that Kazakstan from 1 April 2008 would raise its transit fee from \$1.1 to \$1.4. This would substantially raise costs for gas transportation companies such as RosUkrEnergo. However, the gas price for Ukraine was then already fixed at \$179.5.<sup>166</sup>

By February 2008, RosUkrEnergo bought approximately 60 bcm of Central Asian gas per year, and sold 55 bcm at the border to UkrGaz-Energo. The rest RosUkrEnergo sold in Europe.<sup>167</sup> However, on 12 February 2008, Presidents Vladimir Putin and Viktor Yushchenko, the presidents of Russia and Ukraine, agreed to reform the gas deliveries to Ukraine. Russia and Ukraine would set up two joint ventures, between Gazprom and Naftogaz Ukrainy, on parity terms. The first joint venture would purchase Central Asian gas from Gazprom Export, deliver it to the Russia-Ukraine border, and sell it to the second joint venture, which would handle customs clearance of the gas and sell it to Ukrainian buyers. At the time of the agreement, RosUkrEnergo acted as the first joint venture, while UkrGaz-Energo acted as the second.<sup>168</sup> But on the same day, 12 February 2008, Gazprom announced that it would no longer trade through RosUkrEnergo but instead form a new joint venture, on a parity basis, with Naftogaz Ukrainy for this purpose. Such an agreement would be signed on 14 February 2008 (on which date Ukrainian President Viktor Yushchenko did ask his government to return the role of supplying industrial businesses to the state energy firm, Naftogaz Ukrainy,<sup>169</sup> which would have been the first step to separate RosUkrEnergo from the Ukrainian gas trade). The price at the border would remain \$179.5 until the end of 2008, it was announced, since this was the outcome of the day's meeting between Putin and Yushchenko.<sup>170</sup>

Analysts then rushed to find the explanation behind the decision of the two presidents to cut out RosUkrEnergo. Many connected the decision to the arrest in Moscow in late January 2008 of Semyon Mogilevich. In Moscow, Stanislav Belkovsky, general director of the National Strategy Institute and a some-time consultant to Yulia Tymoshenko, immediately explained that the recent arrest of Mogilevich was the first step in the elimination of RosUkrEnergo.<sup>171</sup> In Ukraine, the inner circle of advisors of Ukraine's then Prime Minister, Yulia Tymoshenko, certainly drew the same conclusion.<sup>172</sup>

So who was Semyon Mogilevich, whose name already has appeared several times, and what did he have to do with the Ukrainian gas trade? Mogilevich, who on 23 January 2008 was taken into custody, and subsequently arrested, under the alias of Sergei Schneider, certainly had several friends and acquaintances who played key roles in this trade. These people included the already mentioned Dmytro Firtash, Oleg Palchikov, and Zeev Gordon as well as Maria Kashkina and Olga Schneider, both of whom Mogilevich had married. Anything else was difficult to ascertain – and more than a little complicated. In addition to the name under which he was arrested, Mogilevich, according to a Russian law enforcement source had used 17 other names (among them Sayman, Suvorov, Telesh, and Palagnyuk) and held passports from several countries, reportedly including Russia, Israel, and Hungary (although the Hungarian embassy in Moscow has denied that Mogilevich held Hungarian citizenship).<sup>173</sup> The arrest was made in conjunction with an investigation not into the gas trade but into Arbat Prestige, a Moscow cosmetics firm accused of tax evasion. However, Mogilevich officially worked as a consultant in a company called Evergate Ltd. Mogilevich had by then assumed the name of his former wife, Olga Schneider, a 33-year-old lawyer who some media reports linked to Arbat Prestige as

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<sup>165</sup> Gazprom press release, 4 December 2007.

<sup>166</sup> *Vedomosti*, 25 January 2008 ([www.vedomosti.ru](http://www.vedomosti.ru)).

<sup>167</sup> *Vedomosti*, 13 February 2008 ([www.vedomosti.ru](http://www.vedomosti.ru)).

<sup>168</sup> See, e.g., *BBC News*, 12 February 2008; Interfax, 6 March 2008.

<sup>169</sup> *Asia Pulse*, 22 February 2008.

<sup>170</sup> *Vedomosti*, 13 February 2008 ([www.vedomosti.ru](http://www.vedomosti.ru)).

<sup>171</sup> *Financial Times* ([www.ft.com](http://www.ft.com)), 25 January 2008.

<sup>172</sup> See, e.g., WPS Russian Media Monitoring Agency, 11 February 2008.

<sup>173</sup> ITAR-TASS, 29 January 2008, 11 February 2008.

well.<sup>174</sup> Evergate was a company directly involved in the barter deals (gas for food) in the trade between Russia, Ukraine, and Turkmenistan (such deals were, as noted, commonplace until at least 2006, as was made abundantly clear by the 14 May 2001 contract between Naftogaz Ukrainy and Turkmenneftegaz already referred to). Evergate was founded by Maria Kashkina who also acted as the firm's director. Until recently, Kashkina had worked at the Moscow office of Elmstad Trading Limited (Cyprus), which delivered food to Turkmenistan in exchange for gas for Ukraine and was set up by General Company Resource, a firm founded by Olga Schneider. In 2002, Elmstad's Moscow office was, as noted, headed by Oleg Palchikov, who later headed the Russian office of Eural Trans Gas (which in turn was founded by, among others, Zeev Gordon, one of Mogilevich's lawyers).<sup>175</sup> Another former wife of Mogilevich's, Galina Telesh, whom Mogilevich had married in 1995, from February 2003 held 34 per cent in a firm named OOO Rinvey, which in turn held a 40-per cent stake in Arbat Prestige from June 2003 to at least December 2003. Another of Rinvey's listed owners in February 2003 was Olga Zhunzhurova, the wife of the already mentioned Igor Fisherman, yet another onetime business partner of Mogilevich's. Two other Rinvey share holders in February 2003 were Dmytro Firtash and his former wife Maria Firtash.<sup>176</sup> Firtash sold his Rinvey stake in June 2004, a spokesman at his firm Group DF stated.<sup>177</sup>

In other words, the arrest of Mogilevich unearthed plenty of intriguing business relationships, but it was less clear how to interpret them. Even though various observers and analysts made a great deal of the alleged involvement of Mogilevich in the Ukrainian gas trade, it remains quite possible that his arrest had nothing whatsoever to do with the decisions of Presidents Putin and Yushchenko.

### ***The March 2008 Ukrainian Gas Debt Crisis***

Due to the differences between Russia and Ukraine with regard to the gas trade (Ukraine's failure to pay its gas debt; to make things worse, gas had been delivered although there had as yet been no price agreement for 2008, which in theory meant that Ukraine had never promised to pay), by late February 2008 it was not yet clear when the new gas trade regime as agreed by Presidents Putin and Yushchenko would be put in operation.<sup>178</sup> Presidents Putin and Yushchenko had, as noted, reached an agreement already on 12 February 2008.<sup>179</sup> However, due to domestic Ukrainian politics and the then rivalry between Yushchenko and Ukraine's prime minister Julia Tymoshenko, the latter then muddled the issue by holding further negotiations in Moscow on 20 February 2008. The response of the Russian leadership was to support the Ukrainian president's position in Ukraine's political struggle by sticking to the agreement negotiated with Yushchenko.<sup>180</sup>

Nonetheless, the controversy between Ukraine's president and prime minister prevented the agreement on Ukraine's debt from being implemented. It seemed that Ukraine would not pay, and the possibility that Ukraine again would begin siphoning off gas seemed imminent to Gazprom. In response, on 3 March 2008, at 10:00 Moscow time, Gazprom cut gas supplies to Ukraine by 25 per cent.<sup>181</sup> The following day, Gazprom announced that it had reduced gas exports to Ukraine by another 25 per cent and that further cuts might be in order unless Ukraine resumed negotiations.<sup>182</sup> Ukraine responded by hinting that it would cut flows of Russian gas in transit to Europe; however, instead Ukraine drew upon its storage reserves to meet domestic demand.<sup>183</sup>

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<sup>174</sup> *Moscow Times*, 28 January 2008.

<sup>175</sup> WPS Russian Media Monitoring Agency, 4 February 2008.

<sup>176</sup> *Moscow Times*, 1 February 2008.

<sup>177</sup> See, e.g., Interfax-Ukraine, 1 February 2008.

<sup>178</sup> *Vedomosti*, 20 February 2008, 27 February 2008 ([www.vedomosti.ru](http://www.vedomosti.ru)).

<sup>179</sup> See, e.g., *BBC News*, 12 February 2008.

<sup>180</sup> See, e.g., *Kommersant*, 21 February 2008.

<sup>181</sup> AFP, 3 March 2008.

<sup>182</sup> Interfax, 4 March 2008.

<sup>183</sup> International Energy Agency (IEA), *Natural Gas Market Review 2008* (Paris: OECD/IEA, 2008), 165.

On 5 March 2008, Gazprom announced that telephone conversations between Presidents Putin and Yushchenko, and between Aleksei Miller, head of Gazprom, and Oleh Dubyna, head of Naftogaz Ukrainy, had taken place and the parties had agreed on how to proceed.<sup>184</sup>

Even so, Tymoshenko on 6 March stubbornly notified President Yushchenko that the Ukrainian government, which she headed, would not execute the gas agreement negotiated by him and President Putin.<sup>185</sup>

Eventually, in a meeting in Moscow on 12 March between the heads of Gazprom and Naftogaz Ukrainy, Gazprom agreed to supply Ukraine with gas for the rest of the year. Between March and December 2008, the gas price for Ukraine was, as originally agreed for gas from Central Asia, set at \$179.5. However, Ukraine agreed to pay the higher rate of \$315 for the gas supplied in January and February, since this was Russian gas. The two sides also signed an agreement on development of gas sector co-operation. Gazprom would henceforth supply Ukraine's industrial customers directly, so as to cut out unwanted intermediary companies. For this reason, Gazprom introduced its wholly owned subsidiary OOO Gazprom Sbyt Ukraina, which will buy up to 7.5 bcm of gas per year from Naftogaz Ukrainy to supply industrial consumers in Ukraine.<sup>186</sup> UkrGaz-Energo – but not RosUkrEnergo – was thus, in early March 2008, removed from the Ukrainian natural gas market. Henceforth, Naftogaz Ukrainy would itself handle the import of Central Asian gas into Ukraine.<sup>187</sup> As a result, gas was later in the year purchased by Naftogaz Ukrainy at the Russia-Ukraine border.<sup>188</sup>

### ***The Russian Decision to Introduce European Market Prices***

It was clear, however, that something would have to be done about the consistent problem of Ukraine's gas supply. The recurring gas price negotiations never failed to poison relations between primarily Ukraine and Russia but relations between them and the Central Asian gas producers were affected as well.

On 11 March 2008, the heads of the gas monopolies of Russia, Kazakstan, Uzbekistan, and Turkmenistan for this reason jointly declared that from 2009, they would all sell gas at European market prices.<sup>189</sup> Prices would be based on those negotiated in western Europe. There would be no more subsidised gas to those countries that have come to depend on cheap gas, such as Ukraine.

This was no mere bluster. On 22 July 2008, Gazprom's Miller visited Ukraine's capital Kiev to discuss the gas price. He proposed switching to a gas pricing based on a formula under which Ukraine would buy gas at 75-80 per cent of the price that Poland pays.<sup>190</sup>

Then, on 25 July 2008, Miller visited Turkmenistan's President Berdymuhammedov in Ashgabat. During the visit, Gazprom signed an agreement on the pricing mechanisms that will be guiding the Turkmenistani gas exports to Russia up to 2028. From 2009, Russia will pay a base gas purchasing price based on the average wholesale price in Europe and Ukraine. The 2009 price for Turkmenistani gas would thus be in the range of \$225-295, as compared to Gazprom's present purchasing price of \$150 (for the second half of 2008) and China's present purchasing price of \$195 plus a transmission fee of \$50.<sup>191</sup>

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<sup>184</sup> Gazprom press release, 5 March 2008. As for Dobynga, he was chairman of Naftogaz Ukrainy since 24 December 2007. For Dubyna's biography, see the *Real'na polityka* web site, <http://rpl.net.ua>.

<sup>185</sup> Unian News Agency, 7 March 2008 ([www.unian.net](http://www.unian.net)).

<sup>186</sup> BBC News, 13 March 2008; IEA, *Natural Gas Market Review 2008*, 166.

<sup>187</sup> Ukrainske Radio ([www.nrcu.gov.ua](http://www.nrcu.gov.ua)), 13 March 2008. However, so far the firm's web site, [www.ukrgazenergo.ua](http://www.ukrgazenergo.ua), remains online.

<sup>188</sup> Gazprom press release, 5 September 2008.

<sup>189</sup> Gazprom press release, 11 March 2008.

<sup>190</sup> *Kommersant-Ukraina*, 23 July 2008.

<sup>191</sup> Gazprom press release, 25 July 2008; *Asia Times*, 30 July 2008 ([www.atimes.com](http://www.atimes.com)).

## ***Concluding Remarks***

From a pricing perspective, the proposals and agreements introduced by Gazprom's head Miller in the spring and summer of 2008 were businesslike offers. A transport premium would have to be paid, and according to these formulas, it would be worked into the price. In other words, Gazprom was, despite many unfavourable press reports to the contrary, set on its course towards market relations. For sure, the introduction of export prices aligned to those being paid elsewhere in Europe will not immediately help Ukraine solve its chief problem: an obsolete, energy-inefficient heavy industry sector that depends on imports of cheap natural gas. It might even lead to a sharp rise in unemployment and will certainly disrupt sectors of the Ukrainian economy. Yet in the long run the introduction of market prices will help the national economies of all countries involved in this particular natural gas trade to develop, including that of Ukraine. An increased level of energy efficiency is desirable, but for sure a belated transition into modern business practices and industrial standards will not be easy for Ukraine. On 1 October 2008, Miller noted that the price of natural gas supplied to Europe for the first time had exceeded \$500.<sup>192</sup> Gazprom's new gas pricing formula will not be to the liking of the Ukrainian heavy industry.

Still, a new price will have to be agreed. On 2 October 2008, Russia and Ukraine announced that they had signed an intergovernmental memorandum on co-operation in the natural gas sector and agreed that the gas price for Ukraine would gradually increase to market levels over the next three years. They had also decided that from 1 January 2009, Naftogaz Ukrainy would be the only importer of natural gas to Ukraine. However, the actual price would be discussed later, they announced.<sup>193</sup>

This postponement was not necessarily a prudent move. To the already inherent difficulties in the negotiation process has since been added a financial crisis, which has affected the Russian as well as Ukrainian and Turkmenistani economies. The natural-gas trade relationship between these three countries is bound to be affected as well, and it seems unlikely that negotiations will run more smoothly in the near future than in the past. This is unfortunate, since the opaque relationships, secret contracts, and hidden beneficiaries of the past have engendered substantial corruption, with serious losses to both the Russian and Ukrainian states as well as consumers and shareholders there and elsewhere in Europe. If such practices continue, perhaps in response to pressures caused by the financial crisis, the countries involved as well as consumers and shareholders can expect to suffer further losses at a time when they ill can afford to do so.

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<sup>192</sup> Gazprom press release, 1 October 2008.

<sup>193</sup> Platts, 3 October 2008.



## ***Appendix: Dramatis Personae***

Source references to these capsule biographies can be found in the notes to the main text.

### ***Bakai, Ihor Mikhailovych***

Ukrainian businessman. Previous head of the privately owned Ukrainian firms Respublika (1994-1995) and Interhaz (1996). In September 1997, he was appointed first deputy chairman of the State Committee for Oil, Gas and Refining. From 1998 to 2000, picked by Ukraine's President Kuchma as the first chairman of the state oil and gas company Naftogaz Ukrainy. Bakai, who from October 2003 to December 2004 also served Kuchma as director of State Property Management within the presidential administration, was eventually accused of having operated a multi-million-dollar slush fund for the president. He resigned on 24 March 2000 and moved to Russia, from where the post-Kuchma Ukrainian government wanted him extradited. However, Bakai was granted Russian citizenship and could not be extradited. Born on 17 November 1963.

### ***Berdymammedov, Gurbanguly Myaligulyyevich***

President of Turkmenistan from 21 December 2006. Born on 29 June 1957.

### ***Boiko, Yuriy Anatolievych***

Ukrainian businessman and politician. From 1981, Boiko worked in various industrial enterprises. His career took a decisive turn with his 31 January 2002 appointment as chairman of the Ukrainian state oil and gas company Naftogaz Ukrainy. This also brought a position in the ministry of fuel and energy. In August 2003, Boiko was appointed first deputy minister of fuel and energy, while retaining his post at Naftogaz Ukrainy. Boiko also held a position on the board of RosUkrEnergo from its inaugural meeting in 2004 until perhaps June 2005, even though neither Naftogaz Ukrainy nor the Ukrainian government had any acknowledged link to the private company Raiffeisen Investment AG which owned the Ukrainian half of RosUkrEnergo. In August 2004, he was decorated Hero of Ukraine for his work within the energy sector. On 4 March 2005, he was dismissed from both his ministerial post and the job for Naftogaz Ukrainy by President Yushchenko, in a move initiated by Yulia Tymoshenko. However, from August 2006 until 20 December 2007, Boiko was minister of fuel and energy. Born on 9 October 1958.

### ***Chuychenko, Konstantin Anatolievich***

Russian official. Active in the Ukrainian gas trade in his capacity as Gazprom representative. In 1987, Chuychenko graduated from the Law Faculty of Leningrad State University, where he studied at the same time as Dmitry Medvedev, who now is Russia's president. In 1989-1992, he served in the KGB (some claim that he in 1992 served a short period of time in Germany). Since March 2001, Chuychenko was the head of the legal department of Gazprom, and since April 2002, a member of the management committee of Gazprom. From July 2004, he was a managing director of RosUkrEnergo. However, since 13 May 2008, he is an aide to the President of the Russian Federation and head of the Presidential Control Directorate. On 25 June 2008, Chuychenko left Gazprom's management committee. Born on 12 July 1965.

### ***Didenko, Ihor Mykolayivych***

Ukrainian businessman and politician. Following a livelihood in Komsomol and several industrial enterprises including Ukrnafta, Didenko in 1998 attempted a political career. On 10 June 1999, however, he joined the management of Naftogaz Ukrainy, where he on 18 July 1999 became Bakai's first deputy. On 7 April 2000, Didenko was appointed Bakai's successor as acting chairman of Naftogaz Ukrainy, a post he held until 7 June 2000. Didenko was arrested in Germany on 14 June 2001, accused of the embezzlement in the 1990s of 4 million Deutschmarks intended for pay-outs to compensate the victims of Nazi concentration camps and forced labour still living in Ukraine. In June 2004, he was sentenced to imprisonment in Germany on these charges. However, he was subsequently acquitted in another court in December 2004. On 25 May 2006, Didenko was reinstated at Naftogaz Ukrainy. And in January 2008, Didenko was again appointed first deputy chairman of Naftogaz Ukrainy. Born in 1964.

### ***Dubyna, Oleh Viktorovych***

Ukrainian politician and businessman. Worked in several industrial enterprises. From 3 January to May 2001, Dubyna was deputy prime minister of Ukraine. From 3 November 2001 to November 2002, he served as first deputy prime minister. From December 2002 to September 2003, Dubyna was advisor to President Kuchma. In parallel to these political posts, from 2000 to 2003, he sat on the board of various industrial companies in Ukraine including Naftogaz Ukrainy. Since 24 December 2007, Dubyna is chairman of Naftogaz Ukrainy. Born on 20 March 1959.

***Firtash, Dmytro Vasylevich***

Ukrainian businessman. He currently runs a group of companies named Group DF, established in early 2007. In the late 1980s, Firtash was involved in commodity trading in the Ukrainian and Russian parts of the Soviet Union. In the early 1990s, Firtash worked with Igor Makarov of Itera. Firtash had interests in Moldova and Turkmenistan and ran a company called Highrock Properties Ltd., allegedly together with an Ukraine-born associate named Igor L'vovich Fisherman, who in turn has been suspected to have been a one-time associate of Semyon Mogilevich, an Ukraine-born allegedly deeply involved in organised crime (both Fisherman and Mogilevich are wanted by the FBI for racketeering and other crimes), who in turn has been linked to former Ukrainian Prime Minister Pavlo Lazarenko, who eventually was condemned for money laundering. In late 2002, Firtash founded Eural Trans Gas. In 2003, Firtash reportedly acquired control of one of Makarov's enterprises known as Highrock Holdings, formed in 2001. Firtash was also involved in RosUkrEnerg, founded in July 2004, of which he owns 45 per cent. Firtash was reportedly also the owner of the Kiev basketball club and two Ukrainian television channels, K-1 and K-2 (both launched in 2005). He also had business interests in Russia together with his former wife, Maria Firtash. Born on 2 May 1965.

***Fursin, Ivan Gennadiyevych***

Ukrainian businessman and associate of Dmytro Firtash. Owner of 5 per cent of the equity in RosUkrEnerg. In addition, Fursin owned several other enterprises including a small Ukrainian bank, Misto-Bank in Odessa. Born on 16 September 1971.

***Ivchenko, Oleksiy Hrihoriyivych***

Ukrainian businessman and politician. In the Soviet period, he worked, by his own testimony and in similarity to many other entrepreneurs often illegally, in the construction business. Following the dissolution of the Soviet Union, employment in various industrial enterprises followed. In 1995-1997, Ivchenko worked for Interhaz, founded by Ihor Bakai. He was the firm's general representative in western Ukraine in 1995-1996, then deputy director of the department for realisation of gas in 1996-1997, and finally first vice president of Interhaz, with responsibility for gas supply to industrial enterprises, from 1997 until the firm folded. Ivchenko already in 1996 embarked upon a political career. In 1997, he became an advisor to prime minister Pavlo Lazarenko. Following more political activities, often in conjunction with the oil and gas business, in which he allied himself to Viktor Yushchenko, Ivchenko on 3 February 2005 was appointed first deputy minister of fuel and energy. On 3 March 2005, President Yushchenko appointed Ivchenko chairman of Naftogaz Ukrainy, a position he kept until 11 March 2006 (although he was relieved of the position of first deputy minister of fuel and energy already on 9 December 2005). The prosecutor-general of Ukraine subsequently accused Ivchenko of embezzlement of state funds during the time when he was chairman of Naftogaz Ukrainy; however, the charges, which included his acquisition of a new Mercedes paid for with state funds, seemed petty in comparison to other corruption cases. Born on 2 January 1963.

***Kravchuk, Leonid Makarovyich***

Ukrainian politician. President of Ukraine from December 1991 to July 1994. Succeeded by his former prime minister, Leonid Kuchma. Born on 10 January 1934.

***Kuchma, Leonid Danylovych***

Ukrainian politician. President of Ukraine from 19 July 1994 to 23 January 2005. Succeeded by Viktor Yushchenko. Born on 9 August 1938.

***Lazarenko, Pavlo Ivanovych***

Ukrainian politician. Presidential representative in Dnipropetrovsk Oblast and powerful supporter of President Kuchma in the 1994 presidential elections. Lazarenko was an early associate, since 1992, of future prime minister Yulia Tymoshenko. Appointed Prime Minister on 28 May 1996, until 2 July 1997 when he resigned. Created the gas trading concession system in May 1996. Was elected to parliament in March 1998. In December 1998, detained on the border to Switzerland on money-laundering charges. Again detained upon attempting to enter the United States on 20 February 1999. In August 2006, Lazarenko was convicted and sentenced to prison in the United States for money laundering and extortion, having stolen approximately \$114 million from the government of Ukraine during 1996-1997. Born on 23 January 1953.

***Makarov, Igor Viktorovich***

Russian sportsman and businessman. Began a career as a trader in the late 1980s. Makarov traded food for Turkmenistani oil in the early 1990s. He then founded the two firms Omrania and Itera in 1992. Itera from 1994 supplied gas to Ukraine and since at least 1998 to Armenia, Georgia, Belarus, and Moldova as well, a group of countries known as the problem clients of Gazprom since they paid seldom if at all for gas deliveries. The rapid rise of Makarov's company Itera came amid suspicions that it was nothing but a front for Gazprom executives in what some believed was a scheme for certain of them to siphon off Gazprom profits. Following the 2001 appointment of Aleksei Miller as new head of Gazprom, Itera and Gazprom suddenly became fierce competitors. Makarov, who remains the head of Itera, was born in Ashgabat, Turkmenistan, in 1962.

***Medvedev, Dmitry Anatolievich***

Elected President of the Russian Federation on 2 March 2008. Following a political career in St. Petersburg, Medvedev was in 1999 brought to Moscow by soon-to-be President Putin, whom he had known since at least 1991. He served in various positions in first the government and then the presidential administration. In 2000, Putin appointed Medvedev chairman of the board of directors of Gazprom (in 2001, he became deputy chairman, then, from June 2002, again chairman of the board of directors) in addition to his other posts. On 30 October 2003, Medvedev replaced Aleksandr Voloshin as Putin's chief of staff, a position held by Voloshin ever since Yeltsin's time as Russia's president. This move may have marked Putin's final break with the Yeltsin team. Medvedev retained the new position until November 2005, when he instead was appointed first deputy prime minister. Born on 14 September 1965.

***Miller, Aleksei Borisovich***

Russian official and businessman. Deputy chairman of the board of directors of Gazprom as well as chairman of Gazprom's management committee. Miller, whom President Putin knew personally since at least 1991, was after a career in various government and commercial enterprises in 2000 appointed deputy minister of energy of the Russian Federation. On 30 May 2001, he became chairman of Gazprom's management committee in a move widely believed to have been an effort to regain control of the firm and its revenues from Rem Vyakhirev and his associates. Born on 31 January 1962.

***Mogilevich, Semyon Yudkovich***

Ukraine-born businessman and alleged organised crime leader wanted by the FBI for racketeering and other crimes. Arrested in Moscow in early 2008. Born on 30 June 1946.

***Niyazov, Saparmurat Atayevich***

President of Turkmenistan from 1990 until his death on 21 December 2006. Succeeded by Gurbanguly Berdimuhamedov. Born on 19 February 1940.

***Otchertsov, Valery Georgievich***

The vice-president of the Supreme Soviet (parliament) of Turkmenistan from 1989 to 1991. Minister of economics and finance as well as deputy chairman of the Cabinet of Ministers of Turkmenistan from 1991 to 1996. One of several Turkmenistani officials who set up the gas company TurkmenRosGaz. By early 1997, he had moved to Moscow and accepted an offer to become vice-president of Itera, a competitor to TurkmenRosGaz. He has since held several high posts at Itera. As for TurkmenRosGaz, it was disbanded in June 1997. Born in 1945.

***Palchikov, Oleg Anatolievich***

Businessman. In 2000-2001, Palchikov [Pal'chikov] worked in the Moscow-based firm General Company Resource, in which capacity he maintained links with Elmstad Trading Limited, tied to Semyon Mogilevich, and Highrock Properties Ltd, linked to Dmytro Firtash. In 2001, he started the firm Geopromtrans, of which he owned a 70-per cent stake, which became licensed to carry out geological surveys for the gas and oil industry. From April 2001 to 2004, Palchikov was head of Elmstad Trading Limited's Moscow office. From December 2002 to 2004, he was also the Moscow representative of Eural Trans Gas. From July 2004 to April 2007, Palchikov was a managing director of RosUkrEnergo. Palchikov's wife, Lyubov', reportedly used to work for Itera-Rus' and Gazprom. Born on 28 July 1964.

***Putin, Vladimir Vladimirovich***

Russian politician. President of the Russian Federation in 2000 to 2008. Since then Prime Minister of Russia. Born on 7 October 1952.

***Tymoshenko, Yulia Volodymyrivna***

Ukrainian politician. Prime Minister of Ukraine between 4 February and 8 September 2005 and again since 18 December 2007. Before her political career, Tymoshenko amassed substantial wealth in primarily the gas industry. In 1991, she became the managing director of the business enterprise Korporatsiya Ukrayins'kiy Benzin (KUB; known in English as the Ukrainian Oil Corporation). In 1995, she became the head of the firm United Energy Systems of Ukraine (Edyni Enerhetychni Systemy Ukrayiny, UESU), the most powerful of the gas traders in the Ukrainian gas trading concession system. Due to what many interpreted as patronage from then Prime Minister Lazarenko, UESU not only won the coveted mandate for wholesale gas sales in Donetsk, the country's largest industrial region, but also played a regulatory role through a related firm, the Ukrainian Gas Resources Consortium (UGC; Ukrayins'kiy Hazoresursniy Konsortsium). When Lazarenko fell from power in July 1997, UESU lost its powerful position and went bankrupt. Tymoshenko had then already embarked upon a political career. Born on 27 November 1960.

***Voronin, Ihor Pavlovych***

Ukrainian businessman. Deputy chairman of the Ukrainian state oil and gas company Naftogaz Ukrainy since April 2002. In 2001-2002, Voronin worked as assistant to the then first deputy prime minister of Ukraine, Oleh Dubyna. From the inaugural meeting of RosUkrEnergo in 2004 until perhaps June 2005, Voronin was one of the two who represented the Ukrainian side of the firm, despite the fact that Naftogaz Ukrainy had no apparent investment in RosUkrEnergo and no acknowledged link to the private company Raiffeisen Investment AG which actually held the equity. On 2 February 2006, he was nominated chairman of the management board of UkrGaz-Energo. Born in 1968.

***Vyakhirev, Rem Ivanovich***

Russian industrialist and official. First head of Gazprom. After a career within the Soviet gas industry, he in 1983-1985 was appointed deputy minister for the gas industry of the Soviet Union, followed by an appointment as first deputy minister for the gas industry of the Soviet Union in 1986-1989. From 1989, he became deputy chairman of the management committee of the state gas concern Gazprom. From 1992 to 30 May 2001, he was chairman of the management committee. Until June 1996, he was also chairman of the board of Gazprom. In addition, he held several other posts within industry and the government. When President Putin in 2001 replaced him with Miller as head of Gazprom, Vyakhirev's son Yuriy was head of the firm's export arm Gazexport while his daughter Tatiana was among the owners of the Gazprom group's pipeline construction firm Sroytransgaz. On 31 May 2001, Vyakhirev was chosen as head of the newly created Russian Gas Society, a position he retained until 20 December 2002. Born on 23 August 1934.

***Yeltsin, Boris Nikolayevich***

Russian politician. President of the Russian Federation from 1991 to 1999. Born on 1 February 1931, died on 23 April 2007.

***Yushchenko, Viktor Andriyovych***

Ukrainian politician. President of Ukraine from 23 January 2005. Born on 23 February 1954.

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