

Identifier	Created	Classification	Origin
06KIEV333	2006-01-25 15:07:00	CONFIDENTIAL	Embassy Kyiv

Cable title: **UKRAINE: YUSHCHENKO DISCUSSES ENERGY, RUSSIA,**

Tags: [PREL](#) [PGOV](#) [ENRG](#) [EPET](#) [ETRD](#) [MARR](#) [MCAP](#) [RS](#)
[UP](#)
[Show metadata](#)

 [how-to read a cable](#)

C O N F I D E N T I A L SECTION 01 OF 05 KIEV 000333

SIPDIS

SECDEF FOR OSD/ISP
 DOE FOR LEKIMOFF
 SEOUL PLEASE PASS DNSA CROUCH

E.O. 12958: DECL: 01/24/2016

TAGS: PREL PGOV ENRG EPET ETRD MARR MCAP RS UP
SUBJECT: UKRAINE: YUSHCHENKO DISCUSSES ENERGY, RUSSIA,
DEFENSE REFORM, DOMESTIC POLITICS

REF: 05 SECTO 9 (S-YUSHCHENKO DECEMBER 7)

Classified By: Ambassador, reason 1.4 (b,d)

1. (C) Summary: In a January 23 meeting with EUR Assistant Secretary Fried, EB Assistant Secretary Wayne, Assistant

SIPDIS

Secretary of Defense for International Security Policy Flory,

SIPDIS

NSC Director Wilson, and Ambassador, President Yushchenko Yushchenko said energy issues were at the center of his agenda; he made a pitch for U.S. technical assistance on energy policy, particularly with regard to nuclear energy and energy conservation. He sought U.S. reaction to Ukrainian aspirations to develop a closed nuclear fuel cycle as a means to reduce dependency on Russia, which currently enjoys a monopoly on nuclear fuel supply to Ukraine. Yushchenko returned repeatedly to the topic of RosUkrEnerg (RUE) throughout the 75-minute meeting, reviewing the history and figures acting as middlemen between Russia and Ukraine on natural gas supply and transit. He expressed confidence that recent disputes with Russia over gas and the Black Sea Fleet could be managed successfully. Defense reform was progressing based on a move to a fully professional force by 2010, increased armed forces budgets and attention to social needs of servicemen, and a drive to separate the military from business. On domestic politics, Yushchenko characterized the current Rada as a Kuchma-era legacy in its dying days, described the pain of former ally Tymoshenko's most recent barrage of attacks, and asked the delegation to pass word to the President and the Secretary that he was confident that the forces of democracy would prevail over the "forces of revenge" in the March 26 elections and form the next government.



2. (C) A/S Fried stressed that the U.S. was committed to Ukraine's sovereignty and was ready to work with whichever government emerged from democratic elections in March, that Ukraine should not feel as if it stood alone in the face of Russian pressure on gas, and that the U.S. had serious concerns about RUE, a shadowy organization associated with corruption and possibly criminal elements. A/S Flory underscored Secretary Rumsfeld's commitment to a strong defense relationship with Ukraine, commended Ukrainian defense reform efforts, thanked Yushchenko for Ukrainian contributions to international security, and emphasized U.S. support for Ukraine's NATO and Euro-Atlantic aspirations. A/S Wayne informed Yushchenko about USTR's restoration of GSP privileges earlier January 23, expressed hope that a U.S.-Ukraine WTO bilateral accession agreement could be concluded in coming weeks, noted European awareness of the importance of energy security, and raised concern about the recent abrogation of an MOU to establish a securities clearing mechanism. End summary.

U.S. supports Ukraine, worried about RUE

3. (C) A/S Fried emphasized that the USG delegation came to Ukraine to deliver a message of USG commitment to Ukraine's sovereignty, its future as a free nation, and its right to make its own choices about its place in the world. The Poles and the Balts had succeeded in asserting such rights in the face of Russian pressure and opposition, and Ukraine would as well, as long as its leaders were strong enough to continue reform. The U.S. supported the principles of the Orange Revolution -- democratic choice and being the master of one's own house -- while understanding that politics in newly democratic countries could be messy at times, as we had seen in countries like Poland and Hungary in the early 1990s. The U.S. stood ready to work with the government chosen by the Ukrainian people in the March parliamentary elections, even as we hoped that the government would be a strong supporter of reform.

4. (C) On the New Year's gas showdown with Russia, A/S Fried referred to Secretary Rice's very strong and clear remarks about U.S. views of Russia's actions. Ukraine should not feel as if it stood alone in dealing with this challenge, even if Russia attempted to create that impression. Both Fried and A/S Wayne underscored that the Europeans had woken up to the issue of energy security; the task ahead was to keep them awake and focused. Fried stressed the importance of working together -- Ukraine, the U.S., the EU, and Central Asian countries -- to prevent a monopoly over gas and gas transmission routes. As Secretary Rice had said publicly, a medium-to-long-term strategy needed to be pursued. Solutions such as additional pipelines would take time, but Ukraine had partners ready to work with it. The U.S. also stood ready to assist Ukraine in energy conservation and energy efficiency. Wayne stressed the importance of diversification of sources, increased domestic exploration, and efficiency. He expressed optimism that two factors might temper Russia's hard-nosed energy diplomacy in the coming months: 1) Russia's aspiration to make energy security the centerpiece of its G8 chairmanship and the vigorous criticism it received over its New Year's gambit, and 2) Gazprom's interest in selling shares internationally and convincing investors that it acted like a normal company.

5. (C) A/S Fried stressed that while the U.S. had sympathy for Ukraine during the gas crisis and felt the price compromise at \$95 per thousand cubic meters seemed reasonable, we did not understand or support the enhanced role for RosUkrEnergo, a suspect, nontransparent firm. The

U.S knew that Ukraine did not invite RUE to the table, but the U.S. also hoped Ukraine did not feel obligated to conclude arrangements that might give criminal, corrupt elements access to the Ukrainian market. Electorates across Central Europe had responded well to anti-corruption policies, and the energy sector and RUE in particular were notorious in that regard.

Yushchenko on RUE and middlemen

6. (C) Yushchenko, accompanied by FM Borys Tarasyuk and Foreign Policy Adviser Kostyantyn Tymoshenko, returned repeatedly to the topic of RUE throughout the 75-minute meeting. From the day Ukraine had first contracted Turkmen gas, securing transit through Russia had presented a challenge. Initially Gazprom, through Gaztransit, handled transit arrangements directly. Then Gazprom passed such services to "purely commercial structures," the first being Itera. Yushchenko professed not to know who had founded Itera "in some islands near the U.S." but presumed Russian officials at the highest level were the beneficiaries; certainly there were no Ukrainians involved now, neither GOU structures nor individuals. After apparent struggles between competing Russian interests, EuralTransGas took over, again without GOU partners, since Gazprom would not allow that.

7. (C) Finally, Yushchenko continued, RosUkrEnergo was established in 2003, again without formal GOU involvement. While he could guarantee that Naftohaz had not formally lobbied for RUE, he could not rule out the possibility that the idea behind RUE had started at the initiative of then-President Kuchma in 2002. One version of the ultimate beneficiaries had Putin and ex-chief of staff Medvedev on the Russian side and Kuchma and (then-Naftohaz Chair) Yuriy Boyko on the Ukrainian side, though Yushchenko doubted the scheme was that simple. Regarding the oft-mentioned role of (organized crime figure) Semyon Mogilievich, Yushchenko noted stories in the Russian press suggesting that Mogilievich had sold his shares in RUE to a high-ranking Russian official.

8. (C) Yushchenko said he had raised a series of questions about RUE with Putin in Astana January 11. Putin had professed not to know who was behind RUE, but indicated Russia was ready to change Gazprombank as the primary listed shareholder of RUE to Gazprom itself. That changed nothing for Ukraine, said Yushchenko, beyond serving as confirmation that Russia was firmly committed to RUE's role as part of its strategy.

9. (C) Yushchenko repeated his earlier pledge to Ambassador to hand over GOU documents about RUE. Yushchenko had tasked the Security Services (SBU) to find out who on the Ukrainian side was associated with RUE. The investigation continued; the SBU had uncovered seven to eight persons and different structures, but no definitive proof of who was genuinely behind the effort. According to the materials the GOU had, it could characterize RUE's capital, the amount of shares, who stood behind the shares, who was the management, who sat on the board, and what the affiliated structures were. On the Ukrainian side, representing CentralGasHolding, were ex-Naftohaz Chair Yuriy Boyko and deputy Naftohaz Chair Ihor Voronin, plus (UK citizen) Robert Shetler-Jones, (Austrian) Wolfgang Putschek, "and some Americans." Russian officials included Gazprom Chair Aleksey Miller, Gazprom UK Chair Yuriy Komarov, Gazprombank CEO Andrey Akimov, and Gazprom deputy Chair Aleksandr Medvedev.

Renewed pitch on nuclear energy cooperation

10. (C) Yushchenko repeated his December pitch to the Secretary for developing enhanced bilateral cooperation on

SIPDIS

nuclear energy issues (reftel). Russia was very active with its own nuclear strategy, including a proposed 30 new reactors. RosAtom had visited Kiev January 21 to explore related joint activities with Ukraine, including uranium mining, production of turbines and other equipment (with KharkivTurboAtom) and power plant IT equipment traditionally produced in Ukraine. Despite such cooperation, Ukraine felt frustrated; as Europe's largest producer of uranium, it still needed to purchase all of its nuclear fuel from Russia, even if the raw uranium came from Ukraine initially.

11. (C) Yushchenko said that Ukraine's fuel diversification strategy in the nuclear sector away from complete dependence on Russia had a two-pronged approach: possible U.S. sources, along with pursuit of Ukraine's ability to complete the entire fuel cycle domestically. Nuclear power generated 52 percent of Ukraine's energy; while two-thirds of its reactors would end their intended life span within eight-ten years, Ukraine felt confident that it had the technology to safely extend the life span another 20-30 years. A/S Fried pledged to take Yushchenko's interest back to Washington for discussion with DOE and other interested parties; he stressed that the current standoff with Iran over its own nuclear program made the issues of enrichment and closed cycle capabilities very sensitive, even if Ukraine's interest were purely in the energy generation field. Yushchenko expressed understanding of the sensitivities of the issue and stood ready to hear further USG thoughts on the issue. A/S Wayne added that in the wake of Yushchenko's January 10 phone conversation with Secretary Rice, she had asked Wayne and others to look again at the nuclear energy issues Yushchenko had raised in December (reftel).

Energy Sector problems

12. (C) FM Tarasyuk intervened to explain to Yushchenko the efforts at cooperation with Westinghouse on the nuclear fuel qualification project dating back to the 1990s, noting that the project had not yet been completed. Ambassador interjected that Westinghouse had been stymied by a lack of reform in the energy sector; this was a problem not only in the nuclear power sector, but also in oil and gas. The Embassy's nuclear expert had recently met with Presidential chief of staff Rybachuk and a GOU expert; Rybachuk had passed some Ukrainian ideas, which we would examine for ways we could help. Ambassador recounted one example of the frustrating nature of how energy development issues were handled in Ukraine: a tender to explore offshore Black Sea oil/gas fields, a very positive concept in general, had been issued on Christmas Eve and was slated to close just prior to the March 26 elections. With this timing, the tender was not designed for success in terms of attracting Western bids, and laws regarding exploration continued to be problematic; Ambassador suggested vested domestic interests wanted to keep it that way. Ambassador added that while U.S. energy advisers enjoyed productive meetings with PM Yekhanurov, others in the energy sector continued to refuse to talk to them.

13. (C) Yushchenko asked if Energy and Fuels Minister Plachkov and Naftohaz Chair Ivchenko were not being cooperative. Ambassador replied that while he had enjoyed a good meeting with Plachkov, Plachkov expressed no interest in meeting the U.S. advisers. Yushchenko suggested making a

joint request for a group meeting the week of January 30 to discuss a wide range of energy issues. Due to absence of the U.S. expert on nuclear issues that week, Ambassador suggested two separate meetings, the first on gas and oil, and the second on nuclear issues a week later. Yushchenko agreed.

14. (C) Yushchenko highlighted progress in the domestic energy sector. When he became PM in 1999, payment for gas by users totalled around seven percent of the amount owed; it had been 99 percent in December and was now 100 percent. The next sensitive issue would be the liberalization of gas and energy prices.

Relations with Russia

15. (C) On the current state of negotiations with Russia, Yushchenko mentioned the amicable nature of his discussions with Putin in Astana January 11 and characterized the current round of discussions with Russian representatives on the formation of a joint venture between Naftohaz and RUE as very important to establish the basis for future cooperation regarding gas. On the Black Sea Fleet (BSF), the relevant subcommittee of the Yushchenko-Putin Commission would meet in the near future (note: February 14) with the goal of executing additional agreements on a series of unresolved issues, including the lighthouses at the center of the most recent controversy, other navigational aids, use of radio frequencies, mitigation of environmental damage due to fleet activities, and the rules for Russian BSF entry/egress into/out of Ukrainian territorial waters.

16. (C) A/S Fried acknowledged the U.S. did not fully understand what animated Russian President Putin. He assured Yushchenko that while the U.S. sought to work with the Kremlin on important international challenges in the Balkans and concerning Iran, the U.S. would not sacrifice our principles or our friends in order to maintain that relationship. We would work with the Russians as much as we could, but when we needed to, we would speak out, as shown by the Secretary's remarks in the aftermath of the New Year's gas showdown.

Bilateral security relations strong, reform progressing

17. (C) A/S Flory stressed that Secretary Rumsfeld was committed to a strong defense relationship with Ukraine and to supporting Ukrainian defense reform. He thanked Yushchenko for Ukrainian contributions to international security, beginning with troop contributions to Balkans peacekeeping operations in the 1990s, and continuing through the present with deployments to Iraq and Kosovo, support to Operation Active Endeavor, airlift of the Southeastern Europe Brigade (SEEBRIG) to Afghanistan, and humanitarian assistance after Hurricane Katrina and the Pakistan earthquake. Defense Minister Hrytsenko had impressed Rumsfeld and other NATO ministers with his vision, competence, and commitment to thorough reform of the defense and security sectors. The U.S. remained a strong supporter of Ukraine's NATO and Euro-Atlantic aspirations.

18. (C) Yushchenko referenced Ukraine's military strategy through 2010. The ongoing experiment with three non-conscript, contract-based brigades had raised many problems; Yushchenko had visited one of the units in December. He remained confident that Ukraine would find a formula that would make possible the transition to a fully professional force by 2010. Recalling his own conscription experience with 150 soldiers crowded into a single barracks,

he said that the military was refitting such barracks to serve as hostels suitable for families; the Defense Ministry had created more new housing in 2005 than in the previous five years combined. The 2006 budget gave the armed forces 8 billion hryvnia (roughly \$1.6 billion), the first full funding since independence, Yushchenko claimed. Most critical was the adoption of NATO standards, a task to which Ukraine's leadership was fully committed.

19. (C) Ukraine faced a significant challenge in pruning away the structural deadwood inherited from Soviet security structures, Yushchenko continued. Up to 40 percent of existing military structures were unnecessary and redundant, lowering the efficiency of what needed to be retained. One of the next steps on the agenda was getting the military out of the business world; an estimated 600 enterprises involved in all sorts of production, repair, and real estate management needed to be spun away from the formal military structures. Yushchenko joked that if current patterns remained in place, Ukraine would need to throw five to ten generals in jail every year.

Bilateral economic issues

20. (C) A/S Wayne informed Yushchenko that USTR had announced earlier January 23 the restoration of Ukraine's GSP privileges as a result of progress on intellectual property rights, including both legislative and enforcement activities; this was an important step forward. The U.S. and Ukraine were very close to a bilateral WTO accession agreement, with a handful of issues remaining to be worked out between Economy Minister Yatsenyuk and USTR. Yatsenyuk had told Wayne earlier January 23 that he hoped to conclude the process in several weeks (septel); the U.S. remained hopeful this would be possible. Ukraine still had several other bilateral agreements outstanding, and the Rada still needed to pass additional bills before Ukraine could join the WTO. Wayne raised one new troubling issue: PM Yekhanurov had recently signed an order canceling an MOU on establishing a securities clearing mechanism without consulting with the World Bank and U.S. beforehand. In most other countries, the system was industry-owned, not government directed. Ambassador said he would follow up with relevant Ukrainian officials. (Note: Ambassador handed Yushchenko a non-paper on the subject.)

Politics: Rada's final days, democracy will prevail

21. (C) On the fluid domestic political scene, A/S Fried repeated the Secretary's counsel in December: coalition politics could be difficult, but we hoped Yushchenko would keep his options open. Yushchenko replied that the U.S. should not be worried about the drama of recent days in the Rada (parliament); this Rada, elected in 2002 and very much a creation of former President Kuchma, was staggering through its final days. It was regrettable that the Rada had proven unwilling in 2005 after Yushchenko's inauguration to help consolidate the country and support reform, despite the presence of some good personalities in the Rada. The tragedy of the Rada's composition and direction, said Yushchenko, was that it had been an undemocratic body in its inner workings, a Kuchma-era leftover not reflective of the real political needs or moods of the Ukrainian populace.

22. (C) Yushchenko stressed that he had no doubts that the forces of democracy would prevail in the March elections. He asked the delegation to pass a message to the President and the Secretary that the "forces of revenge," which he defined

as the Party of Regions, the Communists, the SPDU(o), and Natalya Vitrenko, would poll no more than 30-35 percent combined. The post-election issue facing Ukraine would be not which parties won, but how to forge a democratic coalition with a reform agenda. Yushchenko said that it had been very painful when the "loved by all" Yuliya Tymoshenko had unleashed a new barrage of accusations in the wake of the January 4 gas deal and had supported the January 10 Rada vote to dismiss the Yekhanurov government. Regardless, he concluded, the winners of the March 26 elections would have to find common ground.

23. (U) The delegation cleared this cable.

24. (U) Visit Embassy Kiev's classified website at www.state.sgov.gov/p/eur/kiev.
HERBST

Website pages 