

**Identifier**

06KIEV380

Created

2006-01-30 14:39:00

Classification

SECRET

Origin

Embassy Kyiv

Cable title: UKRAINE: PRIME MINISTER YEKHANUROV WARNS RUSSIANSTags: [EPET](#) [ENRG](#) [PGOV](#) [PREL](#) [RS](#) [UP](#)[how-to read a cable](#)[Show metadata](#)

S E C R E T SECTION 01 OF 04 KIEV 000380

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DOE FOR LEKIMOFF, CCALIENDO

E.O. 12958: DECL: 01/30/2016TAGS: EPET ENRG PGOV PREL RS UPSUBJECT: UKRAINE: PRIME MINISTER YEKHANUROV WARNS RUSSIANS
MAY CUT OFF GAS FEBRUARY 1

REF: A. KIEV 337

B. KIEV 333

C. KIEV 316

D. KIEV 312 AND PREVIOUS

Classified By: Classified by Ambassador; Reasons 1.4 (b and d)

1. (S) Summary: Ukrainian Prime Minister Yuriy Yekhanurov told Ambassador on January 28 that Russia was threatening to cut off shipments of Turkmen gas to Ukraine as early as February 1 because of the GOU's delay in implementing the January 4 agreement between Russia's GazProm and Ukraine's NaftoHaz. Russian gas at USD 230/tcm would be available. He had learned of this threat in a meeting the day before with Dmytro Firtash, a key figure behind RosUkrEnerg (RUE) and close associate of organized crime kingpin Semyon Mogilievich. Yekhanurov said the delay in implementing the agreement resulted from GOU insistence on 1) a measure of transparency from RUE and 2) keeping RUE from direct contact with the Ukrainian market. Yekhanurov sought assurance that the U.S. would support Ukraine if Russia brought about another supply crisis. Ambassador said the U.S. would support a GOU stand against the shady gas trader RUE. Yekhanurov outlined other GOU initiatives to reform the oil and gas sector and enhance energy security, stressing the need for transparency. He digressed to politics to hint at the possibility of an Orange-Blue (i.e., Yushchenko-Yanukovich) alliance without Tymoshenko. End Summary.

Crowding Out Turkmen Supply

2. (C) PM Yekhanurov asked to see the Ambassador alone the afternoon of January 28. The PM described how Russia had maneuvered to reduce Ukraine's access to Turkmen gas. Ukraine had agreed with Turkmenistan in early December to buy 40 BCM for 2006 at the price of USD 50/TCM for the first half and USD 60/TCM for the second half of the year (in delivery



schedules, the 40 BCM translated into 126 MCM per day). Turkmenistan had agreed last year to sell Russia 30 BCM in 2006, but in January the Russians successfully pressured

Ashgabat to frontload its deliveries to Russia. Turkmenistan agreed that it would provide Russia 15 BCM in the first quarter of 2006 (half of the year's total), leaving less for Ukraine. As a result, Russia claimed that Ukraine could only receive 40 MCM per day from Turkmenistan instead of 126 MCM.

Ukraine Admits to Siphoning

3. (C) Ukraine, Yekhanurov said, had been meeting its consumption needs through a variety of sources. Not counting gas purchased from Russia, Ukraine had a supply per day of 230 MCM (80 MCM of its own production, 40 MCM from Turkmenistan and 110 MCM from its reserve). During the first half of January, before the cold snap, Ukraine had needed 270-80 MCM a day; with the cold snap the number ranged from 280 to 420 MCM a day. To meet the difference between supply and demand during the frost, Ukraine took more gas from the pipeline. (Note: In saying this, as he had also done publicly, Yekhanurov was essentially admitting that Russian accusations on this score were true.) Yekhanurov said that according to the Russians, Ukraine had taken 2.5 BCM more in gas than contracted and that this must be paid at the rate of USD 230 per 1000 CM. As temperatures over the last two days had risen (with highs of 26-28 degrees Fahrenheit), Ukraine's use of gas had dropped back to 270 MCM per day. Ukraine, he said, was now conveying to Europe not just the 347 MCM contracted, but 355 MCM (i.e., including gas from Ukrainian gas storage facilities) to start making up for the additional gas Ukraine took during the cold weather.

Cutoff Redux?

4. (C) According to Yekhanurov, Russia was preparing for another gas shut-off to Ukraine and was seeking to position itself for the coming information war in Europe. To this end, it had proposed to sell gas to Turkey at a low price so that Turkey would have reason to blame Ukraine when the gas supplies fell short. Russia had also stated that there might not be enough gas for the Olympic village in Italy if Ukraine continued to siphon off gas. Fortunately, Yekhanurov said, Europe had not fallen for this Russian line. The EU had said that it understood why, in the wake of the cold weather in Russia and Ukraine, gas deliveries to Europe had dropped recently.

5. (C) Yekhanurov then relayed what he had learned the day before (January 27) in his meeting with an unhappy Dmytro Firtash, one of the key figures in RUE and an associate of OC boss Semyon Mogilievich. Firtash had said that Moscow did not understand the delay in creating the joint venture between RUE and NaftoHaz to sell Central Asian gas in Ukraine. Firtash had threatened that if the GOU did not set up the JV, it would purchase no gas from Central Asia, but would only get gas from Russia at USD 230. The JV needed to be created and the contract for gas purchases signed by February 1.

GOU Seeks RUE Transparency, Firewall for Domestic Market

6. (C) The PM said he told Firtash that he would go ahead with the joint venture if RUE did a public presentation in Ukraine revealing all its principals and dealings and also

provided full documents on its activities to the state Anti-Monopoly Committee. If that independent body gave RUE an OK, the GOU could go ahead with the JV. In addition, Yekhanurov said he told Firtash, the JV would only have authority to sell gas to the state trading center (&torgoviy dom8 in Russian), and not directly to Ukrainian consumers. (Note: It is widely supposed that one of GazProm's key goals is to gain access via RUE to Ukraine's domestic supply system.)

RUE: Some Transparency, No Firewall

7. (C) Firtash promised RUE would do a public presentation in Ukraine on Monday (January 30), and would submit documents to the Anti-Monopoly Committee that same day, Yekhanurov related. Firtash said that the documents would be those required by Swiss law, since that is where RUE is registered. (Note: Yekhanurov commented to Ambassador that such documentation was likely to be thin.)

8. (C) According to Yekhanurov, Firtash rejected the notion that the JV could only sell to the state trading center, and again threatened a gas cutoff if no acceptable deal was signed. Yekhanurov said he told Firtash that if Russia shut off the gas, the GOU would claim 15% of all gas transiting Ukraine as payment for transit, claiming that this was the term of the last agreed contract.

9. (C) Yekhanurov told Ambassador that he was on the horns of a dilemma. If he went ahead with the deal with RUE, he and the Our Ukraine party would be accused of corruption. If he rejected the deal, he would be accused of plunging Ukraine into the deep freeze as Russia cut off gas. The Russians were pressing to sign the contract Monday or Tuesday (January 30-31). Yekhanurov said there was a 50/50 chance that would happen.

U.S. No Fan of RUE

10. (S) Ambassador reminded Yekhanurov that the U.S. had strong misgivings about the role of RUE in the gas deal announced January 4. Ambassador said that senior Department officials had asked him to convey the message that if Ukraine took a stand against the role of RUE, the U.S. would be supportive. He told Yekhanurov that GOU insistence that RUE present clear, authoritative info on its members and dealings was laudable.

11. (S) Ambassador informed Yekhanurov of Assistant Secretary Fried's talks in Europe after leaving Kiev the week before, and noted that Europe as well as the U.S. was quite concerned about RUE's prominent role in the gas deal. Calling for RUE to come out of the closet was something Europe would likely support. It would be extremely imprudent of Russia, Ambassador said, to repeat a gas cutoff to Ukraine, especially in defense of the prerogatives of RUE. Ambassador promised to relay Yekhanurov's concerns to Washington.

12. (C) Comment: It is likely that RUE will take some steps toward transparency early this week, but we are skeptical that these steps will be substantial or that it will abandon its ambitions to gain a foothold in Ukrainian distribution without a fight. If the Russians and RUE compromise on this point, it will mean that the attention brought to bear in Europe, the U.S., and in international agencies such as FATF, has been effective. If an anxious GOU blinks first and signs

off on the creation of the JV without RUE concessions, it will mean that Firtash's threat will have carried the day.

Time to Reform the Oil and Gas Sector

13. (C) The PM then turned to the oil and gas sector in general. He said that he would be PM at least through May and would be devoting his time to his official responsibilities, not politics. He wanted to use this time to begin a real reform in the oil and gas sector. He realized the sector was not transparent. While it may have served the interests of an authoritarian figure such as Kuchma, a nontransparent sector did not suit a democracy. His ideas included:

- making all oil and gas deals transparent;
- ensuring that the major companies such as UkrTransHaz and NaftoHaz functioned as truly separate companies;
- concluding the current tender for exploration in the Black Sea and proceeding with new ones in the Black Sea and the Sea of Azov; and
- working closely with the USG-sponsored energy advisers in developing plans.

14. (C) While Ambassador endorsed Yekhanurov's plans, and offered USG assistance, he also noted some ongoing problems in the oil and gas sector. The first Black Sea tender, for example, was a source of concern. Although Yekhanurov had characterized it as successful because it had drawn at least six interested bidders, Ambassador noted that this was a relatively small number of bidders. Chevron/Texaco was not interested, he pointed out, which could be an indicator of the tender's shortcomings. When Ambassador said that the short lead time for the tender was another problem, Yekhanurov said the GOU was eager to have it completed before the election. He promised to improve the next tenders by, inter alia, drawing on the advice of the USG-funded energy advisers.

15. (C) Ambassador encouraged Yekhanurov to enable foreign investment throughout the sector. Ambassador said he was aware that a Canadian firm owned primarily by U.S. investors had been rebuffed in trying to conclude a production-sharing agreement with Ukrhazvydobuvannya to refurbish existing gas fields and increase production. Although not familiar with the specific case, Yekhanurov replied that the Kuchma regime had signed many contracts regarding gas fields at the end of 2004, once it had become clear how the elections would turn out. The current GOU was seeking to annul some of those contracts, and suggested that perhaps the firm in question was involved in one of those cases.

GOU Seeks Independence in Nuclear Sector

16. (C) Yekhanurov also spoke about the need for Ukraine to become independent from Russia in the area of nuclear energy. He said that he would like to proceed with the Nuclear Fuels Qualification project, which envisioned having Westinghouse provide nuclear fuel to Ukraine. He had heard that the project could take as much as eight years, which was too long for Ukraine. He added that if Ukraine could not find another supplier of nuclear fuel soon, it would develop the capacity to produce its own fuel. Ambassador cautioned Yekhanurov against Ukraine going its own way in developing a full fuel cycle. Ambassador promised to pass back to Washington these

concerns, but added that a response could take some time.

Maybe Orange Goes Better with Blue than with Brown(shirts)

17. (C) Yekhanurov commented on political strategy. For him the most important factor in evaluating a party was its attitude toward property rights. He would sit down with Yanukovych (Kuchma's last Prime Minister), and if Yanukovich endorsed property rights, he would work with him. It was clear, Yekhanurov said, that Yuliya Tymoshenko (his predecessor as Prime Minister under Yushchenko) was only interested in returning private property to the control of the state. People were now referring to the Tymoshenko bloc as "national socialists," he said. Ambassador replied that, while there were certainly nationalists and some socialists among Tymoshenko's supporters, the term "national socialist" was inseparable from its historical associations. Yekhanurov responded that, nonetheless, many of Ukraine's best-known nationalists had to be described as socialists -- including "Rukh" founder Vyacheslav Chornovil (killed in 1999 in a suspicious traffic accident) as well as one of Chornovil's political heirs, Yuriy Kostenko. (Comment: Yekhanurov appeared to be rather explicitly laying the groundwork for a rapprochement and possible alliance with Yanukovych.)
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