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TAGS: EINV ENRG EPET PINR PREL UP

SUBJECT: UKRAINE: RUSSIA DEMANDS UKRAINE PAY ITS GAS DEBT,
OR ELSE

REF: KYIV 2221

Classified By: Ambassador for reasons 1.4 (b) and (d)

1. (SBU) Summary. As annual gas negotiations between Ukraine and Russia intensify, Russian President Medvedev weighed in on Ukraine's gas debt in Ukrainian press reports, hinting at gas cutoffs if Ukraine does not pay its debt by the end of the year. Gazprom CEO Alexei Miller added an additional threat, saying Ukraine could pay \$400 per thousand cubic meters (tcm) of gas or more in 2009 if it fails to pay its outstanding debt. There is no shortage of views on Ukraine's gas price for 2009, with most commentators assuming that Ukraine will need to pay substantially more than the current \$179.5/tcm. To date, Gazprom and Naftohaz have not been able to agree on the exact debt Ukraine owes and a mechanism for repayment, which in turn is stalling progress on a gas price agreement for 2009. Gazprom says Ukraine owes it \$2.4 billion, while Prime Minister Tymoshenko denies that the debt belongs to Ukraine. As the squabbling over the debt continues, Ukraine has at stake coveted long-term contracts, a gradual increase to market prices, and the removal of gas intermediary RosUkrEnerg (RUE) from the current gas arrangement. End summary.

Medvedev Threatens "Serious Steps"

2. (SBU) The Ukrainian press reported that Russian President Medvedev had told Ukraine it must pay its outstanding natural gas debt of \$2.4 billion immediately, and directed Gazprom CEO Alexei Miller to employ all legal means to ensure Ukraine follows through. Medvedev explained that either Ukraine would freely pay its debt, or Russia would take "serious steps" to collect the debt itself, without defining what those steps might be. Later, Gazprom spokesperson Sergei Kupriyanov explained in the press that if Ukraine did not pay its debt and new contracts were not signed by January 1,



2009, Gazprom would be forced to suspend gas supplies to Ukraine; yet, he was hopeful gas cutoffs could be avoided through ongoing negotiations. He added that Gazprom was preparing legal documents to take Ukraine to international court over the gas debt if needed. On November 21, Ukrainian President Yushchenko directed the government to resolve the debt to Gazprom in 5 days. As of November 24, the debt issue remains unresolved.

3. (SBU) Ukrainian Prime Minister Yuliya Tymoshenko disputed the debt in the press, claiming the debt belongs to gas intermediary RosUkrEnergo (RUE) and not to Ukraine. Nevertheless, Tymoshenko remains hopeful all gas debt misunderstandings will be resolved, gas contracts will be signed by the end of the year, Ukraine will gradually move to a market price for gas, and RUE will be removed from the gas transport arrangement with Russia.

Miller Says Gas Price Can Reach \$400/tcm

4. (SBU) Gazprom's CEO Alexei Miller was more specific than Medvedev on the gas debt. Ukrainian media reported that Miller estimated the debt to be more than \$2.4 billion. He said Putin and Tymoshenko had agreed via their October 2 Memorandum of Understanding that the outstanding debt would be repaid immediately (reftel). He added that to date there has been no movement from the Ukrainians to settle the debt, and said Ukraine can expect a gas price above \$400 per thousand cubic meters (tcm) for 2009 if it failed to do so.

Others Offer their Views

5. (C) As in the lead-up to gas negotiations in past years, players on both the Ukrainian and Russian sides are offering up what they think will be the price in 2009. Kostiantyn Hryshenko, Ukraine's Ambassador to Russia, told the Ambassador on November 20 that if Ukraine would pay off its \$2.4 billion debt, RUE would be eliminated from the bilateral gas trade, and Ukraine would maintain its current price for gas of \$179.50/tcm. In October, Naftohaz and Gazprom officials stated that Ukraine would most likely have to pay \$250-\$300/tcm. Most Ukrainian energy experts doubt that Ukraine will get any price lower than \$250/tcm.

6. (SBU) Estimates have generally moved downward as the world economic crisis has unfolded and oil prices continue their free fall. Ukrainian officials have repeatedly told us that they were hopeful that the 2009 gas price would be linked to the spot market price for oil, since Russia ties gas prices to Europe to the oil price. To our knowledge, such a linkage is not a done deal. Russia's agreement to move to European prices for Ukraine is contingent upon Ukraine's full repayment of its gas debts. Nonetheless, the lack of linkage may actually benefit Ukraine in the short term, as it may be able to negotiate a 2009 price that is still less than the prices paid by western European countries next year, assuming that it pays off the debts to Gazprom.

7. (SBU) Both sides are giving contradictory information about the size of the debt. Naftohaz has claimed that the debt is \$1.3 billion, and not \$2.4 billion as Gazprom charged, but other press reports cite Naftohaz officials admitting that Naftohaz might owe an additional \$250 million in late fees and \$870 million for gas for October, putting Naftohaz's debt closer to \$2.42 billion. Sources at Gazprom have suggested that Naftohaz settle the debt by waiving

transit fees on Gazprom gas shipments to western Europe, but Naftohaz and Gazprom officials have not officially acknowledged any such arrangement. Gazprom also has well-publicized financial problems and falling gas prices leave it also strapped for cash, making it unclear whether Gazprom would accept anything besides cash at this time.

Comment

8. (C) Medvedev's tough talk has many Ukrainians worried about possibly high 2009 gas prices and possible gas cutoffs. The Ukrainian press continues to report that the fragile Ukrainian economy could not handle a gas price of \$400/tcm. Naftohaz's de-facto bankruptcy leaves it little room to settle the debt without government intervention. It appears that Tymoshenko agreed to pay off all outstanding debts in order to secure a long-term contract, a gradual move to European prices, and the removal of infamous gas intermediary RUE. Ukraine remains in a weak bargaining position vis-a-vis Russia, and its only real option is to pay the debt. End comment.
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