

## Ukrainian Oil and Gas Wars: A History of Corruption, a Future of Doubts



Analyst Olena Tregub

If anyone knows the ins and outs of Ukraine's oil and gas industry, it's Olena Tregub. Tregub, originally from the Ukraine, has spent the past several years working in Washington, DC as an independent political analyst and expert on Ukrainian oil and gas. She has written on topics about the Ukrainian economy for the Institute for Euro-Atlantic Cooperation in the Ukraine, a political action group supporting Ukraine's EU integration. And when asked for her opinion on the current state of the country's oil and gas business, she doesn't mince words.

"Traditionally, the industry has been about as transparent as a black box," she says. "Only a few analysts in the whole country of Ukraine understand the oil and gas business. It's been so complex and corrupt that it's considered a state secret."

That may sound like an exaggeration, but to the handful of analysts familiar with the country's history of government and business corruption, especially among oil and gas barons who have stolen billions from deals with Russia's Gazprom, "black box" is an apt description. Ever since Ukraine established independence in the early 1990s, the country has struggled for economic viability, losing manufacturing market share and accumulating massive oil and gas debt.

Most experts agree that the key to Ukraine's long-term stability is a combination of energy independence and massive economic and democratic reforms. Ukraine is home to Europe's third-largest shale gas reserves at 42 trillion cubic feet, according to the U.S. Energy Information Administration.

But instead of making Ukraine into an economic powerhouse, the country's rich shale reserves – combined with political instability and rivalries with Russia and other energy-producing countries on the Caspian Sea – have created a system rife with corruption and secrecy. Many Ukrainian leaders have been willing to pursue economic security no matter what the cost. Shady business deals have plagued the country's energy industry from the beginning.

And, after the recent landgrab by Putin, the Ukrainian oil and gas industry is under strain to clean up its act. The new Kiev government under acting President Oleksandr Turchynov is spearheading anti-corruption investigations of the oil and gas industry while dealing with the double threat of an economic collapse and Russia's military build-up along the entire Ukrainian border.

## The "Black Box" Explodes

*Ukraine's location makes it an ideal corridor for transporting oil and gas from Russia and the Caspian Sea to European markets. Disruption of that exchange would pressure both European economies but also Russia's, which is dependent on energy exports.*



Source: U.S. Energy Information Administration, INOGATE (Interstate Oil and Gas Transport to Europe), East European Gas Analysis, AP

([image source](#))

Ukraine is situated at the nexus of an oil and gas war – more politely, a “rivalry” between Russia and its many energy competitors, including the US, Iran, the Caspian Sea coastal countries ([Azerbaijan](#), [Kazakhstan](#), [Turkmenistan](#)), and Ukraine itself.

What's more, Ukraine's position as the hub and "corridor" between the major energy producers (Russia and the Caspian Sea countries) and consumers in Europe and Asia, along with its multiple pipelines and underground gas storage capacities, (especially in its western region) make the country a slam dunk for international brinkmanship, US-Russian oil and gas rivalries, and – of course – politicians on the take. ([source](#)).

A notable example is Yulia Tymoshenko, Ukraine's first female prime minister. Tymoshenko was convicted of oil and gas company embezzlement and abuse of power for her 1990s involvement as a president of United Energy Systems of Ukraine, a natural gas trading company with strong ties to Russia's Gazprom. She was sentenced to seven years in prison and ordered to pay the state \$188 million – charges that international supporters claimed were politically inspired.

More recently, of course, there is Ukrainian president Viktor Yanukovich, a leader who mixed Russian and EU loyalties. Yanukovich had the distinction of being ousted from office twice after charges of corruption had prompted huge street protests – first during the Ukrainian 'Orange Revolution' of 2004, in which his election as President was declared fraudulent; and again in February 2014, after street protests had left 88 dead, many of them shot by uniformed snipers.

Yanukovich, the son of an impoverished metal worker, was an economics student and coal industry executive before joining the Ukrainian government. As Ukraine's president, he became known for his opulent 345 acre presidential retreat which included a faux galleon, \$2 million sauna and exotic animal zoo – along with sweetheart deals with a network coal and gas billionaires tied to Russia's Gazprom.

Just before his fall, Yanukovich's and his government had tried to cement relations with the European Union through a prospective trade deal that could have brought the country much closer to EU integration and much-needed economic reforms. However, Yanukovich reneged on the deal at the last minute when Russia's Vladimir Putin stepped in to offer a package of loans and natural gas price reductions.

"Yanukovich's decision to abandon the EU agreement in favor of Putin's sudden offer of a 30% cheaper gas bill and a \$15 billion aid package provoked the people's protests," observed Nafeez Ahmed, an expert on US-Russian oil and gas trade relationships, writing in [The Guardian](#).

Citizen groups in Ukraine, who were already furious with Yanukovich for his personal excesses and crony capitalism, revolted. They were all too aware of dramatic price increases of food, gas, and other consumer goods. The country – hungry, economically depressed, and angry – was already a powder keg. And Yanukovich's sudden, senseless about-face lit the match of revolt.

Less than two weeks later, new authorities in Kiev invaded Yanukovich's estate searching for direct evidence that the president – along with his multi-millionaire son Oleksand, and a network of friends and government cronies — had profited extravagantly from shale gas exploration contracts formed between Ukrainian companies and Western business partners such as Royal Dutch Shell, Chevron, and Exxon. Yanukovich's henchmen had tried to dispose of the documents in a reservoir as they fled the presidential estate, but journalists and citizens groups have recovered them.

"These documents are the biggest proof we have of Yanukovich and his regime's corruption," said Natalie Sedletska, a journalist with Radio Liberty, an Ukrainian democracy channel. "There is evidence not only of the dispossessed president's extravagant and



luxurious lifestyle here, but also of the culture of bribery, corruption and nepotism.” ([source](#)).

Soon after, people and companies associated with Yanukovych and his son began to fall: One of the first was Dmitry Firtash. Firtash, a close Yanukovych associate, made billions importing Russian natural gas to Ukraine as co-owner of RosUkrEnergo AG, a company half owned by Gazprom. Firtash was arrested in Austria in mid-March at the request of US authorities, but has now been released on record bail (US\$172 million) on the promise that he remain in Austria to cooperate with an international investigation. A US court is moving to extradite Firtash to the United States for trial.

The charges? Alleged bribery and creation of a criminal organization protecting his foreign chemicals and gas business. “‘Firtash may hand over a treasure trove of information about deals involving Russian state gas exporter [OAO Gazprom \(GAZP\)](#) that the U.S. would consider corrupt,’ said [Mikhail Korchemkin](#), a former analyst for the Soviet Union’s Gas Ministry in Moscow and founder of Malvern, Pennsylvania-based East European Gas Analysis.

Firtash, whose company was once the sole importer of Russian gas to the Ukraine in 2006 to 2009, when price disputes with Gazprom resulted in supply halts and shortages across Europe, denies these allegations. Like disgraced Prime Minister Yulia Tymoshenko, Firtash has claimed that his arrest is politically motivated and is direct US retaliation for Russia’s moves in Crimea.

## The Black Sea Chess Game



Ukrainian prosecutors are also investigating evidence of corruption even among small oil and gas contractors. One example: a boutique Kiev geological consultancy group, SPK-GeoService, allegedly received interests in shale gas projects led by Royal Dutch Shell and Chevron worth hundreds of millions of dollars.

At this point, the new Kiev government has reported no evidence of criminal activity in the GeoService case. But prosecutors claim they want to understand how a geological consultancy that made no significant financial outlay could have won a 10% stake in two giant shale deposits (Yuzivska and Olesska) owned by another state company in exchange for helping expedite the project. Both Shell and Chevron entered into these existing shale ventures in 2013, promising to invest billions in exploration in return for their stakes.

SPK-GeoService has denied any business improprieties, while Shell said its arrangement was transparent and that it had done “extensive due diligence” on GeoService. Chevron declined to comment, citing its policy of refraining from comment on commercial transactions.

Russia’s military annexation of Crimea – including its gas plants – has thrown virtually all cooperative Black Sea shale drilling projects into question. ([source](#)).

“The previous [Ukrainian] government was so insanely corrupt when it signed deals with [Western] partners for shale exploration in Western and Eastern Ukraine,” says Olena Tregub. “One of the partners was a firm connected to the son of President Yanukovych – that under the new government these deals will have to be renegotiated.”

At this point, deals made by Shell and Exxon are now in “legal limbo,” according to Chris Weafer, a partner at Macro Advisory in Moscow. Other international partners, like Exxon Chairman and CEO Rex Tillerson, have expressed unwillingness to take sides in the crisis.

Cooperative licenses to drill may be delayed or cancelled, especially since Russia has moved quickly to nationalize all assets, including drilling platforms and pipelines, of Crimean state oil and gas companies such as Chernomornaftogas.

## **Putin’s Geopolitical Weapons**

Vladimir Putin’s decision to occupy and annex Crimea is more transparent than his oil and gas dealings, according to Olena Tregub.

“He uses gas and oil as a geopolitical weapon,” she said. “His biggest motivation is to stay in power – he claims he has to restore Great Russia as a superpower. The state of the Russian economy affects the legitimacy of his regime.”

But Russia is already seeing decreased natural gas sales, especially to Europe, which is seeking energy diversity through alternate gas pipelines and suppliers. Through conservation efforts and recent warm weather, Europe is buying less gas from Russia’s Gazprom.

“In reality, Gazprom is a failing company; it’s almost bankrupt,” Tregub reported. “But if there is a military conflict [in Eastern Europe], there will be a spike in gas and oil prices.” Disruptions to European supplies would presumably follow, benefiting Russia at least temporarily.

Tregub believes that Putin’s plan in Crimea would be to block or at least delay Western and Ukrainian exploration of shale resources in and around the Black Sea – which threatens to undermine Russia’s energy grip over Europe. Since the Ukrainian government has penned shale deals with Western companies like Exxon and Chevron to achieve greater energy independence, Russia will disrupt those deals to prevent them from interfering with Gazprom’s regional monopoly

Putin’s administration is also concerned about international prices for oil in the event of a

European embargo on Russian oil.

“Putin is afraid that the Iranians will start to sell their oil to Europe [which they have promised to do] in large volumes, causing prices to drop,” Tregub explained.

“The Russian budget depends on the oil prices,” she said. “If, say, the prices go below \$70 a barrel, the Russian government will have trouble paying its pensions, salaries, and other expenses, and the economy may falter.”

Another Russian alternative to destabilize Ukraine is to use potent non-military weapons: for example, fomenting civilian rebellion (led by pro-Russian factions) or jacking up gas prices while squeezing the government into prompt repayment of billions in debt. However, if Putin pushes prices too high, he runs the risk of creating a complete economic collapse in Ukraine. A major oil and gas supply or pricing disruption could mean the Ukrainian government will stop paying anything – and that would represent a huge blow for both Gazprom and the Russian economy.

How, then, can Ukraine turn the situation around?

Putin’s shield is not infallible, many experts say. The best way to thwart Putin’s efforts is to support the new Ukrainian democracy, diversify energy supplies and give massive aid to its struggling economy. If Putin raises gas prices too precipitously or proceeds too aggressively with military action, both Europe could turn to other energy suppliers, including the US, Iran, and the competing Caspian sea countries, for energy aid – although how much, how fast, is open to question.

Ukraine’s best long-term bet is to exploit the two large, untapped shale reserves it does have, suggests Tregub.

In the interim, the US and other countries will need to supply emergency energy and consumer goods supply lines to Ukraine, helping it avoid an economic and humanitarian disaster.