

Time for a Tripartite Gas Pipeline Consortium for Ukraine

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The future of Ukraine's gas transit pipeline is back on the agenda, and it is time for the European Union to come up with constructive ideas on what to do.

Immediately after his election, President Yanukovich agreed a deal with Moscow on 21 April in which Ukraine would get a price discount on gas supplies for ten years, alongside an extension of the lease for the Black Sea fleet for another 25 to 30 years.

In addition, Moscow has proposed a full merger between Gazprom and the Ukrainian gas distribution company Naftogaz, which, given the disproportionate size of the two parties, would mean a takeover by Gazprom. Russia is offering to pay for the modernisation of the transit pipeline, which indeed will be an expensive refit, costing maybe around \$10 billion. But President Yanukovich has said No to the merger proposal – it was a bridge too far in ceding control of strategic assets to Russia. He has however signalled his interest in the idea of a tripartite Ukrainian-Russian-European consortium for the gas pipeline, which has been discussed on and off since the days of President Kuchma. At that time, in 2002, the idea was for the German gas importing company, Ruhrgas, to join an essentially Russian-Ukrainian scheme.

In January 2009, at the time of the crisis in which Russia interrupted gas supplies to Ukraine and consequently to EU markets, CEPS published a paper advocating that the tripartite consortium idea be reconsidered in a revised form that would see the full involvement of the EU itself as well as some European energy corporations.¹ There would be a new corporation that would secure a long-term lease of around 20 to 30 years for use of the trunk gas pipeline, and undertake its renewal and maintenance. There would be Ukrainian, Russian and European shareholders. In particular there would be equity investment by the EBRD and loan financing from the European Investment Bank (EIB) in addition to the participation of European energy companies. Crucially, the participation of the EBRD and EIB would be tasked with overseeing the corporate governance of the consortium.

In 2009, however, the Yushchenko government was not interested in bringing in Russia on the deal. The European Commission followed Yushchenko's line and in February 2009 convened a conference in Brussels on the modernisation and governance of the Ukrainian gas distribution infrastructure. The Ukrainian side

¹ Elena Gnedina & Michael Emerson, *The Case for a Gas Transit Consortium in Ukraine: A Cost-Benefit Analysis*, CEPS Policy Brief No. 180, Centre for European Policy Studies, Brussels, January 2009.

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produced complex plans for the reform of the governance of Naftogaz, and the conference adopted numerous recommendations and plans for useful but hardly strategic projects. While the Russian minister of energy was invited, this was essentially a bilateral European-Ukrainian affair, to the point that the Russian minister walked out before the end, feeling that Russia had not been treated as an equal partner.

The European Commission does not seem to have reacted so far to the latest show of interest by Yanukovich in the tripartite consortium proposition. The basic mechanism for a tripartite consortium is clear enough, although many details would need to be negotiated, such as the distribution of shares between Ukrainian, European and Russian partners. The main question is whether it is worthwhile for the EU to pick up the issue and make a proposal. There are four reasons why the EU should do so.

First, it is a necessary and bankable project. It is necessary because the pipeline network is old and badly depreciated, and in need of expensive refurbishment. With a long-term lease of 20 to 30 years on the trunk transit pipeline, supported by a tripartite treaty to give the project the highest level political and legal basis, the corporation would have a guaranteed source of income from transit revenues. The EBRD and EIB could supply a critical mass of initial financial pledges alongside Gazprom and some European energy companies, and from there the foundations for securing further bond funding in international financial markets could be laid.

Second, it is a project that would enhance European energy security. The project would separate (technically, politically and legally) the gas transit function of the trunk pipeline from the domestic Ukrainian gas distribution network, with proper taps, meters and above all managerial control to separate gas flowing to Europe and gas going to the Ukrainian distribution network. This would exclude recurrence of the crises of 2006 and 2009 when bilateral Russian-Ukraine payment problems resulted in the cutting of supplies to the EU.

Third, it could be an action that demonstrates the EU's capacity for rapid strategic action in foreign and security policy, which is so far sorely lacking. This is an initiative that Mr Guenther Oettinger, the new energy chief at the European Commission, could advance in association with Mr Stefan Fuele, his colleague responsible for neighbourhood policy, and High Representative Catherine Ashton, inviting the EBRD and EIB to a working group to outline an operational proposal.

Fourth, and most important on top of these already important merits, the project would create political synergies between the EU, Russia and the common neighbourhood of which Ukraine is the core. This would signal a switch of paradigm in the affairs of wider Europe. It would be a step away from the competition for primacy over spheres of influence between the EU and Russia in their common neighbourhood, towards a cooperative regime with synergetic benefits for all parties. The EU typically argues that it does not want primitive geopolitical competition over its Eastern neighbourhood, and yearns for a more enlightened and inclusive pan-European order. It has not been doing so well in achieving this. Here is a real chance to take a major step in the desired direction. For the moment the Commission is silent. Will it miss the chance?