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## Russian Federation: Executive Branch

By Susan Cavan

### **Chubais retires...or not quite yet**

It seems that rumors of Anatoli Chubais' retirement were a bit premature. Chubais often had mentioned that the 1 July completion date for the disaggregation of RAO/UES (Russia's Unified Electrical System corporation) also would mark the date of his retirement. However, on just that day, Chubais met with President Medvedev and reportedly was offered a position as chairman of the oversight board of Russian Nanotechnologies. The board currently is headed by Leonid Melamed, who previously served as a senior aide to Chubais. After so many strenuous years in the inner circles of Kremlin power, retirement might have seemed an attractive idea to Chubais; the nanotechnologies industry, already budgeted to receive 130 billion rubles in state investments (a figure likely to increase), also could hold significant appeal. There has been no report of Chubais' decision as yet. (1)

The reorganization and eventual dismantling of RAO/UES marked the end to a long-running battle for Chubais, who has found a unique way to celebrate the accomplishment. He will auction off the office chair, from which he led RAO/UES, with proceeds to benefit a children's charity in the Kaluga Region. Chubais pointed out the significance of his donation: "I am still sitting in it and there have been attempts to knock it [out] from under me, but I fought back as best I could." (2)

Speaking of attempts to knock out Chubais, three suspects on trial in the attempted assassination of Chubais were acquitted by a Moscow court last month, after a 5 June not guilty verdict from the jury. In 2005, Chubais came

under attack in his car by a roadside explosion and armed individuals. Chubais was not injured in the attack. Commenting on the verdict, Chubais said, "I consider it a mistake." (3)

At least one of the suspects, a reported member of GRU, wants his old job back. Vladimir Kvachkov, who previously worked at the Center of Military Strategic Studies of the General Staff, announced, "I'm acquitted. There is nothing anymore to keep me from getting my job back." "Besides, I'm nearly finished with my thesis on theory of special operations..." (4)

### **The quiet war**

In an address prior to the presidential election, successor candidate Dmitri Medvedev had very pointed remarks about state officials who abused their office: "We need to create a system in which stealing from the state is dangerous and unprofitable. ... [W]e can't just put our snout in the trough and believe that we have made a success of our life. ... Leave the public sector and go to work in the private sector." (5) As president, Medvedev seems poised to launch a campaign both to entice some officials into leaving state service voluntarily, while simultaneously pursuing targeted corruption investigations aggressively – all of which is stoking an already factious apparat.

The contentious nature of the Putin-Medvedev succession laid bare certain factional splits and rivalries within the elite, notably among the siloviki. While the Medvedev presidency still is getting its legs underneath it, the apparat divisions appear to be widening as skirmishes break out over new rules for state officials, and, perhaps more importantly, control of the main corruption investigations committee.

On 2 July, Arkadi Dvorkovich, Medvedev's economic adviser, announced that state officials who occupy spots on the boards of directors of Russia's state-owned companies soon would be removed and replaced with "independent

directors." (6) The separation of officials from corporate boards will move in two phases: first, the wholly state-owned companies, followed by state-controlled companies. This disentanglement of state officials from their corporate connections is part of a larger anti-corruption drive being drawn up by the president's anti-corruption council, headed by Kremlin Chief of Staff Sergei Naryshkin. Legislation to support the council's program is expected in October, or at least by the end of the year. (7)

Despite Medvedev's apparent interest in pursuing corruption in this manner, Vice Prime Minister Igor Sechin, head of the so-called "losing clan" during the succession battle, as well as Chairman of the Board of Rosneft, urged caution and circumspection in implementing the president's initiative: "Work to replace government officials with independent directors will proceed, but it should be done carefully, without reducing capitalization." (8)

According to Sechin, Russian companies already have "independent" directors, and "we can think" about augmenting their number. He clearly suggests an oversight role in any personnel changes. "If we see such bright personalities for Rosneft, we will agree with their appointment to the Board of Directors, while observing the procedure." (9)

While it seems clear that Sechin hoped to signal apparat-corporate stability in his attempts to mitigate, if not stymie, the effects of this Kremlin plan, President Medvedev appears unlikely to abandon such a high-profile element of his anti-corruption campaign. In a recent meeting with First Deputy Prime Minister Igor Shuvalov, Medvedev asked for a report on his "instructions to the government ... about the board of directors of state-run companies." In response, Shuvalov described the contours of a plan that provides wide latitude in the definition of "independent." "In line with your instructions, we saw to it that joint-stock companies should be headed by a government member, or high-ranking official of the President's Executive Office; we made sure that all other directors were

either professionals or work under contract with the Russian government or represent some public organizations. Above all, we wanted to make sure that these officials were independent, that they would care for their joint-stock companies, and that there would be no conflict of interest, that they would not be affiliated with competing businesses. A list of such individuals has been compiled and approved by the government cabinet." (10, Emphasis added) Clearly, some work has to be done to reconcile the purpose of this reform with the process set out to achieve it.

Perhaps the most bitter battle, and one that has been brewing for months, concerns control of the anti-corruption drive through chairmanship of the Investigations Committee. The current besieged chairman, Aleksandr Bastrykin, has thrown a deputy overboard in the face of serious criticism over a major, provocative investigation and been forced to abandon its prosecution. (For more on the Storchak and Bulbov cases and their ramifications, please see *The ISCIP Analyst*, Vol. XIV, No.12, 24 Apr 08.) Now, Bastrykin has been called to resign after media reports appeared, claiming that he has significant business interests in the Czech Republic. Procurator-General Yuri Chaika at least offered to inquire about the report, "I will talk with Bastrykin to clarify some points ... If there are grounds, we will initiate [an inquiry]." (11)

For his part, Bastrykin has denied the allegations: "I officially state that neither I nor members of my family were ever involved in any business activity, either in Russia or abroad." (12)

Aleksandr Khinshtein, Duma deputy for One Russia and author of the comments in the *Moskovskii komsomolets* article that started this brouhaha stands by his allegations and suggests that Bastrykin either sue him for libel or resign. (13) While it should be fairly easy to trace Bastrykin's business dealings, some individuals, nonetheless, seem to have put a great deal of effort into discrediting him.

As analysts search for signals that suggest who really is ruling Russia in the current diarchical structure, the winners and losers in the side combat over control and scope of any corruption investigations or legislation may provide a clear picture of the relative status of the president, prime minister, or, at the very least, their champions and allies.

Source Notes:

- (1) Vedomosti, 3 Jul 08; Russian Business Monitor, 4 Jul 08 via Lexis-Nexis Academic.
- (2) ITAR-TASS, 713 pm EST, 30 Jun 08 via Lexis-Nexis Academic.
- (3) Gazeta, #110, 17 Jun 08; Russian Press Digest via Lexis-Nexis Academic.
- (4) Komsomolskaya Pravda, 17 Jun 08, p. 4; What the Papers Say via Lexis-Nexis Academic.
- (5) "Interview with Itogi Magazine," 18 Feb 08; www.medvedev2008.ru via Johnson's Russia List (JRL), 27 Feb 08, 2008-#42.
- (6) "Independent execs to replace govt. officials," RIA-Novosti, 2 Jul 08 via Lexis-Nexis Academic.
- (7) "Medvedev expects new anti-corruption law to be passed this year," RIA-Novosti, 2 Jul 08 via Lexis-Nexis Academic.
- (8) ITAR-TASS, 935 PM EST, 9 Jul 08 via Lexis-Nexis Academic.
- (9) Ibid.
- (10) Beginning of a working meeting with First Deputy Prime Minister Igor Shuvalov, 11 Jul 08, President of Russia Official web portal via www.kremlin.ru.
- (11) Interfax, 3 Jul 08 via Lexis-Nexis Academic.
- (12) Argumenty I Fakty, 9 Jul 08 via BBC Monitoring Library via <http://bbcmonitoringlibrary.com>.
- (13) "Russian MP challenges investigations chief to sue him over newspaper article," BBC Monitoring Library, 9 Jul 09 via <http://bbcmonitoringlibrary.com> (no primary source given).

# Russian Federation: Domestic Issues and Legislative Branch

By Rose Monacelli

## **Have a baby, win a refrigerator?**

The world's population is aging, but in few countries is it of more concern than in Russia, where the population has fallen by six million persons in the last 15 years. (1) In 2006, President Vladimir Putin referred to the issue of population decline as "Russia's most acute problem today." (2) A United Nations-sponsored study released in April found that the issue has grown even more serious over the past two years. This year, Russia's current population of 142 million is expected to decrease by .5%, or roughly 667,000 persons, falling to between 125-135 million by 2025, and as low as 100 million by 2050. (3) In economic terms, the country's workforce will lose eight million workers by 2015 and up to 19 million by 2025, seriously jeopardizing Russia's slowly growing status as a global economic power. (4)

Population change is based on three factors: birth rate, death rate, and immigration. In order to maintain the current population level, the average Russian woman would have to have 2.2 children. The current figure stands at 1.3 children. (5) In 2007, Putin attempted to resolve this situation by declaring that 2008 would be the "Year of the Family" and launching a campaign designed to encourage marriage and childbirth. This announcement followed the official designation of September 12 as national "Family Contact Day," an annual celebration on which Russian couples are encouraged to say home from work in order to enjoy "marital closeness" in the hopes of producing children exactly nine months later on "Russia Day," June 12. (6) Currently, 65% of Russian families have one child, and of those, only one-third want a second, (7) despite Prime

Minister Putin's recent decision to award women 250,000 rubles (approximately \$11,000) for having a second child. (8)

However, these "solutions" to the population crisis fail to take into account the issue's roots – Russia's lack of basic infrastructure, jobs and economic stability. Efforts to improve the quality of life would go a long way towards making couples secure enough to consider expanding their families. Incentive programs actually may make the situation worse, as in Ulyanovsk, where "Family Contact Day" already had been celebrated unofficially since 2005. (9) Governor Sergei Morozov introduced the holiday as a "sex day" (10) to combat his region's discouraging two-to-one death-to-birth ratio, offering prizes to couples that could "give birth to a patriot on Russia day." In 2007, the grand prize, a new sport utility vehicle, went to the only family to have given birth to a fourth child, but every woman who gave birth on June 12 received \$300. (11)

On one hand, the program was a success, as 87 children were born in Ulyanovsk last year on June 12. On the other, the popularity of this type of program illuminates larger issues at work in the region that previously had been best known as part of Russia's "Red Belt." Located to the west of the Volga River, the "Red Belt" is an area comprised mainly of farming communities, which have seen none of the benefits of the past decade's economic reforms enjoyed by Russia's larger cities. It is an area where few can afford the most basic necessities, which may explain why so many women appeared eager to give birth for the opportunity to win cash prizes or appliances, without thinking of the long-term implications of having a child for profit. (12)

Although most women interviewed on or after June 12 have refuted any suggestion that they had planned to give birth on June 12, it appears that labor was induced artificially on such a wide scale that some of the region's maternity wards, which had been filled to capacity that day, may have run out of labor-



inducing drugs. A remarkable number of cesarean sections were performed, as well. (13)

The newest initiative designed to increase Russia's population is another government-sponsored holiday, the recently introduced "Day of Family, Love, and Fidelity," celebrated annually on July 8. The holiday, sponsored by Russia's new First Lady Svetlana Medvedev, who closely supervised the planning of the day, is designed not to induce people to fall in love, but to help couples to remain in love. (14) Celebrated in 25 regions, the inaugural "Day of Family, Love, and Fidelity" included a large ceremony in a southern Moscow park at which 200 medals were awarded to couples married longer than 25 years (no small feat in a country with an 80% divorce rate) and the dedication of a new bench designed "with a back shaped like outstretched angels' wings and a curved seat that encourages couples to slide closer together," so that they might discuss their differences. (15)

In the Krasnoyarsk region, the day was stretched into a weeklong festival dedicated to convincing women not to have abortions. (16) In light of the country's current population woes, abortion has become a popular topic among politicians eager to reintroduce legislation banning the practice. Although the procedure was legalized again in 1995, it has alternated in and out of legitimacy since Stalin first prohibited it in 1936. (17) Although the abortion rate is falling, current figures indicate that on average, thirteen abortions are performed for every ten births in Russia. (18) Those opposed to the idea of legally banning the practice have argued that the choice should lie with the woman, and that a ban will only increase the number of illegal, dangerous procedures, possibly sustaining or even increasing the number of deaths in the country. They maintain that other methods, (including hinting that abortions may lead to sterility or other health concerns or appealing to prospective mothers on moral grounds) are just as effective in reducing the abortion rate. Both sides agree that all concerned would benefit from an increased emphasis on family planning.

### **Blogger convicted for comments in an online journal**

On the same day as couples across Russia renewed their love and celebrated the future, a judge's ruling in Syktyvkar forcibly reminded onlookers that some things in the country continue to operate as they did in the past. Musician Savva Terentiev was sentenced to twelve months in jail for the incitement of hatred and violation of human dignity. State prosecutors argued that Terentiev's comments, which included the recommendation that "one infidel cop per day" be burned, (19) were punishable under Article 282 of Russia's Criminal Code, which covers what can and cannot be said through the country's various mass media outlets – despite the fact that the law does not specify the Internet as a form of mass communication. The Internet's wide accessibility, argued State Prosecutor Lada Luzan, classifies it as such. (20)

It is this classification that may have wide-reaching implications for the future of free speech in Russia. Terentiev's case is the first on record involving a journal entry from an online blog, but it's one in a long line of situations in which the Russian government has taken exception to its citizens' right to speak freely online. Most of the cases that have gone before the court system have involved the incitement of racial, ethnic, or religious hatred. The July 8 ruling, however, was the first time that the Russian government successfully prosecuted someone's personal opinions found in an online journal. This situation is expected to have wide-reaching consequences because of the burgeoning popularity of blogging in Russia, which until now has offered an expansive public venue for voicing anti-establishment sentiment free from the threat of retribution.

The members of Russia's remarkably passionate online community have rushed to Terentiev's defense, comparing online blogs to a kitchen table where gossip is passed around. By this reasoning, they argue, the Russian people are free to differentiate between Terentiev's opinion and a direct order. (21) They also cite a similar case in the European Union (EU) court system, where the government

brought suit against a blogger who called police “wild beasts in uniform and sadists” in *Torgerson v. Iceland*. (22) The EU’s Court on Human Rights found that these adjectives couldn’t be considered excessive, and that under Article 10 of the European Convention on Human Rights, which ensures every citizen’s right to freedom of expression, (23) *Torgerson* could not be prosecuted. In *Syktyvkar*, however, the judge refused to take either of these arguments into account.

The jury is still out on whether the *Terentiev* case is a one-time incident based on one blogger crossing the line or whether it should be seen as a warning to other bloggers to keep their opinions to themselves. Either way, the judge’s decision indicates that many in Russia continue to oppose the idea of free and uncontrolled speech. Although it’s too early to judge how this ruling will affect future cases, it has not lessened the resolve of some Russian officials, who have been attempting to introduce censorship measures under the banner of fighting terrorism and extremism for the past decade. The latest of such measures was introduced last month by the Russian Interior Minister Rashid Nurgaliyev, who wishes to officially classify the Internet as a mass-media outlet in order to criminalize “dissemination of extremist and terrorist ideas” online. (24) However, other members of the government oppose such measures on the grounds that extremism won’t be resolved by taking away one method of dissemination, and that the government must find more subtle ways to fight it. As for the Russian people, a recent Perm-Online study indicated that more than 60% oppose measures to limit free speech on the Internet. (25)

Government opposition to promoting ideologies online hasn’t stopped the Kremlin from attempting to use the Internet to sway public opinion in its favor. The Independent Consumers Association (ICA) recently announced that it had found that the government has begun to plant “agents of influence,” otherwise known as “G-Commandos” in online political forums. (26) The G-Commandos, distinguished by their near-constant Internet presence, strong anti-Western, pro-

Kremlin sentiment and tendency to attack viciously anyone who appears to oppose the current regime, frequently change screen names and possibly are linked to Russia's various security agencies. However, like the Terentiev case, the presence of the G-Commandos has had one unexpected result – Internet users have begun to band together to fight the intruders who threaten their free speech and open discussions, in yet another significant example of Russia's unexpectedly empowered web community.

Source Notes:

(1) Nikita Mironov, "Will Russia's population drop one-third by the mid-2000s?" *Komsomolskaya pravda*, 19 Jun 08 via <http://www.kp.ru/daily/24116.3/339907/>. Last accessed 17 Jul 08.

(2) Mark L. Haas, "Pax Americana Geriatrica," *Miller-McCune* 14 Jul 08 via <http://www.miller-mccune.com/article/497>. Last accessed 16 Jul 08.

(3) Sara Rhodin, "From Russia with love: A new holiday to fight population decline," *International Herald Tribune*, 8 Jul 08 via <http://www.iht.com/articles/2008/07/08/europe/russia.php>. Last accessed 16 Jul 08.

(4) Nabi Abdullaev, "Boosting Population a Vague Science," *The Moscow Times*, 11 Jul 08 via <http://www.themoscowtimes.com/article/1010/42/368867.htm>. Last accessed 16 Jul 08.

(5) Abdullaev, *ibid*.

(6) Rhodin, *ibid*.

(7) Mironov, *ibid*.

(8) Yasha Levine, "Incentivized Birth: How Russia's baby-boosting policies are hurting the population," *Slate.com*, 10 Jul 08 via <http://www.slate.com/id/2195133/>. Last accessed 16 Jul 08.

(9) *Ibid*.

(10) Haas, *ibid*.

(11) Levine, *ibid*.

(12) *Ibid*.

(13) Ibid.

(14) Anna Malpas, "A New Day for Family, Love and Fidelity," The Moscow Times, 8 Jul 08 via <http://www.themoscowtimes.com/article/600/42/368786.htm>. Last accessed 21 Jul 08.

(15) Tony Halpin, "Population crisis sees revival of Russian version of Valentines Day," Times Online, 8 Jul 08 via <http://www.timesonline.co.uk/tol/news/world/europe/article4296778.ece>. Last accessed 17 Jul 08.

(16) Ibid – Malpas.

(17) "Will abortion ban improve Russia's demography?" Pravda, 11 Feb 05 via <http://english.pravda.ru/society/family/9168-abortion-0>. Last accessed 17 Jul 08.

(18) Ibid.

(19) "First prison sentence passed on Blogger for remarks in Live Journal," Itar-Tass, 8 Jul 08 via David Johnson's Russia List (JRL), 9 Jul 08, 2008-#129.

(20) Ibid.

(21) "Russian rights activists condemn conviction of Blogger," Interfax, 8 Jul 08 via David Johnson's Russia List (JRL), 9 Jul 08, 08-#129.

(22) Ibid.

(23) "European Convention on Human Rights and its five protocols," Hellenic Resources Network via <http://www.hri.org/docs/ECHR50.html>. Last accessed 21 Jul 08.

(24) "Russian Interior Minister wants to restrict Internet," Ekho Moskvyy Radio, 11 Jul 08 via David Johnson's Russia List (JRL), 14 Jul 08, 08-#131.

(25) Itar-Tass, *ibid*.

(26) Paul Goble, "Window on Eurasia: Kremlin's 'Agents of Influence' Said Tilting Internet Forums against the West," Window on Eurasia, 7 Jul 08 via David Johnson's Russia List (JRL), 9 Jul 08, 08-#129.-#129.

## Russian Federation: Security Services

By Fabian Adami

### **ABM: Russia to react?**

Four months ago, Secretaries of State and Defense Condoleeza Rice and Robert Gates traveled to Moscow for talks with their counterparts. Although a number of issues were discussed, the primary goal was to reassure the Kremlin about, and to obtain its acceptance of, the proposed US anti-missile shield. In order to attempt to assuage Moscow's concerns, the US delegation offered Russia the opportunity to verify that the system "does not work against it," by allowing Russian officials to examine the interceptor bases in the Czech Republic and Poland.

The Russian response to these offers was on the one hand to welcome them, with Foreign Minister Sergei Lavrov claiming that they amounted to US recognition of Russia's concerns, but on the other hand to insist that Russia must have a "permanent presence" at these bases in order to be able to carry out "technical monitoring." In Moscow's view, one-off verification visits do not provide sufficient guarantees of friendly intentions. (1) During the last few weeks, there have been some new developments on the ABM issue that have brought Russian reaction.

First, on July 8th, the US and the Czech Republic signed an agreement for ABM assets to be based on the latter's soil. President Dmitri Medvedev reacted to the agreement by stating that Russia would take "appropriate steps" in response to the development. That such a response will include "military-technical" (2) methods seems clear, but the question remains what precisely Russia is capable of doing. Possible responses could include withdrawal from the 1987 Treaty on Intermediate Range Missiles (INF), or the stationing of tactical missiles near Kaliningrad and in Belarus, (3) but the reality is that Russia's current military capabilities make it highly doubtful whether a direct response is feasible.

Secondly, on July 9th, Iran test-fired a number of missiles. In the days since the incident, it has emerged that the missiles used may not have been Iran's newest, and that photos released by Tehran likely were doctored in order to "exaggerate" the regime's military capabilities. (4) Russia's response to the missile tests has been to use the results to argue its viewpoint that Iran's missiles have a limited range of only 1,240 miles (5) and are not inter-continental. Therefore, they do not directly threaten the United States, and the "current idea of deploying a US...missile shield in Europe, with its parameters, is not needed to monitor and react to missiles with this range." (6) The idea of the ABM system being geared to the future, when Iran might develop ICBM capabilities, does not seem to be in Moscow's thoughts.

The third development is the alleged possibility that, should Poland decide against hosting the missile shield, Lithuania might provide an alternative. On 11 July, the Baltic country's president, Valdas Adamuk, stated that his country would be open to the idea of "stationing those elements" of the shield designated for Poland. (7) Adamuk claimed that no talks have taken place thus far, and that he did not believe Lithuania to be more suitable than Poland. (8) This denial in fact was incorrect: According to the New York Times, State Department Security experts approached Lithuania some time around the middle of June, due to Poland's vacillations. (9)

The "Lithuanian option" apparently has been discussed in that country's media for some weeks, provoking a virulent reaction from Moscow. Sergei Prikhodko, Medvedev's spokesman, told the press that missiles in Lithuania would be "absolutely unacceptable," (10) while Deputy Foreign Minister Sergei Kislyak noted that "Lithuania is closer to Russia's territory," making the system "less attractive for Russia from a perspective of its possibilities of affecting our interests." (11) Placing US missiles in Russia's Near Abroad would be viewed qualitatively differently than putting them only a little farther westwards. Indeed,

such an action would be viewed as an “aggressive” move by the United States itself.

Finally, a possible explanation for Russia's paranoia vis-à-vis ABM has come to light. On 10 July, Alexander Pikaev, head of the Disarmament and Conflict and Settlement Department of Russia's Science Academy, claimed that the US could station nuclear armed ballistic missiles at the Czech and Polish bases, under defensive pretexts. Without real and ongoing verification capabilities, Russia's military would, according to Pikaev, have to "take into consideration the worst scenario." (12)

Given the Academy of Science's close ties to the establishment, this viewpoint must be regarded as official.

It is possible—although no evidence exists to prove this at the time of writing—that the talks with Lithuania were and are designed to push Russia into a diplomatic maximal or minimal corner: We will build our system, but you choose—the missiles either go to Poland, farther from your soil, or to Lithuania, right on your border.

Russia may never accept the ABM system, because its foreign policy worldview sees NATO and the US as its primary opponents and targets. But it may mute its objections, given such a choice.

### **Return of Kuril Islands?**

On the fringes of the G8 summit held early this month, President Dmitri Medvedev conducted brief bilateral talks with a number of his counterparts. Medvedev's meeting with British Prime Minister Gordon Brown, reportedly bad tempered, focused on the ongoing diplomatic rows over TNK-BP and the Litvinenko assassination, and apparently reached no resolutions. (13)

Discussions between the Russian President and German Chancellor Angela



Merkel centered almost exclusively on energy, and an agreement was reached to hold future in-depth talks over the purchase and sale of natural gas and oil. (14) The talks that apparently were the most congenial and yielded the most concrete results were those between Medvedev and Japanese Premier Yasuo Fukuda.

The two leaders discussed a wide range of issues, reaching agreement on some, and confirming their intent to talk further about others. Russia and Japan are to sign a criminal-judicial treaty, which will allow law-enforcement officials in both states to open contact and "obtain cooperation" from their counterparts without the necessity of diplomatic involvement. The agreement was necessitated by the (apparently) ever-increasing cooperation between organized crime groups in both countries, particularly in relation to the smuggling of stolen cars between Russian and Japanese ports, and fisheries infringements. (15) Fukuda and Medvedev also agreed on environmental issues, recognizing that the two countries must cooperate on measures to reduce the levels of ice drift and ice melt in the Sea of Okhotsk. (16) The problem is exacerbated by chemical waste dumping, particularly into the Amur river, which feeds into the Sea of Okhotsk. (17)

The most interesting aspect of the bilateral talks concerned the long-running territorial dispute between Japan and Russia over the Kuril Isles, most of which the Soviet Union was permitted to annex from Japan at the end of the Second World War. However, the four southernmost islands remain in dispute. The two leaders agreed that territorial issues must be resolved as soon as possible, and that the basis for talks on the islands is to be the joint Japanese-Soviet declaration of 1956, which holds the return of territory seized by the USSR contingent on the conclusion of a peace treaty between the two countries. (18) The territorial dispute seems now to have assumed a new importance, with both Fukuda and Medvedev acknowledging that it stands in the way of deepening ties between their countries. (19)

Most revealing is that Prime Minister Vladimir Putin will be the point-man for Russia on all of the aforementioned issues. Putin, together with Foreign Minister Sergei Lavrov, is to travel to Japan for in-depth talks at an as-yet unspecified date later this year. (20) The fact that Putin will be in charge indicates the amount of sway he continues to hold, particularly with regard to foreign policy and security.

Source Notes:

- (1) See The ISCIP Analyst, Volume XIV, Number 12 (24 April 08).
- (2) "Russia: Possible Retaliation for US Missile Def Radar in Czech Republic Analyzed. Article by Aleksandr Reutov Under Rubric 'In The World: 'Russia Responds To Actions of the Probable Missile Defense Only in Words for Now'." Kommersant Daily, 12 Jul 08; OSC Translated Text via World News Connection.
- (3) Ibid.
- (4) "Iran 'Faked Missile Test Image'," BBC News, 10 Jul 08 via [www.news.bbc.co.uk/2/hi/middle\\_east/7500917.stm](http://www.news.bbc.co.uk/2/hi/middle_east/7500917.stm).
- (5) "Tests Show US Shield Not Needed," BBC News, 10 Jul 08 via [www.news.bbc.co.uk/2/hi/europe/7501498.stm](http://www.news.bbc.co.uk/2/hi/europe/7501498.stm).
- (6) "Iran Missile Tests Prove US Missile Shield Unnecessary," FARS News Agency, 12 Jul 08; OSC Translated Text via World News Connection.
- (7) "Lithuania Says May Host Part of U.S. Missile Shield," Interfax, 11 Jul 08; OSC Translated Text via World News Connection.
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- (15) "Japan, Russia Plan Treaty on Criminal Probes," The Daily Yomiuri Website, Tokyo, in English, 3 Jul 08 via Lexis-Nexis.
- (16) "Fukuda, Medvedev to Expand Dialogue," The Daily Yomiuri, 9 Jul 08 via Lexis-Nexis.
- (17) "Japan, Russia Agree To Protect Environment Near Disputed Islands," Kyodo News Service, Tokyo, in English, 8 Jul 08; BBC Monitoring via Lexis-Nexis.
- (18) "Medvedev Hints Resolution Possible To Islands Dispute," The Daily Yomiuri, 4 Jul 08 via Lexis-Nexis.
- (19) Ibid.
- (20) "Fukuda, Medvedev to Expand Dialogue," The Daily Yomiuri, 9 Jul 08 via Lexis-Nexis.

## Russian Federation: Energy Politics

By Creelea Henderson

### **Russian-Czech oil drawdown: A shot across the bow?**

On Friday, July 11, Czech authorities reported a precipitous drop in crude oil volumes flowing through the Druzhba pipeline from Russia, the country's main supplier, responsible for 5.5 of 7.7 million tons of oil consumed annually by the Czech Republic. (1) The Russian side provided no immediate explanation for the drawdown that reduced supplies to the Czech Republic by half at week's end. (2)

Earlier in the week, US Secretary of State Condoleezza Rice was in Prague to sign an agreement, together with her Czech counterpart Karel Schwarzenberg, to deploy a radar system in the Czech Republic as part of a US global missile shield that is fiercely opposed by Moscow. The coincidence of events was impossible to ignore, arousing widespread suspicion that the cut in oil supplies is intended to be understood as retaliation by Moscow against the Czech Republic for its failure to toe the Russian line on missile defense in Eastern Europe. (3)

On Monday, July 14, an official at Transneft, Russia's oil export monopoly, announced that the drop in oil volumes was the result of a decision by two Russian firms to refine more crude at home. "It is in no way linked to politics. It is pure commerce," said Transneft Vice-President Mikhail Barkov. (4) Anxious to avoid a showdown with Moscow, the Czech government quickly endorsed the innocuous explanation: "I want to believe that the reasons which the Russian supplier states are only technical," said Czech Prime Minister Mirek Topolanek, who added that his government "is not going to take any steps because at the moment there is no threat for the citizens, thanks to diversification of supplies." (5)

The Prime Minister is understandably reluctant to admit that a diplomatic crisis with Moscow is brewing at a moment when his country is moving forward with a plan opposed by Russia to host components of a US missile shield. His willingness to accept Moscow's banal explanation for missing oil volumes must be regarded therefore as so much diplomatic unguent applied to a gash in Russian-Czech relations. Unconstrained by such imperatives of office, however, precedents should be acknowledged for Russia's punitive drawdown in energy supplies to neighboring countries where government policies have run counter to Moscow's strategic concepts.

Ukraine has seen natural gas supplies cut on two occasions as a result of pricing disputes that flared up after the Ukrainian government challenged Russia's

monopolistic export policies: In January 2006, the Ukrainian government refused to turn over its national pipeline grid to Russia's Gazprom. In retaliation, Gazprom opted to raise its prices by 460%, from \$50 up to \$230 per 1,000 cubic meters of gas. (6) When Ukraine balked at the sharp increase, Gazprom shut off the country's gas supply. In March 2008, Ukrainian Prime Minister Yulia Tymoshenko fought to cut intermediary companies out of the natural gas supply chain. Her attack against the thoroughly corrupt intermediaries met with resistance from Gazprom, which used its 50% ownership in the enterprises as a channel to control gas deliveries on the Ukrainian domestic market. The dispute escalated when Tymoshenko refused to accept an energy bill totaling \$1.5 billion presented by Gazprom, laying blame for the debt on the intermediaries instead.

Georgia suffered a loss of gas supplies in January 2006, when explosions in Southern Russia severed the country's gas pipelines. Although the Russian government rejected his allegations, Georgian President Mikheil Saakashvili had no doubts about Moscow's complicity in the blasts. "The places where it happened, the environment in which it happened, the history in which it happened - this all looks like a policy decision," said Saakashvili, who noted that the sabotage followed upon veiled threats by Russian officials after Georgia refused to sell its gas pipeline network to Gazprom. (7)

Some observers point to Russia's shutoff of deliveries of crude oil to Belarus in January 2007 as evidence that economic factors outweigh political considerations to form the guiding principle of Moscow's energy export practices. Such an assessment overestimates the degree of mutual sympathy binding the two countries at the time the trade war erupted. Moscow had grown impatient with the galloping corruption across its border, an untenable situation that jeopardized the security of Russian crude supplies bound for European markets. Moreover, when Moscow threatened to institute stiff price hikes for its oil and gas supplies to Belarus, the government in Minsk slapped tariffs on Russian crude supplies transported across Belarusian territory. Such an affront to its authority

made Moscow bring both political and economic retaliation to bear on a contumacious client state: a drop in energy supplies flowing from Russia is a bright red flag. Explanations based solely on economics do little to mitigate the impression created by the emerging pattern of red flags.

The Czech Republic expects to ride out the current crude shortage by tapping into a three month supply of national reserves and raising deliveries from a West European pipeline system. (8) Tomas Bartovsky, spokesman for the Czech Ministry of Industry and Trade, remarked that if Russia had intended to threaten the country, it would have cut the flow of natural gas instead of oil, as gas supply sources are less diversified. His comment was a significant admission of the fragility of his state's position vis-à-vis Russia, and an inadvertent suggestion that the current drawdown could be interpreted as a warning of trouble in the future. A statement issued by the Russian Foreign Ministry in response to the Prague missile defense agreement echoed that menace by threatening to "react, not through diplomatic means, but with military and technical methods." (9) If the specter of a Russian military strike against Eastern Europe seems dim, a targeted shutoff of Russian energy supplies is a perfectly conceivable "technical method," already being deployed by Moscow.

#### Source Notes:

(1) "Czech ministry says oil supply problem unrelated to dispute with Russia," International Herald Tribune, 14 Jul 08 via

<http://www.ihrt.com/articles/ap/2008/07/14/europe/EU-Czech-Russia-Oil.php>.

(2) "Czechs told Russian oil supply cut 'not political,'" Reuters, 14 Jul 08 via

<http://uk.reuters.com/article/oilRpt/idUKL1461032420080714?pageNumber=1&virtualBrandChannel=0&sp=true>.

(3) Ibid.

(4) Fabrichnaya, Yelena, "Russia says Czech oil supply cut 'not political,'" The

Guardian, 14 Jul 08 via <http://www.guardian.co.uk/business/feedarticle/7650777>.

(5) Ibid.

(6) Eke, Steven, "Russia Threatens Ukraine Gas Cut," BBC News, 13 Dec 05 via <http://news.bbc.co.uk/1/hi/business/4526138.stm>.

(7) Chivers, C.J., "Pipeline blasts cut Georgia gas supply," International Herald Tribune, 22 Jan 06 via <http://www.ihf.com/articles/2006/01/22/news/georgia.php>.

(8) Fabrichnaya, Yelena, *ibid*.

(9) Golts, Alexander, "Battling Cold War Cliches," The Moscow Times, 15 Jul 08 via <http://www.moscowtimes.ru/article/1016/42/368949.htm>.

## Newly Independent States: Caucasus

By Robyn Angley

### **GEORGIA**

#### **A little bit louder and a little bit worse**

Tbilisi, Sukhumi and Moscow have witnessed a veritable parade of Western dignitaries over the last several months as American and European officials seek to defuse the tension sparked by the recognition of Kosovo (and the precedent it set), as well as Russia's declaration of its intent to forge a closer relationship—perhaps akin to that between the US and Taiwan—with Abkhazia, one of Georgia's separatist republics. The situation has caused a stir in the West, with a variety of notables, among them US Secretary of State Condoleezza Rice, making their way to the Caucasus in search of a solution.

The recognition of Kosovo by western governments has produced increased Russian involvement in the separatist regions, including the deployment of an assortment of paratroopers and railway troops to Abkhazia. According to recent announcements from the Russian Defense Ministry, the railway troops, at least, are scheduled to be withdrawn "in the near future," having completed their work on a segment of railway connecting Sukhumi and Ochamchire. (1)

A 27 June article in the Russian newspaper Kommersant reported that Georgian officials had offered to partition Abkhazia into zones of influence, while retaining the republic under de jure Georgian rule. (2) The report was refuted vigorously by both Georgian and Russian authorities.

More recently, in early July, Russia sent fighter jets flying over South Ossetia as a warning “to cool hot heads in Tbilisi.” (3) As that incident reemphasizes, Abkhazia is not the only separatist regime with which Tbilisi must negotiate. A series of hostage takings in South Ossetia—by both sides—is an indicator of increased tensions between Tbilisi and Tskhinvali. In response to the fly-over, Georgia recalled its ambassador to Russia, Erosi Kitsmarishvili. Kitsmarishvili is the former owner of the Rustavi-2 television station, which played a significant and sometimes provocative role in then-opposition leader Mikheil Saakashvili’s protest campaign against former president Eduard Shevardnadze. The violation of Georgian airspace became the subject of intense debate at the UN Security Council on 22 July.

In light of the increased security threat, Georgia’s parliament has voted to increase the size of the Georgian army by 5,000 troops. Additionally, large-scale military exercises have taken place both in Russia and in Georgia. One such exercise took place in Georgia under the auspices of the NATO Partnership for Peace Program. It involved 1,650 troops and included American, Georgian, Armenian, Ukrainian, and Azerbaijani forces. A second exercise, much larger in scale, was held across the Russian North Caucasus region, including Chechnya, North Ossetia, and Ingushetia, and mustered around 8,000 troops, in addition to numerous combat vehicles and aircraft. (4) The stated purpose of the Russian exercise was to increase the “interoperability” of its multiple service branches.

A German sponsored peace plan for Abkhazia, put forth in mid-July, was rejected by Sukhumi, although, surprisingly, it subsequently received positive feedback from Russian Foreign Minister Sergei Lavrov. The German plan was presented



to the relevant parties by Berlin's Foreign Minister Frank-Walter Steinmeier at a time when tensions between Georgia and Russia, as well as between Tbilisi and its separatist republics, are at their highest point in years. The plan envisioned three stages to a Georgian-Abkhaz peace process. The first phase would consist of confidence-building measures, including an agreement on the non-use of force and the return of Georgian refugees to Abkhazia. The second phase called for reconstruction projects in Abkhazia, funded by donor countries. The third and presumably most challenging phase would be the resolution Abkhazia's status. Both Russian and Abkhazian officials have objected strongly to the linkage of a non-use of force agreement with the issue of return of refugees, while Georgia refuses to sign such an agreement without that proviso. Additionally, Abkhaz and Russian representatives have called for the removal of Georgian forces from the upper Kodori Gorge as a precursor to negotiations.

That Russia and Georgia should be at odds with one another is nothing new. Neither is Sukhumi's continued resistance to Georgia's repeated attempts to resolve Abkhazia's status in a way that includes the republic as part of Georgia. However, Germany's increased involvement could be an indication that Europe may take a more active role in negotiations that up to now have been devoid of substantive European participation.

## **ARMENIA**

### **Turkish-Armenian talks and World Cup diplomacy**

Turkey and Armenia's acrimonious (and diplomatically non-existent) relationship may be taking a turn for the better if recent developments are any indication.

Armenian president Serzh Sarkisian has invited Turkish president Abdullah Gul to join him in Yerevan on 6 September to watch the two countries' teams contest a World Cup qualifying match. Following Sarkisian's invitation, officials from both countries met in Bern, Switzerland, for talks, the details of which have not been publicized.

It is too early yet to say what the outcome of these overtures may be or how they may affect the outstanding issues in the Turkish-Armenian relationship. There are several major points of contention between the two neighbors. The closed border between Turkey and Armenia—Ankara’s response to Yerevan’s conflict with Turkish ally, Azerbaijan, over Nagorno-Karabakh—is a major impediment to Armenia’s economic growth. Another significant issue is Armenia’s call for a Turkish acknowledgement that the mass slaughter of Armenians that took place in the waning days of the Ottoman Empire was genocide. Several of Armenia’s political parties have made Turkish recognition of the genocide a central part of their platforms. These domestic constituencies have made it difficult for Armenian officials to negotiate with their Turkish counterparts without preconditions, despite repeated statements of their willingness to do so. However, perhaps Sarkisian will be able to muster enough political clout to move the discussion along.

Source Notes:

- (1) “Russian railway troops to withdraw from Abkhazia – Defense Ministry,” RIA Novosti, 21 Jul 08 via Lexis-Nexis.
- (2) “Russia, Georgia deny plan to divide Abkhazia,” Agence France Presse, 27 Jun 08 via Lexis-Nexis.
- (3) “Georgia recalls Moscow ambassador,” BBC News, 10 Jul 08 via <http://news.bbc.co.uk/2/hi/europe/7500772.stm>.
- (4) Natalia Korchmarek, “Russia begins military exercise close to Georgia’s borders,” Noviy Izvestia, 16 Jul 08; RusData Online via Lexis-Nexis.

## Newly Independent States: Central Asia

By Monika Shepherd

### **KYRGYZSTAN**

**Kyrgyz water shortages produce sparks, but little power**

While on a recent trip to inspect and laud the efficiency and successful privatization of one of Kyrgyzstan's small hydroelectric power stations, perhaps as part of a propaganda campaign to sell the country's business elite on the general concept of privatizing the country's hydropower industry, President Kurmanbek Bakiev felt compelled to temper his praise with a rather blunt warning of future energy shortages: "...I do not guarantee that electricity will be enough to supply everybody. It is necessary to begin making preparations right now. If someone thinks that the winter will be the same as last year, one will be mistaken. This winter will be very difficult. There will be electricity cuts." The president urged that not only residents, but schools find alternatives to electric power, recommending that they turn to coal as a heating source. (1)

Bakiev's comments echoed an announcement made the previous day by the Ministry of Industry, Energy and Fuel Resources, informing the public that due to inadequate water supplies in the Toktogul Reservoir, which generates 40% of Kyrgyzstan's electricity, there would be power cuts to private residences, schools, and hospitals. The ministry suggested that people buy coal and/or mazut (heavy, low quality fuel oil) in order to heat their homes once the cold weather sets in. In an effort to conserve energy, the ministry will shut off electricity supplies to residential heaters on August 1, (2) perhaps hoping to avoid power reductions to the country's businesses and industries, like those which plagued Tajikistan last winter. Electricity rates also will be raised by 10-12%. (3)

Kyrgyzstan, much like Tajikistan, is heavily dependent on its hydropower industry for electrical power, and low water levels in the rivers which supply the Toktogul Reservoir indicate that the coming winter will see widespread power shortages. The reservoir requires at least 12 billion cubic meters of water in order to produce enough electricity to meet the country's demands, but is currently 3-4 billion cubic meters short, due to an inordinately high demand for power last winter. The Kyrgyz hydropower industry further is plagued by aging, inefficient infrastructure

and equipment, theft, and the government's inability to attract foreign investment in its energy sector. (4) The Bakiev administration's latest efforts have been to attract sufficient financial backing to finish building the Kambar-Ata-1 and Kambar-Ata-2 hydroelectric power stations (located on the Naryn River) whose construction has been in limbo since the collapse of the Soviet Union. Last March, it seemed that this goal finally had been achieved, when First Deputy Prime Minister Daniyar Usenov announced that Kazakhstan and Russia had agreed to form a joint venture (with a 33% share apiece and 34% for Kyrgyzstan) to complete the Kambar-Ata projects. (5) However, one of the conditions required for the projects to move forward was the privatization of hydropower stations, as well as heating and power plants in Bishkek and Osh, including the Kambar-Ata plants; unfortunately, when the privatization bill came up for a vote by the Kyrgyz parliament last June, it failed, (6) and President Bakiev and his deputies have since been engaged in trying to negotiate a new deal with Russia.

Following his recent visit to Moscow to meet with President Medvedev and Prime Minister Putin, Bakiev claimed that Russia once again is considering investing in his country's hydropower industry. Medvedev and Putin agreed to send a "working group" to Kyrgyzstan in the near future for the purpose of studying ways in which Russia can invest in the Kyrgyz economy; Bakiev apparently chose to interpret this gesture as a Russian commitment to finance the Kambar-Ata projects. (7)

In addition, the Kyrgyz government still seems to hold out hope that it will be able to attract Iranian investment in the projects; a few days before Bakiev's journey to Moscow, Prime Minister Igor Chudinov met with Bahman Ayar-Reza'i, the managing director of the Bandar-Abbas Persian Gulf Zone for Mineral and Metal Industries (subordinate to the Iranian Ministry of Industries and Mines), and suggested that should Iran decide to finance hydroelectric power stations in Kyrgyzstan, such as the Kambar-Ata stations, electricity supplies would be sufficient to allow export to Iran. Chudinov also invited Iranian companies to

invest in the construction of a China-Kyrgyzstan-Uzbekistan railway line, (8) but so far, Iran has not made financial commitments to any of these ventures.

In spite of the president's and the Ministry of Industry, Energy and Fuel Resources' warnings of power shortages in the fall, Kyrgyzstan began exporting a small amount of power (500m kWh total) to Kazakhstan on July 14 and will continue to do so until the end of August. Exporting even such a small amount of electricity is necessary because it is the revenue from these exports which makes it possible for the Bishkek Thermal Power Plant to buy fuel. (9) Unfortunately, Kyrgyz electricity exports to Kazakhstan set off sparks between the Kazakh and Uzbek governments last week, when Kazakhstan did not receive adequate water supplies from the Dostyk channel (which runs from Uzbekistan to Kazakhstan via Kyrgyzstan) to meet its irrigation needs. Kazakh Vice Prime Minister Umirzak Shukeev fired off a telegram to Uzbek Vice Prime Minister Rustam Asimov demanding that the Uzbek government restore water levels in its section of the Dostyk channel and threatening to cease buying Kyrgyz electricity, which is used to pump the water into the South Kazakh oblast's cotton fields. (10) This situation is illustrative of a much larger and potentially disastrous dilemma confronting the Central Asian states: do they allocate more water for hydropower generation or for crop irrigation and can one exist without the other? The Syr-Darya River is the only water source which can meet both of these goals (11) and it seems that there is no longer enough to go around.

Kyrgyzstan and Tajikistan are facing severe energy shortages, due to water shortfalls, for the upcoming heating season and the entire region will suffer food shortages, should water levels continue to drop, due to lack of rainfall and the inequitable distribution of water resources. Last winter saw grain shortages throughout most of Central Asia and the cost of food in general has risen dramatically. Food prices combined with increasing energy rates have prompted a more than 15% rise in Kyrgyzstan's inflation rate, according to Economic Development and Trade Minister Akylbek Japarov. (12) Prime Minister

Chudinov, on the other hand, has blamed the rise in prices on groups of semi-criminal “middlemen,” who use the agricultural market to launder funds gained through their illegal enterprises and, as a result, artificially inflate the price of agricultural products. (13) There is little doubt that the activities of organized crime groups victimize the average consumer, not only in Kyrgyzstan, but throughout Central Asia and that these groups contribute to much of the corruption found in the region, however, the crime groups are only half of the equation – the corrupt government and law enforcement officials who permit the crime groups to function make up the other half. Unless Chudinov launches a wholesale anti-corruption drive, it seems unlikely that these crime groups’ activities will cease and that any economic benefits will flow to the average consumer.

Shifting blame for the dire situation with food and energy prices and supplies from the government to (as yet unspecified) criminal groups may benefit Chudinov politically, but it may not be sufficient to assuage the average Kyrgyz citizen this winter, when his family is sitting in the cold and dark, trying to scrape enough som (Kyrgyz currency) together to afford at least one daily meal. Conflicts over water use undoubtedly will continue and unless this year’s grain harvest is vastly larger than last year’s (which seems unlikely, given, locust infestations, the lack of rain, and other problems), the Kyrgyz government may find itself unable to meet its citizens’ most basic needs – food and adequate (heated) shelter.

#### Source Notes:

- (1) “Kyrgyz President Warns Of Fuel Shortage, Winter Power Cuts,” 15 Jul 08, Kyrgyz Television 1; BBC Worldwide Monitoring via Lexis-Nexis Academic.
- (2) “Kyrgyzstan: People to Pay for Energy Crisis,” 14 Jul 08, Central Asia news, Ferghana.Ru via <http://enews.ferghana.ru/article.php?id=2418&PHPSESSID=be1b21f9220577cc82faa>, accessed 22 Jul 08.

- (3) Natalia Leshchenko, "Water and Energy Crisis Fuels Kazakh-Uzbek Dispute, Kyrgyzstan Prepares for Energy Shortages," 21 Jul 08, Global Insight; World Markets Research Limited via Lexis-Nexis Academic.
- (4) "Kyrgyzstan: People to Pay for Energy Crisis," 14 Jul 08, Ferghana.Ru, ibid.
- (5) "Kazakhstan, Russia To Build Hydroelectric Power Stations In Kyrgyzstan," 15 Mar 07, AKIpress; BBC Worldwide Monitoring via Lexis-Nexis Academic.
- (6) "Parliament rejects Kambarata privatization bill," 20 Jun 07, The Times of Central Asia via Lexis-Nexis Academic.
- (7) "Kyrgyz, Russian Leaders Reach Accord On Writing Off Kyrgyz Debt – President," 17 Jul 08, Kyrgyz Television 1; BBC Worldwide Monitoring via Lexis-Nexis Academic.
- (8) "Kyrgyz Premier, Iranian Official Discuss Economic Cooperation," 14 Jul 08, Kabar; BBC Worldwide Monitoring via Lexis-Nexis Academic.
- (9) "Kyrgyzstan Starts Exporting Electricity To Kazakhstan," 15 Jul 08, Kazakhstan Today news agency website; BBC Worldwide Monitoring via Lexis-Nexis Academic.
- (10) "Uzbekistan turns off water to Kazakhstan," 21 July 08, Central Asian News Service-Kazakhstan via <http://en.ca-news.org/news/10644>, accessed 24 Jul 08.
- (11) Merhat Sharipzhan, "In Central Asia, Water Could Lead To Fire," 23 Jul 08, Radio Free Europe/Radio Liberty via [http://www.rferl.org/content/Commentary\\_Water\\_Crisis\\_Central\\_Asia/1185586.html](http://www.rferl.org/content/Commentary_Water_Crisis_Central_Asia/1185586.html), accessed 24 Jul 08.
- (12) Victoria Svetlichnaya, "Kyrgyz inflation higher than expected," 17 Jul 08, The Times of Central Asia via Lexis-Nexis Academic.
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## Newly Independent States: Western Region

By Tammy Lynch

## **UKRAINE**

### **Exploring Ukraine's Vanco dispute**

The Western business community in Ukraine still is reeling over the government's decision to annul a major deep-water oil and gas exploration contract involving a US-based company. "How will companies sign contracts if they are canceled at a press conference, without negotiations to find out whether the company is willing to make changes before all this is aired as part of campaign speeches?" asked Morgan Williams, president of the US-Ukraine Business Council. (1)

To be sure, it is understandable why the unilateral canceling of a contract without benefit of court or mediation decision would send shockwaves through potential investors, and the government must begin to understand that this type of remedy is not supported in Western circles. Nevertheless, while the government handled the situation badly, it does appear to have had grounds for concern. The issue appears far more complex than originally thought.

The contract with an affiliate of Vanco International Ltd. - a subsidiary of Houston's Vanco Energy Company - was "revoked and terminated" on 21 May. The Production Sharing Agreement had a 30-year span and reportedly could have involved up to 15 billion dollars in investment to complete the surveying, prospecting and possibly extracting of oil and gas on Ukraine's Black Sea shelf. Most experts suggest that the area at issue - the Prykerchenska region of the shelf - contains enough gas to provide the country with 25 percent of its domestic needs per year.

The depth of the gas, however, is extremely problematic, and the size of the area is unusually large at 13,000 square kilometers. Therefore, the government issued a highly specialized request for proposals in late 2005 to conduct the exploration work.



On 19 April 2006, Vanco International Ltd won the tender to develop the Prykerchenska area. The bid, submitted jointly with UK-based JNR Eastern Investments, beat out, among others, a joint bid by Shell and Exxon Mobil.

Jim Bown, Vanco's representative in Ukraine, told journalists at the time that the Vanco-JNR bid was a 50/50 partnership, with Vanco providing the technical expertise and JNR "the financial dimension." Vanco International, registered in Bermuda, but reportedly based in Switzerland, suggested it would spend around \$330 million over eight years to explore the field. Any financial guarantees associated with the winning bid presumably would be the responsibility of JNR, based on Bown's comments at the time. (2)

The details of the Production Sharing Agreement were negotiated for 18 months, with much of the time reportedly spent waiting for the government's responses to Vanco's proposals.

Finally, the contract was signed in fall 2007. But while the Production Sharing Agreement (PSA) reportedly was signed between Ukraine and Vanco International Ltd., all licenses for subsoil exploration were awarded to an entity known as Vanco Prykerchenska. This company, according to the government, was said to have been registered on 18 October 2007, just one day prior to the signing of the PSA. (3)

(As we go to press, the government suggested that the contract actually was not signed by Vanco International, but by Vanco Prykerchenska Ltd. This claim is unconfirmed, as the document is unavailable, and a source associated with Vanco Energy denies this statement. However, Vanco Prykerchenska is the entity requesting arbitration for failure to fulfill a contract, suggesting that it may be the actual party to the contract at this point.)

President Viktor Yushchenko signed the PSA in a public ceremony on 19 October 2007, announcing on his website that he would hold an event “to sign a production sharing agreement to explore the Prykerchenska area of the Black Sea shelf between Ukraine and Vanco Energy Company.” (4) The deal, he said, “is a strategic project for Ukraine and this is a unique precedent for, on the one hand, formulating a national energy strategy and, on the other hand, for cooperating with the world’s leading international investors.” (5)

The agreement was signed, perhaps not coincidentally, almost directly following a snap parliamentary election that led to a change in government from then-Prime Minister Viktor Yanukovich to current-Prime Minister Yulia Tymoshenko. The ceremony occurred as the new parliamentary majority coalition was being formed.

In explaining his ministry’s decision to revoke licenses for subsoil use, Environmental Protection Minister Heorhiy Filipchuk suggested that Vanco International was not granted the right in the PSA to transfer rights of subsoil use to its affiliate. (6)

Moreover, both Filipchuk and Tymoshenko complained that Vanco International did not provide the required information about its affiliate. On 21 May, Filipchuk said, “We still have not received confirmation of financial, technological or technical documentation from this company [Vanco Prykerchenska].” (7)

Gene Van Dyke, the President of Vanco Energy Company and Board Chair of VPL, vigorously denies the government’s charges. “According to the Production Sharing Agreement,” he said, “Vanco International Ltd., winner of the tender, has the right to pass further execution of the agreement to a company founded with this purpose – for example, Vanco Prykerchenska Ltd.” (8) Van Dyke also suggested that the government had all necessary information on the Prykerchenska affiliate. Moreover, in an interview this week, a Vanco

representative, who asked that his name be withheld, noted that the company often works through consortiums and profit-sharing agreements.

VPL has called on the Ukrainian government to allow the publication of the PSA (also known as the Hydrocarbons Sharing Agreement), which it says has been misrepresented and quoted out of context for the purpose of misleading the public. (9)

Tymoshenko is standing her ground, however, suggesting that the deal with Vanco International and VPL was “a corrupt agreement concluded by the previous government.” The government “has put a stake in the ground on this issue,” she said, and expressed confidence in “a very strong case.” (10)

Her primary contention appears to be that the VPL ownership includes a company closely linked both to former Prime Minister Yanukovich, who suddenly approved the deal before leaving office, and the current Secretary of the National Security and Defense Council, who has taken the lead in defending the agreement.

Vanco Prykerchenska confirmed in May that it is not owned wholly by Vanco International, as assumed by many. Instead, its ownership is split “in parity” among four entities: Vanco International, the Donetsk Fuel and Energy Company (DTEK), Integrum Technologies of Austria, and Shadowlight Investments Ltd., linked to Russian businessman Yevgeny Novitsky. (11)

It is the inclusion of DTEK that reportedly got the government’s attention. DTEK is the corporation linked to System’s Capital Management, which is owned by Ukraine’s richest billionaire Rinat Akhmetov. In addition to his business interests, Akhmetov serves as a parliamentary deputy and is allegedly the chief financier of former Prime Minister Yanukovich’s Party of Regions. Akhmetov is also a close ally of Raisa Bohateryova, now the head of President’s Yushchenko’s National

Security and Defense Council. Bohateryova serves on the Party of Regions Political Council and was one of the leaders of the Party's parliamentary faction during Yanukovich's premiership.

Neither DTEK nor any of Vanco International's current partners in Ukraine were involved in the original bid proposal. At the same time, JNR Eastern Investments, Vanco's original financial partner, is no longer involved with the project.

While DTEK's connections are clear, Integrum Technologies is unknown. Its ownership has not been disclosed by anyone involved in the project, and the government claims to be unable to find its backers.

An email request from this author to Vanco Prykerchenska asking for contact information for Integrum Technologies received no response. The Austrian company appears to have no website, or at least none that appears on any general search engine.

Hans Stege of the Kremlin, Inc. Blog, has been one of the most aggressive pursuers of information about Integrum. Since May, he has spent considerable time calling and emailing Austrian, Ukrainian and Russian companies attempting to locate contact information for Integrum Technologies, but to no avail. (12)

The shadowy nature of the company has allowed Ukraine's government to speculate about its ownership – suggesting everything from Gazprom to companies related to the presidential secretariat. None of this speculation is based on any available information and certainly cannot be proven.

The Vanco Energy Company website is no help; the site makes no mention of Vanco Prykerchenska or its owners. In fact, the site has little information about its Ukraine work. The company is highly respected for its deep water exploration

in several African countries, and openly lists its partners in these countries on its website. It makes no mention of any partners in its description of its work in Ukraine. (13)

An archived page located through a Google search (and not available when entering the site through its main page), however, shows what appears to be a graphic of a power point presentation slide. The slide – titled “Legal Structure” -- provides an overview of the Vanco Energy Company through the use of a flow chart.

“Vanco Energy Company is an integrated independent oil and gas company which operates its exploration and production activities through its wholly owned overseas subsidiary, Vanco International Ltd. and through the wholly owned subsidiaries of Vanco International Ltd.,” the slide explains. “Vanco's integrated corporate structure is consistent with generally accepted practices of the international petroleum industry.” (14)

The graphic flow chart appears to show a company called “Vanco Ukraine Ltd. (Bermuda)” as a subsidiary of “Vanco International Ltd. (Bermuda).” The slide is dated April 2006. (15)

Vanco International’s bid proposal to Ukraine was submitted in April 2006.

Despite these questions, like many Western investors, the US Ambassador to Ukraine expressed regret over Ukraine’s decision. “I am very disappointed that the Cabinet of Ministers today took unilateral action to revoke the Production Sharing Agreement [that] the Government of Ukraine negotiated with U.S. company Vanco,” Ambassador William Taylor said in a statement. “For the government of Ukraine to attract investors,” he continued, “particularly in those sectors vital to its energy security, it needs to make clear that it respects the sanctity of contracts and the rule of law.” (16)

This is, of course, very true. The manner in which the Tymoshenko government annulled its agreement with Vanco International is questionable. The case not only demonstrates the continuing opaque nature of government agreements, but also underscores the utter failure of the country's judicial system to mediate conflict. The country long has been criticized for a culture of corruption – judges routinely are accused of accepting bribes or backing down in the face of severe intimidation, while prosecutors often are dependent on political favors for their positions. As a result, power plays and public relations often are substituted for legal remedies, as even political leaders have little trust in the judicial system.

Following the government's announcement, President Yushchenko responded by requesting that the country's prosecutor-general intervene. Without benefit of investigation or court ruling, the prosecutor immediately issued an order to the government to revoke its decision. Because Tymoshenko apparently views the prosecutor as a vessel of the president (with some reason), she simply ignored the order.

On 4 June, Yushchenko issued a decree ordering the government to rescind its decision. Tymoshenko ignored that decree, too, noting that it had come based on a recommendation of Bohateryova's National Security and Defense Council. Yushchenko also created an interdepartmental commission to investigate the situation, and placed Bohateryova—Rinat Akhmetov's ally—in charge of it. (17)

The Vanco case highlights many of the most urgent problems facing Ukraine. Continued reliance on administrative methods to remedy questionable contracts—to say nothing of the fact that so many questionable contracts exist—should cause serious concern for corporations looking to work in the country. Close relationships between political leaders and businesses involved in major contracts also undoubtedly do not send the appropriate signals.

Furthermore, the ease with which Western corporations may become (sometimes unwittingly) enmeshed in the country's muddy business environment is unsettling. Corporations attempting to conduct normal business often find themselves held hostage to political turf battles and politically-oriented business interests.

As the government works to clean up its business dealings, it must also understand the need to reform the judicial and prosecutorial mechanisms that should protect both private investors and the government. If nothing else, this should be the message of the Vanco dispute.

Source Notes:

- (1) Anna Poludenko, "Tymoshenko cancels Vanco contract in fight with Yushchenko," Kyiv Post, 22 May 08 via [www.kyivpost.com](http://www.kyivpost.com).
- (2) John Marone, "Vanco wins Black Sea deepwater tender," Kyiv Post, 27 Apr 06 reprinted in Alexander's Gas and Oil Connections, Vol 11, Issue 10, 18 May 06 via [www.oilandgas.com](http://www.oilandgas.com).
- (3) Alexander Serafimovich, "Ukraine's government says: Vanco go home!," Oil and Gas Eurasia, June 2008, No. 6 via [www.oilandgaseurasia.com](http://www.oilandgaseurasia.com) and [www.eurasiapress.com](http://www.eurasiapress.com).
- (4) "Ceremony to sign deal with Vanco," Press office of President Viktor Yushchenko, 19 Oct 07 via [www.president.gov.ua/en/news/7901.html](http://www.president.gov.ua/en/news/7901.html).
- (5) "Ukraine strikes deal with Vanco," Press office of President Viktor Yushchenko, 19 Oct 07 via [www.president.gov.ua/en/news/7905.html](http://www.president.gov.ua/en/news/7905.html).
- (6) Alla Yeremenko, "The Black Sea Shelf to the Bearer," Zerkelo Tyzhnia, 17 May 08 via BBC Monitoring, Lexis-Nexis.
- (7) Ibid.
- (8) Press Release, Vanco Prykerchenska Ltd, 12 Jun 08 via PRNewswire.
- (9) Press Release, Vanco Prykerchenska Ltd., 17 July 08 via email to author.
- (10) BYuT Inform Newsletter, 22 Jul 08 via email to author.

(11) Alla Yeremenko, "The Black Sea Shelf to the Bearer," *Zerkelo Tyzhnia*, 17 May 08 via BBC Monitoring, Lexis-Nexis.

(12) See "A Tale of Two Business Cultures: The Integrum Technologies Case," 3 Jul 08, Kremlin, Inc. Blog for an interesting (and sometimes humorous) description of Hans Stege's attempts to track down Integrum Technologies ([www.dartmouth.edu/~stege/blog/?p=112](http://www.dartmouth.edu/~stege/blog/?p=112))

(13) Website located at [www.vancoenergy.com](http://www.vancoenergy.com).

(14) Vanco Energy Company website, [www.vancoenergy.com/aboutus/legalstructure.htm](http://www.vancoenergy.com/aboutus/legalstructure.htm).

(15) *Ibid.*

(16) "Statement by U.S. Ambassador Taylor on Vanco Case," Public Affairs Section, U.S. Embassy, 21 May 08.

(17) "Bohateryova will study the agreement between Ukraine and Vanco," *Forex and Finance*, 21 May 08 via [www.fin-forex.com](http://www.fin-forex.com).

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