

Russian Energy Sector Opaqueness
Testimony before the Senate Foreign Relations Committee
Roman Kupchinsky
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Mr. Chairman, honorable members of the committee, I ask that my full written statement be included in the record.

Today I want to address the question of criminality and the lack of transparency in the Russian energy sector.

The reason for this is that in the near future the United States will become more dependent on LNG (Liquefied Natural Gas) imports from Russia. Last year Gazprom executives stated that they intend to supply up to 20 percent of the US LNG market by 2015. And while this will help America meet its energy needs, the LNG business needs to be fully transparent and in compliance with American law.

Unfortunately, persistent opaqueness in the Russian oil and gas sectors along with a number of murky schemes created by Gazprom, the Russian state-owned gas monopoly, has lowered Russia's business reputation to the point where many Western companies are loath to trust their Russian partners, and are forced to deal with them mostly out of necessity.

There is a great deal of evidence which suggests that Russian organized crime has been involved in the Russian energy business – with the full knowledge and quiet approval of the Russian leadership – both past and present. I will describe some of these schemes in my testimony.

Prior to his election, Dmitry Medvedev, the new President of Russia, was the Chairman of the Board of Gazprom, which supplies 25 percent of Europe's natural gas. Was Medvedev aware of Gazprom's alleged links to organized crime? Many observers believe that he was and chose to remain silent about it.

I also believe that it is inconceivable for him not to have known the facts.

The nexus of organized crime and government in Russia is not a new phenomenon, but today it has taken on an important geopolitical role.

Russian organized crime, with the tacit support of the Kremlin, is playing a significant role in expanding the Kremlin's economic hegemony throughout the former USSR and the Warsaw Pact countries.

In Romania the aluminum business was taken over by Russian owned companies using suspect means and there are serious questions about how that country's gold mining industry is being bought up by companies from Central Asia who are friendly to the Kremlin and who appear to have a working arrangement with some high level Romanian officials.

In the Baltic States, the Kremlin has deliberately done everything in its power to isolate and punish the Lithuanians, Latvians and Estonians for standing up to Russia by spending billions of dollars in order to insure that energy supplies destined for Europe circumvent these countries via the Nordstream pipeline.

In Hungary, shady companies with suspected links to organized crime and to Gazprom seek to control large segments of the domestic gas distribution and power generation business.

Within the Kremlin there are competing clans who want to maintain the flow of cash through little-known middleman companies in the gas trade in order to finance various political projects (many of which spout stridently anti-American propaganda) as well as provide for their own personal needs.

Gazprom, with the silent support of the Kremlin has set up 50 or so middlemen companies, silently linked to Gazprom and scattered throughout Europe - such as the Centrex group of companies and the Gazprom Germania network - which do not add any value to the price of Russian gas being sold on European markets; yet they earn enormous sums of money which appears to simply vanish through shell companies in Cyprus and in Lichtenstein.

Last year, the CEO of Germany's largest gas company E-ON Ruhrgas, Burghard Bergmann, who is the only Westerner on the Board of Directors of Gazprom, told the Chairman of the Board, Dmitry Medvedev (now the President of Russia) that Gazprom Germania and a Swiss-based middleman, RosUkrEnergo, should be disbanded. Bergmann also complained that Russian state - backed gas schemes in Hungary were opaque and tarnished Russia's reputation.

The Gazprom board rejected Bergmann's request. Part of the reason could well be that Russia does not have a Foreign Corrupt Practices Act – the Kremlin and Russian law enforcement agencies tend to close their eyes on how Russian energy companies – be it the private oil company Lukoil or the state owned oil company Rosneft or Gazprom - conduct business abroad.

These energy deals are closely linked to Russian foreign policy.

“Pipeline diplomacy” practiced by the Kremlin is dominated by a small group of individuals and what we are in fact witnessing is the large-scale privatization of foreign policy by the Russian elite.

Some American experts downplay the lack of transparency and the dubious methods used by Russian state-owned companies to conduct business by saying “Companies in the US and Europe also do crooked things” and point to the Enron affair and recent accusations of wide scale bribery by the German company Siemens. The argument is that American “Russophobe’s” are holding Russia to a higher standard.

The difference however, is that the U.S. and Germany arrests and prosecutes criminal behavior while in Russia the crooks not only go scot free - they are awarded state medals for their actions, while individuals like Mikhail Khordokovsky, who opted to run a clean shop and refused to bow to Putin’s will, wind up prison.

One gas trading intermediary company, RosUkrEnergo, based in Zug, Switzerland, is owned 50 percent by Gazprom and 50 percent by two Ukrainian businessmen who hid their identities for years and who are alleged to be linked to Russian organized crime. This is a classic case study of how the Kremlin and Gazprom conspired to protect what was believed to be a criminal enterprise.

Russian President Vladimir Putin, was directly involved in creating this company along with former Ukrainian President Leonid Kuchma in July 2004, and has publically defended RosUkrEnergo on a number of occasions saying: “Believe me; we don’t know the identities of the hidden Ukrainian owners [of RosUkrEnergo].”

Putin’s statement raises an important issue. Is it common practice for Gazprom, the world’s largest gas company, to sign multi-billion dollar contracts with individuals whose names they do not know? How can this state-owned company possibly conduct due diligence?

To make matters worse, Gazprom vehemently denied allegations in the world press that its partners, whose names they claimed not to know, were in league with Russian organized crime figures. Later when the public evidence became overwhelming, Gazprom and Putin accused the Ukrainian government of “forcing” the Russian side to accept the Swiss-registered company into the Ukrainian-Russian gas contract signed in 2006.

Who can believe that Ukraine can force Russia to do whatever it wants!

To achieve their ends, Gazprom shut off gas supplies to Ukraine in January 2006 – and to Europe – until their terms were met. The then- Ukrainian Prime Minister Yuriy Yekhanurov stated that one of Gazprom’s main demands during the negotiations was that the Swiss- based RosUkrEnergo be included in the contract.

One of the managing directors of RosUkrEnergo was Konstantin Chuychenko; three weeks ago Russian President Dmitry Medvedev made him a key advisor in his new administration.

Can any of Gazprom's statements be taken at face value?

What next?

As you might know, Gazprom is seeking to list on the NYSE. This is something Congress should support in principle – it makes economic sense to have the world's largest gas company listed on the NYSE.

At the same time, it is imperative that we do not reward Gazprom management, which often acts as a tool for Russian foreign policy, for its opaque ways of conducting business.

It is not enough for the NYSE to state that everything is in order with Gazprom's bid to list without a thorough due-diligence investigation into its European operations and its strong-arm tactics within Russia. I believe the Department of Justice should oversee this due diligence investigation in order to insure its accuracy.

In the long run Congress must take all appropriate measures it can to assure the nation that the US – Russia energy relationship is free of uncertainty and questionable practices in order to protect the energy security of the United States.

Thank you.

Roman Kupchinsky was the director of the Ukrainian Service of Radio Free Europe/Radio Liberty from 1989-2002. He is currently a partner in the risk analysis firm AZEast Group. He immigrated to Brooklyn, NY in 1949 from a refugee camp in Austria; served in the US Army as a rifle platoon leader in Vietnam in 1968 and has a BA in political science from Long Island University.