



Parliament Opens First Session, Yanukovych Resigns

Newly elected lawmakers gathered last Friday for the first session of the Verkhovna Rada at which the cabinet of Prime Minister Viktor Yanukovych resigned.



▲ Ukraine's parliament building.

All BYuT lawmakers entered the first session wearing white sweaters with red hearts, the symbols of the bloc. Their leader Yulia Tymoshenko was elected head of the faction as well as deputy leaders including Oleksandr Turchynov, Yosyp Vinsky and Hryhoriy Nemyria.

The two western leaning blocs, BYuT and OU-PSD, have enough seats to form a new governing coalition with 228 votes. The democratic coalition, backed by President Viktor Yushchenko, is expected to be formed this week.

"We have a coalition agreement with our partners OU-PSD and hope that a democratic coalition will be formed quickly," said Ms Tymoshenko.

The parliament has 30 days to form a parliamentary majority and another 30 days to form a government.

Under Ukraine's law the cabinet continues to fulfil its duties until a new government is formed.

"I announce the renunciation of the powers of the Ukrainian government," said Mr Yanukovych solemnly.

The five political parties that breached the three percent of the vote barrier needed to enter parliament formally formed their factions and elected their heads. These are the Party of Regions (175 seats); the Bloc of Yulia Tymoshenko (BYuT) (156 seats); Our Ukraine – People's Self-Defence (72 seats); the Communist Party (27 seats); the Lytvyn Bloc (20 seats).



▲ Last Saturday, Yulia Tymoshenko lit candles in memory of the millions of Ukrainians who perished during the Holodomor. This year was the 75th anniversary of the 1932-1933 mass famine which was engineered by Josef Stalin as part of his drive for agricultural collectivisation.

The Naftohaz Time Bomb

There is a time-bomb ticking in Ukraine's energy sector that could have profound implications for the nation's economy and international image.



Ernst & Young, the auditors of the Ukrainian state gas company, Naftohaz Ukrainy, have failed to sign-off the company's financial accounts for 2006. Its

principal concern is whether Naftohaz can continue to function as "a going concern" and

meet its financial obligations without government support.

So what's the big deal? Everyone knows that the ailing state-owned company is a "basket case." With its transit and storage fees pegged to deeply discounted rates set in 2006, Naftohaz has been stripped of its industrial markets for gas and saddled with unprofitable municipal and domestic supply contracts that force it to make a thumping loss.

But the issue is not the viability of Naftohaz as a money-making enterprise but rather the wider repercussions of it failing. The reality is this: if its accounts are not signed off by midnight on 31 December 2007, Naftohaz will be in default of its covenants. Consequently, its foreign bond owners are likely to demand repayments early and in full. Faced with this situation, Naftohaz would have to repay immediately \$2.6 billion under cross default clauses.

As if this wasn't bad enough, the impact of its failure on the government's ability to fund debt on the international market would be catastrophic. As the government is the sole shareholder and has, in the past, provided letters of assurance, the default would cause it to be downgraded to a status consistent with a "banana republic." As a result, the cost of borrowing on international markets would rocket.

According to a senior emerging market analyst at one of the top five US investments banks, "Litigation by foreign creditors could be a distinct possibility. Already the market is beginning to penalise Ukraine, with five-year Credit Default Swaps on Ukraine widening out by perhaps as much as 100 base points in recent weeks, in my opinion mostly related to concern over developments at Naftohaz. A default is likely to increase the cost of borrowing to the government by at least a further 100 base points."

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The 100 base points figure equates to an extra one percent, which, although it sounds trivial, could cost the government millions.

So what is the solution?

To defuse the ticking bomb in time the government has to wake up to the issue and

act quickly.

According to investment bankers, the most sensible course of action is for the Ministry of Fuel and Energy to prepare a draft law for parliament to meet the requirements of the independent



auditors by providing tax relief for the company. This solution would be more about balance sheet restructuring and accounting procedure than raiding government coffers to allocate hard funds. Such a quick-fix would provide the new government with the necessary time to decide how to best restructure and support Naftohaz, rather than let it continue to wither on the vine.

"This issue is of national concern," said Viktor Pynzenyk, the former-finance minister and a BYUT deputy chairman, "the implications for the government's ability to raise money on the financial markets will be severely impacted if action is not taken within the next five weeks. All parliamentary parties need to work together for the common good to resolve this."

Some observers have speculated that the outgoing Yanukovych-administration is well aware of the impact of the default and is leaving the matter unresolved as a time-bomb for the incoming Orange government. Absolving themselves from responsibility, the opposition could use it to launch a scathing attack on a new Tymoshenko-government.

"The consequences of the government's reckless energy policy are coming home to roost," said Mr Pynzenyk, "we require a root and branch reform of this sector and must overturn draconian legislation in place."

This "draconian legislation" includes the punitive Decree 31 (see Inform issue 46, 28 August 2007), which has led to the recent announcement by Cardinal Resources that it is quitting Ukraine for good.



Draconian Law Forces Cardinal to Quit

Cardinal, which has operated in Ukraine for twelve years, is concluding the sale of its business to the Kuwait Energy Company for \$71 million. Its shares were suspended from trading on the UK's AIM stock market on 1 October.

Decree 31 became law in January 2007. Its aim was to generate much needed revenue and to subsidise the effect of increases in domestic gas and heat prices by providing a cheap source of gas for the government. It obliges any foreign company partnering through a Joint Activity Agreement to sell its gas to Naftohaz Ukrainy at \$1.50 per thousand cubic feet – a rate that not only falls below the current market price of \$4.80 per thousand cubic feet but is lower than most production costs.

Faced with selling gas at a loss, Cardinal put as much gas as it could into storage in the hope that the law would be reversed.

The company's CEO, Rob Bensch, who lobbied valiantly for a change in policy, admitted that, in the end, the company had no option but to sell.

"Under present circumstances, the sale of the company's interests in Ukraine is the only viable option available other than an administration-insolvency procedure," said Mr Bensch.

"The road to energy independence lies in attracting foreign companies to partner in exploration and in helping us to exploit new reserves."

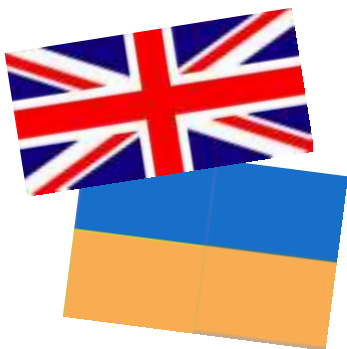


"It is only serving to deter investment," said Hryhoriy Nemyria, deputy BYuT chairman and Ms Tymoshenko's foreign affairs adviser. "The road to energy independence lies in attracting foreign companies to partner in exploration and in helping us to exploit new reserves. Forcing those companies that invest in our country to sell gas at a loss has sent a shiver down the spines of the investment community. This law needs changing."

Mr Nemyria's words will come as a welcome relief to other energy companies such as Shell, Petrobras and Europa Oil and Gas, which will watch developments with bated breath. But for Cardinal any law change will come too late.

British Support for Tymoshenko as PM

The British Business Club in Ukraine (BBCU), has thrown its weight behind a Tymoshenko-government. Headquartered in Kyiv, the BBCU is the leading British/Ukrainian networking and training organisation for promoting business contacts in Ukraine. Commencing operations in



2006, the BBCU is focused on helping British and Ukrainian companies to establish business contacts in their respective markets and develop their full potential.

Gerald Bowers, Head of the BBCU, told Inform that his organisation "is 100 percent behind Yulia Tymoshenko becoming the next prime minister and forming a democratic government." Mr Bowers endorsed Ms Tymoshenko's nomination as prime minister saying, "I believe she will be the best choice for prime minister for the Ukraine/British business community and we back her without reservation."

The United Kingdom remains one of the largest investors in Ukraine. According to the Ukrainian Statistics Committee, as of 1 July 2006, the share of foreign direct investment from the UK to Ukraine was \$1.435 billion. Principal sectors for investment are the financial sector, metallurgy, wholesale trade and services, food processing industry, construction and real estate.

Moroz Rebuked



▲ Oleksandr Moroz who, by his own actions, has cast himself into the political wilderness.

Lawmakers rebuked Oleksandr Moroz the former-Speaker of the Verkhovna Rada during last week's first session of parliament.

The leader of the Socialist Party used the podium to attack the legitimacy of the 30 September parliamentary election. As Mr Moroz was speaking, deputies from OU-PSD and BYuT took the unusual stance of leaving the session hall.

The OU-PSD leader said, "Deputies took a 10-minute recess because they were unwilling to listen to Mr. Moroz's counter-productive discussion."

BYuT deputy Andriy Shkil commented, "It was a voice from the grave. We did not want to listen to him."



Mr Moroz made himself deeply unpopular in July 2006 when he and his party defected from the Orange alliance to join the Party of Regions and Communist Party in the ill-fated "Anti-crisis Coalition." The defection paved the way for Viktor Yanukovych's premiership.

Mr Moroz's betrayal has not been forgiven by the Orange politicians. The electorate also turned on him and at the 2007 election the Socialist Party performed dismally at the ballot box, failing to enter parliament with only 2.86 percent of the vote.



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