



President José Manuel Barroso  
European Commission  
Rue de la Loi 200  
1049 Brussels  
Belgium

5th March, 2009

**Re: Corruption and European Energy Security**

Dear President Barroso,

Global Witness is a non-governmental organisation that campaigns against the misuse of natural resource wealth for corruption and conflict. We wish to request a meeting with you to discuss our concerns about the link between corruption and security of energy supply and how the European Union can address it.

You may recall our letter of 23rd June 2006 on this theme. We have been prompted to write to you again by the Russia-Ukraine gas dispute - in particular, the role of RosUkrEnergo - and our concern about its implications for the security of energy supplies from the former Soviet Union and the developing countries. We attach our recent *Financial Times* op-ed on this theme.

It is generally accepted that without good governance, the revenues earned by countries that export energy can easily be easily misappropriated or wasted. The result is entrenched poverty and misgovernment which can make countries more unstable, threatening energy supplies and creating human misery which the European Union, as a leading member of the international community, will be compelled to address.

We note a strong recognition of these links in the *Report on the Implementation of the European Security Strategy*, approved by the Council in December 2008, which states that: "Greater diversification, of fuels, sources of supply, and transit routes, is essential, as are good governance, respect for rule of law and investment in source countries" (page 5). This report also notes: "Ruthless exploitation of natural resources is often an underlying cause of conflict ... Preventing threats from becoming sources of conflict early on must be at the heart of our approach" (page 8-9).

So we were surprised to find, in the documents published by the Commission about the Second Strategic Energy Review, no equivalent discussion of the relationship between corruption, poor governance instability and energy supply. We find this absence unfortunate, especially in the wake of long-standing concerns about the gas trade through Ukraine, and it strongly suggests to us that the European Union needs to join up its policies on energy and governance in a much more coherent way.

We would like to suggest some concrete and practical steps that could be taken by the Commission and EU member states to promote greater transparency in the energy industry, as a way of improving governance in countries that supply energy to Europe, and within the trade itself. We welcome the support of the Commission for the Extractive Industries Transparency Initiative, of which Global Witness has been a

Board member for the last two years, but we regard support for the EITI as only one of many policies that the European Union needs to adopt.

### **RosUkrEnergo and the Ukraine gas trade**

We first wrote about the gas trade in our investigative report of April 2006, *It's a Gas: Funny Business in the Turkmen-Ukraine Gas Trade*, which we enclose. We expressed concern in that report at the lack of full and credible information on the structure of the trade, its financial flows and beneficiaries, notably the intermediary firm RosUkrEnergo. Unfortunately, our concerns have proved to be prescient.

Prime Ministers Putin of Russia and Tymoshenko of Ukraine are reported to have cited corruption as an obstacle to resolving the gas dispute. For example, Mrs Tymoshenko was reported by the *Kyiv Post* on 13<sup>th</sup> December 2008 as saying: "resistance to exclusion of this corporate intermediary [RosUkrEnergo] is very strong and, unfortunately, senior political officials in our country have been engaged in order to preserve the corruption on the gas market." She has made similar statements to the press for several years.

The *Washington Post* reported the following comment by Mr Putin on 9th January 2009 about what he referred to as 'Ukrainian political leadership': "What they are fighting for today is not the gas price, but a chance to keep their middlemen, in order to use the dividends obtained for personal ends and personal enrichment, and in order to receive financial resources needed for their future political campaigns."

The questions about RosUkrEnergo are well-known. The company was granted its role in the gas trade in 2004 via an agreement between Russia and Ukraine, signed on the Russian side by Mr Putin. Yet the Ukrainian half of the company is owned, not by the Ukrainian state, but by two private individuals whose names were kept from the public until 2006, after Global Witness named one of them in *It's a Gas*.

RosUkrEnergo has reported an annual income of nearly US\$800 million but we still struggle to understand what services it has provided to the gas trade that could not have been provided by Gazprom or the Ukrainian state gas company, Naftohaz Ukrainy. As is well-known, RosUkrEnergo is domiciled in Switzerland, but its chain of ownership actually runs through EU member states.

### **The role of European banks and companies**

A bank based in an EU member state, Austria, enabled the two Ukrainian shareholders of RosUkrEnergo to conceal their investment for nearly two years, from July 2004 until April 2006, by holding their shares in trust and refusing to disclose their identities to the public. The same bank acted as banker to Eural Trans Gas, another gas intermediary which preceded RosUkrEnergo and was controlled by one of the same Ukrainian shareholders. Eural Trans Gas was based in another EU member state, Hungary.

Austria is also the base of a holding company through which the two Ukrainian investors now own their shares in RosUkrEnergo, which is itself owned by companies based in Cyprus. It is reasonable to infer from these facts that any income earned by the Ukrainian shareholders of RosUkrEnergo may have passed up a chain of corporate ownership which runs through the jurisdictions of two EU member states.

We find it ironic, given the intense hardship which the gas dispute inflicted on many thousands of EU citizens, that EU-based companies have played these roles in maintaining the opacity of the gas trade.

### **Not just RosUkrEnergo**

Opacity in the gas trade in Ukraine far predates the existence of RosUkrEnergo. There are unresolved questions about the roles played by different individuals and companies which date back to the 1990s. So the removal of intermediaries would not, in itself, be sufficient to ensure transparency.

For example, we note that Naftohaz Ukrainy, the state-owned gas company of Ukraine, has not been independently audited for two of the past four years. As observers, we have found it hard to make sense of the various claims and counter-claims about gas debts, which have been a central feature of the dispute, in part because of lack of verified information about Naftohaz Ukrainy's operations and finances.

Without the public disclosure of full information about the volumes of gas flowing through the Ukrainian network, the income generated from the gas trade and the identities of its beneficiaries, then there is no possibility of meaningful oversight, either by the citizens of Ukraine or by European customers. The European Union is uniquely placed to insist that Ukraine open its gas industry to greater public scrutiny, as a condition of closer friendship. It would be unwise to miss the opportunity to do so.

### **Not just Ukraine**

The European Union imports energy, whether directly or indirectly, from an arc of countries that starts in western Africa, though the Middle East and round to the former Soviet Union. Some of these countries suffer from weak governance and high levels of corruption which make them potentially unstable.

It is true that political instability in energy-exporting countries does not automatically lead to supply cuts. Some countries have suffered instability, even violent conflict, without a material impact on their energy exports. But it would be unwise for European energy consumers to assume this will always be the case.

In Nigeria, there is a very clear causal relationship between corruption, political instability and supply disruptions. In Ukraine, if we accept the comments of Mr Putin and Mrs Tymoshenko, corruption has played a major part in the recent gas crisis. We note the interest of the European Union in sourcing more energy from highly opaque and potentially unstable regions of central Asia.

Even if energy supplies do somehow continue throughout a violent conflict in a supplier country, the cost of that conflict in human misery and political instability will still have to be addressed by the European Union as an aid donor and a leading member of the international community. The export of terrorism into Europe from the civil war in oil-rich Algeria in the 1990s is a good example.

We note two countries where the European Union is seeking to expand its energy supplies, and where opacity is well-established as a serious concern: Nigeria and Turkmenistan.

### **Opacity and energy security in Nigeria...**

The European Commission agreed in September 2008 to give Nigeria financial and political support to build a trans-Saharan gas pipeline. Yet it is generally accepted that official corruption has been a major cause of rebellion in the Niger Delta that has claimed many lives and cut into oil exports.

It is inconceivable to us that the European Union would place any reliance on gas supplies from Nigeria without making exerting every possible effort against the corruption and misuse of energy revenues which have done so much to create conflict in that country. It would be immoral and unwise not to.

Nigeria is a candidate of the Extractive Industries Transparency Initiative (EITI). Global Witness has been a Board member for the last two years, so we are acutely aware both of the importance of EITI to Nigeria, and its fragility. But EU support for EITI in Nigeria will be of little use without effective safeguards against the laundering of stolen oil wealth through the European banking system and effective enforcement of anti-bribery laws on European companies operating in Nigeria.

It is a matter of established fact that corrupt officials from Nigeria used banks in Europe in the 1990s to launder stolen public money. The global financial crisis has raised so many questions about the effectiveness of banking regulation in general that we cannot be relaxed about the effectiveness of existing controls against money-laundering in the European Union or anywhere else.

### **...and in Turkmenistan**

The Central Asian country of Turkmenistan has significant reserves of offshore hydrocarbons and a recent audit maintains that its onshore gas reserves are at least the fourth largest in the world. Although these onshore reserves are currently closed to investment by European companies, this could change in future if Turkmenistan decides to diversify its energy export routes. We have spoken to officials at several major Western oil companies who are clearly interested in the country's energy reserves.

There has been a lot of talk recently that Turkmenistan, with its huge gas reserves, could supply energy to Europe by routes that bypass Russia. We take no view on whether such plans are realistic or not, but we believe the European Union should exercise great caution in promoting energy investment.

Turkmenistan suffered for more than a decade under a dictatorship that in many ways resembled North Korea: its late dictator, Saparmurat Niyazov, was a serial human rights abuser. It has been well-known, at least since we published *It's a Gas*, that Niyazov funded his autocratic rule with the help of a leading European bank which took the country's gas revenues on deposit. Although these were ostensibly state revenues, they were in practice under Niyazov's sole control.

The new government of Turkmenistan is hardly less autocratic and repressive than the dictatorship it replaced, nor has it proved any more open to date about how exactly the country's gas wealth is managed and used. Naturally we hope for greater reform, openness and respect for basic human rights to take root in Turkmenistan in future. But it would be unwise to assume that these things will not happen without sustained and intelligently applied pressure from energy consuming regions, notably the European Union.

So are dismayed that some parties within the European Union, having offered Niyazov a trade agreement which did not interest him, are now planning to offer a similar agreement to current Turkmen president Berdymukhammedov. This approach of offering concessions that have not been asked for, in return for little or nothing in the way of genuine reform, does not seem either sustainable or intelligent to us.

### **So what can be done?**

Having recognized the relationship between opacity, corruption and the security of energy supplies, the European Union would be in a very strong position to effect change by promoting transparency and good governance in the energy trade, and in energy-supplying countries.

The first step is to move beyond the assumption, which we have encountered in official circles in Europe from time to time, that buyers of energy cannot influence the actions of sellers and therefore that the European Union cannot expect basic standards of transparency and decent behaviour from its suppliers.

This assumption is self-defeating and can verge at times on a hypocrisy which denies to the citizens of foreign countries the rights that European citizens expect for themselves. It is also mistaken in fact. The relationship between the European Union and its energy suppliers is not purely one of buyers and sellers.

In reality, energy trading companies and energy supplying countries are arguably as dependent on the European Union as the European Union is on them. Some countries seek aid and technical assistance, others seek access to European markets. Energy companies, whatever their origin, seek access to Europe's banking

system and financial markets as well as to its energy consumers. Less tangibly, countries and companies alike seek the legitimacy that a union of democracies can confer.

We do not suggest that the European Union can or should dictate the behaviour of its suppliers, or of global energy companies, in any absolute way. But we do believe Europe has enormous influence which could be used intelligently, abroad and at home, to create international standards of transparency and good governance that all countries and companies may be persuaded to support, in their own self-interest.

We would like to suggest some concrete, practical and achievable actions and ask the opportunity to discuss with the Commission ways in which they could be mainstreamed into the various instruments of EU policy, both at the level of the European Union and EU member states.

Some of these steps are specific to particular countries: others are more systemic. The underlying aim is to ensure greater transparency at each stage of the energy trade from the extraction of oil and gas, to the transport of energy, to the sale of energy to European consumers. There are financial flows and chains of corporate ownership associated with each stage which need to be as transparent as possible.

### **Transparency in the extraction of oil and gas**

1. The European Union should build on its support of the Extractive Industries Transparency Initiative by requiring all resource-rich countries that receive EU development aid and technical assistance to implement the EITI and helping them to build the necessary institutional capacity and expertise in order to do so. Transparency has little meaning without public debate, so the European Union must also be ready to speak out strongly in favour of the right of civil society groups to debate resource transparency issues and raise them with their governments.
2. The Commission and EU member states should ensure that the promotion of transparency in the disclosure of revenue and profit flows, of energy contracts and beneficial ownership of energy companies, is mainstreamed into their diplomatic dialogues with all energy-supplying countries.
3. The Commission has called for the creation of an entity (the Caspian Development Corporation) to buy gas from the Caspian region and invest in infrastructure, including the building of new pipelines. Transparency requirements should be incorporated into the statutes of this company.
4. The European Union should offer Turkmenistan assistance in improving the efficiency of its energy sector in return for greater fiscal transparency, using the International Monetary Fund's *Guide to Resource Revenue Transparency* as a model. It is at these early stages of negotiations for access to Turkmen energy that the European Union will have most influence.

### **Transparency in the transportation of energy**

5. The European Union should insist that Ukraine publishes independent audits of Naftohaz Ukrainy and an independent review of the Ukrainian gas industry, its financial flows and beneficiaries.
6. Ukraine and other oil and gas transit countries should be urged to set up independent bodies to oversee the energy industries, possibly modelled on the multi-stakeholder bodies of the EITI.
7. The European Union should make its aid and technical assistance to Ukraine, and any closer economic or political relationship between the two, conditional on Ukraine completing the two above actions. If necessary, they could be EU-funded.

8. The European Union should create an independent regulator to collate and double-check information from industry about the flow of energy into Europe, in order to check that supplies are in fact being provided under legitimate contractual arrangements, from legitimate sources.

### **Transparency of financial flows and corporate ownership**

9. The Commission should urge EU member states to investigate the activities of RosUkrEnerg and other gas intermediaries active within European jurisdictions, to confirm (in the light of the allegations by Mr Putin and Mrs Tymoshenko) that all applicable laws have been complied with.
10. EU member states should require all companies in their jurisdiction to disclose their ultimate beneficial ownership, which should be recorded in a public register.
11. The European Union should not offer trade privileges or financial support to any resource-rich countries which do not meet basic international standards of financial transparency – for example, by failing to publish comprehensive national budgets.
12. All companies that produce or trade energy, and come under the jurisdictions of EU member states, should be required to disclose all revenue payments that they make to governments, whether in the European Union or elsewhere.
13. Any company that wishes to list or trade its securities on financial markets within the European Union should be required, as a condition of listing, to publicly name all of its significant shareholders for at least the preceding five years.
14. EU-based banks should be required to turn down any business with customers, or accept any funds, whose ultimate beneficial ownership is not publicly disclosed.
15. The European Union should pro-actively enforce its laws and regulations against money-laundering and intensify its support for efforts to prevent the flow of criminal funds through the international financial system, including through offshore tax havens.
16. The European Union and its member states should offer full diplomatic support and, if necessary, protection to members of civil society in resource-rich countries who advocate for accountable government and public financial management in their own countries.

I would like to thank you for your attention and would welcome the opportunity to present our views to you in person.

Yours sincerely,

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Director of Campaigns, Global Witness

Copies to: the Commissioners for Enterprise and Industry; Justice, Freedom and Security; Enlargement; Development and Humanitarian Aid; External Relations and European Neighbourhood Policy; Internal Market and Services; Energy and Trade.