Weekly Analytical Comments

Energy News

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Five plus one

The President determined five objectives and one priority of the Energy Security Doctrine

At the Security Council's final meeting of this year, President of Russia Dmitry Medvedev ordered the Government to elaborate the Energy Security Doctrine and identified five priority objectives of the future document. This document should link together the programs, general schemes, and strategies in the energy field, which have been accepted and considered by the Government in the latest years.

The first-priority activities on realization of the doctrine include:

- Sustainable and long-term supply of energy resources;
- Intense development of hydropower energy and alternative energy sources (including crude hydrocarbons production from unconventional sources);
- Determination of the quick emergency reaction procedure, special anti-terrorist protection of energy facilities;
- Modernization of the fuel and energy complex facilities;
- International cooperation in the energy field.

First, the government should focus not only on energy saving, but on achieving the result at reasonable costs of energy delivery to consumers as well. The only thing Gazprom has been busy with in the latest years was constructing pipelines under orders of Prime Minister V. Putin. These projects had low economic viability and extremely high costs.

The outrageous example of unreasonable gasification is represented by the Sakhalin – Khabarovsk – Vladivostok gas line, which aims to supply gas to the administrative centre of the Primorye, under personal commission of Vladimir Putin in view of the Asia Pacific Economic Cooperation (APEC) summit. In terms of gas logistics and resource supply, the decision to construct a wide-diameter pipeline from Sakhalin to Vladivostok seems at least controversial, as the project's initial cost is more than $200bn, meanwhile, it creates problems for local coal producers and subsequently cuts gas price considerably, and at the same time the officials have to discuss possible construction of the LNG production and export complex, since there is no full-scale gas market in the region.

Second, Dmitry Medvedev called for more active development of hydropower energy and other non-fuel types of energy, which are the most cost-efficient and environmentally safe, and for extensive construction of power facilities in the regions based on local resources, including renewable and alternative power sources (by that, copying Western countries, with their scarce mineral reserves). According to the President, Russia will also require "a separate program on production of crude hydrocarbons from unconventional sources". Page 3

Will Chubais be made responsible for the Sayano–Shushenskaya accident?

A year and a half after the Sayano–Shushenskaya hydroelectric power station accident, investigative authorities brought a charge against the former director of the station Nikolay Nevolko.

He was incriminated the crime envisaged by part 2 of Article 143 of the Criminal Code of the Russian Federation (violation of safety rules or any other labour protection rules, committed by a person who has the responsibility of observing these rules, entailing, by negligence, the death of a person). According to the version of the investigation, this fact was the one to cause the emergency of August 17, 2009, which destroyed 9 of 10 units, the turbine house, and took the lives of 75 people. N. Nevolko faces punishment in the form of up to three years imprisonment. The facility's restoration estimated cost is RUR40 bn. Restoration should be completed in 2014. As early as in October of 2009, Rostechnadzor prepared the report on causes and possible culprits of the emergency. The agency listed 25 persons who could be accessorial to the emergency, including N. Nevolko.

Criminal investigation of this case has been prolonged, due to performance of the complex technical, technological, finance and economical, and forensic examination. Employees of the Independent Forensic Examination centre of the Russian Ecological Foundation TECHECO acted as experts. 1200 volumes with the criminal case materials were handed over to the specialists for examination. The expert opinion filled 26 volumes.

The investigation plans to bring a charge in the nearest future to six more persons involved in this case, whose names have not yet been disclosed.

TOP NEWS

News brief

At the Security Council meeting **D. Medvedev** determined five key priorities for the future Energy Security Doctrine: adhere to a policy of reasonable costs of energy delivery to the consumers,hydropower energy and other non fuel energy development, quick emergency reaction procedure, modernization of all infrastructural facilities of the fuel and energy complex,stimulation of international cooperation with the Asia Pacific states named as a priority. Page 1

Gazprom submitted possible variants of the trunk gas pipeline construction to the Yakutia Administration. According to rough calculation,one kilometer of the pipeline will cost Gazprom approximately $7.5-8 mn per one kilometer of the route. The first variant (2956 km) is planned in the vicinity of the settlements which should be gasified and lies along the ESPO pipeline. The second alternative (2738 km) is planned with regard to the highest possible reduction of the route length. Page 3

Rosneft decided to build a petrochemical complex with maximum annual capacity of 10 mnt instead of a high-technology refinery (20 mnt capacity) in the Primorye. The construction will start in 2012 and the first stage will be launched by 2016-2017. The estimated cost of the project is $10 bn. Page 4

The **Ministry of Economic Development** held the discussion on three alternative draft laws (from the FAS,the FTS and the Ministry of Economic Development) with amendments to the Law on Natural Monopolies. The agencies permanently fail to come to an agreement on the definition of the term “natural monopoly”. The FAS considers activity of any company holding more than 35% of a market share should be regulated and the FAS has the right to determine,whether a company is a monopoly entity or not. The FTS believes that market share is not a crucial characteristic at all and the state regulation of price,it should be softened. The Ministry of Economy suggests a compromise - a state monopoly can be freed of state regulation,if the market of its operations becomes competitive. Page 5

Stockholders of the **Caspian Pipeline Consortium (CPC)** signed documents on extension of the Tengiz – Novorossiysk oil pipeline project to 67 mnt (current 28 mnt). The project’s cost amounts to $5.4 bn. As a result the oil pumping tariff grew 25.7% from 30.24 to 38 $/t. However,the consortium still lacks full set of arrangement to load 100% of additional capacity of the pipeline with transporting companies. Page 6

Croatia refused to extend the contract for purchasing Russian gas,which expires on December 31,2010. The Croatian company signed a three-year contract on purchasing 750 Mmcm with Italian Eni. Eni had been struggling for its share in the Italian market since Edison launched a the floating terminal near Rovigo exporting the Qatar gas. Page 8

Latvijas gaze approved a new contract on natural gas purchasing from Gazprom,having introduced a new calculation formula for purchased gas. The price will depend on consumption volumes. The new formula is still to be approved by Gazprom management. Tha Latvian claim this system makes it possible to Gazprom to increase its profits while allows Latvijas gaze to reduce domestic prices 5-6%. Page 8

Nord Stream AG and the banking syndicate signed the letters of responsibility to issue a loan on $2.5 bn for the second stage of the NordStream project. AS at the end of 2010 Nord Stream has spent EUR4.8 bn from the total capital investment budget of the project (EUR7.4 bn). It is planned that the pipeline will function at its full capacity of 55 bcm annually in 2013. Page 9

On purchasing the Polish Grupa Lotos, **Gazprom** neft and **Rosneft** will gain control over the major oil-producing assets of Lithuania. According to the previously signed agreement Grupa Lotos will acquire 59.41% of Geonafta shares,which accounts for two-thirds of all crude oil produced in Lithuania. Page 9

Highlights / Government and Infrastructures

Five plus one

Continued from page 1

This is, first of all, coal bed methane and shale gas. It is not quite clear, why Russia would need it, when it has enough cheap natural gas from conventional fields. It seems more like a tribute to fashion.

But the quick emergency reaction procedure for the fuel and energy complex facilities is really very important, regarding the high hazard level of power facilities, along with certain problems with safety standards. D. Medvedev also offered to completely prohibit «the use of worn and obsolete power equipment» and to inspect oil-producing offshore facilities. The former is not possible at all at the current stage (it will require creation of the industry anew). The latter will create more problems for LUKoil on the Caspian Sea and in the Kaliningrad region, for Sakhalin-II and, especially, Sakhalin-I (the Project's Operator has serious controversies with Gazprom and the Government on gas production and sales). For now, there are no more offshore facilities in Russia.

The fourth objective of the doctrine is the modernization of all infrastructural facilities of the fuel and energy complex and their transition to the innovative development pattern. As for now, this is just a slogan at its finest, as there are no resources available for such a modernization. Along with that, the industrial lobbyists headed by Deputy Prime Minister for fuel and energy Igor Sechin, are quite interested in that slogan, since they plan to get fiscal benefits and other tools stimulating capital investments, justified by the mentioned modernization projects.

Within the international cooperation framework, the President ordered to add the cooperation with the Asia Pacific states to the list of priorities, thus underlining once more the complexity of advancing the energy dialogue with Europe and the evident need of Moscow to "suppress" its Western counterparts by the Eastern vector. The decision on the form of the beginning of negotiations with Europe on the draft International Energy Security Convention prepared by the Russian side has not yet been made. Dmitry Medvedev softened his stand in terms of readiness for discussion of modernization of the Energy Charter Treaty withdrawn by Russia a year ago (but which still serves as the basis for relations in the energy field for the EU and 20 more states which ratified the document in full). Also, it is possible not to advance a separate new document, when there is neither window of opportunities, no serious support group or urgent need for its endorsement on the international level.

ERTA view

So, the President demonstrated that he had learned a lot on his post. As a good politician, he answered the questions important for the country once again, and he did it so that no one could argue with him. Goals are important, methods are evident, but it is not quite clear, though, what to do and how to do it. This is likely unclear not only to us, but to the author of the concept, the field-specific Adviser to the President A. Dvorkovich as well.

D. Medvedev raised the security development problems, while the topics of maintaining the existing security level stayed off-screen. No answers have been given to old problems of the fuel and energy complex, such as extreme growth of costs, instability of tax legislation, vague prospects of market liberalization, etc. Each of widely known problems could break not only the energy security doctrine, but the whole state economy as well.

Two pipelines – two lightful stories

Gazprom submitted two options for the Chayanda – Khabarovsk gas pipelines: a short one and an expensive one

Gazprom submitted the Declaration of Intentions to the Yakutia Administration on construction of the trunk gas transportation facilities from the Chayanda oil/gas-condensate field. This document anticipates two possible alternatives of construction of the Yakutia – Khabarovsk gas pipeline, which aims to transport the Chayanda gas to the Pacific Ocean.

The first alternative route 2965 km long (including 1312 km on the Yakutia's territory) will pass along the ESPO pipeline's route. Within the segment from Aldan to the Amur Oblast boundary, the new pipeline's route will pass along the Amur Yakutsk trunk line and the Skovorodino-Yakutsk motor road.

The second alternative was planned with regard to the highest possible reduction of the trunk gas line's route length. After the Lena River crossing, the gas line should be laid in the autonomous direction to Skovorodino, where it will enter the transport communications corridor and will go further to the end point along the same route as planned for the first alternative. In the second alternative the length of the route within the Yakutia's territory will be 990 km, and total length of the trunk gas line will be 2738 km.

Cost of the projects has not yet been revealed; however, according to informal information, amount of capital investments on the first "longer" alternative, exclusive of pre-project technical research, would be RUR700 bn. Cost of the "cheaper" alternative would be approximately RUR650 bn The second alternative was planned with regard to the highest possible reduction of the trunk gas line's route length, while the first one is planned in the vicinity of the Yakut settlements which should be gasified. As such, one kilometer of the pipeline will cost Gazprom approximately $7.5-8 mn per one kilometer of the route (including compressor stations, but exclusive of costs of the Lensk complex for recovery of helium from the Chayanda gas).

Gazprom needs sources of gas to load the Page 4

Government and Infrastructures

Two pipelines – two lightful stories

Continued from page 3

Sakhalin-Khabarovsk gas pipeline. The Sakhalin resources will not be sufficient for this purpose within the nearest 15-20 years, even provided the optimistic scenario of offshore gas projects development (not to mention a whole set of economic problems). That is why the corporation has to accelerate the Chayanda field development, construction of gas processing facilities and the helium utilization plant, as well as the Yakutia-Khabarovsk gas pipeline. Even in spite of the problems with the Chayanda reserves. Investigation of the field's geology showed that it could not produce up to 25 bcm of gas annually, which is required for effective operation of the wide-diameter pipeline. The process of granting the corporation with several more Yakutia licenses without tenders has not yet brought the results.

Along with that, the Gazprom CEO Alexei Miller announced that the assessment of capital investments into Altay project (the second project of gas supplies to China) has not been changed, amounting to $13-14 bn. According to the corporation's plans, the construction will begin immediately, when the commercial long-term contract with the Chinese on gas supply is signed (Gazprom thinks that they will be successfully completed to the second quarter of 2011).

ERTA view

Concerns on economic efficiency of this project have been pronounced many times. Still, the active phase of the Chayanda gas-condensate field development and startup of the Yakut gas production centre are getting more and more closer. Even Gazprom's plans on completion the Justification of Investments into the Chayanda gas-condensate field development as soon as in the first half of 2011 cannot change the situation (up to now, only the technical scheme of the field development has been approved). The field will definitely be developed, the gas pipeline will definitely be constructed.

It is widely known, that laying of the pipelines within the same corridor may reduce the costs significantly. However, oil and gas producers are persistently discussing other options. Let us present an example of a typical problem.

For the sake of security, the gas pipeline has to be laid at a distance of not less than several hundreds of meters from the oil pipeline. But the oil pipeline, laid in several places along the river (the materials and equipment were shipped by river), simply locks the possible gas pipeline's route from the river itself. Of course, oil producers had not anticipated the "technological windows" for the parallel construction. One could not definitely get the one-corridor effect, laying the pipe on the other bank of the river or at a significant distance.

The economy could probably be achieved on the secondary effects, such as the unified auxiliary transport infrastructure, unified power supply system, unified personal support system. However, let us take the question of Gazprom's settlements with Transneft for earlier expenditures out of context.

Reshuffle in the Primorye

Rosneft decided to build a petrochemical facility instead of an oil refinery

Rosneft rejected the idea of the refinery construction in the Primorye. Instead, the company will build the first stage of a 5 mnt-capacity petrochemical complex by 2016-2017, with possibility of expansion to 10 mnt annually.

At the first stage, this complex will process 3.5 mnt of naphtha (straight-run gasoline) and liquefied hydrocarbon gases, as well as 1.5 mnt of gas condensate. Startup of the first phase is scheduled for 2016-2017. The petrochemical complex will be able to further increase its capacity by 5 mnt due to oil stock.

Since 2007, Rosneft has been developing a plant construction project in the ESPO end point (port of Kozmino). Initially, it has been viewed as a sophisticated refinery with processing depth of more than 93%. In 2008, Rosneft established the RN – Primorsky Refinery company. From the very beginning, this project got its petrochemical component, production of polypropylene and paraxylene. The most part of it, however, should have been taken by oil processing. The end of the construction was scheduled for 2014. For now, the only actual part of the project still existing is that of petrochemical.

The Eastern Petrochemical Company will be the one to implement the project. The start of the construction is scheduled for 2012. According to Eduard Khudainatov, estimated cost of construction is $10 bn. Earlier, Rosneft has estimated the sum of investments as $22 bn, but at that time the planned refinery's capacity was 20 mnt.

ERTA view

One Russian banker says: "They invented the terms: petrochemistry, oil refining... The very thing to thrill the public. It does not matter whether it will be a refinery or a petrochemical complex. Oil is at the inlet, certain oil-processing products at the output. The set of products is to be determined by the possibility to sell them on the market".

Government and Infrastructures

Unnatural Monopoly entity

Traditionally, federal agencies divide the authorities during the endorsement procedure of the new version of the Law “On Natural Monopolies

The Ministry of Economic Development held a meeting of the mediation committee, where three alternative packages of amendments to the Law on Natural Monopolies were discussed. Definition of the term “natural monopoly” became the most controversial matter. This evidences the systematic nature of contradictions and different understanding on the object of regulation. The definition will determine the companies, prices on whose services will be stated by the state, and the agencies which will make the decision on introduction of the direct price regulation.

According to the existing version of the Federal Law “On Natural Monopolies”, only an economic entity performing one of nine types of monopolistic activities in the non-competitive conditions can be accepted as a natural monopoly entity. If it satisfies these two criteria, the prices on its services are set by the FTS on the economically justified level. Traditionally, the courts interpret the absence of competition as a single producer controlling the 100% market share; i.e., if the second player appears in the market, notwithstanding its share, the monopolist rids itself of the state regulation of prices on its services by the FTS. In this case, however, he enters the jurisdiction of the Federal Law “On Protection of Competition”, and the FAS becomes its regulator. The only exclusion is the gas industry, where prices for Gazprom are regulated by the state, but in this case, other suppliers are present in the domestic market.

The draft law prepared by the FAS aims to extend the definition of a natural monopoly entity. According to it, all companies performing the activities of natural monopoly character and holding leading positions in the market (more than 35%) should be considered regulation entities. Also, the FAS offers to add the services on water supply and air traffic to the types of natural monopoly activities listed in the law. If this draft is passed, the FAS will get the right to determine, which of the major companies operating in the listed industries is a monopoly entity, and which is not. The FTS will preserve the right to determine the economically fair tariff for such a company.

The FST argues against this interpretation. In its opinion, the dominating position does not depend on a natural monopoly entity itself. They offer to extend state regulation on the companies without considering their market share. As for the state regulation of prices, it should be softened. In addition to direct determination of tariffs or price cap, the FTS suggests that the companies would be granted with the right to determine prices on their services by themselves, and the Tariff Service would preserve the right to intervene in case of unfair price growth. However, this scheme, like the FAS draft law, anticipates disclosure of information on the economic activities of a monopolist.

The Ministry of Economy suggests to combine both of the approaches. According to the ministerial draft law, a state monopoly can be freed of state regulation, if the market of its operations becomes competitive. In this case, the decision on state regulation ending is made by the FTS, based on the FAS resolution and on endorsement of the Ministry of Economy.

Evidently, no compromise has been achieved, especially in the situation, when the officials should have to discuss their own authorities.

ERTA view

For more than ten years, “the relatively new and raw enough” legal base has been representing one of the problems of the contemporary Russian economics. There is a stable opinion that its thorough perfection could provide one of the most effective tools of the state development. As it was said in the manual on the Soviet spare parts: “Improve with a file, if required”.

They plan to introduce amendments into the Federal Law “On Natural Monopolies” for the TWELFTH time. A riotous thought creeps in, that the problem lies not only in improvement of the existing legal base. That’s why many people do not consider the content of amendments to be important at all.

Imagine that you see evident disorder, garbage and noise near your house. Do you need a special law to state that disorder is disorder, and not something else? There is, probably, no need for legal approval of the measures preventing this disorder.

Everybody sees the current state of the Russian markets. Many understand the essence. But nobody does anything. Or rather, we pretend that we believe the officials, who pretend that they believe that their amendments to the law could change the day.

But please, do not take these words for a call to complete cease of any law-making.

Government and Infrastructures / M&A

Fuel crisis expands

We still record the continuation of a “silent” fuel crisis. And we still do not understand the real reasons. More than that,we doubt that oil products could be kept by companies until January 1 (this is too long and physically difficult to be done).

However, diesel prices are growing very fast. And this situation has been already recorded by the Rosstat (Russian State Statistics agency). Also, the agency recorded the fall of diesel fuel production in early December.

This is added by reports on serious problems on the market of jet fuel and liquefied gas.

We know at least five solid reasons, but no one of them looks decisive. We will be glad to discuss your opinion in any format.

Tengiz – Novorossiysk pipeline’s expansion

here are still no agreements on full loading of additional capacities

Stockholders of the Caspian Pipeline Consortium (CPC) signed the documents on extension of the Tengiz – Novorossiysk oil pipeline project to 67 mnt. The project’s cost amounts to $5.4 bn. The consortium will budget the construction on the account of the tariff profits (estimate for 2010 is $1.1 bn). Guarantees of budgeting and profitability of the project will be represented by long-term “pump or pay” contracts, according to which, the stockholders – producing companies would take responsibilities on loading the extended pipeline’s capacities. In case of insufficient supply of oil to the system within the agreed volumes, the producing company will have to reimburse the CPC with the sum of lost profits. In addition, stockholders will grant the company a delay on loan payments in the sum of approximately $5 bn until 2015. If the own funds are not sufficient,the CEC will take the credit of approximately $1 bn,supported by long-term transportation contracts.

In fact, there are still no agreements on the use of the full additional capacity of the pipeline after the extension. According to the informal data, the CPC stockholders are ready to use 80% of additional 40 mnt annually. In particular, the consortium offered the quote of 8 mnt to Lucarco (controlled by LUKoil) but the company confirmed 6 mnt only. The same is with Rosneft-Shell Caspian Ventures Lmt (51% is owned by Rosneft,49% - by Shell). CPC offered it the 6 mnt quote, but it would be ready to take only 5 mnt with its further reduction to 2 mnt.

Besides,the matter with further oil transportation routing from Novorossiysk is not yet clear. Negotiations with Bulgaria on construction of the Transbalkanian oil pipeline, aimed at transition of oil from the Black Sea basin to the Mediterranean basin, have reached a deadlock. Moscow is not as enthusiastic about joining the trans-Turkish Samsun-Jeikhan project as it was last year. That is, there is still the use of overloaded straits controlled by Turkey (the Bosporus and Dardanelles Straits).

Nevertheless, the political decision saying that the additional volumes of Kazakhstan oil will flow to the sales markets via Russia, not Azerbaijan and Georgia, has been made. Geostrategically, this is an important achievement. The project of the Common Free Market Zone of Russia, Kazakhstan, and Belarus has likely played its role.

Caspian Pipeline Consortium

The matter of increasing the CPC capacity from initial 28 mnt (as for now,up to 34 mnt can be transported annually) to 67 mnt annually arose immediately after the pipeline’s startup in 2001. Five years ago,the project’s cost estimate was $2 bn, and it was supposed that the investments will be paid in 2012. However, no guarantees of the pipeline’s loading were given at that time. The new financial model postponed the payback terms beyond 2024. Along with the budget growth, the oil pumping tariff grew as well (from 30.24 to 38 $/t).

ERTA view

The key statement is: “Anyway, the political decision... has been made”. This is the thing: the struggle for changes in the CPC corporate composition has been proceeded for many years just because of the possibility to make such political decisions.

All the rest has stayed unchanged: the unavoidable growth of tariffs,necessity to credit the stockholders,negative consequences for the final economics of oil-producing consumers, lack of understanding concerning further oil transportation routes.

Economics loses out to politics once more. Since the political decision has been made, answers to the questions will be searched for later. This will be done until the project becomes totally unreasonable (let’s hope this won’t be the case).

M&A

ONGG is ready to pay more

Oil companies stand in line to gain the possibility of the mutual participation in development of Trebs and Titov fields together with Bashneft

ONGG, "unhooked" by the Russian officials, along with several Russian companies, from participation in the bid for the Trebs and Titov fields, does not lose hope to agree on partnership with the future license holder, Bashneft. Deputy Minister for Oil and Gas of India Radju Narasimkha declared last week that the relevant negotiations were underway. Deli tries to extend its presence in the oil and gas projects, including in Russia, but still loses the battle of global contest to China. The advantage of the Indians is their readiness to overpay for the assets, and this is important to Bashneft, which, not being one of the First Four in Russia, will have certain problems with budgeting the development of these gigantic (by its standards) fields, with their reserves amounted to 140 mnt.

On December 2, the interstate committee admitted the bid on those blocks failed; however, after consideration of the technical and economical parameters offered by Bashneft, the application was approved. When the government approved issuance of the license, Bashneft will pay RUR18.476 bn. (the initial price).

Other oil companies stand in line to gain the possibility of the mutual participation in development of these fields with Bashneft. In any case, Bashneft will have to agree with LUKoil on the infrastructure: the company of Vagit Alekperov owns 25 well on the license block, as well as the pipeline to Varandey offshore terminal.

ERTA view

Trebs and Titov fields development is a rather large project which is noticeable even in the global oil scale.

Globally, when large projects are going to be launched, "wolves are swarming", that is, consortiums are formed, financial costs and other risks are assessed, operator is chosen, and the process of obtaining the right for development is launched. This zero stage of project implementation is very important, determining in many senses the future life of the project.

In Russia, the development right is approved by a license. Traditionally, the licensing process and the consortium-forming process in Russia are spaced in time. The law, though, does not prohibit the consortium of companies to obtain a license.

The process of license issuance for Trebs and Titov fields has been already performed... according to some special rules. Now, we observe the process of forming the consortium according to quite different rules.

The opinions like that: "Don't you understand? This was organized the way, so that the foreigners would pay more cash and get less rights. This is a policy that supports Russian oil companies", look sort of naive. They do not explain, why this very company is supported, and the other one is not.

It seems, that such support provides only short-term advantage to a Russian company. Meanwhile, it brings long-term strategic damage to the whole oil industry, forming an economically unequal strategy of the Russian oil companies.

Rotenberg will get Gazprom bureniye for RUR 4bn.

Gazprom assessed 100% of Gazprom bureniye LLC, planned to be sold in the first and second quarters of 2011, in the sum of RUR4 bn. Stroygazmontazh of Arkady Rottenberg, which was created on the base of a set of former Gazprom-owned construction subsidiaries and which now gets a significant share of the best contracts from the corporation, is considered to be the main and, likely, the only claimant for this asset.

In March 2008, Rottenberg's structures bought in trading five contractual companies of the corporation for RUR8.3 bn - practically at the initial price. As early as in May 2008, Stroygazmontazh won the first bid from Gazprom, gaining later four more large orders, including two of them without competition: the Olympic gas pipeline Dzhubga-Lazarevskoye-Sochi and the Sakhalin-Khabarovsk-Vladivostok pipeline. The company participates almost in all major construction projects of the monopolist.

In 2009, consolidated proceed of Stroygazmontazh was RUR100.3 bn, the profit of the holding company was approximately RUR1 bn. In 2009, the profit of Gazprom bureniye was RUR39.3 bn, net loss – RUR1.86 bn, short-term loans and credits as at the beginning of the year - RUR6.09 bn.

With regard to the program of geologic exploration works accepted by the gas corporation for 2011-2013, which includes intensification of exploration drilling and the main entrance to Yamal, Gazprom bureniye is expecting flocks of orders from the monopoly.

International

The ENI market has been enlarged by Croatia

Croatia refused to extend the contract for purchasing Russian gas

Croatia refused to extend the contract for purchasing Russian gas. The existing agreement,according to what Gazprom export supplied the Croatian INA Group with up to 1.2 bcm of gas annually,is to be expired on December 31. The Group's subsidiary Prirodni plin has signed the contract with the Italian Eni for purchasing of 750 mcm of gas, beginning January 1. The contract is signed for three years only and prepared based on the results of the bid, which Gazprom had participated in as well.

Croatia consumes about 3 bcm of gas annually, covering more than 60% of the demand by its own production.

Lately, the Italian Edison launched the floating terminal near Rovigo exporting the Qatar gas, thus strengthening competition in the North of the Apennines with the pipeline gas from Russia and Norway. Following that, the major market player Eni has started to loose its market share even quicker (it reduced almost twice within the first 9 months of 2010). Not surprisingly, Eni makes maximal effort to win the share on the markets of other European countries, thus creating problem with sales to Gazprom.

The company, which is still the main and basic Gazprom partner in the South Stream project, has not been behaving like a partner for long. The Italians are the worst clients in Europe in terms of taking gas under long-term contracts (preparing to pay penalties); they sabotage cooperation under the South Stream project, make advances to Turkmenistan and Azerbaijan on gas delivery to Europe, bypassing Russia.

Last week, Eni purchased Minsk Energy Resources, operator of three licensed shale gas fields in Poland. In this, one can see not only a tribute to fashion of European and American majors who buy assets in the USA and stake out claims for prospective sites in Europe.

Easy times for loyal ones

The price on Russian gas in Latvia may decrease 7%

The Board of Directors of the gas distribution company Latvijas gaze approved a new contract on natural gas purchasing from Gazprom. The Board endorsed the new gas purchasing price calculation formula, which is still to be approved by Gazprom management. The agreements will be likely approved officially during the scheduled visit of the President of Latvia Valdis Zatlers. It is planned that the new contract will be signed for one year, to see it in operation.

According to the company's expectations, the contractual gas price for the consumer may be reduced by 10-15%. For now, though, Latvijas gaze has not introduced such radical reductions for its clients. Beginning with January 1, 2011, the price of gas used for heating of houses will be reduced by 7%, for the houses with gas stoves – by 4%, for industrial consumers - by 5%. The thing is that, according to the formula anticipated by the new version of the contract, the price will depend on consumption volumes. Its use allowed Gazprom increasing its profit, regardless of price reductions. Latvia obliged to increase its gas consumption in 2011 by 30%, compared with the pre-crisis level.

It should be noted, that the Latvian government (in contrast to those of Lithuania and Estonia) has made no efforts to limit the ownership rights to the gas infrastructure of energy corporations in connection with introduction of the Third Package provisions in the European Union.

The major stockholders of Latvijas gaze are: E.ON Ruhrgas – 47.23%, Gazprom - 34%, Itera Latvija - 16%. The member of the Board of the Russian corporation Kirill Seleznev is the Chairman of the Board of Directors. The similar structure of ownership has place in the companies of Latvia and Estonia.

Negotiations with the companies of two other Baltic states are still ongoing. Not long ago, Lithuania, which has been declaring all year long its commitment to prevent Gazprom and E.ON Ruhrgas from managing their national gas distribution company, softened its position. Probably now it expects to get more desirable gas delivery terms, as the others.

ERTA view

So, that's agreed with Latvia. Reduction of gas process is expected. It may not be significant, but the very fact is important. It seems that Gazprom, by this situation, shows the example to the tough neighbor – Lithuania.

In terms of the business, the Croatian decision to refuse from the Russian gas deliveries should not be taken as a political one. Gazprom Export was an honest participant of the bid – and lost it. Likely, Croatia chose the more economically suitable decision. The decision is based on the geographic location of the country and active LNG trade in Europe.

International

Half way

As at the end of 2010 Nord Strem spent EUR 4.8bn out of total poject capital investment of EUR 7.4bn.

Nord Stream AG and the banking syndicate signed the letters of responsibility to grant the funds for the second phase of the NordStream project. Almost three dozens of commercial banks will give $2.5 bn to the company established by Gazprom (51%), the German E.ON Ruhrgas and Wintershall (15,5%), the Dutch Gasunie (9%), and the French GDF Suez (9%). Of this sum, the banks will give EUR1.7 bn as the security of the export promotion agencies (the Italian SACE and German Hermes, as well as within the program of unbound assurance of German loans) for 16 years, and EUR 800 mn (non-secured banking credits) for 10 years. The participants of the consortium should pay about EUR800 mn more to the authorized capital. This sum is required for completion of construction of the two-line gas pipeline from Russia to Germany on the Baltic Sea bed.

EUR3.9 bn (including EUR3.1 bn for security) was invested by banks and EUR1.6 bn – by stockholders for the first project's phase. The funds were transferred in spring with a delay and cost RUR1.4 bn (commissions and credit-servicing costs before the beginning of gas transit and gaining profits). Cash shortage was covered by stockholders on the account of bridge loans on the market terms.

As at the end of 2010, Nord Stream has spent EUR4.8 bn from the total capital investment budget of the project (EUR7.4 bn). EUR2 bn is planned to be transferred to the construction in 2011, with more EUR600 mn – in 2012. In 2013, the gas pipeline will work at its full design capacity – 55 bcm annually. Gazprom export contracted 100% of capacity on take-or-pay conditions.

Covering operation

On purchasing the Polish Grupa Lotos, Gazprom neft and Rosneft will gain control over the major oil-producing assets of Lithuania

On purchasing the Polish Grupa Lotos, Gazprom neft and Rosneft will gain control over the major oil-producing assets of Lithuania. Such perspectives are due to the signed contract on purchasing by Lotos Group from the Lithuanian Investment foundation Hermis Capital of 59.41% of shares of Geonafta, which accounts for two-thirds of all crude oil produced in Lithuania. Lotos, through its subsidiary Petrobaltic, owns as much as 40.59% of Geonafta shares. In turn, Geonafta owns 100% of Gencu Nafta (develops the Genchskoe deposit), 50% of the local production leader Minijos Nafta, and 50% of the producing company Manifoldas. Geonafta itself controls the Kretinga, Girkaliai, and Nausodis fields.

Considering the fact that, in addition to Polish assets, Russian state companies plan to buy out the Mazheykaisk refinery from the PKN Orlen Group, return of Russian companies to the Lithuanian fuel and energy complex may be rather impressive.

This scheme came to be so economically ineffective, that Vilnius has recently asked Minsk to be a mediator in negotiations with Moscow on restart of deliveries through the Druzhba pipeline. This is very important for Lithuania, since, for now, loading of the Mazheykaisk refinery is hardly more than a half of its nominal capacity. Russian authorities have noted many times, that the pumping could be renewed, if Russian investors received the Lithuanian refinery. According to PKN Orlen top managers, the matter of the refinery's sales can well be solved next February. Lotos privatization will take place nearly at the same time.

ERTA view

The news on oil processing in Belarus and Lithuania attract vivid interest. Recent agreements on removal of customs duties on oil deliveries to Belarus, along with changes in the oil products duty payment procedure, will change again the picture of the region. As for now, this is not a final status of the system. To be continued...

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