

Kovykta: unanswered questions

Who is ready to pay a billion dollars for RUSIA Petroleum?

Tags: [Kovykta](#), [RUSIA Petroleum](#), [Irkutsk region](#), [East Gas Program](#)



Despite all market rumors and expectations, Gazprom won the auction for sales of the property of RUSIA Petroleum – the bankrupt holder of the

license for the Kovykta field in Irkutsk region. The monopoly company promised to pay 1.5 times as more as the start price – RUR22.3 bn. On completion of the deal, Gazprom will obtain the license for this field.

And NOVATEK, which could become the final owner of the RUSIA's assets, if the state-owned Rosneftegas would win the auction, obtained the strategic partner – the French company Total. As such, Total will take the Gazprom's place, purchasing 12% of NOVATEK's shares from Gennady Timchenko and Leonid Mikhelson, along with the right to increase its share to 19.4% within three years. Also, it will become the major foreign participant of the Yamal LNG with its 20% in this project.

The Kovykta reserves amount to approximately 2 tcm of gas. The sum of the deal was disclosed by TNK-BP's CFO (and RUSIA's major shareholder and creditor) Jonathan Muir. He said that his Company was fully satisfied with the sum of the deal, and TNK-BP, as creditor, would receive all the money.

Gazprom has got the asset. In terms of the state energy policy in East Siberia and Far East, it makes sense. Though, it is not quite understandable, if to look at the monopoly's behavior and the large-deal practice on the gas market in the last months. Before the auction, the affiliate of the state-owned Rosneftegaz – Vostokgazinvest LLC - had been considered the favorite. Also, the analysts had expected that

NOVATEK, which had been collecting the "tempting" assets, supported by G. Timchenko's lobbyist activities, would have got Kovykta. According to informal data, the pledge for participation in the auction (RUR 3 bn) on behalf of Rosneftegaz was deposited by Vostokgazinvest LLC – and it was established only on January 20 of this year. The Deputy Director of NOVATEK's Production Department, Alexander

Popov, became its General Director.

However, in a day before the application submittal deadline, the RUSIA Petroleum's bankruptcy manager Oleg Smetanin rescheduled the auction sales from February 15 to March 1. It is quite possible that this act was connected to the changed Gazprom's position on Kovykta: it convinced the head of the government that Kovykta should have remained the state property. From the very beginning, the Kovykta matter has been controlled by the state management. It is not a mere occasion that Rosnedra, with all reasons to terminate the Company's license, have done nothing of that kind during four years, in spite of legislative requirements. And Gazprom has likely got authorities «from the top». Also, Gazprom has started negotiations on purchasing the Kovykta-Zhigalovo gas line from the East Siberian Gas Company (joint venture of TNK-BP and the Administration of the Irkutsk Region). The book value of this pipe would be approximately RUR6 bn. Negotiations were started in mid-February.

Why the situation has turned around, is not quite clear. The most reasonable guess is that it would be too risky to sell Kovykta "off the books" in the height of the decisive round of gas cost negotiations between Gazprom and China. For many times, both parties have declared their intentions to sign the first long-term gas supply contract in June 2011. It was the Kovykta gas China has counted on from the very start of the project and negotiated that with RUSIA Petroleum's shareholders. When Gazprom, having got the status of the sole export channel, became the Russian side's negotiator, Beijing has been continuously justifying its claims for low prices by its knowledge about net cost of the Kovykta gas production and relatively short distance from the field to the Chinese borders.

The Kovykta development schedule is not clear for now. Until now, Alexei Miller and other Gazprom's top managers have made very abstract declarations on this matter, in the manner of the Eastern Gas Program: "Beyond the year of 2017". Now, the corporation will have to specify the terms. The thing is that Rosnedra will have not only to give the license to a new owner of the infrastructure, but to introduce certain amendments, including those concerning the terms of the production beginning.

In this format, however, the deal still has opponents. On the day when Gazprom and the bankruptcy manager were going to sign the sales and purchase agreement, the mass media published the information that Minenergo stood against the deal. Among the named reasons were too high price (though it was evidently approved by the government, in order to recompense the historical project expenditures of TNK-BP in the sum of \$654 mn) and absence of approval by Gazprom's Board

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News brief



Gazprom has won the auction for sales of the property of RUSIA Petroleum, the **Kovykta** license holder, promising to pay RUR22.3 bn. Its obtaining of the field's license is now paperwork and time. ➤ Page 1

NOVATEK found the strategic partner – **Total**. The French company will close the deal on purchasing of 12% of the Russian company's shares by April, and within three years, increase its share in NOVATEK to 19.4%. In addition, Total will participate in the Yamal LNG Project (its share will be 20%). ➤ Page 3

A wave of changes in the **energy industry** is covering Russia. Tariff growth rates are becoming slower, capacity supply agreements are being reviewed. Generating companies advance their own proposals concerning the reform and write letters to Prime Minister V.Putin. Is this the end? Or dead end? Or, may be, another round of the reform? ➤ Page 3

LUKoil managed to sign an agreement with **Gazprom** on supplies of its gas from the Bolshekhetskaya Depression and the Caspian fields. Gazprom takes an obligation to take comprehensive measures to accept LUKoil's gas, preserving the right to set limitations. ➤ Page 8

Russia is still flirting with the Russian oil importers. The Minister for Energy S.Shmatko announced the necessity to sign **long-term oil supply contracts**, in order to secure price risks. And, according to the Minister, increasing of oil deliveries is not the intent of Russia. ➤ Page 9

TNK-BP hopes to continue its expansion abroad. The things, though, are not so brilliant: Vietnam and Venezuela are not so attractive, while the Algerian assets have already slipped through the Company's fingers... However, on the background of a new continuing conflict of the TNK-BP's shareholders in Russia, foreign failures do not seem a catastrophe at all. ➤ Page 10

The Turkish-Russian interstate agreement on the **Samsun-Jeikhan** oil pipeline has not been signed again. The parties continue bargaining. Will the pipeline's fate follow that of the Burgas-Alexandropolis, or will the parties satiate their political and financial appetites, solving at the same time their gas and nuclear problems? ➤ Page. 10

Dmitry Firtash is trying to put through another combination. Now, he is supporting the Ukrainian authorities in their intent to place **Naftogaz'** shares on the stock exchange. So, the sky above the **Gazprom's** plans to create a joint venture with Ukraine and to get control over the Ukrainian gas transportation system (GTS) is becoming cloudy. ➤ Page 11

The next extension of **Alexei Miller's** labor contract is near. V.Putin has signed a relevant directive addressed to state representatives in the Board. Rumors on Miller's retirement have not been supported again. ➤ Page 11

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of the Directors.

In spite of the signed sales and purchase agreement, the whole matter has got hung up for a month (Gazprom must transfer the money within 30 days). If Gazprom's assets book value as per December 31 of 2010 will be more than

RUR7.44 tn, the Board's approval will not be necessary. In this case, the sum of the Kovykta deal will be less than 0.3% of the value of the corporation's assets, and such deals do not require the Board's approval. According to the law, evaluation must be ended before March 31, 2011.

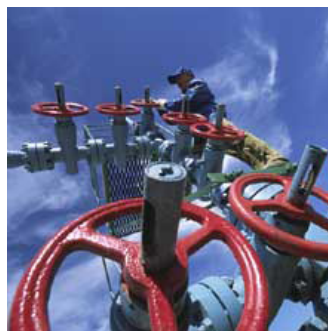
ERTA view

At the last stage of its development and under the tender supervision of BP, the Kovykta project has reached the stage of the process engineering and negotiations with the consumers (China and South Korea) about gas prices.

This was the last drop. Gazprom managed to convince the Russian authorities that different export gas prices in the course of negotiations, and particularly with the Chinese, were unacceptable. Options of possible export price coordination were not even considered. In summer 2006, for special "security", the RF Law "On Gas Export" was passed.

Since that time, the situation has not been changed in principle. Any scheme of the Kovykta development is possible only in case of the unified price of gas sales to China. Therefore, the Kovykta project development can be managed by Gazprom only.

Rather, the question is that the advancing Russian private- and state thought may demonstrate new forms of this management.

Total NOVATEK**What is the price of friendship and who is worth being a friend**Tags: [Total](#), [NOVATEK](#) [HOBATƏK](#), [Gennady Timchenko](#)

On March 2, late in the evening, in the weekend retreat of Prime Minister Vladimir Putin, two memoranda were signed. They made TOTAL and NOVATEK strategic partners. The agreement was signed by TOTAL CEO Christophe de Margerie and NOVATEK's President and

co-owner Leonid Michelson.

According to the main document, Total will close the deal on purchase of 12% of NOVATEK for \$4 bn until April and increase its share to 15% within a year and to 19.4% - within three years. The major NOVATEK's shareholders Gennady Timchenko and Leonid Mikhelson (who, according to the latest information, control more than 50% of the Company) will act as sellers. The shares to be sold by each of them are not disclosed.


According to Mikhelson, the sum of the initial deal was calculated based on the market share quotations, i.e., approximately \$11-11.5 for one share. The day the deal was announced, the Moscow Interbank Currency Exchange (MICEX) trading session was closed at the level of \$13 per share, while in early December the price was only \$10 per share.

Six and a half years ago, Thierry Desmarest, predecessor to Christophe de Margerie, and L. Mikhelson signed the similar protocol on purchasing of NOVATEK's blocking shareholding for less than \$1 bn. At that time, the Russian authorities were informed about that initiative, so to say, from the papers. FAS did not give its permit for the deal, in spite of the letters sent by the President of France Jacques Chirac to the Russian President Vladimir Putin. Finally,

NOVATEK's shareholders decided to reject cooperation with Total and to sell about 20% of shares by means of public offering at the London Stock Exchange. Moreover, in summer 2006, Gazprom became strategic investor of NOVATEK (which to that time had partially taken over Itera, together with the niche of the largest Russian independent gas producer). The monopoly company purchased 19.4% from the companies controlled by Leonid Mikhelson. Total, however, did not step back. It started cooperating with Gazprom on the Shtokman project and courting NOVATEK at the same time. The companies started with the joint project on a small thermokarst field. At that time, Vladimir Putin gladly announced that the investors were going to put up about \$900 mn into the project. Though, this project has not yet seen any real big investments. And now, with the highest approval, Christophe de Margerie visited the Russian President Dmitry Medvedev, before going to Novo-Ogarevo to sign the agreement.

In fact, this means that the reverse process was launched. Total becomes the NOVATEK's strategic partner. Indirectly, this will take place at the account of the reduced Gazprom's share. But it will be the state corporation which will benefit from this castle, but NOVATEK's private shareholders and, probably, Gazprombank which is not controlled by the gas monopoly any more.

Last December, Gazprom sold 9.4% of NOVATEK's shares to Gazprombank. And a month ago it disclosed in its report that the sum of the deal was \$1.9 bn. For the moment of signing of the agreement, this was 30% as lower as the market cost. Investors were told a story about low liquidity of NOVATEK's shares and a fair discount. Gazprombank immediately wrote a two-year call for those shares to the Cyprus offshore company Hibridge Ventures Limited, owned on the parity basis by Timchenko and Mikhelson.

According to the terms of the call, Hibridge  Page 4

Total NOVATEK

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will buy the shares “at the price formed in accordance with the average weighed cost of NOVATEK’s shares during 30 trading days preceding the date of writing of the call”. As such, Gazprombank will receive about RUR82 bn (\$2.8 bn) Hibridge. For the similar package, Total paid to Mikhelson and Timchenko \$3.1 bn. The profit of Gazprombank will be \$900 mn, that of NOVATEK’s major shareholders - \$300 mn.

In addition, the French company has become the first and main foreign partner to NOVATEK in this project. It will get 20% of the Yamal LNG project. According to

Leonid Mikhelson, Total will get the major part of 23.7% of the Yamal LNG shares. NOVATEK bought the right to dispose them from Gennady Timchenko’s structures for \$10 mn. According to the terms of the call, if NOVATEK finds a buyer for these shares, it can purchase them from G. Timchenko for \$450 mn.

The sum to be paid by Total is not disclosed. If NOVATEK will not intend to get any profits from his new strategic partner and give its share at its cost, the sum will be \$376 mn. The transaction must be closed before July.

ERTA view

Again, Total has demonstrated its admirable stability. This quality is seen not only in its relations with NOVATEK, for instance, renewal of the idea of purchasing the Company's shares after six years. Total has shown the same qualities in joining the Shtokman Project, where the time period is much longer. Total’s partners should take into account, that such persistency, sometimes even stubbornness, is an inherent quality of the French company, which it demonstrates in many areas. This is, for instance, its hard assertion of its case of the Shtokman development plan in discussions with Gazprom. Now, one can correct the vivid statements made by NOVATEK that the LNG project will be launched in 2016-2018: we assume that the real schedule will be extended.

Brandishing fists before the fight proves anyone’s might

The pre-election struggle of the Russian government against the electric power price growth may end in full-scale revision of the results of the reform in the industry

Tags: [reforma](#), [energy industry](#)



The issue of improvement of the capacity supply agreements (CSA) was discussed at the meeting held by First Deputy Prime Minister Igor Shuvalov. Within the framework of the Strategy-2000,

Minenergo, Mineconomrazvitiya and the expert group for the reform of natural monopoly holders were commissioned to consider the question on introduction of competitions into the CSA system.

In fact, the thing is the creation of the secondary market of power capacity construction obligations. The CSA is a form of investment return warranty given to a particular investor (as payment for capacity), while this investor takes strict obligations to build the capacity to a definite date, with huge penalties in case of failure to follow the schedule. Creation of the market of the rights to power-generating assets construction within the CSA framework was supported by major consumers, such as RUSAL. It managed to enlist other metals companies which decided that the CSA, in its existing form, were too expensive for consumers. RUSAL alone had to pay \$6.7 bn within 10 years.

According to the co-leader of the expert group and former Deputy Chairman of the Board of RAO UES Russia Yuri

Udal'tsov, this covers only the facilities, construction of which has not been started and its owners are ready to reduce obligations voluntarily, refusing from the CSA. Minenergo was commissioned to determine the scope of non-started constructions with capacity less than 10 KW. The released assets will be offered at the bids which will have to make investors reduce the power station construction costs. The reduced costs of investors will lead to reduction of costs of capacity buyers and, at the end, to reduction of the end power cost.

Then the lobby of generator companies entered the struggle. General Directors of WGC-4 (controlled by the German E.ON), Fortum (the Finnish Fortum) and Enel WGC-5 (the Italian Enel) Sergei Tazin, Enrico Viale and Alexander Chuvaev sent a letter to Prime Minister V. Putin, where they expressed their “incomprehension and concerns” about the governmental intent to restrain power tariffs, as it gave a reason “to doubt the firmness of previously declared basic parameters of the wholesale market operation”.

The electric power price growth was discussed in mid February at the meeting of the Presidium of the Government. The officials were not content with the fact that the end value of power was growing more rapidly than it had been expected (forecast for 2011 - plus 15%). According to Deputy Prime Minister Igor Sechin, such tendency was observed in almost half of the regions – 38. To mend the things, he offered, in particular, not to perform indexation of capacity tariffs this year, since

Brandishing fists before the fight proves anyone's might

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they covered the permanent expenditures of the energy companies. In addition, it is necessary to change the capacity calculation formula for "unavoidable generators" (stations which failed to pass the selection, as their maintenance was too expensive), to reduce the investment component for nuclear power stations (NPS) and hydropower stations (HPS) and to extend the tariff regulation period for grid companies from three to five years, as this will help to smooth the growth of cost of their services. All this will help the consumers to save like RUR64 bn.

In this case, the opinion of foreign investors is more important for the government. They think that current excessive tariffs are caused by their lowering at the initial stage of the energy reform, as well as expensive services of grid companies. This was accompanied by growth of fuel prices (gas, coal and black oil).

Meanwhile, it will be generating companies which will suffer most as a result of the measures suggested by Deputy Prime Minister. Of the total sum saved, like 54%, or RUR 35 bn, will have to be provided by the power producers.

Moreover, according to accusations made by the authors of the letter, the government itself made many stations "unavoidable generators", preserving cross-subsidization between heat and capacity (to restrain household service tariffs). Refusal to index the capacity payments changes the rules of the game a lot. Creating the long-term capacity market rules, the authorities promised annual revision of its cost with regard to inflation. If indexation will be cancelled, energy companies will, in fact, sell power at the cost of 2009, since last year, by proposal of Mineconomrazvitiya, the lowering coefficient of 0.9 was applied to the capacity price, while the actual inflation for that period was 26%.

By the opinion of the investors, one more serious violation of the prior promises given by the government is the considered possibility of price reduction within the CSA framework. These documents should guarantee return of investments within a specified period. Profitability of the invested capital under CSA is 14-15% during 10 years. This is the very sum of guarantees, under which foreign investors have obliged to invest EUR5.5 bn to construction of new generation facilities.

Finally, the whole CSA mechanism has become doubtful. At a conference "The Electricity and Capacity Market: Problems and Prospects", the head of non-commercial partnership "Council of the Market" Dmitry Ponomarev said that the structure of the long-term capacity market (LTCM), introduced since January 1 of 2011, might work not more than one year. "The Council of the Market", regulating operation of the wholesale and retail power markets, is developing a new model which does not include market method of separate determination of capacity and power prices. By his opinion, this model must be based on the principles of "generation sufficiency" and "cost optimization".

The new structure has not yet been fully developed. It is expected to be completed by July 2011. In particular, it

means that long-term competitive power takeoff (CPT) for 2012 and beyond will be shifted to autumn: they will be held until July 1, as it has been expected before, but until October 1.

"The Council of the Market" suggests refusing from price requests at competitive power takeoff. Thus, selection will be held by power stations' capacity volumes only. On submittal of volume requests by generating companies, the System's Operator will decide whether the generation for an energy system is sufficient. After that, it will make a conclusion on cost optimization. It is supposed that free power and capacity agreements (FPCA) signed between generators and buyers at the wholesale market will be used for price determination. These direct agreements should be one-rate, that is should include fixed as well as variable generator's costs (power and capacity price) at a time. Suppliers which did not sign FPCA should get only the so-called "reserve payment" for their capacity, and it will be low. Consumers which did not sign FPCA will be obliged to pay this "reserve rate" with a particular "penalty coefficient".

By now, FPCAs at the energy market are relatively rare. As per the end of 2009, according to evaluation given by Dmitry Ponomarev, the share of direct contracts in the price zone of Europe and the Urals was 6%, in Siberia – 24%. The market structure does not promote FPCA-based operations. This is caused, in particular, by the fact that the market forms a unified electric power price determined by the most expensive of the selected price applications. Under these conditions, efficient generators with low operational costs understand that they will get high margin in any case, so, they are not interested to sign FPCA. Though, it is not quite clear how exactly the new model will motivate signing of FPCA.

Generators have their own suggestions concerning the reform. They are lobbying two alternatives. In order to implement the first schedule, the number of the free power flow zones (FPFZ) should be required based on physical possibility of power flows between them, and the maximally possible price level should be raised, in order to create real stimulus to invest money into new capacity modernization and construction. Also, by opinion of the energy companies, it is necessary to review the approach towards tariffication of expensive unavoidable generation, to introduce the day-ahead market requests submittal by consumers, and to change the CPT rules. In particular, generators should be given a possibility to shift the losses from power sales during "cheap" hours and CPT to the day-ahead requests.

The second alternative offered by generators is transition to the one-rate market model with additional capacity payments. For this purpose, two types of additional payments should be stated: the basic capacity payment (which will be gradually reduced within five years) and individual payments, such as payment for refusal from cross-subsidizing between the power and heat production. According to this scheme, CPT will be abandoned, while the capacity supply agreement (CSA) will

Brandishing fists before the fight proves anyone's might

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remain unchanged. Consumers and guarantor suppliers will begin submitting the day-ahead requests for 100% of the volumes, and retail consumers will be able to sign direct contracts with the suppliers of the wholesale market for

electricity and power. As a result, consumers will get the power price-restraining tools, and generating companies will begin to compete for maximal generation.

ERTA view

Creation of the relatively independent market pricing mechanisms in the Russian economy has not been completed. There is only one scenario of a manual control mechanism which can work effectively in this huge country: "Everybody is allowed in, nobody out". In all other cases, defenseless consumers stay alone with the unlimited price growth. But the "not-let-out" mechanism immediately threatens the investments and the industry's development. The statements saying that "all this is a temporary measure, until the elections are over" are mere trickery. Our energy industry is not a famous spherical cow in vacuum. It can be compared with other countries, in order to assess its competitive ability.

The next national "energy discussion" is upcoming. And this discussion has no leaders. After leaving of Anatoly Chubais, this position is pathologically vacant, and no one desires to take it. In terms of various resource expenditures of absolutely all participants of this process, from energy producers to energy consumers, this is the most ineffective way. We cannot but remember the national objectives of energy efficiency and resource savings declared by the Russian government. It is likely, though, that the key words here are "absolutely all". The decision will be made much easier after good tormenting for all. Good torments make accepting practically any workable decision.

Stepashin, oil processing advisor

The Accounts Chamber assessed effectiveness of the state policy in the field of oil processing and found that the officials had too much confidence in oil companies

In the height of the discussions on the tax reform in the oil industry, when the submittal of the General Oil Industry Development Program to the government was scheduled for March, the Accounts Chamber prepared for Deputy Prime Minister Igor Sechin the document titled "The Strategic Audit of Use and Enhancement of the Oil Processing Industry Potential".

The Accounts Chamber assessed effectiveness of the state policy in the field of oil processing and found that the officials had too much confidence in oil companies. The production enhancement plans announced by the Russian companies did not match their own investment programs. Estimated amounts of the investments required by the industry, supported by Minenergo and stated in the Energy Strategy of Russia until 2030, was underestimated in one and a half times by oil companies. The corrupted data may be introduced into the General Oil Industry Development Program until 2020.

The Draft General Program anticipates that RUR8.8.tn should be invested into production and processing development until 2020. This sum was taken from the earlier document – The Energy Strategy until 2030. According to the Accounts Chamber, this earlier document includes a too optimistic estimate of necessary investments. The sum of \$625 bn, huge by any standards, will be enough only in case of extremely favorable conditions, i.e. maximal oil prices and minimal expenditures of the companies. The real sum will likely be much higher: not less than one trillion dollars.

The Head of the Accounts Chamber Sergei Stepashin expresses his concerns about the fact that such an important document is elaborated based on unreliable data and his willing to participate in its correction. In addition, he suggests performing, together with Minenergo and interested oil companies, the additional simulations analysis and assessment of competitiveness of the Russian oil industry.

ERTA view

The Russian Chamber of Accounts is a constitutional mechanism. It does not mean, however, that the respect toward the national Constitution should automatically be given to all acts of the Chamber.

The Chamber of Accounts is a nucleus player on the green cloth of the Russian Fuel and Energy Complex. Its previous public entry related to the analysis of the ESPO construction costs, and A. Navalny made it especially resonant. However, instead of «Bravo, well done!», one wants to cry after each entry: "So, what next?" The Chamber of Accounts is a supervision body, and it seems like that is not its function to punish for violations revealed, but to offer practical solutions of the revealed problems. However, when the next found contrivance is left without consequences, it may be correct to review the focus of interest and to make a professional request: "And how are things there, behind the curtain?" Otherwise, there is no need to rootle round only to adopt the funds and to demonstrate the useful, but nonviable reasonability.

Consumers penetrate the gas oligopoly circles

Mineral fertilizers manufacturers continue trying to get preferences on the threshold of gas prices liberalization

Tags: [gas price](#)



Until now, mineral fertilizers manufacturers have addressed Deputy Prime Minister Igor Sechin, asking to develop for them a privileged price formula, which would regard not only the European prices of all products, but spot gas prices as well, which

are now lower. Recently, the Akron General Director Ivan Antonov has sent a letter to the government, asking to help the Company to purchase gas fields or to establish a partnership with independent gas producers, to provide the Company's own manufactures with gas. One of the options considers purchasing of the share in an existing gas company, for example, in one of Rosneft's subsidiaries.

Akron's position is supported by the President of Tatarstan Rustam Karimov. According to him, the Republic

of Tatarstan can also join the Company's gas project. In particular, the local Ammonia OJSC is also dependable on supplies of gas and other commodities.

The letter does not explain why it is the government, and not the Company's shareholders, who must solve its problems. Moreover, Akron has already owned the gas asset (21% of shares of Sibneftegaz, which holds the license for the Beregovoye field with the rated annual production up to 12 bcm of gas). However, in September 2009, after three years of negotiations, the package was sold to Itera for EUR92 mn. Akron did not manage to come to an agreement on the Beregovoye gas purchases to satisfy its needs (Akron consumes approximately 2.5 bcm annually).

The price level of the assets with such production capacity is demonstrated by the ongoing deal between Farkhad Akhedov an Inter RAO on sales of 49% of Nortgaz shares to the state company for \$1.5 bn.

BP's gambit

AAR and BP continue tactical games around the BP-Rosneft deal

AAR and BP continue tactical games around the BP-Rosneft deal. It was expected that the meeting of the TNK-BP's Board held on March 4 would discuss the proposals of the management, but the essential discussions were rescheduled for March 12, by the initiative of BP's representatives.

According to the management's proposal, TNK-BP should take the BP's place in the deal with Rosneft. The Company wants to purchase for \$7.6 bn 5% of BP's shares and to exchange them further for 9.58% of Rosneft's shares. Also, it wants to become the Rosneft's partner in a joint venture on development of three blocks on the Kara Sea shelf. In addition, TNK-BP will take the BP's place in a joint venture with Rosneft on operation of the Arctic shelf.

The final decision on the deal has not yet been made, but BP has already indicated its position in the letter sent to TNK-BP. Naturally, BP does not support the proposal of the management, as the Company has no sufficient technological and budget resources to implement the joint project.

At the same time, BP has formally violated the agreement with AAR, because it should have offer from the very beginning to realize the partnership with Rosneft through TNK-BP. Russian co-owners (Alfa's head Mikhail Fridman, who has been Acting President for more than a year, his partners – German Khan and Viktor Vekselberg, Executive Vice-Presidents), who currently have full control over the management, have likely not received any definite restriction from the state authorities. So, they again drove BP in the corner. At the same time the court under the Stockholm Chamber of Commerce started the proceedings on this matter.

With regard to the fact that Rosneft has no need

in partnership with TNK-BP, it is quite possible that AAR's objective is not replacement of BP in the deal, but advantageous negotiating position in case TNK-BP is merged by the oil state-owned company. The current situation makes such an end quite possible.

Sitting in a trap, BP cannot vote at the Board's meeting against the management's proposals, or it will have to forget about partnership with Rosneft. But it has no right to agree on them, or in this case Rosneft will not like this partnership.

For now, statements of the Russian officials evidence their readiness to wait and see where the corporate scandal will come to. Last week, for instance, it was the first time when Vladimir Putin gave his comments about this situation, saying that he personally had never known about possible controversies between BP and AAR, that the British had never warned him, and that they would have to solve mutual claims on bilateral base. At the end of the conflict, someone of the participants (likely BP) may be ready to settle is on any terms.

Vladimir Putin hopes that TNK-BP and BP will be able to settle the internal conflict amicably. This was the opinion of the Russian Prime Minister expressed to the reporters. Being asked about his vision on settlement of the TNK-BP - BP conflict in view of the BP's pans concerning exchange of assets with Rosneft, V. Putin said that the final decision would be made by judicial authorities. "These are their problems, they must solve them between themselves", Putin said.

"They once signed an agreement on joint operations. It is known that TNK-BP thinks that BP has to receive TNK's approval for all of its business activity in

M&A

BP's gambit

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Russia and to work together with it. BP refers to the fact that this rule is not absolute or universal, saying that they work on Sakhalin without TNK-BP. Putin said, expressing his hope that the sides could settle this conflict by amicable means or to come to a compromise.

Along with that, V. Putin admitted that the conflict had been a surprise for the Russian side. "None of the sides informed Rosneft that there might be some problems»,

Prime Minister said. "I knew nothing about it: I met the BP head, and he did not tell me a word», Putin added.

Also, Prime Minister considered it possible that TNK-BP would participate in development of the Russian shelf. "This is a special case", he said, meaning participation of TNK-BP in offshore operations. "TNK-BP can also take part in the development if it offers acceptable terms of cooperation to one of these companies. Why not?", Putin said.

Non-aggression pact

Board Alexei Miller and Vagit Alekperov signed the Agreement for supply of gas from the fields of the Bolshekhetskaya Depression and the North Caspian area

Tags: [LUKoil](#)

After several years of negotiations, the Chairman of Gazprom Board Alexei Miller and President of LUKoil Vagit Alekperov signed the Agreement for supply of gas from the fields of the Bolshekhetskaya Depression and the North Caspian area.

According to this document, in 2012-2016, LUKoil will supply natural gas from the Bolshekhetskaya fields to Gazprom. Gas will be supplied to the Gazprom's gas transportation system near the Yamburgskaya compressor station.

The document specifies the supply volumes. It is expected that they will amount to 8.35 bcm of gas in 2012 and will be changed, as new fields will be put to operation. Along with that, the agreement anticipates possible limitations of gas supply to the gas transportation system (GTS), depending on "the Gazprom's system load".

Gazprom rejected the idea of independent operation in market from the very beginning, signing in 2005 a contract for supply of gas from the Nakhodkinskoye field (the first one on the Bolshekhetskoye Depression). The Company built and handed over to Gazprom the gas line from the field to GTS with capacity up to 25 bcm annually (this is the peak yield of 5 Depression field). Then it started selling gas at the entrance to the system, but failed to bring Nakhodka to permanent project production, due to the crisis and decreased demand. Last year, Gazprom took off about 8 bcm. At the same time, the price formula allowed Gazprom to sell the gas at a price much higher than the FTS price for the Yamal Nenets autonomous district, assuring high sales profitability.

In addition, the agreement signed by A. Miller and V. Alekperov anticipated solution of problem with disposal of the associated gas from the LUKoil's Caspian fields. For many times the oil company's head accused Gazprom before Prime Minister Vladimir Putin and Deputy Prime Minister Igor Sechin, saying that it could not dispose

associated gas produced during bringing to operation of the Korchagina field (last year) and Filanovskogo field (scheduled on 2014-2015). According to the document, Gazprom will take comprehensive measures to accept all gas volumes to its GTS and will supply similar volumes under the replacement schemes to the LUKoil Group facilities. The form of gas acceptance into GTS, however, is not given in detail. It is not clear, in particular, who and in what extent will take the expenditures for construction of the connecting infrastructure or, in other words, where exactly the gas receiving point will be located. Earlier, Gazprom offered LUKoil to build the 700km-long gas line to interconnect the Caspian fields and GTS. The oil company plans to use associated gas at its petrochemical facility.

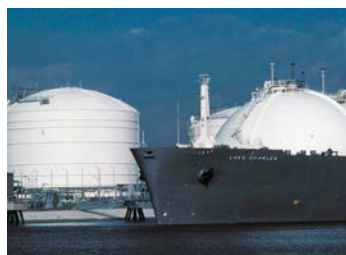
ERTA view

The meetings of Gazprom's and LUKoil's CEOs have been held for more than ten years. During this time, Gazprom has received a new CEO. Noticeably, these meetings have certain properties of international meetings between the state leaders. High Contracting Parties negotiate on the principles. And then, practical executors of both parties suffer long torments, trying to realize those principles. The results vary a lot.

The agreement for the Bolshekhetskaya gas supplies has been signed long ago. And it has been known for a long time that the key issues within this agreement are: supply price and volumes. Their critical character made LUKoil to suspend its Bolshekhetskaya field development program. The principally new agreement covers the gas supply replacement scheme, as LUKoil is not only gas producer, but its major consumer. And again and evidently, the devil here lies in details. The gas cannot be delivered to the Unified Gas Supply System (UGSS) at a certain price in West Siberia and received at the very same price from the UGSS at the Russian South. But the question.

The “grow-into” production site

SIBUR bought the Baltic LNG



SIBUR (controlled now by NOVATEKs head Leonid Mikhelson) decided to purchase the Baltic LNG project from the Gazprom and Sovkomflot structures. This project has been frozen for long.

General Director of Baltic LNG and former head of the Gazprom's Department for Corporate Policy Alexander Krasnenkov said that SIBUR needed the production site of that project in the port of Primorsk for the purpose of construction of the methanol

plant with throughput capacity up to 2 bcm of gas annually.

Gazprom Germania owns 80% of Baltic LNG, Sovkomflot – 20%. The company was established to design the LNG plant with capacity 3.5-5 mnt annually.

The sum of the deal is not disclosed, but, according to informal data, it will be a symbolic sum covering the expenditures of former shareholders.

However, SIBUR will launch the project not before 3 or 4 years. To these times, gas price liberalization may make the production of the new plant non-competitive in terms of world markets. Besides, the existing SIBUR's investment program until 2015 does not include the investments into such a plant.

ERTA view

Construction of an onshore methanol plant and entrance to the international methanol market... is very attractive indeed. The core thing in this project is its planned location at a distance of several thousands of kilometers off the gas fields. And even the possible Shtokman gas supply will not change the situation with the evidently expensive gas. So, we could recommend the project initiators to accompany the plant's engineering with engineering of a mechanism ensuring the acceptable price of gas onshore the Baltic Sea – i.e. production cost + transportation cost.

By the way... gas is also present in the Far East. And there, tankers have not to work their way through the narrow Danish belts. Though, it is another story...

Futures bring nervousness

Russia decided to use instability on the oil market, caused by Libyan events, to promote the idea of long-term oil contracts

The Russian Ministry for Energy Sergei Shmatko said that Russia would increase oil production and export, in order to prevent the price growth in his interview given to the German magazine WirtschaftsWoche.

The Russian Minister recommended the importer states to adopt long-term contracts which would serve as guarantees from price fluctuations.

Russia, in spite all its intents, is hardly able to increase crude export. Its current production possibilities are limited to a high extent. It will be able to maintain the production level in the long-term prospective (according to proposals of Minenergo), only in case that material tax benefits for development of new fields will be given and the general fiscal regime will be softened.

The only possible way to increase export to Europe is to redirect some part of the volumes supplied to China through the ESPO pipeline. However, this scenario can be realized only in case of trade (or real) war between Moscow and Beijing.

The OPEC states, with their production quotas, have free capacities. In case of deficit, they will be able to compensate the Libyan volumes. Saudi Arabia – the largest world exporter – has already declared that it would increase

crude production to 700 bbl/day - up to 9 mn bbl (this is almost 40% of the Libyan production).

Gazprom, by request of its partners, has sharply increased gas export to Italy (from 30 to 48 mmcm daily) to cover the stopped pipeline from Libya Greenstream (its daily capacity is approximately 25 mmcm).

ERTA view

During the last dozen of years, this trick has become so trivial... In the critical situations on the world oil market, the Russian state representatives address OPEC with an appeal to coordinate the efforts. As an evidence of their readiness to negotiate, they speak about current reduction (not increase) of oil production volumes in Russia. But the real reasons for that reduction (not increase) lie in a quite different area.

Since the trick is trivial, the response to it is known beforehand: “to talk, we are always ready”. Maybe, the crisis phenomena on the world oil market will reach the extent when OPEC, Russia and other oil-producing countries will launch practical consultations. But something makes us feel that in this case their key initiators will not be Russia or OPEC states.

End of the cream-of-the-cream

The Deputy Chairman of the Board and future TNK-BP's head Maxim Barsky has announced that the Company was interested only in Vietnamese production assets



That is why the Company rejected 50% of Dung Quat Refinery offered by Petrovietnam. Instead of it, the Company would like to purchase several more gas blocks located close to those purchased from BP.

They include such blocks as 11.2 (75% is owned by KNOG, 25% by Petrovietnam), 12w (75% - Premier Oil, 25% - Delek Energy), 05.3 (50% shares are owned by BP and ConocoPhillips each) and 05.2 (75% - BP, 25% - Petrovietnam). The result of negotiations between the TNK-BP management and the Petrovietnam delegation before the March holidays is not known.

In August 2010, TNK-BP and Petrovietnam signed the Memorandum on Understanding. This document anticipated creation of a joint venture in Vietnam and Russia for operation in the areas of exploration, production and processing. Petrovietnam offered TNK-BP participation in expansion of the Dung Quat Refinery from 6.5 mnt to 10 mnt. In turn, TNK-BP offered the Vietnamese company the shares in development of the Verkhne-Tarsky block owned by Novosibirskneftegaz and the assets owned by Varieganneftegaz and Buguruslanneft.

Then, in autumn, TNK-BP agreed to purchase the BP's assets in Vietnam and Venezuela. The British company had to sell them, in order to compensate numerous losses caused by the accident in the Gulf of Mexico. In Vietnam, in particular, TNK-BP purchases the BP's share (35%) in the offshore producing gas block 06-1, 32.7% in the Nam Con Son pipeline and terminal, 33% in the Phu My 3 power station.

For now, TNK-BP's active expansion abroad is limited by assets put up for sale by BP. Other projects meet obstacles. Though, the situation with the shares of the British shareholder is not that simple. TNK-BP counted very much on the BP's project in Algeria - In Salah field. However, the Algerian Minister for Energy Youcef Yousfi announced that BP rejected its plans of selling Algerian assets to the Russian TNK-BP. The Minister assumed that it might be caused by the fact that the Company had no more need in the money for elimination of consequence of the accident in the Gulf of Mexico. Any way, TNK-BP's chances have been low from the very beginning. The BP's share was claimed by shareholders owning the purchase option, namely Sonatrach and Total. In view of a new conflict between the Russian and British co-owners of TNK-BP, they can well be considered hardly possible.

Blind swapping

Problems with implementation of the Burgas-Alexandrupolis pipeline project did not make Russia to rush headlong into the alternative project on the bypass of the straits – the Turkish-Italian Samsun-Jeikhan



The intergovernmental agreement on this issue was not signed in the course of the Russian-Turkish intergovernmental committee's meeting held on March 4 even in a framework format, though the Russian Energy

Minister Sergei Shmatko had announced this possibility. The Turkish side holds off on issuing the permit to lay the Southern Stream gas pipeline's route in its waters, even though it promised to do this as early as last autumn.

The Samsun-Jeikhan oil pipeline must become an alternative for tanker shipping through the overloaded Turkish Straits. The project capacity of the pipe is 50 mnt of oil annually. In 2009, Russia decided to join this project, requesting 50% share and giving an oral promise about 25-30 mnt of oil. Rosneft and Transneft signed the Memorandum of Understanding. It was done out of spite

of Bulgaria. When the party of the existing Prime Minister Boyko Borisov won the elections, Bulgaria froze the energy cooperation with Russia and is still continuing to block the Trans-Balkan oil pipeline's project (51% of it is owned by Russia).

Formal controversy between Russia and Turkey concerning the Samsun-Jeikhan project lies in the size of tariff. According to preliminary calculations, it varies within the range to \$19-20/ton. Tanker delivery of the oil through the straits is 5 times cheaper (about \$4), and that of through the TransBalkan pipeline, which should also provide the bypass of the straits on the way to the Mediterranean Sea, was expected at the level of \$7-14. A half of the tariff will be received by the Russian side (unlike the Samsun-Jeikhan project). Not to mention the fact that, strategically, the TransBalkan project is more important for Russia.

The Turkish Prime Minister Recep Erdogan is expected in Moscow on March 15-16. To this date, negotiations should get a new impulse.

Naftogaz is going to the stock exchange

Ukraine is looking for an alternative to the proposal to unite the gas transportation systems made by V.Putin

The Gazprom's partner in RosUkrEnergo, the Ukrainian businessman Dmitry Firtash openly supported the plans of the Ukrainian Energy Minister Yury Boyko to place one-fourth share of the state-owned corporation Naftogaz at the stock exchange, instead of the merger with Gazprom owned by Russia. Also, he stands against any form of management of the Ukrainian gas transportation system together with Gazprom. Moreover, in his interview to the French magazine *Politique International*, he supported construction of the liquefied natural gas import terminal and reduction of dependency from the Russian import.

Last spring, the Russian Prime Minister Vladimir Putin offered to create the united company on the base of Gazprom and Naftogaz. The Ukrainian authorities responded that they were ready for parity partnership only. Currently, the parties are discussing the possibility of creation of a joint venture on the base of the part of the assets. Gazprom offers to invest the fields to the joint venture, expecting that the Ukrainian counterpart will agree

to invest its GTS. Though, having got \$100 discount to the import gas price, Kiev is not making haste with the rapprochement, delaying the essential negotiations. In particular, the legislative prohibition for privatization and any other forms of withdrawal or overburdening of the Ukrainian GTS, is still in force. GTS is owned by the state and was given under management of the state company Naftogaz by the governmental order.

In fact, in 2009, RUE was deprived of its business of a mediator on the Central Asian gas supplies to Ukraine and Europe by Julia Timoshenko. According to the decision of the Stockholm arbitration, which admitted the withdrawal of RUE's 11 bcm of gas by Naftogaz in that heating season illegal, the trader received this volume back, but, within the framework of the mutual claims settlement package, immediately sold it to Gazprom, which had allocated it before within its export portfolio. According to the results of this deal, RUE should stop its activities.

Miller has got five more years



On March 3, Prime Minister Vladimir Putin signed a Directive approving the extension of the contract of the Company's Chairman of the Board Alexei Miller for more 5 years. This Directive was addressed to representatives of the state in Gazprom's Board, who hold 6 seats of 11. The monopoly's Board will discuss this question on March 22, more than

in two months before the official expiration of the said labor contract. This situation bears no signs of any intrigue with the post of the Gazprom's CEO. In 2006, the government was delaying formal procedures to the uttermost. The Board's meeting was held late May, a week before the deadline.

It is clear, that A. Miller is good not only for V. Putin, who appointed him to Gazprom 10 years ago and was protecting him all that time from attacks of opponents, but for D. Medvedev as well. A. Miller successfully cooperated with the existing President during 7 years, when D. Medvedev headed the Gazprom's Board.

ERTA view

Generally speaking, whether A. Miller will leave or not, it is a matter of his personal interest only. The focal decision-making point within the existing gas industry management system has been located beyond Gazprom for long. The appearance of a relatively independent charismatic leader of the Company is simply impossible. And appointment of another functional manager to replace A. Miller will not principally change the situation.

New people can appear only with new objectives. So, what is much more interesting now is the discussion of such matters as: changes in the gas price regulation system; the Russian gas market's organization; new formats of interaction between the market players.

I did not choose what companies' shares to buy...

Mass media confirm the connections between General Director of the Russian Technologies State Corporation (Rostekhnologii) Sergei Chemezov and Itera. It became known that, in the period from 2006 to 2009, the company Elsamex Enterprises Ltd, registered in Belize and owned by Chemezov's wife Ekaterina Ignatova, bought 5.1 % of Itera's shares from the Troika Dialog. Last year, she sold the most part of these shares (about 4%) to Itera's Chairman of the Board and major shareholder Igor Makarov. Sergei Chemezov said that he knew nothing about these transactions. Troika Dialog, as a trustee, managed the investments of his family at its own disposal. According to him, it was "a trader's purchase, not a strategic one", and his wife was going to get rid of the rest part (1.1%) of Itera's shares.

Along with that, the Rostekhnologii's CEO did not deny his long acquaintance and "good personal relations" with the Itera's head. Sergei Chemezov has been known as new patron of I. Makarov's business since the time when Itera failed to come to an agreement on mutual activities with the new Gazprom's management. He denies, however, that he has participated in gas business in any ways.

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