

## Russia-Ukraine gas relationship: another attempt to eat a cake and have it



of agreements intended to regulate the problem concerned with return of 12.1 bcm of gas to the Swiss trader and mutual debts.

RUE will receive the gas and sell it to the Gazprom Export bodies with delivery in 2010-2011, with immediate repayment of its full debt to Gazprom Group in the amount of 810 mn USD and to the Ukrainian state company in the amount of 1.7 bn USD.

To the end of the year, the Russian corporation's bodies will receive 4.6 bcm of gas, in the next year – the rest 7.5 bcm. To fill the gap in the gas balance of the state, Naftogaz will continue to purchase Russian gas in accordance with the contract; however, it had asked earlier to reduce obligatory volumes under its take or pay contract. In order to obtain finance for arrangements with Gazprom, Naftogaz obtained the advance gas transit fee in the amount of 1.5 bn USD (the Gazprom-Naftogaz agreement states the provision on annual transit of 112 bcm of gas within five years; in case of lesser quantity of gas, the terms of advance payment return will be extended).

According to the available information, Gazprom Export will purchase the gas from RUE with 10 percent discount to the average long-term contract price. I.e., 290-300 \$/mcm. Meanwhile, RUE should pay its debts (total 2.5 bn USD) momentarily in cash, not waiting for the completion of delivery contracts. In fact, the Russian corporation will give an advance in the amount of 2.5 bn USD towards future deliveries (810 mn USD can be well accepted as set-off) and pay the rest after delivery. As a result, Gazprom will benefit from gas resale to EURpe (20-30 \$/mcm) and receive also 50% of the profit, as a RUE stockholder. Though, the second shareholder, businessman Dmitry Firtash, will get the second half of the margin, which may amount to approximately 1 bn USD.

It is not quite clear, why

Gazprom decided to advance money for transit (no rate discounts are specified). It was likely a term of settlement stated by Kiev. Head of the Ministry of Fuel and Energy of Ukraine, Yury Boyko, tried to obtain safeguards against loading of the Ukrainian gas transport system, but Gazprom did not agree to change the contracts which did not include the take or pay provision. As a result, the Ukrainian party had to be satisfied with virtual guarantees. Namely, Naftogaz has the right to extend the term of advance money working-off to the period beyond 2015, in case Gazprom will not transport at least 112 bcm of gas via the Ukrainian territory, beginning with 2012.

In the third quarter of 2011, the Russian corporation plans to startup the first NordStream line, which will transport a part of gas currently going via Ukraine. To the year of 2013, this gas main should reach its design capacity – 55 bcm. Gazprom is responsible for full load of this pipeline, since the contract with the Nord Stream was signed on take or pay conditions. Kiev is very well informed on that, and it even plans to reduce the transit to 94 bcm of gas (planned volumes for the next year amount to 105-100 cub.m.). When the Nord Stream pipeline reaches its full capacity, and provided that there will be no additional European demand for Russian gas, volumes of transition via Ukraine may drop to 75-80 bcm as soon as in 2013. Kiev can account for 112 bcm, if the European clients of Gazprom would take full contractual volumes only.

It is supposed, that Naftogaz will render to Gazprom transit services in the account of advanced payment during four years (from 2012 through 2015), i.e. approximately 375 mn USD per year. Given the current price of transit via Ukraine (31-33 \$/mcm), it makes 11-12 bcm of gas each year, or total 44-48 bcm. Managers of the Russian corporation have announced many times, that they expected improvements in the European environment, beginning with 2012. If forecasts fail, then, in the worst case, Gazprom will wait for Naftogaz working off its advance money for a year or two more.

At the same time, Naftogaz will use 1.5 bn USD of advance money to perform its gas off-take responsibility to Gazprom (which will also help to close the state's gas balance). In the previous year, like in this year, the Russian corporation made advances to Kiev, reducing the minimal off-take volume to 5 bcm (to 27 and 37 bcm, correspondingly). Meanwhile domestic gas consumption in Ukraine did not increase significantly, and Naftogaz bought some part of export gas, having in mind its settlement of accounts with RUE.

In 2011, Naftogaz is obliged to purchase from Gazprom not less than 41.6 bcm of gas (take or pay level). Meanwhile, according to the agreements achieved by the heads of two states in spring, 30% discount (not more

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## News brief



**Gazprom**, Naftogaz and RosUkrEnergo signed a package of agreements which will resolve the issue of mutual debt repayment and return of 12 bcm to the Swiss trader company. RUE will receive gas volumes then resell it to Gazprom with delivery in 2010-2011 and it will immediately pay off its debt to Gazprom and to the state Ukrainian company in the amount of \$810mn and \$1.7bn respectively. Gazprom export will buy RUE volumes with 10% discount to the average price in long-term contracts. Thus Gazprom will gain profit from reselling discounted gas in Europe and receive 50% of RUE profits as a shareholder. Moreover Naftogaz will get an advance payment for future gas transit in the amount of \$1.5bn from Gazprom in order to be able to settle accounts with the latter (while to be able to meet Ukrainian gas need in full as well). ➤ Page 1

**Rosnedra** recommended that the Government should grant Rosneft production licenses for Admiralteyskaya and Pakhtusovskaya structures after 2013. Group Sintez currently holds the licenses but the effective law "On Continental Shelf" does not allow the company to develop the structures on its own. In three years when the licenses expire, Rosneft will have the right to obtain these licenses almost for free. ➤ Page 3

The authorized governmental body on the PSA project Sakhalin-1 approved the operating budget for 2010. Deputy Energy Minister Sergey Kudryashov took part in the meeting as a co-chairmen on behalf of the federal body. The former co-chairmen on behalf of the Ministry of Energy Sergey Svetlitsky resigned effective as of Dec 1, 2010. Mr. Svetlitsky has always been considered the main opponent to **Exxon Neftegaz** - the operator of the project Sakhalin-1. Mr. Kudryashov has been informally in charge of PSA project monitoring since August. ➤ Page 4

**Transneft** send the offer to the Federal Tariff Service on additional 2-3% increase in oil pumping tariffs starting from January 1, 2011. The company justified the necessity by reduced turnover and the need to finance antiterrorist safety measures. On the whole Transneft tariffs will grow 31.6% YoY by January 2011 or even 35.5% YoY in case the proposed additional rise is approved. Oil companies are likely to face falling profitability of supplies and will be forced to diversify their means of transportation in favor of railways. ➤ Page 5

**Evrosibenergo** of Oleg Deripaska, postponed the IPO in Hong Kong for a prior establishment of a strategic joint venture with the Chinese state company China Yangtze Power. The parties will consider six projects on construction of power stations in East Siberia and Far East. One should not exclude the possibility, that the real cause of IPO postponing was the low interest of the investors. ➤ Page 6

**Vneshekonombank** signed the agreement with the Boguchansk Energy and Metallurgical Association (shareholders RUSAL and RusHydro) under which the Association will receive credit resources from VEB in the amount of RUR 50.01bn on completion of construction of the Boguchansk hydropower station and the Boguchansk aluminum plant. ➤ Page 7

**LUKoil** in its medium-term development plan for 2011-2013 focuses on production growth abroad particularly in Western Africa. About 20 prospective subsoil blocks was revealed in Ghana and Cote d'Ivoire. Negotiations with Gabon and Equatorial Guinea are ongoing. ➤ Page 7

The **11th Gas Exporting Countries Forum (GECF)** ministerial meeting was held in Doha. The energy ministers of the member countries absolutely supported the idea of gas price in the long-term contracts being linked to oil price on a formula basis. No other strategic organizational development documents were approved. ➤ Page 8

**Gazprom and Shell** CEOs, signed in Moscow a protocol on global strategic cooperation. Most likely Gazprom is looking for opportunities to participate in projects in third countries. While Shell is interested in expansion of its participation in development of Sakhalin resources by means of the Kirinsky block owned by Gazprom (part of Sakhalin-III). The latest concept of Sakhalin projects development prepared by Shell was turned down by Gazprom. Shell makes a full stress on the expansion of LNG plant and offers to use the increasing gas production to load the plant, while Gazprom is seeking to load the Sakhalin-Khabarovsk-Vladivostok pipeline. ➤ Page 9

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than 100 \$/bcm) is allowed for the volume of 40 bcm per year only. I.e., Ukraine will have to buy 1.6 bcm of gas by European prices, without any discounts.

Ukraine, having not received any loading safeguards, compromises on establishment of a joint enterprise based on the Russian fields and its own gas transportation system (GTS) and announces its readiness to upgrade its GTS by its own forces. Yury Boyko held a meeting, where he approved the program of investments in the amount of 390 mn USD for the year of 2011 (i.e. almost twice as much as it will be invested into maintenance of the system, according to the results of the current year). These investments will be used for reconstruction of the Soyuz, Urengoy-Pomary-Uzhgorod, Elets-Kremenchug-Krivoy Rog, Ananiev-Tiraspol-Izmail pipelines, Yagotin, Berdichev, and

Komarno compressor stations (gas turbine units will be replaced by electric units, which will allow fuel savings), as well as for the UGSF (underground gas storage facilities).

As for Gazprom, it continues to develop the South Stream project with design capacity up to 63 bcm, which will be able to keep the Russian gas transit via Ukraine to its minimum. Last week, the corporation published a new official assessment of capital expenses of construction of the offshore section and land network beyond the Russian boundaries. Head of Project Management Department Leonid Chugunov, who supervises the project, said that the cost of the project would be 15.5 bn EUR (exclusive of the cost of works on the Russian territory). Earlier, the South Stream head (offshore operator) assessed the cost of the pipeline on the Black Sea bottom as 10 bn EUR.

### ERTA view

Old debts are settled, advance payment for the transit is made. And the money transferred to Ukraine will immediately go back to Russia on account of the Russian gas. Discounts are given for a part of the gas, the other part goes without any discount. And so long and so forth.

While Russia and Ukraine (Gazprom and Naftogaz) follow such schemes of mutual settlements and deliveries, no agreements on establishment of the joint venture and mutual operation of the Ukrainian gas transportation system (GTS) may be reached. This requires quite a different level of interrelations and mutual confidence.

When business is so deeply intertwined with the politics, easy and clear solutions are not always possible. Only when the deals are transparent as child's tears, one can say, that gas deliveries to Ukraine is pure business, nothing personal.

## Rosneft is likely to press Sintez Group on Barents Sea shelf

Rosnedra offered the Government to issue the license for production on the Admiralteyskaya and Pakhtusovskaya structures after the year of 2013 to Rosneft. Rosneft has been interested in them for a long time, but exploration licenses for the blocks are owned by Sintez Group. All attempts of the state bodies to withdraw licenses were challenged at courts, but the group controlled by Senator Leonid Lebedev has not been able to sell these assets. The term of validity of the exploration licenses issued to Sintez will expire in three years, and Rosneft will then be able to get them practically for free, in accordance with Federal Law "On Continental Shelf". The only chance for Sintez is to come to an agreement with another purchaser, say, Gazprom Neft, who has got the right to operate on the continental shelf not long ago and has been looking for new possibilities.

The problem is, that Minprirody has elaborated the offshore site allocation program, having in mind two companies, namely Gazprom (gas) and Rosneft (oil), so, Gazprom Neft should search for the alternatives.

According to estimates made by Sintez, its expenses for appraisal well drilling, the field development project and the oil transshipment facility amount to 80 mn USD. If the production license is given to Rosneft, the state will have to reimburse the company's investments. However, the reimbursement procedure is long and not well practiced.

Meanwhile, Gazprom Neft has already initiated the license-obtaining campaign. The company has already submitted

a request for obtaining of two blocks in the Pechora Sea, and Gazprom Neft – Sakhalin is going to submit two applications on the blocks in the Sea of Okhotsk until the end of this year. Earlier, this company returned the license to Lopukhovskiy block (near Sakhalin shores) to Rosnedra, justifying that by absence of partners for the development. Before 2012, Gazprom Neft should receive from Gazprom two more shelf projects – the Dolginskoye and Prirazlomnoye fields, but the license-passing procedure is not still clear.

### ERTA view

Continuous excitement for no reason is surprising. Just take the map and look at the location of these blocks, Admiralteyskiy and Pakhtusovyi! This is practically a northern edge of the Novaya Zemlya. What real development of these blocks may be spoken of in the foreseeable future! It is understandable, when the state speaks of the arctic shelf and struggles for the right to develop it. It is doing this for the next generations. But when the companies with real economy are trying to use this political hullabaloo to enter the far Northern shelf, this is not clear at all.

For Gazprom and Rosneft, the Russian arctic shelf is not a gift, but a hard burden. And besides, it is clear already, that the companies will not be able to fulfill in full scope even the responsibilities on geological exploration. The extension of exploration licenses up to 8 years is already being discussed.



## Personnel changes at the Ministry of Energy helped to approve the Sakhalin-1 budget

On November 29 (a month before the end of the year), the Authorized state body (ASB) on PSA of the Sakhalin-I Project approved the Project's budget for the year of 2010. The meeting was held by Alexander Khoroshavin, Governor of Sakhalin Oblast, who is a Co-Chairman of the Authorized state body (ASB) representing the regional authorities. The ASB Co-Chairman representing the federal government Sergey Svetlitsky, Deputy Energy Minister, who was considered the main opponent of Sakhalin-I Operator – Exxon Neftegas, did not participate in the meeting.

As a result, the other Deputy Minister, Sergey Kudryashov participated in the ASB meeting on behalf of Minenergo. Informally, he received his authorities to supervise the PSA projects in August, but he is not a formal ASB member. At that time, the Ministry explained, that S. Kudryashov, as an oil&gas expert (previously he had worked in Rosneft, which is a member of a consortium dealing with the Sakhalin-I Project development), would be more qualified to participate in Sakhalin-I technical development discussions with the Operator. In addition to the 2010 budget, the officials considered the new technological scheme and the program of works on field development and production for

the full Project implementation period.

Authorities of V. Azbukin in Minenergo on relations with the state bodies were delegated to Yury Senturin, who was appointed State Secretary in September (Before that, he held the similar post in the Ministry of Education and Science). Some part of authorities of S. Svetlitsky, in particular, finance and economy and capital construction, will be delegated to the other new deputy – namely, the former head of Atomstroyexport Dan Belenky (who replaced Sergey Shmatko on this post). Official supervision of PSA projects will be likely imposed on Sergey Kudryashov.

### Resignations at the Ministry of Energy

This can be easily explained: he had been certified sick the previous two months and resigned by his own volition since December 1. Also, the other Deputy Minister left the Ministry, namely Vladimir Azbukin, who had been taken from Atomstroy export by Sergey Shmatko (and acted as a most useful second of the Head of Minenergo). If V. Azbukin was a victim of the spur of the moment, due to the summer blameworthy caused by failure of the ministries to fulfill the President's orders (V. Azbukin was reprimanded by the Government), S. Svetlitsky lost his post, partially due to the Sakhalin-I conflict.

### ERTA view

The local crisis has been overcome. The budget for 2010 was approved. Against the background of all hardships, reduction of the requested sum for 30% does not seem of any significance.

But not all of the participants were mentioned. In fact, that means that I. Sechin has interfered into the process and solved the problem. We are interested, whether I. Sechin is eager to regulate relations between ExxonMobil and Gazprom on prospective gas deliveries to China as well. Then we take the liberty to give ourselves a clue. There is an excellent instrument, which will be used for the Sakhalin-II Project's gas. The federal budget subsidies will make the expensive Sakhalin gas cheap. Our budget is large, and Russian consumers will appreciate it...

## Bashneft won without a «battle»



The Rosnedra Commission announced the bid for Trebs and Titova fields in the Nenets Autonomous District failed, but recommended the Government to issue the license for the field with ultimate estimated reserves of 140 mnt to the only bid participant – the Bashneft company. The plot about the bid winner was practically over as early as in the end of October, when Surgutneftegas fell out the race

(Gazprom neft, LUKoil, TNK-BP and Nord Imperial had not been allowed to participate in the bid by formal reasons as

early as at the tendering stage). However, the question of companies to be invited by Bashneft for cooperation in the Project implementation is still open.

Negotiations with Rosneft have not yet been successful. Anyway, Bashneft will have to cooperate with LUKoil, with its regional infrastructure (in addition to the wells drilled in the fields, which Bashneft obtained, the company headed by V. Alekperov has pipelines and its own oil-loading export terminal).

The non-alternative license issued to Bashneft allowed the company to pay no significant premium to the initial price states by Rosnedra (the company offered 18.47 bn RUR, given the size of minimal payment – 18.17 bn RUR).

## Transneft intends to raise tariffs one more time



«Transneft sent the offer to the Federal Tariff Service (FTS) on additional rise of the oil pumping tariff to 2-3% since January 1, 2011, though it had promised before to manage with the existing budgeting sources. The company justifies the necessity to

increase the tariff by the reduced turnover plan and the cost of anti-terroristic security of the assets. However, according to the FTS opinion, the question of increased transfer prices should wait for the spring.

In September, Nickolay Tokarev, the Transneft CEO, said that the tariffs would grow in line with inflation. According to the Ministry of Economic Development and Trade's forecast, inflation in 2011 will be approximately 7%, i.e. the 10 percent growth in December already exceeds this level. Besides, he said that no tariff rises were planned for 2011.

In case of the next growth of rates, oil companies will face the reduction of profitability. In general, to January 2011,

compared to early 2010, the tariff of Transneft will grow to 31.6% (if 2-3% growth is not approved) or 35.5% (approved growth). Such significant growth adds difficulties to oil companies, so, lately they have been trying to reject the services of the oil transport monopoly, if possible, and to use other means of oil transportation (railroad transport). This likely explains the reduced turnover plan of Transneft.

The result is a vicious circle, fed by poor control over Transneft expenses within the framework of operational activities and the investment program.

### The history of Transneft tariffs rising

The FTS increases the Transneft transfer Tariff several times in a year. In late 2008, this body approved the growth of rates to 15.7% since the beginning of 2009, and then for 4.4% more from July 1. In late 2009, the FTS approved the growth of rates to approximately 15.9% since the beginning of 2010. Since August 1, the tariff increased to 3.3% more, and since December 1 – to 10% more. The existing oil transfer tariff (including transportation to China) through ESPO amounts to 1 815 RUB/ton, the rate for oil transfer through the BPS is 379 RUB/ton.

### **ERTA view**

To onlookers, this process appears as a vicious circle. One of the strongest reasons of non-controlled tariffs growth in the political projects of Transneft is their actual budgeting from a single pool, and in the requested volume. In such conditions, substantial growth of costs is practically guaranteed.

On the other hand, this stimulates a permanent natural need for gradual increase of tariffs, which, in turn, provokes the launch of new projects. Will there be enough foresight to stop this merry-go-round in time?

## E.ON Ruhrgas sold out its shares in Gazprom



The biggest European client of Gazprom, E.ON Ruhrgas, has finally withdrawn its membership as a stockholder of the Russian gas monopoly. E.ON (consolidation parent of the Essen

company) sold 2.7% of Gazprom stock to Vnesheconombank and realized the rest 0.8% on stock exchanges. Total E.ON stock sale proceeds will be 3.4 bn EUR, and the earnings reflected in the balance will be approximately 2.5 bn EUR.

E.ON expressly announces, that its withdrawal of stockholder membership “does not mean any changes in strategy concerning Russia”. The thing is, that the company, having found itself in difficult financial conditions, decided to sell non-strategic assets in the amount of approximately 15 bn EUR to the year of 2013.

Gazprom does not feel offended by E.ON; however, its relations with this corporation have been rather contradictory in the latest years (E.ON Ruhrgas was close

to be left beyond the Nord Stream and the Yuzhno-Russkoe field development projects, being now in the front lines of European buyers of Russian gas, who is struggling for

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### E.ON Ruhrgas

So, ended the history of the biggest Gazprom foreign joint owner, who had bought, in a matter of months following the default of 1998, 2.5% of stock of its Russian counterpart for 660 mn USD. In the following five years, it increased its stock package to 6.5%, getting a seat in the Gazprom Board of Directors in 2000. Some part of stock (2.93%) was purchased according to so-called “grey schemes” on the Gerosgaz joint venture, which was controlled by Gazprom, but the German partner became a real beneficiary after liberalization of the Russian monopoly's stock market. The year ago, E.ON Ruhrgas handed over this asset to Gazprom in exchange of participation in the Yuzhno-Russkoye field development, with additional payment of 67 mn EUR (while the market price of Gerosgaz stock exceeded 2.8 bn EUR at the moment of the deal). However, the “grey” history of the stock forced the Germans to grant a discount.

## E.ON Ruhrgas sold out its shares in Gazprom

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critical revision of long-term contracts).

Following that, Vnesheconombank, who acted as a federal special agent in this deal, whose task was to prevent Gazprom capitalization collapse, will sell this stock to another strategic player or realize them in the market. The shares have a growth potential, for Gazprom seems like one of the most undervalued Russian company in the post-crisis environment. Only a week before, 3.5 % of Gazprom stock cost 3.24 bn EUR, i.e. were traded lower than a deal price. Quotations, though, were increasing continuously, and the market was closed at a price of 182 RUR/share (notwithstanding the sale of almost 1% of stock at stock exchanges), which corresponds to the price of the stock

package sold by the German company – 3.67 bn EUR. Based on that, the share of Vnesheconombank has already cost approximately 200 mn EUR more, than it should pay.

This deal will seemingly cause no personnel sequences. Burkhardt Bergmann, former head of Ruhrgas, has been holding his seat in the Gazprom Board of Directors for 10 years already. Stock sales could hardly impact his position. He was not holding any posts in E.ON Group for two years, but the top management of the Russian corporation is quite satisfied with him as an independent director. The changes may take place, if he himself would like to retire because of his age.

## Evrosibenergo plans to be friends with China



Evrosibenergo of Oleg Deripaska, which had planned to hold an IPO in Hong Kong within the nearest two weeks, postponed

the offering due to the worsening situation on the Asian markets. At the same time, the company announced the establishment of a joint venture with the Chinese state company China Yangtze Power. Yangtze will become a strategic partner to Evrosibenergo, and the necessity to process the deal was the reason to postpone IPO for two or three months. The Chinese intend to buy the company's shares in the amount of 168 mn USD, within the framework of the scheduled IPO; however, they require the permit of the Chinese government.

Within the framework of a parity joint venture with the Chinese, the parties will consider six projects on construction of power stations in the East Siberia and Far East with total approximate capacity 10 GW within three years. According to the plans of the companies, some part of power generated by new hydropower stations will be exported from Russia to the energy-deficit provinces of the Chinese North and North-East.

However, one should not exclude the possibility, that the real cause of IPO postponing was the low interest of the investors. Formally, the sellers offered no price range. And the deal with the Chinese will serve as a price market indicator (while, typically, it happens quite the opposite).

However, the rules of Hong Kong stock exchange forbid the issuers and their stockholders to make the deals with the stock of their companies within half a year after an IPO. So, the deal with China Yangtze Power should be performed before or during IPO.

Meanwhile, Oleg Deripaska continues struggling with his Norilsk Nickel partner – Oleg Potanin. Evrosibenergo itself

became one of the confrontation players. Andrei Likhachev, The Chairman of the Board of Directors of the company, sent the letter to Vladimir Strzhalkovsky, Director General of Norilsk Nickel, and Vasily Titov, Chairman of the Board of Directors, where he offered to buy out about 79% of OGC-3 stock for 2 bn USD. The price comes in line with the market, being, however, significantly lower than Norilsk Nickel expenses for the asset's purchasing (4.2 bn USD in 2006). More than that, A. Likhachev makes a reservation, that this sum may be corrected after due diligence.

OGC-3 stockholders discussed the scheme of sale or detachment of the general company for many times, but without any success. It became clear not long ago, that Norilsk Nickel arranged on the exchange of the OGC-3 share for 10-15% of InterRAO stock. The Board of Directors of Norilsk Nickel was to consider the matter of OGC-3 share exchange on December 2. But now, when the Evrosibenergo offer appeared, the meeting was rescheduled.

The idea of exchange was not approved by Oleg Deripaska, the other Norilsk Nickel stockholder. He said that the exchange of one non-core asset for another is not reasonable. However, Vladimir Potanin, who had promised OGC-3 to InterRAO, will try to lock the initiative of Evrosibenergo.

### What affects Evrosibenergo valuation?

IPO plans of Evrosibenergo were announced early in this year. Last week, the organizers - Deutsche Bank and Bank of China International – held preliminary meeting with the investors. Stockholders of Evrosibenergo were going to offer like 25% of stock for the amount of 0.9-1.1 bn USD at least (and 1.5 bn USD as a maximum).

The Evrosibenergo balance, fully owned by En+ Group, comprises control package of shares of OJSC Irkutskenergo, OJSC Krasnoyarskaya HPS, Avtozavodskaya HES Ltd., sales companies CJSC Volgaenergosbyt and CJSC MAREM+, as well as the engineering company Evrosibenergo-engineering Ltd. Installed capacity of power stations is 19.5 GW.



## VEB provides RUR 50bn of credit resources to BEMA

VEB finances other projects of federal importance as well. Last week, the bank and the Boguchansk Energy and Metallurgical Association (BEMA) finally signed the agreement on completion of construction of the Boguchansk hydropower station (HPS) and the Boguchansk aluminum plant. BEMA stockholders, RUSAL and RusHydro, will receive credit resources from VEB in the amount of 50.01 bn RUR, but separately.

Until this moment, the parties have had furious discussions on the financing procedure. The BEMO project management model has suffered no-ending changes during the latest years. Only this year, the stockholders have decided to accept the two-key system, which anticipates, that each participant of the project does the budgeting and performs the scope of works within its profile. Existence of separate credit agreements between BEMA stockholders and VEB indicates that as well.

According to one of them, CJSC "Boguchansk Aluminum

Plant" will get 21.9 bn RUR, and according to the other one, the amount of 28.1 bn RUR will be transferred to OJSC "Boguchansk Hydropower Station". Terms of credit are different as well: 14 years for the plant and 16 years – for the hydropower station. Evidently, the companies will pay the lends separately, accounting from cash flows generated by each of the facilities. In addition, the credit should be secured. Therefore, in case of the next extension of the startup terms for the station or the plant, the stock of RUSAL and RusHydro subsidiaries, by means of which the stockholder participate in the project, together with the bills of exchange of the Boguchansk HPS and the Boguchansk Aluminum Plant (Boaz) will be deposited as a pledge. Even before the credit agreements were signed, the state authorities had made it clear, that the state support would mean the state control over the project implementation schedule as well.

### ERTA view

Again, these are echoes of a well-known theme about electric power export from the East of Russia to China. An excellent investment project! And these projects have been under discussion for the second dozen years. But the Chinese want to purchase power only at a relatively low price, as they have cheap domestic coal generation. And Russia itself, under Chinese strong pressure, justifies economical effectiveness of a low price for the supplied power.

The project is underway, investments are flowing, but offered power prices are significantly lower than its cost for the Russian consumers. And this difference causes a problem.

Though, in our case, we have a very specific Russian consumer, who always managed to get a very low tariff for himself. All is seemingly well: the goods are delivered to the Russian consumer, as well as Chinese consumers at a similar low price. And the Chinese are ready to invest into the overhead power lines' construction.

But it turns out that unique Russian consumers and their Chinese partners receive the power at one price, and all the rest ordinary Russian consumers on the same market face a higher price...

## Lukoil will build up its overseas production



LUKoil continues to wait for production downturn (first of all, in Russia) and plans to strengthen its expansion abroad. The company plans to invest about 1 bn USD in the African projects.

The medium-term development plan of LUKoil for 2011-2013 includes expansion of production abroad. The company deals with realization of the production projects in Iraq, Kazakhstan, Uzbekistan. Also, it owns the processing facilities in Holland, Italy, Bulgaria,

Romania, and Ukraine. But it is Western Africa, where LUKoil is one of the major players, which should become the focus of the future growth. In particular, about 20 prospective subsoil blocks was revealed in Ghana and Cote d'Ivoire. Negotiations with Gabon and Equatorial Guinea are ongoing. The expansion vector could not be changed even by the export duty preferences, granted by the federal authorities for LUKoil Caspian projects. In early November, the decision was made on inclusion of the oil produced in the Caspian fields of the Group (Korchagina and Filanovskogo fields) into the discount customs code, used for oil export from the East Siberian subsoil blocks.

### ERTA view

Foreign projects of LUKoil have seemed once very ambitious, especially, when they were accumulated under control of LUKoil Overseas. The number of projects increased, and the Company presented at the CERA Week 2006 conference in Houston the thrilling global expansion plans. It is true that they are really successful in many areas. What if the share of foreign production would grow and become substantial, according to the company's top management's plans? But if they become to demonstrate substantial growth of production abroad against reduced production in Russia, what will the state managers of the Russian fuel and energy complex say about that?

*International*

## The members of the Gas Exporting Countries Forum favor oil price formula basis in long-term gas contracts

The 11th Gas Exporting Countries Forum (GECF) ministerial meeting was held in Doha. The participants approved no strategic organizational development documents, not going beyond the declarations on absolute support of the long-term contracts based on the oil price formula. They supported the initiative advanced by Qatar and Russia, who offered to hold the Gas Summit of the state heads and governments in November 2011 in Doha, and chose Egypt as the next site of the ministerial meeting (June 2, Sharm El Sheikh).

The parties had no intent to agree on cartel reduction of production (and they could not, since most of them have long-term contractual liabilities). But in fact, normal response of gas producers to the weak market takes place just now, along with attempts of the purchasers to change the delivery system: they freeze investments into new projects (or, at least, talk of that).

This, of course, is not caused by the activities of GECF, who only tries to find its place in the dialogue between the producers themselves and gas consumers. Difficulties with ratification caused the problems for Leonid Bokhanovsky, General Secretary of the Forum, in terms of pumping the budget up. The approved budget for 2010 was some higher than 6 mn USD (533 000 USD per participant). To the beginning of the year, however, less than a half of the payments were collected, since only five states (Russia, Qatar, Algeria, Libya, Trinidad and Tobago) of eleven had ratified their membership in the organization. Equatorial Guinea and Egypt completed ratification procedures in March, Nigeria – in September. Iran, Bolivia, and Venezuela have not joined officially yet (it is typical, that all three of them are not gas exporters in the full meaning of the term, but Teheran was one of GECF initiators). More than that, the core ministers of Bolivia and Nigeria did not come to

the meeting of December 2.

Along with that, it was important for Russia to get trump cards for further discussions with the European Council. Sergey Shmatko, the Russian Minister of Energy, said that the GECF participants supported the initiative of Russia on the necessity of additional consultations with them on the matters of implementation of the “third energy package”. By the highest standards, this topic is of any interest for three pipeline gas exporters only – Russia, Algeria, and Libya. Qatar is indifferent, or even interested in liberalization, like other LNG suppliers, but not enough to initiate the open struggle with Moscow on this matter.

On November 7, the Russian delegation, headed by President Dmitry Medvedev, will likely go to Brussels to the next EU-Russia summit with the thesis supporting consultations on the «third package».

### Gas prices

Meanwhile, strong snowfalls and cold weather in Europe led to the situation, when spot natural gas prices exceeded Gazprom long-term contractual prices for the first time in the last year and a half. According to Alexander Medvedev, Deputy President of the Russian corporation, the average price for the fourth quarter is 327 \$/mcm. On December 1, the Netherlands stock exchange TTF sold gas for \$331, the Australian hub in Baumgarten - 336 \$/mcm, the NBP in Great Britain – for 342 \$/mcm.

In the last two weeks, the prices overcame the existing gap (about \$50) with long-term contracts connected with oil quotations. For the moment, this is not a fundamental trend (since there is still excessive gas in the market in the average annual balance), but an additional evidence of the fact, that the European stake on spot pricing brings additional risks to energy security as well as unpredictability.

### ERTA view

The questions of the possibility, the form of the cartel and what agreement can be made are permanently being discussed. But this process has been underway for several years, without even a slightest possibility of any real agreement to be made. The fact is, that, for now, the basic result of the process is its existence. No practical outcome can be expected in the nearest time.

## TNK-BP will create its own international trader

Graham Sharp, Senior Vice-President of TNK-BP, announced the company's intent to establish an international trading company. Supposedly, the trader will be registered in Geneva and start its operations in the third quarter of 2011, reducing the volumes of delivery through third parties, including Gunvor of Gennady Timchenko.

Among the Russian companies, only LUKoil and Gazprom Neft have trading subsidiaries (Litasko and Gazprom Neft Trading, correspondingly). The other companies use the services of international mediators. Gunvor of Gennady

Timchenko accounts for about one third of the Russian export volumes (mostly Rosneft, Surgutneftegas, and TNK-BP).

Currently, TNK-BP exports 1.2 bbls of oil and oil products daily. To reach international levels, the company should double these volumes. TNK-BP plans to increase its sales to 2 mn bbl per day (about 100 mnt annually) during 2-3 years. The half of it will be represented by third-party production and foreign assets of TNK-BP.



## Shell does not give up on gas business development in Russia



Alexei Miller and Peter Vozer, Gazprom and Shell CEOs, signed in Moscow a protocol on global strategic cooperation. The point is the return to the idea on asset exchanges between the companies. While, in 2005, Gazprom and Shell

were going to exchange their shares in projects to be implemented on the Russian territory, now participation of the Russian corporation in the projects of the European leader of exploration and production of hydrocarbons in the third countries is discussed. The main interest of Shell in Russia, in its turn, is expansion of its participation in development of Sakhalin resources by means of the Kirinsky block owned by Gazprom (part of Sakhalin-III).

In summer 2009, at the meeting with Jeroen van der Veer, who retired from the post of Shell's CEO, and Peter Vozer, who was to replace him, Vladimir Putin said that he considered it "quite possible to continue cooperation with the company in the other fields". The English-Dutch corporation prepared the policy of Sakhalin-II Project expansion and Sakhalin-II Project development. The document anticipated that, as soon as in the second quarter of 2011, the parties would sign a legally binding agreement

on implementation of the extended project. In particular, it was planned that, to 2016, the third train of the liquefied natural gas plant on Sakhalin with annual capacity of 5 mnt would be built, rapid development of the Lunskeye field reserves (part of Sakhalin-II) would begin, in order to supply feedstock to new LNG facilities, and at least 50% of the Yuzhno-Kirinsky prospect block (part of Sakhalin-III) would further go to the Sakhalin LNG plant.

In order to supply gas to the Sakhalin-Khabarovsk-Vladivostok pipeline constructed by Gazprom, Shell suggested to use some part of the Lunskeye field gas (up to 3.7 bcm, starting from 2012), with gradual increase to 5 bcm (beyond 2016), for the account of beginning of production in the small Kirinskoye field.

This policy was handed over to Gazprom for consideration, the conclusion delivered by Gazprom dobycha shelf was negative, which develops the Kirinskoye field and supervises the development of Sakhalin-III Kirinsky block. More than that, the corporation has already rescheduled the Kirinskoye field putting in line from 2014 to 2011, increasing the investments into the project, in order to load the first pipeline to Vladivostok. But the most important fact is that Gazprom, for the medium term, needs at least 30 bcm of gas to fill the gas pipeline, regarding the fact that construction of the gas liquefaction or compression facilities are planned to be constructed at its end, for the purpose of export deliveries (Primorsky Krai has no market for these volumes). Expansion of the Sakhalin LNG plant does not correspond with these plans at all, unless the miracle would occur, and all potential excessive gas from the Sakhalin pipe would be contracted by China. But even in this case, there will be no gas sufficient for the third LNG plant's train.

However, P. Vozer met Vladimir Putin again in September in Sochi, and the Russian Prime Minister named the conditions of Shell business expansion in Russia, namely, permit for Gazprom to participate in the projects in the third countries. Following that, preparations for signing the protocol intensified, and the issue of participation on Sakhalin-III Project was still included into the agenda. Also, one may not exclude the possibility, that Shell, like the Japanese partners of Sakhalin-II, received an offer to participate in gas production in Yakutia and LNG production in Vladivostok.

### Sakhalin -2

In 2005, Gazprom and Shell, who at that time owned 55% of Sakhalin-II project together with the operator's functions, signed the memorandum on asset exchange. The Russian corporation was ready to hand over a half of the Zapolyarnoye field deposits development project. The year later, however, the situation started to follow the scenario which was negative for foreign investors: the state accused the Sakhalin-II players in overstating of expenses and violations of environmental regulations during implementation of the project. In December 2006, after the Kremlin meeting, the agreement was signed. It stated that Gazprom would obtain the control package of shares in Sakhalin Energy for 7.45 bn USD (this corresponds approximately with the half of historical project costs), and the shares of Shell, Mitsui, and Mitsubishi would be reduced to 27.5, 1., 5, and 10%, correspondingly.

### ERTA view

Shell and Gazprom have not yet come to an agreement on work within Sakhalin-III project, but the General Agreement has been signed. Is it an answer?

Sometimes, it seems that Shell had to give up on Gazprom long time ago. Everyone remembers the situation with Sakhalin-II (though, a lot of money was paid at that time). We can recall a more "ancient" story. For example, in spring of 2000 Gazprom and Shell loudly announced that they came to the principal agreement on mutual development of the Zapolyarnoye field. Agreements, however, did not survive even till the middle of the year. And facing such history of interrelations, Shell continues to search for new projects in Russia...

Likely, Shell understands that, given all greatness of Gazprom, Russia is a greater figure, and it would be foolish and short-sighted to give up on our country with its natural resources. Possibly, this understanding allows Shell to exist for many dozens of years, since the company's history in the global petroleum industry is quite longer than that of Gazprom.

## Partners for the nuclear power station construction in Bulgaria are found



Russia has found its first partners for construction of the Belene nuclear power station (NPS) in Bulgaria, cost of which is more than 6 mn EUR. These are Fortum (Finland) and Altran (France). This will allow

to establish a project company for construction of the station and to start construction works on the first power block's site in September 2011. The project's configuration has not yet been determined: for now, new investors will receive only minimal shares in the NPS construction company, i.e. budgeting sources are not determined.

Sophia still doesn't want to take the Russian credit for construction of the station, while it has no own resources.

Besides, the parties still cannot come to an agreement on the NPS cost. Sergey Kirienko, head of Rosatom, said the other day that the price was fixed on the level of 6.4 bn EUR. It seems that this is just the final Russian price offer submitted to the Bulgarian party in November,

during the visit of Vladimir Putin. However, Boyko Borisov, the Bulgarian Prime Minister, said after signing the memorandums, that the NPS should not have cost more than 5 bn EUR.

There is still a lot to be discussed, and this is confirmed by terms of the Project implementation. Establishment of the Belena project company will take up to ten months, and concrete casting of the foundation of the first power block is scheduled for September 2011. The date of startup, though, is still the same, that is, the year of 2016.

Certain progress of the Bulgarian project was accompanied by improved prospects of the Baltic nuclear power station. Lithuania has not managed to find an investor for construction of the nuclear power station, which could generate the deficit of power occurred due to closure of the Ingalinskaya NPS. The last pretender, the Korean KEPCO, abandoned its application without any explanations. The French EdF had stopped negotiations earlier. The Lithuanian government puts a good face on the matter, declaring its intentions to hold open negotiations with all possible investors.

## Viktor Vekselberg is leaving TNK-BP



From the beginning of the new year Viktor Vekselberg, co-owner of TNK-BP, will officially leave his post of Executive Director on gas business development of the company and focus on the Skolkovo innovative center's project, which he headed in spring by a personal commission from the President of Russia. His post in TNK-BP may be taken by Mikhail Slobodin, his junior

partner in IES Holding, who is going to leave IES.

The idea is, that the other Russian co-owners – Mikhail Fridman (who took the President's post on temporary conditions) and German Khan – should leave TNK-BP with Viktor Vekselberg. If everything is clear with the first of them (he should leave the President's post to Maxim Barsky, who will become the sound CEO of TNK-BP since January 1, by agreement between stockholders), German Khan, according to certain information, would like to serve

his position.

In addition to gas business, Mikhail Slobodin will possibly supervise the energy area (now it belongs to the area of responsibility of Sergey Berzitsky, Vice-President for Exploration and Production). Along with that, his main responsibility will still be representation of interests of Viktor Vekselberg in the oil company's management.

It should also be noted, that TNK-BP negotiates the acquisition of gas distribution assets of IES Holding of Viktor Vekselberg. With arrival of Mikhail Slobodin, this may lead to development of gas retail business in the oil and gas company. TNK-BP submitted the application for acquisition of gas distributing organizations to the Federal Antimonopoly Service.

IES Holding has been looking for purchasers of its assets between independent gas producers for a long time. TNK-BP is interested in IES assets, though they are rather worn-out, because the company can reach end gas consumers. Earlier, TNK-BP announced its ambitious strategy of gas production growth to 30 bcm until 2020 (in 2009, production amounted to 12.1 bcm).

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