

Yamal LNG: New Year presents from the Prime Minister



Yamal LNG controlled by NOVATEK and the structures of Gennady Timchenko got the chance to acquire additional resources for the Yamal gas liquefaction project. Prime Minister Vladimir Putin added

the comprehensive plan for natural liquefied gas production development on the Yamal Peninsula with two new tasks. Mr. Putin signed the Order on October 11, before the meeting in Novy Urengoy. According to the Order Rosnedra, the Ministry of Energy, the Ministry for Economic development, and “all related federal executive power agencies” should afford the right of the subsoil use for the Severo-Obssky and Vostochno-Tambeisky blocks, located in the Gulf of Ob of the Kara Sea, and the Salmanovskoye (another name Utrenneye) and Geofizicheskoye onshore fields on the Gydan Peninsula. Reserves of the latter two fields exceed 900 bcm (by categories C1 and C2), while the Severo-Obssk and Vostochno-Tambeisk blocks contain up to 1.5 tcm of possible gas resources.

The order doesn't specify any particular future holders of the licenses. As for today, however, the comprehensive plan has been fully prepared for the Yamal LNG project only. Having received strong governmental support, the Yamal LNG stockholders may have decided that they are not satisfied with the resource base of the Yuzhno-Tambeiskoye field only (1.2 tcm of reserves). Moreover, administrative influence of G. Timchenko has likely allowed him to expand the project's resource base by sidestepping Deputy Prime Minister Igor Sechin, who is in charge of the fuel and energy complex. Relations between two men have been very tense recently.

In early October, Vladimir Putin ordered the governmental committee on the fuel and energy complex, mineral replacement, energy efficiency enhancement “to provide, according to the due procedure, implementation of the activities aimed at expanding the resource base of the created natural gas liquefaction centre on the Yamal Peninsula, including by means of licensing of the unallocated subsoil fund». Deputy Prime Minister for the fuel and energy complex Igor

Sechin heads this committee. However, no meetings of the committee have been held in the past month and a half. Nevertheless, the decision on the particular blocks licensing has been made and handed down personally by Prime Minister to the dedicated agencies.

These government agencies will have to work hard to overcome the barriers which have been created earlier to prevent handing over of large and offshore fields from the unallocated subsoil fund to private investors with the offshore holding companies (like Yamal LNG). Anyway, it is entirely possible, that the licenses will be finally issued to other eligible companies, which will further be able to capitalize them by sending to NOVATEK or Yamal LNG.

The Salmanovskoye and Geofizicheskoye fields are classified as strategic fields, and they were named in the list of assets of federal significance, by order of the Head of the previous Government Viktor Zubkov (now First Deputy Prime Minister and Chairman of the Board of Directors in Gazprom), dated November 28, 2007. According to the Article 12 of the Federal Law “On Gas Supply”, these sites can be granted without auction to the owner of the Unified Gas Supply System (i.e. Gazprom) or a regional gas supply system owner; otherwise, a special bid must be held. The gas monopoly has yet managed to get more than a dozen fields from this list. They include a series of blocks (Severo-Tambeisky and Zapadno-Tambeisky), which can be used by the corporation within the framework of the Yamal LNG project. However, they are planned to be brought to operation only in 20 years, so, no actual preparatory works are underway. Furthermore, with regard to the last Gazprom trend, when it assigned a part of prospective assets to NOVATEK, it is entirely possible that the Tambeisk group of fields will be fully controlled by Gennady Timchenko's structures (he is the largest NOVATEK stockholder).

Rosnedra has a fresh experience of holding a bid for issuing a license to a particular applicant - Trebs and Titov oil fields were specially prepared for Bashneft).

The situation with offshore blocks is even more complex. The Federal Law “On Continental Shelf” limits the list of potential bidders by state companies with 5-year experience of offshore field operations. Minprirody is elaborating the amendments which are intended to liberalize this order a little, but they do not refer in any way to participation of private companies.

Meanwhile, the agencies started to fulfill Prime Minister's commissions given in Novy Urengoy. The Ministry of Finance published a draft law on amendments to the Tax Code. According to them, the Yamal gas produced for liquefaction, as well as associated condensate, will be MET-free. Likely, the amendments to the Customs Code on zero export duties for the Yamal gas and condensate, being prepared by the Ministry for Economic development, will be formulated on similar condition.

If the approach of the Ministry of Finance ➤ Page 3

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News brief



Yamal LNG controlled by NOVATEK and the structures of Gennady Timchenko got the chance to acquire additional resources for the Yamal LNG project. Prime Minister Vladimir Putin ordered to afford the right for the subsoil use for a number of block with two strategic fields among them (Salmanovskoye and Geofizicheskoye) during 2011. The order doesn't specify any particular future holders of the licenses. However, there is the only project with comprehensive development plan being elaborated so far – the Yamal LNG project. The strategic fields can be granted to Gazprom only. But having in mind Gazprom's latest concessions made for the benefit of NOVATEK, one can suppose that these blocks will be a part Yamal LNG project resource base in the end.

The approved tax benefits can be applied only to gas produced for liquefaction and associated condensate. Thus any gas and condensate production at the Yamal LNG project won't be tax exempt till the LNG plant is launched. ➤ Page 1

The UES System Operator held the competitive power selection for the next year (CPS-2011) and set the price for power only 4 % higher the state regulated prices. The price for power in the zones of free power flow of the Centre and the Urals amounted to RUR123 000/1MW monthly. Price caps were determined for the territories, where competition was not sufficient: in the European area RUR118 100, in Siberia – RUR 126 400/1MW monthly. Moreover some stations were shifted to the so-called forced regime (stations which did not meet the technical specifications, or those with too high excessive costs). ➤ Page 4

Gazprom нефть called back one of its claims to the FAS of Russia in the amount of RUR 1.3bn and announced that it hoped to come to an amicable agreement with the FAS. Gazprom нефть resisted longer than other large oil producers in Russia. Once amicable agreements are signed oil producers will have to pay about RUR 11bn to the budget. ➤ Page 5

The Russian subsidiary of the German **E.ON – WGC-4** (Wholesale Generating Company) is giving the next credit to its major stockholder in the amount of RUR 1.75bn for 6 months (the previous credit amounted to RUR 1.47bn). WGC-3 justifies the possibility to give the loan by temporary available of free cash from operations. The interest rate is not announced. ➤ Page 6

Oleg Deripaska was elected the head of the Board of Directors of Irkutskenergo for the first time. Before that, the company had always been managed by state representatives. Indeed, Oleg Deripaska has something to protect. Hydro power station controlled by O. Deripaska have long-term contracts for cheap power supply (almost 3 times cheaper than international competitors) to the Siberian aluminum plants of RUSAL. ➤ Page 7

The **Russneft** Board of Directors approved the ambitious development strategy till 2017, where the production target is 18.5mnt, while the company production was only 14.2mnt in 2008. Surely massive investments would be required, but currently the company has USD 6.6bn of debt (as at the end of the 3Q 2010). By the end of the year Russneft plans to restructure its debt with the creditors: prolongate the payment period and decrease interest rates to 8% (current 12%). ➤ Page 7

The **Ministry of Fuel and Energy of Ukraine** revives the struggle with the **Private Group** of Igor Kolomoisky for control over oil company Ukrnafta and other oil and gas assets. Yury Boyko plans to hand over Ukrnafta and other assets to the state company Naftogaz under the pretext of low operational performance (9 months oil production fell 12.9% YoY). The final goal is to create a vertically integrated company. ➤ Page 9

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undergoes no significant changes during the endorsement process, participants of the Yamal LNG pilot project based on the Yuzhno-Tambeisk field will not be able to claim for condensate tax benefits until the LNG plant is launched. I.e., the scheme with prior cash generation from sale of MET-exempt condensate will not suit Yamal LNG. The launch of the LNG plant is currently scheduled for 2016. Any delay in startup of the LNG facilities will not be offset even partially by the condensate export duty preference mode.

To the end of this year, the Ministry for Economic development, the Ministry of Transportation, the Ministry of Energy, the Federal Customs Service (FCS), the Federal Migration Service (FMS), the Federal Security Service (FSB), and Ministry of Industry and Trade officials must prepare an additional set of documents on construction of the port infrastructure and a navigable canal through the Sabetta shallow waters, construction of an airport; measures on state financing of ice-breakers construction and tanker fleet; tax and customs benefits for imported equipment for Yamal LNG; easier stay regime for workers, including non-residents, in the border area.

MET benefits are not only for Yamal LNG project

Beginning from the plant's startup, the Yamal liquefied gas production projects (Yamal LNG is the only one announced so far) will be exempted from Mineral Extraction Tax (MET) payments for gas and condensate produced within 12 months, or until the total production volume reaches 250 bcm of gas and 20 mnt of condensate. That means that, in theory, other companies will be able to benefit from preferences lobbied by the project's stockholders for Yamal LNG. For example, Gazprom may easily come back to the idea of the LNG plant on the base of the Kharasaveisk field, which it has rejected due to its economic inefficiency, since the state was not going to grant any benefits. The GenScheme of gas industry development, elaborated by Gazprom experts, included assessment of the LNG export terminal construction near Kharasavey port, which was considered more advantageous, compared to the area of Sabetta stlm. at the north-eastern edge of Yamal (this is the point planned for transportation of Yuzhno-Tambeisk hydrocarbons).

ERTA view

Gazing into the Russian political crystal ball is still quite a thankless job. The one who does not guess is worth a brass farthing. The life of those whose guess is right is not worth even that in the eyes of the informed people. So, one needs maneuvering.

Is it worth to be limited by assumptions that the mentioned fields are intended for NOVATEK of all others? Other configurations are possible: in particular, active introduction of the national assets into the Project, establishment of offshore production within NOVATEK-Rosneft consortium, and, maybe, NOVATEK-Zarubezhneft.

The geography of the mentioned fields (shelf of the Gulf of Ob and the Gydan Peninsula) justifies certain concerns about quick start of the active phase of the projects. The essence of this operation may possibly lie in increased capitalization of the companies which are going to enter the loan market.

The list of assumptions can be extended. For example, one may doubt the conventional wisdom saying that the Yamal LNG project is a great success of G. Timchenko and NOVATEK. The project could well become a heavy burden. You have earned a lot of money – take the responsibility to invest the breakthrough project for Russia, notwithstanding its enormous risks.

Upside opportunities you cannot miss!



Last week, the representatives of the state company and the Russian government made the day with declarations in a long-forgotten style.

Gazprom CEO A. Miller said that he had no doubts in brilliant perspectives of capitalization growth in the company headed by him. It would reach not only the pre-crisis level, but even the fair price (two years ago A. Miller mentioned \$1 tn). And he

recommended to buy Gazprom stock).

In his turn, I. Sechin said that Rosneft was seriously underestimated. "Rosneft is clearly underestimated like threefold", said Deputy Prime Minister.

Synchronism of these declarations on different companies is surprising. One can see with the naked eye, that Gazprom stock pricing correlates with gas prices at Henry Hub (located in the USA). Does A. Miller's statement mean his belief in significant long-term growth of global prices, while the head of the Russian Ministry of Finance A. Kudrin is saying about forecasted stabilization or even drop of oil prices?

The UES System operator held the competitive power selection for 2011



Last week, the UES System Operator held the competitive power selection for the next year (CPS-2011). The price for power in the zones of free power flow (ZFPF) of the Centre and the Urals, where

it was determined according to the free rules of the long-term capacity market, amounted to RUR123 000/1MW monthly. A price-cap was established on the rest of the unified energy system's territory, where competition was not sufficient, according to the Federal Antimonopoly Service of Russia (FAS). The price-cap and, correspondingly, the power price in the European power area amounted to RUR118 100, in Siberia – RUR 126 400/1MW monthly. Therefore, long-term capacity market parameters taken as the basis for generating companies' activities in 2011, appeared to be only 4 % higher than the state regulated prices. It was planned that the system operator would determine the power price level for the five-year period during several CPSs. This procedure was timed to the liberalization of the electric power market, beginning with January 1, 2011. Finally, however, the state had to introduce the antimonopoly cap in almost all of power systems and make some stations shift to the so-called forced regime. They include either the stations which did not meet the technical specifications of the System Operator, or power units with too high fixed costs. The capacity price and electric power rate for the forced regime were determined by the Federal Tariff Service (FTS) of Russia.

In most cases, this tariff was significantly higher than the price-cap or competitive price. The minimal forced-regime capacity tariff is RUR99 400/1 MW monthly. This rate was assigned to the part of Surgutskaya HPS-1 capacities (WGC-2 owned by Gazprom). The maximal tariff is RUR1.49mn/1 MW monthly (WGK-1 of Urengoy HPS, managed by Inter RAO). The FTS order on forced regime mentions individual power units of all wholesale

Competitive power selection for 2011

48 general companies and 228 power stations were selected at CPS-2011. Total "old" capacity volume varies from 147 to 155.3 GW. In addition, new facilities were accepted without competition (those were built under obligatory investment programs and paid according to higher rates under the power delivery contracts). Within 2011, their power volume must double from 5.1 GW in January to 11 GW in December. Maximal power-takeoff volume will reach 165.5 GW.

generating companies (WGC) and territorial generating companies (TGC), except for those owned by IES-Holding (TGC-5, TGC-6, Volzhskaya TGC, TGC-9) and Finnish Fortum (formed TGC-10).

Moreover, even some of the power stations participated in CPS-2011 will have to be guided by tariff decisions made by FTS. According to the rules, 15% of the most expensive applications of general companies are selected in the ZFPF of the Centre and the Urals after selection of all the capacity required by the System Operator. The highest of the rest of application is the one to determine the final capacity price. FTS calculates the economically feasible tariff for 15% of the most expensive applications. Capacities of those power units will be paid according to the lowest of two evaluations – the own application of the general company and the FTS tariff. According to the Market Council's estimate, power demand in these zones will be approximately 47 GW, this mechanism will cover approximately 7 GW.

For example, the Gubkinskaya HES (Kvadra, former TGC-4) received the tariff of RUR3.86mn/1MW monthly, or 31 times as higher as the CPS price. The Sharyinskaya HES (TGC-2 of Sintez Group) received the tariff of RUR2.3mn/1MW monthly, or 19 times as higher as the CPS price. However, a set of power assets received the FTS evaluations which were evidently lower than their applications. For example, the economically feasible price for the Troitskaya HPS of WGC-2 was RUR 52.8thnd/MW monthly, for the Voronezhskaya HES-2 of Kvadra – RUR 35.6thnd.

ERTA view

The program of reorganizing the Russian energy market is beginning to fade, losing shape. The reform designers had a clear and consistent ideology. One may criticize it or not agree with it, but the fact is that the program existed.

Now, we observe the process of theory's tying to practice. This is understandable to a significant extent. The state is concerned about possible uncontrolled growth of electric power tariffs. However, there is a steady impression that the process of "considering the formed realities" is gradually slipping into rejection from initial idea of establishing market relations based on competition in the energy field.

Publicity was inherent to the team of A. Chubais. The steps taken were explained in public. Transformation ideologists and organizers were ready to stand strong squalls of criticism. Now, there is a lack of such public explanations. The key cause for that may likely be the lack of ideological core of transformations currently underway in the energy market... Or, parties of interest together with executives do not feel like revealing their goals in public.

Gazprom нефть gave way to the FAS

«Gazprom нефть called back one of its claims to the FAS of Russia in the amount of RUR1.3bn and announced that it hoped to come to an amicable agreement with the FAS. The oil subsidiary of Gazprom resisted longer than the others, winning one of the trials, even when the Supreme Arbitration Court Presidium adjudged TNK-BP to pay a penalty in favor of Igor Artemiev's agency, and the government ordered the oil producers and FAS to come to an agreement (penalty reduction in exchange for admission of guilt).

Rosneft, LUKoil, TNK-BP, and Gazprom нефть were fined RUR 26.1bn in two stages: RUR5.4bn within the first phase of cases (slightly more than RUR 1bn per each company, or 1% of earnings), and RUR 20.7bn within the second stage (summer 2009).

According to amicable settlements, oil producers must pay the first penalties in full scope, since they are minimal (1% of turnover). Penalties of the second phase, after admission of guilt and taking responsibilities for oil products realization on the market, were also reduced to 1%. On the whole oil producers must pay about RUR11 bn to the budget.

ERTA view

The most decisive players of the fuel market consider the existing situation as a fuel crisis which has not been seen for many years. Within the incomplete month, the diesel price in the Kaluga Oblast has increased for more than five rubles per one liter! They say that it was the diesel market that was affected by the crisis to the highest extent, and there are rumors about physical lack of diesel fuel. According to certain information, the municipal transport in some provincial towns stopped working due to lack of fuel. Refineries use various reasons (including repairs) to reduce loading to minimally possible limits.

We do not know the reasons for all that is happening. We've heard about overrunning large-scale Gazprom нефть deliveries of motor fuel to China. Supposedly, there are problems with tank returns, which led to strong deficit of railroad tanks. The more credible story is one of provident oil companies. According to it, the producers keep the fuel, filling all available storage facilities. By that, they are preparing for introduction of excises beginning from January 1, 2011 and further changes of oil products tax rates. The companies are hurrying to raise the prices just now, before the New Year, simply because now this is possible. And later, after the introduction of state-authorized growth of taxes and regulated tariffs, all that will be kept over vigilant watch. And the excise will easily bring profits, since it is charged on production, not sales.

If this is really so, then the situation with the FAS legal claims to oil companies seem piquant. On one hand, all FAS actions become non-adequate, and on the other hand, the regime of total silence in mass media suggests realization of the higher-level agreements.

The 5-year investment program of the Federal Grid Company amounts to RUR 1 trillion



The new investment program of the Federal Grid Company (FGC) for the period of 2010/2014, approved by the Ministry of Energy, anticipates the level of development investments – RUR952.4bn. Its main spending item

will be renewal of fixed assets. In 2010, investments will be reduced by RUR 450mn to RUR 170.5bn, compared to the previous plan, but the FNC spendings will only rise, beginning with 2011.

In 2011-2012, the spending will increase by RUR 35.3bn, to RUR 554.7bn. Although the company has reported to save RUR 52bn due to changing technical solutions and updating the project implementation schedule (the main

savings were provided by rescheduling of startup of some of the facilities for the later date, partially due to changing plans on construction of generating facilities and regional development), but additional spendings in the amount of RUR 87bn have occurred.

These additional spendings are required for construction of power facilities for the ESPO pipeline (RUR 36.2bn), power supply of the Skolkovo innovation centre (RUR 11.7bn), protection of the FNC facilities (RUR 7.8bn) and renewal of the fixed assets (more RUR 14.5bn), the Sochi Olympic Games (RUR 5.5bn) and the Federal Target Program (FTP) facilities for development of the Far East and the Trans-Baikal (more RUR 6.2bn). I.e., the significant part of the additional costs is related to commissions of the government.

FGC plans to budget the most part of the investment program (63.3%) on its own account (i.e., the tariffs). The company plans to borrow 34.4% of the sum (RUR 327.2bn), and to receive about RUR 22bn from the state budget.

M&A

Itera attracted its first international loan



On December 8, Itera took the three-year syndicated loan in the amount of \$250 mn. The underwriter is the London

branch of Deutsche Bank AG. Raiffeisen Bank and UniCredit Bank also form the consortium. The first-year interest rate was set at LIBOR+5.25%, for the first six months the annual rate will be 5.7%.

This is the first foreign credit of the company, taken under the English legal standards. Now, it will be easier for the company to enter the international finance markets.

Itera immediately transferred the most part of the received credit funds to pay off the \$160 mn credit to the Saint-Petersburg Bank, which had been taken before for the purpose of purchasing 21% of the Sibneftegaz shares from Akron. The rest of the funds will also be spent for restructuring credits.

At the same time, the Bank of Moscow granted the company with the first tranche in the sum of RUR 500mn, under the credit agreement. The credit agreement is valid till May 10, 2011; duration of tranches – not more than 90 days; maximal credit line – RUR 1bn, according to the statement of the Bank of Moscow. The credit was given for the purpose of financing the operating activities of the company.

The biggest LPG shipment company is on sale

OJSC Freight One reported to the Federal Agency for State Property management (Rosimushchestvo) its wish to participate in the bid for the SG-Trans 100% stock package sales bid. Freight One plans to finance a possible deal with the money received from bond issues (in 2011, the company plans to place shares for RUR 10bn) as well as loans. According to mass media, SG-Trans business on LPG storage and sales can be detached and then sold, as it doesn't represent the core business activities for Freight One. NOVATEK may be a purchaser.

One should keep in mind, that Gennady Timchenko (who is the main co-owner of NOVATEK) is considered to be the most possible buyer of Freight One itself, during the privatization program announced by the government.

SG-Trans consultants - Booz & Co. - recommended to sell the LPG storage and sales business, since the company's positions in this business are weaker than in the transportation segment. According to the consultant's assessment, profit from this deal would be RUR 2.5-3.1bn.

The exact date of privatization has not yet been determined. Earlier, 100% company's shares, assessed at RUR 11bn, has been included into the privatization program of 2010, but the project was postponed.

What is SG-Trans?

SG-Trans is the biggest owner of the LPG transportation specialized fleet. The company's fleet includes 14.5 thousand tank cars, transportation volume in 2009 amounted to 4.6 mnt. Major clients of the company include Rosneft, SIBUR, LUKoil, and NOVATEK. In addition to tank cars, SG-Trans owns 12 liquefied gases sales branches (including storage bases), 59 gas filling stations (GFS).

E.ON raised money in Russia once again

While Itera is taking credits, the Russian subsidiary of the German E.ON – WGC-4 is giving the next credit to its major stockholder. The parent company will get RUR 1.75 bn for 6 months. However, the general company has the right to request for the early return of the money. WGC-4 justifies the possibility to give the loan by temporary available of free cash from operations.

The interest rate is not announced, but it should be rather low, since E.ON has an access to "cheap" borrowing resources, notwithstanding certain downturn in operational performance. As per the end of the first half of 2010, WGC-4 had approximately RUR 12bn on short-term deposits in the Russian banks (including about RUR 1.74bn in euro). Yield on deposits does not exceed 1% in euro and 4-5% in rubles. Likely, WGC-4 will replace one of the deposits for the loan to E.ON.

The practice of crediting own shareholders is not very common in the energy industry. But WGC-4 has already given the credit in the sum of RUR 1.47bn to E.ON. The most well-known example of that kind is represented by the loan in the sum of RUR 12.8bn, issued to Mosenergo in 2009 to CJSC Gazenergoprom Invest (member of Gazprom Group). The monopoly lent this sum to IES Holding of

Viktor Vekselberg for the purpose of purchasing 11.3% of TGC-7 shares.

ERTA view

This is a common business operation. Within a group of affiliated companies, a company with surplus cash gives a credit to another structure. The cause of the surplus is clear as well. The energy reorganization activities of several generating companies helped to accumulate a good reserve of funds for investment programs realization and construction of new generation facilities. But the crisis occurred, and the need in new generation facilities was rescheduled for later.

Actually, this operation was not the first one. Irrespective of tax benefits obtained by the holding-company, this deal does not look sane within the framework of power tariff regulations. Only look at that: a "rich" Russian generating company (operating in the market where price of electric power is rising rapidly enough (with the help of the government)) gives a credit to a "poor" company from Europe, where the growth rate of power tariffs is significantly lower.

Oleg Deripaska heads the BoD of Irkutskenergo



Oleg Deripaska is preparing to protect his interests as the head of the Board of Directors of Irkutskenergo. In November, he was elected a member of the BoD by the company's shareholders for the first time, and headed it at once. Before that, the Board had been managed by state representatives, though the state had had no control over the company for a long time. Evrosibenergo controls 6 of 11 votes in the Irkutskenergo Board of Directors.

The state's share in Irkutskenergo will soon be handed over to RusHydro. The procedure will be held in two stages: firstly, according to the President's decree, Rosimuschestvo will hand over the shares to Inter RAO during an additional offering in 2011, and the latter, in turn, will place them into trust to RusHydro. The state company's top management will, evidently, take more active part in managing Irkutskenergo than Rosimuschestvo.

Meanwhile, RusHydro has already consolidated about 25% of shares of the second largest Russian HPS, namely

Krasnoyarsk HPS (6 GW), which is also consolidated by Evrosibenergo of Oleg Deripaska. The state company received the shares from Madake Enterprises Company Ltd. (member of the Siberian Coal Energy Company (SUEK related group) in exchange of 4.53% of its treasury securities. According to informal data, the price of the deal amounted to RUR 21bn.

Indeed, Oleg Deripaska has something to protect. HPSs controlled by O. Deripaska have long-term contracts for cheap power supply to the Siberian aluminum plants of RUSAL.

Power expenditures of the world competitors of the aluminum holding company, given the existing aluminum prices, amount to approximately \$660/ton. European and Ural plants of RUSAL pay about \$550/ton, the Krasnoyarsk plant - \$370/ton, and the Bratsk and Irkutsk plants - \$240/ton.

It is possible that the membership of Oleg Deripaska is explained not only by protection of his interest in the aluminum business, but as well by the intent to restructure Evrosibenergo (to transfer the company to unified shares, thus increasing its value before organizing the offering on stock exchange). The company's IPO on the Hong Kong stock exchange was postponed for the next year.

ERTA view

It seems that RUSAL business needs protection. This is not only because of its essence, but because of the way it is organized as well. But protection in the field of energy will be definitely not enough.

To draw the complete picture, one should remember the location of RUSAL plants. As everybody knows, alum earth and alumina are not transported through pipelines. So, in addition to power tariffs, RUSAL needs to protect the railroad transportation tariffs. As far as we know, the term of the previous secret transportation contract between RUSAL and the Russian Railroads expires in 2011.

Russneft adopted a new development strategy



The Russneft Board of Directors approved the development strategy which considers the «aggressive» production growth. The strategy of the company owned by Mikhail Gutseriev and the System is elaborated until the year of 2017. The ambitious production target is 18.5 mnt, and Russneft capitalization should increase to approximately \$5 bn. (existing estimate - about \$2 bn).

In 2008, the company produced 14.2 mnt of crude oil, holding the 8th position in the list of Russian producers. In the past year, production dropped to 12.7 mnt, but it stabilized this autumn.

It will be rather difficult to achieve the goal stated in the Strategy. To enhance production to 18.5 mnt, investments would be required, and for that, crude oil prices must exceed its current level for a several consecutive years. Besides, the company has the debt (\$6.6bn, as at the end of the third quarter). Out of the total sum, \$2.2bn if the debt

to the Glencore trader (date of payment – December 31, 2010 with overdue interest of \$ 279mn), \$4.2bn more is the debt to Sberbank (\$1bn to be paid in March 2012, and \$2.7bn - in February 2016 (credit without interest)). To the end of this year, Russneft plans to sign an agreement with its creditors on debt restructuring for the period of 10 years and rate reduction from 12% to 8%.

ERTA view

When M. Gutseriev was functioning as a private businessman, he managed to implement his extra-ambitious plans for many times. Of course, there is a low-base effect, changing pre- and post-crisis market conditions which should be taken into consideration... However, the regime of manual operation allows to apply "special" instruments that can make a company easily thrive or block company's activity as well: Transneft, Russian Railroads... The only question is: what do the managers need?

International

Belgium gave hope to Gazprom



The main document signed during the visit of President of Russia Dmitry Medvedev to Belgium, was a memorandum between Gazprom export and the Belgian Fluxys on mutual understanding in the field of underground gas storage. This document anticipates that both parties, supported by the governments of their states, will hold negotiations with the Belgian national regulator of the energy market (CREG), in order to examine the possibility of leasing the volumes of the Loenhout underground gas storage facilities (UGSF) within the framework of an open and transparent procedure. To 2015-2016, Gazprom is expecting to get to its disposal the storage facilities with capacity of 300 Mmcm of gas (total capacity of this storage facility will increase to 700 Mmcm in 2011).

On the other hand, the Russian gas corporation cannot store gas in the existing Fluxus facilities, due to peculiarities of the Belgian law. Contractors supplying gas to the Belgian market have the priority in signing a contract for storage, and Gazprom does not belong to them (his deliveries are transited to Great Britain). Currently, hope has appeared that Brussels is going to come to terms. In October, Minister for Energy and Environment Paul Magnat presented a strategy, which main objective was transformation of Belgium into "the gas crossroad of the Northwestern Europe". Gazprom and Fluxus hope that this

would change the regulator's policy towards the companies which exploit transit possibilities of the country (and the memorandum signed in the presence of Dmitry Medvedev and the Belgian Prime Minister Yves Leterme guarantees that).

In order to enhance the security of energy supply of Belgium, Gazprom offers to add this future contract with the paragraph, saying that, in case of gas deficit for internal needs (supply problems or snap), Fluxus would be able to use Gazprom storage reserves at its own disposal. It is not quite clear, how this could work, having in mind the contractual responsibilities of Gazprom towards its own customers. As for now, this is only a political declaration, stating that the long-term contract for storage of the Russian gas will help to enhance the energy security of Belgium.

Why the Belgian would not give access to the Loenhout UGSF for Gazprom

Until now, the Russian corporation has not managed to get access to the Belgian UGSF, which could significantly improve Gazprom positions on the market of Great Britain, where winter gas sales bring high profits. Three years ago, Gazprom and Fluxys negotiated on mutual investments into construction of a new storage facility based on the Poederlee field with capacity 300 Mmcm. But CREG refused to grant Gazprom with the right to contract the facility on the long-term basis, and the political crisis in Belgium prevented from solving this problem on the interstate level. As a result, the project failed, due to alleged absence of economic viability, though the main obstacle has a political origin.

Russia accepts zero oil duties for export in Belarus at the cost of ratification of all agreements of the CES



At the latest meeting of the Interstate Council of the Eurasian Economic Community (EurAzES), Presidents of Russia, Belarus, and Kazakhstan agreed to ratify all agreement of the Common Economic Space (CES) in 2010. CES will start

functioning since 2012. This became possible, when Dmitry Medvedev and Alexander Lukashenko had regulated the oil and oil products duties issue just before that. The Minister of Economic Development Elvira Nabiullina made it clear that, beginning with next January, Russia would be ready to collect no duties from oil delivered to Belarus, provided that CES documents would be ratified and Minsk would return the profits from export of Belarusian oil products to the Russian budget.

Oil duties have been negotiated for several years rather emotionally. Moscow refused to subsidize Belarusian refineries, supplying duty-free only 6.3 mnt of oil required to saturate the Belarusian market with oil products. Additional 15 mnt annually are subject to usual export duty,

since Minsk has exported oil products manufactured from this crude oil and gained extra profit.

The day before the EvAzES meeting, Prime Minister Sergei Sidorsky had fled to Moscow urgently, but his negotiations with V. Putin brought no success, as the guest brought no constructive proposals with him.

Russia will lose annually approximately \$4.5 bn on abolition of oil duties and get approximately \$2.5 bn from export of Belarusian oil products.

The sum of losses can be reduced. According to the draft agreement of oil and oil products export duties, Belarus will have to set the rates similar to those set in Russia (according to Belstat, in 2009 Belarus exported 15.5 mnt of oil products). Deputy Minister of Finance Sergey Shatalov said in October, that oil product duty would be able to increase sharply, up to 90% of the oil duty. As for now, the officials have not dared to make such a radical step. Minfin and Minenergo have already agreed on the rate schedule for 2011-2012. They are: for dark oil products – 46.7 and 52.9% of oil duty; for light oil products – 67 and 64%. In 2013, they will meet at the level of 60%.

International

The Ukrainian Ministry of Fuel and Energy wants to revive the struggle with the Private Group of Igor Kolomoisky

The Ministry of Fuel and Energy of Ukraine has demonstrated its intent to revive its struggle with the Private Group of Igor Kolomoisky for control over oil assets. Head of the Ministry Yury Boyko announced that the state does not like the current situation in the oil and gas industry of the country, in particular, performance indicators of Ukrnafta. He is going to give operational control over the oil group back to Naftogaz of Ukraine and to create a vertically-oriented state holding company.

Sharp production drop of Ukrnafta during 9 months of the year of 2010 formed the background for a new attack of the state. Production of crude oil and gas condensate amounted to 1.89 mnt, or 12.9% less than during the similar period of the past year; production of natural gas dropped to 1.87 bcm (17.6% less).

Also, Privat controls the Kremenchug (Ukratnafta), Drogobych, and Nadvirnyansk refineries, about 1.5 thousand fuel stations, oil bases and transshipment terminals in the port of Odessa, as well as Ukrtransnafta – the state oil transport monopoly. These assets, and the Kremenchug facility first of all, may become targets of the campaign promised by Mr Boyko. The state owns 43% of Ukratnafta shares. Precarious balance achieved between the Privat Group representatives and the state at the meeting of stockholders held on July 14, 2010 can be attacked by plans to create a vertically integrated oil company (VIOC). The

Ukrnafta

Naftogas owns 50% plus 1 share of Ukrnafta. However, beginning from 2003, the oil company's managers have been acting in favor of Privat Group, which consolidated about 42% of Ukrnafta shares (in order to hold a meeting of stockholders and to take the reins, Naftogaz should have 60%, according to the law on joint stock companies). Due to breakdown of potentially dangerous meetings of stockholders, minority stockholders of Ukrnafta managed to control the company and even successfully oppose the monopoly.

Russian stockholders of Ukratnafta (Tatneft), who demand to give them back the property rights on the asset lost during the term of Julia Timoshenko, may become potential allies to Yury Boyko.

Even now, a relatively simple and effective instrument to fight Privat for oil assets is evident. This is introduction of changes to the law. The draft bill on reduction of the quorum required for a stockholders' meeting from 60% to 50% of voices was submitted to the Verkhovna Rada as early as in June. If it is passed, Return of control over Ukrnafta will be a matter of time and paperwork.

Until now, Kolomoisky has managed to agree with the ruling group. It is rumored in Ukraine, that he might become the first target of anti-oligarchic company of the Party of Regions, aimed to property redistribution.

ERTA view

Settlement of the conflict with Privat Group on the matter of Ukrnafta management is worth being considered as a milestone event. Many Russian businessmen working in Ukraine have their reasons to say in private talks: "They have the same situation as we are, the only difference is a small delay in time. We are the same!" Not taking into account a certain feeling of offense caused which such a thesis causes, one may suppose that there is a next cycle of struggling with the "wrong oligarchy" in Ukraine. Russia has already experienced that.

Vilnius "opened up" its gas pipelines for Gazprom



3 Eagerness of Lithuania to take the property rights for the infrastructural company Lietuvos dujos away from Gazprom and E.ON Ruhrgas has died away. On Wednesday, the government was going to submit to the

Seim for review the legal acts legalizing this reorganization, but postponed any decisions upon the pretext of the need to get advice from the European Commission. Vilnius faced a dilemma: the EC directive requires to separate gas suppliers from transmission pipelines (Lithuania has not asked for the possibility to use the softest third alternative within the Third energy package of legislation, which allows a supplier or marketer to own the infrastructure). On the other hand, there are no companies in Lithuania wishing to purchase the assets, and nationalization is impossible, as the

government has no funds to buy out and finance the gas pipeline infrastructure which was privatized by them only a few years ago.

So, Vilnius decided to keep aloof from negotiations with the owners, delegating this right to Brussels. Anyway, the Russian and German corporations managed to freeze enthusiasm of the Lithuanian government, which was going to introduce the rules of the Third energy package on its own market as soon as possible and under the most radical scenario, taking revenge on Gazprom, who had refused to grant gas discounts.

Gas pipelines in Lithuania

Almost all gas pipelines in Lithuania belong to Lietuvos dujos company. Its stockholders are: the Russian Gazprom (37.06% of shares), the German E.ON Ruhrgas (38.91%0, and the government of Lithuania (17.7%).

Personalities and Meetings

The US Special Envoy shared his views on the energy sector development in Eurasia

Last week, the U.S. Special Envoy for Eurasian Energy Richard Morningstar came to Moscow on a short visit. The Russian party has not reported on negotiations with the American diplomat, but he himself gave an interview to a Russian newspaper on the results of the meetings in the Ministry of Foreign Affairs and the Ministry of Energy. He says that the Administration of Barack Obama is trying to cooperate with Russia on energy matters, but the U.S. energy interests in Eurasia still differ from those of Russia. In fact, he confirmed that the public statement on the Caspian gas lines made by the President of Turkmenistan Gurbanguly Berdimukhamedov (this is a matter of the states participating in the project, not by all Caspian bordering countries) was offered and actively supported by Washington. Also, he expressed his confidence that Baku would sell gas produced from the Shakh-Deniz second phase to Europe (not to Gazprom, who offers a better price). He confirmed, though, that the real terms of new Azeri gas would be closer to 2020. And the Nabucco stockholders plan to bring the pipe into operation with the Caspian gas six years sooner. Also, on his opinion, while

the scenario of transporting the compressed gas through the Caspian Sea eliminates political problems related to absence of agreements on the status of the Caspian Sea, it does not allow to build a full-scale corridor for delivery of significant volumes to the West.

Meanwhile, Turkmenistan, blackmailing the Chinese, signed a framework agreement with Afghanistan, Pakistan, and India on construction of the Transafgan pipeline (TAPI), which would transport up to 33 bcm of gas annually to the South Asian markets, starting from 2015. The interstate agreement on TAPI construction was signed by Presidents of Turkmenistan (Gurbanguly Berdimukhamedov), Afghanistan (Khamid Karzay) and Pakistan (Asif Ali Zardari) and the Minister of Oil and Natural Gas of India Murli Deora. Elaboration of this project is favorable for Russia, since it reduces the risks of Turkmenian gas entrance to European markets. At the same time, possibility of realization of this project is quite low, due to military situation in Afghanistan and Pakistan, as well as historical hostility between Delhi and Islamabad.

Rosneft is reshuffling its senior personnel



President of Rosneft Eduard Khudainatov arranged a series of local management reshufflings. Based on the results of a business trip to Rosneft facilities in Krasnodarsky Krai, the new company's President fired the General Director of Krasnodarneft Nikolay Kovalev and three of his deputies. Besides, the head of Rosneft regional office in the Southern Federal District Viktor

Gladsky lost his post. Before that, heads of the Tuapse refinery Valery Ezhov, Purneftegaz - Vitaly Litvinenko, and RN-Service – Eduard Tropinin had been fired.

The cause for sweeping was given by deteriorated performance indicators and lack of the production maintenance program.

The personnel reshuffle will likely be continued. Evidently, E. Khudainatov has respect from Deputy Prime Minister - Chairman of the Board of Directors Igor Sechin, who gave him a certain carte blanche for firing managers from the old team of Sergey Bogdanchikov.

It also became known, that the post of the Rosneft CEO's advisor on international projects was given to Andrey

Bezrukov, who was deported from the USA this summer as a Russian spy. Prime Minister Vladimir Putin personally promised to find a job for the revealed spies. A. Bezrukov graduated in the USA, majored in international management (in 1995/1997 he got the Magister degree on international business at the ENPC School; then he studied in London School of Economics and York University of Toronto. He also finished the one-year course in the John F. Kennedy School of Government in Harvard University).

Meanwhile, the Rosneft Board of Directors made a decision that the company's top managers would receive the bonus for 2009 in the company's shares. With the right to sell them not sooner than in 6 months. Immediately five members of the management (of seven) increased their positions in the company. The position of E. Khudainatov increased from 0.0028 to 0.0051%; of Vice President Peter O'Brien – from 0.0024 to 0.0047% (in the form of GDR); of Deputy Chairman of the Board Larisa Kalanda – from 0.0025 to 0.0035%; of the member of the Board Gani Gilaev – from 0.00009 to 0.0004%; and of Vice President Sergey Tregub – from 0 to 0.0007%. Reward in shares has always been given only to independent directors of Rosneft: Hans-Joerg Rudloff, Vice President of the Russian Academy of Sciences (RAS) Alexander Nekipelov, and VTB President Andrey Kostin (years of 2008-2009).

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