Weekly Analytical Comments

ENERGY NEWS

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BP had no right

Chronicle of chronic failures

Tags: TNK-BP, Rosneft

The Stockholm arbitration has made a decision on the claim of the Russian TNK-BP stockholders' consortium AAR (Alfa Group of Mikhail Fridman, Access of Leonard Blavatnik and Renova of Viktor Vekselberg) to BP on violations of the TNK-BP shareholders' agreement. The Stockholm arbitration decided that BP had no right to create a strategic alliance with Rosneft and to exchange the shares with the state-owned company in the absence of the permit of the TNK-BP's Board of the Directors. The court supported AAR by all items. According to its resolution, the agreements on the strategic alliance, exchange of the shares between the Companies and their joint operation on the Russian shelf will be revoked.

BP declared that it would address the Stockholm arbitration and try to get a possibility to at least exchange its shares with Rosneft, since, on the Company's opinion, this deal did not violate the shareholders' agreement, because this "investment was not strategic". The decision should be made within 10 days.

At first, Rosneft made no comments about this decision; next day, the Deputy Prime Minister and Rosneft's Chairman of the Board Igor Sechin said that he hoped that the decision made by the Stockholm arbitration was not final. He is expecting to get the approval of the deal as soon as on April 7 and to close in timely, before April 14, according to the Rosneft-BP's agreement.

Also, he made it clear that the state company was not going to buy the AAR's share in TNK-BP, in order to settle the claims of the Russian shareholders to the deal between BP and the state company.

All AAR's claims may be settled, if BP agrees to participate in the TNK-BP's deal. However, representatives of neither the British company, nor Rosneft have supported the proposal of the Russian shareholders.

The deal with BP is not the only joint Rosneft's project with participation of foreign companies which faces serious difficulties. On the threshold of the meeting between the state company's CEO Eduard Khudainatov and Chevron managers, the information appeared that the partners could not agree on the principles of cooperation on exploration of Val Shatsky in the Black Sea.

In June 2010, the companies signed a preliminary agreement of joint works on Val Shatsky in the presence of Prime Minister Vladimir Putin. Chevron will finance the initial stage of exploration, which cost is estimateв in $100 mn, and it will get 33% in the joint venture. Assumingly, two wells will be drilled until 2014. The project's investments into exploration were estimated in $1 bn, into production – RUR1 tn. According to Igor Sechin, drilling operations will

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News brief

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FAS of Russia submitted the bill "On Oil and Oil Products market pricing" including the method of calculation of the oil and oil products competitive price formula. Page 3

Approval of the new tax method for the oil industry, offered by the Ministry of Energy and supported by Deputy Prime Minister for the Fuel and Energy Complex I.Sechin is being delayed. According to the Ministry of Finance, **the "60/66" formula will not be introduced before June 2011.** At the same time, the Ministry of Finance offers again to increase the tax burden on gas producers. The Ministry offers to increase the mineral extraction tax (MET) in 2.11 times to the approved rates: to RUR529/mcm since 2012 анв to RUR558/mcm since 2013. Page. 4

Transneft was the first among monopoly companies to publish the data on oil and oil products transportation tariffs, the volume of investments into oil pipelines' construction and reconstruction, and the data on oil quality. This was done in accordance with the governmental decisions. Page 6

Sergei Popov and Andrei Melnichenko are sharing the last joint asset – **SUEK**. Control over it will be given to Melnichenko's structures. Page. 6

NOVATEK is going to buy option for purchasing additional 25.1% of the Yamal LNG shares. Who the Company is going to buy it from, is not disclosed. Page 7

Gazprom and Wintershall signed a memorandum on participation of the German company in construction of the offshore segment of the **South Stream**. The Germans will get 15% at the expense of the ENI's share. Page 8

The **Russian** and **Moldavian** authorities endorsed the payment scheme for a huge gas debt. The main idea is to divide the total gas debt into two parts: the Moldavian and Transnistrian parts. Page 10

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BP had no right

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start in the end of 2011.

The agreement on creation of a joint venture and start of exploration should be signed until the end of March. But Rosneft insists on registration of the joint venture in Russia, against the plans of Chevron. Also, the parties cannot agree on the court to settle the disputes in. Chevron has certain concerns about the impossibility to select the suppliers which are determined by Rosneft. There are some problems with the project's budgeting.

Val Shatsky is a former Yukos asset purchased by Rosneft in 2007. Rosneft owns the license for the West Chernomorsky license block. Its estimated prospective resources are 860 mnt, though Rosneft and Chevron give no fresh information on it. Earlier, the estimated field reserves were 97 mnt.

The parties have officially denied the information on serious controversies, though the agreements on creation of a joint venture have not yet been prepared.

ERTA view

Many of us remember our college professors, who taught us to study various phenomena by means of their simulation: either experimental, or computational. Simulation helps to predict the consequences of particular events with relatively minor resource spending.

However, there are phenomena which simulation is too complex. For instance, a series of phenomena in the area of nuclear physics can still be checked by a full-scale nuclear explosion only. Simulation of climatic phenomena is the same.

Here, considering interaction between the big business and the state politics (and the former is always bigger), one remembers the words said by investment bankers about a specific dilemma. On one hand, interaction with state-owned companies increases investment risks; on the other hand, realization of large investment projects in certain countries without interaction with the state companies (or without their support) is impossible.

These phenomena may be so complex indeed, that one is not able to simulate them, or it is so difficult that no reliable results are guaranteed. Consequences of such phenomena may be checked by practical appliance only.

As for nuclear explosions, by the way: the states have been able once to agree on their prohibition. So, the use of nuclear energy may be improved without any explosions.

FAS builds competition under the formula

Tags: FAS, Ministry of Energy, oil

The government continues discussing the methods of oil products prices restraining. The Federal Antimonopoly Service (FAS) of Russia submitted the bill "On Oil and Oil Products market pricing in the Russian Federation", which includes the method of calculation of the oil and oil products competitive price formula. This document will likely not be endorsed by The Ministry of Energy, which has offered a softer mechanism of price regulation in the bill "On Oil".

The bill offered by FAS states the procedure of oil and oil products market price indices calculation for the domestic market. According to this bill, indices will be used for large-scale wholesale oil products sales, as well as regarded by the state authorities during oil products procurement. In fact, FAS tries to fix the oil products competitive price legally; deviations from this price will be considered as an effort to state monopoly prices.

Until recently, FAS has been pushing oil companies to exchange floors, considering their prices as competitive ones. However, due to low liquidity of the Russian floors, wholesale divisions of seller companies often acted as buyers at the exchange floors. Using a series of two-sided transactions, when only one company could timely reserve the money for purchasing of a big lot, one could form any exchange floor price which eliminated FAS claims. After the exchange floor price growth in early 2011, FAS stated that it would no longer consider exchange floor prices as a competitive price indicator and that it would be going to initiate again the discussion of the price formula, which was stopped in the beginning of the past year, due to development of the exchange floor trade. Moreover, the price growth on the threshold of the elections made the government to go on the "manual" management of the industry and to reduce retail prices by administrative methods. At the same time, the dedicated agencies were ordered to eliminate the possibility of such a scenario in future, and FAS responded with the mentioned bill.

According to the bill, the internal off-market index will be formed on the basis of mandatory registration of all off-market deals of large companies (share of which on the regional market is more than 35%) on the Saint-Petersburg exchange floor. Earlier, the Ministry of Energy has tried to trace such deals, but the obtained price indicators did not satisfy the market players.

The Ministry of Energy, in its turn, offered to include the possibility of government-stated maximal prices for individual oil products into the law "On Oil". The softer version of this clause was included into the final version of the bill submitted to the government by the Ministry of Energy on March 18. According to it, maximal prices of an individual oil product will be introduced, if its retail price for the pervious months grew for 30% and more.

In this case, the maximal retail price will be stated for the period not exceeding 90 days in the region (or several regions), where an abnormal price growth Page 4

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FAS builds competition under the formula

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has been observed. This definition is very careful and “should suit everybody”.

There must be an extraordinary situation to cause the prices to grow for more than 30% in a month. According to Rosstat, gasoline prices in 2010 have grown to 6.5%, diesel fuel – to 23%.

ERTA view

According to the Russian Constitution, formation and establishment of the economic policy basics is a prerogative of the state. Also, the Constitution does not permit any economic activities leading to unfair competition and monopolization. That is why the Russian state is responsible for this in the area oa oil products production and sales. Or, more precisely, this is done by FAS as a representative of the Russian government.

But the FAS’ activity on building a fair price formula seems a bit strange. In fact, this activity may be considered as an evidence that FAS, or the government, has no power to apply traditional anti-monopolistic methods.

In the course of privatization in Russia, there were a lot of declarations on creation of the competitive oil products market. As a result, regional monopolies have appeared which, in fact, operate in the regions in the absence of any competition. Moreover, the “cleanup” of the recent ten years has reduced this competition significantly.

There have been efforts to create exchange floors. But now, the authorities themselves admit that exchange floors do not in fact fulfill their objectives, not assuring market sales of oil products.

Now, the price formula is being built. Seemingly, it is worth praises: they do what they can, if they are not able to use other methods. However, Russia has an experience concerning price formula, for instance, in the gas industry, where the net back ideology is being reversed. There are many reasons in support of it, and the oil products price formula will bring a lot of them. One of the reasons is connected with the fact that, unlike the oil market, which is globally considered as a really existing one, the market of oil products (as well as the network gas) is much more localized and located close to consumers. These are end-use products, unlike oil, which is not consumed directly. So, there are many problems concerning the connection point. Moreover, there is no logical explanation of a direct connection between the price of gasoline for a resident of Novosibirsk and the oil products basket in Amsterdam.

So, we consider these proposals of FAS more tactical, not long-term and strategic measures. Twenty years have passed. And we are still tactical...

Keep a foot in both worlds

The ministry of Finance wishes to collect more and to offend less

Tags: Ministry of Finance, Ministry of Energy

Approval of the new tax method for the oil industry, offered by the Ministry of Energy and supported by Deputy Prime Minister for the Fuel and Energy Complex I.Sechin, is being delayed due to the efforts of the Ministry of Finance. S.Shatalov said that the “60/66” formula would not be introduced before June 2011.

The “60/66” regime was developed by the Ministry of Energy in the end of the last year as a measure aimed against the export of crude oil which was processed into oil products for the sake of savings due to low export duty. This regime antici pates refusal from the existing gradual leveling of export duties on light and dark oil products by 2014, as well as simultaneous transition to eq ual duties on light and dark oil products at the level of 66% of the crude oil export duty. At the same time, it is expected that the crude oil export duty will be reduced to approximately 5-7%. According to the calculation formula, the percent of the difference between the oil monitoring and the cut-off prices will be lowered from 65% to 60%. Assumingly, the new regime will make the export of crude oil and light oil products more profitable, closing at the same time the export of black oil.

The target objective of the “60/66» regime is elimination of the export-oriented oil processing, which share amounts to 15% for today. Most oil companies with the processing volume less than that of production lose nothing from introduction of the new regime. Individual initial processing plants found themselves in the risk zone. According to the Ministry of Energy, the processing volume of Kirishinefteorgsintz will be reduced more than twofold – from 20 mnt to 8 mnt; generally, though, Surgutneftegaz will get advantages from the new regime. The situation of Tatneft will be the same: its new initial oil processing plant with capacity 7 mnt will not be profitable; though, with total production level of 25 mnt, the Company will get a general advantage from reduction of the oil export duty. Bashneft, which processing level is two times as higher as its production, and Nizhnekamskneftekhim owned by TAIF will face the most difficult situation. the Ministry of Finance is discussing the loss reimbursement ways with these companies.

In addition, the discussions include possible bringing of the «60/66» regime in line with a new adaptive oil production taxation system, including introduction of an Page 5

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Keep a foot in both worlds

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additional profit tax (APT), which is to be submitted to the government. In violation of the provisions on the Ministries, the new taxation scheme for the industry is developed by the Ministry of Energy, not the Ministry of Finance, which has recently presented a reference on the project. The the Ministry of Finance's experts express their discontent with the the Ministry of Energy's concept, since it does not cover the new tax administration issues.

Some momentary problems have been observed. The "60/66" regime has been developed with regard to oil price range from $90 to $100/bbl. With these prices, the new regime will close the export-oriented oil processing at almost all refineries. But with the price of $120/bbl, the export of black oil is still profitable,even under the "60/66" regime. So, the regime will not achieve its purposes.

Key decisions on the oil industry taxation will likely be made by the government in May. In addition to the APT concept and introduction of the "60/66" regime, the government will consider preferences for the Vankor field in East Siberia. The 50% export duty preference for the Vankor crude oil has been approved by the government for the term expiring on May 1, 2011. Rosneft insists on extension until 2014. Last week, Prime Minister Vladimir Putin gave a commission to consider this matter and to submit the opinion before May 1; i.e., Vankor preferences will not likely be cancelled after May 1. Meanwhile, a new governmental fight for the gas industry taxation is expected. the Ministry of Finance has prepared the traditional spring document titled "The Basic Areas of Tax Policy for the Next Three Years». New proposals for 2012-2014 include the idea to increase tax burden on gas producers: the gas MET growing rates were slower than the oil ones. Since this year, the tax rate has increased from RUR147/mcm to RUR237/mcm, to be increased along with the inflation rate. The Deputy Minister for Finance Sergei Shatalov has said before that RUR100 bcm annually was a minimum tax to be collected from gas producers without any financial harm to them.

Now, the Ministry offers to increase the mineral extraction tax (MET) for gas in 2.11 times to the approved rates: to RUR529/mcm since 2012 and to RUR558/mcm since 2013.

Compared to this year, the Gazprom's tax burden may increase in 2012-2013 in $5.2 bn and $5.7 bn, correspondingly. In addition to the monopoly, this increase will touch NOVATEK protected by the Prime Minister in the latest times. With the production level of 45-50 bcm of gas, the tax burden will increase in $500 mn, causing sharp reduction of the Company's profits.

ERTA view

Tax situations in oil and gas industries differ a lot. They in oil industry talk about the changes in taxation, yes. But, along with that, a certain bas has been created which determines the volume of withdrawal of oil companies' profits by the state. Now, they talk about particular clarifications and corrections of faults, as well as about elimination of paradoxical situations, including, for instance, profitability of export of low-quality oil products which are sold, in fact, as crude. Also, they talk about creation of tax conditions for new field development. These questions are serious, no doubt; but they will not bring critical changes into the oil industry taxation.

The situation in the gas industry differs. Its taxation has been relatively low for many years, being explained by the slogan "they have to invest much". But this situation has changed critically. With this preferential taxation (let us also remember preferential taxation of gas condensate), the country sees establishment of new international-level gas companies, and Gazprom's investments happen to be extremely expensive.

As for the state, it founds itself in the situation when it must invent the mechanism to compensate the increasing gas spending (the population, agricultural producers, the Russian East...). So, it is more the gas industry where there is a necessity to create the taxation system.

Government and Infrastructures / M&A

Rapid response and what's behind it

Transneft demonstrated the reason for rate increasing

Tags: Transneft, ESPO, tariffs

Transneft was the first among monopoly companies to publish the data on oil and oil products transportation tariffs, the volume of investments into oil pipelines' construction and reconstruction, and the data on oil quality. Until now, the Company has considered this information to be secret, but in the end of the past year the government ordered Transneft to disclose it.

In 2011, the company is going to spend RUR161.2 bn for construction of new facilities. Almost a half of this sum (RUR83.9 bn) will be invested into ESPO-2. The total project's cost is estimated in RUR327 bn. This year, Transneft will spend RUR20.7 bn for BPS-2 and RUR18.2 bn for expansion of ESPO-1. Total cost of these projects, according to the monopoly, will be RUR100.1 bn and RUR 72.6 bn, correspondingly.

The monopoly estimated construction of the Purpe-Samotlor oil pipeline (a part of the Subarctic-Purpe-Samotlor system which has to connect the Yamal fields and ESPO) 430 km long with capacity 25 mnt annually in RUR53.1 bn (the sum of investments for 2011 is RUR16.2 bn). This is one-third as more as the initial estimates made by Transneft: In 2010, the project's cost estimate was RUR40 bn.

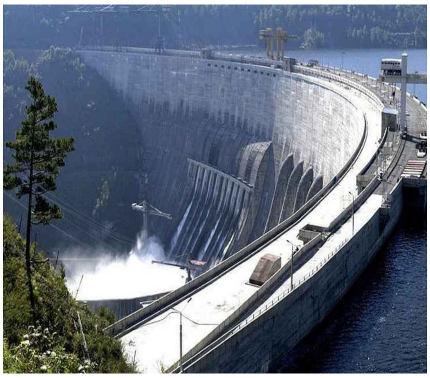
ERTA view

We consider this quick publication as an answer given by Transneft to the decisions of the state (represented by FTS) on the Company's oil transportation tariffs. It is known that Transneft has asked to raise them for approximately 3% since January 1, but was rejected. One of the basic reasons for this request was the fact that Transneft received last year the missing earnings from transportation re-routing. The reality has found to me much worse that the plans.

So, on receiving the answer that the tariffs have been raised several times, Transneft has explained what it needs money for. Its representatives reply to the state authorities: "You refuse to raise the tariffs now, then you will do it later, and the rates will be higher".

Hopes of RusHydro

The Company expects electricity prices to grow



The RusHydro's Board of the Directors approved the Company's business plan for 2011-2015. According to it, to 2015, the Company plans to increase revenue growth 1.6 times, or to RUR136.1 bn, and the profit growth - 2.2 times, or to RUR57 bn.

In 2010, by the Russian Accounting Standards (RAS), the Company may get the gain of RUR82.8 bn (+4.8% to 2009 values) and the profit of RUR26.6 bn (2.6 times growth); in five years, these indicators must grow in 1.6 and 2.2 times, correspondingly (to RUR136.1 and to RUR57 bn). By the results of 2010, the Company's EBITDA may amount to RUR46.4 bn (1.8 times growth, compared to 2009), and to 2015 this indicator will grow in twice, reaching RUR90.2 bn.

RusHydro's assumptions are as follows: the actual share of the energy market liberalization will increase (since 2014, all consumers, including the population, will purchase the electric power on the free market), the energy itself will cost more, first of all, due to the fuel prices growth. In addition, it is expected that power generation will grow due to increased water content, and more new stations will be brought into operation.

The Company plans to start paying dividends, which have not been paid in first three years of the Company's operation (including the year of 2010). Since 2011, RusHydro plans to give 5% of its profit, as it is anticipated by its dividend policy. Payments for 2011 may amount to RUR2.04 bn and increase to 2015 to almost RUR2.9 bn.

RusHydro plans active operations on the debt market. In the next five years, the Company's long-term loans and credits will grow in 32.4%, or to RUR49 bn, the short-term ones - in 4.3 times, or to RUR35.2 bn. This money will be spent for the investment program and new acquisitions.

The end of partnership

Tags: SUEK, Donalink

Former partners in MDM Bank Sergei Popov and Andrei Melnichenko are sharing their last joint asset – the Siberian Coal Energy Company (SUEK). Control over it will be given to Melnichenko's structures.

SUEK is the Russian largest coal company. It provides more than 30% of energy-generating coal supplies for the domestic market and more than 25% of the Russian coal export. In 2010, the Company's net profit was RUR7.6 bn.

Now, the Cyprus company Donalink Ltd. owns 99.84% of SUEK's shares. Linea (the Bermudas) and STI (Jersey Island), controlled by Andrei Melnichenko and Sergei Popov, own 48.65% of its shares each. More 2.7% Page 7

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The end of partnership

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of the shares belong to Altmirco Enterprises owned by SUEK's General Director Vladimir Rashevsky.

In accordance with the shareholders' agreement,the share of STI in the SUEK's capital will be reduced to the level less than the block shareholding. According to SUEK evaluation, A.Melnichenko will pay about $1.9 bn. Sergei Popov/s Company will get $888 mn, or all Donalink's dividends. Before that, Donalink shares owned by STI will first be transitioned to the privileged category and cancelled after the deal.

The shareholders' structure will be change in the threshold of the SUEK IPO in London planned for the second half of this year. The company SUEK Plc will be registered on Cyprus in the nearest days. Through it,SUEK plans to perform the placement. SUEK Plc will become an owner of SUEK shares. As for Donalink,it will purchase all shares of SUEK Plc,based on their valuation of $8 bn.

In view of IPO, SUEK will get rid of energy assets, so, the investors will deal with a purely coal company. The energy assets (61.2% of TGC-13,50% of Kuzbassenergo's shares, 100% of the Siberian Generating Company LLC, 98.5% of Sibenergoholding) will be united in a specially created company Sibenergy,which will be sold to SUEK's shareholders. The extra meeting of SUEK's shareholders has decided that SUEK would by 10% of the Company's shares from Donalink Ltd for $800 mn. The money obtained will be spent by Donalink for purchasing of Siberian Energy Investments from SUEK. The bought shares will be further cancelled.

As a result,STI's share in Sibenergy will be the same as that of in SUEK Plc. Before IPO,SUEK will issue additional shares in the amount of 10% of the authorized capital, which will be offered to investors. More 5% of SUEK's shares will possibly be offered by STI. In addition, it is supposed that S.Popov will withdraw its capital from the coal company until the end of this year.

Late 2006,after ten-year cooperation and not explaining any reasons,Andrei Melnichenko and Sergei Popov started sharing their assets. Then,Sergei Popov got MDM Bank, and Andrei Melnichenko – the Mineral and Chemical Company EuroChem. It was supposed that the SUEK"s control package would be sold to Gazprom,but the deal has never been made,because,according to some information, the shareholders wanted to raise the Company's valuation.

ERTA view

The situation seems quite trivial. When the people end their partnership,they share their business. This happens everywhere. The situation may be non-trivial only in terms of the size of a business. The object is the Russian largest coal company! Russian has already seen major business divisions,say,between V.Potanin and M.Prokhorov. But we think that this time we'll see a highly careful division.

In future,the historians will have to assess the role and extent of connections between SUEK and the Russian political elite.

Control costs money. And the money is loved by all

The NOVATEK's Board approved the purchase of a call for 25.1% of the Yamal LNG shares, reduced the Company's Board in twice and endorsed the payment of huge dividends.

Who the Company is going to buy the Yamal LNG block shareholding from, is not disclosed. The sum consists of %15 mn for the right to buy the shares and $511 mn for the shares themselves,if NOVATEK decided to buy them before June 2012. Therefore,the Company has obtained the rights for all project's 100%.

51% of the shares it bought in May 2009 for $650 mn from its shareholder Gennady Timchenko. And the three-year call with him for more 23.9% was signed at the same time. The cost of the package is $450 mn plus $10 mn for the call itself.

Supposedly, G.Timchenko has bought 74.9% shares of Yamal LNG from the structures close to Gazprom,which got them from Alisher Usmanov. The sum of the deal is not known. However,the Gazprombank's report for 2009 contains the information that the bank sold 25.1% of Yamal LNG shares,which have been on its balance since 2005,to an unknown company for $78.5 mn. Later,the governmental Committee for Foreign Investments gave a post factum approval for this deal,where the structures of G.Timchenko's junior partner Peter Kolbin act as a buyer. Based on this valuation,one can calculate the sum of 100% of Yamal LNG shares paid by G.Timchenko and his partners: approximately $300 mn.

The profit earned by G.Timchenko's structures from these transactions can be calculated as well. They have already got $650 mn from NOVATEK for the control package and $25 mn for the calls. There is no much doubt that these calls will be sold for more $961 mn,since NOVATEK plans to use 49% of them to attract foreign shareholders to the project. I.e.,G.Timchenko will get more than $1.6 bn.

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Control costs money. And the money is loved by all

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NOVATEK has already signed a memorandum with the French Total which plans to buy 20% of Yamal LNG to the middle of this summer. However, the price of the deal has not yet been agreed. In theory, Total, as a strategic partner of L.Mikhelson and G.Timchenko, who sell it 12% of NOVATEK for $4 bn, may get the package in a highly risky project without a large premium.

Negotiations with Shell, Statoil, Qatargas and Japanese companies are also underway.

ERTA view

Large projects inevitably require big money and powerful people, and the Yamal LNG project has finally got all necessary attributes. Now, the project has a single owner who is already attracting foreign partners.

What is interesting, is that the material essence of this project (including the conditions for the LNH plant construction and the necessity to transport LNG through the ice) has not been changed during the last five months. It is the same as it was in the times when N.Bogachev was trying to attract Respol to participate in the project's implementation.

Now, however, the project was given more tax preferences, together with a whole chain of re-sellers; each of them, earning his bread by sweat of his brow, increases the project cost. This chain includes such names as A.Usmanov, Gazprombank, G.Timchenko. So, before it produced the first gas, the Yamal LNG has assured additional confidence in the future for many good people.

To buy and to lose

Tags: ONGC, Bashneft

The Indian authorities fined ONGC Videsh for the deal on Imperial Energy purchase. The Chief Controller and Auditor of India, CAG, found that the Company lost $265 mn by the purchase of the British Imperial Energy, the company producing crude oil in the Tomsk Region.

Imperial Energy was bought for $2.2 bn in 2009. To the date of initial offer, the market premium amounted to 62%. The Indian government approved this deal under the condition that the internal rate of return (IRR) of ONGC Videsh from this purchase would be 10%. It was also expected, that after its transition to ONGG, the Company would increase production almost in twice, from 15,800 bbl daily to 35,000 bbl daily. But the Company failed to reach this target.

The ONGC management explained the failure by severe Siberian weather and the crisis. Since mid-2008, many small oil producers have had to maintain low production levels in view of low oil prices.

As for Sistema negotiating with ONGC on Imperial Energy's takeover by Bashneft, the audit report will become an additional negotiating argument to agree on lower cost of the asset. Sistema is interested in new assets, Imperial Energy in particular, as it will assure additional loading of the Bashneft's refinery. For ONGC, the share in Bashneft is more attractive than Imperial Energy.

Earlier, it has been supposed that the Indians would get up to 20% in the Oil Company Sistema.

ERTA view

Experts have expressed their concerns many times about the specific international oil and gas business practices by ONGC. They noted, for instance, principally different business approaches practiced by the Indians and the Chinese. So, we can state the occurrence of inevitable. Only it is difficult to understand why it happens now, not earlier... or later.

On the other hand, the Company does not deal with open money-laundering, nor it buys totally dummy corporations. So, the declarations made by the Chief Auditor of India may be considered as follows: "We may hear them, but no business conclusions can be made, or they are not evident". This situation is more alike to audit inspections, declarations and reports of the Russian Accounts Chamber.

Merry joint walk

«South Stream» gets new shareholders

Tags: South Stream, Wintershall

The progress of the South Stream project has been a matter of key attention for Vladimir Putin. First, Gazprom and Wintershall signed in Novo-Ogarevo a memorandum on participation of the German company in construction of the offshore segment of the South Stream. Them the Prime Minister visited Slovenia and Serbia, where the founding documents on the latest joint venture within the Project with the Slovenian Geoplin were signed and the Serbian gas line's segment was presented.

The concept of South Stream's management by Gazprom and Eni on the parity basis, which has been found to be highly unsuccessful, will be changed. The Gazprom's memorandum signed with the German Wintershall, which will get 15% on the account of the Italian

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share,and the earlier one with the French EdF,which should get 10%,on participation in engineering of the pipeline on the Black Sea bottom are aimed to change the management structure and to “Europeanize” the South Stream project. This is very important on the threshold of the negotiations with the European Committee on the Project’s status. In the absence of the permit given by Brussels, construction of the gas pipeline will have no sense, since, according to the new rules,the shareholders will have no right to manage transportation facilities without a special permit.

And this permit is delayed. The European Committee, actively and unconditionally,supports the project “Southern Gas Corridor”, competing with the South Stream for sales markets and general opportunities on delivery of the Caspian gas to Europe beyond Russia. Participants of both projects declare their intent to make investment decisions before the end of this year.

The South Stream anticipates construction of the pipe on the Black Sea bottom from Russia to Bulgaria. Gazprom is holding independent negotiations on construction of onshore segments in transit states to the delivery points in Austria and Italia. Intergovernmental agreements have been signed with all potential transiters, including Bulgaria, Serbia, Hungary, Austria, Slovenia and Greece, and even joint ventures have been created for TEO preparation. Throughput of the offshore segment may reach 63 bcm in case of construction of four lines.

Joining procedures of EdF and Wintershall will go in parallel and should be completed before the end on this year, when a new four-party shareholders’ agreement is signed. The Eni’s share will be lowered to the block shareholding; according to Alexei Miller, though, an additional participant may appear.

At the same time, Gazprom and the partners should prepare the through project’s TEO. This forecast is too optimistic, with regard to the fact that investigation of the offshore segment in the Turkish economic zone has not been started. Ankara issued a permit for corresponding works only in February, and they can be started only in summer.

The investment decision on all segments is expected to be made before the end of this year; construction will be started in 2012, first gas will be transported in December 2015.

Justification for the Serbian segment is the only one ready for today. From the very beginning, Belgrade has been the most tractable and reliable partner to Gazprom in this controversial project. The Serbians are the only ones who have agreed to give the control package to the Russian party; the others founded a joint venture on the parity basis. It is not surprising that the TEO for the Serbian segment has been prepared first, in spite of the fact that, geographically,it is the middle of the project. Besides,Serbia is not a EU member, and the approval process concerning Belgrade is going much easier.

The Serbian 397-410 km long segment with two compressor stations will cost Gazprom and Srbijgas approximately EUR1.5 bn (or approximately EUR4 mn/ km, with regard to two compressor stations). The expected inlet throughput of the pipe is 38.5-40.5 bcm annually. For comparison, the offshore segment must transport up to 63 bcm annually; it means that approximately 20 bcm will go to the Italian South.

Gas deliveries to Serbia through the South Stream will amount to 4 bcm (for now,it gets less than 2 bcm through Ukraine), including transit gas. In addition, the Russian gas to Serbia may be supplied to Croatia and Bosnia-Herzegovina also: 2 bcm and 1.2 bcm, correspondingly.

Along with that, the partied have not agreed on transit fee evaluations. The Serbian Minister for Ecology Oliver Dulic announced at the presentation that the Balkan side might earn EUR500 mn annually as the transit payment through this pipeline. The pipe will be constructed and managed by the joint venture, and Gazprom will get one half of the transit rate.

But the Russian corporation’s presentation and press release say that the transit payment for 25 years of operation will be approximately EUR4 bn. This is,in average,EUR160 mn annually, or bout EUR1 for transportation of 1 mcm for 100 km (at full load). This is too cheap. For the same service,Gazprom pays almost $2.8 to Naftogaz of Ukraine, and even the EuRoPolGaz joint venture (the Polish Yamal-Europe segment) get about $2. Transportation through the Belarusian Yamal-Europe segment costs to Gazprom less money, but it is fully owned by the Russian corporation.

ERTA view

We see again who is the Russian gas major and who was the main ideologists of taking Europe into new gas grampus by means of construction of offshore gas pipelines. This project is a direct complement to NordStream, and the matters of its cost (and madly huge one) pale into insignificance. The global energy policy is more important.

We’d only like to now, whether the Russian Federation has enough resources to realize such global projects, with regard to the fact of simultaneous realization of similar gas projects in Asia. Also, the matter of adequacy of Gazprom, in its existing status, as a tool for the global energy policy implementation is interesting as well.

International

Who needs these principles

Lithuania faces the risks of big losses and minor advantages

The field of battle between Gazprom, E.ON Ruhrgas and the Lithuanian government moved to the parliament of that country. Its deputies got a letter signed by the Gazprom's Deputy Chairman of the Board Valery Golubev and the Managing Director of E.ON Ruhrgas International Peter Frankenberg, where they described the details of the Lietuvos dujos conflict and asked to consider all pros and contras before adopting new gas laws.

This February, the government of Lithuania introduced to the parliament draft changes to the gas business legislation, which anticipate appliance of the EU Third Energy Package according to its most hard scenario. In case they are adopted, Lietuvos dujos, 75% of shares in which are owned by Gazprom and E.ON Ruhrgas, will be deprived of its gas transportation and gas distribution assets.

Top managers of Gazprom and E.ON Ruhrgas believe that the Lithuanian Cabinet of Ministers offers to apply the Third Package provisions in the country without good reasons, in a closed manner and without compliance to its purposes. Adoption of the proposed bill versions will lead to "inappropriate and excessive negative consequences for Lietuvos dujos, Lithuanian gas consumers and the investment environment in this country".

The projects consideration date has not yet been stated. As it can be seen from the materials published on the Seym web-site, the Law Department of the Parliament has written a many-page reference with numerous comments to these bills.

Nevertheless, Golubev and Frankenberg make an appeal to the Parliamentarians "to make a critical assessment of the bills and to see whether they consider the understandable concerns or not". Also, they express their readiness to participate in any public hearings held by the Seym in this matter.

One of the deputies from the party of the ruling coalition Kiastutis Masuilis responded to this letter momentarily. He addressed the High Commission for Corporate Ethics with a request to investigate this case. The deputy thinks that the lobbyist activity of Golubev and Frankenberg "may possibly be illegal", as they are no officially registered lobbyists.

The fight in the Seym is expected to be hot. Today, the ruling coalition (three fractions) has a very fragile majority (74 voices versus 64 voices of four fractions of the minority and independent deputies). In early March, the opposition tried to initiate no-confidence vote concerning the Energy Minister Arvidas Sekmokas, who leads the activities against Gazprom and the management of Lietuvos dujos. But this initiative has failed after hot debates.

Along with that, the letter has seemingly had an effect on the governmental circles. For the first time for a long period, the Lithuanian Ministry for Energy held the meeting with the LD shareholders' delegation. They discussed the appliance of the EU Third Energy Package's provisions to the Lithuanian gas transportation system and the Russian gas prices. Though no agreements have been reached, the fact of such a dialogue itself is an evidence of possible accommodation. Until this time, the officials have refused from the meetings and offered contacts only under the condition of the EC mediation. Also, each party has threatened to send claims to the international courts.

On Gazprom's opinion, Lithuania takes only 50-60% of the contracted gas volumes (2.5 bcm, instead of 5 bcm). This fact gives it no reason to claim the price discount, which is determined under the formula tied to the oil basket. The contract itself and the price formula have been approved by the Lithuanian government.

Sovereignty recognition = debt refinement

Moldavia agrees to share with Transnistria: gas assets and gas debts

Tags: Moldavia

The Russian and Moldavian authorities endorsed the general payment scheme for the gas debt of Moldavia and Transnistria. This matter was discussed at the meeting of the Russian-Moldavian intergovernmental committee for economic cooperation held in Moscow. According to the Moldavian Deputy Prime Minister and Minister for Economy Valeriu Lazer, the main idea is to divide the total gas debt into two parts: the Moldavian and Transnistrian parts.

The debt of Kishinev to Gazprom amounts to approximately $350 mn, while the debt of the unrecognized Transnistria exceeds $2.2 bn.

Until this time, Kishinev has refused to fix legal division of gas assets, in spite of the fact that it has not controlled them in practice, since Transnistria declared its independence in 1990. Moreover, in 2006, the President of the unrecognized Transnistrian Moldavian Republic (TMR) Igor Smirnov signed a decree on withdrawal of Tiraspoltransgaz from the Moldavian national operator – Moldovagaz Joint Stock Company (50% of it is owned by Gazprom) and foundation of a fully autonomous company Tiraspoltransgaz-Pridnestrovie LLC, which now manages the pipes and their content on the TMR territory. Now, the Moldavian side is ready to consider the Transnistrian gas enterprise as a separate entity, with the separate debt in the Page 11

International

Sovereignty recognition = debt refinement

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sum of $2.2 bn. When the division is stated, Gazprom and Transnistria will solve the debt payment problem according to the bilateral procedure.

Until now, however, the Transnistrian authorities have never admitted any debts. Igor Smirnov has declared many times that Transnistria had no gas debts. Tiraspol still upholds this position. The Transnistrian authorities pay for the consumed gas to no one, while collecting the payments from their own population and enterprises with the tariffs which are lower than that of in Russia. The gas price on the RF domestic market in 2011 is RUR287,000/$83/mcm, while the Transnistrian consumers, until recently, have paid a significantly lower price for the Russian fuel. The private residents paid 544 Transnistrian rubles ($51)/mcm, and heat supply organizations responsible for heat delivery to apartment buildings - 137 Transnistrian rubles ($13)/mcm. The tariffs have been recently corrected by the decree of President Smirnov, and now the price for the population is $78/mcm, for heat supply organizations - $35.

The most part of the gas is consumed by large Transnistrian industrial enterprises, including the Rybnitsky Metallurgical Plan (owned by the Russian capital, one of its shareholders is Alisher Usmanov) and the Moldavian HPS CJSC (owned by Inter RAO UES). The former takes about a half of all gas consumed by Transnistria (average annual consumption of the Republic is approximately 1.5 bcm). The Transnistrian authorities sell gas to industrial giants for $140/mcm. Such price may seem strange in view of the fact that Moldavia (and Transnistria is legally considered its constituent entity) buys the Russian gas for$295/mcm.

Negotiations on gas debt settlement will not be simple, since this is a private main of the Transnistria's leader Igor Smirnov.

ERTA view

Today, our first comment was about interaction between big energy business and the politics. Let us end with the same topic.

It is the next time when we see that politics is the most efficient way to earn money in the energy area. The only question is: who will pay in the end? It is clear that Gazprom needs only live money, and it will face problems with its collection. The previous experience showed that the end payers were always the same: consumers and tax payers.

Belarus is asking for new debt rescheduling

Now the currency market is guilty. Who will be the next?

The First Deputy Prime Minister of Belarus Vladimir Semashko asked the Gazprom's CEO Alexei Miller for gas debt rescheduling. Due to new cash redundancy rules applied to currency purchases, Beltransgaz has faced cash deficiency in the sum of about $400 mn. However, the next payment for the gas delivered in February, which had to be transferred to the Russian company's account before March 23, has been made.

The panic on the Belarusian currency market made to introduce the rule of 100% cash redundancy for the month ahead. In terms of Beltransgaz, it means that it should find the cash for additional payment of 1/12 of an annual payment to Gazprom. In the first quarter of this year, the Russian gas price for Belarus was $223/mcm. About 6 bcm of gas will be delivered in the first quarter, and the annual plan amounts to 22 bcm.

The parties do not wish to conflict. Beltransgaz is likely counting on softening of the currency policy. The National Bank of Belarus has already promised to cancel the rule of 100% cash redundancy for the month ahead, introduced on March 16, since April 1.

Though, new payment problems are inevitable. New gas price growth in Belarus is expected in the second quarter. The oil and oil products prices have grown significantly since the beginning of this year, causing the growth of gas price under the Gazprom's long-term contracts, including for Minsk.

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