

Shell weighs its options

The Sakhalin 2 partners are mulling a range of concessions in a bid to placate critics of the project

Shareholders in the Shell-led Sakhalin 2 project look increasingly ready to make concessions to Gazprom. In the face of mounting pressure to give the gas giant access to the project and criticism of operator Sakhalin Energy's environmental record, the consortium is looking at its options.

Shell may now consider giving Gazprom a role in selling LNG from Sakhalin 2, company sources tell *Argus*. The gas giant's monopoly on gas exports does not cover production-sharing agreements like Sakhalin 2.

Shell's softening stance coincides with natural resources minister Yuri Trutnev's visit to the island. Trutnev said he plans to press for criminal charges against Sakhalin Energy over damage to the environment.

But giving Gazprom a role in gas sales from the project will be a last resort, observers say. And it is unclear how such a scheme would work in practice, as Sakhalin Energy has already signed sales contracts with customers in Asia-Pacific for the entire initial production volume.

Shell is looking at revising the terms of an asset swap designed to give Gazprom a Sakhalin 2 stake. Shell initially offered the gas firm 25pc from its own stake in the project, in exchange for 50pc in the 3.3bn m³ Zapolyarnoye field in west Siberia. But Gazprom has been seeking a bigger share since Shell controversially doubled the second-phase budget to \$20bn last year (*FSUE*, 15 July 2005, p5).

A Shell spokesman insists that Gazprom has never asked for a controlling stake, something widely assumed by observers. But the two firms have recently held meetings where they discussed what role

Gazprom will play in Sakhalin 2, as well as alternative asset swaps. "We are mainly discussing what extra assets we can offer," the spokesman says, but declines to name specific assets. "As we have said before, we hope to welcome Gazprom as a partner in the project," Shell chief Jeroen van der Veer said on 26 October.

Mitsui and Mitsubishi, which hold 25pc and 20pc of Sakhalin 2 respectively, have indicated that they are prepared to offer Gazprom some of their shares (*FSUE*, 15 September, p3). But, until now, Shell said it will not amend the terms of the deal signed last year, or offer more assets.

Sakhalin Energy looks set to come under further pressure when Russian authorities complete their evaluation of the project's second-phase budget in December. Russia is expected to reject the revised budget.

"The major increase in Russian revenues, which occurs after cost recovery ends, will be delayed," van der Veer admits. "But over the life cycle of the project, Sakhalin 2 will generate some \$50bn of revenue for Russia at \$34/bl oil prices, and \$80bn of revenue for Russia at \$50/bl oil prices."

President Vladimir Putin recently said he considers Sakhalin Energy's reasons for doubling the budget irrelevant. Failure to get the new budget approved will make it more likely that Shell agrees to revise the asset swap with Gazprom, a Shell spokesman says.

Russian environmental watchdog Rosprirodnadzor says it has letters proving that Sakhalin Energy covered up damage to the environment, and plans to prosecute (*see p4*). The project operator says the letters are "based on hearsay and no science or hard facts".

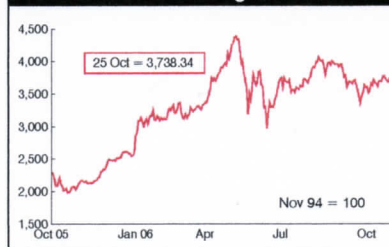
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Urals Med differential to BFO \$/bl



ASP Russian oil and gas index



Crude	\$/bl	Products	\$/t
Seaborne	25 Oct	Baltic	25 Oct
BFO (dated)	58.73	Gasoil	547.28
Urals NWE	55.38	M100 SR	265.00
Urals Med	55.53	M100 cracked	260.00
Druzhba		Black Sea	
Germany	52.73	Gasoil	545.50
Poland	52.63	NW Europe	
Czech Rep.	53.13	Gasoil	559.00
Slovakia	53.08	Fuel oil (3.5%)	256.50
Hungary	53.08	VGO (1.6%)	364.00

Mitvol turns up the heat

Oleg Mitvol, the outspoken deputy head of Russia's environmental watchdog, Rosprirodnadzor, tells Argus he has proof that Shell management covered up environmental damage at Sakhalin 2 — and plans to prosecute.

Sakhalin Energy, operator of the Shell-led Sakhalin 2 project, says it has sorted out all the environmental criticisms raised by Rosprirodnadzor and that there are no grounds to revoke its permits. Do you agree?

Sakhalin Energy has agreed that all our complaints are legitimate but they have only addressed the problems in the Makarovsk region, where construction of the pipeline has been suspended. To address all of our criticisms they will need to clean the Aniva bay on the south end of the island — which has been destroyed by Sakhalin Energy — introduce fish there and plant new trees.

Do you think that this will be possible for them?

No, I do not believe that it is possible.

Is it possible to find a compromise?

According to the Sakhalin 2 production-sharing agreement [PSA], all disagreements between the investor and the state should be settled in Stockholm. The only way to find any sort of compromise will be through international arbitration in Stockholm.

Who will take Sakhalin Energy to court?

I will take them. I have documents proving that the Sakhalin Energy management was aware that the company violated technical standards, but carried on trying to meet project deadlines and refused to stop work. I am confident of winning my case in Stockholm.

What documents are these? Where are they from?

I have email correspondence between executives in Sakhalin Energy management from 2002. I received these letters from John Donovan, owner of the anti-Shell website www.royal-dutchshellplc.com. I received them on 19 October and forwarded them to Sakhalin Energy with a request for an official reply. But I have not received any reply so far. I presume that they are in shock.

How could you prove that these documents are genuine?

They appear genuine and we have special services working to prove this. Once they have been verified, we will have enough evidence to take Sakhalin Energy to court. If we win, the Sakhalin 2 consortium should pay compensation for all the environmental damages — which will come to over \$10bn — as well as compensation to the state for loss of revenues caused by the additional delays.

Where did you get the figure of \$10bn from?

This figure was calculated by a group of experts, including Rosprirodnadzor. It is a rough figure. In November, we will

set up a special commission comprising Russian and international experts to assess the cost of damages.

Do you think that environmental approval for Sakhalin 2 will be revoked?

I do not know. Sakhalin Energy has a strong lobby in the government. The fact that Rostekhnadzor [Russia's technical watchdog] is reluctant to sign the document to revoke the environmental approval supports this view.

Rosprirodnadzor has stepped up its investigations into oil companies in Russia. Why is this happening?

In late September, natural resources minister Yuri Trutnev met President Vladimir Putin. They concluded that many oil companies have not developed all of the fields for which they have licences, and this means that the state receives less tax revenue. Many companies are doing all they can to win as many new licences as possible to increase their capitalisation without any thought of developing them. Companies find it very easy to persuade officials to renew these licences. We think that this should be stopped.

Why have you started with Lukoil? Was the audit timed to coincide with the company's annual presentation in New York on 18 October?

Ivan Blokov from Greenpeace told us that Lukoil and TNK-BP had committed the most serious environmental violations in Russia — the former at its fields in the Komi autonomous republic and the latter at Samotlor in west Siberia. There was no connection between the timing of our audit and Lukoil's presentation in New York.

Blokov says TNK-BP has invested a lot of money to sort out the problems in Samotlor.

I hope that this is true. We want to encourage oil companies to care about nature.

How can Rosprirodnadzor do that?

We have to make sure that companies develop their projects in accordance with their licence agreements and do not damage the environment. If we do find violations, we recommend that the licensing commission, led by Rosnedra [Russia's agency for subsoil use], revoke that firm's licence.

Could you give examples of when licences were revoked?

Last year, around 80 licences were revoked.

And that followed complaints from Rosprirodnadzor?

Yes.

Rosprirodnadzor has asked Rosnedra to revoke Rosneft's licences in Sakhalin. Are you going to audit more of Rosneft's fields?

Yes. I do not want to name the fields now. But I am confident that all oil companies will be audited in the next two years.