

Working paper

Northern Offshore Oil and Gas Resources: Russian Policy Challenges and Approaches

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Introduction

From being on the brink of bankruptcy in 1998, Russia has made a remarkable economic comeback, largely driven by high oil and gas prices. Oil and especially gas is to an overwhelming extent produced in the northern parts of Russia and the potential for further development of the industry is also to be found in the North, both onshore and offshore. While the tension manifested in Russian northern politics and development identified in the introduction to this volume, namely the balancing of market and geopolitical/strategic concerns, is evident throughout the petroleum industry, it is especially prominent in offshore development. This is because development of the petroleum resources on the continental shelf will be difficult, if not impossible, to realize without the involvement of foreign competence and capital. At the same time, offshore oil and gas are clearly defined as ‘strategic’ natural resource assets and, consequently, fall under the evolving legislation and policies on strategic resources that explicitly limit such non-Russian involvement.

The aim of this chapter is to assess the place of offshore petroleum development in the context of overall Russian energy priorities and to examine the evolution of offshore policy and strategy at both the federal and company (Gazprom and Rosneft) levels. The chapter first reviews some key developments in Russian energy policy since 2005 before examining Russian governmental offshore policy development. The offshore strategies of the two companies likely to play a prominent role in Russian offshore development, Rosneft and Gazprom, as well as the interactions thus far between these two companies are then outlined. In tracing the often troubled and halting evolution of federal policy and practice, the question of the extent to which the strategic importance assigned to offshore petroleum reserves is translating into coordinated, strategic action and long-term policy thinking is raised and discussed in the concluding section.

Becoming ‘strategic’: The geopolitical significance of Russia’s natural resources

While president Putin’s vision of a strong, centralized federal government playing a leading role in the management of key economic sectors like energy can be traced several years earlier (Balzer, 2004), increased state control over Russian natural resources and profits was a characteristic of Vladimir Putin’s second presidential term (2004-2008). The vocabulary of ‘strategic resources’ has been a key feature of this increased attention, which has manifested itself both in new legislation to govern new projects and in efforts to restructure the existing portfolio of large oil and gas projects within Russia.

The legislation on strategic resources, which had been long debated and examined in various branches of government before its final approval in April 2008, identifies economic sectors in which substantial involvement and investment of foreign-owned companies would require explicit permission from governmental authorities. The law covers 42 industries that are defined as strategic to Russia’s defense and security (like arms, air-

craft), fishing and seafood production, precious metals and hydrocarbons among others. Foreign private investors must now gain approval of the Russian government before acquiring more than a 50% stake in a strategic company, with a stricter level of 25% set for companies owned by foreign governments and international organizations. This package of legislation included the new 'Law on Foreign Investment in Strategic Sectors'¹ as well as accompanying changes in existing laws, notably the Law on Mineral Resources. The mineral sector is singled out for stricter regulations than the general norm and comprise 'geological studying of underground resources and (or) exploration and exploitation of minerals'. Deposits of oil reserves of more than 70 million tons and gas deposits of more than 50 billion cubic meters (bcm) are now termed 'resources of federal significance'. This still leaves numerous fields below the threshold, although offshore fields are termed 'of federal significance' notwithstanding their size.

Private foreign investors who want to acquire, alone or as a group, more than ten per cent of a Russian company engaged in use of mineral resources of federal significance need advance approval from the authorities. Possibly, if the shares are distributed between unrelated investors, foreigners may own up to 20 per cent combined without special permission. But this is not clearly spelled out in the law. For foreign government controlled investors, the rules are stricter. They encounter a corresponding five percent limit.

An explicit goal of the new legislation is to increase the predictability for foreign investors and to some extent it codifies regulations which already have been applied informally. The new law is said to be based on a 'permission principle' with few absolute prohibitions. Indeed the new law gives considerable discretion to the executive branch, and a liberal-minded government could, based on the law, give foreign investors significant roles in exploration and extraction of hydrocarbons. The implementation of the law remains to be seen, but the tone in the law and the present dominant discourse and recent political action make a broadly liberal interpretation of the law less plausible.

Overall, the new legislation has important implications for the general development of the petroleum sector in Russia. The legislation:

- Removes competition on the continental shelf
- Further increases the privileged position of Gazprom and Rosneft
- Complicates the operations of private Russian oil companies, notably Lukoil and TNK-BP
- Introduces a new layer of bureaucracy.

¹ Full name: 'On the order of realization of foreign investments in economic enterprises having strategic significance for securing the defence of the country and the security of the state'.

Given that a good deal of disagreement persists in Moscow in terms of both the letter and the spirit of the law, it is likely that the process of developing implementation mechanisms will be slow and contested.

While the legislation moved rather slowly and was discussed for nearly three years, the Russian state apparatus worked comparatively quickly to reorganize existing projects so as to place the state and state-owned petroleum companies in leading roles in key oil and gas projects. The attempt to realize a leading role for the state and state-owned companies and to minimize the position of foreign and non-state owned endeavors in the oil and gas sector in advance of the legislation on strategic resources is exemplified by the pressure placed on the Sakhalin-2 consortium. Sakhalin-2 operated in Russia under a production sharing agreement (PSA) that allowed the companies involved (Shell, Mitsui and Mitsubishi) to recoup their initial investments in this offshore oil project in the Russian Far East before they were required to start substantially sharing project profits with the Russian state. Dissatisfaction with this particular PSA project came to a head when the Sakhalin-2 consortium announced a 10 billion dollar price overrun during phase 2 of their project – a budget increase that would have further delayed the point at which the Russian state would have a right to a substantial percentage of project profit. The public announcement of this budget overrun was followed by an environmental review of the project took place, which led to the suspension of a key expert review/approval by the Ministry of Natural Resources. This was widely seen as a method for exerting pressure on the Sakhalin-2 consortium partners and resulted in Gazprom gaining a 50% plus one share of the consortium on favorable terms (see Bradshaw, 2006). The focus on the project was also part of a general dissatisfaction with these PSAs, which were signed in the 1990s under Yeltsin's administration in a period of relatively low hydrocarbon prices and Russian economic transition. With the high oil prices of today, the structure of these agreements came to be seen as unacceptably disadvantageous.

The inclusion of Gazprom in this project was in keeping with the Kremlin's overall efforts to reassert control over Russian energy development by putting the state-controlled companies Gazprom and Rosneft in charge of existing projects. Outside of the Sakhalin projects, the Russian offshore remains undeveloped and, consequently, Russian authorities are operating with a more or less 'clean slate.' In an energy market increasingly looking northwards and with Russia facing problems keeping up oil production and balancing gas supplies with projected domestic demand and export commitments, offshore resources are becoming increasingly significant.

The Russian offshore strategy

Russia has a continental shelf of 6.2 mill. km² of which 4 million are considered to be of potential interest for oil and gas production (Strategiya..., 2006). According to Russia's Ministry of Natural Resources (MNR), one third of Russia's initial gas resources and 12 per cent of oil resources are located on the continental shelf (Varlamov, 2007). This corresponds to 13.5 billion tons of oil and 73 trillion m³ of natural gas. Of this two thirds are said to be located in the Barents and

Kara Seas (Strategiya..., 2006). The Ministry has on different occasions published very optimistic statements about future output, such as that the shelf could produce 95 million tons of oil and 320 BCM of natural gas by 2020 (see Trutnev, 2005). Offshore production today is only around 5 mill tons of oil, exclusively from Sakhalin.

While offshore resources are often presented as an important element in Russia's future energy balance, efforts to develop a comprehensive offshore strategy began relatively late. Throughout the 1990s Russia did not really have a plan for development of offshore resources and very little attention was devoted to offshore exploration. In the words of Natural Resources Minister Trutnev: 'Since 1993, no serious exploration of the RF continental shelf has in fact been undertaken. The amount of exploration operations was reduced to a tenth compared with the mid 1980s when most of the known fields were discovered' (Trutnev, 2006).

The closest we come to a strategy from this period are plans developed by Gazprom, which were endorsed on the political level, but remained unimplemented (see, for example, Moe and Jørgensen, 2000). Offshore resources were considered a long-term option, and Gazprom gave little priority to such development after the company had secured control over promising fields in the Barents Sea. Gazprom interests changed, however, a few years ago with liquefied natural gas (LNG) becoming an increasingly interesting business prospect (among other motivating factors discussed below). Meanwhile the government has also taken steps to work out a strategy for offshore development (Naumov, 2007).

The government started a process in October 2003 and the Ministry of Natural Resources worked out a 'Strategy for exploration and development of the oil and gas potential of the continental shelf of the Russian Federation until 2020' that was presented at a meeting of the Russian government in March 2006, but has yet to be adopted officially. (Strategiya, 2006) Nevertheless, the MNR and affiliated structures, as well as other actors on occasion, continue to refer to this document as the offshore strategy and its main points are therefore worth reviewing. Overall, the strategy points out the vast potential of the offshore and argues for the realization of ambitious production goals – 95 mill. tons of oil and 150 BCM of natural gas offshore by 2020. However, the strategy also points out the obstacles to realisation of those goals. These include:

- Low level of exploration
- High investment risk
- High exploration and development costs due to remote locations
- Poorly developed infrastructure supporting production and transportation of offshore resources
- Unattractive and unstable fiscal regime. High government take
- Bureaucratic system of state management and issuance of user rights for offshore resources
- Insufficiently developed legal framework, not adapted to the specifics of offshore activity

The strategy sets out to address these problems. One important issue is financing of geological exploration/surveys. According to the strategy, the state should finance regional surveys, with resource users (the companies) paying for exploration and appraisal drilling. However, the state should finance all exploration in 'disputed, [foreign] border areas, of zones with a high potential', and also 'areas where for defence and security reasons' only state companies can be admitted. What these clauses mean exactly is not defined, but they indicate that foreign policy and security concerns loom large in official thinking about offshore activities.

To support and facilitate exploration by companies, which clearly will account for the lion's share of exploration costs, the strategy points out several mechanisms:

1. Adoption of a legal system for purchase of geological information
2. Long term plan for licensing rounds
3. Extension of license periods to 7-10 years
4. Finder's rights, meaning that the company discovering a field shall receive the right to development without a new auctioning process.
5. Improvement of the fiscal regime and reduction and differentiation of taxes on production
6. Developing infrastructure stimulating offshore activities
7. Support for Russian machine-building industry developing offshore technology

In addition the strategy prescribes a series of measures to enhance environmental safety of offshore operations.

The strategy was accompanied by an ambitious 'Complex plan of action', outlining specific tasks and timelines, in which some of the issues raised above have been concretely addressed.

- Item 3 - extension of license periods was accepted via an amendment to the law on mineral resources in late autumn 2007.
- Item 4 – finder's rights were introduced by a government resolution already before the final draft of the strategy was published, but the procedure seems to leave considerable discretion to the authorities, and the principle contradicts the law on mineral resources, in which auctioning is required (a revised or new law on mineral resources is still in process).
- Item 5- Improvement of the fiscal regime is a broad issue. But a system for a differentiated mineral resources tax (NDPI) was implemented from 2007. It was, however, only applied to Eastern Siberia. It is expected that it will be extended to most offshore areas.
- Another measure that has been given attention is the establishment of a state shipbuilding holding, which was decided early 2007. This relates to item 7, since an explicit goal is to build platforms and ships for offshore activities (Rossiskaya Gazeta, 2007a).

Still, two years after presentation of the strategy it can be observed that only some of the mechanisms listed above have been established – and then only partly – and that there is a serious delay in implementation of the action plan.

The lack of thrust is apparent and may be partially explained by the fact that the strategy has not been fully endorsed by the government. We believe there are several reasons for this. The MNR presented a ‘State strategy for exploration and development of the oil and gas potential of the continental shelf of the Russian Federation’, which can be seen as a predecessor to the present strategy, to the government already in December 2004. According to the Natural Resources Minister, the document had then been endorsed by all ministries and agencies (Trutnev, 2005). In this earlier document, production sharing agreements (PSAs) were presented as a major instrument to attract investments. It also proposed that the Ministry of Finance and the Ministry of Economy consider a series of tax measures to improve the investment climate, including: reduced taxes and duties, tax holidays and credits to operators, uplift, tax exemption for exploration work, and customs exemption for importation of unique equipment.

A high-level inter-agency commission was established in July 2005 to finalise the strategy (Mezhvedomstvennaya Komissiya, 2005). Apparently in this process MNR's proposals met resistance and the final draft, as summarized above, appeared watered down. PSAs had more or less gone out of fashion again, and it seems that the proposed tax revisions had met resistance. Thus major mechanisms had disappeared from the strategy and left the MNR's almost frantic appeals about offshore development without much clout. But there is also another reason why MNR has not succeeded. There is no doubt that there has been an increased focus on offshore resources the last few years. This has attracted increased attention from several agencies, with their own agendas. The Ministry of Energy and Industry, which has been marginalized in resources management, worked out their own strategy – ‘Program for complex development of hydrocarbon resources in Russia's north-western region until 2020’. The major theme in this document (which we have not seen) is to maximise the use of the domestic scientific and industrial potential (Naumov, 2007). It has been accompanied by a concept for a ‘National action programme for technical and technological support for development of the oil and gas potential of continental shelf of the Russian Federation’ worked out by the Ministry's two subordinate agencies, Rosenergo and Rosprom (Rossiyskaya Gazeta, 2006). This work has also run into difficulties. It was supposed to be presented to the government in the autumn of 2006, but two years later a final draft had not emerged (Grigor'ev, 2007).

Realising that its own strategy is far from sufficient, the MNR in 2007 started cooperating with the Ministry of Economic Development for the preparation of a ‘Federal target programme for development of the continental shelf’ (Rossiskaya Gazeta, 2007b). The status of this process is unknown.

In total, it is clear that a coherent strategy has not been adopted on the federal level. As often is the case in Russia, when introduction of indirect measures and framework conditions become logjammed, the idea of creating a new state structure arises. Unsurprisingly, then, the question of *who* should develop offshore resources remained a topic of debate.

The MNR has for some time proposed the creation of a state company to take care of offshore exploration, arguing that this body could 'distribute blocs more efficiently. After having received geological data we could put blocs on the shelf into use'.² In early December 2006, the creation of a new gigantic state company, which would own a controlling stake of all projects on the Russian shelf and be formed from parts of Gazprom, Rosneft and Zarubezhneft, was discussed explicitly at a meeting of the Security Council (Gazeta.ru, 2006). This plan, however, seemed to have been abandoned by late February 2007, when the president of Rosneft said that the federal government planned to divide all new offshore oil and gas fields *between* Rosneft and Gazprom. The MNR was reported to be considering four unnamed options for how to divide the fields between the companies, with the intention of releasing a plan in summer 2007 (Medetsky, 2007). Then, in April 2008, the Minister of Natural Resources announced that blocs on the continental shelf will be divided between Gazprom and Rosneft according to their expected 'profile' – oil or gas (Kommersant, 2008). This happened at the same time as the new legislation for strategic resources made it clear that henceforth only experienced Russian state owned companies would be given licenses on the continental shelf –in practice Gazprom and Rosneft.³

The implication of the statement by the Minister seems to be that division of the projects will be done on an uncontested basis. There still could be points of contention, however, even if direct competition is removed from the licensing phases. Some of these potentially problematic issues are taken up in the remaining sections of this chapter. In any case the government, by its declaration combined with the restrictions in the new legislation of foreign investment, has to large extent ceded control of developments in the offshore sector to these two companies. Consequently, the offshore strategies of these companies and the extent to which and how Rosneft and Gazprom are already competing and cooperating is of relevance to understanding how an offshore regime might develop.

Gazprom and Rosneft Offshore Strategies and Interaction

Both companies have stated specific interests in offshore stakes and generated plans meant to facilitate offshore development. In mid-April 2007, Gazprom submitted a memo to the MNR listing deposits in the

² Deputy Minister Varlamov in Rossiyskaya Gazeta, 2007b.

³ The third state oil company, Zarubezhneft, set up to work in projects abroad, has however declared that it feels competent to participate on the Russian continental shelf and could be interested, particularly in the Barents Sea. (RBK daily, 2008)

Kara and Okhotsk Seas for which it would like to be receive licenses. In May 2007, Rosneft sent MNR a similar list of offshore fields for which they would like to obtain licenses in 2007, including locations in the Okhotsk, Barents and Laptev seas. This corresponded with Rosneft's announcement of its intention to produce 25 million tons of oil and 40 bcm of gas from new areas in the Sea of Okhotsk by 2020 and 20- million tons of oil and 70 bcm of gas from the Barents (Sakhalin Times, 2007).

Capital, however, may become a constraint for both companies in commencing a new phase of expensive offshore development. Both Rosneft and Gazprom share the characteristic of relatively large debt of 25 and 40 billion respectively. Rosneft spent more than 25 billion in acquiring Yukos assets, taking loans from a consortium of Western banks to cover the cost. The acquisition made it into the country's largest oil company (Elder, 2007). Gazprom is now the world's second-largest energy company and has a monopoly on gas export. However, for Gazprom to maintain its output, an estimated investment of 18 billion USD per year between now and 2030 is needed (Simmons and Murray, 2007).

Rosneft Offshore Strategy

Interestingly, in Rosneft's growth strategy⁴ and Production and Development plan⁵ no mention of the northern offshore is made except in relationship to Sakhalin. In a more informal March 2006 statement, however, Rosneft named the Sakhalin-3 projects (Kirinsky Block) and shelf deposits in the Kara, Barents and Chukotka seas as of interest for acquisition (Rosneft, 2006a).⁶ In many ways, Rosneft's strategy offshore can perhaps be most usefully understood as part of their regional strategy for the Russian Far East rather than as an offshore strategy per se.

However, the concrete actions and projects of Rosneft reveal an orientation towards the offshore and the North outside of the Far East. Rosneft has worked extensively to further develop the export capacity of their Arkhangelsk terminal with a floating storage facility and an offshore tank farm, with the aim of overcoming problematic capacity constraints in Transneft's northwestern pipeline system. Although this increased capacity is meant primarily to support oil production in northern Russia and the Timano-Pechora oil province, it may represent capacity for future growth in the North, including offshore. Rosneft also ordered three ice breaking shuttle tankers from a Spanish shipyard, primarily intended for transport between Arkhangelsk and Murmansk from 2008 (Vzglyad.ru, 2006), but such tankers could also be relevant for transport from offshore fields. In addition, Rosneft has agreed to launch a shipping service for offshore oil projects in cooperation with the state-run shipping company Sovkomflot (Gazeta.ru, 2006).

⁴ See www.rosneft.com/printable/Upstream/growthstrategy

⁵ See www.rosneft.com/printable/upstream/productionanddevelopment

⁶ Rosneft is also carrying out an exploration project on the West Kamchatka shelf in cooperation with the Korean National Oil Company.

In Rosneft's gas strategy, Rosneft states that natural gas is becoming an increasingly important part of the company's business, particularly in relationship to integrated oil and gas projects off Sakhalin. This expansion into gas marks a point of closer interface with Gazprom and its monopoly export network. The gas from these far eastern areas is 'intended for parts of Russia currently not covered by existing pipelines and rapidly-growing Asian export markets'.⁷ Regardless, gas is still not a top priority in Rosneft's planned and existing offshore projects. For example in relationship to the Sakhalin-4 and 5 fields, Rosneft is planning on re-injecting all associated gas during the initial production of crude oil to maintain reservoir pressure. After all crude oil is recovered, Rosneft may produce gas if its production and transportation are commercially viable.⁸ With Sakhalin-3 and West Kamchatka projects, all gas will be re-injected except for small amounts used to power the project's pumping stations onshore.

As will be discussed in greater detail below, the question of Rosneft gas has already been problematic in terms of the Sakhalin-1 consortium's initial plans to export gas to China via a proposed pipeline. Rosneft, as part of this consortium, seems to have blocked that move, possibly foreseeing the potential conflict with Gazprom and suggesting as an alternative LNG and tankers (White and Ball, 2007). Rosneft leaders were reportedly very dissatisfied with the ultimate outcome of selling Sakhalin-1 gas to Gazprom for regional domestic use.

For Rosneft, expanding into gas clearly means developing new forms of cooperation with Gazprom. This need is clearly stated in the company's 'Vision and Strategy' section of their website. 'While management believes Rosneft will be technically able to produce approximately 40 bcm of gas by 2012, attaining this level of production will depend on Rosneft's ability to sell the gas... which is dependent upon the negotiation of an agreement with Gazprom that is currently under discussion'. The question of how such a cooperation might function is returned to below, following a brief review of Gazprom's offshore and oil strategies.

Gazprom

Gazprom stands for approximately 87 per cent of Russian gas production and controls the lion's share of Russian gas reserves. Gazprom runs the integrated trunk pipeline system and has an export monopoly. However, Gazprom faces a significant challenge in maintaining supply after 2010, due to falling output in three of four of its major fields. Increased offshore activity is presented as a key elements in the company's response to this challenge. A 'Concept for development of hydrocarbon resources on Russia's continental shelf until 2030' was adopted in 2003.

⁷ See www.rosneft.com/printable/upstream/gasstrategy

⁸ See

www.rosneft.com/printable/Upstream/Exploration/ExplorationAssets/Sakhalin-5

Based on this concept document, Gazprom prepared a more detailed program in 2005 that divides the continental shelf into four regions (Kirillov, 2007).

- Pechora Sea: Mainly oil – includes Prirazlomnoye and Dolginskoye and structures close to them;
- North-Eastern Barents Sea: Mainly gas – Shtokman and satellites;
- Ob and Tazov Bay: Mainly gas – Severo-Kamennomyskoe, Kamennomyskoe-More, and others;
- Kara Sea: Mainly gas – Offshore section of Kharasavey and Kruzenshtern, offshore fields Leningradskoe and Ruzanovskoe.

The order of development has been determined by the size of resources, distance to existing infrastructure, and optimization of industrial development. Gazprom's announced plans can be summarized thus:

1. Offshore oil production in the Pechora Sea will start first. It has a higher priority now due to Gazprom's stronger engagement in oil. However, a firm year for start-up of Prirazlomnoye has not been set.
2. Shtokman is to be put into production in 2013-14 to fill up the Nordstream pipeline and meet demand for LNG in the Atlantic region, as well as domestic supplies. Adjacent fields will be connected at a later stage.
3. The largest field in Ob –Tazov Bay will be brought into production in 2015-2017. Later offshore fields, like Chugoryakhinskoye, will be connected.
4. The fields in Kara Sea will be brought on stream around 2028-29 when onshore fields on the Yamal peninsula have peaked.

Altogether, according to Gazprom, implementation of this plan will amount to a production level of 180 BCM natural gas and 11 million tons of oil in 2030.

These plans must not be mistaken for a projection of what is actually going to happen and the timelines proposed, for example, for the Shtokman field already seem unrealistic. They presuppose, for instance, that Gazprom will be given a more or less free rein offshore. This special role offshore has, of course, been confirmed by the new legislation discussed earlier. However, even if the company enjoys a very strong political position today, it is not certain that it will do so in five years. We think it is more important to read the plans as aspirations as of today. It is then useful to suppose that the company will engage in decision-making in the near future aimed towards realizing this plan to the extent possible. A more comprehensive evaluation of the resolve of both Gazprom and Rosneft with regard to offshore development would have to take into account a fuller picture of the strategies and investment opportunities of these two companies. This falls outside the scope of the present article. But one would logically expect that the monopoly position now given to the two companies for offshore gas and offshore oil respectively will not be an incentive to increase the offshore efforts, other factors remaining unchanged.

Gazprom and Rosneft Interaction

Pundits often describe Gazprom and Rosneft as being locked in political and economic competition that has only become more intense since their failure to merge in 2005 and in the efforts to acquire the remaining assets of bankrupt Yukos. This competition is seen not only as one of business competition, but political competition as well. Gazprom has been associated with now President Dmitri Medvedev (formerly Deputy Prime Minister), while Rosneft's link to Putin's inner circle is Igor Sechin, who was Deputy Chief of Staff in the presidential administration and was named deputy prime minister in the Putin government. Medvedev and Sechin have served as chairmen of the board of Gazprom and Rosneft, respectively. Recent statements from the MNR indicate that Gazprom's profile as a gas producer and Rosneft's as an oil producer are meant to suffice for dividing up the continental shelf between the two, thereby forgoing competition between the two companies. However, if we look at onshore oil and gas development as a corollary, it becomes clearer that the picture is not so simple. Although Gazprom is without a doubt the dominant Russian gas producer, oil companies also play a role in the Russian gas market and independent gas producers along with major Russian oil companies control about 1/3 of Russia's natural gas reserves. Many of the oil companies are responsible for the vast quantities of gas flared each year as they do not have the incentives and access needed to bring this gas to the market. However, flaring may be ruled unlawful by 2011 and legislation is currently being discussed that would greatly limit flaring, such as enforcing the use of 95% of associated gas in primarily oil projects (Simmons and Murray, 2007). This may be another driving force behind Rosneft and Gazprom's increased cooperation, should Rosneft wish to sell its gas on the Gazprom-controlled export market.

The relationship between Gazprom and Rosneft is likely to become only more interactive, due to 1) the important place now given to state-run energy endeavors; 2) the thus far equally privileged relationship given to these companies in terms of offshore resources; and 3) the increasingly artificial divide between oil and gas projects and companies. But will it lead to cooperation or more competition?

Despite the rhetoric of competition surrounding the political affiliations of each company, there certainly exists a level of cooperation between the two companies. Gazprom and Rosneft had previously (2001) entered into an agreement to join forces for the development of the Prirazlomnoye oil field and Shtokman gas condensate fields, and set up the 50/50 Sev-morneftegaz joint venture to implement the agreement (Gazprom, 2004). The partnership was dissolved when Gazprom bought out Rosneft, which needed cash for its purchase of Yuganskneftegaz. The partitioning of Yukos also changed the power constellations in the fuel and energy sector and the announced merger between Gazprom and Rosneft was shelved.

However, merely a year after the failed merger efforts, Rosneft's President, Sergei Bogdanchikov, could describe cooperation with Gazprom as 'regular' and note that 80% of Rosneft's gas was delivered to consumers via Gazprom's transport systems (Rosneft, 2006b). In November 2006, Gazprom and Rosneft signed a partnership deal on strategic cooperation

for joint work in oil, gas and electricity production, as well as joint bids on energy contracts. The main aim of the partnership agreement was to avoid confrontation and extensive competition on the domestic and foreign markets between Gazprom and Rosneft, although the agreement may further reduce the influence and space for international energy companies as well. The document states specifically that the companies plan on jointly developing tenders and participating in auctions for subsoil use rights and plan to implement projects together on a 50/50 basis. They will also cooperate in developing and creating geological and geophysical information databases and in exchanging information during exploration. More specifically, under the agreement Gazprom will acquire natural gas from Rosneft at the West Siberian fields that link up to Gazprom's gas transportation system at a 2006 production level. Further agreements in relationship to new fields and an expanding transport system will be made in subsequent agreements, and it should be noted that the agreement did not lay out any specific projects. The agreement will remain in place until 2015, with the option of five-year renewal periods (Gazpromstock.com, 2006).

Both Rosneft and Gazprom are now actively involved in oil and gas consortiums that have reached production phases off Sakhalin, rendering the Sea of Okhotsk interesting for seeing how the companies interact offshore today in practice. Eastern Siberia and the Far East have recently been made a prioritized area for regional gas development. The state's program on integrated gas production, transportation and supply system in Eastern Siberia and the Far East places emphasis on both supplying gas domestically and increasing exports to China and other Asia-Pacific countries. The program was approved on 15 June 2007 by the Government Commission responsible for fuel and energy sector issues, and Gazprom was appointed coordinator of the Program implementation with special emphasis placed on meeting the growing gas market in the region domestically. Then Deputy Prime Minister Medvedev argued that the strategy of the RF was to have one company as the sole exporter of gas produced in Russia and stressed that this is the best strategy for economic effectiveness in the Russian Far East (Sakhalin Times, 2007b).

While Gazprom's focus on and role in the Far East and East Siberia is a relatively recent one (with Gazprom's 2007 entrances into the Sakhalin-2 consortium and the Kovytko project⁹), Rosneft had been in many ways more established in the region via its involvement in Sakhalin projects. Rosneft owns over 30% of the oil and gas reserves and resources in the Far East and has argued that the 'more the company's reserves are concentrated locally, the greater the synergies it can achieve from its activities.' (Bogdanchikov in Rosneft, 2007) There are signs that Gazprom's aggressive entry into the Far East fields and markets caused tension between the two companies. For example, on one regionally important issue, Gazprom appeared to have won the day. By mid August it was clear that Sakhalin-1 gas would be used on Russia's domestic

⁹ In addition, Gazprom Neft received Russian governmental permission to explore the Lopukhovskoye field until 2010, possibly in partnership with Statoil (not confirmed by Statoil representative) (Sakhalin Times, 2007c).

market, rather than exported directly to China. Gazprom has been working to consolidate the Chinese market and blocked Exxon Mobil from selling the gas it produces at Sakhalin-1 to China (Sakhalin Times, 2007d). Officially, Rosneft puts a positive spin on this development, noting that 'while the PSA governing Sakhalin-1 allows for gas export independent of Gazprom, collaboration with Gazprom could be desirable in the event that pipelines to northeastern China become the favored export route.'¹⁰

At a June 30, 2007 meeting of Rosneft's shareholders, a commitment to cooperating with Gazprom was reiterated. Bogdanchikov stated: 'Gazprom needs gas pipelines and fields, and we are positioning ourselves as an oil company, although we are also involved in the gas business. Our plans for the period up to 2020 will increase the proportion of our earnings from gas sales to 30%. Using Gazprom's potential in a number of vital areas (linked with transport and export), will of course also benefit Sakhalin.'¹¹ Despite this announced cooperation rivalry between the companies is reportedly intense, and the relationship between the top leaders said to be bad.

Conclusions

The interaction of Rosneft and Gazprom on Sakhalin illustrates some key aspects of their interrelationship and has much to say about what Russian offshore development may look like in the medium-term. While these two state controlled energy companies do cooperate on some issues, competition between them can be seen as the primary characteristic of their interactions. In this way, although a fundamental principle of Russian energy policy is that of national control, one can discern room for change.

Firstly, the relationship between the state-controlled companies and the increasing overlap between their traditional areas of commercial dominance encompass a level of volatility. Also, having traced the often circuitous changes in Russian offshore policy and the variety of sometimes contradicting ideas that have been presented over the past two years, another important feature of Russian offshore policy becomes clear: it remains unconsolidated and plays out against either (or both) a backdrop of ad hoc decision-making or of competition between key elements of the state. Ideas that seemed to have been completely abandoned later resurface and new strategies and proposals continue to be developed, which perhaps speaks to different governmental bodies attempting to put their stamp upon and secure a role in offshore development policy. The ongoing development of the legal framework for strategic resources and its actual implementation, with the important questions it raises about foreign involvement, add additional complexity to the policy environment in Moscow, presenting obstacles to strategic and unified policy work.

¹⁰ See www.rosneft.com/printable/Upstream/Productionanddevelopment

¹¹ Rosneft. General Shareholders' Meeting.
www.rosneft.com/printable/Investors/shareholdersmeeting/meeting767/meeting/i

At the same time, many Russian actors involved in this political-commercial milieu seem to recognize the importance of creating stable rules for investors, and stability and facilitating investment are keywords of now President Medvedev's political vocabulary. However, it may also be misleading to anticipate an 'offshore regime' or an 'offshore policy' in the singular. Perhaps we may not see a unified regime at all, with the government adopting particular approaches to particular projects that are responses to the circumstances of the moment and location.

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