

Oil groups can still gain from a new era in Russia

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TNK-BP, the joint venture between the British oil company and Russia's Alfa Access Renova, is likely to have its licence for the giant Kovytko field in Siberia revoked in the next few days. The move is a prelude to Gazprom, the Russian state-owned oil and gas giant, taking a majority stake in the gas field and possibly in TNK-BP itself.

Paradoxically, while this change is not good news for TNK-BP it is a sign of progress for Russia and for other foreign oil companies seeking to do business in the country.

Oil companies need nothing so much as predictability, a set of rules that are likely to be in place for a long time so that investment decisions can be based on solid assumptions. The biggest challenge that oil companies have confronted while doing business in Russia through the Yeltsin and early Putin years has been that the rules have changed constantly – as have government officials, attitudes to rule enforcement and just about everything else. The dismantling of Yukos and the jailing of its founder, Mikhail Khodorkovsky, are the best-known examples of this trend.

The Russian government's actions with respect to TNK-BP, and to Shell's Sakhalin project several months ago, suggest that the era of "the tyranny of unpredictability" may be drawing to a close. A template is emerging for how Moscow will work with western oil companies in Russia in the coming years.

No non-Russian company will be allowed to own more than 49 per cent of an important energy project. Companies that hold such positions will have to sell some of their stake to one of the state-owned giants, Gazprom and Rosneft. Foreign companies that resist lowering their stakes to below 50 per cent will be "encouraged" to sell them down through the threat of various regulatory interventions, including environmental assessments, tax audits and other intrusions.

All main decisions concerning the direction of the oil industry will be made in the Kremlin because of the strategic nature of the industry and its importance in enhancing Russia's influence on the world stage. Resistance by western firms will be largely futile as the Kremlin does not believe that the presence of western oil companies is critical to the development of the domestic oil industry. Nor does it believe that the so-called IOCs – international oil companies – have many attractive options outside Russia.

Majority ownership in smaller oil deposits may be possible for western companies, although the rules with respect to these fields are less clear and the big oil companies could be kept out of such projects in favour of more pliable smaller players.

These rules are neither ideal for IOCs nor necessarily in the long-term strategic interests of Russia.

Moreover, bringing existing agreements into conformity with these new rules will be both painful and, at times, not sanctioned by law. The “independent” agencies of government – the tax service, the environmental scrutiny bureaux and others – are in fact answerable to the Kremlin and will continue to do its bidding to support the new status quo.

Yet the new climate is likely to be both predictable and durable. Investment decisions will finally be made on the basis of an accurate sense of what the future holds. Investment in Russia will remain profitable as long as oil prices remain above \$40 a barrel. And, given the country’s large deposits, ignoring Russia is not an option for big oil companies in need of reserve replacement.

In addition, projects that have been on hold as the new rules were being written – Kovytko among them – will be developed, bringing new supply on stream. This is likely to reduce supply concerns in the coming years and could result in lower oil prices.

Most Middle Eastern countries are closed to foreign investment altogether, at least with respect to ownership of reserves. Latin America is an increasingly challenging place to do business with the rise of resource nationalism in Venezuela, Bolivia and elsewhere. West Africa’s chronic political instability has caused repeated problems in Nigeria, which has the region’s biggest oil deposits.

Russia offers a reasonably attractive combination of rich deposits and a workable business climate. Future investment there by the IOCs can be both secure and profitable.

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