Russian Petroleum Investor,

the leading publication on the former Soviet Union oil & gas industry.

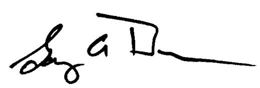
Dear Colleague:

I have enclosed an issue of *Russian Petroleum Investor*, our monthly briefing on the oil and gas industry in Russia, the Caspian, Asia, and the Baltics for your review.

Russian Petroleum Investor provides detailed information unavailable anywhere else, including comprehensive interviews with key decision-makers, inside reports on oil and gas projects—what's working, what's not, and why. Each issue of *Russian Petroleum Investor* contains 60 pages of research and in-depth analysis covering politics, law, projects, regional developments, exports, finance, and taxes.

Russian Petroleum Investor's inside sources give you a direct line to new laws, regulations, appointments, and policy trends. Articles provide insights and forecasts of pending developments, and their impact on your investments.

Sinerely,



Gary A. Brown
Publisher

For An Additional Complimentary Sample

Name Title
Company
Address City/State
Zip Country E-mail
Phone Fax

bisnisbriefing

**For more information, call (978) 287-0301,
fax (978) 287-0302, e-mail us at info@wtexec.com,
or send this form to**
WorldTrade Executive, Inc.
P.O. Box 761, Concord, MA 01742 USA.

Or Request Your Sample Online!
http://www.wtexec.com/rpi.html

RUSSIAN PETROLEUM INVESTOR

Political and business intelligence for energy investors in the FSU

Russia
The Caspian
Central Asia
The Baltics

February 2002

Volume XI Issue 2

In This Issue:

A monthly advisory service of

WorldTrade Executive, Inc.

Table of Contents

In This Issue

Russian Petroleum Investor

ANALYSIS AND ADVICE FOR INVESTORS IN THE CIS

PUBLISHED BY WORLDTRADE EXECUTIVE, INC.
PO BOX 761, CONCORD, MA 01742
PHONE: 978 287-0301
FAX: 978 287-0302
EMAIL: INFO@WTEXEC.COM
WEB PAGE: WWW.WTEXEC.COM

Russian Petroleum Investor

Political and business intelligence for energy investors in the FSU

Please sign me up for a one-year subscription to Russian Petroleum Investor

❑ $2,569/year, U.S. delivery ❑ $2,669/year, non-U.S. delivery

❑ Enclosed is a check drawn on a U.S. bank payable to: WorldTrade Executive, Inc.

❑ Please charge my credit card:

❑ Visa/MasterCard ❑ American Express ❑ Diners Club

❑ Please send me an invoice

For fastest service, fax this order form to (978) 287-0302 or call (978) 287-0301. Orders may also be mailed to: WorldTrade Executive, Inc., P.O. Box 761 , Concord, MA 01742 USA

Card # Exp.

Signature

Name/Title

Company

Address

City/State/Zip Country

Phone Fax

E-mail

Wire transfers may be sent to:
Fleet Bank, 100 Federal Street, Boston, MA 02110 USA
ABA, No. 0110-00-390. For credit to WorldTrade Executive: Account 771-98097

WorldTrade Executive, Inc.

The International Business Information Source™

Other WorldTrade Executive, Inc. newsletters and reports on Russia and the NIS, include:

Caspian Investor

Published monthly, **Caspian Investor** provides business intelligence on project developments, financing, politics, legislation, taxes, and transportation issues affecting each of the Caspian states. Price: $1,798 (within USA), $1,898 (foreign delivery).

Who's Who in the CIS Oil & Gas Industry

Comprehensive directory with over 100 pages of organization charts and direct contact information of key government officials and top executives involved in the FSU energy industry. Latest edition + two quarterly updates: $519. (Also available on CD-Rom.)

Russia/Central Europe Executive Guide

Published monthly, **RCEEG** provides detailed advice—prepared by people facing legal and practical issues in the region every day—on how to do business in Russia, the CIS, and East/Central Europe. Focuses on key mechanical issues such as accounting and tax matters, the due diligence process, local sourcing, permits, labor, finance, and environmental issues. Price: $838 (within USA), $888 (foreign delivery).

To subscribe, or to request a free sample issue, please contact WorldTrade Executive, Inc. at (978) 287-0301 or visit our web site at www.wtexec.com

Duma to Adopt PSA Tax Rules in Spring, But Will That Be Good News?

Tussling over Taxes

By Andrei Mescherin

During the spring parliamentary session, the State Duma is going to supplement Russia's Tax Code with a new chapter regulating the specifics of taxing parties to projects based on production-sharing agreements (PSA). The result of this work is crucial to the fate of all new Russian PSAs. But the situation is complicated: Parliament must choose between a liberal tax draft law worked out by a group of deputies and a draft law submitted to the Duma by the government in December that is exceptionally onerous for investors. A compromise draft law reconciling the positions of the government and investors could save the day. But so far it is not evident that the outcome of the negotiating process will be favorable for investors.

In December, the Russian government officially submitted to the Duma a draft law stipulating the inclusion in the Tax Code of the new Chapter 24^2 Taxation Systems in Fulfilling Production Sharing Agreements. (It presumably will be inserted between chapters 24 on Unified Social Tax and 25 on a Tax on Organizations' Profit, both passed earlier.) The new chapter supposedly will establish tax rules for parties to PSAs starting January 1, 2003. Simultaneously, all norms currently regulating taxation specifics in implementing PSAs will be withdrawn from other sections of the Tax Code and the Law on PSAs.

"The appearance of a special chapter in the Tax Code exhaustively regulating the specifics of taxing parties to production-sharing agreements is a long-awaited event for investors," said Sergei Ivanenko, chairman of the Duma Commission on PSAs. "The Duma is prepared to pass without delay the draft law establishing sensible tax rules that would pave the way for tens of oil and gas PSAs. But, unfortunately, the tax rules proposed by the governmental draft law deprive investors of the preferences that were promised by the PSA law. Therefore, the fate of the draft law will not be unchallenged, and I think deputies will find cogent arguments to persuade government officials of the expediency of passing a more liberal law."

The most serious argument with which parliament may influence the government is an alternative draft law on taxing parties to PSAs, which was drawn up by a group of deputies back in early 2001 and exasperated government officials by its radical liberalism. "Although the government issued a negative response to the deputies' draft law in spring, the latter was not recalled but only put on ice on the initiative of the deputies themselves," explained Alexei Mikhailov, a State Duma deputy who co-authored the original law on PSAs.

He added, "If the government keeps pushing for its version, parliament will have to choose between the two draft laws proposing fundamentally different models of taxing parties to PSAs. Similar situations emerged on multiple occasions already in the work on other sections of the Tax Code and each time the government avoided open confrontation, accepting compromises."

Revenge Attempt

The government's December draft law differs from the version proposed by the RF Finance Ministry in the spring of 2001 only by insignificant details. (See "Stability Undermined," *Russian Petroleum Investor* June/July '01.) This looks like a major defeat for Economic Development and Trade Minister German Gref, who is the key government coordinator of PSAs and who opposed the Finance Ministry draft law because of its lack of allure to investors. Now that he has obtained several token concessions in the text of the draft law as a consolation prize, Gref has backed off from further scrapping with the Finance Ministry.

Meanwhile, the government's draft law is attracting serious displeasure from potential investors in Russian PSA-based oil and gas projects. And this exasperation has a serious foundation. The draft law increases the number of taxes and payments that are mandatory for investors. In addition, the government proposes scrapping an exemption from VAT of goods and services designed for PSA-structured projects and limiting opportunities for gaining an exemption from payment of a number of taxes. The draft law does not ensure real guarantees of the stability of tax rules and fiscal burden for the agreement's validity term. And investors are critical of many more features of the draft law.

Tax Basket for PSA Investors

The governmental draft of the Tax Code chapter Taxation Systems in Fulfilling Production Sharing Agreements obligates the investors of PSAs to pay the following taxes:

1) value added tax;
2) tax on organizations' profit;
3) unified social tax;
4) tax on production of minerals;
5) payments for using natural resources (payment for using water bodies, payments for polluting the environment, payments for using the forest stock, etc.);
6) state duties;
7) customs fees;
8) federal and regional license fees.

Only property located on the subsoil block and used exclusively for activity envisioned by the agreement is exempt from the property tax. An exemption from the tax on the owners of transport facilities does not apply to cars.

"The governmental version of the Tax Code chapter on PSAs is seen as an attempt to hit out at the main ideas and principles of the original legislation on PSAs, such as stability, full recovery of costs, and flexibility in negotiations on economic terms for separate projects," believes Vladimir Konovalov, executive director of Petroleum Advisory Forum. (This organization expresses the interests of large foreign oil and gas companies accredited in Russia). "The passage of this law would actually deny Russia benefits from massive direct foreign investments."

Distorted Approach to PSA

The governmental draft law distorts the base principle of production sharing's commercial terms. Under the PSA law, revenues from the sale of the produced raw material, after royalty payment, should be funneled first and foremost into compensation for the investor's costs, and only after expenses are fully paid back may the state claim a share of the profit. The government proposes a fundamentally different model: the level of reimbursement of the investor's costs should be limited to a depreciation norm.

In the event of shifting reimbursement of expenses under PSAs to the amortization regime, the capital investments payback period will virtually double, to ten to fifteen years. This will sharply worsen projects' economics and increase investment risks. "Reimbursing expenses through depreciation norm is baneful to PSAs," believes Nikolai Smirnov, head of the Department for PSAs at Tyumen Oil Co. "Investors will simply refuse to commit funds to large Russian oil and gas projects."

However, government officials have a different viewpoint on this score. "Under operating rules, the state has not enjoyed for many years direct budget benefits from implementing huge projects on PSA terms," said Anna Salina, deputy head of the Finance Ministry's Tax Police Department. "Changes proposed by us are aimed at eliminating this unfairness. In my view, the state, which is the owner of subsoil, should gain substantial benefits at initial stages of production."

Deputies Seek Taxes List

The deputies' version of the draft law on tax regulation of PSAs (see "Making Taxes Less Taxing," *Russian Petroleum Investor*/April '01) differs drastically from the governmental version not only in its absolute respect for the investor's right to the priority reimbursement of expenses. The deputies propose a short and closed list of taxes to be paid in implementing PSAs. In so doing, the investor is guaranteed an exemption from any present and future taxes that were not included in this list.

The draft law initiated by the group of deputies proposes for the first time mechanisms really providing guarantees of stability in the tax load when implementing production-sharing agreements. In the event of unfavorable tax legislation changes that damage project economics, the investor may choose to either ignore these changes, or include additional tax expenses in the list of reimbursable costs, or demand compensation from the government. The draft law allows the investor to use these mechanisms by way of application, without waiting for a permit from the government.

"Doubtless, the deputies' draft law is preferable in order to improve the investment climate and ensure high and sustained state revenues," said Ivanenko, chairman of the Duma Commission on PSAs. "But in the present-day political realities, the Duma is unable to pass laws in defiance of the government's view. Therefore, working out a new compromise draft law regulating tax rules for parties to PSAs is seen as the sole constructive solution."

Quest for Compromise

The idea of seeking compromise solutions to taxing PSAs won unqualified support at parliamentary hearings held in late November. A resolution on the results of the parliamentary hearings underscores that "a situation where two alternative draft laws are in opposition to each other is unproductive and may have an adverse impact on the investment climate as a whole." Deputies have already proposed that the government set up a working group to hammer out a coordinated version of the Tax Code chapter on taxing PSAs.

In principle, the government also does not reject the possibility of a further quest for mutually acceptable solutions. "I think it would be expedient to go ahead with consultations on the draft special chapter of the Tax Code at the beginning of the year, in which representatives of the government, oil and gas companies, and the State Duma will take part," Gref said at a December meeting with representatives of Russian and foreign oil and gas companies. "We are prepared to follow up on the discussions so as to look into all of our positions once again, outline our approaches and, perhaps, find for yet another time possible compromises on issues that we so far failed to fully harmonize."

Obviously, a mutually acceptable compromise between the investors and the government will not be easy to achieve. The investors' arguments have long been known to government officials, but this did not prevent them from submitting an anti-investment draft law to the Duma. Contradictions over the system of taxing parties to PSAs reflect a conflict between an investment future and the state's short-time fiscal ambitions. Therefore, ahead is a crucial battle. ❑

Right to Reimbursement Of Expenses

The government's version of the Tax Code chapter Taxation Systems in Fulfilling Production Sharing Agreements includes a list of an investor's expenses reimbursed to it at the expense of reimbursable production.

The reimbursable expenses incurred by the investor prior to an agreement's entry into force include:

1) expenses on the preparation and conduct of negotiations with a view to signing an agreement, coordination and examination of the agreement, doing a feasibility study;
2) expenses on prospecting, appraisal, and exploration activities;
3) other expenses whose list is set by the agreement.

The list of reimbursable expenses incurred in implementing the agreement includes:

1) the investor's actual expenses under the agreement, which are endorsed by the Management Committee;
2) contributions to the Liquidation Fund.

The Management Committee may endorse changes in the items of the investor's reimbursable expenses only within the limits of 5% of the sum of expenses under each item of the endorsed annual estimate of expenses.

The list of the investor's non-reimbursable expenses includes:

- expenses on acquisition of a package of geological-geophysical information for participation in a tender and on the payment of a fee for bidding in a tender;
- bonuses, rentals, tax on production of minerals, profit tax, fine and penalty;
- payments (interest) on the received credits and borrowed funds;
- expenses on items, exceeding restrictions set by the agreement;
- payments for emissions and discharges of pollutants in excess of the norm;
- contributions to regions' socio-economic development;
- legal costs;
- expenses on the sale of reimbursable and profit output owned by the investor;
- expenses on an audit at the requirement of the investor's shareholders;
- expenses on eliminating the consequences of an insured accident made in excess of the sum of insurance indemnity.

Status and Development Trends of Russian Law on Subsoil Uses: Many Gains, but More Needed

Seeking Clarity

By Nikolay Isaakov
and Alexey Frolov

It is no secret that Russia's investment appeal is largely rooted in the vast amounts of minerals found on its territory. The statutory conditions and procedures for obtaining and exercising mining rights certainly constitute a key ingredient of this attraction. Even though subsoil-use projects with foreign equity participation in Russia have varying degrees of political overtones, similar to practically all other countries that prioritise mineral extraction as the linchpin of their economic development, the legal aspects of the state's regulation of subsoil uses are also exceptionally important from the standpoint of attracting both domestic and foreign investment to the Russian economy.

Seen from this angle, the follow ing review of the current status and development trends of the more important elements of Russian subsoil law could be of interest to both existing and prospective investors in the sector.

Subsoil Use Licensing

Russian subsoil law has undergone sweeping change over the past ten years. Following the break-up of the Soviet Union, Russia had to build its legal system anew in the same way as it had to overhaul its political and social systems. The legal regulation of many issues that did not even exist in the former USSR had to be provided from scratch, often by rule of thumb, without the necessary practical experience to back up these efforts.

Licensed subsoil uses were among the numerous legal voids inherited from Soviet times. The government licensing of mining operations in Russia only started with the issue of the Law on Subsoil Resources (the Subsoil Law) in February 1992. This statute required that such operations be preceded by obtaining special government authorizations in the form of licenses to be granted by the executive authorities of Russian Federation territorial constituents and the government agency for management of subsoil resources.

The Subsoil Law was quickly followed, in July 1992, by Regulations on Procedure for Licensing Subsoil Uses, which remain in effect to this day. The regulations have, inter alia, laid down general procedures for the conduct of tenders and auctions for subsoil sites. These two pieces of legislation provided the mainstays of the new regulation of subsoil uses in the country.

However, since their licensing was something hitherto utterly unprecedented in Russia, many gaps still remained and have had to be individually filled in subsequent legislative amendments and new regulations, which will be discussed below.

Grounds for Issue of Licenses

Procedures for grant of mining rights form an important aspect of the subsoil use licensing system. Article 13 of the Subsoil Law, as initially worded, set out the general requirement that subsoil use licenses be granted through tenders or auctions. It stipulated that "the procedure for granting licenses for each site or a cluster of sites shall be prescribed by government licensing agencies."

The new Russian legislation implemented in 1992 thus required in unequivocal terms that all subsoil use licenses, regardless of the type, category, or location of a particular deposit or the type of extraction operations planned, be issued only through competitive bidding. The sole exception, as allowed by the Regulations on Procedure for Licensing Subsoil Uses, was that all operators that had obtained their mining rights before the licensing system was established in Russia in the middle of 1992 were entitled to licenses to the corresponding sites automatically, without having to win a tender or auction.

In 1995, the Subsoil Law was supplemented by a new Article 10.1, which provided for a limited number of cases in which mining rights could likewise be granted by a decision of the appro-

Nikolay Isaakov is a chief of legal department of LUKOIL Overseas. Alexey Frolov is a natural resources lawyer with the Baker & McKenzie Moscow office.

priate authorities without a tender or auction:

- to bury toxins and radioactive wastes;
- by way of re-executing valid licenses;
- to use subsoil sites for local needs, use subsoil sites containing common minerals, or use subsoil sites for purposes unrelated to the production of minerals; or
- for the geological exploration of subsoil resources.

The list of cases in which licenses could be issued other than through competitive bidding was further extended in 2000 when the Subsoil Law was substantially reviewed to include, for example, a restated Article 10.1. The latter stipulates that, in addition to the above instances, subsoil use licenses may also be given by a decision of the appropriate authorities:

- upon a mineral deposit's discovery by a subsoil user engaging, at its own expense, in the geological exploration of subsoil sites for the purposes of prospecting for and producing the deposit's minerals;
- for the geological exploration and production of subterranean waters used for supplying drinking water to the population or supplying industrial water to industrial projects;
- for the construction and operation of underground facilities other than those relating to the production of minerals;
- for the construction and operation of oil or gas storage tanks in bedrock and for the disposal of industrial and household wastes;
- for the placing of vital geological assets under special protection;
- on the basis of a production-sharing agreement which has come into force; or
- to grant rights to use a subsoil site for a short term (up to one year), when the rights of another user were terminated before the expiry of the latter's license.

The Subsoil Law was also enlarged to include a new Article 13.1, which stipulated, in particular, that if an announced tender for rights to use a subsoil site is ruled unsuccessful because only a single bid is received, the license may still be granted to the sole bidder on the terms and conditions announced for the tender.

This shows that Russian subsoil legislation has tended to develop to ensure a balanced range of options for licenses to be granted both through competitive bidding (tenders or auctions) and on the basis of direct negotiations with duly authorised agencies. Even though the list of grounds for granting subsoil use licenses other than on the basis of such commercial contests has been continuously extended, tenders or auctions still constitute a sine qua non for the issue of a "new" license to produce minerals or a "combined" license authorising both geological exploration and production operations.

Procedures for grant of mining rights form an important aspect of the subsoil use licensing system. Article 13 of the Subsoil Law, as initially worded, set out the general requirement that subsoil use licenses be granted through tenders or auctions.

Regulatory Gains Foreseen

Further improvements to the regulation of procedures for the grant of mining rights are expected from the contemplated new federal law on the licensing of subsoil uses to replace the 1992 Regulations. However, the corresponding bill, though in the pipeline for several years now, has gone no further than a first reading in the State Duma, the lower house of the Russian legislature, way back in 1997. The draft was once again sent to the Duma's relevant committees in March 2000, but has since got stuck there. Although the need for this kind of statute has acquired urgency, it cannot be predicted even tentatively when it is going to materialize.

The trend of ever more liberal license-issue procedures in Russia on paper, meanwhile, is set off by an increasingly hard line taken to granting mining rights by the relevant authorities in practice. The contrast has been especially manifest following a high-level reshuffle at the Ministry of Natural Resources, which was taken over by a new team led by Vitaly Artyukhov in the middle of 2001.

One of the first steps taken by the new minister upon being appointed was signing Executive Order No. 475-r dated 22 June 2001, to suspend the grant of mining rights. The measure remained in effect for two months, during which no new licences were issued, drawing resentment from many investors then waiting for such documented proof of their victories at corresponding tenders or auctions.

Artyukhov's next noteworthy move came when he issued Order No. 604 dated 24 August 2001, whereby all decisions to issue or re-execute licences, as well as those to arrange competitive bidding for mining rights, were to be cleared through the ministry's expert panel specially organized for such reviews.

The order has effectively established a new authority (expert panel), a nod from which is all-important for anyone hoping to gain mining rights. With the process of obtaining subsoil use licenses thus further extended and complicated, the new arrangement has not been welcomed by investors either.

Legal Aspects of License Re-issue

One issue of critical significance to structuring practically any subsoil-use project is whether it is possible to legally secure the re-execution of an existing license in the name of another party. Fairly often, investors only agree to become involved on condition that the existing license be re-issued in the name of their subsidiary, even though subject to certain conditions precedent. The legislatively institutionalized right to transfer mining rights, whereby the licensing authorities are obliged to duly approve and document such assignments from the original licensee to the transferee, is an important option giving investors welcome leeway in determining the structure of their projects within statutory limits.

The initial Subsoil Law did not provide for any possibility of license transfers, meaning that mining rights could not lawfully be assigned under any circumstances.

It became apparent soon after the statute had come into force, however, that the interests of making participation in the development of Russia's natural resources a better investment opportunity required legalizing the possibility of subsoil-use license transfers. As a result, the Subsoil Law in 1995 was supplemented by Article 17.1, which permitted licenses to be re-issued, but only in the following cases:

1. where the subsoil-user enterprise's corporate structure is changed as a result of its reorganization;

2. where the subsoil-user enterprise is reorganized by way of a merger or consolidation with another enterprise, but continues to own at least one-half of the new company's charter capital; and

3. where the subsoil-user enterprise is reorganized by way of a split-up or split-off if the resulting new company carries on operations on the former user's site in accordance with the same license.

> ***The Subsoil Law was also enlarged to include a new Article 13.1, that stipulated if an announced tender for rights to use a subsoil site is ruled unsuccessful because only a single bid is received, the license may still be granted to the sole bidder on the terms and conditions announced for the tender.***

It should be said that some provisions of Article 17.1 were (and remain) legally unclear, fuzzy, and ambiguous. It lists, for example, a subsoil user's absorption of another enterprise by merger among reasons for license re-issue. It is perfectly clear, however, that in the process of this kind of take-over, the latter venture will be wound up and its rights and obligations will pass fully to the subsoil user, which will continue its existence under the same name and having the same corporate structure. The question arises: Is it necessary in this case to re-execute its former license? The answer is plainly in the negative. As originally formulated, Article 17.1 also negated the reverse possibility of a license being re-issued in the event that the subsoil user ceases to exist as a result of a merger leaving it absorbed by another business.

Clarification Still Needed

Article 17.1 then further allowed a subsoil use license to be re-executed during a subsoil user's reorganization by split-up or split-off only if the resulting company actually "carries on operations on the former user's site in accordance with the same license." If this provision were interpreted literally, the conclusion could be that it prescribed the following sequence of steps: first, the new company actually commences operations on the former user's site and only then is it issued its own license. However, the new company may not engage in any such operations in accordance with the former subsoil user's license unless the latter's license is re-executed in its own name, since the Subsoil Law only permits any subsoil uses on the basis of an appropriate licence. The result is a vicious circle: The new company cannot obtain its own licence until it commences operations on the former licensee's site, but it may not do so until it wins the corresponding license. The provision concerned was thus devoid of any legal logic. Fortunately, it has been subsequently amended.

Considering the legal lack of clarity of individual wordings of Article 17.1 of the Subsoil Law and the fact that the procedures involved in license re-execution in the event that a subsoil user is restructured, including its reorganization by merger, consolidation, split-up or split-off, were very time-consuming and involved from the corporate point of view, it is hardly surprising that the statutory possibilities of transferring mining rights were actually used only in exceptional instances. Therefore, despite providing such theoretical openings in 1995, Article 17.1 of the Subsoil Law was in actual fact largely inoperable.

Last but not least, it also overlooked the case most often encountered in practice where a subsoil user establishes a subsidiary specially to develop a specific site, with the grant of equity in such new venture to an interested investor.

Seeking to fill the resulting legal vacuum, the Russian Committee on Geology and Subsoil Uses issued Order No. 65 on 18 May 1995, i.e. shortly after Article 17.1 had been added to the Subsoil Law, to approve an Instruction on Procedure for Re-Execution of Subsoil Use Licences (Instruction No. 65). Clause 17 of Instruction No. 65 stipulated that where "a subsoil user acts as a founder of a new legal entity specially to carry on operations on its site in accordance with the terms and conditions of its licence, such license may be re-executed in the name of such new legal entity, provided that the former subsoil user owns at least one-half of the new legal entity's charter capital."

Clause Sparks Many Disputes

It should be noted that in Russian state arbitration practice, Clause 17 of Instruction No. 65 has repeatedly constituted the focus of disputes and litigation. One cannot but see that it clearly amounts to an unduly broad interpretation of Article 17.1 of the Subsoil Law and introduces new grounds for license re-issue in addition to those actually provided for in the Subsoil Law. The lack of legal subtlety made it evident that the Committee on Geology and Subsoil Uses obviously overstepped the limits of its powers on this issue.

When dealing with related disputes, the state arbitration courts would, as a rule, draw the same conclusion and stick to the customary interpretation of Article 17.1 of the Subsoil Law, which does not provide for licenses to be re-executed in such situations. In its judgement in Case No. A-37-90/97-7, dated 12 February 1997, the Magadan region state arbitration court, for example, ruled that Instruction No. 65 "contradicts the law and goes beyond the powers vested in the Russian Committee on Geology and Subsoil Uses by its bylaws dated 12 August 1994. Therefore, the arbitration court… must find in accordance with the law."

Clause 17 of Instruction No. 65 was finally repealed in April 1999 owing to its visible conflict with the Subsoil Law.

In practice, a substantial number of licenses in Russia after 1995 were still re-issued on the basis of Clause 17 of Instruction No. 65. Owing to the highly dubious legal force of this regulatory act, however, all of them could have been disputed. It was only in January 2000 that Article 17.1 was supplemented to include a provision similar to that which had been found in Clause 17 of Instruction No. 65.

In practice, a substantial number of licenses in Russia after 1995 were still re-issued on the basis of Clause 17 of Instruction No. 65. Owing to the highly dubious legal force of this regulatory act, however, all of them could have been disputed.

Article 17.1 of the Subsoil Law has since been amended more than once (the last time in May 2001), and the exhaustive list of grounds for the re-execution of subsoil licences presently looks as follows:

(1) reorganization whereby the subsoil user's corporate structure is changed;

(2) subsoil user's reorganization by merger or consolidation, with the absorption of another legal entity;

(3) subsoil user's reorganization by merger, leaving it absorbed by another legal entity in accordance with Russian law, if the other legal entity meets the requirements for subsoil users and has a staff of duly trained professionals and adequate finances and technical capability to ensure the safety of its operations;

(4) subsoil user's reorganization by split-up or split-off if the new legal entity intends to carry on operations in accordance with the former subsoil user's license;

(5) subsoil user's establishment of a new legal entity to carry on operations on the subsoil site provided to the former under its subsoil use license, provided that the new legal entity was established according to Russian law, was assigned such assets as are required for those operations listed in the license to use the subsoil site concerned, including assignments of field facilities within the license area, and obtained the authorizations (licenses) necessary to undertake such operations involved in subsoil uses, and that the former subsoil user's equity in the new legal entity's charter capital upon the transfer of use rights to the site in question exceeds 50%;

(6) purchase by a business in the manner stipulated by the Federal Law on Insolvency (Bankruptcy) of assets (property complex) of a bankrupt subsoil user, provided that the buyer is a legal entity organized under the laws of the Russian Federation and meets the qualifications/requirements made for subsoil users by Russian subsoil law; and

(7) use of a subsoil site on the basis of a production-sharing agreement, in which case the corresponding license is to be re-executed in accordance with the Federal Law on Production-Sharing Agreements.

It can be concluded, therefore, that there is an unrelenting trend for the range for the expansion of grounds provided for in Russian law for the transfer of mining rights from one party to another.

This said, it should be added that individual wordings in Article 17.1 of the Subsoil Law, which define procedures and grounds for license re-execution, still call for further improvements, as they are not always logical or precise.

> ***It should be added that individual wordings in Article 17.1 of the Subsoil Law, which define procedures and grounds for license re-execution, still call for further improvements, as they are not always logical or precise.***

That provision in Article 17.1 discussed above, which allows a subsoil use license to be re-issued if its holder absorbs another legal entity, but does not work in practice, for example, has remained flawed but unchanged since 1995.

That provision of Article 17.1 permitting a license to be re-issued to enable a new legal entity, which is owned at least 50% by the former licensee, to operate on the latter's site, makes the additional requirement that the new legal entity be assigned "such assets as are required for those operations listed in the license to use the subsoil site concerned."

The specific assets thus required remain anyone's guess. For instance, if the new subsoil user was granted title to all wells sunk in the license area, but was not provided with the local shuttle-worker settlement, does this constitute grounds for refusing to reissue the license in such legal entity's name? The Subsoil Law does not answer this question and is clearly in need of further clarification.

However, the relatively progressive significance of Article 17.1 should not be downplayed, as it offers a certain freedom of action for subsoil users willing to transfer their licences to third parties and thus marks a long stride forward along the path of liberalising the government regulation of mineral production operations.

Nevertheless, certain provisions of Article 17.1 of the Subsoil Law remain badly drafted and require improvement.

Payments for Subsoil Uses

Another fundamental aspect of subsoil use procedures is the system of payments for subsoil uses.

President Vladimir Putin on 8 August 2001 signed Federal Law No. 126-FZ to add Chapter 26, Tax on Mineral Production, to the Russian Tax Code and amend Section V, Payments for Subsoil Uses, of the Subsoil Law. This statute comes into force on 1 January 2002.

It will streamline the charging of taxes and other fees for subsoil uses, as the underlying idea behind the new law is that all taxes owing from subsoil users should be subject to the Tax Code, with all other levies they have to pay subject to the Subsoil Law.

Tax on Mineral Production

The Tax on mineral production (the Tax) is a new Russian federal tax. It will replace those deductions for mineral resource generation which were previously required by the Subsoil Law.

The Tax will be payable primarily by subsoil users, and its base will be calculated separately for each type of mineral as the value of the payer's mineral output.

A standard unit of minerals produced will, as a rule, be valued on the basis of earnings determined according to the selling prices charged by the taxpayer, net of VAT, excises and transport costs, including expenses for paying customs duties and charges, obligatory cargo insurance, discharge, loading, trans-shipment, port terminal, and forwarding services.

Subsoil Use Fees

The amended Article 39 of the Subsoil Law lists the following subsoil use fees:

(1) one-time disbursements for subsoil uses upon the occurrence of certain events specified in the license (One-Time Disbursements);

(2) regular royalties payable for subsoil uses;

(3) fees for geological information about subsoil resources;

(4) tender (auction) fee; and

(5) license fee.

One-Time Disbursements

One-Time Disbursements are payable by subsoil users upon the occurrence of certain events specified in their licenses. The minimum (starting) rates may not be less than 10% of the Tax assessed on the basis of the average annual designed capacity of the user's production facilities.

The sums of One-Time Disbursements are

finalized upon the results of a tender or auction, and fixed in a subsoil use license.

Tender/Auction and License Fees

Payment of a tender or auction fee is a precondition of bidding, and depends on the costs of arranging, conducting and determining the outcome of a tender or auction and on the compensation paid to professionals retained to help organize such bidding.

A license fee is payable upon the issue of a license, and fixed depending on the costs of executing and registering the licence.

Regular Royalties for Subsoil Uses

According to Article 43 of the Subsoil Law, regular royalties collected for subsoil uses are a consideration for exclusive rights granted to a subsoil user to prospect for and evaluate mineral deposits, perform surveys and geological exploration, or build and operate underground facilities unrelated to mineral production. They are payable separately for each type of subsoil use.

The amounts of such royalties are established with due regard for the economic and geographical conditions of a particular area, the size of the site to be worked, the type of mineral, the duration of work planned, the extent to which the territory has been explored by geologists, and the degree of risks involved.

Rates are fixed per square kilometer for each site—within the range allowed by the minimum and maximum rates to be set by the Russian Government—by the executive authority of the corresponding territorial constituent of the Russian Federation upon a motion by the regional office of the Ministry of Natural Resources.

The procedures and conditions for the collection of regular royalties for subsoil uses and fees for geological information are to be determined by the Russian Government.

The latter, therefore, is to issue a number of documents for the system of payments for subsoil uses to assume its final shape.

License Recall

A clearly defined statutory procedure for termination of subsoil use rights is a principal condition for subsoil use projects in Russia to become attractive, because it is needed by investors as a lever against arbitrary acts by unscrupulous bureaucrats. The Russian Ministry of Natural Resources is known to have stepped up attempts to withdraw mining rights from those subsoil users which, in its opinion, are in breach of those conditions set out in their respective licenses.

There are indeed numerous examples in Russia where license holders seriously default on the conditions of their licenses or take too long to even begin any operations in their license areas. The licenses in such cases can and should be taken away, but such punishment should be meted out in strict compliance with the law, which, for its part, must be clear and unequivocal on those circumstances under which mining rights may be recalled.

According to Article 29 of the Subsoil Law, a breach of any fundamental condition of a license constitutes grounds for cancelling the latter.

Regrettably, the Subsoil Law does not make it expressly clear which conditions of a license are deemed fundamental and which breaches of such conditions are serious enough to call for its withdrawal. For now, any, even a relatively insignificant departure from any condition of a license may be cited as a reason for revoking the licence.

Minister of Natural Resources Artyukhov said recently that licenses would for the most part be withdrawn "for failure to comply with license requirements, most notably those concerning environmental and fiscal issues," but these comments still do little to explain his ministry's general stand on license recalls.

Conclusions

It appears fair to conclude, based on the above review of Russian law on subsoil uses, that their legal regulation over the past ten years has undergone perceptible changes aiming, as a rule, to liberalize existing procedures and practices in this field and to grant subsoil users ever broader rights within statutory limits.

However, improvement to the relevant legislation is a matter closely linked to the political course steered by the national leadership, and all too often turns into a compromise between different political forces, each of which is pursuing its own interests.

Nevertheless, it is gratifying that the evolution of subsoil legislation for the most part is going in a direction that should make investments in subsoil uses an ever-more attractive option. At the same time, it is crystal-clear that current realities call for efforts along these lines to proceed at a much faster pace, and conform to a higher standard.❑

Railway Reform Aims at Improving Oil Producers' Access to the System, Lower Tariffs

New Track

By Alex Kacherov

In late 2001, the Russian government reviewed the package of proposals for reforming the country's vastly important railway system, still operated by the Soviet-era Ministry of Railways. The draft laws were returned for further work to government and Duma experts, and are likely to be presented to the cabinet meeting in first-quarter 2002. Because 80% of Russia's refined products are transported by rail, the reform could generate major benefits for producers and exporters of refined products and crude oil, including easier access to the system, better service, and lower tariffs.

In December, the Russian government returned a package of draft laws on reforming the country's railway system for further work to the group of experts from several government agencies and Duma committees. As a result, the reworked proposals will be reviewed by the cabinet in the first quarter and submitted to the State Duma within the first half of 2002. Despite this delay, there are indications that the Putin administration is finally getting serious in its intention to reform Russia's railway system, one of the last vestiges of the Soviet-era socialist state.

Under the current system, inherited from the Soviet-era planned economy, the railroads are controlled by the powerful government Ministry of Railways, known by its Russian acronym MPS. The ministry controls the rail tracks and stock of railcars, and it sets tariffs for transportation (under the supervision of government regulators, which establish caps for tariff increases). In recent months, pressure for MPS reform has grown. In November, a corruption investigation against powerful Railways Minister Nikolai Aksyonenko forced him to go on temporary leave. The system has come under criticism as non-transparent and failing to respond to the demands of the emerging market economy.

According to Yevgeny Yasin, former Economy Minister and a key expert on Russian economic reforms, "MPS has so far failed to create a normal market of railway cargo transportation. The tariffs established by the ministry are far from transparent, as no one can see the real transportation cost component in these tariffs."

'MPS has so far failed to create a normal market of railway cargo transportation. The tariffs established by the ministry are far from transparent, as no one can see the real transportation cost component in these tariffs.'

While details of the government reform plan are being finalized, the major directions of the reform have emerged. They are likely to include establishing a state-owned company to replace the ministry, separation of ownership of rail track from the ownership of rail car stock, and allowing private shipping companies to own rail cars and operate shipping companies.

Product Exports by Rail

Reform of the nation's railway system will have significant implications for producers, traders, and exporters of refined products. According to the official data of the Ministry of Anti-Monopoly Policy, nearly 80% of all refined products in Russia is transported by rail. About 50 million to 55 million tons of refined products are annually delivered by rail transport for export to foreign countries, including 3 million tons delivered to FSU states.

The main consumers of Russian petroleum products delivered by rail are UK, Italy, Ireland, Denmark, Germany, Finland, Cyprus, Poland, Belarus, Mongolia, Kazakhstan, and Ukraine. The low quality of output at Russia's outdated refineries has traditionally limited product exports to heavier products such as fuel oil. While there is some demand for lighter Russian products, such as diesel fuel and gasoline, this demand is limited. In the future, the toughening policy of the European Union aimed at reducing the import of low-quality oil products with high sulfur content may seriously affect Russian petroleum products export.

Nevertheless, recent modernization of some Russian oil refineries and the ongoing modernization of some others (including the Moscow, Ryazan, Omsk, Perm and Ufa refineries) has substantially improved the output mix of Russian petroleum products. The yield of light, high-grade fuels (such as high-octane gasoline and low-sulfur diesel fuel) is increasing. Because domestic demand for these products is still fairly low and is expected to grow at a modest pace, the export market will be ever more important for high-grade Russian refined products, analysts say.

Oil Transportation Increases

The last two years have witnessed a growing trend to ship Russian crude oil for export by rail with annual volumes ranging from 3 to 5 million tons (excluding transit). This growth is partially caused by high oil prices, which made rail a commercially viable alternative to pipeline transportation. In any case, rail transportation is also important to oil producers as a back-up option. Virtually every company has to work out a scheme of alternative export deliveries in case of difficulties in pipeline transportation, such as unforeseen reduction of pipeline export quotas, technical difficulties, or other limitations imposed by Transneft, limitations of sea terminal capacity, and seasonal price fluctuations.

Crude oil is transported by rail primarily from Timan-Pechora basin (Northern railway) and Volga-Urals region (Kuibyshev railway). It is further transported to Tallinn and Finland; the latter takes 160,000-170,000 tons of exported and Kazakh crude monthly for refining at its own refineries.

President of Russian oil major YUKOS Mikhail Khodorkovsky believes that major opportunities exist for exporting East Siberian crude by railway. According to Khodorkovsky, this export route geographically offers better options than a European route. The inferred reserves of this region are estimated at about 8 billion tons of oil, while proven reserves currently stand at 500 million tons. YUKOS, which declared East Siberia as its area of strategic interest, pioneered rail supplies to the Chinese oil market several years ago. The average monthly volume along these routes amounts to 50,000 tons.

At this point, crude oil unloading facilities in Russian ports are operating at peak capacity. The largest volume of crude oil is unloaded from rail tank cars at Novorossiysk (3.6 million tons in 1998), Tuapse (3 million), St. Petersburg (1.7 million), Nakhodka (1.1 million), Vanino (800,000), Kaliningrad (700,000), and Vladivostok (600,000).

Separating Functions

One of the key elements of the reform plan mulled by the government is separating the function of owning and operating the railroad infrastructure from the functions of ownership of rail cars. Under this plan, the MPS would reduce its ownership of a number of rail cars; and a number of private operators, each owning its own fleet of rail cars, will work as shippers on the railroad system. Experts say this measure will resolve several problems plaguing Russia's railroad system.

Tank Car Ownership

SG-Trans	-	20,000
SFAT	-	6,600
Russky Mir	-	4,300
LUKOIL	-	5,300
Bashneft	-	1,660
Slavneft	-	1,300

Source: RPI Inc.

Emergence of private operators is expected to alleviate the shortage of tank cars currently experienced by MPS. According to Sophia Katkova, deputy director of the Transportation and Forwarding Department at Trading House Transneft, a Transneft-affiliated trader, the shortage of tank cars is an acute problem impeding transportation of crude oil and refined products in and from Russia. Katkova warns that, with the ministry unable and unwilling to invest funds in building more tank cars, the shortage will reach 30,000 units by 2005—unless private operators step in and fill the gap.

The trend of increasing non-MPS ownership of tank cars is already apparent, with an increasing number of private shipping companies, as well as oil companies, investing in their own fleet of

Rail Export Approval Rules

Effective 2002, Russian crude oil exporters using the rail system will have to obtain the approval of the Energy Ministry. Prior to the new regulation announced by the Energy Ministry in December, crude oil exports bypassing the Transneft system did not need the approval of the Energy Ministry. Under the new regulation, crude oil exported by rail must have Energy Ministry approval in order to clear customs.

Crude oil exports by rail are expected to reach 1.5 million tons in the first quarter of 2002. Total crude oil exports to non-CIS states are expected to reach 32.4 million tons for that quarter.

Railways Ministry Overhaul Plan

Today, Russia's railway system is fully owned and operated by the Ministry of Railways (MPS). That structure is stipulated traditionally by the central place the railway system has always occupied among all means of transportation in Soviet and Russian economy. Paying little attention to the development of its automobile industry, unlike the US or Western Europe, Russia never created a well-developed network of motor highways. Taking into account enormous distances across nine time zones spanning the Russian Federation, rail transportation remains a key element of the Russian economy.

The key concepts of government reform plan envision the following:

- separating the functions of state administration from economic management of railways, with administrative/regulatory functions to be retained by government regulators, and commercial operations to be transferred to relevant state-owned and private companies;
- establishing the joint stock company "OAO Russian Railways," 100% owned by the state (similar to RAO Gazprom or RAO Unified Energy System, operator of Russia's electricity grid);
- revision of the Railway Charter to streamline relations between shippers and customers and to establish the standard of contractual relations between the operator of the infrastructure, owners of rolling stock and uses of the system; corresponding amendments are to be made in the Law on Natural Monopolies.

The package of reform measures will include draft laws prepared by experts from the Railway Ministry and other agencies: "On Railway Transport in the RF," "Charter of the RF Railway Transport," and "On OAO Russian Railways." Experts from government agencies and the Committee on Transportation of the Duma are reviewing these documents to prepare for submission to the government.

In addition, proposals developed jointly by the Ministry of Economic Development and Ministry of State Property envision limiting the government control only to rail tracks and a limited number of rail cars, and treating the rail tracks as a "natural monopoly," i.e. allowing equal access to the rail infrastructure by government and private shippers alike. At this point, however, it remains unclear whether these proposals will gain the support of the government.

tank cars. The largest owner is SG-Trans with 20,000 tank cars; among oil companies, LUKOIL owns 5,300 (see table). However, at this point private operators cannot function as full-fledged competitors to the MPS as they remain under the foot of the Ministry's monopoly in terms of setting time schedules, controls, planning and so on. Giving greater freedom to private operators will encourage more investment activity by private operators.

Government experts say that under the reform plan more private companies should emerge, promoting competition between operators and better service to the clients. First Deputy Minister of Railways Alexander Misharin told the media: "Russia should have many more private shipping companies than it has now. … This will make state-owned cars run faster and encourage investment in new rolling stock."

Tariff Incentives Expected

The emergence of private operators is likely to benefit users of the railway system by generating lower tariffs. Tariffs offered by private operators are typically more competitive than those using MPS's own shipping services. Thus, transporting a tank car of gasoline from Tyumen to Estonia using the ministry's tank car costs about $105 per ton. At the same time, the ministry charges the licensed private operators only $77 per ton. The operator is then able to pass part of the margin of $28 per ton to the client. The more private operators emerge, the more discounts will be passed on to the users of the system, generating across-the-board tariff decreases, proponents of reform say.

Another important component of the proposed rail changes is reforming the way rail tariffs are calculated in order to make them more predictable and transparent. Within that framework, the government plan envisions separating the charge for rail car usage, currently included by MPS into its transportation tariff, from the distance charge. This will make the tariff more transparent to outside users.

In addition, as of March 2002, the government will equalize the tariffs charged for domestic and export destinations. This would benefit exporters of refined products and crude oil, lowering their transportation costs. Previously, tariffs for export destinations, such as sea terminals, were substantially higher than those charged for domestic transportation. This frequently led exporters to resort to all sorts of "gray" schemes, under which the exporter declared a domestic destination for its export cargo to pay a lower fee, and then invented ways to get the cargo across the border without properly registering it.

Positive Impact on System

Industry observers say the planned reforms, if implemented, would have a beneficial impact on the railway system itself, and on its users from the oil industry, facilitating lower tariffs, increasing capacity, and giving the users of the transportation system more predictability.

"Converting the railway transport to a market-based system and allowing a greater number of private operators into the field will benefit the system, allowing an end to the administrative, non-economic system of distribution of rail cars," said a rail transportation manager for one of the major US oil companies operating in Russia and the FSU. "This is especially important for those [foreign] companies that want to stay here for a long time and really want more predictability and reliability in terms of access to tank cars. The MPS reform will lead to more transparency and openness, and will have a positive effect on the general investment practices [in Russia]."

Meanwhile, a number of issues remain unclear. One is the timing of reform. Analysts say that, while the government is finally showing political will to enact reform, the timetable remains unclear for implementing some changes and overcoming the entrenched resistance of ministry bureaucrats and the vested interests surrounding them. Last but not least, deregulation and the emergence of more private operators will not resolve the issue of development and expansion of the rail infrastructure itself. That requires major capital investment, and even after the reform it will remain the function of the government-owned rail infrastructure operator. Until such investments are made, oil exporters using the rail system will continue to experience major bottlenecks on key export directions such as Novorossyisk terminal on the Black Sea and Leningrad port on the Baltic. ❑

Russian Consortium Mulls Inviting Foreign Partners to Northern Caspian

Subdued Signals

By Vladimir Biktanov

The consortium of three of Russia's largest oil and gas companies, Gazprom, LUKOIL and YUKOS, established in 2000 to explore and develop acreage in northern Caspian, is reportedly revising its xenophobic attitude toward foreign participation in this project. Top-level managers are giving out tentative signals of their companies' readiness to accept a foreign player or players.

When Caspian Oil Co. (KNK) was formed by Gazprom, LUKOIL, and YUKOS on July 25, 2000, to explore for oil and gas in the Russian sector of the Caspian Sea, senior executives of these companies stated unequivocally that the venture would off-limits for foreigners. Today, they say the consortium is prepared to consider buy-in proposals. Paradoxically, it is not the lack of success that is making Russian companies less xenophobic. The project is apparently developing with success.

"The KNK consortium is a very eloquent example of cooperation among Russian companies LUKOIL, YUKOS, and Gazprom," LUKOIL president Vagit Alekperov told *Russian Petroleum Investor*. "A joint management team was already set up in KNK, work is proceeding very harmoniously, all that was planned is being fulfilled, and we are sure that things will develop this way in the future as well. Work to shoot seismic is currently under way, the obtained materials are being processed. In 2002, we will submit a preliminary evaluation of reserves to the government. We plan that KNK will drill the first exploratory well in the latter half of 2003 or in early 2004."

As KNK general director Alexander Porokhnin told *Russian Petroleum Investor*, "The exploration period spans five years and is broken into three stages. In 2001-02, the company performs technical research and designates a site for drilling wells. Seismic research is being carried out by the Astrakhan company Geo-Khazar, which won a tender for these types of work. Exploration drilling will be conducted in 2003-04 and the obtained data are to be processed in 2005."

Good Piece of Property

In early 2001, KNK gained a license for its block off the northern shores of the Caspian covering an area of 14,000 square kilometers. The acreage lies in the shallow part of the northern Caspian where water is just 1 to 5 meters deep, in the immediate proximity of the delta of the Volga river. It holds a place neighboring LUKOIL's licensed block Severny, at which the largest Russian company is already pursuing prospecting and exploration activities and has spudded four exploratory wells.

KNK evaluates highly the potential for the presence of oil and gas in its block. According to Russian specialists' forecasts, minimum total oil reserves of the Russian shelf on the acreage of the Caspian Oil Co. are today estimated at 240 million tons of fuel equivalent. Indeed, the recoverable reserves of six structures within the neighboring Severny block, which were prepared for deep drilling, are put at 500 million to 900 million tons of fuel equivalent. But KNK has yet to conduct a supplementary survey of its block. It is expected, Porokhnin noted, that additional exploration will sizably raise the figure of the supposed hydrocarbon reserves in the KNK acreage.

In early 2001, KNK gained a license for its block off the northern shores of the Caspian covering an area of 14,000 square kilometers. The acreage lies in the shallow part of the northern Caspian where water is just 1 to 5 meters deep.

Konstantin Kleshchev, doctor of geological-mineralogical studies, director of All-Russian Research Geological Oil Institute (VNIGNI), told *Russian Petroleum Investor*: "By geological features, the Russian part of the northern Caspian shelf and the Kazakh part of this shelf are comparable. But although they lie in one Caspian Sea, in geological terms these are two different oil- and gas-bearing provinces. The Kashagan structure [in the Kazakh part of the shelf] lies on the periphery of the Precaspian depression. Such fields as Tengiz and Karachaganak in northern Kazakhstan, and Astrakhanskoye in Russia, were discovered in this Precaspian depression."

Kleshchev added, "The Russian part of the Caspian shelf, where LUKOIL and KNK are already operating, is attributed to another basin named Mangyshlaksko-North-Caucasian. Fields from the east, from Mangyshlak [the Mangyshlak plateau in southwestern Kazakhstan] stretch there, and in the west this province reaches out Northern Caucasus [the so-called Karpinsky Swell]."

The geologist concluded, "In brief, these are totally different provinces that have absolutely different oil-bearing strata or formations, and different geological conditions. Certainly, all this affects the quality of oil. Oil in Kashagan contains sulfur, hydrogen sulfide, and other impurities. And oil in the Russian part of the province is good. It virtually contains no impurities and is very close in quality to North Caucasian crude."

Foreigners Invited

Some 100 wells are to be drilled in the oil fields development phase. At the first stage that will begin in 2006, it is planned to produce 100,000 tons of oil per year and in six or seven years to bring the annual oil output volume to 10 million tons. The KNK project spans 30 years, the payback period is seven to ten years.

At the stage of prospecting and exploration activities, the KNK member-companies plan to invest $100 million to $120 million. The total cost of the project, according to KNK experts' evaluations, will run into $1.5 billion. After eighteen months since its formation, the consortium no longer counts only on the three founders' funds, as it did initially. Alekperov told *Russian Petroleum Investor*, "As for potential involvement of foreign investors in the KNK project, if someone expresses the desire to join the project, the consortium members will consider this proposal."

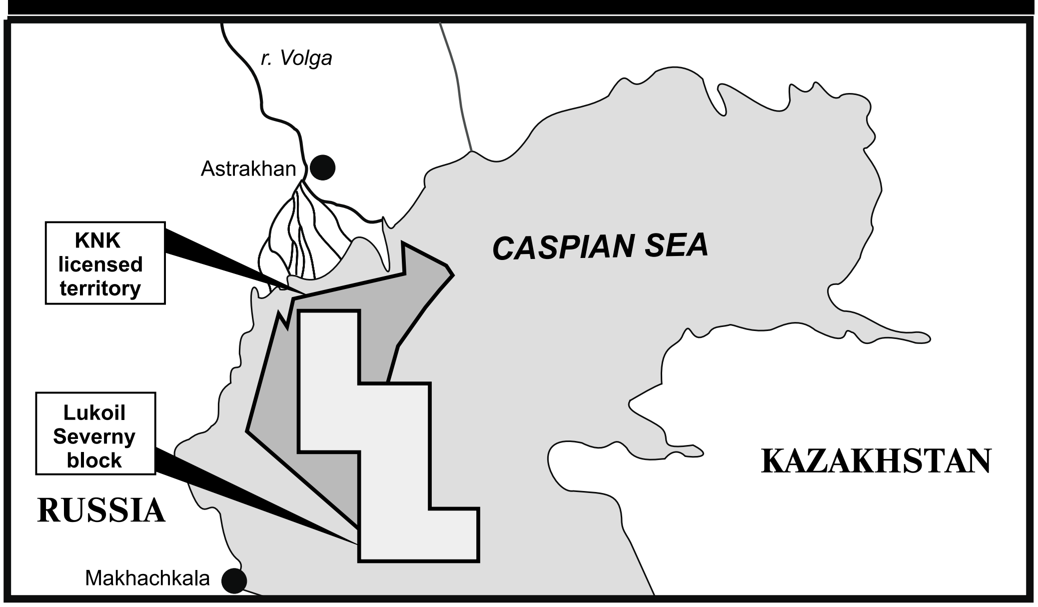
At the stage of prospecting and exploration activities, the KNK member-companies plan to invest $100 million to $120 million. The total cost of the project, according to KNK experts' evaluations, will run into $1.5 billion.

In setting up KNK, its founders categorically rejected this possibility. YUKOS spokesman Andrei Krasnov says consortium members were intent on demonstrating that Russian companies can tap their subsoil without foreign financial aid. (See "Full House," *Russian Petroleum Investor*/August '00.) In fact, creation of the KNK consortium was the first case in the oil and gas industry when three leading Russian companies banded together for a single project.

Gazprom Role Significant

Stephen O'Sullivan, head of the Oil & Gas Research Department at Moscow-based United Financial Group investment firm, said, "I think it is significant that two of Russia's leading energy companies, Gazprom and LUKOIL, are teaming up to develop the northern Caspian. I am not sure what YUKOS's

KNK LICENSED TERRITORY



KNK at a Glance

Representatives of LUKOIL and YUKOS oil companies and also Gazprom gas concern announced in Moscow on July 25, 2000, the creation of Caspian Oil Co. (KNK), a limited liability entity, and signed the founding documents.

Caspian Oil Co. was established to prospect for, explore, and develop oil and gas fields in the Caspian region, first and foremost in the Russian part of the Caspian Sea shelf.

Each of the three founder-companies contributed one-third of KNK's charter capital. Caspian Oil Co. was registered in Astrakhan city in 2000.

In keeping with a decision of the founder-companies, KNK is governed by a general director and an observation council elected for two years. Alexander Porokhnin, a LUKOIL representative who previously worked at this company's subsidiary LUKOIL-Astrakhanmorn1eft, became KNK general director for the first two years. A YUKOS representative will replace him for two years and after that management of the company will pass to Gazprom for two years. KNK is headquartered in Astrakhan, the largest administrative and industrial center on the coast of the Russian part of the Caspian.

A block for geological exploration, the North Caspian acreage, allotted to Caspian Oil Co. lies in the northern shallow zone of the Caspian Sea in immediate proximity to the delta of the Volga river and frames from the north LUKOIL's own licensed block Severny. KNK's licensed block is 14,000 square kilometers.

Exploration efforts have as their goal to conduct a comprehensive study of the licensed block's subsoil to prospect for, explore, and appraise the reserves of oil and gas fields and prepare them for commercial development.

According to Porokhnin, closures of three large anticlinal zones—Poldnevsko-Kulalinskaya, Promyslovskaya and Caspian—stand out within the boundaries of the western part of the block from north to south. Materials of a seismic survey performed in earlier years reveal local uplifts within their boundaries, whose sizes allow geologists to regard them as objects of the search for hydrocarbons accumulation.

A program of work for a five-year period, which was set by the license of the Russian Ministry of Natural Resources, envisions seismic research to determine the territory's potential for containing hydrocarbon accumulation and select the most interesting object of operations to drill wildcat wells.

According to the concept of the geological exploration of the licensed block and in line with the license agreement, geological-geophysical research is carried out in three stages. The first stage covering 2001-02 targets seismic surveys that will make it possible to identify and prepare for drilling the more promising structures.

Wildcat-appraisal drilling at an object of drilling prepared by seismic research is supposed to be performed at the second stage spanning 2003-04.

The third stage, to be mounted in 2005, will focus on compiling a geological-geophysical report, calculating possible resources, and drawing up recommendations on wildcat and exploratory well spacing.

The waters of the licensed block are shallow with sea depth from 1 to 5 meters and are characterized by proximity to the Astrakhan biosphere reserve, zones of feeding grounds for particularly precious fish species. These conditions for the conduct of oil and gas operations necessitate development of specific technical, technological, and ecologically safe solutions for shallow waters tied to the problem of minimizing the negative impact on the environment.

Russia's Caspian Sector

The Russian part of the Northern Caspian waters is a total of 64,000 square kilometers in size. Twenty potentially oil- and gas-bearing structures have been discovered here. The extent to which total initial recoverable resources are explored does not exceed 10%, including 15% for oil and 5% for gas.

Russian Ministry of Natural Resources officials reckon that, if the extent to which the Azeri sector is explored is accepted as 100%, then the same figure for the Kazakh sector will be 75%, and for the Russian sector a mere 25%.

The Khvalynskaya structure of the Severny block, a license for which is held by LUKOIL, and also the small oil field Inchkhe-more off Dagestan (reserves: 10 million tons of fuel equivalent) are Russia's sole Caspian plots that are prepared for development.

CaspOilDevelopment consortium, which was set up by Britain's J.P.X. (30.5%) and Russia's Roscaspneft (39.5%) and Dagneft (30%), will pursue development of the Inchkhe-more structure.

The LUKOIL Project

LUKOIL got down to exploration of the Caspian Sea's mineral resources in December 1996. Extensive work on the geological exploration and development of the northern part of the Caspian has been carried out for the last five years. Astrakhan now has its own infrastructure for prospecting and exploration operations. The jack-up drilling rig Astra underwent modernization at the Astrakhan shipbuilding plant. Overall expenses on geophysical and geological research and also putting in place infrastructure have run to more than $300 million.

The research identified ten promising oil- and gas-bearing structures, of which six are prepared for deep drilling, and also discovered two fields: Khvalynskoye (oil-gas) and the gas-condensate deposit named after Yuri Korchagin. Five of these structures lie within the boundaries of LUKOIL's Severny licensed block. The combined recoverable hydrocarbon resources of the five structures total 460 million tons of fuel equivalent.

The first Khvalynskaya-1 well began to be drilled on LUKOIL's block in 1999. The first exploratory well that yielded oil was drilled here, attaining a depth of 4.2 kilometers on March 23, 2000. A total of four wildcat wells are supposed to be drilled. Penetration of exploratory wells will begin in the fourth year of the project's execution, oil production in the fifth year. If forecasts pan out, the peak output level of 15 million tons per year will be reached in the eighth year of development. A total of 200 development wells are to be drilled. The reserves of the Khvalynskoye field are estimated at 250-300 million tons of fuel equivalent.

The Severny offshore block lies 130-150 kilometers from the coast, southeast of the Volga delta. The eastern border of the block is adjacent to the assumed delineation line of the Kazakh Caspian Sea shelf. The block occupies an area of 8,000 square kilometers, the sea depth is 25-35 meters.

PSA for LUKOIL Blocks

Last July 13, the Duma passed on first reading a draft law on adding the Yalamo-Samursky and Tsentralny promising blocks on the Caspian shelf to the list of subsoil blocks that may be developed on production-sharing terms.

LUKOIL is the subsoil user of these blocks, with combined reserves of about 770 million tons of oil. The fields are located at a sea depth of 190-800 meters; the distance to Astrakhan is 440-500 kilometers, to Makhachkala 180-150 kilometers.

Total capital investments required to develop the Yalamo-Samursky block are estimated at $5.6 billion. It is assumed that, if hypothetical resources are confirmed, production may commence in 2007. Close to 10 million tons of oil per year will be recovered from the field by 2025.

Capital investments in efforts to mine the Tsentralny high-potential block are estimated at $11.3 billion. Raw material production may kick off in 2009. It is planned to recover up to 20 million tons of oil per year on average by 2025. Presently, seismic survey at the blocks has been performed and it is supposed to get down to geological-exploration activities in early 2002.

role in this project is, other than the fact that YUKOS's Samara refinery is located nearby."

He added, "The presence of Gazprom will be an advantage in case the consortium discovers gas [as happened in a few other projects in the Caspian, including LUKOIL's Severny block]. At this point, the consortium hopes to discover oil. The logical destination of this oil would be the markets of Southern Europe, LUKOIL's refineries in southeastern Europe [Ukraine, Romania, Bulgaria]. The oil would be exported either by the CPC pipeline and through the Black Sea."

According to a source in Agip North Caspian Operating Co., or Agip KCO, formerly known as Offshore Kazakhstan International Operating Co., "Russian offshore projects in the Caspian, namely LUKOIL's and KNK's, will have a competitive edge over their Kazakh counterparts in more respects than geographical location and proximity to the export terminals. The Russian government is determined to assist these projects both politically and financially, the latter in the form of production-sharing agreements for them. As Deputy Prime Minister Viktor Khristenko said repeatedly, the cabinet is going to support including Caspian projects in the

Competition from Astrakhan

Despite the support Caspian Oil Co. (KNK) consortium received in Moscow, local authorities' attitude in Astrakhan is more competitive. As Astrakhan region governor Anatoly Guzhvin said at a meeting with journalists in Moscow in November, "The region's need for investments is estimated at $1 billion. We already have accords worth $500 million to $600 million with Russian and foreign companies. Hydrocarbons account for two-thirds of the required funds," the governor said.

To this end, the Astrakhan region administration put up for auction three promising blocks in 2001 and two more are planned to go on the block in early 2002. Astrakhanneftеprom company, a joint venture of Stroitransgaz and the local administration, became the winning bidder for one of them, Severo-Astrakhanskoye. The winner recently signed an agreement on joint work with Agip Energy of Italy (an Eni unit). According to Stroitransgaz vice president Viktor Ott, recoverable oil reserves in this block total 500 million tons of oil and in future the company plans to feed the produced oil into the Caspian Pipeline Consortium system.

Says Guzhvin: "We conceived Astrakhanneftеprom as a rival to Gazprom and LUKOIL, which filled the space of the Astrakhan region and set up a year and a half ago, jointly with YUKOS, the Caspian Oil Co." To all appearances, this competitor will fight with developers of neighboring offshore fields for a place in export pipelines.

list of projects eligible for PSA status, regularly updated by the State Duma.

Ray Leonard, vice president, exploration and new ventures at YUKOS and member of the board of directors of KNK, cited the border problem with Kazakhstan that the consortium participants have to deal with. He said, "Right now, we are concentrating on the question of the memorandum of understanding with regard to the treatment of the Caspian and a common value structure or something that will be under Kazakhstan jurisdiction, but the Russians have been allocated a chance to work in that area. It's our strong intention to settle all problems with the Kazakhstan side and to work at our licensed territory. As to the activity of the Caspian oil company itself, I must say that it goes successfully. YUKOS certainly supports all efforts of LUKOIL and Gazprom to make the KNK activity real success."

LUKOIL's Alekperov reckons in this regard: "There are no factors containing oil companies' vigorous activity in the Caspian Sea waters today. That is, only problems among states exist there today, which are not yet fully settled; but at the same time all foundations have been laid down for the economic development of these territories."

Costly Environmental Work

KNK's trio of founders not only combined their potential, they also shared financial and economic risks in developing the new hydrocarbon block in the Caspian. The consortium members have to furnish significant capital outlays because development of the licensed block requires the application of the most advanced technologies. This is dictated in part by the state of the environment; the licensed block is located beyond a 10-mile coastal zone but at a relatively close distance to water-swamp areas under protection, zones with special conditions for the habitat of marine animals, fish and birds of the northern Caspian. In view of this, the consortium is compelled to apply technologies that minimize the impact on living organisms of pursuing prospecting operations, oil and gas extraction.

Alexander Afanasenkov, executive vice president and head of the Geology Department of YUKOS, who chairs KNK's observation council, said the consortium has from the outset analyzed the experience of offshore oil exploration operations around the world to define its own production concept in the unique conditions of the northern Caspian. Underlying it is the principle of "zero discharges," which is applied, in part, in the Caspian by LUKOIL oil company. This principle envisions taking products of drilling, waste of production, and economic activity to the shore with subsequent utilization using special technologies.

Although the founders of the KNK consortium have opened the door to foreign participants, their role can be relegated to participation in contract work, for example involving Halliburton (US) in developing fields of LUKOIL's Severny block.

Drilling operations at KNK's licensed block will be performed with a view to minimizing their impact on the marine ecosystem. Drilling will be conducted from stationary platforms since there is no drilling unit in the Caspian today, which could operate on the licensed block in shallow water conditions. The company plans to use both foreign and Russian drilling equipment meeting the latest safety standards.

"Orientation to the zero discharge principle naturally drives up the cost of development operations, but to preserve the unique environment of the Caspian Sea this principle should become an underlying rule in drafting international agreements on oil company operations in the Caspian," Afanasenkov underscored. "KNK set a task to itself to bring the impact to the minimum permissible level allowed by legislation on environmental protection."

Foreigners for Services?

Although the founders of the KNK consortium have opened the door to foreign participants, their role can be relegated to participation in contract work, for example involving Halliburton (US) in developing fields of LUKOIL's Severny block. The Russian company drew in Halliburton to perform several types of work in its project, such as well cementing, etc. Given KNK's plans to develop its licensed acreage, foreign companies-suppliers of equipment and technology may count on winning contracts with the consortium.

In addition, considering the project's sizable cost, foreign partners of KNK can make their own contribution to arranging credits and loans of international financial institutes and banks. The investment climate in Russia, which has improved lately, will facilitate these efforts.

Transportation Options

Members of the Caspian Oil Co. (KNK) consortium have not yet developed a scheme of oil transportation from the fields of their licensed block in the northern coastal part of the Caspian. However, development studies already carried out by LUKOIL for transporting oil from the fields of its Severny licensed block, which adjoins KNK's licensed territory, may be instrumental in drawing up transportation schemes for oil that will be produced by the consortium.

The oil- and gas-bearing structures of the Severny block lie 130-150 kilometers from the shore (KNK's promising structures are even closer to the shore). To move oil onward will require laying some 100 kilometers of a pipeline to the trunk oil pipe of the Caspian Pipeline Consortium or slightly more to existing oil pipelines that are part of the Transneft system.

According to current predictions, at peak production LUKOIL will be able to take from the shelf of the Severny block up to 15 million tons of oil per year. If export pipelines do not have enough capacity to accommodate these volumes, the company has its own oil refinery nearby in Volgograd. In addition, LUKOIL has its own river-sea tankers; therefore, LUKOIL not expected to face problems with selling its offshore oil.

Another member of the consortium, YUKOS, has its own oil refinery in Samara city. Also, YUKOS has close relations with Volgotanker, Russia's largest oil river-shipping company. The latter is Russia's largest shipper of crude and refined products via combined sea/river routes. The Samara-based company owns 332 vessels with the total deadweight of 1,360,000 tons, including 223 tankers capable of both river and sea navigation. Over 80% of freight is oil and products. Maximum capacity of its river-sea tankers is 5,000 dwt. Tankers of this type make autonomous runs not only in navigable rivers and canals of Russia, which link the Caspian Sea with the Baltic Sea, but also deliver bulk oil to Black Sea ports of Ukraine, Bulgaria, and Romania.

About 78% of Volgotanker's total shipment are on contracts with YUKOS. Until recently, YUKOS and its affiliated companies held 62% of the total stock in Volgotanker. In early summer of 2000, YUKOS sold most of its Volgotanker shares. YUKOS spokesman said, "Strategically, YUKOS remains the largest client of Volgotanker. But we prefer it in the role of independent carrier and not a transportation arm of our corporation."

Eivald M.Q.Roren, president of World Petroleum Congress, told *Russian Petroleum Investor*: "I think the attitude of the international investment community towards Russia is changing in a positive way. It is a very important factor, this positive development with regard to investments and willingness to invest in Russia. And it is a reliable scenario for world oil pricing that helps these developments, because investors base their investments upon certain factors such as reliability on pricing, and on taxes, that is regulatory environment of Russia and for that matter of any country. I think Russia has currently made a considerable improvement in this regard," Roren said. ❑

Azeri-Chyrag-Gyuneshli Project Becomes Hostage to Pipeline Construction Plan

Troubled Connection

By Aida Sultanova and Maya Nobatova

Baku and Washington backing of the project to construct a Baku-Tbilisi-Ceyhan pipeline has resulted in a situation in which it becomes the sole option for exporting the main volume of "big" Azeri oil. Even LUKOIL, which opposed the project, is joining its proponents. But this progress only draws nearer the time when difficulties with maintaining oil throughput and generating revenues from pumping may create financial problems for Baku-Ceyhan project creditors.

Two projects are picking up their pace in the western Caspian region, with each one's development becoming an important condition of implementing the other. The Phase-1 project for full-scale development of the Azeri-Chyrag-Gyuneshli (AChG) block of offshore fields, the largest in Azerbaijan, kicks off in 2002. Azerbaijan International Operating Co. (AIOC) is executing this project. Phase-1 aims at bringing annual oil production to 24 million tons in 2005 from about 6 million tons in 2001. The bulk of oil should be transported via the new Baku-Tbilisi-Ceyhan (BTC) pipeline, due to begin operating in 2005, since the existing Baku-Novorossiysk and Baku-Supsa pipes do not have enough capacity to accommodate it. Almost all AIOC shareholders are members of the Group of Sponsors of the BTC project.

The project to construct BTC, with throughput capacity of 50 million tons per year and a price tag of at least $2.8 billion, is also preparing to shift into an active phase. This winter, Turkish pipeline company BOTAS plans to hold a tender for the purchase of equipment and services for the BTC section on Turkish territory. BOTAS is looking for contractors to build pumping stations and a terminal in Ceyhan, plus supply compressors, valves, fiber-optic cable, and other equipment. The tender results should be summed up no later than mid-May since BOTAS is set to launch construction of the Turkish portion of the pipeline at mid-year. The trunkline should go into operation in 2005.

As both projects move forward, it becomes clear that the AIOC oil will not be sufficient in 2005 to justify the BTC pipeline. In the last two years, proponents of the pipeline to Ceyhan have been looking for other companies to supply oil for the BTC. These plans recently gained sensational support in Moscow, which traditionally has opposed the BTC project. Until now, Russian leader LUKOIL opposed the scheme to build a pipeline to Ceyhan. But last fall, Leonid Fedun, vice president of LUKOIL, stated that the BTC project became more attractive thanks to changes in commercial terms.

Boosting BTC Profitability?

Britain's BP, a leader in both the AIOC and BTC projects, has drawn up a new concept of building and operating the pipeline to Ceyhan. Its essence is in raising the project's profitability rate: to 24% instead of the former 17%. The projected figure looks rather high since the rate for a cheaper project, to construct a Kazakhstan-Turkmenistan-Iran oil pipe, is planned at 15%. Progress in boosting the BTC's profitability looks even more striking considering that, in the early stage of project organization, Natik Aliyev, president of the State Oil Company of the Azerbaijan Republic (SOCAR), said the pipeline was being planned as a non-profit enterprise.

Improvement in the project's profitability is due to several factors. First, Turkey lowered payment for land by altering the pipeline's route. Second, the authors of the feasibility study on the project now proceed from the premise that six rather than the earlier-planned eleven pumping stations will be required. Natik Aliyev told *Russian Petroleum Investor*: "We assume that the cost of construction will remain at the level of $2.4 billion—the same as we planned earlier." Meanwhile, following a preliminary engineering of the route, foreign specialists concluded that the project's cost would be $2.8 billion to $2.9 billion, with the possibility of further vacillations.

An expert at the Russian Trunk Pipelines Design Institute (Giprotruboprovod) said: "Six pumping stations may not be enough for the operation of the 1,746-kilometer BTC pipe. The usual practice is construction of stations for each 150-200 kilometers. Possibly, a drop in the number of stations is explained by a decrease in the pumping volume." This version looks plausible because BP and SOCAR say that initially the BTC pipeline will be pumping 25 million tons of oil per year and will reach out the 50-million-ton level in the more distant future.

The tactic of a gradual expansion in throughput capacity is already being employed in the Caspian region. The Caspian Pipeline Consortium (CPC), built a pipe from western Kazakhstan to the Russian Black Sea coast in 2001 with annual throughput of 28.2 million tons even though the design capacity was 67 million. The original, larger pipe would have cost upwards of $4 billion, but the reduced throughput called for just $2.6 billion. Evidently, the investors of the BTC construction also plan to boost its capacity and spending on expansion gradually. But expenses on raising capacity will then be added to initial investments and the project's profitability rate of 24% may decrease because of the surge in expenses in subsequent years.

Pipe Called Vital to Nation

LUKOIL likely is also aware of the stakes involved in the BTC pipeline project. Fedun speaks not only about the commercial merits of the project but also Russia's strategic losses if the pipe is not built: "Russia should link its oil pipelines with the Baku-Ceyhan pipe. This will make it possible to channel huge flows of Caspian oil into the Mediterranean Sea; otherwise, a collapse is in store for our economy. Caspian oil, which is of higher quality than Russian crude, will squeeze out the latter from its traditional markets."

EXISTING AND PLANNED EXPORT ROUTES OF CASPIAN OIL

LUKOIL in Azerbaijan

Russian company LUKOIL participates in three offshore projects to develop fields on Azerbaijan's Caspian Sea shelf—Azeri-Chyrag-Gyuneshli (10% equity interest), Shakh-Deniz (10%), Yalama (60%), and one onshore project to rehabilitate, explore, and develop the onshore Govsany and Zykh fields (50%).

So far, the Russian company has been producing oil in Azerbaijan only under the Azeri-Chyrag-Gyuneshli project, exporting it via the Georgian port of Supsa. The rest of the project is in the development stage. Within the framework of the Zykh-Govsany project, LUKOIL has already formed an operating company and completed delineation of the contracted block. The company undertook, among other things, to drill two exploratory wells on the contracted acreage over three years. In addition, the company will conduct a 3-D seismic survey and geo-technical studies of separate portions of the acreage. The block's residual reserves total an estimated 17 million to 20 million tons of oil.

Last November, SOCAR extended the exploration period under the Yalama project, which was expiring in December, to 2007. LUKOIL needs to construct at least two appraisal wells with a target depth of some 300 meters on the contracted acreage. The structure's reserves are estimated at 130 million tons of oil.

Presently, LUKOIL is consulting with the State Oil Company of the Azerbaijan Republic (SOCAR) on developing an offshore block of promising structures (D-8/D-10/D-11) in the southern part of Azerbaijan's Caspian Sea sector with reserves of 120 million tons of oil. According to Azeri specialists, the structures also contain vast natural gas reserves. Statoil (Norway) and UNOCAL (US) sought operatorship over these blocks prior to LUKOIL.

The Russian company also mulls variants of a further expansion in the chain of its gasoline stations in the republic. LUKOIL today operates nineteen such retail outlets in Azerbaijan. In future, their number will grow to 25-30. In Baku, the company owns a reloading oil base with a capacity of 120,000 tons of oil products per year. According to company CEO Vagit Alekperov, LUKOIL is set to control 20%-25% of Azerbaijan's retail oil products market.

In 2001, the overall volume of the company's investments in Azerbaijan's projects, except AChG, will total about $50 million. LUKOIL has already invested upwards of $200 million in Azeri-Chyrag-Gyuneshli, and the overall sum of the company's investments in the republic since 1995 has reached $300 million.

Agip KCO, operator of the project to develop the Kashagan offshore field, the largest in Kazakhstan, has already reported that it would feed its oil into the CPC pipeline—up to 15 million tons of oil per year. The champions of the Ceyhan project propose integrating the CPC and BTC pipelines to divert all or part of Kazakh oil towards the Mediterranean Sea. (See "CPC Plus BTC" and map.)

Implementation of these plans calls for building a connecting branch line several hundred kilometers in length, with the higher cost resulting in higher transport charges. For example, the current CPC tariff is $25 per ton, while a BTC tariff is planned at $18 for shareholders and may run at around $40 for other users.

Profits Are Threatened

In addition, integration of the pipelines threatens to slash CPC shareholders' profits due to a drop in volumes pumped via their pipeline. Another problem that may lurk for them in entering the BTC pipeline is the difference in the quality and price of Kazakh and Azeri offshore crudes. SOCAR's Ilkham Aliyev has spoken about the need to compensate Azeri exporters for losses incurred as a result of blending their higher-quality crude with Kazakh raw material. The size of compensation is unknown because the CPC blend has not yet positioned itself on the world market, but in any case the situation is not a very encouraging prospect for Kazakh exporters.

The need for non-Azeri oil to fill the BTC pipeline is of changeable nature. Production under the AIOC project will be steadily growing from 2005 to 2010, reaching close to 48 million tons of oil per year. Ullage in the Ceyhan pipeline for non-Azeri crude—for example, Kazakh oil—will correspondingly be decreasing. Meanwhile, production under Kazakh projects

(Tengiz, Karachaganak, Kashagan) will also be climbing exactly within that period.

Pumping their output through the BTC pipeline will require a sizable expansion in its throughput capacity, whose financing will fall on the shoulders of Kazakh exporters, at least in the form of a hike in tariffs. It may be advantageous for Russia to funnel Caspian oil flows to the Mediterranean market, but using for this purpose the integration of the BTC and CPC pipelines is not a very good situation for Kazakh exporters.

LUKOIL in Pivotal Role

Proponents of a pipeline to Ceyhan need the backing of at least LUKOIL, which earlier promised to export its share in the AIOC output to Novorossiysk, given the full-scale development of AChG. The Russian company holds 10% of AIOC shares, and the consortium may fall short of receiving 2.4 million tons of oil for pumping into the BTC pipeline in 2005 alone. LUKOIL is now pressing the Russian government for a permit to pump its oil to Ceyhan. The company has ambitious plans in Azerbaijan (see "LUKOIL in Azerbaijan"), which need support from Baku officials, for example in exchange for backing the BTC project.

However, there is also a staunch opponent of the BTC project among the AIOC members. ExxonMobil (US), holding roughly 10% in the consortium, is loath to use the pipe to Ceyhan and plans to pump oil to Supsa. Having obtained unsuccessful exploration results under their Azeri E&P projects, the Americans are in no rush to organize new developments in Azerbaijan—thus decreasing their presence and interest in the country. Therefore, SOCAR may not be able to talk the company into altering its opposition. This means that one-tenth of

Russian Projects to Bypass Bosporus

Russia is currently developing two projects to deliver Russian and Caspian oil to the Mediterranean coast by skirting Turkish Black Sea straits. One is project to build a trans-Balkan pipeline from the Bulgarian port of Burgas to Alexandropoulis in Greece, and the other is a project to integrate the trunk oil pipelines Druzhba and Adria in Croatia.

Russia has been considering the trans-Balkan project jointly with Greece and Bulgaria since 1994. The oil pipeline is designed to transport Russian and Caspian crudes, which are lifted from ports Novorossiysk and Supsa, to the Mediterranean Sea bypassing Turkey's Black Sea straits. The pipeline will be 320 to 400 kilometers in length and its cost $700 million.

In early December, Russian oil company LUKOIL CEO Vagit Alekperov proposed extending the Burgas-Alexandropoulis oil pipeline to Salonika, the site of a large oil-refining plant. He unveiled his initiative to journalists in Athens during Russian president Vladimir Putin's official visit to Greece. According to Alekperov, extending the pipeline's length by 150 kilometers will require some $500 million.

Caspian oil may reach the Mediterranean market also through the Druzhba and Adria oil pipelines system. In October 2000, Russian oil company YUKOS and Croatian oil transport company JANAF signed an agreement on upgrading the Adria oil pipeline.

Integration of the two oil pipelines would open an outlet to the Adriatic Sea through Croatia's deepwater port of Omishal, which is capable of receiving tankers of up to 500,000 deadweight tons. At the first stage, the route will be able to handle up to 5 million tons of oil per year.

The project to integrate Druzhba and Adria involves, apart from Russia and Croatia, also Belarus, Ukraine, Slovakia, and Hungary. Because of the route's great length—over 3,000 kilometers—the transit countries decided to set a special reduced through tariff of $0.64 for pumping 1 ton of oil over 100 kilometers. Negotiations on the tariff have been going on since 1997 and all countries agreed with it except Ukraine, which has not made a final decision as yet. This is the key impediment to creation of a new export route.

the AIOC's annual output will not go into the Ceyhan pipeline.

The absence of ExxonMobil's oil in the BTC pipe will not spur optimism among international financial institutions whose credits pipeline proponents want to begin drawing this year. There are also other circumstances that concern banks, companies, and countries involved in the BTC project. Last fall, Russia made considerable headway in developing oil export routes from FSU to the Mediterranean market—Croatia and Greece. (See "Russian Projects to Bypass Bosporus.") Execution of these projects will make it possible to eliminate the problem of the limited throughput capacity of the Bosporus strait, which is one of the arguments in favor of building the pipeline to Ceyhan.

Starting in 2002, the AIOC members will find themselves in a complicated situation. The volume of Azeri oil will permit the route to Ceyhan to operate at a throughput that makes it economically viable only for several years. Exporters of non-Azeri oil are so far not rushing to participate in construction of BTC. Commercial banks are unlikely to give solid backing to a pipeline project with a throughput problem. The AIOC Group of Sponsors will most likely have to shoulder the bulk of construction expenses and forget about a fast return on investments. The project to develop AChG, the most profitable in the western Caspian, may see its economics decline for the majority of participants because of the not very successful export solution, construction of the BTC pipeline. ❑

CPC Plus BTC

Participants in the Baku-Tbilisi-Ceyhan (BTC) project have long been mulling the possibility of hooking up Kazakh oil to this route. In June 2000, the US Agency for Trade and Development awarded a grant to Kazakh national company Oil and Gas Transport to explore opportunities for laying a pipeline from Aktau to Baku to transport Kazakh oil along the Caspian seabed. However, in the spring of 2001, Russia and Iran signed a memorandum in which they categorically opposed construction of any pipelines across the Caspian. As a result, the issue of funneling Kazakh crude into the Baku-Ceyhan pipeline across the Caspian no longer arose.

The issue of transporting Caspian oil via Baku with an outlet to Turkey's Mediterranean port of Ceyhan re-emerged in early November 2001, when Leonid Fedun, vice president of Russian oil company LUKOIL, addressed it at a press conference in Moscow. "This will make it possible to channel into the Mediterranean Sea huge flows of Caspian oil, otherwise our economy will face a collapse," he said. According to him, Russia should connect its oil pipelines, specifically the pipe of the Caspian Pipeline Consortium (CPC), which has just been put onstream, with the Baku-Tbilisi-Ceyhan oil pipeline now on the drawing boards. The possibility of using the Baku-Makhachkala oil pipe is viewed as one of the variants of linking BTC with CPC.

Georgy Chanturiya, head of the Georgian International Oil Co. (GIOC), proposed laying a connecting pipeline across Abkhazia's territory, which, in his view, would help settle the Georgian-Abkhazian conflict. As the Azeri new agency Media-Press reported in early December, Chanturiya called on Russia to explore the possibility of connecting in parallel the CPC pipe with the Baku-Supsa oil pipeline and the Baku-Ceyhan line, which is currently in the design stage. According to Chanturiya, diverting part of the oil from the CPC route to the Mediterranean port would enable Caspian exporters to solve the Bosporus problem and supply without a hindrance their raw material to world markets.

Commenting on the statement by the GIOC chief, the State Oil Company of the Azerbaijan Republic (SOCAR) noted that this option is quite possible, but in the long term. "From the theoretical point of view, one should not rule out that in future two regional pipelines—CPC and BTC—may be closed into a single pipeline system," said Vitaly Beglyarbekov, deputy head of SOCAR's Foreign Investments Department. In his view, the technical issues of this initiative can be resolved: the parties may create a quality bank to avoid losses in blending various grades of crude, and the construction of a connecting pipe between the CPC and BTC is feasible.

CPC representatives have so far declined to comment on the issue of the possible export of Kazakh oil via the BTC pipeline. However, to all appearances, oil transportation from the Caspian region via Turkey's Black Sea straits may encounter real problems shortly. In November, Kazakh news media reported that Ankara demanded a triple tariff from Astana on the passage of each tanker laden with Kazakh oil through the Turkish straits.

Changes in Russian and Ukrainian Gas Strategy Spur Export Boost by Caspian Gas Producers

The Russian Factor

By Maya Nobatova

The European gas market continues to hold particular allure for producing companies in the Caspian region. Gas producers are attracted by its giant scale (450 billion cubic meters per year), high prices (over $200 per 1,000 cubic meters), and the availability of a transport infrastructure between FSU countries and Europe (throughput capacity in some sections of up to 170 billion cubic meters). For now, gas produced in the CIS is transported to Europe only by Russia, which jealously protects its markets against Caspian rivals. But there are signs of changes in Russian policy, opening the European market to other suppliers.

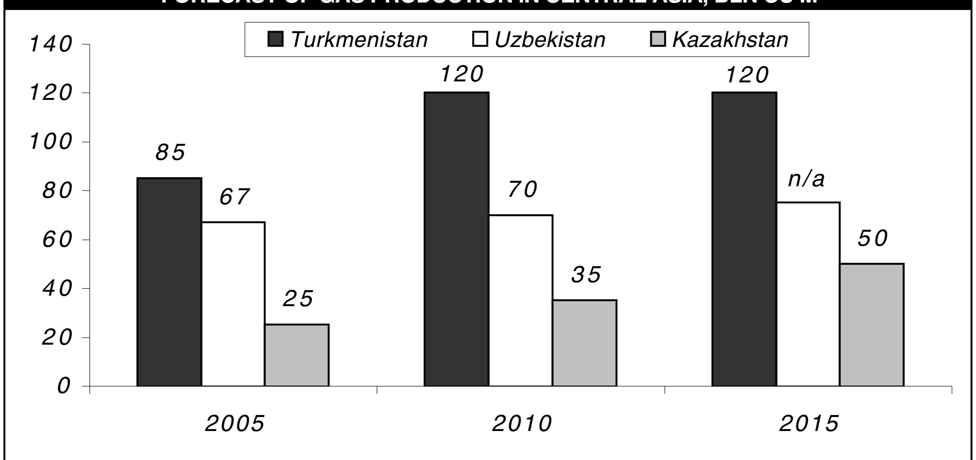
The first quarter of 2002 may see the start of sweeping transformations in the gas strategy of Russia, Ukraine, and Caspian countries. The end result would be demolition of some players' monopoly in gas transit and others' control of export. Before the end of March, Russian gas company Gazprom, the largest in the world by production and sales volumes, plans to complete construction of the Blue Stream export pipeline. It is designed to export Russian gas to Turkey along the Black Sea seabed. Gas will begin to be supplied in the third quarter and a total of 365 billion cubic meters will be exported under a 25-year contract.

In addition to building Blue Stream, Gazprom plans to construct two more pipelines in the next ten years, one from Belarus via Poland and Slovakia, and the other from Sweden to Germany across the Baltic Sea seabed. The goal of these projects is to deliver Russian gas to European consumers bypassing Ukraine. (See "Gas Pipelines to Bypass Ukraine.") Up to 70% of Russia's overall volume of gas export currently flows via Ukraine. Gazprom chairman Rem Vyakhirev said at a press conference in late 2001: "Construction of a pipeline circumventing Ukraine is a vital necessity and a measure taken under circumstances." Those circumstances include Ukrainian consumers tapping gas from transit pipelines and not paying for it.

Vladimir Saprykin, director of energy programs at the Ukrainian Center of Economic and Political Studies named after A. Razumkov, told Russian Petroleum Investor: "Following the construction of Russian pipelines skirting Ukraine, we may annually fall short of receiving 76 billion cubic meters of [Russian] gas [that until now has been crossing Ukraine]." Saprykin co-authored the country's draft Energy Strategy for Up to 2030, which the Ukrainian government charged the Ministry of Fuel and Energy to draw up in late 2001 (it is currently under consideration in the ministry).

Underlying the draft is Kiev's intention to brace itself for a reduction in its share of Russian gas in the overall structure of pumping via Ukrainian pipes from 75% to 30%-35%. In the opinion of Kiev experts, the exit of Russian gas from Ukrainian pipelines will free up space for other producers' export and transit,

FORECAST OF GAS PRODUCTION IN CENTRAL ASIA, BLN CU M



Source: RPI Research

Gas Pipelines to Bypass Ukraine

Russia's Gazprom is set to maintain a 25% share of the European gas market over the next ten years. In the opinion of Russian experts, the implementation of the Blue Stream project will fully satisfy Turkey's natural gas requirements. Due for completion by the end of March 2002, the pipeline running along the Black Sea bed to Turkey is projected to have a design capacity of 16 billion cubic meters by 2008. It is supposed to supply 2 billion cubic meters of gas in 2002 and 4 billion cubic meters in 2003.

According to company board chairman Alexander Miller, who spoke at a summit of the Baltic Development Forum in St. Petersburg in the fall of 2001, construction of a Yamal-Western Europe gas line and also a North European gas pipe, which will link gas lines of the European Union and Russia, will also serve to boost Gazprom's export to Europe. The routes of both the projected export pipelines will circumvent Ukrainian territory.

The project of Russian gas transit from the Yamal field to West European countries targets building a connecting 600-kilometer gas line to link the Yamal-Western Europe gas pipe running across the territory of Belarus and Poland with a system of gas pipes that have an outlet to Slovakia from Ukrainian territory. An international consortium of Gazprom, Germany's Ruhrgas and Wintershall, France's Gaz de France, and Italy's SNAM was created in October 2000 to execute this project. Work is currently under way to define the sources of financing for the project and also hammer out the pipeline's route with Poland. It is supposed that almost 60 billion cubic meters of Yamal gas will be supplied under this project to Italy, Germany, and France.

Gazprom plans to get down to materializing the project to construct the North European gas pipe in 2006-07. The Baltic gas pipeline is supposed to run via Finland and onward to Germany along the Baltic Sea bed. Presently, the project is in the discussion stage. Work to draw up the project will involve Gazprom, Ruhrgas, and Wintershall as well as Fortum (Finland). The companies' representatives reached this accord in April 2001.

and output from the Caspian region may come as a replacement.

Caspian Gas Vital to Ukraine

Indeed, Ukraine is hatching grandiose plans for utilizing Caspian gas. The draft of the Energy Strategy envisions that gas supplies to Ukraine from Kazakhstan and Uzbekistan will initially be organized to flow via Russian pipelines. At the second stage, Kiev is set to begin importing gas from Turkmenistan, Azerbaijan, Iran, and Norway, bypassing Russian territory. At the third stage, Ukraine hopes to receive liquefied gas from the Caspian region.

Kiev needs Caspian gas for a variety of reasons. First, Russia plans to cut the amount of gas it sends across Ukrainian territory; part of that gas remained in Ukraine as a Russian payment for the transit. In addition, Ukraine projects gas consumption growth from 73.4 billion cubic meters in 2000 to 116.4 billion in 2030. Lastly, Ukraine plans to export gas. But Ukraine's own gas production will increase from 18 billion cubic meters in 2001 to 26 billion in 2030. Therefore, to meet the combination of domestic and export requirements, Ukraine needs sizable volumes of foreign gas. To lure them, Kiev is even prepared to transfer its gas pipelines under foreign company management as a guarantee of the cessation of gas pilfering. (See "New Round of Battle for Privatization.")

Gas shortage in Ukraine occurs simultaneously with gas surplus in Central Asia. Turkmenistan already has a contract to sell to Kiev 250 billion cubic meters of gas in the next five years. Kazakhstan's government predicts that in 2005 the country will be able to export about 10 billion cubic meters of gas and in 2015 upwards of 30 billion. The Karachaganak, Kashagan, and Tengiz fields, which are being developed by foreign investors Karachaganak Petroleum Operating Co., Agip KCO, and Tengizchevroil JV, will become a base for export. Annual gas export from Uzbekistan beyond the Caspian region in 2005-07 will amount to more than 12 billion cubic meters. These volumes will be produced by Russian companies Itera and LUKOIL, as well as Britain's Trinity Energy.

Uzakbai Karabalin, Kazakh deputy prime minister of energy and mineral resources, believes that the westbound route (via the existing Central Asia-Center pipeline) is the best direction for the export of Kazakh and Caspian gas in general. The pipeline's throughput capacity totals 67.5 billion cubic meters of gas per year. It is linked with Russian export gas pipelines running to Europe and can be sizably expanded. Projects to organize export of Central-Asian gas in other directions, for example to China, Afghanistan, and Turkey, calls for building new pipelines and are seriously complicated by financial and political risks. (See "Open-Pipe Policy?" *Russian Petroleum Investor*/January '02.)

Moscow Wants to Rule

The delivery of surplus Central Asian gas to Ukraine, which needs it, is possible only with the consent of Russia, which is located between much of the Caspian region and Europe. Moscow, which is eager to free itself of its transit dependence on Ukraine, is interested in establishing control over Caspian exports. The reason is that Caspian producers themselves and Ukraine want to trade gas in Europe, on markets where Gazprom has traditionally operated and from which it does not intend to depart.

It appears Moscow has come up with a formula to divide the European market with Caspian countries, and it is signing them up. In late November, Russia and Kazakhstan signed an agreement on cooperation in the gas sphere. It envisions cooperation in gas exploration and production and also the creation of a Russian-Kazakh parity joint venture for gas trade in third countries. Gazprom and Kazakhstan's national company Oil and Gas Transport, whose shares are 100% owned by the state, will become the JV partners. Russia and Turkmenistan plan a similar deal. The nature of these documents makes it clear that Moscow is willing to concede part of the market to Caspian nations in exchange for getting part of the profit from export.

Russia moves to strike such a compromise because the gas sector needs tens of billions of dollars to tap new gas reserves in the northern part of the country and to maintain export shipments to Europe at a level close to 200

New Round in Privatization Battle

For many years, Kiev has been hatching plans to set up an international consortium as operator of the Ukrainian export gas transport system (GTS). Speaking in Brussels in November, First Deputy Prime Minister Oleg Dubinin stated that Ukraine was prepared to "create on the basis of the Ukrainian GTS an autonomous network of pipelines that would operate as an international JV or an international consortium involving European gas companies." In his view, gas pipelines need to be turned over to foreign companies as concessions for 30 years.

Shell (UK/The Netherlands), which has been trying for years to secure Ukrainian International Gas Transit System (IGTS) as a concession, has sent its proposals on founding the consortium to the Ukrainian government, according to Les Lastoweckyi, head of the company's representative office in Kiev. "The essence of our proposed consortium concept is to bring together stakeholders that can secure sustainable long-term utilization and development of the system on a sound economic and commercial basis," he said.

In his view, the consortium will be responsible for investments in Ukraine's transport system throughout the entire concession period, and its members will earn revenue from payment for gas transportation. In the process, Lastoweckyi said, "The tariff policy will be a critical element. A balance will need to be found between the interests of those who pay tariffs, i.e. shippers, and those who will receive revenues from these tariffs either directly or indirectly, i.e. including the state through dependent tax receipts."

Presently, Ukrainian authorities are drawing up a concept of the GTS's development and effective management, using also proposals by Shell. However, not all Ukrainian experts, in selecting a form of the Ukrainian gas pipelines management, favor concession. Specialists at the Ukrainian Center of Economic and Political Studies named after A. Razumkov, for one, believe that privatization of the gas transport system is the most promising variant of attracting investors.

"We think that 50% plus one share in GTS should be kept with the state, and the remaining shares should be distributed in roughly equal amounts between Gazprom and a large European oil and gas company," said Vladimir Saprykin, director of the center's energy programs.

However, the issue of privatizing GTS or its transfer as concession cannot be solved without the consent of Verkhovnaya Rada, which opposes this process. For example, the draft law On the Specifics of Privatizing Ukraine's Gas Transport System Facilities, which was prepared by a group of deputies, has not been able to clear this supreme legislative body since September 2000. However, some Ukrainian experts link the current surge in the government's activity aimed at setting up a consortium to run gas pipelines with the forthcoming parliamentary elections in Ukraine, due in March 2002. In their view, the government hopes that a new Verkhovnaya Rada will vote to approve the draft law permitting the privatization of GTS.

billion cubic meters per year. The joint marketing of gas with Caspian countries absolves Russia of the need to make these investments, enabling it to honor export commitments with the aid of Central Asian raw material.

Caspian countries also stand to benefit from joint marketing, since the current schemes of cooperation with Russian companies are not seen as very advantageous. For example, Gazprom buys Kazakhstan's Karachaganak gas for slightly more than $10 per 1,000 cubic meters, Itera pays Uzbeks slightly more. Turkmenistan sells 1,000 cubic meters of gas to Gazprom for $36 but gets only half of that in hard currency, the remainder being in Russian goods.

Caspian countries will be able to raise export profitability when they start selling gas to end consumers in Ukraine and Europe rather than to Russian dealers. The founding of joint marketing enterprises involving state-controlled national companies offers this opportunity to Caspian governments. However, foreign investors producing gas in Central Asia will gain little from seeing such companies as TNG among the dealers. The point is that the dealers' profit will be larger, the cheaper they buy gas from producers.

Foreigners Eye Russian Allies

But, possibly, foreign companies may lower dependence on Russian-Caspian state dealers. To emulate Caspian governments, which are building alliances with state-controlled Gazprom, investors could cooperate with private Russian companies. First International Oil Co. (US) has already set up two collaborative E&P projects with Russia's Itera and Rosneft in Kazakhstan to gain an opportunity to export future output via Russian pipes.

During his tour of the country's major gas fields last November, Russian president Vladimir Putin reiterated his intention to spin off an independent pipeline company from Gazprom. Russian oil companies contemplating utilizing pipeline transport for gas sale are heavily lobbying for this decision. It is unlikely that Russians will eagerly share room in the pipe with foreign companies, but if they become parties to joint extraction projects, problems with transit via Russia will decrease considerably.

Significant in-depth changes are occurring today in the gas strategy of FSU countries. Russia, once it encountered the need for massive investments to tap its own new gas reserves, prefers to take part in reselling Caspian raw material. Ukraine, fearing to be left without gas due to a reduction in Russian transit, is prepared to turn over its pipelines to foreign companies, reducing marketing and transit risks of Caspian export. Caspian countries give preference to a compromise with Russia in utilizing state-owned pipelines over the construction of new pipes. These developments clearly show foreign companies that prospects for Caspian gas projects are tied most firmly with the Russian factor. ❑

New Kazakh Law on Investments Creates Equality By Stripping Foreigners of Privileges

Dis-Advantaged

By Ivan Grigoryev

Starting with the new year, foreign oil companies will need to watch carefully the plans and actions of their Kazakh peers. Changes in Kazakhstan's legislation enhance significantly the status of domestic players, while foreigners lose any advantages they previously enjoyed. Thus, Western investors would be wise to begin seeking partners among Kazakh companies—rather than compete with them.

This winter, Kazakhstan is scrapping legislation extending to foreign investors a more favorable regime for executing projects than has been available to national enterprises in recent years. The Law on Investments, which was due to be passed by parliament in December, should go into force in January. Its enactment automatically will annul the laws On Foreign Investments, dated December 27, 1994, On State Support of Direct Investments, dated February 28, 1997, and On Introducing Changes and Additions in Some Legislative Acts on Investment Issues, dated August 2, 1999.

All of those legislative acts had awarded varying concessions and privileges to foreign companies. The new law proclaims that the new rules of the game will be equal for both foreign and Kazakh investors. Rights are being equalized by stripping foreigners of privileges and extending new opportunities to Kazakhs. Establishing such a new order is one of the law's goals, which include maintaining the policy of attracting investments and upgrading the system of their state support.

But foreign companies do not believe the Kazakh innovations improve the investment climate and they discern a threat to their contracts. Last July, when the draft law came up for consideration by the Kazakh government, it drew sharp protests from investors. Members of the Kazakhstan Petroleum Association, a grouping of foreign petroleum companies, objected to revoking privileges enjoyed by investors. However, the government ignored the protests, and Astana's decision clearly signals that strategic changes have occurred in its investment policy.

Law Empowers Government

Modifications in legislation enacted by the Law on Investments were bred by Kazakhstan's striving to create a legal foundation for the government to exert greater influence on investors. For example, foreign companies annually burn 3 billion out of 12 billion cubic meters of the produced associated gas. Among them are international Tengizchevroil JV, Hurricane Kumkol Munai (a joint-stock company based on Yuzhneftegaz, which was bought by Canada's Hurricane in the mid-1990s), Aktobemunaigaz (bought by China National Petroleum Corp.), and Mangistaumunaigaz (acquired by Indonesia's Central Asian Petroleum, linked with Russian capital).

New Rights for Kazakh Investors

Kazakh investors have obtained from the government guarantees previously envisioned only for foreign companies. The Law on Investments awards to Kazakhs guarantees of compensation in the event of nationalization and requisition of property and also guarantees of the free use of revenues. The government guarantees to investors protection against unlawful actions by state bodies and officials. All investors, regardless of nationality, now have the right to compensation and reimbursement for losses incurred as a result of unlawful actions by authorities.

Under the new law, normative legal acts affecting investor interests should be published. Thanks to this, investors will be guaranteed the necessary information tenable them to ward off illegitimate actions by state officials. The law declares that audits carried out by state bodies, as well as their control and supervision over investors' activity, should be conducted only under the procedure and within the time span set by Kazakhstan's legislation. The right to carry out audits and exercise control and supervision over an investor's activity can be enjoyed only by those state bodies to which this right was granted by legislative acts.

CHANGES IN THE OPERATING REGIME OF FOREIGN AND KAZAKH INVESTORS

Foreign investors:	Kazakh investors:
Lost guarantees of the tax regime stability.	Received guarantees of compensation in the event of nationalization and requisition.
Opportunities to turn to arbitration court became limited	Opportunities for investments were extended.
State agencies' control was tightened.	State agencies' control was reduced.

Source: Government of Kazakhstan

It is more profitable for companies to burn the gas than for them to invest sizable funds in constructing gas utilization facilities. Under past legislation, expenses of burning gas were included in the working capital and regarded as part of the investments. Investors could spend as much as they wished on burning gas, presenting these expenditures as investments that should be paid back and taken into account when engaged in production or profit sharing.

The Kazakh government has been persuading investors for several years without particular success to build gas utilization facilities, but it now has found a way to shore up its demands. The Law on Investments withdraws working capital from the investments notion, and these expenses are no longer qualify as reimbursable. The same law envisions awarding tax breaks to projects involving raw material processing, creation of new production capacities, and workplaces. Projects targeting gas processing are attributed to this type of projects and may claim privileges. (See "Preferences for Additional Investments.")

Dispute Resolution Narrows

But the government looks in broader terms at tackling the task of boosting state leverage on investors than simply initiating gas utilization projects. The new law narrows the notion of "investment disputes," which previously has implied all investor conflicts with Kazakh entities at any level and involving any form of ownership from natural monopolies to commercial banks. Investors could appeal actions in international court. This prospect seriously hindered Kazakh bosses from forcing foreign investors to play by their rules, for example, in the late-1990s war between Hurricane Kumkol Munai and the Shymkent oil refinery over the terms of processing.

But now the foreign companies' protection is undercut by the fact that only conflicts associated with the parties' contractual obligations will qualify as "investment disputes." Only these conflicts come under the jurisdiction of international courts. Disputes that go beyond the contract framework will be considered exclusively in accordance with Kazakh legislation. Foreign companies face the task of shaping their strategy in the country in line basically with the Kazakh political policies rather than the world standards of doing business.

No Guarantees for Newcomers

For investors already operating in Kazakhstan, the need to adapt to the new legal climate is still limited by the guarantees of the stability of the terms of their contracts—the so-called grandfather clause. Foreign companies that launch investments after the enactment of the new law do not have these guarantees and their deals could be dramatically altered over time.

The Law on Investments abrogates the grandfather clause contained in article 6 of the Law on Foreign Investments. It provided to companies guarantees of invariability of the contract terms irrespective of changes in national legislation and international treaties. The new law does not contain this norm. One of the draft law authors told *Russian Petroleum Investor*: "We gave up this norm since its extension to all investors will entail great losses for the budget in future. And providing guarantees only to foreign companies is unfair with regard to Kazakh firms."

Still, the absence of a grandfather provision under Kazakh law means contract terms of foreigners' deals can be revised negatively. The government's policy in the last three-four years was aimed at expanding subsoil users' obligations, and since the latter half of the 1990s also at toughening the tax regime. The size of the overall tax burden in the rose from 60% to 75% between the mid-1990s and the present. The danger of tightening the tax regime dramatically increases risks, for example those of E&P projects to develop the Caspian Sea shelf (with its hypothetical reserves of 12 billion tons of oil equivalent), which is today the most promising from the point of view of geology in Kazakhstan.

The estimated cost of offshore projects in Kazakhstan varies from close to $1 billion to upwards of $20 billion as in the case of the Agip KCO project (formerly known as the Offshore Kazakhstan International Operating Co., or OKIOC). Such undertakings have high cost-output ratios and geological risks since exploration efforts on Azerbaijan's Caspian Sea shelf in the last four years often discovered much less reserves than anticipated. So investors face geological risks, the potential for exploration disappointments, and higher taxes—all decidedly discouraging factors.

Members of Agip KCO demanded ahead of the project's 1998 start-up that the Kazakh government include guarantees of tax stability in the contract terms. Otherwise, the consortium companies threatened to reject it altogether. Now investors will not have legal grounds to seek guarantees of the stability of the tax regime even for the most risky projects.

Foreigners Hang Back on Bids

Foreign companies are already displaying caution in the changing climate that Astana is creating for developing its Caspian shelf. Not one application was filed in two tenders for tapping the untested Karazhanbas-more and Darkhan offshore structures in 2001. And there is no joy in the new Law on Investments for foreign investors in E&P projects. Meanwhile, hypothetical hydrocarbon reserves, which such projects could develop, make up 90% of the total volume, according to the US Department of Energy.

At first glance, Astana appears to be toughening its terms to scare off new foreign investors. But it seems the government is rather changing priorities. Authorities are re-orienting to national capital, which is more customary to the Kazakh system of government. The Law on Investments awards to national investors a whole set of rights, which previously they were denied. (See "New Rights for Kazakh Investors.") While the regime if being toughened for foreign investors, it becomes more favorable for national investors. (See table.)

Kazakh companies perceive such changes as a signal to more energetically use the accumulated financial and political capital. Speaking at the KIOGE-2001 international investment conference in October, Nurlan Balgimbayev, head of the Kazakh national oil company KazakhOil, proposed to the government that his company be made the operator of all offshore projects. National company Oil and Gas Transport (TNG) is hatching plans to organize not only transport but also upstream projects. The current management of KazakhOil and TNG includes close relatives of the country's president, Nursultan Nazarbayev, and the companies' profits in the last several years have been steadily high and keep growing.

Preferences for Additional Investments

The Law on Investments seeks to force foreign investors to meet Kazakh expectations by deploying both the carrot and the stick. The government has long demanded that oil investors engage not just in exploration and production but also hydrocarbons processing and waste utilization. In the new law, Astana makes clear that it is ready to spur investor interest in projects in addition to their E&P schemes.

The document declares that "the goal of state support through granting investment preferences is to stimulate investments in the creation of new production units, expansion and upgrade of existing such facilities on the basis of advanced technologies, in efforts to create new and keep the existing workplaces, and also environmental protection." This means that the government will not award preferences for exploration and extraction but will grant them, for example, to projects focusing on gas utilization, processing of industrial waste, and cleanup of contaminated territory.

Two types of investment preferences are envisioned: tax breaks and grants in kind. The first provides an exemption from payment of the property tax for a term of up to five years and a reduction in some other payments to the budget, depending on the size of investments in fixed assets of the Republic of Kazakhstan's legal entities. In the opinion of the law's authors, specifying the investors' status should prod them towards registration in Kazakhstan rather than in offshore zones. State grants in kind signify extending to investors gratis ownership rights to some assets (land, buildings, equipment), which are necessary for execution of an investment project.

Previous legislation stipulated that the list of production units of particular importance, to which investment preferences may be extended, is endorsed by an authorized state agency as presented by the Investment Committee of the Republic of Kazakhstan's Foreign Ministry. The new law passes the function of endorsing the list of the priority types of activity to the Kazakh government. This means that all ministries and agencies interested in securing privileges for projects in industries that they oversee will be involved in defining sectors of paramount importance. This system offers investors an opportunity to use Kazakh agencies as lobbyists to secure privileges for their projects.

The government will endorse maximum volumes of investments and the time frame during which the extended tax preferences will be valid for each priority type of activity. If the established maximum volume of investments is surpassed, the validity terms of the applicable tax preferences are defined by a special decision of the government. The law does not set the minimum size of investments, which will allow both large and small investors, with Kazakh entrepreneurs most frequently representing the latter, to apply for preferences.

The new Law on Investments signals to foreign companies that they should seek alliances with Kazakh oil enterprises in order to enter the Kazakh hydrocarbons business. The Kazakh companies will be able to better protect the common interests of their partners in projects than lawyers in Kazakh courts, and it will be easier for them to win concessions from the government. The only problem is only that, in Kazakhstan as occurred earlier in Russia, the evolving investment policy aims to turn foreign investors into junior partners of national companies. ❑

An Analysis of the Changes Introduced by Kazakhstan's New Tax Code

Taxing Times

By Ian P. Slater

This article discusses the most significant changes introduced by Kazakhstan's new Tax Code. The new Tax Code comes into effect beginning January 1 and replaces the current Tax Code from this date. Some specific beneficial provisions of the current Tax Code, however, will remain effective until later dates (these are listed in the last section of this article).

Corporate Income Tax

Deductibility of Interest

Further limits on deductibility of interest on loans from non-residents will be introduced in addition to the currently established threshold, which is 1.5 times the refinancing rate of the National Bank (for loans in tenge) or two times LIBOR (for loans in foreign currencies). The additional cap will limit the deductible interest payable to non-residents to the amount of interest multiplied by the withholding tax rate on interest (arguably 15%) and divided by the corporate income tax rate (30%). The same procedure will also apply to interest on property held in trust, financial lease, discount or premium on bonds, and interest on bank deposits.

Depreciation

Some changes are also made with respect to the tax depreciation deduction. Application of double tax depreciation rates (currently applicable to new machinery and equipment) will be extended to any fixed assets put into operation for the first time. However, losses resulting from deduction of tax depreciation expense at double rates may not be carried forward. Finally, the new Tax Code does not provide for revaluation of fixed assets, which means that, beginning January 1, 2002, it will no longer be possible to reevaluate fixed assets for tax purposes.

Exchange Rate Gains

Exchange rate gains will now be taxable. Accordingly, exchange rate losses will be deductible, but may not exceed exchange rate gains received in the same period plus 50% of taxable income. For this purpose, the amount of taxable income will exclude the exchange rate gain and loss. Non-deductible excess is carried forward subject to *(i)* the above limit, i.e., the amount of the exchange rate gain received plus 50% of taxable income, and *(ii)* the statute of limitations, which is five years. Exchange rate loss on construction-related loans arising during construction must be capitalized.

The required recognition term for income from doubtful liabilities and deduction on doubtful claims will be increased from two to three years. Claims resulting from sales to non-residents, which have permanent establishments in Kazakhstan, will now also be treated as doubtful whereas under the current Tax Code they are not.

In terms of labor-related costs, no limit will be imposed on the deduction of temporary disability and maternity leave allowance-related costs. Currently these deductions are limited to 1.5% of gross payroll fund for the reporting period. The transportation and accommodation expenses related to business trips will be deducted in the amounts actually incurred, while currently there are certain limits. Deductible per diems for business trips within Kazakhstan will be increased from half of a monthly calculation index (or

Some changes are also made with respect to the tax depreciation deduction. Application of double tax depreciation rates (currently applicable to new machinery and equipment) will be extended to any fixed assets put into operation for the first time.

Ian Slater is a partner with the Central Asia Tax Services division of Andersen (formerly known as Arthur Andersen) in Almaty.

$2.60) to two monthly calculation indices (or $11).

Even though this still does not reflect the reality, it represents a substantial increase. Limitations for deductible per diems for business trips outside Kazakhstan are currently, and will be under the new code, established by a separate resolution of the government. Currently, they vary from $30 to $70 depending on the country, and are expected to be the same under the new Tax Code unless the government's resolution changes.

Apparently, limits will be established for deductible insurance expenses (currently, there are no such limits; insurance expenses are deductible as actually incurred, except expenses on the accrual type of insurance).

Capital gains or losses from sale of shares and bonds listed at the exchange in categories A and B will be excluded from taxable income. This will replace the similar exclusion provision related to the sale of shares in open joint stock companies.

International Taxation

Kazakhstani Source Income

The definition of Kazakhstani source income will change in the new Tax Code. One of the most important changes is that income from certain types of services provided outside Kazakhstan to a Kazakhstani resident or a permanent establishment of a non-resident will be deemed Kazakhstani-source income, whether or not a corresponding corporate income tax deduction is claimed by a Kazakhstani payor of such income. Such services include management, marketing, financial, consulting, audit, legal services and others.

For withholding tax rates, income from insurance premiums will be taxed at 10% and reinsurance premiums will be subject to withholding tax at 5%, whereas the 5% rate currently applies to both.

Taxation of Foreign Entities' Permanent Establishments

The definition of a permanent establishment of a foreign legal entity will be expanded. Furthermore, deduction of general and administrative costs incurred outside Kazakhstan will be disallowed for permanent establishments of non-resident legal entities, unless protected by a double-tax treaty.

Simplified procedures of obtaining treaty relief will be introduced for:

Income from certain types of services provided outside Kazakhstan to a Kazakhstani resident or a permanent establishment of a non-resident will be deemed Kazakhstani-source income.

- foreign legal entities entitled under the double-tax treaty to reduced rates of withholding tax on passive income (dividends, interest and royalties). This applies to foreign legal entities without a permanent establishment in Kazakhstan or where such passive income is not attributable to a permanent establishment;
- reduction of the branch profit tax rate according to the double-tax treaty for legal entities operating through a permanent establishment; and
- foreign legal entities operating in Kazakhstan through a permanent establishment entitled to income tax exemption on international transportation services under the double tax treaty.

It is unclear whether the same simplified procedures will apply to income from other services performed outside of Kazakhstan or if a treaty claim will need to be filed in order to apply a treaty exemption. A withholding tax deposit will be introduced for double-tax treaty clearance for foreign legal entities, the Kazakhstani activities of which do not rise to the level of a permanent establishment. Finally, the new Tax Code explicitly provides against treaty shopping.

Subsurface Users

General

There are two tax regime models available to subsurface users in the Republic of Kazakhstan. These are the Production Sharing Agreement (PSA) model and the non-PSA model. Under the PSA tax regime model, the subsurface user is liable for paying the share of production to the Republic of Kazakhstan and only a specific range of taxes. The non-PSA model assumes payment of all taxes and levies established by tax legislation. In general, the current Tax Code provides that the level of total tax liabilities must be the same, regardless of which of the two tax regime models is used. Based on the new Tax Code, it would be logical to assume that the overall tax burden pertaining to the PSA model may be greater than the tax burden under the non-PSA model.

The new Tax Code provides a list of recoverable and non-recoverable costs for the purpose of PSAs that will be newly concluded. In general, recoverable costs are defined as justified expenses of a subsurface user, actually incurred during the execution of the relevant work program.

In addition, the new Tax Code provides for a list of provisions that must be included in a subsurface-use contract. Furthermore, it outlines specific terms of a PSA, including the total production subject to sharing, the proportion of production to be used for cost recovery, the subsurface user and the republic's shares.

Tax Stability
Under Article 179.4 of the current Tax Code, stability of the tax regimes in subsurface use contracts is guaranteed for the following contracts:

- those made prior to January 1, 1996;
- those made after January 1, 1996, as an extension of contracts previously concluded;
- those made after January 1, 1996, which have undergone the obligatory tax examination.

The new Tax Code, however, contains no equivalent of Article 179.4. Instead, it provides for the following:

- if changes to the tax legislation are made, the tax terms established in a subsurface use contract may be amended upon mutual agreement of the parties;
- if changes to the tax legislation benefit a subsurface user, tax terms of the subsurface use contract will be amended to restore the original economic interests of the Republic of Kazakhstan.

Thus, there will be a lot more uncertainty surrounding the tax stability issue for subsurface users with the introduction of the new Tax Code. This may make it possible for the Kazakhstani government to believe that it can start renegotiation of the existing contracts if there are favorable changes in taxes. Moreover, unlike the current tax legislation, the new Tax Code makes it clear that if the Republic of Kazakhstan repeals a tax or a levy stipulated by the contract, the subsurface user must continue paying such tax or levy in line with the contract until the contract's applicable tax terms are revised.

Ring Fencing
Generally, the new Tax Code provides for the same ring fencing[1] rules for subsurface users carrying out business under more than one contract. In other words, similar to the current legislation, the new Tax Code will treat each subsurface use project as a separate taxpayer, therefore disallowing deductibility of costs incurred under one contract from revenues earned on another.

There are two tax regime models available to subsurface users in the Republic of Kazakhstan. These are the Production Sharing Agreement (PSA) model and the non-PSA model.

Value Added Tax (VAT)

The Kazakhstani VAT system will shift from "territorial principle" to "place of supply" principle. This means that the "VAT-ability" of a particular supply will be decided based on place of supply criteria somewhat similar to those in the EU 6th Directive. Currently, VAT is charged on goods/services physically sold/carried out in Kazakhstan.

Under the new Tax Code the place of supply for goods is defined as:

- the place where transportation commences if goods are transported or mailed;
- otherwise, the place where goods are transferred to the purchaser. The new Tax Code is unclear whether this involves a physical transfer or a transfer of rights or anything else.

For services the place of supply will be:

- the place where immovable property is located for services directly related to such property;
- the place where services are actually carried out for services related to movable property;
- the place of business or any other activity of the customer for: transfer of rights to use intellectual property, consulting services, audit services, engineering services, legal services, accounting services, attorney services, advertising services, data processing services, rent of movable property (except for rent of transport vehicles by transportation companies), supply of personnel, communication services, and similar services;
- otherwise, the place of business or any other activity of the service provider.

Auxiliary sale of goods or services will be deemed to take place wherever the underlying sale takes place. However, no definition of auxiliary sales exists.

The date of supply for VAT purposes will be explicitly defined in the new Tax Code. For goods, the date of supply will be the date of dispatch in cases where goods are shipped, or the date of transfer of ownership title to the purchaser if goods are not shipped. For services, the date of supply will be determined as the earlier of the dates—when services are rendered or when an invoice is issued. For services performed continuously, the date of supply will be the earlier of the dates—when an invoice is issued or when a payment (including advance payments) is received.

VAT Registration
Separate VAT registration will be introduced (currently no such registration is required). VAT registration must be sought once the minimum taxable turnover threshold is exceeded within a twelve-month period. The minimum threshold is 10,000 times the monthly calculation index, which sum currently equals approximately

$51,840. Taxpayers registered before 2002, which exceed the established threshold, will have to obtain a separate VAT registration by February 1, 2002. Even if the minimum threshold is not exceeded, a taxpayer may voluntarily apply for VAT registration to be able to offset input VAT.

The new Tax Code clarifies that the transfer of rights to intellectual property constitutes turnover on sale of services.

The new Tax Code changes the term for reducing output or input VAT on doubtful claims and obligations from two to three years.

The new Tax Code envisages that, in order for the taxpayer producing zero-rated supplies to be entitled to a refund of the entire excess VAT credits, such taxpayer must not only have zero-rated supplies accounting for 70% or more of the total supplies, but must also make zero-rated supplies regularly (constantly). However, the new Code establishes no criteria of regularity (constancy).

The new Tax Code specifies that only sale and rent of residential buildings (except first sale, rent of hotel buildings and hotel rooms) will be exempt from VAT. Under the current Code rent and sales of any buildings (except first sale and hotel rooms) are exempt.

The new Tax Code specifies that capital payments under financial lease are not exempt from VAT; only interest payments are exempt.

The terms for payment of VAT (including reverse-charge VAT) and VAT filings will change under the new Tax Code.

Property Tax

It will now be legislated that the tenant (under rent arrangements other than financial lease) may pay the property tax on rented property, subject to the agreement between the tenant and the owner of the property. The tax so paid, however, is treated as income of the owner of the property. In practice such arrangements were used previously as well if it was convenient for the parties, however, they are for the first time stipulated in the law. The same applies to property held in trust management.

The lessor remains the payer of property tax on property under financial lease.

Land Tax

The land tax rate for aerodromes located within inhabited areas will be lower than currently. For this the new Code defines an aerodrome as a land plot specifically designed for take-off, landing, taxiing, parking and servicing aircraft; however, this specifically does not include airport buildings.

Tax Audits and Tax Fines

The new Tax Code defines the different types of tax audits and the purpose of each type of audit. Some of these definitions are inherited from the existing internal instruction of the tax authorities.

The new Tax Code establishes the same general rules for the frequency of tax audits as currently established:

- general audits (i.e., covering all taxes and levies) may not be conducted more than once a year;
- special audits (i.e., covering one tax or levy) may not be conducted more than once in six months for the same tax or levy.

However, under the new Tax Code, in certain circumstances tax audits may be performed any time. Such special circumstances include VAT audits in connection with the VAT refunds to producers of zero-rated supplies, counter audits, liquidation or reorganization audits, a specific order of the Ministry of State Revenues in respect of a taxpayer, and others.

The new Tax Code also provides for time limitations for tax audits; normally a tax audit may not last for more than 30 business days, with certain exceptions. The current Tax Code does not contain such details, although in practice the tax authorities usually followed the same time frames.

The date of supply for VAT purposes will be explicitly defined in the new Tax Code. For goods, the date of supply will be the date of dispatch in cases where goods are shipped, or the date of transfer of ownership title to the purchaser if goods are not shipped.

More detailed rules for conducting tax audits are set forth in the new Tax Code, for example: when tax payment notification must be sent to the taxpayer; how the act of the tax audit should be formulated; and the points of the tax audit's start and finish.

Appeals

Under the new Tax Code, appeals against the results of tax audits will be filed with the tax authority immediately superior to the tax body that performed the audit. In case of a negative response, the appeal may be filed with the Ministry of State Revenue. Under the new Tax Code, a taxpayer may also appeal to the court immediately after the tax audit without waiting for results of an administrative appeal. The time frames for filing an appeal and consideration of the appeal by the tax authorities are increased in the new Tax Code. Under the new Tax

Code, a taxpayer will have the right to file the appeal against the tax audit results within ten working days after receipt of the notification, instead of the current five. Under the new Tax Code, the tax authorities will have fifteen working days for consideration of an appeal, instead of the ten currently allowed.

Impounding Bank Accounts

Under the current Tax Code, the tax authorities have the right to collect the amount assessed as a result of a tax audit from a taxpayer's bank account if said taxpayer did not receive a positive decision on his administrative appeal or did not appeal to the court within 30 days after notification. According to the new Tax Code, the tax authorities cannot collect the amount assessed as a result of the tax audit while the taxpayer is appealing against the assessment, either to the tax authorities or to the court.

The new Tax Code does not contain provisions related to tax fines. Tax fines will be levied in accordance with the Administrative Code.

Investment Incentives

Beginning 2002, the property tax, land tax and corporate income tax exemptions for investors operating in the priority sectors of the Kazakhstani economy under contracts with the government will be replaced by what is referred to as an "investment tax preference." Investment tax preferences may be granted in the form of additional corporate income tax deductions on fixed assets, which have been newly put into operation under an investment project, and exemptions from property tax on such fixed assets. Issues pertaining to these preferences will be governed by the new Tax Code and the new Law "On State Support and Protection of Investments" (which is also expected to come into force beginning January 1, 2002, and is currently available only in draft).

The Law "On State Support and Protection of Investments" is expected to replace the current Laws "On Foreign Investments" and "On State Support to Direct Investments." According to this new, draft Law, in addition to tax preferences, customs preference may be granted to the investors in the form of exemption from customs duties of certain imports. In addition, state grants may be given to Kazakhstani legal entities in the form of transferring state property to such legal entities.

Investment tax preferences may be granted in the form of additional corporate income tax deductions on fixed assets, which have been newly put into operation under an investment project, and exemptions from property tax on such fixed assets.

Transitional Provisions

The offset regime of paying import VAT on goods included in the special list will remain effective until January 1, 2003. This offset regime allows non-payment of import VAT at customs, and its declaration as both output and input VAT in the VAT declaration (Paragraph 2 of Article 71-1 of the current Tax Code).

Extension of the deadlines for paying certain taxes, fines and interest granted to companies engaged in machine building, textiles, sewing, leather-processing and foot-wear industries, rubber and plastic manufacturing or in the chemical industry as of July 30, 1999, is effective until January 1, 2003. The same applies to extensions granted to certain agricultural producers as of January 1, 2000 (Paragraphs 9 and 10 of Article 179 of the current Tax Code).

Exemption of certain interest incomes from income tax granted to banks will be effective until January 1, 2004 (Subparagraph (7) of Paragraph 1 of Article 34 of the current Tax Code).

The general rule is that payments received by the tax authorities are allocated first to cover any interest, second any penalties, and only last the principal amount of tax. However, as a privilege for taxpayers, the government had previously permitted any payments received to be allocated first to the principal tax liability. This will remain effective until January 1, 2004 (Article 153 of the current Tax Code and Article 33 of the new Tax Code).

The special tax regime with regard to direct taxes granted to producers of excisable goods under contracts made before January 1, 1994, will remain in force until January 1, 2007 (Paragraph 4-1 of Article 179 of the current Tax Code).

[1]Ring fencing mechanisms usually take the form of requirements by governments of transitional economies to prevent operators of newly privatized utilities from cooperating in anti-competitive practices. ❑

Russia's Largest Oil Company, LUKOIL Strives to Continue Setting the Industry Pace

Front Runner

Russia's largest integrated oil company LUKOIL celebrated its tenth anniversary on November 25. In an exclusive interview, Russian Petroleum Investor *talks with LUKOIL president Vagit Alekperov about his company and its industry. His views provide a glimpse of the way the elite of the Russian oil industry thinks and the goals the national industry leaders pursue.*

Russian Petroleum Investor: *LUKOIL company turned ten on November 25. What can you say about the path trod by the company over this period? What are the main achievements? What is to be done?*

Vagit Alekperov: The 10th anniversary of our company marks ten years of the drive to reform the Russian oil industry, because in that distant year of 1991 the government signed an ordinance to found a concern on the basis of Western Siberia's three producing enterprises Langepas-Urai-Kogalym [hence, the acronym LUK]. This laid the foundation for breaking down the monopoly on the production of oil, its processing, and the sale of refined products on the territory of the Soviet Union, not yet the Russian Federation [at that time]. Since then, the industry began to undergo reform, operating in the competitive environment and having gone through several critical moments.

But today one may state that the Russian oil industry has adapted itself to the market, it operates for the consumer, and oil companies are in stiff competition among themselves on the Russian Federation territory. Now, the first steps have been taken to build on the basis of Russian majors the first large international oil companies, which are successfully operating also beyond the Russian Federation. Over ten years, we scored an all-important achievement: we broke down the oil industry monopoly and created the vertically integrated company LUKOIL that currently pursues the sole goal of earning solid profit along the entire vertical line. Our shares are quoted on international stock exchanges. We put together a unique team of specialists who find virtually any kind of operations within the framework of our vertical line within their capabilities.

What have we failed to accomplish? Unfortunately, we failed to build oil and gas companies on the basis of petroleum companies. We all but failed over these ten years to enter the gas business: both in marketing our associated gas and in the natural gas business. I believe that in the next ten years our company will become a major oil and gas entity in whose structure gas will account for 25%-30%. To achieve this goal, we need a law on equitable opportunities in gas transportation, an explicit policy of liberalizing the gas market.

I think that in the next ten years Russian oil companies will be built proceeding from both the structure of their reserves and the operations' organizational system. They will come to be similar to all companies in the world. Oil cannot be separated from gas.

Equal Partners

Russian Petroleum Investor: *LUKOIL was the first to start operating jointly with foreign partners in Russia, attracting foreign investments. What is the company's current strategy towards foreign partners? What do you think—do Western operators have a future in Russia?*

Alekperov: Certainly, we have become equal. The territory of Russia, the laws of Russia are equal to all. If earlier some exceptions were made, which concerned tenders for the right to obtain a license for developing fields, now, with a transition to an auction system, absolutely all are equal. In the current period of the oil industry's development, oil fields are located as a rule either in hard-to-access places, which are remote from communications facilities, or in deep sea waters. This requires great risks both financial—for geological-exploration activities—and other regional, technical, and geological; therefore, these risks need to be spread among ourselves. We have good experience of work in consortia on Azerbaijan's territory, on the Caspian shelf. And we would certainly want to use this experience on the territory of the Russian Federation. We favor pooling efforts in our work with both Western and Russian partners.

Here is a specific example. After LUKOIL identified structures productive in hydrocarbons in the Russian part of the Caspian, we did not move to have a license issued only for ourselves. Our company came up with an initiative to

LUKOIL at a Glance

LUKOIL is Russia's largest oil company, founded as a state concern in 1991 and as an open joint-stock company in 1993 based on a score of the country's oil industry enterprises that were undergoing privatization. The company developed rapidly, consolidating separate assets. This process was accompanied with a growth in output volumes, expansion in the resource and marketing base, diversification and globalization of business, and an improvement in corporate standards.

According to the results of the evaluation by independent company Miller & Lents (US), the company's proven oil reserves as of January 1, 2001, totaled 2 billion tons, which makes up nearly 1% of the world's total proven reserves. Proven natural gas reserves reached 100 billion cubic meters. The company is in the top spot in the world among joint-stock companies by proven oil reserves and is in fourth place in the world by proven oil and gas reserves.

In 2000, the company produced 77.7 million tons of oil (2% of the world's total production) and 2 billion cubic meters of natural gas. Oil production on Russian territory stood at 75.6 billion tons; in FSU and non-FSU countries, 2.1 million tons. In 2000, oil production soared by 2.1 %, gas output gained by over 6%.

Oil refining (with account of processing at refineries not owned by LUKOIL) surpassed 45 million tons.

LUKOIL provides over 23% of Russia's total oil production and export, more than 14% of oil refining, and is the largest supplier of various grades of fuel.

LUKOIL owns basically capital-intensive production units and finances large-scale investment projects. Ambitious programs—to tap oil and gas resources of the Timan-Pechora province, the Northern Caspian, and Yamal, develop petrochemical complexes, modernize processing plants, and create a powerful tanker fleet—are in the preparation or implementation stage. The company's investments in 2001-10 are estimated at almost $30 billion.

The figure for the company's total reserves includes ongoing foreign projects (Azerbaijan, Kazakhstan, Egypt) without factoring in data on the Northern Caspian (the Russian part). The relatively proven reserves of the West Qurna field in Iraq total 2.4 barrels of oil; however, considering the United Nations sanctions against the Republic of Iraq and uncertainty over the intention to lift them, these reserves are not included in the total figure of the company's reserves.

Western Siberia, where upwards of 60% of LUKOIL's reserves are concentrated, remains the main resource region for the company. The share of reserves in the European region (one-third of the company's total proven reserves) has increased significantly, due to the acquisition of large regional companies KomiTEK and Arkhangelskgeoldobycha, which possess considerable volumes of untapped reserves.

Since traditional oil and gas provinces of Western Siberia and the Privolzhsky region have become depleted, the problem of bringing into production new oil and gas fields is very acute. The Timan-Pechora oil- and gas-bearing province (the north of European Russia) is one of the most hydrocarbon-productive among those areas recently discovered. The proven reserves alone of this region's 190 hydrocarbon fields total close to 2 billion tons.

The Northern Territories project, involving apart from LUKOIL also its Arkhangelskgeoldobycha subsidiary and Conoco (US), is one of the largest developments in Timan-Pechora. This project was included in the law on the list of fields and subsoil blocks eligible for development at production-sharing terms.

In the opinion of LUKOIL president Vagit Alekperov, Timan-Pechora oil will begin to be supplied to the American market in 2005-06. While implementing this project in 2001, the company mastered the technology of the year-round lifting of oil from an arctic terminal in the Varandei village (the Nenets Autonomous District) on the Pechora Sea coast. The company's immediate plans include completion of construction of a reloading terminal in the area of Murmansk, where large-tonnage tankers will pick up oil from LUKOIL's ice-resistant tanker fleet.

At present, LUKOIL has its own fleet of over 120 purpose-built ships, including ten ice-resistant tankers to move out oil from the arctic coast. The overall cargo-lifting capacity of the company's fleet is over 1 million tons.

Another promising oil and gas province is the Caspian region. The drilling of the first exploratory well in the Khvalynskaya structure of the Severny licensed block in the Russian part of the Caspian Sea was wrapped up in

March 2000. Drilling to a depth of 4.2 kilometers identified seven oil- and gas-bearing formations. The recoverable reserves of the Severny block are estimated at nearly 450 million tons of hydrocarbons.

The role of LUKOIL's foreign resource base (5% of the company's total proved reserves), whose core fields are concentrated in Azerbaijan and Kazakhstan, is increasing.

Refining and Marketing

Over ten years of operations, LUKOIL's primary oil refining (with account of processing at refineries not owned by LUKOIL) more than doubled from 20.6 million tons in 1991 to 45 million tons in 2000. In 2000, the company processed at its own refineries in Russia 23.2 million tons, including 8.5 million tons at the Volgograd refinery, 11.1 million tons at the Perm refinery, and 3.6 million tons at the Ukhta plant. Under agreements on processing at refineries not owned by LUKOIL in Russia, the company refined 13 million tons of crude.

In 1998-99, LUKOIL took the lead position in the oil-refining sector of southeastern Europe. It acquired three foreign refineries: PETROTEL in Romania (capacity: 4.7 million tons per year), Neftokhim Burgas in Bulgaria (10.5 million tons), and the Odessa refinery in Ukraine (3.9 million tons). In 2000, the company processed 9 million tons of oil at foreign refineries.

With the purchase of these oil refineries, LUKOIL has created the largest oil base for the supply of oil products in the Black Sea region and is gradually developing a service station network there. Analysts at the company reckon there will be oil surplus in this region shortly. Russian export will be complemented with huge oil flows from Kazakhstan and Azerbaijan, and the problem of passing through the Black Sea straits will inevitably be exacerbated. Proceeding from this prospect, LUKOIL decided to structure its strategy to deploy oil inside the Black Sea region and export only refined products, whose passage through the straits is not restricted.

The company is carrying out a strategic plan for developing the oil products retail network. In the period up to 2005, LUKOIL will build 620 new gasoline stations and upgrade 280 such retail outlets on Russian territory.

In November 2000, LUKOIL and Getty Petroleum Marketing Inc. (US) signed an agreement on the stage-by-stage acquisition of 100% of shares in this American company, worth a total of $71 million. As a result of this deal, LUKOIL bought 1,260 gasoline stations in thirteen US states.

set up a Russian consortium. We shared our information with our colleagues, YUKOS and Gazprom. This was how the first Russian consortium, Caspian Oil Co. [KNK], in which our company holds an equal number of votes with partners, was founded.

Our cooperation with the American company Conoco today makes great strides. There were problems as well, because functions of those who will deal with PSAs [production-sharing agreements] were not ironed out in the government. But today we are actively working with American partners. By the way, they officially warned us about the upcoming merger with Philips Petroleum, provided all information. In so doing, they stated that this action would not affect in any way our joint project Northern Territories and that Conoco is not only interested in this project but also in expediting it. Therefore, as part of our project, we are now focusing on a variant to put onstream one of the fields covered by Northern Territories as an outstripping pilot development. We adhere to the view that international consortia today need to be formed at large fields.

King of the Hill

Russian Petroleum Investor: *Until recently, LUKOIL was the leader of the Russian oil sector on the stock market. However, recently first Surgutneftegaz and then YUKOS outpaced the company by market capitalization figures. What is your attitude to the possibility that LUKOIL may lose the lead position among Russian oil companies and the latter become more attractive in market terms?*

Alekperov: The question is interesting. In the run-up to the jubilee, our board of directors met to address the issue of the investment attractiveness of LUKOIL company. The point is that there are certain ebbs and flows in each company. It is a market. LUKOIL shaped itself up earlier than all other Russian oil companies and enjoyed a specific advantage. Our company was developing to a large degree extensively, investing in new acquisitions. Many said we were squandering our resources, that money needs to be put up in Western Siberia. But I think no one in Russia has better geologists than ours and already at that time we were thinking about the future.

The point is that, in geology terms, LUKOIL does not have such a suitable field as, say, Priobskoye of YUKOS.

Today, our Kogalym [LUKOIL-Western Siberia subsidiary] operates at peak production rates but produces more than in the years of Soviet government. Therefore, we made a strategic decision to plow all free investment resources into the development of new promising fields, on the Caspian Sea shelf and in Timan-Pechora. This is what is exactly occurring now. We proceed from the premise that LUKOIL will not be revving up production in 2003-04. But last year [2000] we ramped up production in Timan-Pechora by 50% and we will do the same this year [2001] and at the same pace. Development of the Caspian will get under way in 2004.

LUKOIL's real production peak will commence in 2005-06. It is at this point that we will make use of our competitive edge. Going all out now in the bid to keep up with YUKOS, which has objectively better geological conditions in the upstream [the Priobskoye field] would be extravagant and useless for us. In addition, it should be borne in mind that not a single other Russian company except LUKOIL is actually in the market. All companies—Surgut, YUKOS, Sibneft—belong to managers. There is a tough rule in the West: If less than 25% of shares are traded, the company is not allowed to be listed on a stock exchange, be it the New York or London bourse. All these companies have less than 25% of their shares in the real market. This means that companies operate easily when shares ride upward and are insured against steep declines since they may have an opportunity to exploit this situation.

By shares, dynamic LUKOIL can objectively be compared only to UES [Unified Electric Systems], roughly 50% of whose stock is also traded. Therefore, one may speak about the real dynamic of shares only when all of us will be under equal conditions and have equal opportunities, when the management and companies close to it will not be able to play on the rally or plunge in shares, to pump out or pay dividends to each other from one and the same pocket.

Therefore, on the one hand, it is an objective process. When LUKOIL was one of its kind, it was great; when rivals appeared, our greatness split into the number of our competitors. But, at the same time, we think that we were and remain the leaders and will strive towards this leadership. I do not have any doubts that in time we will be able to gladden both our shareholders and investors, as they in Russia say, with new labor victories.

Beyond the Borders

Russian Petroleum Investor: *LUKOIL has been actively acquiring assets abroad lately. How do you visualize the company's future abroad?*

Alekperov: We need to diversify production. In the company's long-term plans spanning a period of up to 2010, we project to have 20% to 30% of our production exactly in our foreign projects beyond the territory of the Russian Federation. Presently, the company produces close to 80 million tons both in Russia and in the near and far abroad. LUKOIL is the sole Russian company that is producing oil outside the Russian Federation: in Azerbaijan, Kazakhstan, and Egypt [jointly with Agip of Italy].

LUKOIL is an aggressive company in the good sense of this word as far as a hunt for projects is concerned. Therefore, we consider all regions of the world, which have a good potential in oil production, as a potential area to expand our activity, specifically the Middle East [Iraq], Africa [Algeria], Latin America [Colombia, Venezuela].

Russian Petroleum Investor: *LUKOIL's advancement in the northwestern direction has been noticeable lately. Does it not hamper the company that YUKOS has already established its presence in Lithuania? Did the company's plans with regard to Mazeikiu Nafta [Lithuania's largest oil holding encompassing an oil refinery, export terminal, and pipelines; a controlling interest is held by the state, with one-third of the shares owned by American company Williams International] change?*

Alekperov: We had an unswerving and clear-cut position with regard to Mazeikiu Nafta. We always proposed one thing, namely: We are prepared to become a shareholder with the right to manage this project. Our point of view on this project did not change. As for development of our retail network on the territory of the Baltic states, we are today the largest operator in this region. We keep building up our potential on the markets of Lithuania, Latvia, and Estonia. Today, we have already begun supplying 40% of these markets with oil products from the Nizhegorodsky oil refinery in the Russian Federation.

Terminals Galore

Russian Petroleum Investor: *What is LUKOIL's current attitude towards the Baltic Pipeline System (BPS)? Does this pipeline create natural competition for the Varandei terminal? [BPS was built by Transneft state company to export oil from the southern part of Timan-Pechora and Western Siberia via the Russian Baltic Sea port of Primorsk; the Varandei sea terminal was built by LUKOIL on the Pechora Sea coast in the Nenets Autonomous District to export oil from its fields in the north of Timan-Pechora via the North Sea Route.]*

Alekperov: BPS does not create competition for the Varandei terminal. BPS carries oil from Komi, Kharyaga, that is, from the southern part of Timan-Pechora, and we are the major user of the BPS services. And the Varandei terminal is designed for our northern fields that do not stretch far enough to reach BPS. These are a group of fields covered by Northern Territories [the joint

LUKOIL-Conoco project], these are Varandei, Toravei, and others. The Varandei terminal is essential to us for oil export to the north of Europe and the eastern coast of the United States. A significant increase in oil shipments from the northern part of the Timan-Pechora oil- and gas-bearing province is planned exactly on these routes. This region is recognized as the top-priority area of our company's investment activity.

Early oil from the Varandei and Toravei fields has already been lifted via the Varandei sea terminal starting from the year 2000. The operation experience proved that oil can be lifted all-year-round under arctic conditions. Eventually, as other fields are being tapped, it is envisioned to build a stationary lifting terminal in Varandei for the all-year-round movement of oil to a roadstead transshipment complex in the area of the Kola peninsula in the Barents Sea and onward by sea to Europe and the United States. The terminal is planned to be brought to full capacity, which is 12 million tons per year, in 2007.

Russian Petroleum Investor: *In conjunction with Gazprom's recent agreement with Rosneft on collaborative development of the Prirazlomnoye field on the Pechora Sea shelf following the pull-out of Wintershall of Germany from this project, doesn't LUKOIL plan to create in partnership with these companies a common infrastructure in this area, considering that Prirazlomnoye, Varandei, and other fields are in one node?*

Alekperov: You touched on a major problem. We always proposed considering this region as an integral whole and creating a unified transport infrastructure as well as a unified infrastructure for production bases, which could service the entire region. It will be far more expensive to develop each of the projects in this region separately than to build a single infrastructure for a whole string of projects. As for the Prirazlomnoye

Curriculum Vitae: Vagit Yusufovich Alekperov

Experience:

1993 – present:	President of LUKOIL joint-stock company
1991 – 1993:	President of LangepasUraiKogalymneft oil concern
1990 – 1991:	Deputy, first deputy minister of oil and gas industry of the USSR
1987 – 1990:	General director of Kogalymneftegaz oil and gas production board
1985 – 1987:	First deputy general director of Bashneft production association, Western Siberia
1979 – 1985:	Worked for Surgutneftegaz and Bashneft production associations in senior executive positions
1974 – 1979:	Caspmorneft production association where he worked his way up from a foreman in oil and gas production to engineer-technician, shift superintendent, senior engineer to deputy head of an oil field
1972 – 1974:	Driller at Caspmorneft production association
Education:	In 1974 graduated from Azerbaijan Oil and Gas Institute named after M. Azizbekov with a degree in the technology and comprehensive mechanization of oil and gas field development. Mining engineer
	Holds a doctoral degree in economics
	The author of the monographs "Russia's Vertically Integrated Oil Companies: Methodology of Formation and Realization" (Moscow, 1996), "Russia's Oil. View by Top Manager" (Moscow, 2001)
Personal:	Born in Baku, Azerbaijan, on September 1, 1950 Married, one son.

field, we are firmly convinced that Russian companies themselves may execute this project without the participation of foreign partners. We have both the financial resources and the technologies for this, and we also have the know-how to do it.

We have already proposed setting up a consortium of Russian companies for the Prirazlomnoye project; there was no talk about stakes so far. Naturally, we assume that LUKOIL must be equal among the equal [have an equal interest on an equal footing with Gazprom and Rosneft]. We have an explicit position on the Prirazlomnoye field issue. Rosshelf company holds a license for the field. LUKOIL is also a shareholder in it through its Arkhangelskgeoldobycha subsidiary—a Rosshelf shareholder—and we will firmly stand on these positions. We think that LUKOIL's know-how cannot be brushed aside, it is so far the sole Russian company, in both oil and gas, with experience of work on the shelf.

Caspian Trio Works Well

Russian Petroleum Investor: *What headway does a tripartite cooperation among LUKOIL, Gazprom, and YUKOS make in the Russian part of the Caspian where a joint consortium, Caspian Oil Co. [KNK], has already been set up? Do the partners intend to attract foreign investors?*

Alekperov: KNK is an excellent example of cooperation among Russian companies. A joint board was already set up in KNK, work is being carried out very efficiently, all that was planned is being fulfilled, and we are sure things will continue this way. Efforts are now focused on seismic shooting, processing of seismic materials. We plan that KNK will spud the first exploratory well in the latter half of 2003 or early in 2004. As for potential involvement of foreign investors, if someone wants to joint the project, the consortium members will consider this proposal.

Russian Petroleum Investor: *How do you evaluate on the whole prospects for LUKOIL's operation in the Caspian region?*

Alekperov: I think the pace at which hydrocarbon resources are being tapped in the Caspian today is fairly good. Sizable investments go to Azerbaijan and Kazakhstan. In the last five years, our company has been making heavy investments in development of fields in the Russian part of the Caspian. I reckon that there are no factors containing oil companies' vigorous activity in the Caspian Sea waters today. That is, only problems among states exist there today, which are not yet fully settled; but at the same time all foundations were laid down for the economic development of these territories.

We will carry on vigorous operations on Azerbaijan's territory, we are mulling an array of other projects in this state. We are beefing up our investment programs in the northern Caspian [the Russian part] within the framework of our Severny block; next year, we will already reach the point of endorsing our block's oil reserves. The latest results that we have obtained there are very good. All wells that were drilled at the Severny block proved prolific. We discovered large oil and gas reserves.

Russian Petroleum Investor: *What can you say about plans to transform LUKOIL into an oil and gas company? What gas assets does the company possess?*

Alekperov: We do have gas assets. Hypothetical gas reserves of LUKOIL company are 10 trillion cubic meters; by these figures, we are second after Gazprom [29.9 trillion cubic meters]. First and foremost is a high content of gas in the discovered fields of the northern Caspian [specifically, the Khvalynskoye field]. Timan-Pechora has a very high gas factor. At issue is that we will even be building gas-liquefaction facilities in Timan-Pechora because it is pretty hard to lay a pipeline in the tundra. We have very large gas reserves in Yamal, which we will likewise be developing, and we will launch exploration and trial drilling as early as in 2002. There are gas reserves in the Saratov region [Privolzhye], a large petrochemical complex, where gas will be the main raw material, will be under construction there. On top of all this, we have, albeit small, gas assets bought by us in Uzbekistan, which we begin developing in partnership with Itera company this year. ❑

'Unfortunately, we failed to build oil and gas companies on the basis of petroleum companies. We all but failed over these ten years to enter the gas business: both in marketing our associated gas and in the natural gas business.'

RUSIA Petroleum Investors Snub Gazprom in its New Eastern Export Coordinator Role

Humiliated Giant

By Vladimir Baidashin

Using its newly acquired vague status of "state coordinator" for all Siberian gas ventures targeting China and other Asian nations, Gazprom is considering ways of gaining participation in the Siberian Kovykta project. The gas mammoth was defeated and even humiliated in its first attempt at talks with BP and other partners in Kovykta. The developers of Kovykta frankly told Gazprom not to bother.

On December 4, a group of Gazprom managers headed by Vladimir Rezunenko, board member and head of Gazprom's Strategic Development Department, met representatives of RUSIA Petroleum Co., the license holder and operator of the Kovykta project in Irkutsk, Eastern Siberia. The Siberian guest list included representatives of RUSIA Petroleum shareholders BP (UK), Tyumen Oil Co. (TNK), Interros holding company, and the Irkutsk regional administration. In addition, president of Gazprom subsidiary Vostokgazprom Sergei Zhvachkin was present. (See "Clinched Eastward," *Russian Petroleum Investor*/June/July '01.)

The official agenda of the conference was discussion of the Russian government's most recent idea to prepare a comprehensive document named "The Program of Creating a United System of Gas Production, Transportation and Supply in Eastern Siberia and Far East, with the Prospect of Gas Exports to the Markets of China and Other Nations in the Asian Pacific Region."

Last summer, the Russian cabinet appointed the Ministry of Energy "the state coordinator" of drafting this program. According to Interros deputy CEO Sergei Aleksashenko, who was present at the meeting, the coordinator status also includes the task of regulating export prices of gas, "to prevent losses to the national budget," and keeping the records of energy production, consumption, and export in the area. "The coordinator will be able to report to the government at any given moment what is the price of exported gas, and keep that price at the highest possible level to maximize the state revenues," he said.

> ***Gazprom now has to choose one of two ways of dealing with Kovykta. One option is to buy a stake in RUSIA Petroleum from existing owners. ... The other, less costly possibility is forcing its coordinator status on RUSIA without investing.***

In July, the ministry officially delegated the authority to draft and coordinate the program to Gazprom, throwing in the status of the coordinator of all gas projects that target Asian markets.

Shape of Things to Come

Since the Kovykta project is the only such project in mainland Russia that is actually moving ahead (see "Who's in Control?" *Russian Petroleum Investor*/June/July '01), the partners in RUSIA Petroleum became the first representatives of interested parties to be invited for negotiations with Gazprom officials. The outcome of this meeting was well worth watching because it could serve as a model for future relations between Gazprom in its coordinator status and Russian and foreign investors with eastward-bound gas projects in Siberia.

At first glance, the short press release issued by RUSIA Petroleum after the December 4 meeting reflected the warmest possible relations between Gazprom and Kovykta. It said the representatives of the Kovykta project "welcomed the decision of the Ministry of Energy to establish Gazprom in the status of the developer of the program and the coordinator of its implementation."

"These polite words are the only positive result of the meeting," one participant told *Russian Petroleum Investor.* "The gist of the debates was not to seek points of mutual interest but to draw a line between Gazprom's ambitions and the practical interests of gas producers and exporters. This is why Gazprom has decided to keep mum about the outcome of these negotiations, and the press release originated from RUSIA."

Cold Shoulder for Gazprom

The rest of the press release reveals the hard-nosed reality: "Those present were unanimous in understanding that the functions delegated to Gazprom to coordinate the Russian-Chinese cooperation in the gas industry, as well as to coordinate the creation of preparing a long-term program of gasification in Eastern Siberia and Far East, do not envisage delegating to Gazprom any other authorities non-existent in the current Russian laws to regulate the actions of the participants of gas projects carried out in that area."

The coordinator status of Gazprom, the press release goes on, "does not endorse Gazprom's interference in the work at those projects without their participants' consent, and cannot be an obstacle for fulfillment of earlier obligations of those participants."

In plain words, those present at the meeting, including Gazprom officials, agreed that the new "coordinator" will have to

PLANNED GAS PIPELINES TO CHINA

Kovykta at a Glance

The Kovykta gas-condensate field was discovered 350 kilometers northeast of Irkutsk (the administrative center of the Irkutsk region) in 1987. Initial estimates for free gas reserves were not high: 192.7 billion cubic meters of gas in the C1 category and 199.7 billion cubic meters of gas in the C2 category on the state register as of early 1992. A single gas field of this size, in the absence of any infrastructure, could be viewed only as a raw material base for the economy of the Irkutsk region and did not generate investor interest.

Thus, the Irkutsk regional administration became the initiator of developing the Kovykta project. RUSIA Petroleum company was founded by exclusively local enterprises in April 1992 (which is evidenced by the company name, an acronym of four local cities: Raduzhny, Usolye-Sibirskoye, Irkutsk, and Angarsk). Varyeganneftegaz E&P company and Angarsk Petrochemical Co. became its key founders. A license to prospect for, explore, and produce hydrocarbons was issued to RUSIA Petroleum in 1993, good until 2018.

The results of a supplementary exploration work carried out by RUSIA Petroleum were summed up in 1995, and the field was registered to contain 869.6 billion cubic meters of gas. But this amount still was not enough to generate widespread investor interest, especially since only 277 billion cubic meters were endorsed in the C1 category, and the greater part of reserves was classified in the C2 category. A supplementary survey of the field was needed, but would entail further investments. The relatively small Russian companies-shareholders in RUSIA Petroleum did not have sufficient funds and the project appeared to be virtually put on ice.

It began to be revitalized when British Petroleum moved into the Irkutsk region. In 1997, BP acquired a 10% block of SIDANCO shares for $571 million and, concurrently, within the framework of a separate agreement, SIDANCO's 45% stake in RUSIA Petroleum. The British company's interest in developing a gas field in Eastern Siberia was in line with BP's Asia strategy of striving for a foothold in China's gas market, the fastest-growing gas marketplace in the world.

Today, BP owns 30.84% of the RUSIA Petroleum equity and another 0.5% through its equity position in SIDANCO. BP participates in the management of RUSIA Petroleum, in ensuring the technical aspect of the Kovykta project, and in interaction with China along all channels.

The confirmed reserves of the Kovykta gas-condensate field, according to the latest data of the supplementary geological survey conducted by RUSIA Petroleum in 2000, total about 1.6 trillion cubic meters of gas and 95 million tons of condensate. The reserves of blocks adjacent to Kovykta (Khandinsky and Yuzhno-Ust-Kutsk) total upwards of 400 billion cubic meters of gas. Licenses for the adjacent blocks are held by Tyumen Oil Co. (TNK), a RUSIA shareholder. The Kovykta project targets annual production of 30 billion to 35 billion cubic meters.

On February 12, 2001, the Kovykta field was put by the Russian president's decree on the list of subsoil blocks eligible for development on production-sharing terms. This was followed in April by a special meeting in the Russian Ministry of Natural Resources, involving representatives of the concerned ministries, the State Duma, Irkutsk regional administration, RUSIA Petroleum and TNK. Participants at that meeting decided it was expedient to sign a single production-sharing agreement on the project, envisioning unifying RUSIA's license for the Kovykta field and TNK's licenses for the adjacent Khandinsky and Yuzhno-Ust-Kutsk blocks.

A coordinating committee for preparing a PSA on the entire "unified" Kovykta field was created under the RUSIA board of directors. This work was finalized by the end of 2001. TNK will present the project to state bodies. (See "Who's in Control?" *Russian Petroleum Investor*, June/July '01.)

stay away from other companies' gas projects and refrain from inventing illegal pretexts for interfering. "Details of the coordinator status are still unclear, but we believe that the investors' interest must not suffer from the coordinator's actions," said Peter Henshaw, BP director for external affairs in Russia.

A senior official of the Irkutsk administration was skeptical about the other task of Gazprom, drafting the gas development program for Eastern Siberia and Far East. "We have seen plenty of such papers. The last one, for example, was the State Concept of Long-Term Development of Siberia, which took dozens of skilled researchers several years to prepare. It was a good plan that included recommendations on organizing gas ex-

Gas Transportation Options

In July 2001, the Russian Energy Ministry authorized Gazprom to be a state coordinator of Russia's all export projects to supply gas to China. According to Gazprom data obtained by *Russian Petroleum Investor*, there are four such projects in the country today:

- to supply 20 billion cubic meters of gas from the Kovykta gas-condensate field over 30 years;
- to supply 25-30 billion cubic meters of gas per year from the north of Western Siberia and 8 billion cubic meters from the south of Western Siberia (the latter is an additional supply for the west-east trans-China gas line, in whose construction Gazprom intends to take part);
- to supply gas from fields in the Republic of Sakha (former Yakutia) amounting to 20 billion cubic meters over 25 years starting 2005;
- to supply almost 10 billion cubic meters of gas annually from the Sakhalin-1 field.

At this point, projects to build relevant export gas pipelines from Russia to China are at different stages of study. However, judging by information coming from Beijing, China appears to prefer the Kovykta project, to which it is attaching top priority. Work is currently afoot with the Chinese to develop a feasibility study for the project to lay a pipeline from the Kovykta field to China.

The target date for the project is early 2002. But there is disagreement over the future gas pipeline's route. Russia and China agree the initial section should run from Kovykta to Angarsk. Then Russia proposes a western route traversing Mongolia that would supply, in passing, gas to this republic. China, which evidently perceives a political emphasis in this, insists on an eastern line bypassing Mongolia.

The overall length of the Russian route is some 3,400 kilometers (including 1,030 kilometers via Russian territory, 1,020 kilometers via Mongolia, and 1,350 kilometers via China). The Chinese route would be 4,500 kilometers. It's also unclear what amount of Kovykta gas will be involved or to which areas it will be delivered. These issues hold technical and, moreover, financial significance in the route selection process: Depending on the selected route, the difference in the project cost may vary as much as $1 billion.

RUSIA Petroleum's Position

The management of RUSIA Petroleum has stated on various occasions that the company-subsoil user of the Kovykta field favors the western option of building a gas pipeline from the Irkutsk region to China.

Specifically, RUSIA Petroleum asserts the area of Bohai Bay and northeastern China are the most likely sales markets for the Kovykta gas. In fact, two main routes are under consideration for an export gas line from Russia to China: the western option (across Mongolian territory to Beijing and south to Jybo city, and also to southern areas of northeastern China) and the eastern option (via the Chita region and Buryatia to northeastern China and onward to Beijing).

According to RUSIA Petroleum representatives, sections with special construction conditions occur on the entire length of the route both under western and eastern options: high seismic activity, national parks and ancient or historic buildings, structures, and sites, rock that stays frozen for years, flooded soil, and sections that differ vastly in height. In the westbound direction, virtually all of the dangerous sections are of great length; therefore, construction of a gas line would require heavy spending (according to RUSIA Petroleum's preliminary estimates, $1.2 billion to $1.3 billion; Sumitomo Corp. reckons up to $3 billion) and it will take ten to twelve months longer than under the western option.

Gazprom's Proposal

In May 2001, Gazprom discussed with Chinese company PetroChina issues of transporting gas via the Yamal-Altai-Russia's border with China route. At point is the supply of 25 billion to 30 billion cubic meters of gas over 30 years plus a line of the gas pipe that could be laid from Western Siberia via Altai, and an 80-kilometer section of the Russian-Chinese border on the joint of the frontiers of Russia, China, Mongolia, and Kazakhstan. Vostokgazprom company, which was authorized by Gazprom to implement the gas concern's eastern Siberian strategy, virtually is already engaged in translating this project into life.

Some time ago, Vostokgazprom, which incorporates Gazprom-affiliated large regional gas producing companies Tomskgazprom, Altaigazprom, and Krasnoyarskgazprom, came up with its own variant of Russian gas export to China. Gazprom holds a controlling interest in Vostokgazprom.

According to the company, projected volumes of gas and fluid hydrocarbons extraction on the territory of Vostokgazprom's operation in the Tomsk region (south of Western Siberia) will make it possible not only to meet all requirements of the Tomsk and neighboring regions in a span of three to five years but also to sell part of the output on the foreign market. Company insiders argue that the so-called Altai option is the most realistic in terms of time-span since it uses the existing gas transport scheme and Tomsk fields already under development.

According to Vostokgazprom officials, larger gas fields in the Tyumen region as well as huge fields in Krasnoyarsk territory (Evenkia, eastern Siberia), which are being prepared for development, may be hooked up to this scheme in the future. According to Vostokgazprom president Sergei Zhvachkin, the Altai option does not rival other variants, specifically the Kovykta field, and may serve as a component of them.

Vostokgazprom officials say potential gas resources on the territory of the company's operation in the Tomsk region total, according to the tentative estimate of VNIIGaz institute, over 1 trillion cubic meters. The company's Tomskgazprom subsidiary holds licenses for the right to use the subsoil of seven oil-gas-condensate fields in the Tomsk region.

2010 Is a Target

BP Kovykta project director Derek Cochrane says the consortium plans to supply first gas to consumers (20 billion - 30 billion cubic meters per year) in 2008-10. These dates coincide with the target date for launching the Kovykta field into production, which is recorded in the special Federal Program Energy-Efficient Economy For 2002-05 and For a Longer Period Ending in 2010 endorsed on November 29, 2001. "The Kovykta field will be developed in the Irkutsk region with gas production of up to 20 billion cubic meters in 2010," the program states. According to Cochrane, the total cost of the Kovykta project, including development of the field and construction of a gas line, is estimated at $15 billion to $20 billion.

Yuri Komarov, a senior manager of Gazprom and its board member overseeing the gas concern's export policy, has expressed his view about the start in Kovykta gas supplies. "Gas export to China is the issue of a distant future," he said in an interview with Russian daily *Vedomosti* on December 11, 2001. "China is not going to resort to external sources of gas supply in the next ten-twenty years. But this policy also meets our interests, the interests of Gazprom. It is economically highly unprofitable to come on an unprepared market now with large volumes of gas and to transport this gas there for large distances."

He added, "When the Chinese develop their own market, it will then be possible to speak about supplies from Russia. But in order to operate in China, one needs to create a springboard there. The nearest gas resource is Kovykta. But one should also not forget about gas from Western Siberia and the Far East. However, if the Chinese do not move to attract our interest and do not create economically acceptable terms for investor companies, I doubt that any company be it Gazprom, Shell, or Exxon will be able to operate there."

Gazprom Lobby in Irkutsk

A special working group to consider mechanisms for Gazprom's entry into the project to develop the Kovykta field was set up in Irkutsk with the backing of the local administration in April 2001. According to Nikolai Melnik, vice governor of the Irkutsk region, this decision was made at a meeting involving the governor, representatives of the Irkutsk regional administration, Gazprom, and major shareholders of RUSIA Petroleum company. The working group is composed of representatives of the Irkutsk administration, RUSIA Petroleum, BP (UK), TNK, and other shareholders. Melnik acknowledged that the meeting was convened at the Russian Energy Ministry's initiative.

"Ahead of this meeting, RUSIA Petroleum shareholders discussed prospects for developing the Kovykta field and came to a conclusion about the expediency of a large Russian company joining the project. This circumstance lends stability to the project and will expedite its implementation," Melnik said. According to him, participants in the meeting did not rule out the possibility of Gazprom acquiring RUSIA Petroleum shares.

Vladimir Vasilyev, expert with the regional administration's Fuel and Energy Sector Department, told *Russian Petroleum Investor* that the working group meeting addressed, in part, two possible ways for Gazprom to enter the Kovykta project. The first is to set up a consortium or a joint venture between RUSIA Petroleum and Gazprom. The second is "to enable Gazprom to become a large shareholder in RUSIA Petroleum". So far, both of these proposals are on the agenda. As for BP, the biggest current shareholder, according to its spokesman: "BP would welcome any Russian participation in the project under a single license and production-sharing agreement structure. This would make the project viable."

In the opinion of Irkutsk administration officials, the most realistic way for Gazprom to join the Kovykta project lies through acquisition of RUSIA Petroleum shares. Vladimir Sklyarov, head of the Irkutsk region's Subsoil Department, told Russian Petroleum Investor that "acquisition of RUSIA Petroleum shares is the most effective and real way for Gazprom to join the Kovykta project. Of course, it was much easier to obtain shares of the license-holding company two-three years ago. Today, it is more complicated to do it because the entire shareholder structure has been formed. It is now needed to enter into negotiations with holders of RUSIA Petroleum share parcels; possibly some of them, expressing good will towards Gazprom, may concede part of their shares."

As for the possibility that the project's largest shareholder BP might lower its equity stake in the Kovykta project if Gazprom joins it, Scott Kerr, BP chief manager, production, Russia and Kazakhstan, noted that BP's stake would depend on the structure of the Kovykta project. According to him, "The optimum structure of this project would look as follows: BP, one-third of the equity interest in the project; Russian companies, one-third; and buyers of Russian gas, also one-third."

RUSIA Petroleum shareholders' support of authorities' proposal to appoint Gazprom as a coordinator of all gas projects in Siberia and the Far East "can be regarded as a breakthrough of sorts," said a senior Gazprom manager. "Until now, RUSIA shareholders, with the exception of the Irkutsk authorities, opposed our participation in developing Kovykta without joining the group of shareholders," said the Gazprom official. "Some shareholders voiced apprehensions that Gazprom, without holding a large stake in RUSIA, will claim control over cash flows from gas export."

TNK and BP executives continue to adhere to this point of view, a source close to RUSIA shareholders believes. This is exactly why Gazprom, unwilling to sour relations with the major shareholders, is likely to buy some share parcel. It will most likely be holding company Interros' interest (some 27%), the source reckons. Interros chief Vladimir Potanin repeatedly has stated that gas extraction and sale was not a core business for his company, and therefore it would most likely sell its gas business as it did its oil business. (A large block of shares in SIDANCO that belonged to Interros was sold, in part, to TNK shareholders in August 2001.)

Interros general director Andrei Klishas said at a briefing in Moscow before the meeting in Gazprom that Interros was prepared to begin talks with any RUSIA Petroleum shareholder or Gazprom about selling part of or the entire block of shares in RUSIA Petroleum that it owns. At the same time, he noted that the company has not pursued such negotiations and Gazprom had not approached it with an acquisition offer.

ports to Asia, too. However, nobody has ever done anything to carry those plans out. They are all wishful thinking of our bureaucrats, who would not spend a red penny to make them real. This one will be no exception."

Project's Doors Are Shut

Gazprom's half-hearted attempt to speak to RUSIA from the state coordinator position probably reflects its old intention to control, or at least penetrate, the Kovykta project. Both Gazprom managers and Energy Ministry officials have spent much time trying to find a way into the Russian gas giant. The main snag is Gazprom's wish to step in without assuming most of the required financial obligations.

Just before the meeting, Gazprom chairman Alexei Miller met with Irkutsk governor Boris Govorin, who has been insisting on giving Gazprom a role in Kovykta. Govorin told *Russian Petroleum Investor*: "We invited Gazprom to Kovykta many times, but its former management was not interested. Now we are witnessing a new interest there, and we would like to see Gazprom among the participants in the Kovykta project, which targets the as-yet undeveloped markets of the Asian-Pacific area. We are ready to support Russian players wishing to participate, and we would prefer to see the domestic share in RUSIA Petroleum totaling at least 51%." (The Russian-owned share currently is 46.32%, split among Irkutsk Region Property Fund, Interros Holding Co., Tyumen Oil Co., and Rosinvestneft.)

Commenting on Gazprom's role at Kovykta, Henshaw said: "Our position on that is quite clear: If they want to become a shareholder, that's fine. But they need to buy their share in order to become a shareholder on a commercial basis. And I understand they tried to do this when they discussed this with Interros before, earlier this year [2001]. If somebody is prepared to sell its shares at the right price, that might happen. But this was not really discussed in any detail at that meeting with Gazprom. BP is not looking to sell its interest. The main issue for BP is not whether Gazprom has a percentage interest or equity stake in RUSIA. The main issue is how they see their role as coordinator: What does that mean? All of the shareholders that were present at that meeting have the same view: Let's try to understand, let's try to define, let's be specific about what Gazprom's role will be."

Since the Kovykta project is the only such project in mainland Russia that is actually moving ahead, the partners in RUSIA Petroleum became the first representatives of interested parties to be invited for negotiations with Gazprom officials.

Friends in High Places

Gazprom now has to choose how to deal with Kovykta. One option is to buy a stake in RUSIA Petroleum from existing owners. Head of Interros Vladimir Potanin has admitted on several occasions that his company would be prepared to sell its near-27% position if the price is right. Interros officials claim Gazprom has not approached them with any proposals, but such a deal is still a possibility.

The other, less costly option is forcing its coordinator status on RUSIA without investing. At a press briefing on December 10, Minister of Energy Igor Yusufov announced: "It is not important which option Gazprom chooses. They are all acceptable. Under one scenario, Gazprom can get a commission for gas sales; under another one, they might wish to buy a stake in the project."

Russian Petroleum Investor sources at the Energy Ministry confirm that Yusufov regards Gazprom's coordinator status as an excellent reason for channeling all gas exports from Siberia to Asia through the monopoly. The fight to impose Gazprom on RUSIA Petroleum, and on all the future gas projects in Siberia, in one form or another is far from over. At the December meeting, RUSIA won the first round in this match, mainly because no Russian law gives Gazprom the right to interfere in private companies' business. But Russian laws are often disregarded by government officials, who will certainly be tempted to continue their attacks. ❑

Russian Oil Companies Search for International Lenders for Major Projects

Capital Quest

By Vladimir Sysoyev

Russian oil companies reaped major windfalls in the last couple of years when oil prices stayed at a relatively high level. Nonetheless, they are not enough to finance large-scale projects to tap new fields or buyouts of companies in other countries. Therefore, the Russians are forced to resort to the international capital market.

Russia's domestic capital market is fairly limited. According to various estimates, a mere 0.4% to 2% of investments in industry were drawn from the Russian stock market; enterprises' own funds continue to account for the bulk of investments. At the same time, the country's banking system is rather weak and does not have the financial wherewithal to extend sizable credits to oil companies. The country's largest bank—Sberbank, a monopoly preserved since Soviet times—is comparable in capital to medium-size Western banks. And the capitalization of the entire Russian banking system does not surpass that of a single large international bank.

In this situation, Russian energy companies are striving to step up operations on international capital markets. They put the entire spectrum of fiscal instruments to use: the issue of international bonds, American and Global Depository Receipts (ADRs and GDRs), equity participation in one project or another, and credits from banks.

"The internal bond market is more profitable [for the borrower] in terms of interest rates. If inflation stays at an annual 18%-19%, a serious oil company may draw funds on it at 20.5%-21% interest in rubles. That is, a real inflation-adjusted rate is close to zero. For example, Nizhnekamskneftekhim and RITEK companies obtained money at this interest rate," said Alexei Tretyakov, a corporate bonds analyst with Zenit Bank. (The bank acts as a consultant and underwriter in borrowing funds in Russia and abroad).

He added, "If funds are drawn through Eurobonds, the rates, as practice shows, run at about 13%. It is of course expensive, but funds can be drawn on the domestic market for eighteen months as maximum; this time-span will be enough only to replenish working capital. To finance more or less long-term projects, Russian oil companies are forced to enter international capital markets."

Slow Recovery

The national default dealt a serious blow to confidence in Russian oil companies as borrowers in 1998. Some companies experienced difficulties with fulfilling existing financial commitments, demanding a deferment in repaying credits or redemption of Eurobonds. Separate deals with foreign financial companies and banks did take place (Slavneft, for one, managed to sign an agreement on cooperation with a string of Spanish banks in December 1998 and the US Export-Import Bank in April 1999).

Oil companies began to recover in earnest from the lenders' and investors' crisis of confidence sparked by default in 2000-01. At this point, they began to step up their activities on the domestic and international capital markets. Tyumen Oil Co. (TNK) managed to draw the largest international credit. It obtained from EximBank a $534-million credit, which is to be released in two installments. The first $292-million tranche was earmarked for rehabilitation of the Samotlor oil-gas-condensate field, the second tranche of $217 million is for upgrading the Ryazan oil refinery.

TNK plans to take out a $250-million syndicated credit in third-quarter 2002 arranged by Deutsche Bank. The company has already signed a mandatory agreement with Deutsche Bank on organizing financing for ecological rehabilitation of the Samotlor field.

TNK plans to take out a $250-million syndicated credit in third-quarter 2002 arranged by Deutsche Bank. The company has already signed a mandatory agreement with Deutsche Bank on organizing financing for ecological rehabilitation of the Samotlor field. The terms of obtaining the credit are currently being hammered out. According to available information, the loan will most likely be awarded to the company for four years.

On August 23, 2001, Sibneft announced it received a three-year, $250-million credit from ABN Amro Bank of the Netherlands. These funds will be used for three activities: to replenish working capital, make capital investments, and refinance credits that were obtained in the fall of 2000 ($100 million from WestLB and $180 million from Standard Bank). In August 2001, state oil company Slavneft gained a syndicated $160-million credit from a pool of Western banks and a $220-million credit from Japanese banks within the framework of an intergovernmental agreement between Russia and Japan.

By and large, credits are available to companies with stable financial data. “The risk of generating no return on investments is increasing in the present-day situation. Similarly, the risk for finances attracted for this purpose is soaring. Therefore, companies that failed to become ‘fat-grown’ and to create strategic reserves will have a tough time,” said Mikhail Kozlov, an analyst with Region investment company.

Bond Activity Still Modest

The volume of the corporate bond market in Russia is about $700 million (this figure takes into account all companies, not just oil firms). Experts anticipate the day when individual companies’ offerings will exceed $100 million—but so far not a single company has attained that height. By comparison, large Western corporations as a rule do not work with such tiny sums and make jumbo bond placements worth several billion dollars as minimum at a time.

“The maximum volume of international bond emissions on which Russian companies may count in the present-day conditions vacillates around $300 million,” Tretyakov assumes.

Rosneft acted as a trail-blazer in Eurobonds placement in the aftermath of the 1998 crisis. On November 14, 2001, it successfully placed an issue of its Eurobonds with a five-year maturity worth a total of $150 million. This paper had a yield of 13% in hard currency. The borrowed funds will be plowed into the company’s development: into strategic projects to boost oil production at Sakhalin and Western Siberia and also into revamping the Komsomolskoye and Tuapse oil refineries.

Last October, Sibneft announced the issue of $250-million worth of Eurobonds. On November 6, Moody’s ratings agency awarded a B1 rating to them. In so doing, Moody’s relied on the company’s fundamentals: production growth, a rise in profit, impeccable credit history, and compliance with international corporate standards.” (Not coincidentally, in August 1997, Sibneft was the first Russian company to issue three-year Eurobonds worth $150 million, which were repaid in August 2000. In March 1998, Sibneft issued six-month, non-coupon bonds worth $200 million, which were repaid on time.)

Rosneft acted as a trail-blazer in Eurobonds placement in the aftermath of the 1998 crisis. On November 14, 2001, it successfully placed an issue of its Eurobonds with a five-year maturity worth a total of $150 million.

Tatars Handle Their Debt

Last November 11, Tatneft and BNP Paribas (Suisse) SA bank signed a credit agreement under which Tatneft will receive a 30-month, $100-million credit. The credit is secured by contracts for the supply of Tatneft output and will go to develop the company’s production base. It is Tatneft’s second long-term, hard-currency credit since signing a debt-restructuring agreement in October 2000.

By contrast, in 1998 Tatneft suspended the servicing of short-term credits worth $600 million. Creditors agreed to restructure the company’s debt and in December 1998 Tatneft has resumed payments. Tatneft used twice a fifteen-day grace period (in October 1998 and April 1999), during which it had the right to defer payment of a coupon on a $300-million Eurobond loan. Since 1999, the company has been servicing its own debt liabilities on time and in full, and in 2000 it signed a debt-restructuring agreement with creditor banks. To all appearances, the company has managed to regain the full confidence of investors and creditors.

LUKOIL's Postponed Sale

For over a year, the Russian government has been trying to sell its share parcel in LUKOIL. It owns 6.13% of the oil company's shares (a total of 50 million shares). In late 2000, the Russian Federal Property Fund announced the planned sale as the key deal for 2001. However, that winter its plans to sell the parcel were thwarted when BP Amoco (UK) unexpectedly sold 7% of LUKOIL shares that it owned. Following this move, it was difficult to find a buyer for another large block of shares and the government had to postpone the implementation of its plans.

On top of this there emerged one more difficulty. Under Russian legislation, the sale of large chunks of state property requires State Duma consent, which the government did not have. However, this problem was solved fairly simply: a joint-stock company Kompaniya Proyektnoi Privatizatsii was created, into whose charter capital 6.13% of LUKOIL shares, which were put up for sale, were transferred. And later this company sought to issue 3rd level ADRs for the shares and place them on the New York Stock Exchange (NYSE). That is, from the formal point of view, the shares were being sold by Kompaniya Proyektnoi Privatizatsii rather than the government.

After this, the Russian Federal Property Fund began preparing all the necessary documents for LUKOIL shares to go to the NYSE. However, in July it was decided to place the shares on the London Stock Exchange (LSE). Officially, this step is explained by a reduction in political risks involved in shares circulation. But the United States adheres to sanctions with regard to the Sudan, Iran, and Iraq, in which LUKOIL has an array of projects. Sanctions may in principle be applied on US territory to companies cooperating with these states.

In late 2001, however, the Russian government was forced first to delay the sale of the block of shares until the first quarter of 2002 and then to postpone it indefinitely. The reason: the drop in world oil prices and decline in oil company share quotes (which affected not only Russia). Currently, LUKOIL stock costs slightly more than $10 per share whereas the government was set to sell them for $15 as minimum. The budget was to gain a total of $750 million from their sale, and the deal promised to be one of the largest in the history of Russian privatization.

Bond Issues Postponed

At the same time, the dive in oil prices and increase in risks are driving Russian companies to revise their bond-issuing plans. LUKOIL, for one, planned to place convertible bonds in 2002, but in late 2001 it was forced to put that off indefinitely due to unfavorable market conditions. "Currently, Russian sovereign Eurobonds are traded with an yield at the 12% level. A premium of 1%-2% as compared to state paper is quite reasonable, but against a backdrop of plummeting prices investors may want to raise it. Therefore, now is not the best time for placing securities," Kozlov said. Notably, Rosneft initially planned to issue $300-million worth of its bonds and ultimately ventured for an emission half that size.

Tretyakov clarified: "Investors are ready in principle to invest in Russian oil companies. They regard the purchase of their securities as a profitable acquisition. However, the key factor that influences their interest is oil prices. Unless they stabilize at a more or less sensible level, investors will most likely be sitting and waiting."

Tyumen Oil Co. (TNK), for example, has tied the possible issue of its Eurobonds worth $300 million to $500 million in early 2002 to the oil price trends on the world market. Originally, the company planned to issue $300-million worth of Eurobonds, but in July 2001 it decided to increase the issue to $500 million. It was planned that, given a favorable market situation and foreign investors' sustained high interest in Russia, TNK would place them in November 2001. However, company officials opted to postpone the emission to February-March 2002 at best.

Syndicated Credits Favored

In principle, a syndicated credit from a Russian bank is the cheapest way to obtain funds. In this case, accompanying expenses (apart from interest) are minimal. In issuing Russian bonds, extra expenditures include payment for the services of an underwriter for a listing, and the federal tax of 0.8% of the emission volume is paid. Bonds placed on Western markets cost as much as twice that sum, since accompanying expenses there are as a rule higher than in Russia. The terms of drawing credits from Western banks are usually not made public, but on the whole they involve less expenses than an issue of Eurobonds.

However, the "issue of ADRs is more gainful from the strategic point of view [they are longer-term and so can be used for capital investments, and their buyers are usually strategic investors rather than [speculators]. Usually, they are bought by strategic portfolio investors who are not only eager to generate profit as soon as possible, like speculators, but are also keen to participate in the company management," Kozlov said.

Five Russian oil companies—LUKOIL, Surgutneftegaz, Tatneft, Chernogorneft, and YUKOS—have issued ADRs of various levels for their stock. In addition, some companies issued Global Depositary Receipts, which are in circulation on European stock exchanges. Let's say almost 5% of YUKOS shares are in circulation as ADRs. In principle, this company does not need to draw funds through the issue of these instruments. But its management does not rule out the possibility of reaching to the market of 2nd and 3rd level ADRs in 2002-03. So far, YUKOS is unprepared for this: the composition of its owners or information on remuneration to YUKOS's 70 top managers have not been fully disclosed as yet.

Targeting the NYSE

Sibneft, which so far does not have ADRs (but has GDRs that are traded on German stock exchanges), is preparing in principle to issue its ADRs and place them on the New York Stock Exchange. However, shares need to have a higher value for this emission to be carried out. Therefore, the company is now trying to boost its capitalization. But the lack of transparency and the ensuing investor wariness inhibit these efforts.

For example, on October 23, Sibneft shares on the Russian stock market fell more than 10% after it became known that the company bought from its controlling shareholders a 27% block of shares that it had sold to them several months earlier (it bought the block from the same shareholders for the first time in late 2000). Some observers reckoned all these share purchase/sale operations were executed to strip the company's assets.

LUKOIL plans to get a listing on the London Stock Exchange before February 2002; initially, this procedure was planned to be finalized in December 2001. This delay was due to the fact that the government has been shifting its plans to sell its LUKOIL share parcel on the London Stock Exchange rather than NYSE as was earlier planned. However, the LUKOIL listing may be postponed indefinitely in conjunction with a further adjustment in the government's plans. (See "LUKOIL's Postponed Sale.")

In this situation, Russian energy companies are striving to step up operations on international capital markets. They put the entire spectrum of fiscal instruments to use.

Funds Fade with Oil Prices

According to Kozlov, "Oil companies' conduct on financial markets is understandable. When Urals crude traded at \$23 per barrel, it was very profitable to draw funds for development of companies and their production base. However, the current slide in oil prices will in all likelihood have an adverse impact on this activity."

In this situation, there is unlikely to be a gain in share value or, similarly, more advantageous terms for placing ADRs and GDRs. Russian oil companies will delay issuing securities that trade as proxies for their shares when they are clearly undervalued on the stock exchange. Additionally, at least part of the investment programs likely will be curtailed or put on hold and, hence, less borrowed funds will be required.

However, it is unlikely that Russia's oil companies may do without funds drawn from foreign sources in the medium and long term, given a relative stabilization in global oil prices. Therefore, it makes sense for potential creditors to follow the development of events in the Russian oil industry, which—thanks to its giant size alone—represents an interesting market for organizing international financing. ❑

Gazprom Shares to Gradually Become More Available to Foreign Investors

At Long Last

By Marina Mikhailyukova

Russia seems to be displaying true concern about attracting foreign investments in gas giant Gazprom. The Program of Liberalizing Gazprom's Shares was worked out on president Putin's instruction and is currently in discussion among governmental agencies. Its primary task is to boost the liquidity of the largest Russian monopoly's shares and, finally, fulfill a 20% quota in Gazprom's paid-in capital with foreign holdings.

In early November, Dmitry Medvedev, deputy head of the Russian president's administration and concurrently chairman of the Gazprom board of directors, told journalists the outlines of the draft Program of Liberalizing Gazprom's Shares. According to the program, the liberalization process will be carried out in at least two stages. The first stage will see decentralized trading in the holding company's shares inside Russia. In the second, a mechanism will be created to fill a 20% quota of foreign participation in Gazprom's equity.

"Liberalization of the Gazprom shares market meets first and foremost foreign investors' interests," said Vladimir Metnev, manager of Aton Investment Co. "If it is carried out, they will gain access to a unified and transparent shares market that will be distinguished by greater liquidity and dynamic than Gazprom's American Depository Shares [ADS] market."

In light of the upcoming restructuring of the holding company, this program is acquiring particular value for foreign investors: they are getting an opportunity to participate in the impending process to divvy up the Russian gas monopoly's assets. In addition, foreigners' equity participation in Gazprom will allow them to exert influence on management and, hence, push for the largest gas holding company to become more open and transparent to them.

Key Points Need Clarification

Nonetheless, many issues remain unclear. First, the exact dates for the start in its implementation have not yet been announced. Second, the mechanism for selling a 20% portion of the company shares to foreign investors has not been hammered out into final shape. Third, a 20% cap on foreign ownership in Gazprom has not been revised by lawmakers upwards and, hence, none of the foreign investors will be able to buy, at least officially, a blocking parcel of shares in the Russian gas giant in the foreseeable future. Theoretically, this can be done only in alliance with Russian shareholders.

Gazprom's situation on the securities market is a unique phenomenon even for Russia. Actually, two stock markets exist: domestic (for Russians) and external (for foreigners). ADRs, which make up slightly less than 3.5% of the gas holding company's entire shares market, are traded outside Russia. Under Russian legislation, they cannot be converted into Russian shares, unlike similar instruments of any other Russian oil and gas company. "The limited supply of ADS and impossibility to convert local shares into ADS brings about a situation where Gazprom's ADS cost twice as much as its domestically traded stock," according to Konstantin Reznikov, an oil and gas analyst at Alfa Bank.

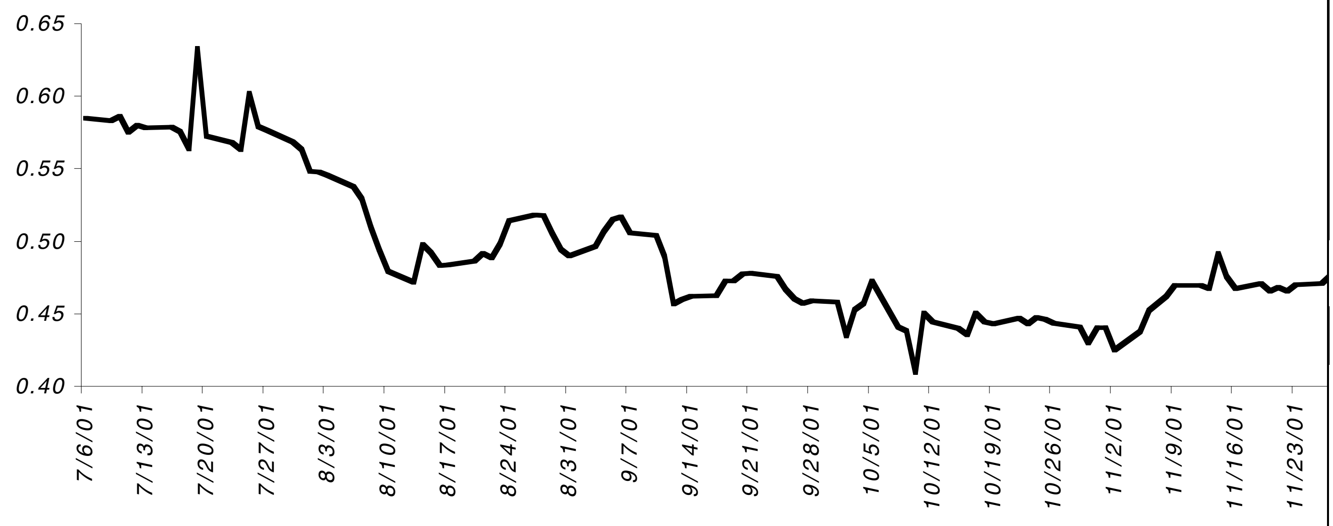
A two-tier stock structure was created at the first stage of the company's privatization in 1996 to distinguish between Gazprom shares in foreign hands (ADRs) and those owned by residents (local shares).

In light of the upcoming restructuring of the holding company, this program is acquiring particular value for foreign investors: they are getting an opportunity to participate in the impending process to divvy up the Russian gas monopoly's assets.

Aliens in Gazprom

Nevertheless, these limitations do not prevent foreign investors from acquiring domestic Gazprom shares. Investors use "gray" schemes, whereby a

CHANGES OF RTS INDEX (JULY-DECEMBER, 2001)



Source: RTS

foreign investor registers a Russian legal entity. The legal entity purchases domestic Gazprom shares, and then provides a guarantee that all of its assets belong to a foreign owner. According to various estimates, 5% to12% of Gazprom shares currently belong to such shareholders. Such loopholes do not contradict existing legislation. Their only drawback for the investor is in the fact that the foreign investor cannot "legalize" himself by openly declaring his ownership of the stock, and therefore remains unable to participate in the management of the company by voting with his shares.

The sole large foreign investor of RAO Gazprom, enjoying full rights, is German concern Ruhrgas, whose stake amounts to nearly 4.5%. The Russian government made an exception of Ruhrgas, allowing it to obtain Russian shares. Indeed, the government sold this parcel to Ruhrgas to obtain funds to pay off its foreign debt. And despite the small size of the share parcel, an independent representative of Ruhrgas holds a seat on Gazprom's board of directors.

Understandably, leaving aside the exceptional Ruhrgas relationship, this situation does not suit potential serious investors and, therefore, president Putin made a decision on drafting a program of liberalizing the Gazprom stock market.

Undertaking Change in Stages

In the first stage, it is planned to lift restrictions on trading in Gazprom stock within Russia (currently, only four exchange floors are eligible to trade shares) and allow trade on all trading floors in Russia that hold a Federal Commission on Securities (FCS) license. It is likewise supposed to eliminate the monopoly on the depository accounting of Russian shareholders. The records of all shares that are available on the domestic market are currently maintained in the electronic format by SR-DRAGO, a 100% Gazprom subsidiary.

"The governmental commission led by Medvedev made a wise decision worthy of Solomon to begin with liberalizing the domestic shares market," believes Valery Nesterov, an oil and gas analyst with Troika-Dialog investment bank. "Sweeping changes occurring in the company hold positive significance first and foremost to foreign investors. These are a new management team, which came into the company, and its efforts to boost the company's transparency, moves to divest non-core assets, establish control over cash flows, bring order to the investment policy, order in terms of the company planning, capital investments, export

The Federal Commission on Securities (FCS) proposes selling local shares to foreigners on the specially selected trading floor. Gazprom believes that the sale should be carried out through an auction system, asserting that the auction system is the most transparent.

contracts, etc. This is what investors will be primarily looking at, and maintaining the two-tier stock market may in this sense remain to be warranted."

The second stage envisions filling up a 20% quota of foreign participation in the company's authorized stock. The size of this quota was set under former president Boris Yeltsin and sealed legislatively. However, until now it remains unfulfilled. The Working Group members have not yet chosen which one of four proposed schemes to adopt. "Each of the agencies, whose representatives participate in drafting the program, comes up with its own variants and protects its own departmental interests," Nesterov said. "Essentially, at issue is who will cash in on this process."

Sales Structure Debated

The Federal Commission on Securities (FCS) proposes selling local shares to foreigners on the specially selected trading floor. Gazprom believes that the sale should be carried out through an auction system, asserting that the auction system is the most transparent.

The Russian Federal Property Fund (RFPF) has proposed selling Gazprom shares to non-residents through a state structure rather than a stock exchange, and the state agency's services would be paid with shares of the gas giant. The fund is poised to raise the state-owned stake in Gazprom this way. In addition, this scheme will gladden not only the state but also the holders of "gray" shares. They will simply make settlements with "gray shares," and no new investors will come in.

The anti-monopoly ministry proposed an auction sale of the right for foreigners to acquire Gazprom shares. This right will likely be issued in the form of a certificate enabling the buyer to purchase Gazprom shares. This scheme, like the previous one, is advantageous to the holders of "gray" stock. The latter will simply buy the right to a purchase and, since they already hold the shares, it will not be expensive for them to legalize them by swapping gray shares for Russian shares. However, ordinary investors simply willing to acquire Gazprom shares will hesitate for a long time before buying this right. First, this approach will drive up the shares' cost and, second, there is no guarantee that this right will not decline in price, so the investor might lose money on the resale.

So far, it is unknown what the government will choose. In addition, one should not rule out a variant under which ultimately, when the draft law is already passed, the government may issue several permits in favor of several methods.

So far, it is unknown what the government will choose. In addition, one should not rule out a variant under which ultimately, when the draft law is already passed, the government may issue several permits in favor of several methods.

"The block of shares up for sale will simply be split into several parcels, each of which will be sold under a certain scheme," one of the group members suggests. "It seems to me that two schemes will most likely be chosen. It is an RFPF scheme, so its proposal is very appealing to the government because of its state slant. At the same time, the RFPF's profit from the sale of Gazprom shares can also be written into revenue from privatization, in general, an additional collection of money for the budget. The second is somewhat in the middle between the RFPF and Gazprom schemes, which are very much alike. Auction quotas so patently meet the interests of the holders of 'gray' shares and put new investors at such a disadvantage that they are sure to be found faulty."

Each of the proposed schemes has its pluses and minuses. Alexei Savchenko, manager of Boston Consulting Group, reckons that "foreigners are interested in acquiring these shares within the framework of a system that will not propose or ensure inflated prices. There should not be a monopoly here on the part of offerings, and prices of these offerings should not be exorbitantly high. And the source of these shares' origin and who will cash in on them do not make any difference to foreign investors," he believes. ❑

When Structured Deals Backed by Commodities Are The Only Source of Term Finance

Structured Finance

By Dr. Thomas Oehl

Westdeutsche Landesbank Girozentrale (WestLB) has established a leading position in financing international trade involving import and export of commodities, with special emphasis on emerging markets. This article details a particular market and transaction in which the bank functioned to expedite economic growth and privatization. Following some preliminary remarks about the general nature of structured commodity finance, the author reviews the situation in Ukraine and describes the acquisition of a major Ukrainian refining facility and the support of the commercial operations at the refinery by means of a structured commodity finance transaction.

In a typical structured commodity finance transaction, the lender assumes a broad scope of political and commercial risks. In addition to sovereign risk, these include performance risk of the producer, product-related risks, price and marketing risk. As appropriate, the lender may take steps to mitigate these risks by means of insurance coverage, swaps, or other contractual arrangements with counterparties.

The track record for structured commodity finance indicates that it is a successful tool for financing trade and investment in emerging markets. Properly structured, such financing will minimize, in most cases even exclude, transfer and convertibility risk of proceeds that might normally be associated with emerging markets transactions. It also excludes completion and construction risks. The associated commercial risks involving the producer and distributor(s) are mitigated structurally to the appropriate level.

Typical structured commodity finance applications include:

- toll processing financing;
- pre-production and pre-export finance;
- barter, countertrade and off-set financing; and
- "semi buy-back" and/or rehabilitation financing.

Development of 'New Economy'

Compared with other states of the Commonwealth of Independent States (CIS), such as Russia and Kazakhstan, development of Ukraine has been somewhat laggard. Contributing factors have included continuing political, legal and economic uncertainties, as well as a lack of natural resources. The latter are the principal medium for privatization and, therefore, advancement of a free market economy.

Since 1999, a reform government has been aggressively trying to expedite the country's progress. Its external debt with private and sovereign creditors—the so-called London and Paris Club—has been restructured, an ambitious privatization program is under way, and legal and fiscal liberalization are combining to create a competitive environment for local enterprise. These moves have been contentious and have placed the government under a great deal of pressure. However, their cumulative effect has probably become too great to reverse; it seems unlikely that any change in the power base would reverse the trend toward privatization and free market economics.

Since 1999, Ukraine has become one of the fastest-growing economies within the CIS, fueled by a substantial increase in foreign direct investment. The national budget is in balance, the current account is steadily improving and the central bank's hard currency reserves have doubled However, Ukraine is still a challenging environment in which to raise funds to facilitate trade or investment. Structured commodity financing is still virtually the only medium available to raise capital for these purposes.

Focus on Capital-Intensive Industries

The national privatization program has been concentrated on processing, refining and extractive industries (oil, petrochemicals, base metals and steel) for which Ukraine had been a strategic center within the Soviet Union. In particular, Ukraine had been the petroleum refining center of the USSR, with five refineries having a stated annual capacity

Dr. Thomas Oehl is vice president, international trade and commodity finance—structured commodity finance—at the Düsseldorf headquarters office of Westdeutsche Landesbank Girozentrale (www.westlb.com/itcf).

Finance

approaching 75 million metric tons of crude oil.

Investors in Ukrainian privatization projects have principally been other CIS-resident firms, familiar with the local environment and how to deal with it. A few Western investors have approached the economy, but have largely been disappointed in the results of their projects.

Investments have tended to be integrative, i.e., investors have been firms that require large supplies of processed or refined commodities, or which have correspondingly large supplies of raw material, such as crude oil, for processing.

LiNOS: Privatization Success Story

A.O. Lisichansknefteorgsinterz (LiNOS), established in 1976, is located in southeastern Ukraine, close to the Russian border. It is the most modern refinery in the CIS, with an annual capacity of approximately 20 million metric tons.

During the period after the breakup of the Soviet Union, matters at LiNOS were rapidly progressing from bad to worse. Absent the means to pay for them, crude oil supplies evaporated and production declined precipitously, from 20 million metric tons in 1992 to less than a million metric tons in 1999. The refinery was in bankruptcy because of its heavy debt burden and lack of business.

Last year, Tyumen Oil Co. (TNK) commissioned WestLB to evaluate LiNOS and develop an acquisition strategy for the refinery, its first investment project outside Russia. TNK is the fourth-largest oil producer in Russia, with an annual output of about 40 million metric tons. The LiNOS acquisition was a strategic move to gain both refining capacity and a position in the Ukrainian market.

TNK acquired LiNOS in a structured transaction, using its wholly owned Ukrainian subsidiary. The acquisition secured a supply of crude for LiNOS; both production and domestic market share improved rapidly and exponentially. Since acquisition, TNK has been actively addressing restructuring of the refinery's existing debt burden.

Support of the Acquisition

The basis for the financing was the secured crude oil supply that TNK would make available to LiNOS. In recognition of this security, the lender assumed both performance risk for LiNOS and Ukrainian political risk.

The landmark transaction that resulted is the largest-ever financing for a private Ukrainian entity without a sovereign guarantee. The initial facility of $50 million was increased, last June, to $75 million to accommodate the increased scope of operations at the refinery.

The structure, which is depicted in the accompanying diagram, is both innovative and complex. The financing supports processing crude oil at LiNOS, supported by pledges of stocks and contract receivables and by a guarantee from TNK, the parent company.

Export sales proceeds are paid directly into an escrow account that is maintained at WestLB in Düsseldorf. Ownership of product that is sold domestically is retained by WestLB until payment is received; sales are covered via a stand-by arrangement with a reputable export off-taker.

The results of the transaction have produced a "win/win" scenario for all parties. TNK's local subsidiary, after its acquisition of LiNOS, has become the second biggest company in Ukraine. It has obtained a 30% share of the high-profit domestic market, and is the largest exporter of refined oil in the country. ❑

Conference Calendar

February

2nd Turkish International Upstream & Downstream Oil & Gas Exhibition & Congress (TUDOGE 2002)
Istanbul, Turkey
February 28-March 2
ITE Group
Tel.: 44 20 7596 5000
Fax: 44 20 7596 5106
E-mail: oilgas@ite-exhibitions.com

March 2002

1st Georgian International Oil, Gas, Energy & Infrastructure Exhibition & Conference (GIOGIE 2002)
Tbilisi, Georgia
March 19-21
ITE Group
Tel: 44 20 7596 5000
Fax: 44 20 7596 5111
E-mail: oilgas@ite-exhibitions.com

For more information, please contact: Thomas Wu, Director of Marketing, World Trade Executive, Inc., at:
Tel.: 1 (978) 287-0301;
Fax: 1 (978) 287-0302;
Email: Tom@wtexec.com.

Please note: Conference announcements are subject to space availability.

Professional Announcements

Statistics

OIL PRODUCTION IN SEPTEMBER 2001

(thousand tons)

Company	September Actual	Daily Average	+/- Daily . September Vs August	YTD
Vertically Integrated Companies:				
Bashneft	*994.4*	*33.15*	*0.12*	*8,881.0*
LUKOIL:				
LUKOIL-Astrakhan	6.1	0.20	0.01	55.4
Bitran	40.4	1.35	0.02	362.4
KomiTEK	338.5	11.28	0.29	3,131.3
LUKOIL-Kaliningradmorneftegas	55.0	1.83	(0.01)	492.5
LUKOIL-Zapadnaya Sibir	3,690.0	123.00	0.35	33,871.4
LUKOIL-Nizhnevolzhskneft	246.7	8.22	(0.05)	2,194.0
Nobel Oil	102.4	3.41	(0.30)	969.9
LUKOIL-Permneft	444.3	14.81	(0.01)	4,009.2
LUKOIL-Perm	232.7	7.76	0.04	2,091.8
Total for LUKOIL	*5,156.0*	*171.87*	*0.34*	*47,177.8*
ONAKO:				
Neftepromprodukt	0.0	0.00	0.00	362.1
Orenburgneft	679.4	22.65	0.15	5,535.2
Total for ONAKO	*679.4*	*22.65*	*0.15*	*5,897.4*
Rosneft:				
Dagneft	28.2	0.94	(0.05)	261.0
Krasnodarneftegaz	105.5	3.52	0.00	943.8
Rosneft-Purneftegaz	819.1	27.30	0.05	7,135.7
Rosneft-Sakhalinmorneftegaz	127.2	4.24	0.01	1,118.9
Rosneft-Stavropolneftegaz	93.1	3.10	(0.06)	826.7
Rosneft-Termneft	11.0	0.37	0.00	99.3
Yugneftegaz	22.6	0.75	0.04	199.6
CHENEKO-Grozneftegas	72.1	2.40	(0.02)	431.2
Total for Rosneft	*1,278.6*	*42.62*	*(0.02)*	*11,016.1*
SIBNEFT (Noyabrskneftegaz)	*1,804.2*	*60.14*	*1.26*	*14,887.5*
SIDANCO:				
Novosibirskneftegaz	4.5	0.15	(0.00)	40.5
Saratovneftegaz	121.0	4.03	(0.00)	1,086.1
Udmurtneft	413.8	13.79	0.04	3,798.5
Varyeganneftegaz	221.7	7.39	0.06	1,890.3
Total for SIDANCO	*761.0*	*25.37*	*0.09*	*6,815.4*
Slavneft:				
Slavneft-Megionneftegaz	1,042.0	34.73	0.17	9,297.6
Arigolneftegeologiya	20.4	0.68	0.10	141.7
Nafta-Ulyanovsk	7.8	0.26	0.02	65.3
Slavneft-Kranoyarskneftegaz	0.0	0.00	(0.01)	2.8
Obneftegeologiya	16.3	0.54	(0.04)	177.7
Slavneft-Megionneftegazgeologiya	0.0	0.00	0.00	3.9
Sobol	37.0	1.23	(0.02)	309.6
Varyeganneft	118.5	3.95	0.10	1,016.8
Uzunneft	2.7	0.09	(0.00)	19.6
Total for Slavneft	*1,244.7*	*41.49*	*0.30*	*11,034.9*
Surgutneftegaz	*3,700.4*	*123.35*	*1.19*	*32,470.2*
Tatneft	*2,022.7*	*67.42*	*0.13*	*18,408.0*

OIL PRODUCTION IN SEPTEMBER 2001 (thousand tons)				
Company	September Actual	Daily Average	+/- Daily Avg. September Vs August	YTD
Tyumen Oil Company:				
Nizhnevartovsk Oil and Gas Production Company	460.0	15.33	0.41	3,808.1
Tyumenneftegaz	183.5	6.12	(0.03)	1,628.5
Samotlorneftegaz	1,333.1	44.44	0.11	11,824.8
TNK-Nizhnevartovsk	544.3	18.14	0.17	4,802.4
TNK-Nyagan	267.8	8.93	0.23	2,324.6
Total for Tyumen Oil Company	*2,788.7*	*92.96*	*0.90*	*24,388.4*
YUKOS:				
Samaraneftegaz	809.5	26.98	0.40	4,537.3
Yuganskneftegaz	3,065.8	102.19	0.50	26,490.9
YUKOS	67.8	2.26	0.20	522.0
Tomskneft	980.6	32.69	0.20	8,730.2
Total for YUKOS	*4,923.7*	*164.12*	*1.30*	42,718.8
Total for Vertically Integrated Companies	***25,353.8***	***845.1***	***5.8***	***223,695.4***
Non-Specialized State-Controlled Companies:				
Gazprom	824.0	27.47	0.08	7,570.1
RF Ministry of Natural Resources	0.0	0.00	0.00	0.0
Rostopprom	49.9	1.66	0.02	458.5
Total for Non-Specialized State-Controlled Companies	***873.9***	***29.13***	***0.10***	***8,028.6***
Other Oil-Producing Companies:				
Aganneftegazgeologiya	5.1	0.17	(0.00)	41.6
AKI-OTYR	2.7	0.09	(0.01)	12.6
Akmay	0.6	0.02	0.00	4.5
Aksaitovneft	9.0	0.30	0.01	78.8
ALOIL	8.9	0.30	0.05	66.9
Archneftegeologiya*	4.3	0.14	0.02	15.6
Archinskoye	3.0	0.10	(0.01)	33.8
Arkhangelskgeoldobycha**	30.2	1.01	0.07	205.5
Arktikgaz	9.3	0.31	0.02	78.0
Arktikmorneftegazrazvedka	1.7	0.06	0.00	16.7
Arktikneft	0.0	0.00	(0.29)	71.4
Asteron	0.0	0.00	0.00	0.0
BelKamNeft	142.9	4.76	0.02	1,258.7
BelKamNeft the lider of concortium	36.9	1.23	0.10	226.8
Bulgarneft	10.9	0.36	0.01	94.2
Chepetskoye NGDU	5.1	0.17	0.05	34.4
Chishmaneft	14.5	0.48	0.04	116.4
ChURS	0.9	0.03	(0.00)	8.2
CNP & SEN	4.7	0.16	0.01	39.7
DDM*	0.2	0.01	(0.00)	2.3
Dinelneft*	0.2	0.01	0.00	2.6
Druzhbaneft*	1.1	0.04	0.01	6.6
Eastern Transnational Company*	1.2	0.04	(0.04)	14.1
Elabuganeft	2.2	0.07	0.00	20.3
Enisei*	29.6	0.99	0.14	177.0
Evikhon	0.0	0.00	0.00	0.0
Futek	0.3	0.01	(0.00)	3.0
Geologiya	12.3	0.41	0.01	106.4
Geological Exploration Center	6.7	0.22	0.01	55.1
GEO-NARAT	0.0	0.00	0.00	1.6
Geotekh	5.2	0.17	0.01	39.5
Ingushneftegazprom	16.0	0.53	0.01	140.3
Irelyakhneft	3.6	0.12	0.05	32.3
Institute ROSTEK	0.3	0.01	(0.00)	2.9
Kaliningradskaya GDNGE	0.0	0.00	(0.18)	40.1
Kalmnedra	1.9	0.06	(0.02)	19.6

OIL PRODUCTION IN SEPTEMBER 2001 (thousand tons)				
Company	September Actual	Daily Average	+/- Daily Avg. September Vs Auqust	YTD
Kalmneft	14.5	0.48	(0.05)	140.2
Kalmpetrol*	1.7	0.06	(0.00)	15.5
Kalmytskaya Oil Company	0.0	0.00	0.00	0.0
INGA	0.9	0.03	0.00	12.2
Khancheiskoye NGDU*	5.1	0.17	0.06	18.3
Khanty-Mansiyskaya Oil Company*	0.4	0.01	(0.01)	5.0
Kolvageoldobycha	0.0	0.00	(0.03)	5.8
Kolvaneft	7.9	0.26	(0.04)	77.2
Kondurchaneft	3.2	0.11	0.00	35.0
Krasnoleninskneftegazgeologiya	0.0	0.00	0.00	5.3
Lenaneftegaz	47.7	1.59	(0.03)	214.9
Maykorskoye	1.8	0.06	(0.00)	19.1
Mellyaneft	5.5	0.18	0.02	33.3
Meretoyakhaneftegaz*	2.2	0.07	(0.01)	11.3
Mokhtikneft	8.5	0.28	0.05	68.2
Nazymgeodobycha*	0.1	0.00	0.00	0.5
Nazymskaya NGRE	2.4	0.08	0.00	14.2
Nefterazvedka	0.6	0.02	0.00	3.3
Negusneft	50.1	1.67	0.15	377.9
Nenetsk Oil Company	0.0	0.00	0.00	26.1
Nefteburservice	0.3	0.01	0.00	2.6
Nefteservice*	0.2	0.01	(0.00)	2.8
Neftinvest*	1.7	0.06	0.00	5.4
NeftUS*	14.5	0.48	0.07	27.4
Nizhnevolzhsk Fuel Company	0.0	0.00	0.00	59.1
Nizhnevolzhskgeologiya	7.4	0.25	0.01	57.3
Nokratoil	1.0	0.03	0.01	7.9
Norilskgazprom	0.2	0.01	0.00	4.1
Nortgas*	1.4	0.05	0.03	2.0
Novafininvest*	3.6	0.12	0.06	13.1
Novosibirskgeologiya	0.0	0.00	0.00	0.0
Onix Plyus*	1.1	0.04	0.01	3.7
Orenburggeologiya	55.5	1.85	(0.02)	406.2
Orenburggeoneft	4.6	0.15	(0.09)	44.9
PARMA-OIL	12.5	0.42	0.10	94.9
Paytykh Oil	0.0	0.00	0.00	0.5
Pecheraneft*	0.0	0.00	0.00	0.1
Penzaneft NGDU	5.2	0.17	0.05	37.3
Permoblneft	5.6	0.19	0.00	48.3
Preobrazhenskneft	4.2	0.14	(0.01)	29.6
PUR-LAND	0.0	0.00	0.00	0.0
Purovskaya Oil Company	0.0	0.00	0.00	1.3
Recher-Komi Oil Company	0.3	0.01	0.00	3.3
RITEK	80.6	2.69	0.02	651.6
RITEKSandibaneft	6.3	0.21	0.02	40.6
RITEK-Vnedrenye	0.0	0.00	(0.48)	114.7
RMNTK Nefteotdacha	0.4	0.01	(0.00)	2.2
RKM-Oil	7.0	0.23	0.04	43.4
Rospan	23.6	0.79	0.09	205.7
SANK	0.0	0.00	0.00	0.0
Selena	3.5	0.12	0.01	22.8
Saneko	15.6	0.52	0.03	126.9
Saratovneftegeofizika	5.3	0.18	0.00	32.7
Saygas	0.2	0.01	0.00	1.9
Sevosetinneftegazprom Concern	0.3	0.01	0.00	3.6
Sheshmaoil	13.0	0.43	(0.01)	113.8
Shiginskoye*	0.0	0.00	0.00	1.8
Selkupneftegaz* (Seneco)	0.0	0.00	0.00	13.0
Siboil	0.0	0.00	0.00	0.0
SMP-Neftegaz	43.0	1.43	0.03	351.2
Sobolinoye*	2.2	0.07	(0.00)	20.1
Stroyneftgaz	0.0	0.00	0.00	0.0
Tarkosalyeneftegaz	30.4	1.01	0.08	201.3
Tatnefteotdacha	14.2	0.47	0.01	122.0
Tatnefteprom	19.7	0.66	0.03	166.5
Tomskgazprom	31.8	1.06	0.18	257.0
Tomskneftegazgeologiya	6.2	0.21	0.00	63.3
Transoil	1.5	0.05	0.02	14.0
Troitskneft	6.4	0.21	0.00	44.4

OIL PRODUCTION IN SEPTEMBER 2001 (thousand tons)				
Company	September Actual	Daily Average	+/- Daily Avg. September Vs August	YTD
Tyumennedra	0.0	0.00	0.00	0.0
Tebukneft	82.1	2.74	(0.02)	761.4
Tebuk*	0.0	0.00	(0.05)	9.6
Tsetan-Geo*	0.7	0.02	0.00	4.5
Udmurt National Oil Company	10.4	0.35	0.03	77.6
Udmurt Oil Company	3.7	0.12	0.02	34.2
Udmurtgeologiya	13.2	0.44	0.02	115.1
Ukhtaneft	22.7	0.76	0.04	175.2
Ukhtaneftegazgeologiya	0.0	0.00	0.00	0.8
Ulan-Khol neft	0.0	0.00	0.00	0.0
Ulyanovskneft	24.1	0.80	(0.04)	229.5
Ural Oil Company	4.4	0.15	(0.06)	55.0
Uralneft	0.0	0.00	0.00	0.2
Uralneftegazprom	6.1	0.20	0.02	50.4
Urengoyneftegazgeologiya	0.0	0.00	0.00	0.0
Yus	0.1	0.00	(0.01)	1.7
Varandeyneftegaz	0.0	0.00	(0.43)	54.4
VIPOIL-Neftegaz	0.0	0.00	0.00	0.0
Vishera Oil&Gas Producing Company	4.4	0.15	0.00	34.8
Visheraneftegaz	2.7	0.09	(0.00)	24.3
Visheraneft*	0.0	0.00	(0.00)	1.1
Volganeft	3.6	0.12	0.08	12.5
Vostok-Ural-Oil	2.5	0.08	(0.01)	23.8
Vostsibneftegaz	0.0	0.00	(0.00)	34.9
Yakutgazprom (Taas-Uryakh-Neft)	11.2	0.37	0.06	105.0
Yamalneftegazgeologiya	0.0	0.00	0.00	4.2
Yeganoil (Egan-Oil)	13.0	0.43	(0.00)	118.4
Zapolyarneftegazgeologiya	0.0	0.00	0.00	0.0
Zirgan	0.9	0.03	(0.00)	8.2
Total for Other Oil-Producing Companies	***1,160.1***	***38.67***	***1.06***	***1,160.1***
AIK-LUKOIL	174.3	5.81	0.02	1,444.1
AmKomi	8.8	0.29	(0.03)	77.5
Bashmineral	4.7	0.16	0.00	43.7
Bitech-Silur	34.4	1.15	(0.02)	306.6
Chernogorskoye	33.0	1.10	0.02	295.8
Geoilbent	75.6	2.52	0.29	553.6
Goloil	4.8	0.16	0.03	27.8
IDELOIL	5.7	0.19	0.02	44.5
Investnafta	5.0	0.17	0.01	42.5
Kama-neft	36.1	1.20	0.01	325.1
CanBaikal Resourses Inc.	2.0	0.07	(0.01)	15.9
Kara-Altyn	18.8	0.63	0.01	155.8
Khantymansiyskneftegazgeologiya	57.2	1.91	0.01	442.3
KomiArcticOil	91.6	3.05	0.12	660.5
KomiQuest	5.9	0.20	0.00	53.8
Magma	24.4	0.81	(0.02)	210.3
Nedra	9.1	0.30	0.04	72.8
Pechoraneft	3.3	0.11	(0.18)	47.7
Pechoraneftegaz	25.1	0.84	0.01	210.6
Permtex	30.4	1.01	(0.00)	246.3
PermTOTINeft	11.6	0.39	(0.00)	101.2
Petrosakh	18.2	0.61	(0.01)	167.3
Polar Lights	123.2	4.11	0.22	1,181.0
Purneftegazgeologiya	12.3	0.41	0.01	122.7
Russian Fuel Company	24.2	0.81	0.01	207.0

Statistics

OIL PRODUCTION IN SEPTEMBER 2001

(thousand tons)

Company	September Actual	Daily Average	+/- Daily Avg. September Vs Auqust
Sakhalin Energy Investment Company	289.1	9.64	(1.42)
Severnaya Neft (Northern Oil)	90.7	3.02	0.07
Sinco	10.3	0.34	0.08
Stimul	16.2	0.54	0.01
Tatex	38.0	1.27	0.02
Tatoilgas	22.0	0.73	0.03
Tomsk Petroleum und Gaz	12.9	0.43	0.09
Total Exploration Production Russia	45.5	1.52	(0.01)
Tura Petroleum Company	0.0	0.00	0.00
Tursunt	27.6	0.92	0.01
Uralskaya Neft (Ural Oil)	13.2	0.44	(0.01)
Vanyeganneft	226.8	7.56	0.00
Vatoil	227.7	7.59	0.07
Vatoilneftedobycha	15.3	0.51	0.10
VINKA	0.1	0.00	(0.00)
Volgodeminoil	35.8	1.19	0.00
White Nights	63.8	2.13	0.00
Yangpur	7.3	0.24	0.00
Yugraneft Oil Company	7.8	0.26	(0.01)
Yugraneft Corp.	31.5	1.05	(0.03)
Total for Joint Ventures	***2,021.3***	***67.38***	***(0.40)***
Total	***29,409.1***	***980.3***	***6.5***

Note: All figures are preliminary.

* New companies, or companies previously not reported; nonreconcilable totals reflect incomplete data supplied by the RF Ministry of Ener

Source: RF Ministry of Energy

OIL EXPORTS FROM RUSSIA IN SEPTEMBER 2001

(thousand tons)

Producer	Seaports				Druzhba Pipeline							Monthly Summary			
	Ventspils	Novo-rossiysk	Tuapse	Odessa	Germany	Poland	Czech Rep.	Slovak Rep.	Hungary, Slovenia	Lithuania	Butinge	September	Daily Average	+/- Daily Avg. September vs. August	YTD
Oil Export under the Obligations of RF												0.0	0.00	0.00	54.0
Vertically Integrated Companies:															
Bashneft	93.0	115.0			93.0							301.0	10.03	(1.58)	2,937.0
LUKOIL:															
LUKOIL	140.0	195.0		63.0		10.0	50.0					458.0	15.27	8.82	2,034.0
LUKOIL-Astrakhanmorneft												0.0	0.00	0.00	0.0
LUKOIL-Zapadnaya Sibir	65.7	402.5	144.9	121.0		50.8	84.2	41.5			100.0	1,010.5	33.68	(9.54)	11,793.7
LUKOIL-Nizhnevolzhskneft		100.0										100.0	3.33	0.11	900.0
LUKOIL-Perm						59.0		32.0				91.0	3.03	(0.32)	730.9
LUKOIL-Permneft				50.0								50.0	1.67	1.67	655.0
Nobel Oil												0.0	0.00	0.00	40.0
Vatoil						49.0		34.0				83.0	2.77	(2.32)	778.0
KomiTEK						30.0						30.0	1.00	(1.65)	439.0
Total for LUKOIL	205.7	697.5	144.9	234.0	0.0	198.8	134.2	107.5	0.0	0.0	100.0	1,822.5	58.79	(1.60)	17,370.6
Rosneft:															
Rosneft-Dagneft												0.0	0.00	(0.26)	181.8
Grozneftegaz		68.0										68.0	2.27	0.40	368.0
Rosneft-Krasnodarneftegaz												0.0	0.00	(2.10)	404.0
Rosneft-Purneftegaz		136.0	126.9									262.9	8.76	0.46	2,687.2
Rosneft		142.8										142.8	4.76	4.76	418.8
Sakhalinmorneftegaz												0.0	0.00	0.00	0.0
Stavropolneftegaz												0.0	0.00	0.00	20.0
Rosneft-Termneft		4.0										4.0	0.13	(0.22)	93.0
Yugneftegaz		2.8										2.8	0.09	(0.20)	61.8
Total for Rosneft	0.0	353.6	126.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	480.5	16.02	2.84	4,234.5
Sibneft (Noyabrskneftegaz)		285.6	107.3		156.0	60.3						609.2	20.31	(2.26)	5,217.2
SIBUR (Sibneftegazpererabotka)												0.0	0.00	0.00	0.0
SIDANCO:															
Novosibirskneftegas						5.0						5.0	0.17	0.04	18.0
Nefteburservice*												0.0	0.00	(0.03)	0.8
Saratovneftegaz						10.0	35.0					45.0	1.50	0.05	526.0
Udmurtneft	149.0											149.0	4.97	0.48	1,205.9
Varyeganneftegaz												0.0	0.00	(0.19)	283.0
Total for SIDANCO	149.0	0.0	0.0	0.0	0.0	15.0	35.0	0.0	0.0	0.0	0.0	199.0	6.63	0.31	2,033.7
Slavneft:															
Arigolneftegeologiya								6.0				6.0	0.20	(0.01)	39.0
Slavneft-Megionneftegaz	199.9	78.7			2.0			77.0			47.0	404.6	13.49	(0.16)	3,444.9
Sobol												0.0	0.00	(0.03)	77.4
Megionneftegazgeologiya												0.0	0.00	0.00	3.8
Uzunneft												0.0	0.00	(0.03)	5.8
Total for Slavneft	199.9	78.7	0.0	0.0	2.0	0.0	0.0	83.0	0.0	0.0	47.0	410.6	13.69	(0.23)	3,571.0
Surgutneftegaz		75.0			768.0	200.0		40.0	40.0			1,123.0	37.43	(11.76)	11,880.0
Tatneft	202.0	85.5			163.0	132.7	33.0	67.4				683.6	22.79	(1.94)	6,860.7
Tyumen Oil Company:															
Nizhnevartovsk Oil and Gas Company									17.0			17.0	0.57	0.02	889.6
Orenburggeologiya										48.0		48.0	1.60	1.60	48.0
Orenburgneft	199.0	58.4			117.0					80.0		454.4	15.15	6.38	3,008.4
TNK-Nizhnevartovsk									25.0	72.0		97.0	3.23	(4.02)	944.0
TNK-Nyagan	3.6					2.0			14.0			19.6	0.65	(1.62)	442.0
Tyumen Oil Company												0.0	0.00	0.00	58.0

Statistics

OIL EXPORTS FROM RUSSIA IN SEPTEMBER 2001 (thousand tons)															
	Seaports				Druzhba Pipeline							Monthly Summary			
Company	Ventspils	Novo-rossiysk	Tuapse	Odessa	Germany	Poland	Czech Rep.	Slovak Rep.	Hungary, Slovenia	Lithuania	Butinge	September	Daily Average	+/- Daily Avg. September vs. August	YTD
Tyumenneftegaz	29.0								7.0			36.0	1.20	0.94	393.5
Samotlorneftegaz		416.1	76.0		51.0	164.5			7.0			714.6	23.82	3.26	5,201.2
Total for Tyumen Oil Company	*231.6*	*474.5*	*76.0*	*0.0*	*168.0*	*166.5*	*0.0*	*0.0*	*70.0*	*200.0*	*0.0*	*1,386.6*	*46.22*	*6.56*	*10,984.7*
Vostochnaya (Eastern) Oil Company:															
Tomskneft												0.0	0.00	0.00	205.5
Total for Vostochnaya (Eastern) Oil Company	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.00*	*0.00*	*205.5*
YUKOS:															
Samaraneftegaz		269.2				257.6			156.0			682.8	22.76	3.33	5,333.2
Tomsk Petroleum und Gaz												0.0	0.00	(0.13)	20.0
Yuganskneftegaz	104.0	137.1							240.0	259.8	363.0	1,103.9	36.80	(3.04)	10,240.6
YUKOS									24.0	40.0	28.0	92.0	3.07	1.00	1,758.5
Total for YUKOS	*104.0*	*406.3*	*0.0*	*0.0*	*0.0*	*257.6*	*0.0*	*0.0*	*420.0*	*299.8*	*391.0*	*1,878.7*	*62.62*	*1.17*	*17,352.3*
Total for Vertically Integrated Companies	***1,185.1***	***2,571.7***	***455.1***	***234.0***	***1,350.0***	***1,030.9***	***202.2***	***297.9***	***530.0***	***499.8***	***538.0***	***8,894.7***	***296.49***	***(1.00)***	***54,587.5***
State Controlled Companies:															
Gazprom		24.8			13.5	57.0						95.3	3.18	1.89	1,104.8
RF Ministry of Natural Resources	3.0				7.0	8.0						18.0	0.60	(0.27)	207.9
Rostopprom		8.2				1.0						9.2	0.31	(0.55)	178.7
Transneft		200.0										200.0	6.67	6.67	200.0
Total for State-Controlled Companies	***3.0***	***233.0***	***0.0***	***0.0***	***20.5***	***66.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***322.5***	***10.75***	***7.73***	***1,691.4***
Other Oil-Producing and Exporting Companies:															
Aganneftegazgeologiya					1.0							1.0	0.03	(0.06)	15.0
Aki-Otyr						1.0						1.0	0.03	0.00	5.0
Aksaitovneft								3.0				3.0	0.10	0.00	24.0
Aloil							2.0					2.0	0.07	0.00	28.7
Arcticgaz		2.5										2.5	0.08	0.01	59.2
Archinskoye						0.7						0.7	0.02	(0.09)	16.1
Arcneftegeologiya*					3.0							3.0	0.10	0.00	6.0
Belkamneft					83.0							83.0	2.77	1.09	450.0
Bulgarneft									4.5			4.5	0.15	0.00	27.3
Chepetskoye NGDU												0.0	0.00	(0.11)	11.7
Chishmaneft												0.0	0.00	0.00	56.9
Churs								0.4				0.4	0.01	0.00	2.7
CNP & SEN					2.0							2.0	0.07	(0.03)	13.0
Druzhbaneft					0.3							0.3	0.01	(0.00)	2.0
Elabuganeft							1.4					1.4	0.05	0.00	7.2
Enisei												0.0	0.00	(0.52)	60.8
Grits												0.0	0.00	0.00	0.0
Geologiya								4.0				4.0	0.13	0.00	45.0
Geological Exploration Center					2.5							2.5	0.08	0.00	24.0
Geotekh									1.6			1.6	0.05	(0.00)	14.0
Gratan												0.0	0.00	0.00	0.0
Ingushneftegazprom												0.0	0.00	0.00	96.0
Institute ROSTEK						0.5						0.5	0.02	0.00	0.9
Kalmneft		1.0										1.0	0.03	0.01	64.7
Kalmnedra		3.0										3.0	0.10	0.10	11.0
Kalmpetrol		0.1										0.1	0.00	(0.06)	4.8
Kalmyk Oil Company												0.0	0.00	0.00	0.0
INGA												0.0	0.00	0.00	0.0

OIL EXPORTS FROM RUSSIA IN SEPTEMBER 2001

(thousand tons)

Company	Seaports				Druzhba Pipeline							Monthly Summary			
	Ventspils	Novo-rossiysk	Tuapse	Odessa	Germany	Poland	Czech Rep.	Slovak Rep.	Hungary, Slovenia	Lithuania	Butinge	September	Daily Average	+/- Daily Avg. September vs. August	YTD
Kogalymnefteprogress												0.0	0.00	0.00	0.0
Kolvageoldobycha												0.0	0.00	0.00	0.0
Kolvaneft											13.0	13.0	0.43	0.43	32.7
Kondurchaneft					1.3							1.3	0.04	0.00	9.1
Krasnoleninskneftegaz												0.0	0.00	0.00	0.0
Krasnoleninskneftegazgeologiya												0.0	0.00	0.00	0.0
Khanty-Mansiyskaya Oil Company*												0.0	0.00	(0.03)	1.0
Lenaneftegaz												0.0	0.00	0.00	0.0
Makro Trade												0.0	0.00	0.00	0.0
Maykorskoye								0.8				0.8	0.03	0.01	5.8
Melyanneft					1.3							1.3	0.04	0.00	8.3
Meretoyakhaneftegaz					2.7							2.7	0.09	0.09	6.9
Mokhtikneft	7.2											7.2	0.24	0.24	23.7
Nazymskaya NGRE												0.0	0.00	(0.06)	2.0
Negusneft		2.1										2.1	0.07	(0.09)	29.6
Nenetsk Oil Company												0.0	0.00	0.00	6.0
NeftUs*											5.0	5.0	0.17	0.17	5.0
Nokratoil												0.0	0.00	0.00	2.3
Norilskgazprom												0.0	0.00	0.00	0.0
Obneftegeologiya								0.1				0.1	0.00	0.00	0.1
Orenburggeologiya												0.0	0.00	(0.60)	190.4
Parma-Oil								11.0				11.0	0.37	0.01	49.7
Penzaneft												0.0	0.00	0.00	0.0
Permoblneft						1.8						1.8	0.06	0.00	14.0
Petrosakh												0.0	0.00	0.00	0.0
Prom-Gaz												0.0	0.00	0.00	0.0
Purneftegazgeologiya												0.0	0.00	0.00	6.0
Purovskaya Oil Company												0.0	0.00	0.00	1.5
RITEK	25.4					38.3						63.7	2.12	(0.01)	472.6
RKM oil												0.0	0.00	(0.17)	12.1
RMNTK Nefteotdacha												0.0	0.00	0.00	0.0
Saygas					1.0							1.0	0.03	0.03	1.0
Selena								1.0				1.0	0.03	0.00	8.0
Severnaya Neft (Northern Oil)	35.7											35.7	1.19	0.12	347.0
Sheshmaoil					5.0							5.0	0.17	0.01	38.2
Siboil												0.0	0.00	0.00	0.0
Somes												0.0	0.00	0.00	0.0
Sobolinoye*						2.0						2.0	0.07	0.00	4.0
SMP-Neftegaz	16.6											16.6	0.55	0.06	150.4
Tarkosalyeneftegaz					3.1							3.1	0.10	(0.24)	80.5
Tatnefteprom	5.8											5.8	0.19	(0.03)	49.7
Tatnefteprom-Zyuzeyevneft												0.0	0.00	0.00	14.3
Tatnefteotdacha												0.0	0.00	(0.23)	43.8
Tomskgazprom					16.8							16.8	0.56	0.37	74.6
Tomskneftegazgeologiya						0.5						0.5	0.02	(0.05)	45.0
Trans Nafta												0.0	0.00	0.00	0.0
Transoil					1.2							1.2	0.04	0.02	7.4
Troitskneft					2.5							2.5	0.08	0.00	17.5
Tyumenimpex												0.0	0.00	0.00	0.0

Statistics

OIL EXPORTS FROM RUSSIA IN SEPTEMBER 2001

(thousand tons)

Company	Seaports				Druzhba Pipeline							Monthly Summary			
	Ventspils	Novo-rossiysk	Tuapse	Odessa	Germany	Poland	Czech Rep.	Slovak Rep.	Hungary, Slovenia	Lithuania	Butinge	September	Daily Average	+/- Daily Avg. September vs. August	YTD
Varyeganneft			25.0					31.0				56.0	1.87	0.87	357.0
Varyeganneftegas	10.0					80.0						90.0	3.00	0.29	583.5
Visheraneftegaz												0.0	0.00	(0.06)	9.2
Visherskaya Oil and Gas Company						1.6						1.6	0.05	(0.00)	13.0
Volganeft												0.0	0.00	(0.01)	1.3
Vostok-Ural-Neft												0.0	0.00	(0.03)	14.7
Udmurt National Oil Company												0.0	0.00	(0.15)	30.9
Udmurt Oil Company						2.5						2.5	0.08	0.00	17.0
Ulyanovskneft												0.0	0.00	(0.55)	119.0
Ural Oil Company												0.0	0.00	0.00	13.7
Uralneftegazprom		8.0										8.0	0.27	0.27	8.0
Yakutgazprom												0.0	0.00	0.00	0.0
Total for Other Oil-Producing Companies	***100.7***	***16.7***	***25.0***	***0.0***	***126.7***	***129.0***	***3.4***	***51.3***	***6.1***	***0.0***	***18.0***	***476.9***	***15.90***	***1.05***	***3,973.28***
Joint Ventures and Service Companies:															
Producing JVs:															
AIK-LUKOIL		33.0										33.0	1.10	(1.25)	501.0
AmKomi						4.3						4.3	0.14	0.00	18.6
Akmay												0.0	0.00	0.00	1.0
Bashmineral					2.0							2.0	0.07	0.00	13.4
Bitran												0.0	0.00	0.00	0.0
Bitech-Silur	12.4											12.4	0.41	0.04	138.5
Chernogorskoye			6.0		5.6	26.8		1.3				39.7	1.32	0.92	167.9
Econeft												0.0	0.00	0.00	0.0
Geoilbent		11.0										11.0	0.37	(0.28)	227.0
Goloil						1.0						1.0	0.03	(0.03)	5.0
Ideloil					2.0							2.0	0.07	0.02	19.1
Investnafta					0.3							0.3	0.01	(0.03)	23.7
Kabbalneftetopprom												0.0	0.00	0.00	0.0
Kama-neft							3.4	16.7				20.1	0.67	0.23	128.0
CanBaikal Resources												0.0	0.00	(0.04)	4.0
Kara-Altyn	6.2											6.2	0.21	0.02	48.7
KomiArcticOil	67.0											67.0	2.23	(0.51)	472.0
KomiQuest					2.3							2.3	0.08	0.00	13.0
KhantymansiyskNGgeologiya	2.0											2.0	0.07	(0.48)	186.9
Magma						23.0						23.0	0.77	0.23	168.0
Nafta-Ulyanovsk												0.0	0.00	0.00	9.0
Nedra								4.7		4.5		9.1	0.30	0.22	28.2
Pechoraneftegaz	4.8											4.8	0.16	(0.33)	99.9
Permtex					3.0							3.0	0.10	(0.26)	194.0
PermTotiNeft								0.8				0.8	0.03	(0.24)	31.9
Polar Lights	16.0					30.0						46.0	1.53	0.08	423.5
Rosnefteexport												0.0	0.00	0.00	0.0
Russian Fuel Company						3.5		0.7				4.2	0.14	(0.27)	72.1
Samarainvestneft												0.0	0.00	0.00	3.0
Sinco												0.0	0.00	0.00	0.0
Sobol					1.0							1.0	0.03	0.03	1.0
Stimul		8.4										8.4	0.28	0.04	15.9
Stroineftgaz												0.0	0.00	0.00	0.0
Tatex						13.1						13.1	0.44	(0.00)	175.0

Statistics

OIL EXPORTS FROM RUSSIA IN SEPTEMBER 2001 (thousand tons)															
	Seaports				Druzhba Pipeline							Monthly Summary			
Company	Ventspils	Novo-rossiysk	Tuapse	Odessa	Germany	Poland	Czech Rep.	Slovak Rep.	Hungary, Slovenia	Lithuania	Butinge	September	Daily Average	+/- Daily Avg. September vs. August	YTD
Tatoilgaz					7.6							7.6	0.25	0.01	79.8
Tebukneft					7.0						20.0	27.0	0.90	0.06	290.0
Total Exploration Production Russia	42.0											42.0	1.40	0.14	361.0
Tomsk Petroleum und Gaz									5.0			5.0	0.17	0.17	5.0
Tsetan-Geo*	0.5											0.5	0.02	0.00	2.0
Tura Petroleum												0.0	0.00	0.00	0.0
Tursunt					10.0		18.0					28.0	0.93	0.29	131.0
Udmurttorf		0.1										0.1	0.00	0.00	0.1
Ulyanovsknefteotdacha												0.0	0.00	0.00	0.0
Ukhtaneft												0.0	0.00	0.00	0.0
Uralskaya Neft (Ural Oil)												0.0	0.00	(0.48)	56.0
Uralskaya Oil Company												0.0	0.00	(0.07)	35.3
Vanyeganneft		32.1	12.5		30.8							75.4	2.51	(0.26)	700.0
VINKA												0.0	0.00	0.00	0.0
Volgodeminoil		13.0										13.0	0.43	(0.04)	117.0
White Nights	1.0											1.0	0.03	(0.91)	244.0
Yangpur					1.0							1.0	0.03	(0.06)	25.0
Yugraneft Oil Company												0.0	0.00	0.00	32.0
Yugraneft Corp.						1.0	17.2					18.2	0.61	(0.29)	95.0
Total for Producing JVs	***151.9***	***97.5***	***18.5***	***0.0***	***72.6***	***102.7***	***38.6***	***24.2***	***5.0***	***4.5***	***20.0***	***535.5***	***17.85***	***(3.34)***	***5,362.48***
Service Companies and JVs:															
Argenta												0.0	0.00	0.00	0.0
Nefterazvedka												0.0	0.00	0.00	0.0
Preobrazhenskneft												0.0	0.00	0.00	0.0
Pur-Lend												0.0	0.00	0.00	0.0
Severgazprom												0.0	0.00	0.00	9.0
Severnoeneftegaz												0.0	0.00	0.00	0.0
Tatoilpetro												0.0	0.00	0.00	0.0
Vasyugan Services												0.0	0.00	0.00	0.0
Ulan-Holl neft												0.0	0.00	0.00	0.0
Yeganoil (Egan-oil)												0.0	0.00	0.00	0.0
Total for Service Companies and JVs	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.00***	***0.00***	***9.0***
Total for JVs and Service Companies	***151.9***	***97.5***	***18.5***	***0.0***	***72.6***	***102.7***	***38.6***	***24.2***	***5.0***	***4.5***	***20.0***	***535.5***	***17.85***	***(3.34)***	***5,371.5***
Total for Russian Federation	***1,440.7***	***2,918.9***	***498.6***	***234.0***	***1,569.9***	***1,328.6***	***244.2***	***373.3***	***541.1***	***504.3***	***576.0***	***10229.5***	***341.0***	***4.4***	***93,508.9***

Note: All figures are preliminary; nonreconcilable totals reflect incomplete data supplied by the RF Ministry of Energy.

Source: RF Ministry of Energy

Statistics

*OIL EXPORTED BY OTHER OWNERS (The following figures are included in the main table) (thousand tons)														
		Seaports				Druzhba Pipeline							Monthly Summary	
Owner	Producer	Ventspils	Novo-rossiysk	Tuapse	Odessa	Germany	Poland	Czech Rep.	Slovak Rep.	Hungary, Slovenia	Lithuania	Butinge	September	Daily Average
Archinskoye	Sobolinoye						2.0						2.0	0.07
Chishmaneft	Stimul		8.4										8.4	0.28
Frolovskoye NGDU	Russian Fuel Company		0.3										0.3	0.01
KomiTEK	LUKOIL (LUKOIL)	100.0											100.0	3.33
LUKOIL (LUKOIL)	KomiTEK						30.0						30.0	1.00
LUKOIL (LUKOIL)	LUKOIL-Zapadnaya Sibir	65.7	402.5	144.9	121.0		50.8	84.2	41.5			100.0	1,010.5	33.68
LUKOIL (LUKOIL)	LUKOIL-Nizhnevolzhskneft		100.0										100.0	3.33
LUKOIL (LUKOIL)	LUKOIL-Permneft				50.0								50.0	1.67
LUKOIL-Perm	Nedra								4.7				4.7	0.16
LUKOIL-Perm	Chernogorskoye						6.8		1.3				8.1	0.27
LUKOIL-Permneft	LUKOIL (LUKOIL)							50.0					50.0	1.67
LUKOIL-Zapadnaya Sibir	LUKOIL (LUKOIL)		195.0		63.0		10.0						268.0	8.93
Nobel Oil	LUKOIL (LUKOIL)	40.0											40.0	1.33
Rosneft	Rosneft-Termneft		4.0										4.0	0.13
Rosneft	Rosneft-Purneftegas		136.0	126.9									262.9	8.76
Rosneft-Krasnodarneftegas	Rosneft		65.0										65.0	2.17
Rosneft-Purneftegas	Rosneft		69.8										69.8	2.33
Rosneft-Stavropolneftegas	Rosneft		2.0										2.0	0.07
Rosneft-Termneft	Rosneft		6.0										6.0	0.20
Russian Fuel Company	Udmurttorf		0.1										0.1	0.00
Samarainvestneft	Russian Fuel Company		2.9										2.9	0.10
Sibneft	Sibneft-Noyabrskneftegaz		285.6	107.3		135.0	56.0						583.9	19.46
Sibneft	Yugraneft						4.3						4.3	0.14
Sibneft-Noyabrskneftegaz	Sibneft					21.0							21.0	0.70
Tatneft	Negusneft		2.1										2.1	0.07
Tyumen Oil Company	Samotlorneftegas		351.1	76.0		51.0	164.5			7.0			649.6	21.65
Tyumen Oil Company	TNK-Nyagan	3.6					2.0						5.6	0.19
Tyumen Oil Company	Tyumenneftegaz	29.0											29.0	0.97
Tyumen Oil Company	TNK-Nizhnevartovsk										72.0		72.0	2.40
Tyumen Oil Company	Orenburgneft	135.0	58.4			117.0					80.0		390.4	13.01
Tyumen Oil Company	Orenburggeologiya										48.0		48.0	1.60
Udmurtneft	Saratovneftegas						10.0	35.0					45.0	1.50
Udmurttorf	Russian Fuel Company		5.0										5.0	0.17
Ulyanovskneft	Uralneftegazprom		8.0										8.0	0.27
Yuganskneftegaz	YUKOS											28.0	28.0	0.93
YUKOS	Samaraneftegaz		269.2				257.6			156.0			682.8	22.76
YUKOS	Yuganskneftegaz	104.0	137.1							240.0	259.8	363.0	1,103.9	36.80
YUKOS	Tomsk Petroleum und Gaz									5.0			5.0	0.17

Note: All figures are preliminary.

Source: RF Ministry of Energy