

Sector Case Study: Oil and gas exploitation in Siberia

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Focus on Finance Newsletter, Maart 2001

Greenpeace cleaning up an oil spill in Nizhnevartovsk, August 2000

Oil & gas: environmental havoc

The tundra and boreal forests of Siberia, where around 80% of the Russian oil and gas is produced, are severely endangered by the continuous exploitation of natural resources. "Thirty years of intensive energy resource exploitation has caused great damage to the nature of the Russian Federation, especially to the northern parts", a World Bank study concluded last June. "The area of contaminated soils and water basins is constantly growing as a result of the production of energy resources. The quality of flora and fauna is not only affected at the production sites; constant hazards and oil pipeline ruptures distribute the damage widely. Today, the accumulated amount of oil emulsions and sludge in the nature is estimated to be 1.2 billion tons. Every year, about 30,000 hectares of land is damaged." [1]

This environmental devastation also has a great impact on the lives of the local inhabitants. Rivers are polluted by oil, forests are cut down and fragmented, forest fires in primary forests increase significantly and gas-burning flames have been lighting everything in a crimson glow. Many indigenous families have lost access to adequate pastures for reindeer herding, but are not offered adequate compensation.

Public funds open up Russia's oil and gas resources

Foreign aid to clean up the Siberian environment has been promised ever since the fall of the Soviet empire in the early 1990s, in exchange for access by Western oil companies and countries to the vast reserves of oil and gas. In the first few years however, political and economic instability prevented the massive inflow of Western capital in the Russian oil and gas sector. Some smaller companies tried their luck, while some of the majors tested the water. Yet, as banks and other financial institutions were reluctant to follow, investments did not reach high levels.

Western politicians did their best to pave the way, by launching the Energy Charter initiative. This intended to provide a clear juridical and fiscal framework for investments in the Russian oil and gas sector, but only after years of difficult negotiations the Energy Charter finally came into force in April 1998. In the meantime, public institutions as the World Bank and the European Bank for Reconstruction and Development (EBRD) were almost the only financial institutions prepared to invest in the Russian oil and gas sector.

The first wave of foreign commercial investments

All this changed dramatically after Boris Jeltsin was reelected as president in June 1996. This created the illusion of political stability, and the promise of the swift creation of a stable legal and fiscal framework. Almost all Western oil majors rushed off to Siberia, looking for investment opportunities and partners (which was necessary to get a operating license).

In the meantime, the enormous Russian gas ministry had transformed itself into the state-owned Gazprom company. The oil sector at the other hand, had split up in a large number of larger and smaller oil companies, which by sometimes mysterious ways came under the control of a handful of oil barons. The largest of these new oil companies were Lukoil, Yukos, Sibneft, Rosneft, Tatneft, Sidanco, Surgutneftegaz, Slavneft, and Tyumen Oil. [2]

In this period, the Western as well as the Russian oil and gas companies suddenly could count on many Western banks to finance their investment plans. Oil and gas prices were high, sales in Western Europe were guaranteed, and the political situation seemed reasonably stable. Between mid-1996 and mid-1998, massive loans poured into the Russian oil and gas industries.

Gazprom leading the troops

Leading the troops was of course Gazprom, a company which on its own controls around one-third of the world's gas reserves. To finance its massive pipeline project between the Yamal peninsula in the northern part of Siberia and Western Europe, Gazprom needs around US\$ 40 billion until 2005. A large part of this amount was financed by a series of giant syndicated loans.

In August 1995, the German part of the pipeline was financed by a US\$ 1.3 billion loan arranged by Commerzbank. In April 1997 Gazprom entered into a US\$ 2.5 billion loan agreement with a consortium of banks, led by Dresdner Bank. In May 1997 a DM 1,675 million loan followed, arranged by Dresdner Bank and Deutsche Bank, as well as a US\$ 265 million loan arranged by the EBRD. In June 1997, a bridging loan of US\$ 1.2 billion was signed, now led by Dresdner Bank and Crédit Lyonnais. In November 1997 this bridging loan was replaced by a US\$ 3 billion financing arranged by Dresdner Bank and Crédit Lyonnais. In April 1998, Morgan Grenfell and Enskilda arranged a US\$ 230 million loan, and finally in July 1998 a US\$ 200 million loan was arranged by ING Barings, Bayerische Landesbank, Chase Manhattan and a conglomerate of Hungarian banks.[3]

Loans for oil companies

Some of the new Russian oil companies were also able to obtain giant loans. A few examples from a large list: Lukoil, the largest Russian oil company, signed a US\$ 1.5 billion loan agreement in January 1998 with a banking syndicate arranged by ABN Amro, Citibank, Deutsche Bank, Credit Suisse First Boston, and Société Générale. The loan would be used for projects in the Timano-Pechora basin, the north of the Caspian Sea and in West Siberia.[4]

Furthermore, Lukoil hired Western investment banks for a series of bond issues in 1997: US\$ 230 million by Greenwich NatWest, Paribas and SBC Warburg Dillon Read in May, US\$ 125 million by Credit Suisse First Boston in June, and US\$ 350 million by SBC Warburg Dillon Read in October.[5]

Crédit Lyonnais, Goldman Sachs and Merrill Lynch arranged a loan of US\$ 500 million loan for Yukos in October 1997. Dresdner Bank together with HypoVereinBank and Greenwich NatWest arranged a US\$ 175 million loan for Sidanco in March 1998, and Dresdner Bank together with Commerzbank and DG Bank arranged a US\$ 80 million loan for Slavneft.[6]

ABN Amro and Lazard Frères & Cie. have been involved in financing the Sakhalin 1 project, on the far eastern peninsula Sakhalin, in which ExxonMobil, Rosneft, Sodeco and ONGC participate. The Sakhalin 2 project on the same peninsula, involving Shell, Mitsui and Mitsubishi, received a US\$ 348 million financing from JEXIM, the EBRD, and OPIC, arranged by Chase Manhattan.[7]

1998: the hype collapses

And then suddenly the bubble burst. In August 1998, Russia plunged into a crisis. The ruble collapsed, the Russian state went bankrupt, as well as many Russian banks. Some Western oil companies sold their stakes and left. Others tried to continue working in Russia, but reduced their commitments as the political uncertainty over production sharing agreements continued.

Western bankers, however, lost all confidence, and were not prepared to consider any investment in Russia for the next two years. Gazprom and the largest Russian oil companies had to raise money in

other ways: by selling their shares abroad, or by issuing bonds. And when these sources dried up, they had to depend on retained cash flows and non-payment strategies.[8]

2000: the return of public foreign investments

During 2000, the need for fresh investments reached very high levels. At the same time, the appetite for the Russian oil and gas industry slowly returned in the financial world after the presidential election of Vladimir Putin in March 2000. But, as in the early 1990s, again the private banks looked for public backing and initiatives. This time two public institutions in particular were prepared to play this role: the US Export-Import Bank and the EBRD.

The US Ex-Im Bank in April 2000 finally approved two loan guarantees for loans to Tyumen Oil (TNK). The first guarantee of a US\$ 198 million loan by Chase Manhattan is meant for modernising the Ryazan refinery. The second guarantee of US\$ 292 million on a loan of US\$ 334 million by Commerzbank will be used for the rehabilitation of the giant Samotlor oil field in western Siberia. The Ex-Im Bank had already authorized the Ryazan refinery in February 1997, and the Samotlor oil field in August 1994, but both were not implemented yet.[9]

Samotlor oil field

Especially the rehabilitation plan for Samotlor is controversial. Everybody agrees that the oil field and the surrounding area need attention. According to the World Bank, "the Samotlor oil field is now classified as an ecological catastrophe zone." [10]

To underline how serious this catastrophe is, Greenpeace Netherlands commissioned an environmental assessment study of the area, which will be published this March. Greenpeace advocates using rehabilitation funds primarily for oil recovery and mitigation projects.

An interesting aspect of the loan guarantee for the rehabilitation of the Samotlor field, is the fact that the American company Halliburton is the main contractor. The US Ex-Im Bank was finally persuaded to issue the loan guarantee after intensive lobbying by the CEO of Halliburton, Dick Cheney. Since January 2001 Cheney happens to be the new vice-president of the United States.[11]

The other public institution returning on the Russian oil and gas scene, was the European Bank for Reconstruction and Development (EBRD). In March 2000 the EBRD decided to lend US\$ 150 million over three years to Lukoil, if the company would comply with US-based accounting standards. A few months later, a US\$ 250 million loan to Gazprom was approved by the EBRD. [12]

Socio-Ecological Union calls upon investors to review alternative options

In 1995, just before to the first foreign investment wave in Russia's oil and gas industry began to boom, Alexei Grigoriev of the Socio-Ecological Union Russian stated that Russian environmentalists "ask the citizens of Europe to think not only about short term profits and convenience from increased Russian oil exports, but also to carefully consider the globalization of environmental problems. What kind of world do they wish for their children to inherit? These are not merely words. It is a choice that Russians and Europeans must confront."

Grigoriev called upon the financial sector to consider alternative investment options: "The Russian energy sector, like Russian society as a whole, has great potential to save energy and decrease the emissions of greenhouse gases. Instead of investing taxpayer money in the promotion of global warming and destruction of the taiga, funds should be put into environmentally friendly ventures whose goals are increasing the sustainability of both the Russian and global economies. Among the most obvious candidates for such investments are the public transportation sector, the natural gas transportation and distribution systems, energy generation capacities and industrial technologies and improved insulation and heating of buildings. The real challenge for foreign experts and financial

institutions is to commit themselves to identify or create projects in these areas and help to organize and coordinate environmental friendly investments." [13]

2001: a new wave of private bank loans ?

The loans supported by public institutions, might have triggered a new shower of private bank loans to the Russian oil and gas sector. The compliance by some large Russian oil companies with Western accounting standards at least makes them more eligible. The first big drops have already fallen, and there is probably more to expect.

In January 2001, HypoVereinbank, Crédit Agricole Indosuez and WestLB launched a Euro 250 million five year secured term loan for Gazprom. "The facility is the first syndicated euro denominated facility for Gazprom and the first medium term facility not covered by an export credit agency guarantee since the crisis of 1998", according to Euroweek. [14]

Sibneft finalised a \$180m pre-export financing in November 2000 with seventeen banks. And in January 2001, ING Barings and Société Générale were finalising the arranger group for another \$150m pre-export financing facility for Sibneft. [15]

Lukoil's Initial Public Offering in New York

Apart from this new wave of bank loans, another development to watch is the planned listing of Lukoil on the New York Stock Exchange (NYSE). In the first half of 2001, the Russian government is planning the sale of a 6 per cent stake it holds in Lukoil, in the form of American Depositary Shares (ADSs). Although several other Russian companies have ADSs registered in the US, Lukoil would be the first Russian oil company to issue level three ADSs - enabling it to raise new capital on the NYSE. Morgan Stanley Dean Witter is appointed as sales advisor. [16]

Conclusion

In the past ten years, the Siberian oil and gas sector attracted substantial investments from the international banking community. Public and private banks co-financed the oil and gas sector on a massive scale, particularly between 1996 and the onset of the financial crisis of 1998. After a two year break, some public financial institutions reentered the sector last year. This seems to have unleashed a new wave of private bank loans, starting at the end of last year.

In the meantime, while the West now has access to the Siberian oil and gas reserves, the Siberian environment and its inhabitants are still in the same deplorable state as they were under the Soviet regime. Indeed, the situation is more likely to aggravate when financial institutions fail to address the environmental damage caused by their clients.

Notes

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