

Commercial Update – Sakhalin Region, November 2006 (Russian Far East)

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Oil and Gas

Shell is ready to transfer control over Sakhalin-2 to Gasprom. (Source: Sakh.com; Reuters; December 11, 2006)

Shell agreed to transfer control over Sakhalin-2 to Gazprom, Reuters announced. According to unofficial information, as a result of negotiations, Shell is going to keep the major, at least 25% stake of shares. Gazprom declined to comment on this statement, although Shell's press center confirmed that negotiations took place.

Russia suspends Sakhalin-2 water permits (Source: Reuters, December 07, 2006)

Russia stepped up pressure on Sakhalin-2 venture by saying it had suspended water permits in a move that could cause further delays to the \$22 billion project. The Russian Natural Resources Ministry said in a statement that its water resources agency had suspended 12 water-use licenses of Sakhalin's top contractor Starstroi, a joint venture between Russian firms and Italy's Saipem.

It gave Starstroi two months to correct the violations. In September, Russia revoked environmental permits accusing Shell of violating their terms, a charge Shell denied. "During the suspension period they cannot start new work, but can only rectify violations," Anna Khitrova, a spokeswoman for the agency, told Reuters.

Analysts say the latest move is part of an attempt to force Shell and its partners Mitsui and Mitsubishi to concede to less favorable terms. They also see a wider Kremlin campaign to limit foreign involvement in energy.

Construction of PA-B oil platform completed in South Korea (Source: *The Sakhalin Times*, December 01, 2006)

The construction of the PA-B oil platform was completed at Samsung Heavy Industries Shipyard in South Korea. The platform is designed to extract oil at the Sakhalin-2 Piltun-Astokhskoye offshore field in the Sea of Okhotsk. In 2005, the foundation for the platform was mounted 13 kilometres northeast off the Sakhalin coast. The platform will be installed in summer 2007. As soon as the PA-B is launched, there will be five oil platforms exploring and developing offshore fields. At present, the Moliqpaq, Orlan and Yastreb platforms are pumping oil from the Sea of Okhotsk. The LUN-A platform is being prepared for launch.

Sakhalin-1 crude cargoes to be loaded in December (Source: *The Sakhalin Times*, December 01, 2006)



Picture by sakhalin1.ru

said.

This is an improvement from when loadings commenced at the end of August, where the first tanker took about seven days to load. Typical loading operations for an aframax tanker at the DeKastri terminal are about 14 hours.

The Sakhalin-1 consortium is set to load four to six cargoes of crude in December at the DeKastri terminal, up from October and November volumes, but still well below its target of 10, a port source told Reuters. The terminal, which has already loaded three 80,000-100,000 deadweight metric tons tankers this month, is currently taking about three to four days to complete loading operations. Two tankers were loaded in October. "There should be four tankers loading this month, and this is in line with the original plan of between four and six tankers a month," the source

ONGC Videsh eyes stake in Sakhalin-3 (Source: www.financialexpress.com; December 02, 2006)

India will invest \$5 billion in various projects to source one billion barrels of oil and oil-equivalent gas from Russia to diversify its energy sources. This was announced by ONGC Videsh Ltd's R.S. Butola at a function organized here to receive the first oil from Russia's Sakhalin-1 project. The consignment of 92,055 metric tons (672,000 barrels) of Sokol crude was ferried on

board the Russian MK Viktor Titov — the oil tanker of Primorsk Shipping Company on a charter of ONGC Videsh Ltd. The tanker left DeKastri port in Russia on November 14.

ONGC is now eyeing a stake in the prestigious Sakhalin-3 field in Russia. However, official sources disclosed that rather than using the earlier practice of securing oil and gas properties in Russia through negotiations, ONGC will have to bid to secure oil and gas properties in Russia. The company has already initiated discussions with Russian oil and gas majors Rosneft and Gazprom for putting in a joint bid to acquire a stake in Sakhalin-3 project.

Russian Authorities Expect Shell to Change PSA Terms for Sakhalin-2 Project (Source: *Moscow News*, November 28, 2006)

Russian state auditor Sergei Abramov said on November 27, that he expects Sakhalin-2 project to accept a change in the terms of its production sharing agreement to bring a compromise deal soon. “We are expecting the operator to show goodwill. We want the operator to take the initiative to improve the terms for the Russian Federation. I’m sure a mutually acceptable solution will be found. We believe it will be very soon,” Abramov was quoted by *Reuters* as telling a briefing in Moscow. Shell and its partners, Japan’s Mitsui and Mitsubishi, have come under a lot of criticism from the Russian authorities for doubling the cost estimate of the Sakhalin-2 oil and gas project to \$22 billion, meaning the Russian state will have to wait longer to see any profit from the venture.

Russian officials have put pressure all of its three PSAs in the last few months, launching environmental and technical checks on ventures led by Exxon Mobil and Sakhalin-2. Ministers have repeatedly said Russia has no plan to scrap the PSAs, but they have not explained how they might find a compromise over the costs, which have been the subject of negotiations since Shell announced its revised budget last year.

Abramov said Russia would not unilaterally revise the PSA, but it would never agree to a budget of \$22 billion.

“But we are ready to review their new calculations when they are submitted,” he said, adding that he was confident a deal could be struck. “It’s not mere optimism, it’s common sense. This project is important not only for its operator but for the Russian Federation as a whole.”

He said the terms of the PSA meant Russia would get 10 percent of project revenues regardless of oil prices, but it regarded that as unfair and it wanted a bigger slice of the profits when oil prices were higher.

But Abramov said Gazprom’s inclusion in the group of Sakhalin-2 shareholders could pave the way for a solution to the dispute over the venture’s budget.

Sakhalin-1 production to reach production capacity by year-end. (Source: *Sakh.com*; *Sakhalin Oil and Gas News*; [*Pacific Russia Information \(PRI\) Group*](#) - November 7, 2006)

Jim Taylor, Executive Vice-President of Exxon Neftegas Limited (ENL) announced that the Sakhalin-1 oil and gas project will reach its ultimate capacity at the end of 2006. A total of 250,000 barrels of oil will be produced monthly. As part of the project, the Yastreb drilling rig extracts hydrocarbons through deviated wells. According to Jim Taylor, the Orlan at-sea platform will begin operation at the end of the year. The Orlan is situated 30 miles offshore Sakhalin.

During the project's 40 years lifetime, a total of 12.5 million tons of oil will be extracted annually.

Rosneft and BP in Shareholder Agreement for Sakhalin-5 and 4. (Source: www.energia.gr; November 27, 2006)

Rosneft and BP have signed shareholder and operating agreements for joint activity on the East-Schmidt (Sakhalin-5) and the West-Schmidt (Sakhalin-4) license blocks. Projects are implemented under the effective legal framework between Rosneft (51%) and BP (49%). Operational management of the projects will be conducted by CJSC Elvary Neftegas established in 2003 for exploration on the Kaigansko-Vasuykansky license block (Sakhalin-5).

It is planned that the exploration activities on both blocks including drilling of 6 wells will be financed by BP until commerciality is confirmed; following commercial discovery the expenses will be reimbursed from Rosneft's share of production. Subsoil users of the blocks are two 100% Rosneft subsidiaries CJSCs Vostok Schmidt Neftegas and Zapad Schmidt Neftegas.

Exploration on the blocks and design of the joint development strategy on Sakhalin-4 and Sakhalin-5 are being conducted by the parties. Set up of joint production and transportation infrastructure will allow optimization of the projects' capacity and may support the creation of the island's biggest oil and gas complex in the North Sakhalin.

Management of the companies believe BP's considerable offshore knowledge combined with more than 75 years of Rosneft's experience in Sakhalin would allow the most effective use of modern technologies and compliance with health, safety, security, and environmental requirements. Lord Browne and Sergey Bogdanchikov signed a joint statement expressing satisfaction with the achieved agreements that open up new opportunities for both companies at the next stage of their cooperation.

Regional News

The gap between the most and less developed regions of Russia isn't narrowing. (Source: Kommersant.com, December 03, 2006)

The gap between the most and least developed regions of Russia isn't narrowing, the RF Statistics Service said in the report on January-September of this year. The good news is that the leading regions are pulling up neighbors, where both production and income are increasing.

"The growth in key economic indicators was noted in the better part of the RF regions," said the Russian Statistics Service. The greatest acceleration was registered in Primorsky Krai, Kaliningrad, Sakhalin, Leningrad and Moscow regions, as well as in Moscow and Aginsk Buryatia's Autonomous District.

At the same time, production fell in 15 regions of Russia, including the North Caucasus, Magadan region, Taimyr, Koryakia and Chukotka.

But there are some changes. Some regions, where declining output was expected, benefited from the surge in production. Primorye posted growth of 23 percent and Sakhalin stepped up 30 percent. For Sakhalin, this increase is apparently rooted in the oil projects – the crude production there jumped 1.4 fold on year in the first nine months of this year.

Canon Russia official evaluates Yuzhno-Sakhalinsk for manufacturing opportunity. (Source: Sakh.com, Sakhalin Oil and Gas News [Pacific Russia Information \(PRI\) Group](#), November 15, 2006)

Keith Maskell, head of Canon Russia, visited with the Yuzhno-Sakhalinsk City Administration. The well-known corporation intends to develop business in the Far East and considers Yuzhno-Sakhalinsk as a possible place for production expansion. Canon plans to construct copying-duplicating machines manufacturing facilities. Mr. Vitaliy Gomelevsky, the Vice Mayor, thanked the company representatives for their interest in Yuzhno-Sakhalinsk and the business proposition. “Yuzhno-Sakhalinsk Administration sees future development of the town in manufacturing complexes construction, where local citizens can work. We developed a number of social-economic projects—such as solid domestic waste recycling facilities, water supply point on river Uyunovka, and many others. We intend to engage foreign partners in development of these projects,” said Vitaliy Gomelevsky. He also emphasized that projects offered by the town are very attractive for investment and will pay off in a few years. Keith Maskell said that the proposal will be considered very closely as participation in social projects is a very good opportunity for Canon to popularize brand of the corporation.

Gazprom, Sakhalin oblast sign gasification agreement. (Source: Sakh.com; Sakhalin Oil and Gas News; [Pacific Russia Information \(PRI\) Group](#) - November 15, 2006)

Mr. Ivan Malakhov, Governor of Sakhalin Oblast, and Mr. Alexander Anenkov, Vice Chairman of the Executive Board of OAO Gazprom, signed an agreement on gasification of Sakhalin Oblast. According to the agreement, the parties will develop and invest in the project to gasify as well as into the regional energy savings program, and a program to shift auto, railway, water and air transport and agricultural equipment to compressed and liquefied gas.

Commenting at the event, the Governor noted that he was happy to participate in the agreement signing: “Not so long ago we signed a master agreement and we just signed a specific agreement on gasification. Our first objective is Heat Power Plant #1 of Yuzhno-Sakhalinsk. Sakhalin Oblast Administration, Sakhalin-2 project operator, and RAO UES of Russia are in negotiations.” Alexander Anenkov confirmed that Gazprom’s priority is the Russian consumer. The next step to implement the agreement is development of an investment plan for the gasification project and general plans to supply gas.



Picture by The Sakhalin Times

Federal Migration Service steps up pressure on foreign companies.

(Source: The Sakhalin Times,

Officers from the Federal Migration Service (FMS) discussed a set of measures to reduce the number of foreigners working in Sakhalin without work permits.

At a meeting held on November 27, the FMS announced that it had issued

8,300 work permits to foreigners in 2006, 80% of those were to those employed in construction. 6,700 of these were involved in Sakhalin-1 or Sakhalin II projects. The service insists that several foreign companies are illegally employing specialists on business visas.

Work permits were primarily introduced in Russia for foreigners hired to do the jobs that Russian personnel are not able to fulfill. "We understand that many jobs, especially those involving foreign technology, need specialists from abroad," a FMS official said. "However, we feel that many times Russian specialists are being overlooked for job in favor of foreigners," he added. The official stated that in the first 10 months of this year, 800 foreigners were denied entry into Sakhalin for trying to enter the region for purposes "incompatible with their visas." All of them were employed by construction companies.

The FMS added that some companies have unreasonable requirements while hiring employees like "having fluency in English." The service is aware that most of the foreign executives in Sakhalin work on one-year multiple entry visas. In 2007, the service plans to clamp down heavily on companies employing foreigners in business visas. The FMS also insisted that many companies are unnecessarily hiring foreign specialists and not maintaining quotas, which are mandatory according to Russian law.

TIA-Ostrova agency quoted a FMS official as saying that there would be massive checks on foreign specialists in Sakhalin from January. The agency quoted the official as saying, "even a foreigner who lifts a pen to write something, without a work permit will suffer penalties under Russian Law."

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