

Stalled Oil Deal Hits Income, Image

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Cracks have begun to appear in a \$16 billion tie-up between Rosneft and BP following a tribunal decision blocking the deal.

Deputy Prime Minister Igor Sechin on Friday reconfirmed Rosneft's commitment to BP as a partner for Arctic exploration, even as competitors lurk in the background, collateral damage becomes visible on the horizon, and alternative scenarios emerge.

"BP suits us as a partner," said Sechin, who is also Rosneft's board chairman. "We are working from the premise that this deal is really useful for the Russian oil and gas sector and for the company."

A London-based arbitration tribunal blocked the Rosneft-BP deal on Thursday following a legal challenge by the Alfa, Access and Renova Group, or AAR, the Russian partners of BP in TNK-BP, the country's third-largest oil company.

AAR maintains that the terms of the deal violated the TNK-BP shareholder agreement.

In a statement the group said that “according to the tribunal, BP cannot proceed with any part of its proposed Rosneft transaction.”

Stan Polovets, AAR chief executive, said that “willfully ignoring the provisions of the shareholder agreement was a serious misjudgment by BP.”

“We expect [BP chief] Bob Dudley to make every effort to rectify the situation and rebuild the trust that has been lost between BP, AAR and the management of TNK-BP,” he added.

BP said it was “disappointed that these agreements, which are important for Russia, for Rosneft and BP, cannot now go ahead in the form intended.”

BP added that it has asked the tribunal whether a share swap between the two companies can proceed on its own — without the joint venture in the Arctic.

Sechin said Thursday’s ruling was not definitive but “an extension for further consideration.” The final decision is expected by April 7, he said.

Doran Doeh, a partner at SNR Denton (CIS), said “the question will be whether a share swap of that kind actually comes within the meaning of the provisions of the [TNK-BP shareholder] agreement for doing business in Russia.

“BP would argue that ... it’s just a share swap, a corporate level thing and nothing to do with TNK-BP or AAR.”

RIA-Novosti quoted an AAR source on Friday as saying the tribunal’s decision was unambiguous and AAR views BP’s prolongation of the process as a PR stunt.

“It’s difficult to see the rational for such a pure share swap deal,” a source close to AAR told The Moscow Times on Sunday. “AAR will oppose any such attempt,” arguing that it is also strategic and therefore covered by the same clause.

The Financial Times reported Friday that BP shareholders are reluctant to support a share swap without confirmed participation in Rosneft’s Arctic exploration.

Legal challenges and delays to the deal have raised the prospect that Rosneft may seek financial compensation from BP.

“The company will consider who is responsible for frustrating the agreement’s implementation,” Sechin said. “Definite losses are already being felt.”

“Rosneft could try and seek compensation from BP for loss of prospects and revenue,” Doeh said. “But they would need to convince the tribunal that there is an actual quantifiable loss — which could be difficult.”

“A more likely scenario,” he said, “was that Rosneft would seek to recoup its legal costs — which may be substantial — from BP. There also may be other things they could claim.”

This is not the first time the billionaire Russian shareholders of TNK-BP — Mikhail Fridman, Viktor Vekselberg and Leonard Blavatnik — have caused BP’s Dudley acute problems.

During a bitter shareholder dispute in 2008, Dudley, then-head of TNK-BP, was forced to leave Russia and his post at the company after the government failed to renew his visa.

A proposal on March 13 would have resulted in TNK-BP's replacing BP in the deal with Rosneft, but it was rejected by the TNK-BP board.

Rosneft has repeatedly stated that it would not accept such a substitution.

"Shares in TNK-BP are not traded in New York, London or Frankfurt and were not considered from the point of view of an asset swap," Sechin said, adding that TNK-BP's only contribution to the development of the Arctic shelf could be an offer to outsource.

"Rosneft had already considered various factors when looking for a potential partner," he said.

Predicting the outcome of the impasse is complicated by the secrecy of the TNK-BP shareholder agreement and the exact terms of the BP-Rosneft deal.

If there is no resolution by April 7, and Rosneft and BP remain committed to working together, said Ildar Davletshin, an oil and gas analyst at Renaissance Capital, "they will have to somehow over-come the existing [TNK-BP] shareholder agreement."

One possible scenario is a buyout of AAR's share in TNK-BP. Vedomosti re-ported Friday that a source close to AAR had put a \$30 billion price tag on such a buyout.

Davletshin said such a price was "at the high end of the range" for a valuation of AAR's share in TNK-BP, and \$27 billion would be a fairer price. Assuming a 50-50 cash-equity price split, he said, either BP or Rosneft have enough financial leverage to "digest this amount."

In a press release Thursday, AAR emphasized the business successes and financial value of TNK-BP.

Sechin, however, denied on Friday that Rosneft was in negotiations with AAR. "We have received no proposals from AAR in the framework of these proceedings," he said.

Davletshin said another option was for AAR to exit via an initial public offering of TNK-BP. AAR could divest itself of half of its holding through the IPO, Davletshin said, and then sell the rest for shares and cash to BP, which would have the option of then selling it to Rosneft. Or, Davletshin added, "AAR could be involved in this joint venture in the Arctic — maybe as a private investor through equities."

Shamil Yenikayeff, an oil and gas research fellow at the Oxford Institute for Energy Studies, said the onus was on BP. "BP needs to find a solution," he said. "If they don't resolve the situation ... other companies will step in, and that would mean huge reputation damage for BP."

Norway's Statoil and Norsk Hydro have extensive experience developing offshore resources, as do British-American oil majors Exxon Mobil and Shell.

Rosneft is already collaborating with Exxon Mobil on the Black Sea shelf, while Shell has

expressed its interest a similar joint venture project.

Rosneft chief executive, Eduard Khudainatov, said last week that the company was also considering partnerships in the Arctic with Chinese and Indian companies. “I should tell you that the whole world is interested in the Arctic,” he said.

Rosneft may not have any difficulty finding partners for joint exploration and drilling work in the Arctic — but finding another company willing to replicate the scale of the share swap with BP would be much harder.

The share swap with BP occurred against the background of the company’s weaknesses following the Deepwater Horizon disaster in April 2010.

The unanswered question, however, is why BP failed to foresee the legal challenge from AAR — particularly in light of Dudley’s personal experience with the tenacity and connections of TNK-BP’s Russian shareholders.

British newspaper The Daily Telegraph reported Saturday that Prime Minister Vladimir Putin had warned BP management about possible trouble from TNK-BP prior to the deal’s signing, without citing any sources.

“It was a major fault of BP’s legal department,” said Alexander Eremin, an analyst at Finam. “BP just messed up.”

Yenikeyeff said it was an error of judgment. “BP miscalculated when they signed the deal with Rosneft,” he said. “They thought that because Rosneft is a state company the political resources would be adequate to push the deal through. Obviously the Russian state does not want to muscle them [AAR] out.” Yenikeyeff said this might be because of a desire not to harm the business climate by putting state pressure on investors.

Other analysts speculated that the situation may be a reflection of pre-election maneuvering within the government — or that government officials and oligarchs, whose objectives remain opaque, might be playing a longer-term game. Sechin said March 11 that “whatever the decision of the London court, towards which we have the greatest respect, Rosneft will choose itself with whom it will work.”

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