

A Double-Edged Blessing

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After an unsuccessful attempt to pair with BP, Rosneft sealed the coveted strategic partnership with U.S. energy giant ExxonMobil last week. To highlight the importance of the deal for the Kremlin, Prime Minister Vladimir Putin and Deputy Prime Minister Igor Sechin was present at the official signing ceremony to give their tradition blessing.

The ceremony could have been more upbeat had the deal not been concluded on the ashes of another “strategic Arctic partnership” sealed between Rosneft and BP in January only to collapse by May. The failed partnership and subsequent news of repeated raids on BP’s Moscow offices by Russian court marshals raised questions about the longevity of Exxon-Rosneft partnership. Nonetheless, the new agreement is good news for both companies.

In a nutshell, Exxon will be making most of the advanced payments for oil and gas exploration work in Russia’s Arctic Kara Sea and the Tuapse block of the Black Sea together with Rosneft. It will invest \$3.2 billion in return for 33.3 percent ownership of the projects, while Rosneft will have a 66.7 percent stake. Exxon will bring in its deepwater drilling expertise and technology that Rosneft lacks as well as build modern infrastructure using its know-how.

Rosneft can now also fulfill its long-sought goal of going international and will be able to get stakes in the North American projects.

The entire Arctic region is thought to have up to 25 percent of the untapped oil and gas reserves in the world, which could amount to up to 90 billion barrels of oil and 120 trillion cubic meters of gas. If the exploration phase be successful, the U.S. energy giant is looking into pouring tens of billions into development and production.

Of course, a large part of the success of the strategic partnership will depend on what the exploration of the Arctic and Black Sea regions brings. With only a third of shares in the joint projects, Exxon appears to be confident that the new energy findings will cover its initial expenses and generate profit in near future. But it is not yet clear when the “near future” is, what political changes will take place in Russia during that period and how they will have an impact on state-controlled Rosneft.

Furthermore, Russia’s blessing could be a double-edged sword. On one hand, due to the importance of the projects for the Russian government, Exxon will likely be safeguarded from notorious operational problems in the country. But dealing with the state can be tricky. It is important to remember that both BP and then Exxon were chosen as partners for Rosneft thanks to their deepwater exploration and production skills and technologies and the opportunity for the Russian company to go international.

As part of the partnership, Exxon is already expected to bring in the vital know-how. Rosneft, emboldened with its successful partnership with Exxon, is likely to seek expanding its foreign operations together by pairing with other world energy players. This in time will erode the exclusiveness that Exxon currently has by being the only gateway for Rosneft to equity shares in its North American projects.

The question is whether Rosneft, after working with Exxon for several years, will try to part ways with Exxon once it feels confident and skillful enough to explore on its own.

Last year, the Russian government amended its law on subsoil use, allowing the state to terminate the exploration and production licenses issued for a foreign company operating in so-called strategically important sectors. The subsoil law defines any field containing more than 50 billion cubic meters of gas and 70 million tons of oil as “strategically important.” A foreign company could have its operational license revoked if the state considers the company’s operations as “a threat to national defense and state security.”

It is true that the subsoil law requires the state to compensate foreign investors in the event of a state takeover, but there is no guarantee that the compensation will be adequate. It could be only pennies on the dollar.

Given the optimistic estimates for hydrocarbon resources both in Kara and in the Black Sea, the Exxon-

Rosneft partnership is likely to fall under the “strategically important” category. Will Exxon be able to defend itself once the Russian state’s blessing is no longer there?

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