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Caspian Pipeline Upgrades Without Additional Debt

By Howard Amos

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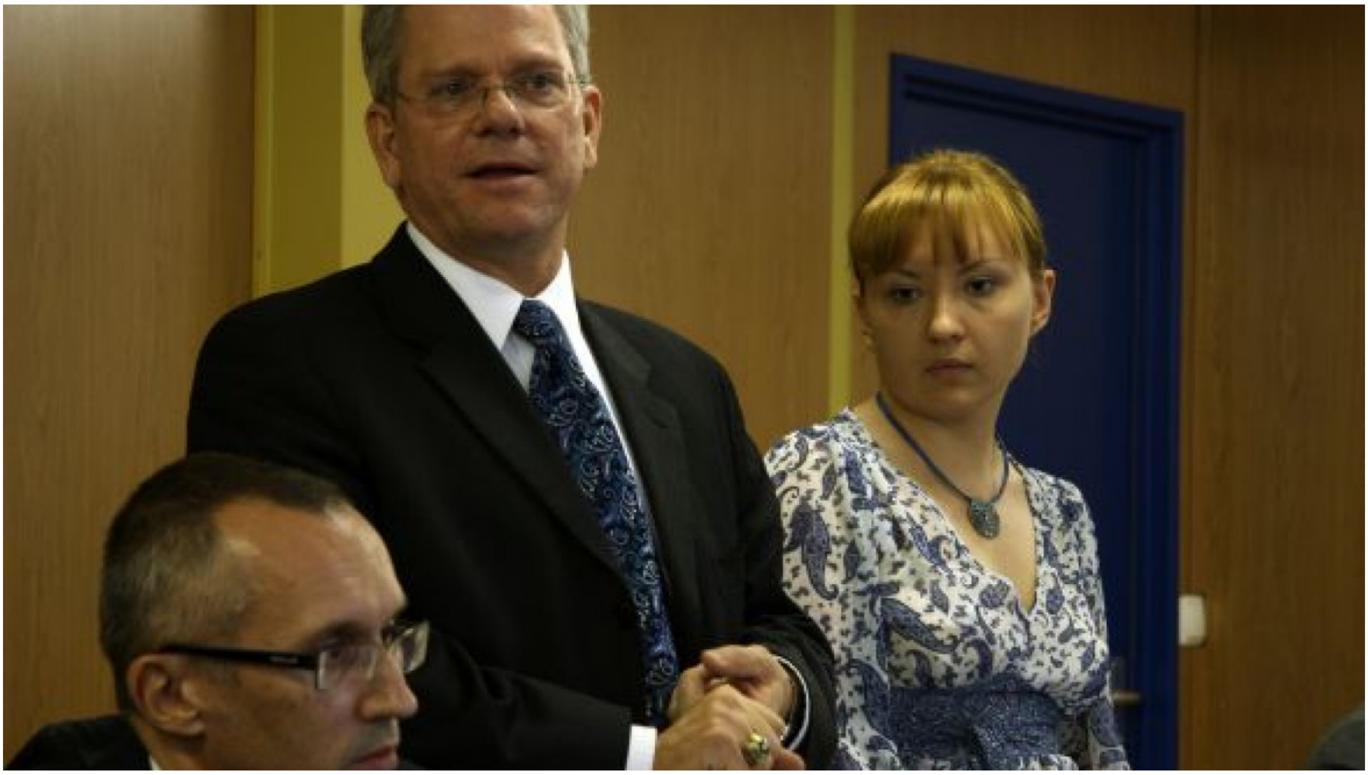

William Simpson, CPC deputy project director **Howard Amos**

KROPOTKINSKAYA, Krasnodar Region — The Caspian Pipeline Consortium holds up Kropotkinskaya pumping station as the poster child for its $5.4 billion expansion project to double the volume of crude it ships out across the Black Sea every year.

Just over 100 kilometers outside of Krasnodar, the regional capital, Kropotkinskaya is reached along a gravel road that winds through fields of corn. Opened in 2002, it is now undergoing major reconstruction, including an extra 100,000 cubic meters of storage capacity and an additional main pumping platform.

The work is part of Phase 1 of CPC's expansion — announced in December 2010 — implementing the upgrade of five pumping stations along the pipeline's 1,511-kilometer route from Kazakhstan's Tengiz oil fields, around the Caspian Sea to the marine terminal at Novorossiisk.

Phases 2 and 3 will include the installation of 10 new pumping stations, six new tanks at the company's tank farm near the Black Sea, a new offloading line through which the crude is transferred to waiting tankers, and improvements to the network's communication system.

William Simpson, CPC deputy project director, said late last week that CPC had now awarded all its construction contracts.

"The project is well under way. We have executed all our major agreements, and we are progressing according to plan," he told reporters at the Kropotkinskaya pumping station Thursday.

Although executives have said repeatedly that the company was likely to raise up to $1.2 billion in foreign loans for the project, Simpson said the work was progressing within budget and would not be seeking any external funding in 2012.

The construction required by the expansion program is overseen by Transneft in Russia and KazMunaiGaz in Kazakhstan. International major Chevron is responsible for the tank farm and marine terminal.

KazMunaiGaz (19 percent) and Chevron (15 percent) are major shareholders in the project with the Russian Federation's 24 percent stake managed by Transneft. There are also eight other equity holders in the venture, which is the only privately run oil pipeline in Russia, including LUKoil, Rosneft, Shell, Mobil, ENI and BG Group.

"We are engaging the talents and skills of our major shareholders to help manage the project," Simpson said.

The four contractors on the Russian section of the expansion — Velesstroi, Transneftstroi, Stroiinnovatsii and Stroitekhnokontrakt — are employed directly by CPC.

Simpson admitted that this complex structure created organizational challenges. "It's a very efficient way of running the job at the field level, but it just does create additional interfaces for managing the project," he said.

The financial viability of the giant infrastructure project is ensured by take-or-pay agreements signed by producers that impose financial penalties if contracted crude volumes are not supplied as stipulated.

Sergei Karpezin, a legal manger at CPC, said the complexity of the take-or-pay agreements had been one of the main reasons behind the almost nine years worth of negotiations that preceded the final investment decision last year.

"There was a lot of time given over for discussion of this mechanism because every pipeline user who signed the take-or-pay agreement understood what they were risking," he said.

After the expansion, the pipeline will be able to pump 67 million tons of oil a year — up from the 33 million to 35 million tons of which it is currently capable. The pipeline was always designed for this increased capacity, but was built with fewer pumping stations than required because of worries over the reliability of supply. There will be no substantial alterations to the 100-centimeter-diameter pipeline itself.

About one loaded tanker a day currently departs from CPC's marine terminal to sail across the Black Sea and through the Bosporus. Most of CPC's crude is sold to European customers.

Matko Novak, a director at Velesstroi, which is doing the work at Kropotkinskaya, said 309 people were employed on the site. The upgrade is currently 20 percent completed and the scheduled finishing date is September 2012. Velesstroi is also a contractor on the 4,070-kilometer Eastern Siberia-Pacific Ocean pipeline.

Under the expansion program there are 18 major construction contracts along the length of the pipeline.

Although all the contractors are Russian firms, only 70 percent of the equipment ordered for the expansion will be manufactured domestically. CPC deputy director Alexander Blagov said the remaining 30 percent would be obtained abroad.

"The 30 percent is high-technology equipment that we do not produce [in Russia]," he said.