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Sanctions Squeeze Western Oil Service Companies Out of Russia

By Alexander Panin

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U.S.'s Halliburton had to abide by the sanctions, and in May suspended operations with Gazprom Bureniye, a drilling company owned by Arkady Rotenberg.

Western service companies, a valuable source of expertise and equipment for Russian oil majors, will be forced to limit or even cancel their operations in the country as the result of a new round of sanctions imposed by the European Union and the U.S. on Moscow last week, industry experts said Monday.

This could delay some of Russia's hard-to-reach oil development projects and see Western service firms lose revenue.

On Friday, following similar measures taken by the EU, the U.S. imposed sanctions on Russian hydrocarbons producers Gazprom, Gazprom Neft, LUKoil, Surgutneftegaz and Rosneft, banning Western firms from supporting their activities in exploration or production of oil from deep water, Arctic offshore or shale projects.

U.S. companies have until Sept. 26 to wind down transactions with the sanctioned oil majors in these areas.

According to REnergyCO, a Canada-based consultancy that analyzes the oil and gas industry of former Soviet countries, about a quarter of all companies involved in the oil business in Russia are based in the West. Russia's Energy Ministry earlier said that in some areas, like development of unconventional or hard-to-recover reserves, the involvement of Western companies rises to as much as 70 percent.

Technically, hard-to-reach oil development that heavily relies upon Western expertise is not affected by the sanctions — which specifically mention shale oil projects. But the same technology, fracking, is used to extract both, industry experts said.

"This means that if Western-produced software and equipment employed as part of the fracking process is no longer supplied due to the ban, it would affect some of these projects," said Dmitry Lebedev, the head and owner of REnergyCO.

He estimated that up to 15 million tons of oil in Russia is extracted using the fracking technology annually. This is a roughly equivalent to all oil currently coming from Russia's shelf, including in the Arctic, and is about 3 percent of Russia's 500 million ton annual production.

The two largest Western companies that until recently were helping giants like Rosneft, Gazprom Neft and LUKoil tap into the vast resources on Russia's continental shelf and develop unconventional reserves are Europe and US-based Schlumberger and the U.S.'s Halliburton. Each of them relies on Russia for about 5 percent of their global revenues, according to an estimate by RBC Capital Markets, meaning the companies together could lose more than $4 billion in revenues if the door shuts on the Russian market.

Sanctions have already affected the operations of both companies in Russia, though just two months ago a Schlumberger executive said he did not expect the face-off between Moscow and the West to impact the company's business.

Because of an earlier ban imposed on the supply of oil-related equipment to Russia, Schlumberger recently started transferring foreign staff familiar with the technology from Russia to other global projects, RBC reported Friday, citing sources in headhunter agencies. The company also complained about the loss of effectiveness due to the restriction on the use of equipment.

Halliburton also had to abide by the sanctions, and in May suspended operations with Gazprom Bureniye, a drilling company owned by Arkady Rotenberg. The businessman, thought to be a close ally of President Vladimir Putin, was included in the U.S.'s sanctions list in March.

Both Schlumberger and Halliburton could not provide immediate comment on Monday on whether they had plans to limit or fold their business in Russia but industry analysts said it was inevitable.

"Halliburton has already left the market and Schlumberger is likely to follow, to be quickly replaced by Russian service companies," said Rustam Tankayev, lead analyst at the Russian Union of Oil and Gas Producers.

He said Russian companies have developed similar technology to their Western counterparts but were struggling to gain contracts because oil majors chose firms like Halliburton or Schlumberger for their top quality and reliability — even though they come at a higher price.

Other analysts agreed that Western companies are likely to gradually leave Russia, saying this will only benefit domestic service providers.

"In recent years, Russian oil and gas producers were relying too much on ready-to-use Western technology. Sanctions have forced them to look to domestic service companies and offer them more attractive terms for cooperation," said Sergei Smirnov, the head of Sozvezdye, an association of companies that supply equipment for the oil and gas industry.

He also said Russian companies themselves over the years became more competitive, consolidating their assets and techniques.

"Besides, Russia's partners from China, Korea and Singapore have always been flexible and ready to substitute much of the Western-produced technology and equipment that we have been using," Smirnov concluded.

Contact the author at a.panin@imedia.ru