

BP, Rosneft in Landmark Swap

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Putin meeting with Dudley, left, and Sechin, fourth left, at his Novo-Ogaryovo residence near Moscow on Friday. **Alexsey Druginyn**

Positive experience gathered by BP in the aftermath of the Deepwater Horizon disaster, the largest oil leak in U.S. history, contributed to Rosneft's decision to strike an \$8 billion share-swap and wide-ranging cooperation agreement with the international oil giant Friday night.

Igor Sechin, Rosneft's chairman and a deputy prime minister, said in televised remarks Saturday that BP has “a great deal of experience, including in the Gulf of Mexico cleanup operation.”

BP and Rosneft will work together in the exploration and development of a 125,000-square-kilometer area of the Kara Sea on Russia's Arctic continental shelf — one of the world's last remaining unexplored basins. This is the first time a foreign company has been granted such extensive access to Russia's Arctic resources.

Prime Minister Vladimir Putin said the area contains some 5 billion tons of crude oil, about

one-tenth of Russia's Arctic zone's 51 billion tons, enough to fully meet global demand at current levels for about five months.

The two companies also announced plans to establish an Arctic technology center in St. Petersburg that will liaise with research institutes and develop specialized technologies.

To cement the agreement, BP will swap 5 percent of its shares, valued at \$7.8 billion, for 9.5 percent of Rosneft. BP will become the biggest nonstate equity holder in Rosneft, a company 75 percent controlled by the government, while Rosneft will have the second-largest stake in BP, after Blackrock Inc., with 5.93 percent. The shares are subject to mutual lock-in restrictions for a period of two years.

The swap confirms the close economic relationship that the companies hailed in an e-mailed statement as a “groundbreaking global strategic partnership.” It is the first time an international oil company of BP's standing has formed an equity-linked venture with a national oil company like Rosneft.

But BP and Rosneft are unlikely to have representatives on each other's boards, said Konstantin Uminov, an analyst at Rye, Man & Gor Securities.

It is unclear whether the paperwork for the agreement will be finalized in time for Rosneft to receive BP's first dividend payout since pressure from the United States forced a suspension after the Deepwater Horizon explosion in April. Rosneft would be in line for a \$100 million dividend on its 988,694,683 ordinary BP shares.

The deal received strong support from Putin, who met with BP CEO Robert Dudley at his Novo-Ogaryovo residence outside Moscow on Friday before the deal was announced in London at midnight Moscow time.

The joint work of BP and Rosneft “has a real chance of acquiring a large-scale character and of having a noticeable impact on the world's oil and gas industry,” Putin said.

Putin brushed off suggestions that BP has been tainted by the Gulf of Mexico oil spill, quoting the Russian proverb that “one man with experience is better than two without.” He also said the government intended to create “a very favorable tax regime for the realization of this project.”

Britain's energy minister, Chris Huhne, said the deal was “good news for Europe, for the U.K.'s energy security and worldwide.”

Reaction from the United States was less positive, with fears that Russian government control of BP shares might compromise U.S. economic security. “The details of this deal and its impacts on the operations of BP America need to be thoroughly examined,” said Congressman Edward Markey, the top Democrat on the House Natural Resources Committee.

“BP once stood for British Petroleum. With this deal, it now stands for Bolshoi Petroleum,” he said in a statement published on his web site.

The announcement of the agreement came after the publication of a report last week by a U.S. President Barack Obama-convened commission on the Deepwater Horizon oil spill that

heavily criticized BP.

Rosneft stands to gain significantly from the deal as Russian energy companies turn from declining “legacy assets” in Siberia to “frontier regions” like the Arctic to maintain their production capacity.

The Arctic shelf presents serious challenges for oil production in terms of climate and accessibility. Areas like the three blocks in the Kara Sea that Rosneft and BP will explore — EPNZ 1, 2 and 3 — are only navigable 100 days a year because of ice.

BP could provide Rosneft with a considerable bank of technology and know-how to master these conditions.

“Our future joint venture will utilize the experience and expertise of BP,” Rosneft president Eduard Khudainatov said in a statement.

Rosneft is currently in partnership with Chevron to develop the Black Sea shelf.

But Friday's deal is also a springboard for Rosneft's global ambitions. “It is the first step to build up [Rosneft as] a global player,” said Uminov, of Rye, Man & Gor Securities.

This is not the first time BP has worked with Rosneft. In October 2010, Rosneft purchased a 50 percent stake from Petroleos de Venezuela in German refining venture Ruhr Oel joint with BP.

In 2006, BP bought about \$1 billion worth of Rosneft shares when the company listed in London and signed a joint protocol on research in the Arctic.

The latest agreement is also a positive step for BP, which has faced increasing difficulties in the United States after April's blow-out. Tying up with Rosneft will give BP a competitive edge in Russia, said Valery Nesterov, an analyst at Troika Dialog.

“This is a deal we wanted to do for a long time,” BP chairman Carl-Henric Svanberg said Saturday, Bloomberg reported.

It is now clear that “BP sees Russia as the biggest source for future growth,” said Vladimir Rusinov, head of Renaissance Capital's oil and gas group.

But BP's relationship with Russia has not always been smooth. The company's joint venture in Russia with a group of oligarchs, TNK-BP, was rocked by a control battle in 2008 that concluded with Robert Dudley, TNK-BP's CEO at the time, having his work permit revoked.

Moreover, the production of oil in the Kara Sea will not happen overnight. Nesterov said infrastructure challenges mean that the crude would not begin flowing for at least seven years.

He added that the development of such resources was a long-term process — not just the result of one decision. “To say straightaway that everything will be well is not a good idea,” he said.

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