

# \$32Bln Not Enough for TNK Partners

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May 17, 2011

**The**  **Moscow Times**

The groundbreaking \$16 billion Arctic oil exploration deal between BP and Rosneft backed by the Russian and British governments stood in tatters Tuesday as BP's oligarch partners turned down a \$32 billion offer to let it go ahead — \$5 billion more than what had been put on the table a month earlier.

The deadline for the conclusion of the deal — already extended once — expired at 3 a.m. Tuesday in Moscow.

“We have made massive efforts to find a resolution to the situation, and over the last three months we have looked at various options. But it hasn't worked out,” said BP's Russian spokesman, who was leaving for vacation.

The “strategic alliance” between BP and Rosneft — which included a share swap of 5 percent of BP for 9.5 percent of Rosneft — was challenged in a Stockholm arbitration tribunal by Alfa, Access and Renova Group, which represents the oligarch partners in TNK-BP — Viktor Vekselberg, Mikhail Fridman and Len Blavatnik.

AAR successfully argued that the deal violated the TNK-BP shareholder agreement and would damage the company's long-term prospects. In their view, TNK-BP is the primary vehicle for BP in Russia and any deal like the one proposed between Rosneft and BP must be approved by the TNK-BP board.

Faced with Rosneft's unwillingness to work with TNK-BP in the Arctic, BP had few options but to attempt to organize the buyout of AAR from TNK-BP. Well aware of their strong bargaining position, AAR held out for a high price — reportedly demanding between \$35 and \$40 billion to give up their stake.

A source close to AAR said that, following the 11th hour, four-way negotiations between BP, Rosneft, AAR and the Russian government, \$32 billion was now a “benchmark floor valuation” for their 50 percent stake in TNK-BP.

“Whilst talks will be ongoing, at this point it does not look like Rosneft plans to proceed with the original Jan. 14 Rosneft-BP transaction,” he said. “AAR see TNK-BP as a very attractive business with great prospects, and are committed to developing it — in Russia and internationally. They are not willing sellers.”

BP CEO Robert Dudley, who said Friday that he was “optimistic” about an agreement, put on a brave face.

“TNK-BP has been an excellent investment for all parties since 2003,” he said Tuesday. “It is gratifying that both BP and AAR have agreed to look beyond the disagreements of the past few months and to fully focus on this important and successful business we have built together.”

BP's share price rose in London on the news that what many investors perceived as a risky Russian move was unlikely to go ahead, although it finished down 0.8 percent at 434.8 pence.

Energy Minister Sergei Shmatko expressed disappointment that a resolution had not been found. “I hoped so much that the deal would go through that I didn't think about who else might become a partner [for Rosneft],” he said.

Rosneft is likely to seek compensation from BP for costs incurred by the failure of the deal.

There will have been a guarantee warranty clause in the Rosneft-BP deal, said Vsevolod Miller, a lawyer at Yukov, Khrenov & Partners, and BP will be in breach because of its probable failure to disclose the TNK-BP shareholder agreement. “Rosneft will sue BP for breach of this warranty — they will sue for direct damages, which are likely to run into the millions,” Miller said. The state-owned oil giant, however, does not have grounds for a case against AAR, Miller added.

A Rosneft spokesman did not reply to repeated calls to his cell phone Tuesday.

Rosneft closed down 0.9 percent in Moscow on Tuesday to 228.59 rubles. TNK-BP was also down, falling more than 3 percent, the most since May 5.

Shamil Yenikeeff, a research fellow at the Oxford Institute for Energy Studies, said there were three possible scenarios going forward: that BP would find the extra money to buy out AAR, that Rosneft would seek to involve other international oil majors in Arctic projects, or

that — more unlikely — a way would be found to include AAR and TNK-BP within a joint BP-Rosneft venture.

The root cause of the conflict, he said, was the different ways in which BP and AAR viewed TNK-BP.

“BP have always thought of TNK-BP as a regional company, whereas the Russians [AAR] really wanted TNK-BP to become an international company.”

The agreement with Rosneft announced Jan. 14 would have given BP access to the Kara Sea in Russia’s Arctic — unprecedented for a foreign company — which is estimated to hold as much as 100 billion barrels of crude.

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

Rosneft is currently collaborating with Exxon Mobil on the Black Sea shelf, while Shell has repeatedly expressed its interest in joining a similar project.

Shell’s chief executive Peter Voser reiterated the company’s ambitions on Tuesday, Bloomberg reported. “Russia is important for us in the long term,” he said.

Other analysts pointed to speculation that it was a lack of trust between Rosneft and AAR that had stalled the deal and said BP and Rosneft might yet still succeed in finalizing an agreement if certain guarantees could be made.

Unconfirmed media reports suggested that Rosneft’s insistence that the share swap be carried out immediately had worried AAR that a way might be found to avoid subsequently buying them out. No legal mechanism for allaying these fears could be found in time.

Andrei Kostin, a board member of Rosneft, said Tuesday that there is still an opportunity for talks with BP, Bloomberg reported. “BP has always been a good partner for Russian companies.”

Shmatko said that “talks [with BP] may continue one way or another.”

Moreover, demonstrating that BP was not prepared to be bullied by AAR, a Moscow banking source said, could strengthen Dudley’s negotiating position.

Although he publicly endorsed the deal at its outset, Prime Minister Vladimir Putin has said the government will not intervene in the shareholder conflict. “This was a corporate deal, signed in keeping with corporate procedures and concerning the companies alone,” Putin’s spokesman Dmitry Peskov said, Interfax reported.

Some experts have suggested that a massive state buyout of AAR was politically sensitive and could be dangerous for the Kremlin if it was perceived as a government-backed enrichment of already wealthy oligarchs. President Dmitry Medvedev distanced himself from the BP-Rosneft deal with his March “Magnitogorsk Theses” when he instructed Deputy Prime Minister Igor Sechin to step down from the board of Rosneft.

A suggestion that the political and financial wrangling over the Arctic deal could harm Russia's investment climate, however, was dismissed by analysts.

"It's not something that will turn investor perception on Russia around," said Katinka Barysch, chief economist at the Center for European Reform. "There's nobody who is blue-eyed about Russia these days, especially in the energy sector."

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