ANALYSIS

Control and Internationalization: Rosneft Swallows TNK-BP

By Jonas Grätz, Zurich

"It's all our money", said Igor Sechin, CEO of Rosneft, during a conference call on Tuesday 24th October 2012. He was talking about the dividends of the joint-venture TNK-BP from the first half of 2012. Due to the conflict between the shareholders of BP and AAR, a consortium of Russian "oligarchs", they had not been paid out. The Sunday before this announcement Sechin had come back from London, where he had signed a deal with BP on the takeover of its half of TNK-BP. In exchange, the British oil major would get US-$17.1 billion plus 12.84% of Rosneft's shares. Later, BP would buy an additional 5.66% of Rosneft's shares. Back in Moscow, Sechin inked a deal with AAR to buy their part of the joint venture for US-$28 billion. Not many details emerged on this agreement, however. The AAR "oligarchs" may yet receive parts of the sum in Rosneft shares, as a concession to "liberal" factions in Moscow. However, the bigger part is likely to be in cash, with a tacit agreement that they will reinvest the major part of it in Russia.

If the takeover of TNK-BP proceeds as planned, which seems likely, it would line up nicely with an overriding political trend pursued by the Putin regime: the displacement of the "oligarchs" of the 1990s from the oil and gas industry and their replacement by members of the "new" regime that have a strong connection to Putin. The trend began with the bankrupting and takeover of oil company YUKOS by Rosneft in 2003/04 and proceeded with the takeover of Roman Abramovich's Sibneft by Gazprom in 2005. Further smaller consolidations followed, such as the squeezing out of international investors from the Sakhalin-II project, or of TNK-BP from the Kovykta project by Gazprom. The actors were always the same: Sechin was the driving force behind the destruction of YUKOS, as he is driving the takeover of TNK-BP today. This continuing recourse to greater control of the regime to alleviate frictions is an indicator of its hardening and a symptom of a lack of elite contestation. This concentration of ever more power in ever fewer hands will not only have repercussions inside Russia, but also on the European oil market.

The deal takes place at a time when signs of systemic tensions in Russia are becoming more apparent. Tensions are not only of a political nature, but also economic. Economic stagnation in the EU and worldwide is having an impact on Gazprom due to lower demand and downward pressure on prices. The premise, on which the export strategy of the conglomerate was based—restricted supply and rising demand—does not hold anymore. The heavy-handed gas giant is nevertheless pursuing its pipeline mega-projects that do not fit well with the flexibility revolution on the gas market, which has been brought about by liquefied natural gas tankers. Moreover, Gazprom's insistence on oil-price linkage for a supply deal with China obstructed its successful conclusion. Meanwhile, costs are rising due to the expensive mega-projects and the necessity of bringing new fields on stream to replace the declining production of mature fields.

The oil industry does not have problems in marketing, but in production. High taxation and the privileging of the majority state-owned Gazprom and Rosneft led to insufficient investments into new fields and exploration. High taxes put the Kremlin into a position where it can basically choose which fields are being developed by granting tax exemptions.

Against the background of Gazprom's structural problems, Putin apparently chose to bet on Rosneft instead. Despite the suboptimal experiences with Gazprom, he chose to expand politically controlled corporate power instead of strengthening institutions, which could have improved investment conditions in the country. The stronger concentration, meanwhile, will help in leveraging Russian oil reserves towards international players in the oil industry.

After consolidating TNK-BP, Rosneft will be in a dominant position in the Russian oil sector, extracting 40% of the total. Together with Gazprom Neft, state-controlled companies will extract half of Russia's oil. Private oil companies, particularly the not so well connected LUKoil, will be left standing. To develop new projects in the Arctic and elsewhere, Rosneft is going to attract foreign capital and know-how, leveraging Russia's resource base. In the course of asset swaps, Sechin and Putin will demand shares in production, refining and marketing assets elsewhere in exchange for the participation of BP and other foreign companies in Russian projects. Rosneft will be able to internationalize quickly as a result. The partnership with BP is excellently suited in this respect.

The course of events has been "civilized" this time, in contrast to the YUKOS takeover. Only one manager of TNK-BP was detained, but "administrative resources" have not been applied more broadly. This may be a sign that the Russian regime is considering the global constraints: the country needs foreign technology and investments and cannot afford negative headlines in the economic press at the moment. But a second, perhaps more important driver is the fact that a subtle approach better corresponds to the current needs of Sechin. Whereas he orchestrated the takeover of YUKOS from the background in 2003, he has emerged from the shadows as the leader of Rosneft. Back in 2003, the episode was one of asset redistribution, now it is about their legitimization and the integration of Sechin into the world of global corporate leaders. The YUKOS episode yielded a host of bad press and litigation, which for some time hampered the internationalization of Rosneft. Thus, another raid would have hampered Sechin's ambitions to transform Rosneft into a global energy company by partnering with international majors. The deal with BP shows that those companies are ready to work with state-backed oil companies as the YUKOS episode recedes into the past, regardless of pending legal issues from the YUKOS takeover.

With regard to markets in the EU, it is likely that Rosneft will try to increase its leverage over the trade of crude oil and products. In contrast to Russian natural gas, the market share of oil is growing. Further takeovers or participation in refining assets in Central Eastern Europe and Central Europe are highly likely, as many countries in the region rely on Russian oil supplies. Meanwhile, Russian plans to establish the Urals oil grade as a benchmark for oil pricing would have overarching repercussions for European oil markets. Up to now, oil in Europe was priced against the Brent/BFOE benchmark from the North Sea, which has been produced by many different companies. But its production is in terminal decline. Against this backdrop, Russian investors are currently building a large oil storage terminal in Rotterdam with the aim of establishing a base for Urals trading in the most liquid European oil port. The consolidation of Russian oil production could be useful to garner influence on oil prices.

It is unlikely that the takeover of TNK-BP by Rosneft will bring efficiency gains to the Russian oil industry. Instead, greater regime control and concentration of corporate power will be leveraged to gain greater influence on foreign markets. Also, the regime will have more influence over extra-budgetary flows of oil revenues. Thus, to ease systemic tensions in Russia the regime once again decided to widen its direct control and to expand influence over external markets.

About the Author
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Additional Reading
- Poussenkova, Nina: *Lord of the Rigs. Rosneft as a Mirror of Russia's Evolution*, Baker Institute Policy Report, No. 35, March 2007, http://www.bakerinstitute.org/programs/energy-forum/publications/energy-studies/docs/NOCs/Papers/NOC_Rosneft_Nina.pdf.
- Sakwa, Richard: *The Quality of Freedom. Khodorkovsky, Putin, and The Yukos Affair*, Oxford: Oxford University Press 2009.