



# BP's Russian roulette

The beleaguered oil company has come out fighting. But a deal with the Russian Government-owned Rosneft was always going to prove controversial.

RUTH COLLINS

In January, BP and state-owned Russian energy company Rosneft shocked the world by signing a US\$16bn share swap deal. The two companies intend to jointly exploit oil and gas reserves in Russia's Arctic shelf and make Rosneft the largest single shareholder in BP. The deal, which will also see BP increase its holdings in the former assets of Yukos oil company, occurred only a matter of weeks after Yukos' former CEO, Mikhail Khodorkovsky, was sentenced to a further six years in prison.

A stark reminder of BP's recent past also came shortly after, when the company reported a loss of US\$4.9bn – mainly due to US\$40.9bn for charges relating to the Gulf of Mexico oil spill – making 2010 its first year of losses for 20 years. The tie-up therefore not only raises many questions about the viability of a British – Russian exploration operation, but also poses questions about the future of BP and the oil and gas industry as a whole.

## Why Russia? Why Rosneft?

On 20 April 2010, an explosion at the Deepwater Horizon oil rig in the Gulf of Mexico killed 11 people and unleashed an estimated 170 million gallons of oil into the Gulf. President Barack Obama placed a six-month moratorium on offshore drilling in the Gulf, which has yet to be lifted, largely due to delays in securing permits from the Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE), the body now in charge of overseeing offshore drilling. There has been considerable criticism from environmental campaigners and the US Government that the company has moved on too soon after the spill. Although it is not altogether unexpected that BP has looked elsewhere says Michael Dulaney, a partner at Perth office of Johnson Winter & Slattery and Senior Vice-Chair of the IBA Oil and Gas Law Committee. 'The US has put

restrictions on offshore drilling, so naturally companies have had to look further afield,' says Dulaney. 'So it isn't surprising that BP has turned its attention to Russia. After all, BP has major business in the north of Europe and it's trying to mend fences there, as well as in the US and in Canada.'

Rosneft is Russia's largest oil producer, with estimated proved reserves of 22.9bn barrels of oil equivalent and seven refineries with an aggregate production of 985,000 barrels a day. This, combined with the fact that many experts estimate that the Arctic shelf may hold up to seven per cent of the world's explored oil reserves and 30 per cent of its gas

sued everyone that we think is responsible and we learn more every day.' A recent report by the National Oil Commission found that BP, Transocean, Halliburton and regulators are all liable for nine key mistakes that are believed to have increased risks that contributed to the oil spill.

Some US politicians have expressed concerns that the tie-up between BP and Rosneft may make it more complicated for individuals and companies in the fishing industry to obtain compensation. Serna, however, is confident that this will not affect his clients: 'I think it is reassuring that BP still has the money to buy Rosneft shares,' he says.

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**Michael Dulaney**

Senior Vice-Chair of the IBA Oil and Gas Law Committee.

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reserves, makes Rosneft an extremely attractive corporate partner. In the share swap deal BP is due to gain access to some 48,263 square miles of unexplored basins in the South Kara Sea. In a reversal of BP's fortunes, in February Rosneft announced a 64 per cent rise in annual profit for 2010.

### **Deepwater Horizon**

As reported in the August 2010 issue of *International Bar News*, the legal implications of the 87-day oil spill are long and complex and there are many pending settlements and ongoing claims. Enrique Serna of Serna & Associates in San Antonio, Texas, knows this all too well.

Serna & Associates is the only US law firm that is actively pursuing claims relating to the oil spill on behalf of foreign governmental entities. Serna is currently representing the three Mexican states, Veracruz, Tamaulipas, Quintana Roo, who are suing BP and several other companies for alleged losses stemming from the spill. Mexican-born Serna benefits from a bilingual and bicultural background as well as prior experience of representing Mexican states, corporations and citizens in the US for over 17 years. Just under a year since the spill, he highlights the on going need to 'fine tune liability and long-term damages' and acquire the necessary compensation for his clients. 'BP obviously wasn't the only company involved,' he notes. 'The MDL shows that there are other entities that must share responsibility for this disaster. These states have

'It's understandable that the company wants to move on and I wouldn't think that my clients have any reason to worry now that it has signed this deal. Whatever happens with the Rosneft tie-up, we hope that BP does not forget the environmental disaster that they are leaving behind in the Gulf of Mexico and we hope that they learn from it. The Arctic Ocean is a very delicate part of our world's eco system and that seems to be their next move.'

### **Environmental Impact**

The deal has also understandably upset environmentalists and Greenpeace was quick to voice its criticism. In a statement to the media, Ivan Blokov, Campaign Director of Greenpeace Russia, highlighted what's at stake: 'Given that in 2009 alone, Rosneft had 12,000 pipeline breaks, 7,526 of which resulted in oil leaks, it would be an understatement to say we are concerned about these two companies operating together in the Arctic.'

In one sense, however, it seems that the spill in the Gulf has acted as a wake up call for BP. In November 2010, Wytch Farm in the UK, BP's largest onshore oil field in Western Europe, was closed for maintenance following the discovery of a leak in the Dorset-based pipeline. In response to the Wytch Farm closure, a BP spokesman told a British newspaper, 'Because of what happened last year, anything that looks like there could be a pipeline integrity issue means we are being extra careful.' In January this year, the Aleyska pipeline on Alaska's North Slope, which is half-owned by BP, was

## FACTBOX: BP IN RUSSIA

- 1997:** BP pays US\$571m to acquire a ten per cent stake in SIDANKO, Russia's fifth largest oil company at the time.
- 1998:** BP and Rosneft form joint venture Elvari NefteGaz, to explore for oil and gas off the coast of the island of Sakhalin in the North Pacific.
- 2003:** BP establishes its Russian joint venture, TNK-BP, following a merger between TNK, SIDANKO and Onako and a number of BP's Russian oil assets.
- July 2007:** TNK-BP agrees to sell Gazprom its majority interests in the Kovykta gas field in Siberia.
- February 2008:** BP decides to close its offices in Sakhalin after the company fails to make significant discoveries there.
- March 2008:** Russian police raid the offices premises of BP and TNK-BP in Moscow.
- July 2008:** TNK-BP's Russian shareholders AAR threaten BP with legal action.
- July 2008:** Russian authorities refuse to renew TNK-BP CEO Bob Dudley's visa and he is forced to flee the country.
- January 2009:** BP relinquishes TNK-BP board authority to the AAR group.
- October 2010:** Rosneft becomes a joint owner with BP in four Ruhr Oel refineries in Germany that have a combined capacity of 1.04 million barrels per day.
- January 2011:** BP announces US\$16bn share swap with Russia's state-owned oil group Rosneft.
- January 2011:** TNK-BP claims that the current terms of the share swap deal are in violation of its shareholder agreements, which requires BP to carry out all projects in Russia and the Ukraine through TNK-BP. An injunction is imposed on the deal by London's High Court following AAR's lawsuit.

also shut down after a leak was discovered at a pump station.

However, Charlie Kronik, Greenpeace spokesperson in the UK, stresses that as well as the potential impact on the environment, the deal also points to greater problems in today's energy sector. 'We feel very strongly that energy security is a growing problem,' he comments. 'It is increasing demand for mobility and with rising oil prices, the markets are very volatile.'

The unstable nature of the oil markets was shown earlier this year as the political situation in Egypt grew increasingly precarious. At the end of January the protests pushed oil prices to over US\$100 for the first time in over two years. They then dropped back down to US\$85.52 on 11 February when President Hosni Mubarak resigned and left the country.

Kronik firmly believes that the tie-up is 'not just significant in terms of BP's recent history, but also highlights both the economic and environmental risks of being dependent on oil and gas companies, as well as posing questions about our future energy security.'

### US hyperbole or Bolshoi Petroleum

The US reaction was predictably full of hyperbolic rhetoric. Following the announcement, one US congressman even mockingly dubbed the company 'Bolshoi Petroleum' to highlight its shifting allegiance towards Russia.

At the beginning of February, BP announced its plans to sell two US refineries, the Carson refinery in California and the Texas City refinery, which had its own disaster in 2005, when an explosion killed 15 employees and injured a further 170 people. These closures will also affect other parts of the company's business across California, Arizona and Nevada and are due to reduce BP's refining capacity in the US by 50 per cent by the end of 2012.

Many in the US have interpreted these moves as BP turning its back on its responsibilities in the Gulf and as a marked indication that it is no longer interested in exploring oil reserves in the US. At the time of writing, the moratorium still stands and the US is understandably preoccupied with contending with rising oil prices and the ongoing need to boost domestic energy production. The fact that BP announced its first year of losses for over two decades earlier this year is another key factor in highlighting the great deal of commercial sense behind the BP-Rosneft tie-up.

Peter Leon, a partner at Webber Wentzel in Johannesburg and Co-Chair of the IBA Mining Law Committee, says, 'There is no denying that the exploration opportunities for BP with Rosneft in the Arctic Sea are huge, whereas right now in the US, they are very limited. For BP, I think this is more about making the most of an excellent commercial opportunity and exploring what could potentially be an extremely rich area.'

As well as the US refinery closures, BP has also announced plans to restructure its business to make up for charges related to the spill. The company has already sold interests in Argentina, Colombia, Egypt, North America, Venezuela and Vietnam. In February, it announced its plans to sell stakes in gas fields in the southern North Sea and the Dimlington gas terminal and sell its controlling interest in the Wytch Farm oilfield by the end of 2011.

### Befriending the Kremlin

There has been much speculation over the nature of the deal, which is due to see Rosneft gain five per cent of BP and BP gain a 10.8 per cent stake in Rosneft. In spite of reservations over BP's decision to join forces with a Kremlin-owned company and the issues this may raise, there is no doubting the value of combining local knowledge and language skills with foreign know-how and experience. 'The share swap is a way of mitigating risk,' says Dulaney. 'A foreign oil company like BP needs a Russian partner to assist with internal mobilisation. Equally Rosneft has no home-grown experience in this area, so it is giving up its reserves in exchange for BP's experience. So in terms of commercial and technical value, it is an extremely mutually beneficial arrangement.'

Russia's poor safety track record in the energy sector also concerns environmentalists and industry specialists. In 1994, a 19-year-old ruptured Komineft pipeline spilled around 84 million gallons of oil into the Kolva River in the Arctic. Coal mine explosions have dominated the last two decades. In May 2010, poor safety standards led to two methane explosions at a coal mine in Raspadskaya, Siberia, which killed over 70 miners and injured many more. Both disasters highlight the drastic need to update ageing infrastructure.

In 2010, cuts to infrastructure were considered a major contributing factor to the wildfires that blazed across Russia, killing over 50 people in their wake. However, in spite of concerns over safety standards, it is possible that the tie-up will give Rosneft and the

Russian Government the necessary funds to improve infrastructure and safety procedures for offshore oil drilling. 'There have been a lot of oil and gas leaks in Russia due to antiquated equipment,' says Dulaney. 'Therefore, by signing a deal with BP, this will hopefully help mitigate the risks and make Rosneft's exploration in the Arctic much safer and more efficient.'

### Old friends or foes

The share swap has seen a setback, however, having been put on hold while a dispute with Russian investors in TNK-BP is resolved through arbitration. TNK-BP is Russia's third largest oil producer and was created from the merger of BP's Russian and Ukrainian operations with those of the Alfa-Access-Renova (AAR) consortium. At the end of January AAR claimed that the current terms of the share swap deal are in violation of its shareholder agreements, which requires BP to carry out all projects in Russia and the Ukraine through

TNK-BP. Skadden Arps Slate Meagher & Flom represented AAR and successfully obtained an injunction on the deal in London's High Court. Linklaters advised BP on the transactional side of the deal and is also representing the oil giant in the dispute. Rosneft is not involved in the arbitration proceedings but is being advised by Freshfields.

The dispute does not seem to have fazed BP though and at the time of writing,

the arbitration tribunal had extended the injunction blocking the deal. The injunction marks a certain element of *déjà vu*, however, given Bob Dudley's history with TNK. A former CEO of TNK, Dudley became embroiled in a shareholder dispute and was forced to leave Russia in July 2008 when the authorities refused to renew his visa.

The boat was also rocked a matter of weeks later when Rosneft announced its plans to undertake joint operations in the Black Sea with BP's US rival ExxonMobil. This may have fuelled sceptics' arguments over the Russian company's transparency. However, BP will not have stepped into the tie-up blindly according to Leon: 'The Gulf aside, BP is an astute

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**Enrique Serna**  
Serna & Associates

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operation and it will not be naive about the risks of falling prey to Russian politics,' he stresses. It is perhaps more likely that, buoyed by its successful tie-up with BP, Rosneft became eager to strike a deal with another of global oil giant. Certainly, Russia's deputy prime minister and Rosneft chairman Igor Sechin described the decision as part and parcel of Rosneft's 'increasingly integrated and global' approach.

At the time of writing, TNK-BP and BP are in talks over a possible resolution to the dispute. In response to the injunction, Bob Dudley told reporters in London: 'We were always intending to offer them [TNK] the opportunities, and there may be some resolution that may be financial, it may be a strategic change of direction in TNK-BP, this will resolve itself in time.'

Whatever the result of the injunction, it is unlikely that this is the last we have heard of BP and Rosneft joining forces. In spite of losses over the past year, BP's decision to embark upon a partnership with Rosneft is indicative of a new phase in BP's development. 'We are refocusing BP so that we can increase our investment in its future; investing in reducing risk, in exploration, in new projects, in emerging economies, and in new strategic partnerships,' added Dudley. In 2010 and 2011, the company entered into agreements and obtained licences to gain access to a range of locations, including Australia, Brazil, the South China Sea, Indonesia, Azerbaijan and the UK. For the meantime anyway, it seems there is little stopping BP. ☒

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