



BP and the Russian Bear A Case Study

BP is the largest foreign investor in Russia, while EU reliance on Russian gas was highlighted in January 2009 when gas supplies through Ukraine were disrupted¹. This case study illustrates how on several occasions BP has come under pressure from the Russian state and has successfully sought EU backing. For the EU, BP represents a counterweight to Gazprom in an energy policy which depends upon Russian gas².

The EU's Russian Bear-Hug

BP was eager to access Russia's oil and gas reserves after the collapse of the Soviet Union and in 1997 bought a 10 per cent stake in the Siberian oil company Sidanco, paying some US\$ 500 million³.

As the Cold War ended, the EU also set its sights on Russian oil and gas. The Union is the world's second largest energy consumer⁴, while Russia with the world's largest natural gas reserves⁵, is the region's undisputed energy superpower, providing 40 per cent of the EU's gas imports⁶.

The then British Prime Minister Tony Blair hosted BP's Sidanco signing at Downing Street, giving it the air of an international treaty⁷. He did so not only as British Prime Minister but also as head of the incoming EU Presidency.

BP concluded its deal with Sidanco in the context of another historic signing - the Partnership and Co-operation Agreement between the EU and Russia - which entered into force the same year⁸. Russia sought equal partner status in its relations with the EU, agreeing four areas for co-operation: economic, judicial, cultural and security⁹.

¹ Macalister, T. and Hollingsworth, M. (2003) Price-fixing row over BP's Russian oil deal, The Guardian, 26 June 2003, <http://www.guardian.co.uk/business/2003/jun/26/oilandpetrol.news>

² EUBusiness (2006) Europe relies on Russian gas fields, 28 December 2006, http://www.eubusiness.com/news_live/1167246002.6

³ Koenig, P. (2003) BP - From hate to love in Russia, Times Online, Special Report, 5 October 2003, http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article1166265.ece

⁴ Kryzanowski, M. (2007) Investing in Energy Mastering Climate Change, European Investment Bank Forum, Ljubljana, 27-28 September 2007, p6 http://www.eib.org/attachments/general/events/forum2007_09_kryzanowski.pdf

⁵ Energy Information Administration of the US Government (2007) Russia Energy Data Statistics and Analysis - Oil Gas Electricity Coal, <http://www.eia.doe.gov/cabs/Russia/Background.html>

⁶ EUBusiness (2006) Europe relies on Russian gas fields, 28 December 2006, http://www.eubusiness.com/news_live/1167246002.6

⁷ Coates, S. (2007) BP was nicknamed Blair Petroleum, Times Online, 2 May 2007, <http://www.timesonline.co.uk/tol/news/politics/article1733912.ece>

⁸ DG Trade (2008) European Commission - External Trade - Trade Issues - Bilateral Trade Relations - Russia, http://ec.europa.eu/trade/issues/bilateral/countries/russia/index_en.htm

⁹ DG External Relations (2008) EU-Russia Common Spaces, http://ec.europa.eu/external_relations/russia/common_spaces/index_en.htm

The economic element of the EU-Russia partnership was intended to harmonise Russian commercial law with EU standards, a move that would provide greater protection for BP's investments in the country¹⁰.

BP's then Chief Executive Lord Browne, later told the Financial Times that the company had made use of government support to "underpin" business¹¹.

Existing Tensions

The EU and Russia had already signed an energy deal in 1991¹². The Energy Charter was designed by the European Community to promote international energy co-operation. The EU and former Soviet states signed up to the legally-binding treaty which came into force in 1998. The treaty envisaged free trade, transit and investment in the energy sector¹³. But Russia has so far failed to ratify the treaty, not wanting to relinquish Gazprom's state monopoly over the country's gas export pipelines¹⁴.

Once ratified, the Charter will be of real benefit to companies like BP which want to invest in Russia¹⁵. Under the Charter, investments would be protected as the treaty requires rules on exploration, development and acquisition of energy resources to be non-discriminatory and transparent¹⁶. The EU has threatened not to support Russia's accession to the World Trade Organisation until Moscow ratifies the treaty¹⁷.

BP's Troubled History in Russia

In 1999, BP's Russian investment started to turn sour when another Russian oil company, TNK bought a lucrative Sidanco subsidiary in a controversial bankruptcy auction¹⁸. Months of negotiations followed before TNK agreed to return the subsidiary in exchange for a 25 per cent stake in Sidanco¹⁹.

In 2001 TNK bought out the other shareholders in Sidanco giving it control of the company, and leaving BP with a powerless 10 per cent holding²⁰. BP was left with the choice of losing its investment entirely or gambling more money on the troubled venture. Eventually BP agreed to buy a further 15 per cent share in the company, enough to give it shareholder blocking rights under

¹⁰ DG External Relations (2008) Common Economic Space, European Commission - External Relations - Russia - Common Spaces, 19 July 2008

http://ec.europa.eu/external_relations/russia/common_spaces/economic_en.htm

¹¹ Financial Times (2002) The Politics of Oil, Alexander's Gas and Oil Connections, 1 August 2002

<http://www.gasandoil.com/goc/features/fex23444.htm>

¹² Energy Charter Secretariat (2008) Energy Charter - 1991 Charter

<http://www.encharter.org/index.php?id=29>

¹³ Energy Charter Secretariat (2008) Energy Charter, Frequently Asked Questions,

<http://www.encharter.org/index.php?id=18>

¹⁴ Rettman, A. (2006) EU losing faith in Russia energy charter scheme, EUobserver, 17 October 2006

<http://euobserver.com/9/22664>

¹⁵ Amkhan, A. (2003) The Role of the Energy Charter Treaty in the EU-25 Oil Industry, Energy Charter Secretariat, p3, Slide 6, http://www.world-petroleum.org/slovenia/pdf/slovenia_9-11_april.pdf

¹⁶ Energy Charter Secretariat (2008) Energy Charter - Investment <http://www.encharter.org/index.php?id=6>

¹⁷ Mahony, H. (2007) MEPs link Russian WTO membership to energy rules, EUobserver, 4 September 2007, <http://euobserver.com/9/24687>

¹⁸ Bierman, L. and Fedotov, Y. (2002) Bankruptcy in Russia, Department of Management - Lowry Mays College and Graduate School of Business - Texas A. & M. University and Department for International Relations St. Petersburg State University

http://eng.som.pu.ru/files/upload/research/cases/07_Bankruptcy_In_Russia.pdf

¹⁹ Times Online (2007) BP in Russia - A Timeline, 4 June 2007

http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article1881606.ece

²⁰ The Oil Daily (2001) TNK BP to End Sidanco Dispute, 2 August 2001

http://www.accessmylibrary.com/coms2/summary_0286-10509043_ITM

Russian law, but forcing BP to work as partners with TNK - the company which had taken part of their investment from them a few months earlier²¹.

Re-Shaping the Energy Dialogue

This took place against a backdrop of Russia's deteriorating economic climate. The country's economy had suffered as a result of the Asian economic crisis and the Russian central bank had been forced to devalue the rouble just nine months into the Sidanco deal²². The EU is Russia's largest trading partner and EU-Russian trade was hit hard by the crisis²³. European Union officials met with the IMF, World Bank and G7 in September 1998 to plan their response²⁴, while British Minister for Trade, Brian Wilson, continued to insist that businesses saw Russia as an important growth market despite the crisis²⁵.

At the EU-Russia Summit of May 2001, when uncertainty over BP's Sidanco investment was at its peak, the agenda included discussions around "the need for Russia to provide a stable and reliable legal and institutional framework ... especially relevant to the ongoing Russia-EU energy dialogue,"²⁶.

The Largest Foreign Investment since 1917

The press reported that BP had been badly burned by the Sidanco debacle²⁷, but John Browne, then Chief Executive of BP, remained keen, believing that Russia "rivals any other potential opportunity available anywhere in the world,"²⁸. In 2003 BP made the largest foreign investment in Russia since 1917²⁹, registering TNK-BP as a joint venture, owned and controlled 50 per cent by BP and 50 per cent by Alfa-Access-Renova (AAR) the group of four Russian oligarchs, previously in control of TNK³⁰.

With the TNK deal, BP became the largest foreign investor in Russia and TNK-BP became the first Russian oil company not to be majority-controlled by Russians³¹. As a result, the EU-Russia Energy Dialogue inevitably took on a new flavour. Discussions on "relations between producer and consumer countries" inevitably included relations between TNK-BP production and EU consumption. "Improvement of the investment climate" inevitably benefited BP more than any other EU firm³². Both the then British Prime Minister, Tony Blair and Russian President Vladimir

²¹ Reuters (2002) BP Confirms Raising Stake In Russia's Sidanco - The Financial Express, 17 April 2002

<http://www.financialexpress.com/news/BP-Confirms-Raising-Stake-In-Russia&8217s-Sidanco/43408>

²² BBC News (1998) Russia crisis - Chronology of events, BBC Online Network, 6 September 1998,

http://news.bbc.co.uk/1/hi/special_report/1998/08/98/russia_crisis/165646.stm

²³ DG Communication (2001) Background note on the EU Russia summit - Moscow 17 May 2001, European Commission, Rapid - Press Releases - Europa, Memo 2001 No. 178, 15 May 2001

<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/01/178>

²⁴ BBC News (1998) Blair calls G7 crisis meeting over Russia, BBC Online Network, 7 September 1998

http://news.bbc.co.uk/1/hi/business/the_economy/166582.stm

²⁵ BBC News (1998) EU - No Bail Out For Russia, BBC Online Network, 6 September 1998

<http://news.bbc.co.uk/1/hi/world/europe/165588.stm>

²⁶ DG Communication (2001) Background note on the EU Russia summit - Moscow 17 May 2001, European Commission, Rapid - Press Releases - Europa, Memo 2001 No. 178, 15 May 2001

<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/01/178>

²⁷ Macalister, T. (2003) BP buys into big oil in Russia, The Guardian, 11 February 2003

<http://www.guardian.co.uk/business/2003/feb/11/russia.oilandpetrol>

²⁸ Times Online (2007) BP in Russia - A Timeline, 4 June 2007

http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article1881606.ece

²⁹ Reuters (2003) BP biggest ever foreign investment, AME-Info, 13 February 2003

<http://www.ameinfo.com/22547.html>

³⁰ TNK-BP (2008) Our Company, <http://www.tnk-bp.com/company>

³¹ Reuters (2007) Key facts about Russia's Kovykta gas field, 28 May 2007

<http://uk.reuters.com/article/businessNews/idUKSPI84993920070528>

³² DG Energy and Transport (2008) Energy - EU-Russia Energy Dialogue - Overview, European Commission, 13 October 2008, http://ec.europa.eu/energy/russia/overview/index_en.htm

Putin attended the TNK-BP signing, hosted by the UK Foreign and Commonwealth office at Lancaster House³³.

BP was careful to structure the deal in a way that reduced the risks, yet the history of the joint venture has not been easy. BP has faced several altercations with the Russian state and in 2007, TNK-BP relinquished control of its Kovykta gas-field to Gazprom, following months of accusations that the company was failing to meet production figures set down in its licence. BP said it had been forced to scale back production because it had been denied export routes for the gas by Gazprom, which controls all of Russia's major gas pipelines³⁴.

The situation again made headlines in 2007 when British Prime Minister Tony Blair raised the issue at the G8 summit³⁵.

A Madhouse in BP's Midst

In March 2008 the FSB (the Russian secret service) raided TNK-BP's Moscow offices, charging a TNK-BP employee and one other man with spying. Less than a week later BP was forced to suspend 148 foreign staff seconded to TNK-BP because of visa complications. In May the FSB again raided TNK-BP's offices while BP was faced with a lawsuit from an unknown Siberian company. The same month TNK-BP Chief Executive, Robert Dudley publicly acknowledged differences with the four Russian shareholders in the company. They called for Dudley's resignation and boycotted a board meeting when he refused to step down³⁶.

In June 2008 Dudley was questioned for five hours by the Interior Ministry as part of an investigation into tax irregularities at TNK before he joined the company³⁷, a move widely seen as the state putting pressure on Dudley to leave³⁸. As relations between BP and Russian shareholders deteriorated further, the Russians announced legal action in an attempt to seize greater control of the company from BP. Meanwhile Viktor Vekselberg, one of the four AAR shareholders described the situation at the highest level of management within TNK-BP as "a madhouse,"³⁹.

Commissioner Speaks Out

BP at least had support from the EU. In June 2008, the then European Trade Commissioner Peter Mandelson was in Moscow ahead of an EU-Russia Summit. In an interview, he took the opportunity to intervene in the TNK-BP dispute, saying: "I regret very much any instance, for example in the case of TNK-BP, where tempers seem to have flared ... What this is doing is creating a bad image [of Russia] ... it goes all the way around the world." Mandelson called for a "grand energy bargain" between the EU and Russia and said that the TNK-BP dispute "has got to be resolved speedily,"⁴⁰. In his interview, Mandelson urged the Russian government to "step back"

³³ Macalister, T. and Hollingsworth, M. (2003) Price-fixing row over BP's Russian oil deal, The Guardian, 26 June 2003, <http://www.guardian.co.uk/business/2003/jun/26/oilandpetrol.news>

³⁴ Reed, S. Bush, J. and Matlack, C. (2007) BP's Russian Deal Oils the Wheels, Business Week, 22 June 2007, http://www.businessweek.com/print/globalbiz/content/jun2007/gb20070622_001502.htm

³⁵ Wintour, P. (2007) West fearful of Russia says exasperated Blair, The Guardian, 9 June 2007 <http://www.guardian.co.uk/politics/2007/jun/09/uk.russia>

³⁶ Halpin, T. (2008) TNK-BP Timeline of events, Times Online, 7 July 2008 http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article4286033.ece

³⁷ Reuters (2008) TNK-BP CEO to answer tax questions in Russia, 10 June 2008 <http://www.reuters.com/article/mergersNews/idUSL1069191520080610>

³⁸ Reuters (2008) Russia TNK-BP head Dudley may resign soon - Report - Industries - Energy - Reuters, 27 May 2008, <http://www.reuters.com/article/rbssEnergyNews/idUSL276957920080527>

³⁹ Halpin, T. (2008) TNK-BP Timeline of events, Times Online, 7 July 2008 http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article4286033.ece

⁴⁰ Reuters (2008) Mandelson calls for grand energy bargain between Russia and EU, International Herald Tribune, 19 June 2008, <http://www.iht.com/articles/2008/06/19/business/ruble.php>

and allow the investors to resolve their differences⁴¹. Mandelson was a powerful ally for BP: Russian President Dmitry Medvedev responded within days telling Reuters news agency that the state should not interfere in corporate conflicts and criticising shareholders who expect to resolve disputes with the help of the state⁴².

At the same EU-Russia summit, External Affairs Commissioner Benita Ferrero-Waldner also raised the issue of investor confidence in Russia with the Russian government⁴³.

The Chief Executive has left the Country

Dudley left Russia at the end of July 2008 complaining of “sustained harassment”⁴⁴. BP said Dudley would continue to run TNK-BP from an undisclosed European location with a handpicked team of BP staff⁴⁵. However, within days, rumours were circulating that Dudley might step down as part of a deal with AAR⁴⁶.

On 30th July 2008 BP's chief executive Tony Hayward met with AAR shareholder Mikhail Fridman in Prague⁴⁷, raising suspicion that Dudley was based there, although his location remained secret.

In September 2008 BP signed a memorandum of understanding (MOU) with its AAR partners. The Chairman Peter Sutherland assured investors of stability and spoke of “aligning the two sides around a shared agenda,”⁴⁸. His words echoed confident statements made by Dudley five years previously⁴⁹. Under the terms of the deal, Dudley stepped down to be replaced by a new independent chief executive⁵⁰.

In October, the Russian businessman Denis Morozov emerged as the front runner to succeed Dudley, yet by January 2009 TNK-BP had still not agreed his appointment⁵¹. BP refused to comment, further underlining the distance between the company and its Russian partners. Despite the delay in appointing a new chief executive, on 15 January TNK-BP announced the make-up of a new board of directors. The team includes the former German Chancellor Gerhard Schroeder, a political heavyweight with close ties to president Putin and extensive experience at the heart of EU decision making⁵².

⁴¹ Nicholson, A. (2008) Mandelson Urges Russia to Step Back From TNK-BP Row, Video Interview from Moscow, Bloomberg, 20 June 2008, '04:21

<http://www.bloomberg.com/apps/news?pid=20601072&sid=aShsrARqX5kM>

⁴² Sweeney, C. Stott, M. Lowe, C. and Bolding, P. (2008) EU raises TNK-BP with Russia, Reuters, 27 June 2008, <http://uk.reuters.com/article/worldNews/idUKL2736400920080627>

⁴³ Sweeney, C. Stott, M. Lowe, C. and Bolding, P. (2008) EU raises TNK-BP with Russia, Reuters, 27 June 2008, <http://uk.reuters.com/article/worldNews/idUKL2736400920080627>

⁴⁴ Thomson Financial News (2008) TNK-BPs Dudley may quit under shareholder compromise deal, Forbes, 1 August 2008, <http://www.forbes.com/afxnewslimited/feeds/afx/2008/08/01/afx5278648.html>

⁴⁵ Fortson, D. (2008) BPs Russian boss Bob Dudley goes into hiding, The Sunday Times, 27 July 2008 http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article4407496.ece

⁴⁶ Thomson Financial News (2008) TNK-BP's Dudley may quit under shareholder compromise deal, Forbes, 1 August 2008, <http://www.forbes.com/afxnewslimited/feeds/afx/2008/08/01/afx5278648.html>

⁴⁷ Russia Today (2008) BP Chief Tony Hayward Holds Talks With Mikhail Fridman, 1 August 2008 <http://www.russiatoday.com/business/news/28345>

⁴⁸ BP Press Office (2008) BP and AAR Move to Resolve Joint-Venture Dispute, Press release, 4 September 2008, <http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7047682>

⁴⁹ Russian Investment Review (2003) Cover Story - TNK-BP An Inside Look, Vol. 2, No. 1, Spring 2003 http://www.russiainvestors.com/archive/vol2no1_cstory.html

⁵⁰ BP Press Office (2008) BP and AAR Move to Resolve Joint-Venture Dispute, Press release, 4 September 2008, <http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7047682>

⁵¹ Pagnamenta, R. (2009) Wrangle over new chief's pay delays TNK-BP dispute, Times Online, 17 January 2009, http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article5533165.ece

⁵² TNK-BP (2009) TNK-BP Announces New Board of Directors, Press Release, 15 January 2009 <http://www.tnk-bp.com/press/releases/2009/1/103>

BP And The EU - Shared Agendas?

The EU has supported BP's moves into Russia over an extended period, spanning more than ten years. These are not one-off gestures of support: EU underpinning for BP's business in Russia has been broad-based and systemic. The EU has assisted BP not out of benevolence towards the company but through a perceived shared interest, yet it is far from certain that what benefits BP also benefits the EU as a whole.

BP Chairman Peter Sutherland has been a strong proponent of the "shared agenda". Sutherland chairs the working group on Foreign Economic Relations at the European Roundtable of Industrialists (ERT). "Its work is based on the premise that open international flows of trade, investment and expertise are a critical component of European competitiveness ... ERT supports efforts to further strengthen the formal ties between the EU and Russia, insofar as this will contribute to closer economic and business relations," BP's Head of European Affairs Howard Chase is the convenor of the group⁵³.

As chair of the working group Sutherland put his name to ERT's 2006 paper "Seizing the Opportunity: Taking the EU-Russia economic relationship to the next level". The paper argued that Russian policy-makers "can best strengthen investors' confidence by taking measures that strengthen the perception that investments are safe and can be put to the most productive use"⁵⁴. This argument has subsequently been at the core of EU's demands over the TNK-BP dispute.

ERT has been a leading proponent of the argument that what benefits European business benefits the EU, but the argument has its critics. Jennifer Morgan, then of WWF attacked the "old-style approach in energy relations between EU and Russia for focusing on oil, gas and pipelines, which continue to dominate at the expense of renewable energy." She argued that "By joining forces towards non-carbon energy, the EU and Russia could significantly contribute to the reduction of global greenhouse gas emissions ... However the overall priorities of the EU-Russian energy relations seems to have gone back to the seventies when the entire debate was geared towards oil, gas and nuclear, and supply pipelines."⁵⁵

The EU's best interests arguably lie in greater energy-independence and in structuring its economy around renewable energy, creating more jobs and increasing energy security^{56, 57}. Even ERT argues that to base Russian-EU economic relations primarily on gas and oil risks exposing the Russian economy to "Dutch Disease"⁵⁸, where rapid growth in the oil and gas sector strangles other sectors of the economy, whilst also pushing basic necessities out of reach for much of the population due to soaring exchange rates⁵⁹. However, despite these warnings BP is more

⁵³ European Round Table of Industrialists (2008) Working Groups - Foreign Economic Relations http://www.ert.be/working_group.aspx?wg=5

⁵⁴ ERT (2006) Seizing the opportunity - Taking EU-Russia relations to the next level, p3 and p13, <http://www.ert.be/doc/0147.pdf>

⁵⁵ EUractiv (2008) EU-Russia Energy Dialogue - EU - European Information on Energy Supply, <http://www.euractiv.com/en/energy/eu-russia-energy-dialogue/article-150061>

⁵⁶ Sanders, R. (2004) Investment in renewable energy better for jobs as well as environment, Extract from the report - Putting Renewables to Work How Many Jobs Can the Clean Energy Industry Generate, Press Release, UC Berkeley News, 13 April 2004, http://berkeley.edu/news/media/releases/2004/04/13_kamm.shtml

⁵⁷ Clegg, N. (2008) Securing Britain's Energy, New Statesman, 21 May 2008 <http://www.newstatesman.com/politics/2008/05/coal-power-carbon-energy>

⁵⁸ ERT (2006) Seizing the opportunity - Taking EU-Russia relations to the next level, p11 <http://www.ert.be/doc/0147.pdf>

⁵⁹ PLATFORM et al. (2002) Some Common Concerns, p151, "Dutch Disease" http://www.foe.co.uk/resource/reports/common_concerns.pdf

interested in replacing its depleting reserves with Russian gas and oil than in developing its interests in renewable energy⁶⁰.

Disruption to EU gas supplies in January 2009 - as Ukraine quarrelled with Russia and pipelines were shut down - exposed EU reliance on Russian gas. A dependence that does not support EU energy security, but does support BP's financial security. That financial security depends on BP maintaining its position as a bridge between Russian resources and EU customers. Given the company's turbulent relationships in Russia, BP draws on the EU to help it maintain that position. The EU assists BP because, while it may not be in the long term interests of the EU to depend upon Russian gas, EU energy policy currently relies on it. Without BP, it would have to rely on Russian state companies, most notably Gazprom. As TNK-BP is currently the only major oil and gas company in Russia with no state involvement, and the only major energy company in the country not majority-controlled by Russians, it is a key partner for the EU.

Conclusion

BP's operations in Russia have received substantial EU support, thanks to a perception that the EU shares the company's agenda and should therefore support its interests. This perceived shared agenda is a clear indication of BP's achievements in relationship building in Brussels.

Such relationships are built gradually across a range of encounters, with BP's interests put forward by industry bodies as well as by individuals from the company. Such encounters are seldom documented, but when the EU intervenes on BP's behalf, it is nevertheless highly likely that conversations have taken place and in many cases it is inconceivable that they have not.

This close relationship and shared agenda raises important questions about EU energy policy and energy security, particularly in the context of the EU's relationship with Russia. As events at the start of 2009 have illustrated, the EU cannot rely on Russian gas for its energy supplies and what may be in the best interests of BP is not always in the best interests of the EU.

⁶⁰ Greenpeace UK (2008) Back to petroleum - 2007 results reveal the recarbonisation of BP, Press Release, 5 February 2008, <http://www.greenpeace.org.uk/media/press-releases/2007-results-reveal-the-recarbonisation-of-bp-20080205>