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there and run pricing as a team.' It just happened. We just gave them the information to know whether they were killing the guy next door or vice versa."

The cultural change blossomed. Wallace reinforced it with other information tools. He wanted to open new avenues of communication with people at all levels and all locations of the organisation. "Electronic mail is informal communication. It opened up a new communication link for us clear down through the organisation. It gave us a new link to people. In 1985, we had about 450 users on the electronic-mail system. Of that 450, about 250 were in R&D and 200 of them were in information systems. Today, we have over 8 000 people worldwide on the system and there are fewer than 10 000 exempt employees in our company."

Tangible results

As a direct result of the use of information systems, the executive team was in closer touch with business operations and with customers, and employees began understanding their roles and responsibilities better. The results were quite tangible. "As we got our systems up and operating, the performance of our company just ramped up like this," explains Wallace, inclining his arm in an upright position. "You just can't believe it. It became an overnight success story. Unbelievable. It was beyond even my wildest expectations. I have seen our system increase the profitability of Phillips Petroleum Company by \$25m to \$40m a year in a matter of weeks."

Wallace's own words summarise the importance of information systems to

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leadership: "If the drive of the '90s is survival and the fundamental drive for executives is optimising the effectiveness of the organisation – I don't care whether you're using Peter Drucker's theories or William Ouchi's – if you don't have a good information system, you haven't got a chance of altering the effectiveness of the organisation. Not a chance." □

OPINION

Time To Harmonise Russian Oil Law

Andrey Konoplyanik wrote this article early this year, shortly before being elected Deputy Minister at the Russian Ministry of Fuel and Energy. He urges reform of the law

FOREIGN CAPITAL required to develop Russian hydrocarbons can be mobilised either through loans and compensation arrangements (a mechanism characteristic of the Soviet era), or through direct investment by foreign companies. In view of the Soviet experience in using the former, it should now be recognised that the latter, direct-investment approach should be favoured as most likely to yield best results.

Capital resources

Energy resource development projects typically demand very high investment. In Russia, such requirements are growing as depletion of fields in accessible areas forces companies out into more remote regions where climatic and geological conditions are much harsher.

Some of the oil and gas projects now on the Russian agenda require such huge

investment that no western company, however well endowed, would be capable of tackling them single-handed. Take, for instance, the Bovanenkovskoye field in west Siberia's Yamal peninsula. Studies carried out at Moscow's Institute of Energy Studies show that some \$56bn in 1989 prices would be needed to achieve a production ceiling of 160 billion cubic metres a year at this field and to build a trunkline linking the area with gas consumers.

Foreign companies interested in such giant projects should band together in consortia, pooling both their own and borrowed capital resources. Such consortia could include not just oil companies but also banks, investment funds, insurance companies and others.

The sort of companies committing themselves to such projects will insist on sticking to the rules of the game gov-

erning their own western investment environment. Going along with the existing, ex-Soviet economic mechanism would be regarded as unacceptably risky, particularly given the scale of investment required in energy. But how far does current Russian foreign investment legislation meet with the needs of the kind of foreigners the country is trying to attract?

Existing law

In the absence of any Russian mining law, prospective foreign investors in the energy sector must, for the time being, be guided by the law on foreign investors of the Russian Federation. However, this is only an umbrella-type of legislation setting out general guidelines for overseas investment on Russian territory.

Article 3 of the above law states that foreign investments in the energy and

mining sectors can be made through:

- Participation in joint ventures with former Soviet legal entities as partners; or
- Enterprises wholly owned by foreign investors; or
- Acquisition of rights to use land and other natural resources; or
- Other investment arrangements subject to applicable legislation.

Article 20 states that industries open to foreign investors will be subject to special permits or licences. But, so far, no list of such industries has been drawn up. However, work on a draft of licensing regulations for mineral resources, including hydrocarbons, is about to be completed.

Direct legislation allowing enterprises to be wholly owned by foreign investors is also unavailable. And the new law now under review defines the licensing procedure in terms too general to be applicable.

Acquisition of rights to use land or mineral resources is covered by Article 40 on concession agreements. However, this article is of little use, as yet, because it contains a reference to Russian concession laws that do not even exist.

A draft of Soviet national concession law was being developed even before the failed coup of August 1991. Two alternative versions had been drafted: one entitled "On the Procedure for Granting Concessions to Foreign Countries and Companies"; and a second dubbed "On Foreign Concessions in the USSR".

Concession fixation

Both these drafts and Article 40 of the Russian Law on Foreign Investments (which in effect draws heavily on earlier Soviet documents), limit foreign investment in mineral projects to the concession formula, or, in other words, to just one of several possible production arrangements normally available to international business.

Concessions are no longer regarded as the most suitable arrangement for Russia to use in hosting foreign investors. New drafts of the Russian law are now being prepared which are expected to legitimise not just concessions, but also production-sharing contracts, risk service contracts and other arrangements currently available to energy companies elsewhere in the world. Still, at the moment, only Article 40 and various decrees and executive orders have the force of law with respect to energy investment by foreign companies.

The current wave of foreign investments is the third in the history of Russia/USSR. The first occurred at the time of the first industrial revolution in the late 19th and early 20th century and

the second during the period of Lenin's New Economic Policy in the early 1920s. On both occasions, the mining industry was a prime motivator in efforts to encourage foreign investment in the economy. However, success in attracting overseas investment, even in energy, was then, as now, modest.

Lessons of history

Lessons learnt over the five years since the doors of the Soviet economy were again opened to the outside world have proved without doubt that the mechanisms we rely on to do business with foreign investors are still a strictly home-made invention. They take little, if any, advantage of Russia's national historical experience, or that of the West, and display a disregard for current world practices. The general inappropriateness of legislation has been the major cause of the problems undermining the few energy and resource projects negotiated with foreign investors so far. Chevron's experience at Tengiz is a prime example of the shortcomings of the system.

Disadvantaged host

It is equally absurd that the joint venture laws applied in the energy and mining industries actually work to Russia's disadvantage. Legislation appears to have been drawn up without regard for the specific features of the mining industries. It does not, for instance, provide for any royalties to be paid to the owner of the resources. Nor does it allow for the host country to include its resources in the overall evaluation of the partners' contributions to the joint venture's authorised capital.

If Russia was to make its resources part of its contributed assets, the contribution of the foreign company would have to be increased accordingly, or else the distribution of profits would have to be revised in favour of the host country.

Also unacceptable is the excessive tax relief allowed to foreign companies by current joint venture legislation. Under Russian law the highest tax rate levied on enterprises with foreign investment is just 25%. This rate is:

- Only half the actual tax rates generally applied to energy and mining companies in current world practice; and
- Two or three times lower than the mean special profit tax payable by oil corporations which typically ranges from 50% to 85%.

Out of tune

Under current legislation, all the possible arrangements for foreign involvement in the development of Russia's energy

resources are contradictory and, it can be argued, are of no practical interest to western investors at all.

Russia's energy industries will only begin to attract large-scale foreign investment when the legal system is harmonised with consensus oil and gas commercial arrangements in use worldwide. At present, the Russian laws merely retard the investment process.

Production arrangements with foreign companies currently applied in the international oil industry fall into two broad categories: concessions and contracts. The latter grouping includes production-sharing contracts (PSCs) and risk or no-risk service contracts. PSCs are probably the most appropriate arrangement for Russia during the period of transition from centrally-planned to free-market economics.

PSCs have a number of advantages over concession-style deals for the Russian oil industry. In the first place they maximise the amount of oil, itself a convertible commodity, which flows to the host country. Under terms of a concession agreement, Russia would instead be the beneficiary of taxes paid in non-convertible roubles.

Local participation

While the host country plays no active role in a concession arrangement, production-sharing contracts would allow Russian companies to participate directly in an oil and gas development. Russians could, therefore, gain valuable first-hand experience of operating skills and practices, expertise and know-how. Such arrangements would also facilitate the transfer of western technology into the Russian oil and gas sector.

Risk service contracts also allow for local participation in resource development, so are more attractive than concession arrangements. But, given Russia's precarious financial state, it would probably be impossible, at present, to distribute risks equitably between partners. As long as the rouble remains non-convertible, foreign companies are unlikely to be prepared to assume all risks at the exploration stage, in exchange for reimbursement later.

Production-sharing and risk service contracts are not yet allowed by Russian law. The conclusion of any such agreement requires either a decree from the Supreme Soviet or from the President himself. However, once the Russian draft law on mineral resources is passed and existing laws on foreign investment amended, scope for overseas participation in the energy sector should be substantially expanded. □