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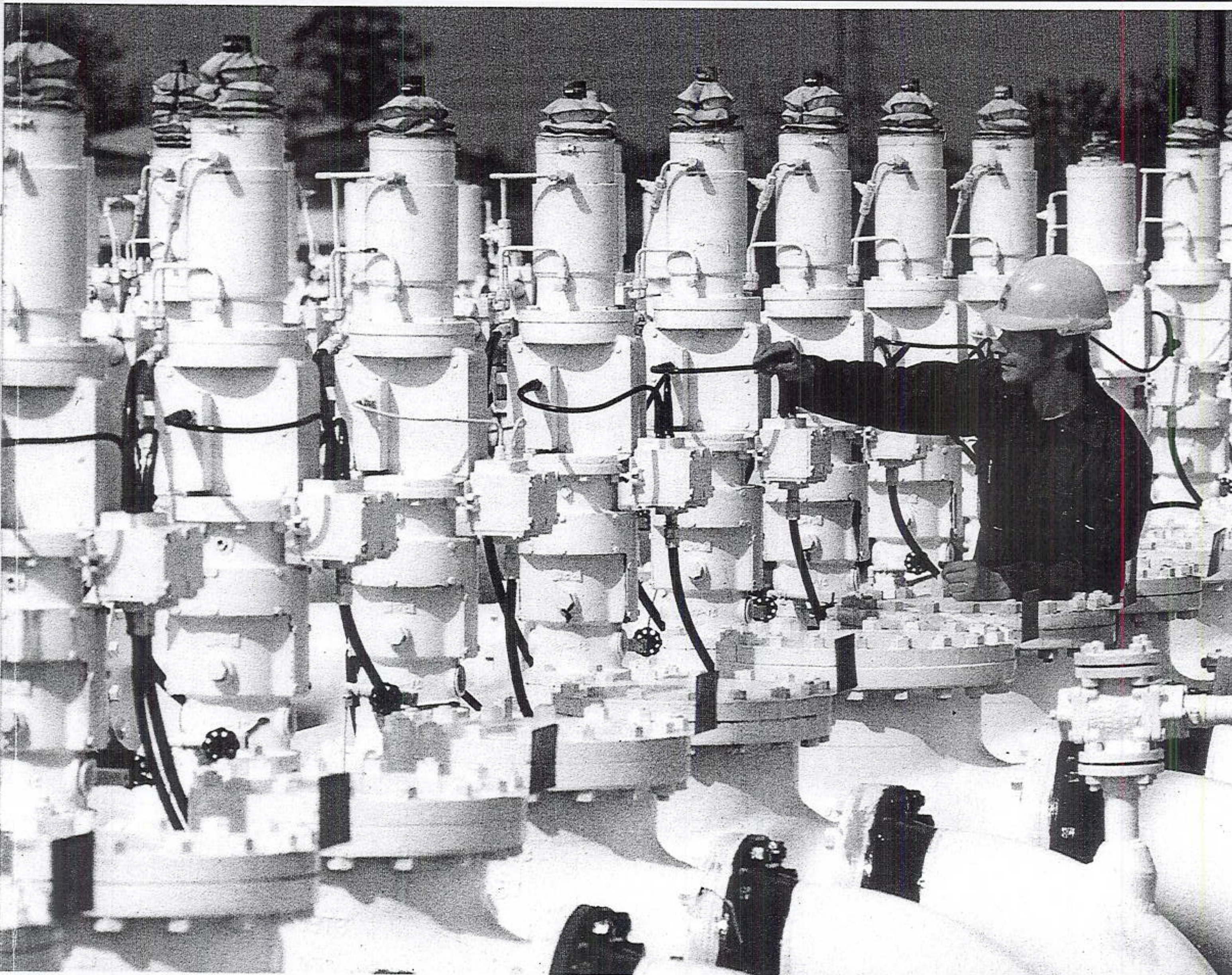

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Sakhalin tender process tortuous

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In May 1991 the Sakhalinmorneftegaz production association—in charge of surveying, exploration, research, development, and engineering off Sakhalin Island—on instructions from the U.S.S.R. Ministry of Oil and Gas Industry and the Russian Federation's State Committee for Geology announced a tender for a joint feasibility study to develop existing fields and explore areas of the shelf adjacent to the fields (OGJ, Mar. 23, p. 128).

The tender covered a total offshore area of 17,000 sq km, or about 10% of the explorable Sakhalin shelf.

Fields discovered by early 1991 had a total potential deposit of about 230 million tons (1.679 billion bbl) of oil and condensate and about 600 billion cu m (21.19 tcf) of gas.

All fields and promising structures were found in a coastal strip confined to a 50-60 m water depth. Odoptu and Chaivo fields were not included in the tender zone. The discoveries and the prospect of identifying new deposits heightened the interest of foreign companies in the tender.

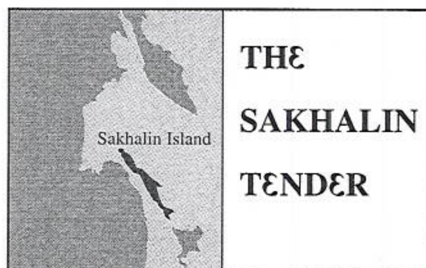
Six companies or combines signed on for the tender and purchased the appropriate package of data, terms, and conditions:

- Exxon Corp.-Sakhalin Oil Development Co. (Sodeco)
- Mobil Corp.
- Royal Dutch/Shell Group-Showa Shell Sekiyu KK.
- BHP Petroleum Pty. Ltd.-Amoco Corp.-Hyundai Heavy Industries Ltd. (BAH).
- McDermott International Inc.-Marathon Oil Co.-Mitsui & Co. Ltd. (MMM).
- Idemitsu Kosan Ltd.

Palmco, a joint venture of Ralph M. Parsons and South Korean firms, withdrew from the tender.

Pursuant to the tender's terms and conditions, in early August 1991, the contenders submitted their respective proposals to Sakhalinmorneftegaz. Examination of the foreign companies' proposals was based on these criteria:

- Time schedule for commercialization of the fields.
- Time schedule for delivery of gas to consumers in Russia's Far Eastern Economic Region.
- Exploration and surveys in the tender zone.
- Evaluation of promising new areas in terms of time and the size of deposit.
- Reasoning behind the engineering and technological solutions and their reliability and environmental safety.
- Preparedness to capitalize authorized funds.



It was anticipated that the interests of the Sakhalin free economic zone would be implemented mainly through taxes and other payments generated by the project and by allocation of such money to the respective republic and local budgets.

Having analyzed the materials received from the foreign companies by Sept. 20, 1991, Sakhalinmorneftegaz had made a well considered proposal to the Tender Organizing Committee (TOC) to recognize as the tender winner the MMM group and recommended a feasibility study be jointly drafted, so that following its examination by the Examining Board in 1992, project implementation could begin.

Sakhalin actions

Pursuant to official terms and conditions of the tender, TOC was prepared to announce Oct. 5, 1991, its decision to select a foreign partner to conduct a joint feasibility study and have it completed by May 1, 1992.

However, on Oct. 18, 1991, V. Fedorov, governor of the Sakhalin region, unilaterally and without consultation with Russia's government or TOC submitted to the foreign companies a new set of requirements, some of which contravene the Russian federation's laws on ownership (Article 21) and foreign investment (Article 42).

The idea behind such requirements essentially was that by Nov. 10, 1991, the foreign companies were to include the following provisions in their respective proposals:

- Delivery of natural gas to the Sakhalin region was to be increased to 3 billion cu m in 1995, 5 billion cu m in 1997, and 8 billion cu m in 2005.
- The amount of gas for export was to ensure minimal profitability of the project, with remaining gas to be delivered to Khabarovsk Territory.
- Cooperation options to be provided were to include—apart from a joint venture—concessions, production sharing contracts, and service contracts.
- The foreign companies were to prepare to embark upon the oil and gas project and simultaneously finance and build in the Sakhalin region various manufacturing and social facilities, including roads and railways, sea ports, airports, coal pits and mines, facilities to manufacture construction materials, agroindustrial facilities, hospitals, facilities for children, et al., for a total amount of about 10 billion rubles, according to an estimate by the city executive committee.

Financing for the manufacturing and social program would come from the proposed reduction in royalties from 12.5% under the tender terms to 1.5% and from granting the foreign partner a 7 year tax holiday for the repatriated profit.

Lack of approval

Information on tax and royalty privileges was conveyed to the foreign companies without approval from Russia's government or its Supreme Soviet, which constituted a violation of federal legislation.

In fact, the above requirements were to have been met through drastic cuts in or through complete shutdown of gas supplies to the Khabarovsk and Maritime Territories, which would inevitably have resulted in further deterioration of the region's fuel and energy situation.

Besides, the foreign partners would have received tax benefits unsupported by legislation.

To summarize, the hydrocarbons of the continental shelf are regarded by the island's administration as the property of the Sakhalin Region in contravention of the governing legislation.

Following the adoption Dec. 27, 1991, of the decree on allocation of government property in the Russian Federation by Russia's Supreme Soviet, the decision by the Sakhalin administration also came into conflict with that legislation, which reaffirmed that the resources of the continental shelf constitute exclusively federal property.

Sakhalin Tender Committee

To analyze proposals by foreign companies regarding terms and conditions of the Sakhalin region, on Nov. 12, 1991, the Sakhalin Tender Committee (STC) was constituted by decision of Gov. Fedorov, as were seven groups of experts representing the subcommittees of the Executive Committee on energy, environmental protection, economics, construction, transport, communications, food, social issues, and public relations.

Pursuant to the deadline of Nov. 28, the groups of experts had submitted to STC their respective conclusions. STC, after consideration of such conclusions, was to submit to the Sakhalin governor its proposals on the tender winner by Nov. 30.

The expert groups selected the MMM group, with four first place slots out of a total of 12½ slots, and the BAH group, with three first place slots out of a total of 13½ slots, as the two winners.

It should be noted, however, that the BAH group received one of its first place slots from the Commission of the Executive Council for Environmental Protection even though BAH proposed commencing development of Piltun-Astokhskoye field by installing an early production system and transporting the oil in tankers from the production site for the first 3 years. That is the most environmentally hazardous technique, given the region's hydrometeorological and ice conditions.

Failing to meet the deadline, on Nov. 28, 1991, the administration of the Sakhalin Region represented by Lt. Gov. and STC Chairman V. Mozolevsky put forward additional requirements. They required foreign companies to submit by Dec. 7, 1991, draft contracts for a feasibility study to determine the economic viability of the fields on the assumption that the foreign partner and the domestic partner would select a mode of cooperation calling for a production sharing contract.

However, the projects submitted by the foreign companies were not discussed.

A surprise came when STC's final protocol, signed only by Lt. Gov. Mozolevsky on Jan. 8, 1992, named BAH and the Exxon-Sodeco combine winners. That differed not only from the conclusions of the seven groups of experts but also from the intentions of the foreign companies.

Salmanov Commission

On Dec. 3, 1991, the Examining Council under the chairman of the Russian government set up another panel of experts to consider the tender

WATCHING THE WORLD

With Roger Vielvoye from London

Ranking the companies

There's nothing like an industry table to catch the attention of readers, particularly those whose companies appear in the upper levels or who aspire to the top spots.

Of course, there are those, usually sliding down the table, who claim that rankings are meaningless, and the only performance that counts is the return for shareholders.

U.K. North Sea producers

On that basis the exploration and production arm of British Gas plc should be mulling with considerable pleasure the rankings of oil companies in the U.K. North Sea by analysts County Natwest Woodmac, Edinburgh, Scotland.

And the company that should be writing off the industry table idea should be Shell U.K. Exploration & Production, which, according to Woodmac's Top 20, has been ousted from the No. 2 spot by the expansionist-minded British Gas subsidiary.

British Gas, previously in fourth position, also leapfrogged Esso Exploration & Production, Shell's 50-50 partner in most areas of the British continental shelf.

The Top 20 is based on the total value of companies' U.K. oil and gas assets onshore and offshore. Other tables list the companies on the basis of reserves, production, gross acreage, and net acreage.

The British Gas advance results from an increase in the value of its Morecambe field in the Irish Sea following its decision to elevate production facilities to base load operations in addition to its previous role as a peak shaver. British Gas also is involved in major new projects such as Everest and Lomond fields, which boost the total value of the company's U.K. offshore assets to $7.35 billion.

No. 1 in all the categories is BP Exploration with assets worth $12.82 billion and production of 632,000 b/d of oil equivalent—459,000 b/d of oil and 979 MMcfd of gas.

One significant change in BP's position during 1991 is in the gross acreage table. Although the company continues to head the list, its lead over other companies has been reduced by a low key performance in the U.K.'s 12th and frontier licensing rounds and relinquishment of ninth round acreage during the year.

The company's total acreage position fell by about 12% and now represents less than 20% of all U.K. offshore acreage, compared with 23% early in 1991.

Lasmo plc, which completed a takeover of Ultramar plc at the end of last year, jumps into second place in the gross acreage league from 16th the previous year. It also moves to 10th place in the overall ranking from 15th in the 1991 list.

More climbers

Hamilton Bros. Oil & Gas moves into the master list at 20th place, up from 23rd, on the strength of its successful exploration campaign in the Irish Sea. Other climbers included Conoco (U.K.) Ltd. to fifth from seventh place and Enterprise Oil plc to sixth from eighth.

For everyone that goes up, a company comes down.

The main losers in 1991 were Texaco North Sea to eighth from sixth, Fina Exploration & Production to 18th from 14th, and Elf U.K. Ltd. to seventh from fifth, although that excludes the effect of Elf's two-thirds share in Elf Enterprise Caledonia, successor to Occidental Petroleum.

proposals by foreign companies. That commission was chaired by F. Salmanov, First U.S.S.R. Deputy Minister of Geology.

The Salmanov Commission ruled that the 17,000 sq km of prime territory offered for the tender was unprecedented in world practice, and that in order to prevent monopoly by individual companies, the area should be divided into several blocks. Each was to be put up for tender.

Additional negotiations with foreign companies were contemplated to discuss this along with other problems.

The panel of experts proposed dividing the tender zone in the following manner:

- Block 1, about 5,800 sq km, including Arkutun-Daginskoye oil and gas field and two conditioned structures, East Kaiginskaya and East Odoptinskaya. The panel arbitrarily included in the block Chaivo and Odoptu fields covered under the general agreement with Japan and excluded for that reason from the tender zone by the tender organizers. The panel slated this block for transfer to the Exxon-Sodeco group.
- Block 2, about 4,500 sq km, including Piltun-Astokhskoye gas field and the conditioned Lozinskaya and Bautinskaya structures. That block was slated for transfer to the randomly formed group of MMM-Idemitsu.
- Block 3, more than 7,500 sq km, including Lunskoye, Veninskoye, and Kirinskoye oil/gas/condensate fields and the conditioned Nabilskaya and South Lunskaya structures. That block was slated for transfer to the randomly formed group of BAH-Mobil.

No technological or economic rationale was suggested for the proposed division of the tender zone.

We believe that decision not only runs counter to the terms and conditions of the tender announced in May 1991 but also slows to a snail's pace development of the fields discovered in the tender zone for these reasons:

- It will take several years of additional exploration to ascertain economic viability of developing the first block because development of Chaivo and Odoptu fields, excluded from the tender zone, is at present economically unsound.
- Development of the second block through inclusion of Piltun-Astokhskoye field appears economically viable. However, that would effectively cut off the gas supply to the internal market in volumes sufficient for Russia's Far Eastern Region.
- Joint development of the Lunskoye gas/condensate field separated from the rest of Block 3 cannot be expected to commence before 1997-98 because only at that time can one expect sufficient demand for gas in the Asia-Pacific region not covered by long term contracts. That demand could be met by gas export from the Sakhalin shelf, which would pay back the foreign exchange invested in the development of the block. The domestic market's demand for gas will not be met because the proceeds in rubles for domestic sales of gas internally would not offset the foreign exchange injected into the block by the foreign partner.
- The proposed division of the tender zone into blocks would require more time to harmonize interests of the foreign companies and coordinate their activities. Therefore, the question of early supply of gas to the mainland would simply have to be struck off the agenda.

This is the second of two articles on the Sakhalin tender process. Next: Conclusions and outlook.

Therefore, the work of the Salmanov Commission did not expedite a final verdict on the tender.

If anything, the Salmanov Commission called for a new tender on new terms and conditions. It must be recognized, however, that the commission did not receive any decisionmaking mandate by virtue of being set up as a "commission of experts." The commission's conclusions should have been submitted to Russia's government and the Examining Council under the Chairman of the Russian Government.

The uncertainty of a final verdict for the tender announced in May 1991, created mainly by intervention by the administration of the Sakhalin Region, not only led to delays in starting development on the shelf, it also could have discredited Russia because a long term project of such size is invariably under close scrutiny from the world press and the financial and business community of industrialized capitalist nations.

In view of the above, and on instructions from the Chief State Inspector of the Russian Federation of Nov. 19, 1991, and pursuant to an executive directive of the Russian government of Dec. 23, 1991, a government committee was constituted and headed by V. Danilov-Danilyan, Russia's Minister for Ecology and Natural Resources, to synthesize the results of and to select the winner of the tender announced in May 1991 for development of oil and gas on the Sakhalin shelf. ▪

U.S. gas pipelines cutting deals, expanding

Intrastate U.S. gas pipelines continue to capture new markets and offer more transportation alternatives for North American gas producers.

In the latest action, two systems have signed long term contracts with public utilities and a third has outlined plans to add capacity and delivery points:

- Valero Natural Gas Partners LP, San Antonio, agreed under a 10 year contract beginning July 1, 1992, to supply all gas requirements of City Public Service (CPS), San Antonio's gas and electrical power utility. The contract replaces an agreement under which Valero supplies 80% of CPS gas needs, expected during 1992 to total about 50 bcf.
- Sponsors of the proposed Empire State Pipeline signed a 15 year agreement to transport 20 MMcfd of gas for New York State Electric & Gas Corp. (NYSEG), Binghamton, N.Y. Empire is to transport a 50-50 mix of U.S. and Canadian gas to customers in the western and central New York communities of Auburn, Geneva, and Lockport.
- Overland Trail Transmission Co., operated by a subsidiary of Union Pacific Fuels Inc. (UPFI), Fort Worth, will expand system capacity by about 40 MMcfd. Overland also plans to install a connection with recently activated Kern River Pipeline (OGJ, Mar. 16, p. 28) and increase receipt and delivery capability with Colorado Interstate Gas Co. (CIG).

Valero gas sale

Valero won the contract with CPS in an open bidding process that began last fall.

Terms of the contract allow CPS and