



CHATHAM HOUSE

KEEI Seminar

2006 Sino-Russian Oil and Gas Agreement and the implications

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I. Core of Beijing Agreement in March 2006

During the President Putin's State visit to Beijing in March 2006, there were Three major agreements between Russia's state energy firms and CNPC :

- The First is the Memorandum of Understanding between Gazprom and CNPC with regard to natural gas supply to China. Gazprom said it will build two gas pipelines with a delivery capacity of 30-40 bcm/y each. The proposed gas supply timing is 2011.
- The Second is the Cooperation Agreement between Rosneft and CNPC. The two firms intend to form a JV that would spend US\$ 2 billion on gasoline stations and an oil refinery with a refining capacity of 10 mt/y. The two firms also intend to set up an oil exploration and production JV to bid for oil blocks in Russia.
- The Third is a protocol between Transneft and CNPC to begin a feasibility to build a branch of the planned Eastern Siberian – Pacific Ocean pipeline to China. CNPC is going to offer US\$ 400 million loan for the branch pipeline development.



II. Gazprom's Asian Policy

1997.02 Gazprom CEO Rem Vyakhirev announced the firm's intention to formulate a comprehensive policy to penetrate Asian gas market.

1997.06 Vyakhirev revealed a detailed blueprint for Gazprom's new Asian initiative in a speech delivered to the World Gas Conference.

1997.08 Gazprom and CNPC signed an agreement on cooperation in the gas sector.

1997.10 Valery Remizov, Deputy Chairman of Gazprom confirmed that Gazprom has to decide the exact means by which west Siberian resources will be exported to China. The two options under considerations are i) the construction of a 6,000 km pipeline to Shanghai, ii) the construction of a new terminal in southern China to facilitate increased exports of LNG



1997.11 President Yeltsin attended the Fifth Russian-Chinese Summit in China. The Memorandum signed by both Boris Nemtsov, first deputy premier and Li Lanqing, the Chinese counterpart gave top priority to large scale energy projects – Irkutsk-China gas pipeline project, West Siberian-China gas pipeline project, and Electricity export from Irkutsk to China – as a means of creating A solid and substantial basis for a long term relationship between Russia and China.

1997.12 Gazprom and CNPC ratified the Memorandum on Negotiations between Gazprom and CNPC on the implementation of the project for the delivery of Russian natural gas to the eastern areas of China.

1998.07 Gazprom and the Administration of Tomsk Region signed a 5 year Cooperation agreement to enhance industry infrastructure.

1998.08 Gazprom announced the results of a preliminary FS on West Siberian-China exports were promising. The target supply source, Bolshekhetskaya Cavity region of West Siberia contains approximately 3 tcm of gas reserves, including 0.75 tcm of C1 reserves, 0.6 tcm of C2 reserves, and 1.2 tcm of C3 reserves.



1998.11 Vyakhirev disclosed the details of two promising export options to China at the Summit Conference in Kuala Lumpur :

- The Altay project : envisaging the export of West Siberian gas to the Shanghai region of China via Xinjiang province
- The Baikal project : envisaging the export of West Siberia gas to the Shanghai region via a 6,467 km pipeline passing through Krasnoyarsk, Irkutsk, Mongolia and Beijing.

1999.02 Both governments agreed to undertake FS on West Siberian gas exports to Shanghai areas.

1999.10 Vostokgazprom based in Tomsk region was formed by Gazprom (49%) And Hungarian-based General Banking & Trust Co Ltd (51%) which is partially owned by Gazprom through its Gazprom bank.

2001.03 PetroChina announced 19 western companies passed the pre-launch qualification evaluation and Gazprom is included in this evaluation list.



2002.07 On July 4th, 2002, PetroChina finally signed the MOU on JVs with three international partners for the West-East Pipeline project and the partners are :

- Royal Dutch Shell + HK China Gas Co
- ExxonMobil Corp + CLP Holdings
- Gazprom + Storytransgaz

2002.07 Russian Governmental Order (July 16, 2002) authorised Gazprom and the Energy Ministry to prepare the document for Asian gas export programme, and the same order made Gazprom as the co-ordinator of carrying the programme out.

2003.06 Gazprom new CEO Alexei Miller's speech at the 22nd World Gas Conference made very clear Gazprom is authorised to develop a Unified Gas Supply System (UGSS) for its gas export to Asia.

2004.03 Gazprom signed an agreement with the Chongqing Municipal Gas Group to build a 200 mcm underground natural gas depot.

2004.05 China Gas Holdings Ltd signed a LOI with Gazprom for joint development of gas projects in China and for Gazprom to be a strategic investor in the Chinese pipeline gas provider.



2004.06 Gazprom reconfirmed the firm will remain as Russia's sole gas exporter and its 100% subsidiary Gazexport will negotiate with potential customers on volumes, scheduled and gas price formula.

2004.07 PetroChina announced the firm decided to terminate the JV Negotiations with foreign groups – Shell, ExxonMobil and Gazprom – with regard to the US\$ 18 billion West-East pipeline development.

2004.08 In response to CNPC's decision, Gazprom confirmed that Kovykta Gas cannot be exported to China and Korea, during its meeting with Kogas in Moscow in early August.

2004.09 Gazprom's Strategic Development Department made a presentation On "Eastern Siberia & Far East Natural Gas Production and Transportation Options Economic Feasibility Study" in Irkutsk. This is the so-called "Discussion Package" for the Interagency Working Group to develop a Programme for creating a Unified Gas Production, Transportation and Supply System in Eastern Siberia and the Far East with potential exports to markets in China and other countries in Asia and the Pacific.



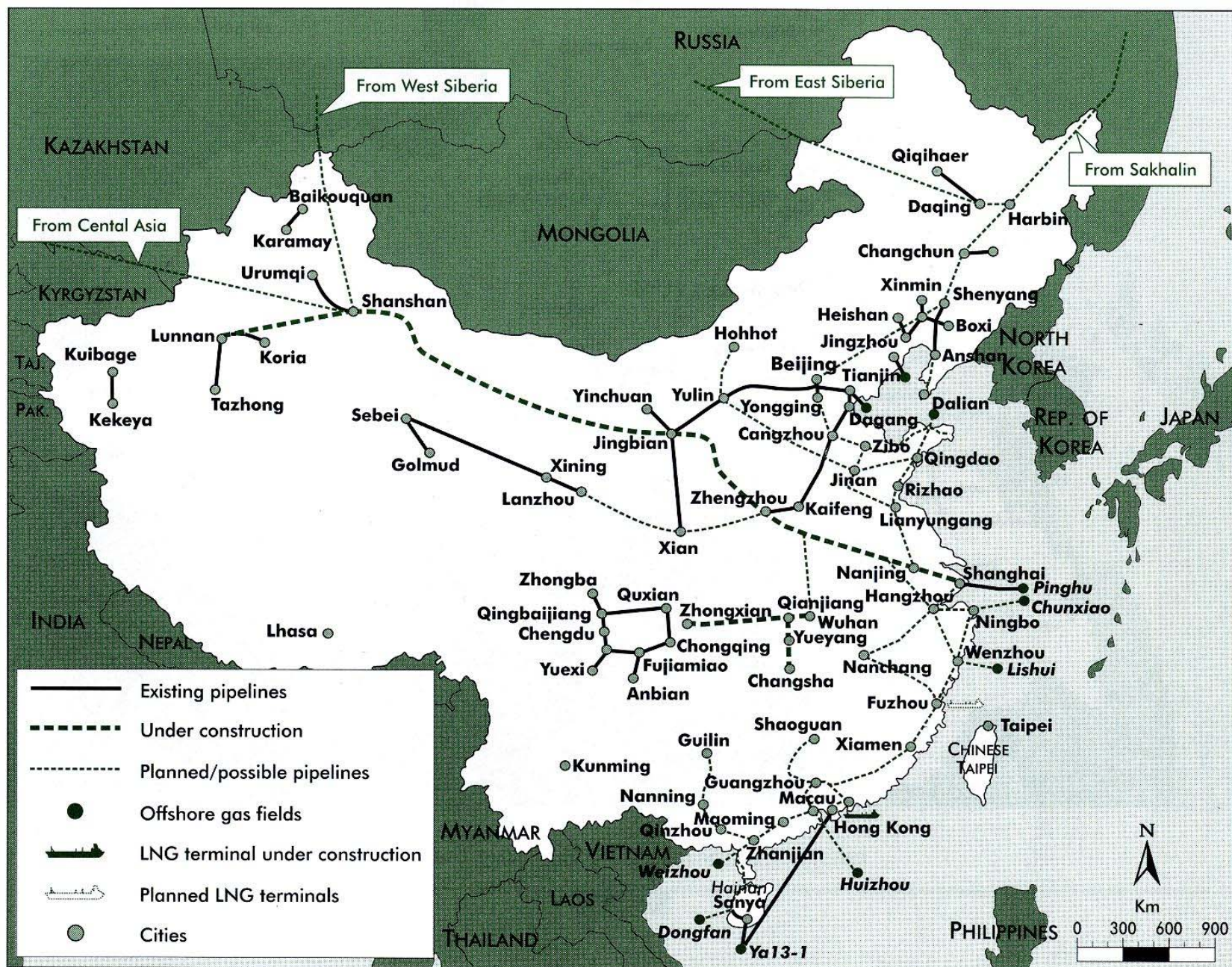
2004.10 On Oct 14th, 2004, Gazprom and CNPC have agreed to sign a strategic Partnership agreement in Beijing.

2004.11 The first meeting of Gazprom and CNPC Joint Co-ordinating Committee was held in Sanya City.

2005.09 Alexander Medvedev, deputy chairman of Gazprom and head of Gazexport said Gazprom has no limitation on its potential investments in China market. He said “We are still interested, even though foreign participation in the West-East pipeline project has been stopped. Gazprom is interested in Chinese assets related to the transportation, distribution and sale of gas...The question of China Gas Holding shares is not on the agenda, but other gas distribution assets are of interest for us”.

2005.10 Gazprom has won a contract to design an underground gas depot in China. The contract was signed during a visit to China by Gazprom delegation led by the firm’s deputy chief executive Alexander Ananenko. The design project is entrusted to VNIlgaz, Gazprom’s chief research and development centre.





Central Asian Gas Supply Alternative

1) Kazakhstan Gas Supply to China :

In September 2003, Kazakhstan Premier Danial Akhemtov said Astana and Beijing authorities are considering three natural gas supply options :

- To make use of existing Tashkent-Almaty gas pipeline
- To build a pipeline from western Kazakhstan through Kyzylorda, Chimkent and Almaty (also using existing stretches of pipeline)
- To build a completely new line running 2,000 km along the Petropavlovsk-Astana-Karaganda-Balkhash from the Kazakhstan's north through the country's centre to the border with China.

At the beginning of 2006, the FS on pipeline gas from Kazakhstan to China was announced. It was a wake-up call to Kremlin decision makers.



2) Turkmenistan Gas Supply to China :

In Early April 2006, Ashgabat and Beijing signed an agreement to supply 30 bcm/y of gas from Turkmenistan to China from 2009.

On top of this, China aims at signing a PSA for an upstream project before the end of 2006. The target exploration area is the Right Bank of the Amu Darya River, where the estimated reserves are 1,800 bcm (of which proven and probable 40 bcm, possible 161 bcm, and speculative 1565 bcm).

3) Uzbekistan Gas Supply to China :

In May 2005, CNPC set up a JV with Uzbekneftegaz to explore and develop Reserves on the Ustyurt Plateau, and in September 2005 the firm joined the consortium of developers near the Aral Sea. The area's gas reserves are estimated at over 2,000 bcm.

In short, the year of 2009 for the gas supply from CARs is not so realistic but these options serve as a very effective leverage for China against Russia.



III. Rosneft's Conciliatory Stance towards China

CNPC's lending of US\$ 6.0 billion in return for 48 mt of Russian crude oil supply to China played a pivotal role in transforming Rosneft from a virtually empty shell to a major production asset. The money was used for Rosneft's acquisition of Yuganskneftegas asset by paying US\$9.5 billion.

This year Rosneft aims at IPO and selling 49% of the equity. The target is to raise up to US\$ 20 billion, and CNPC was also offered to buy out the equity. Ironically the successful IPO will guarantee a legal action by former Yukos Shareholders. China's serious investment in Rosneft is very important for the successful IPO, but it is not clear whether CNPC is ready to take the risk of legal challenge.

Considering that Rosneft will be the main supplier of crude oil for Taishet Skovorodino-Nakhodka pipeline, the fate of Rosneft's IPO will have a very serious implications towards the Taishet-Nakhodka pipeline development.

It remains to be seen whether agreement on Rosneft's JVs with CNPC for both downstream and upstream will lead to CNPC's equity positioning in Rosneft.





IV. Transneft's Wisdom

The Beijing Agreement was a big disappointment to CNPC but Transneft could not take any risk by officially endorsing the pipeline between Skovorodino-Daqing section.

Transneft is seeking Japan's commitment for the section of Skovorodino-Nakhodka pipeline development, and any hurried announcement supporting Skovorodino-Daqing would wipe out role of Japan in the pipeline development. This is the reason why only the FS on Skovorodino-Daqing line was agreed during the Beijing meeting.

Russia's priority is to secure enough proven oil reserves that could justify the second stage (Skovorodino-Nakhodka) pipeline development, and Transneft is desperate to secure Japan's commitment for the development.

It remains to be seen whether Japan's massive scale financing for the second stage development will be materialised without the settlement of the territorial disputes.



V. Implications towards the Korean Peninsula

Despite many ups and downs, it looks certain that the coming decade is going to witness a massive scale of oil and gas trading between Russia and China. The Impact to the Korean Peninsula will not be small.

Korean Government needs to review the following points :

- Kovykta gas project and Gazprom's UGSS initiative : Even though Gazprom's Deputy chairman Ananenko said Kovykta gas cannot be exported to China before 2015, a co-ordination between China and Korea could move the timing well before 2015.
- Taishet-Nakhodka crude oil pipeline development will make Nakhodka as Northeast Asia's crude oil trading hub, and Korea needs to consider the initiative for the joint terminal and storage development.
- Sino-Russian oil and gas cooperation will usher in a new trading pattern in the coming years and a joint study between the two Koreas for the energy supply for DPRK should be initiated.

